

# FTAs and the Prospects for Regional Integration in Asia<sup>1</sup>

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## Abstract

Trade policy in Asia has switched from non-discriminatory unilateral liberalisation, reinforced by GATT/WTO commitments, to discriminatory FTAs. The paper surveys the FTA activity of the major regional players: China, India, the ASEAN countries, Japan and South Korea. It concludes that emerging FTAs are weak and partial. A hub-and-spoke pattern of dirty FTAs will not drive regional economic integration or further integration with the global economy. Rather it could be a force of regional economic disintegration – especially if the multilateral trading system weakens further. At the same time, FTA activity is distracting attention from the WTO, and, more fundamentally, from unilateral liberalisation and domestic structural reforms. Hence Asian trade policies need to be rebalanced, with better-quality FTAs and more focus on the WTO. However, more important than the WTO and FTAs is a fresh spurt of unilateral liberalisation and structural reform – outside trade negotiations.



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## INTRODUCTION\*

Trade policy in Asia has changed much since the late 1990s. Pre-Asian crisis, the emphasis was on unilateral, non-discriminatory liberalisation, reinforced by the Uruguay Round Agreements. Since then attention has switched to discriminatory bilateral and regional free trade agreements (FTAs). Multilateral liberalisation has stalled; most governments have become less active in the WTO; and the enthusiasm for further unilateral liberalisation and related structural reforms has waned. The conspicuous exception is China. There, liberalisation has continued to race ahead, and has been anchored by very strong WTO commitments.

The larger backdrop is the historic – but very recent – integration of first China and then India into the global economy. But in between also lies the longer history of first northeast-Asian and then southeast-Asian integration into the global economy. Such preliminary observations also raise the question of economic integration *between and among* these different parts of Asia – or the lack thereof – and how that relates to trade policies.

This sets the stage for the core questions this paper addresses. Do FTAs in Asia facilitate regional economic integration, and, by extension, global economic integration? How credible are negotiating positions, the choice of negotiating partners, and the agreements already in operation? How good or bad is the fit between FTAs and economic policy at home? And how do FTAs relate to involvement in the WTO?

The following account focuses on east and south Asia – “globalising Asia”. It leaves north and west Asia – which remain largely non-globalised – out of the picture. Much will be said about China, India and southeast Asia though, inevitably, Japan and South Korea (and, to a lesser extent, Taiwan, Hong Kong, Australia and New Zealand) will be drawn into the picture.

The first section presents brief background on trade and foreign-direct-investment (FDI) patterns in the region, and on trade-policy reforms post-Asian crisis. The next – and central – section focuses on FTAs. Then follow sections on the WTO, and on prospects for further trade-and-investment liberalisation and regional integration in Asia.

## BACKGROUND: TRADE AND FDI TRENDS; TRADE-POLICY REFORMS POST-ASIAN CRISIS

### Trade and FDI trends<sup>2</sup>

For the last half century, Japan and the next generation of Tigers (South Korea, Taiwan, Hong Kong and Singapore) have dominated Asian economic activity. But China is catching up fast. It is already more globally integrated than Japan in terms of trade and FDI penetration; and has recently displaced Japan as the world’s third largest trading nation. Trade in goods is 70 per

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cent of GDP; FDI stock stands at almost 40 per cent of GDP; and multinational enterprises account for about 60 per cent of merchandise trade.

India's global integration pales in comparison, but it has come far by its own standards. It is the world's 30<sup>th</sup> largest trading nation in goods. Trade and FDI stock are just over 25 per cent and 5 per cent of GDP respectively. Annual FDI flows and overall FDI stock are less than a tenth of Chinese levels. As for other south-Asian countries, severe political instability and ethnic strife hamper their global integration and economic progress.

Finally, countries in southeast Asia are highly dependent on the world economy. Like China, FDI-driven exports are central to their growth models. Southeast-Asian trade levels are on a par with China – though this reflects fast Chinese catch up with southeast-Asian trade shares. The average trade-to-GDP ratio is over 130 per cent. FDI inflows are well below Chinese levels but some way ahead of Indian levels.

What does this tell us about the emerging international and Asian division of labour? Japan, South Korea, Taiwan, Hong Kong and Singapore have comparative advantage in high-value goods and services. China has clear-cut comparative advantage in labour-intensive goods exports. Given its huge pool of cheap labour, India too should be a labour-intensive, FDI-driven exporting powerhouse. But severe labour-market restrictions strangle industrial employment. Agriculture is hobbled by external and internal trade restrictions. And the employment-generation effect from services exports is a drop in the ocean compared with what it could be in manufacturing.

Southeast Asia stands to gain from deeper integration into global supply chains, now including China. But to exploit these niches fully, the older ASEAN members must liberalise further, especially in services and agriculture, and strengthen domestic institutions in order to compensate for eroded cheap-labour advantage. The newer, poorer ASEAN members should exploit cheap-labour advantage, especially as relative incomes rise in China.

### **Trade-policy reforms post-Asian crisis<sup>3</sup>**

Since the early 1980s, a veritable trade policy revolution has spread across the developing world as part of wider packages of market-based reforms. The Asian financial crisis, however, raised strong doubts about further liberalisation. This has centred on financial liberalisation, especially of short-term capital flows, but it has had a knock-on effect on trade and FDI. Broadly speaking, previous liberalisation has not been reversed, but its forward momentum has slowed.

Southeast Asia fits this pattern. The real burst of trade-and-investment liberalisation took place in the 1980s and first half of the 1990s. These measures were generally not reversed post-Asian crisis. But, with the exception of Singapore, government enthusiasm for further liberalisation declined markedly. Overall, southeast Asia presents a varied picture: free-trade Singapore is at one extreme; other old ASEAN members have relatively liberal trade policies (with average tariffs under 10 per cent, correspondingly low non-tariff barriers and an open FDI regime in manufacturing), but with large pockets of protection in agriculture and services; and the new ASEAN members are still highly protected.

How does China fit in? Its first decade of reforms centred on internal liberalisation, especially in agriculture. Then followed a brief period of uncertainty and suspense after the Tienanmen massacre. The last 12 years, however, have seen the biggest trade-and-investment liberalisation programme the world has ever seen. In short time, China has swung from extreme protection to rather liberal trade policies, indeed very liberal by developing-country standards. This was crowned by its accession to the WTO, with by far the strongest commitments of any developing country. The protective impact of classic non-tariff barriers has come down to less than 5 per cent; and the simple average tariff has come down from 42 per cent in 1992 to 9.8 per cent after WTO accession. The pace of internal and external liberalisation has not let up since. It is now clear that the main obstacles to doing business in China have less to do with formal border barriers and more with (formal and informal) non-border barriers.

