

Trade Arrangements and Evolving East Asian and Asia Pacific Economic Architectures

Robert Scollay*

Associate Professor, Department of Economics, University of Auckland, New Zealand

John. P. Gilbert

Associate Professor, Department of Economics and Finance, Utah State University, USA

Abstract:

The paper begins by noting that proposals involving significant developments in the regional trade architecture are being developed within regional processes that in some cases are simultaneously pursuing other dimensions of regional economic integration: monetary and financial cooperation in the case of ASEAN + 3, and the establishment of a common market in the case of ASEAN. At least three of these regional processes (ASEAN, ASEAN +3, and APEC) count among their ultimate objectives the development of some form of regional “community”, with a scope in that each case includes but also goes beyond traditional elements of regional economic integration.

This paper then considers the economic analysis and evidence relating to the choice of optimal regional trade architecture for the Asia-Pacific region, and the extent to which it might correspond to any of the trade architectures currently being proposed. The analysis will include the possibility that optimal regional trade architecture might extend beyond the conventionally-defined boundaries of the Asia-Pacific region. The paper then goes on to consider questions of coherence between an optimal regional trade architecture and the ongoing pursuit of other elements of regional economic integration within other regional processes. This leads to a discussion of coherence between the different regional integration processes themselves and their variously specified objectives, including any changes that might be proposed to enhance coherence.

Key words: Trade Architecture, Economic Integration, ASEAN, APEC

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* Correspondent Author: (+64) 9 373 7599, Ext. 86910, Email: r.scollay@auckland.ac.nz

1. Introduction:

Trade arrangements constitute one form of economic architecture that is in the process of evolution in East Asia and the Asia-Pacific region. Trade architectures however can no longer be viewed in isolation but must be seen in the context of the broader regional economic integration initiatives that are also being developed in the two regions. These initiatives all encompass trade arrangements, either existing or proposed, but they each also incorporate a number of other dimensions of economic integration, with considerable variation among them in the range of dimensions covered, in the modalities adopted, and in the depth with which different dimensions are pursued. There are in other words multiple economic architectures in play at varying stages of development, with considerable uncertainty as to how far and at what pace each development will proceed, and whether and in what way their development will be related to each other. The fact that both East Asia and the Asia-Pacific must both be cited as regions in this context highlights a further element of complexity in the situation, namely the diversity of views over the degree of emphasis that should be given to East Asian economic integration on the one hand, and Asia-Pacific economic integration on the other, as well as the relationship between the two.

The purpose of this paper is to explore the future development of regional trade architectures in the light of the current and possible future evolution of the broader regional economic integration initiatives of which they now form a part, taking into account the varying objectives of the different initiatives and the needs and imperatives to which each initiative responds. The paper is organised as follows. The next section briefly reviews the different dimensions of regional economic integration exhibited in East Asian and Asia-Pacific initiatives, and the modalities through which they are pursued or might be pursued in future. The following section provides a brief analysis of how the various dimensions of integration are in practice incorporated in the agendas of the various economic integration initiatives in the East Asia and the Asia-Pacific region. This analysis is then briefly related to the integration needs that can be identified among participants in the major economic integration

initiatives. A brief review of the role of trade liberalisation in economic integration leads into the suggestion that this role can be most effectively performed by region-wide FTAs. A selection of trade indices is then examined to explore the strength of the case for the three region-wide FTAs that have been proposed in East Asia and the Asia-Pacific, and this exploration is continued in the following section by drawing on the results of computable general equilibrium (CGE) simulations. The paper concludes with a brief discussion of some of the obstacles to the implementation of the region-wide FTAs, and some possible strategies for circumventing them.

2. Dimensions of Regional Economic Integration: Review:

In considering the modalities through which the various dimensions of economic integration are pursued in East Asia and the Asia-Pacific, it is useful to distinguish between “hard” measures, which involve reciprocally binding legal obligations, and “soft” measures, which do not, even though participants may sometimes choose to regard the commitments that they embody as binding on themselves. “Soft” measures in turn may be subdivided into those that involve non-binding commitments to achieve clearly-defined targets or to undertake clearly-defined actions, on the one hand, and those that involve commitments to cooperate or consult around a defined set of issues.

Trade and investment liberalisation was traditionally regarded as the key focus of regional economic integration. In the Asia-Pacific region unilateral liberalisation was an important factor historically, and APEC in the mid-1990s embarked on an ambitious and intellectually appealing effort to achieve ambitious, time-bound regional liberalisation targets on a voluntary, non-binding basis. This effort however foundered on the insistence by a number of APEC members on binding reciprocity in trade liberalisation initiatives. Today legally-binding reciprocal agreements are the usual currency of trade liberalisation initiatives in the Asia-Pacific region, a trend reinforced by the shift in emphasis that has taken place from multilateral to preferential liberalisation. When multilateral liberalisation predominates,

application of the WTO's non-discrimination principle ensures that increases in market access resulting from liberalisation by any WTO members is equally available to all other members. Under these conditions the standard arguments in favour of unilateral liberalisation are more persuasive than in a world or region of proliferating preferential trade agreements, where market access assumes much greater prominence as a key consideration for individual economies. Initially these agreements may be viewed as opportunities for increased market access opportunities, but increasingly the defensive concern of avoiding discrimination relative to competitors in key markets tends to assume greater importance, giving rise to a "domino effect" which helps to explain why the spread of preferential trade agreements in a region like the Asia-Pacific tends to develop a self-reinforcing momentum once it is under way.

WTO rules also influence the form that regional trade liberalisation initiatives must take. In the case of trade in goods, any reciprocally binding trade liberalisation initiative involving a developed WTO member must take the form of a free trade agreement (FTA) or customs union complying with GATT Article XXIV. Initiatives involving developing WTO members may be governed by the less stringent rules of the 1979 Enabling Clause. Agreements may of course and often do contain provisions that go far beyond a conventional FTA or CU, but the WTO rules require that the essential trade liberalising provisions take one or other of these forms.

Preferential agreements for liberalising trade in services are required to comply with GATS Article V, regardless of whether developed or developing members are involved.

Investment agreements are not governed by WTO rules, but are inevitably concerned with establishing legally-binding rules, and also liberalisation commitments where these form part of the agreement. Stand-alone bilateral investment agreements (BITS) were relatively common in the past, but today investment provisions are commonly included as chapters in FTAs.

It has long been recognised that liberalisation of trade and investment by removing barriers is insufficient to realise the full potential for free flow of trade and investment between the members of trade and investment agreements. Trade and investment

facilitation measures will typically be as important or in some cases more important for this purpose than liberalisation commitments, and certainly are often perceived as such by business interests. In the case of trade these will involve provisions relating to matters such as customs procedures, technical barriers to trade, sanitary and phytosanitary measures, and electronic commerce. Rules of origin form an essential part of any agreement to liberalise trade on a preferential basis, but it is now recognised that in many cases the design of rules of origin can be at least as important as the removal of tariffs in determining how far trade is liberalised in practice. Investment facilitation measures may include provisions to reduce bureaucratic obstacles faced by foreign investors, but successful stimulation of increased investment flows may depend on a range of further policy measures, as noted below. Trade and investment facilitation may be pursued on a voluntary, non-binding basis, as has been the case within APEC for many years. Increasingly, however, a range of trade facilitation provisions is being routinely included in FTAs and other preferential trade agreements.

A very substantial broadening of regional economic integration agendas in East Asia and the Asia-Pacific is due in part to the recognition that trade and investment liberalisation and facilitation pursued in isolation will often not realise their full intended benefits, and in some cases may even produce perverse results. In order to deliver their promised benefits trade and investment liberalisation and facilitation need to be embedded in a broadly-based framework of sound economic policies. The framework will include macroeconomic elements, such as the fiscal and monetary policies required to maintain economic stability and promote growth as well as social safety nets and other social welfare policies, and microeconomic elements, such as policies dealing with market regulation (including financial market regulation), competition, tax, labour markets, and education. Other elements such as the legal environment can also come into play. To the extent that elements of this framework are missing or deficient, trade liberalisation and facilitation may fail to produce its desired result, while the facilitating environment for trade and investment liberalisation and facilitation that such a framework provides is likely to be at least as important as the provisions of an

investment agreement for stimulating increased investment flows. In APEC the term “structural reform” is used to describe an agenda covering most elements of the broader policy framework, and that term will also be used here.

