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# Competing Regionalism – Patterns, Economic Impact and Implications for the Multilateral Trading System

*The stagnation of the Doha Round trade talks has given a fresh impetus to regionalism worldwide which manifests itself in a race for markets between regional trading blocs. This Forum is concerned with the patterns of regionalism to be found in different parts of the world, with their interplay and the implications for the multilateral trading system.*

Stephen Woolcock\*

## European Union Policy on Free Trade Agreements

The publication of the policy document *Global Europe* in October 2006 marked a shift in the focus of EU trade policy towards a new active phase of bilateralism.<sup>1</sup> This has taken the form of the EU initiating negotiations on new free trade agreements (FTAs) with (South) Korea, ASEAN and India as well as Central America and the Andean Community. This is a shift in focus rather than a fundamental course change, because the EU has previously made extensive use of FTAs or region-to-region agreements. But for a period of seven years from 1999 the EU maintained a *de facto* moratorium on new FTA initiatives, while it pursued a comprehensive trade agenda at the multilateral level.<sup>2</sup>

The multilateral level has fallen short of anything like the comprehensive agenda favoured by the EU. Failure to launch a millennium round of the World Trade Organisation (WTO) in 1999 and then the declining ambitions of the Doha Development Agenda (DDA) when a round was finally launched in 2001 have seen to this. So the bilateral or regional level offers a means of pursuing the EU's original aims. The same is of course true for other countries, hence the rise in FTAs.<sup>3</sup> Another factor behind the shift towards more emphasis on FTAs has been the EU's desire to match the FTAs negotiated as part of the US "competitive liberalisation" strategy. This marks a clear shift in US trade policy towards greater use of sequential bilateral trade negotiations. There has also been the dramatic growth in the number of FTA initiatives in East, South East and

South Asia that has exposed the lack of any EU FTAs in the region. The overarching motive for the EU's new FTA initiatives is, however, to defend European commercial interests. This contrasts with the motives behind other EU preferential agreements that tended to involve important political factors.

The negotiation of the new FTAs poses a significant challenge to EU trade negotiators. Can the EU deliver in terms of negotiating FTAs that add substantially to the benefits the EU has under the WTO level commitments of its FTA partners? Can the EU match what the USA and others have negotiated with Korea and other ASEAN members? In terms of the EU's role in the international trading system, can the EU deliver in terms of the objective, set out in the *Global Europe* policy, of ensuring that these new FTAs are compatible with the EU's continued support for multilateralism?

### Focus Currently on Commercial Relations with Asia

The EU is no newcomer to preferential agreements and negotiations have been under way on a number of agreements even during the *de facto* moratorium on new FTAs. But most of the previous agreements ne-

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<sup>1</sup> European Commission: *Global Europe: competing in the world: a contribution to the EU's growth and jobs strategy*, COM/2005/100 final, Brussels 2006.

<sup>2</sup> S. Evenett: "Global Europe": An Initial Assessment of the European Commission's New Trade Policy, in: *Aussenwirtschaft*, Vol. 61, No. IV, 2006, pp. 377-402.

<sup>3</sup> R. V. Fiorentino, L. Verdeja, C. Toqueboeuf: *The Changing Landscape of Regional Trade Agreements: 2006 Update*, Discussion Paper No. 12, WTO, Geneva 2007.

gotiated or still in the pipeline were motivated as much by foreign policy and security concerns as commercial interests.

The Europe Agreements negotiated with the Central and East European states in the immediate post Cold War period were clearly part of a broader policy of establishing the economic and commercial foundations for the post Cold War settlement in Europe.

The Economic Partnership Agreement (EPA) negotiations with the African Caribbean and Pacific (ACP) states initiated with the Cotonou agreement in 2000, which are supposed to be completed by 2008, are essentially motivated by developmental aims. Despite the criticism from development NGOs that the EU is inappropriately seeking reciprocity in these negotiations, the ACP states only account for about 4% of EU exports and do not figure in the offensive interests of EU exporters. The EU's main offensive interests vis-à-vis developing country markets lie in the large emerging markets of China, India and Brazil.

The EuroMed Association agreements begun in 1995 under the Barcelona Process were motivated by political and security concerns. The aim has been to promote economic development and thus political stability in the North African and Middle Eastern near neighbours of the EU. Security concerns also feature in the Stability and Security Agreements (SAAs) with the states in the western Balkans.

The EU has been keen to use region-to-region agreements, in which the EU negotiates an FTA with a partner region rather than individual countries, as a means of promoting regional integration in other regions along the lines of European integration. The desire to support integration in South America was clearly a motivation behind the EU-Mercosur negotiations that began in 1995, but are as yet not completed. The EU is also seeking to use the region-to-region approach in the EPA negotiations, in the negotiations with Central America and most recently in the negotiations with ASEAN. Unlike the use of trade agreements to promote stability in the EU's near neighbourhood, which has in most cases been very successful, the region-to-region policy has not succeeded. In the case of Mercosur and the EPAs, slow progress towards integration in the EU's partner regions has been a major cause of difficulty and delay. The prospects for an EU-ASEAN region-to-region agreement do not look much better, given the difficulties negotiating with a group of countries at very different levels of economic development.

A few EU bilateral agreements have been commercially motivated. EU-Mexico was clearly a means of ensuring that EU exporters and investors did not suffer from trade diversion or investment deflection as a result of NAFTA. The EU-Chile negotiations, which started in 1995 along with EU-Mercosur because Chile was at that time planning closer links with Mercosur, were also commercially motivated.

The current phase in EU FTA policy is however much more clearly commercially driven. The aim is to establish preferences with the Asian region given its growing economic importance. To date Asia has been the EU's "weak link" in terms of preferential agreements. All it has is the ASEM summit meetings and the TREATI agreement with ASEAN, which is focused on more informal regulatory cooperation. The renewed growth in the region thanks to the emergence of China, along with the ASEAN plus 3 (China, Japan and Korea) negotiations and a string of other FTA negotiations within the region has raised concerns that European commercial interests will suffer. The final straw has been the extension of the USA's competitive liberalisation strategy to the region through the FTAs with Singapore (ratified), Korea (negotiated) and Thailand and Malaysia (in negotiation).

### **The Prospects of Success**

Before assessing the prospects of success of the EU FTA policy it is necessary to be clear on the aims of EU policy. The commercial/trade policy aims can be summarised as follows: (i) to keep the trade liberalisation agenda moving in the absence of much progress at the multilateral level; (ii) to prevent trade (and investment) diversion stemming from other FTAs; and (iii) to shape the future trade agenda especially in rule-making. The EU also hopes that the FTAs can be used to ensure more effective enforcement with agreed international rules on the protection of intellectual property rights. As this is more enforcing existing rules than new commitments it is not covered here.

The prospects for success in the first aim are good. If the Doha Development Agenda fails to make a breakthrough in the autumn of 2007, it must be assumed that some years will elapse before new multilateral negotiations can begin. In the meantime the FTAs will have ensured that the EU is engaged in liberalisation efforts with some of its key trading partners in the interim. Success in the DDA would be welcomed by the EU, but is likely to be incomplete and will probably need to be followed by other multilateral negotiations some years down the road. In such a scenario the EU can help shape the agenda for such a future round by

negotiating FTAs, especially when these are with other key WTO members such as India.

Success in containing trade diversion depends on the scale of real or potential trade diversion in the first place. This requires a more detailed assessment of the substance of FTAs than is possible here. In general terms there must still be some doubt that some of the intra-Asian FTAs are going to amount to much in terms of substance.<sup>4</sup> On the other hand the US FTAs in the region are based on an elaboration of the US's so-called "gold standard" for FTAs. In practice this means refined versions of the NAFTA, as in the US-Singapore and KORUS (Korea-US) agreements. This "gold standard" is comprehensive. For example, it comes close to 100% coverage of tariff lines, has significantly GATS-plus commitments in services, TRIPs-plus provisions in intellectual property and includes comprehensive investment rules. The test of EU success can therefore be measured in terms of whether it can match the US FTA commitments such as in the negotiations with Korea.

The US "gold standard" for FTAs lost some of its shine in KORUS, which excluded some sensitive sectors. But to date the US FTAs have been closer to 100% coverage of tariffs than the EU FTAs, which tend to have close to 100% coverage of industrial tariffs, but exclude tariffs for a good number of agricultural tariff lines. Given EU and Korean offensive and defensive interests one might expect near full coverage of industrial tariffs in any EU-Korea FTA, but the exclusion of sensitive agricultural tariff lines. The market access aspects of an EU FTA with ASEAN are likely to be negotiated bilaterally and here the EU will also be struggling to match the scope of US FTAs. Given reciprocal negotiations, the defensive EU interests in agriculture may mean the EU is unable to match what the US has got in terms of industrial tariffs with their FTA partners. In the case of India tariff negotiations are likely to be difficult and there is a real danger of a re-run of the WTO debate in the non-agricultural market access (NAMA) negotiations, with the EU seeking commitments from India on industrial tariffs that India is unable or unwilling to make. In the FTA agreement between India and Singapore India agreed to go to zero tariffs on only 25% of its industrial tariffs, so matching this is not going to be difficult but equally could not count as a success.

In terms of services trade the EU will also be looking to match the significantly WTO-plus commitments

<sup>4</sup> R. Sallly: FTAs and the Prospects for Regional Integration in Asia, European Centre for International Political Economy, ECIPE Working Paper, No. 1/2006.

made in KORUS and US-Singapore.<sup>5</sup> An important test of success therefore will be whether the EU is able to match the scope of these services commitments. The EU has important offensive interests, especially in the emerging Indian market. But there is clearly scope for reciprocal commitments with India as the Indian service sector is internationally competitive in a number of sectors such as information technology. Liberal investment provisions are closely linked to services trade and on investment the US "gold standard" embodies comprehensive investment provisions including pre-investment national treatment, *de facto* expropriation rules and investor-state dispute settlement. This standard is applied to all US FTA partners regardless of their level of development. The EU has only recently agreed a common EU platform for investment rules in FTAs, because the member states have claimed competence over some aspects of investment and have negotiated their own bilateral investment treaties. But the EU common platform is less comprehensive than the US "gold standard", so even if the EU is successful in negotiating investment provisions with its Asian partners it will not match what is in the US FTAs.

Turning to the prospects of success in the EU shaping the agenda for trade rules through its FTAs, this concerns essentially the "Singapore issues" (investment, competition, public procurement and trade facilitation) and other more established regulatory issues concerning technical regulations and food and environmental standards. In the case of Korea the prospects for success look reasonably good. Korea has signed the 1994 WTO Government Purchasing Agreement (GPA) so there is no issue on public procurement. There is also already bilateral cooperation between the Commission and Korean competition authorities, so there should be scope for strengthening this in an FTA. The developed nature of standards and certification in Korea should also facilitate closer cooperation between the EU and Korea in the TBT (Technical Barriers to Trade) and SPS (Sanitary and Phytosanitary) fields.

The EU ASEAN negotiations on rules offer perhaps the best opportunity for the EU. In some areas such as in technical barriers to trade there is existing machinery in the form of the TREATI that can be built upon. As with all non-tariff barrier issues the adoption of provisions on TBT and SPS cooperation in an FTA is only

<sup>5</sup> A. Mattoo, C. Fink: Regional Agreements and Trade in Services: Policy Issues, World Bank, Washington D.C. 2002; C. Fink, M. Molinuevo: East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas?, draft 2007; M.-F. Houde, S. Miroudot, A. Kolse-Patil: The Interaction Between Investment and Services Chapters in Selected Regional Trade Agreements, COM/DAF/INV/TD(2006)40 FINAL, Paris 2007, OECD.

the beginning. Real progress towards facilitating trade is likely to only come afterwards with the implementation of the agreement.

The FTA negotiations with India will again pose the greatest challenge. They will bring together the EU, the main proponent of the Singapore issues, with the main opponent of including these issues in trade rules. If the EU can make progress in negotiations with India on these topics it is likely to have a significant effect on the course of any future multilateral rule-making.

### Conclusions

Although it is too early to judge how successful the EU's FTA strategy will be in terms of gaining WTO-plus provisions with its partners, the fact that the EU is negotiating will help to ensure that the EU can shape the trade rules as they develop over time, with or without a Doha Development Agenda agreement.

In terms of the declared aim of ensuring EU FTAs are compatible with multilateralism the first test is whether EU FTAs will meet the substantially all trade test of Article XIX of the GATT and Article V of the GATS. EU FTAs have, as noted above, been more "flexible" than the US ones. This means there have been more sectors excluded from liberalisation commitments. The EU policy is that 90% of trade is equivalent to substantially all trade. This falls a bit short of the US FTA coverage and means that there is scope for excluding a good number of sensitive agricultural sectors. Although there is no agreed definition of substantially all trade, excluding all the EU's sensitive sectors from liberalisation is clearly questionable in terms of the spirit of the WTO rules. In services the GATS test is if anything a little higher, but the EU is likely to perform as well as most other countries in terms of the percentage of service activities covered by commitments.

