

REGIONAL ECONOMIC INTEGRATION IN EAST ASIA*

There has been a proliferation of proposals for bilateral free trade areas (FTAs) in East Asia in recent times. These initiatives fly in the face of the long-standing support of key players in the region such as Japan for the MFN-based non-discriminatory trading system and the commitment to non-discriminatory trade liberalisation and reform within APEC. As China establishes its role in the WTO, its interests are very much in an open global trading system. The paper argues that the core interests of East Asian economies remain in non-discriminatory global trading arrangements and prosecuting those interests within the Doha Round of trade negotiations. It suggests that a way forward in sorting out the trade-distorting and protectionist effects of FTAs would be for East Asian economies to take a lead in negotiations on strengthening the WTO rules on preferential trade arrangements. In terms of global economic welfare, the only good preferential arrangement is one that disappears in time. The paper makes specific recommendations for re-vamping the rules on preferential trade arrangements with that objective in mind.

In the East Asian region, there has typically been a relative absence of bilateral and subregional preferential trading arrangements. Indeed this was, until recently, a distinguishing feature of the regional economy. Of the world's major economies, only China, Japan and the Republic of Korea were not party to any preferential trade arrangement. The region was deeply aligned to the global system and this outward orientation was seen as having served East Asia's interests well.

Until recently the only examples of economic integration agreements in the region were the ASEAN Free Trade Agreement (AFTA) and the Australia/New Zealand Closer Economic Relations Agreement (ANZCERTA). One-way-only preferential trade agreements also existed between Australia and New Zealand on the one hand and Papua New Guinea (PAFTA) and the Pacific island states (SPARTECA) on the other.

AFTA was slow to implement progress in its early years but has made significant headway more recently. ANZCERTA is regarded, including in the WTO, as the closest, of all the many bilateral agreements in place, to having achieved consistency with the WTO rules on regional

trading arrangements. Not only is the agreement comprehensive, but no new barriers have been constructed to the outside world. Both Australia and New Zealand continued to open up their markets unilaterally to global markets as they simultaneously forged their own closer economic relationship.

In the 1990s, there was a proliferation of preferential trading arrangements elsewhere in the world, with some negative impact on East Asian economies. APEC's fundamental principle of open regionalism, meanwhile, reinforced East Asian member countries' resistance to the establishment of preferential internal trading arrangements which discriminate against other trading partners. Considerable progress has been made in terms of both facilitation and liberalisation of trade and investment through the APEC process of concerted unilateral decision-making. Average tariffs have declined significantly and continuously since APEC's formation in 1989 and APEC governments are setting positive examples in new areas such as investment, competition policy and government procurement.

The last 12–18 months has seen a marked apparent departure from past policy thinking throughout the East Asian region. APEC is no longer seen as the only mechanism for regional economic cooperation. Most countries in East Asia are now proposing or negotiating bilateral or plurilateral sub-regional trade arrangements of one kind or another. Fresh impetus has developed for the establishment of some kind of East Asian economic community, though the final form this might take and the steps by which it might be achieved remain very unclear. The motivations behind this explosion of new proposals are many and complex.

Factors motivating interest in sub-regional integration

Building a sense of security among neighbours

The motive for regional economic cooperation is often political as well as economic. For the European Union (EU), for example, which has no common foreign or security policy, trade policy represents the only available instrument for external influence. Political factors, more than any others, have been the key motivation behind the EU's drive for bilateral free trade agreements, first with European neighbours, then more globally. The same situation applies for the United States. For example, the proposed Free Trade Area of the Americas (FTAA) is explicitly linked to the promotion of democracy as well as economic development.

East Asian economies are searching for means of closer cooperation on security as well as economic matters. Both motivations figure, for example, in the broad 'ASEAN + 3' framework

for cooperation among ASEAN, Japan, China and Korea. The choice of partners for closer economic cooperation is also driven by political motives. Some proposals are politically driven initiatives to 'get closer' to and increase confidence about trade and investment with already significant trading partners. From an economic perspective, however, the gains from trade creation are greatest where the partner countries have complementary economies. Although it is in a country's economic interest to choose a partner with high complementarities, the more frequent reality is that countries seek out as partners those economies which do not threaten their 'sensitive' sectors.

