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**Working Paper**

## Dealing with the Proliferation of Bilateral Trade Agreements: Consolidation, Multilateralization, Harmonization, or Dilution?

ERD Working Paper Series, No. 123

**Provided in Cooperation with:**

Asian Development Bank (ADB), Manila

*Suggested Citation:* Menon, Jaytan (2008) : Dealing with the Proliferation of Bilateral Trade Agreements: Consolidation, Multilateralization, Harmonization, or Dilution?, ERD Working Paper Series, No. 123, Asian Development Bank (ADB), Manila, <https://hdl.handle.net/11540/1778>

This Version is available at:

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ADB

ECONOMICS AND RESEARCH DEPARTMENT

ERD WORKING PAPER SERIES NO. 123

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Proliferation of Bilateral  
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Jayant Menon

September 2008

Asian Development Bank





ERD Working Paper No. 123

**DEALING WITH THE PROLIFERATION  
OF BILATERAL TRADE AGREEMENTS:  
CONSOLIDATION, MULTILATERALIZATION,  
HARMONIZATION, OR DILUTION?**

JAYANT MENON

SEPTEMBER 2008

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**Asian Development Bank**

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September 2008  
ISSN 1655-5252

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## **FOREWORD**

The ERD Working Paper Series is a forum for ongoing and recently completed research and policy studies undertaken in the Asian Development Bank or on its behalf. The Series is a quick-disseminating, informal publication meant to stimulate discussion and elicit feedback. Papers published under this Series could subsequently be revised for publication as articles in professional journals or chapters in books.



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## ABSTRACT

Bilateral free trade agreements (BTAs) have been proliferating. The outcome of this proliferation of often overlapping BTAs and plurilateral free trade agreements is described as the spaghetti bowl effect or, in the Asian region, the noodle bowl effect. This is costly and welfare-reducing. How should this situation be remedied? This paper evaluates the various options proposed in dealing with the spaghetti bowl. A general limitation of these proposals is their tendency to group all kinds of BTAs together and treat them as a homogeneous group. Thus, the proposals ignore underlying differences in motivation in the formation of BTAs. To overcome this, the paper develops a taxonomy for classifying BTAs by motivation before considering the effectiveness of the different remedies proposed. Each proposal has its pros and cons, and can cater to different types of BTAs. Thus, a combination of the various proposals may be warranted, even in the event of an expeditious and *bona fide* conclusion to the Doha Round.



*"I think the noodle bowl will become an inedible quagmire—it may take a long time to throw out but sensible businesses will simply order up other dishes."*

Hugh Patrick,  
Columbia University (personal communication)

## I. INTRODUCTION

Every country in the world today, with the exception of Mongolia, is a member of at least one plurilateral free trade agreement (PTA) and bilateral free trade agreement (BTA), and most are members of multiple BTAs. If PTAs were considered the main threat to the world trade system in the 1990s, the concern has since shifted to BTAs.<sup>1</sup> The number of BTAs has been growing at an astounding pace. The outcome of this proliferation of often overlapping BTAs and PTAs is described as the spaghetti bowl effect or, in the Asian region, the noodle bowl effect. This phenomenon increases the cost of doing business and welfare losses associated with trade diversion, due to inconsistencies between various elements of the agreements. These include, for instance, different schedules for phasing out tariffs, different rules of origin, exclusions, conflicting standards, and differences in rules dealing with antidumping and other regulations and policies (see Pangestu and Scollay 2001).

How do we remedy the situation? There appears to be widespread agreement that a successful conclusion to the stalled Doha Round of the World Trade Organization (WTO) would be the best way forward in minimizing the negative impacts of the current mess. Given ongoing uncertainty as to the timing and nature of such a conclusion, and concern that any expedited resolution may involve significant compromises that could undermine the outcome itself, interest has shifted to alternative measures in addressing this problem. Some see these as interim steps in addressing the problem, while others propose them as full-fledged remedies. All of them are premised on the assumption that even a bona fide conclusion to the Doha Round may no longer be sufficient to remedy the chaotic trading environment of criss-crossing BTAs and overlapping PTAs.

A general limitation of the proposals put forward in dealing with the spaghetti bowl effect is that they tend to implicitly group all kinds of BTAs and PTAs together as a homogeneous group. In other words, the proposals ignore underlying differences in motivation in forming BTAs and PTAs. It

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<sup>1</sup> There are various stages in economic integration that are used to classify trade agreements, beginning with single-sector agreements such as the United States–Canada Auto Pact or the European Coal and Steel Community. This is followed by multisector agreements that limit the extent of preferential tariffs, such as the Association of Southeast Asian Nations prior to full implementation of the ASEAN Free Trade Agreement, and South Asian Preferential Trade Agreement prior to full implementation of South Asian Free Trade Area (SAFTA) in South Asia. Next are free trade agreements (FTAs) (with independent external tariffs), customs unions with a common external tariff, and common markets with integration extending beyond goods to factors of production. This paper focuses on FTAs—by far the most popular and widespread type of BTA.

is argued that the underlying motivation will be critical in determining whether or not a particular remedy is likely to be effective in minimizing the impacts of the spaghetti bowl effect. In other words, unless the proposed remedy does not directly conflict with the underlying motivation in forming the BTA, it is likely to be resisted by the parties concerned, and is unlikely to work.

A second limitation relates to how some of the proposed remedies are presented. In general, these are promoted only in terms of neutralizing the distortions associated with the spaghetti bowl effect. The related but often ignored issue is the impact that the proposed remedies have in terms of promoting trade liberalization beyond neutralization of the spaghetti bowl effect. In other words, to what extent can a proposed remedy go beyond dealing with the distortions associated with overlapping BTAs and PTAs with its differing rules and requirements, and further the cause of promoting freer trade?

With these limitations in mind, the paper develops a taxonomy for classifying BTAs by underlying motivation before considering the effectiveness of the different remedies proposed, both in terms of how they address the spaghetti bowl effect, and more generally how they pursue liberalization. The paper begins by providing some facts and figures relating to BTAs including their proliferation in Section II. Section III adapts a taxonomy developed in Menon (2007b) to classify BTAs by their main driving force, or motivation, to provide the backdrop for the ensuing analysis. Section IV begins by outlining the various options proposed in dealing with the consequences of the spaghetti bowl effect, before providing an assessment of their ability to do so. A final section provides a summary of main points.

## II. BTAs: SOME FACTS AND FIGURES

A complete listing of the BTAs that involve at least one country from the Asia and Pacific region,<sup>2</sup> together with their status, is provided in Table 1, and summarized in Table 2. The same information is provided in Figure 1.

Between 1983 and 1999, the interest in forming BTAs grew at a slow but steady pace. From 2000 however, this growth started to accelerate. Between 2000 and 2004, the number of concluded BTAs more than doubled, and doubled again in the next 4 years to reach 77 by January 2008. At the moment, there are another 65 BTAs that are currently under negotiation, and 44 more that have been proposed. This last number in particular keeps increasing.

Of the BTAs that have been concluded or are under implementation, the United States (US) tops the list with 16 of them, followed by Chile (12), Singapore (10), Mexico (9), and Japan (8). Of the BTAs for which framework agreements (FAs) have been signed or are currently being negotiated, Singapore tops the list with 10; followed by India with nine; and Australia, People's Republic of China (PRC) Japan, and Pakistan with seven each. The majority of these BTAs, whether concluded, being negotiated, or yet proposed, are interregional in nature, in that one partner lies outside the "region", however defined. Table 3 considers various definitions of the region, where it is evident that the share of intraregional BTAs is very low for both ASEAN+3 and ASEAN+6 definitions. Even when the region is defined to include the full complement of countries covered in this paper, the share of the Asia and Pacific region is still only about half.

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<sup>2</sup> There are several definitions of the Asia and Pacific region. In this paper, the region is taken to mean members of ASEAN, Asia-Pacific Economic Community (APEC), plus South Asia. The Central Asian Republics and Russia are excluded, but considered in Menon (2007b).

