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# The move to preferential trade on the Western Pacific Rim: some initial conclusions

John Ravenhill*

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# The move to preferential trade on the Western Pacific Rim: some initial conclusions

JOHN RAVENHILL*

*Since the turn of the century the Asia-Pacific region has become the most active location for the negotiation of preferential trade agreements (PTAs)—a dramatic change from the period before the financial crises of 1997–98. Substantial variance in scope exists among the more than 80 PTAs currently being implemented, negotiated or which are under study in the region. Those involving the United States are by far the most comprehensive. At the other end of the spectrum are those involving ASEAN and China, which are largely 'aspirational' in their provisions. This variance points to the range of economic and political objectives that PTAs serve. Regardless of the comprehensiveness of their coverage, the overall economic effects of the new PTAs is likely to be small given the prevailing low level of tariffs, the intervention of other factors such as fluctuating exchange rates, the proliferation of agreements (which removes the advantages they accord individual partners), and the unwillingness of governments to liberalise 'sensitive' sectors. Few of the agreements move substantially beyond existing WTO provisions. The proliferation of PTAs not only has tended to shift attention and resources away from negotiations at the global level but also runs the risk of fragmenting the 'pro-liberalisation' coalition in countries that have signed multiple agreements.*



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

Since the turn of the century, the Asia-Pacific region has become the most active location for the negotiation of PTAs. The proliferation of agreements represents a dramatic transformation from the situation that applied only a few years before. Before the East Asian financial crises of 1997–98, only one preferential trade agreement of any substance existed in East Asia—the Association of Southeast Asian Nations (ASEAN) Free Trade Agreement

John Ravenhill is Professor in the Department of International Relations, Research School of Pacific and Asian Studies, Australian National University. <john.ravenhill@anu.edu.au>

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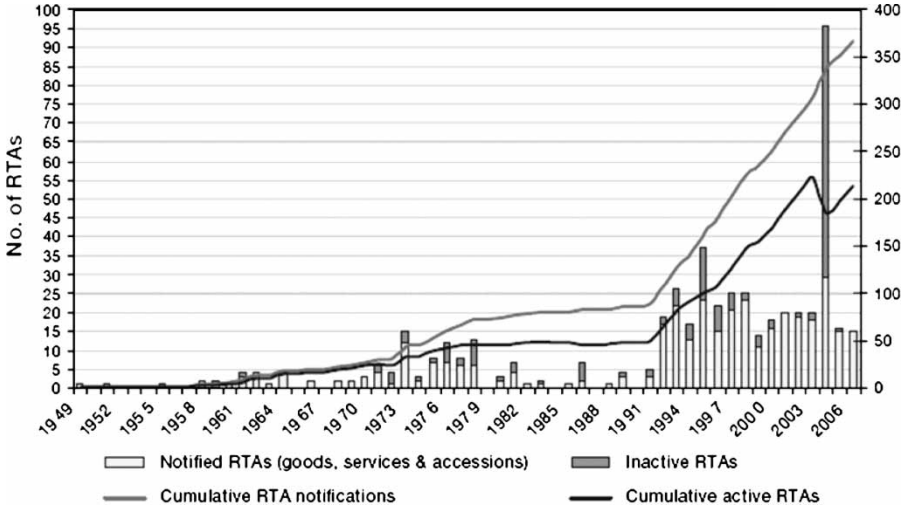


Figure 1. Number of PTAs notified to the GATT/WTO by year of entry into force
*Source*: (Fiorentino, Verdeja and Toqueboeuf, 2007 Chart One).

(AFTA).[3] None of East Asia's major economies—China, Japan, Korea, and Taiwan—were parties to a preferential agreement. In the five years following the crisis, they all jumped aboard the PTA bandwagon—and the Australian government and others that had similarly been sceptical of such agreements in the past joined suit. Today, there are more than 80 PTAs involving East Asian economies that are either being implemented, negotiated or the subject of study groups (Table 1).

## Scope and Motivations of Asia-Pacific PTAs

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

While all of these treaties constitute some variant of preferential trade agreement, they are far from identical in their scope (or, indeed, in the motivations of the participants). Table 2 highlights the principal country differences in the design of the agreements. The table reflects my judgements on the typical content of these PTAs. Such content reflects not just national preferences but what limitations to achieving its domestic preferences a country is willing to accept and yet still sign on to an agreement.

