

## Idiosyncratic Features of the Contemporary Regional Economic Architecture in Asia

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The objective of this article is to examine the characteristic features of contemporary policy-led regionalism in Asia. It identifies the positive and negative features associated with the free trade agreements that have proliferated in Asia during the first decade of the 21<sup>st</sup> century. There has been a marked transformation in Asia's regional architecture in a short span of a decade-and-a-half. The mode and conduct of multilateral trade has been significantly transformed during recent years and Asia could not possibly remain immune to this transformation. The importance of regionalism in multilateral trade has increased steadily. In addition, the trade-investment-services nexus has developed and grown increasingly important. As business firms now manufacture parts of their products across the border, bilateral trade agreements (BTAs), regional trade agreements (RTAs) and free trade agreements (FTAs) of the contemporary period need to take into account the new kind of trade barriers that have been created due to the changing mode of trade. The contemporary regional agreements need to be designed to facilitate the new modes of conducting business and trade. It was understood rather late in Asia that the 'WTO-Plus' FTAs are more functional and result-oriented than their predecessors.

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JEL Classification: F10, F13, F15

### I. Introduction

In comparison to the other economically prominent regions of the global economy, Asia is widely considered to be under-institutionalized. Besides, initial regionalization of the Asian economy took place in a market-driven manner. That said, there has been a marked transformation in Asia's regional architecture in a short span of a decade-and-a-half. The genesis of Asian real sector or trade related regionalism, also termed as *de jure* economic integration, was the Association of Southeast Asian Nations (ASEAN). Although ASEAN is the oldest institution of regional cooperation in Asia, the launch of Asian regional

regionalism was not only slow but also did not progress consistently for a long period. The Bangkok Declaration was signed in 1967 between the five founding members of ASEAN, namely, Indonesia, Malaysia, the Philippines, Singapore and Thailand. At the time of birth, none of the founding principles of ASEAN were economic in nature. It was a loosely founded political organization, whose primary purpose was to promote regional peace and stability in a sub-region that had a history of volatility. It is Asia's only multipurpose regional organization and remained dormant until the Bali Summit in 1976 (Ariff 2011).

Further poorly visualized, somewhat maladroit, attempts were made to build a formal regional community of nations, but they produced few tangible results of value and utility. From the perspective of regional integration, the Asian economy underwent a great many alterations but a genuine economic community of Asian economies has remained a work in progress. The region is not only far from forming a European Union (EU)-like community of nations but even the outlines of regional architecture are also nebulous and ill-defined. Candidly assessed, a monetary union, or an Asian single market, or an Asian Economic Community is not a few short years away. However, although little tangible progress has been made in this direction, this is not to deny that some semblance of regional architecture has evolved and that real sector integration has taken place. It needs to be clarified that the oft-used term regional architecture implies "institutions, mechanics and arrangements that together provide necessary functions for regional cooperation" in the areas of trade, economic development and finance (Hu 2009, p. 4).

The objective of this chapter is to examine the real sector or trade related regional integration in Asia; its principal focus is the post-Asian crisis (1997-98) growth in Asian regionalism and the prominent associated issues. The discussion deals with this issue through institutional and theoretical investigation, supported by insightful data analysis. Real sector or trade-related regional integration could plausibly be the beginning of natural sequencing of future monetary, financial and economic integration. This was the trajectory of progression in the EU. How this process unfolds would have notable implications for and impact on the region. Given the rising importance of Asia and the on-going shift in the global center of gravity, it would also be of global significance.

### *1. Defining Regionalism*

In forming a preferential trade agreement two or more economies begin by

significantly reducing or eliminating trade barriers among them. Terms like “preferential trade agreement” or “regional trade agreement” are used to denote an exception from the non-discriminatory principle of the GATT/WTO system, or the most-favored-nation (MFN) clause, enshrined in Article I. Trade policy discrimination, permitted under Article XXIV of the General Agreement on Tariffs and Trade (GATT)<sup>1</sup> and Article V of the General Agreement in Trade in Services (GATS)<sup>2</sup>, is the central principle behind the formation of preferential trade agreements. FTAs are also allowed under the Enabling Clause of the GATT for special treatment for the developing countries. Trade policy discrimination was adopted under the GATT in 1979 and it enabled developed countries to give differential and favorable treatment to developing countries. As a rule of thumb, agreements notified under the Enabling Clause tend to be less comprehensive than agreements notified under GATT Article XXIV.

There can be a whole range of discriminatory preferential agreements between countries, ranging from minimal agreements that simply exchange partial tariff preferences to full-blown FTAs that go way beyond agreements on tariff reductions. Different types of trade agreements can be demarcated in three different stages of progressive integration. The well-known Balassa (1961) classification in this regard is as follows: (i) A preferential trading arrangement (PTA) and an FTA comprise the first stage of shallow integration. An FTA is the principal and commonly used instrument of formal regional integration. In a basic and simple form an FTA is a legal treaty between the governments of the signatory countries to reduce or eliminate trade barriers, usually in a phased manner. However, in an FTA the member countries determine and keep their own levels of trade barriers vis-à-vis the non-member countries.