Managing trade frictions

The management of potential or escalating trade frictions is a very important economic motive for regional cooperation. It was part of the underlying rationale for the formation of APEC, which offered an opportunity for trade and investment policy dialogue, including between Japan and the United States, at a time when trade frictions across the Pacific risked impacting negatively on other regional economies. This motive is now relevant for countries such as the Republic of Korea in the drive for the proposed 'Plus Three' arrangement (China, Japan, Korea). The danger of course is that bilateral and sub-regional deals can lead to the proliferation of non-transparent mechanisms for managed bilateral trade that are not consistent with World Trade Organization (WTO) objectives.

Some countries also see inclusion inside preferential arrangements as a possible means of avoiding exposure to contingent and safeguard protection. In part, for example, the fact that Australia is currently seeking a free trade agreement (FTA) with the United States explains the fact that Australia is not joining other affected countries in complaining to the WTO about recent US safeguard duties on steel. This is a two-edged sword. Resort to special bilateral arrangements can preclude having recourse to the WTO rules. Signing away these hard-won rights in the WTO contributes to a breakdown in the WTO system.

Capacity building for development

Regional integration is a natural and constructive response to the forces of globalisation. Closer integration of neighbouring economies is seen as a first step in creating a larger regional market for trade and investment. This works as a spur to greater efficiency, productivity gain and

competitiveness, not just by lowering border barriers, but by reducing other costs and risks of trade and investment.

Bilateral and sub-regional trading arrangements are sometimes advocated as development tools as they encourage a shift towards greater market openness. Such agreements can also reduce the risk of reversion towards protectionism, locking in reforms already made and encouraging further structural adjustment. In China's case, for example, capacity building and development of shared resources is a strong motivating factor behind the thrust for sub-regional cooperation with immediate neighbours, some of whom are not WTO members. This is the case, for example along the Lancanjiang–Mekong River valley.

Stepping stones to multilateral liberalisation

In broad terms, the desire for closer regional integration is usually related to a larger desire for 'opening to the outside world'. Regional economic cooperation is being pursued as a means of promoting development through greater efficiency, rather than as a means of disadvantaging others. Most of the members of these arrangements are genuinely hoping that they will succeed as building blocks for progress with a growing range of partners and move towards a generally more free and open global environment for trade and investment.

But regional arrangements will always be 'second best' options. The chances of new bilateral or sub-regional arrangements contributing to rather than undermining the rules-based multilateral system, centred on the WTO, will depend both on the economic characteristics of the countries involved and on the details of the design of the new partnerships. They will also depend on the circumstances and imperatives in international trade diplomacy and whether they act to diminish and limit the discriminatory and protectionist effects of regional arrangements or whether they allow them to become entrenched. It could be argued, for example, that successive rounds of multilateral negotiations under the General Agreement on Tariffs and Trade (GATT) diminished and limited the discriminatory and protectionist effects of Europe's common external industrial tariffs, although not those of the Common Agricultural Policy (CAP), by effectively bringing them down to zero. There is no such powerful or effective international discipline or requirement in international trade law that will have a similar effect in respect of the discriminatory and protectionist effects of the North American Free Trade Agreement (NAFTA) or the spate of newly initiated FTAs. If they are designed badly and there are no such external or inbuilt disciplines, regional arrangements will certainly be stumbling blocks rather than stepping stones to multilateral free trade.

Trade diplomacy insurance policies

To some extent, the East Asian region's interest in bilateral trade arrangements dates from failure of the 1999 WTO Ministerial in Seattle. Already in the middle years of the long-drawn-out Uruguay Round, regional governments such as Australia had started to look for possible alternative means for negotiating improved market access in the region. And in recent years, when the obstacles to launching a new multilateral round seemed intractable, interest in alternative approaches intensified once more. Proposals for bilateral FTAs emerged largely as trade diplomacy insurance policies, should the round not eventuate.

But the new WTO round has now begun. The Doha Round has a very comprehensive agenda and a very short time frame. At this juncture, after the success at Doha, there should be no need to persist with the 'insurance policy' strategy. Indeed, there is a serious danger that the pursuit of such policies will distract attention and jeopardise the round.

The copycat syndrome

As East Asia watches the rest of the world, including the United States and the EU, negotiate bilateral preferential deals with trading partners — initially outside the East Asian region but steadily geographically closer — there are real, if unjustified, fears of East Asia 'being hurt' and 'being left out'.