Table 1. Bilateral and Minilateral PTAs Involving the Economies of East Asia and Oceania (June 2007)

| Country/ Grouping | Implementing/ Signed | Negotiating | Study Group |
|---|---|---|---|
| ASEAN | AFTA[#], China, Korea | Australia-New Zealand, India, Japan | EU, US |
| Australia | New Zealand, Singapore, Thailand, US | ASEAN, Chile, China, Gulf Cooperation Council, Japan, Malaysia. | Indonesia, Korea |
| Brunei | AFTA, Chile-New Zealand-Singapore* | Japan | US |
| Cambodia | AFTA | | |
| China | ASEAN, Chile, Hong Kong, Macau, Pakistan Thailand | Australia, Gulf Cooperation Council, Iceland, New Zealand, SACU[§], Singapore | India, Japan-Korea, Korea, Peru, South Africa |
| Hong Kong | China | New Zealand | |
| Indonesia | AFTA, Japan | Pakistan | EFTA, India, US |
| Japan | Indonesia, Malaysia, Mexico, Philippines, Singapore, Thailand | Australia, ASEAN, Brunei, Chile, Gulf Cooperation Council, Korea, Vietnam | Canada, India, South Africa, Switzerland |
| Korea | ASEAN**, Chile, EFTA, Singapore, US | Canada, India, Japan | Australia, China, EU, India, China-Japan, Malaysia, MERCOSUR[±], Mexico***, New Zealand, South Africa, Thailand |
| Lao, PDR | AFTA | Thailand | |
| Malaysia | AFTA, Japan | Australia, New Zealand, Pakistan, US | Chile, India, Korea |
| Myanmar | AFTA, BIMSTEC**** | | |
| New Zealand | Australia, Singapore, Thailand, Brunei-Chile-Singapore* | ASEAN, China, Gulf Cooperation Council, Hong Kong, Malaysia | India, Korea, Mexico |
| Philippines | AFTA, Japan | | Pakistan, US |
| Singapore | AFTA, Australia, EFTA, India, Japan, Jordan, Korea, New Zealand, US, Brunei-Chile-New Zealand* | Bahrain, Canada, China, Egypt, Kuwait, Mexico, Panama, Peru, Qatar | Pakistan, Sri Lanka, UAE |
| Taiwan | Guatemala, Nicaragua, Panama | Dominican Republic, El Salvador, Honduras, Paraguay | |

Table 1 (*Continued*)

| Country/ Grouping | Implementing/ Signed | Negotiating | Study Group |
|---|---|---|---|
| Thailand | AFTA, Australia, China, India, New Zealand, BIMSTEC**** | Bahrain, EFTA†, India, Peru, US | MERCOSUR |

*Notes*

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

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

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

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

#AFTA: ASEAN Free Trade Agreement.

†EFTA: European Free Trade Area.

±MERCOSUR: Southern Common Market.

§SACU: Southern African Customs Union.

Of the agreements involving the six countries/country groupings represented in Table 2, those involving the United States are by far the most comprehensive—both in their coverage of trade in goods and services and in their inclusion of a variety of 'WTO Plus' provisions related to intellectual property, labour and environmental standards. Most of their provisions take effect immediately. Those involving Australia, while comprehensive in their product coverage, are typically less ambitious in the WTO Plus area—for instance, by not going beyond existing international commitments on intellectual property rights, making no reference to environmental or labour standards, and failing to move beyond pledges to consult on competition policy and government procurement.

In the middle of the spectrum are Japan and Korea, with Japan's typical agreement being somewhat more comprehensive in its coverage than those of Korea. Outside of the area of investment, agreements involving these countries have few WTO Plus provisions. A distinctive feature of the Japanese and Korean commitments to the realisation of 'Comprehensive Economic Partnerships', however, are provisions for technical assistance on capacity building for less developed partners. At the other end of the spectrum, are the agreements of ASEAN and China. These typically are little more than frameworks, agreements to negotiate further cooperation on matters related to international trade. Product coverage in goods trade is far from complete; that of trade in services even less so. Neither of these parties typically includes references to intellectual

Table 2. Predominant Features of Country Approaches to FTAs

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

Table 2 (*Continued*)

| | US | Australia | Japan | Korea | ASEAN | China |
|---|---|---|---|---|---|---|
| Government Procurement | Yes | Yes: Information Exchange. Australia not a party to WTO GPA. | No | Yes | No | No |
| Dispute Settlement | Yes: Usually-Includes Investor-State Disputes (Aus. Agreement an exception). | Yes. Investors may refer disputes to ICSID or UNCITRAL | Yes: includes Investor-State Disputes. | Parties to Agreement. Parties can block panel | Parties to Agreement | Parties to Agreement |
| Capacity Building | No | No | Yes | Yes | Yes | Yes |
| WTO Compliant** | Yes | Yes | ? | ? | No | No |

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

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

DSP: Dispute Settlement Procedures.

