

# ***“Best Practices” in Regional Trading Agreements: An Application to Asia***

Michael G. Plummer\*  
Johns Hopkins University SAIS-Bologna  
Via Belmeloro, 11  
40126 Bologna  
ITALY  
tel: (+39) 051.2917.811  
e-mail: [mplummer@jhupbc.it](mailto:mplummer@jhupbc.it)

*Key words: Regionalism, economic integration, Asian trade and investment*

## **Abstract**

Regionalism in Asia, particularly in the form of free-trade areas (FTAs), is a recent trend that is becoming increasingly important. This has been disturbing to many, given the significance of trade and investment in Asian economic growth and development and the region’s key role in global commerce. Given this trend, the goal of this paper is to develop a blueprint, or a set of “best practices,” that can be used as a guide to FTAs in order to ensure that they approximate first-best outcomes to the greatest extent possible. Next, the paper applies this framework to the existing FTAs between Asian countries and their regional and extra-regional partners. The results suggests that the more advanced regional accords generally receive high grades with the notable exception of rules of origin, which tend to be even more problematic in the context of accords including one OECD country than those that do not.

\*This paper is based on research that was supported by the Office of Regional Economic Integration (OREI) of the Asian Development Bank (ADB). The author received excellent input and suggestions throughout the project from the OREI staff, especially Messieurs Kawai, Rana, Madhur, Wignaraja, and Capanelli. The paper was also presented at an OREI conference, “Brainstorming on Asian FTAs,” held at the ADB 20 March, 2006, at which he received useful comments from participants, in particular Robert Scollay, Peter Drysdale, Seiji Naya, Ted James, Chia Siow Yue, Mohammad Ariff, and Narongchai Akrasanee. He is also grateful to anonymous referees for useful and insightful comments on an earlier draft of the paper. All remaining errors are solely the responsibility of the author.

# “Best Practices” in Regional Trading Agreements: An Application to Asia

*Michael G. Plummer*  
*Johns Hopkins University SAIS-Bologna*

## I. Introduction

As of the end-2005, there existed 300 regional trading agreements between WTO members, up from 130 as of January 1, 1995.<sup>1</sup> Regionalism has come late to Asia; apart from the ASEAN Free-Trade Area (AFTA) in 1992, no Asian country had a significant bilateral or plurilateral accord in place prior to 2000, whereas today there exist at least a dozen major free-trade areas (FTAs) and many more in the works. Given the uncertain outcome of negotiations at the multilateral negotiations under the Doha Development Agenda, the regionalism movement currently constitutes the most significant trend in international commercial policy. Unlike multilateral liberalization, regionalism tends to be controversial in economic and policy circles for a variety of reasons, most of which being linked to the fact that preferential trading arrangements, such as FTAs and customs unions, are by their very nature discriminatory. Why adopt “second-best” policies, such as free-trade areas, when the first-best policy can be obtainable through multilateral negotiations? Others would argue that regionalism and multilateralism are consistent, even, perhaps, reinforcing. They would cite the fact that the vast majority of regional trading arrangements have been negotiated over the past decade, when international trade and investment have boomed and globalization has intensified. This is not to say necessarily that regionalism *caused* this expansion in trade, but it does give *prima facie* evidence that they are compatible.

---

<sup>1</sup> WTO website, [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm), accessed September 11, 2005.

The disagreement among mainstream economists over this issue pertains to means, rather than ends. Each school advocates global free trade (and investment) as an ultimate goal, but they differ in opinion as to whether or not regionalism is a stepping-stone in this direction, or a bottleneck. This split is arguably the first major policy difference that has emerged among international trade economists since the “new international economic order” debate of the 1960s.

Could there be a synthesis? Yes. In fact, the basic idea of “open regionalism,” which emerged in the context of the Asia Pacific Economic Cooperation (APEC) forum, is explicitly to unite the region through non-discriminatory means. The idea found its theoretical origin in the Kemp-Wan Existence Theorem (Kemp and Wan 1976), which stipulated the conditions of a Pareto-optimal customs union, i.e., one in which all countries would be better off.<sup>2</sup> By liberalizing unilaterally but in concerted fashion among countries producing the majority of world output, “open regionalism” under APEC was advocated as a first-best approach to regionalism and became enshrined in the APEC “Bogor Vision” of open trade and investment in the region by 2010 (2020 for developing countries). However, while the economics of such an approach would be generally applauded by both the pro- and anti-regionalism camps, the politics were clearly second-best (at the most): “value-added” in trade liberalization toward the Bogor goals has been marginal, and the first deadline is only four years away. The vagueness of the commitment (e.g., what “open trade and investment” means, the question of whether or not “open regionalism” should be non-reciprocal for non-partners in order to reap the benefits), and its “voluntary” nature have taken away any political urgency. While the countdown to 2010 may create some momentum, the political obstacles will be daunting.

---

<sup>2</sup> In short, this would be possible if the customs union were to: (1) set the common external tariff such that trade with the outside world not be affected (thereby setting trade diversion to zero); (2) impose free trade within the customs union, such that efficiency gains would be generated; and (3) provide a compensation mechanism for any country that would be a net loser.

Instead bilateral and plurilateral (defined here as between one or more countries and one regional group, or two regional groups) accords ostensibly have emerged to fill the gap left by APEC in “uniting” this region. Practically all countries in Asia now have at least one bilateral agreement in place--with more on the way.

Given that regionalism in Asia and, indeed, the entire world is a “fact on the ground,” the main objective of this paper is to go beyond the traditional “building blocs versus stumbling blocs” debate by underscoring the potential benefits of bilateral and regional agreements *under the condition* that they follow “best practices”<sup>3</sup>, which we develop in Section III. As an application of these “best practices,” which have been called the Ten Commandments of Regionalism<sup>4</sup>, we analyze existing regional accords between Asian countries and their regional and extra-regional partners in Section IV. In setting the stage for this analysis and providing necessary background information, we review exiting regional accords in Section II. Section V gives some concluding remarks.

## **II. Bilateral and Regional Accords in Asia**

There have been many excellent surveys of regional economic integration in Asia (e.g., Kawai 2005, Naya 2002, Asian Development Bank 2002). Hence, this section focuses on analysis of the various accords currently in existence (and for which there is sufficient “transparency” that allows us to analyze them). The flurry of negotiations makes it quite difficult to keep up with proposed FTAs, which tend to start off with a bilateral trade agreement and/or a

---

<sup>3</sup> By “best practices” we are referring to those that approximate a first-best solution to the greatest extent possible in practical terms.

<sup>4</sup> I am grateful to Narongchai Akrasanee, who used this term as Chair of a session of the Asian Development Banks, “Brainstorming on Asian FTAs” conference, held on 20 March 2006, at which I presented an earlier version of this paper.

formal framework agreement. Given that our ultimate goal will be to see to what degree these agreements conform to a “building bloc” or “outward-oriented” approach to commercial policy (and how to improve them), we do not include these in this study, as the results are not yet known. For a July 2005 survey of various accords in the Asia-Pacific region, see Feridhanusetyawan 2005.<sup>5</sup>

The texts of modern Asian FTAs are complicated and can be quite diverse, though there tends to be considerable overlap in terms of topics addressed. In order to simplify the task of reviewing these accords, we group them into three different types. i.e., Full FTAs; Limited FTAs; and Framework Agreements, and summarize their salient components in Table 1. There can be significant variation within each of these groupings, but we will get more into a taxonomical review of their coverage and depth in Section IV.

Full FTAs tend to be highly comprehensive, covering both goods and services and usually investment. A good benchmark for Full FTAs are Singapore’s bilateral agreements with developed countries, which are all advanced, as is clear from Table 1 (and discussed below). Limited FTAs usually contain a positive list of goods and/or services that are accorded tariff preferences, to be expanded gradually. They tend to be a first step towards stronger integration. As far as Framework Agreements are concerned, those that involve ASEAN stipulate objectives to strengthen and enhance cooperation on economic, trade, and investment matters, to liberalize progressively and promote trade and to facilitate the more effective integration of newer ASEAN members. In general, they lay the foundation for negotiations in future FTAs.

There appears to be general conformity on issues undertaken in negotiations under Full FTAs. Hence, in Table 1 we do not detail all possible features of these agreements (in order to

---

<sup>5</sup>An adequate summary of the results of the various empirical models looking at the economic effects of these arrangements is beyond the scope of this study, though we do include references to specific, pertinent studies. For a summary of the effects of various initiatives, see Feridhanusetyawan 2005, Naya and Plummer 2005, and Scollay and Gilbert 2002.

save space). Other components that emerge in these agreements include: (1) abolition of tariffs and non-tariff barriers on included projects<sup>6</sup>; (2) anti-dumping provisions; (3) customs procedures, essentially modelled on “best practices”; (3) professional services (either with details included specifically in the agreements or as a framework for future negotiation); (4) dispute-settlement mechanism (of various degrees of detail); and (5) balance of payments safeguards, generally referring to the IMF protocols and the GATT 1994 “Understanding on Balance of Payments Provisions”.

Here are some salient observations regarding the components of these agreements:

1. As the only major sub-regional initiative in East Asia, AFTA is unique in many ways. We have classified it here as a “Full FTA” but this might be controversial. AFTA continues to be a fairly “loose” agreement, with extensive coverage of goods but limited *real* coverage of anything else except investment, and investment is covered under the AIA/AIC agreements (i.e., outside of, but obviously related to, AFTA). There is an ASEAN Framework on Services (AFS) but its coverage continues to be relatively limited. In fact, creating essentially a free market in services under the proposed ASEAN Economic Community (AEC)<sup>7</sup> would merely be a matter of building on the AFS. AFTA’s protection of intellectual property rights (IPR) essentially refers to WTO TRIPS. The monitoring and enforcement mechanisms still need to be worked out properly before true “deep integration” emerges; settlements within AFTA at present tend to be *ad hoc*.

---

<sup>6</sup> With the exception of AFTA, this implies an abolition of tariffs and non-tariff barriers for included projects, which in the case of Full FTAs tends to be fairly comprehensive. AFTA is an exception in that it defines free trade to be tariffs of 0-5 percent.

<sup>7</sup> The AEC was proposed by the ASEAN Leaders in November 2002. In theory, it would create a region in which trade in goods and services, capital, and skilled labor would flow freely, though the details have yet to be worked out.