India has had a rather different trajectory. Its retreat from the “licence raj” – its equivalent of Soviet-style central planning – began half-heartedly in the 1980s; but it was a foreign-exchange crisis in 1991 that provided the window of opportunity for more thoroughgoing market-based reforms. These were radical by Indian standards, though less so compared with policy reforms elsewhere. They covered macroeconomic stabilisation, trade liberalisation, relaxation of FDI restrictions, privatisation and, not least, the dismantling of domestic licensing arrangements that had governed most formal economic activity. The average tariff has come down to about 20 per cent from 125 per cent in 1991. Most border non-tariff barriers (NTBs), internal licensing restrictions and restrictions on manufacturing FDI have gone. This still leaves high protection in agriculture and services.

Since the initial burst in 1991–93, Indian reforms have proceeded in a stop-go manner. They have not been reversed; but they have moved ahead more slowly and fitfully compared with southeast Asia (pre-Asian crisis) and China (pre- and post-Asian crisis). Democratic politics, including the complications of multi-party governing coalitions and the federal division of powers between the Union government and the states, has made faster, more decisive reforms elusive.

Japan, South Korea and Taiwan have sent mixed signals on market-based reforms. Japan and South Korea have been reluctant to liberalise trade and FDI further (though South Korea did partially open its financial sector as part of an IMF bailout package). Taiwan did liberalise substantially in the run up to its WTO accession in 2001.

## **THE NEW FTAS IN ASIA: SENSE OR NONSENSE?**

By July 2005, 330 regional trade agreements (RTAs) had been notified to the GATT/WTO – 206 of them since the establishment of the WTO in 1995. Over 180 are currently in force, with many more expected to be operational soon. RTA activity has increased pace since 1999/2000, and even more so since the launch of the Doha Round in 2001.<sup>4</sup>

Before the new wave of RTAs, east Asia tended to rely more on non-discriminatory unilateral and multilateral liberalisation, whereas other regions, such as eastern Europe, Africa and Latin America, have long been involved in (discriminatory) RTA activity. Now Asia is playing catch-up, with RTA initiatives spreading like wildfire in the past six years. This has mostly

taken the form of bilateral (country-to-country) FTAs rather than plurilateral or regional negotiations. The major regional powers – China, India and Japan – are involved, as are South Korea, Australia, New Zealand, Hong Kong, the ASEAN countries, as well as other south-Asian countries. As of 2005, ASEAN as a regional grouping, China and India were involved in 7, 9 and 15 FTA agreements or negotiations respectively. If individual ASEAN-member FTA initiatives are counted, there are currently 17 FTAs in force and 60 more in the pipeline in China, India and southeast Asia. The USA is involved with individual countries in east Asia, as are some Latin American countries (notably Mexico, Chile and more recently Brazil). South Africa is actively considering initiatives in the region. Of the major powers, only the EU has so far remained outside the fray of RTA activity in Asia (Sen 2006).<sup>5</sup>

Why this rush of FTA activity?<sup>6</sup> Foreign-policy considerations loom large. FTAs are viewed as a means of cementing stronger political (as well as economic) links with favoured partners, e.g. as a door opener to other strategic, security-related agreements. This is clearly the case with Singapore, particularly its FTA with the USA. On the economic front, FTAs are a response to stalled multilateral liberalisation and a weak WTO. Indeed, they are seen as insurance policies against continuing WTO weakness: they secure *preferential* access to major markets; and are a means of managing and defusing trade tensions with powerful players.

Not surprisingly, governments in the region and elsewhere present FTAs in a positive light. They are seen as part of a benign “competitive-liberalisation” process, a building block of multilateral liberalisation. FTAs among small clubs of like-minded countries can, they argue, take liberalisation and regulatory reform farther than would be the case in a large, heterogeneous and unwieldy WTO. This can in turn stimulate multilateral liberalisation.

For FTAs to make economic sense, they should have comprehensive sectoral coverage, be consistent with relevant WTO provisions (in Article XXIV GATT and Article V GATS), and preferably go beyond both WTO commitments and applied practice at home. In other words, they should involve genuine and tangible, not bogus, liberalisation. There should be strong provisions for non-border regulatory cooperation, especially to improve transparency in domestic laws and regulations in order to facilitate market access and boost competition. Rules-of-origin (ROO) requirements should be as simple, generous and harmonised as possible to minimise trade diversion and red tape. Strong, clean “WTO-plus” FTAs should reinforce domestic economic and institutional reforms to remove market distortions and extend competition. Finally, non-preferential (MFN) tariffs should be low in order to minimise any trade diversion resulting from FTAs.

All this presupposes a sense of economic strategy when entering into FTA negotiations – on choosing negotiating partners, assessing the costs and benefits of negotiating positions, and how they relate to the WTO and to the national economic-policy framework. A sense of strategy, with careful preparation through research, analysis and reflection, is even more important for key FTA negotiations and subsequent implementation than it is in the WTO. Bilateral negotiations with major powers – especially with the USA and EU – are much more issue and resource-intensive than WTO negotiations. They demand better preparation and coordination across different agencies within government, and between government and non-governmental constituencies, especially business.

Unfortunately, the above characterisation is the exception, not the rule, of FTAs in practice. The EU, NAFTA and Australia-New Zealand CER (ANZCERTA) are the exceptions. These have zero tariffs and quotas on all (or almost all) intra-RTA goods trade; comprehensive coverage of services trade and of cross-border investment (in goods and services); WTO-plus commitments on cross-border labour movement (essentially free movement of labour in the EU and ANZCERTA); WTO-plus commitments on government procurement, trade facilitation and competition rules; strong disciplines and intensive cooperation on all manner of non-border trade-related regulation; and, not least, low average MFN tariffs that reduce trade diversion.

However, most other FTAs and customs unions are weak, often falling short of WTO provisions. This is particularly true of South-South FTAs (i.e. between developing countries), but also holds for many North-South FTAs. Such FTAs tend to be driven by foreign-policy aspirations, but with justifications that are all too often vague, muddled and trivial, having little relevance to commercial realities and the economic nuts and bolts of trade agreements. This can amount to little more than symbolic copycatting of other countries' FTA activity and otherwise empty gesture politics. In such cases economic strategy is conspicuous by its absence.

The predictable results of foreign-policy-driven FTA negotiations light on economic strategy are bitty, quick-fix sectoral deals. Politically sensitive sectors in goods and services are carved out, as are crucial areas where progress in the WTO is elusive (especially disciplines on anti-dumping duties and agricultural subsidies). Little progress is usually made in tackling domestic regulatory barriers (e.g. relating to investment, competition, government procurement, trade facilitation, cross-border labour movement, and food-safety and technical standards). These FTAs hardly go beyond WTO commitments, deliver little, if any, net liberalisation and pro-competitive regulatory reform, and get tied up in knots of restrictive, overlapping rules of origin. Especially for developing countries with limited negotiating capacity, resource-intensive FTA negotiations risk diverting political and bureaucratic attention from the WTO and from necessary domestic reforms. Finally, the sway of power politics can result in highly asymmetrical deals, especially when one of the negotiating parties is a major player.