TABLE 1  
BTAs OF COUNTRIES IN ASEAN, APEC, AND SOUTH ASIA, AS OF JANUARY 2008

CONCLUDED <sup>1A</sup> /UNDER IMPLEMENTATION <sup>1B</sup>			FRAMEWORK AGREEMENT SIGNED <sup>2a</sup> UNDER NEGOTIATION <sup>2b</sup>			PROPOSED/UNDER CONSULTATION/STUDY <sup>3</sup>		
No.	Parties	Date	No.	Parties	Date	No.	Parties	Date
1	ASEAN–Korea	Jul-06	78	ASEAN–Australia and New Zealand	Feb-05	143	Australia–Korea	Dec-06
2	ASEAN–PRC	Jan-05	79	ASEAN–EU	May-07	144	Australia–Mexico	Jan-06
3	Australia–New Zealand	Jan-83	80	ASEAN–India (FA signed)	Jan-04	145	India–Australia	Jan-08
4	Canada–Chile	Jul-97	81	ASEAN–Japan (FA signed)	Nov-07	146	India–Colombia	Mar-01
5	Canada–Costa Rica	Nov-02	82	Australia–Chile	Dec-06	147	India–EFTA	Nov-07
6	Canada–EFTA (concluded)	Jun-07	83	Australia–GCC	Jul-07	148	India–Indonesia	Aug-05
7	Canada–Israel	Jan-97	84	Australia–UAE	Mar-05	149	India–Israel	Aug-07
8	Canada–United States <sup>4</sup>	Oct-87	85	Canada–Andean Community	Jun-07	150	India–Russian Federation	Oct-07
9	Chile–Colombia (signed)	Nov-06	86	Canada–Caribbean Community	Oct-07	151	India–Uruguay	2004
10	Chile–EFTA	Dec-04	87	Canada–Central America (EFTA)	Nov-01	152	India–Venezuela	2004
11	Chile–Mexico	Aug-99	88	Canada–Dominican Republic	Jun-07	153	Indonesia–EFTA	Nov-05
12	Chile–MERCOSUR	Oct-96	89	Canada–Singapore	Jan-02	154	Indonesia–Australia	Jul-07
13	Chile–Panama (signed)	Jun-06	90	India–Egypt	Jan-02	155	Japan–Canada	Nov-05
14	Chile–Peru (signed)	Aug-06	91	India–EU	Sep-05	156	Korea–GCC	Nov-07
15	EFTA–Singapore	Jan-03	92	India–GCC (FA signed)	Aug-04	157	Korea–MERCOSUR	Dec-07
16	India–Afghanistan (signed)	Mar-03	93	India–Korea	Mar-06	158	Korea–South Africa	Jun-05
17	India–Chile (signed)	Mar-06	94	India–Mauritius	Aug-05	159	Korea–Thailand	Aug-03
18	India–MERCOSUR (signed)	Jan-04	95	India–SACU (FA signed)	Nov-04	160	Malaysia–India	Jan-05
19	India–Singapore	Aug-05	96	India–Thailand (FA signed)	Oct-03	161	Malaysia–Korea	Nov-05
20	India–Sri Lanka	Dec-98	97	Japan–Australia	Apr-07	162	New Zealand–India	May-07
21	Indo–Nepal Treaty of Trade	Jun-02	98	Japan–GCC	Sep-06	163	New Zealand–Korea	Dec-06
22	Japan–Brunei (signed)	Jun-07	99	Japan–India	Feb-07	164	New Zealand–Mexico	Nov-02
23	Japan–Chile	Sep-07	100	Japan–Korea	Dec-03	165	Pakistan–Afghanistan	Jun-06
24	Japan–Indonesia (signed)	Aug-07	101	Japan–Switzerland	May-07	166	Pakistan–Brunei	Mar-06
25	Japan–Malaysia	Jul-06	102	Japan–Vietnam	Oct-06	167	Pakistan–Jordan	Jun-06
26	Japan–Mexico	Apr-05	103	Korea–Canada	Jul-05	168	Pakistan–Kazakhstan	Dec-03
27	Japan–Philippines (signed)	Sep-06	104	Korea–EU	May-07	169	Pakistan–Philippines	Apr-04
28	Japan–Singapore	Nov-02	105	Korea–Mexico	Mar-06	170	Pakistan–Tajikistan	Dec-05

continued.

Table 1. *continued.*

CONCLUDED <sup>1A</sup> /UNDER IMPLEMENTATION <sup>1B</sup>			FRAMEWORK AGREEMENT SIGNED <sup>2a</sup> UNDER NEGOTIATION <sup>2b</sup>			PROPOSED/UNDER CONSULTATION/STUDY <sup>3</sup>		
No.	Parties	Date	No.	Parties	Date	No.	Parties	Date
29	Japan–Thailand	Nov-07	106	Malaysia–Australia	May-05	171	Pakistan–Thailand	Sep-06
30	Korea–Chile	Apr-04	107	Malaysia–Chile	2007	172	PRC–India	Jun-03
31	Korea–EFTA	Sep-06	108	Malaysia–New Zealand	May-05	173	PRC–Korea	Mar-06
32	Korea–Singapore	Mar-06	109	New Zealand–GCC	Jul-07	174	PRC–Norway	Mar-07
33	Korea–United States (signed)	Jun-07	110	New Zealand–Hong Kong	Nov-00	175	PRC–South Africa	Jun-04
34	Laos–Thailand	Jun-91	111	New Zealand–PRC (FA signed)	Dec-04	176	Singapore–Bahrain <sup>5</sup>	Oct-03
35	Malaysia–Pakistan	Jan-08	112	Pacific ACP–EC	Sep-04	177	Singapore–Sri Lanka	Aug-03
36	Mexico–Bolivia	Jan-95	113	Pakistan–Bangladesh	Nov-03	178	Singapore–UAE <sup>5</sup>	Mar-05
37	Mexico–Costa Rica	Jan-95	114	Pakistan–GCC (FA signed)	Aug-04	179	Thailand–Chile	Mar-06
38	Mexico–EFTA	Jul-01	115	Pakistan–Indonesia (FA signed)	Nov-05	180	Thailand–MERCOSUR	Mar-06
39	Mexico–EU	Jul-00	116	Pakistan–MERCOSUR (FA signed)	Jul-06	181	United States–Brunei	May-07
40	Mexico–Israel	Jul-00	117	Pakistan–Morocco	2005	182	United States–Indonesia	Jan-07
41	Mexico–Nicaragua	Jul-98	118	Pakistan–Singapore	Aug-05	183	United States–Pakistan	Aug-07
42	Mexico–Uruguay	Jul-04	119	Pakistan–Turkey (FA signed)	May-04	184	United States–Philippines	1989
43	New Zealand–Singapore	Jan-01	120	Peru–EFTA	Apr-06	185	United States–Sri Lanka	2002
44	Pakistan–Iran	Sep-06	121	PRC–Australia (FA signed)	May-05	186	United States–Taipei, China	2002
45	Pakistan–Mauritius	Jun-05	122	PRC–GCC	Apr-05			
46	Pakistan–Sri Lanka	Jun-05	123	PRC–Iceland (FA signed)	2006			
47	Papua New Guinea–Australia	Sep-91	124	PRC–Peru	Jan-08			
48	PRC–Chile	Oct-06	125	PRC–Singapore	Oct-06			
49	PRC–Hong Kong, China	Jan-04	126	PRC–SACU	Jul-04			
50	PRC–Macao	Jan-04	127	Singapore–Egypt	Nov-06			
51	PRC–Pakistan	Jul-07	128	Singapore–Kuwait	Jul-04			
52	PRC–Thailand	Oct-03	129	Singapore–Mexico	Jul-00			
53	Singapore–Australia	Jul-03	130	Singapore–Peru	Feb-06			
54	Singapore–EFTA	Jan-03	131	Singapore–Qatar <sup>5</sup>	Nov-06			
55	Singapore–Jordan	Aug-05	132	Singapore–Ukraine	May-07			
56	Singapore–Panama	Jul-06	133	Taipei, China–Dominican Republic	2006			
57	Sri Lanka–Iran (signed)	Nov-04	134	Taipei, China–Paraguay (FA signed)	Aug-04			
58	Taipei, China–Guatemala	Jul-06	135	Thailand–Bahrain (FA signed)	Dec-02			

*continued.*

Table 1. continued.