**Table 1**  
**Asian Bilateral and Plurilateral Accords**

Year	Partners	Type	Main Features
1992	ASEAN (AFTA)	Full FTA	Not fully comprehensive; fairly simple ROO; separate framework agreements on services and FDI as well as on IPRs (builds on TRIPS).
2000	ANZSCEP (SGP/NZ)	Full FTA	Comprehensive; ROO: general VA rule (40%); “negative list” in services; FDI essentially fully covered; IPR included: TRIPS; general commitments on competition; only APEC non-binding rules on government procurement
2000	EFTA-SGP	Full FTA	Comprehensive; complicated product specific ROO; FDI essentially fully covered; IPP included: TRIPS; refers to WTO Government Procurement Agreement
2002	JSEPA (J/SGP)	Full FTA	Comprehensive; complicated, product specific ROO; “negative list” in services; separate financial-services and capital market development measures; FDI essentially fully covered; IPR included, doesn’t refer to TRIPS; builds on WTO Government Procurement
2003	USSFTA (US/SGP)	Full FTA	Highly Comprehensive; 10 year implementation; restrictive mainly in textiles and apparel; complicated, product specific rules of origin (ROO), including “Integrated Sourcing Initiative”; generous “negative list” in services; capital controls only as safeguard; FDI essentially fully covered; extends WTO TRIPS; limits on SOE competition; builds on WTO Government Procurement.
2003	SAFTA (SGP/Australia)	Full FTA	Comprehensive; simple general ROO: 30% or 50% local value content; “negative list” in services, no safeguard measures except for BoP purposes; FDI covered; separate, additional commitments for financial

			services to ensure transparent market access; measures on movement of persons included; builds on TRIPS; Australia not signatory to WTO GPA, but government procurement covered
2003	ECOTA (Afghanistan/Iran/ Azerbaijan/ Kazakhstan/ Pakistan/Turkey/ Tajikistan/ Turkmenistan/ Uzbekistan/Kyrgyz Republic)	Limited FTA (Parties recently agreed to sign FTA in 2006)	Covers trade in goods: positive list to be gradually expanded so as to cover at least 80% of the goods on tariff lines; IPRs included: protection shall be gradually improved in order to be of a level corresponding to the standards of multilateral agreements within 8 years
2003	Korea/Chile	Full FTA	Comprehensive; restrictive in agriculture; complicated product specific ROO; “negative list” in services, financial services not included; FDI covered; builds on TRIPS; Chile not signatory to WTO GPA but government procurement covered.
2004	India/Mercosur	Limited PTA	Positive list of goods with tariff preferences; general 40% ROO
2004	SJFTA (Jordan/SGP)	Full FTA	Comprehensive; complicated product specific ROO, separate provisions for textiles and apparel; investment governed by separate bilateral treaty (2004); IPR refers to WTO commitments;
2004	Japan/Mexico	Full FTA	Comprehensive; fairly complicated and diverse ROO; services and FDI broadly included; IPRs not extensively covered, but commitment to multilateral agreements; Mexico not signatory to WTO GPA, but government procurement is covered
2005	Thailand/Australia	Full FTA	Comprehensive; complicated product specific ROO; special safeguard measures for sensitive agricultural goods; services broadly included and full coverage of FDI; builds on TRIPS; government procurement not covered, but commitment to add as soon as possible



2005	CECA (India/SGP)	Full FTA	Comprehensive; ROO: generally 40%, but includes product-specific rules as well; services and FDI broadly covered; “negative list” in services; measures on movement of persons included; commitment to develop IPR co-operation, no mention of TRIPS; does not cover Government Procurement, India not signatory to WTO GPA;
2005	KSFTA (Korea/SGP)	Full FTA	Comprehensive; 10 year implementation; complicated ROO, product specific rules that apply only to non-originating materials; “negative list” in services; FDI and financial services broadly included, some sector specific commitments for financial services; provisions on movement of persons; builds on TRIPS; parties signatories to WTO GPA
2005	Trans-Pacific SEP (Brunei/Chile/NZ/SGP)	Full FTA	Not fully comprehensive; complicated and product specific ROO; “negative list” in services that excludes financial services, but Parties commit to commence negotiations on financial services chapter in 2 years; FDI not covered; builds on TRIPS; parties not signatories to WTO GPA but government procurement extensively covered
2006	SAFTA (Bangladesh/Bhutan/India/Maldives/Nepal/Pakistan/Sri Lanka)	Limited FTA	Not comprehensive; tariff reduction to 20% (non-LDC) or 30% (LDC) in 2 years and to 0-5% in 5 years; sensitive goods are exempt (positive list); generally reserves favorable treatment to LDCs
2005	Korea/EFTA	Full FTA	No text available yet; comprehensive agreement that provides for liberalisation of trade in goods, services and public procurement and protection of IPRs. Negotiations on separate agreements on agriculture and investment were also concluded.
2001	ASEAN-CER (ASEAN/Aus/NZ)	Framework Agreement for CEP	Goal is to double trade and investment between the regions by 2010; negotiations for FTA started in 2005
2003	ASEAN/Japan	Framework Agreement	Parties agree to negotiate in order to progressively liberalise trade in goods and

		for CEP	services and create a liberal and transparent investment regime. The implementation of measures leading to the CEP, including elements of a possible FTA, should be completed by 2012
2004	ASEAN/India	Framework Agreement for RTIA	Parties agree to negotiate in order to establish a RTIA (Regional Trade and Investment Area) which includes a FTA in goods, services and investment. Negotiations are to be finalized by 2005 (FTA and ROO) and 2007 (trade in service and investment)
2002	ASEAN/China	Framework Agreement for FTA	Parties agree to negotiate in order to establish a full FTA by 2012. Newer ASEAN members are allowed a longer timeframe (2015)

2. As was noted above, the other subregional groupings in Asia, i.e., SAARC's SAPTA and the ECO's ECOTA, tend to be far less advanced than ASEAN. We include these as "Limited FTAs" but in effect they are just preferential trading arrangements, similar in approach to ASEAN's earliest Preferential Trading Agreement (PTA) of the 1970s. While SAPTA does allow for special treatment of its least-developed member-states, coverage is unlikely to stimulate trade. They offer relatively limited positive lists and unimpressive margins of preference (as was the case with the original ASEAN agreement), though some items are accorded a higher margin of preference for least-developed member-states in SAPTA. Rules of origin in these agreements tend to be relatively simple, but as the margins of preference are so limited, there apparently would be no need even in theory for a more complicated rules of origin approach. Enforcement mechanisms are weak. Investment is not dealt with in these agreements, though the ECO has been working on an investment framework (similar in approach to "Bilateral Investment Treaties"). In sum, these agreements could almost as easily have been classified as "Framework Agreements" as they are

merely first steps in what will be a long process.<sup>8</sup> They are mainly political in nature; as such, they are, perhaps, paving the way for deeper cooperation in the future, as the earlier PTA did. But at present they are superficial at best.

3. With respect to plurilateral accords, that is, between a region and a country or another region, no Full or Limited FTA currently exists, though ASEAN has Framework Agreements towards this end with Australia and New Zealand, Japan, India, and China. No doubt this reflects the difficult nature of negotiating a bilateral accord in the context of an *FTA*, rather than a *customs union*. Indeed, the EU, which from its beginning as the EEC, has been able to negotiate myriad agreements with countries and even regions with relative ease due to the fact that it has a united commercial policy. No such united policy exists in the context of an FTA, and ASEAN commercial policies, though relatively liberal compared to other developing countries, tend to be highly diverse.<sup>9</sup> Still, ASEAN has always had a preference to negotiate with partners as a group, in part out of fear that separate trade deals could hurt the process of economic integration within ASEAN itself.

With respect to the Framework Agreements themselves, ASEAN and Australia and New Zealand (through their “Closer Economic Partnership”, or CEP, which is an advanced FTA) finally followed up on its Framework Agreement intentions in March 2005 with negotiations toward the creation of an FTA. ASEAN and CEP ministers recently finished their 10<sup>th</sup> consultations (29 September 2005). China has moved much more quickly; after its “early harvest” program with ASEAN in January 2004, it finalized a deal on trade in goods and a blueprint for FTA negotiations by the end of that year. The agreement on trade in goods began implementation in July 2005 and China and ASEAN are currently working on services and investment; the fourth

---

<sup>8</sup> We label them as “Limited FTAs” only because they are written up as actual accords, rather than a framework for future negotiations.

<sup>9</sup> For example, Singapore is essentially a free-trade country and one of the most advanced economies in the world; the CLMV transitional economies are far less open and sophisticated.

consultations between Chinese and ASEAN senior officials began on September 26, 2005.<sup>10</sup> Still, it is important not to exaggerate how much the trade and goods agreement itself covers; to date, tariff lines enjoying zero tariffs only constitute 4.8 percent of the total.<sup>11</sup> The services agreement is expected to be signed at the 11<sup>th</sup> ASEAN Summit in Malaysia in December.<sup>12</sup> The ASEAN-India Framework Agreement stipulates that the first phase of negotiations on an FTA (and the rules of origin) should be complete by the end of 2005, leaving the agreement on services and investment for 2007.

4. Bilateral accords with key non-regional OECD members, in particular the United States, the EU, Japan, and Australia, are in many ways quite similar. These tend to be “Full FTAs” with extensive product coverage for goods and services, especially for the agreements involving Singapore (Singapore has FTAs with Japan, the United States, Australia, and New Zealand<sup>13</sup>), and include the many areas cited above under Full FTAs. In fact, the United States has said explicitly that it would like the US-Singapore FTA to be a “model” for bilateral FTAs with all qualifying ASEAN

---

<sup>10</sup> [http://www.shanghaidaily.com/art/2005/09/26/191989/China\\_and\\_ASEAN\\_focus\\_on\\_FTA\\_talks.htm](http://www.shanghaidaily.com/art/2005/09/26/191989/China_and_ASEAN_focus_on_FTA_talks.htm)

<sup>11</sup> [http://english.people.com.cn/200509/29/eng20050929\\_211656.html](http://english.people.com.cn/200509/29/eng20050929_211656.html)

<sup>12</sup> [http://english.people.com.cn/200509/29/eng20050929\\_211656.html](http://english.people.com.cn/200509/29/eng20050929_211656.html)

<sup>13</sup> EFTA also has an FTA with Singapore, but the EU does not. However, the EU did launch the Trans-regional EU-ASEAN Trade Initiative (TREATI) talks in April 2003 to improve economic relations between the EU and ASEAN regions. Its practical emphasis was on health and hygiene standards and the protection of intellectual property rights, with trade barriers and other issues left to be handled at the Doha Development Agenda talks. As is discussed below, in April 2005, the EU Trade Commissioner, Peter Mandelson, and the ASEAN Trade Ministers agreed to set up a “Vision Group” to consider such new cooperative initiatives, including a possible EU-ASEAN Free-trade Area.

countries,<sup>14</sup> and at the time of this writing it had recently finished its fifth round of bilateral negotiations with Thailand. The United States and Japan are both signatories to the WTO Government Procurement Protocol, and their bilateral FTAs tend to build on these, even with partners that are not signatories. Australia is not a signatory to the WTO Government Procurement protocol but it does tend to include government procurement in its arrangements. New Zealand explicitly includes the APEC Non-binding Principles on Government Procurement in its FTA with Singapore (ANZSCEP).

All OECD partners include IPR chapters that extend and/or reinforce WTO TRIPs, and investment provisions tend to be fully covered. Indeed, in these agreements the WTO “Singapore Issues,” which it was said “doomed” the WTO Cancun Ministerial, are addressed essentially in full. The agreements with the United States tend to be the deepest and include such sensitive sectors as financial services, capital controls, and competition policy, including competition by state-owned enterprises.