The USA eschews such a "trade-light" approach, rather advertising strong, comprehensive, WTO-plus FTAs. This normally entails major concessions by its negotiating partners, but few US concessions – as the FTAs now in force with Australia and Singapore demonstrate. US FTAs have wide and deep coverage of goods, services and investment, with strong disciplines to limit domestic regulatory discretion and to improve transparency; very strong intellectual-property protection; mutual recognition agreements on standards and professional qualifications; disciplines on government procurement, trade facilitation and competition rules; provisions for temporary movement of business people; and (fairly weak) commitments on labour and environmental standards. The edifice is underpinned by strong dispute settlement, including investor-state dispute settlement, and mechanisms for intensive regulatory cooperation. On the other hand, there are weaker disciplines or carve-outs for some politically-sensitive sectors (particularly in US agriculture); no WTO-plus disciplines on agricultural subsidies or anti-dumping measures; and often complicated and restrictive rules of origin (Sally 2005a).

Latin America, Africa, the Middle East and the ex-Soviet Union now contain a hotch-potch of weak and partial FTAs. The average African country belongs to four different agreements, and the average Latin American country belongs to seven. Overlapping FTAs have different tariff schedules, rules of origin and implementation periods. This is exacerbated by poor implementation and relatively high MFN tariffs. CIS, COMESA, SADC, EAC, WAEMU and SAARC (now SAFTA) are such examples; and they could cost more in lost trade revenues than they gain from tariff preferences (World Bank 2004 & 2005).

Restrictive rules of origin are especially troubling. EU, US and NAFTA rules of origin differ considerably from each other, and have different rules for different products (combining two or more criteria in myriad ways). For instance, NAFTA rules of origin may be equivalent to a tariff of 4.3 per cent; and they could be the main factor in the limited impact of NAFTA on Mexican exports (World Bank 2004: 70). Other FTAs, e.g. AFTA, COMESA and ECOWAS, have less restrictive rules of origin. But nearly all South-South FTAs have significant product-specific exemptions from uniform ROO criteria, a tendency to increasing product-specific ROO complexity, and high-cost certification procedures to determine the origin of goods. In general, even subtle differences in rules of origin can divert trade and associated investment (Estevadeordal and Suominen 2003; WTO 2002).

Is this FTA spaghetti bowl in danger of being replicated in Asia? Or are the new Asian FTAs more serious? Do they hold out the prospect of strengthening regional and global integration? Now it is time to consider in turn the FTA activity of the major Asian players: China, the ASEAN countries, India, Japan and South Korea. Start with China.

### **China and FTAs**

China is considering or negotiating FTAs left, right and centre – in east and south Asia, the Middle East, Latin America, Africa, and with Australia and New Zealand (Antkiewicz and Whalley 2005). It has 9 FTAs on the books and is considering negotiations with up to 30 other countries. Its core FTA strategy, however, is directed at its northeast and southeast-Asian neighbourhood. Politically, China would like to use FTAs to establish leadership credentials in east Asia. Economically, it wants extra export market access as well as secure access to energy and other commodity imports. Overall, China clearly aims to be the political and economic driving force in the region. China-driven FTAs are a means to that end.

Japan dominates the region, with over 50 per cent of east-and-south-Asia combined GDP at market prices. But China's shares of intra-regional trade and regional GDP are growing very fast. After Japan, it is the largest regional importer of parts and components; and it is deeply enmeshed in fast-growing regional production-sharing arrangements, especially in IT products. The bulk of China's regional trading activity takes place in northeast, not southeast, Asia. However, starting from a low base, China's trade with ASEAN has boomed since the second half of the 1990s, and particularly so with the older and more developed ASEAN members (the ASEAN 5: Singapore, Malaysia, Thailand, Indonesia and the Philippines) (Sally and Sen, 2005: 95-97; Ng and Yeats 2003).



Comprehensive, clean, WTO-plus Chinese FTAs with regional partners might make economic sense, given ever-closer trade-and-investment linkages in east Asia, particularly involving global manufacturing supply chains. The problem is that the region subsumes a diverse array of economies with big pockets of protection here and there. Opening to trade with China would leave several sheltered sectors exposed: such as agriculture in Japan and South Korea; and agriculture, textiles and clothing in the lesser-developed ASEAN countries (Indonesia, the Philippines, Cambodia, Laos, Vietnam and Myanmar). Extreme agricultural protection in Japan and South Korea will make comprehensive China-Japan and China-Korea FTAs almost impossible to negotiate. Also, ambitious FTAs between developing countries with similar resource and production structures, and therefore with competing products, are extremely difficult to negotiate. That is the major problem for a China-ASEAN FTA. The risk is that, like inter-developing-country FTAs in the past, it might end up as a bitty deal covering some sectors but with large areas excluded and with restrictive rules of origin. This would minimise mutual gains and increase the risk of trade diversion.

The China-ASEAN set of negotiations, more than any other FTA initiative, is the one to watch in the region. The aim is to have an FTA in place by 2010. It would be the largest FTA ever negotiated, covering 11 diverse economies with a population of 1.7 billion and a GDP of US\$2 trillion. An “early-harvest” programme, in force since July 2005, has cut or eliminated about 10 per cent of tariff lines, mainly in agricultural products. Other tariffs are to be cut and then eliminated on a “normal track” between 2005 and 2010. Ninety-five per cent of tariff lines should be covered by 2010. Some remaining tariffs will be eliminated by 2012; those on a “sensitive list” will be reduced to 0-5 per cent by 2018; and those on a “highly-sensitive list” will have a tariff cap of 50 per cent thereafter. The new ASEAN members have an extension to 2015 and 2020 to comply with normal-track and sensitive-track obligations respectively. The intention is for the Normal Track to cover 90 per cent of China-ASEAN trade – roughly consistent with the post-Uruguay Round understanding of GATT Article XXIV’s “substantially all trade” criterion. Rules of origin are to follow the AFTA (ASEAN Free Trade Area) standard of 40 per cent local content across product groups. A new Arbitral Panel will resolve disputes where consultations fail. WTO disciplines will apply on safeguards, anti-dumping measures, intellectual-property rights, subsidies and countervailing measures, sanitary and phytosanitary standards, *inter alia*. Negotiations are due to begin on services and investment, with economic cooperation planned in other areas (Sen 2004: 75-84; Soesastro 2006).

Revealingly, the initiative, overarching strategy and negotiating motor come from Beijing, not the ASEAN capitals. ASEAN collectively is weak, divided and lacks a common negotiating machinery. Its weaker members, especially Indonesia, the Philippines and the new ASEAN members, are reluctant to open protected agricultural sectors. No wonder that tariff negotiations have been tortuous, and little progress has been made in other areas. That said, the goods negotiations have delivered more progress than expected in terms of Normal Track coverage and reasonably simple, harmonised rules of origin (both on the AFTA model) (Soesastro 2006).

