

Chapter **II.9**

East Asian Regionalism and the Multilateral Trading System ERIA

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II.9 East Asian Regionalism and the Multilateral Trading System

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1. Introduction

In the midst of the rapid growth of regionalism, the multilateral trading system (MTS) remains important in ensuring a favorable environment for global trade. In fact, the increasing number of bilateral and regional trade agreements has raised various issues that could be effectively addressed at the multilateral level. With more than 400 preferential agreements around the world, mostly of a bilateral nature, it is almost impossible to make ensure that all these agreements are compatible with each other and with WTO rules. The diversity of the trade concessions and rules has limited the benefits of liberalization being realized, not to mention the trade diversion effects implicit in preferential treatment.

Regionalism in East Asia is not spared such concerns. Several initiatives have been proposed to deal with the above challenges, but at the moment no significant program is in place. While the WTO seems quite distant from the recent development of regional integration in East Asia, countries in the region could and should utilize it to avoid the problems escalating.

This chapter briefly looks at the issues related to regionalism in East Asia and examines the role of the multilateral trading system. The key message of this chapter is that countries in the region should support multilateral initiatives. This would not only help progress the multilateral liberalization process, but also reduce the problems and challenges stemming from integration in the region.

2. East Asia and the rise of regionalism

East Asia is actually a latecomer to regionalism. During the 1990s only one free trade agreement (FTA) was in place, formed by several countries in South East Asia under the ASEAN Free Trade Area (AFTA). Later the AFTA would extend to include all

countries in the sub-region. Other countries in East Asia remained devoted to the WTO although they have also become involved in so-called open regionalism arrangements based on voluntary undertakings taken under the auspices of the Asia Pacific Economic Cooperation (APEC) Process.

There are several reasons why regionalism did not appeal to a lot of interests in the region, including historical, political and economic issues, but mainly because the economies did not really see the importance of an intraregional market. Economic development in the region owed much to each country pursuing its own export-oriented strategy. Countries in the region found that the markets for their products were mostly located outside the region, where access was based on the most-favored nation (MFN) principle or non-reciprocal preferential arrangements.⁴⁹ The development of 'Factory Asia' since the 1980s increased the significance of intra-regional trade, especially among countries in South East Asia, becoming important production bases for foreign multinationals.

But the first response was not regionalism. Instead, countries in the region pursued unilateral liberalization by reducing their applied MFN tariffs in order to facilitate the necessary imports of intermediate products. These efforts were driven partly by the desire of East Asian countries to attract foreign direct investment (Baldwin 2006).

While unilateral liberalization has served the region well in facilitating the development of production networks and the industrialization of many countries, there is no assurance that governments would embrace an open trade regime all the time. During the Asian financial crisis of 1997, the governments of those countries affected by the crisis raised their tariffs in order to protect domestic production sectors. The widening gap between the MFN applied rate and the WTO bound rate –

⁴⁹ Some new industrializing countries in the region, such as South Korea and Taiwan, made intensive use of the Generalized Scheme of Preferences (GSP) to support market access of their products in the early stages of their development. Later, other countries in the region also relied on such schemes to enter developed countries' markets.

as a result of unilateral liberalization of applied tariffs, together with slow progress in multilateral trade negotiations to lower bound tariffs – allows countries to increase trade barriers.

This and several other developments prompted East Asian countries to proceed with more legally binding and reciprocal commitments typically embedded in a PTA.⁵⁰ ASEAN countries reduced the number of excluded products in their existing AFTA scheme, leading towards faster and broader coverage of preferential liberalization. Bilateral PTAs, especially between individual ASEAN members with other countries in the region, started to emerge. ASEAN as an entity also pursued trade agreements with its trading partners in the region. By 2010, this group of South East Asian countries had managed to form five trade agreements with six important countries: China, Japan, South Korea, Australia and New Zealand, and India.

Not only has regionalism become prevalent, PTAs in the region also include various measures beyond the traditional elimination of trade barriers, such as investment provisions, competition policy and protection of intellectual property rights. These are common features in the new generation of trade agreements that address a range of behind-the-border issues related to the internationalization of production.

