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**ADB Working Paper Series**

**Multilateralizing Asian Regionalism**

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**Abstract**

Motivated by the proliferation of free trade agreements (FTAs) in Asia over the last decade, this paper studies the challenges faced by the Asian “noodle bowl”—overlapping, multiple trade rules, regulations, and standards in Asia—in the process of regional and global trade integration. The paper first highlights the importance of trade and investment linkages among Asian economies that have formed Asian supply chains, called Factory Asia. It then considers ways and means of multilateralizing Asian trade regionalism by discussing the pros and cons of various approaches—such as the Association of Southeast Asian Nations (ASEAN)-centered regional trade agreements, including the Regional Comprehensive Economic Partnership agreement, and cross-regional FTAs, including the Trans-Pacific Partnership agreement and a future Asia–European Union FTA. The paper emphasizes the promising role of inclusive Asian regionalism and the need to move to global integration.

**JEL Classification:** F13, L23, O19

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## 1. INTRODUCTION

Effective free trade agreements (FTAs) have only recently come to Asia. For most of the last 60 years, Asian FTAs were scarce and the ones that existed had not been substantially implemented, except for the Association of Southeast Asian Nations (ASEAN) Free Trade Agreement (AFTA). All that changed in the year 2000. Since then, close to 190 FTAs have emerged both within the region and with countries in other regions. The region that at the beginning of the century had almost no FTAs is now the region with too many to count.

This proliferation of Asian FTAs has created the so-called Asian noodle bowl of trade arrangements. It poses problems as the agreements are overlapping, complex, and different—with different liberalization schedules, exclusion lists, rules of origin, standards, etc. This carries the risk of becoming unwieldy and makes doing business cumbersome, particularly for small and medium-sized enterprises (SMEs).

This paper discusses how the costs of the Asian noodle bowl can be reduced, how Asian FTAs can be made consistent with the World Trade Organization (WTO) global liberalization process, and how Asia can remain integrated with the major markets in North America and Europe. One obvious solution is to set all most favored nation (MFN) tariffs to zero. But in the absence of this first-best solution, various attempts to multilateralize Asian regionalism are worth considering. Multilateralizing regionalism is a catchall term for schemes that reduce the degree of discrimination created by existing FTAs. The ultimate multilateralization would be to extend duty free treatment to all nations, thus eliminating preferences. More modestly, it refers to plans to knit together sets of bilateral and plurilateral agreements in a way that reduces discrimination among a set of nations—such as those in Asia—who trade intensively among themselves.

This paper discusses the pros and cons of various approaches—including ASEAN-centered trade agreements (called the ASEAN+ approach)—while taking into account the possible implications for cross-regional FTAs, i.e., those with the United States (US)—through the Trans-Pacific Partnership agreement—and the European Union (EU)—through a future Asia–EU FTA.

## 2. OVERVIEW AND STATE OF PLAY

This section reviews the state of Asian trade and FTAs. It starts with a discussion of the basic features of trade patterns, tariff structures, and FTAs in the region, and explains how the proliferation of Asian FTAs has created the noodle bowl problem.

### 2.1 Asian Trade Patterns and Tariffs

Most Asian economies are heavily dependent on manufactured trade. Leaving aside a few natural resource-rich and/or agricultural nations—Australia, Indonesia, and New Zealand—the share of manufactures in exports exceeds 60% and most of them are 70% or higher (Table 1). A similar pattern is found on the import side, although many Asian economies are substantial importers of primary goods—agricultural products as well as fuels and mining products.

**Table 1: Asian Economies' Trade Composition (2011)**

	Share of Exports (%)			Share of Imports (%)		
	Agricultural products	Fuels & mining products	Manufactures	Agricultural products	Fuels & mining products	Manufactures
Japan	1.3	4.6	88.2	11.2	40.1	47.0
HK, China	2.0	2.5	89.6	4.7	5.4	84.6
Korea, Rep. of	2.3	11.8	85.3	6.6	42.0	51.0
Taipei, China	2.2	8.1	87.8	5.5	30.1	62.6
Australia	12.6	59.0	10.5	5.8	18.9	69.1
New Zealand	63.9	9.0	22.0	11.1	19.2	66.0
Singapore	2.5	21.0	68.3	3.8	34.4	60.1
Indonesia	24.0	42.2	34.1	12.7	26.6	59.9
Malaysia	17.1	20.2	62.0	11.3	17.4	69.2
Philippines	11.2	8.5	79.8	11.0	23.3	65.7
Thailand	20.8	7.0	69.6	6.7	23.6	62.4
Viet Nam	22.9	11.6	64.0	12.3	15.9	68.9
PRC	3.4	3.1	93.3	8.3	29.6	59.2
India	11.3	23.7	61.7	4.9	39.6	41.4

PRC = People's Republic of China; HK, China = Hong Kong, China.

Source: WTO Trade Profiles, downloaded November 2012.

The trade policy of these economies is highlighted in Table 2. The first striking feature is the very high fraction of non-agricultural imports that are granted duty-free status. Hong Kong, China; and Singapore are the extremes as they essentially impose no tariffs, and most high-income economies in the region—apart from the Republic of Korea (henceforth, Korea) and Australia with their respective 39% and 50% MFN duty free shares—allow more than two-thirds of their non-agricultural imports without tariffs. Major middle-income ASEAN countries—such as Malaysia, Indonesia, and Thailand—similarly grant duty free status to non-agricultural imports on a very large share of their imports, with 77% for Malaysia while the Philippines allows only 34% of imports duty free. India is the most closed in non-agricultural goods import among the economies listed in the table, with a mere 19% of MFN duty free imports.

**Table 2: Aggregated Trade Policy Indicators (2011)**

	MFN Duty Free Imports (%)		MFN Tariff Rates (%)						Tariff binding coverage (%)
	Non-agricultural goods	Agricultural goods	All goods		Non-agricultural goods		Agricultural goods		
			Bound	Applied	Bound	Applied	Bound	Applied	
Japan	82.6	46.3	5.3	5.3	2.6	2.6	22.8	23.3	99.7
HK, China	100.0	100.0	0.0	0.0	0.0	0.0	0.0	0.0	45.6
Korea, Rep. of	39.3	7.1	16.6	12.1	10.2	6.6	56.1	48.6	94.6
Taipei,China	73.7	45.4	6.4	6.1	4.7	4.5	17.5	16.6	100.0
Australia	49.9	49.5	10.0	2.8	11.0	3.1	3.5	1.4	97.1
New Zealand	67.9	51.0	10.1	2.0	10.7	2.1	6.0	1.4	100.0
Singapore	100.0	98.8	10.3	0.0	6.4	0.0	26.9	0.2	69.7
Indonesia	58.0	45.8	37.1	7.0	35.6	6.9	47.0	8.1	96.3
Malaysia	77.4	76.9	23.0	6.5	14.9	5.8	66.8	10.8	84.3
Philippines	33.9	6.3	25.7	6.1	23.4	5.7	35.1	8.7	67.0
Thailand	47.3	26.6	28.0	9.8	25.5	8.0	39.9	22.0	75.0
Viet Nam	44.0	44.5	11.5	9.8	10.4	8.7	18.5	17.0	100.0
PRC	46.0	0.9	10.0	9.6	9.2	8.7	15.7	15.6	100.0
India	19.2	21.3	48.7	12.6	34.6	9.8	113.1	31.4	73.8

PRC = People's Republic of China; HK, China = Hong Kong, China.

Source: WTO Trade Profiles, downloaded November 2012.

The simple average of tariffs is correspondingly low, at least as concerns applied rates. Again, Hong Kong, China and Singapore have zero applied tariff rates. For high-income economies in the region the applied rates are below 6% for all except Korea, which has a rate of 12%. Tariffs are higher, often twice as high, in middle-income ASEAN members, India and the People's Republic of China (PRC). Apart from Australia and New Zealand, tariffs on agricultural goods are far higher than they are on non-agricultural goods, which include industrial products, fuel, and mining products.

Another stark feature of the data is the large gap between bound and applied rates in the region. Apart from Hong Kong, China and Japan that have low bound and applied rates, all other Asian economies have bound their rates many times the level of their applied rates.

### Supply chains

One of the unique features of Asian trade is vertical intra-industry trade among the supply chains developed through the region's economies. That is, technologically advanced economies in the region export sophisticated parts and components to less technologically developed economies in the region where these are assembled into final products and shipped to developed country markets, especially the US, the EU, and Japan. Although this started as a simple trade, going from Japan to ASEAN—and more recently to the PRC as well—and then exported to the US, Europe, and Japan, it has become a far richer pattern. Now sophisticated components are supplied by Korea and Taipei,China in addition to Japan, and less sophisticated parts and components are produced by other emerging economies—such as Malaysia and Thailand—and sold to each other.

The basic point can be seen in Table 3. Close to 70% of Japan's exports to East Asia consist of intermediate goods and less than 30% of final goods. When exporting to the US, however, the pattern is reversed, i.e., close to 55% final and 45% intermediates. A more pronounced pattern



is seen for Taipei,China; the Republic of Korea; and Malaysia. A similar pattern is observed for Indonesia and the Philippines, albeit to a lesser extent. However, Indonesia shows somewhat different patterns as it is a major supplier of primary goods for other East Asian economies and its intermediate good export share to East Asia is low at 46%, though over half of its manufactured exports to the US are final products (plus primary goods).