This does not mean, of course, that countries in the region will in fact gain by following suit. On the contrary, East Asia is likely to lose, rather than gain, from mimicking the closed trading bloc approach in other regions. Alternative more open models of cooperation are required that are more consistent with both the WTO and the Bogor goals. Nevertheless, 'being left out' causes resentment. Indeed, many agreements negotiated for underlying geopolitical reasons may prove counterproductive in overall strategic terms precisely because of unforeseen consequences of this nature.

Costs, benefits and risks of bilateralism

The benefits of regional integration arise from the scale and competitiveness effects of domestic market enlargement and from the trade creation associated with the switching of demand to cheaper suppliers in partner countries. It is also often the case that, although the net effect of trade creation and trade diversion is negative, there may be positive welfare gains for certain

individual partners to a regional trade agreement. In the somewhat unusual case of Canada, for example, with more than 80 per cent of total trade with the United States, there is no doubt that the agreement with the United States has had significant welfare effects for Canada. In many other cases, however, the evidence on the benefits side is insubstantial.

What is clear is that, in order to reap the perceived benefits motivating regional economic cooperation, it is essential to avoid or minimise the potential costs. It is important for policymakers to be conscious of the economic risks involved and to design new regional arrangements accordingly. The fact that the WTO rules are weak means that conformity with the rules alone is not sufficient to guarantee outcomes in line with the best economic interests of participant countries. In order to minimise the costs involved and establish appropriate policy principles, it is important to understand first the nature of the various costs potentially involved.

Trade and investment diversion

An FTA is a preferential arrangement which discriminates against outsiders to the agreement. Depending on the extent of complementarities between the partner countries, there will be both trade creation and trade diversion effects. The lower the complementarities between the partner economies, the more trade diversion will be likely to dominate.

Trade diversion is difficult to measure in the case of non-tariff barriers and harder still for non-border trade restrictive measures. Most economic modelling work, being based largely on data available for trade in goods, inevitably will underestimate the extent of trade diversion involved in any potential agreement. One reason is that the extent of underestimation will depend on the relative importance of the service sectors in the economies involved, as service sector restrictions in particular tend to be of a regulatory nature. Another is that to date there has been very little attempt to measure the related investment diversion involved.

To the extent that trade and investment diversion takes place, there will be a loss of productivity, competitiveness and global commercial opportunity arising from the traditional inward-turning exclusive nature of FTAs. Economic benefits are likely to be reaped by specific sectoral interests but the overall economy will lose in terms of growth potential.

Some commentators note that FTAs will not impose excessive trade diversion costs if 'sensitive' sectors are excluded from the agreement — that is, if they have no overwhelming liberalising thrust. Equally, of course, exclusion of sensitive sectors will mean that any positive trade creation effects will also largely be lost. FTAs which exclude sensitive sectors are generally referred to as 'dirty' agreements in that they depart from the WTO rules on comprehensiveness.

There is an argument around, therefore, that as long as the agreements are ‘dirty’, outsiders do not have to worry about them too much as they involve neither economic gain to the parties nor loss for non-parties. This is not the perspective implicit in the WTO rules, nor is it the view of the WTO Secretariat, which argues increasingly that it is not merely the WTO rules which are at stake here, but world trade growth itself.

Implications for world trade

The negotiation of inconsistent, non-transparent and overlapping sets of bilateral rules outside the WTO system ultimately adds to the costs of doing business. It leads to commercial confusion as to which rules apply in which markets and under which circumstances.

The more new arrangements come into place, the more complex the tangled web of new rules becomes. This effect has been described as the ‘noodle’ or ‘spaghetti’ bowl effect. Unfortunately, the new rules being agreed among regional partners are also very difficult, time consuming and expensive to administer. FTAs in particular rely on the enforcement of rules of origin, which are becoming increasingly difficult to administer, since globalisation and intra-industry trade are making it harder to establish the source of products.

If all the regional trade agreements which have been negotiated to date were implemented fully, the WTO Secretariat estimates (WTO 2001) that as much as half of world trade would be tied up in a spaghetti bowl of new discriminatory rules which impede world trade. This represents a tremendous leakage from world trade, with significant negative consequences for the rate of growth of world trade. East Asian trade could suffer the same fate if countries in the region were to pursue closed-bloc-type trading arrangements of the traditional kind which risk fragmentation of the regional trading environment.

It is ultimately not possible to have it both ways. If governments want a multilateral trading system that works, and world trade growth at its maximum, then regional economic cooperation must be designed in such a way as not to undermine the system. If not, the rate of growth of world trade and investment flows will slow. The negotiation of exclusive trading blocs contributes directly to this outcome.

