

3. New Regionalism: Options for China and East Asia

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Half of world trade is now conducted under preferential trading arrangements,¹ up from 40 percent in 1988-92.² In East Asia, the past several years have seen a plethora of proposals for new preferential arrangements, both bilateral and regional. Though very few of these proposals have thus far reached the negotiation stage or been formalized, several economies in the region are seriously engaged in developing new preferential trading relationships, while others are actively considering moves in this direction. They include China and two countries, Japan and the Republic of Korea, that were formerly staunchly against the preferential route to trade liberalization.

The most significant of the new initiatives, in terms of members, is the China–ASEAN³ Free Trade Area now under negotiation. If agreement is reached, this will be the world's biggest free trade area, encompassing 1.7 billion people, a collective GDP of almost US\$2 trillion,⁴ and intra-regional trade of US\$1.2 trillion. Other recent proposals include bilateral cooperation between Japan and Korea and between Japan and Singapore, and broader cooperation, for example in ASEAN+3 (China, Japan, and Korea) and ASEAN+CER (Australia, New Zealand Closer Economic Partnership.). New early warning systems, as well as numerous technical assistance and information exchange arrangements, are also being considered.

Preferential trading arrangements are sharply at odds with previous East Asian preferences for a nondiscriminatory approach to reform.⁵ In the mid-1990s, economies in the region pursued a unilateral and non-preferential route to trade liberalization—an approach that is embodied in the principles of the Asia-Pacific Economic Cooperation (APEC process) and supported by evidence that such a commitment contributes to growth, development, and greater integration in economic terms and more broadly. The East Asian economies,

[†] This chapter draws on three background papers prepared for this study: Peter Lloyd and Mark Crosby (2002), Mari Pangestu (2002), and He Fan (2002), as well as other papers listed in the references. We have also benefited from the excellent research assistance that was provided by Qing Lani Wu (from the Kennedy School of Government, Harvard University, USA) during her internship at the World Bank

¹ WTO (2000a and b).

² Grether and Olarreaga (1998).

³ The Association of Southeast Asian Nations (ASEAN) comprises 10 members: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

⁴ This size of GDP is half of Japan's, but if current growth rates are maintained, it will catch up with Japan's in the next 5 to 10 years. In purchasing power parity (PPP) terms, China's GDP now exceeds that of Japan (World Bank, 2002).

⁵ Until a few years ago, apart from the ASEAN Free Trade Area (AFTA), East Asia had no formal regional cooperation agreements. A proposal by PM Mahathir in December 1990 to form an East Asian Economic Grouping elicited strong protests from then U.S. Secretary of State James Baker, and support of the proposal from Japan or China was not forthcoming. There was in general a strong sentiment against institutionalizing regional cooperation or regionalism. See also Munakata (2001).

especially, undertook unilateral liberalization mainly on a Most-Favored-Nation basis, encouraged by regional peer pressure and WTO commitments, among other factors.

Reasons for new regionalism

The new regionalism in East Asia seems to be motivated by several factors. The first is a concern to reduce the risks of financial contagion and unusual exchange rate instability, the damaging effects of which were made clear by the Asian financial crisis. The crisis showed that rapid depreciation of one country's currency could adversely affect the export competitiveness of other countries, especially neighbors producing the same products for the same export markets.⁶ The crisis initially propelled countries to explore options for monetary cooperation and macroeconomic policy coordination,⁷ but, by highlighting the economic interdependence of the region, it has also given rise to proposals for regional cooperation in trade and investment.

Box 3.1: Forms of regional preferential trading arrangements

Statistics on regional trading arrangements (RTAs) notified to the WTO show that more than twice as many preferential trading arrangements (197) are in force today as 10 years ago.⁸ Nearly all WTO members (97 percent) now participate in RTAs, and many belong to more than one. Some, like the European Union members and Mexico, belong to more than 10.⁹ EU-centered or -related RTAs make up about half of the RTAs in force.

1. *Sectoral preferential trading arrangements*: preferential tariffs in selected sectors and goods. Examples are the European Coal and Steel Community and the ASEAN Preferential Trade Agreement (PTA) scheme, which preceded the AFTA scheme.
2. *Free trade area*: removal of tariffs and other trade regulations that restrict trade among the members (may apply to goods and/or services).
3. *Customs union*: a free trade area plus harmonization of tariff rates and trade regulations that face third countries (may apply to goods and/or services).
4. *Common market*: free trade area among members in goods, services, capital, and labor. Entails removal of all barriers and trade regulations that restrict trade among members in goods, services, capital, and labor.
5. *Single market*: a common market plus harmonization of all laws and regulations and taxes that affect market prices.
6. *Economic union*: common market and unification of economic institutions and coordination of economic policy among member countries. Supranational institutions are established with decisions binding all members. Involves considerable surrender of national sovereignty.
7. *Monetary union*: a single currency and a single central bank.
8. *Fiscal union*: equal tax treatment in one country of enterprises and persons from anywhere within the RTA region.

Sources: Lloyd and Crosby (2002), Chia (2002).

⁶ Eichengreen (2001).

⁷ Kaminsky and Reinhart (1999) have shown that output losses are much more significant when a currency crisis is accompanied by major financial sector problems.

⁸ WTO (2002).

⁹ Crawford and Laird (2000).

A second key reason for the new trend is the perceived need by other economies of the region for stronger cooperation with China, both as a growing import market and as a rising competitor in export markets. Over the decade 1990-2000, China experienced an average real rate of growth of 10 percent a year, and its exports quadrupled from some US\$62 billion to US\$250 billion. Meanwhile, investment flows to China increased dramatically from some US\$3 billion to more than US\$40 billion.¹⁰

A third factor is the interest of business communities in getting preferential access to foreign markets, especially when these are imperfectly competitive markets in which some form of establishment is required. There are significant benefits from being the first movers in such an environment. The greater tradability of many services and the growth of foreign direct investment have contributed to this focus in policymaking.

Other factors include the move by many economies, especially the more developed in the region, to lower their average tariffs; the growing recognition of the value of harmonizing standards and regulations, if these are not to impede trade; and the higher concentration of trade among regional partners, especially in East Asia. These changes have affected countries' assessment of the costs and benefits of entering into preferential agreements. Some countries are also seeking to forge new agreements as a defensive response to arrangements being created elsewhere.

Agreements on economic cooperation offer opportunities to build a sense of community or to repair past tensions between neighboring economies. Membership of regional trading arrangements and informal economic cooperation forums provides occasions for numerous meetings between senior officials, ministers, and leaders, and it has been seen as a crucial component of the community building that has taken place in the region, especially in ASEAN. APEC meetings have also provided an important forum to discuss economic and, increasingly, noneconomic issues of concern to members without having to negotiate. The discussions and negotiations that take place, including issues not yet covered in the WTO, are also seen as important capacity-building exercises.

