

The Move to Preferential Trade on the Western Pacific Rim: Some Initial

Conclusions

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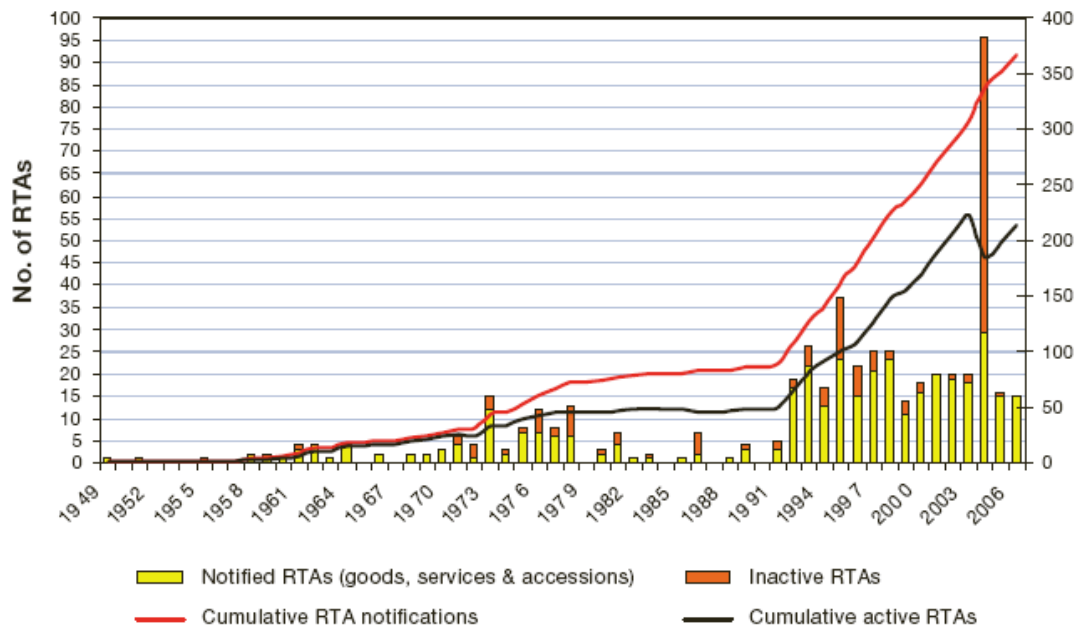
Love them or loathe them, preferential trade agreements (PTAs) are now a prominent and seemingly permanent part of the global trade landscape.¹ In the dozen years since the World Trade Organization (WTO) came into being, members have notified it of the creation of more than 240 PTAs covering goods or services—a dramatic contrast to the GATT years between 1949 and 1994 when only 124 such agreements were notified. Today there are around 220 active agreements that have been notified to the WTO—with a substantial further number yet to be notified (Figure One).²

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¹ I prefer the terminology of preferential trade agreement to that of free trade agreement because it more accurately captures the essence of the treaties—they often fall far short of creating genuinely free trade between the parties. Rather, they provide parties' exports of some goods and services with preferential access to their partners' markets. To compound terminological confusion, these agreements are sometimes referred to as regional trade agreements. As we will see, whereas such terminology was accurate for early preferential trade agreements that typically joined geographically contiguous economies, today's preferential arrangements often link economies that are in different geographical regions. They continue to be labeled regional trade arrangements because all non-universal trade agreements are scrutinized by the WTO's Committee on Regional Trade Agreements.

² According to the Asian Development Bank, in 2007 there were another 61 PTAs that had not been notified to the WTO, which involved the economies of East Asia, Oceania, and South Asia, where framework agreements and treaties had been signed or were under negotiation. A further 47 agreements had been proposed. Asian Development Bank, Asia Regional Integration Centre, Table 2. FTAs by WTO Notification and Status (cumulative), <http://aric.adb.org/2.php> (consulted 25 October 2007).

Figure One: Number of PTAs notified to the GATT/WTO by year of entry into force



Source: (Fiorentino, Verdeja and Toqueboeuf, 2007 Chart One).

Since the turn of the century, the Asia-Pacific region has become the most active location for the negotiation of PTAs. The proliferation of agreements represents a dramatic transformation from the situation that applied only a few years before. As we are frequently reminded, before the East Asian financial crises of 1997-98, only one preferential trade agreement of any substance existed in East Asia—the ASEAN Free Trade Agreement.³ None of East Asia’s major economies—China, Japan, Korea, and Taiwan—were parties to a preferential agreement. In the five years following the crisis, they all jumped aboard the PTA bandwagon—and the Australian government and others that had similarly been sceptical of such agreements in the past joined suite. Today, there

³ In addition, in 1975 seven countries--Bangladesh, India, Lao People’s Democratic Republic, the Republic of Korea, Sri Lanka, the Philippines and Thailand—signed the “First Agreement on Trade Negotiations Among Developing Member Countries of ESCAP”, known as the Bangkok Agreement (renamed the “Asia-Pacific Trade Agreement” in 2005), and in 1991 Laos and Thailand had concluded a preferential trade agreement. These agreements provided only very limited liberalization of trade in goods. In Oceania, the Australia-New Zealand Closer Economic Relations Trade Agreement had been signed in 1983.

are more than 80 PTAs involving East Asian economies that are either being implemented, negotiated or the subject of study groups (Table One).