5. Japan’s first FTA was its agreement with Singapore in 2002. The agreement is comprehensive, but somewhat less so than the US-Singapore agreement. Since then, it has reached FTA accords several ASEAN countries, most recently (August 2005) with Thailand. Details are either unavailable at present regarding these agreements or are still being worked out,<sup>15</sup> such as in the case of Japan-Thailand. This FTA is slated to be signed in April 2006 with a goal of implementation five months later. It would appear, however, that while there will be substantial coverage of the auto sector (an area which proved to be extremely difficult in the negotiations) included agricultural

---

<sup>14</sup> There are two conditions: (1) the ASEAN member state must be a member of the WTO; and (2) it must have a Trade and Investment Facilitation and Liberalization (TIFL) accord in place, meaning it must have normal trade relations with the United States.

<sup>15</sup> Bilateral trade agreements have been worked out with Malaysia and the Philippines.

goods will be fairly limited (e.g., rice and sugar are excluded). Rules of origin considerations still need to be worked out.

6. The EU has not yet negotiated an FTA with any Asian country. It may appear odd that this economic grouping, which more than any other has led the regionalism movement and has often served as a model for ASEAN and others, has not joined other OECD countries in forming FTAs in the region. As Asia is the most dynamic region in the world, such neglect obviously comes with considerable risk. In part, this neglect is due to the fact that the EU's attention has been focused elsewhere: in May 2004, it enlarged to include 10 additional Central and Eastern European members; it has been preoccupied with the EU Constitution and associated referenda, which eventually ended in failure (for the time being); it has been focusing on internal growth problems and debates surrounding its commitment to become the most competitive knowledge-based economy in the world by 2010 (the "Lisbon Agenda"); and its primary trade initiatives in Asia have focused on dealing with China in the wake of the expiry of the Agreement on Textiles and Apparel in January 2005. However, the EU has always kept a close watch on these trends in Asia. Its response to APEC was to create ASEM, but it has done little with ASEM (as APEC itself has done little in terms of deeds) outside of basic consultations and studies as to how to improve bilateral relations. Moreover, the EU is now rising to the challenge: In April 2005, the EU and ASEAN trade ministers agreed to set up a "Vision Group" to consider such new cooperative initiatives, including a possible EU-ASEAN Free-trade Area.

In sum, Asia has been successful in negotiating a number of bilateral and regional FTAs, and has plans for several plurilateral agreements. This process is very recent; outside of AFTA (1992), the first bilateral FTA in the region, between Singapore and New Zealand, was signed only in 2000. If one includes all of the proposed agreements at various levels of discussion

and negotiation, as well as the others that will emerge in response to these, it is easy to forecast a complicated web of formal relationships, of various degrees of depth, binding the region together. It is not difficult to understand and appreciate the anti-regionalism camp's concern that such a "spaghetti bowl" of regional accords could be potentially damaging to the global trading system. The EU has had to live with such a system for decades, and it has created considerable complications in certain areas (Messerlin 2001).<sup>16</sup> We now tackle this debate in some detail.

### **III. Turning Stumbling Blocs into Building Blocs: How to Minimize Spaghetti-bowl Effects**

The "spaghetti bowl" effect refers to the Italian pasta dish famous for being highly intertwined. The term is used generally in a derogatory manner by critics of regionalism to underscore problems in terms of coverage diversity, overlap, and "contradictions" associated with a country's having many different preferential trading agreements. As was noted above, this is potentially a real problem in the global marketplace. A strong advantage of MFN in the WTO framework is that it generally (but not totally) avoids this problem.

Exactly how big is this problem, and how might countries minimize the associated effects? We endeavor to address these issues in this section. We begin with a conceptual/analytical approach to the problem; rather than reviewing the "building blocs versus stumbling blocs" debate on this issue as has been handled elsewhere, we focus on some of the advantages that "deep" regional accords might have over WTO-based agreements. This result is not guaranteed; hence we next

---

<sup>16</sup> For example, bilateral agreements with Mediterranean countries eventually led to the new to create a plurilateral "Global Mediterranean Policy." A variety of influences has led the EU to abandon its Lomé Agreements in favor of the Cotonou Agreements, which essentially creates a series of FTAs with former colonies (ACP countries). Presently over 80 percent of EU total trade takes place under its "pyramid of preferences," rather than WTO-MFN.

proceed to develop a framework that might be used to minimize the negative implications of preferential trading arrangements in general and “spaghetti bowl” effects in particular. Given that regionalism in Asia is gaining momentum and will likely continue to do so for some time, such guidelines are important in order to keep the agreements efficient, open, and supportive of global trade and investment.

***a. Introductory Comments Regarding Regionalism versus Multilateralism***

It is important to note first of all that, while WTO accords do impose a certain symmetry, they do not guarantee it. For example, the WTO sets out rules of behavior in terms of anti-dumping that are no doubt superior to a system void of rules. But they do not harmonize all anti-dumping practices. Member-states continue to have a great deal of flexibility in this regard (and probably always will have, at least in the context of the WTO). The existence of a WTO Valuation Agreement on customs is extremely useful but there continues to be considerable variation in terms of adopted practices across WTO member-states. The same can generally be true of the Singapore Issues, IPR protection, and the like, in which the WTO often has little or incomplete jurisdiction (and likely will not have much more for the foreseeable future).<sup>17</sup> A salient disadvantage of the multilateral approach under the WTO is that harmonization of such rules and policies has proven to be extremely difficult, and progress highly limited, due to the diversity of its membership, as well as disagreements as to how comprehensive the mission of the WTO should be.

The usefulness of regional agreements—and certainly one reason for their popularity (see World Bank 2005, ADB 2002, Kreinin and Plummer 2002, Frankel 1998)—lies in their ability to drive integration and cooperation in areas that have hitherto been neglected by the WTO, e.g., in

---

<sup>17</sup> Indeed, one reason for the failed WTO Ministerial at Cancun is related to the rejection of reform under the rubric of the Singapore Issues, in particular investment policy, by developing countries.



terms of tariff, non-tariff and non-border measures. Thus, while it is true that a multilateral approach would dominate a bilateral/regional strategy if all the same measures are included and harmonized/liberalized to the same extent, it is not a dominant strategy once we relax this (unrealistic) assumption of symmetry in liberalization.

In fact, when critics of regionalism demonstrate the inferiority of preferential treatment relative to free trade, frequently the analysis falls into “straw man” analysis. For example, the rules of origin constraints under NAFTA, discussed below, in automobiles (62.5 percent) and certain textile products (effectively 100 percent) do not fit the criteria for “open regionalism” under any definition of this term. However, these are probably among the most obvious out of relatively few such divergencies in what is in reality a liberal agreement. Besides, for NAFTA, the effective benchmark should be the *status quo*, not *free trade*. Would auto and textile imports to the United States have been much less restrictive without NAFTA? Not necessarily. In fact, admitting that associated trade diversion does have costs, we cannot say that NAFTA closed those markets, since failure to meet NAFTA rules of origin meant recourse to the *status quo*. The *status quo* did not become more protective; in textiles and apparel, the US market has become *more* open with the expiration of global import quotas on January 1 2005 (under Uruguay Round commitments). Again, Mexican textiles receive preferential treatment and, hence, trade diversion is a cost to be borne by non-partners and US consumers, but there still is an associated trade creation effect that would have not occurred had there been no NAFTA.

Many American economists supported NAFTA not for love of regionalism or their belief that it would have great effects on allocative efficiency in North America through the liberalization of tariff and non-tariff barriers, which were, after all, low in the aggregate.<sup>18</sup> Effects

---

<sup>18</sup> These were higher in the case of Mexico, but as Mexico is a small economy compared to the United States and Canada, the net effects could not be large.

on the United States and, especially, Canada, were estimated to be small. Rather, it was supported in the main because it would lock in the Mexican economic reforms leading up to NAFTA and would set the stage for further liberalization. Given the history of economic volatility in Mexico, NAFTA as a “policy anchor” was deemed to be extremely useful. Once NAFTA began to be implemented in full force (i.e., after the Mexican crisis in December 1994, which had little or nothing to do with NAFTA directly), the net effect on macro performance in Mexico has been very positive (Kose and Rebucci 2005). In 2005, the US government gave a high priority to an FTA with Central America (“CAFTA”) in hopes that it would have the same stabilizing effect.<sup>19</sup> And while the percentage of total Mexican trade has risen to somewhat over three-fourths (from two-thirds) in the wake of NAFTA, a result of both trade creation and diversion, one cannot say that Mexico has been “captive” in NAFTA. In fact, Mexico now has negotiated some 39 FTAs. Moreover, openness of the Mexican economy has allowed non-partner countries to benefit; the financial sector in Mexico, for example, is characterized by a considerable European presence.

Again, this is not to argue that restrictive rules of origin and other inward-looking clauses in regional trading arrangements do not constitute a problematic aspect of preferential trading arrangements. As is argued below, a consistent, liberal, across-the-board rules of origin policy is the least distortionary in a second-best world. But we should not exaggerate its absolute importance in the regionalism debate.

A related point was underscored analytically in Wonnecott and Wonnecott (1981) in terms of tariff liberalization. Early advocates of a purely non-discriminatory approach to tariff liberalization (in the tradition of Cooper and Massell 1965 and Berglas 1979) maintained that such a

---

<sup>19</sup> It is interesting to note that CAFTA was passed in the United States only after personal lobbying by the President himself, and then the pact passed by only a two vote margin in the House of Representatives. But Congressional opposition was not due to a dislike of regionalism per se but rather a dislike of trade liberalization, that is, it was generally opposed on traditional protectionist grounds.

strategy was always superior to a regional approach. Every country has within its own powers the ability to unilaterally liberalize its commercial policy regime, and if this is done on a non-discriminatory basis, there will be only trade creation and no trade diversion. Hence, unilateral trade liberalization “dominates” FTAs and customs unions, as the latter generate trade diversion as well as trade creation. Wonnecott and Wonnecott (1981) pointed out that these “unilateralists” missed the obvious point that countries engage in regional trade negotiations in order to open up their partner(s)’s market, rather than merely to extract gains through greater domestic liberalization. Thus, while trade diversion is eliminated under a non-discriminatory approach, the fact that foreign markets are left untouched without negotiation would suggest that the welfare gains would be limited. Indeed, an FTA could be superior to unilateral liberalization if the gains in terms of increased national welfare due to foreign reductions in tariff barriers (for example, through gains to domestic exporters and improvements in terms of trade) were greater than the losses due to trade diversion.

Moreover, time *and* depth matter. Many protagonists of a purely multilateral approach to economic cooperation tend to present arguments without a well-defined time horizon. But time is important when considering the present discounted value to national welfare of a regional trading accord compared to multilateral free trade. A heuristic example may help underscore this point. Suppose, say, Indonesia, has an option to create an FTA with Japan, but its leaders know that this will have some costs in terms of trade diversion. The “first-best” (global free trade) policy, its leaders might reckon, would ultimately be the best deal for Indonesia, as non-discriminatory free trade would have no trade diversion and could maximize trade creation. But timing would be crucial as to whether or not Indonesia should agree to the accord from an economic perspective. Suppose that global free trade were an option immediately. *Ceteris paribus*, free trade would be better than the deal with Japan. But what if the FTA with Japan were possible today, and yet global

free trade would take 5 more years? Which would be better? It would depend on what the Indonesia-Japan deal would look like (relative to the global deal); nevertheless, it could be that free trade would still be worth the wait. But what if free trade were to take more like 20, 30, or 40 years? After all, the GATT/WTO has existed for almost a half-century, and global free trade is nowhere in sight. Of course, this type of analysis will be a function of the type of regional accord, in particular if it is inward-looking or outward-looking. If it were the former, the deal with Japan could end up being very much to the detriment of Indonesia. As we shall see in terms of the “building bloc versus stumbling bloc” debate, the type of agreement is of the essence. But it would also be important to know what the multilateral deal would be. If a regional accord entailed far more reforms *vis a vis* market-friendly, efficient policies at macro and micro levels whereas global free trade meant merely the abolition of tariff and non-tariff barriers, the former could still potentially be as good or better than the latter.