In principle, elements of a structural reform agenda can be pursued either through “soft” measures based on voluntary, non-binding measures or through “hard” measures, involving legally-binding commitments. The choice will reflect considerations such as sensitivities over sovereignty, perceptions of economic interest, and capacity constraints. Experience would suggest that in East Asia and the Asia-Pacific structural reform agendas are most likely to be pursued on a voluntary, non-binding basis, at least for the time being. Regional groupings that decide to deepen their integration through the establishment of a “single market” may however need to contemplate legally-binding agreements covering at least some elements of the structural reform agenda, as the European Union experience illustrates. A “single market” as conventionally understood raises labour mobility issues and issues relating to freedom of capital movements that go beyond those covered in conventional investment agreements, both of which by their nature are likely to require legally-binding agreements of some kind.

Recognition of macroeconomic interdependencies within regional groupings characterised by a significant degree of economic integration leads naturally to a concern with monetary and financial coordination. In East Asia this concern surfaced quickly and dramatically as a response to the East Asian financial and economic crisis of 1997-98. A wide spectrum of possible coordination measures is possible. Towards one end of spectrum, monitoring and surveillance arrangements can be classified as “soft measures” since while they involve commitments to engage in certain activities, the commitments are not of a legally-binding nature, and economies participating in such arrangements are typically concerned not to concede elements of sovereignty. A liquidity pooling arrangement such as the Chiang Mai Initiative (CMI) crosses the boundary into binding agreements, and a regional fund such as the stillborn Asian Monetary Fund would require still more tightly defined obligations. Arrangements to peg regional currencies to each other, perhaps linked through a regional currency basket, would represent a further

step towards full monetary and financial integration. Adoption of a single currency in a monetary union represents the ultimate degree of such integration.

Moving along the spectrum toward progressively deeper monetary and financial integration involves progressively greater need for policy harmonisation, with corresponding increases in the degree of national sovereignty that must be given up. A system of pegged regional exchange rates would not be viable in the absence of a significant degree of policy harmonisation, supported by an effective liquidity pooling mechanism. The final step of monetary union requires acceptance of a single monetary policy by the members of the union, supported by firm commitments to maintain an agreed degree of policy harmonisation in other dimensions of macroeconomic policy.

Sustainability issues have also come to the fore in regional economic integration agendas, as they have world-wide. Issues on regional agendas include climate change and other environmental issues, energy security and food security. Counter-terrorism and other human security issues such as responses to epidemic diseases and natural disasters may perhaps also be classified under this heading. As in the case of structural reform, although legally-binding agreements are possible, it seems that many or most these sustainability issues will for the time being at least be pursued on a voluntary non-binding basis within regional integration agendas in East Asia and the Asia-Pacific. The desirability and possible shape of binding agreements on climate change, and the range of membership needed to make such agreements viable, is of course a matter of international controversy. Regional agendas on such subjects may focus on consensus-building.

Moves to deepen regional economic integration agendas have been matched by heightened concerns over economic disparities between participants in integration processes and the possibility that these disparities may lead to a maldistribution of the economic benefits of economic integration initiatives. The upshot has been the inclusion on regional economic integration agendas of the provision of capacity-building assistance to weaker members to ensure that they are able to share equitably in the distribution of benefits. The appearance on some regional integration agendas of infrastructure development and provision of regional public goods also reflects these concerns.

Community building in a wider sense is an explicit objective of a number of East Asia and Asia-Pacific regional economic integration initiatives. Community building can and does include social and cultural as well as economic dimensions, and can link easily with sustainability issues, as well as with political and security concerns at the regional level, although the latter lie outside the scope of this paper. Many community-building initiatives will by their nature be pursued on a voluntary non-binding basis, although legally binding agreements will be possible and maybe even necessary in some cases.

3. Trade and Other Dimensions in East Asia and Asia Pacific Integration Initiatives:

As is well-known, the proliferation of FTAs in East Asia and the Asia-Pacific region since the turn of the century has resulted in a phenomenon known as the Asia-Pacific “spaghetti bowl” or “noodle bowl”: a largely uncoordinated patchwork of some 35 bilateral and 6 plurilateral FTAs spanning the region with numerous overlaps, intersections and gaps. The arbitrary patterns of discrimination, exclusion and inclusion produced by such an uncoordinated development must at the very least create some hindrances to region-wide integration. Considerable concern has been expressed by some business interests at the potential complications of having to deal with the different rules and provisions of FTAs with each separate trading partner, in particular with different rules of origin, and the increases in transactions costs potentially resulting for business, although more research, some of it now under way, is needed to quantify the likely size of these costs.

The verdict of Richard Baldwin (2006) on the proliferation of preferential trading agreements in the global economy can be applied to the manifestation of the phenomenon in East Asia and the Asia-Pacific as well: “almost nobody believes this is the best way to organise (regional) trade”. At the same time, as Baldwin also notes, “regionalism”, by which he means the spread of preferential trading arrangements, “is here to stay”: it is a trend which is unlikely to be reversed any time soon. The corrective action that governments might realistically be expected to take is to find ways to reconfigure the region’s preferential trade architecture so as to increase the beneficial effects and reduce the unfavourable consequences for

the economies of the region. In fact each of the three major regional economic integration initiatives in the region has on its agenda a proposal for a region-wide FTA with the potential to rationalise the “spaghetti” or “noodle” bowl.

The ASEAN Plus Three group, formed after the East Asian crisis, has since 1999 been considering a proposal for an ASEAN Plus Three FTA, the East Asian FTA (EAFTA). Three study groups have so far reported favourably on the proposal, but no decision has yet been taken by the ASEAN Plus Three governments. The ASEAN Plus Six or East Asian Summit Group, which includes India, Australia and New Zealand as well as the ASEAN Plus Three members, and which held its first leaders’ summit in 2005, is working on a proposal to establish a Comprehensive Economic Partnership for East Asia (CEPEA). The CEPEA is envisaged as including an ASEAN Plus Six FTA, although it appears that the initial focus will be on enhancing trade facilitation within the group, with the FTA to follow at a later date.

APEC, embracing 21 economies on both sides of the Pacific, including the major economies of both North America and Northeast Asia, has since 1994 been pursuing an objective of free trade and investment in the Asia-Pacific region, employing its agreed voluntary non-binding modality, enhanced by procedures organised around the member economy’s individual action plans (IAPs), directed towards generating peer pressure on members to demonstrate progress toward the objective. Frustration with the lack of progress from this “concerted unilateral” approach, and concern at the implication of proliferating bilateral FTAs, led the APEC Business Advisory Council in 2004 to raise the possibility of a Free Trade Area of the Asia Pacific (FTAAP), effectively an APEC FTA. The FTAAP proposal was taken up by APEC leaders in 2006 and endorsed by them as a “long term prospect” in 2006.

Two further initiatives involving potential consolidation or plurilateralising of existing FTAs can also be briefly mentioned. The Arco del Pacifico group of Pacific seaboard economies in the Americas is working on an initiative to rationalise the many FTAs currently linking them by establishing a single FTA covering the whole group. The TransPacific Strategic Economic Partnership, or P4 agreement is an

initiative by four smaller APEC economies – Chile, Singapore, New Zealand and Brunei – aimed at generating momentum towards a larger and more inclusive APEC-wide trade arrangement. The potential for this agreement as a “stepping stone” to a broader Asia-Pacific trade arrangement has recently been significantly enhanced by the decision of the United States to negotiate for membership of the group, and by the announcement of Australia, Peru and Viet Nam that they too may be interested in joining.

The ASEAN Plus Three group, the ASEAN Plus Six/East Asian Summit Group, and APEC each have regional economic agenda that extends far beyond trade. Common elements in these agendas, all pursued hitherto through voluntary non-binding processes with varying degrees of depth and sometimes under different titles, include trade facilitation, structural reform, sustainability, reduction of disparities between members, and community-building.

A point of difference on the other hand is that the ASEAN Plus Three group is the only one of the three to have included “hard measures” on monetary and financial coordination on its regional economic integration agenda, although the results to date have been limited to the CMI and the Asian Bond Market proposal, with deeper measures such as formal exchange rate coordination seemingly some way off if they are to materialise at all. There is no apparent interest on the part of India, Australia and New Zealand in moving down this path within the CEPEA initiative, and the agenda of the APEC finance minister’s process is limited in accordance with APEC’s agreed modality to voluntary non-binding actions.