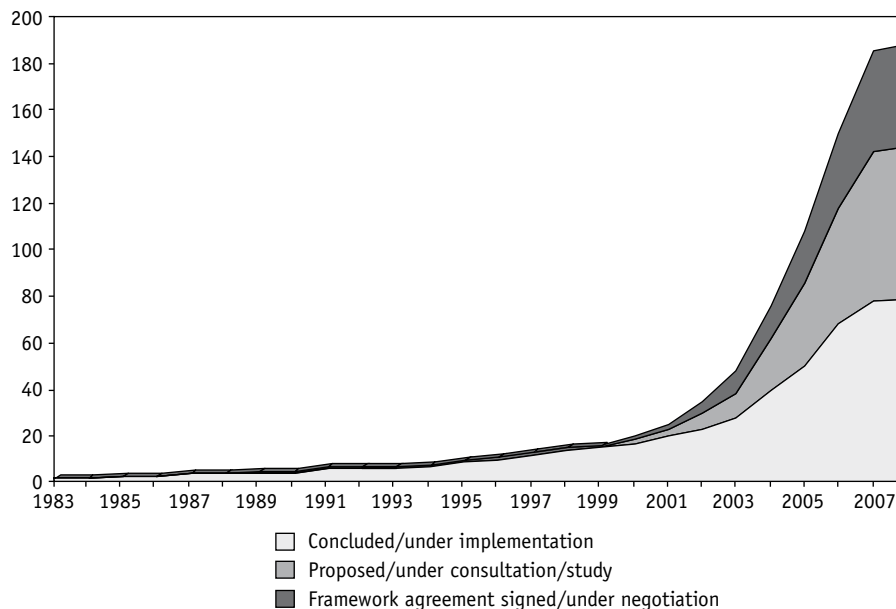
CONCLUDED <sup>1a</sup> /UNDER IMPLEMENTATION <sup>1b</sup>			FRAMEWORK AGREEMENT SIGNED <sup>2a</sup> UNDER NEGOTIATION <sup>2b</sup>			PROPOSED/UNDER CONSULTATION/STUDY <sup>3</sup>		
No.	Parties	Date	No.	Parties	Date	No.	Parties	Date
59	Taipei,China–Nicaragua	Oct-07	136	Thailand–EFTA	Oct-05			
60	Taipei,China–Panama	Jan-04	137	Thailand–Peru (FA signed)	Nov-05			
61	Thailand–Australia	Jan-05	138	Ukraine–Singapore	May-07			
62	Thailand–New Zealand	Jul-05	139	United States–Malaysia	Mar-06			
63	Thailand–Peru (signed)	Nov-05	140	United States–Thailand	Jun-04			
64	United States–Australia	Jan-05	141	United States–SACU	Nov-02			
65	United States–Bahrain	Aug-06	142	United States–UAE	Nov-04			
66	United States–Chile	Nov-04						
67	United States–Colombia (signed)	Nov-06						
68	United States–Israel	Sep-85						
69	United States–Jordan	Dec-01						
70	United States–Marshall Islands	May-04						
71	United States–Micronesia	Jun-04						
72	United States–Morocco	Jan-06						
73	United States–Oman (signed)	Sep-06						
74	United States–Panama (signed)	Jun-07						
75	United States–Peru (signed)	Apr-06						
76	United States–Palau	Oct-94						
77	United States–Singapore	Jan-04						

FTA = free trade agreement, FA = framework agreement, EFTA = European Free Trade Association, GCC = Gulf Cooperation Council, SACU = South African Customs Union, MERCOSUR = \_\_\_\_\_?????, EU = European Union, UAE = United Arab Emirates, PRC = People's Republic of China, ACP-EC = \_\_\_\_\_????.

- 1<sup>a</sup> Concluded: Parties have signed the agreement after completing negotiations. Some FTAs would require legislative or executive ratification.
  - 1<sup>b</sup> Under Implementation: FTA has entered into force.
  - 2<sup>a</sup> FA Signed: Parties have initially negotiated and signed an FA.
  - 2<sup>b</sup> Under Negotiation: Parties have begun negotiations without an FA.
  - 3 Proposed/Under Consultation/Study: Parties are considering an FTA, establishing joint study groups or joint task forces, and conducting feasibility studies to determine the desirability of entering into an FTA.
  - 4 Superseded by the North Atlantic Free Trade Agreement.
  - 5 Now GCC–Singapore FTA.
- Sources: Author's compilation based on data from the following websites: Asian Regional Information Center <[aric.adb.org](http://aric.adb.org)>; Australian Government Department of Foreign Affairs and Trade ([www.dfat.gov.au](http://www.dfat.gov.au)); Bilaterals.org <[www.bilaterals.org](http://www.bilaterals.org)>; Foreign Affairs and International Trade Canada <[www.dfait-maeci.gc.ca](http://www.dfait-maeci.gc.ca)>; Office of the US Trade Representative <[www.ustr.gov](http://www.ustr.gov)>; Organization of American State's Foreign Trade Information System ([www.sice.oas.org](http://www.sice.oas.org)); and World Trade Organization <[www.wto.org](http://www.wto.org)>.



FIGURE 1  
BTAs OF COUNTRIES IN ASEAN,<sup>3</sup> APEC, AND SOUTH ASIA, BY STATUS,  
CUMULATIVE AS OF JANUARY 2008



Sources: Author's compilation based on data from the following websites: Asian Regional Information Center <aric.adb.org>; Australian Government Department of Foreign Affairs and Trade (www.dfat.gov.au); Bilaterals.org <www.bilaterals.org>; Foreign Affairs and International Trade Canada <www.dfait-maeci.gc.ca>; Office of the US Trade Representative <www.ustr.gov>; Organization of American State's Foreign Trade Information System (www.sice.oas.org); and World Trade Organization <www.wto.org>.

### III. FACTORS DRIVING THE PROLIFERATION OF BTAs

Why are BTAs so popular? In answering this question, a set of general as well as specific factors or motivations for the popularity of BTAs needs to be identified. The general motivations apply to most, if not all BTAs, but there is always at least one additional specific factor that drives the formation of a BTA (even as usually there is more than one specific factor involved). For instance, each party to the BTA may have their own motivation in pursuing the agreement, and this may not coincide with the interest of the other party. It is also possible that each party has more than one motivating factor in pursuing the BTA. When there are two or more factors motivating the BTA, the dominant one is used in classifying the BTA.

#### A. General Factors

An important general reason for the popularity of BTAs is the apparent disenchantment with the pace of progress with liberalization at the multilateral level. The difficulties associated with

<sup>3</sup> Lao PDR is a member of ASEAN, but not APEC.

concluding the Doha round have simply reinforced this view. Many countries feel that the WTO has failed to deliver and so have pursued BTAs (and PTAs) as a means of pressing ahead with their trade and liberalization agendas.<sup>4</sup>

A form of snowballing or domino effect, as with PTAs in the past (see Baldwin 1996), has also been driving the growth in BTAs. In the Asia and Pacific region, interest in forming BTAs began in the late 1990s with Japan, Republic of Korea, New Zealand, and Singapore. By 2000, Australia, PRC, Thailand, and US had joined the trend, with more than 40 new BTAs proposed or negotiated (see Table 2). Momentum gathered over the subsequent years to the point where other countries in the Asia and Pacific region felt disadvantaged if they did not join the club. The number of BTAs thus continued to grow, and almost doubled to 109 between 2002 and 2004. There is clearly a momentum driving some of the growth in BTAs with countries not wanting to be left behind in this apparent race.<sup>5</sup>

It is often claimed that some, if not most, BTAs are essentially politically motivated. There is no doubt that political economy considerations, and indeed political parties or politicians themselves, play a major role in driving the proliferation of BTAs. A recent example of this is how the control of both Houses by the Democrats has put at risk a number of BTAs that the Bush administration has been pursuing. Although this paper tries to take into account political, strategic, and foreign policy-related issues, it focuses on economic and economic related considerations because they are easier to identify and measure. Thus, the discussion that follows is likely to understate the role that politics and politicians play in the proliferation of BTAs, simply because these influences are often difficult to measure or model, let alone classify.

## B. Specific Factors

In trying to classify BTAs, with a view toward a better understanding of them and their motivating factors, previous researchers have focused on issues such as relative size of the partners (Bonapace 2004, Whalley 2008); or geographic dispersion (Scollay 2003); while still others have referred to a range of trade, political, and other noneconomic issues (e.g., Pangestu and Scollay 2001, Baldwin 2004, Ravenhill 2006). These studies generally fail to identify any clear or consistent pattern relating to size or geography, and usually conclude that a myriad of factors are probably involved. Menon (2007b) brings together, in a systematic way, various economic, political, and strategic factors underlying the proliferation of BTAs in an attempt to redress this ambiguity.

This section adapts the taxonomy in Menon (2007b) to focus on economic motivations. This adaptation, or the original taxonomy, does not attempt to explain or classify all BTAs, only most of them. There are apparently a host of BTAs that are basically single or limited-issue agreements, which may not even try to address tariff or nontariff barriers. Furthermore, these may be sector- or

<sup>4</sup> In a paradoxical twist, it seems WTO meetings themselves are being overshadowed and are providing an opportunity for members to pursue new BTAs with other member countries. In a Bangkok-based daily, (*The Nation* 2004), an item reports that "In the corridors of the WTO meetings, Thai officials discussed the possibility of FTAs with Mexico, Chile and Peru." In the same vein, it is somewhat ironic that the Japan-Singapore BTA was concluded at the APEC summit meeting in Shanghai in October 2001.