Indeed, the point expressed above in terms of the Wonnecott and Wonnecott framework is even more important when applied to modern FTAs, which include non-tariff and non-border policies that the WTO does not yet touch (and may never, in some cases) and for which a unilateral approach would have limited benefits. The extensive tariff liberalization over the past two decades in East Asia, and more recently in parts of South Asia, would suggest that countries have *increasingly less* incentive to engage in the WTO should it continue to focus on tariffs and mostly on manufactured products and limited agricultural goods. While progress was made at the Uruguay Round, further integration of the international marketplace will be more difficult at the margin, for the remaining areas that now have the greatest potential for improving international interchange tend to be the most delicate, in terms of their traditional political sensitivity (e.g., various agricultural products and areas in which a country has comparative disadvantage), national-sovereignty questions (e.g., with respect to IPR, labor and environmental protection), and the power

over domestic regulation (e.g., the Singapore issues). Progress in these areas at the WTO has always proven to be exceedingly difficult, and they continue to be so today. The Seattle Ministerial, Cancun Ministerial, and Hong Kong WTO Ministerial in December 2005 testify to this.

Herein lies the attraction and, in many ways, advantage that regionalism holds over multilateralism: it allows like-minded countries to address far more issues and in a shorter period of time. By choosing one or several like-minded partners, countries are able to make more progress in terms of deep integration than they could in the extremely-diverse WTO context. Recent interest in regionalism on the part of OECD countries that have traditionally shunned them (the United States, Japan, South Korea, Australia and New Zealand, and so on) derives from their desire to address these many issues and their understanding that they cannot accomplish them in the context of the WTO, or at least not in the short/medium run. A successful conclusion to Doha would, perhaps, have an impact on the momentum behind the regionalism movement, but this is not guaranteed: the incentives for new bilateral/plurilateral accords, as well as for deepening existing ones, would remain.

But what is guaranteed through a successful Doha Development Agenda is a reduction in the potential negative effects of these regional agreements and overall less risk to the integrity of the international trading system. Moreover, to the extent that Doha can, indeed, make Article XXIV more effective in ensuring that these new regional agreements will be outward-looking and consistent with a WTO approach, the risks associated with regionalism could be significantly mitigated.

Such important steps forward would be cheered by all pro-globalization economists, regardless of whether they are in the pro- or anti-regionalism camp. Nevertheless, the challenges are great, perhaps overwhelming, at least for Doha. Success, assuming it arrives, in the current WTO negotiations would be defined at a much more modest level. In the meantime, it is a good

working assumption that the current regionalism trend will continue—indeed, intensify—in the short- and medium run.

Hence, the obvious question emerges as to how regional agreements themselves can work in favor of global free trade. We approach this question from two perspectives. First, there is the more “macro policy” perspective relative to the “building blocs versus stumbling blocs” debate. Next, we look at the nuts and bolts of regional agreements and ask how their very components can be made to minimize any associated policy distortions, and how they may be harmonized in order to avoid the “spaghetti-bowl” effect discussed above. In other words, we ask the question: given that regionalism is a second-best policy, to what degree and how can it be made to resemble the first-best as much as possible? As noted above, Kemp and Wan (1976) were the first to show that a customs union could be made Pareto Optimal, i.e., first best, focusing on tariff adjustments. We will try to revisit this approach in the broader context of policy formation in the context of non-border issues.

#### ***b. A Taxonomy of Relevant Policies and Approaching First-Best***

The desirability of preferential trading agreements in general and “stumbling bloc versus building bloc” considerations in particular constitute the most divisive debate among mainstream international trade economists. But while there is no consensus, essentially all would agree that the relationship between regionalism and overall policy reform is of the essence. To the extent that regionalism is open and supports a market-friendly economic reform process, it would be welcomed by all. The debate outlined above centers around this question.

Even though a great deal has been written on this and related issues, little has been done focusing on specific components of regional trade groupings themselves and how they influence the debate. True, there are many anecdotes, with rules of origin being a favorite example

as to how FTAs embody a good deal of hidden protectionism. However, we have argued that focusing on such anecdotes may not be productive; what matters is the entire picture and how it compares to the *status quo*. In this subsection, we endeavor to highlight some of these component policies and suggest how they might be developed in order to minimize distortions and favor an outward-oriented approach...in other words, how the “*spaghetti-bowl* effect” might be minimized and turned into a “*lasagna* effect”.<sup>20</sup>

APEC and the Pacific Economic Cooperation Council (PECC) have also taken up the issue of best practices in FTAs, but the analysis does not go far beyond the expression of general principles and guidelines.<sup>21</sup> They stress that FTAs should embrace non-discrimination (presumably where possible, as FTAs by their very nature are discriminatory), comprehensiveness, flexibility, WTO-consistency, transparency, and cooperation. However, as noted by Scollay (2004), the language of related statements do not go far beyond that of the relevant clauses in the 1994 WTO Understanding on Interpretation of GATT Article XXIV.

In this section, we consider some of the more salient components of FTAs that require close attention and analysis in the development of outward-oriented, efficient FTAs.

1. **Product coverage: Goods.** *Comprehensive coverage is best, to be included within a reasonable period of time (defined as 10 years by the GATT/WTO).* Article XXIV of the GATT/WTO stipulates that, in an FTA or customs, product coverage should include “substantially all goods.” However, few FTAs cover all goods. Even NAFTA, which is comprehensive by most measures, does not effectively include all goods; tomatoes, for example, remain *de facto* outside of

---

<sup>20</sup> While both belong to the Italian food group known as “pasta,” lasagna is made using a straight, flat noodle and is multilayered.

<sup>21</sup> See, for example, PECC Trade Policy Forum 2004 and summaries in Scollay 2004.

the FTA. The US-Australia FTA, negotiated in 2004, is between two advanced countries, each actively involved in global liberalization of manufactured goods, agriculture, and services. Yet, sugar is excluded from the US-Australia FTA, and beef has a 17 year implementation period. The EU-EFTA FTA in the 1970s excluded agricultural goods, and, actually, the US-Canada Auto Pact of 1965 only included *one* sector, i.e., the automotive sector. Clearly, the rigors of Article XXIV have not been very binding in this regard.

Exclusions of individual products can be problematic on efficiency grounds, particularly when they involve products that are used as inputs in the productive chain. For example, duty free inputs on steel will cause exaggerated protection of value added (the “effective rate of protection”) in the automotive sector. Exclusion of tariffs on imported lumber will do the same in the furniture industry if the latter is excluded from liberalization. “Positive list” approaches tend to be the worse possible mechanisms in this regard, as items that would generate trade creation are excluded and those that would generate trade diversion (i.e., promote intra-regional trade at the expense of non-partners) would be included.

Thus, to the greatest political extent possible, the FTA should include all goods. Some will no doubt be excluded either temporarily or permanently, but such exemptions should be as few as possible and should take into account the important effects that they might have on the effective rate of protection, as well as on trade diversion.

**2. Product coverage: Services.** Again, *comprehensive coverage and a reasonable time period for implementation are best* from an economic perspective, and transparency is important in some areas. Services present some special and important challenges. Certain services are fairly easy to liberalize, e.g., in terms of allowing for the movement of professional persons, tourist-related services (the most important in terms of exports for the ASEAN countries, for example), and even high-tech/knowledge-based services. Others are extremely difficult. Educational services tend to



be highly protected. Financial services are often the most difficult to include in any liberalization package. Even the EU, which has been a regional trading organization for almost a half-century and technically completed its “Single Market” over 10 years ago, has a long way to go before incorporating financial services at the EU level, despite commitments to do so. The same is true about postal services, which continue to be protected within the EU based on their “universal service obligations” but in reality due to heavy unionization of the sector. Within the framework of GATS, some financial services will be included but education and postal services will be excluded due to their politically-sensitive nature.

Hence, if such opposition to full inclusion of services exists in advanced developed-country agreements, it is obvious that certain sectors will be controversial in developed-developing country accords. Nevertheless, they should be included as much as possible. In fact, in many Asian developing countries, this could be one of the best policies for “forced” structural policy change in the region. Telecommunications and financial services might even be highest on the list of the most productive in this sense. Development of the telecommunications is extremely important in the functioning of a modern economy, as it serves as a key input to knowledge-based products and services. Financial-services development is essential in modernizing the financial sector, increasing opportunities for savers and investors, and enhancing the integrity of the financial system. And given the importance of education in the modernization of instruction and preparing populations for a highly-competitive global economy, greater competition in this sector is critical in achieving the development goals of many developing (and developed) Asian economies. Already liberalization is taking place; the process can be enhanced through FTAs. For example, Singapore has long sought to increase competitiveness of its higher education in order to be a global competitor. Provisions laid out in the US-Singapore FTA, for example, are expediting this process.

3. **Rules of Origin.** *Rules of origin should be as low as possible as well as symmetrical.* “Abuses” of rules of origin in FTAs is the most common criticism of regional agreements by economists. In our discussion of existing FTAs in Asia above, we noted that developed-country agreements tend to be more comprehensive and “deeper”. They also have their dark sides, and the darkest of these sides is arguably the rules of origin provisions. Research as to how much compliance with rules of origin taxes efficiency is difficult to find. One estimate (Estevadeordal and Suominen 2003) calculates the cost to be in the range of 3-5 percent of the f.o.b. value of the exported goods.<sup>22</sup>

Brenton and Imagawa (2005) generalize the various approaches to determining rules of origin and their advantages and disadvantages. In contrast to developing-country accords such as AFTA, which tend to have simple rules of origin (usually at about 40 percent), the developed-country accords tend to be extremely complicated and often very high. The United States and, often the EU, especially insist on generally product-specific rules of origin, yielding highly-divergent rates. These can be used to protect domestic industry inappropriately, rather than merely making sure that a product is mainly produced within the region. In NAFTA, for example, the rules of origin come to 62.5 percent in automobiles and essentially 100 percent in many textile products (under the “yarn forward” rule). There is also the famous (and strange) case of EU imports of fish: one would think that rules of origin of fish, which obviously do not have component imports, would be simple. But to receive access to the EU’s GSP, a developing country must satisfy the following conditions: the vessel has to be registered in the beneficiary country or any EU member-state and must sail under the flag of a beneficiary/EU member; the vessel must be at least 60 percent owned by nations of the beneficiary or EU country, or by companies with a head office in the beneficiary of EU country, of which the chairperson and a majority of the board members are nationals; and the master and officers of the ship must be nationals of the beneficiary or EU member country, and 70

---

<sup>22</sup> This study is available on the PECC website: [http://www.pecc.net/trade\\_washington.htm](http://www.pecc.net/trade_washington.htm).

percent the crew must be nationals of the beneficiary country or the EU (Brenton and Imagawa 2005).