Policy attention and resources

The negotiation of new regional and bilateral trading arrangements will consume significant policymaking and scarce trade negotiating resources — some of which will inevitably be diverted

from the Doha Round. This could lead to a slowdown in the negotiating process in Geneva and a major blowout in the timetable agreed for completion of the round. This means a delay in the delivery of the much bigger economic gains available from global than from regional trade liberalisation. It is important to recall, in pursuing bilateral trade negotiations, that liberalisation of trade within the WTO membership can lead to gains which dwarf those available among smaller subsets of countries.

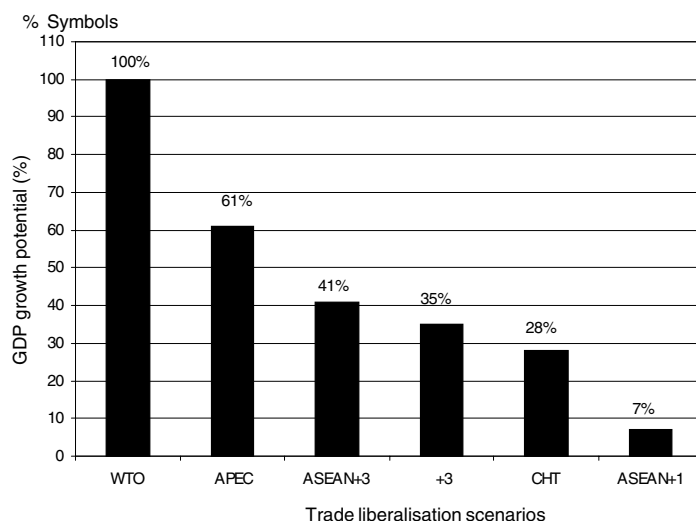
Figure 1 shows the results, for example, of Global Trade Analysis Project (GTAP) simulations using 1995 trade data to assess the relative benefits for the Chinese economy of various possible bilateral, regional and multilateral scenarios for trade liberalisation (modelled as a reduction to zero of all tariffs on all goods). Each simulation measures the relative impact on GDP growth potential of a move to free trade within a specific regional grouping, compared with the impact of free trade within the full WTO membership. Five regional groupings were chosen:

- APEC (the simulation assumes concerted elimination by APEC members of all tariffs on all traded goods, on a non-discriminatory 'open regionalism' approach).
- FTA between ASEAN plus China (ASEAN + 1)
- FTA between China, Japan, Korea ('Plus Three')
- FTA between ASEAN plus China, Japan, Korea (ASEAN + 3) and
- FTA between China, Hong Kong and Chinese Taipei (CHT)

The results show that the overall economic gain to China from liberalisation within any of the regional arrangements examined would be smaller than the gain stemming from multilateral liberalisation. After the WTO, the next best option is APEC-wide trade liberalisation on a non-discriminatory basis. Alternative sub-regional preferential options all entail significant lost economic opportunities in terms of GDP growth potential. The results show that China has a clear economic interest, moreover, in expanding the membership of ASEAN + 1 and moving in the direction of ASEAN + 3.

It is of interest to compare China's simulated experience with neighbouring East Asian trading partners with that of Mexico, already a member of NAFTA. Figure 2 illustrates the relative impact on Mexican GDP growth potential of three regional trade liberalisation scenarios: NAFTA plus Central America (NA + CA); NAFTA plus Chile, Argentina and Brazil (NA + C,A,B); and Free Trade of the Americas Agreement (FTAA).

Figure 1 Benefits of multilateral vs regional goods trade liberalisation for China, (1995 trade data)



Note: See text for explanation of groupings.