<sup>5</sup> Baldwin (2006b, 22) argues that it could continue to play a role in the proliferation of BTAs in the region in the coming years: "If history is any guide, the domino effect in East Asia will spread to many, many more countries in the neighborhood. In Europe, for example, several waves of domino effects have left the European Union with preferential trade deals with every WTO member except for nine. It is therefore conceivable that the 13 members of the ASEAN+3 group will end up signing a very large number of bilaterals in the coming years."

TABLE 2  
BTAS OF COUNTRIES IN ASEAN, APEC, AND SOUTH ASIA (CUMULATIVE) AS OF JANUARY 2008

YEAR	CONCLUDED <sup>1a</sup> UNDER IMPLEMENTATION <sup>1b</sup>	FA SIGNED <sup>2a</sup> UNDER NEGOTIATION <sup>2b</sup>	PROPOSED/UNDER CONSULTATION/STUDY <sup>3</sup>	TOTAL
1983	1	0	0	1
1984	1	0	0	1
1985	2	0	0	2
1986	2	0	0	2
1987	3	0	0	3
1988	3	0	0	3
1989	3	0	1	4
1990	3	0	1	4
1991	5	0	1	6
1992	5	0	1	6
1993	5	0	1	6
1994	6	0	1	7
1995	8	0	1	9
1996	9	0	1	10
1997	11	0	1	12
1998	13	0	1	14
1999	14	0	1	15
2000	16	2	1	19
2001	19	3	2	24
2002	22	7	5	34
2003	27	10	10	47
2004	39	22	14	75
2005	49	36	22	107
2006	67	50	32	149
2007	76	64	43	183
2008	77	65	44	186

FTA = free trade agreement, FA = framework agreement.

<sup>1a</sup> Concluded: Parties have signed the agreement after completing negotiations. Some FTAs would require legislative or executive ratification.

<sup>1b</sup> Under Implementation: FTA has entered into force.

<sup>2a</sup> FA Signed: Parties have initially negotiated and signed the FA.

<sup>2b</sup> Under Negotiation: Parties have begun negotiations without an FA.

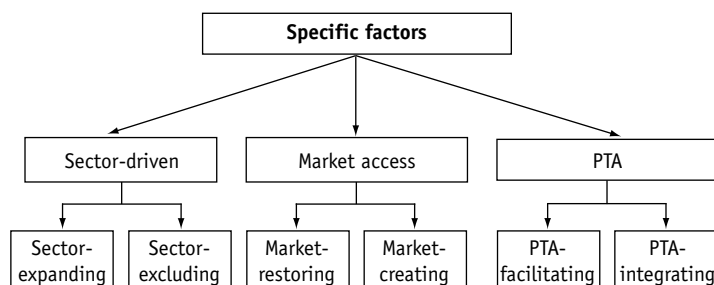
<sup>3</sup> Proposed/Under Consultation/Study: Parties are considering an FTA, establishing joint study groups or joint task forces, and conducting feasibility studies to determine the desirability of entering into an FTA.

Sources: Author's compilation based on data from the following websites: Asian Regional Information Center <aric.adb.org>; Australian Government Department of Foreign Affairs and Trade (www.dfat.gov.au); Bilaterals.org <www.bilaterals.org>; Foreign Affairs and International Trade Canada <www.dfait-maeci.gc.ca>; Office of the US Trade Representative <www.ustr.gov>; Organization of American State's Foreign Trade Information System (www.sice.oas.org); and World Trade Organization <www.wto.org>.

product-specific, which makes generalization even more difficult.<sup>6</sup> There is not much that can be done to accommodate these single- or limited-issue BTAs in a taxonomy, apart from recognizing that they exist and that they may need to be considered separately.

There are three broad categories of specific economic factors that can be identified: sector-driven, market access, and PTA-based. As depicted in Figure 2, each of these three categories has two subcategories. Thus, in total, six specific economic factors are identified to explain the proliferation of BTAs.

**FIGURE 2**  
**DIFFERENT MOTIVATIONS FOR FORMING BTAs: SPECIFIC FACTORS**



## 1. Sector-Driven BTAs

Sector-driven BTAs are subdivided into sector-excluding and sector-expanding BTAs. These BTAs are motivated mainly by one or a few key sectors. There is both a positive and negative element to this sector-based motivation, with some BTAs designed to expand liberalization into sectors or areas that have previously been ignored at the multilateral level, and others designed to exclude sensitive sectors or issues.

### (i) Sector-Expanding BTAs

It is easy to see why BTAs are easier to negotiate and conclude than PTAs or a multilateral deal: with only two parties involved, the potential for disagreement is reduced. As the focus of liberalization shifts away from the relatively easier task of reducing trade taxes on industrial products, achieving agreement on a multilateral level has become more difficult as the agenda broadens to address less transparent forms of protection, more complex issues, and new sectors. By requiring only two parties to agree, a BTA could face fewer obstacles than a regional or multilateral pact. BTAs may then have the potential to achieve a deeper level of integration than that possible through the multilateral approach alone. Even if it is not any deeper, it is often argued that we might be able to get there more quickly using the bilateral approach compared to the multilateral one. Thus, sector-expanding BTAs are often described as “WTO Plus” or “New Age” BTAs. The US–Singapore BTA is one of the first such BTAs, and is being used as a model by BTAs being pursued by the US with other ASEAN countries as part of its “Enterprise for ASEAN Initiative”.

<sup>6</sup> For example, out-of-season fruit and vegetables could motivate a BTA, such as the US–Chile agreement (that also included copper) or the proposed Pakistan–Indonesia one (seasonal differences in citrus fruit).

Of the various so-called “Singapore issues” that were raised at the WTO Ministerial Conference in Singapore in 1996, only the rather fuzzy concept of trade facilitation measures appears to have survived on the WTO agenda. Other Singapore issues such as establishing rules for investment, competition policy, and government procurement are being pursued in some sector-expanding BTAs. Progress with liberalization of services in general has been slow at the multilateral level and fraught with difficulties given country-specific sensitivities. A wide-ranging multilateral deal looks unlikely in the near future. Some sector-specific BTAs have emerged in response to such an environment. In this environment, BTAs have also been driven by the fact that preferential access may enable a supplier to steal an irreversible march on the competition, and cement a long-term advantage in the market. Many of the US BTAs with developing countries are pursuing more favorable rules relating to investment and intellectual property rights. Most of these BTAs involve countries that have had long-standing and strong trade relations, but are now looking to extend that relationship to new areas, especially in services.

### **(ii) Sector-Excluding BTAs**

Apart from services, the most sensitive sector as far as liberalization is concerned is agriculture. Most sector-excluding BTAs relate, in one way or the other, to this sector. An example of the negative element would be the BTA between Japan and Singapore, known as the Japan–Singapore Economic Partnership Agreement (JSEPA). Japan has long resisted joining PTAs because of its reluctance to liberalize its agriculture sector, while in Singapore the absence of any significant agricultural sector has facilitated the signing of this BTA. Even the few agricultural products that Singapore does export were easily excluded from the JSEPA, such as cut flowers and ornamental fish. Less than 10% of the volume of exports of agricultural products from Singapore to Japan is provided with duty-free access, and the JSEPA did not create any new preferences in the agricultural sector (Ravenhill 2006).

A similar set of exclusions of sensitive sectors can be found in Japan’s BTA with Mexico. Unlike Singapore, Mexico does have a large agricultural sector and is a major exporter of meat (pork in particular) to Japan, so the exclusions have been so widespread that about 13% of Mexico’s exports to Japan are excluded from the BTA. So, even when agriculture is important to one partner but sensitive in the other, it appears that BTAs can still be concluded by excluding this sector. Apart from exclusions, there is also greater room to manipulate rules of origin in a one-on-one setting to limit liberalization of sensitive sectors. Clearly the flexibility provided by BTAs through one-on-one negotiations allows such compromises to be made, and trade agreements to be concluded when they might otherwise stall or fail.

## **2. Market Access BTAs**

Market access BTAs can be divided into two groups: market-restoring and market-creating.

### **(i) Market-Restoring BTAs**

In the discussion earlier on general factors behind the popularity of BTAs, it was noted that one of the reasons was the apparent disenchantment with the pace of progress of liberalization at the multilateral level. The same disenchantment with the WTO was one of many factors driving

the original interest in PTAs. It also set off a kind of snowballing or domino effect (see Baldwin 1996). As the world trade system started being carved up into blocks, countries that did not belong to a PTA felt compelled to form or join one in order to secure regional markets, or compensate for markets in other regions that were becoming more isolated and less accessible as a result of preferential arrangements.