Table 1 Bilateral and Minilateral PTAs involving the economies of East Asia and Oceania (June 2007)

Country/Grouping	Implementing/ Signed	Negotiating	Study Group
ASEAN	AFTA[#], China, Korea	Australia-New Zealand, India, Japan	EU, US
Australia	New Zealand, Singapore, Thailand, US	ASEAN, Chile, China, Gulf Cooperation Council, Japan, Malaysia.	Indonesia, Korea
Brunei	AFTA, Chile-New Zealand-Singapore*	Japan	US
Cambodia	AFTA		
China	ASEAN, Chile, Hong Kong, Macau, Pakistan Thailand	Australia, Gulf Cooperation Council, Iceland, New Zealand, SACU[§], Singapore	India, Japan-Korea, Korea, Peru, South Africa
Hong Kong	China	New Zealand	
Indonesia	AFTA, Japan	Pakistan	EFTA, India, US
Japan	Indonesia, Malaysia, Mexico, Philippines, Singapore, Thailand	Australia, ASEAN, Brunei, Chile, Gulf Cooperation Council, Korea, Vietnam	Canada, India, South Africa, Switzerland
Korea	ASEAN**, Chile, EFTA, Singapore, US	Canada, India, Japan	Australia, China, EU, India, China-Japan, Malaysia, MERCOSUR[±], Mexico***, New Zealand, South Africa, Thailand
Lao, PDR	AFTA	Thailand	
Malaysia	AFTA, Japan	Australia, New Zealand,	Chile, India, Korea

Country/Grouping	Implementing/ Signed	Negotiating	Study Group
		Pakistan, US	
Myanmar	AFTA, BIMSTEC****		
New Zealand	Australia, Singapore, Thailand, Brunei-Chile- Singapore*	ASEAN, China, Gulf Cooperation Council, Hong Kong, Malaysia	India, Korea, Mexico
Philippines	AFTA, Japan		Pakistan, US
Singapore	AFTA, Australia, EFTA, India, Japan, Jordan, Korea, New Zealand, US, Brunei-Chile- New Zealand*	Bahrain, Canada, China, Egypt, Kuwait, Mexico, Panama, Peru, Qatar	Pakistan, Sri Lanka, UAE
Taiwan	Guatemala, Nicaragua, Panama	Dominican Republic, El Salvador, Honduras, Paraguay	
Thailand	AFTA, Australia, China, India, New Zealand, BIMSTEC****	Bahrain, EFTA†, India, Peru, US	MERCOSUR

Notes

* After the Clinton administration's proposal for an FTA among the United States, Australia, Chile, New Zealand and Singapore lapsed, Chile, New Zealand and Singapore signed the "Pacific-Three FTA" in October 2002. On 3 June 2005, with Brunei's accession to the agreement, it was renamed the Trans-Pacific Strategic Economic Partnership.

** Excludes Thailand, which refused to sign after Korea excluded rice and 200 other agricultural products from the agreement.

*** After failing to reach agreement on negotiation of an FTA, Korea and Mexico agreed in September 2005 to negotiate a more limited economic cooperation agreement.

**** Bay of Bengal Initiative for MultiSectoral Technical and Economic Cooperation (Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, Thailand).

AFTA: ASEAN Free Trade Agreement

† EFTA: European Free Trade Area

± MERCOSUR: Southern Common Market

§ SACU: Southern African Customs Union

Scope and Motivations of Asia-Pacific PTAs

We now have a substantial database from which we can begin to draw conclusions about the move to preferential trade in the Asia-Pacific region. Inevitably, such conclusions will have to be tentative. The number of agreements that are actually being implemented is still relatively small; many of them have only entered into force in the last couple of years and contain provisions that will not be fully implemented for some considerable period. Nonetheless, some clear patterns have begun to emerge.

While all of these treaties constitute some variant of preferential trade agreement, they are far from identical in their scope (and, indeed, in the motivations of the participants). Table Two highlights the principal country differences in the design of the agreements. The table reflects my judgement on the typical content of preferential trade agreements involving the countries—and reflects not just national preferences but what limitations to achieving its domestic preferences the country is willing to accept and still sign on to an agreement.

Of the agreements involving the six countries/country groupings represented in Table Two, those involving the United States are by far the most comprehensive—both in their coverage of trade in goods and services and in their inclusion of a variety of WTO plus provisions related to intellectual property, labour and environmental standards. Most of their provisions take effect immediately. Those involving Australia, while comprehensive in their product coverage, are typically less ambitious in the WTO Plus area—not going beyond existing international commitments on intellectual property rights, making no reference to environment, labour standards, or going beyond pledges to consult on competition policy and government procurement.

In the middle of the spectrum are Japan and Korea, with Japan's typical agreement being somewhat more comprehensive in its coverage than those of Korea. Outside of the area of investment, they have few WTO Plus provisions. A distinctive feature of the Japanese and Korean commitments to "Comprehensive Economic Partnerships", however, are provisions for technical assistance on capacity building for less developed partners. At the other end of the spectrum, are the agreements of ASEAN and China. These typically are little more than frameworks, agreements to negotiate further cooperation on matters related to international trade. Product coverage in goods trade is far from complete; that of trade in services even less so. Neither of these parties typically includes references to intellectual property rights (except in China's case, reference is sometimes made to the need to achieve a balance between the interests of rights holders and users). Government procurement and competition policy are similarly off the agenda. They contain no reference to environmental issues (while agreements involving Japan and Korea do so, the obligation established by the treaty is typically very weak); and as with the agreements involving Japan and Korea, mention of labour rights is absent.