Last, countries cite their perceptions of a slow pace of progress in trade liberalization, or the expectations of poor prospects, under WTO and existing regional cooperation mechanisms such as ASEAN and APEC, and the example set by increased economic integration in Europe and North America.

Outline of chapter

The chances for a new WTO trade round have now brightened, and East Asia stands to gain from any breakthroughs in the multilateral trade liberalization that is now being considered at the global level. There is concern that the pursuit of a regional approach might deflect attention from the multilateral agenda, that it could hold East Asia back from reaching its full economic potential, and that it could cause increased economic and political tensions in the region. Experience shows that a haphazard and uncoordinated proliferation of preferential agreements can increase the costs of doing business.

¹⁰ ASEAN-China Expert Group (2001).

To help the economies of the region make informed decisions on trade policy and economic integration, this chapter reviews current and proposed regional trading arrangements and discusses issues in their design. The first section of this chapter outlines the agreements now in force and under discussion in East Asia. The second section examines what the literature tells us about the benefits and risks of such arrangements and draws out some policy implications for East Asian economies; it includes a look at whether a regional approach can complement a multilateral approach. The next section focuses on the evolving relationship between China and ASEAN and the implications for their cooperation agreement now under negotiation. This is followed by a discussion of regional financial cooperation and a final section that concludes.

Regional trade agreements in East Asia

Bilateral and multilateral trading arrangements in East Asia are proliferating and becoming more complex. Chia (2002) distinguishes between economic *regionalization* and *regionalism*. Regionalization refers to the increase in economic interdependence that takes place as the result of increased intraregional trade, investment, technology, and migration flows, without any formal framework of cooperation. It is often termed *market-driven* integration because it occurs as each economy undertakes its own unilateral process of opening up, as well as fulfilling its multilateral commitments. Regionalism refers to *formal* economic cooperation and economic integration arrangements, and agreements between two or more countries that are designed to achieve economic growth through trade and investment liberalization and facilitation.

Market-driven integration or regionalization has been occurring in East Asia since the mid-1980s through increased trade and investment linkages. The process has been driven by unilateral reforms in individual economies and by the logic of the “flying geese” pattern of relocating production processes to cheaper areas abroad as domestic costs rise. Firms moved their production processes from Japan to the East Asian newly industrializing economies (NIEs) in the 1970s and early 1980s, to Southeast Asia in the mid-1980s to early 1990s, and to China in the mid-1980s to mid-1990s.¹¹ To support the vertical specialization and division of production along the value chain, intraregional trade has grown rapidly in components, parts, and inputs.

Recent rise of regionalism in East Asia

Table 3.1 lists actual and potential trading arrangements involving East Asian economies.¹² Most of these are still in the form of proposals and studies, or at the negotiation stage. Some may never be implemented, since there remain many unresolved issues, and others may only become implementation agreements associated with APEC processes.

¹¹ Song and Xu (2000). The distinct period for each group of economies is also the period when flows of foreign direct investment, especially intraregional FDI, accelerated into that group.

¹² This section provides only an introductory overview of the various regional and multilateral trade arrangements in East Asia, but the following questions may need further research: How large is intra-AFTA trade relative to AFTA's total trade? How much intra-AFTA trade is excluded because of “sensitive sectors”? How would these numbers change if China were added? How much variance is there among AFTA and ASEAN members in how much of their trade is covered? The answers to these questions will influence how different countries and groups approach others and their approach to liberalizing in other geographic areas.

Table 3.1: Proposed and actual regional trading arrangements involving East Asian countries

	<i>Bilateral Asia Pacific</i>	<i>Type of agreement</i>	<i>Status</i>	<i>Year</i>
1	Singapore-Australia	Free Trade Area	Under Negotiation	2000
2	Singapore-Canada	Free Trade Area	Under Negotiation	2001
3	Singapore-Chile	Free Trade Area	Under Negotiation	2000
4	Singapore-Japan	New Age Economic Partnership	Signed	2002
5	Singapore-Mexico	Free Trade Area	Under Negotiation	1999
6	Singapore-New Zealand	Closer Economic Partnership	Implemented	2001
7	Singapore- Korea, Rep. of	Free Trade Area	Proposal	
8	Singapore-Chile	Free Trade Area	Under Negotiation	2000
9	Singapore-Taiwan (China)	Free Trade Area	Proposal/Study	2002
10	Singapore-USA	Free Trade Area	Under Negotiation	2000
11	Korea, Rep. of-Australia	Free Trade Area	Official Discussion	2000
12	Korea, Rep. of-China	Free Trade Area	Proposal/Study	
13	Korea, Rep. of-Chile	Free Trade Area	Under Negotiation	1998
14	Korea, Rep. of-Japan	Free Trade Area	Official Discussions/study	1998
15	Korea, Rep. of-Mexico	Free Trade Area	Official Discussions/study	2000
16	Korea, Rep. of-New Zealand	Free Trade Area	Official Discussions/study	2000
17	Korea, Rep. of-Thailand	Free Trade Area	Proposal/Study	2001
18	Korea, Rep. of-USA	Free Trade Area	Under Negotiation	2001
19	Japan-Canada	Free Trade Area	Proposal/Study	2002
20	Japan-Chile	Free Trade Area	Official Discussions/study	2000
21	Japan-Mexico	Free Trade Area	Official Discussions/study	1998
22	Japan-Thailand	Closer Economic Partnership	Proposal/Study	2002
23	Hong Kong (China)-New Zealand	Closer Economic Partnership	Official discussion	2001
24	Thailand-Croatia	Free Trade Area	Proposal	2001
25	Thailand-Czech Rep.	Free Trade Area	Proposal	2001
26	USA-Philippines	Free Trade Area	Proposal	2002
27	USA-Taiwan (China)			
	<i>Regional plus</i>			
28	AFTA	Free Trade Area	Implemented	1992
29	AFTA+CER	Closer Economic Relations	Official discussions/Study	1999
30	ASEAN+China	Free Trade Area	Official/Study/Negotiation	2001
31	ASEAN+Japan	Comprehensive Econ. P'nership	Official Discussions	2002
32	ASEAN+ Korea, Rep. of	Free Trade Area	Official discussions	2002
33	Singapore+EFTA	Free Trade Area	Signed, Implem. '03	2002
34	ASEAN+3	Free Trade Area	Official discussions/Study	2000
	<i>New regional</i>			
35	Japan-h Korea, Rep. of-China	Free Trade Area	Official discussions/study	2000
36	Pacific 5	Free Trade Area	Proposal	1998

Notes:

EFTA: Switzerland, Iceland, Liechtenstein, and Norway.

Pacific 5: Singapore, Australia, New Zealand, United States, and Chile.

ASEAN: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam.