The deep integration measures are: (ii) A customs union (CU), which differs from an FTA in that it adopts common trade barriers or external tariff structure vis-à-vis the non-member economies. (iii) The next stage is a common or single market. It is essentially a CU with deeper integration between member economies, entailing liberalized movement of factors of production between the members. A monetary union comes next when the countries have a common currency and to an extent they also have common economic policies. The last stage is an economic union. This taxonomy presents a sequenced pattern towards

<sup>1</sup> The original GATT text (GATT 1947) is still in effect under the WTO framework, GATT 1994 is a modification of this original text.

<sup>2</sup> Although in the original articles of agreement of the GATT there were clear rules regarding the formation of PTAs, they are fairly imprecise, incomplete and were never seriously enforced.

closer and deeper integration. Analysts usually focus on FTAs or CUs while analyzing trade blocs. Two types of effects of forming an FTA are generally estimated, the first is the trade effects and the second the welfare effects. FTA is often used as a generic term. To clarify, an FTA can also be bilateral.

The present era of regionalism began with the European Economic Community (EEC) Treaty, signed in Rome in 1957. Over the years regional agreements evolved considerably and in their present form can be really complex, having an enormous impact over the national and regional economies. Conceptually and physically regional integration progresses in stages from an FTA to a customs union (usually between two neighboring countries or within sub-regions), then a deeper common market and further on to an economic and monetary union, encompassing multifaceted financial and fiscal issues. Asia is no different. An acknowledged late comer to regionalism, Asia's regional architecture may well pass through these stylized stages. Conventionally FTAs aimed at liberalizing trade in goods by eliminating tariffs, but in recent years FTAs frequently go beyond this mark. Their coverage goes 'behind-the-border' issues and includes tariff-equivalent non-tariff barriers (NTBs), trade in services, investment, intellectual-property rights (IPR), competition policy, government procurement and dispute settlement. Since 2000 this trend in what is known as "deep" or "WTO-Plus" regional integration has intensified.

## *2. On-Going Policy Debate*

During the 1990s, efforts towards regional community building were made under the auspices of Asia-Pacific Economic (APEC) forum, but trade and economic liberalization under APEC petered out without making much headway by the end of the decade. Since this point in time endeavors to build a regionally integrated economic community shifted to Asia, particularly the North East and South East. After the mid-1990s, particularly following the Asian crisis, driven by a shared sense of purpose several earnest attempts were made to build an Asian regional architecture having an Asian identity, character and disposition. There were few Asia-Pacific initiatives until the Trans-Pacific Partnership (TPP) picked up resolute momentum in 2011.

Commissioning of the East Asian Vision Group (EAVG) in 2000 was a defining moment in this regard. Leaders of ASEAN-Plus-Three (APT)<sup>3</sup> countries

<sup>3</sup> The ASEAN-Plus-Three (APT) economies comprise the ten members of the ASEAN bloc, plus China, Japan and Korea (Republic of).

took initiative to establish the EAVG. In their report in October 2001 the EAVG recommended formation of “a *bona fide* regional community” making collective efforts to not only economic progress and prosperity but also peace. The EAVG advocated that the Asian governments “work towards building and ‘East Asian Community’...” (EAVG 2001, p. 2). During the first decade of the 21<sup>st</sup> century, myriad small and large attempts were made to regionally integrate by mostly individual and occasionally sub-groups of Asian economies. These approaches were largely multipronged. During the second decade they reached a critical juncture to start carving their regional institutional architecture for the future. If the Asian countries stay the course, they have a long way to go in conceptualizing and implementing a functional regional architecture.

The first initiatives that the Asian economies took were to integrate globally. As this chapter elucidates, in the post-2000 period trade policy took a discernible regional turn and regional initiatives became predominant. For deep seated economic and political reasons regionalism supplanted the multilateral initiatives in trade liberalization. Discrimination against multilateral trade had a distorting effect on it. In accordance with this new proclivity, regional economic architecture in Asia began altering. The pace of change gradually accelerated. Asian economies have been mutually integrating, first in a market-driven manner and then in a policy-driven formal manner, with the regional governments taking initiative.

For the Asian economies, for maintaining and stabilizing their dynamic GDP growth at this juncture, collective action toward regional economic cooperation and *de jure* regionalism will be appropriate. As the Asian economies took initiative to globally integrate, their relatively recent advances towards a shared vision of regional cooperation need not be seen as turning away from their penchant for global integration. It will be pragmatic as well as reasonable for them to ensure that, to the extent possible, their emerging regionalism should be complementary to globalism and multilateral initiatives, not a substitute for it.