Inevitably, variation occurs across any individual country's agreements, reflecting the respective bargaining leverage and negotiating capacity of the parties. Of particular interest are negotiations between parties with dramatically different preferences on PTAs. Where such talks have taken place in the Asia-Pacific region, the model of the more powerful country has typically prevailed. The US-Singapore Economic Partnership Agreement reflects US preferences for a comprehensive, legally-binding agreement with WTO Plus provisions. But Singapore's agreement with India is much more "aspirational"

in character, with very limited coverage of goods and services (both based on a positive list approach); it contains no reference to government procurement, competition policy, or labour or environmental standards. To secure an agreement with India, a country regarded as a potentially significant strategic partner, Singapore was willing to sign off on an agreement that was far from complete, almost certainly is not consistent with WTO obligations, and, indeed, falls far short of what the Singapore government had initially stated as its objectives in the negotiations.

Table Two: Predominant Features of Country Approaches to FTAs

	US	Australia	Japan	Korea	ASEAN	China
Rules of Origin	Complex—product specific	Value Added/Change in Tariff Heading Country Specific	Complex—product/country specific	Complex—product/country specific	Local Value Added	Local Value Added [some product specific, e.g., Chile agreement]
Product Coverage*: Goods:	B Comprehensive excl. sensitive agricultural products	A Comprehensive	C Significant Exclusions especially agriculture	C Significant Exclusions especially agriculture	D Selective—multiple exceptions	D Selective—multiple exceptions
Services:	Yes: All Modes. Negative List. Exclusions, e.g., financial services, air services.	Yes: All Modes. Preference for negative list but has accepted positive list in Thai agreement.	Yes: All Modes. Negative List. Exclusions, e.g., financial services.	Yes: All Modes but vague provisions on market access. Exclusions, e.g., financial services.	Limited Coverage	Limited Coverage
Time-Frame	Immediate/up to 10 years.	Phased: product specific 0 to 20 years	Phased—product specific over 10 years	Phased—product specific over 13 years	Flexible/Vague	Flexible/Vague
Investment	Yes. National, MFN & Minimum Standard of Treatment. No TRIMs.	Yes: National and MFN Treatment.	Yes: National and MFN Treatment. No TRIMs. Includes maintenance of existing restrictions. International Arbitration of Disputes	Yes: National and MFN Treatment. No TRIMs. International Arbitration of Disputes.	“Cooperation”	“Cooperation”
Intellectual Property Rights	Yes—WTO Plus. Extension of copyright protection and patents. Protection for test data for pharmaceuticals.	Yes: WTO Consistent. Commitment to International Conventions. Cooperation on Enforcement.	Yes: WTO Consistent, National & MFN Treatment. Commitment to TRIPs, Paris & Berne Conventions	Yes: WTO Consistent. Commitment to international conventions.	No	Where reference included it is to achieving “balance” between right holders and “legitimate” interests of users.
Labour Standards	Yes: commitment to enforcement of national laws consistent with international obligations. Penalties under DSP for non-compliance.	No	Reference only to parties not attempting to attract investment by lowering protections in existing domestic laws.	No	No	No

Environment	Yes: effective enforcement of national laws that encourage “high levels” of environmental protection. Penalties under DSP for non-compliance.	No	Weak—reference to parties not lowering environmental standards to attract investment.	Weak—reference to parties not lowering environmental standards to attract investment.	No	No
Competition Policy	Yes	Yes: Cooperation/ Consultation	Yes	Yes	No	No
Government Procurement	Yes	Yes: Information Exchange. Australia not a party to WTO GPA.	No	Yes	No	No
Dispute Settlement	Yes: Usually- Includes Investor-State Disputes (Aus. Agreement an exception).	Yes. Investors may refer disputes to ICSID or UNCITRAL	Yes: includes Investor-State Disputes.	Parties to Agreement. Parties can block panel	Parties to Agreement	Parties to Agreement
Capacity Building	No	No	Yes	Yes	Yes	Yes
WTO Compliant**	Yes	Yes	?	?	No	No

* where A = full coverage, D = very selective.

** Compliance with Article XXIV.8 requirement that agreements should cover “substantially all the trade” between the parties. Sometimes the requirement is interpreted as the agreement should cover 90% of existing trade with no sector excluded. Agreements that involve only developing economies can be notified under the “Enabling Clause” whose requirements are even less specific (used, for instance, for the Framework Agreement on Comprehensive Economic Co-operation between the Association of Southeast Asian Nations and China).

ICSID: International Centre for Settlement of Investment Disputes

UNCITRAL = United Nations Commission on International Trade Law

Source: Author’s interpretations of contents of agreements on various government web sites. The United Nations Economic and Social Commission for Asia and the Pacific maintains a useful database of agreements at <http://www.unescap.org/tid/aptiad/default.aspx>

The very significant variations in the scope of PTAs that Pacific Rim countries have negotiated to date reflect differences in levels of economic development and in bureaucratic capacity across the region. But they also point to the variety of objectives that PTAs serve. These are as diverse as the agreements themselves. Given the complexities of the issues involved in negotiating PTAs, and the multiple stakeholders affected by these agreements, to disentangle the political from the economic is no easy task. And within both categories, several sets of motivations often co-exist.