ASEAN+3: ASEAN plus Japan, Korea, and China.

AFTA: ASEAN Free Trade Area.

CER: Australia-New Zealand Closer Economic Partnership.

Sources: Austria (2002), and recent reports in media.

The arrangements mooted or under discussion are all free trade areas, not customs unions. Like regional trading arrangements elsewhere in the world, they extend beyond the traditional areas of trade policy—such as tariffs and nontariff measures—and into investment, services, and standards. These are areas that the WTO covers, but where the progress of WTO negotiations might be seen as too slow (for example, in services), or where WTO coverage is very limited (for example, investment issues in goods production). All the discussions make reference to WTO consistency and also refer to other rules such as open access and comprehensive coverage.

Geographic proximity is not a key consideration. While some agreements are between close neighbors, others are between trans-Pacific partners, such as Mexico and Singapore or Korea and Chile. Several take ASEAN/AFTA as their focal point and build upon AFTA.

ASEAN Free Trade Area

The ASEAN Free Trade Area was until recently the only preferential regional trade agreement in East Asia. AFTA now has 10 member economies with a combined population of nearly half a billion and a combined GDP almost as large as China's. AFTA became effective January 1, 2002, for the original six ASEAN members; longer timetables apply to the newer members: 2004 for Vietnam, 2006 for Lao PDR and Myanmar, and 2008 for Cambodia.

Formal economic integration under AFTA is confined mainly to tariff reductions, and intra-ASEAN trade already enjoys low tariffs. AFTA's target is for 0-5 percent tariffs for intra-ASEAN trade among the original six signatories; in fact, 90 percent of intra-ASEAN trade can already be conducted at tariffs in the 0-5 percent range. The average ASEAN common effective preferential tariff (CEPT) fell from 12.76 percent to 2.91 percent over the 1993-2002 period. Because individual ASEAN economies were already liberalizing their trade individually before AFTA came into force, AFTA's common effective preferential tariff rates differ little from the MFN rates, and indeed for two-thirds of the items in AFTA's inclusion list, the two tariffs are the same. This has meant that not much of intra-ASEAN trade has come in under the CEPT tariff.¹³

The integration of trade and investment—as well as, to some extent, services and factor movements—among AFTA members is due more to the unilateral liberalization that has been undertaken by individual members and to the market forces integrating their economies, especially those that are close neighbors, than to the agreement itself. Different AFTA members have different trade policy regimes: Some have chosen to multilateralize their AFTA commitments, while others have chosen the same schedule of tariff reductions as AFTA but with a slightly higher end point on an MFN basis compared to the AFTA preferential rate.

AFTA has evolved more gradually than regional cooperation schemes in North America and Europe. Strong expressions of political commitment, and proposals to widen ASEAN cooperation, have not always been followed up with concrete and broad-ranging

¹³ Soesastro (2001).

implementation.¹⁴ The idea of a comprehensive and integrated framework to cover investment, services, trade and investment facilitation measures, competition policy, and antidumping has been proposed, but has not progressed very far.

Proposed regional arrangements involving China

Various initiatives have been discussed in the last few years to strengthen cooperation in trade, investment, and finance between China and Northeast Asia, China and ASEAN, the economies of Hong Kong (China), Macau (China), and East Asia-wide. At a recent meeting in Hong Kong (China), China announced the possibility of a Hong Kong (China), Macau (China), and China free trade area.¹⁵ And there have been discussions of separate bilateral agreements between China and Asian countries such as Korea and Thailand. The recently completed ASEAN+3 (China, Japan, and Korea) Bilateral Swap Arrangement of the Chiang Mai Initiative may be seen as a precursor to expanded trade arrangements and greater financial and macroeconomic cooperation and coordination.¹⁶

Proposals for Northeast Asian economic cooperation involving China, Korea, and Japan face many obstacles such as agricultural protectionism and the complex and shifting political relations in Northeast Asia.¹⁷ Proposals such as a Northeast Asian Council and Northeast Asian Development Bank have not gone far at all.¹⁸

China–ASEAN cooperation. The most concrete proposal is for economic cooperation between China and ASEAN. In November 2000, the fourth meeting of the ASEAN+3 leaders created a task force to study the possibility of establishing an ASEAN free trade zone, and in November 2001, “to everyone’s surprise” (He Fan (2002)), ASEAN leaders and Chinese Premier Zhu Rongji endorsed the establishment of a free trade area between China and ASEAN economies within 10 years.¹⁹ Negotiations are ongoing, including on issues of product coverage.

The envisaged scope of the agreement is quite comprehensive; on trade in goods, it goes beyond the removal of tariffs and nontariff barriers to include trade facilitation measures such as conformity of standards and procedures, and it also covers trade in services. The aim is to introduce tariff reductions for a certain group of products over three years beginning

¹⁴ There is evidence that some AFTA members have fallen behind in their reform schedules; an example is delays in including the automotive and petrochemical sectors in the AFTA by Malaysia and the Philippines, respectively.

¹⁵ The main reason is that after China's WTO accession, these three will be three separate customs territories and China would not be able to give preferential treatment to Hong Kong or Macau unless they were members of a free trade agreement.

¹⁶ Unlike in the EU and NAFTA, in East Asia, monetary and financial cooperation has tended to precede cooperation in trade. Barry Eichengreen (2001).

¹⁷ Such as the role of China in the Korean Peninsula situation and Japan’s alleged support for Taiwan.

¹⁸ He Fan (2002).

¹⁹ Agreement was also reached at the November 2000 meeting to review the possibility of an East Asian economic zone. The fact that the China-ASEAN economic cooperation has forged ahead faster than East Asia-wide cooperation (or a similar earlier idea for cooperation between Japan and ASEAN), indicates, some would say, the lack of vision and strategy of Japanese leadership at the moment about its leadership in the region (Asahi.com, November 2001). The main issue in Japan in this regard is resistance to opening up its agriculture sector.

before January 1, 2004, and, for other products, over the agreed time frame of the free trade area—either to 2013 or to 2010.

Other ASEAN proposals

In response to the proposed creation of the ASEAN-China free trade area, other countries have now shown interest in free trade agreements with ASEAN. Japanese Prime Minister Koizumi recently suggested an ASEAN-Japan Comprehensive Economic Partnership, an arrangement that would include traditional as well as new elements related to facilitation, standards, and other forms of cooperation. Korea has made a similar proposal, and at the APEC 2002 meeting in Mexico, even the United States made a similar overture. President George W. Bush put forward a new trade initiative called the U.S. Enterprise for ASEAN Initiative, under which ASEAN could liberalize its trade with the United States. No timetable has been set.

In the last year or so, Thailand has begun a more deliberate pursuit of bilateral and regional arrangements, and concerns are being expressed about how this will affect ASEAN economic regionalism and cooperation.