Some BTAs have developed in response to such a global trading environment. The motivation behind them is to try and restore trade links that existed prior to a trading partner joining a PTA. They generally apply to nonregional but traditional trade partners where one or both have become members of a relatively integrated PTA, which has weakened trade links between them as a result. These BTAs are designed to bypass, or at least reduce, the discriminatory treatment imposed upon them as a result of the PTA. Lloyd (2002, 6) describes this as the one factor that is common to all new PTAs and sees it as becoming more important relative to the other factors. As Lloyd puts it, "This is the fear of exclusion from major markets. In this context, exclusion does not mean that a country is denied access to a market, that is, total exclusion. It means that it has access on terms less favorable than some other country or countries" (Lloyd 2002, 6).

With the European Union (EU) and North American Free Trade Agreement (NAFTA) as centers of regional preferential trade, and with little or no prospect of other countries becoming members of these regional trade blocs, many of the BTAs being pursued with them (either with the EU or NAFTA or with individual member countries) would serve as examples of restoring market-access BTAs.

The US is a major trading partner for most of the ASEAN countries. As noted earlier, with the exception of Cambodia and Myanmar, all other ASEAN countries have either concluded or are pursuing BTAs with the US. For the ASEAN countries, the BTAs are viewed as a means of restoring market access in the post-NAFTA era.

### **(ii) Market-Creating BTAs**

Market-creating BTAs usually involve countries seeking to strengthen trade and investment relations when there has been little or weak economic relations in the past. To the extent that limited trade in the past has been due to trade barriers or other regulatory or commercial restrictions, market-creating BTAs may be successful in achieving its objective of promoting bilateral trade. They could also involve one party that is basically a highly trade-liberalized economy, such as Chile or Singapore. These countries have little left to liberalize on the tariff front but are looking for better access to new markets. Countries looking to conclude BTAs with such low- or zero-tariff countries are usually motivated by access to nontrade sectors, particularly services. In this respect, these BTAs are similar to sector-expanding BTAs, but differ from them in that they involve new or nontraditional trading partners. These highly liberalized countries also provide the best gateway, or conduit, to the region that they belong to, if the partner country is looking for such regional access. For example, many of the countries pursuing BTAs with Chile are looking for a foothold in the broader Latin and South American markets.

Another instance could involve both countries having relatively high trade barriers with the rest of the world, but then each removed them preferentially among regional partners in a PTA. In this case, there may be potential for boosting trade between the two countries through a BTA that opens up a conduit between the PTAs that each country is a member of. On the other hand, if

historically weak trade relations is due to economic reasons based on comparative advantage, such as competitive rather than complementary resource endowments, then such BTAs will have little, if any, effect on boosting bilateral trade, unless the preference margins are very large.

### 3. PTA-Based BTAs

The PTA based category is also divided into two subcategories: PTA-facilitating and PTA-integrating BTAs.

#### (i) PTA-Facilitating BTAs

These are BTAs designed to hasten the pace of integration between a nonmember and a member of a BTA. Although both parties are usually countries, they need not be so; they could also be BTAs or PTAs. An example of this would be the India–Thailand BTA, with India looking to strengthen ties with ASEAN Free Trade Area (AFTA). The same is true of the “Plus 3” countries of ASEAN, with PRC, Japan, and Korea pursuing individual BTAs with ASEAN members. Such BTAs can also be pursued with the PTA as a whole, and all the “Plus 3” countries are doing so with ASEAN.

#### (ii) PTA-Integrating BTAs

These are BTAs between members of a PTA. These types of BTAs stand out because unlike all other BTAs, the parties involved already have some form of a preferential trade agreement designed to promote closer economic relations between them. Examples of such BTAs include the Lao PDR–Viet Nam BTA and the Singapore–Thailand BTA, where all countries are also members of AFTA.

## IV. ALTERNATIVE APPROACHES TO DEALING WITH THE PROLIFERATION OF BTAs, AND THEIR EFFECTIVENESS

There are four broad approaches that have been proposed in addressing the proliferation of BTAs, and minimizing the damage that the spaghetti bowl effect is having on the world trade system. These are:

- (i) *consolidation* of BTAs into PTAs (e.g., Brummer 2007, Kawai and Wignaraja 2007, Kawai 2007)
- (ii) *multilateralization* of preferential tariffs and other accords (e.g., Feridhanusetyawan 2005, Menon 2007a)
- (iii) *harmonization* of most favored nation (MFN) tariffs through coordinated reduction (Pangestu and Scollay 2001; Baldwin 2004; Hoekman and Winters 2007; Estevadeordal, Freund, and Ornelas 2007)
- (iv) *dilution* of rules of origin (ROOs) through liberalization (Baldwin 2006a; Gasiorek 2007; Estevadeordal Harris, and Suominen 2007)

In what follows, the rationale for each approach is provided before assessing how effective it is likely to be in achieving its objectives.

## A. Consolidation of BTAs into PTAs

This section deals with the consolidation of BTAs into regionwide free trade agreements (FTAs), or blocks, where the various BTAs between members belonging to the same region are supposed to become largely redundant. There are numerous examples of defunct BTAs following the establishment of the European Union that lend credence to this approach. In the Asia and Pacific region, the US–Canada BTA was superseded by the establishment of NAFTA. An Asia-wide FTA could supersede a host of regional BTAs, and consolidate them into one regionwide agreement, if the rules are changed to accommodate this.

The consolidation approach has the potential to reduce, perhaps even eliminate, intraregional BTAs. In terms of our taxonomy, this would cover PTA-integrating BTAs and, depending on the size of the consolidated PTA, some or all PTA-facilitating BTAs as well. It is hard to imagine how it would neutralize any other type of BTA however. Most BTAs in the Asia and Pacific are interregional in nature, as seen from Table 3. In the Asia and Pacific region, Kawai and Wignaraja (2007) propose an ASEAN+3 FTA initially, then an expansion to ASEAN+6 in their main consolidation proposal. From Table 3, an ASEAN+3 FTA could potentially address only 6% of all BTAs, while an ASEAN+6 FTA would cover less than a quarter of them. In short, it would not affect the vast majority of BTAs—not in terms of neutralizing them anyway.

**TABLE 3**  
**SHARE OF INTRAREGIONAL BTAs FOR DIFFERENT DEFINITIONS OF “REGION”**

GROUP	CONCLUDED <sup>1a</sup> UNDER IMPLEMENTATION <sup>1b</sup>		FA SIGNED <sup>2a</sup> UNDER NEGOTIATION <sup>2b</sup>		PROPOSED/UNDER CONSULTATION/STUDY <sup>3</sup>		TOTAL	
	No.	Share (%)	No.	Share (%)	No.	Share (%)	No.	Share (%)
ASEAN+3	11	14	1	2	1	2	12	6
ASEAN+6	17	22	14	21	11	25	42	23
ASEAN+6 +Other APEC <sup>4</sup>	34	44	27	41	20	45	81	44
ASEAN+6 + Other APEC + Other South Asia	40	52	30	63	26	59	96	52

ASEAN = Association of Southeast Asian Nations, APEC = Asia Pacific Economic Cooperation forum, FTA = free trade agreement.

<sup>1a</sup> Concluded: Parties have signed the agreement after completing negotiations. Some FTAs would require legislative or executive ratification.

<sup>1b</sup> Under Implementation: FTA has entered into force.

<sup>2a</sup> FA Signed: Parties have initially negotiated and signed the FA.

<sup>2b</sup> Under Negotiation: Parties have begun negotiations without an FA.

<sup>3</sup> Proposed/Under Consultation/Study: Parties are considering a FTA, establishing joint study groups or joint task forces, and conducting feasibility studies to determine the desirability of entering into an FTA.

<sup>4</sup> Lao PDR is a member of ASEAN, but not APEC.

Sources: Author’s compilation based on data from the following websites: Asian Regional Information Center <aric.adb.org>; Australian Government Department of Foreign Affairs and Trade (www.dfat.gov.au); Bilaterals.org <www.bilaterals.org>; Foreign Affairs and International Trade Canada <www.dfait-maeci.gc.ca>; Office of the US Trade Representative <www.ustr.gov>; Organization of American State’s Foreign Trade Information System (www.sice.oas.org); and World Trade Organization <www.wto.org>.



On the negative side, this consolidation approach may not always be easy to implement, with its serious technical and implementation problems associated with “folding several FTAs together that have different tariff rates and innumerable rules of origin (often defined differently by product) for preferences to kick in” (Bhagwati 2006).