As long as tariff preferences have not been negotiated away in multilateral rounds divergent rules of origin will represent a barrier to trade. The EU approach to preferential rules of origin has been to harmonise in the shape of the PanEuro model. But this represents a fairly complex system of rules that uses a range of criteria from change of tariff heading to value content and technical requirements. If the EU is to minimise the negative effects of preferential agreements it will need to work for convergence between the PanEuro rules and other rules of origin based on a less complex system. But this is such a challenging task that it may be quicker and easier to reduce tariffs and thus the need for rules of origin.

In the longer term one can expect the trend towards tariff reductions and increased services liberalisation commitments to continue, albeit at a slow pace. This means that tariffs will continue to decline in importance and other aspects of trade policy, such as rule-making, will become more important.<sup>6</sup> This then raises the question of how the EU can ensure that any provisions on the Singapore issues in its FTAs are such that they can be multilateralised. This also raises the question of which "model" for rule-making will be used, the approach in the EU FTAs or that used in the US FTAs.<sup>7</sup> On non-tariff barriers such as TBT and SPS measures the EU can use FTAs to promote the effective application of principles set out in the respective WTO agreements, such as transparency, mutual recognition and equivalence. In this way efforts to implement the FTA provisions will tend to be non-preferential in their nature and thus consistent with multilateralism.

<sup>6</sup> S. Woolcock: Trade and Investment Rule-making: The Role of Regional and Bilateral Agreements, Tokyo 2006, United Nations University Press.

<sup>7</sup> P. Lloyd, D. MacLaren: The EU's New Trade Strategy and Regionalisation in the World Economy, in: *Aussenwirtschaft*, Vol. 61, No. IV, 2006, pp. 423-486.

Claude Barfield\*

## US Trade Policy: The Emergence of Regional and Bilateral Alternatives to Multilateralism

From the 1940s, when the postwar multilateral trading system was founded around the rump provisions of the General Agreement on Trade and Tariffs

(GATT), to the mid-1980s, the United States steadfastly opposed derogations from MFN obligations and, therefore, most regional trading arrangements (Cold War exigencies account for the exception regarding the formation and growth of the European Commu-

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nity). Essentially, the US adhered to a two-track trade policy: (1) multilateralism, embodied in its membership in the GATT and in its leadership in eight rounds of trade-liberalizing GATT negotiations; and (2) unilateralism-bilateralism, dictated by the substantive reality that GATT did not cover key trading sectors and thus powerful domestic interests demanded that US political leaders pursue independent bilateral negotiations – particularly with Japan and the EC – to achieve trade policy goals beyond multilateral disciplines.<sup>1</sup> Unilateralism was linked directly to bilateral negotiations as the US also reserved the right to act on its own by enforcing its will should bilateral negotiations fail.

### Broadened Trade Policy Agenda

Change came during the 1980s as the US essentially drifted into regional alternatives through a combination of diverse forces and unlinked events. The seeds of this broadened trade policy agenda could be found in United States Trade Representative (USTR) William Brock's call in 1982 for a GATT-plus negotiation (conditional MFN) if efforts for a new multilateral trade round failed; but Brock's move was actually a tactical means of forcing action at the multilateral level, not the signal for a change in the fundamental priorities of US trade diplomacy. Similarly, the decision to sign a bilateral FTA with Israel in 1983 was motivated entirely by political and security interests, not trade policy considerations. Finally, the first economically significant FTA initiatives – US-Canada and US-Canada-Mexico (NAFTA) – were proposed by Canada and Mexico respectively, and not by the United States.<sup>2</sup>

By the late 1980s, however, other forces were coming into play that would induce the United States to introduce bilateral and regional agreements permanently into its portfolio of trade instruments. In Europe, the EC seemed finally to be moving toward significant economic union, with the successful campaign for EC 1992 and later the signing of the Maastricht Treaty. The United States, thus, for the first time in the postwar period faced a trading partner with economic power equal to its own.

Further, beginning with the Bush (I) administration, but continuing in more urgent and vocal fashion in the Clinton administration, voices for a greater priority for regional trade policies obtained greater influence within the US executive. Secretary of State James Baker

chafed at the inability to conclude the Uruguay Round and became attracted to the opportunities for smaller bilateral and regional trade deals. Even earlier as Secretary of the Treasury under President Reagan in 1988, he had stated that while the United States hoped that liberalization would occur in the Uruguay Round, "If not, we might be willing to explore a market-liberalizing club approach through minilateral arrangements or a series of bilateral arrangements".<sup>3</sup>

In addition, Baker, as the architect of US policy regarding the 1980s Latin American debt crisis, viewed FTAs with Latin American countries as powerful complementary inducements for them to pursue more rational (bitter medicine, in some cases) macroeconomic policies. Thus, Baker was largely responsible for President Bush's espousal of the Enterprise for the Americas initiative in 1990 to extend NAFTA to all of Latin America.

And in a move that resonates within the current debate over the correct balance in US Asian trade and diplomatic policy, it was Baker who challenged (behind the scenes) the first proposal for an intra-East Asian regional institution in form of an East Asian Economic Caucus, advanced by Malaysia in 1991. Baker made clear to US allies in the region that the United States would oppose any plan that "drew a line down the middle of the Pacific" and placed the United States on the other side of that line.<sup>4</sup> Baker's attempt to meld trade policy with broader diplomatic and security goals also has echoes – and personal ties – with a similar effort on the part of the current Bush administration--not the least because the president's first US Trade Representative, Robert Zoellick, was a Baker protégé at the State Department and brought this same broader vision (unusual for a trade official) to his job.

### The Clinton Years

For much of the period of the Clinton presidency, regional policies took on a more narrow economic focus. In explanation of this narrowing, it must be remembered that by 1993, when President Clinton entered office, the Cold War was over, China's startling rise as an economic and potential military power was still over the horizon, and Muslim terrorism, while evident in such incidents as the World Tower plot, was not

<sup>1</sup> Claude E. Barfield: Regionalism and U.S. Trade Policy, in: Jagdish Bhagwati, Arvind Panagariya (eds.): *The Economics of Preferential Free Trade Agreements*, Washington, DC 1996, AEI Press, pp. 136-57; I. M. Destler: *American Trade Politics*, 4th Edition, Washington, DC 2005, Institute of International Economics.

<sup>2</sup> Claude E. Barfield: *Regionalism and U.S. Trade Policy*, op. cit.

<sup>3</sup> As quoted in Vinod K. Aggarwal, Kun-Chin Lin: APEC as an Institution, in: Richard E. Feinberg, Ye Zhao (eds.): *Assessing APEC's Progress: Trade, Ecotech, and Institutions*, Singapore 2001, ISEAS, pp. 177-190, here p. 16.

<sup>4</sup> James A. Baker III, Thomas M. DeFrank: *The Politics of Diplomacy: Revolution, War and Peace, 1989-1992*, New York 1995, G. P. Putnam's Sons.

yet perceived as a large threat to the West. Thus, the mantra of the time was that “economic security” had replaced traditional security policy as the main focus of US diplomatic initiatives. This shift was underlined by the widespread perception (exploited effectively by candidate Clinton in 1992) that US “competitiveness” had declined in the 1980s.<sup>5</sup>

It is not surprising, then, that the trade policy of the first Clinton administration took on a strongly mercantilist flavor – and that Asia emerged as the most important priority for new trade initiatives. Given the inherited challenges from the Bush administration, NAFTA and Latin America first took center stage. Despite deep divisions within his own party (and within the White House itself), President Clinton staked a great deal of presidential authority on the passage of NAFTA in the summer of 1994. And in December 1994, he built upon this success by convening the Summit of the Americas in Miami that produced a major decision to negotiate a hemispheric free trade agreement by 2005.<sup>6</sup>

Although NAFTA and the Miami Declaration (as well as successful completion of the Uruguay Round) were chalked up as major triumphs, Clinton administration officials looked to Asia as the most promising political and economic opportunity to place a Clinton stamp on US trade policy. Politically, Asia and the APEC initiatives were wholly Clinton initiatives, not hand-me-downs from the Republicans. Clinton advisers correctly told the president that Asia was an area he could claim as his own. Second, and of equal importance, because of the rapidly increasing economic growth and power of the nations of East Asia, this region represented the greatest opportunity to increase US exports and to regain symbolically US “competitiveness”.<sup>7</sup>

With great fanfare, in 1994 the administration launched its “Big Emerging Markets” initiative to target nations where US corporations had the greatest potential to boost exports.

<sup>5</sup> Robert Z. Lawrence: International Trade Policy in the 1990s, in: Jeffrey A. Frankel, Peter R. Orszag (eds.): American Economic Policy in the 1990s, Cambridge, MA 2002, The MIT Press, pp. 277-327.

<sup>6</sup> Richard Feinberg: Comparing Regional Integration in Non-Identical Twins: APEC and the FTAA, in: Integration and Trade, Vol. 4, No. 10, 2000, pp. 3-30; Robert Z. Lawrence: International Trade Policy in the 1990s, op. cit.

<sup>7</sup> Claude E. Barfield: Trade, Investment and Emerging U. S. Policies for Asia, in: Claude E. Barfield (ed.): Expanding U.S.-Asian Trade and Investment: New Challenges and Policy Options, Washington, DC 1997, AEI Press, pp. 17-55; see also Richard Feinberg: Comparing Regional Integration in Non-Identical Twins: APEC and the FTAA, op. cit.

Of the top ten so identified, more than half were from Asia (counting Taiwan and Hong Kong as separate entities).

With the Clinton administration also, for the first time, academic economists in high governmental positions spoke out in favor of giving priority to bilateral and regional free trade agreements. The 1994 and 1995 Economic Reports of the President presented detailed explanations of the Clinton administration goals and priorities for trade policy. They represented a distillation of the strongly held views of two of the administration’s principal economic spokespersons on trade – National Economic Council Chair Laura Tyson and Under Secretary of the Treasury Lawrence Summers. While acknowledging that the “most far reaching of the administration’s market opening efforts has been ... the Uruguay Round of GATT,” the 1995 Economic Report states that the “most distinctive legacy” of the Clinton administration in the trade policy arena will be the “foundation it has laid for the development of overlapping plurilateral trade agreements as stepping stones to global free trade”.<sup>8</sup>

A second important fact that emerged during the Clinton presidency was a deepening partisan division over US trade policy.<sup>9</sup> Bending to rising demands from key Democratic party constituencies – particularly the labor movement, but also environmental and consumer groups – congressional Democrats increasingly opposed new bilateral and regional trade initiatives. This phenomenon was first graphically illustrated in the NAFTA debates and votes – particularly in the US House of Representatives – where, despite strong support from the White House, the agreement failed to get a majority among House Democrats. And during President Clinton’s second term, sixty to seventy percent of House Democrats were regularly voting against trade initiatives, such as new Fast Track legislation or bilateral trade deals. The partisan divide continued and even deepened during the first six years of the Bush administration, with Republicans increasingly depending solely on partyline votes to advance bilateral FTAs.

### The Trade Policy of the Bush Administration

As with all incoming administrations, the Bush administration inherited and carried forward important elements of international trade policy from the Clinton and earlier administrations. The most significant was a commitment to the multilateral trading system and

<sup>8</sup> Economic Report of the President, Washington, DC 1994, Government Printing Office; Economic Report of the President, Washington, DC 1995, Government Printing Office; see also Claude E. Barfield: Trade, Investment and Emerging U.S. Policies for Asia.

<sup>9</sup> I. M. Destler: American Trade Politics, op. cit.

the World Trade Organization; but it faced two large obstacles to advancing the traditional US multilateral goals in January 2001: the lack of a so-called Fast Track (later labeled Trade Promotion: TPA) Authority, which had lapsed in 1994 and not been renewed; and the skepticism in many capitals around the world regarding the effort to launch a new trade round, after the 1999 disaster in Seattle.

Regarding TPA, US Trade Representative Robert Zoellick stressed from the outset the necessity for the United States to “regain the momentum on trade.” Starting with the April 2001 Quebec Summit of the Americas, at which the president lent support to a new round, and continuing with a whirlwind set of trips during the spring and early summer by Zoellick – to South America, Asia and Europe – the United States took the lead in pressing ahead with a drive to launch a new round at Doha in September. Concomitantly, the administration warned Congress of the negative consequences of a failure to reenact TPA. In June 2001, Zoellick told the Senate Finance Committee: “This is a moment we must seize together.”<sup>10</sup> To jump forward, the Doha Round was successfully launched in November 2001, and as a part of the wave of national unity after 9/11; and the administration was granted TPA in June 2002.

In addition to a priority commitment to the multilateral trading system and the WTO, two other themes dominated the trade policy of the Bush administration. The first was an explicit linkage between trade policy and overall US foreign and security policy – particularly after 9/11. The second was the doctrine of “competitive liberalization,” a slogan that meant that the administration was committed to negotiations with individual nations, groups of nations and whole regions (as a complement to its multilateral negotiations), on the theory that through the discrete use of the huge US market such negotiations would set off a competitive process toward global free trade.