ASEAN is in a unique position at the hub of a whole series of proposed preferential arrangements, but probably due to its own internal weaknesses and lack of leadership it does not seem to be making the most of this position. Hence, to achieve success, ASEAN would be well advised to ensure that it has a clear vision of what it wants to achieve from regionalism and that it has a coherent framework for deciding which agreements to enter.

Costs and benefits of economic regionalism

What can countries hope to achieve from preferential trade agreements? What does the literature say about the economic costs and benefits of these agreements?

The economic benefit of a preferential trade agreement is the economic efficiency gains from trade liberalization. A member country will allocate resources to sectors in which it has a comparative advantage vis-à-vis other members, and trade is created. The greater size of the combined market can also contribute to economies of scale and attract foreign direct investment, though since the benefits depend on the size of markets as well as on the producers in the RTA, they vary widely across countries.

Other than the traditional economic benefit of greater efficiency, countries enter into RTAs for many development-related reasons. Such arrangements offer the chance to create larger regional markets that are more attractive to foreign investors; to sequence liberalization by opening up in stages; to lock in place unilateral reforms; and to pursue structural change jointly with other members. Liberalization, trade facilitation, and structural reform are often thwarted by vested interests, and regional cooperation for the joint promotion of these processes can make them easier to achieve. For smaller states, RTAs also offer the opportunity to build capacity in trade negotiations.

Preferential agreements also carry risks, one of which is that trade may be diverted away from more efficient nonmembers to less efficient members. If a preferential agreement diverts more trade than it creates, it will yield smaller efficiency gains than would multilateral liberalization. The larger the difference between the preferential RTA tariff and the external tariff imposed on imports from nonmembers the greater the trade diversion effect. Trade may also be diverted if members of a free trade area impose rules of origin, since these may cause imports to be redirected through the member country that has the lowest external tariff.

The literature on the benefits and costs of regional trade agreements does not offer conclusive guidance on whether trade creation will outweigh trade diversion or on what such agreements will contribute to welfare.²⁰

The view of Srinivasan, Whalley, and Wooton (1993) is that quantitative assessments do not offer sufficient grounds for either vigorous support or vigorous opposition to preferential agreements. They reviewed work in this field based on computable general equilibrium models and found that the welfare effects of preferential agreements had probably been positive but not very large.²¹

Krueger (1995) found that trade diversion tended to occur less in those RTAs whose members had high levels of bilateral trade before entering the agreement. And Yeats (1998), looking at experience in Mercosur, found that trade diversion can be minimized if external tariffs are low and if members become more open by further reducing their external tariffs as they enter the RTA.

Soloaga and Winters (1999), in a comprehensive study of nine arrangements over 17 years, found no indication that the rise in preferential agreements in the 1990s had significantly boosted intra-bloc trade. At the same time, with respect to trade diversion, they found significant effects only in the EU and European Free Trade Area (EFTA).

²⁰ Much depends on the assumptions made and the methods used to measure trade creation and diversion, and whether the effects measured are dynamic or static. Some authors find a positive net trade creation effect (Salazar), while others argue that there has been a serious net trade diversion effect in some cases, such as in North America (Panagariya). The balance between positive and negative effects may also differ between members and nonmembers of an RTA. For example, dynamic benefits might outweigh positive effects for members, but nonmembers might still be adversely affected by trade diversion as a result of their exclusion. Yeats (1998) found net trade diversion in the case of Mercosur, where a contributing factor seems to have been the high margins of preference. However, for some pairings, the cost in terms of trade diversion may be relatively small, when trade barriers are already low. The preferential trade agreement route then looks like a low-risk option.

²¹ Computable General Equilibrium (CGE) models have the advantage of providing more options for good choices of base scenarios and for capturing more of the detail of preferential policies. The models are becoming increasingly sophisticated and able to incorporate scale effects, imperfect competition, and capital accumulation. Panagariya (2000), however, identifies a number of problems in the modeling approaches. Appendix C of "The Angkor Agenda" (available from http://www.aseansec.org/aem/angkor_agenda.pdf) also lists a number of empirical papers.

Davis, McKibbin, and Stoeckel (2000) found that a joint free trade arrangement between AFTA and CER would yield worthwhile benefits²²: for AFTA, an extra \$US25.6 billion and for CER, an additional \$US22.5 billion, in GDP in net present value (that is, in discounted cash flow) terms. The real consumption gain, allowing for the ability to shift spending through time, would be 1 percent by 2005 for AFTA and 0.6 percent for CER.²³

However, the same study also found that if APEC proceeds on schedule, the additional gains from the AFTA-CER arrangement would be relatively small: Those to AFTA would be just over \$US10 billion, and those to CER members, just under \$US2 billion. The reasons are that (1) trade between AFTA and CER is small, compared to members' trade with APEC as a whole, and (2) APEC is not preferential so that some of the APEC gains could in fact be attributable to the AFTA-CER connection, to the extent that this encourages further liberalization by APEC members.

Free trade or a bloc-ed up world?

The question of whether regional trade arrangements are stumbling blocks or building blocks to a more open multilateral system has often been raised. RTAs have not always been effective in locking in unilateral reforms,²⁴ and it is not clear whether they can achieve deeper and faster liberalization than can a multilateral approach. Negotiations of RTAs have arguably been no more successful than multilateral negotiations in dealing with sensitive sectors and issues, and they have also tended not to cover sensitive sectors such as agriculture. Further, regional arrangements may divert attention and resources away from multilateral and unilateral efforts to liberalize and facilitate trade. Especially in small economies, concentration on negotiating regional agreements could have dire implications if it slows down progress on these fronts.

These concerns aside, several recent studies suggest that, under some circumstances, uncoordinated preferentialism could lead to global free trade. Their results are derived from special conditions—in which just one (differentiated) good or service is traded in oligopolistic markets—but they provide some guidance and focus for cooperation.

First consider the case when, driven by producers' interest in getting access to rents in foreign markets, economies form a bloc to which others seek membership. If the bloc's constitution says that everyone who wants to join must be let in on the same terms as the original members, then the excluded economies continue to seek to join until everyone is a member.

²² They use the APG-cubed model (18 countries and 6 sectors), which permits the identification of dynamic gains and allows for allocative efficiency effects, terms of trade changes, and capital accumulation for goods and for services, as well as endogenous productivity effects.

²³ These gains are nearly three times as great as those found by an earlier study that excluded services liberalization and the productivity effect.

²⁴ There is some evidence that this has worked effectively in some cases in the Western Hemisphere, but in other cases unilateral reforms have been delayed as economies held back moves to open up until such time as they entered into RTA and WTO negotiations.