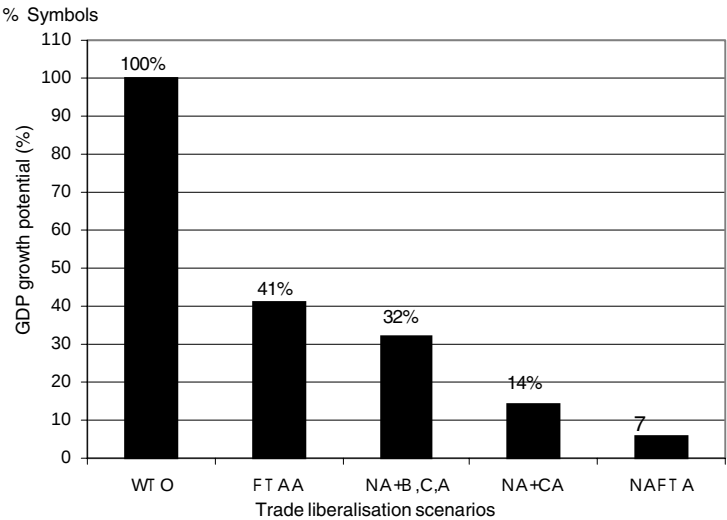
The simulation results presented in Figure 2 show remarkable similarities in the kinds of sub-regional policy choices and associated economic costs and opportunities facing both Mexico and China. Mexico's participation in NAFTA delivers significantly less economic gain than could be delivered through multilateral liberalisation. Moreover, economically Mexico has much to gain by any move to broaden the membership of NAFTA. Clearly the FTAA delivers more benefit to Mexico than smaller sub-regional groupings with Central America or with Chile, Argentina and Brazil. But even the FTAA can not deliver for Mexico any more than 40 per cent of the economic benefits available through multilateral liberalisation.

These particular sets of simulations suggest that the more extensive the regional integration, the deeper the economic gains will be. Sub-regional economic cooperation should therefore be planned from the outset, to enable a broadening of the membership. And it should be designed in such a way as to minimise forgone global opportunities.

Other models of regional economic cooperation

The traditional FTA approach, designed to reduce border measures affecting trade in goods, is becoming less relevant in the modern trade environment. Closer economic partnerships of the

Figure 2 Benefits of multilateral vs regional goods trade liberalisation for Mexico (1995 trade data)



Note: See text for definition of terms.

21st century need increasingly to deal with matters such as customs procedures, contingent protection, harmonisation of standards, dispute settlement, factor mobility, competition policy and e-commerce. Some also seek to address development issues through capacity building and social issues such as labour and the environment.

In designing new models of cooperation suited to the needs of the East Asian region, priority must be given to ensuring that the interests of non-participants are not damaged and that the agreements do not undermine the partner countries' shared, overriding interest in an open, rules-based multilateral trading system.

Various models of regional integration are being contemplated. Some are more suited to the East Asian environment than others. Many of the new economic partnerships are still being built around the core of a preferential arrangement; despite the WTO rules, and the economic costs, many of these deals exempt all sensitive sectors. As a result, they will deliver very small economic gains — but large systemic risks. They will also prove difficult to link together to create region-wide, let alone global, zones of free trade.

Awareness is growing within East Asia that, while all economies can work towards mutually beneficial trade and investment facilitation, not all pairs or groups of economies can

contemplate preferential deals that are consistent with WTO objectives. Trade and investment facilitation agreements (TIFAs) and closer economic partnerships (CEPs) provide appropriate alternative models. These agreements are much less costly for the global economy and can deliver at least equivalent economic gains for the partner countries.

The Transatlantic Economic Agenda being implemented between the United States and the EU is an example of such an agreement. It does not deal with border barriers, which are left to the WTO; instead, it focuses on regulatory impediments, which are now widely regarded as the most important set of obstacles to commerce between the United States and the EU. TIFAs are also being implemented or considered between Australia, New Zealand and ASEAN and between Australia and Japan.

Careful attention needs to be given to ensuring, in advance, that new agreements will operate in practice as building blocks so that separate overlapping bilateral and regional initiatives can be subsequently brought together. If new agreements are tailor-made for specific sectoral interests or have overly complex rules of origin, they will be open to wider accession in principle only and not in practice. Open-ended accession needs to be part of the design of the agreement from the outset. If not, the region could see a proliferation of the costliest kind of 'hub-and-spokes' arrangements.

Within the region, consideration also needs to be given to whether new agreements will weaken or strengthen existing economic cooperation in APEC. At the APEC meeting in 2001 in Shanghai, member economies agreed that subgroups of APEC members could pursue trade and investment facilitation and liberalisation initiatives wherever possible, without necessarily having to wait for all member economies to reach consensus. Such agreements would be known as 'pathfinder agreements'. This is an important development as it provides new flexibility for sub-regional and bilateral agreements between APEC members. There is now a need for APEC to set out some guidelines for the design of 'pathfinder' agreements to ensure that they are compatible not only with the WTO but also with open regionalism and the Bogor goals and timetables.