In its initial years the ASEAN Plus Three group tended to be viewed as the “peak grouping” for the pursuit of “East Asian Regionalism”. The more recent development of a detailed economic integration agenda by the ASEAN Plus Six group means that there are now two contenders for this status.

The members of two smaller regional initiatives within the Asia-Pacific region, ASEAN and ANZCERTA, are committed to the establishment of a “single market” among themselves. In ASEAN’s case the commitment to a “single market” is part of a commitment to establish an ASEAN Economic Community (AEC), which in turn is part of a decision to establish an integrated ASEAN Community comprising the AEC, and ASEAN Social Community,

and an ASEAN Security Community (ASEAN 2003). Soesastro (2008) notes that the AEC proposal represents a departure from ASEAN practice hitherto, in that it is set out in a Blueprint incorporating clearly defined goals and timelines. The Blueprint delineates 176 “priority actions to be taken within a strategic schedule of four implementation periods”, and Soesastro also notes that it comprises “a binding document of commitments by member”. ASEAN has also prepared itself for pursuit of a more formal approach to regional economic integration by forming itself into a legal entity complete with a Charter, or constitution, something that has not been done to date by the members of any other economic integration in the Asia Pacific region. Soesastro notes that in the ASEAN view implementation of the AEC is a prerequisite for deeper economic integration in East Asia, and this view appears to be reflected in the CEPEA work programme, which contains a heavy emphasis on deepening economic integration within ASEAN as an initial priority. In terms of existing formal agreements, ASEAN members have already concluded an ASEAN Free Trade Agreement or AFTA (in 1992), agreement to establish an ASEAN Investment Area (AIA) and an ASEAN Framework Agreement in Services (AFAS).

Australia and New Zealand, the two members of ANZCERTA have since 1988 been committed to the gradual establishment of a “single market” between them. The “single market” has been developing in piecemeal fashion from the basis of the original ANZCERTA agreement, and by now includes many of the provisions that would conventionally be expected in a “single market”, with the notable exception of formal freedom of movements of capital, and also the lack of a customs union.

4. Economic Integration Initiatives as Responses to Integration Needs:

A feature of integration within the ASEAN Plus Three group has been the rapid expansion of production networks. This has been a significant factor behind the spectacular growth of intra-East Asian trade. Ozeki (2008) notes that from 1980 to 2005 the share of parts and components within this rapidly expanding trade increased from 6% to 28%, while the share of capital goods rose from 9% to 19%. The expansion of production networks is seen as the likely explanation for these changes.

The expansion of production networks generates a demand for deeper integration within East Asia. Kimura (2008) highlights a range of policy initiatives needed to support the continued development of production networks. Completion of trade liberalisation within East Asia, supported by extensive trade facilitation measures, features strongly on their list, along with many elements of structural reform and other measures designed to enhance the investment environment. It seems likely that another consequence of the growth of production networks will be an increasing demand from business for measures to promote and maintain macroeconomic stability within the East Asian region. The distinctive interest in monetary and financial coordination within the ASEAN Plus Three group is likely to owe something to this demand as well as to the need to respond to the East Asian financial crisis. If the ASEAN Plus Three group does move to deeper monetary and financial cooperation it is likely to be in response to demand from the business sector.

By contrast India, Australia and New Zealand have not yet been significant participants in the expansion of East Asian production networks. They have been suppliers of natural resource based products to East Asian industries, and Australia and New Zealand have figured as markets for the finished goods from the production networks. Their interest in ASEAN Plus Six has thus been predominantly in maintaining and expanding their trade and investment linkages with East Asia. This interest is served particularly by the trade liberalisation and facilitation elements of the ASEAN Plus Six economic integration agenda. The elements of the agenda dealing with structural reform, sustainability and capacity building also align with the interests of these additional ASEAN Plus Six members.

Likewise, the APEC membership beyond the ASEAN Plus Six group has not played a major role in the development of East Asia-based production networks. Developments with some of the characteristics of production networks have occurred in the Americas, notably involving the United States, Mexico, Central America and to a lesser extent the Caribbean, underpinned by NAFTA and other US trade initiatives with partners in region. Thus trade and investment liberalisation and facilitation has played a central role in APEC's economic integration.

Elements of the structural reform and sustainability agendas were in many cases originally introduced into the APEC agenda to support the liberalisation and facilitation agendas, although they may have subsequently developed a life of their own. The APEC finance ministers process, as already noted, is focused on voluntary, non-binding initiatives. It has been supportive of East Asian developments in the area of monetary and financial coordination, without necessarily promoting an APEC-wide extension of these developments.

The development of the content of the economic integration of the three region-wide integration initiatives thus reflects the economic conditions within each group. Trade and investment liberalisation is an important element in the agenda of each group, and in each case supported by agenda components covering structural reform, sustainability, reduction of disparities between members and community-building. The ASEAN Plus Three group is distinctive for the depth of integration demanded to support the growth of its production networks, and for the interest shown in monetary and financial coordination.

5. The Role of Trade Liberalisation:

Trade liberalisation is a necessary but not sufficient condition for regional economic integration. As noted above it is a central element in the regional economic integration of each of the three region-wide groupings.

In addition to the fact that today it is almost invariably implemented through agreements containing reciprocally binding legal commitments, another distinctive feature of trade liberalisation in its preferential mode is that, because of its inherently discriminatory character, it can inflict economic harm, most obviously on the economies against which preferential trade agreements discriminate, and less obviously on the participants in the agreements themselves.

In regions where economic integration is being pursued it is obviously desirable to avoid discrimination as far as possible. Furthermore, if it is accepted that far-reaching non-discriminatory liberalisation on a global basis is not feasible for the time being, and that countries are likely to demand reciprocity in liberalisation, it may be plausible to argue that preferential liberalisation that does not discriminate within a large integrating region

characterised by deep trading relations among its members – a large region-wide FTA in other words – could be a reasonable second-best objective, especially if potential damage due to discrimination can be minimised. This can be achieved by ensuring that MFN trade barriers are maintained at, and where necessary reduced to low levels, and by ensuring that additional participants from outside the region can be linked to the regional initiative on comparable terms, either by accession to the regional agreement or through separate FTAs with individual members of the regional agreement. From this perspective the entry of the EU into the Asia-Pacific FTA landscape, through its negotiations for FTAs with Korea, ASEAN, the Andean Community and Central America, must be viewed in a positive light, since these FTAs have the potential to reduce the scope of trade diversion, both for the EU itself and its Asia-Pacific FTA partners.

6. Which Region-wide FTA?

This section of the paper briefly reviews some evidence relevant to the question of which region-wide FTA would be most beneficial for the Asia-Pacific region, drawing on data illustrated in the graphs at the end of the table, highlighting summary statistics on the trade between major sub-regions of East Asia and the Asia-Pacific, together with South Asia. The graphs draw on three indices of inter-regional trade: trade shares (Figures 2(a)-(e)), trade intensity (Figures 3(a)-(e)) and commodity complementarity (Figures 4(a)-(e)). Trade shares simply indicate the share of the sub-regions in each other's trade; in other words, for each sub-region, how important are the other regions and intra-sub-regional trade in its trade. The intensity index measures the weight of a sub-region in another region's trade compared to its weight in world trade as a whole. An index value above one indicates that a sub-region trades more, while an index value of less than one indicates that it trades less, with a given sub-region than might be expected on the basis of that sub-region's trade with the world as a whole. The commodity complementarity ratio indicates the extent to which the commodity composition of one sub-region's exports matches the commodity composition of another country's imports, with the match being more complete the closer the value of the index approaches 100.

The data provides strong support for trade liberalisation across East Asia. Figure 1 shows that

Northeast Asia accounts for a large and rising share of world exports, while the share of world exports of Southeast Asia is small but growing strongly. Northeast Asian economies conduct just over 40% of their trade with other Northeast Asian economies and a further 10% of their trade with Southeast Asia, so that slightly more than half of their trade is conducted within East Asia. This percentage has been rising over recent years, with a sharp increase in trade within Northeast Asia offsetting a slight fall in the share of trade with Southeast Asia. The percentage of Southeast Asia's trade conducted within East Asia is even higher, at just under 60%, made up of 35% of trade conducted with Northeast Asia and almost 25% of trade within Southeast Asia itself. These shares have been relatively stable in recent years. Trade intensity indexes and commodity complementarity ratios for trade between Northeast and Southeast Asia are also high. Thus this data provides strong support for the evidence presented in Ozeki (2008) of a high degree of trade integration within East Asia, in turn supporting arguments for more complete trade liberalisation within that region.