Another possibility is the merging of blocs. Andriamananjara (1999) considers the incentives to merge smaller blocs; he starts with a situation in which each economy forms a bloc with one neighbor. In the next stage, the members of one agreement merge with those of one other agreement, and so on. Could this process continue until global free trade is reached, or will it stop before then? He finds that global free trade can be attained, but only if the general level of inter-bloc tariffs is low enough; when tariffs are low, the oligopolistic firms that populate this model can make greater profits with unrestricted access to all markets.

These two situations suggest that it would be worthwhile to introduce rules on the use of preferential agreements and, in particular, rules on accession to such agreements. When bloc members have discretion over who can join, they will stop letting in others before global free trade is reached. So, without a rule on accession, free trade blocs will stop growing at a point short of universal free trade.

Network effects are a factor that could drive the outcome of a preferential approach further toward free trade. When direct network effects exist, the value of a product increases with the number of consumers who use a compatible product. Gandal and Shy (2001) show that when these effects are significant, the incentive to form a standards union disappears.

Freund (2000b) provides another perspective on the process of consolidation by examining serial bilateralism.²⁵ She finds that the benefits of a bilateral agreement include higher profits from preferential access to foreign markets and higher consumer surplus at home. These gains always outweigh the loss of profits in the home market and the loss of tariff revenue that results from offering foreign suppliers access at preferential rates. This is the case no matter what agreements are already in place and what other economies have done. The consequence is that the best strategy for each economy is to have a bilateral agreement with every other economy. In this model, in the presence of uncoordinated bilateralism, the outcome is free trade.

In reality, as Freund points out, there are costs associated with having a series of bilateral agreements, including those associated with complex rules of origin. The issue of sensitive sectors is also ignored. And the more dimensions there are to an agreement, the more scope there is to apply discrimination in a variety of ways and the more difficult it becomes to bolt different agreements together.²⁶ Cooperation with one set of partners can make it more difficult to harmonize with other partners and impede the signing of new preferential agreements; this could stop the proliferation of agreements before free trade is reached. The issues that are now on the trade liberalization agenda—for example, in services, standards, and investment—are likely to make preferential agreements increasingly complex. The outcome in practice is likely to be a host of different agreements between different groups of partners—the “spaghetti bowl” effect.

²⁵ She uses the same segmented oligopolistic market model as Andriamananjara (1999), but now governments maximize welfare, that is, the sum of producer and consumer surplus, plus tariff revenue. The outcome of unilateral policymaking is that each government sets the optimal tariffs on imports from other economies, taking those economies' tariffs as given. In this setting, when bilateral agreements are possible, each country wants to sign an agreement with every other country.

²⁶ Findlay (2001) and Snape (1996b).

Latin America's overlapping preferential agreements have produced this effect. Experience shows that in these circumstances the costs of doing business increase, pushed up by inconsistencies among different agreements—for example, different schedules for phasing out tariffs, different rules of origin, exclusions, conflicting product standards, and differences in rules on antidumping and other regulations and policies. The more dimensions there are to the agreements and the more agreements there are, the wider the scope for such inconsistencies. And, if the costs of doing business increase, further trade diversion effects may arise.

Distribution of benefits: hubs and spokes

Many of the proposed regional trading agreements in East Asia are of the so-called hub and spoke pattern.²⁷ The concern here is that the balance of advantages in hub and spoke arrangements will tend to favor the hub, because of its stronger bargaining position and the greater attractiveness to investors of its central location. Agreements on contentious matters will also tend to be tailored to the demands of the hub. The existing spokes, for their part, having secured their preferential access, will have an incentive to oppose the admission of new members into the circle.

The key findings of the substantial literature on hub and spoke arrangements²⁸ can be summarized as follows.

Hub and spoke agreements do not provide equal market access to all participants. Even if tariffs were removed along each spoke, the spoke countries would still not have free access to each other's markets but only to that of the hub.

Snape (1996a) explains that there is an incentive to create tailor-made agreements to deal with products that the hub country regards as contentious. He also notes how small countries have incentives to join preferential agreements, especially as more and more countries sign up with the hub economy; indeed, the hub and spoke system can “spread like a rash.”²⁹ The spoke economies may or may not have deals with each other.³⁰

The hub economy benefits from its preferential access to each spoke economy, compared to all the other spokes. Only firms based at the hub get duty-free inputs from each spoke. The hub country also gains if it diverts investment from each of the spokes; its favored position gives producers access not only to the domestic market but also to those of all the spoke economies. Further, producers based in the hub are likely to be able to get more inputs at low or zero tariffs than those based in the spokes, since they can source both from the hub and

²⁷ Suppose there are three countries: A, B, and C. Country A concludes separate agreements with B and C, but B and C do not have an agreement with each other. Country A is the hub, and B and C are the spokes. Lloyd (1996), using this example, points out that the entity at the hub could itself be a regional trading agreement.

²⁸ See, for example, Snape (1996a); Wonnacott (1996); Snape, Adams, and Morgan (1993); and Anderson and Snape (1994).

²⁹ Baldwin (1997).

³⁰ A simple, one-sector, illustration of this process at work is air transport. This case, of international air transport where the hub and spoke approach has been pursued by the United States, highlights the manner in which spoke countries can end up at a disadvantage compared to the hub country. See Findlay (1997).

from any of the spokes. An inefficient pattern of investment may be perpetuated, as a result of inertia, even if a hub and spoke system evolves into a free trade area.³¹

A spoke economy does not gain from free trade with other spokes, it could be damaged by discrimination in other spoke markets, and it might have a reduced ability to compete in all markets against firms that are based in the hub.³² It can respond in three ways:

1. It could organize equivalent agreements with other spoke countries. But doing so may be costly, and the risk is that a series of such agreements negotiated one after the other could simply add to the layers of discrimination, as each pair deals with its own set of difficult issues.
2. It can make one bloc with all the other spokes. Realistically, however, since the original membership of the set of spokes was the result of the pressures from interest groups in the hub, it may be difficult for this group to agree subsequently and simultaneously on how to deal with a now larger set of contentious issues.
3. It can unilaterally cut tariffs to the rest of the world. Depending on the extent of these cuts, such an initiative could offset the investment diversion effects. The spoke agreement would then be part of a transition to free trade, but an expensive one. In hindsight, a giant leap to free trade is preferable to a couple of small steps.

Hub and spoke mechanisms can lead to greater resistance to multilateral liberalization. Snape (1996a) argues that each spoke country has paid a price for its preferential access to the hub country, and that it will resist further reductions of tariffs on an MFN basis that erodes the value of its special deals on sensitive products.

At the least, the trade policy of the hub will become a point of potential conflict among current and prospective members of the arrangement.³³ Spokes may seek to have new members come in with fewer and fewer benefits; this desire may come not only from domestic interests in the spoke countries, but also from foreign investors who have invested in these countries in order to gain access to the hub. (These investors may be originally from the hub country, and they will not be without influence in their old home.)