Policy coherence: developing a set of principles

In the simultaneous pursuit of trade policy at the multilateral, regional, sub-regional and bilateral levels, what matters most is that a country's overall trade policy stance is consistent and coordinated. For WTO members, the best guide to trade relations at all levels is embodied

in the WTO principles of transparency, non-discrimination and national treatment. While the WTO rules on regional trade agreements (RTAs) are weak and do not in practice inhibit member countries, it is nevertheless important to minimise, through careful design of any new arrangements, the potential costs and risks associated with regionalism.

GATT Article XXIV allows departure from the non-discrimination principle for the reduction of customs duties and 'other' trade barriers in RTAs if substantially all the trade is covered and if no new barriers are constructed. Article V of the General Agreement on Trade in Services (GATS) allows for economic integration in services covering substantially all services trade and substantially all service sectors. The notion of 'substantially all' is vague; the general rule of thumb is at least 80 per cent, but this needs to be clarified.

The enabling clause of the GATT allows developing countries more flexibility in implementing RTAs. AFTA, for example, did not have to meet the full rigour of GATT Article XXIV. Agreements among developing countries can be phased in over a longer period and their coverage can be less comprehensive.

The basic WTO requirements for comprehensiveness on the one hand and liberalisation rather than protectionism on the other are designed to ensure that regional arrangements do not undermine the multilateral system. In essence, if RTAs are comprehensive, it is easier in time to bring other economies on board. Comprehensive arrangements can be more readily multilateralised and more readily linked with other bilateral and regional arrangements. If they are not comprehensive, but are tailor made to suit the specific partners by excluding sensitive sectors, they will not be easy to link up with other arrangements. The danger in this approach is fragmentation of the global trading system and the creation of new restrictions on trade which in themselves become difficult to negotiate away.

If the world was to divide, for example, into three large regional trading blocs, it would be in everyone's interest to ensure that linkages between the groups were facilitated rather than restricted. The WTO rules provide some guidance on how to achieve precisely such an outcome. It is very important, therefore, in designing new RTAs, to ensure that the trade regimes satisfy, at a minimum, the existing WTO requirements.

The importance of careful design of regional economic agreements can not be overestimated. The most recent World Bank study on regional trading arrangements (World Bank 2002) concludes:

... 'trade blocs are political...the politically feasible alternative to a costly trade bloc is probably a better designed bloc ...

The study goes on to conclude that for most developing countries, and especially for the poorer ones, a North–South regional trade arrangement is likely to be superior to a South–South one. It also emphasises that economic benefits will flow from a policy of external openness in conjunction with regional integration. Simultaneous lowering of external barriers will increase the economic gains and reduce the losses of any regional grouping. Finally, the study shows that the very existence of regional economic cooperation groupings creates demand for additional membership – and recommends that this might as well be accepted from the outset.

Box 1 sets out what we believe are the most critical design principles for new bilateral and sub-regional groupings in East Asia in order to minimise the various costs associated with preferential trade. The Australian Government has imposed two additional guidelines for the pursuit of bilateral agreements:

- the agreement must offer deeper market access and broader economic gains (faster economic growth and stronger employment growth) than the multilateral processes
- results must be achieved more rapidly than could be achieved through the multilateral processes.

These self-imposed guidelines are particularly useful in minimising wastage of policy resources and effort. The key to a successful regional or bilateral strategy is to avoid damaging the trading interests of other countries. Negotiation of traditional FTAs is costly because they discriminate against outsiders and divert imports and exports away from them. Other models of economic integration are hence more likely to suit East Asia's overall interests better. Open-ended arrangements are the best because they allow for other trading partners to accede to them in due course, enhancing the overall economic gains. In practice, however, widening of RTAs is difficult if they are not designed with this objective in mind.

Putting the principles into practice

There is strong, relatively sudden interest in forming plurilateral sub-regional arrangements in East Asia. And the current environment for doing so, following China's accession to the WTO, is very positive. Closer economic integration among East Asian economies can be pursued by devising a gradually broader range of cooperative arrangements to facilitate trade and investment.