Throughout modern history, all economic cooperation agreements have been accompanied by expectations that collaboration in areas of “low” politics will lay the foundations for peaceful co-existence among participants. The European Coal and Steel Community, the predecessor to the European Union, is a classic example. Nowhere is the practice of using economic cooperation as a means of confidence-building among distrustful neighbours better illustrated than in ASEAN where four decades of (albeit at best partially successful economic collaboration) has provided the basis for a nascent security community.⁴ For many commentators, NAFTA was as much about stabilizing the Southern boundary of the United States as it was about creating economic gains.

On the political dimension, governments may perceive the agreements as much as an opportunity to enhance their standing in the region as to improve relations with the other party to the agreement. PTAs may be an instrument to enhance claims to diplomatic recognition (primarily a pre-occupation of Taiwan, although Taipei’s success in concluding agreements only with three small Central American states has merely served to underline its diplomatic marginalization). They may be a means for great powers to

⁴ On the limitations of ASEAN’s economic collaboration see Ravenhill (2007). On ASEAN as a security community see Acharya

reward loyal allies, as appears to have been the case in Washington's choice of PTA partners under the Clinton and Bush administrations, leading some to suggest that a "securitization" of US trade policies has occurred.⁵ And they may represent a defensive reaction by government to invitations from partners that they feel that they cannot knock back without endangering relations (a concern that the Japanese government acknowledged in responding positively—albeit sometimes without a great deal of enthusiasm—to overtures from some ASEAN governments). The negative reaction of the Indonesian government to Australia's initial deflection of overtures for a PTA illustrates the political dilemmas that governments overburdened by multiple negotiations can face.

Political factors may be an early step in decision-making on agreements that ultimately are shaped by economic considerations. In the case of the US, for instance, having decided to go down the preferential trade path as a means to achieve economic objectives that it was unable to attain at the global level, Washington then decided to prioritize negotiations with "proven allies". Even if the primary objectives of a state in initiating the negotiation of a PTA are political, the agreements, however, will inevitably also serve some economic purpose (although, as discussed further below, this will not necessarily produce welfare gains for the parties).

Turning to the economic dimension, three principal motivations are evident in Asia-Pacific agreements negotiated to date. The most ambitious agreements aim to promote deeper integration, to go beyond existing WTO commitments particularly on services—and in the US case on environment, intellectual property, and labour standards. A second prominent economic reason for entering into PTA, for China, in particular, has been to use them to attempt to secure access to raw materials. Here the emphasis has been

⁵ For instance, Higgott (2004).

less on the comprehensiveness of the agreement than on specific sectoral arrangements, amid expectations that the agreements will lead to a general improvement in relations between the parties. Finally, a number of the agreements seem to have been motivated primarily by the concern of domestic economic interests and/or governments to “level the playing field”, to remove the disadvantages that their domestic companies face in competition in foreign markets. *Keidanren*, the Japanese Business Federation, was particularly vocal in pressing for Japan to sign a PTA with Mexico, where its corporations (particularly car manufacturers) were disadvantaged by the PTAs that Mexico had negotiated with the United States and the European Union.⁶ Similar motivations are evident in Australia’s negotiations with the Gulf Cooperation Council, a principal export market for the Australian motor industry. Table Three provides a summary of dominant economic and political motivations in recent Asia-Pacific PTAs.

Table 3: Dominant Motivations in Recent Asia-Pacific PTAs.

Promote Regional Leadership	Achieve Diplomatic Recognition	Reward Allies	Deepen Integration: WTO Plus	Resource-Seeking	Level the Playing Field/Seek Specific Economic Advantages
China-ASEAN	Taiwan-Guatemala	AUSFTA	US-Singapore	China-SACU	Japan-Mexico Australia-GCC

Evaluating the new Asia-Pacific PTAs

Overall Economic Effects

Pointing to the political objectives that governments pursue through PTAs serves to

⁶ Keidanren (2000). See Solis (2003), Manger (2005) and Yoshimatsu (2005) for further discussion.

remind observers that it may not be appropriate to judge these agreements on economic criteria alone. Yet, it is the extent to which the economic impact of the agreements lives up to (often exaggerated) expectations that tends to capture public attention and, which, in principle, should be easier to evaluate than the less tangible political impacts. In practice, however, estimating the actual economic effects of the agreement is far from easy. We have to bear in mind the caveats regarding the small number of agreements that have been negotiated, and the phase-in periods for their full implementation. Several other factors may limit the impact of the agreements:

(1) *A large percentage of the total trade between the parties may already be little affected by tariffs.* Average bound MFN rates for manufactured products for industrialized economies following the implementation of the Uruguay Round agreement were 3.5% for Japan, 3.9% for the United States, and 4.1% for the European Union. Close to one half of Japan's tariff lines were bound at zero; the equivalent figures for the United States and the European Union were, respectively, 40% and 27% (Bacchetta and Bora, 2001).

Products may also be accorded duty-free entry into a partner's markets through other mechanisms, such as a sectoral trade agreement—the Information Technology Agreement being the most notable example—or through duty-drawback arrangements for imported components that are assembled for subsequent export.