**Table 3: Primary, Intermediate, and Final Good Export Shares (%), 2011**

	US			EU27			East Asia		
	Primary goods	Inter-mediate goods	Final goods	Primary goods	Inter-mediate goods	Final goods	Primary goods	Inter-mediate goods	Final goods
Japan	0.2	45.3	54.5	0.5	50.2	49.2	2.2	69.1	28.7
PRC	0.4	26.4	73.2	1.0	33.3	65.8	1.8	49.0	49.2
Republic of Korea	0.2	49.4	50.4	0.3	52.6	47.1	1.2	78.6	20.2
Taipei,China	0.3	47.2	52.6	0.3	56.1	43.6	0.6	81.1	18.3
Indonesia	21.9	21.2	56.9	21.8	42.4	35.9	42.0	45.8	12.3
Malaysia	1.4	56.7	41.9	7.2	63.1	29.7	8.3	76.6	15.0
Philippines	1.8	48.9	49.4	2.8	60.7	36.5	10.3	65.4	24.3
Thailand	8.0	26.2	65.7	6.4	31.7	61.9	10.7	54.8	34.5
East Asia	1.4	33.9	64.7	2.2	40.4	57.4	5.9	64.4	29.6

US = United States; EU27 = The European Union of 27 Member States; PRC = People's Republic of China.

Source: RIETI website, <http://www.Rieti-tid.com/>.

The patterns for the PRC and to a lesser extent Thailand are somewhat different. The PRC, a manufactured good assembler par excellence, does not export as much in intermediate goods as other East Asian economies but exports final goods everywhere. More than 70% of PRC exports to the US, more than 65% of its exports to the EU, and close to half its exports to East Asia are final goods. Even for the PRC, however, intermediate products are twice as important in their exports to East Asia as they are to the US. The figures for Thailand are less pronounced than those for the PRC, but it also has high shares of final products when exporting to the US (more than 65%) and the EU (more than 60%), while producing less in intermediate goods than other East Asian economies. Thus the PRC and to some extent Thailand are indeed assembly factories for other supply chain economies in East Asia.

Summing up, East Asian economies tend to produce and sell intermediate goods to each other and final products to the US, the EU, and Japan (although the latter two are not shown in the table). As is known by now, this “Factory Asia” trade pattern has been created initially by foreign direct investment (FDI) activities of global multinational corporations—Japanese, European, and American—and more recently by firms from within emerging East Asia (Baldwin 2007).

### **Manufacturing vs. agricultural interests**

The tight relationship between FDI and intra-East Asian trade in parts and components also means that nations' industrialization strategies are linked to trade with both the regional partners and the global markets in manufactured products. This creates an important pro-trade constituency in the various nations, which act to promote trade liberalization and maintain openness. In short, the intertwining of corporate and national interests throughout the region tends to reduce the mercantilist forces that typically result in domestic industrial protectionism.

However, several countries in the region—particularly Japan, Korea, and some ASEAN countries—have large, not-so-competitive agricultural sectors while other countries are large

exporters of agricultural products. In every region in the world, trade in agricultural goods is more politically sensitive than is trade in manufactured goods and Asia is no exception. Much of this sensitivity arises from the extremely diverse policy stances adopted by various nations. Some nations welcome food imports while others feel the need to secure sufficient food supply domestically for the population or to protect their own farmers from highly competitive foreign farmers. This diversity of agricultural interests makes it much harder to arrive at a region-wide cooperation that includes both manufacturing and agricultural trade.

## 2.2 Notable Features of Asian FTAs

This section provides an analysis of notable features and characteristics of East Asian FTAs. They include configuration, geographical orientation, and scope (in terms of “WTO-plus” issues).

### Configuration: bilateral vs. plurilateral FTAs

The configuration of FTAs in East Asia can be divided into bilateral and plurilateral, as in Table 4 for 2013. Bilateral FTAs refer to agreements between two countries. Plurilateral FTAs include several forms—agreements involving more than two countries, one country (or countries) and a trading bloc (like ASEAN), or two trading blocs (e.g., ASEAN–EFTA).<sup>1</sup> On the whole, countries are opting for simple bilateral FTA configurations rather than the more complex plurilateral ones as they tend to be easier to negotiate. There were 57 bilateral FTAs (i.e., 79% of the total) and 15 plurilateral FTAs (21% of the total)<sup>2</sup> among 72 concluded FTAs as of February 2013. Bilateral FTAs also dominate FTAs that are yet to be concluded, making up 68% of those under negotiation and 74% of those proposed.

**Table 4: Number of FTAs in East Asia, 2013**  
(By Status, Configuration, and Geographical Orientation)

FTA by Status	No. of FTAs	By Configuration		By Geographical Orientation	
		Bilateral	Plurilateral	Intra-East Asia	Extra-East Asia
Concluded	72	57	15	28	44
Under Negotiation	53	36	17	8	45
Proposed	34	25	9	7	27
<b>Total</b>	<b>159</b>	<b>118</b>	<b>41</b>	<b>43</b>	<b>116</b>

Note: East Asia includes the ten ASEAN member countries; Australia; People’s Republic of China; Hong Kong, China; India; Japan; Republic of Korea; New Zealand; and Taipei, China. Bilateral FTAs involve only two parties, while plurilateral FTAs involve more than two parties (e.g., ASEAN). Intra-East Asia FTAs are those among East Asian economies only, while extra-East Asian FTAs are those between at least one East Asian economy and a partner (or partners) from outside East Asia.

Source: ADB, Asian Regional Integration Center (ARIC) website.

<sup>1</sup> An issue may arise when a trading bloc with a single authority (like the EU) forms an FTA with a country. Though such an FTA may be considered as bilateral, it is plurilateral in our definition as in the case of the Singapore–EFTA, Korea–EFTA, Korea–EU, and Singapore–EU FTAs. Other definitions of bilateral and plurilateral FTAs exist in the literature; a bilateral agreement may alternatively include more than two countries where one of them is a trading bloc itself (e.g., the Korea–EU or Singapore–EU FTA) while a plurilateral agreement is an FTA in which the number of FTA partners exceeds two.

<sup>2</sup> They include: the Asia-Pacific Trade Agreement (APTA); the ASEAN Free Trade Agreement (AFTA); the Preferential Trade Agreement-Group of Eight Developing Countries; Trans-Pacific Strategic Economic Partnership (TPP) Agreement; ASEAN–PRC FTA; ASEAN–Japan CEPA; ASEAN–Korea FTA; Korea–EFTA FTA; Korea–EU FTA; Singapore–EFTA FTA; and the Taipei, China–El Salvador–Honduras FTA.

Among the 15 concluded plurilateral agreements, AFTA stands out for its economic importance in the region and is establishing itself as a hub for East Asia's FTA activities by forming plurilateral FTAs in the region—the so-called ASEAN+1 FTAs. ASEAN has also become a focal point for the emergence of a new category of trading-bloc to trading-bloc agreement (e.g., the ASEAN–Australia–New Zealand FTA (AANZFTA). The other concluded plurilateral agreements connect various East Asian countries with others outside the region.<sup>3</sup> There are also 17 plurilateral agreements under negotiation and another 9 under proposal.

### **Geographical orientation: intra- vs. extra-East Asian FTAs**

Table 4 also shows the geographical orientation of East Asian FTAs with economies within the region and those outside. The high degree of extra-regional orientation of East Asian FTAs is striking—44 concluded FTAs out of 72 in February 2013 (61% of the total) are with countries or groups outside East Asia. The extra-regional orientation of East Asian FTAs under negotiation and proposed is even higher at 85% and 79%, respectively.

Both bilateral and plurilateral FTAs exhibit high degrees of extra-regional orientation in a sample of 159 FTAs (including both concluded and non-concluded). Japan has started economic partnership agreement (EPA) negotiations with the EU, and ASEAN as a group is contemplating negotiations with the EU after the launch of the ASEAN Economic Community in 2015. The PRC, Japan, Korea, and Singapore have concluded extra-regional agreements with Latin American countries. The PRC and Singapore are now actively promoting FTAs with African countries. Thus, East Asian economies have a strong preference for maintaining open trading relations with the rest of the world rather than becoming inward-looking.

### **Scope: “WTO-plus” elements**

There are two general trends globally in terms of the scope of FTA provisions. First, many recent agreements frequently go beyond the WTO regulatory framework to include provisions on a host of issues—such as the Singapore issues (trade facilitation, investment, government procurement, and competition policy), intellectual property, and other measures (WTO 2011). Second, FTAs between developed and developing countries often include such provisions, which may reflect the emphasis that developed economies give to these issues. Agreements containing these broader provisions are sometimes referred to in the literature as “WTO-plus” elements.