Also, since the turn of the century China played a steadfast role in the growth of both market-led and formal regionalism. As the regional economic structure began to grow in a China-centric manner, the recent growth of Asian regionalism also became partially China-centric. More accurately China led the path of regional integration, *a fortiori* in the post-Asian crisis period (Gill and Kharas 2009). It was a severe crisis. Virtually all Asian currencies depreciated sharply, some losing almost 50 percent of their values by January 1998. Economic, social

and political fallout of the crisis was distressfully huge. Since the crisis formal regionalism made material progress in Asia. In the medium- or long-term this process will result in significant geo-economic and geo-political transformation of Asia. Rapid clip regional economic growth, particularly China's vertiginous growth, catalyzed the process of regional integration (Zou *et al.* 2006). Growing number of trade agreements and progress in regional integration resulted in a decline in trade costs in Asia relative to the other regions of the global economy (Pomfret and Sourdin 2009).

Policy debate on the future of economic agreements in Asia became progressively lively and energetic. The present surfeit of reciprocal or bilateral trade agreements (BTAs) and free trade agreements (FTAs) in the region is seen by some analysts as having low utility in increasing trade and welfare in the region. Both trade theory and computable general equilibrium (CGE) analysis suggest that larger number of participating economies in an FTA result in greater benefits. Towards the end of the last decade, scholarly attention was focused more on the possible creation of an Asia-wide consolidated economic cooperation agreement. In addition, subsequent APEC summits kept on insinuating towards building on the existing regional cooperation frameworks and follow up on the concept of a Free Trade Area of the Asia-Pacific (FTAAP). There are others who point to the difficulties in arriving at a consensus on a region-wide agreement (Chia 2010). The process of expansion of the Trans-Pacific Partnership (TPP) is presently underway. It is the latest model of this kind.

## II. Asian Regionalism: Vintage 21<sup>st</sup> Century

The conduct of multilateral trade has undergone a discernable transformation during the first decade of the 21<sup>st</sup> century, and *pari passu* so has the nature of regionalism. Contemporary regionalism is different from that in the 20<sup>th</sup> century and in turn it has influenced multilateral trade. The 21<sup>st</sup> century regionalism is not principally and primarily about preferential market access, which was the case with the 20<sup>th</sup> century regionalism. This transformation was aided by two important factors: First, the advances in the information and communication technology and second vertical specialization of trade and expansion of supply chains discussed in detail in section 3. Together they have created a "trade-investment-services nexus" (Baldwin 2011, p. 1), which in turn gave Asia an appearance of a regional factory. This nexus has become highly relevant for the contemporary international commerce. Therefore contemporary

regionalism is more concerned about supporting it than simply emphasizing market access.

The trade-investment-services nexus evolved because trade was no longer confined to goods. The nexus came into being sequentially in a rational and somewhat intricate manner. The process worked as follows: First, trade expanded to trade in goods and services, and it combined with cross-border investment in production facilities. To that technology transfer and use of high-technology infrastructure for coordinating dispersed production activities were added. Trading activity was no longer simple. The next development was trade in parts, components and sub-assemblies, which increased progressively and became a high proportion of total trade in several Asian economies. The relevant services needed for the 21<sup>st</sup> century trading practices include telecommunications, internet, express package delivery, increased use of air cargo facilities, trade finance, customs clearance services and the other business services. This new dimension as well as technique and mode of trading have affected the evolving makeup of FTAs and RTAs.

The evolution of trade on the above-mentioned lines in the 21<sup>st</sup> century made trade more complex than that in the past and it needed to be governed by a different set of equally intricate rules. The novelty of the 21<sup>st</sup> century regionalism is that it is not so much about the conventional preferential market access in the FTA partner economies, but about the policy framework that supports the trade-investment-service nexus and keeps it proficiently operating. This implies that the 21<sup>st</sup> century regionalism is driven by different politico-economic forces from those that drove the 20<sup>th</sup> century.

Unlike the FTAs and RTAs of the 21<sup>th</sup> century, the older ones were simpler and shallower in their composition, frequently dealing merely with phased tariffs slashing and the ROOs. The FTAs and RTAs of the present period need to respond to the needs of business firms that either produce part of their product in the neighboring countries or have a quasi-permanent relationship with suppliers in the neighboring countries. By making their operations international, business firms are exposing themselves, their capital, technological prowess, marketing knowhow to international risks. According to Baldwin (2011) this mode of operations entails hazards for tangible and intangible property rights. Such threats work as the new kind of trade barriers.

### *1. Stylized Features of the Growth of FTAs*

Unlike the BTAs, FTAs and RTAs of the earlier period, the ones that are being formed in the present period need to take these barriers into account. Another requirement of the current period is coordination in production facilities in two or more neighboring countries in such a way that customers receive quality goods at competitive prices. This would call for a well thought-out business plan on trade in parts, components and intermediate goods as well as a range of commercial services. To be effective, applicable and functional the 21<sup>st</sup> century BTAs, FTAs and RTAs need to ensure that their operations facilitate the new mode of conducting businesses, in turn making them more efficient and profitable. An increasing number of the 21<sup>st</sup> century FTAs and RTAs have been so negotiated that they respond to the emerging needs of the time and therefore they tend to be different and deeper compared to the ones that were negotiated in the past.