ICSID: International Centre for Settlement of Investment Disputes.

TRIMs: Trade-related investment measures.

TRIPs: Trade-related aspects of intellectual property rights.

UNCITRAL: United Nations Commission on International Trade Law.

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

property rights (except in China's case, reference is sometimes made to the need to achieve a balance between the interests of rights holders and users). Government procurement and competition policy are similarly off the agenda. They contain no reference to environmental issues (while agreements involving Japan and Korea do so, the obligations established by their treaties are typically very weak); and as with the agreements involving Japan and Korea, mention of labour rights is absent.

Inevitably, variation occurs across any individual country's agreements, reflecting the respective bargaining leverage and negotiating capacity of the parties. Of particular interest are negotiations between parties with dramatically different preferences on PTAs. Where such talks have taken place in the Asia-Pacific region, the model of the more powerful country, not surprisingly, has typically prevailed. The US-Singapore Economic Partnership Agreement reflects US preferences for a comprehensive, legally-binding agreement with WTO Plus provisions. But Singapore's agreement with India is much more 'aspirational' in character, with very limited coverage of goods and services (both based on a positive list approach); it contains no reference to government procurement, competition policy, or labour or environmental standards. To secure a PTA with India, a country regarded as a potentially significant strategic as well as economic partner, Singapore was willing to sign off on an agreement that was far from complete, one that almost certainly, is not consistent with WTO obligations, and, indeed, falls far short of what the Singapore government had initially stated as its objectives in the negotiations.

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

Throughout modern history, all economic cooperation agreements have been accompanied by expectations that collaboration in areas of 'low' politics will lay the foundations for peaceful co-existence among participants. The European Coal and Steel Community, the predecessor to the European Union, is a classic example. Nowhere is the practice of using economic cooperation as a means of confidence-building among distrusting neighbours better illustrated than in ASEAN where four decades of (albeit at best partially successful economic collaboration) have provided the basis for a nascent security community (on the limitations of ASEAN's economic collaboration see Ravenhill 2007; on ASEAN as a security community, see Acharya 2001. Similarly, for many commentators, North American Free Trade Agreement (NAFTA) was as much about stabilising the southern boundary of the United States as it was about creating economic gains.

On the political dimension, governments may perceive the agreements as much as an opportunity to enhance their standing in the region as to improve relations with the other party to the agreement. PTAs may be used as an instrument to enhance claims to diplomatic recognition (primarily a preoccupation of Taiwan, although Taipei's success in concluding agreements only with three small Central American states has merely served to underline its diplomatic marginalisation). They may be a means for great powers to reward loyal allies, as appears to have been the case in Washington's choice of PTA partners under the Clinton and Bush administrations, leading some to suggest that a 'securitisation' of US trade policies has occurred (for instance, Higgott 2004). And they may represent a defensive reaction by governments to invitations from partners that they feel that they cannot knock back without endangering relations (a concern that the Japanese government acknowledged in responding positively—albeit sometimes without a great deal of enthusiasm—to overtures from some ASEAN governments). The negative reaction of the Indonesian government to Australia's initial deflection of overtures for a PTA illustrates the political dilemmas that governments overburdened by multiple negotiations can face.

Political factors may be an early step in decision-making on agreements that ultimately are shaped by economic considerations. In the case of the US, for instance, Washington decided to prioritise negotiations with 'proven allies' in selecting its partners for negotiating PTAs—but this preference for working with friends has not prevented it from rigorously pursuing its own economic interests once negotiations begin. Even if the primary objectives of a state in initiating the negotiation of a PTA are political, the agreements will inevitably also serve some economic purpose (although, as discussed further in Philippa Dee's article in this issue, the establishment of a PTA will not necessarily produce welfare gains for the parties).