Stringent rules could have important trade diversion and investment diversion effects, with a potentially high cost to non-partners. For example, the boom in FDI in Mexico in the automotive industry was no doubt due to NAFTA and no doubt came at the expense of more efficient investment elsewhere in Asia. To keep these effects to a minimum and avoid the complicated web knit by the rules of origin codes, Singapore worked out with the United States the “integrated sourcing initiative,” in which selected products that are not made in Singapore, but exported through Singapore, are deemed as of Singapore origin and entitled to preferential treatment when exported to the United States.

**4. Customs Procedures.** *To the greatest extent possible, customs procedures should follow global best practices and GATT/WTO-consistent protocols.* Customs and related procedures are at the heart of “trade facilitation,” a key priority in the Doha Development Agenda. They are obviously closely related to rules of origin, as one of the key challenges of customs officials is to clear countries-of-origin of imports. The extent of globalization of production combines with the need for rules of origin in the context of FTAs (and, sometimes, customs unions, if the issue relates to non-reciprocal agreements such as the General System of Preferences or the EU’s “everything but arms” initiative for Least Developed Countries) to ensure that customs procedures and related regulations form an essential component of any regional accord. A key issue in the customs negotiations pertains to transparency and “risk management”.<sup>23</sup> “Best practices” under the WTO relate to the Agreement on Customs Valuation, which provides private-sector access to a review and appeal mechanism. Some agreements go further than the WTO Agreement on Customs Valuation; for

---

<sup>23</sup> That is, “a systematic framework to assess the risk on goods imported which target limited resources on high risk goods and high risk traders while facilitating the clearance of legitimate cargoes through the checkpoints” (Chia 2005).

example, in the context of the US-Singapore FTA, the US import declaration is the only document necessary to prove origin.<sup>24</sup>

Regional trading agreements can be used as instruments to modernize customs laws, regulations, administrative guidelines, and procedures. The most basic questions being asked are (McLinden 2005, pp. 76-77): (1) has a process of continuous review been created?; (2) has an official process of the review and rationalization of exemptions and concessions been developed?; (3) Is there in place an efficient cross-agency process in applying regulatory requirements?; (4) have internationally-accepted conventions and standards, including those found under the WTO Valuation Agreement, been implemented? (5) Do regional trading groups adopt internationally accepted standards and work toward regionalization of best practices?; and (6) are the laws, regulations, procedures, and administrative guidelines transparent?

If “best practices” are developed, progress in this area could be an important advantage of FTAs, especially if, as part of the agreement, developed countries help modernize these procedures, build capacity, transfer related technology, and train administrators. One does see this happening in such agreements, such as in the (non-preferential) US-Vietnam Bilateral Trade Agreement and Japan’s New Miyazawa Plan.

**5. Intellectual Property Protection:** *IPR guidelines should be non-discriminatory and consistent with TRIPS, TRIPS Plus, and related international conventions.* The protection of intellectual property is one of the most sensitive issues in negotiating FTAs. Developed countries, having a strong comparative advantage in IPR-intensive products, want to make sure that IPR is taken seriously both *de facto* and *de jure*. In fact, many developing countries, including those that often find themselves on the US “special 301 watch list” of IPR offenders, have appropriate laws on the

---

<sup>24</sup> Chia (2005).

books, but lack implementation of these laws, as well as enforcement. Developed countries have included IPR as essentially a *sine qua non* in bilateral FTAs.

Developing countries often criticize the IPR stance of developed countries as being too severe and too favourable to innovators, e.g., granting patent monopolies for an exaggerated amount of time, or being too insensitive in areas such as pharmaceuticals. On the other hand, it may be that stronger, more serious IPR protection can actually be positive for the development of a country's own innovative and artistic sectors. Moreover, a new literature in the international investment area gives credence to the view that FDI is not only a function of IPR protection but also influences the sectoral distribution of FDI and the degree of technology transfer. Countries with stronger IPR protection tend to receive more FDI in sectors in which technology transfer is more likely.

In any event, the extent to which IPR-related clauses within an FTA reinforce international conventions, the more likely the accord will support multilateralism, provided, of course, that the clauses are non-discriminatory across countries.

**6. Foreign direct investment.** *Investment-related provisions should embrace national treatment, non-discrimination, shun performance requirements, and have a highly-inclusive negative list, as well as provide the usual protection necessary for foreign investors.* As was noted above, Asian countries generally place a strong emphasis on FDI, and having liberal, non-discriminatory provisions tend to be less controversial than in the case of other developing regions. Exceptions might exist with respect to FDI in state-owned enterprises and "sensitive" sectors. This is true not only for developing Asia but also developed countries: state-owned enterprises have traditionally restricted significantly FDI penetration in areas such as defence, public morals, the media, and certain other sectors of high "national security" or "national sovereignty" importance. The United States, for example, is only now considering allowing significant FDI in its airline industry. Hence,

every country will have “negative lists” with respect to FDI. This will always be true with or without FTAs. For our purposes, we would stress that pacts should keep them to a minimum.

Also, it is important that the accords embrace national treatment, thereby not giving preferential treatment to local relative to foreign firms. This has important implications for creating a competitive environment. Further, with respect to the “outward orientation” of the agreement, non-discrimination *vis a vis* non-partners is also essential in creating a level playing field. For example, in the US-Thai Treaty of Amity, Thailand gives certain preferences to US firms that are not accorded to multinational affiliates of other countries. This part of the agreement has expired; it will no doubt be an area of discussion in the on-going US-Thai FTA negotiations.

**7. Anti-dumping.** *Anti-dumping procedures and dispute resolution need to be transparent and fair, and the process needs to be well specified and effective.* Anti-dumping and countervailing duties, also known as “administrative actions,” have been condemned as an important weapon in the arsenal of the “new protectionism.” Anti-dumping duties have mainly been used by developed countries but some developing countries have begun to use them as well. Anti-dumping measures may or may not be stipulated directly in an agreement; sometimes, the references may be exclusively directed to the WTO dispute resolution. Anti-dumping clauses in an FTA might be used as a means to tighten anti-dumping evaluations procedures, promote transparency, and expedite any processes. But it also important that dispute settlement procedures be clearly identified and respected. Otherwise, confusion can follow. The most obvious example of this problem is the on-going dispute between the United States and Canada regarding soft-wood lumber exports from the latter to the former. The United States claims that Canadian loggers have been given unfair subsidies (mainly in the form of subsidies stumping fees in state-owned forests), whereas the Canadians argue that the Americans are exaggerating this effect and, in effect, the United States also subsidizes their lumber industry. A NAFTA panel ruled in favor of Canada; a

recent WTO panel has now (2005) ruled in favor of the United States. There continues to be uncertainty as to what the next step will be in the process. In the meantime, US-Canadian trade relations are arguably at an all-time low, despite having an FTA since 1989.

8. **Government procurement.** *Government procurement should be open and as non-discriminatory as possible, and procedures should be clear and as open as possible.*

9. **Competition.** *Policies related to competition should create a “level playing field” for both locals and partners, and they should not put non-partner competition at a disadvantage.*

10. **Technical Barriers to Trade.** *These should be kept to a minimum, with clear and transparent mechanisms for determination of standards.* The WTO Agreement on Technical Barriers to Trade (TBT) attempts to “ensure that technical negotiations and standards, as well as testing and certification procedures, do not create unnecessary obstacles to trade.” TBT takes on particular significance at the global level, as many of its aspects, including harmonizing standards, “mutual recognition,” defining what are legitimate means of protecting, e.g., animal and plant life and the environment, etc., should have global rules of conduct. International standards, however, are bound to be general; FTAs, as they only involve a few or several countries, can potentially achieve far deeper means of integration and progress in this area. What would be critical for efficiency and outward-orientation, therefore, would be that any TBT clauses in FTAs should be based on international standards, have high levels of transparency, embrace best practices, and eschew discrimination against outsiders as much as possible.<sup>25</sup> The Uruguay Round created a “Code of Good Practice for the Preparation, Adoption and Application of Standards” by standardizing bodies; FTAs should build on these, or at least not contradict them.

---

<sup>25</sup> As one would essentially always have trade diversion in an FTA (one way or another), the same is true of harmonization of standards within a regional group. When the EU launched its Single Market Program beginning in 1986, for example, one major aspect was the harmonization of standards and professional qualifications, thereby making a truly regional market. A European standard, however, cannot be completely a global one.

In sum, by adopting best-practices, Asian FTAs could generate significant gains in terms of economic efficiency, well-beyond the effects of traditional FTAs (which can potentially be welfare-inhibiting) and, arguably, beyond what any realistic multilateral approach could possibly hope to generate. How much is “significant”? This would be difficult, indeed, to model. However, the EC’s Single Market Programme, which did not focus entirely on best-practices but is largely devoted to improving efficiency through the harmonization of the types of policies including in this section, was estimated (Cecchini 1988) to increase EC GDP by up to 6.5 percent. Moreover, in order to compare traditional estimates—induced by liberalization of tariff and tariff-equivalent non-tariff barriers--of gains due to trade liberalization in Asia (Scenario 1) and more general trade-cost reduction effects such as improving customs clearance, lower transaction costs, and facilitation of international market access (Scenario 2), Brooks, Roland-Holst and Zhai (2005) run simulations to compare the aggregate impact on real income, exports, and terms of trade.<sup>26</sup> They assume that non-policy-related trade costs are around 120 percent and are cut by half over a twenty-year period for East Asia, Southeast Asia and South Asia.<sup>27</sup> The results are illuminating. Under Scenario 1, real income rises in the range of 0.9-2.9 percent for East Asia, 1.9- 6.6 percent for Southeast Asia, and 0.3-0.6 percent for South Asia. Under Scenario 2, the gains are many times as large, that is, 8.1-53.8 percent, 35.5-116.6 percent, and 10.4-22.4 percent, respectively.

Hertel, Walmsley, and Itakura (2001) go even further in their analysis of the potential gains from the Japan-Singapore FTA. They essentially develop a dynamic GTAP-based model using an *ex ante* simulation but with some *ex post* features in estimating what we’ve defined above as dynamic and policy relationships in the model. Thus, they add to traditional trade barrier effects

---

<sup>26</sup> Brooks, Roland-Holst and Zhai (2005) model the Scenario 2 liberalization as an “iceberg effect,” in which a fraction of goods and services “melt away in transit due to the trade costs” (p. 4, fn 4).

<sup>27</sup> It is important to note that this value is a guesstimate and is not derived systematically or empirically.



the harmonization of e-commerce standards, liberalizing rules in trade in services, automating customs services in Japan (to be consistent with Singapore), and investment flows. Interestingly, given the nature of this “new age” agreement, *all* regions of the world gain, including, of course, Japan and Singapore. Fully 70 percent of the gains accrue to Japan (a good share of which due to improved customs services). Hertel, et. al. stress that it is precisely the “new age features” which drive the positive results for all...and these are just a few of the possible areas we delineate above, as well as being between two advanced countries with less to gain from “best practices”.