Even though less developed economies retain higher tariff levels (particularly bound tariffs), the bulk of a country's exports may still enter a partner's market duty-free. This is particularly the case for an economy like Australia's that is heavily dependent on commodity exports. For instance, Australia's four most valuable exports to Thailand, accounting for 55% of the total value of Australian exports in 2005-6, were all

minerals/energy resources, which would have entered the Thai market duty-free even in the absence of the Australia-Thailand PTA (Department of Foreign Affairs and Trade, *Trade Topics: A Quarterly Review of Australia's International Trade, Summer 2006* [January 2007]). In aggregate, elaborately transformed manufactures constituted only 4% of Australia's total exports to Thailand in 2005-6; services contributed a similar percentage. The share of Australian exports to Thailand actually enjoying a tariff advantage by virtue of the bilateral trade agreement was relatively small.

(2) *The advantages created by PTAs may be more than offset by other factors.* The most obvious is changes in exchange rates. The Australian dollar has appreciated by more than 20 percent against the US dollar in the two years since the Australia-US trade agreement was implemented, a figure more than five times the average US bound tariff on manufactured imports.

Reductions in tariffs may also have little impact if products face significant non-tariff barriers, a dimension of trade largely neglected by most PTAs to date (the notable exception being negotiations on services, which are primarily about non-tariff barriers).

(3) *The response of private sector actors.* Two principal assumptions regarding private sector actors are made in estimating the effects of preferential trade agreements. The first is that these actors will undertake the administrative action necessary to gain access to preferential tariffs. The second is that actors in the supply chain (importers, wholesalers, retailers) will pass on the benefits of reduced tariff rates to consumers so that lower prices will lead to higher demand for the imported product. Both assumptions may be heroic.

Compliance with the rules of origin that are a necessary part of preferential trade agreements imposes significant costs on exporters. Companies have to demonstrate that

imported inputs from other parties do not exceed the value specified by the preferential agreement, and/or that specific processes and/or product changes have been undertaken locally. For the EU, EFTA and NAFTA, the costs of compliance with rules of origin are estimated to range between 4 and 8 percent of the cost of a consignment (Estevadeordal, Harris and Suominen, 2007; Manchin and Pelkmans-Balaoing, 2007). Costs escalate when companies face multiple rules of origin in complying with the various PTAs that their government has signed—as is the case for Australian exporters who face different rules of origin for each of Australia’s PTAs.

These costs often more than offset the preferential advantages created—(again recall that the average bound tariff on manufactures for industrialized economies is around 4 percent). The consequence is that companies simply do not bother with the paperwork required to gain concessions under the PTA. The most notorious example is the ASEAN Free Trade Area where less than five percent of total intra-regional trade takes advantage of preferential tariffs (McKinsey and Company, 2003). In 2001, the weighted utilization rate of preferences in US PTAs was 54%; for the preferences the US afforded to the Caribbean and Andean countries, the ratios were under 36% and 25% respectively (Lederman and Özden, 2005: Table 1C). Carrere and de Melo (2004) estimate that preferential margins of at least 10 percent would be needed to compensate for the costs of complying with a typical value-added rule of origin under NAFTA. Manchin and Pelkmans-Balaoing (2007) suggest that companies undertake the paperwork required to take advantage of the preferential rules of the ASEAN Free Trade Agreement only when the difference between the preferential tariff and MFN treatment is between 10

and 25 percent (where tariffs are above 25 percent, the products are also usually subject to restrictive non-tariff barriers).

Even if companies go to the trouble of undertaking the paperwork required to gain preferential treatment under a PTA's rules of origin, there is no certainty that the savings will flow through to lower prices and thus affect consumers' decisions. As just discussed, compliance with the rules in itself imposes costs on exporters—which one can expect that they will seek to recover. And, as we have seen in Australia over the years as dramatic fluctuations occurred in the exchange rate of the Australian dollar, wholesalers and retailers may decide because of competitive pressures (or the lack thereof) to withhold price rises or reductions. Again, the relatively low levels of tariffs has to be put into context—in this instance the 100% markup that one typically finds in many areas of retailing.

Moreover, as students of industrial organization know well, private companies' decisions on where to locate production, and from where to source supply, are driven by a variety of factors beyond the presence or absence of trade barriers. Take, for instance, the recent agreement that General Motors signed with the United Auto Workers in which GM committed itself to continued production and to the assembly of new models at specific factories in the US in exchange for concessions on health care benefits. Commitments to local workforces/communities, whether for economic, political or social reasons, are even stronger in Japan and Korea, and may easily outweigh the impact of marginal changes in costs brought about by removal of tariffs.

(4) *The Erosion of Preferential Margins*: Preferential Trade Agreements are, in Fred Hirsch's (1976) terminology, "positional goods". Those in possession of such goods

derive maximum benefit from them when others do not have access to them.⁷ With the proliferation of preferential agreements around the region, the advantages enjoyed by the early comers are being quickly eroded. Consider, for instance, the benefit to the Australian auto industry from the removal of the 25 import duty on pickups (utes), one area of manufacturing highlighted at the time of the negotiation of the Australia-US PTA as potentially being a major beneficiary of the agreement. Yet, before a single truck was exported to the United States, Washington signed a free trade deal with Korea, conferring similar benefits on a country whose domestically-owned companies are much better placed to take advantage of the tariff removal. And the US began negotiations for a PTA with Thailand, the world's second largest producer, after the US, of pickups. While such a levelling of the playing field will not only be welcome by countries that are latecomers to PTAs but also by economists because it minimizes the risk that these agreements will generate trade diversion, it inevitably reduces the likelihood that any individual agreement will generate substantial gains (as opposed to minimizing losses from agreements partners have with third countries) for participants.