3. Issues and challenges of regionalism in East Asia

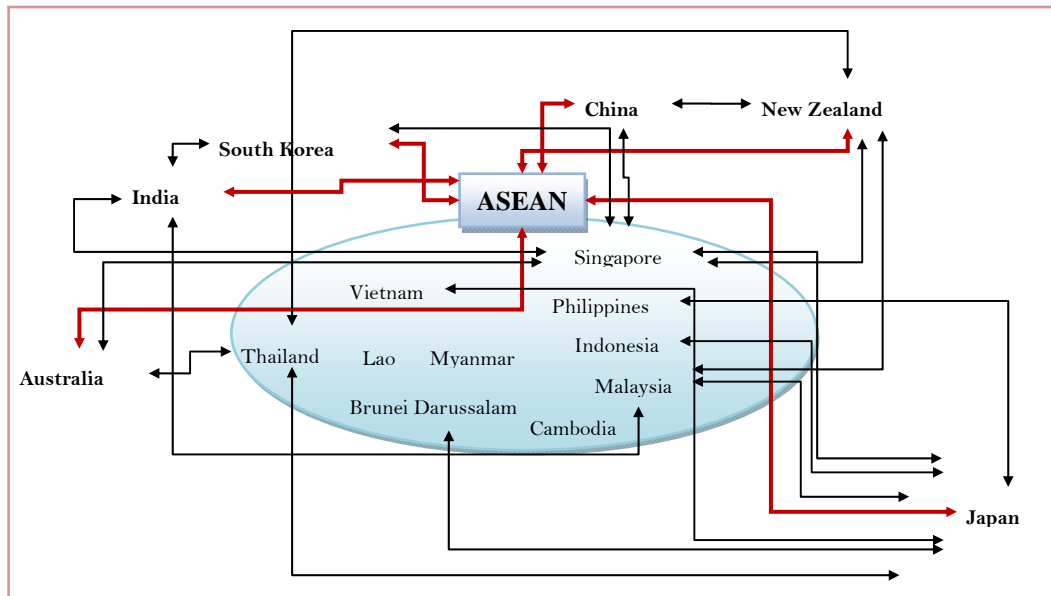
The emergence of regionalism has raised concerns over preferential concessions and other related aspects of PTAs. Some issues relate to practical aspects of regionalism. Currently there are 17 bilateral PTAs among countries in East Asia. While ASEAN as a group has formed five trade agreements with six trading partners in the region, several individual members have also concluded bilateral agreements with those other countries (**Figure 2**). Some individual members, such as Singapore, even have bilateral PTAs with all six partners.

⁵⁰ Many observers also argue that the crisis created the need for countries in the region to work more closely together as they can no longer depend on the EU and US markets; therefore regionalism in East Asia has flourished (see for example Baldwin (2006) or Pomfret (2010)).

This overlapping arrangement of bilateral and regional PTAs has been the source of many difficulties in realizing the potential benefits of trade liberalization. One frequent feature of trade agreements in the region is a low utilization rate of tariff preferences. Several firm surveys conducted to document the use of preferential treatment under East Asian PTAs found that firms in the region did not use PTAs optimally (see for example Kawai and Wignaraja 2011).

Various reasons can explain this observation, ranging from a lack of information to the difficulties in complying with requirements. All of them boil down to the fact that preferential treatment requires certain rules to ensure that preferential tariffs only apply to products from trading partners. Those rules of origin (ROO) have to be satisfied before the benefits can be obtained. This procedure normally incurs costs either to acquire necessary documents, to collect and make use of relevant information or to comply with relevant rules. It becomes more tedious and costly when overlapping agreements, as depicted in **Figure 2** below, use different types of ROO, especially when the regional supply chain requires intermediate goods to cross borders several times in the process of production.

Figure 2. Bilateral and Regional FTAs in East Asia



Source: Author

A less obviously adverse effect of preferential treatment is that it likely does not make the members better off. The reason is that the preferential removal of tariffs may lead to trade diversion, where the source of some imports changes from the most efficient supplier to the country receiving preferential treatment. Empirical studies on East Asian PTAs reveal that trade diversion cannot be ignored, although a positive effect of trade creation also takes place (see for example Urata and Okabe 2010).

4. The merits of the multilateral trading system

Aware of the above challenges, East Asian countries have tried to come up with an arrangement that would minimize the unfavorable impacts of preferential liberalization. Steps to increase the utilization of preferential facilities, as well as to simplify rules and procedures, are among the goals of greater integration in the region. Harmonizing liberalization coverage and ROO among overlapping trade agreements in the region would simplify and facilitate integration further. The launch of the Regional Comprehensive Economic Partnership (RCEP), an ASEAN-led

initiative for an East Asia region-wide trade agreement, is an attempt to harmonize regionalism in the region.

However, this is much easier said than done. Tariff elimination schedules under five ASEAN+1 FTAs are currently so diverse that the countries concerned maintain 55 different tariff elimination schemes with different implementation timetables. Each ASEAN member also schedules a different list of product exclusions with different trading partners. There are numerous types of ROO applied in those PTAs and the same products are often subject to different ROOs under related PTAs. It will be very difficult task and require considerable effort to make RCEP function effectively in addressing the above-mentioned challenges.