#### ***IV. To What Degree Are Existing Arrangements in Asia Consistent with Minimizing the Spaghetti-Bowl Effect?***

To what degree do the regional accords listed in Table 1 conform with the “best-practices” outlined in Section III? In this section, we address this question by evaluating the existing accords, delineated in Table 2, and then “rating” them according to the areas analyzed in Section III. In gauging how well a specific agreement meets our “best practices” definition, we assign “letter grades, in which: (1) “A” deems that the agreement generally conforms to our criteria and does not contradict GATT/WTO principles; (2) “B” signifies that the agreement is an approximation of best-practices, but there is room for improvement; (3) “C” would suggest that the agreement has many “holes” in it; is possibly “inward-looking”; and/or has certain potentially problematic features; (4) “D” implies that the agreement is, indeed, inward-looking and potentially disruptive to international trade; and (5) “I” (for “incomplete”) denotes that the area is basically excluded from the agreement.

Of course, such a rating scheme will have to be somewhat subjective; each agreement is sufficiently nuanced as to preclude confident generalizations and uniformity of evaluation. However, it is hoped that such a rating scale will give an idea as to how closely the various

agreements come to minimizing the costs of discrimination inherent in FTA and maximize the benefits of regional cooperation. Nevertheless, we *do not* calculate a “grade point average” for each accord; this would require a far too subjective rating scale. An example might illustrate the problem. We can compare AFTA and the US-Singapore in terms of their respective (a) product coverage in services; and (b) rules of origin. As will be seen below, we would give respectively to AFTA and US-Singapore a C and an A for category (a), and a A- and a C for category (b). We are bold enough to do this, as services in the US-Singapore agreement are covered extensively, whereas in AFTA they do not appear in specific terms except in a limited manner in the ASEAN Framework on Services (AFS), which has a long way to go; the US-Singapore agreement has complicated rules of origin provisions, whereas the AFTA agreement is far more transparent (it receives an “A-“ only because its 40 percent rules of origin is not as “low as possible”). But how would we calculate an average grade for the two? We could impose symmetry, and assign a 50 percent weight to each. But who is to say that services is as important as rules of origin in an FTA? Services would tend to expand the potential benefits of the FTA, in terms of trade creation and trade facilitation and other means of enhanced efficiency, but rules of origin could be highly significant if they lead to greater trade diversion. They are apples and oranges; hence, we choose not to mix them.

It is apparent from this analysis that most FTAs involving developed countries tend to receive high marks with the exception of one category: rules of origin. Comparative analysis of the agreements in this area is extremely difficult due to the complicated nature of the subject and the product-by-product approach of the various agreements. Estevadeordal and Suominen (2005) attempt to do this for several of the pacts we discussed, including AFTA, Japan-Singapore, US-Singapore, and Singapore-New Zealand (as well as others).<sup>28</sup> Their analysis supports our

---

<sup>28</sup> Estevadeordal and Suominen (2005), Annex 9.B.

conclusions below, that is, these accords do have restrictive rules of origin clauses, with the exception of AFTA.

Table 2 displays the grades that we would assign to each sector/issue and each agreement. In addition, we give some evaluating comments on the more significant agreements.

1. *AFTA* (multiple protocols: January 1992-January 2003). We reviewed above the evolution of ASEAN economic cooperation extensively. It should be noted, however, that relative to all “Full FTAs,” AFTA is the most difficult to track and evaluation, as it really does manifest itself in pieces. While many of the other Full FTAs are hundreds of pages long, the AFTA agreement, signed 28 January, 1992, comes to approximately four pages, supplemented by an additional six pages outlining the workings of the CEPT, i.e., the means by which tariff demobilization would take place. The agreement has several additional protocols and amendments, including those necessary to include the accessions of the transitional ASEAN countries in the mid-late 1990s. These have broadened the coverage of AFTA significantly over the years, defining “temporary exclusions lists” and means for their inclusion over time<sup>29</sup>; expedite the integration process; deepen CEPT tariff cuts within the AFTA framework from 0-5 percent to 0 percent (as of the “Protocol on the CEPT” signed 31 January, 2003); and eventually foster other areas of cooperation under the AFS, AIA/AIC, and so on. In this sense it is the least “transparent” of the Full FTAs; however, it does demonstrate an evolutionary drive toward closer integration, which is consistent with the ASEAN approach to economic integration. Moreover, as noted above, a main goal of the ASEAN Charter,

---

<sup>29</sup> According to the “Protocol on the Special Arrangement for Sensitive and Highly Sensitive Products,” signed in Singapore, 30 September 1999, all products on the temporary exclusion lists should be included by 2010 for the ASEAN-6, and up to 2017 for the transitional ASEAN countries.

supported at the Kuala Lumpur Heads of State Summit in December 2005, will likely be to integrate these many documents.

It is also noteworthy that, in Article I of AFTA, the agreement specifies explicitly that “Member States shall endeavour to strengthen their economic cooperation through an outward-looking attitude so that their cooperation contributes to the promotion of global trade liberalisation.” No other agreement has such a clear statement in favour of open regionalism as its absolute first priority. In fact, ASEAN Member Countries have been lowering their external barriers at the same time that they have been liberalizing intra-regional barriers through the CEPT, thereby reducing any potential marginal-of-preference that could lead to trade diversion. This is also true for investment flows; FDI is largely being liberalized on a non-discriminatory basis.

**Table 4:  
Grading Existing FTAs in Asia**

Accord	Goods	Serv.	ROO	GovPro	Comp	Inv.	IPR	Mon	TBT
AFTA	A	C	A-	I	I	A-	I	C	I
SGP-NZ	A	B	A-	B+	A	A	A	A	A
EFTA-SGP	C	A	C	B+	B	A	A	A	B
JPN-SGP	A	A	C	A	B	A	A	A	B
US-SGP	A	A	C	A	A	A	A	A	A
AUS-SGP	A	A	C	A	A	A	A	A	A
KOR-CHLE	B	B	C	A	A	A	A	A	A
JPN-MEX	A	B	C	A	A	A	A	A	A
THAI-AUS	A	B	C	B-	A	A	A	A	A
INDIA-SGP	B	B	C	C	C	B+	C	A	A
KOR-SGP	B	B+	C	A	A	A	A	A	A

Notes:

1. Goods=Trade in Goods; Serv=Trade in Services; ROO=Rules of Origin; GovPro=Government Procurement (chapter/clauses); Comp=Competition (chapter/clauses); Inv.=FDI provisions; IPR=Intellectual Property Protection (WTO TRIPs plus related conventions); Mon=Monitoring and dispute settlement provisions; TBT=Technical Barriers to Trade.

2. Grading is based on: consistency with WTO and outward-orientation; best-practices; scope.

2. *Singapore-New Zealand* (ANZSCEP; 182 pages, including annexes; November 2000). New Zealand has evolved substantially over the past 20 years, from one of the most inward-looking economies in the OECD to one of the most outward-oriented. Hence, this accord is between two sophisticated, developed economies. And this is demonstrated in the high marks for the accord. It is outward-oriented and comprehensive, in terms of both goods and services. Even the rules of origin, which is based on either tariff transformation or a simple 40 percent rule, is liberal relative to other accords involving developed countries. It is interesting that the agreement actually refers to APEC commitments (under national treatment and coverage in services) in anticipation of the 2010 “deadline” (Article 20:4); they also refer to APEC non-binding rules under government procurement, rather than the relevant WTO protocol. In terms of transparency, the agreement is fairly straightforward, with the exception of services, which leaves quite a bit open. “MFN status” is explicitly included in the investment section. The “technical barriers” section is particularly advanced (and takes up a relatively large part of the agreement). The Part on “intellectual property” merely refers to WTO protocols.

3. *EFTA-Singapore* (590 pages, 545 of which comprise annexes; entered into force January 2003). This is a plurilateral agreement, in that the European Free Trade Area has had a FTA for over 30 years, and is between developed, sophisticated economies. The agreement essentially only covers manufactured products (Chapters 25-97 of the HS system) and, as such, is fairly restrictive in terms of goods. This comes as no surprise; one of the main reasons the remaining EFTA countries have not joined the EU relates to agriculture, which is even more protected in EFTA than it is in the EU. It is, therefore, no coincidence that city-state Singapore is unique as an FTA partner of EFTA in Asia. Sanitary and Phytosanitary measures are simple and insist on non-discrimination, but do nothing in terms of attempted harmonization of further cooperation. Competition-related clauses, including anti-dumping and those affecting state-owned enterprises, refer to WTO protocols, with a

commitment (Article 50) to eschew any anti-competitive practices. By far the largest part of the actual text refers to trade in services; scope, as defined in Annex VII, includes considerable detail on professional (and business-related) services and tends to be quite liberal in this regard, consistent with other Singapore FTAs. Postal services are included, as are telecommunications—that is, those outside the purview of the Singapore Broadcasting Authority Act—and market access considerations for broad-band multimedia (no doubt, a high priority for Nokia) to be reviewed in the future, leaving ambiguity (but EFTA is protected in the Singapore market by its MFN clause in the agreement’s text). Limited progress appears to have been made on educational services in terms of mutual recognition, and university education is excluded (though secondary and post-secondary technical and vocational education are included). Coverage of financial services is broad. The investment agreement is fairly standard, with a strong emphasis not only on national treatment but also MFN (also the case with services and IPR protection). Government procurement provisions are strictly WTO-related.

4. *Japan-Singapore FTA* (JSEPA; January 2002; 512 pages, of which 432 annexes). Many of the same provisions found in the EFTA-Singapore FTA are found in this one as well, though coverage, particularly in the goods sector, is more comprehensive. Interestingly, earlier on in the agreement (Article 6), Japan and Singapore anticipate any potential “spaghetti bowl” problems, noting that any apparent contradiction between this and any other agreement shall be immediately addressed. Anti-dumping is not included in the agreement but rather relegated to WTO rules. Rules of origin tend to be product-specific and fairly complicated, which is actually the only draw-back in a liberal, straight-forward agreement. On the other hand, the emphasis on “paper trading” in this agreement (Chapter 5) suggests an advanced approach to trade facilitation. Services coverage is generally extensive (and, as in other accords, includes MNF clauses, though the language tends to be less direct). However, business practices (Article 66) are less explicitly detailed than in the case of the

EFTA-Singapore FTA. It is noteworthy, however, that the Parties agree to cooperate on the building of “capital markets,” which would appear to be manifesting itself not only on a bilateral level but within the APT process. Joint human-resource development is also a priority. Investment is fully covered, and dispute settlement is transparent and clear (Article 82). IPR protection is relegated to the WTO TRIPs agreement (Article 86) but is expanded at length in Chapter 10. In fact, the IPR provisions in the Japanese and US FTAs with Singapore are highly advanced in this respect. Mutual recognition of professional persons is spelled out in detail, as is (short-term) movement of natural persons. Government procurement is WTO based, and includes a liberal threshold of SDR100,000. The Parties vow to avoid anti-competitive behaviour (Articles 103-104), but resolutions of related disputes are not clear from the agreement (they are to wait for the “Implementing Agreement”).