Impact on Foreign Direct Investment Flows

The very significant increase of FDI inflows from the United States to Mexico immediately following the implementation of NAFTA led some commentators to suggest that conclusion of a PTA could be a positive stimulus to investment flows between partners, an issue that figured prominently in some discussions at the time of the Australia-US negotiations. While, again, it is early days in the implementation of the new

⁷ And have an incentive to try to deny others from gaining access to them—one reason for the restrictive rules of origin in many PTAs, and for the lack of enthusiasm that Philippa Dee describes in her paper for negotiating provisions that are open to all.

Asia-Pacific agreements, there is no evidence to date that they have had an independent impact that will make any noticeable difference to aggregate investment flows. And, again, even for large economies, a single major investment/divestment can significantly distort trends in foreign investment.⁸ So, too, can changes in domestic laws that are unrelated to PTAs—changes in US tax treatment of FDI led to massive outflows of US FDI from its PTA partner, Singapore, in 2005. And, in that FDI and trade are sometimes substitutes for one another, particularly where the motivation for investment is tariff-hopping to service protected domestic markets, the freeing of trade can have a negative effect on FDI. More recent data for Mexico suggests that whereas NAFTA had an early positive effect on US FDI, by the late 1990s FDI into Mexico had fallen below levels that modelling would predict. Since the signature of the Australian-US FTA, the US share of incoming FDI into Australia has declined whereas that of economies with which Australia does not currently have PTAs—China and the European Union—has increased. In a study of the effects of NAFTA, Lederman *et al.* conclude that “FTAs are neither necessary nor sufficient for countries to attract increased FDI inflows”, a conclusion echoed by a major World Bank survey of PTAs.⁹

PTAs and Regionalism

Much has been made of the fact that the increase in the number of preferential trade arrangements involving East Asian countries occurred in the wake of the financial crises of 1997-98. The crises have been seen as precipitants both of a new East Asian sense of identity and of a desire to act collectively to reduce vulnerabilities. While a case can be

⁸ For further discussion in the East Asian context see Ravenhill (2006).

⁹ Lederman, Maloney and Serven (2005) quoted in Cosbey, Tay, Lim and Walls (2004); for the World Bank’s conclusions see World Bank (2004).

made that the new cooperation on finance, embodied in the Chiang Mai Initiative, does represent a regional response of this type (albeit a weak one given the small sums involved),¹⁰ the pattern of PTAs negotiated by East Asian countries does not sustain an argument that a new regionalism is developing. Indeed, exactly the opposite has occurred—if anything, the new PTAs have undermined the preferences given by the region’s longest-standing preferential agreement, ASEAN.

A casual glance at Table One belies any argument that the new PTAs are reinforcing an East Asia regionalism. Fully two-thirds of the agreements signed by East Asian economies to date are with countries outside East Asia—the figure for those currently being negotiated or under study is even higher, over 80 percent. And as noted in the discussion of approaches to PTAs above, where East Asian economies have entered into PTAs with industrialized economy partners, these have had provisions for “deeper” integration than the arrangements they have negotiated with one another. The consequence is that some ASEAN economies now afford more extensive preferential treatment either to countries outside ASEAN but in East Asia (notably Japan) or to countries outside the East Asian region (most notably through Singapore’s agreement with the United States—but similar conclusions can be expected for any agreements negotiated with the EU). Such arrangements undermine the much-vaunted ASEAN-first principle.

Who is Invited to the Table?

Also evident from a casual glance at Table One is the very uneven distribution of agreements across the region. In part, this distribution represents government choices,

¹⁰ Macintyre, Pempel and Ravenhill (2008)

with Singapore an early and by far the most active negotiator of agreements. But the distribution is not just a reflection of voluntary action. The exclusion of Taiwan, the region's fourth largest economy, save for agreements with a handful of the countries that still accord it diplomatic recognition has already been noted. But also largely absent from the negotiating table are the region's low income economies (especially Cambodia, Laos and Myanmar, but also Indonesia and the Philippines). Their under-representation in the agreements is a reflection of the fact that they typically have relatively little to offer partners (although Indonesia is an exception given its natural resources), their lack of negotiating capacity, and partners' concerns about the lack of state capacity to enforce any agreement reached. While the low-income economies benefit from the GSP schemes offered by industrialized economies, these provide neither the comprehensiveness of coverage nor the legal security afforded by PTAs.

Who Concedes Most?

Globally, a consistent pattern is evident in PTAs: smaller economies typically concede more than their larger partners in negotiating these agreements.¹¹ Both the EU and the US have extracted more concessions from their partners than they themselves have given up. We have seen similar outcomes in the Asia-Pacific region—witness the US agreements with Australia and Singapore, and Japan's agreements with ASEAN economies (see the paper by Aurelia George Mulgan). But there has been one important exception to this generalization about larger parties extracting the lion's share of concessions: China's PTAs with ASEAN, Hong Kong, and Macau—where China has been willing to sign off

¹¹ Freund (2003). Whether this asymmetry in concessions carries over into asymmetries of gains from the agreements is another matter. Smaller parties would usually be expected to gain more (at least in proportion to the size of their economy) in a relationship between parties of unequal size. And conventional economic analysis would suggest that the party that makes more concessions will gain more because of the additional competition faced by its domestic producers.

on an agreement where it has made by far the most concessions (seen, for instance, in the “Early Harvest” provisions of the ASEAN agreement). This outcome can be explained as a reflection of the dominance of political motivations in driving the agreements—or, more cynically, that China is willing to accept short-term losses in the expectations of long term economic gains. Whether this pattern of China’s making more concessions than do its small economy partners will carry over into its negotiations with industrialized economies remains to be seen (cf. Yang Jiang’s paper for the workshop).