In sum, the hub and spoke structure contains many risks. Economies that are large enough have strong incentives to assume the role of hub economy and to dominate a group of complementary economies in their region. But doing so leads to a structure of layers of discrimination and potential conflict. A hub economy that is already dominant in economic terms can easily be perceived as trying to acquire political dominance by biasing the rules of the new trading system in its favor.³⁴

³¹ Wonnacott (1996).

³² Wonnacott (1996).

³³ Andriamananjara (1999).

³⁴ Wonnacott (1996).

Conclusion

What type of regional arrangements will best serve the East Asia region? First, they should not become a “stumbling block” to multilateral liberalization. Second, they should focus less on easing market access and more on facilitating trade measures and achieving cooperation on external issues of common interest and mutual benefit, such as some of the negotiating issues in the WTO. Third, they should contribute positively to the multilateral trade liberalization process, for example, by including standstill provisions on further barriers to trade and investment; by implementing a simultaneous program of reduction of barriers to nonmembers; by allowing the most liberal rules of origin possible; and by avoiding the spaghetti bowl outcome for other issues.

China and ASEAN

Adjustments in industrial trade and investment resulting from China’s accession to the WTO are likely to occupy the East Asian economies for the next decade. ASEAN members can count on both increased export competition with China and new opportunities within China. This section briefly explores some of the issues this raises for a preferential agreement between China and ASEAN.

At the outset it is important to emphasize that among the ASEAN economies, three of the poorest—Vietnam, Lao PDR, and Cambodia—are not WTO members yet and, as a result, do not have MFN status to export to China. It is a priority issue to ensure that these three members be integrated in the WTO system as soon as possible to avoid unbalanced market access outcomes.

After China’s accession, the new pressure from competition will further sharpen China’s competitiveness and its ability to win market shares, including in ASEAN members’ domestic markets. This is already happening in labor-intensive products such as textiles, garments, labor-intensive electronics/electrical appliances, footwear, and toys. Furthermore, China will now have the same MFN treatment as all other ASEAN member countries; this status makes it a more stable supplier—a desirable feature from the point of view of importing firms.

The planned removal of quotas on textiles and garments, if fully implemented by 2005, will also mean that the ASEAN economies will have to compete openly with China in third-country markets, and it is likely that ASEAN, and other developing Asian economies in South Asia, will lose market share to China. In the U.S. market for textiles and clothing, for example, ASEAN countries have up to now managed to maintain and sometimes slightly increase their share, aided by the quota allocations in this market.³⁵ But in Japan’s more openly competitive market, they have been losing ground to China; 62 percent of Japan’s

³⁵ James et al. (2002). Before its WTO accession, China was not eligible to take advantage of growth in the U.S. quotas.

imports of textiles and apparel now come from China, and only 8 percent come from ASEAN.³⁶

China is also increasingly competitive in high-tech products. There are predictions that by 2006, chip manufacturing in Shanghai will be as big as that in Taiwan (China) and this will make China an important competitor to both Taiwan (China) and Singapore. Taiwan (China) is fully aware that, politics aside, it must integrate economically with China. The only way it can remain competitive in the global market is to relocate production plants in China, as it has been doing for some time. This trend will accelerate after the WTO accession and could have serious implications for ASEAN. Singapore may find it difficult to compete with high-tech exports produced in China.

Like other countries, ASEAN members will also have access to the more open and growing Chinese market, where import tariffs on ASEAN manufactured products will continue to come down from 15 to 10 percent in the next five years. Quotas and quantitative restrictions will be removed and replaced by tariff quotas. This will be important for ASEAN agricultural products such as palm oil, rice, and sugar. Other nontariff barriers and investment-related measures, such as local content and trade-balancing requirements, will also be removed, immediately or gradually. Under its accession commitment, China will open up its services sector over the next five years; especially important for ASEAN economies will probably be professional services, tourism, and the possibility of some professional labor migration.

China's demand for imports from ASEAN is likely to increase. Products that will benefit include oil and gas, wood, rubber, food and other agriculture-based products, as well as some manufactured products such as electrical machinery. It is up to ASEAN member economies to ensure their competitiveness in supplying these products to China.

Other than greater market access, the hope is that China's WTO accession will result in greater transparency and certainty in laws and regulations and their implementation. Surveys of business people in Malaysia and Singapore reveal common problems that ASEAN and other investors have in doing business in China. They cite unpredictable laws, uncertain product standards, weak legal infrastructure, insufficient trade facilitation measures, inefficient bureaucracy, low quality of work, poor protection of intellectual property, financial market restrictions, and poor enforcement legislation.

China's accession will eventually benefit ASEAN as a whole. China's restructuring is providing an impetus for the establishment of new regional production networks, initially in electronics, which promote more productive firms. For now, these production networks are oriented toward export to developed countries, but the growing markets within East Asia provide a potential complementary source of demand.³⁷ The China-ASEAN trade agreement, with its "Early Harvest" provisions, provides another avenue through which the poorer

³⁶ For instance, for cotton knit apparel, the share of China in Japan's market increased from 47.3 to 77.3 percent, and for manmade fiber knit apparel from 59.1 percent to 80.4 percent over the 1996-2001 period. Japan does not impose bilateral quotas and thus reflects more open competition.

³⁷ China's domestic market is the largest of these, but recent trends show Korea, Thailand, and other economies growing on the strength of domestic consumption demand.

countries in the region, including non-WTO members,³⁸ can benefit from trade opportunities in the region.

ASEAN-China economic relations

ASEAN and China have strengthened their mutual trade and investment ties in the last decade, propelled by the dynamic growth in China, and in ASEAN before the crisis; by the liberalization undertaken by individual countries; and by their geographic proximity.

ASEAN as a region is China's fifth largest trade partner, after the United States, Japan, the European Union, and Hong Kong. The share of ASEAN in China's trade is still quite small, at around 8 percent, though it has been growing by 20 percent a year during the last decade. Between 1991 and 2000, ASEAN increased its share of China's exports from 5.7 to 6.9 percent, and of China's imports from 6 to 9.9 percent.

ASEAN exports to China still consist mainly of resource- or agriculture-based products (minerals, pulp, wood, vegetable oil, rice, and sugar). However, a growing share consists of machinery and electrical components for assembly into final goods in China. These exports are linked to trade-related investments and are part of the multinational regional production structure as well as the regional pattern of sourcing.³⁹ Intra-industry trade also takes place in textiles and fibers.⁴⁰

Investment relationships between ASEAN and China have also been strengthening. Investments have flowed from ASEAN countries into China in the last decade, with varying degrees of success. Singapore was one of the first Southeast Asian countries to enter when China first opened up to foreign investment in the late 1970s; reflecting ancestral links, the investments went mainly to small businesses in Guangdong and Fujian. By the end of 2001, Singapore was the fifth largest investor in China, with a cumulative realized investment of US\$18.6 billion in that country.