Even if it were possible to implement, would there be any incentive to do so? A living example is provided in South Asia with the establishment of the South Asia Free Trade Area (SAFTA) in 2004, which came about after a number of intraregional BTAs had been concluded (see Table 1), such as the India–Sri Lanka pact. According to Weerakoon (2008), the India–Sri Lanka BTA is superior in its provisions to SAFTA in almost all respects, and as a result, 93% of Sri Lanka’s exports to India currently enter duty free using the provisions of this BTA. Rather than consolidating and neutralizing this or other BTAs, it would appear that SAFTA has been rendered irrelevant by the presence of these BTAs. It could be argued that this may be a timing issue, since the full implementation of the SAFTA accords will not occur until 2016. Although this could be the case and can only be determined in the future, there are underlying reasons to suspect that it is more than just a timing issue.

Once again, it may be a question of underlying motivation, and this view is captured in the following quotation from the Bangladeshi Minister of Commerce, Amir Chowdury: “When it comes to (our) regional FTA, big economies like India and Pakistan may not offer handsome duty cuts due to distinct interests with an individual country. But they may offer large duty cuts in bilateral FTAs with Bangladesh.” This position implies that not only would existing intraregional BTAs continue in operation following the creation of a consolidated regional FTA, the incentive to pursue new intraregional BTAs would still remain. If this is true, then the consolidated regional FTA would simply add another strand to the spaghetti bowl. In short, it is questionable whether the consolidation approach is a practical and effective way to address even intraregional BTAs.

Thus, the ball needs to be back in the court of the “consolidators”, who advocate this case. So far, there appears to be very little detail to go on with. Moreover, the contrary case, that it would be very difficult to achieve, is compelling. This arises because the BTAs are a highly heterogeneous group of agreements. They invariably have different tariff rates, different treatment of quantitative restrictions, different sector exemptions (and often different “phase-in” rates for them), different ROOs (often defined product by product), and a host of other arrangements ranging from some service sector liberalizations to labor and standards provisions. If consolidation were to proceed, the more likely outcome is some sort of “lowest common denominator” result, which achieves very little (Hill and Menon 2008).

But there is a greater concern associated with employing this approach in addressing the proliferation of BTAs. This approach could serve to further fragment the world trade system, if it is perceived to be carving it up further, by introducing another distinct regional block. That is, apart from the EU and NAFTA, a consolidated Asian FTA may be viewed as the third block, or the third carved up, and thereby isolated, region. It is therefore critical that consolidation involve a concerted effort to ensure that the FTA is open, and perceived to be so.

If the consolidated FTA is perceived as being isolating, or discriminatory in any way, it may provide fresh impetus for a new wave of market-restoring BTAs as traditional trade partners outside the region seek to retain trade access with members of the newly formed FTA. Perception and reality can vary but, in this context, it may be perceptions that matter in the end, whatever the reality. It is hard to imagine how a new, large, consolidated block could be perceived as anything other

than threatening, if not sinister, to nonmember traditional trading partners, however open it is designed to be. If this is indeed the perception, and with more countries outside the region than inside, it is possible that the total number of BTAs could actually increase as a result. This could happen if the reduction in the number of intraregional BTAs through a consolidated FTA is more than offset by the number of interregional market-restoring BTAs that it indirectly induces. This is hardly a remedy to the problems facing the world trade system. To the contrary, it could add to the spaghetti bowl effect itself.

## **B. Multilateralization of Preferential Tariffs and Other Accords**

Once a country has concluded BTAs with most, if not all, of its major trading partners, it may then make sense to equalize preferences across these BTAs, and offer them to non-BTA countries on an MFN basis. This would remove the administrative burden, and eliminate distortions to country and global trade patterns. As is often the case with reversing much of second-best policies, however, it is the actual realized cost of implementation rather than any potential unrealized benefits that usually drives the process. There are also significant unrealized benefits that will accrue to the country concerned as well as the world trade system if this process of multilateralizing preferences is pursued, irrespective of the reason for doing so.

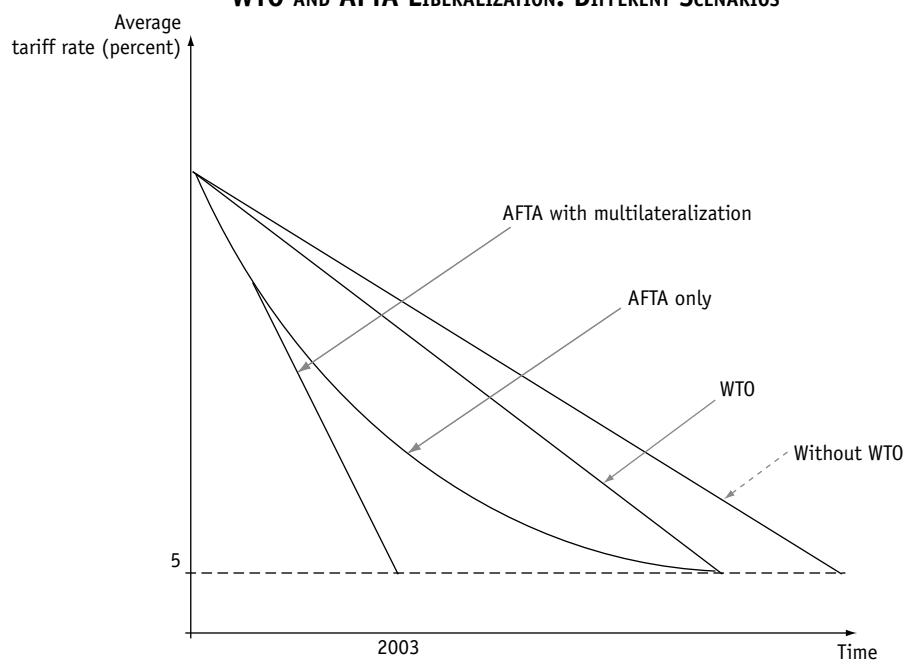
Although this approach is appealing in theory, and has the potential to remedy the spaghetti bowl effect, how realistic is it in practice? There are precedents to the voluntary multilateralization of preferential accords, so this is not a pipe-dream. Indeed, AFTA and the actions of its original members confirm this possibility (see Menon 2007a, Feridhanusetyawan 2005). At the Asia-Pacific Economic Community (APEC) Leaders Summit in Subic Bay in 1996, President Ramos of the Philippines raised the option of multilateralizing, within APEC, the AFTA accords. At the time, Indonesia had already begun providing its AFTA accords to other APEC countries. Although this proposal was never formally adopted by AFTA members, the original members have been pursuing multilateralization of their accords, not just within APEC, but on an MFN basis on a wide range of products. In 2002, preferences were fully multilateralized, or the margin of preference (MOP) was zero, for more than two thirds of the tariff lines for the original ASEAN countries (Feridhanusetyawan 2005). This share continues to increase year by year, although admittedly the MOP for a range of sensitive products remains high.

In terms of supporting the process of global trade liberalization, the multilateralization process fares well. Because preferential tariff reduction schedules are generally more ambitious and rapid, this approach can accelerate the pace of multilateral trade liberalization.

To illustrate the process using AFTA as an example, Figure 3 compares, in stylized form, trade liberalization outcomes under various scenarios involving WTO and AFTA. WTO negotiations and outcomes reduce the amount of time required for countries to move toward their goal of free and open trade (defined here as 0–5% average tariff rates). How does multilateralization of AFTA accords affect this outcome? If AFTA is implemented on a purely minimalist basis, or without any multilateralization of tariff preferences, then the time taken to arrive at the aforementioned goal is unchanged. Average tariff rates do fall more rapidly, however, particularly up to AFTA's 2003 deadline for 0–5% internal tariff rates for its original members, although this gain could be offset by the trade diversion that it would also induce. If, however, members choose to fully multilateralize their preferences for all tariff lines soon after AFTA's commencement, then the deadline for free and open

trade is moved forward to coincide with AFTA's deadline of 2003. In reality, it can be observed that preferences for a majority of tariff lines have been fully multilateralized. If the remaining one third or so of tariff lines are dealt with in the same way soon, then the deadline will fall somewhere between 2003 and the WTO-based deadline. If this happens, AFTA would have served as a building block that enables countries to pursue multilateral goals at a faster pace.

FIGURE 3  
WTO AND AFTA LIBERALIZATION: DIFFERENT SCENARIOS



Source: Menon (2007a).

How about the multilateralization approach's capacity to neutralize the spaghetti bowl effect? What kind of BTAs would this approach cater to? It could cover most, if not all, market access BTAs, since the objective is mainly to restore or expand trade, and not exclude or protect it in any way. For similar reasons, it could also apply to all types of PTA-based BTAs.