5. *US-Singapore FTA* (USSFTA; 240 pages plus annexes; May 2003). As noted above, the USSFTA is thought to be one of the most modern FTAs in the world. The United States has explicitly expressed its intentions to use it as a model for accords with other ASEAN countries (under the “Enterprise for ASEAN Initiative”) and is no doubt a benchmark for other accords is either negotiating or contemplating in the region. Hence, its “efficiency” and “openness” are of the essence, given the importance of the United States in the global economy. Coverage of goods is comprehensive, though it devotes an entire chapter (Chapter 5) to textiles and apparel, with a view to ensuring that “trade deflection” won’t take place through Singapore. Singapore, for its part, was able to negotiate a waiver on rules of origin for about two-dozen products under its “Integrated sourcing Initiative.”<sup>30</sup> Services coverage is also comprehensive, going somewhat beyond the other

---

<sup>30</sup> Even “chewing gum” found its way into the agreement by way of compromise. Chewing gum had been banned in Singapore, but the United States claimed this was a sort of technical barrier to trade. An agreement was struck whereby US chewing gum can be sold in Singapore...in Pharmacies.



Singapore accords noted above (especially in terms of banking services and capital controls). As is the case with all US FTAs, the rules of origin tend to be complicated. The anti-competition clause is better developed than in the case of the other accords, as is IPR protection. An entire Chapter is devoted to Technical Barriers to Trade, with references especially to the WTO but also APEC. Controversially, labor and the environment each have Chapters in this agreement, a result of political realities in the United States. However, the compromise agreement turned out to be fairly uncontroversial (and will be a model for other accords, no doubt): Singapore agrees merely to serious implementation of its *own* laws *vis a vis* labor and the environment. They also vow not to increase competitiveness by lowering standards in any of these areas.

6. ***Australia-Singapore*** (SAFTA; 117 pages plus annexes; 2003). Our final Singapore-based bilateral agreement with a developed country, Australia, exhibits many of the same features as the agreements above, particularly ANZSCEP. This is no doubt a result of the “Closer Economic Relations” FTA between Australia and New Zealand, which is highly-comprehensive and has been effective in linking the two countries’ economies. Symmetry in the agreements was, therefore, important in order not to cause any trade deflection or other “spaghetti-bowl” effects. Coverage of goods and services is comprehensive; in fact, services, such as financial services and telecommunications services, are arguably even better developed in this agreement. Anti-dumping is essentially WTO-based, as are safeguards. Rules of origin are complicated, but somewhat less so than in the US case; various rules apply, and percentage of value added is generally defined either as 30 percent (for selected goods) or 50 percent (for all other goods). Rules on government procurement are fairly elaborate, but references to WTO protocol somewhat vague and non-committal (Article 18). Investment, competition, TBT, and dispute settlement are fairly standard and well-developed in this agreement. IPR protection builds on WTO TRIPS.

7. *Korea-Chile* (130 pages; signed February 2003). While Chile has many FTAs in place, this accord was the very first FTA for Korea. It may appear strange that Korea would choose Chile as its first preferential partner, particularly since Chile's share of Korean trade and investment is so small. But in the main this was more of "starter agreement" for Korea, a means to begin the process of incorporating FTAs in its commercial policy with an "easy country," to which sensitive sectors in Korea would be minimally exposed. While manufactured goods are essentially covered, agriculture products are restricted. Rules of origin are complicated. The agreement does build on many WTO protocols, including in the areas of anti-dumping, sanitary and phytosanitary measures, IPR protection, trade-related investment measures, and technical barriers to trade. The investment agreement, which replaces an earlier "BIT," takes up a more than commensurate share of the agreement (relative to the others) and is fairly exhaustive in its coverage of investment issues. Services liberalization, however, is incomplete and somewhat piecemeal. Quantitative restrictions are allowed, and financial services are excluded. Telecommunications are included, but mainly only ensure guaranteed access to local services.

8. *Japan-Mexico FTA* (135 pages; signed September 2004). Bilateral trade and investment between Mexico and Japan is small for each as a percent of their respective totals. However, each counts the United States as its most important economic partner, at least at the signing of the agreement.<sup>31</sup> Given NAFTA, the usefulness of this agreement to Japan is clear, and Japan, being the second largest economy in the world and a major source of FDI, was an attractive partner for Mexico. In addition, Mexico has been seeking to diversify its trade and investment partners (currently the United States is dominant, particularly in trade, for which the US market accounts for approximately 80 percent of total Mexican trade). NAFTA also made an FTA with Japan easier; many of the same components manifest themselves in this agreement. Coverage is similar to the

---

<sup>31</sup> Shortly after this time, China became Japan's most important trading partner.

Japan-Singapore FTA and other modern FTAs mentioned above. Financial services is included but is geared more to cross-border trade in financial services, rather than a “deep” approach to integration of the sector. Telecommunications are excluded altogether. Government procurement is covered extensively, including the creation of a “sub-committee” to monitor and ensure that the provisions of the agreement are respected. There is little written with respect to trade-labor concerns (especially relative to NAFTA and other US accords) but there is an explicit commitment to not use environmental measures in order to attract FDI (Article 74). Monitoring and dispute settlement are clear and receive attention throughout the Agreement. “Competition” is included (Chapter 12) but the Agreement only outlines general guidelines of comportment.

9. ***Thailand-Australia FTA*** (118 pages, excluding annexes; 2004). As both Thailand and Australia are major exporters of agricultural goods, this side of the agreement was easier to reach than was the case for many of the other accords (except, of course, the Singapore agreements). Services liberalization, however, is not comprehensive. Sanitary and Phytosanitary measures, as well as technical barriers to trade, are dealt with in-depth. Investment and competition policies are included as separate chapters (Chapter 9 and Chapter 12, respectively). Government procurement is included, but its provisions are not clear: it establishes the creation of a working group with a general mandate to give recommendations. IPR protection focuses on WTO protocols, with additional general commitments to protection.

10. **Limited and Emerging Agreements: ECOTA, the Proposed SAFTA (January 2004), and the Proposed Transpacific Strategic Economic Partnership (June 2005).** The main goal of ECOTA was to: (1) reduce barriers to international trade, particularly in the areas of non-tariff and technical barriers; (2) integrate ECO such that the region would become more competitive internationally; and (3) boost intra-regional trade, which was only at approximately 7 percent of total trade at the time the agreement was signed. The agreement itself was not easy to reach, given

the extreme diversity of the organization, from countries with highly-developed commercial policies such as Turkey (which has a customs union with the EU) to those with emerging policies in Central Asia (and Afghanistan, which is a member of ECO). The low intra-regional trade share was a reflection both of barriers to trade, especially high and unpredictable border-fees and other non-tariff barriers, and the fact that the region has comparative advantage in many of the same industries, which in turn are characterized by inter-industry trade. Hence, in practice the goal of increasing intra-regional trade should have been secondary; defining “boosting intra-regional trade” as a goal in the Treaty of Izmir (establishing ECO) could potentially be problematic if it were to take place through trade diversion. And while there is a good deal of market-friendly and outward-looking aspects to ECOTA, it remains an incomplete agreement in many aspects. Agriculture is essentially excluded, as are all sensitive manufacturing goods (in fact, the agreement appears to take a “positive list” approach to integration, similar to the ASEAN PTA). Rules of origin still need to be worked out, as well as the tariff demobilization component. In sum, listing ECOTA in Table 4 would have required a number of Ds, Is, and question marks, so we deemed it best to exclude it until it is better developed.

The SAFTA agreement is slated to go into force in January 2006, after “completion of formalities” and various ratification measures are completed in the member states. This suggests that, if sufficient political will is mustered, the agreement will eventually emerge; but, at present, it is essentially a framework agreement that would lead up to an FTA. For example, rules of origin are not specified; the agreement just mentions that they are to be negotiated (Article 18). Product coverage remains unclear, though the tariff demobilization process is specified. One prominent feature of the agreement regards “special and differential treatment” for the Least Developed Countries of SARRC, which are among the poorest in the world.

In addition to the South Asian Preferential Trading Agreement (SAPTA), which is a highly-limited regional trading accord that was negotiated a decade ago, India also has like agreements with MERCOSUR (January 2004; 12 pages) and Nepal (December 1991; 9 pages). We exclude these from the table given their lack of significant content in terms of actual liberalization.

The Transpacific Strategic Economic Partnership, comprising Brunei, Singapore, New Zealand, and Chile, would appear to be modern FTA, replete with references to WTO and APEC protocols. This FTA would have to be extensive given the member-states; Singapore, for example, already has an FTA with each of these countries. But like SAFTA, the Agreement has left much to be worked out, and its date of implementation is unclear (the Parties have 6 months from 15 June 2005 to sign the Agreement). However, the text as it now stands would suggest an outward-oriented, comprehensive agreement between these four small countries.

#### ***IV. Conclusions***

In a controversial academic piece in the *American Economic Review* (but widely circulated beforehand), Andrew Rose tests the hypothesis of whether or not the WTO has really made a difference in stimulating world trade (Rose 2004). Using a gravity model of international trade, he rejects this hypothesis. In other words, over the 1948-2000 period, being a member of the WTO had no statistically-significant effect on influencing bilateral trade, when one controls for other relatively standard variables. Now, while few would doubt the analytical robustness of the article (the *American Economic Review* has arguably the most rigorous academic review process in the United States), the piece has been criticized from a variety of angles, including the fact that it focuses on overall bilateral trade, rather than trade by sectors. One certainly wouldn't expect a

significant WTO effect in agriculture, textiles and clothing, and other protected sectors that have basically remained outside of the GATT/WTO liberalization process. Still, that is his point: the GATT/WTO has not done enough.

On the other hand, Rose 2004 does find strong effects in terms of the importance of regional trade agreements such as FTAs and customs unions, and especially monetary union. His results in this sense are consistent with the by-now huge stock of empirical research on the determinants of trade and even investment flows using gravity models. These models generally do not tell us whether or not the effects of regional integration are due to trade creation or trade diversion, though the impressive internationalization of the world economy would certainly suggest that the former dominates the latter.<sup>32</sup> No doubt this is due to the fact that these regional trading agreements promote far deeper integration between countries, including not only many sensitive sectors hitherto unaffected by the WTO but also non-tariff, non-border, regulatory, and other trade- and investment-related policies.

In fact, the economics literature, as well as the GATT/WTO Rounds themselves, have placed far too much emphasis on tariffs. It is true that they are easiest to analyze (for economic models) and negotiate (for policy makers) but they are no longer the most important obstacles to international trade. In fact they have become increasingly irrelevant, and with them much of the standard “trade creation and trade diversion” approach to estimating the worthiness of a regional trading agreement. According to the World Bank (2005, p. 66), the average tariff of NAFTA countries comes to approximately 3 percent and that of AFTA, slightly less than 5 percent. Obviously, the effects of these FTAs, for better or worse, will ultimately not be decided by the usual

---

<sup>32</sup> While the type of agreement obviously matters, empirical models of just about all modern regional trading arrangements, be they *ex-ante* or *ex-post*, tend to generate net trade creation. See Frankel (1997) and Kreinin and Plummer (2002) for surveys.

net efficiency calculations. The economics of FTAs have become far too complicated, and generally speaking economic analysis and negotiators have often failed to keep pace.

In any event, the regionalism trend is here to stay. Regardless of the argumentative merits of the pro- and anti-regionalism camp, it is a “fact on the ground” that preferential trading agreements, in particular FTAs, have been flourishing. There are myriad reasons behind this movement, with convincing economic, political-economy, and strictly political arguments. But this does not mean that evaluating regionalism is the economic equivalent of counting how many angles can dance on the head of a pin. An inward-approach to regional economic cooperation could pose serious risks to the countries espousing them as well as to the international marketplace. Given that all major countries now subscribe to regional trading accords to various degrees, this suggests a threat that must be evaluated with continued vigilance.

