Volume 10 | Issue 34 | Number 2 | Article ID 3811 | Aug 19, 2012

The Advance—and the Limits—of Trade Integration in Asia□□アジアにおける貿易統合の前進--およびその限度

Heribert Dieter

Introduction

After decades of preoccupation with traditional security issues, trade, finance and investment have become key areas of concern to policy makers in Asia, broadly defined to include South Asia, Southeast Asia and East Asia. Whereas in the past, governments in Asia applied a traditional understanding of security, today 'economic security' is part of a broadened concept of security that most countries in Asia apply (Pempel 2010a: 213). Of course, international trade and the efforts to deepen intra-regional trade integration are part of this process.

In the midst of the global financial crisis in 2008 and 2009, international trade seemed to be collapsing. Especially those economies that showed very high levels of integration into the global economy, e.g. Singapore, suffered badly. By 2010, however, trade was recovering quickly two years after the crisis broke. Asian economies have of course not been hit as hard by the global financial crisis as the European and American economies. Since the crisis, trade has again led recovery. Thus, trade integration is enjoying renewed attention in the region and beyond.

In Asia, trade integration has shaped the economic and political debate for decades. There has always been a distinction between market-led and policy-led trade integration. The former refers to the tendency of firms to obtain raw materials, intermediate products and end products across borders from the cheapest source. The second form is government-induced trade integration, in particular the creation of preferential trade agreements such as free trade areas and customs unions whose trajectory may be shaped by political calculation.

Lines demarcating the two types of integration are however hazy. Market-led integration is not occurring in an economic space free of government regulation, but relies primarily on the multilateral regulatory framework that has been created by governments. The multilateral regulation of trade has been suffering in the last decade, both because of the unwillingness of WTO member countries to conclude the Doha Round of trade negotiations and due to the increasing competition from preferential trade agreements. Often, policy makers perceive preferential trade agreements as a substitute for multilateral regulation. This can be observed in Asia and elsewhere.

The creation of preferential bilateral or regional trade agreements in Asia and elsewhere occurs at a time of market-driven internationalisation of production. Dicken has suggested that in recent decades, the global economy has been affected by two distinct but related developments: the increasing transnationalization of production networks and the rapid emergence of regional trade agreements (Dicken 2005: 1). Both are important for developed and developing countries alike. Transnationalization of production networks results in the relocation of production to other countries, and these changes affect economic prospects in many parts of the world.

This article analyzes the evolution of trade

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

integration in Asia in the past decade. First, I will look at the actual development of trade in the region. Needless to say much of the increase of trade in the region is due to the phenomenal rise of China as a player in international economic relations. I will then examine the mushrooming of preferential trade agreements in Asia. Whilst their coverage and appeal varies, all of them include the creation of a free trade area among the participating economies as a core element. I then assess this approach and analyse the limited utility of preferential trade agreements in an era of growing economic integration including the increasing use of intra-regional productions networks. Against this background, the prospects and efficacy of an Asian customs union are considered.

Market-led trade integration

In the two decades since 1990, deepening trade integration has been primarily market-driven, not state-led. As will be demonstrated, government initiatives in Asia, primarily the creation of preferential trade agreements, have not contributed significantly to the deepening of trade relations. Instead, transnational corporations operating across national borders have established production networks in Asia, even in the absence of government support for the deepening of intra-regional trade. The result has been a region-wide 'factory Asia', driven by markets rather than by governments (Pempel 2010a: 215).

Of course, one of the main factors for the rise of trade integration, both market-led and policy-driven, has been the rise of China, occurring at a time when the United States under George W. Bush implemented a policy of hostile unilateralism. As the US put security issues at the centre of its foreign policy, China demilitarised its rhetoric and policies. In contrast to previous decades, in the 21st century China promises a common future in harmony and prosperity. China's policy shift has resulted in a remarkable revision of perceptions in East Asia, as David Shambaugh noted earlier: "Today China is an exporter of goodwill and consumer durables instead of revolution and weapons" (Shambaugh 2004: 65).

In the early 21st century, the rise of China has been the most important development for all Southeast and East Asian countries and their economic cooperation endeavours (Ravenhill 2008: 48). In recent years, China's astute diplomacy has made a significant contribution to the rise of the country's status in the region. China, for example, was the first non-ASEAN country to sign ASEAN's Treaty of Amity and Cooperation (TAC). By signing the this non-aggression treaty at the ASEAN summit in Bali in 2003, Beijing eased fears of China's military intentions, at least temporarily (Narine 2007: 214). This paved the way for numerous preferential agreements with Asian countries, both those concluded or in negotiation.

In the last three decades, China has developed into an economic hub in Asia. Countries throughout the region have established intensive economic and trade relations with China. Today, about 50 percent of China's trade is intraregional. Even for Japan, until 2012 the world's second-largest economy, China is vitally important. In 2009, China replaced the US as Japan's largest export market, and China is the largest importer to Japan (IMF Directions of Trade 2009). Moreover, China does not generate a large trade surplus with its neighbours as it does with the United States and Europe.