Asian FTAs have indeed begun to address issues that were not included in the original WTO framework. The WTO system that emerged from the Uruguay Round in the mid-1990s consisted of substantive agreements on goods, services, Trade-Related Intellectual Property (TRIPs), and Trade-Related Investment Measures (TRIMs). The subsequent WTO Doha Round trade talks initiated in 2001 have focused on liberalization in agricultural and non-agricultural market access. The four Singapore issues (competition, intellectual property, investment, and public procurement) which were provisionally included in the early work program were later dropped at the WTO Ministerial Conference in Cancun in 2004.<sup>4</sup>

The Asian economies have begun to address the WTO-plus elements in their FTAs. Earlier studies showed that Asian FTAs varied considerably in their scope with some being highly sophisticated while others were more limited (Banda and Whalley 2005; Plummer 2007). However, a systematic cross-economy review of the full scope of Asian FTAs, including more

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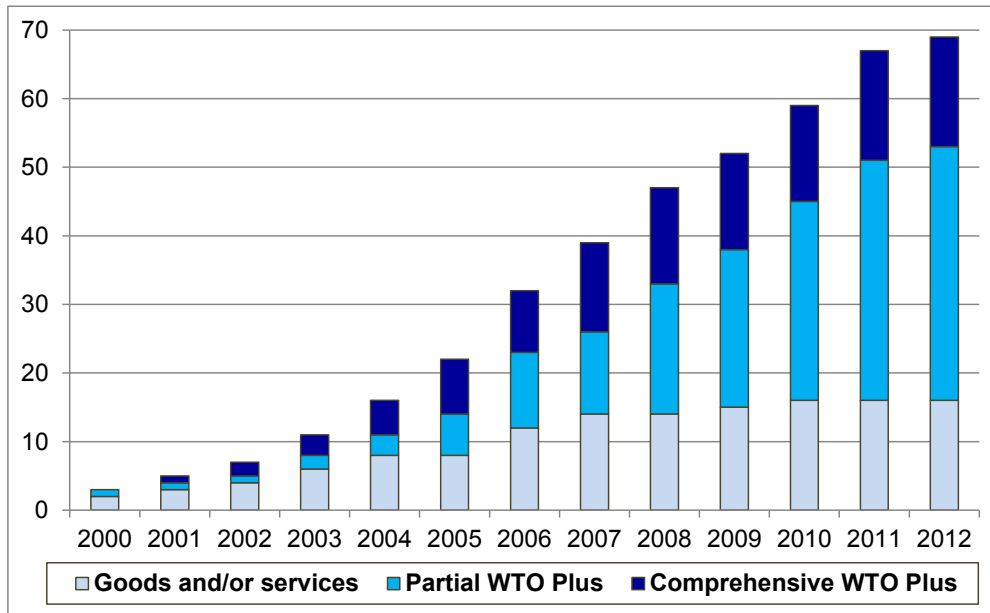
<sup>3</sup> For instance, APTA covers East Asia (the PRC, the Republic of Korea, and Lao PDR) and South Asia (Bangladesh, India, and Sri Lanka).

<sup>4</sup> This section draws from Kawai and Wignaraja (2013).

recent ones, reveal that the region’s FTAs tend to increasingly embrace the WTO-plus elements.

Figure 1 shows the scope of Asian FTAs concluded between 2000 and 2012 by: (i) narrow agreements that deal with goods and/or services; (ii) somewhat broader agreements covering goods, services, and some Singapore issues (partial WTO-plus); and (iii) comprehensive agreements covering goods, services, and all four Singapore issues (comprehensive WTO-plus). Those FTAs shown in categories (ii) and (iii) may be considered WTO-plus FTAs. The scope of concluded agreements reflects a combination of economic interests, economic strength, and negotiation capacity.

**Figure 1: Scope of Concluded FTAs in Asia Total, 2000–2012 (Number of FTAs)**

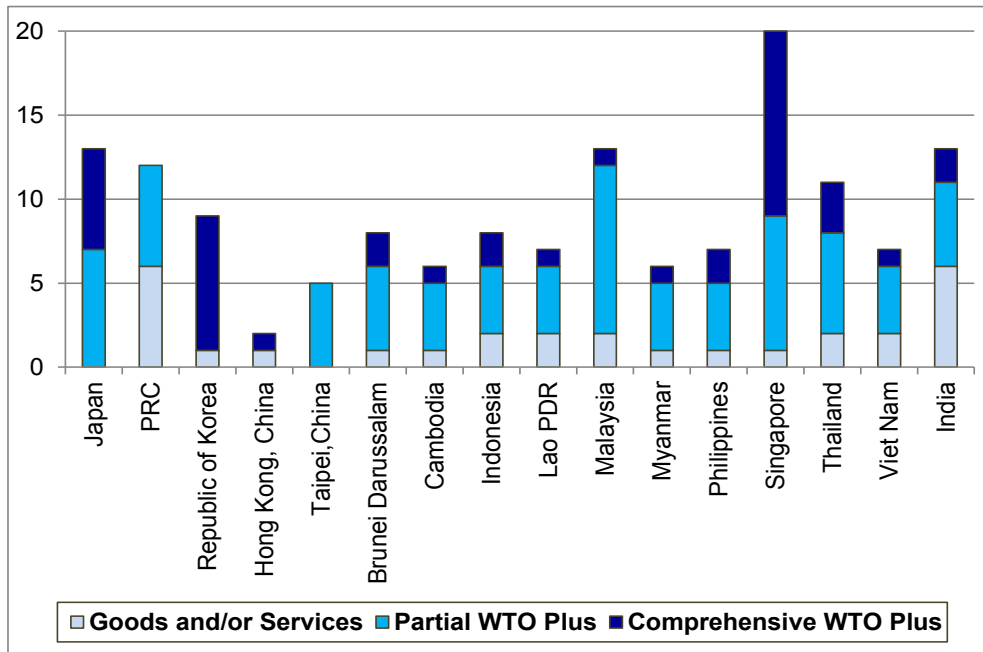


Source: ADB, Asian Regional Integration Center (ARIC) Website.

The pattern is striking. Early Asian FTAs seemed to be concerned largely with goods and services. From the mid-2000s onwards, however, significantly more emphasis was given to broad agreements with many WTO-plus elements. By 2012, 16 (23% of the total) FTAs were goods and/or services only, 37 (54%) FTAs were partial WTO-plus, and 16 (23%) FTAs were comprehensive WTO-plus.

Figure 2 shows the scope of Asian FTAs by economy for 2012. Three leading participants in Asian FTAs—Japan, Korea, and Singapore—strongly favor the WTO-plus approach to FTAs and tend to emphasize comprehensive agreements. All of Japan’s agreements and most of Korea’s and Singapore’s are WTO-plus. Brunei Darussalam, Indonesia, Malaysia, Philippines, Thailand, and Viet Nam also largely follow the WTO-plus format.

**Figure 2: Scope of Concluded FTAs in Asia by Economy, 2012 (Number of FTAs)**



Source: ADB, Asian Regional Integration Center (ARIC) website.

Historically, the PRC has been relatively cautious regarding the scope of its FTAs, preferring agreements focusing on goods and services only. More recently, however, the PRC has begun to experiment by incorporating some WTO-plus provisions into agreements such as the PRC–New Zealand FTA. Thus, with a few exceptions, Asian economies are increasingly favoring WTO-plus rather than narrowly limited agreements.

Kawai and Wignaraja (2009) found some additional noteworthy points concerning WTO-plus provisions in Asian FTAs. Agreements between developed economies and developing and emerging economies have generally taken the WTO-plus format. Examples include the ASEAN–Japan Comprehensive Economic Partnership Agreement (CEPA), the PRC–New Zealand FTA, the ASEAN–Australia–New Zealand FTA, and the Trans-Pacific Partnership (TPP) agreement. Also, Korea and Singapore tend to behave like developed economies in their agreements with many developing economies. This behavior is visible in the Singapore–PRC FTA and Korea–Chile FTA. Further, some existing FTAs are gradually being expanded to include WTO-plus coverage. Examples include the ASEAN–Korea FTA. And finally, the trend towards increasing WTO-plus elements in Asian FTAs means that the region’s FTA activity would likely persist even if the Doha Round trade talks (focusing on liberalization in agricultural and non-agricultural market access) were to be concluded in the future.

The inclusion of WTO-plus provisions—particularly the four Singapore issues—would be desirable in all forthcoming Asian FTAs. The value of such efforts should be obvious. Competition policy and investment provisions are integral ingredients in facilitating FDI flows and the development of production networks. Inclusion of provisions on trade facilitation and logistics development would help lower transactions costs in conducting trade. Cooperation provisions—along the line of the Asia-Pacific Economic Cooperation (APEC) Economic and Technical Cooperation (ECOTECH) agenda—would stimulate technology transfer and industrial competitiveness.

## 2.3 The Asian Noodle Bowl: Overlapping Rules of Origin

Rules of origin (ROO)—which determine whether certain goods can enjoy preferential bilateral tariffs and thus prevent trade deflection among FTA members—are a particularly interesting aspect of East Asian FTAs. For manufactured goods, ROO may be of three types: (i) a change in tariff classification (CTC) rule defined at a detailed Harmonized System (HS) level; (ii) a local (or regional) value content (VC) rule; and (iii) a specific process (SP) rule. The CTC rule requires all the inputs to come in under a different tariff heading from the exported good, the local (or regional) VC rule requires that a certain fraction of the exported good's value-added comes from the country (or region) of an FTA, and the SP rule requires a particular production process to be performed in the exporting nation.