When the focus is broadened to ASEAN Plus Six, the data shows that both Australasia and South Asia account for very small shares of world trade, but Australasia conducts about 53% of its trade with Northeast Asia, made up of 37.5% of its trade with Northeast Asia and 15.5% of its trade with Southeast Asia. Both trade shares have increased strongly in recent years. The share of Northeast Asia in South Asia's trade is somewhat more modest, at just under 20% for Northeast Asia and 10% for Southeast Asia, making a total of just under 30% for East Asia as a whole, although both shares have begun to increase. Unsurprisingly, given the low shares of Australasia and South Asia in world trade, their shares in the trade of East Asia are very low, particularly in the case of South Asia. On the other hand, Australasia trades very intensively with Northeast and Southeast Asia, as do the two East Asian sub-regions with Australasia. Commodity complementarity indexes are moderately high for Australasia's exports to Northeast Asia and Southeast Asia, but the complementary indexes for the East Asian region's exports to Australasia are surprisingly low. The intensity of trade in both directions is high between South Asia and Southeast Asia, but not between South Asia and Northeast Asia. Trade intensity between South Asia and Southeast Asia

has also exhibited a mildly increasing trend in recent years. The commodity complementarity indexes for South Asia's trade with both East Asian sub-regions are low in both directions, but display an increasing trend in all cases, which is especially pronounced for the exports of Northeast and Southeast Asia to South Asia.

The summary data thus indicate that for the East Asian sub-regions and Australasia a CEPEA FTA offers an avenue for further consolidating and strengthening the substantial degree of trade integration that already exists between them. For the two sub-regions and India, as the leading economy of South Asia, it provides a means of reinforcing the increasing trend in trade integration between them that has begun to develop in recent years.

Compared to CEPEA, an FTAAP excludes India and potentially adds North America (NAFTA), Chile, and Peru, along with Russia and Papua New Guinea. Here the focus will be on the NAFTA members in North America. The NAFTA countries' share of world exports has fallen sharply in recent years. The share of NAFTA's trade conducted with East Asia has remained relatively constant, at 20% for Northeast Asia and just under 5% for Southeast Asia, making a relatively constant 25% for East Asia as a whole, whereas the share of trade that NAFTA countries conduct with each other has fallen from 48% to just over 43%. NAFTA's share in the East Asian subregions' trade has also fallen sharply, to 17.5% in the case of Northeast Asia and 13.5% in the case of Southeast Asia. The trade intensity index for trade between NAFTA and the Northeast Asia hovers around one in both directions, but is much lower in both directions for NAFTA's trade with Southeast Asia.

Perhaps the strongest evidence provided by the summary data to support the continued importance of trade integration between NAFTA and East Asia is the relatively strong commodity complementarity for exports in both directions between NAFTA and both Northeast Asia and Southeast Asia. This suggests the importance of North America and East Asia as markets for each other's exports. Evidence provided by Ozeki (2008) is also suggestive of the importance at least of North America for East Asian exports. While noting the rapid growth in importance of trade in components and capital goods in trade within East Asia, he also

notes that "around 70 percent to 80 percent of total (East Asian) exports of finished goods were sold outside (East Asia) in the 2000s". This is a strong indication that NAFTA, along with EU and to a lesser extent other regions such as Australasia remain important as sources for the final output of East Asia production networks.

A revealed preference for maintaining trade integration across the entire Asia-Pacific region, along with the inclusion of India, can be detected from casual observation of the membership of existing FTAs. While some 11 of the existing FTAs are agreements between members of the ASEAN Plus Three Group, there are a further nine FTAs between economies of the region where at least one of parties is a member of CEPEA but not of ASEAN Plus Three. Likewise there are a further 14 FTAs between Asia-Pacific economies where at least one of the parties is not a member of CEPEA.

In considering the merits of a region-wide FTA that extends beyond the Asia-Pacific region to encompass the full membership of CEPEA or APEC, two points can usefully be made. First, a CEPEA FTA or an FTAAP in principle necessarily incorporates full trade liberalisation within ASEAN Plus Three. It thus satisfies the imperative for full trade liberalisation within East Asia, without precluding the adoption of deeper integration measures exclusively among the ASEAN Plus Three members, through moving further in the direction of monetary and financial coordination or even integration, deeper community building measures, or deeper commitments to each other in any other of the other dimensions of economic integration. East Asia would retain the ability, through pursuing any or all of these deeper integration measures, to assert to its desired degree its separate entity as a distinct region. Second, the CEPEA and FTAAP do not have to be viewed as mutually exclusive options. They could be reconciled for example by the simple expedient of inviting India to join the FTAAP.

7. Evidence from CGE Simulations:

This section reports the results of computable general equilibrium (CGE) simulations undertaken to explore the potential economic impact of various alternative trade architectures for East Asia and the Asia-Pacific region. The results summarised here are for the welfare impact of an ASEAN Plus Three FTA

(EAFTA), an ASEAN Plus Six (CEPEA) FTA, an FTAAP, and an extended scenario that combines CEPEA and the FTAAP (i.e. it adds India to the FTAAP) as well as adding EU FTAs with Korea, ASEAN, the Andean Community and Central America. For purposes of initial comparison results are also provided for a simulation incorporating a large number of existing FTAs, intended to represent the status quo. A list of FTAs included in this simulation of existing agreements is provided in Table 1.

The simulations from which the results are derived were of a standard type, using the GTAP VI database, which has a base year of 2001. In establishing the baseline for the simulations adjustments are made to the GTAP VI database as described below to take account of accession of China to the WTO, enlargement of the EU to 25 members, phase-out of Multifibre Agreement (MFA) quotas, and implementation of the ASEAN Free Trade Agreement (AFTA). These modifications generated a modified “baseline” database, computed “as if” all of these developments had already taken place in 2001. No account is taken of the time path for the phasing in of liberalisation commitments, either in the agreements included in the “baseline” or the agreements being simulated. Agreements are also simulated as “clean” FTAs, with no account taken of any exclusion of products from each agreement. From this perspective the simulations represent the upper bounds of the liberalisation that could potentially take place, since in practice agreements typically provide for the exclusion of some products, and extensive phase-in periods for the elimination of tariffs on others. The results should be interpreted as indicating how the future states of these economies would differ if the preferential arrangements being simulated have been implemented, compared with the states that would exist if these arrangements had not been implemented.

A standard, multi-region comparative static formulation of the basic CGE model is used, assuming perfectly competitive markets and constant returns to scale technology. The major departure of the model from those of standard trade theory is the assumption of product differentiation by national origin, controlled by a set of Armington substitution elasticities. This serves the dual purpose of allowing two-way trade in each product category, and avoiding extreme production and trade responses. All model equations are as in the standard GTAP model and are discussed

in detail in Hertel (1997). Results are presented for two versions of the simulations. The first is a medium-run (MR) version, allowing for full factor mobility, which can be interpreted as incorporating the full effects of resource allocation resulting from the trade initiatives in question. The second is long-run (LR) version, where in addition to fully mobile factors returns to capital converge to a steady-state equilibrium across all sectors in each economy, with the capital stock allowed to adjust in order to produce this result. This version can be interpreted as incorporating an approximation of growth effects. Welfare effects are measured by the equivalent variation method.

For the simulations reported here each economy was divided into 31 sectors, and the world was divided into 24 individual economies (including 19 of the 21 APEC economies) and seven regions each of which is an amalgamation of multiple economies (one of these being the EU-25). Results are reported here only for CEPEA members (excluding the smaller ASEAN countries), Hong Kong, Chinese Taipei, and NAFTA members. While the database includes the services sector (split into traded and non-traded services) and some impediments to services trade, the representation of the services sector and services trade barriers remains rudimentary. Accordingly it was decided not to include reduction or elimination of services trade barriers in the simulation. The results are summarised in Figures 5-7 at the end of the paper.