Given the new business and economic environment and changing industrial structure, let us first examine the idiosyncratic features of FTAs in Asia. The first one is that they differ widely in terms of design, objective, intent, scope and purpose. They can be arrayed on a continuum from the narrow FTAs, which are focused only on trade in goods and therefore trade liberalization attempted by them is minimal to those that are more comprehensive and entailing deep liberalization and regulatory cooperation and harmonization characteristically needed by a contemporary FTA. Some FTAs still emphasize economic objectives more, while others are basically inclined towards political objectives. This wide diversity in FTAs is essentially attributed to the level of economic development of the FTA forming countries, the development strategy followed and the basic motivation for entering into a trade agreement (Capling and Ravenhill 2011).

The second one is the concern of the potential partner economies at the time of FTA formation regarding coming to an agreement with the least discord, keeping the negotiations cost-effective and complete negotiations proficiently in a small number of negotiation rounds, in a reasonable time. This concern led to formulation of a large number of BTAs in Asia that could be negotiated relatively faster. A general reason behind the proliferation of FTAs is that negotiating plurilateral RTAs is always a complex and time-consuming process. The partners may also have to settle intricate and controversial issues on which accord may take a long while. There have been cases when after prolonged negotiations an agreement eluded. In 2000, Asian economies were a part of 46



FTAs, 8 of which were plurilateral RTAs. In 2010, this numbers shot up to 180, of these 58 were plurilateral.

## *2. Limitations Originating from Rapid Growth in Regionalism*

Asian economies formed a good number of BTAs and FTAs, many of them were of shallow variety. Consequently they remained limited and uneven in their impact (Mercurio 2011). Policy makers in Asia did so despite being fully cognizant of the fact that many agreements that covered mere border trade measures and were made between two partners have a limited payoff in terms of increasing trade. Also, welfare implications of such BTAs were not high. Still emphasis on BTAs in Asia continued to be high. A multiplicity of BTAs promoting formal regional integration evolved as a characteristic feature and an accepted mode to progress towards regionalism. For instance, when the APT finance ministers met in the aftermath of the Asian crisis, to establish the framework of currency swaps, the agreement was for the region. However, the swaps themselves were to be negotiated bilaterally.

There was excessive importance on market access for goods in the Asian FTAs. Low level of ambition and motivation in designing them was another drawback of Asian BTAs and FTAs. In many cases liberalization rates are low, which limits integration of the member economies. The Asian agreements also suffer from a significant range of exclusions, which also limits the payoff from forming a BTA or an FTA. In addition, the persisting NTBs go a long way in reducing the impact of regional integration. Impediments like these tend to restrict the coverage, depth and scope of Asian BTAs and FTAs. Mercurio (2011, p. 121) asserted that they simply are not “broad enough to have a meaningful impact on the business community or broader economy”.

Another much-debated characteristic of the Asian FTAs is that majority of them tend to be of the hub-and-spoke variety. Many BTAs and FTAs overlap. They create the problem of what Bhagwati *et al.* (1998) termed the “noodle bowl” or “spaghetti bowl” syndrome. As there is a profusion of bilateral agreements in Asia, it tends to exacerbate the ‘noodle bowl’ effect. This effect is caused by overlapping or criss-crossing of BTAs and FTAs. Overlapping agreements, no matter what kind, create a complicated web, which in turn become a serious operational snag. The overlapping agreements are usually inconsistent with respect to tariff phasing-out schedules, exclusions, standards and rules dealing with antidumping and other mutually agreed regulations. Their

conflicting provisions could generate complex patterns of discrimination and exclusion in the region.

This effect results in inefficiency and high costs due to multiple ROOs. They pose a severe burden on business firms, eventually increasing the cost of doing business and rendering BTAs welfare-reducing. Such “noodle bowl” or “spaghetti bowl” effect may well spawn greater distortion in multilateral trading system (Bhagwati 2008; Menon 2009). There are many other problems that noodle bowl effect can potentially create. For instance, they can encourage protectionism.

### *3. GATT/WTO Paradigm*

FTAs following the GATT/WTO paradigm were regarded as narrow in scope because their essential focus was on the border liberalization measures, which implies phased reduction or elimination of tariffs. They were usually limited to trade in goods, or sometimes extended to services. It was not appreciated that mere reduction of tariffs could not be helpful in providing a level field to the firms of two or more trade partner economies. In general the agreements made by China and ASEAN are of this kind. They are low in ambition and narrow in coverage. For the most part they were limited to trade in goods and infrequently trade in services was included. With a few exceptions, they followed the GATT/WTO paradigm. Their detailed features are elaborated in the following paragraph.