### Trade and Security

Even before 9/11, Zoellick had placed US trade policy in a context of larger US foreign policy goals (such a connection came naturally to Zoellick, who had served in the Bush I State Department, as an acolyte to James Baker; and would go on after his stint at USTR to serve as Deputy Secretary of State under Condi Rice). In September 2002, the administration formally included trade policy in its white paper, “The National Security Strategy of the United States

<sup>10</sup> Robert B. Zoellick: Statement Before the Committee on Finance of the U.S. Senate, Washington, DC, 21 June 2001.

of America.” The introduction to the document stated: “(T)he United States will use this moment of opportunity to extend the benefits of democracy, free markets, and free trade to every corner of the world ... Poverty does not make poor people into terrorists and murderers. Yet poverty, weak institutions, and corruption can make weak states vulnerable to terrorist networks and drug cartels within their borders .... Free trade and free markets have proven their ability to lift whole societies out of poverty – so the United States will work with individual nations, entire regions and the entire global trading community to build a world that trade in freedom and therefore grow in prosperity ... (We) will build on these common interests to promote global security.”<sup>11</sup>

Looking back over the record of the Bush administration, certain FTAs can be explained largely in terms of important US political and security goals. This would certainly be true of the cluster of Middle East and Mediterranean agreements that have been negotiated or are currently in negotiation: Jordan (concluding negotiations began under President Clinton); Morocco; and Bahrain. In addition, there are continuing preliminary discussions with Egypt, and in November 2004, the President notified Congress that the administration planned to pursue FTA negotiations with the United Arab Emirates and Oman. All of these bilateral negotiations are taking place pursuant to a long-range US plan to construct a Middle East FTA by 2013.<sup>12</sup>

It is also clear that foreign policy and security considerations – viz. support on Iraq – played a significant role in moving Australia to the top of the list of FTAs in 2002-2003. Conversely, opposition to US security interests meant that some nations – specifically, New Zealand – were denied the “right” to begin negotiations for an FTA (USTR Zoellick made this explicit connection in 2003, citing opposition to the war in Iraq and the refusal of NZ to allow nuclear powered ships into its harbors).<sup>13</sup> In less dramatic fashion, the US briefly held up final ratification of the US-Chile FTA because

<sup>11</sup> Executive Office of the President: The National Security Strategy of the United States of America, White Paper, 20 September 2002, <http://faculty.washington.edu/nsingh/The%20National%20Security%20Strategy%20of%20the%20United%20States%20of%20America.htm> [accessed 3 July 2007].

<sup>12</sup> For details on these and other proposed FTAs, see Ian Ferguson, Lenore Sek: Trade Negotiations During the 109th Congress: Updated January 19, 2005, Order Code IB 10123, Washington, DC 2005, Congressional Research Service; and Robert Z. Lawrence: Recent US Free Trade Initiatives in the Middle East: Opportunities but no Guarantees, Harvard University – John F. Kennedy School of Government Faculty Research Working Paper Series No. RWP06-050, December 2006, <http://www.iie.com/publications/papers/lawrence1206.pdf> [accessed January 23, 2007].

<sup>13</sup> Inside US Trade, 23 May, 2003.

of Chile's opposition to the United States on Iraq in the United Nations.<sup>14</sup>

### Competitive Liberalization

The negotiation of bilateral and even regional FTAs preceded the Bush II administration by well over a decade, and had been concluded under both Republican and Democratic presidents. But as is the case with the connection between trade and security, it was the Bush II administration that first attempted to place these agreements within the context of a national trade strategy, under the title of "competitive liberalization." As explained by USTR Zoellick in early congressional testimony, through competitive liberalization – the competition produced by leveraging the huge US market to negotiate multiple bilateral and regional agreements – "the United States adds to its ability to shape the future trading system ... By moving on multiple fronts, (the United States) can create a competition of liberalization that will increase US leverage and promote open markets in our hemisphere and around the world."<sup>15</sup> Thus, as he told a group of business editors and journalists in 2002: "(M)y parting insight for you is to follow the FTAs. We will launch them, negotiate them, pass them and then launch more. Our aim is to use these FTAs – in conjunction with global and regional negotiations – to create a new ongoing momentum for trade policy. We want the march of FTAs to create a force of momentum that lasts far beyond this Administration."<sup>16</sup>

### FTAs – the Selection Process

Early on, Members of Congress and elements of the US business community raised questions about "competitive liberalization" and the introduction of non-economic factors into the selection process. In response to the questions and skepticism regarding the ultimate benefits for the United States, by 2003 the White House and USTR had instituted a more formal interagency process to establish priorities in the selection of candidates for future FTAs. In May 2003, the National Security Council (actually following directions from USTR) issued guidelines for assessing future FTA partners. In addition to setting forth a consolidated list of substantive factors, the guidelines established a

formal interagency decision making process, including responsibilities for four ascending (in terms of rank) interagency groups.

The six criteria included the following:

- *Country readiness*: involves an assessment of the country's political will, capability to assume trade obligations and overall rule of law system.
- *Economic/commercial benefit*: assesses the likely economic benefit to the United States, including potential for increased exports in specific sectors. This analysis also surveys potential increased import competition for particular US sectors.
- *Benefits to broader trade liberalization strategy*: relates to support from the prospective FTA partner for overall US trade goals, including success in meeting its WTO obligations and support for US positions in regional and WTO negotiations.
- *Compatibility with US interests*: FTA partners examined for compatibility with broad US interests, including support for US foreign policy and security interests.
- *Congressional/private sector support*: interagency groups review the extent to which the prospective FTA partner has garnered support (opposition) from Congress, business groups and civil society.
- *US government resource restraints*: factor involves primarily restraints on USTR: staff availability, likely travel and negotiating time, comparable priority with other USTR negotiations and obligations.<sup>17</sup>

Administration officials warned that these criteria were not hard and fast and that they would evolve over time. In addition, USTR Zoellick stated that they "carry no coefficients" – that is, the administration has not and will not assign relative weight to individual factors. Other administration officials told the GAO that NSC and USTR views are central but that other agencies could and did weigh in with complementary or conflicting views.<sup>18</sup>

### The Results: 2001-2007

When the Bush administration came into office, the only FTA in place was the 1983 US-Israeli agreement. Since 2001, under the aegis of the new Trade Promotion Authority, the administration has negotiated and placed in force six bilateral agreements, spanning

<sup>14</sup> Ian Ferguson, Lenore Sek: Trade Negotiations During the 109th Congress, op. cit.; Robert Z. Lawrence: Recent US Free Trade Initiatives in the Middle East: Opportunities but no Guarantees, op. cit.

<sup>15</sup> Robert B. Zoellick: Statement Before the Committee on Finance of the U.S. Senate, op. cit.

<sup>16</sup> Robert B. Zoellick: So What Is There to Cover? Globalization, Politics, and the U.S. Trade Strategy, Address to the Society of American Business Editors and Writers, Phoenix, AZ, 30 April 2002, [http://www.ustr.gov/assets/Document\\_Library/USTR\\_Speeches/2002/as-set\\_upload\\_file718\\_4245.pdf](http://www.ustr.gov/assets/Document_Library/USTR_Speeches/2002/as-set_upload_file718_4245.pdf) [accessed 3 July 2007].

<sup>17</sup> U.S. Government Accountability Office (GAO): International Trade: Intensifying Free Trade Negotiating Agenda Calls for Better Allocation of Staff and Resources, GAO-04-233, Washington, DC 2004, <http://www.gao.gov/highlights/d04233high.pdf> [accessed April 18, 2006].

<sup>18</sup> Ibid.

**Table 1**  
**US Bilateral and Regional Trade Agreements**

Bilateral FTAs	Regional FTAs
<b>Bilateral FTAs in Force</b>	<b>Regional FTAs in Force</b>
1 Israel	1 NAFTA
2 Jordan	2 CAFTA-DR <sup>1</sup>
3 Chile	
4 Singapore	
5 Australia	
6 Morocco	
7 Bahrain	
<b>Bilateral FTAs Pending Implementation</b>	<b>Other Regional FTAs</b>
1 Oman	1 SACU <sup>2</sup>
<b>Bilateral FTAs Pending Congressional Approval</b>	<b>Proposed Regional FTAs</b>
1 Peru	1 MEFTA <sup>3</sup>
2 Colombia	2 FTAAP <sup>4</sup>
3 Panama	3 FTAA <sup>5</sup>
4 Republic of Korea	
<b>Other Bilateral FTAs in Negotiations</b>	
1 Malaysia	
2 Thailand	
3 UAE	

<sup>1</sup> El Salvador, Nicaragua, Honduras, Guatemala and the Dominican Republic.

<sup>2</sup> South Africa, Botswana, Lesotho, Swaziland, Namibia.

<sup>3</sup> Jordan, Lebanon, Israel, Palestine, Egypt, Syria and Iraq.

<sup>4</sup> Australia, Brunei, Canada, Indonesia, Japan, Malaysia, Philippines, New Zealand, Singapore, Republic of Korea, Thailand, United States, Republic of China(Taiwan), Hong Kong(China), China, Mexico, Papua New Guinea, Chile, Peru, Russia, Vietnam.

<sup>5</sup> Antigua and Barbuda, Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, USA, Uruguay and Venezuela.

Source: Office of the United States Representative.

the globe from the Middle East to Latin America and East Asia (see Table 1). In addition, there is one FTA (with Oman) pending implementation, and four FTAs (Peru, Columbia, Panama, and South Korea) that have been completed but await congressional approval. Finally, bilateral FTA negotiations are in various states of progress with three other countries (Malaysia, Thailand and the UAE).

In regards to plurilateral and regional agreements, the Bush administration's only success thus far is the CAFTA agreement with Central American countries (El Salvador, Nicaragua, Honduras, Guatemala, and the Dominican Republic). Over the longer term, the Bush administration plans to continue to pursue FTAA negotiations that began under President Clinton; and to these negotiations, it has announced plans for more

distant negotiations in the Middle East (MEFTA), southern Africa (SACU), and East Asia (FTAAP).<sup>19</sup>

### Regional vs. Bilateral Agreements

With the future uncertain, there are still lessons that have emerged from the first seven years of Bush administration trade policy. Under USTR Zoellick's original vision of competitive liberalization, bilateral agreements were to be linked ultimately to regional agreements (a kind of "open" bilateralism), which in turn would coalesce into global free trade. The real challenge – and potential flaw – in Zoellick's strategy was and is that while a large economy like the United States will find it easy to entice and cajole many small countries around the world to link up with its huge market through bilateral FTAs, when it comes to negotiating sizable regional agreements (such as the 34-nation FTAA) many of the same political and economic barriers and conflicts that plague multilateral negotiations in the WTO inevitably come into play. Thus, there is the danger that at the end of the day, the result could be the worst of all possible worlds – as warned by international trade economists Jagdish Bhagwati and others – that is, a "spaghetti bowl" of multiple, market-distorting bilaterals.<sup>20</sup> At least thus far, that seems to be what is happening with US trade policy in Latin America and East Asia.

### FTAA

For this paper, a brief review of the history and current state of play with regard to the Free Trade Area of the Americas (FTAA) will serve as an illustration. Agreed to in 1994, official negotiations for an FTAA were launched in 1998, with the original goal of completing the agreement by January 2005. After initial meetings, nine areas were targeted for the agreement. Some duplicated groups later formed in the Doha Round of WTO negotiations (market access, agriculture, services, subsidies, trade remedies) and some went beyond (TRIPS plus, competition policy, government procurement). Originally, it was agreed that all decisions would be taken by consensus and that at the end there would be a single undertaking.<sup>21</sup>

<sup>19</sup> Because TPA authority lapsed at the end of June 2007, and is unlikely to be renewed for FTAs before the end of the Bush administration, forward motion on bilateral and regional FTAs will not take place at least until a new president and new Congress are in place in January 2009.

<sup>20</sup> Jagdish Bhagwati: U.S. Trade Policy: The Infatuation with Free Trade Areas, in: Jagdish Bhagwati, Anne O. Krueger: The Dangerous Drift to Preferential Trade Agreements, Washington, DC 1995, AEI Press, pp. 1-18; Jagdish Bhagwati: A Stream of Windows: Unsettling Reflections on Trade, Immigration, and Democracy, Cambridge, MA 1998, MIT Press.

<sup>21</sup> For details, see Richard Feinberg: Comparing Regional Integration in Non-Identical Twins: APEC and the FTAA, op. cit.

In April 2001, after an initial series of meetings and negotiations, the first draft text was produced, basically containing a compilation and consolidation of proposals tabled by FTAA member states. It was counted as a solid first step, but it also demonstrated large gaps and bracketed disagreements. Meanwhile, the Doha Round was launched in 2001, and US trade negotiators were given new instructions and objectives in the TPA that also passed Congress in August 2002.<sup>22</sup>

In November 2002, after it became clear that major differences continued over the scope and depth of proposed obligations, the United States and Brazil – the two main antagonists – agreed to jointly chair the negotiations. Throughout 2003, however, the differences widened and at a ministerial meeting in November at Miami, FTAA negotiators bowed to the inevitable and agreed to a scaled-down negotiating agenda. The basic problems and issues went right back to the issues central to the Doha Round. The United States maintained that negotiations on agricultural subsidies and trade remedy measures (antidumping, safeguards, CVDs) could only be handled at the multilateral level. Since these areas constituted the most important demands for Brazil and other Latin American countries, they in turn refused to advance proposals on services, TRIPs, investment and government procurement. At the Miami ministerial, the result was what has been labeled “FTAA lite”: that is, an agreement to establish several tracks or “tiers” for the negotiations. There would first be a common set of obligations for all 34 nations; but in addition, there would be a second set of obligations based upon a voluntary plurilateral agreement. Since 2003, two things have happened: (1) continuous fighting over just which issues are part of the common set of obligations and which are voluntary; (2) both the United States and Brazil have stepped up efforts to go around the FTAA negotiations, attempting to enlist other Latin American countries through bilateral agreements or signing on to the Mercosur Agreement.<sup>23</sup>

As stated above, the lesson here for the US doctrine of “competitive liberalization” is that even with the best of wills and a strong commitment of resources it may not be possible to create regional “building blocks” on the path to global free trade.