A first point to note in the results is that the ASEAN Plus Three FTA generates inferior welfare effects to the status quo (“existing”) for the six ASEAN members shown. To understand the likely reason for this, it should be remembered that the ASEAN Plus Three FTA does not result in any trade barrier removal for these countries since they are each already parties to bilateral or plurilateral FTAs with each of China, Japan and Korea, while their preferences in those markets will be partially eroded by the liberalisation of trade between the three Northeast Asian economies. The ASEAN Plus Three FTA does on the other hand produce an improved welfare outcome compared to the status quo for Japan and Korea. The improvement can be interpreted as an indication of the gains forgone by Northeast Asian economies by adopting FTA configurations that do not involve liberalisation among themselves.

An ASEAN plus Six FTA on the other hand generates welfare outcomes that are superior to those from the status quo for each of the three Northeast Asian economies and for all of the ASEAN economies shown except Thailand and Viet Nam. The welfare outcomes for ASEAN Plus Six are also superior to those from ASEAN Plus Three for all the ASEAN Plus Three members shown except Japan and Viet Nam, for whom the welfare effects from the two FTAs are approximately equal. Unsurprisingly the ASEAN Plus Six FTA yields a welfare gain for India whereas the ASEAN Plus Three FTA, from which India is excluded, reduces Indian welfare. For Australia and New Zealand also, the ASEAN Plus Six FTA yields superior outcomes to those from the ASEAN Plus Three FTA, which is not at all surprising given that they are included in the former and excluded from the latter.

The FTAAP in turn produces superior welfare outcomes to the ASEAN Plus Six and ASEAN Plus Three FTA for all East Asian CEPEA members except Korea and Singapore, and also for New Zealand but not for Australia. The reduction in welfare for Korea, Singapore and Australia under the FTAAP, compared to the ASEAN Plus Six FTA, may possibly be attributable to the erosion under the FTAAP of preferences that they enjoy under their respective FTAs with the United States. Unsurprisingly, for three economies that were excluded from the ASEAN Plus Three and ASEAN Plus Six FTAs, namely the United States, Canada, and Chinese Taipei, the FTAAP converts welfare losses recorded under the previous scenarios into welfare gains, and both Hong Kong and Mexico gain more from the FTAAP than from earlier scenarios. The slightly lower welfare gain for India under the FTAAP compared to the ASEAN Plus Six FTA may possibly be attributed to preference erosion.

An implication from these results is that if the status quo is taken as the starting point, then in order to produce improved welfare outcomes for the majority of East Asian economies (other than Hong Kong and Chinese Taipei) it is necessary to move beyond the ASEAN Plus Three FTA to the ASEAN Plus Six (CEPEA) FTA. The FTAAP yields still greater welfare gains for all East Asian economies shown except Korea and Singapore, and superior welfare outcomes also for all other economies shown except Australia and India. A further twist is provided by the

results for the last scenario, incorporating a series of proposed FTAs by the EU with different Asia-Pacific economies. The results for this scenario yield welfare gains for the East Asian economies involved in the proposed FTAs with the EU that are higher than their gains under the FTAAP, substantially so in some cases, but slightly lower welfare gains for all other economies shown.

8. Convergence and Non-Convergence in FTA Design: Possible Responses:

To demonstrate possible economic benefits of a trade agreement is not of course to demonstrate its political or technical feasibility. Each of the three proposed region-wide FTAs faces formidable obstacles, some faced in common, but others specific to each proposal. The likely obstacles include but are not limited to difficulties over liberalisation of sensitive sectors and over sensitive negotiating issues (including of course rules of origin), perceptions of geopolitical interests and rivalries, and particular difficulties in bilateral relationships.

For reasons of space and time, this section will focus on just one set of such obstacles, namely wide divergences in FTA design exhibited in the FTAs already negotiated by various Asia-Pacific economies, and the likelihood that these divergences will also be reflected in conflicting proposals for design of the region-wide FTAs. The design of existing FTAs diverges both in the range of issues covered and the depth and level of ambition exhibited in the provisions of individual chapters. The divergences reflect differing perceptions of economic interest, sometimes related to different views on the purpose and appropriate range of contents of an FTA, and also capacity constraints.

Views on the range of issues to be covered have spanned the spectrum from the early ASEAN position that "ASEAN-Plus" FTAs should be restricted to provisions related to liberalisation and facilitation of trade in goods, trade in services, investment and dispute settlement, to the view of a number of APEC developed economies that FTAs must be comprehensive, with provisions covering not only those subjects but also additional subjects such as competition policy, government procurement, intellectual property, and electronic commerce. The evidence of recently-concluded FTAs suggests that this gap may be at least partially bridgeable.

Notwithstanding ASEAN preference for a more limited range of provisions, the bilateral FTAs that individual ASEAN economies have concluded with developed economy partners such as Japan, Australia and New Zealand have typically included chapters covering most if not all of the subjects in question. The level of ambition in these chapters however is generally very modest, and this leads to the second cause of divergence, which could potentially prove more intractable, namely diverge in depth and level of ambition.

FTAs concluded by the US with Asia-Pacific economies include provisions on subjects such as intellectual property and competition policy that are far more detailed, prescriptive and far-reaching than the chapters on the same subject in FTAs concluded by Japan, Australia and New Zealand with their Asia-Pacific developing economy partners. In the case of government procurement the divergence appears to be between economies that have adopted the WTO plurilateral Government Procurement Agreement (GPA) and are comfortable committing themselves to provisions that are generally in line with the requirements of that agreement, and those that have not signed the GPA and appear to prefer much more modest provisions on government procurement in their FTAs.

It remains to be seen whether these gaps can be bridged in negotiations. There must however be concern that provisions on which the United States in particular may be inclined to insist may prove to be completely unacceptable to some East Asian economies, while an insistence on more modest provisions by the latter may prove equally unacceptable to the United States. An outcome of that nature, or the expectation of such an outcome might be one of the factors driving the East Asian economies to adopt the ASEAN Plus Three or ASEAN Plus Six model rather than the FTAAP.

To the extent that the reluctance of East Asian developing economies to accept such provisions is due to the recognition of their own capacity constraints, a possible solution that presents itself would be the immediate adoption of more modest FTA provisions, combined with agreement to work jointly on relieving the identified capacity constraints through appropriate initiatives under the cooperation/technical cooperation and structural reform agendas of the relevant economic integration process, on the basis that the FTA provisions will be upgraded when the parties concerned have developed the necessary capacities.

Another possible approach, apparently adopted in the FTAA negotiations, would be negotiate the provision of the region-wide FTA at a level acceptable to all parties, and to agree also that provisions of existing agreements will remain in force where they provide for deeper commitments than was able to be agreed in the region-wide agreement.

As a final comment, if the negotiation of region-wide FTAs proved too difficult in the short term there are nevertheless steps that governments could consider pursuing in order to improve the regional trade architecture. As an example, agreement on appropriately trade facilitating cumulation provisions to be incorporated into the rules of origin of the region's FTAs could go a considerable distance toward counteracting the unfavourable implications of the "spaghetti/noodle bowl".

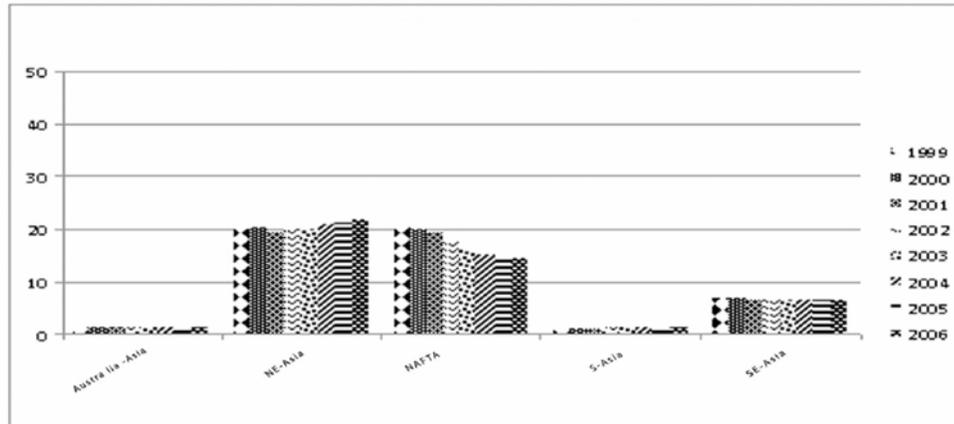
References:

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2. Baldwin, R.E. (2006), "Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade," *World Economy*, 29, (11), 1451-1517.
3. Hertel, T. (1997) *Global Trade Analysis: Modeling and Applications*, New York: Cambridge University Press.
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Table 1. List of FTAs Covered in Simulation of Existing FTAs (Status Quo)

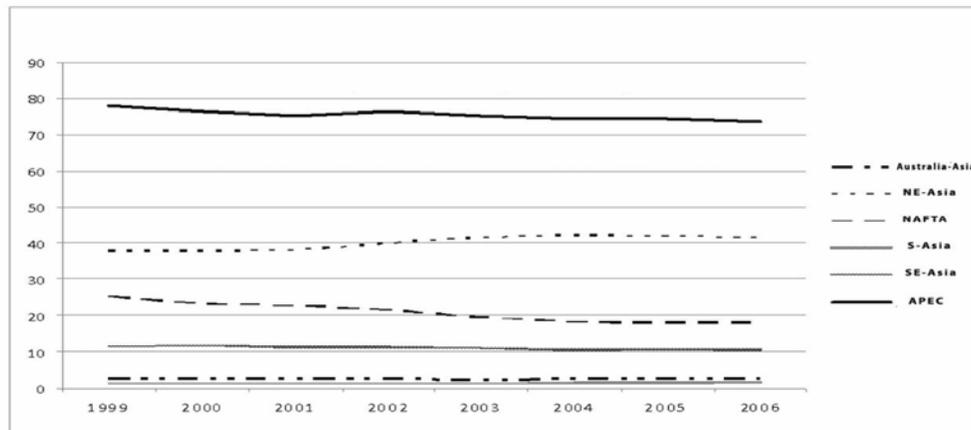
Singapore-US
Singapore-Japan
Singapore-Australia
Singapore-NZ-Chile
Singapore-Korea
Japan-Mexico
Japan-Malaysia
Japan-Philippines
Japan-Thailand
Japan-Chile
Korea-Chile
Chile-US
Chile-China
Chile-Canada
Chile-Mexico
Chile-EU
Mexico-EU
Australia-US
Australia-Thailand
NZ-Thailand
China-Hong Kong
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Colombia-US
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ASEAN-Japan
CER-AFTA

Source: Authors



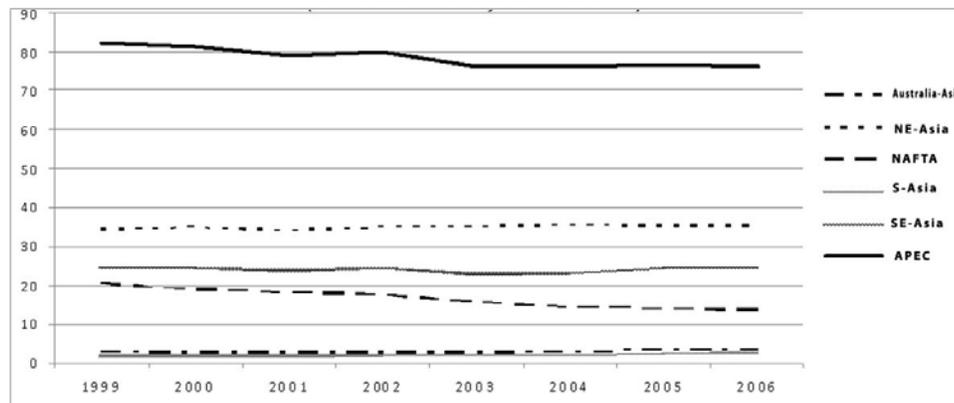
Source: WITS

Figure 1: Share of World Exports by Subregion



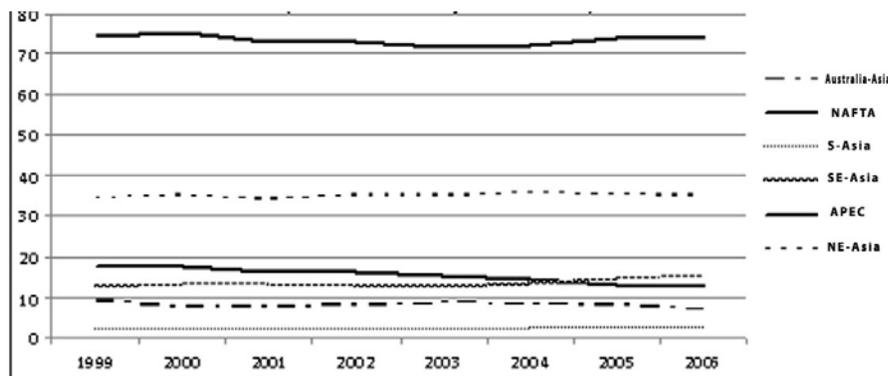
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Figure2(a) Shares of Other Subregions in Northeast Asian Trade



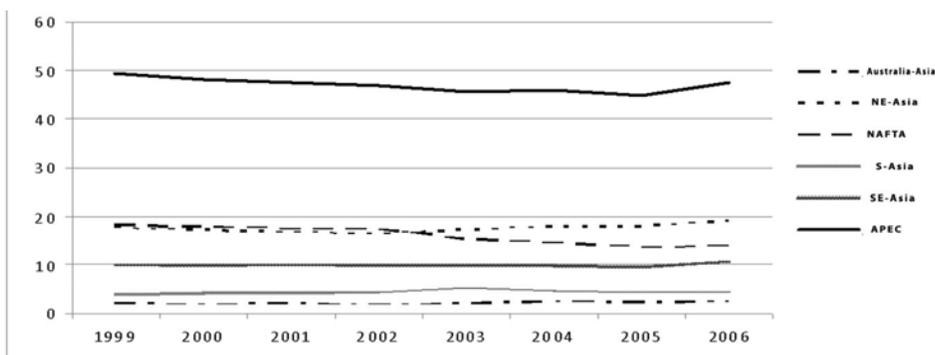
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Figure 2(b) Shares of Other Subregions in Southeast Asian Trade



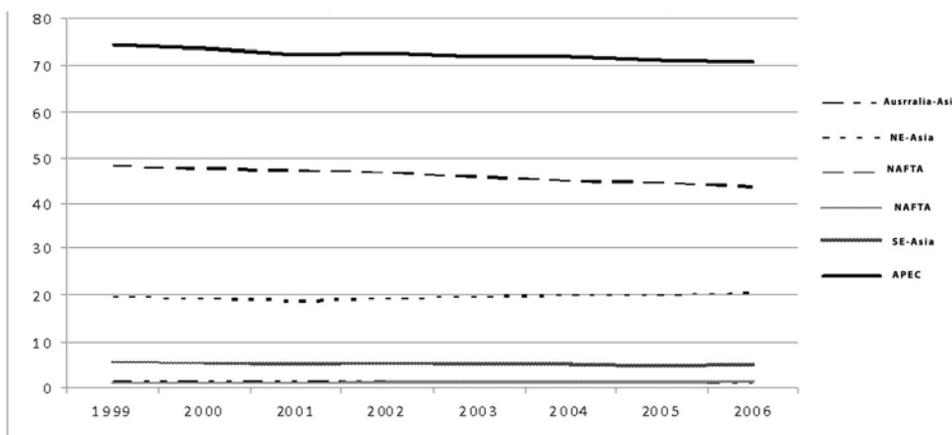
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Figure 2(c) Shares of Other Subregions in Australasian Trade



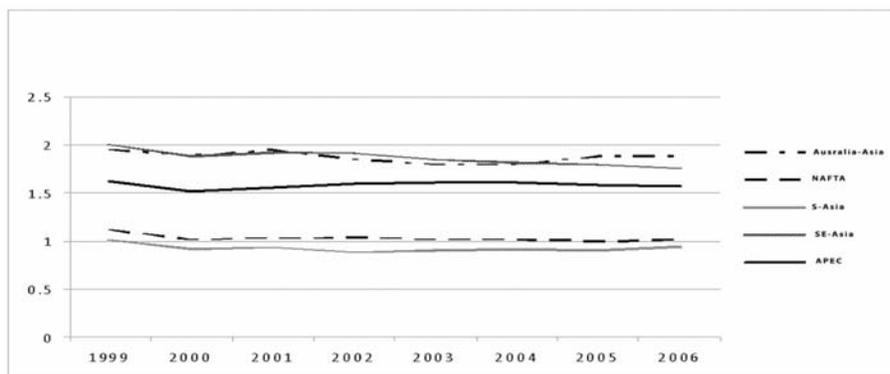
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Figure 2(d) Shares of Other Subregions in South Asian Trade