WTO Plus?

A principal advantage over trade negotiations at the global level that many commentators saw for PTAs was that they would enable parties to negotiate “deeper” integration, to go beyond existing measures at the WTO. It is the case that most of the PTAs negotiated in the Asia-Pacific region contain some “WTO plus” elements—but often these provisions are very shallow.

As already noted, the agreements involving the United States go furthest beyond existing WTO commitments, and embrace a range of areas for further cooperation. Even the United States, however, has stepped back in several areas from the comprehensiveness of the provisions of NAFTA. Two are particularly notable: none of its recent agreements contains a side agreement on the environment, unlike the provisions in NAFTA for a North American Commission on Environmental Cooperation with its own secretariat. The US has also backed away from provisions on investor-state disputes after Congress expressed concerns that through PTAs foreign investors were enjoying rights not available to domestic investors.

Compared with the US treaties, the WTO Plus provisions in other PTAs around the region are weak. The typical reference is to cooperation on matters such as competition policy and/or to facilitation. And the provisions on the environment are typically no stronger than commitments that states will not lower environmental standards in their efforts to attract foreign investment. None of the agreements has a reference to labour standards—save in the Japan-Philippines PTA, which provides that “The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic labor laws”.

Certainly, there is no evidence from the experience of PTAs in the Asia-Pacific that a platform is being built that will permit easy transfer of WTO Plus provisions from the PTAs to the global level. This conclusion is entirely consistent with that reached by an OECD survey of earlier regional agreements, which found a similar lack of transfer from the regional to the global level (Organisation for Economic Cooperation and Development, 2002). And there are areas in the PTAs, e.g., provisions in the US agreements that relate to pharmaceuticals (see the Faunce and Shats paper for the workshop), that are arguably antithetical to global agreements, especially the Doha Declaration on TRIPs and Public Health.

Foundations for Broader Regional Agreements?

To what extent have the new agreements laid the foundations for wider participation? The answer is very little. Although some—notably those between Australia and Singapore, and Australia and Thailand—make allowance for other countries’ accession to the treaties, there are only two instances in the region where this has happened. The first is ASEAN, where the expansion of its membership to include Cambodia, Laos and

Myanmar, brought three additional parties into the ASEAN Free Trade Agreement. The second is the Trans-Pacific Strategic Economic Partnership, an extension of the “Pacific 3” PTA between Chile, New Zealand, and Singapore, that occurred when Brunei acceded to the arrangement in June 2005. In most of the other agreements around the region, the country-specific nature of the rules of origin significantly complicates their extension to other parties.

Promoting Domestic Structural Adjustment

The argument that PTAs could be used to promote domestic structural adjustment was particularly popular in some official and academic circles in Japan (and to a lesser extent Korea).¹² The logic was that by entering into negotiations with countries with significant agricultural exports, Japan would have to make concessions in this area—and in doing so would establish the principle that agriculture would not be exempted from trade negotiations. The PTA would serve as a “wedge in the door”, opening up the sector most resistant to liberalization.

Space precludes a detailed discussion of the Japanese case (see Aurelia George Mulgan’s paper). In support of the “PTAs as promoters of structural adjustment” argument, Japan has included provisions on some agricultural products in its PTAs (save for that with Singapore, where the few “agricultural” exports from Singapore—primarily cut flowers and goldfish—were deemed too sensitive for inclusion). But the coverage has been very limited—leading even a commentator normally supportive of Japan’s PTA strategies, Shujiro Urata [*citation], to question whether the agreement that Japan signed with Mexico was consistent with WTO requirements.

¹² Munakata (2002), Munakata (2006) provide the best examples.

The lack of specificity of the provisions within the WTO on PTAs, especially that related to the meaning of the requirement that “substantially all the trade” between parties should be liberalized, and the failure of the Committee on Regional Trade Agreements to reach a judgement on the numerous agreements submitted for its consideration, has afforded countries the opportunity to exclude sensitive sectors from agreements. And, of course, it has not just been Japan that has done so—witness the US exclusion of key agricultural sectors from its agreement with Australia, and, more surprisingly, its acquiescence in Korea’s exclusion of rice from the Korea-US PTA.