Characteristically Japan and Korea are known for making relatively more comprehensive agreements, which did not stay confined to the GATT/WTO Paradigm. The agreements in which the US is a partner are the most comprehensive of all in terms of their coverage. Not only their coverage is wide but also they have the largest WTO-Plus provisions, including labor and environmental standards. As a rule, BTAs and FTAs in the Asia-Pacific region are more comprehensive in compared to those within Asia. Australia and New Zealand follow the US model, but less WTO-Plus provisions than the US. Close scrutiny of FTAs negotiated since 2000 in Asia makes it obvious that Asian policy mandarins were not fixated on matching their efforts with those of the EU and were not advancing towards a common market and deeper economic integration.

#### 4. *WTO-Plus FTAs*

The realization of Asian policy makers regarding WTO-Plus FTA being more functional, result-oriented and potentially more rewarding was somewhat late to dawn. Therefore they turned belatedly towards the WTO-Plus kind of BTAs and FTAs. The US became a trend setter in this regard. The blueprint and norms followed by the US had a demonstration effect. Therefore many Asian BTAs and FTAs that were negotiated during the recent years went beyond the GATT/WTO model. Asian economies that negotiated agreements during the recent years preferred to enter into what became known as the “new age” or “WTO-Plus” FTAs, which had rationally wider scope and therefore comprehensive ramifications for the FTA partners. They eventually led to higher welfare gains.

The behind-the-border issues that come under WTO-Plus agreements include NTBs, FDI regulations, trade in services, mobility of labor, IPRs and the like. Competition policy is yet another area that needs to be settled in such a manner that the firms in FTA partner economies are able to fairly compete in the countries which negotiated a FTA. The WTO-Plus agreements commonly include the four Singapore issues as well.<sup>4</sup> This kind of coverage can potentially create new business opportunities for the firms in the FTA partner economies (Freund and Ornelas 2010). The eventual impact is deeper integration among the regional economies.

Three ASEAN-Plus-One agreements, with China, Japan and Korea, are WTO-Plus. It is indicated by their formal names and by their comprehensive scope.<sup>5</sup> Conversely, China preferred to have limited scope FTA agreements that cover merely trade in goods and services. However, this has lately changed and the more recent agreements made by China have the WTO-Plus elements in it. Of late, other Asian economies have also changed their approach and they begun favoring the WTO-Plus agreements rather than the narrowly limited ones. Indonesia, Korea, Malaysia, the Philippines and Vietnam all have recently turned towards the WTO-Plus kind of agreements.<sup>6</sup>

<sup>4</sup> The four so-called Singapore issues are investment, competition policy and transparency in government procurement. The fourth issue is simplification of trade procedures, an issue sometimes referred to as “trade facilitation”.

<sup>5</sup> Their formal names are as follows: (1) ASEAN-China Framework Agreement and Comprehensive Economic Cooperation, (2) ASEAN-Japan Framework Agreement and Comprehensive Economic Partnership and ASEAN-Korea Comprehensive Economic Partnership.

Numerous large MNCs, which made Asia their home, played a significant role in making Asia more conscious of the WTO-Plus FTAs. They were absolutely *au point* in hypothesizing that a policy environment of free trade and investment in neighboring Asian economies would benefit them by making it efficient for them to operate in Asia. It would be more lucrative, effectual and efficacious for the MNCs to operate in the Asia if Asian agreements are negotiated WTO-Plus. As more and more economies in Asia are linked through the WTO-Plus kind of BTAs and FTAs, deepening their regionalism, MNCs' production networks could be expanded and deepened. Furthermore, investment liberalization under this kind of FTAs could be more welfare enhancing for the region. Thus the gains are mutual.

### 5. Under-utilization of FTAs

Theoretically it is a valid belief that FTAs unify a region and usher in free trade in the unified region. Whether it really happens in regional trade is open to question. Mercurio (2011) compiled and compared the utilization rates from multiple surveys. A survey of Japanese firms all over Asia reported that 31.8 percent of them in Singapore made use of the provisions of the ASEAN agreement. This was the highest use of reported. Only 5.0 percent Japanese firms in Malaysia reported using the ASEAN agreement. Low utilization rates imply that the increase in intra-trade was not the direct result of trade agreements.

The Asian utilization rates compare unfavorably to those of other RTAs like NAFTA. The US firms importing from Canada reported 54 percent utilization and those exporting to Canada reported 50 percent utilization. Mexican firms exporting to the US reported 62 percent utilization. The reason why these rates are not still higher is that a large number of tariff lines receive duty free treatment under the MFN clause. Therefore 45 percent of Canadian exports to the US and 37 per percent from Mexico enter the US markets free of any tariffs. Therefore these exports did not need any preferential treatment engendered by NAFTA.

Hiratsuka *et al.* (2009) investigated Japanese MNCs and large firms' behavior while dealing with Asian FTAs. Their study included the affiliates of the Japanese MNCs that operated in Asia. Their conclusion regarding utilization of FTA was negative, that is, the Japanese MNCs or large firms had not only

<sup>6</sup> This section draws on Kawai and Wignaraja (2010).

inadequate knowledge regarding the current FTAs in Asia but also they infrequently utilized by them. A JETRO (2009) survey of Japanese MNCs corroborated this conclusion regarding the underutilization. It put the finger on the rationale behind underutilization of FTAs. Japanese MNCs found that the difference between preferential tariff rates under the FTA and the most-favored-nation (MFN) tariff rates was so minuscule that it was not worth their while to utilize the former. Besides, the duty drawback system managed to recover their tariff payments. The JETRO (2009) survey did not mention lack of knowledge of FTAs or complexities in their operations as the reasons behind underutilization.