Recently, China itself has begun a vigorous outward investment drive, and the government has encouraged Chinese companies to invest in and contract for major engineering and construction projects.⁴¹ This go-abroad policy appears to be designed to expose Chinese firms to international business practices as well as for resource security, given the demands for fuel, minerals, and other resources of this high-growth economy. For example, the Chinese state-owned offshore oil company, CNOC, recently acquired Spanish oil company *Repsol-YPF* for its Indonesian oil and gas assets⁴²; other gas purchase deals between Indonesia and China are being negotiated.

³⁸ Vietnam, Lao PDR, and Cambodia are not yet WTO members.

³⁹ ASEAN (2001) and Yusuf (forthcoming).

⁴⁰ ASEAN countries' main exports to China are listed in the appendix to this chapter, at www.aseansec.org/13196.htm

⁴¹ *Far East Economic Review*, March 28, 2002.

⁴² This acquisition, for US\$584 million, is the biggest foreign acquisition of Indonesian oil and gas assets in the last decade (FEER, March 28, 2002).

Given the sluggish growth of most economies of the group, ASEAN in general remains a less attractive destination for Chinese investment than Latin America, the United States, or Europe. Thus far, it accounts for 20 percent of China's outward investment.

ASEAN and China have important relationships in services, especially tourism, finance, and telecommunications. China's growing prosperity means that an increasing number of Chinese tourists are visiting ASEAN countries; 2.2 million visited ASEAN countries in 2000, particularly Thailand, Vietnam, Singapore, and Malaysia. For their part, ASEAN tourists visit China in increasing numbers. One drawback to investment and tourist destination attractiveness in ASEAN is the discriminatory treatment of ethnic Chinese minorities in some of these countries, especially Indonesia. This needs to be overcome and properly managed, given its sensitive nature.

Proposed ASEAN-China Free Trade Area: Goals and means to achieve them

In 2001, China and ASEAN agreed to establish an ASEAN-China FTA within 10 years. The stated motivation of this initiative is to take advantage of complementarities and build on existing strengths, to make the region collectively more efficient and competitive, and to attract investment. The aim is to use the enhanced efficiency to compete in third markets, as well as to provide members with preferential entry to each other's markets (China being the largest market). The experience of AFTA and other RTAs that have been introduced recently suggests that any kind of ASEAN-China free trade area must go beyond the liberalization of cross-border barriers. The proposal prepared by the expert group⁴³ is in fact comprehensive and covers trade and investment liberalization in goods and services, trade and investment facilitation, capacity building and technical assistance, and cooperation in various areas. Certainly the agreement promises big economic benefits. Estimates based on the study by the expert group indicate that the China-ASEAN agreement would augment trade on both sides by 50 percent and increase GDP by 0.9 percent for ASEAN and by 3 percent for China. China's exports to ASEAN countries would be 55 percent greater with the agreement than without it, and ASEAN countries' exports to China would be 48 percent greater.⁴⁴

For ASEAN, the agreement would provide first-mover advantages in the Chinese market before this is opened on an MFN basis (Box 3.2). As well as provide opportunities for this "Early Harvest," it is hoped the agreement would address various nontariff barriers of concern to ASEAN members, such as quotas on palm oil and other agricultural products; China's complex import procedures (whereby, for example, only state-owned enterprises are allowed to import palm oil); and issues of testing, standards, and labeling requirements, investment promotion and protection, visa facilitation, and infrastructure development. It may also provide opportunities to build up the capacity of ASEAN's less developed members.

⁴³ ASEAN-China Expert Group on Economic Cooperation, "Forging Closer ASEAN-China Economic Relations in the 21st Century," Report submitted to the ASEAN SEOM-MOFTEC, October 2001. (ASEAN 2001.)

⁴⁴ He Fan (2002:14), quoting Zhou Keren, Vice Minister of MOFTA.

But the idea is not yet widely accepted by ASEAN members, and some of them have indeed expressed concern about their ability to compete with China and about whether a free trade area would be mutually beneficial. Thailand and Singapore seem to be the most supportive of the idea, with Indonesia and the Philippines taking a moderate position, Malaysia adopting a careful stance, and the lower-income economies within this group (Cambodia, Lao PDR, Myanmar, and Vietnam) expressing the most concern about their ability to compete and mutually benefit from such an arrangement. China, for its part, has an interest in the reduction of ASEAN tariffs and trade barriers on products of special export interest, including motorbikes and vehicle components.

Box 3.2: “Early Harvest”

Early Harvest consists of liberalizing tariffs in priority sectors of interest and implementing other trade and investment facilitation measures that are deemed to generate immediate benefits to the ASEAN and Chinese business communities. These measures could include:

- Development and technical assistance to build capacity among countries, particularly for the new members of ASEAN, so as to improve their competitiveness
- Trade and investment facilitation measures.
- Trade policy dialogue.
- Business sector dialogue.
- Facilitation of visa arrangements for business people.
- Standards and conformity assessment.
- Measures enhancing market access opportunities for specific products or services of interest to ASEAN and China, such as agricultural and tropical products, textiles and clothing, machinery and electronic products, footwear, oils and fats, foodstuff, forestry and aquaculture products, and energy. The list of products and services will be determined by mutual consultation.
- Extension of MFN treatment of China’s accession commitments to non-WTO members of ASEAN in compliance with WTO rules.
- Any other measures delivering immediate mutual benefits.

Source: SEOM-MOFTEC Inputs on Forging Closer ASEAN-China Economic Relationship (Second SEOM-MOFTEC Meeting 28 October 2001, Brunei Darussalam).

As He Fan (2002) suggests, it may be that China wants to assuage ASEAN countries’ fear of “the China threat” by opening up its markets to them. Other than the relatively comprehensive economic integration proposed, such an agreement and cooperation would enhance the sense of community within the region, reduce tensions, and contribute to stability. It may also enhance members’ cooperation on the external front; for China and ASEAN alike, the process of getting to know each other is important, and it is hoped that it will provide a basis for developing a cooperative stance on external issues of common concern, such as the global financial architecture. In the near term, given that the share of ASEAN in China’s trade is still small, the political impact of the China-ASEAN free trade zone may be more important than the economic impact.

Progress in implementing the agreement is likely to be slow, even though it is known that the wider and deeper the coverage, the greater the benefits will be. The agreement will probably

be confined initially to eliminating tariffs on goods. Sensitive sectors such as agriculture will probably be excluded, and progress will be slow in other areas such as the removal of nontariff barriers, liberalization of services, investment, and other new-age RTA issues such as the treatment of workers, environmental standards, and the movement of labor. But if the China-ASEAN Free Trade Area is to be a building block for deeper economic integration within the region, the framers of the RTA would be well advised to focus not just on the nitty gritty of item-by-item tariff lines and exclusions but on ways to increase competition and efficiency and real economic benefits. In this regard, Elek (2000) suggests focusing on trade facilitation through, for example, simplifying customs procedures and harmonizing standards.