Turning to the economic dimension, three principal motivations are evident in Asia-Pacific agreements negotiated to date. The most ambitious agreements aim to promote deeper integration, to go beyond existing WTO commitments particularly on services—and in the case of agreements involving the United States, on environment, intellectual property, and labour standards. A second prominent economic reason for entering into PTAs, for China, in particular, has been to use them to attempt to secure access to raw materials. Here the emphasis has been less on negotiating a comprehensive agreement than on specific sectoral arrangements, amid expectations that the agreements will lead to a general improvement in relations between the parties. Finally, a number of the agreements seem to have had primarily 'defensive' motivations—in particular, they have reflected the desires of domestic economic interests and/or governments to 'level the playing field', to remove the disadvantages that their domestic companies face in competition in foreign markets often because of other preferential agreements concluded by their trading partners. Keidanren, the Japanese Business Federation, was particularly vocal in pressing for Japan to

Table 3. Dominant Motivations in Recent Asia-Pacific PTAs

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



sign a PTA with Mexico, where its corporations (particularly car manufacturers) were disadvantaged by the PTAs that Mexico had negotiated with the United States and the European Union (Keidanren 2000; see Solis 2003; Manger 2005; and Yoshimatsu 2005 for further discussion). Similar motivations are evident in Australia's negotiations with the Gulf Cooperation Council, a principal export market for the Australian motor industry. Table 3 provides a summary of dominant economic and political motivations in a sample of recent Asia-Pacific PTAs.

## Evaluating the new Asia-Pacific PTAs

### *Overall Economic Effects*

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

These caveats notwithstanding, several factors can be expected to limit the impact of the agreements:

(1) A large percentage of the total trade between the parties may already be little affected by tariffs.

Average bound MFN rates for manufactured products for industrialised economies following the implementation of the Uruguay Round agreement were 3.5% for Japan, 3.9% for the United States, and 4.1% for the European Union. Close to one-half of Japan's tariff lines were bound at zero; the equivalent figures for the United States and the European Union were,

respectively, 40% and 27% (Bacchetta and Bora 2001). Products may also be accorded duty-free entry into a partner's markets through other mechanisms, such as a sectoral trade agreement—the Information Technology Agreement (ITA) being the most notable example—or through duty-drawback arrangements for imported components that are assembled for subsequent export. Office and telecom equipment constituted 20% of the total merchandise imports of Asian economies in 2006 (WTO 2007); many of these products are covered by the ITA.

Even though many less developed economies retain higher tariff levels (particularly bound tariffs) than do industrialised economies, the bulk of a country's exports may still enter a partner's market duty-free. This is particularly the case for an economy like Australia's that is heavily dependent on commodity exports. For instance, Australia's four most valuable exports to Thailand, accounting for 55% of the total value of Australian exports in 2005–6, were all minerals/energy resources, which would have entered the Thai market duty-free even in the absence of the Australia-Thailand PTA (Department of Foreign Affairs and Trade 2007). In aggregate, elaborately transformed manufactures constituted only 4% of Australia's total exports to Thailand in 2005–6; services contributed a similar percentage. The share (and total value) of Australian exports to Thailand potentially enjoying a tariff advantage by virtue of the bilateral trade agreement consequently was relatively small.

(2) The advantages created by PTAs may be offset by other factors.

The most obvious other factor affecting trade relationships is changes in exchange rates. The Australian dollar has appreciated by more than 20 percent against the US dollar in the two years since the Australia-US trade agreement was implemented, a figure more than five times the average US bound tariff on manufactured imports—a realignment that more than offsets any advantages bestowed by the PTA.

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

(3) The response of private sector actors.

Two principal assumptions regarding private sector actors are made in estimating the effects of preferential trade agreements. The first is that these actors will undertake the administrative action necessary to gain access to preferential tariffs. The second is that the benefits from lower tariffs will be captured by importers and consumers so that lower prices will lead to higher demand for the imported product. Both assumptions may be heroic.

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



These costs often more than offset the preferential advantages created—(again recall that the average bound tariff on manufactures for industrialised economies is around 4 percent). The consequence is that companies simply do not bother with the paperwork required to gain concessions under the PTA. The most notorious example is the ASEAN Free Trade Area (AFTA) where less than five percent of total intra-regional trade takes advantage of the preferential tariffs created by the agreement (McKinsey and Company 2003). While the failure of companies to undertake the paperwork necessary to exploit the preferential advantages created by AFTA may be an extreme example, it is by no means atypical. In 2001, the weighted utilisation rate of preferences in US PTAs was 54%; for the preferences the US afforded to the Caribbean and Andean countries, the ratios were under 36% and 25% respectively (Lederman and Özden 2005: Table 1C). Carrere and de Melo (2004) estimate that preferential margins of at least 10 percent would be needed to compensate for the costs of complying with a typical value-added rule of origin under NAFTA. Similarly, Manchin and Pelkmans-Balaoing (2007) suggest that companies will undertake the paperwork required to take advantage of the preferential rules of the ASEAN Free Trade Agreement only when the difference between the preferential tariff and MFN treatment is between 10 and 25 percent (when tariffs exceed 25 percent the products are also usually subject to restrictive non-tariff barriers, which prevent product access even if companies comply with the rules of origin).