Large micro data generated by the JETRO (2009) survey was utilized by other analysts. Hiratsuka *et al.* (2009) used these micro data to further analyze the pattern of FTA utilization by the Japanese MNCs and affiliates. One generalized conclusion they arrived at was that the smaller the affiliate or business firm, the less likely was its utilization of FTAs in exporting its goods and services. Be it noted that a smaller firm also had less diversified sources of procurement. Additionally, complications created by overlapping FTAs in Asia due to the 'noodle bowl' effect could well deter firms from utilizing them. But based on a large firm level survey in Japan, Korea, the Philippines, Singapore and Thailand, Kawai and Wignaraja (2009) inferred that business firms did not see these complications as serious and therefore the overlapping FTAs were not deterrents in the utilization of FTAs. For sure more facilitation in dealing with FTA operations was considered necessary.

Recent country level and industry level studies indicated businesses not utilizing those preferential arrangements adequately (Kawai and Wignaraja 2011). Share of export value benefitting from the preferential arrangements remained low. This is a good measure of FTA utilization. Inadequate utilization remained the biggest problematic issue for the Asian BTAs and FTAs. One reason for underutilization of Asian FTAs was low trade volumes between the BTA or FTA partners. FTA partners of Japan often reported low utilization due to this reason. A primary survey of 841 of exporting firms conducted in 2007-08 in six Asian economies by ADB showed that the Chinese (45.1 percent) and Japanese firms (29.0) were the highest users of FTA preferences, while those from Korea (20.8 percent), the Philippines (20.0 percent), Thailand (24.9 percent) and Singapore (17.3 percent) made low use of the FTA preferences. Insufficiency of information regarding the FTA and its provisions was given as the most frequent reason behind underutilization of FTAs. Low preference

rates was the second most frequent answer. The ADB survey also indicated that 25 percent of the Asian business firms did intend to utilize the FTA preferences more in future. They have plans in place to achieve this objective.<sup>7</sup>

As regards industry-wise FTA utilization, available data reveal that firms in food, electronics, textiles and garment industries are low users of FTA, while those in machinery and automotive industries use them relatively more. Also, a larger proportion of firms in the latter industries try to make use of the FTA preferences. Approximately half of the firms in the machinery sector and a third in the automotive sector made use of the FTA preferences. In the textile and garment sector this proportion did not rise above a third, while in the food and electronics it was the lowest. Only a fifth of the total number of firms reported utilizing FTA preferences. This pattern of industry-wise utilization confirms the fact that more protected industries with higher margins of preference tend to use FTAs more than other firms which are in industries that are less protected and face lesser margins of preference.

A greater proportion of Chinese firms were able to use FTAs because of the rapid ascendance of China and its firms in the global economy as well as fast build up of production networks in important industrial sectors like automotive and electronics. Similarly better utilization by Japanese firms was essentially due to a sophisticated industrial structure in Japan, which is based on large MNC activities. These MNCs function as anchors for production networks in the region. The Japanese business firms and MNCs also enjoy the benefit of private sector industry associations as well as public trade support institutions. In contrast to these, the Korean firms' utilization of FTAs was much lower because Korea began negotiating FTAs late, in 2004. Also, its initial FTAs were made with smaller economies like Chile and Singapore. In Korean FTAs, the margins of preference were also low.

An array of firm-level factors adversely affected utilization of FTAs. For one, firm size was found to have a decisive impact over the use or non-use of an FTA. Kawai and Wignaraja (2011) inferred that larger firms and MNCs were greater users of FTAs than the smaller ones. This corroborated the conclusions reached by Hiratsuka *et al.* (2009). This pattern of FTA use can be explained by the fact that there are fixed costs of using FTAs. First, acquiring knowledge regarding the FTA provisions, then adapting production patterns and business plans according to the complex tariff schedules and obtaining certificates of

<sup>7</sup> Kawai and Wignaraja (2011) chapter 2 extensively reposts and analyzes the ADB survey results. See pp. 33-73 for details. A total of 841 firms were surveyed in six Asian economies.

origin are all processes that require financial and human resources. Large business firms and MNCs are able to cope with these requirements much better than the small firms.

In the ADB survey noted the complex set of ROOs as a deterrent. It caused delays and high administrative costs. It is generally acknowledged that complexities related to ROOs is a challenging characteristic of Asian FTAs. ROOs are mutually agreed regulations that determine the country of origin of a product for the purpose of trade. In their ROOs partner countries determine and record the proportion of non-originating input in a product in order for it to qualify for preferential access under a FTA. In addition, a “cumulative zone” is determined in the ROO, which specifies the countries whose products can be considered to have originating status for the purpose of the agreement.