China has a separate mini-FTA with Thailand – basically a preferential sectoral deal on some agricultural products. It has full-fledged FTAs with Hong Kong, Macau and Chile; negotiations underway with Australia, New Zealand, Pakistan and the Gulf Cooperation Council



(GCC); and exploratory talks with Japan, South Korea, India, Brazil, the Southern African Customs Union (SACU) and Iceland.

The FTAs with Hong Kong and Macau are reasonably comprehensive: they eliminate tariffs on all goods trade, with fairly liberal rules of origin; have specific GATS-plus commitments in a range of services sectors; and contain provisions for strong regulatory cooperation in several areas. Basically, these Comprehensive Economic Partnership Agreements (CEPAs), as they are labelled, fulfil Chinese diplomatic objectives while making little economic difference to the mainland; and give Hong Kong and Macau WTO-plus access to the mainland market. The FTA with Chile only covers goods, but does so comprehensively (with zero tariffs on over 95 per cent of bilateral trade by 2015)) and with few exceptions. Trade and Economic Framework (TECF) agreements are in place with Australia and New Zealand. The latter are looking for strong WTO-plus FTAs with China. The China-Pakistan FTA framework agreement contains an early-harvest tariff-elimination package, but little else to date. Negotiations may start soon with India, and maybe a little later with SACU. Both are likely to be mini-FTAs: preferential tariff reductions on a limited range of products – along the lines of the recently concluded SACU-Mercosur Preferential Trade Agreement (PTA) and the likely result of the SACU-India PTA. That is because India and South Africa (as well as other SACU members) are defensive and do not wish to open large swathes of their markets to extra Chinese competition (Alves 2006: 34-37).

A key component of China's FTA strategy is to get wider acceptance of "market-economy" status, especially with anti-dumping actions in mind. China is pushing hard for removal of non-market economy status in the WTO, and bilaterally with the EU and US. Singapore, Malaysia, Thailand, New Zealand and Australia have already accorded China market-economy status. The other ASEAN countries did the same in a joint statement (*Straits Times* 2004). Brazil and South Africa have followed. It is not accidental that China is in or talking about FTA negotiations with the countries that have conceded market-economy status. This is bound to be a central Chinese demand in FTA talks with countries outside the region.

In all, China is making the running on FTAs in Asia. Its approach is pragmatic and eclectic, ranging from strong (Hong Kong and Macau) to middling (probably ASEAN) to weak (probably India, SACU and other countries in Africa, the Middle East and elsewhere). Trading interests are placed in the context of foreign-policy priorities of diplomacy and relationship building. The Chinese preference is for short texts, to be filled in pragmatically as negotiations proceed; and consensus-based decision making and conciliation rather than legalistic procedures (Antkiewicz and Whalley 2005: 1540, 1554-1555).

It is already apparent that China's FTAs are driven more by "high politics" (competition with Japan to establish leadership credentials in east Asia; securing privileged influence in other regions) than economic strategy. The latter is barely evident in China's seeming readiness to negotiate (economically nonsensical) PTAs outside east Asia. This contrasts with China's engagement in the WTO. In the latter, its approach is clearly linked to national economic policies that have a single-minded focus on growth. Commercial realities are front and centre in what China does in the WTO. This stands in contrast to most other players, including the

USA, EU, India and Brazil, who sometimes let extraneous political considerations distract attention from the commercial facts on the ground.

The danger is that China's politics-driven FTAs will crowd out sensible, grounded economic strategy. That would be the fast track to weak, partial FTAs that create little trade but a lot more political and economic complications. That is what other players, big and small, are doing. But it would be a serious mistake for China to copy them. FTAs, rather, should fit into the mould set by economic policies at home and in the WTO.

This assessment must, however, be qualified: China's approach to FTAs in east Asia is more serious than it is outside the region. Negotiations are ongoing and there is much to play for. It is still too early to pronounce definitively on China's FTAs.

### **Southeast Asia and FTAs**

Turning to southeast Asia, Singapore blazed the FTA trail, with Thailand next to follow, and now Malaysia, Indonesia and the Philippines trying to catch up. Singapore has agreements in force with Australia, New Zealand, Japan, USA, Jordan, EFTA, South Korea, India, Panama, Qatar and the P4 (a four-way FTA with Brunei, Chile and New Zealand); and several others proposed or under negotiation (with SACU and countries in the Americas, the Middle East and south Asia). Thailand has agreements in force with Australia, New Zealand, Bahrain, China and India, and one concluded with Japan; it is part of the BIMSTEC framework agreement; it is in negotiations with the USA, Peru and EFTA; and is considering yet more FTAs, e.g. with Chile, SACU and Pakistan. Malaysia has an agreement with Japan, is negotiating with the USA, Australia, New Zealand, India, Pakistan and South Korea, and considering other initiatives. Indonesia is negotiating with Japan and may soon start negotiations with Australia and New Zealand. The Philippines is negotiating with Japan and wants an FTA with the USA. Vietnam has an FTA with the USA, is negotiating with Japan and considering other negotiations. In addition, ASEAN collectively has negotiations with China, India, Japan, Australia-New Zealand CER and South Korea (Sen 2004; Sen 2006).

Are strong and credible FTAs emerging in southeast Asia? Optimists would point to the Singapore experience. Singapore does have reasonably strong, WTO-plus FTAs with developed countries, and an especially strong FTA with the USA. All this fits well with the Singapore context of free trade in goods, accelerated unilateral liberalisation of services and a strong regulatory infrastructure. Furthermore, bilateral FTAs envisaged or being negotiated by other ASEAN countries, as well as those involving ASEAN collectively, go well beyond old-style FTAs covering goods alone. They are intended to be WTO-consistent, and notified under Article XXIV GATT and Article V GATS. Their scope extends to services, investment, trade facilitation, regulatory cooperation and dispute settlement (Sen 2006).

On the other hand, Singapore is a misleading indicator for the wider region. Like Hong Kong, it is a free port with zero tariffs on goods, hardly any agriculture and, by regional standards, fairly open services sectors. It is a tiny city-state with efficient, joined-up government, world-class regulatory standards, and solid capacity to negotiate and implement wide and deep trade agreements. Hence it is pretty easy to negotiate WTO-plus FTAs with Singapore. But

these are highly exceptional conditions: nearly all other countries in the world, including all other ASEAN countries, have much more complicated politics and economics. They have more protectionist interests to defend, especially in agriculture and services; bigger, more complicated and divided governments subject to multiple interest-group pressures; weaker institutions and regulatory standards; and weaker capacity to negotiate and implement trade agreements. Predictably, compared with Singapore, they have a fuzzier idea of what FTAs entail. The danger is that they may draw the wrong lessons from Singapore's FTA pathfinder role, and end up with a far messier patchwork of weak, market-distorting FTAs (Sally and Sen 2005: 108).