Given the rather uncoordinated manner in which FTAs have developed in the region, East Asian FTAs have used a range of different ROO. The least complicated ROO are those of AFTA, which requires a 40% VC rule across the board. Many of the FTAs in the region have ROO that are more restrictive. The best way to illustrate the noodle-bowl problem is to look at the ROO applied to specific products, such as the major auto and auto parts products (Table 5). ASEAN's FTAs vary somewhat in their ROO. For instance, the 40% VC rule applies for AFTA and for the ASEAN–PRC FTA, but more stringent ROO for some products (e.g., 45% VC applied for Harmonized Commodity Description and Coding System [HS] 8703, 8704, and 8708) are found in the ASEAN–Korea FTA. Furthermore, the ROO for the same products are different in bilateral FTAs involving the same major economy. In the Japan–Malaysia EPA, the VC requirement for HS 8703 and 8711 is 60%, while in the Japan–Thailand EPA it is 40% for the same two products.

**Table 5: Varying Rules of Origin in FTAs: Selected Products**

Product (HS Code)	AFTA	ASEAN–Korea FTA	ASEAN–PRC FTA	Japan–Thailand EPA	Japan– Malaysia EPA
Motor vehicles for transport of persons, except buses (87.03)	40% RVC	45% RVC	40% RVC	40% RVC or CTC	60% RVC or CTC
Motor vehicles for the transport of goods (87.04)	40% RVC	45% RVC	40% RVC	40% RVC or CTC	50% RVC or CTC
Parts and accessories for motor vehicles (87.08)	40% RVC	45% RVC	40% RVC	40% RVC or CTC	40% RVC or CTC
Motor cycles, bicycles, etc., with auxiliary motor (87.11)	40% RVC	45% RVC or CTC (4 digits)	40% RVC	40% RVC or CTC	60% RVC or CTC

RVC = Regional Value Content; CTC = Change in Tariff Classifications.

Source: Adapted from Kawai and Wignaraja (2008).

### Low margins of preference and utilization rates so far

Several authors argue that, as least until recently, the preferential tariffs in East Asia—including the Common Effective Preferential Tariff (CEPT) in AFTA—have not been much used. Much of the regional trade is in intermediate goods and such goods typically face low applied MFN tariff rates, or at least low margins of preference. The basic point is illustrated in Table 6. Tariffs applied among ASEAN members are not much lower than those applied to North American goods. For example, in general machinery and electrical machinery, the margin of preference is less than 1 percentage point.

**Table 6: Intra-East Asian Preference Margins vis-à-vis North America, 2002**

Sector:	East Asia	North America	Preference Margin
Mining products (HS25–27)	1.7	2.6	0.9
General machinery (HS 84)	1.5	1.9	0.4
Electrical machinery (HS 85)	1.4	1.5	0.1
Others	1.4	1.7	0.3
Precision apparatus	1.2	1.3	0.1
Textiles and clothing	7.3	7.6	0.3
Pottery products	2.9	3.6	0.7
Chemicals	2.4	3.0	0.6
Basic metals	1.8	2.6	0.8

Note: Tariff data for 2002. Values are trade-weighted averages.

Source: Reorganization of data drawn from Freudenberg and Paulmier (2005).

As a consequence, in the early part of this decade, the preferences embedded in the many East Asian FTAs were relatively little used. In other words, the utilization rates were very low. According to Manchin and Pelkmans-Balaoing (2007a), no comprehensive statistics were available on the utilization rate of AFTA CEPT, but an often-quoted figure puts it at 5%. This figure, however, appears to change as the preference schedules are fully implemented. For example, a paper by Chirathivat (2008) reports that Thai firms' utilization rate of AFTA CEPT averages 27%, with their utilization at 81% for transport equipment trade. However, recent data available from a study by Udomwichaiwat (2012) suggests that FTA use has risen significantly; the overall reported FTA use by enterprises in Thailand had risen to 61% in 2011.

### Rules of origin complexity

Studies of ROO in East Asia indicate that complex ROO can raise transactions costs to business firms and that multiple ROO in overlapping FTAs can be particularly burdensome.<sup>5</sup> The textile and garment sector tends to be affected by stringent and restrictive ROO. Precise

<sup>5</sup> See, for instance, Cheong and Cho (2006); James (2006); and Lee, Jeong, Kim, and Bang (2006).

quantitative estimates of the magnitude of the costs of multiple ROO (e.g., as a percentage of export sales) are hard to come by, but using a gravity model, Manchin and Pelkmans-Balaoing (2007b) obtain results that suggest that the administrative costs of obtaining CEPT status within AFTA might be in the range of 10%–25% and that such costs are not much reduced even when an alternative rule for origin determination is provided. One of the implications is that the presence of multiple ROO may further increase administrative costs.

Econometric evidence also suggests that the preferences do matter on the items where the margins of preference are significant (Manchin and Pelkmans-Balaoing 2007a). This implies that the low utilization rates in early years are unlikely to continue as the preference margins expand with fuller implementation of East Asian FTAs. Here it is important to note that AFTA, all the ASEAN+1 FTAs, and most other FTAs in the region have been implemented first for developed countries and then are gradually implemented in the least developed nations by 2020. As firms increase trade and more FTAs are concluded, multiple ROO can become a more serious problem for East Asia in the future. In short, the noodle bowl complexity should really start to bite over the next few years.

### **Results of firm surveys**

Firm surveys are useful to highlight the business impacts of multiple ROO in East Asia. Insights at a regional level are provided by the ADB enterprise surveys conducted in the PRC, Japan, Philippines, Singapore, and Thailand. The surveys provide information on enterprise perceptions of whether dealing with multiple ROO in the region's FTAs significantly adds to business costs.

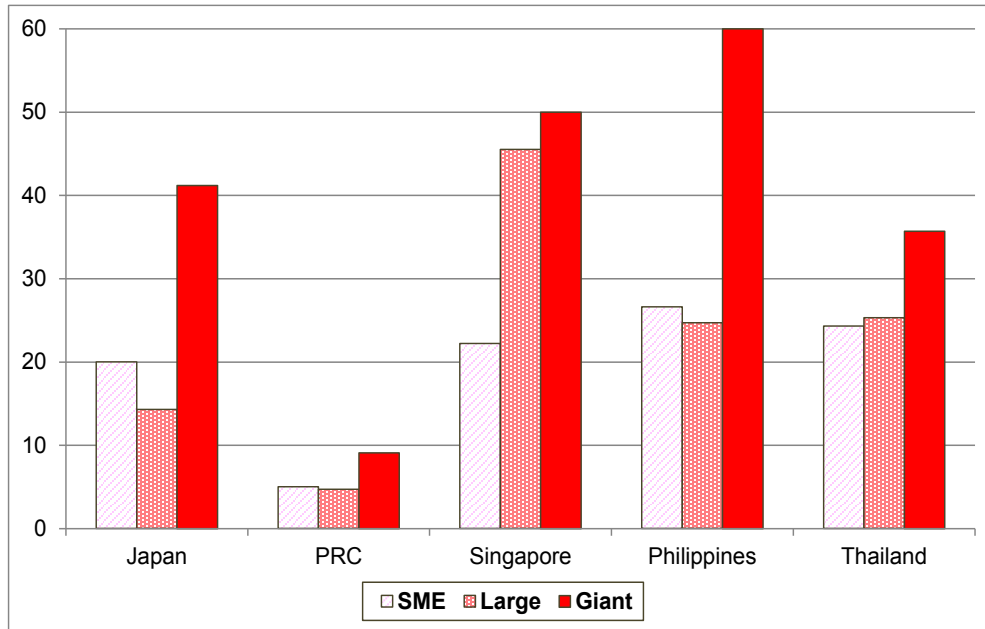
First, given the present level of concluded FTAs in the region, evidence suggests that multiple ROO impose only a limited burden on Asian enterprises. Of the 922 enterprises responding to this concern, only 197 (21%) said that multiple ROO significantly added to business costs. The majority of the sample enterprises did not presently find multiple ROO a problem.

Second, the surveys unexpectedly found that larger Asian enterprises had greater negative perceptions of multiple ROO than did SMEs (Figure 3). This finding presented an interesting puzzle. Econometric analysis showed that large established enterprises tended to export to multiple markets and adjust their business plans in response to FTAs. They are, therefore, more likely to complain about issues of multiple ROO (Kawai and Wignaraja 2011). Smaller enterprises, in contrast, tend to export to a single market and hence do not have much basis for complaining.

Third, the majority of surveyed enterprises would prefer to be able to select the specific ROO included in FTAs. The surveys suggest that enterprises are supportive of having alternative ROO for the same product: (i) if they cannot reach the value-content requirement, having alternative ROO might enable enterprises to still make use of FTA preferences; (ii) as applications using the value-content rule often require confidential cost information, many suppliers and enterprises are reluctant to divulge such information; and (iii) particular ROO are frequently aligned with the technology and production process of particular industries and are less pertinent to all others.



**Figure 3: Burden Imposed by Multiple Rules of Origin in FTAs  
(by % of Respondents by Enterprise Size)**



Note: SME (small- and medium-sized enterprise) = 100 or fewer employees; Large (enterprise) = 101 to 1,000 employees; Giant (enterprise) = more than 1,000 employees.

Source: Kawai and Wignaraja (2011).

The general finding of limited burdens imposed by multiple ROO does not mean that policymakers should be complacent about this topic. As the number of concluded agreements increases, multiple ROO may well become more of a problem for more enterprises. Supportive measures—such as encouraging rationalization of ROO and upgrading their administration—are needed to mitigate the future negative effects of the Asian noodle bowl.