<sup>22</sup> U.S. Government Accountability Office (GAO): Free Trade Area of the Americas: Missed Deadlines Prompt Efforts to Restart Stalled Hemispheric Trade Negotiations, GAO-05-166, Washington, DC 2005, <http://www.gao.gov/new.items/d05166.pdf> [accessed 18 April 2006].

<sup>23</sup> Ibid.; see also Richard Feinberg: Regionalism and Domestic Politics: U.S.-Latin American Trade Policy in the Bush Era, in: *Integration and Trade*, Vol. 4, No. 10, 2002, pp. 3-30.

## East Asia

The geographic area that poses the greatest challenge – thus far unmet – to the central tenet of the Bush administration’s policy of an explicit linkage of trade policy with larger diplomatic and security goals is East Asia. In retrospect, it is clear that two phenomena caught the Bush administration (and the rest of the world) by surprise. These were the speed of the rise of Asian regionalism (or, at least, the sense of an East Asian community), and both the adroitness and the speed with which China assumed a position of leadership, with the clear, if unstated, goal of replacing the United States as the dominant hegemon in the area.<sup>24</sup>

Interestingly, the first premonitions of the rise of East Asian regionalism stemmed initially from the ashes of a proposal put forward in 1991-1992 by Malaysian Prime Minister Mahathir Mohamad for an East Asian Economic Group (EAEG), consisting of the ASEAN countries plus Japan, China and Korea – but conspicuously excluding the United States. This proposal foundered through the force of US objections, but at the same time a less hostile (to the United States) effort by Australia and Japan to create an Asia Pacific Economic Cooperation (APEC) forum gained impetus when the newly installed Clinton administration adopted and upgraded the concept as the major vehicle for its trade policy for East Asia.

Thus began what might be called an APEC phase of East Asian integration, when the United States led a region wide trade liberalization movement, anchored by the first high-level meetings of chiefs of state in Seattle in 1993 and followed by the Bogor declaration in 1994, whereby APEC countries pledged to achieve free trade in the region by 2010 for developed countries and 2020 for developing countries. Ultimately, APEC proved far too ambitious, not the least because the various leading parties had very different goals for the negotiating forum. For the East Asian members, APEC represented a means possibly of curbing US unilateral trade sanctions, while keeping Asian trade a top priority for US trade policy. Instead, the US made it clear that its trade remedy actions were not on the negotiating table; and with the conclusion of NAFTA in 1994 and the Miami declaration the same year pledging free trade in the Americas by 2005, the United States seemed

<sup>24</sup> Claude E. Barfield: The United States, China and the Rise of Asian Regionalism, Paper delivered at the Western Economics Association Annual Conference, Vancouver, British Columbia, Canada, 29 June 2004, [http://www.aei.org/docLib/20040902\\_CHINAP~1.pdf](http://www.aei.org/docLib/20040902_CHINAP~1.pdf) [accessed 23 January 2007].

to veer back toward a hemisphere-first trade policy. The drift of US policy away from APEC was hastened by the failure of its strong drive for APEC-based trade liberalization in the Early Voluntary Sectoral Liberalization (EVSL) initiative in 1997. (This effort, pushed by the United States, would have instituted reciprocity-based trade negotiations for a group of key sectors, including forestry and fisheries, chemicals, forest products, medical equipment, and environmental goods.)<sup>25</sup>

Meanwhile, APEC also did not satisfy the desire of Asian countries for a regional forum of economic cooperation, short of drastic trade liberalization. The onset of the Asian financial crisis in 1997 changed all of the calculations of the major players, both inside and outside the region. It marked the end of the APEC phase of East Asian integration. To the dismay and anger of Asian APEC members, the United States continued to press for the EVSL even as the crisis deepened in 1997-98. In turn, disappointment with the lack of momentum for APEC liberalization caused the United States to shift its focus to China's WTO accession as the top priority within the region and to place more resources in the FTAA process in the Americas.

#### Recent Trends in East Asian Regionalism

Since the late 1990s, East Asian regionalism has witnessed the emergence of three different phenomena in tandem: the decline of the importance and influence of APEC and trans-Pacific regionalism; the rise of alternative intra-East Asian regional organizations and processes – ASEAN Plus Three (APT) and East Asian Summit – that are duplicating, and may well replace, the activities associated with APEC; and an explosion of bilateral FTAs (both among East Asian nations and with nations outside the region). Distracted by the war on terror after 9/11 and the subsequent invasion of Iraq, the Bush administration has failed – at least until recently – to react to these changes and to develop and sustain new strategic US economic and diplomatic policies to meet those challenges.

*APEC Adrift:* With little exaggeration, it can be said that since 1998, APEC has drifted, increasingly bereft of momentum and, as time passed, influence. After the failure of the EVSL effort in 1998, the Clinton administration lost interest in APEC as a vehicle for trade liberalization.

<sup>25</sup> John Ravenhill: *APEC and the Construction of Pacific Rim Regionalism*, Cambridge 2002, Cambridge University Press; Naoko Munakata: *Whither East Asian Economic Integration?*, RIETI Discussion Paper Series, 02-E-007, June 2002, <http://www.rieti.go.jp/jp/publications/dp/02e007.pdf> [accessed 20 April 2006].

After 9/11, pushed strongly by the United States, global security issues and the war on terrorism took center stage at APEC leaders' meetings. In 2003, the official APEC leaders' declaration raised security issues to equal priority with trade and other economic issues, a change that administration officials candidly admitted caused some friction among other APEC members.

Meanwhile, from 2001 to 2005, the US position toward further APEC regional liberalization was either negative or non-committal. In 2003, USTR Zoellick rebuffed a proposal by Thailand to move up the Bogor Goals from 2020 to 2015, arguing that the "best way to move forward" was to use bilateral FTAs "to create models" for future liberalization.<sup>26</sup>

Still, there were those who wanted to revive the trans-Pacific vision of regional integration. In 2004, the influential international trade economist and policy entrepreneur C. Fred Bergsten persuaded the APEC Business Advisory Council (ABAC) to put forward a proposal for a Free Trade Area of the Asia-Pacific (FTAAP). At the Santiago leaders' meeting, although Australia, Singapore and New Zealand supported the idea, the US was noncommittal. Zoellick labeled the proposal a "valuable discussion topic," but he also stated that most ministers were mainly interested in more "practical steps".<sup>27</sup> It was not until 2006, two years later, that President Bush endorsed a study group to assess the possibilities of FTAAP, and even at that point, he only stated that the idea deserved "serious consideration".<sup>28</sup> And it was not until the recent 2007 APEC leaders summit in Sydney, Australia, that Bush administration officials really attempted to exert leadership in advancing the FTAAP proposal – to muted and even lukewarm response from other APEC leaders.<sup>29</sup>

*ASEAN Plus Three:* Meanwhile, the APT increasingly moved to center stage as the chief vehicle for East Asian integration. In 2002, leaders of the APT established an East Asian Study Group, composed entirely of government officials, which subsequently recommended a "step-by-step" approach to trade and fi-

<sup>26</sup> International Trade Reporter, 23 October 2003.

<sup>27</sup> International Trade Reporter, 25 November 2004; see also C. Fred Bergsten: *A New Strategy for APEC*, Speech at the 16th General Meeting of the Pacific Economic Cooperation Council (PECC), Seoul, South Korea, 6 September 2005, <http://www.iie.com/publications/papers/bergsten0905apec.pdf> [accessed 11 July 2006].

<sup>28</sup> International Trade Reporter, 23 November 2006.

<sup>29</sup> U.S. Department of State: *Strengthening Regional Economic Integration: A report on economic integration, including a possible Free Trade Area of the Asia-Pacific as a long-term prospect*, Washington, DC 2007; *Inside US Trade*, 14 September 2007.

financial liberalization in East Asia and suggested that formal negotiations for an intra-East Asian FTA be put off well into the future.<sup>30</sup>

Despite this cautious approach, the APT has steadily moved to duplicate and overtake many of the functions of APEC. There are now annual meetings of trade ministers, and in recent years, the APT has taken on additional activities, with accompanying ministerial meetings, such as the environment, energy, tourism, health and safety, financial services – and recently, regional security.

Originally behind the scenes, but in recent years more openly, the PRC has pushed to increase the stature and activities of the APT. For China, there are three virtues associated with the organization and the process: neither the United States nor Taiwan is a member, and the overriding vision foresees intra-Asian regionalism as the wave of the future. Recently, Chinese scholars, if not Chinese officials, have become quite candid in their view of the future of Asian regionalism and the role of the United States. Chu Shulong, a scholar close to the Beijing government (and a 2006-2007 visiting scholar at the Brookings Institution) recently wrote bluntly: “Americans ... have to realize, soon(er) or later, that a regional economic and security arrangement in Asia without direct US involvement is inevitable in the long run ... simply because ... Asia needs its own economic and security mechanism to (take) care (of) itself.”<sup>31</sup>

*Bilateral FTAs:* The greatest activity in East Asia on the trade front over the last eight years has been the burst of bilateral FTAs that have been negotiated among East Asian countries and between East Asian countries and nations outside of the region. In 1999, except for the loose ASEAN grouping, no nation in East Asia was negotiating or had concluded a bilateral FTA. In 2007, by some counts (it is hard to keep up as more FTAs are being announced every month), East Asian nations are planning, negotiating or have con-

cluded over 100 FTAs.<sup>32</sup> Singapore is the champion in this area, with the PRC, Australia, Korea and Thailand (until the coup) following in its footsteps, and Japan and South Korea catching up.

As noted above, at this point the United States has concluded FTAs with Australia and Singapore, and it is negotiating FTAs with Thailand, Korea and Malaysia. In addition, it has a TIFA with ASEAN, and New Zealand and Taiwan have both requested negotiations of an FTA, thus far without success.

### US Trade Policy Options in East Asia

What follows is a series of trade policy options for the United States in East Asia over the next few years and, in some instances, over the next decade. The order builds from the current bilateral course up to several possible regional frameworks.

1. *Bilateral FTAs: Continue Along the Current Path.* The United States could over the next several years continue on the bilateral path it started down after the disappointment with APEC as a vehicle for East Asian trade liberalization. If the US-Korea FTA agreement is ratified, international trade economist Richard Baldwin has predicted that his long-discussed “domino effect” will finally take hold. In that instance, the prediction would be that Japan would have to take action to counter the trade diversion effects of a US-Korea FTA. Japan potentially would have three options: it could approach either the United States or Korea separately (it could also approach both nations separately, but this is less likely); it could also suggest a three-nation FTA (à la NAFTA). In turn, should a US-Korea-Japan FTA be concluded (or even if negotiations began), other East Asian nations would likely line up quickly to join. A major question then would concern whether the ASEAN nations would negotiate as a group, or whether individual nations would ask to join the new agreement. The wild cards in this expanding FTA scenario would be China and Taiwan. It is not clear whether the United States, for either political or economic reasons, could agree to negotiating an FTA with the PR China. On the other hand, the US would undoubtedly insist that Taiwan be included, setting up the possibility of a compromise that could be sold on the US political scene: that is, as with APEC and the WTO, the PR China and Taiwan would negotiate FTAs simultaneously. It is, finally, unclear what role India would play in this scenario; but that is true with all Asian scenarios at this point.

<sup>30</sup> Youngmin Kwon: *Regional Community-Building in East Asia*, Seoul 2002, Yonsei University Press; Davie Capie: *Rival Regions? East Asian Regionalism and its Challenge to the Asia-Pacific*, in: James R. O'Leary (ed.): *Asia-Pacific: A Region in Transition*, Honolulu 2004, Asia-Pacific Center for Security Studies, pp. 149–65.

<sup>31</sup> Shulong Chu: *Regionalism and China's Peaceful Rise: Local Neighbors and Global Strategy*, Washington, DC 2006, Brookings Institution, pp. 4, 10. Uncharacteristically for Chinese commentators, Chu also took a direct shot at US policies toward Asia, arguing that: “(The) 1997 Asian financial crisis indicates clearly that Americans do not care (about) Asians too much, for it did not act to the crisis as it had done (in the) Mexican financial crisis ... when the US offered about \$30 billion to help ... Mexico. Therefore, since Americans do not care much about Asia, why (should) Asians always care about American concerns about East Asia grouping.” (Ibid., p. 10.)

<sup>32</sup> Asian Development Bank: *ADB FTA Database*, Asian Regional Development Center 2007, [www.aric.adb.org](http://www.aric.adb.org).