Even if companies go to the trouble of undertaking the paperwork required to gain preferential treatment under a PTA's rules of origin, there is no certainty that the savings will flow through to lower prices and thus affect the decisions of importers and consumers. As just discussed, compliance with the rules in itself imposes costs on exporters—which one can expect that they will seek to recover. And, as we have seen in Australia over the years as dramatic fluctuations occurred in the exchange rate of the Australian dollar, suppliers may decide because of competitive pressures (or the lack thereof) to withhold price rises or reductions. Studies in the US have found that only one-quarter to one-tenth of a currency depreciation is passed through as higher prices for imported products (*Wall Street Journal* 2007). Again, the relatively low levels of tariffs (and

preferential advantages generated by PTAs) have to be put into context—in this instance the 100% markup that one typically finds in many areas of retailing.

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



(4) The Erosion of Preferential Margins

Preferential Trade Agreements are, in Fred Hirsch's (1976) terminology, 'positional goods'. Those in possession of such goods derive maximum benefit from them when others do not have access to them (and have an incentive to attempt to deny others access to them—one reason for the restrictive rules of origin in many PTAs and for governments' lack of enthusiasm for negotiating agreements that are open to all, as Dee details in this issue of the journal). With the proliferation of preferential agreements around the region, the advantages enjoyed by the early comers are being quickly eroded. Consider, for instance, the benefit to the Australian auto industry from the removal of the 25 percent import duty on pickup trucks (utes), one area of manufacturing highlighted at the time of the negotiation of the Australia-US PTA as potentially being a major beneficiary of the agreement. Yet, before a single truck was exported to the United States, Washington signed a free trade deal with Korea, conferring similar benefits on a country whose domestically-owned companies are much better placed to take advantage of the tariff removal. And the US also began negotiations for a PTA with Thailand, the world's second largest producer of pickups after the US. While such a levelling of the playing field will not only be welcome by countries that are latecomers to PTAs but also by economists because it minimises the risk that these agreements will generate trade diversion (which occurs when imports are sourced from partners who benefit from preferential tariff treatment rather than the lowest cost producer), it inevitably reduces the likelihood that any individual agreement will generate substantial gains for participants (as opposed to minimising their losses from agreements their partners have signed with third countries).

## Impact on Foreign Direct Investment (FDI) Flows

The very significant increase of FDI inflows from the United States to Mexico immediately following the implementation of NAFTA led some commentators

to suggest that conclusion of a PTA could be a positive stimulus to investment flows between partners, an issue that figured prominently in some discussions at the time of the Australia-US negotiations. While, again, it is early days in the implementation of the new Asia-Pacific agreements, there is no evidence to date that they have had an independent impact that will make any noticeable difference on aggregate investment flows. Even for large economies, a single major investment/divestment can significantly distort data on trends in foreign investment (for further discussion in the East Asian context see Ravenhill 2006a). So, too, can changes in domestic laws that are unrelated to PTAs—changes in US tax treatment of FDI led to massive outflows of US FDI from its PTA partner, Singapore, in 2005. And, in that FDI and trade are sometimes substitutes for one another, particularly where the motivation for investment is tariff-hopping to service protected domestic markets, the freeing of trade can have a negative effect on FDI.

Since the signature of the Australian-US FTA, the US share of incoming FDI into Australia has declined whereas that of economies with which Australia does not currently have PTAs—China and the European Union—has increased. There is no reason to think that AUSFTA is responsible for this declining US share—on the other hand, the record is not consistent with the agreement's having a major independent positive effect on bilateral investment flows. And recent data for Mexico suggests that whereas NAFTA had an early positive effect on US FDI, by the late 1990s FDI into Mexico had fallen below levels that economic modelling would predict (Lederman, Maloney and Serven 2005 quoted in Cosbey, Tay, Lim and Walls 2004). In a study of the effects of NAFTA, Lederman *et al.* conclude that 'FTAs are neither necessary nor sufficient for countries to attract increased FDI inflows', a conclusion echoed by a major World Bank survey of PTAs (World Bank 2004).