Thailand provides a better indicator than Singapore of FTAs in southeast Asia and beyond. Its FTAs have been rushed: careful preparation has been conspicuously lacking. Too many negotiations have been launched, and they have proceeded too fast. High-level policy direction to negotiators has been lacking. The residual FTA logic seems to be narrowly mercantilist: export market access in a few sectors is sought in return for import concessions in a few others, while otherwise preserving the domestic-protectionist *status quo*. This trade-light approach has resulted in weak FTAs that will make little positive difference to competition and efficiency in the Thai economy, but will create complications in the process (not least with a bewildering array of ROO requirements). The US-Thai FTA is likely to be the sole exception due to American demands for wide and deep commitments (though it will add to Thailand's ROO noodle bowl). But negotiations have run into serious domestic opposition in Thailand, which threatens to derail them altogether (Sally 2005a).

Thus far most signs point to ASEAN countries becoming entangled in a web of weak and partial FTAs. First, there is negligible trade with some FTA partners chosen by individual ASEAN countries (e.g. in south Asia, the Middle East, Africa and Latin America). This means any gains are likely to be minimal. Second, some product areas, especially in agriculture, are likely to be excluded from goods liberalisation, though this may still be interpreted as consistent with Article XXIV GATT's "substantially all trade" criterion. Third, non-tariff and other regulatory barriers are unlikely to be tackled with disciplines that go much deeper than existing WTO commitments. That also applies to disciplines on anti-dumping duties and safeguards. Fourth, services commitments are unlikely to advance much beyond GATS, let alone deliver meaningful net liberalisation or regulatory cooperation (e.g. on mutual recognition of standards and professional qualifications). Provisions on investment and the temporary movement of workers are also likely to be weak, with perhaps even weaker commitments on government procurement and competition rules. Fifth, cooperation on trade facilitation, especially customs procedures, may prove more promising; but other economic-cooperation measures, such as on infrastructure and small-to-medium enterprises, will probably be vaguely worded, long on gesture and short on substance.

FTAs with the USA will, however, be exceptions to the above scenario. They will have strong provisions in the main areas mentioned above, very strong disciplines on intellectual property protection, and weaker ones on labour and environmental standards.

Sixth – and probably more important than all the above considerations – it is already apparent that agreements in force and those being negotiated are spinning a spider's web of complex

and restrictive rules of origin that differ between agreements and will prove cumbersome and costly for businesses to implement. Instead of simple, general and liberal rules of origin, e.g. based on a flat percentage of regional-value content (RVC) of the final exported product, a bewildering array of differing product-specific criteria is emerging. These combinations of RVC and product-specific criteria differ between bilateral FTAs. Collective ASEAN FTAs with third countries will compound the problem, if (as is quite likely) they end up with rules of origin that differ not only between these ASEAN-plus FTAs, but also from bilateral FTAs ASEAN countries have with the same third countries.

If this is indeed what emerges, the administrative and other costs of complying with different FTAs with differing rules of origin could be too onerous for most exporters in the region. Many will find it cheaper to pay the MFN-tariff duty than to comply with complex rules of origin in order to export their products duty free.<sup>7</sup> Little trade (and associated FDI) will be created, but there will be more work for customs officials (Sen 2006; Sally and Sen 2005: 108–110).

Seventh and last – but by no means least – the aforementioned defects of bilateral FTAs are likely to be replicated in the collective ASEAN FTAs with third countries. Tariff negotiations with China have delivered more than anticipated, but much else of the FTA remains to be filled in. However, negotiations with other FTA partners are proceeding much more slowly. One main obstacle seems to be the extreme difficulty in achieving common ASEAN positions on anything of substance. If that is so with tariffs, it is likely to be worse with non-tariff barriers, services trade and investment.

## India and FTAs

India is also newly active with FTAs, in its south-Asian backyard, across to southeast Asia, and, in the opposite direction, to the Middle East, Africa and Latin America (Sen 2006). In south Asia it has an FTA with Sri Lanka, which is about to be upgraded; a much weaker one with Nepal; and one being negotiated with Bangladesh. Hitherto loose regional cooperation is supposed to be transformed into the South Asian FTA (SAFTA) by 2010, leading to a customs union by 2015 and economic union (whatever that means) by 2020 (Dubey 2004). But this looks very much like ASEAN Vision statements: rhetorically ambitious but unachievable in practice. For starters, SAFTA excludes Indo-Pakistani trade. Planned negotiations are only on goods; they do not cover services, investment and other non-border market access issues. There are bound to be plenty of exemptions on goods, given similar trade structures with competing products (especially in agriculture). There will be serious ROO complications. Finally, severe political problems in the region (the Indo-Pakistani conflict over Kashmir, and the fact that India is completely surrounded by weak, failing or failed states) will make progress very difficult.

India's approach to FTAs outside south Asia is mostly about foreign policy, with little economic sense or strategy. An FTA with ASEAN is planned for completion by 2011; and bilateral FTAs are also in place with Thailand and Singapore. The India-Thailand FTA is intended to be comprehensive, but is to date limited to an early-harvest that has eliminated tariffs on just 82 products, with very restrictive rules of origin imposed by the Indian government. ASEAN-

India negotiations have also been bedevilled by India's insistence on exempting swathes of economic activity and on very restrictive rules of origin for products covered. The Thailand-Singapore FTA has more content. Indeed, it is the only Indian FTA to come anywhere near comprehensive coverage. India is also exploring an FTA with Malaysia.

In addition, India is part of the BIMSTEC group (the other members being Bangladesh, Sri Lanka, Nepal, Bhutan, Thailand and Myanmar) that plans an FTA by 2017. It has preferential trade arrangements – basically limited tariff-concession schemes – with Mercosur, Chile and Mauritius. India, South Africa and Brazil are planning a (very partial) three-way PTA that would cover certain goods. India is in negotiations with South Korea and the Gulf Cooperation Council (GCC); and it is exploring FTA options with Japan and China.

All signs are that India is spinning a web of weak and partial FTAs around it. This fits with India's overall trade and wider economic-policy profile. Since 1991, trade-and-investment liberalisation has been fitful, incremental and overwhelmingly unilateral. There has been little reliance on reciprocity – trade negotiations and trade agreements – to induce liberalisation at home. India remains defensive in the WTO; and its new FTAs are shallow. Such features reflect tight domestic political constraints (Lawrence and Chadha 2004: 10-11, 44-46). An alternative, more coherent trade-policy package would contain stronger and more comprehensive unilateral liberalisation, reinforced by more positive WTO activity (more flexibility in negotiations and stronger legal commitments) and stronger FTAs. But that would probably require more domestic political space than exists today.

## Japan and FTAs

Japan was the last major trading nation to hold out against discriminatory trade agreements, preferring the non-discriminatory WTO track instead. This has changed decisively in the past five years. Japan's first FTA was with Singapore, and it has been in force since 2002. Then followed an FTA with Mexico, which included very limited tariff liberalisation for some Japanese agricultural imports.