2. *APEC: Coalition of the Willing.* Utilizing APEC as the negotiating forum, the United States could attempt to negotiate with those nations in APEC that were ready to move beyond bilateral FTAs and negotiate a subregional agreement. In order to avoid anger and resentment over future discrimination, the APEC-minus FTA would need to provide a clear docking arrangement so that when ready other APEC nations could more easily join the agreement. This option also would finesse the problem of Taiwan, as it is already a member of APEC. There are also interim steps that the US might take to build toward consolidation. First, it could convene all off the APEC members with which it has bilateral FTAs and start a process of integrating the disparate FTA provisions, moving toward a unified text at some point in the future. As all US FTAs derive from the same basic template, this should not present insuperable obstacles. Further (even though this would likely perpetuate protectionist rules), US negotiators could also begin to discuss melding rules-of-origin provisions. The US could to some degree emulate the EU and attempt to develop a pan-US system of rules of origin that permits diagonal cumulation.<sup>33</sup>

3. *FTAAP.* A bolder approach would entail the US getting behind the Bergsten/FTAAP effort and pushing for an APEC-wide FTA within some time certain – possibly ten years – as a goal. This would build upon an already established process in APEC – the formation of a study group. As with proposal #2, there are a variety of ways the execution of the plan could be structured. One possibility, already a tradition in APEC, would be to set different timetables for the more developed versus the developing country members of APEC.

Given the still raw memories of the EVSL disaster in 1997-98, where the US overplayed its hand and caused a backlash against reciprocal sectoral liberalization in APEC, at this point US trade negotiators will have to tread carefully if they hope to revive APEC as a regional vehicle for trade liberalization.

There are, however, certain signs that, if the US does act with greater finesse, the prospects for APEC revival may be brightening. Regarding reciprocity-based trade liberalization, two important new factors have been introduced since 1998: first, the wave of bilateral reciprocity-based FTAs among East Asian nations and between East Asian nations and nations outside the region; and second, a grad-

ual change in ASEAN's strict "non-interference" and "concerted unilateralism" stances. In both cases a learning process has occurred that may already be exerting an impact on views regarding regional priorities and realities.

With regard to bilaterals, as noted above, there are over 100 in place or under negotiation. All of these FTAs are based upon reciprocal concessions that include some provisions for enforcement. Thus, each nation (all members of APEC) has on one level moved beyond the mantras of the "ASEAN way" that dominated the debate in the 1990s and precluded formally binding obligations. An important sign of the impact of this change came in January 2007 at the ASEAN summit in Cebu, the Philippines. For the first time since its founding, ASEAN leaders agreed to consider stricter rules to implement policies and monitor compliance – including penalties for breaching agreements such as temporary suspension or even expulsion in extreme cases. The rationale behind the proposals was explained by S. Jayakumar, deputy Singapore prime minister and a member of the EPG: "The only option for ASEAN is to take some hard-nosed decisions on reinventing itself so as to stay an effective organization."<sup>34</sup> It would be a mistake to make too much of these tentative decisions; but for the United States, it does signal that quiet diplomacy may find more fertile ground for advancing trade liberalization measures into APEC.

4. *Stand Back and Come in Later.* Finally, the United States could stand back, allowing the current bilaterals to proceed, but not pressing at this point for any consolidation of subregional arrangements or for a regionwide FTA. The United States would thus signal that it did not oppose the new forms of intra-East Asian regionalism as embodied in the APT or the East Asian Summit. At the same time, it could and should quietly inform its closest allies in the region – Japan, Singapore, and (possibly) Korea – that at any point that the nations of the APT or East Asian Summit decide to commit to formal FTA negotiations, the United States wants to be at the table.

### Conclusions

As previously stated, it is likely that US trade policy will go "on hold" until after the 2008 presidential and congressional elections. In the November 2006 mid-term congressional elections, Democrats wrested con-

<sup>33</sup> See Robert Z. Lawrence: Recent US Free Trade Initiatives in the Middle East: Opportunities but no Guarantees, op. cit., for an analysis of EU plans along these lines in the Middle East.

<sup>34</sup> John Burton: Asean discusses tightening rules to enforce group decisions, Financial Times, 10 January 2007.

trol of both houses of Congress from the Republicans – and a key factor in their triumph was the aggressive anti-global, anti-trade campaigns of a number of their novice candidates. In May, 2007 the Democrats in Congress (specifically the new Democratic majority in the House) raised the stakes by demanding – and getting – new mandatory provisions that must be included in all US FTAs. Henceforth, so long as the Democrats control Congress, US FTA partners will have to agree to adopt and enforce five so-called “core labor standards” listed in a 1998 International Labor Organization “Declaration of Fundamental Principles and Rights at Work” (freedom of association, right to collective bargaining, elimination of discrimination in employment, elimination of child labor and elimination of all forms of forced labor). In addition, they must sign a group of multilateral environmental agreements (MEAs), including the conventions on endangered species, marine pollution, whaling, tropical tunas, and wetlands. While small economies such as Peru and Panama will ac-

quiesce to such demands, future regional negotiations will certainly be stymied by the perceived encroachment on national sovereignty that is inherent in the US position.<sup>35</sup>

Against these new US domestic political realities, the diplomatic and security imperatives, particularly in Asia as a result of China’s seemingly inexorable advance, will pose a huge challenge for the next US president and Congress, as they attempt to advance US national interests. At this juncture, it is impossible to predict whether domestic political concerns relating to labor and environmental conditions will triumph over the daunting political and security implications of a failure to engage in Asia through deeper trade and investment agreements.

<sup>35</sup> For analysis of the “grand trade bargain” see Claude Barfield: The Grand Bipartisan Trade Deal, *TheAmerican.com*, 16 May 2007, [www.american.com/archive/2007/may-0507/the-grand-bipartisan-trade-deal](http://www.american.com/archive/2007/may-0507/the-grand-bipartisan-trade-deal); and Gary Hufbauer, Theodore Moran: Why a ‘grand deal’ on labour could end trade talks, *Financial Times*, 13 May 2007; and *Inside US Trade*, 25 May 2007.

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## Competing Regionalism: the Asia-Pacific Region

The economies of the Asia-Pacific region are extremely diverse in terms of average per capita incomes but, in general, they have become increasingly similar with respect to trade policy. Most have pursued a policy of openness to international trade and the region continues to be an exceptionally dynamic part of the world economy. It is also a region which, in common with others, has been active in the negotiation and implementation of bilateral preferential trade agreements, of cross-regional agreements and of other forms of economic and political collaboration. Because of the diversity of the economies in this region, it is helpful, in order to make this review manageable, to identify specific sub-aggregates of countries, as well as the individual large economies. Amongst the sub-aggregates, only ASEAN (the Association of Southeast Asian Nations)<sup>1</sup> and APEC (the Asia Pacific Economic Cooperation)<sup>2</sup> will be discussed in this paper.<sup>3</sup> The individual economies are the People’s Republic of China (hereafter China) and Japan.

The plan of the paper is as follows. Recent developments in the formation of preferential trading arrangements (PTAs) which involve the countries on the Asian side of the Pacific Ocean are reviewed.<sup>4</sup> There exist a number of criteria for assessing the economic effects of preferential trading agreements and regionalism. These include: undertaking a count of the

<sup>1</sup> ASEAN was founded in 1967. The original five countries were Indonesia, Malaysia, the Philippines, Singapore and Thailand. Today, ASEAN has 10 members, Brunei Darussalam having joined in 1984, Vietnam in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. Cf. M. A. B. Siddique: Regionalism, trade and economic development: theories and evidence from the Asia-Pacific region, in: M. A. B. Siddique (ed.): *Regionalism, Trade and Economic Development in the Asia-Pacific Region*, Cheltenham UK 2007, Edward Elgar.

<sup>2</sup> APEC was established in 1989 with 12 members. These were Australia, Brunei Darussalam, Canada, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand and the USA. Since then the list has grown to 21 countries; China, Hong Kong and Taiwan joined in 1991, Mexico and Papua New Guinea in 1993, Chile in 1994, and Peru, Russia and Vietnam in 1998. Cf. M. A. B. Siddique, *op. cit.*

<sup>3</sup> In South Asia there is the South Asian Association for Regional Cooperation which originated in 1985 with the seven countries Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. In 2006, the South Asian Free Trade Area came into being. Cf. M. A. B. Siddique, *op. cit.*

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number which exist cumulatively and which are being negotiated currently; calculating the proportion of world trade that occurs between members of preferential agreements; and measuring the welfare effects directly using CGE models. While economists are well aware of the sources of the costs of PTAs, it would appear that governments are either not so well-informed about them or they choose to ignore them in their pursuit of objectives other than that of gaining the benefits of trade liberalisation. There remains the unresolved debate about whether the gains from trade are better pursued through preferential or multilateral avenues but no attempt is made here at a resolution.

### Recent Developments

The Asia-Pacific region is already replete with PTAs.<sup>5</sup> But many more are being currently negotiated, several are being discussed as framework or feasibility agreements, a few have been mooted but are dormant and yet others have been proposed but there has been no agreement on how or when to proceed. The agreements in this region have a number of characteristics in common: first, they tend to be bilateral agreements; second, they tend to be cross-regional agreements; third, they tend to be partial and sequential in nature; and fourth, the most active countries are members of ASEAN, interpreted here as a region.

These characteristics render the familiar geometry of hubs and spokes difficult to construct, and their economic effects difficult to predict and to interpret. For example, Singapore is within the ASEAN hub; this hub has an agreement with China, it is in the process of negotiating spokes to Australia, India, Japan, Korea and New Zealand; and Singapore has existing individual spokes to a number of countries (e.g. Australia, Japan, Korea, New Zealand and the USA), including two (those with Australia and New Zealand) which will be spokes to the ASEAN hub if the negotiations between ASEAN and CER are successful. Thailand and Malaysia are following the same path but to a more limited extent: the former has bilateral agreements

with Australia and with New Zealand and a framework agreement with India; while the latter has a bilateral agreement with Japan, is negotiating a bilateral agreement with Australia and has completed a partial scope agreement with Pakistan. In a recent cross-regional initiative the Commission of the European Union has proposed bilaterals with ASEAN and with Korea and a partnership agreement with China.<sup>6</sup>

Outside of the ASEAN countries, there are the large economies of China and Japan. China has bilateral agreements with Chile (on goods only) and with Pakistan, she is in the process of negotiating others with Australia, New Zealand and Singapore, and is deliberating on one with India. Japan, although a late starter in PTAs, has signed an agreement with Mexico, has initiated negotiations with Australia and Chile and is contemplating negotiations with India. It should be noted that an ASEAN+3 was mooted some time ago but the bilateral political difficulties between China, Japan and Korea have prevented any progress on this initiative.

Australia, until recently, was a member of only one PTA, namely, the one with New Zealand. However, the current government has become convinced that, despite a continued commitment to the WTO and the multilateral process, the potential benefits to Australia of bilateral preferential agreements should not be missed. As a consequence, in the past four years: there have been three new agreements put into operation (with Singapore, Thailand and the USA); there have been negotiations begun with ASEAN, Chile, China, the Gulf Cooperation Council, Japan and Malaysia; and there have been feasibility (framework) agreements initiated with India, Indonesia and Korea.<sup>7</sup>

At the other extreme from the many bilaterals, there has been the renewed call by the USA at the recent APEC meeting in Sydney for the 21-country group to initiate a feasibility study of a Free Trade Agreement of Asia and the Pacific. However, it was agreed that this initiative would not take precedence over a drive to complete the Doha Round in the WTO and that, instead, four further studies would be undertaken of various aspects of such an agreement. While it was recognised that the gulf between countries over ag-

<sup>4</sup> Use will be made of term "preferential" rather than "regional" because some of the agreements in the Asia-Pacific region are more properly regarded as regional in a narrower sense, e.g. those within Southeast Asia; while those involving countries in Southeast Asia and the American hemisphere are regarded as cross-regional.

<sup>5</sup> The following passage has drawn heavily on R. V. Fiorentino, L. Verdeja, C. Toqueboeuf: *The Changing Landscape of Regional Trade Agreements: 2006 Update*, Discussion Paper No. 12, World Trade Organization, Geneva 2007. No attempt has been made here to provide a definitive list of existing and active agreements, to list those under active negotiation or to list those subject to feasibility studies. The landscape is changing too quickly for such lists to be accurate.

<sup>6</sup> For a discussion of the EU's proposal, see P. J. Lloyd, D. MacLaren: *The EU's New Trade Strategy and Regionalisation in the World Economy*, in: *Aussenwirtschaft* Vol. 61, No. IV, 2006, pp. 423-436.

<sup>7</sup> Department of Foreign Affairs and Trade: *Australia's Trade Policy*, 2007, <http://www.dfat.gov.au/trade/> [accessed on 20 September 2007].

riculture and non-agricultural market access remains wide in the WTO,<sup>8</sup> it was apparently not noted that, except for the omission of Brazil, the EU and India from the APEC group, the APEC countries themselves have exactly the same substantial differences over agriculture and over NAMA which would lead to similar difficulties in any negotiations over a free trade area, unless of course trade liberalisation of some sectors were not put on the negotiating table. An agreement with such omissions across the large economies involved would be highly trade distorting and welfare discriminating.