## PTAs and Regionalism

Much has been made of the fact that the increase in the number of preferential trade arrangements involving East Asian countries occurred in the wake of the financial crises of 1997–98. The crises have been seen as precipitants both of a new East Asian sense of identity and of a desire to act collectively to reduce perceived vulnerabilities. While a case can be made that the new cooperation on finance, embodied in the Chiang Mai Initiative, does represent a regional response of this type (albeit a weak one given the small sums involved—see MacIntyre, Pempel and Ravenhill 2008), the pattern of PTAs negotiated by East Asian countries does not support an argument that a new regionalism is developing. Indeed, exactly the opposite has occurred—if anything, the new PTAs have undermined the preferences given within the region's longest-standing preferential agreement, ASEAN.

A casual glance at Table 1 belies any argument that the new PTAs are reinforcing an East Asia regionalism. Fully two-thirds of the agreements signed by East Asian economies to date are with countries outside East Asia—the figure for those currently being negotiated or under study is even higher, over 80 percent. And as noted in the discussion of approaches to PTAs above, where East Asian economies have entered into PTAs with industrialised economy partners, these have had provisions for 'deeper' integration than the arrangements they have negotiated with one another. The consequence is that some ASEAN economies now afford more extensive preferential treatment either to countries outside ASEAN but in East Asia (notably Japan) or to countries outside the East Asian region (most notably through Singapore's agreement with the United States—but similar conclusions can be expected for any agreements negotiated with the EU). Such arrangements undermine the much-vaunted ASEAN-first principle.



### Who is Invited to the Table?

Also evident from a casual glance at Table 1 is the very uneven distribution of agreements across the region. In part, this distribution represents whether governments have chosen to be activist in the pursuit of preferential arrangements, with Singapore an early and by far the most frequent negotiator. But the distribution is not just a reflection of voluntary action. The exclusion of Taiwan, the region's fourth largest economy, save for agreements with a handful of the countries that still accord it diplomatic recognition has already been noted. But also largely absent from the negotiating table are the region's low income economies (especially Cambodia, Laos and Myanmar, but also Indonesia and the Philippines). Their under-representation in the agreements is a reflection of the fact that they typically have relatively little to offer partners (although Indonesia is an exception given its natural resources), their lack of negotiating capacity, and partners' concerns about the lack of state capacity to enforce any agreement reached. While the low-income economies do benefit from the Generalised System of Preferences schemes offered by industrialised economies, these provide neither the comprehensiveness of coverage nor the legal security afforded by PTAs.

### Who Concedes Most?

Globally, a consistent pattern is evident in PTAs: smaller economies typically concede more than their larger partners in negotiating these agreements.[4] Both the EU and the US have extracted more concessions from their partners than they themselves have given up. We have seen similar outcomes in the Asia-Pacific region—witness the US agreements with Australia and Singapore, and Japan's agreements with ASEAN economies (see the article in this issue by

Aurelia George Mulgan). But there has been one important exception to this generalisation about larger parties extracting the lion's share of concessions: China's PTAs with ASEAN, Hong Kong, and Macau—where China has been willing to sign off on an agreement where it has made by far the most concessions (seen, for instance, in the 'Early Harvest' provisions of the ASEAN agreement). This outcome can be explained as a reflection of the dominance of political motivations in driving the agreements—or, from a more cynical perspective, as a reflection of China's willingness to accept short-term losses in the expectation of long term economic gains. Whether this pattern of China's making more concessions than do its small economy partners will carry over into its negotiations with industrialised economies is highly unlikely (cf. Yang Jiang's article on the negotiations between China and Australia in this issue).

Power also matters in determining the overall content of arrangements. A comprehensive survey of provisions on services in recent PTAs found that the United States consistently obtained better commitments from its partners than did other countries that concluded PTAs with the same partners (Roy, Marchetti and Lim 2007).

## WTO Plus?

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

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

Compared with the US treaties, the WTO Plus provisions in other PTAs around the region are weak. The characteristic reference is to 'cooperation' on matters such as competition policy and/or to 'facilitation'. And the provisions on the environment are typically no stronger than commitments that states will not *lower* environmental standards in their efforts to attract foreign investment. None of the agreements has a reference to labour standards—save in the Japan-Philippines PTA, which provides that 'The Parties recognise that it is

inappropriate to encourage investment by weakening or reducing the protections afforded in domestic labor laws'.