Japan's biggest FTA initiative is the Japan-ASEAN Economic Partnership Agreement, which is supposed to be completed by 2012. It is comprehensive on paper, covering goods, services, investment, trade facilitation and several areas for economic cooperation (Sen 2004). However, progress has been slow – much slower than in the China-ASEAN FTA. This is due to Japanese reluctance to reduce and then phase out agricultural tariffs, and to its insistence on restrictive and often product-specific rules of origin, especially for agricultural products (though for some manufacturing products as well). Another complicating factor is that Japan has given greater priority to bilateral FTA negotiations with individual ASEAN countries. In addition to Singapore, it has recently concluded FTAs with Malaysia and Thailand, and is negotiating with Indonesia and the Philippines. The FTA with Malaysia has come into force; but the one with Thailand has not yet been signed due to the Thai general election. Rules of origin in these bilateral FTAs are also complicated and restrictive. Such bilateralism, especially with its noodle-bowl profusion of rules of origin, is going to make it very hard to achieve a clean, comprehensive Japan-ASEAN FTA. The latter risks ending up as a loose umbrella for a series of bilateral FTAs (Soesastro 2006).

The Japan-Thailand FTA is indicative of Japan's overall approach to FTAs. It is a weak agreement born of mutual defensiveness. Thailand has long transition periods for phasing out tariffs in steel and auto parts; and it has exempted large passenger cars from the agreement. In agriculture, Japan has exempted rice, cassava, beef, dairy, sugar and some other products, and agreed to limited tariff liberalisation in other products. Rules of origin are very restrictive on agricultural and fisheries products – at Japanese insistence. Other market-access elements of the FTA, e.g. on services and investment, are barely WTO plus; and there is hardly any advance on WTO regulatory disciplines in other areas (e.g. SPS, government procurement and competition rules) (Sally 2005a).

Japan has several other FTA initiatives in train. Negotiations have started with Chile, and are due to start soon with India, Vietnam and the GCC. Negotiations with South Korea have stalled. There are proposals to negotiate with Australia, SACU and EFTA.

Japan calls its FTAs “economic partnership agreements” (EPAs) – to indicate that they go beyond traditional FTAs in goods and have comprehensive coverage of trade and investment-related issues in goods and services. That is misleading. EPAs are euphemisms for weak and partial FTAs. In essence, Japan seems to be reacting to China's FTA advance, but without a real strategy. It is much more defensive than China on agriculture and appears not to be interested in ambitious market-access coverage. Also in contrast to China, it seems to prefer bilateral deals with ASEAN countries individually to something more challenging with ASEAN collectively. The latter is, of course, much more difficult to negotiate but holds out the prospect of commensurately greater gains.

### **South Korea and FTAs**

South Korea has FTAs in force with Singapore, EFTA and Chile. An ASEAN-Korea framework FTA was announced in December 2005. Like other ASEAN FTAs, it covers goods, services, investment and other trade-related issues. The aim is to eliminate over 90 per cent of tariffs by 2010. South Korea has carved rice out of the agreement – prompting Thailand to refuse to join the FTA. Negotiations are due to start with India, Canada and Mexico; and South Korea is exploring the possibility of FTAs with China, Mercosur and Australia.

The really big news is the launch of FTA negotiations with the USA. This is by far the most important FTA initiative for South Korea; and by far the most important US FTA initiative in Asia. These talks will prove extremely difficult for South Korea. So far, South Korea, like Japan, has relied on a very trade-light approach to FTAs, especially in carving out much of agriculture. This will not wash with the USA. The latter's approach will be similar to its other FTAs: it will insist on wide and deep commitments in goods (including agriculture), services, investment, trade facilitation, government procurement, competition rules and intellectual-property protection. The US FTAs with Australia and Singapore, and its negotiations with Thailand and Malaysia, provide a good indication of what lies ahead.



## Prospects for regional economic integration: APEC, ASEAN; an east-Asian or pan-Asian FTA?

Having examined bilateral and plurilateral FTAs in the region, now look at other vehicles for regional economic integration. These are APEC and ASEAN, both of which predate the new wave of FTAs; and ideas for pan-east Asian and pan-Asian FTAs in the future.

APEC's heyday was when it was a cheerleader for non-discriminatory unilateral and multilateral liberalisation in the early-to-mid 1990s. It has lost its way since the Asian crisis: its membership is too diverse and unwieldy for there to be any meaningful trade-policy consensus; its agenda has become impossibly broad and unfocused; and attention has shifted to bilateral and plurilateral FTAs (Scollay, 2001: 1144; Ravenhill, 2000: 322, 324-325). APEC's vaunted Open (i.e. non-discriminatory) Regionalism is dead in the water; and these days it is driven by shallow conferencitis and summitry. It cannot be expected to contribute anything serious to regional economic integration.

The ASEAN Free Trade Area (AFTA) is the vehicle for economic integration in southeast Asia. Its progress has not been that great. True, the Common Effective Preferential Tariff (CEPT) scheme was brought forward; and the ASEAN-6 will eliminate all duties on intra-ASEAN trade, save items on the Exclusion List, by 2010, with a deadline of 2015 for the new members. On the other hand, little progress has been made on "AFTA-plus" items, particularly the ASEAN Investment Area (AIA), the ASEAN Framework Agreement on Services (AFAS), non-tariff barriers, and mutual recognition and harmonisation of standards (Sally and Sen 2005: 107-108).

ASEAN member-governments now have a "vision" to create an ASEAN Economic Community (AEC) by 2020, with a single market for goods, services, capital and the movement of skilled labour. This includes a proposal to "fast-track" 11 priority sectors that account for over half of intra-ASEAN trade. Like other ASEAN Visions, however, this one, while ambitious in general statements of principle and rhetoric, is ambiguous on practical goals, methods and deadlines *en route* to 2020.

So far, ASEAN Vision Statements and other blueprints have largely failed to remove the barriers to commerce in Southeast Asia. They seem rather distant from the commercial ground realities. Hence it is not surprising that ASEAN matters are dominated by politicians and officials, with an attendant circus of academics and think tanks; but interest and engagement on the part of business remains absent as usual.

Last, there is much talk in the region of folding bilateral and ASEAN FTAs into larger, integrated FTAs that would cover east Asia, and perhaps include south Asia too. An ASEAN Plus Three (APT) FTA (the "three" being Japan, South Korea and China) has been touted, as has an east-Asian FTA that might include Australia and New Zealand. There is talk of a pan-Asian FTA that would include India or SAFTA. Visions of an APEC FTA, East Asian Economic Community and even an Asian Economic Community have appeared on the horizon. The first East Asian Summit, held in Kuala Lumpur in November 2005, was supposed to get these bigger regional-integration efforts underway, at least for east Asia (Soesastro 2006).