Widespread gains in Asian economies are possible from pursuing simplified approaches to ROO. These would involve harmonizing ROO, addressing the accumulation of value content, and coequality of ROO.<sup>6</sup> It would be extremely useful to identify and adopt international best practices in ROO administration. Such practices might include introducing a trusted-trader program (as used in the North American Free Trade Agreement [NAFTA]), allowing successful applicants to self-certify their own certificates of origin, allowing business associations to issue fee-based certificates of origin, increasing the use of information technology-based systems of ROO administration, and better training of SMEs to enhance their capacity to use FTAs.

<sup>6</sup> Harmonized ROO means the same rules of origin are applied across multiple FTAs. Co-equal ROO means alternative ROO for the same products are available in an FTA and enterprises are free to choose between them. Accumulation of value content provisions allows the use of non-domestic inputs from a specific economy or group of economies (with such inputs taken as originating in the FTA partner economy claiming origin) as determining the products origin. See Kawai and Wignaraja (2011).

### 3. ONGOING MULTILATERALIZATION EFFORTS

#### 3.1 Efforts Without Strong Leaders

In East Asia, the efforts to multilateralize Asian FTAs have been pursued without a regional hegemon as in the case of North America, or a group of strong leaders as in the case of European integration.

##### **Lack of a hegemon or a bi-polar alliance in East Asia**

The lack of a regional hegemon is an important complicating factor for East Asian regionalism. A regional hegemon plays many roles, but the relevant one here is as regulator and harmonizer of regional trade arrangements. By their very size, the US in North America and to a lesser extent in Latin America, and the EU in the Euro-Med region act as coordinators and harmonizers of regional trade arrangements. For example, they tend to orchestrate greater coherence in ROO.

East Asia has two large economies—the PRC and Japan—but neither has emerged as a regional hegemon in the way that the US and EU have done in their respective regions. This complicates matters since the lack of coordination and centralized orchestration can result in a more mottled set of trade arrangements. Efforts to multilateralize regionalism find it harder to get started when no dominant player is in the leadership seat.

In Western Europe, there was no dominant hegemon that led the European economic integration process. The original six members of the European Economic Community—the three Benelux nations, France, Germany, and Italy—formed a core group that eventually led to the creation of a single market, the EU, and the euro area. In this context, a bi-polar alliance formed by France and Germany played a critical role in strengthening the six-country core group.

In East Asia, although neither the PRC nor Japan may play a hegemon role, the two countries have not forged a bi-polar alliance, comparable to the Franco-German alliance in Europe, to accelerate regional trade and investment integration. Despite the difficult bilateral political relationship, the PRC and Japan may further deepen their economic relationship including the formation of a trilateral FTA involving Korea. But it may take some time before they start to think seriously about the importance of their bi-polar alliance.

##### **Emergence of ASEAN as the regional “hub”**

The lack of a regional hegemon or a bi-polar alliance between Japan and the PRC has, by default, led to ASEAN playing a key coordinating and convening role on trade (and other) issues in East Asia. ASEAN has emerged as a natural “hub” for multilateralizing East Asian FTAs. First, it has a long, successful track record as the “convener” of discussions on Asian trade arrangements. In particular, the ASEAN-led talks (ASEAN+3, ASEAN+6, East Asia Summit, etc.) are already a formal, well-accepted feature of the diplomatic landscape. Second, ASEAN has systematically engaged the major trading partners either explicitly as in the case of the PRC, Japan, Korea, India, Australia, and New Zealand, and the EU or less directly—and sometimes individually—in the case of the US. Third, because key production networks are rooted in ASEAN and major economies are linking to ASEAN via ASEAN+1 FTAs, there is an economic and commercial logic backing the role that ASEAN has been playing.

Beyond trade issues, ASEAN has been able to secure a core position in the ASEAN+3 process particularly for financial cooperation, the newly created East Asia Summit (EAS, or ASEAN+8) process for wider economic and political issues, and the ASEAN Regional Forum for security arrangements. The ASEAN+3 leaders agreed in 2004 that the establishment of an East Asian

community is a long-term objective, with the formation of an East Asian FTA and an East Asia Investment Area. When the PRC and Japan, respectively, proposed an East Asia Free Trade Area (EAFTA among ASEAN+3 countries) and a Comprehensive Economic Partnership for East Asia (CEPEA among ASEAN+6 countries) for East Asia, and could not agree on which one to pursue, ASEAN suggested a new concept, the ASEAN Framework for a Regional Comprehensive Economic Partnership (RCEP), by de facto supporting the ASEAN+6 approach, which the PRC accepted.

### **3.2 ASEAN, APEC, and ASEAN+ Efforts**

East Asia has two regional institutions that help coordinate and facilitate cooperation—ASEAN, which dates back more than 45 years, and APEC, which was created at the end of the 1980s. Although very different, the existence of these two organizations provides a forum for multilateral consultation and cooperation.

#### **ASEAN Economic Community**

East Asia's trade multilateralization process began with ASEAN and its strengthening of economic integration among the diverse member states. Under AFTA, the six original signatories eliminated tariffs altogether by 2010 and the four newcomers are expected to do so by 2015. Having also adopted the ASEAN Framework Agreement on Services (AFAS) in 1995 and the ASEAN Investment Area (AIA) in 1998, ASEAN began the ASEAN Economic Community building initiative to make ASEAN a single market and production base by 2015. In moving in this direction, ASEAN members adopted the "ASEAN Charter" to establish the group as a rules-based legal personality, improve the decision-making process, and accelerate economic integration.

This whole process of regional economic integration, which is expected to result in the ASEAN Economic Community (AEC), has forced its member states to coordinate on liberalization of trade in goods and services and of investment. Once the AEC is established, ASEAN becomes a more integrated, coherent region and can more easily work with global players for deeper global links.

#### **APEC's open regionalism**

Established in 1989, APEC has encouraged trade and investment liberalization in a voluntary and unilateral fashion as a trans-regional forum with the basic principle of "open regionalism." APEC has also focused on trade and investment facilitation, which has had significant impacts on trade and investment flows.

APEC's unilateral, voluntary approach has helped East Asian economies in reducing the MFN tariffs—with notable examples being the then non-WTO members, such as the PRC and Taipei, China. By lowering the MFN tariff either to zero or to low levels for manufacturing products, such as mechanical and electrical parts and components. This has promoted intra-industry trade in these products, while reducing the incentives to use FTA preferences in exporting these products.

APEC has also seen some technocratic moves to "tame the tangle" of FTAs. The most notable is the Best Practice Guidelines for FTAs which provide suggestions for "best practice" FTAs. These guidelines have been little used but the very exercise helps sensitize nations to the issues—especially nations which are new to the FTA game. ASEAN also has initiatives aimed at harmonizing the bilateral deals. For example, the ASEAN Investment Area strives to reduce discord among the many investment provisions.

### ASEAN+1 processes

As has been pointed out above, ASEAN has been the hub for ASEAN+1 FTAs with its dialogue partners. The existence of ASEAN's rather liberal ROO has provided a guideline that reduces the degree of arbitrariness in the many FTAs in the region, particularly ASEAN+1 FTAs.

The "plus-3" countries have taken somewhat different approaches to their respective ASEAN+1 FTAs. Japan has taken the approach to first conclude comprehensive bilateral FTAs with major ASEAN members individually and then to forge a comprehensive ASEAN+1 FTA. Japan adopted this approach as its interest was to create a comprehensive EPA that captures many "WTO-plus" issues like investment, competition policy, intellectual property rights, labor mobility and standards, and other types of cooperation measures. These issues vary across countries, so Japan decided to go for bilateral EPAs first. The presence of these bilateral EPAs facilitated the negotiations of the ASEAN–Japan Comprehensive Economic Partnership Agreement (CEPA) as most of the fundamental issues had been resolved within bilateral EPAs. What Japan needed to ensure at the last stage was to make regional cumulation of ROO available for all the signatories.

In contrast, the PRC and Korea started to negotiate liberalization of goods trade, followed by services trade and then investment. Although the modality was somewhat different from the case of Japan, these two economies are expected to come up with comprehensive "WTO-plus" FTAs.

### 3.3 Cumulation of ROO Content Requirements

The PRC, Japan, and Korea have all implemented or concluded their ASEAN+1 FTAs, and we can find ROO cumulation provisions in their respective agreements (see Box 1). This is a significant development in that these "plus-3" countries can be considered to be *de facto* as part of ASEAN as far as ROO regional cumulation is concerned. This will benefit in particular the producers of these countries and consumers in East Asia. The benefits to Japanese and Korean multinationals are particularly large.

A regional ROO cumulation provision included in the ASEAN–Japan CEPA (or AJCEPA) is a major step forward in making an FTA conducive to trade. With the cumulation provision, a Japanese firm exporting a major component (with a value content of, say, US\$70) to its subsidiary in Thailand by using Japan–Thailand (or Japan–ASEAN) EPA preferences, can now export its processed products, with a total value of \$100, from Thailand to Malaysia by using AJCEPA and AFTA even if the value-added in Thailand is only US\$30, i.e., less than 40% of the final value-added requirement under the usual AFTA CEPT arrangement. Such trade would not have been possible without a regional cumulation provision.

However, a problem still remains when a Japanese firm wishes to export its product from Thailand to the PRC, because the ASEAN–PRC FTA does not regard this product as a regional product—rather, it is considered to be a joint product by Japan (70%) and Thailand (30%)—and hence would not be granted tariff preferences. What is clearly needed is the next step where the "plus-3" (or "plus-6") countries with FTAs with ASEAN can cumulate value contents among all their members.