To become viable suppliers to the Chinese market and to compete successfully with China in their own and export markets, ASEAN members need to anticipate and prepare for the structural changes that will happen in China. Their own comparative and competitive advantages need to be continually strengthened. Companies in ASEAN need to focus on specialization and product differentiation, including in terms of quality. Each member country needs to devise a comprehensive program and action plan to anticipate the institutions, human resources, and infrastructure needed to support this program. (In fact, such a program is likely to be a more helpful response to the China challenge than is a regional trade arrangement per se.)

Other than restructuring and maintaining their competitive edge, individual ASEAN countries should continue on the current track of unilateral liberalization and reforms while exploring regional cooperation such as that being proposed through the ASEAN-China initiative.

Regional financial cooperation

Since the Asian crisis, East Asian economies have accelerated cooperation in the financial sector and macroeconomic management.⁴⁵ The initiatives range from institutional—such as the creation of an Asian Monetary Fund, sparked by the initial dissatisfaction with the IMF bailout programs at the beginning of the crisis—to the currency swap lines of the Chiang Mai Agreement. In practice, the efforts have focused more on stabilizing currencies than on coordinating macroeconomic policy or achieving overall financial stability.

Financial cooperation to date has focused on strengthening surveillance and supervisory measures within the region and on swap agreements. ASEAN+3 established an ASEAN+3 Surveillance Process in November 1999, based in the ASEAN Secretariat in Jakarta, to encourage the coordination of macroeconomic and financial policies. The issues to be covered by finance ministers at their meetings are: enhancing cooperation in monitoring short-term capital flows, developing early warning systems, assessing regional financial vulnerabilities, and preventing future financial crisis. The Asian Development Bank has a dedicated monitoring unit to undertake this surveillance task as well as to provide training for central bank officials and promote other regulatory and monitoring initiatives.

⁴⁵ For details see Yusuf (forthcoming), Chapter 5, “Regional Cooperation in East Asia.”

The most concrete initiative is the Chiang Mai initiative of May 2000. This expanded the existing ASEAN swap arrangements to include all ASEAN countries and set up a network of bilateral swap and repo arrangements among ASEAN+3 countries. The aim of the initiative is to provide additional short-term hard currency for countries facing possible liquidity shortfalls. The ceiling for withdrawal is not high and would not have been sufficient to prevent the liquidity shortfall during the crisis. A number of the bilateral agreements have reached their ceiling withdrawal of US\$3 billion. The maximum available for withdrawal under each bilateral swap agreement is to be negotiated between countries, as the terms of collateral and conditionalities need to be determined.

According to He Fan (2002), China was not initially enthusiastic about financial cooperation in East Asia, but has changed its attitude out of concern that if it does not play a positive role in the process, it will be kept out by other countries. The Chinese government reputedly feels that trade and technological cooperation is more fundamental and should be preconditions for monetary cooperation.

Conclusions: The way forward

Regional economic cooperation arrangements in East Asia raise complex issues, and decisionmakers need to understand and assess the options carefully, especially given the limited resources and capacity of some of the region's economies.

East Asian economies seek increased economic efficiency and competitiveness, rather than economic integration in the manner of Europe, and they can pursue these goals through unilateral reforms and through ensuring an open, rules-based multilateral trading system. The role of regional trade arrangements is to facilitate and build toward this outcome. The way forward in the first instance is to ensure that unilateral reforms are continued, that commitments to the multilateral process are faithfully met, and that economies are preparing themselves to maximize the benefits from future developments in the multilateral trading system.⁴⁶ In the process of accession to WTO, for instance, China had to concede on many sectors and issues. In the forthcoming negotiations, China will now be able to press for market access for products and services of importance to its economy, and for discipline and fairness in the rules of the game as well.

Progress on involving a large group of economies can be expected to occur through..?] functional cooperation in the financial and monetary area. The tasks to be covered seem likely to be confined to surveillance, technical assistance and capacity building, information sharing, and limited swap arrangements. Joint macroeconomic policy coordination or currency union seems unlikely in the near future.

⁴⁶ In the cases of both the Maastricht Treaty and NAFTA, crucial unilateral domestic decisions that reflected the pressures of rising openness preceded the negotiations. In the case of the former, French and Italian financial market liberalization were prerequisites, while for NAFTA, Mexican trade liberalization was a necessary precondition (Milner 1998).

Given the limited experience with regionalism in East Asia to date, progress on an inclusive regional trade agreement is likely to be slow. AFTA lacks scope and depth, as noted above, and the China-ASEAN Free Trade Area is likely to suffer from the same problems, since it is based on AFTA. But it is possible that ASEAN-China cooperation can extend to forging common positions for international negotiations, such as in the WTO.

Both in formal regional arrangements such as AFTA, and informal regional processes such as APEC, the goal up to now has been more to stimulate and support unilateral reforms and contribute to multilateral liberalization than to achieve greater regional integration or intraregional trade and investment. In such arrangements in East Asia, it may be that process of regional cooperation is more important to the participants than outcomes. If this is so, the agreements should be evaluated not just on the basis of whether they achieve free trade and investment, but also according to the process whereby each country actually makes progress in unilateral reforms.⁴⁷ And it may be that the informal process needs to be more systematically nurtured so that it will graduate into a more institutional one. Whether this means creating a potential East Asian secretariat needs further debate and deliberation.

Is ASEAN/AFTA the natural locus for regional cooperation? Some analysts believe that it is not in a strong position to serve this important role, as a result of weaknesses within ASEAN itself, which have resulted partly from lack of leadership and slow progress on new areas of cooperation.⁴⁸ To strengthen ASEAN, it has been suggested that the implementation of AFTA be accelerated and that the ASEAN economies rethink their vision of regionalism.

To conclude, broader liberalization on a multilateral basis will lead to greater net benefits, but East Asia is likely to realize net gains if it pursues complementary regional approaches simultaneously with multilateralism. One further benefit from stronger regional cooperation could be a more effective stance at the WTO on issues of common interest—for example, in achieving further discipline on antidumping. China plays a critical role in this regard, given its growing economic dominance in the East Asian region if not the world, and hence the type of regional cooperation arrangement it chooses to participate in will have a lasting impact on the course of events and pace of development in the region. Economic development in China can only strengthen the perception of East Asia as a “good neighborhood” and place to be within the global community.

⁴⁷ For example, APEC had the purported role of helping to break the deadlock in the Uruguay Round negotiations in 1993.

⁴⁸ Soesastro (2001).