CGE modelling exercises tend to predict very modest welfare gains from FTAs between small and medium-sized countries; bigger gains when large countries are involved (with concomitant trade-diversion costs for non-members); and much bigger gains from large regional agreements (again with costs for non-members) (Scollay and Gilbert 2001; Brown, Dear-dorff and Stern 2003: 826-827). Hence the logic of an east-Asian, pan-Asian or APEC FTA. However, the predictable failure of the East Asian Summit to deliver anything of substance speaks volumes about grand visions for regional economic integration. So far the talk is loose and empty – nothing more. Regional players are speeding ahead with quick and dirty bilateral (country-to-country) FTAs, while little progress is being made with the larger ASEAN FTAs (with the exception of the ASEAN-China FTA). The emerging pattern is of a patchwork of bilateral “hub-and-spoke” FTAs, in a noodle bowl of trade-restricting rules of origin. That will probably hinder, not help, the cause of regional economic integration (Ariff 2006).

More generally, bitter nationalist rivalries (especially in northeast Asia and between India and Pakistan), and vast inter-country differences in economic structure, development, policies and institutions, will continue to stymie Asian regional-integration efforts for a long time to come. This applies to east Asia; it applies even more to south Asia. Hence the EU model of close political cooperation and dense institutional integration is inapplicable to the region (Soesastro 2006). In reality, regional economic integration will at best be ASEAN-minus. Even that may be over-ambitious.

The more sensible FTA optimists, at least in east Asia, would counter with the following points. First, the risk of trade diversion is small given that average tariffs in east Asia are low compared with other developing-country regions. Indeed, much intra-regional trade, especially in IT products, is duty free. Second, perhaps loose APT or wider regional cooperation will evolve to iron out ROO complications and set other minimum, WTO-compatible FTA standards (Baldwin 2006). In this scenario, east-Asian FTAs will do little harm, and maybe some good.

One cannot be so sanguine. The emerging FTA noodle bowl in east Asia will still have pockets of trade diversion. These will be sectors like agriculture and textiles with high tariffs, tariff escalation, assorted non-tariff barriers – and restrictive preferential rules of origin. Their effects will be felt in the next 5 years or so as preferential agreements come into force.

In south Asia there is a higher risk of trade diversion, given much higher average MFN tariffs, as well as high tariff and non-tariff barriers that severely restrict intra-regional trade.

The heart of the matter is that within and across south, southeast and northeast Asia, cross-border commerce is throttled by the protectionist barriers that developing countries erect against each other. The type of FTAs that are being negotiated do not presage a return to 1930s-style warring trade blocs. But they are highly unlikely to make a big dent in existing barriers and thereby spur regional economic integration. They might complicate east-Asian intra-regional production networks (the Factory Asia phenomenon), and distract attention from further unilateral liberalisation and domestic reforms. These FTAs have the hallmarks of trade-light agreements. Some might even come close to being “trade-free” agreements. A blunt, uncharitable Texan would say that they are “all hat and no cattle”. As Montaigne said of

Seneca's writing, most of these PTAs make "more sound than sense", and some might even be "pure wind".

Going about FTAs the wrong way – negotiating weak agreements with ROO complications that deflect attention from sensible unilateral reforms and the WTO – could easily lead to a world where most international trade would be governed by arbitrary market-distorting preferences. Then the cornerstone of the multilateral trading system, the principle of non-discrimination embodied in the GATT's Most-Favoured-Nation clause, would become more an abstraction than concrete reality. MFN would end up as LFN – Least-Favoured-Nation treatment. This would make a mockery of comparative cost advantages, the foundation of sensible and mutually advantageous globalisation (Sutherland 2005).

## ASIA IN THE WTO<sup>8</sup>

Frenetic FTA activity does raise questions about Asian countries' engagement in the WTO and their commitment to the multilateral trading system. Do FTAs reinforce Asian influence in the WTO? Or do they divert attention from it? What impact do they have on Asian participation in the Doha Round, and in the longer-term future of the WTO?

Some Asian countries were active in the Uruguay Round, though in different ways. India was arch-defensive and led developing-country opposition to developed-country demands. Japan, at the other end, was an active *demandeur* in market-access and rules negotiations. South Korea, Hong Kong, the ASEAN countries, Australia and New Zealand were newly active in the GATT, alongside their general shift to liberal, outward-oriented trade policies and their increasing integration into the world economy.

Since the Uruguay Round, all the above players have become institutionally well-integrated into the WTO. They have reasonably well-staffed missions in Geneva; take an active part in WTO committees and working groups; are actively involved in formal and informal coalitions on particular issues; and have initiated anti-dumping actions and dispute settlement complaints (both complex tasks). All this presupposes a critical minimum of trade-policy capacity, which the overwhelming majority of developing countries do not possess. Of course other Asian countries with lower levels of development have less trade-policy capacity and are less active in the WTO. This applies to most south-Asian countries and the poorer ASEAN members.

What is the Asian state of play in the Doha Round? India has become even more active than it was in the Uruguay Round, and can lay claim to be one of the three developing-country "big beasts" in the WTO (the other two being Brazil and China). As before, it is generally defensive on the main negotiating issues. However, it has become slightly more flexible on market-access issues, and has discovered offensive interests in the services negotiations. But it needs to be much more flexible. That would bring India's WTO activity closer into line with unilateral reforms at home, and send a powerful liberalising and system-supporting signal to other WTO members.

Japan and South Korea are visibly less active in the Doha Round than they were in the Uruguay Round. They remain arch-defensive on agriculture, and are otherwise passive bystanders. Most conspicuously, Japan punches well below its economic weight in the WTO. Taiwan acceded to the WTO the day after China, but cross-straits political tensions have prevented it from becoming a fully active WTO member. Hong Kong remains a separate member of the WTO after its handover to China. Its WTO activity, however, has been overshadowed somewhat by the accession of the mainland. The ASEAN countries have a kaleidoscope of Doha-Round positions: Singapore has clear market-access priorities; the others have mixed positions, with Indonesia and the Philippines particularly defensive on agriculture. Like their northeast-Asian counterparts, the ASEAN countries have diverted political attention and negotiating resources away from the WTO and towards FTAs. Overall, east-Asian countries are much less active in this round than they were in the Uruguay Round.

The big news for Asia in the WTO is China's accession in 2001. China's WTO commitments are by far the strongest of any developing country in the WTO. This holds for tariff ceilings on goods (including agriculture); non-tariff barriers in goods *and* services; transparency obligations; all manner of domestic regulatory disciplines; and administrative and judicial-review procedures. As a result, China's levels of trade protection are rather low by developing-country standards; and it has acquired a strong stake in a rules-based multilateral trading system. Hence it has been active in the Doha Round, though in a quiet, behind-the-scenes manner. It has been decidedly non-dogmatic and non-confrontational on the main negotiating issues.

Asia needs an effective WTO. East Asia's integration with the world economy gives it a long-term stake in a liberal trading system underpinned by strong, non-discriminatory rules. A patchwork of overlapping and discriminatory FTAs is not enough; and, in the absence of a healthy multilateral system, will probably be damaging. This logic applies compellingly to south-Asian countries too, given their increasing integration into the world economy.

However, with the exception of China, east-Asian countries have been neglecting the WTO in favour of FTAs. That is extremely myopic. They should be active individually and in forging coalitions with like-minded WTO members to advance market-access and rules priorities. Some south-Asian countries, especially India, remain active in the WTO, but are too defensive and inflexible.