### **Box 1: ROO Cumulation Provisions in ASEAN+1 FTAs**

#### **ASEAN–Japan CEPA—Article 29 Accumulation**

- Originating materials of a Party used in the production of a good in another Party shall be considered as originating materials of that Party where the working or processing of the good has taken place.

#### **ASEAN–Korea Agreement on Trade in Goods—Rule 7 Accumulation**

- Unless otherwise provided for in this Annex, a good originating in the territory of a Party, which is used in the territory of another Party as material for a finished good eligible for preferential tariff treatment, shall be considered to be originating in the territory of the latter Party where working or processing of the finished good has taken place.

#### **ASEAN–PRC Agreement on Trade in Goods (ACFTA)—Rule 5: Cumulative Rule of Origin**

- Unless otherwise provided for, products which comply with origin requirements provided for in Rule 2 and which are used in the territory of a Party as materials for a finished product eligible for preferential treatment under the Agreement shall be considered as products originating in the territory of the Party where working or processing of the finished product has taken place provided that the aggregate ACFTA content (i.e., full cumulation, applicable among all Parties) on the final product is not less than 40%.

Source: ADB ARIC FTA Database.

## **4. OPTIONS FOR THE FUTURE**

There is a strong case for multilateralizing East Asian regionalism. The current disorganization of East Asian trade arrangements is growing ever more complex. Worse yet, if nothing is done to “tame the tangle,” the ongoing implementation of preferential tariff cuts combined with overlapping ROO and uneven sectoral coverage poses a risk to the highly efficient intra-regional trading system we have today.

Something must be done. There is a need to broaden the country coverage of FTAs and to weave the matrix of bilateral FTAs into a more cohesive arrangement. There is also a need to broaden the area of cumulation and provide facilitation to help SMEs cope with complex ROO. There is also a need to deepen FTAs in terms of liberalization measures and policy scope, by including a wide range of trade in goods (both manufactured and agricultural) and services as well as “WTO-plus” issues—that is, investment, labor mobility and standards, intellectual property rights, competition policy, dispute settlement, and the like. International trade cannot be expanded without a conducive climate for international business, which involves a tightly knitted package of cross-border movements of goods, services, capital, know-how, technicians, and managers. Setting tariffs to zero simplifies international business, but is far from sufficient.

Two facts condition the modalities for “taming the tangle.” First, East Asia engages in a great deal of intra-regional trade, but it is also linked to the rest of the world, especially the EU and US. For this reason, trade arrangements that are primarily inward-looking will not serve the region’s commercial interest. This implies that the narrow, inward-looking option is off the table. Second, in the absence of a regional hegemon or a bi-polar alliance to play the leadership role—as in other regions—ASEAN has emerged as the regional body most firmly established as convener of talks on regional trade issues. This goes a long way to narrowing down a range of modalities for multilateralizing Asian regionalism.

## 4.1 Extending the ASEAN+ Approach

What is the optimal scope for ASEAN-centered Asian trade arrangements? While other configurations can be envisaged, the formulations that seem most relevant in the medium run are first the consolidation of East Asian intra-regional FTAs into either an ASEAN+3 FTA (called the East Asia Free Trade Area, or EAFTA) or an ASEAN+6 FTA (called the Comprehensive Economic Partnership in East Asia, or CEPEA). The East Asian countries initially could not agree on which one they should pursue between PRC-supported EAFTA and Japan-supported CEPEA. But finally in 2012, they agreed to begin negotiations for a RCEP among the ASEAN+6 countries and its first negotiation started in 2013. The second part of the formulations is for select Asian economies to extend relationships with extra-regional groups, especially the US (or NAFTA) and the EU. The Trans-Pacific Partnership (TPP) is an important vehicle to strengthen the Asia–US trade relationship.

### Case for a RCEP among ASEAN+6 countries

Currently, the complex matrix of ASEAN+1 FTAs are in place. Some “plus” countries have already come up with, or are negotiating for, their bilateral FTAs among themselves—like those for PRC–New Zealand, Japan–India, Korea–India, and PRC–Australia. Combining these ASEAN+1 FTAs and other bilateral FTAs among the “plus” countries, the East Asians can forge an ASEAN+3 or an ASEAN+6 FTA. Such a consolidation of overlapping, multiple FTAs into a single, region-wide FTA can make a significant positive contribution.

The computable general equilibrium (CGE) models based on the Global Trade Analysis Project (GTAP) provide useful insight into the welfare gains from alternative FTA scenarios in East Asia.<sup>7</sup> Numerical results by Kawai and Wignaraja (2008) show that the two East Asia-wide FTA scenarios—ASEAN+3 and ASEAN+6 FTAs—offer much larger gains to world income than any of the three ASEAN+1 FTA scenarios. They also demonstrate that the ASEAN+6 FTA scenario—which is broader in terms of country coverage—offers larger gains to world income than the ASEAN+3 FTA scenario. This supports the rationale for a RCEP, which is essentially an ASEAN+6 FTA. Breakdowns of the world income figures for the ASEAN+3 and ASEAN+6 FTA scenarios also indicate that the gains to members of the FTAs are significant while the losses to non-members (e.g., the US) are relatively small.

### A strategy towards a RCEP

Two fundamental trade-offs emerge when considering the ASEAN+6 option. On the one hand, broadening the list of participants tends to boost efficiency by reducing discrimination and promoting liberalization. On the other hand, decision-making tends to get more difficult as numbers and diversity of interests rise.

In Europe, for instance, there has been a clear trade-off between the depth of integration that can be achieved and the number of participants. The solution has been to have a very broad participation in the duty-free trade area (all of the EU28, the EFTA nations, and many Mediterranean nations) but to draw the circle more tightly for deeper integration. For example, free movement of goods, services, people, and capital applies only to the EU28, although EFTA nations participate in most of this via the European Economic Area agreement. Even inside the EU28 there are circles. Only some EU members are part of the currency union, and not all are members of the passport-free travel zone known as the Schengen Area.

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<sup>7</sup> See, for instance, Cheong (2005); Plummer and Wignaraja (2006); Zhang et al. (2006); and Kawai and Wignaraja (2008).

In the Western Hemisphere, NAFTA was relatively easy to negotiate and implement, but the wider Free Trade Area of the Americas was brought down by an overly wide diversity of positions.

In East Asia, to forge a RCEP among the ASEAN+6 countries, some sequencing may be a realistic path to take. This could be done in theory by consolidating all existing ASEAN+1 FTAs, even without having FTAs among all the “plus-6” countries. Indeed, currently there is no single bilateral FTA among the “plus-3” countries—the PRC, Japan, and Korea (CJK). If the 16 countries were to start negotiations for a RCEP, with all ASEAN+1 FTAs in place but without FTAs among the key “plus-6” countries, then in this whole consolidation process the “plus-6” countries would have to negotiate among themselves, not to mention the need for negotiation to coordinate across the existing ASEAN+1 FTAs. This is doable, but would be messy.<sup>8</sup> To smoothen negotiations for a region-wide FTA, it would be preferable if bilateral FTAs were in place among all the “plus-6” countries along with ASEAN+1 FTAs. This would facilitate the negotiations among the ASEAN+6 countries considerably. For this reason, it is vital for the PRC, Japan, and Korea to start serious negotiations among their FTAs. Despite political difficulties, the three countries agreed in 2012 to launch negotiations on a CJK FTA.

In the end, the exact starting configuration for harmonization efforts may prove less important than is often thought. In other regions, the domino effect tends to bring in nations that were initially reluctant to participate. This happened, for instance, in Europe with the United Kingdom (UK) and other European Free Trade Association (EFTA) nations that stayed out of the European Economic Community (EEC) 6 initially, but soon changed their minds and asked to join once it was clear that the arrangement was working. Similarly, Mercosur started small but its membership spread as the benefits of participation and the risks of exclusion became clearer.

### **Connecting East Asia with the US and the EU**

Relationships with the US—and increasingly with the EU—are critical for the East Asian region, both economically and politically. APEC remains important for East Asia and the US because it is the only multilateral economic forum that connects the US with East Asia. The recent move to forge a TPP is an attempt to connect the US with a select group of East Asian economies through a high-quality, comprehensive FTA. The Asia-Europe Meeting (ASEM) has not been active in pursuing trade and investment liberalization between East Asia and Europe, but it is time to consider a scenario for linking East Asia with the EU.

### **The US and East Asia**

Bilateral FTA talks started between the US and several countries in the region. These have been concluded with Singapore, Australia, and Korea. A series of talks between the US and some of the major ASEAN nations—Thailand and Malaysia in particular—were launched in 2004, but have come up against a variety of objections by the Asian nations to the US FTA template which typically includes free trade in the US’s major agricultural exports as well as government procurement liberalization, and conditions touching on labor and the environment. The expiration (in June 2007) of the US Administration’s negotiating authority, known as Trade Promotion Authority (TPA), has not helped matters.

The US has advocated strengthening economic ties among APEC members through the formation of an APEC-wide free trade area (i.e., the Free Trade Area of the Asia Pacific [FTAAP]). FTAAP could serve as a useful step in reviving the currently stalled Doha Round

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<sup>8</sup> In Latin America, for example, rather than trying to negotiate entry into NAFTA, Chile de facto “joined” NAFTA by signing separate (but very similar) bilaterals with the US, Canada, and Mexico.

trade talks or offer an alternative “Plan B” solution should the Doha Round trade talks fail (Bergsten 2007; Hufbauer and Schott 2009). Creation of FTAAP would likely take many years, involving negotiations among all 21 member economies. Given the large number of APEC members, a smaller group might more successfully initiate the process.