Multilateral liberalization, on the other hand, is relatively free from most of the problems and challenges of preferential regional integration. From a practical point of view, such liberalization follows easier procedural requirements: since it applies to virtually all countries, the need for ROO can be minimized. The benefits from multilateral liberalization can be further realized as the business sector would not need to pay attention to how to make use of greater market access in the destination market, but could rather focus on producing more competitive products. The biggest benefits of multilateralism, however, arise because the process is more likely to include the most efficient suppliers of any given product and therefore the possible trade diversion resulting from any preferential liberalization would be minimized.

Furthermore, the WTO system offers a more effective monitoring and compliance mechanism, including functional dispute settlement. Since this arrangement involves a large number of countries with a wide variety of trade interests, there is a greater chance of finding members that might be hurt by the harmful acts of other members. The smaller number of members in bilateral or regional PTAs reduces such incentives, especially where the bargaining powers of PTA members are not equally

distributed. Together with an efficient dispute settlement mechanism, the WTO system ensures better monitoring of the global trading system and better respect for its rules. Penalty and compensation mechanisms may also work better under the WTO since it may impose more substantial consequences than when applied narrowly among members of a PTA.

Although many PTAs in East Asia provide a dispute settlement mechanism in order to ensure that commitments are properly implemented, the mechanism has yet to be put to the test. When Thailand and the Philippines, two members of the long-standing AFTA, had a dispute over unfair taxation of tobacco from the Philippines, the two countries decided to go to the WTO instead of handling their dispute under the ASEAN mechanism.

All the above considerations highlight the benefits of the multilateral trading system and demonstrate that it is unlikely to be replaced by bilateral and regional agreements. The question is how, amidst the ongoing preferential wave, the MTS under the WTO can be made attractive to all of its members.

5. The Multilateral Trading System: What Should East Asian Countries Do?

There are three main ways to restore the WTO to its former important position among its Members. The first is to reposition the membership's attitudes towards new global trading issues and the second is to achieve a breakthrough in completing the current negotiation round. The third relates to the initiatives to 'multilateralize' regionalism. East Asian countries can contribute significantly to attempts to revive the multilateral trade process.

5.1 Redefining the WTO's role

WTO Members should be brave in redefining their position in global trading activities. One of the reasons why PTAs are so attractive is that they cover many areas that

have not been discussed multilaterally. The current global trading environment has moved away from traditional trade in goods liberalization to behind the border commitments. To win back the hearts of its Members, the WTO process must also begin to tackle such areas, perhaps even encompassing what has been discussed under PTAs. East Asian countries have enough capacity to support such 'new issues' being introduced into the multilateral process; many PTAs in the region have commitments in those areas anyway. In addition, these countries can exercise considerable leverage to make it more appealing. Having China or Indonesia joining plurilateral discussions on an agreement on investment or competition policy would increase the likelihood of other countries accepting such a move.

One area where the WTO should play a more important role is in the elimination and better disciplining the use of non-tariff measures (NTMs). While NTMs have been subject to multilateral disciplines for some time, there is currently no comprehensive initiative to reduce the prevalence of such barriers. The approach is simply that countries can use NTMs so long as they do not replace bound tariffs with NTMs. Other than the non-discrimination principle, there is little by way of stringent disciplines attached to the use of non-tariff measures. Since the last financial crisis, the use of such measures has been on the rise, and the excessive use of NTMs has increased overall levels of protectionism (Evenett 2012).

East Asian countries again have a considerable incentive to push the WTO to address NTMs. Appropriate and non-excessive use of these measures is essential for further economic integration in the region. However, addressing such issues by themselves is not an easy task, due to a lack of sufficient information and political will in many countries in the region. Tackling such issues at the multilateral level would provide more power to address them.

5.2 *Completing the Doha Round*

Completion of the Doha Round is necessary to keep the MTS alive and moving forward. Concluding the negotiations would help WTO Members realize the benefits from all areas that have been discussed in the draft text, including bound tariff reductions, disciplines on subsidies and liberalization of trade in services. This would also provide buffers against protectionism that can easily return during periods of crisis.

The difficulty in completing the Doha Round is understandable as its goals are ambitious: to reach consensus on nine different areas of negotiations, ranging from market access to environmental goods and development under the single undertaking principle, although some important areas have been left out. It is even more difficult considering that there are some 160+ Members involved in the negotiations. The deadlock has mostly come from lack of agreement on market access and domestic support issues in agriculture. Considering the gap between applied and bound tariffs in many developing countries, even substantial cuts would not lead to significantly greater market access for more advanced countries, whose bound rates are typically aligned to the applied rates. The situation is exacerbated by problems concerning domestic support and market access of agricultural products.