It is often argued that preferential accords in the nontariff arena, such as those applying to the services sector, are quite easily multilateralized once they have been negotiated (see Lloyd 2002, Hoekman and Winters 2007). This is because the instrument of protection in many service sector industries is regulation of one form or the other, such as rules relating to foreign investment, competition policy, and government procurement. The same applies to the myriad measures that relate to trade facilitation, as well as technical product standards, sanitary and phytosanitary measures, certification procedures and processes, and mutual recognition arrangements relating to professional qualifications etc. Such regulations are quite naturally applied in a nondiscriminatory fashion, treating domestic and foreign firms<sup>7</sup> equally. This is quite different from tariffs affecting trade in goods, where domestic/foreign and intraforeign discrimination is the objective. If this is the case, then this approach would appeal to sector-expanding and some of the market-creating BTAs.

<sup>7</sup> The nationality of a firm is defined here in terms of location of production rather than ownership.

### **C. Harmonization of Most Favored Nation Tariffs through Coordinated Reduction**

There is often resistance to multilateralizing preferences, after all, preferences form the basis of BTAs and PTAs. If such resistance cannot be overcome, then another way of reducing the MOP and the distortions it creates is to bring down the MFN tariffs themselves. When brought down gradually, the MOP is not zero in the interim or at the end, but much smaller. This approach may be more realistic when members feel committed to the preferential arrangement and therefore prefer a measured approach that retains some integrity of the arrangement, especially in the interim. When employing this method, an aggressive stance would involve a coordinated approach, such as harmonizing MFN tariffs, as with a Customs Union, to the lowest rate applied in the region. This approach does not require a Customs Union to be established, however, as demonstrated by Estevadeordal, Freund, and Ornelas (2007) in the case of Latin American PTAs. This aggressive approach is to be preferred, if practicable, in implementing harmonization of MFN tariffs through coordinated reduction. To some extent, this approach can be considered the dual to the multilateralization approach discussed in Section IVB, but which employs a method more pragmatic than gradualism; and which produces a result that is less ambitious than nonzero MOP. It also differs from multilateralization in that it applies only to tariff but not nontariff measures.

So, in terms of the proposed taxonomy in this paper, it could cater to the same BTAs as the multilateralization approach with the exception of sector-expanding BTAs, and to some of the market-creating BTAs. But as with the multilateralization approach, it will not appeal to countries motivated to conclude sector-excluding BTAs.

### **D. Dilution of ROOs through Liberalization**

Rules of origin in emerging BTAs in the Asia and Pacific region are idiosyncratic without exception, and this appears to be by design rather than by accident (James 2008). An interim measure toward full multilateralization of accords may take the form of loosening up ROOs and diluting their restrictive effect. If members of the BTA or PTA are not yet ready to give up reciprocal preferences, then this approach could be seen as preparing the groundwork for that process. This could be done by harmonization and expanding rules of cumulation. If rules of cumulation are sufficiently expanded and then harmonized across different agreements, the outcome could no longer require complete multilateralization of tariff accords. In this sense, liberalizing or reforming ROOs, like harmonized reduction of MFN tariffs, can be thought of as an alternative means of achieving the same result.

Like the harmonized reduction approach, the dilution of ROOs through liberalization approach would apply mainly to tariff measures, and cater to similar types of BTAs. But it can be more effective in limiting future growth in extra-regional BTAs such as market-restoring BTAs. This is because a system of bilateral hub-spoke agreements with constraining rules of origin is likely to greatly encourage hub-spoke trade at the expense of spoke-spoke trade. So, if the ROOs are sufficiently liberalized and rules of cumulation adequately expanded, it can remove distortions associated with artificial sourcing of inputs simply to meet regional cumulation requirements. This will reduce the incentive for spoke countries to pursue BTAs with either the hub or other spokes in order to prevent (nonpreferential) spoke-spoke trade being diverted to (preferential) hub-spoke trade. The Pan-European Cumulation System is a good model for how this can work (see Gasiorrek 2007).

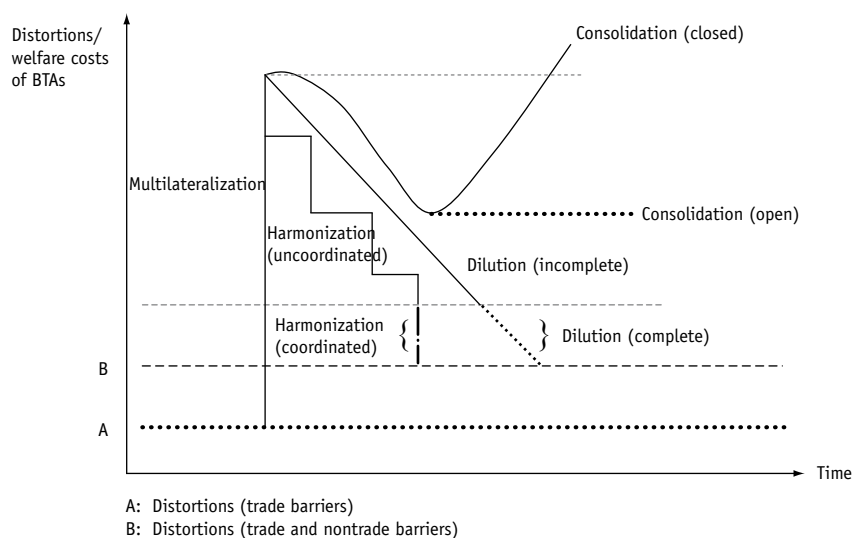
In this way, the dilution approach has an edge over the harmonized approach. It has the same advantage over the multilateralization approach in being better suited to addressing market-restoring BTAs, but not as effective in neutralizing sector-expanding BTAs, since it deals mainly with tariff but not nontariff measures.

## E. A Summing Up

This section summarizes the assessment and likely impacts of the four proposed remedies in addressing the effects of the proliferation of BTAs, as well as promoting liberalization more generally. Figure 4 portrays the likely welfare effects of each remedy, and variants therein, while Table 4 summarizes the ability of each remedy to address the different types of BTAs presented in the taxonomy.

Although Figure 4 is largely self-explanatory, two points are worth highlighting. First is the fact that the multilateralization approach produces the most significant reduction in distortions, and does so in the shortest time frame. It has the capacity to eliminate not only the MOP, but also some of the distortions associated with discriminatory restrictions in the nontrade sector, especially services. It can achieve this in the shortest time-frame because it involves a one-off decision, as opposed to staggered (harmonization) or gradual (dilution) changes.

**FIGURE 4**  
**STYLIZED WELFARE EFFECTS OF DIFFERENT REMEDIES**



If multilateralization is therefore the most preferred approach, the least preferred is consolidation. Although distortions fall initially as (some) intraregional BTAs are neutralized, they can rise again if: (i) a “lowest common denominator” outcome prevails, whereby the average level of distortions actually increases; and/or (ii) they induce new extraregional, or market-restoring, BTAs. If the consolidated FTA is perceived as being relatively closed, then it is likely that distortions could increase substantially. Even if the consolidated FTA is designed to be “open” and perceived to be so, the reduction in distortions is the lowest among the four approaches, because it can only address a limited range of BTAs, as highlighted in Table 4, and more likely on a lowest common denominator basis.

**TABLE 4**  
**EFFECTIVENESS OF PROPOSED REMEDY/APPROACH VERSUS TYPE OF BTA**

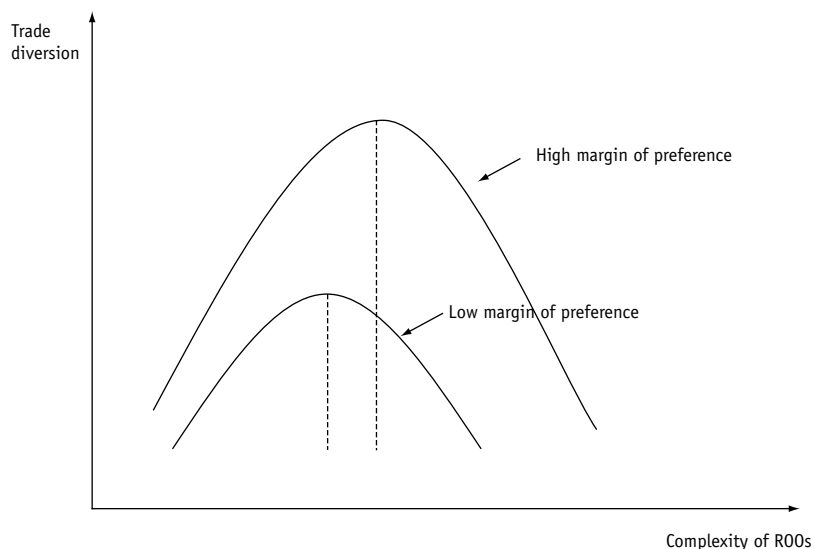
TYPE OF BTA	PROPOSED REMEDY\APPROACH			
	CONSOLIDATION	MULTILATERALIZATION	HARMONIZATION	DILUTION
Sector-expanding		Yes		
Sector-excluding	Partial	Partial	Partial	Partial
Market-restoring		Yes	Yes	Yes
Market-creating		Yes		
PTA-facilitating	Yes	Yes	Yes	Yes
PTA-integrating	Yes	Yes	Yes	Yes
Impact				
Induce new BTAs	Yes (Closed)	No	No	No
	No (Open)			

The consolidation approach has the capacity to address only two types of BTAs, namely PTA-facilitating and PTA-integrating, and these two types of BTAs can be addressed using any of the other three approaches (Table 4). In addition to these two types of BTAs, the harmonization and dilution approaches can also deal with market-restoring BTAs, while the multilateralization approach can additionally neutralize sector-expanding BTAs. All four approaches are able to address sector-excluding BTAs partially (as will be discussed later).