A smaller FTA, the TPP, is attracting a growing number of economies sympathetic to its goal of high-standard liberalization (Markheim 2008). TPP started as the Pacific Four (P4) Agreement, a plurilateral FTA among Brunei Darussalam, Chile, New Zealand, and Singapore that came into force May 2006.<sup>9</sup> The agreement eliminated 90% of all tariffs among member economies upon entry into force and will completely eliminate all trade tariffs by 2015. Since the US announced in 2008 its intent to begin comprehensive negotiations with the P4 economies to join the agreement, six more countries—Australia, Canada, Malaysia, Mexico, Peru, and Viet Nam—have joined the talks. Japan also joined the negotiations in July 2013.

The TPP is often viewed as a key element in a strategic US pivot to Asia. It would solidify US economic, political, and security links with the Asia-Pacific economies for future decades (Gordon 2012). Given its substantial potential benefits, TPP would have a better chance of overcoming US domestic opposition (from trade unions and the US automotive industry) to trade liberalization than would the Doha Round trade talks or new bilateral FTAs.

The goal of the TPP would be to achieve a comprehensive 21st century FTA covering not only tariff reductions and services-trade liberalization but also a large number of WTO-plus issues—such as competition, environmental, and labor standards, intellectual property, investment, public procurement, sanitary and phytosanitary measures, and technical barriers to trade. Regarding market access, in principle all tariffs are eliminated. Non-tariff barriers to trade will be substantially reduced and behind-the-border regulatory reforms would be pursued to guarantee domestic markets are open and transparent.

### **The EU and East Asia**

There are some signs that the launch of TPP negotiations has led the EU to intensify its efforts in the region. This sort of defensive FTA, or domino effect, is often observed.

Trade relations between East Asia and some European nations have proceeded rapidly. EFTA has already signed an FTA with Singapore (2003) and Korea (2006). Switzerland, the only industrial exporter in EFTA, now has an EPA with Japan and Thailand, and is at a negotiation stage with Indonesia and the PRC. The willingness of EFTAs to leave out agriculture—especially sensitive items such as beef and rice—has made it relatively easy to find common ground on bilateral FTAs with East Asian nations. This fact augurs well for the much more commercially important trade pacts that the EU is contemplating, but the situation is different. Following a long tradition going back to the Cold War, EFTA is willing to largely ignore politically sensitive aspects such as democracy, and social and environmental policy.

In mid-2007, the EU began FTA negotiations with ASEAN as a whole. These talks have been complicated by the fact that the EU would have trouble signing agreements with non-democratic governments, which may force the EU to negotiate with the more economically advanced ASEAN members. Indeed, talks on the EU’s standard, less-than-FTA bilateral deals, so-called Partnership and Cooperation Agreements, have already been launched with the major ASEAN members. While the EU is willing to exclude agriculture—a fact that makes trade agreements

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<sup>9</sup> The TPP, previously known as the Pacific Three Closer Economic Partnership (P3–CEP), among Chile, New Zealand, and Singapore, launched its first negotiations at the 2002 APEC Leaders’ Summit. In April 2005, Brunei Darussalam joined, and the original agreement was signed by the four countries in June 2005. The trade bloc then became known as the Pacific–4.



easier with most ASEAN countries—some ASEAN members have their own reservations, particularly commercial concerns about their high-tech industries. The negotiations have been suspended, and ASEAN wishes to resume negotiations after the AEC is launched in 2015.

A successful conclusion of an ASEAN–EU FTA can boost the possibility of a larger, trans-regional East Asia–EU FTA. Once the EU joins the ASEAN+1 process, it would be easier to begin negotiations to form a cross-regional FTA between the ASEAN+6 countries and the EU. If a RCEP among the ASEAN+6 countries is to be forged by then, it would be like one more party joining the ASEAN+6 process, where the EU would negotiate with the “plus-6” countries. Of course, the whole negotiation process would be easier if these “plus” countries already had FTAs in place with the EU—like a Korea–EU FTA (implemented), an India–EU FTA (under negotiation), and a Japan–EU EPA (under negotiation).<sup>10</sup> If a RCEP is not in place, an East Asia–EU FTA negotiation process would be more difficult as the East Asians will have to negotiate not only with the EU but also among themselves. This is another reason why the East Asian countries would be well advised to consolidate their FTAs into a single, region-wide FTA before formally negotiating for a larger, inter-regional FTA.

## 4.2 Ideas for Multilateralizing Regionalism: What Might Work in Asia?

At the September 2007 conference he hosted on the issue of multilateralizing regionalism, Pascal Lamy, Director General of the WTO, closed the conference by stating that it was time to move from words to actions. He said that we had moved

“... from a discussion of the pros and cons of regional trade agreements to a discussion on how do we cope with that and how do we multilateralise these agreements to gain both in coherence and in economic efficiency, taming the tangle, as we said. And this means, rolling up our sleeves and looking into many 'nitty gritty' issues as we have to do it in the World Trade Organization.”

His remarks have stimulated a good deal of fresh thinking on regionalism and how the WTO should deal with it. Here we look at how these ideas might translate into the Asian context (Table 7).

### Asian “Transparency Mechanism” on FTAs

One element of the noodle-bowl syndrome is the difficulty of understanding what is included in the many FTAs. Since this knowledge is expensive to develop but cheap to disseminate, it would be a good idea to have one of the regional bodies provide this regional public good. For example, a reinforced ASEAN Secretariat, APEC Secretariat, or, more immediately, the Asian Development Bank (ADB), could undertake studies of the FTAs in the region in the spirit of the WTO Transparency Mechanism. The signatory nations of these FTAs should, as part of this initiative, agree to cooperate fully in providing the necessary details, documents, and data. As the surveys discussed above pointed out, this would be welcomed by many firms in the region, especially SMEs.

Moreover, given the fast evolving nature of preferential and unilateral (autonomous) liberalization in the region, it might be worth revisiting the major FTA (e.g., AFTA and the various ASEAN+1 deals) at regular intervals, say every three years. As part of this, the regional “Transparency Mechanism” could play the role of an information clearing house devoted

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<sup>10</sup> EU's negotiations with India have proven more difficult than with Korea (agreed and already implemented) and with Japan (negotiations underway).

especially to the details of FTAs including tariffs, rules of origin, and deeper-than-tariff provisions in services, investment, and the like.

**Table 7: Ideas for Multilateralizing Asian Regionalism**

<b>Timing:</b> <b>Actor:</b>	<b>Short-term</b>	<b>Medium-term</b>
<b>Regional Bodies</b> ( <b>ASEAN Secretariat,</b> <b>APEC Secretariat,</b> <b>ADB, etc.)</b>	<ul style="list-style-type: none"> <li>• Establish an Asian “Transparency Mechanism” for main FTAs, which plays the “information clearing home” role in Asian FTAs</li> <li>• Start negotiations on two best-practice templates for future RTAs; first based on the ASEAN model (developing nation FTAs), second on the ASEAN+1 model (for developing-developed FTAs)</li> <li>• Allow plurilateral cumulation in ROO</li> </ul>	<ul style="list-style-type: none"> <li>• Propose global free trade in industrial goods (at least parts and components)</li> <li>• Negotiate plurilateral convergence of rules of origin.</li> <li>• Adopt “either/or” rules of origin to reduce problems of overlapping rules</li> </ul>
<b>RTAs</b>	<ul style="list-style-type: none"> <li>• Adopt 3<sup>rd</sup> Party MFN clauses in service and investment provisions</li> <li>• Adopt development-friendly rules of origin where possible</li> </ul>	<ul style="list-style-type: none"> <li>• Switch to value added rules of origin and implement “Lloyd tariffs”</li> </ul>
<b>Individual Nations</b>	<ul style="list-style-type: none"> <li>• Continue unilateral (or autonomous) MFN tariff cutting; and consider binding them in the Doha Round</li> <li>• Autonomously extend GATS+ commitments to all WTO members</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiate new RTAs based on regional templates</li> </ul>

Source: Authors’ application to Asia of Baldwin, Evenett, and Low (2009), Table 3; and Baldwin and Thornton (2008), Table 6.1.

To make this work, the ASEAN+6 nations should commit to the new mechanism and ensure that new and existing FTAs are reported on time. Where possible, this should include expanded data reporting, especially on services.

As there are already a number of excellent databases on tariffs, this new mechanism’s main value-added could come in the area of services. Under the WTO’s Transparency Mechanism, members are supposed to submit general economic statistics on services, but not necessarily the regulatory policies and practices that confer preferences on firms from FTA member countries. Given the potential noodle bowl in GATS+ regional deals in Asia, gathering more information on barriers to services trade and the commitments made in the various FTAs would help “tame the tangle” without directly impinging on members’ freedom.

**Best-practice FTA templates**

In both Europe and North America, the presence of a hegemon has helped harmonize the FTAs. While there is substantial variation across FTAs in each region, there is also coherence imposed by the hegemon, at least on the hub-and-spoke FTAs signed by the hegemon. The commercial importance of these hub-spoke ties has had the knock-on effect of leading the spoke-spoke FTAs to mimic key elements of the hegemonic template.