Japan, South Korea, Taiwan, Hong Kong, China, India and the more advanced ASEAN members are in an outer core of about 50 countries that need to be active to revive the Doha Round and the WTO's longer-term fortunes. This group comprises the OECD plus about 20 developing countries which collectively account for close to 90 per cent of world trade and FDI. China and India are in an inner core (including the USA, EU and Brazil) that needs to exercise leadership. Without that nothing will move.<sup>9</sup>

## CHINA AND THE UNILATERAL PROGRESS TO FREER TRADE<sup>10</sup>

It is customary to look first to the WTO, or now to FTAs, or to a combination of the two, to advance the liberalisation of international commerce. This is questionable. In Asia and elsewhere, there is too much emphasis on trade *negotiations* and not enough on trade policy linked

to sensible home-grown economic and institutional reforms. Trade negotiations have their place; but they have distinct limits. The transition from GATT to WTO has narrowed the possibilities for multilateral liberalisation and rule strengthening – as the Doha Round has amply demonstrated. Similarly, much-hyped bilateral and regional FTAs are unlikely to inject large doses of additional liberalisation, but will create extra political and economic complications.

Therefore, governments in the region cannot rely on external negotiations for meaningful trade-policy reform. Rather the bulk of external liberalisation and associated “second-generation” institutional reforms will likely come from unilateral measures that spread through competitive emulation – outside trade negotiations.

That is indeed the recent track record. The World Bank estimates that 65 per cent of developing-country tariff liberalisation between 1983 and 2003 ( a 21 per-cent cut in average weighted tariffs) has come about unilaterally, with 25 per cent coming from the Uruguay-Round Agreements and only 10 per cent from RTAs (World Bank 2005: 5). Northeast and southeast-Asian trade-and-FDI liberalisation has been overwhelmingly unilateral. Now this applies to south Asia too. Most recently, the bulk of China’s massive external liberalisation was done unilaterally, not through international negotiations, and *before* WTO accession. China’s extremely strong WTO commitments, and its pragmatic and businesslike participation in the WTO post-accession, are more the consequence than the cause of its sweeping unilateral reforms.

Arguably, China is in many ways today what Britain was in the second half of the nineteenth century: the unilateral engine of freer trade. True, China is far from being the top dog Britain was in the nineteenth century. Nevertheless, it is probably spurring a pickup in trade-and-FDI liberalisation elsewhere in east and south Asia – notably in India. Would all this have happened, or happened as fast, if China had not concentrated minds? Probably not. The southeast-Asian countries in between have slowed down the momentum of liberalisation and regulatory reform since the Asian crisis while China and India have speeded up. The policy gap with China in particular has narrowed. For Southeast Asia to take advantage of the opportunities offered by China’s and India’s global integration, and overcome more-exposed weaknesses caused by protectionist policies and weak institutions, there has to be further liberalisation and regulatory reform. This is less likely to come about through the WTO, FTAs and ASEAN regional cooperation, and more likely to result from unilateral measures by individual governments in response to internal and external conditions. China and India should concentrate minds within ASEAN countries; and it is up to them to follow the liberalisation train through competitive emulation.

That is not to say that a China-induced unilateral method is a total solution. It is unlikely to induce unilateral liberalisation in the developed world, and least of all from the USA, EU and Japan. In the developing world, its results will inevitably be patchy and messy. On its own it cannot slay protectionist dragons and solve international commercial conflicts – least of all in agricultural trade, where unilateral liberalisation has been much more limited than in industrial goods and services. That leaves room for the WTO and FTAs, but these are at best *second* instances of trade policy. But it is important to get priorities right and follow the process bottom-up, not top-down.

## CONCLUSION

Trade policy in Asia is now highly unbalanced. It relies too much on (weak and partial) FTAs. These are probably not going to tear down the remaining protectionist barriers that matter. Consequently, they will not be the driving force of regional economic integration or further integration with the global economy. On the contrary, the emerging hub-and-spoke pattern of dirty FTAs threatens to be a force of regional economic disintegration – especially if the multilateral trading system weakens further.

However, FTAs are a reality; they cannot be wished away; but they can be improved; and they can fit better with trade policy on unilateral and multilateral tracks. That calls for comprehensive, WTO-plus FTAs with simple, harmonised rules of origin. At the same time, Asian governments, particularly in east Asia, should redirect attention to the WTO, with a clear focus on further liberalisation and stronger non-discriminatory rules to underpin it.

More fundamentally, trade policy matters more than trade negotiations. Governments in the region, however, are acting as if it were the other way round. They are relying too much on trade negotiations – particularly FTAs – while neglecting sensible trade-policy reforms at home. This is a reversal of pre-Asian crisis reliance on (non-discriminatory) unilateral liberalisation. What might change this picture is the mind-concentrating effect of faster unilateral reforms in China and India – China in particular. The Chinese engine of unilateral free trade might just induce a fresh spurt of liberalisation and structural reform elsewhere – but perhaps largely outside trade negotiations. Only with such market-based reforms at home do FTAs make sense – not least to minimise the effects of trade diversion.

## Notes

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1. This is an expanded version of a paper that was presented to a conference organised by the Japan Centre for Economic Research in Tokyo, April 2006, and which will appear in the *Asian Economic Policy Review*, Special Issue on Regional Integration in East Asia.

2. The following draws on Martin Wolf, “Why Europe was the past, the US is the present and a China-dominated Asia the future of the global economy”, *Financial Times* 22 September 2003; Sally 2005b; Sally and Sen 2005: 93-101.

3. The following draws on Sally and Sen 2005: 101-107; Sally 2005b: 10-20.

4. <[www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey1\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm)>.

5. The EU has steered clear of FTA negotiations in the region, arguing that WTO negotiations should take priority. Instead it has the TREATI (Trans-Regional EU-ASEAN Trade Initiative) framework for trade-and-investment regulatory cooperation with the ASEAN countries. However, the EU has set up a joint study group with ASEAN to explore the possibility of an FTA, which will report in 2006. See “EU and ASEAN to study possible free trade deal”, *Jakarta Post*, 27 April 2005.

6. The following account on FTA motives, advantages and disadvantages draws on World Bank (2000); World Bank (2004); World Bank (2005); Desker (2004).

7. This is already the case with AFTA, whose take-up of preferences stands at a practically insignificant 3 per cent. This compares with close to 50 per cent for the EU's FTAs and 64 per cent for NAFTA – both considered low utilisation rates. Given quite low average tariffs in ASEAN countries, the costs of ROO compliance probably exceed AFTA's minuscule preference margins (Baldwin 2006; Estevadeordal and Suominen 2003).

8. The following draws on Sally 2005b: 23-38; Sally 2004.

9. On overall Doha Round developments and the future of the WTO, see Sally 2006.

10. This section draws on Sally 2006: 18-22.

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