The consolidation approach may also be an overreaction to the problems associated with the spaghetti bowl effect, or the general proliferation of BTAs. A fact that is being increasingly recognized, and confirmed with data on utilization rates of preferences, is that many BTAs do not have a significant real effect on trade and other flows. Some BTAs are simply paper agreements that have no impact at all, apart from wasted resources in their preparation, negotiation, and maintenance. Others that are being implemented have a much smaller impact than the sectors that they cover because of low utilization rates. Various surveys of utilization rates of preferences lend support to this view (see Grether and Olarreaga 1998). For instance, a survey by JETRO (2003) found that in 2002, the rate within AFTA was only 4% for Malaysia, and 11% for Thailand. That is, the cost of complying with ROOs and other requirements are perceived to be higher than the benefit accorded by preferential treatment, and so exporters choose to ignore the preferential tariff and apply for MFN treatment. Pomfret (2007) claims that most of world trade continues to be conducted in this way, despite the proliferation of preferential agreements.

Figure 5 illustrates this in stylized form. As the complexity of ROOs increases, the amount of trade diversion also increases initially. That is, in order to satisfy increasingly demanding domestic content and other requirements, the sourcing of more and more inputs need to be switched from the lowest cost supplier (assumed to be extraregional) to regional member countries. Depending on the MOP, a turning point is eventually reached, which corresponds to a certain critical level of complexity. Beyond this level, it is no longer perceived to be profitable to try and satisfy the requirements of the preferential agreement, and that it is more cost-effective to switch back to the lowest cost supplier. The level of trade diversion induced starts to taper off. The recorded low levels of utilization rates of preferences would suggest that the level of complexity of most ROOs lie somewhere beyond this critical level.

FIGURE 5  
ROOs AND TRADE DIVERSION



Another reason why consolidation may be an overreaction relates to the role that export processing zones play in providing a refuge for firms looking to escape the quagmire of the spaghetti bowl. For example, the fastest growing segment of world trade is in electronics and components. Here production is being “sliced up” across international boundaries more than ever, as multinational enterprises continue the search for efficient, low-cost production centers that are integrated into their multicountry production and distribution systems.

Asia is the driving force behind the growth of this trade.<sup>8</sup> The big multinational enterprises in these sectors—Intel, Dell, Sony, and others—typically produce, source, and distribute in a dozen or more countries. It is inconceivable that these globally integrated giants can operate effectively across so many customs zones, each with their own set of ROOs. In fact they do not. Instead they generally choose to operate in export zones, where goods flow in and out on a duty-free basis, beyond the reach of PTAs or BTAs. The more these PTAs and BTAs spread, the more these firms will be driven into export zones to escape from them, in the process creating an unhealthy dualism between the zones and the rest of the economy. Unless of course, the countries continue down the path of unilateral liberalization and become, like Singapore and Hong Kong, China, one big free trade area. For this reason, BTAs are ultimately likely to collapse under their own weight (Hill and Menon 2008).

A feature that is clearly apparent from Table 4 is that none of the approaches appear to be able to address sector-excluding BTAs fully. While any of the approaches could be employed to neutralize preferences in sectors other than the ones being specifically excluded (thus the reference to “partial” in Table 4), the liberalization of these excluded sectors remain problematic for all approaches. It is important to note, however, that the distortions emanating from excluding these

<sup>8</sup> Between 1969–1970 and 2005–2006, the share of Asian (almost entirely East Asian) countries in global non-oil exports recorded a three-fold increase, from 11.1% to 33.4%. The fastest growing sectors have been within the machinery and transport equipment group of manufacturing, in particular the information and communication technology products. These have played a pivotal role in this major relocation of global trade to East Asia. By 2005/06, over 67% of total world information and communication technology exports originated from Asia.

sectors are different from those associated with the spaghetti bowl effect. These distortions do not arise from preferences or explicit discriminatory treatment, but from domestic subsidies and other forms of national support, as well as various nontariff measures. But as noted in the Introduction, it is important to consider these proposals not only in terms of dealing with the spaghetti bowl, but more broadly in terms of the overall liberalization process.

What can be done about these BTAs or, more specifically, the sectors excluded in these BTAs? The WTO and the potential role that the Doha Round could play become important here. This is because the multilateral approach is arguably the best forum to deal with liberalization of these excluded sectors. The reason for this relates to the fact that the multilateral approach has one key advantage over the bilateral (or regional) approach, which is the ability to trade concessions across disparate interests, i.e., to weigh the costs to countries of conceding protection in sensitive sectors (such as agriculture) against the benefits from increased market access in areas in which they have a comparative advantage (e.g. through changes to rules relating to investment, intellectual property or services).<sup>9</sup> This constrains negotiating positions and options within the WTO. Every time a BTA allows a country to bypass this trade-off simply through its choice of partner, and secures benefits without incurring costs, the task of liberalizing such sensitive sectors is made more difficult.

## V. SUMMARY AND CONCLUSIONS

The interest in forming BTAs has been growing at a phenomenal rate. In the Asia and Pacific region, defined to cover most of APEC and South Asia, the number of concluded BTAs has almost tripled over the past 5 years, from 27 in 2002 to 77 in January 2008. Furthermore, this interest appears to be increasing at an increasing rate, with the number of proposed BTAs rising from five to 44 over the same period. The outcome of this proliferation of often overlapping BTAs and PTAs is described as the spaghetti bowl effect or, in the Asian region, the noodle bowl effect. However it is called, there is little doubt that BTAs are not a good way to organize trade, and are welfare-reducing.

This paper has considered the various options proposed in dealing with this proliferation, and assessed their ability to do so. But previous assessments have ignored underlying differences in motivation in forming BTAs. To address this, the paper developed a taxonomy for classifying BTAs by motivation before considering the effectiveness of the different remedies proposed. Each proposal has its pros and cons, and any one may be more effective in neutralizing a BTA depending on why the BTA was formed. In short, motivation matters. Thus, a combination of the various proposals may be warranted, given the myriad of motivations.

Although multilateralization of preferential accords is the most preferred approach in dealing with the problem, incentives to do so might be lacking. The least preferred approach is consolidation into regionwide FTAs, because it is both impractical and potentially counterproductive. That is, it could induce a larger number of interregional BTAs than the number of intraregional BTAs that it may neutralize.

<sup>9</sup> See Menon (1998) for more details. A potent example of this trade-off was provided in the lead-up to the WTO meeting in Hong Kong, China in December 2005. Brazil and India, representing the apparent position of a majority of developing countries, proposed opening their markets further to industrial goods and services in exchange for the European Union and the US dismantling the elaborate system of support to their agricultural sector.



Because of differences in motivations, these proposals will have a role to play even in the event of an expeditious and bona fide conclusion to the Doha Round. Nevertheless the WTO remains the best forum to try and address the most stubborn of BTAs, the sector-excluding BTA; and the most difficult of sectors, agriculture, because of the WTO's ability to trade concessions across disparate interests in a multilateral setting.

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## **About the Paper**

Jayant Menon writes that a general limitation of the proposals put forward to deal with the proliferation of the free trade agreements is their failure to consider underlying differences in motivation in forming them. To overcome this, the paper develops a taxonomy for classifying free trade agreements by motivation before considering the effectiveness of the different remedies proposed. The paper finds that each proposal has its pros and cons, and can cater to different types of agreements, leading to the conclusion that a combination of the various proposals may be warranted.

## **About the Asian Development Bank**

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thirds of the world's poor. Nearly 1.7 billion people in the region live on \$2 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. In 2007, it approved \$10.1 billion of loans, \$673 million of grant projects, and technical assistance amounting to \$243 million.