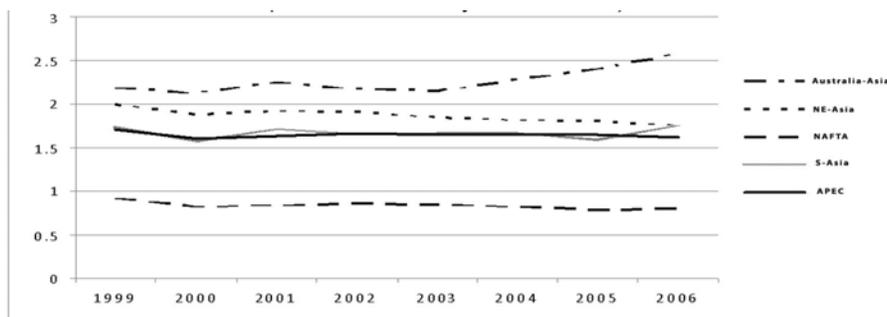
Source: calculated from WITSdata

Figure 2(e) Shares of Other Subregions in North American Trade



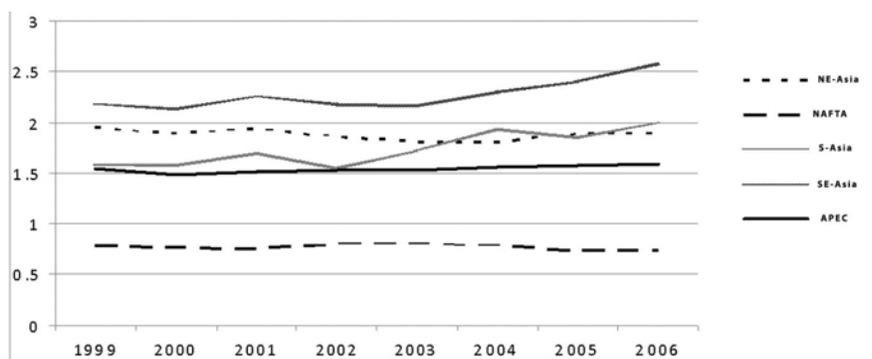
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Figure 3(a): NEAsia: Trade Intensity with Other Subregions



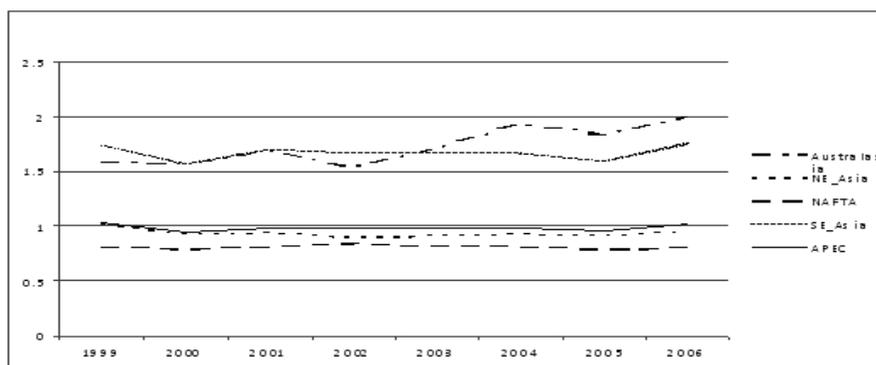
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Figure 3 (b): SEAsia: Trade Intensity with Other Subregions



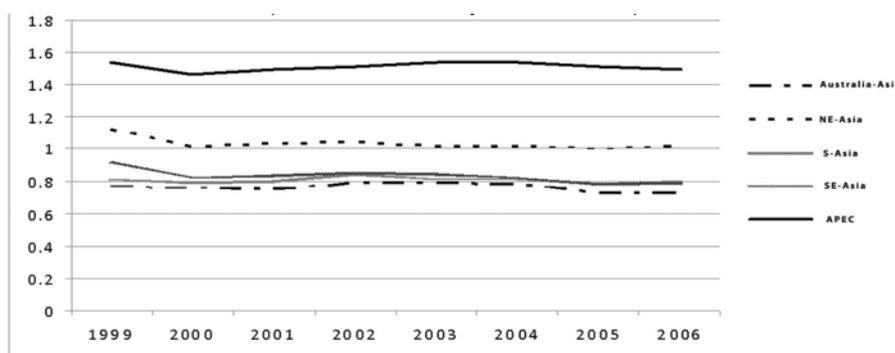
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Figure 3(c): Australasia: Trade Intensity with Other Subregions



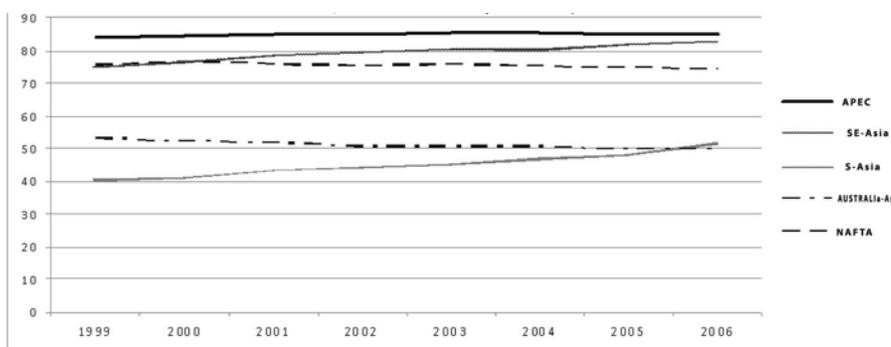
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Figure 3(d): S-Asia: Trade Intensity with Other Subregions



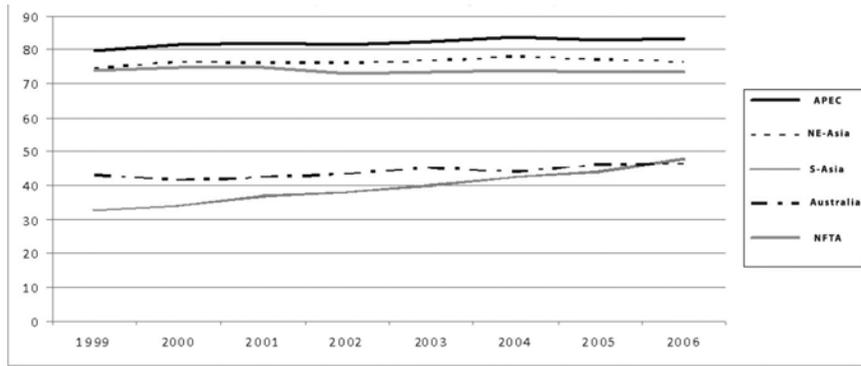
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Figure 3(e): NE-Asia: Trade Intensity with Other Subregions



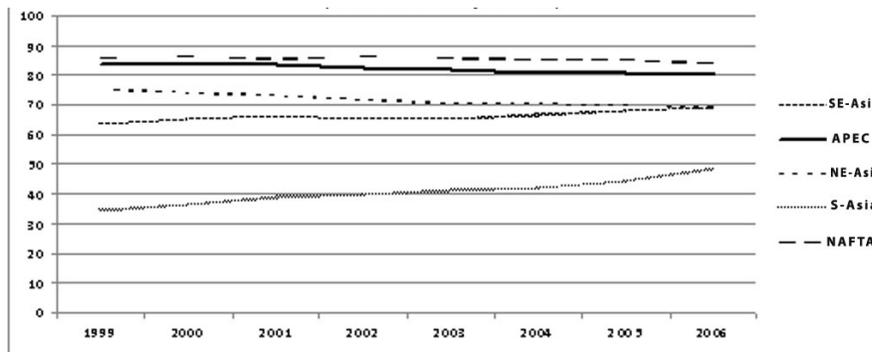
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Figure 4(a) NE-Asia Exports: Commodity Complementarity with Other Subregional Groupings