A successful conclusion to the Doha Development Agenda would be very favourable to the global economy. With respect to the regionalism movement, not only would it, perhaps, strengthen openness rules on Article XXIV beyond the 1994 GATT Understanding, but it would also mitigate the effects of discrimination inherent in regionalism. We believe that Doha should receive the highest possible priority from its member-states.

However, not even a successful Doha will likely turn back the clock on bilateral and regional FTAs. Even if we leave aside the diplomatic and political-economy aspects of regionalism that tend to support the movement, there will remain salient economic influences that will continue to make bilateral, regional and plurilateral FTAs and other forms of regional economic cooperation attractive. Hence, it behoves economists to accept regionalism as a reality, and proscribe means to ensure that the trend be consistent with global market integration as well as being as efficient as possible in terms of minimizing costs associated with this second-best commercial policy.

This has been the main goal of this paper. In addition to evaluating regionalism itself in light of its relative merits and sustainability, we developed a general blueprint to gauge to what degree FTAs meet efficiency criteria and applied them to the case of Asian FTAs, both intra-regional and with partners outside the region.

Our main conclusions from our review of the agreements themselves were several: (1) “Full FTAs” in Asia have tended to be of the “building bloc” rather than the “stumbling bloc” type, though there are some (minor) exceptions in the terms of certain components; (2) many of the FTAs that Asian countries have negotiated tend to be “modern” and among the most sophisticated in the world, including a wide set of sectors, integration mechanisms, and non-border policies; (3) the agreements themselves, particularly those between Singapore and developed countries (e.g., Japan and the United States), are liberal, with the exception of rules of origin. In fact, outside of rules of origin, we would argue that these accords generally unequivocally support the WTO system in most of their provisions, rather than conflict with it; with respect to the more limited FTAs, however, the restricted scope and selectivity of non-border areas can be problematic; and (4) while Asian countries score better than most other FTAs in the international marketplace in terms of their matching a “blueprint” minimizing the costs associated with overlapping accords and consistency (the “spaghetti bowl effect”), progress could be made in this area.

Given the growing importance of Asia in world trade, what happens in this region will be of interest not only in the region but also in the world as a whole. The nuts-and-bolts of regionalism and its associated institutions, so often ignored by economists, require much closer study. It would behoove us to move on from the divisive regionalism versus multilateralism debate, which has not been particularly productive, accept regionalism as a reality, and work seriously to ensure that regionalism ends up promoting multilateral goals.





## REFERENCES

Asian Development Bank and Commonwealth Secretariat, *Towards a New Pacific Regionalism*, Joint Report to the Pacific Islands Forum Secretariat, Pacific Studies Series, October 2005.

Asian Development Bank Institute, *Trade Policy Series: 25 February-March 2 Singapore Executive Summary of Proceedings*, Executive Summary Series No. S58/02 (ADBI: Tokyo, 2002).

Asian Development Bank, *East Asian Growth Area: Brunei Darussalam, Indonesia, Malaysia, Philippines, Integrated Report* (Manila: Asian Development Bank, December 1996).

Baldwin, Richard E. and Elena Seghezza, "Trade-induced, Investment-led Growth," *NBER Working Paper No. 5582*, May 1996.

Berglas, Eitan, "Preferential Trading Theory: The N-Commodity Case," *Journal of Political Economy*, 87 (April 1979), pp. 315-32.

Brenton, Paul and Hiroshi Imagawa, "Rules of Origin, Trade and Customs," Chapter 9 in De Wulf, Luc and José B. Sokol, *Customs Modernization Handbook* (Washington, DC: The World Bank, 2005).

Brooks, Douglas H, David Roland-Holst, and Fan Zhai, “Asia’s Long-Term Growth and Integration: Reaching beyond Trade Policy Barriers,” *ADB ERD Policy Brief No. 38*, September 2005.

Brown, Drusilla K., “Properties of Applied General Equilibrium Trade Models with Monopolistic Competition and Foreign Direct Investment,” in Joseph F. Francois and Clinton R. Shiells (eds.), *Modeling Trade Policy: Applied General Equilibrium Assessments of North American Free Trade* (Cambridge: Cambridge University Press, 1994).

Cecchini, Paolo, *The Costs of Non-Europe* (Brussels: EC Commission, 1988).

Chia, Siow Yue, Special Issues in the EAI Bilateral FTAs: Singapore, contribution to Chapter 4 in Naya, Seiji F. and Michael G. Plummer, *Economics of the Enterprise for ASEAN Initiative* (Singapore: ISEAS, 2005).

Cooper, Charles A. and Benton F. Massell, “A New Look at Customs Union Theory,” *Economic Journal*, 75 (December 1965), 742-7.

Deardorff, Alan, “What Do the Anti-globals Believe?,” *World Economy*, 2004.

De Wulf, Luc and José B. Sokol, *Customs Modernization Handbook* (Washington, DC: The World Bank, 2005).

Dollar, David, “Outward-oriented Developing Countries Really Do Grow More Rapidly: Evidence

from 95 LDCs,” *Economic Development and Cultural Change*, 1992, pp. 523-44.

Estevadeordal, A. and K. Suominen, “Rules of Origin: A World Map,” paper presented at PECC/LAEBBA symposium on Regional Trading Agreements in Comparative Perspective: Latin America and the Caribbean and the Asia-Pacific, Inter-American Development Bank, Washington, DC, 23 April 2003.

Feinberg, Richard E. and Ye Zhao (eds.), *Assessing APEC’s Progress: Trade, ECOTECH, and Institutions* (Singapore: ISEAS, 2001).

Frankel, Jeffrey A., *Regional Trading Blocs in the World Trading System* (Washington, DC: Institute for International Economics, 1997).

Feridhanusatyan, Tubagus, “Preferential Trading Agreements in the Asia-Pacific Region,” *IMF Working Paper Series WP/05/149*, July 2005.

Gilbert, John P., 2003, “CGE Simulation of US Bilateral Free Trade Agreements,” Background paper prepared for the conference on Free Trade Agreements and US Trade Policy, Institute for International Economics, Washington, May 7-8, 2003.

Hertel, Thomas W., Terrie Walmsley, and Ken Itakura, “Dynamic Effects of the “New Age” Free Trade Agreement between Japan and Singapore,” mimeo, Center for Global Trade Analysis (GTAP), Purdue University, September 2001.

Grossman, Gene M. and Elhanan Helpman, *Innovation and Growth in the Global Economy* (Cambridge, MA: MIT Press, 1993).

Haddad, Mona and Ann Harrison, "Are There Positive Spillovers from Direct Foreign Investment? Evidence from Panel Data Morocco," *Journal of Development Economics*, 42, 1993, pp. 57-74.

Herzstein, Robert E. and Joseph P. Whitlock, "Regulating Regional Trade Agreements: A Legal Analysis," Chapter 46 in Macrory, Patrick J., Arthur E. Appleton, and Michael G. Plummer (eds.), *The World Trade Organization: Legal, Economic and Political Analysis* (New York: Springer, 2005), pp. 203-247.

Kawai, Masahiro, "East Asian Economic Regionalism: Progress and Challenges," *Journal of Asian Economics*, Vol. 16 (1), spring 2005.

Kehoe, Timothy J., "Modelling the Dynamic Impact of North American Free Trade," paper 6 in USITC, *Economy-Wide Modelling of the Economic Implications of a FTA with Mexico and a NAFTA with Canada and Mexico*, February 1992.

Kemp and Wan, "An Elementary Proposition Concerning the Formation of Customs Unions," *Journal of International Economics*, 6 (1), February 1976, pp. 95-97.

Kim, S. Henry, Ayhan Kose, and Michael G. Plummer, "Dynamics of Business Cycles in Asia: Differences and Similarities," *Review of Development Economics*, Vol. 7, Issue 3, August 2003, pp. 462-477

Kose, M. Ayhan, and Alessandro Rebucci, "How Might CAFTA Change Macroeconomic Fluctuations in Central America? Lessons from NAFTA," *Journal of Asian Economics*, Vol. 16, No. 1, February 2005, pp. 77-104.

Kreinin, Mordechai E., and Michael G. Plummer, *Economic Integration and Development: Has Regionalism Delivered for Developing Countries?* (London: Edward Elgar, 2002).

Landingin, Nathaniel and David Wadley, Export Processing Zones and Growth Triangle Development: The Case of BIMP-EAGA, Southeast Asia, *Journal of International Development*, 17, pp. 67-96, 2005.

Lewis, Jeffrey, D. Sherman Robinson and Zhi Wang, *Beyond the Uruguay Round: The Implications of an Asian Free-Trade Area*, mimeo, February 1995.

Mai, Yinhua, Philip Adams, Mingtai Fan, and Ronglin Li, "Modelling the Potential Benefits of an Australia-China Free Trade Agreement, mimeo, Center for Policy Studies, Monash University, [www.dfta.gov.au/geo/china/fta/modelling\\_benefits.doc](http://www.dfta.gov.au/geo/china/fta/modelling_benefits.doc), 2 March, 2005.

McLinden, Gerard, "Integrity in Customs," Chapter 4 in De Wulf, Luc and José B. Sokol, *Customs Modernization Handbook* (Washington, DC: The World Bank, 2005).

Menon, Jayant, "Can Subregionalism or Regionalism Aid Multilateralism?: The Case of the

Greater Mekong Subregion and the Association of Southeast Asian Nations Free Trade Area,” mimeo, 2005.

Messerlin, Patrick, *Measuring the Costs of Protection in Europe* (Washington, DC: Institute for International Economics, 2001).

Naya, Seiji F., *The Asian Development Experience* (Manila: Asian Development Bank, 2002).

Naya, Seiji F., and Michael G. Plummer, *The Economics of the Enterprise for ASEAN Initiative* (Singapore: Institute of Southeast Asian Studies, 2005).

PECC Trade Policy Forum, “Asia-Pacific RTAs as Avenues for Achieving APEC’s Bogor Goals,” mimeo, 2004.

Pissarides, Christopher A., Learning by Trading and the Returns to Human Capital in Developing Countries, *World Bank Economic Review* 11 (January 1997), pp. 17-32.

Romer, Paul M., “Increasing Returns and Long-run Growth,” *Journal of Political Economy*, 94, pp. 1002-37.

Rose, Andrew, Do We Really Know that the WTO increases Trade?" *American Economic Review* 2004.

Scollay, Robert, "PTAs in the Asia-Pacific Region: An Overview," in *2004 PECC*, [www.pecc.org](http://www.pecc.org), pp. 79-104.

Scollay, Robert and John P. Gilbert, *New Regional Trading Arrangements in the Asia Pacific?* (Washington, D.C.: Institute for International Economics, 2002).

Wonnecott, P. and R. Wonnecott, "Is Unilateral Tariff Reduction Preferable to a Customs Union?," *American Economic Review*, September 1981, pp. 704-14.

World Bank, *Global Economic Prospects: Trade, Regionalism, and Development 2005* (W