In the absence of an East Asian hegemon, this role has been played by ASEAN. But in ASEAN+1 FTAs, the AFTA templates have not always been used, partly because FTA partners are often developed countries—like Japan and Australia–New Zealand. It is useful, therefore, if one of the regional institutions—such as the ASEAN Secretariat (if it has the additional

resources), the APEC Secretariat, and the ADB—can come up with voluntary best-practice templates for FTA disciplines. In the Asian context, there would need to be two such templates, one for FTAs among developing nations and another for FTAs that involve the developed and developing nations—and thus must be Article 24 compliant under WTO rules.

Of course, this should build on the APEC's excellent initiative, but more efforts are needed to induce developing countries to become serious. The APEC initiative has yielded "model chapters" on trade in goods, technical barriers to trade, transparency, government procurement, cooperation, dispute settlement, trade facilitation, rules of origin, sanitary and phytosanitary standards, and e-commerce. According to Hufbauer and Schott (2009), the model chapters tend to follow chapters of the US–Chile FTA and the US–Australia FTA. These authors also note that the APEC work has had little impact as nations have continued to follow national templates.

### **Helping least-developed Asian countries with regionalism's challenges**

The noodle bowl is more of a problem for poor and small nations since they are struggling to enter the competition for investments and technology that will enable them to participate in the Asian production networks.

One idea would be to encourage Asian nations which sign FTAs with the least-developed Asian nations to suspend or greatly simplify ROO. The basic idea is simple. The formal reason for ROO is to avoid tariff fraud, e.g., goods made in Japan being imported duty free into, say, the PRC via, say, Lao PDR (when both Japan and the PRC have FTAs with Lao PDR but not with each other). However, if Lao PDR in this example has higher MFN tariffs than the PRC—which is the case for many goods—then no firm would have an incentive to divert imports via Lao PDR for the purposes of avoiding tariffs. To allow Lao PDR to enjoy the benefits of trade, its FTA partners may suspend or simplify ROO.

A second part of this concerns rules of cumulation. An important part of industrial competitiveness in today's world is an efficient supply chain. For small nations, especially small developing nations, this means importing many of the parts and components used in their manufactured exports. Bilateral cumulation rules hinder efficient sourcing of parts and components and thus discourage industrialization in small, developing nations. As noted above, many of the East Asian FTAs have been careful to allow broad cumulation rules, the main missing links concern imports from the PRC, Japan, and Korea. Since Japan and Korea are the main sources of many parts and components, the lack of cumulation on an ASEAN+6 basis hinders outsourcing to the less developed Asian nations. Moreover, while the basic ASEAN ROO already allow for regional cumulation, there is a minimum value-added rule (20%) for parts purchased in AFTA before the parts' value can be used for the AFTA 40% VC rule. For least developed nations—like Cambodia, Lao PDR, and Myanmar—this condition could be relaxed. Abundant research shows that ROO can be very restrictive—and especially trade-dampening—when they are combined with restrictive "rules of cumulation." Broadening these rules of cumulation can reduce the restrictiveness of regionalism.

### **Harmonizing ROO**

One very large area in which progress could be made would be to encourage regional harmonization of ROO. A good example can be found in the Western Hemisphere. Currently, East Asia is marked by dozens of different sets of ROO. Globally, there are three broad families (Estevadeordal, Harris, and Suominen 2007). The oldest family is the Latin American Integration Association ROO that are not very restrictive, and the modified form has been embraced by the economically large Mercosur trade bloc. At the other extreme of the complexity/restrictiveness scale are the NAFTA ROO and their application to many bilaterals signed by the NAFTAs. One

step toward multilateralizing Asian regionalism would be to encourage the harmonization of ROO for ASEAN countries.

### **Third party MFN clauses**

Many FTAs contain what might be called automatic anti-“spaghetti bowl” clauses. These anticipate the likelihood that the signing nations will sign more FTAs with third parties. The clauses agree to automatic adjustments to the original FTA. Since these clauses tend to give the same degree of access to all parties, they reduce the possibility that signing more FTAs will make the region an even more complicated environment for businesses.

The classic examples are third Party MFN clauses (also called “non-party MFN”), often found in services FTAs. These say, in essence, “whatever preference either of us gives to someone else in the future will be automatically extended to each other.” Instead of each new FTA adding a new strand of spaghetti, the third party MFN makes it into an every expanding “lasagna plate.” Currently, agreements include such clauses for only certain preferences, mainly on services and government procurement. However, more extensive use could help tame the tangle.

### **Unilateral liberalization**

The most obvious and effective part of unilateral anti-“noodle bowl” policy is the autonomous cutting of applied MFN tariff rates. This practice is already very widespread in East Asia, and it has been pursued within APEC as unilateral, voluntary liberalization which can be enjoyed not only by APEC members but by non-members as well. It should be encouraged more. It could also be usefully applied to the ASEAN+1 nations. However, unilateral liberalization may face increasing difficulties because governments may be more willing to provide market access to foreign trade partners through FTA trade negotiations.

While unilateral tariff cutting has attracted a good deal of attention, trade facilitation measures can have effects similar to those of unilateral liberalization in terms of reducing costs of crossborder trade. A similar move is underway in certain types of services, especially infrastructure and transport services that are useful to manufacturing exports.

### **An Asia-wide free trade zone for industrial goods**

In many sectors, applied tariffs are quite low—especially in the mechanical and electrical machinery sectors. If the EU–ASEAN FTA talks succeed, world trade in these goods will be very close to duty free. This might provide the opportunity to negotiate an FTA-like agreement covering all of East Asia, or even the world.

## **5. CONCLUDING REMARKS**

There has always been a strong case for harmony in East Asian regionalism and the development of “Factory Asia” strengthens the case. East Asia is at present marked by a thoroughly interdependent network of trade and investment—a network which is now critical to the industrial competitiveness of all nations in the region. The unique features of the region, however, meant that regionalism developed along market-driven lines for decades rather than along the more traditional formal-FTA lines. This has changed in the new century.

East Asia has gone from a region with almost no FTAs to a region with too many to count. This explosion of trade arrangements has developed without any organizational plan, guiding principles, or *de facto* hegemon. The result has been a disorganized set of dissimilar trade deals—the famous noodle bowl problem. Since most of the FTAs have only recently been signed, the actual degree of discrimination has only recently begun to bite. As a consequence,

the noodle bowl's impact has so far not been overwhelming for regional business. However, as the noodle bowl FTAs are moving from tariff-cutting promises to actual tariff cutting, the costly impact of the complex and overlapping rules of origin and the patchy coverage will start to be felt by firms in the region.

This is why it is time to start designing the future course for multilateralizing Asian regionalism. The key outcomes should include: (1) a weaving together of the matrix of bilateral FTAs into a more cohesive arrangement, by broadening the country coverage of FTAs and deepening FTAs in terms of liberalization measures and policy issues, and (2) a widening of the range of trade in goods covered (both manufactured and agricultural) and services as well as WTO-plus issues—that is, investment, labor mobility and standards, intellectual property rights, competition policy, and dispute settlement. Modern international business in trade—especially in Asia—involves a web of “things” crossing borders (goods, services, capital, know-how, information, technicians and managers, etc.). “Factory Asia” involves much more than trade in goods, so its trade arrangements should address much wider business issues.

The unique features of Asian trade help establish guiding lighthouses. First, although Asia trades a great deal with itself, it is also very dependent on external markets for final good sales, so an inward-looking solution would not serve the region's commercial interests. Second, ASEAN has emerged as the regional hub for FTAs and a convener of talks on regional trade issues.

These two facts go a long way to narrowing down the range of modalities for multilateralizing Asian regionalism. They suggest that the modalities for taming the tangle within the region would most naturally fall to an ASEAN+6 configuration, with the +6 nations signing FTAs with ASEAN and among themselves and eventually setting up an East Asia-wide FTA. The fact that ASEAN is engaged directly or indirectly with the major markets for “Factory Asia's” output (the EU and the US) suggests that ASEAN might also be a natural hub for ensuring that Asian regionalism is inclusive.

While discussion of the overarching architecture of Asian regionalism is an important discussion, there are a number of actions to be taken in the meantime to multilateralize Asian regionalism. Some of these can be done unilaterally at the national level (especially cutting applied MFN tariffs), at the regional level (e.g., ASEAN-led talks on harmonizing rules of origin and allowing either/or rules to reduce the cost of multiple sets of rules of origin), and at the global level (supporting a WTO action agenda on regionalism).

This paper has suggested a number of these more modest, more technical steps on the road to taming the Asian noodle bowl. These will require extensive discussion and preparation at every level of trade ministries in Asia. The ASEAN Secretariat, with sufficient resources, could be a natural focal point for these efforts.

The range of ideas for multilateralizing regionalism is extremely broad. Perhaps the biggest contribution would be to establish a forum where such ideas could be discussed. In the current climate of trade diplomacy, most East Asian nations are focused on their own bilateral and plurilateral partners. They will find cooperation and coordination to be mutually beneficial. As reducing the cost of complex trade arrangements is inevitably a rather technical matter, national experts should work hard to develop cooperative possibilities before bringing the matter to the political level.

A very good analogy is the work of the International Standards Organization and the World Customs Council. These bodies have shown that continuous, technical discussion can create a flow of modest improvements for the business climate. Why not start this process in Asia?

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