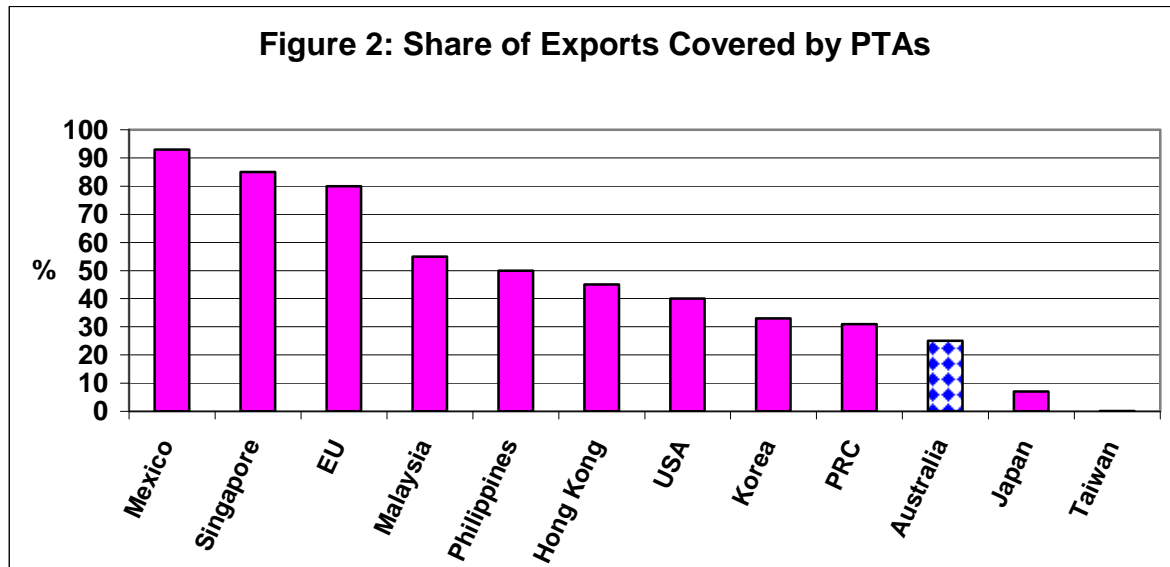
While it is the case, as Aurelia George Mulgan argues in her paper, that the negotiation of PTAs can increase both the external and the internal pressures for domestic structural adjustment with the expectation that this will enable more competitive sectors to realize potential gains, the success of protectionist interests in ensuring that sensitive sectors are carved out of agreements points to the limitations of such arguments. And one might reasonably assume that the logic of the argument would be more compelling for negotiations at the global level where the possibility exists for coalitions of interested parties to exert concerted external pressure, and where the potential gains for competitive domestic interests are greater.

Fragmenting the Pro-Liberalization Coalition?

In a well-known article, Richard Baldwin (1997) argues that the negotiation of PTAs will create a virtuous “domino effect”—the exporters of countries not enjoying such arrangements will press their governments to take action to level the playing field; meanwhile PTAs will strengthen the position of domestic exporting interests and provide them with both the incentive and the means to press for further liberalization. The

evidence from the recent PTAs in the Asia-Pacific region certainly supports the first part of the argument—governments are being pushed by domestic interests to negotiate PTAs that level the playing field in markets where competitors already enjoy the benefits of such agreements. The second part of the argument is less persuasive.

Where exporting interests have achieved free access to a large portion of their markets through preferential trade agreements, they will have few incentives to invest resources to lobby for liberalization at the global level. And where such access to foreign markets has been achieved through agreements where countries have been able to carve out sensitive sectors, they will have little incentive to undertake what—particularly in Northeast Asian countries—is politically risky lobbying in support of the dismantling of protection for sensitive sectors, particularly in agriculture. We have already reached the stage where a substantial share of the exports of some countries is covered by PTAs [Figure 2] (Mexico, Singapore, and the EU have been the most active negotiators of PTAs—should Australia conclude agreements with Japan, China and Korea, the share of its exports to countries with which it has PTAs will rise to 70 percent).



The effects of PTAs in fragmenting the pro-liberalization coalition may be more damaging for trade negotiations at the global level than the oft-cited diversion of negotiating resources and attention from the global to the “regional” level. The access to international markets that manufacturing interests enjoy through preferential and sectoral trade agreements is one reason why there appears to have been substantially less enthusiasm from manufacturing interests for the Doha Round in comparison with its Uruguay Round predecessor.

Conclusion

The proliferation of Preferential Trade Agreements in the Asia-Pacific has yet to have any marked effect on aggregate trade and investment flows. That this should be the case, contrary to some of the wilder claims from economic modelling, is consistent with studies over the years that have emphasized the dominant role of the private sector in leading Asia-Pacific integration, the availability of duty-drawback arrangements, free-trade zones and other mechanisms that have facilitated the development of regional production networks, and the very extensive unilateral trade liberalization undertaken

over the last quarter of a century.

Much international trade is already largely unhampered by border barriers (and PTAs generally fail—with the notable exception of negotiations on services—to address the arguably far more significant behind-borders barriers). Where significant border barriers do exist, they serve domestic political economy purposes that have so far proved largely resistant to the pressures from partners seeking to negotiate bilateral agreements. To date, the agreements negotiated around the region, with the exception of those involving the United States, do not have significant WTO Plus features: those involving China and ASEAN are typically WTO minus. The agreements are of primary benefit to industries facing specific barriers or seeking to overcome disadvantages created by other preferential arrangements.

On the political side, entering into PTA negotiations will not necessarily lead to improved relations. One doubts that relations between Japan and Korea have been improved by negotiations that have failed to produce an agreement ten years after Kim Dae Jung initially proposed a PTA between the two countries. Similarly, relations between Thailand and Korea were hardly improved when Thailand refused to sign on to the ASEAN-Korea agreement because Korea had excluded rice from its commitments. On the other hand, to knock back an invitation to enter into negotiations is not likely to make for good relations. And China's use of PTAs has been a key instrument in its "charm offensive" in the region.

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