Taking China as an example, joint development of shared physical and environmental resources along China's frontiers is especially important. Arrangements for individual issues

Box 1 Guiding principles for regional trade agreements	
Transparent	• Early notification to the WTO accompanied by provision of trade statistics; no further use of the enabling clause; maximum compatibility with the existing disciplines of GATT Article XXIV and GATS Article V.
Comprehensive	• No exception of sensitive sectors (inclusion of all sectors, if necessary subject to different time frames).
Open-ended	• Explicit provision for accession for other regional trading partners.
Minimal trade and investment diversion	• Broadest possible interpretation of ‘no new barriers’, including simple transparent rules of origin; choice of partner countries must be based on proximity, complementarities and significance and rate of growth of bilateral trade and investment flows.
No undermining of WTO rights and obligations	• New bilateral dispute settlement, contingent and safeguard protection mechanisms should be avoided.
Beyond WTO’ content	• The RTA must be trail blazing or template setting for the WTO, without prejudging the outcome of any WTO negotiations already under way.
Multilateralisable	• The RTA must be consistent with Bogor goals and timetables (that is, free trade in goods and services on a most favoured nation basis by 2020), the consistency of anything which is not potentially ‘multilateralisable’ with Bogor will be questionable in its consistency with Bogor.

like mutual recognition of standards or financial cooperation can also be pursued, for example, as APEC ‘pathfinder’ agreements in their own right or under the framework of open-ended TIFAs (rather than FTAs). Such an approach would signal constructively to other trading partners an intention to promote deeper integration with a progressively wider number of regional players. This would set a positive example for the whole of East Asia.

Similarly, the member countries of ‘ASEAN + 1’ should notify this agreement to the WTO, not under the enabling clause,¹ but under GATT Article XXIV and GATS Article V, and efforts

should be made to ensure consistency with the disciplines imposed by that rule. The agreement should be comprehensive, covering all trade, and no new barriers to outsiders should be created. The content of the agreement should be 'WTO plus' in nature. Tariff negotiations should be approached in terms of allowing for early transitional implementation of China's WTO accession commitments in favour of ASEAN countries, especially the least developed non-WTO members. Opportunities for an early harvest should be sought in areas likely to be the least problematic to the wider WTO membership — that is, trade facilitation and frontier infrastructure development, industrial cooperation and joint ventures.

Efforts should be made within the region to ensure that the 'ASEAN + 1' agreement can act effectively as a stepping stone (rather than a stumbling block) to an 'ASEAN + 3' or even broader 'ASEAN + 5' (including Australia and New Zealand) agreement. This will reinforce the requirements that the agreement be truly comprehensive and that it raise no new barriers to other regional players. Similarly, if a 'Plus Three' agreement is to be negotiated at some stage, it would need to be compatible with the 'ASEAN + 1' agreement, and with any agreements between ASEAN and either Japan or the Republic of Korea, if there is to be any hope of linking these various potential agreements at some future point.

Implications for the Doha Round

This paper has set out a number of guiding principles which East Asian WTO members should adopt in the pursuit of their bilateral and regional trade diplomacy in order to minimise resulting damage to the multilateral trading system. However much goodwill there is towards the WTO system, preferential approaches to regional economic cooperation will create systemic risks. In particular, the creation of new rules outside the WTO system means in effect that countries are signing away their hard-won rights in the WTO in favour of special non-transparent bilateral arrangements. These developments attack the very core of the WTO framework of rights and obligations. They impact negatively on the implementation of WTO resolutions and on the WTO's ability to enforce dispute settlement rulings. Ultimately, they will hamper the WTO in providing future leadership.

By themselves, the WTO rules on regional trading arrangements are too weak to prevent an ongoing proliferation of poorly designed and 'dirty' agreements. This 'hole' in the system needs to be fixed if the WTO is to retain its role as the major mechanism for achieving trade and investment liberalisation.

Review of these rules is on the agenda for the Doha Round. If WTO members do not seize this opportunity, there will continue to be a major leakage from the rate of growth of world trade. Until very recently, East Asian countries — including Japan, Korea and Hong Kong as well as Australia and New Zealand — were voluble champions of this cause in Geneva. The fact that the same countries are now pursuing regional and sub-regional arrangements of their own has implications for the work of the WTO. If there are no champions for improvement of the rules, there will be no substantive progress.

In fact, if East Asian countries do not take a lead, it is likely that the Europeans will see it as in their own interest to do so. The EU will be motivated to do so out of fear of the impact on Europe of the possible future shape of an East Asian economic community and the FTAA. The EU also has its own special interests to protect. The Cotonou Agreement (the most recent version of the Lome Agreement which gives preferences to all the ex-colonies) has a finite time horizon and will be replaced by FTAs with each of the ACP (African, Caribbean, Pacific) countries, negotiations for which commence at the end of this year.

Working from the set of policy principles proposed in Box 1 as a guide to East Asian bilateral trade diplomacy, what should these countries be doing simultaneously in Geneva?