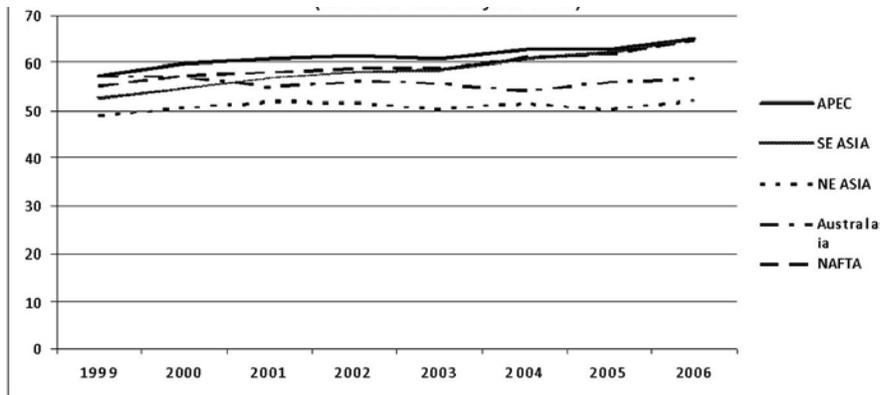
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Figure 4(b) SEAsia Exports: Commodity Complementarity Other Subregional Groupings



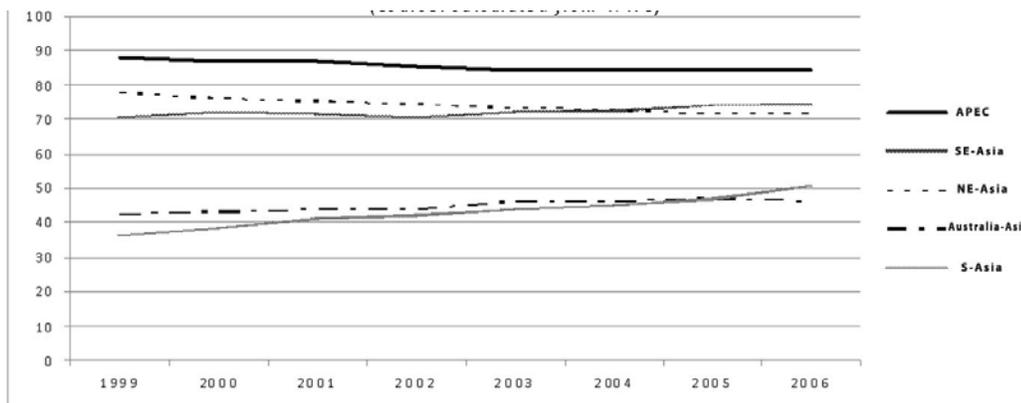
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Figure 4(c) Australasia Exports: Commodity Complementarity Other Subregional Groupings



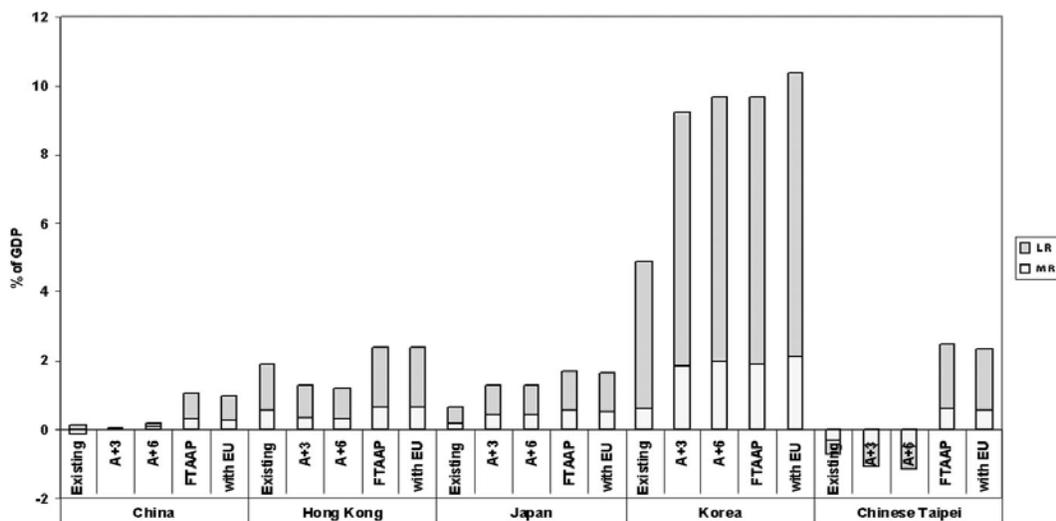
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Figure 4(d) South Asia Exports: Commodity Complementarity Other Subregional Groupings



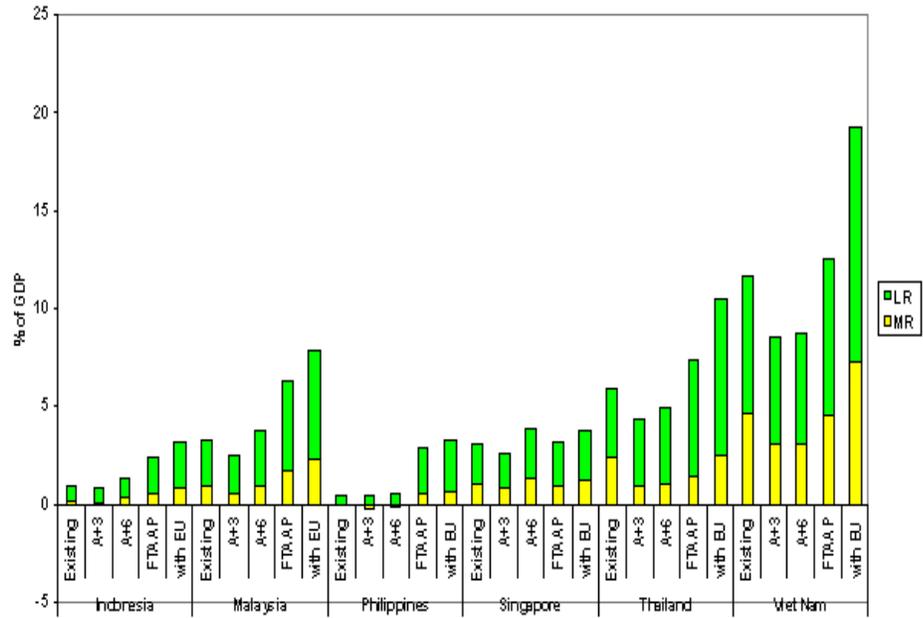
Source: calculated from WITS

Figure 4(e) North American Exports: Commodity Complementarity Other Subregional Groupings



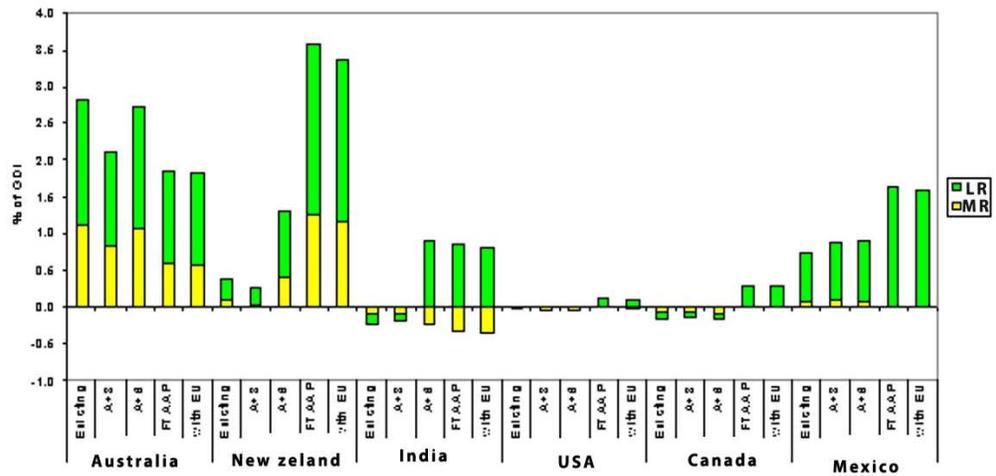
Source: Model simulations

Figure 5: Welfare Effects of Alternative Trade Architectures



Source: Model simulations

Figure 6 : Welfare Effects of Alternative Trade Architectures



Source : Model simulations

Figure 7: Welfare Effects of Alternative Trade Architectures