Opinions regarding the ROO related problems in Asia vary. There are some who believe that the ROO in Asia are complicated and have high administrative costs. However consensus on this issue is missing and Chia (2010) argued the opposite. According to this view, Asian ROOs are not only orderly and logical but they have created a foundation for a strong regional trading system. The survey referred to above in this section also provided some information on this issue (Kawai and Wignaraja 2011). Owing to the “spaghetti bowl” of overlapping FTAs in Asia, multiple ROOs do impose some burden on firms. Only 20 percent firms reported significant cost of multiple ROOs. As regards the countrywide perception, in the ADB survey highest (38 percent) negative experiences were reported by Singaporean firms. Chinese firms were on the other extreme, with only 6 percent firms reporting negative experiences of the ROOs. As regards the firm-wise experiences, the larger firms had higher levels of complaints regarding the multiple ROOs than small- and medium ones. The number of concluded agreements in the region increases is sure to increase with time, the ROO may become increasingly problematic for the trading firms. Therefore administrative efforts to rationalize ROOs are needed to mitigate the negative effects of the “noodle bowl”.

## *6. Persisting Challenging Issues and Inadequacies*

Notwithstanding the fact that regionalism in Asia was adopted late and became operational relatively recently it is facing several challenges. As decision-making in most Asian FTAs is based on forming a consensus, substantial and bold decisions are usually not attempted. Agreements in summits and conventions

can be obtained easily if the agendas are kept lightweight. In addition, members' commitments are frequently non-binding and voluntary. When international secretariats were created, the powers delegated to bureaucracies were limited and closely scrutinized by the member governments. There was little institutional independence for these secretariats (Haggard 2011).

As initially Asian FTAs were excessively focused on market access and did not engage in negotiating comprehensive and deep FTAs, lowering or eliminating tariff barriers was their customary beginning. Gradually comprehension and knowledge developed, the negotiation process matured and advanced towards the so-called behind-the-border issues. NTBs, trade in services, investment, IPRs, competition policy, government procurement and dispute settlement fell under this category. Although these issues have become increasingly important in multilateral trade and relationships between important trade partners, they made limited progress in the Asian FTA. This is a serious blemish of the Asian FTAs. The reason is that under the sponsorship of the GATT/WTO system, tariffs incessantly came down to a low level over the last six decades. The FTA negotiating countries need to know that benefits of an FTA now have to come through the behind-the-border measures, not from lowering or eliminating the tariffs.

Although recently negotiated agreements do go beyond liberalization of trade in goods only, Mercurio (2011) contended that the tariff line coverage of most agreements was not large. Lack of comprehensiveness of Asian FTAs and RTAs is a widespread problem. This means that the condition stipulated by Article XXIV of the GATT is not met by the Asian FTAs and RTAs. Article XXIV is the basis of all the FTAs and emphasizes that trade barriers be eliminated on "substantially all trade". It does not consent to exclusion of any sector of a FTA forming economy. Majority of agreements also have a long list of "sensitive" products, excluding them from the coverage. When they are not excluded, the tariff reductions are only meager. Often these sensitive products are those that are principal export items of the FTA partner economy. The inadequacy of coverage led to just criticism by the UNCTAD/JETRO (2008) study that regarded Asian FTAs as not being genuine free trade agreements.

Furthermore, the liberalization commitments in majority of the Asian FTAs are usually shallow. Too many exclusions and NTBs watering down their effectiveness and utility and they fail to enhance trade. Due to these limitations, the coverage and scope of FTAs becomes narrow, not very useful from the perspectives of regional trading firms. This discourages the intended beneficiaries



and they ignore the FTAs in effect and their utilization rate suffers. The FTAs have limited utility for the exporters and importers or the broader partner economies in general.

Asian FTAs have also been criticized for uneven coverage in their trade in goods. In a majority of them agriculture is not covered significantly and sufficiently. As the farm lobby in most Asian countries has a lot of political clout, it has frequently succeeded in pressurizing negotiating governments and keeping trade in agricultural products out of the agreements. This is another feature that goes counter to the grain of Article XXIV of the GATT/WTO and Article V of the General Agreement in Trade in Services (GATS). The WTO failed to prevent the proliferation of low quality trade agreements. Trade in agricultural products needs to be gradually liberalized and its coverage in future Asian FTAs needs to increase. By advancing in stages this coverage should be made comprehensive.

Although exhaustive country-wise information on the scope of Asian FTAs is sparse, inadequacy of data and information has been a matter of question. In general the Asian FTAs are an unusual mix of simple and limited ones, coexisting with a small number of comprehensive, mature and intricate ones. That being said, on balance a large number of Asian FTAs lack “WTO-Plus” orientation. The fact that many of them are not what is called “new age” FTAs is regarded as their persisting weakness. Apparently they were slow in keeping up with the global trend in this regard.