First, in the interests of transparency, the rules should be clarified to ensure a requirement for early notification, not merely of the outcome of negotiations on bilateral preferential trade agreements, but at the onset of the negotiating process. The current absence of any such requirement encourages delay in the process and works against transparency and peer review.

Second, to encourage greater comprehensiveness, there must be an agreed interpretation or understanding of the meaning of ‘substantially all the trade’ in GATT Article XXIV and ‘substantially all sectoral coverage’ in GATS Article V. Similarly, in GATT Article XXIV the scope of ‘other regulations of commerce’ needs to be defined in such a way as to encourage removal within the RTA of all non-tariff and non-border trade barriers. New understandings should be developed to facilitate inclusion of ‘sensitive sectors’. The provision of longer transition periods would help to encourage this.

Third, to encourage open-endedness, new rules should be introduced to discipline the construction of preferential rules of origin.

Fourth, to encourage a more deliberate effort to minimise trade and investment diversion, the rules should be clarified to ensure that the member countries party to the RTA carry the burden of proof with respect to whether or not new trade barriers have been introduced against non-parties. The rules should also be supplemented by an understanding to ensure that there are no new barriers to either trade or investment.

Fifth, if the WTO system is not to be undermined, new rules are needed to minimise derogation from the balance of WTO rights and obligations via RTAs.

These principles, which are offered as a guide for the WTO rule negotiations, are summarised in Box 2, alongside the matching principles for bilateral trade diplomacy from Box 1. Their application would be beneficial to the East Asian economies even if countries were to move towards their implementation unilaterally. While it will be difficult to negotiate their

Box 2 Guiding principles for WTO negotiations

Regional trade arrangements (from Box 1)

Multilateral rules

Transparent

- Require early notification to WTO, including provision of trade statistics
- Tighten the scope for use of the enabling clause and enable greater application of GATT Article XXIV and GATS Article V

Comprehensive

- Define thresholds for meeting 'substantially all the trade' and 'substantially all sectoral cover'
- Tighten the scope of 'other regulations of commerce' and 'substantially all discrimination'
- Allow longer time frames for 'sensitive sectors'

Open-ended

- Formal requirement for open endedness
- Introduce new rules on rules of origin

Minimal trade and investment diversion

- Burden of proof of no new barriers to lie with countries party to the agreement
- Identify appropriate ways to measure this
- Enhance scope for provision of compensation

No undermining of WTO rights and obligations

- New rules to constrain derogation from WTO processes

Multilateralisable

- Introduce formal requirement for extension of preferences to be linked to immediate or subsequent most favoured nation reduction of barriers

application to established arrangements, such as those in North America and Europe, that is a desirable and clear objective. China, in fact, has considerable bargaining power in delivering on that objective over time.

It is clear that strengthening of the WTO rules in all the various ways outlined above will by itself not be sufficient to stem the enormous leakage of commercial activity from the multilateral trading system into the bilateral arena. New political commitments will also be required to ensure the supremacy of the WTO system. The EU and the United States in particular have not set a good example for the rest of the membership. If the good example which has been set so far in East Asia is to persist, the rest of the WTO membership will also have to demonstrate a clearer commitment to the essential principal of non-discrimination. The Doha Round provides a unique opportunity for all WTO members to influence the nature of the emerging East Asian regional identity.

Notes

- * An earlier version of this paper was published in a book in Spanish edited by Maria Cristina Rosas and Giovanni E. Reyes: *'La OMC y la Ronda de Doha: proteccionismo vs desarrollo'*, Universidad Nacional autononoma de Mexico, ISBN 970-32-0899-1.
- 1 Strictly, it might be possible for the ASEAN + 1 Agreement to be notified to the WTO under the enabling clause of the GATT. Such a course of action would be likely, however, to provoke an unfavourable reaction from many WTO members. This is partly because Article XXIV itself is too weak and the enabling clause effectively gives developing countries 'carte blanche'. It is also partly because Singapore, an ASEAN member, is regarded by most WTO members as having graduated from developing country status. In order to avoid controversy, especially so soon after China's accession to the WTO, the agreement should be notified under GATT Article XXIV and efforts should be made to ensure consistency with the disciplines imposed by that rule. Although there is no strict rule on when agreements should be notified, WTO members would certainly notice if China, as a new WTO member, set an example by notifying at an early stage — that is, on commencement of negotiations — rather than on completion or implementation.

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