Given this very brief summary of some of the developments which are taking place in the Asia-Pacific region, it is natural to ask the questions: where are these developments leading and by what measures should they be assessed. An answer to the first was given by Lloyd.<sup>9</sup> He considered three possible, non-mutually exclusive paths, namely, many new bilateral agreements, the enlargement of existing agreements, and a coalescing of existing multi-country agreements and bilaterals. The first of those paths is already being well-trodden but the most dramatic is the last one. If the proposal by APEC to implement the Free Trade Agreement of Asia and the Pacific were successful, then most of the existing bilateral and plurilateral agreements involving these 21 countries could be dispensed with. However, such a dramatic outcome is very unlikely because, within existing agreements, the extent of free trade is not uniform across all sectors in all agreements, some sectors are entirely excluded while others are only partially liberalised, some agreements are much deeper than others, and the systems used to define the rules of origin differ. So much for the first question. Some answers to the second follow.

### Criteria for Assessing PTAs

There are several criteria against which to assess the effects that PTAs have on the world trading system. The most commonly used measure is the time series of notifications to the WTO under GATT Article XXIV,

GATS Article V and the Enabling Clause.<sup>10</sup> Fiorentino et al.<sup>11</sup> show (in their Chart 1) that there has been a substantial increase in the number of notifications of active PTAs from less than 20 per year in the 1980s to around 80 per year since the mid-1990s. The cumulative total of active PTAs has risen over the same period from around 50 to 214 in 2006. The corresponding figures for all notifications are 80 and 367, respectively. It is easy to draw the inference from these data that the multilateral trading system of the WTO, based on the fundamental principle of most favoured nation (MFN), is disintegrating.

Pomfret<sup>12</sup> has argued that such an inference is wrong for several reasons. These reasons include: first, that some PTAs are much more significant to world trade and to the WTO system than others if they involve large rather than small economies; second, that PTAs which cover trade in goods and trade in services need to be notified under both the GATT and the GATS and there is the consequent possibility of double counting; and third, the numbers in any year depend upon the integration and disintegration of existing PTAs.

A second criterion is the proportion of world trade that is generated amongst countries which are members of PTAs. Again, Pomfret is critical of this measure.<sup>13</sup> Amongst countries with pre-existing low MFN tariff rates, the volumes of trade are likely to be already high and will be largely unaffected by the granting of reciprocal preferences. Hence, the measurement after the implementation of the PTA will show high volumes of trade which have not been created by the formation of the PTA. Moreover, as discussed below, if the MFN tariffs are already low, then little trade will occur at the preferential rates.

A third criterion is the welfare effect. There is a presumption that members of a PTA will benefit, although it is not necessary that they do so, and that non-members will lose. There are two existence theorems that provide the conditions under which non-members will not lose. These are due to Kemp and Wan<sup>14</sup> for cus-

<sup>8</sup> See the current state of play in the documents prepared for agriculture (see WTO: Revised Draft Modalities for Agriculture, TN/AG/W/4 and Corr.1, 1 August 2007, Committee on Agriculture Special Session, [http://www.wto.org/english/tratop\\_e/agric\\_e/agchairtxt\\_1aug07\\_e.pdf](http://www.wto.org/english/tratop_e/agric_e/agchairtxt_1aug07_e.pdf) [accessed on 20 September 2007]) and NAMA (see WTO: Negotiating Group on Market Access, Chairman's Introduction to the Draft NAMA Modalities, [http://www.wto.org/english/tratop\\_e/markacc\\_e/namachairtxt\\_17july07\\_e.pdf](http://www.wto.org/english/tratop_e/markacc_e/namachairtxt_17july07_e.pdf), 17 July [accessed on 20 September 2007]).

<sup>9</sup> P. J. Lloyd: New Bilateralism in the Asia-Pacific, in: *The World Economy*, Vol. 25, No. 9, 2002, pp. 1279-1296.

<sup>10</sup> For the data on counts of PTAs and discussion of them, see R. V. Fiorentino, L. Verdeja, C. Toqueboeuf, op. cit.

<sup>11</sup> Ibid.

<sup>12</sup> R. Pomfret: Is Regionalism an Increasing Feature of the World Economy? Discussion Paper No. 164, Institute for International Integration Studies, Trinity College, Dublin 2006.

<sup>13</sup> Ibid.

<sup>14</sup> Murray C. Kemp, Henry Wan, Jr.: An Elementary Proposition Concerning the Formation of Customs Unions, in: *Journal of International Economics*, Vol. 6, No. 1, pp. 95-97.

toms unions and Panagariya and Krishna<sup>15</sup> for free trade areas. In both theorems it is shown that if the members of the PTA keep the vector of net imports unchanged from the pre-union situation and adjust the tariff vector to achieve this outcome, then non-members have unchanged welfare. In practice, and in accordance with Article XXIV of the GATT, it is the tariff vector that is unchanged and it is the net import vector which is endogenous. Thus, in practice, the formation of a PTA which satisfies Article XXIV will lead to a loss of welfare for non-members and makes explicit the fact that PTAs are actually discriminatory trade agreements (DTAs) and perhaps they ought to be referred to as such.

From the global and WTO perspective, this latter effect is of considerable significance. Measures of welfare have been calculated for various configurations of PTAs in the Asia-Pacific region by Scollay and Gilbert<sup>16</sup> using the GTAP model of the world economy.<sup>17</sup> From the results presented in several of their tables (especially their Tables 3.2c, 3.2d and 3.2e), a number of conclusions emerge. First, in a bilateral agreement involving Japan and Singapore, these countries each gain, some other countries in the region also gain but in aggregate, non-members lose. In a plurilateral agreement involving Japan, South Korea and China, each country gains but again non-members lose. In a hub and spokes arrangement involving ASEAN+3, members in aggregate gain and non-members lose. In an APEC agreement involving "open regionalism", all regions as well as non-members gain but members do so to a lesser extent than in an APEC agreement which is preferential. The latter leads to a loss for the aggregate of non-members. What the authors also show is that the greatest welfare gains occur when there is multilateral trade liberalisation.

The results from simulating changes in trade policies using the GTAP model are determined by liberalisation of trade in goods only. While such a restrictive set of policy changes is unavoidable, given the current content of the protection databases associated with CGE models such as GTAP, it does limit the value of the exercise in measuring the gains from agreements

which contain provisions for the liberalisation of services and behind the border measures.<sup>18</sup>

### The Costs Ignored

As noted above, the conditions that guarantee no loss of welfare for non-members of a customs union or a free trade area are not those which are put in place with the formation of a PTA. Therefore, from a global perspective it is important to acknowledge that there will be short-term costs to non-members, even if, as the supporters of PTAs predict, the long-run outcome of the aggregation of all PTAs is multilateral free trade and long-term welfare gains for all countries. However, if the coalescence of the existing and planned PTAs does not happen, as seems very probable, then these short-term losses become perpetual for countries which do not seek to become members of a PTA. But even if they do become members, they may still lose.<sup>19</sup>

For countries which are members of a PTA, much weight is placed in the literature on the concepts of trade creation and trade diversion. However, some authors have then fallen into the trap of associating trade diversion with a welfare loss. This association is false: trade diversion may cause a welfare loss but not necessarily so as such authors assume.<sup>20</sup> The costs of membership caused by trade diversion are a cost that could be anticipated *ex ante* through the use of CGE analysis.<sup>21</sup>

The most popular form that current PTAs take are variations of free trade areas in which each member retains its pre-existing trade barriers on goods with respect to non-members.<sup>22</sup> In order to prevent trade

<sup>15</sup> A. Panagariya, P. Krishna: On necessarily welfare-enhancing free trade areas, in: *Journal of International Economics*, Vol. 57, No. 2, pp. 353-367.

<sup>16</sup> R. Scollay, J. P. Gilbert: *New Regional Trading Arrangements in the Asia Pacific?*, Institute for International Economics, Washington D. C. 2001.

<sup>17</sup> See T. W. Hertel: *Global Trade Analysis: Modeling and Applications*, New York 1997, Cambridge University Press.

<sup>18</sup> For a discussion of the limitations of CGE modelling, see P. Dee: *The Australia-US Free Trade Agreement – An Assessment*, Paper prepared for the Senate Select Committee on the Free Trade Agreement between Australia and the United States of America, June 2004, for the Australia-United States Agreement, and P. J. Lloyd, D. MacLaren: *Gains and Losses from Regional Trade Agreements: A Survey*, in: *Economic Record*, Vol. 80, No. 251, 2004, pp. 445-467, for a more general discussion.

<sup>19</sup> For an analysis of the probable losses to poorer countries which enter into PTAs with rich countries, see UNCTAD: *Trade and Development Report 2007*, <http://www.unctad.org/> [accessed on 24 September 2007].

<sup>20</sup> For a proof and a discussion of this claim, see P. J. Lloyd, D. MacLaren: *Gains and Losses from Regional Trade Agreements: A Survey*, op. cit.

<sup>21</sup> For the example of the Australia-United States Agreement, see P. Dee, op. cit.

<sup>22</sup> Another feature of some PTAs is that they go deeper than just trade liberalisation in goods and services but they become "WTO+" agreements in the sense that they cover additional issues behind the border to a depth not covered by the Agreements of the WTO.

deflection from non-members to members through the member with the lowest tariff against non-members, rules of origin are necessary. It is in this context that governments appear to ignore the costs of free trade agreements while at the same time over-estimating their gross benefits.

There are two sources of the costs associated with rules of origin which tend to be ignored.<sup>23</sup> First, for exporting firms, there are costs of proving to customs authorities that they have complied with the rules of origin and these costs differ across the different systems of rules. There are three sets of rules used: i) Regional Value Content; ii) Change of Tariff Classification; and iii) specific manufacturing processes. Second, if the importing country is a hub with several spokes, then an item in the same tariff line that is imported from the different spokes and from non-members will be subject to different tariff rates. Hence, the costs to the customs service of assessing the correct rate to apply to the same good but from different sources need to be taken into account in the cost-benefit calculus of PTAs.

Over-estimation of the gross benefits occurs because it is assumed that all trade between members henceforth will occur at preferential rates – in practice it does not. If the margin between the MFN rate and the preferential rate is insufficient to cover the costs incurred by the exporting firm in proving compliance with the rules of origin, then trade will take place at the MFN rate and the volumes of trade within the PTA will be lower than that assumed, as will be the size of the welfare gains.

The empirical evidence on the costs associated with rules of origin indicates that they are significant, that they vary depending upon the form that the rules take, and that the actual net benefits from increased trade are less *ex post* than those anticipated *ex ante*. For example, the Productivity Commission<sup>24</sup> found evidence in the literature that compliance costs

<sup>23</sup> It has been observed by Augier et al. that “[r]ules of origin are usually ignored for two reasons: they are dauntingly complex and at first sight appear mind-numbingly dull.” See P. Augier, M. Gasiorok, C. L. Tong: The Impact of Rules of Origin on Trade Flows, in: Economic Policy, Vol. 20, No. 43, July 2005, pp. 567-624. The complexity has increased in recent years as production fragmentation has become a feature of the manufacturing industries of many countries (cf. S. W. Arndt, H. Kierzkowski (eds.): Fragmentation: New Production Patterns in the World Economy, Oxford 2001, Oxford University Press). Nevertheless, rules of origin are important in helping to determine the net benefits from PTAs which take the form of free trade areas.

<sup>24</sup> Productivity Commission: Rules of Origin under the Australia-New Zealand Closer Economic Relations Agreement, Productivity Commission Research Report, Productivity Commission, Melbourne 2004.

had been estimated to vary between 1.5 per cent and 6.0 per cent of the value of the product traded. Manchin<sup>25</sup> concluded that there exists a minimum threshold rate of 4 percentage points between the MFN and the preferential rate before firms will attempt to comply with rules of origin and seek the preferential rate. One implication of these findings is that the preference utilisation rate will be less than 100 per cent. In the case of the ASEAN free trade agreement, the rate was found to be less than 5 per cent.<sup>26</sup> A corollary is that, as MFN rates have fallen over time, rules of origin will have become more restrictive.

The trade restrictiveness of the different systems of rules of origin which are found in PTAs was estimated by the Productivity Commission<sup>27</sup> through the construction of a restrictiveness index for a sample of 18 PTAs. On a scale of 0 to 1 (where 0 means not restrictive and 1 means totally restrictive) it found that NAFTA was the most restrictive with a score of 0.672 and the least restrictive was the Singapore-Australia FTA with a score of 0.228. The former uses a primary test of change of tariff classification but supplemented with regional value content and secondary tests, while the latter uses regional value content as its primary test. Another PTA with a low degree of trade restrictiveness, and which uses a percentage test, is AFTA with a score of 0.312. While rules of origin are necessary in free trade areas, they should prevent trade deflection in the least trade restricting manner. The strong conclusion to draw from the empirical evidence is that some systems are more restrictive than others and that there are net benefits being foregone unnecessarily.<sup>28</sup>

<sup>25</sup> M. Manchin: Preference Utilization and Tariff Reduction in European Union Imports from African, Caribbean and Pacific Countries, World Bank WPS3688, World Bank, Washington, DC 2005.