Considering FTAs for individual Asian economies, each one of them curiously has both, narrow FTA agreements that deal only with trade in goods, or trade in goods and services trade and the more in-depth WTO-Plus agreements. Two countries are exceptions to this generalization. First, Japan has all its agreements following the WTO-Plus format. Second, Singapore has the largest number of its agreements falling in the WTO-Plus category. An overwhelming majority of its BTAs and FTAs follow the WTO-Plus format. Korea and Malaysia also displayed an increasing propensity to form WTO-Plus kind of FTAs.

### III. Summary and Conclusion

The objective of this article has been to examine the characteristic features of contemporary regionalism in Asia. It identifies the positive and negative features associated with the free trade agreements (FTAs), which include bilateral trade agreements (BTAs). They have proliferated in Asia during the

first decade of the 21<sup>st</sup> century. There has been a marked transformation in Asia's regional architecture in a short span of a decade-and-a-half. This article demonstrates that after pursuing the path of market-led integration and multilateral or non-discriminatory liberalization, Asian economies turned energetically towards institution-led or discriminatory regionalism. This was a major tactical shift in their trade and integration strategy. Although ASEAN is the oldest institution of regional cooperation in Asia, the launch of Asian regionalism was not only slow but also did not progress cohesively for a long period. During the early stages there were poorly visualized attempts to build a formal regional community of Asian economies, but with little tangible success. Efforts to regionalize made under the aegis of the APEC forum petered out towards the end of the 1990s.

The mode and conduct of multilateral trade has been significantly transformed during the first decade of the 21<sup>st</sup> century. Asia could not possibly remain detached from this transformation. The importance of regionalism in multilateral trade has been on the rise. Also, the trade-investment-services nexus has formed and grown increasingly significant. This nexus combined with cross-border investment in production facilities. The next development was trade in parts, components and sub-assemblies, which has increased progressively and become a high proportion of total trade in several Asian economies. These new dimensions of trade have affected the formation of FTAs. Unlike the recent FTAs, BTAs and RTAs of the 21<sup>st</sup> century, the older ones were simpler and shallower in their composition, frequently dealing merely with phased tariff slashing and the ROOs.

As business firms now manufacture parts of their products across borders, the BTAs, FTAs and RTAs of the contemporary period need to take into account the new kind of trade barriers that have been created due to the changing mode of trade. The contemporary regional agreements need to be designed to facilitate the new modes of conducting business and trade. As regionalism grew in Asia, Asian economies formed a good number of BTAs and FTAs, although many of them were of the shallow variety. Consequently they remained limited and uneven in their impact. This policy error was made despite recognition of the fact that agreements that cover mere border trade measures and which are made between only two partners have a limited payoff in terms of increasing trade. Also, many of the FTAs are of the hub-and-spoke variety and overlap each other. This has led to operational inefficiency. Numerous Asian agreements have followed the GATT/WTO paradigm and focused more on border measures and

liberalization. Those entered into by ASEAN and China characteristically belong to this category. In contrast, the agreements formulated by Japan and Korea are known for being more comprehensive. They are not restricted to the GATT/WTO paradigm.

That the WTO-Plus FTAs are more functional and result-oriented was understood somewhat late in Asia. This explains the delay in turning to them. The US was an important trend-setter in this regard. The blueprint and norms followed by the US had a demonstration effect. Following their lead, many Asian BTAs and FTAs that were negotiated during recent years have gone beyond the GATT/WTO model. Asian economies that negotiated agreements over the last few years have preferred to enter into what became known as 'new age' or 'WTO-Plus' FTAs, which had rationally wider scope and therefore comprehensive ramifications for the FTA partners. The behind-the-border issues were covered well under the WTO-Plus FTAs. With the spread of this trend the three ASEAN-Plus-One agreements, negotiated with China, Japan and Korea, were WTO-Plus. The MNCs, which have been playing active roles in Asia, made Asian countries conscious of the added value of the WTO-Plus FTAs.

Numerous surveys reveal that the utilization rates of the FTAs in Asia are usually low. They compare unfavourably to that of NAFTA. This implies that the increasing intra-regional trade in Asia has not been the direct result of progress in regionalism. Recent country-level and industry-level studies have indicated several clear and cogent reasons for the under-utilization of FTAs in the region.

BTAs and FTAs in Asia still have several shortcomings which often render them lightweight and insubstantial. Many of them stem from the process of their initiation and negotiation. Because market access was frequently the primary goal, countries in the region did not consider it necessary to engage in negotiating comprehensive and deep FTAs. Also, tariff line coverage in most FTAs is not large. Many of them have long lists of 'sensitive' products. Liberalization commitments in many of them are shallow and do not go far. They are also uneven in their coverage of trade in goods. For instance, in many of them the agricultural sector is inadequately covered. This is one characteristic that goes against the grain of Article XXIV of the GATT/WTO and Article V of the GATS. There is also a dearth of statistical data regarding the Asian FTAs.

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