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



## Foundations for Broader Regional Agreements?

To what extent have the new agreements laid the foundations for extension to additional participants? The answer is very little. Although some—notably those between Australia and Singapore, and Australia and Thailand—do make allowance for other countries' accession to the treaties, there are only two instances in the region where such a broadening of membership has happened. The first is within ASEAN, where the expansion of its membership to include Cambodia, Laos and Myanmar, brought three additional parties into the ASEAN Free Trade Agreement. The second is the Trans-Pacific Strategic Economic Partnership, an extension of the 'Pacific 3' PTA between Chile, New Zealand, and Singapore, that occurred when Brunei acceded to the arrangement in June 2005. In most of the other agreements around the region, the country-specific nature of the rules of origin significantly complicates their extension to other parties.

## Promoting Domestic Structural Adjustment

The argument that PTAs could be used to promote domestic structural adjustment was particularly popular in some official and academic circles in Japan (and to a lesser extent Korea) (the best discussion is in Munakata 2002, and 2006). The logic was that by entering into negotiations with countries that are significant agricultural exporters, Japan would have to make concessions in this area—and in doing so would establish the principle that agriculture would not be exempted from trade negotiations. The PTA would serve as a 'wedge in the door', opening up the sector most resistant to liberalisation.

In her article in this issue, Aurelia George-Mulgan makes a persuasive case why negotiations of PTAs might strengthen pro-liberalisation domestic forces in their battle with protectionist agricultural interests within Japan. Those arguing that PTAs can serve as promoters of structural adjustment are able to point to

the fact that Japan has included provisions on *some* agricultural products in its PTAs (save for that with Singapore, where the few 'agricultural' exports from Singapore—primarily cut flowers and goldfish—were deemed too sensitive for inclusion). But the coverage of agricultural products has been so limited that even commentators normally supportive of Japan's PTA strategies have questioned whether the agreements that Japan has signed, including that with Mexico, are consistent with the spirit of the WTO's provisions on regionalism.

The lack of specificity of the provisions within the WTO on PTAs, especially that related to the meaning of the requirement that 'substantially all the trade' between parties should be liberalised, and the failure of the Committee on Regional Trade Agreements to reach a judgement on the numerous agreements submitted for its consideration, has afforded countries the opportunity to exclude sensitive sectors from agreements—a process I have termed 'liberalisation without political pain' (Ravenhill 2003). And, of course, it has not just been Japan that has done so—witness the US exclusion of key agricultural sectors from its agreement with Australia, and, more surprisingly, its own acquiescence in Korea's exclusion of rice from the Korea-US PTA.

The negotiation of PTAs can increase both the external and the internal pressures for domestic structural adjustment with the expectation that such influences will enable more competitive sectors to realise potential gains from PTA negotiations. The success, however, of protectionist interests in ensuring that sensitive sectors are carved out of agreements given their often entrenched positions in decision-making structures, as George-Mulgan points out is the case in Japan, illustrates the limitations of such arguments. Those favouring a global approach to trade negotiations would argue that the logic of the external/domestic pressures argument would be more compelling for negotiations at the global level where the possibility exists for coalitions of interested parties to exert concerted external pressure, and where the potential gains for competitive domestic interests are greater.

## Fragmenting the Pro-Liberalisation Coalition?

In a well-known article, Richard Baldwin (1997) argues that the negotiation of PTAs will create a virtuous 'domino effect'—the exporters of countries not enjoying such arrangements will press their governments to take action to level the playing field; meanwhile PTAs will strengthen the position of domestic exporting interests and provide them with both the incentive and the means to press for further liberalisation. The evidence from the recent PTAs in the Asia-Pacific region certainly supports the first part of the argument—governments are being pushed by domestic interests to negotiate 'defensive' PTAs that level the playing field in markets where competitors already enjoy the benefits of such agreements. The second part of the argument is less persuasive.