<sup>26</sup> McKinsey and Company: ASEAN Competitiveness Study, ASEAN Secretariat, Jakarta 2003. (A summary of this report is provided by A. Schwarz, R. Villinger: Integrating Southeast Asian Economies, in: The McKinsey Quarterly, No. 1, 2004, pp. 1-8.)

<sup>27</sup> Productivity Commission: Rules of Origin under the Australia-New Zealand Closer Economic Relations Agreement: Restrictiveness Index for Preferential Rules of Origin, Supplement to Productivity Commission Research Report, Productivity Commission, Melbourne 2004.

<sup>28</sup> For a further discussion of rules of origin, see P. J. Lloyd, D. MacLaren: Rules of Origin, Invited Paper presented at the Australia-China FTA Conference, Shenzhen, China, 28-29 June 2006, [http://www.dfat.gov.au/geo/china/fta/060628\\_shenzhen\\_mclaren.html](http://www.dfat.gov.au/geo/china/fta/060628_shenzhen_mclaren.html) [accessed on 20 September 2007]; and Department of Foreign Affairs and Trade: The 19th APEC Ministerial Meeting: Joint Statement, 5-6 September 2007, Sydney, Australia, [http://www.dfat.gov.au/apec/apec\\_19th\\_ministerial\\_meeting.html](http://www.dfat.gov.au/apec/apec_19th_ministerial_meeting.html) [accessed on 24 September 2007].

### PTAs versus MFN

In the political economy of PTAs, it appears that sight is often lost of the basic idea from international trade theory, namely, that free trade is a means to an end and not the end in itself, the end being the maximisation of a country's social welfare. Of course, this insight is subject to caveats, one of which is the absence of domestic and international distortions. Nevertheless, in general, unilateral trade liberalisation would raise welfare for individual countries; yet very few countries have implemented such a trade policy. Instead, countries have adopted the position that trade liberalisation is a concession to other countries and that such a concession shall only be made in the presence of reciprocal concessions offered by their trading partners.<sup>29</sup>

In the presence of distortions the world is one of second best, a world in which no general policy conclusions can be drawn. It is for this reason that it is difficult to determine whether the international community in total is better served by a proliferation of PTAs than by determined efforts to achieve trade liberalisation through multilateral negotiations.<sup>30</sup>

It is often argued that, because PTAs involve few countries in negotiation when compared with the 150 countries now in the WTO, the gains from preferential trade will arrive sooner than they will in the WTO setting. However, such a claim provides an incomplete account of the cost-benefit calculus. What is necessary is a calculation of the net present value of the outcomes from PTAs, including the losses to non-members,<sup>31</sup> and a comparison with the present value of the net benefits from multilateral negotiations. While the time horizons to completion will be different, so too will be the net benefits for each country. There is a presumption that the net benefit in multilateral negotiations will be larger for each country because of the

reciprocity received from the remaining 149 countries rather than that from the few countries which are parties to negotiations in a PTA. Thus, on the basis of a net present value calculation, the gains from multilateral trade negotiations could well exceed those from PTA unless there was a very strong time preference for the short run and no concern for the discrimination involved in PTAs.

### Conclusion

The numbers of PTAs in the Asia-Pacific region has increased sharply in recent years, a trend that shows no sign of diminishing. As most of these agreements are of a bilateral nature, there remains plenty of scope for new bilaterals to emerge, especially as the appetite of governments for PTAs does not yet appear to be waning.<sup>32</sup> Some of these agreements involve intra-Asian arrangements whilst others are cross-regional; some are bilateral and shallow in scope – omitting some sectors altogether – while the latest proposal from APEC is ambitious in terms of country coverage but as yet unknown in terms of depth of coverage. From the evidence presented above, it is difficult to believe that the continued rush to the spaghetti bowl could be welfare-improving overall or that these agreements could eventually become aggregated into a multilateral outcome.

In comparison with the deep agreements that the super-hubs of the EU and the USA have negotiated, those within the Asian area in general have been shallower and more flexible in scope as well as being more pragmatic in motivation. In addition, the details of the templates used by the EU and the USA are different from each other with respect to behind-the-border measures and to rules of origin. In that sense these two super hubs may be in strategic competition with each other especially if, as some believe, there may be a coalescing of PTAs or if one or other of these templates becomes the basis for new WTO agreements. By contrast, the templates used in the PTAs in the Asian side of the Asia-Pacific region are much looser and more varied. In that context, these three emerging poles of the global economy are quite different, especially with respect to the comprehensiveness of the agreements and the speed of their implementation. The EU and the USA seek to implement comprehensive agreements as a total package whereas those involving ASEAN, China and Japan are more likely to be bilateral, to be layered with respect to depth and to be negotiated layer by layer in a sequential fashion over time.

<sup>29</sup> Ignored here are the various non-reciprocal preferential schemes in existence, e.g. GSP and the Cotonou Agreement.

<sup>30</sup> The rhetoric from the APEC meeting in September this year suggests an ambiguous view on the part of the member countries. "An open, rules-based, multilateral trading system under the World Trade Organization (WTO), ... provides the best means for sustaining economic growth. ... High-quality and comprehensive RTAs/FTAs can ... also serve as building blocks for further development of the multilateral trading system." (Department of Foreign Affairs and Trade: The 19th APEC Ministerial Meeting: Joint Statement, *op. cit.*)

<sup>31</sup> It has been argued in a recent report that the developing countries may not gain from entering into PTAs with developed countries. "The gains for developing countries from improved market access through FTAs are not guaranteed, and may be short-lived, but the loss of policy space is certain." UNCTAD: Trade and Development Report 2007, *op. cit.*, p. 59.

<sup>32</sup> With  $n$  countries, there exist  $n(n-1)/2$  possible bilateral agreements.

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## Tripartite Regionalism in Latin America

The region of Latin America and the Caribbean (henceforth, for simplicity, Latin America) is in its fourth successive year of economic growth, averaging a steady 5 per cent. For 2008, a slight absolute and relative (compared to other major developing world regions) slowing-down of growth has been predicted. However, the forecast is still at a comfortable level of between 4 and 5 per cent.<sup>1</sup>

On the external front, the booming economies of Latin America are engaged in wide-spread regionalism on a variety of scales. This regionalism occurs in the form of preferential trade agreements (PTAs) by which a limited number of countries or country groupings basically exchange market-access rights among themselves on a reciprocal and exclusive basis. At the same time, PTAs in Latin America proceed in an economic environment that is characterised by a relatively high degree of overall external openness. This is the result of unilateral trade reforms in Latin America which were initiated in the 1980s and by and large are still in place in most countries of the region, and it also reflects the multilateral liberalisation steps on which Latin American governments agreed in the Uruguay Round (1986-1994).

For the first time in history, economic growth in Latin America has gone hand in hand with a current-account surplus for the whole region, while the proliferation of PTAs is accompanied by significant changes in the geographic pattern of trade. Most conspicuous is a sharp decline of Europe's role in Latin America's trade. In stark contrast, the trade ties of Latin America with North America and with Asia-Pacific have strengthened. Above all, trade *within* Latin America has grown over-proportionately.

Meanwhile, the extent of PTA-related trade in Latin America has increased considerably and in some cases is very high indeed. An outstanding example is Chile where the share of imports from PTA partners in its total imports was as high as 85 per cent in 2006. For Latin America as a whole, the amount of trade among countries with a common PTA is about three-quarters of all their trade.<sup>2</sup> This compares with an estimated share of PTA-related trade in total world trade of approximately 50 per cent.

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### Pattern of Regionalism in Latin America

Regionalism in Latin America has developed on three different tracks:

- intra-regionally, i.e. within Latin America
- intra-continently, involving the United States and Canada
- trans-continently with trading partners from other – geographically more distant – world regions.

In each case, two different types of agreements can be observed:

- bilateral agreements between two countries or grouping of countries
- plurilateral agreements between several countries or groupings of countries.

Recently bilateral agreements have become more important than plurilateral agreements in Latin America. To some extent this is due to the deadlock of the negotiations on a Free Trade Area of the Americas (FTAA), extending from Alaska to Tierra del Fuego and thus encompassing all the countries of the Western Hemisphere (except Cuba), which has created incentives to negotiate intra-continental agreements on a bilateral basis instead. It also highlights the growing significance of trans-continental PTAs. In this area, bilateral agreements clearly dominate, whereas plurilateral accords such as the four-partite Trans-Pacific Strategic Economic Partnership Agreement between Chile, Brunei Darussalam, New Zealand and Singapore remain a rare exception. Moreover, bilateral agreements have also grown inside Latin America alongside – and even among – the region's plurilateral trade blocs like the Central American Common Market (CACM), the Caribbean Community and Common Market (CARICOM), the Andean Community and the Mercado Común del Sur (MERCOSUR).

### From Closed to Open Regionalism

Regionalism in Latin America has a long tradition. Besides Europe, Latin America was the other centre of

<sup>1</sup> UNCTAD: Trade and Development Report, Geneva 2007.

<sup>2</sup> Antoni Esteve de Oda, Matthew Shearer and Kati Suominen: Multilateralizing RTAs in the Americas: State of Play and Ways Forward, Paper presented at the Conference on Multilateralising Regionalism, Geneva, 10-12 September 2007.

the first wave of regionalism in the post-war world that took off in the late 1950s. This "old" regionalism was marked by plurilateral agreements among neighbouring countries at a comparable stage of development. Typically, these accords were thus either North-North or South-South agreements. In the case of Europe (North-North), they were primarily driven by political motives, providing the basis for peaceful cooperation among former enemies, while in Latin America (South-South) the prime objective was to push industrialisation through the substitution of imports.

Unlike Europe, where regionalism quickly evolved into deep, expansive and fairly open integration among the member countries of the European Community, integration in Latin America proved to be rather ineffective. This is true for region-wide designs like the Latin American Free Trade Association (LAFTA) of 1960 and its successor, the Latin American Integration Association (LAIA) of 1980. It also holds for sub-regional communities such as the Andean Group formed in 1969.

The original idea behind these schemes was to place the strategy of import-substituting industrialisation into a wider geographic frame and thus facilitate greater specialisation among the partner countries and a better use of economies of scale. In practice, however, the policy inevitably led to conflict, because each participant wanted a regional market for its own inefficient industries but was unwilling to buy the expensive or poor quality import-substitutes being produced by its partners.<sup>3</sup> Additionally, the high degree of restrictiveness against trade with third countries, which is typically associated with regional import-substitution strategies and in the case of the Andean Group also included a hostile regime towards foreign direct investment (Decision 24 of the Andean Pact Commission, adopted in 1970), gave rise to inefficiencies of its own, as it stifled competition and sharply reduced choice on domestic markets. Latin America thus became a showcase of "closed regionalism" during the 1960s and 1970s.

However, the opposite term – "open regionalism" – was also coined with a view to Latin America and actually *in* Latin America. Its author is the UN Economic Commission for Latin America and the Caribbean.<sup>4</sup> In

<sup>3</sup> Richard Pomfret: Is Regionalism an Increasing Feature of the World Economy?, in: *The World Economy*, Vol. 30, No. 6, June 2007, pp. 923-947.

<sup>4</sup> ECLAC defines open regionalism as an intermediate step towards global integration of the regional partners. Cf. ECLAC (Economic Commission for Latin America and the Caribbean): *Open Regionalism in Latin America and the Caribbean*, Santiago 1994, ECLAC.

fact, Latin America is a centre of the "new regionalism"<sup>5</sup> that emerged in the late 1980s on a global scale. At the national level, the new regionalism's central feature is the opening up of the domestic economy to trade with regional or extra-regional PTA partners without simultaneously shutting it off against third countries. The development of new regionalism in Latin America thus is part and parcel of the general paradigm change in foreign economic policy from import substitution to export promotion and diversification that took place in the region in the 1980s. PTA liberalisation in Latin America went ahead in lock-step with most-favoured-nation liberalisation which in many Latin American countries started from average levels as high as 40 per cent or more. The new regionalism can also be regarded as representing an external anchor "locking in" the domestic economic and institutional reforms in Latin American countries and thus in particular serving to attract foreign direct investment.

#### **New and Reformed Sub-regional Trade Blocs**

Institutionally, the new wave of regionalism in Latin America manifests itself in the creation of new sub-regional integration communities and a fundamental overhaul of existing country groupings while at the same time numerous new bilateral relationships have emerged. The most prominent addition to the incumbent trade blocs in Latin America is the Southern Common Market. MERCOSUR was founded in 1991, with the objective of establishing a common market providing for the free movement of goods, services, capital and labour among its four member countries (Argentina, Brazil, Paraguay and Uruguay). It was transformed into a customs union in 1995. From the outset, MERCOSUR has been conceived not as an antithesis to global free trade but rather as an intermediate step towards final integration of its domestic economies into the world market. As a customs union, it also aims to enhance the bargaining power of its members in international trade negotiations.

Among the older integration groupings in Latin America, the Central American Common Market began as a free trade agreement in 1961. It deepened into a customs union in 1966 but became moribund between 1976 and 1990, due to armed conflicts in Central America. The revival of CACM in 1990 coincided with the adoption of outward-looking trade policies by its member states, which are currently Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

<sup>5</sup> Jagdish Bhagwati: *Regionalism and Multilateralism: An Overview*, in: Jaime De Melo, Arvind Panagariya (eds.): *New Dimensions in Regional Integration*, Cambridge 1993, Cambridge University Press.