Since East Asian countries have formed many preferential trade agreements among themselves as well as with countries outside the region, extending greater market access to other countries might not lead to significant economic consequences. It all depends on the political willingness to proceed with multilateral liberalization. These countries should use their existing regional forums, such as ASEAN and the East Asia Summit, to come up with real commitments to move forward in completing the WTO's Doha Round, e.g. committing to reducing bound rates below or at least to the same level as current MFN rates, as well as commitments to reduce domestic support levels.

As previously discussed, the central contribution of the MTS is to provide insurance against protectionism. While PTAs are meant to embed such disciplines, it is more economical and effective to do this at the multilateral level. With the ever-growing interconnection of virtually all East Asian economies, it is therefore in their best interests to maintain the WTO trading system and deepen their multilateral commitments.

5.3 *Multilateralizing regionalism in East Asia*

With an increasing number of PTAs there is also a growing need for such agreements to be harmonized with each other. The WTO should position itself to exert more influence over the formation of PTAs. At the moment, there is an obligation for countries that sign preferential agreements to notify and report them to the WTO. But despite this obligation, the WTO has little or no influence on the contents of the PTAs themselves. Although according to GATT Article XXIV and GATS Article V, the WTO can impose a certain number of conditions on PTAs, such control is difficult to effect in practice and can be easily circumvented.

Making PTAs WTO-friendlier is an initiative to which countries in the region can contribute to significantly. There are two aspects that can be dealt with directly and would produce concrete results. The first is simplification of tariff elimination coverage and schedules of reduction among overlapping and related agreements in East Asia. Each country engaged in RCEP should come up with a single product exclusion list for all PTA partners. The schedule of elimination should also be aligned so that it reduces confusion during the transition period. The second is to come up with business-friendly ROO. Countries need to reduce the number of rules currently in place while at the same time offering more flexibility to fulfill the requirements by applying rules of accumulation.

The next stage is to make regional arrangements less trade-diverting. One way this can be done is to reduce local or regional content requirements. This can be achieved by applying less stringent ROOs to enable goods from outside the region also to enjoy lower trade barriers. Another important aspect is to extend, as far as possible, lower trade barriers to non-members of PTAs. Empirical studies have found that preferential liberalization is often followed by a reduction in applied MFN tariffs (see for example Lendle 2007 for the case of ASEAN).

Alternatively, countries might consider achieving a more harmonious external tariff structure. While the region is not, and will not be, a customs union, a more uniform tariff structure towards non-members would make the region more open to the rest of the world while at the same time accelerating integration even further.

6. Conclusion

Both from a practical and a philosophical point of view, the multilateral trading system, with its liberalization and non-discrimination properties, offers more benefits than regionalism. But preferential agreements have a longer history and are often more appealing for participating countries as such agreements provide something tangible to the governments involved. Therefore the question is not which of the two to choose, but rather how to make preferential agreements less discriminatory and more supportive of the multilateral negotiating process. Since countries in East Asia have embraced regionalism intensively, their active involvement in this initiative can provide considerable leverage to the process.

There are three ways in which East Asian countries can contribute to promoting the multilateral trading system. The first is to make sure that the Doha Round is completed successfully. This is not so much a matter of economic consequence, as existing PTAs in the region have promoted openness of the economy. Rather it is about the political willingness of countries to pursue multilateral liberalization. The

second is by supporting the reform of the WTO by promoting wider coverage of negotiations and disciplines. The third is to transform PTAs in the region into arrangements that are less trade-diverting and more flexible for non-member countries. Such an agenda would not only support a more progressive global trading environment but also address many problems and challenges currently faced by countries in the region.

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Regional and bilateral trading agreements are so pervasive today that as of the beginning of 1996 nearly all WTO members were also signatories to at least one existing regional or bilateral trade accord (WTO 1995, 27). Notable exceptions are Hong Kong and Japan, but even these exceptions would vanish if the Asia Pacific Economic Cooperation (APEC) forum became a full-blown bloc.³ Europe. Regional integration has proceeded the furthest in Europe. Nearly the entire region is intertwined in a system of regional trading agreements. The East Asian Economic Caucus (EAEC) grew out of a 1990 proposal by Malaysian President Mahathir bin Mohamad to establish the East Asian Economic Group (EAEG) as a bloc to counter NAFTA and the European Community. East Asian countries are signatories to almost 80 trade agreements. Nearly half of them have been concluded with states within the area. However, economic cooperation is equally active with the rest of the world, which makes East Asia the second most economically integrated region, uniformly outward and inward oriented. (East Asia Community under ERIA: The Role of Japan towards Think Tanks and the Development of East Asia Community). This article aims to explain the role of Japan that has been involving in the strengthening and regional integration of East Asia by providing assistances through the Economic Research Institute for ASEAN and East Asia (ERIA) that has more.