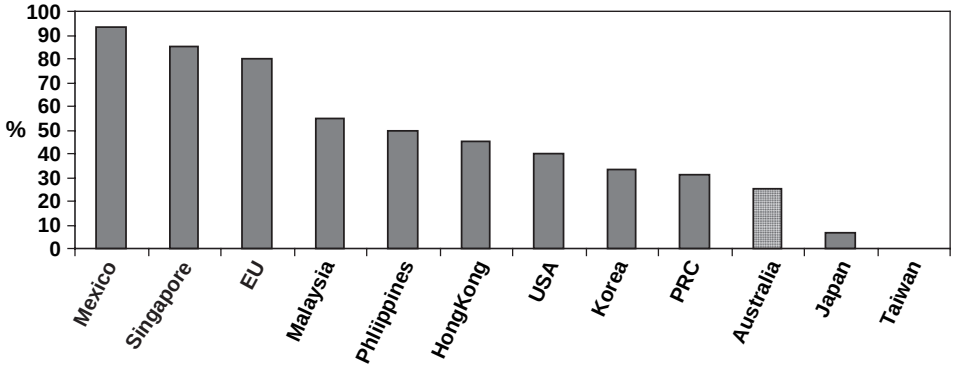


Figure 2. Share of Exports Covered by PTAs

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

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

## Conclusion

The proliferation of preferential trade agreements in the Asia-Pacific has yet to have any marked effect on aggregate trade and investment flows. That this should be the case, contrary to some of the wilder claims from economic modelling, is consistent with studies over the years that have emphasised the dominant role of the private sector rather than inter-governmental treaties in leading Asia-Pacific integration. It is also consistent with analysis grounded in

basic knowledge about the region, especially in relation to the relative ease of movement of goods among countries given the availability of duty-drawback arrangements, free-trade zones and other mechanisms that have facilitated the development of regional production networks, and as a consequence of the very extensive unilateral trade liberalisation undertaken over the last quarter of a century.

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

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

What conclusions can we draw for Australian trade policy? Certainly, the aggregate economic effects of the proliferation of PTAs to date have been minimal, being swamped in many instances by other changes in the context of bilateral trade agreements (Ravenhill 2006b). They have not had the impact that some of their most enthusiastic supporters had anticipated in promoting structural adjustment; indeed, in that governments have been able to exempt the most heavily protected sectors from liberalisation, the agreements may have had exactly the opposite effect by further entrenching protectionist interests. Few agreements negotiated in the region to date include significant WTO Plus provisions; those that do are primarily ones to which the US is a party—and its pursuit of the interests of its domestic pharmaceutical industry through PTAs threatens to do damage to the public health systems of partner states. To the extent that the agreements have had positive economic effects, these have been primarily in instances where governments have been pursuing 'defensive' interests, attempting to redress the damage done to domestic interests by preferential agreements their partners have signed with third parties. The

pursuit of PTAs may not be an optimal policy approach, however, if damage limitation is the principal objective.

## Notes

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1. I prefer the terminology of preferential trade agreement to that of free trade agreement because it more accurately captures the essence of the treaties—they often fall far short of creating genuinely free trade between the parties. Rather, they provide parties' exports of some goods and services with preferential access to their partners' markets. To compound terminological confusion, these agreements are sometimes referred to as regional trade agreements. As we will see, whereas such terminology was accurate for early preferential trade agreements that typically joined geographically contiguous economies, today's preferential arrangements often link economies that are in different geographical regions. They continue to be labeled regional trade arrangements because all non-universal trade agreements are scrutinised by the WTO's Committee on Regional Trade Agreements.
2. According to the Asian Development Bank, in 2007 there were another 61 PTAs that had not been notified to the WTO, which involved the economies of East Asia, Oceania, and South Asia, where framework agreements and treaties had been signed or were under negotiation. A further 47 agreements had been proposed. Asian Development Bank, Asia Regional Integration Centre, Table 2. FTAs by WTO Notification and Status (cumulative), <http://aric.adb.org/2.php> (consulted 25 October 2007).
3. In addition, in 1975 seven countries–Bangladesh, India, Lao People's Democratic Republic, the Republic of Korea, Sri Lanka, the Philippines and Thailand—signed the 'First Agreement on Trade Negotiations Among Developing Member Countries of ESCAP', known as the Bangkok Agreement (renamed the 'Asia-Pacific Trade Agreement' in 2005), and in 1991 Laos and Thailand had concluded a preferential trade agreement. These agreements provided only very limited liberalisation of trade in goods. In Oceania, the Australia-New Zealand Closer Economic Relations Trade Agreement had been signed in 1983.
4. Freund (2003). Whether this asymmetry in concessions carries over into asymmetries of gains from the agreements is another matter. Smaller parties would usually be expected to gain more (at least in proportion to the size of their economy) in a relationship between parties of unequal size. And conventional economic analysis would suggest that the party that makes more concessions will gain more because of the additional competition faced by its domestic producers.

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