The Caribbean Community and Common Market started as the Caribbean Free Trade Association in 1966, with a view to becoming a common market in 1973. However, it was not until 2001 that major steps were undertaken to realise the four freedoms – concerning the movement of goods, services, firms/capital and labour – which are the constituents of a common market, and to harmonise respective laws and regulations among CARICOM members.<sup>6</sup> In negotiations with third countries, including the United States and the European Union, and within the World Trade Organisation (WTO), CARICOM tends to act as a bloc. To this purpose, the Caribbean Regional Negotiating Machinery was created in 1997.

The inward-looking and defensively orientated Andean Pact of 1969, finally, was renamed the Andean Community of Nations in the mid-1990s and in principle became a rather open customs union aimed at improving access for domestic companies to international markets. As early as in 1991, Decision No. 24 on Common Regulations governing Foreign Capital Movement, Trade Marks, Patents, Licenses and Royalties was replaced by Decision 291 liberalising the foreign investment and transfer of technology regimes. However, the Andean customs union remains incomplete while the Andean common market which was planned to start in 2005, encompassing beyond the goods sector the free movement of services, capital and persons within the sub-region, appears to be little more than a vision. This largely also holds for a unified commercial policy towards third countries, even though the member states of the Andean Community have agreed on a number of common rules for the regulation of their external trade.

The negotiations of the Andean countries on a free trade agreement (FTA) with the United States are a striking example demonstrating the actual fragmentation of their external trade policy. These negotiations started out (in May 2004) as a common exercise between just three Andean Community member countries (Colombia, Ecuador and Peru), with the two other members (Bolivia and Venezuela) not taking part. Moreover, the joint negotiation of the group of three soon split up into three separate negotiations conducted individually by each of the three countries with the USA. All this caused a division of the Andean Commu-

nity prompting Venezuela even to leave the trade bloc in April 2006 (and seek membership of MERCOSUR) while Bolivia ultimately decided to stay, albeit with heightened scepticism regarding the common project (and a strong propensity to lean closer towards MERCOSUR). In the end, only the FTA with Peru is likely to be accepted by the US Congress (after a number of amendments concerning environmental and labour protection in Peru), whereas ratification of the Colombian-US FTA is not in sight (mainly for political/human rights reasons in connection with paramilitary activities in Colombia) and the negotiations between Ecuador and the USA have actually broken down amid disputes over the treatment of US direct investment and the extent of intellectual property protection in Ecuador.

#### **New Regionalism Going North and East**

Irrespective of the meagre outcome so far of trade negotiations between the Andean countries and the United States, a major characteristic of the new regionalism in Latin America is the increasing disposition of Latin American countries to enter into bilateral reciprocal agreements with industrialised countries. The “first mover” was Mexico, which together with the United States and Canada is a party to the North American Free Trade Agreement (NAFTA). Chile responded to NAFTA by concluding separate FTAs with the USA and Canada. The latest intra-continental FTA is CAFTA-DR, which is a reciprocal preferential trade agreement between the five member countries of CACM plus the Dominican Republic on the one hand, and the United States on the other hand.

Trans-continently, the European Union’s reaction to these developments was to conclude “mirror” agreements with Mexico and Chile and to launch negotiations with the Andean and the Central American countries. With MERCOSUR, the EU has already been engaged in FTA negotiations for some time, while CARICOM (or, more precisely, a sub-group of CARICOM member countries) is one of the six African, Caribbean and Pacific (ACP) country groupings with which the EU is negotiating reciprocal Economic Partnership Agreements (EPAs) on the basis of the Cotonou Agreement. Most recently, industrialised and developing/emerging countries in Asia have jumped on the PTA bandwagon in Latin America. Cases in point are the agreements concluded by Mexico with Japan and Singapore and by Chile with Japan, China, Singapore and South Korea.

#### **Shallow versus Deep Integration**

A key feature of the North-South agreements in which Latin American countries participate is a relatively high measure of “deep integration”. Deep inte-

<sup>6</sup> On 30 January 2006, the CARICOM Single Market was launched, which for the time being comprises six of the altogether 15 CARICOM member states. The six founding members (Barbados, Belize, Guyana, Jamaica, Suriname and Trinidad and Tobago) agreed on a number of single-market arrangements as building blocks towards developing greater trade and economic cooperation with other countries in the Western Hemisphere and also with more distant partners such as the European Union.

gration essentially involves actions by governments to reduce the market segmenting effect of differences in national regulatory regimes through coordination, harmonisation and mutual recognition of national policies. Accordingly, it primarily aims at the removal of “behind-the-border” barriers to trade in areas like services, intellectual property, government procurement, foreign direct investment, taxation and competition. This is also called the new trade or “trade and” agenda.

Interestingly, the integration schemes agreed among the Latin American countries themselves seem to be less deep than their agreements with industrialised countries. For instance, most intra-Latin American PTAs do not have specific services provisions, such as most-favoured-nation treatment, national treatment, market access, local presence, domestic regulation, recognition of qualifications, transparency, restriction of transfers and denial of benefits.<sup>7</sup> In general, the principle of the nation state which decides autonomously, seeks to resolve inter-governmental conflicts bilaterally and is not prepared to cede sovereign rights to supra-national institutions is still deeply rooted in Latin America. The introduction of “trade and” elements into extra-regional trade agreements with Latin American countries is therefore largely due to the insistence of their “Northern” partners. Not surprisingly, then, it meets with opposition on the Latin American side, as the negotiations between the EU and MERCOSUR show. Especially Brazil has not been willing to deal with the deepening agenda proposed by the EU since the potential benefits from this are deemed to be smaller than the costs associated with the loss in sovereignty.<sup>8</sup>

With regard to the removal of “border” barriers to trade, on the other hand, Latin America intra-regionally often liberalises to a greater extent than extra-regionally. As a result of the numerous plurilateral and bilateral trade agreements recently concluded or renewed in the region, about three-quarters of intra-Latin American trade now proceeds free of tariffs. This figure is expected to rise to 85% by 2015 and thus to reach a higher level than is foreseen in most of the agreements with extra-regional (in particular trans-continental) partners.<sup>9</sup> In these agreements, trade liberalisation is typically also designed to happen asymmetrically, with the

Latin American countries opening their markets at a later stage than their industrialised opposite numbers.

### Race for Markets

From the viewpoint of its developed-country partners, Latin America is a key region in their “race for markets”. This notion aptly describes what is the main driving force of the new regionalism on the part of the leading trading powers. In the case of Latin America it is gaining access to the region’s largest and fastest-growing economies (in particular Mexico, Brazil, Argentina and Chile).

For both the European Union and the United States, the competition motive – to avoid falling behind rivals in cutting bilateral trade deals – ranks high in this context. In its strategy paper of October 2006 for a new trade policy, the European Commission points to “a growing risk of trade diversion detrimental to the EU in the most dynamic countries”, as “the rapid development of third countries concluding FTAs with the EU’s main competitors such as the US or Japan carries risks of marginalizing the EU”.<sup>10</sup> Within the new strategy, top priority is attached to the conclusion of a “deep integration” agreement with MERCOSUR (and of similar agreements with ASEAN and South Korea) that goes beyond existing WTO “disciplines” in the services sector and with regard to product standards, investment policies, public procurement, competition and the enforcement of intellectual property rights in particular. In the United States, in turn, losing ground against competitors, first and foremost from Europe, in the race for preferential market access is a long-standing preoccupation for trade policymakers.

At the same time, there are clear differences between the EU and US approaches towards Latin America in the area of PTAs. They concern the overall PTA strategy as well as the content/substance of the agreements reached. A crucial element of the EU’s strategy in PTA negotiations with Latin American countries is the promotion of economic integration among countries of the region. By implication, the EU now preferably deals with country groupings rather than with individual countries in Latin America. However, especially in view of rather weak institutions in Latin America at the regional/sub-regional level, the bloc approach may face growing difficulty. This in particular holds for those negotiating areas where deeper integration is at stake.

The American approach, on the other hand, is possibly best described as pragmatic-selective. The United

<sup>7</sup> Antoni Esteve de Ordal et al., op. cit.

<sup>8</sup> André Filipe Zago de Azevedo, Renato Antônio Henz: The EU New Trade Policy and the Perspectives for an EU-Mercosur Agreement, in: *Außenwirtschaft*, Vol. 61, No. 4, 2006, pp. 437-446.

<sup>9</sup> Antoni Esteve de Ordal et al., op. cit.; Daniel Solano: Dynamisme du commerce intrarégional en Amérique latine, in: *Problèmes économiques*, 14 March 2007, pp. 33-36.

<sup>10</sup> CEC (Commission of the European Communities): *Global Europe: Competing in the World. A Contribution to the EU’s Growth and Jobs Strategy*, Brussels, 4 October 2006, pp. 14 and 17.

States has embarked on PTA strategies that comprise trade agreements with individual countries (including individual member countries of integration groupings like the Andean Community or MERCOSUR) as well as with country blocs (such as CACM plus the Dominican Republic through the Central American Free Trade Area), as it sees fit. With regard to the substance of the accords, the USA puts particular emphasis on labour and environmental issues, on market access and national treatment in the services sector and on favourable conditions for direct investment (including establishment, acquisition, post-establishment operations and resale) of foreign/American companies in the partner countries. All in all, the PTA strategy followed by the USA towards Latin American countries appears to be more commercially oriented than the EU's policies, which besides trade liberalisation also highlight political dialogue and development cooperation.

#### Implications for Latin America

The developments outlined above are economically significant for the countries of Latin America. To begin with, there is ample evidence to show that trade liberalisation in general has been beneficial to Latin America. However, it is controversial to what extent this statement still holds when Latin American countries exclusively open up their markets to one another or to certain extra-regional trading partners, and thereby inevitably discriminate against other countries. Another matter of dispute concerns the relative merits of these intra- and extra-regional discriminatory agreements themselves and hence the question whether South-South or North-South agreements are better for Latin America.

As to the first question, in most PTAs with Latin American involvement, trade creation seems likely to exceed trade diversion, indicating a net welfare gain for the Latin American partner. For example, the establishment of the Andean Free Trade Zone in 1993 has apparently led to an increase in Andean Community trade, and not to a contraction of extra-regional trade.<sup>11</sup> With regard to MERCOSUR's potential welfare benefits from PTAs with the rest of the Americas and with the European Union, it has been found that

- in both preferential trading regimes trade creation would outweigh trade diversion;
- the related welfare gains to MERCOSUR would add up (rather than cancel each other out) between the two scenarios;

<sup>11</sup> Germán Creamer: Open Regionalism in the Andean Community: A Trade Flow Analysis, in: *World Trade Review*, Vol. 2, No. 1, 2003, pp. 101-118.

- the benefits would significantly increase if deeper integration were taken into account.<sup>12</sup>

In the case of Chile, which is a protagonist of "additive regionalism" (i.e. engaging in overlapping PTAs with many countries), it has been argued that this strategy would always be preferable to single-partner regionalism for the country that adopts it while the third countries excluded from the agreements, however, would invariably suffer economic losses.<sup>13</sup>

Concerning the South-South versus North-South issue, PTAs with industrialised countries appear to confer greater benefits to the Latin American partner countries than agreements of these countries with their regional peers. This is mainly due to the higher profile of deeper integration schemes in the North-South case and the non-traditional gains from trade associated with such schemes.<sup>14</sup> Moreover, the economic impact of preferential trading agreements involving deep integration with WTO-Plus elements tends to a higher degree to be non-discriminatory (i.e. likewise benefiting third parties), which is also beneficial to the global trading system.

However, as noted by Pomfret,<sup>15</sup> WTO-Plus articles in a North-South agreement, which primarily run to the advantage of the partner from the North but preclude desirable policy options of the partner from the South, may be a poor blueprint for global agreements. Examples cited are provisions on foreign direct investment (e.g. concerning rights to compensation when policy changes reduce the expected profitability of a foreign investment) and on intellectual property (such as obligations to register patents on existing drugs if new uses are found, which may lead to the phenomenon called "evergreening" of patents) which go beyond the respective WTO Trade-related Investment Measures (TRIMs) and Trade-related Intellectual Property Rights (TRIPs) agreements. Accordingly, fears have been expressed that North-South preferential trade agreements may reduce the scope for national policies that support development and structural change in developing countries.<sup>16</sup>

<sup>12</sup> G. Philippidis, A. I. Sanjuán: An Analysis of Mercosur's Regional Trading Arrangements, in: *The World Economy*, Vol. 30, No. 3, 2007, pp. 504-531.

<sup>13</sup> Jaime de Melo: Regionalism and Developing Countries: A Primer, in: *Journal of World Trade*, Vol. 41, No. 2, 2007, pp. 351-369.

<sup>14</sup> These non-traditional gains typically occur in the form of reduced transaction costs which unlike the granting of tariff preferences that lead to rents only involve increases in efficiency, thereby avoiding the ambiguity associated with preferential tariff removal that do involve rents. Cf. Jaime de Melo, *op. cit.*

<sup>15</sup> Richard Pomfret, *op. cit.*, p. 931.

<sup>16</sup> UNCTAD, *op. cit.*