While the rise of China to the world's largest exporter has been widely debated, less noted is the fact that the country has also overtaken Japan as the world's third largest importer (after the US and Germany). This makes China a sought-after partner worldwide. Furthermore, China's large trade surpluses are exclusively generated in trade with OECD-countries. In

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

2011 the surplus in trade with the USA was 205.7 billion dollars (with exports of 324.8 billion dollars) and the surplus with the EU 145 billion dollars (with exports of 356.2 billion dollars). By contrast, in 2011 China had a *deficit* in trade with most of its Asian neighbours, including ASEAN, Australia, Japan and South Korea.

*Table 1: China's major trading partners and trade balance (countries and regions) (2011)**

	Exports to	Imports from	Balance of trade (EX-IM)
ASEAN	169,860	192,466	- 22,606
South Korea	82,924	161,673	- 78,749
Japan	147,290	194,409	- 47,119
Australia	33,906	82,929	- 49,023
	3,736	4,990	- 1,254
New Zealand	324,856	119,163	205,702
	356,215	211,200	145,045
United States			
EU			
Total Trade	1,901,478	1,741,449	160,029

**Scale: Millions, Unit: US dollars*

Source: International Monetary Fund, Direction of Trade Statistics, 2012.

In many political systems, exports are considered more important than imports. This is particularly the case for those countries that have followed a strategy of export-led growth. Virtually all Asian countries fall into that category. The political survival of many governments in Asia, including China, rests heavily on the delivery of economic growth (Pempel 2010a: 213). Across Asia, both policy makers and civil society hold the conviction that economic growth and prosperity are tools to enhance a nation's power and prestige (Pempel 2010b: 473).

Since 1990, Asian economies have significantly increased their share of global trade. In 2006, the emerging Asian economies (including India, but not Japan) generated one third of world trade, up sharply from twenty-one percent in 1990 (IMF 2007).[1] While trade with the rest of the world has also increased, the growth of trade within emerging Asia has been particularly rapid. Intraregional trade among emerging Asian economies increased more than nine times between 1990 and 2009 to about 1,224 billion dollars (IMF DOT 2009). Both growth and volume are remarkable even when contrasted with the European Union (EU-15). In Europe, intraregional trade reached three thousand billion dollars in 2009, an almost threefold increase from 1990 (IMF DOT 2009).

In 2009, the share of intra-East and Southeast Asian exports reached close to forty-one percent of overall trade (UN ESCAP 2009: 9), not far behind NAFTA (52.5 percent) or the European Union (EU-15, 59.2 percent). The number is even higher for imports, indicating closer integration. Intraregional import figures for this bloc reached forty-nine percent in 2009 (UN ESCAP 2009: 9), not significantly lower than EU's intraregional imports (64 percent) (IMFDOT 2009). As noted before, the main factor driving this impressive increase of intraregional trade and intraregional division of labour has been the rise of China. Between 1997 and 2007 China's share of intraregional trade doubled. In 2009, the share of China in intra-East and Southeast Asian imports alone was close to thirty-three percent (UN ESCAP 2009: 8)

In general, China has become more important as a destination of exports at the expense of established OECD-economies. Between 1990 and 2006, for the four most advanced newly industrialised countries of Asia (South Korea, Taiwan, Hong Kong, Singapore) China as an export destination grew from 7.9 to 25.4 percent, whilst exports to the rest of the world, including OECD countries, shrank from 57.0 to 38.3 percent. Even for ASEAN countries, which directly compete with China, trade with China grew dramatically. In 1990, only 2.2 percent of exports from Indonesia, Malaysia, Thailand, the Philippines and Vietnam went to China, while in 2006 this figure had risen to 11.1 percent (IMF

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

2007: 44).

In effect, the growing economic ties have led to a rise of China-centred regionalism, if not de jure, de facto. This can not only be recognized in an increase of cross-border trade and investment but also in the intensification of formal integration projects, probably the most important being the China-ASEAN Free Trade Agreement (CAFTA), in effect since 2010.[2] However, China is of course not the only player pushing its preferential trade agreements in the region. This raises the question why Asian economies have departed from the multilateral regulation of trade and are increasingly opting for the discriminating preferential alternative.

Why has support for multilateral regulation of trade disappeared?

The traditional debate on this issue has been characterised by 'stepping-stone' or 'stumbling bloc' arguments. Bilateral or plurilateral agreements were regarded as either contributing to improvements of the multilateral regime or undermining it. However, thus far, the multilateral regime has received very little, if any, stimulus from bilateral agreements. Indeed, the lasting stalemate in the Doha-Round can at least partly be attributed to the existence of alternative, bilateral regimes.

Today, there are almost four hundred free trade agreements and a few customs unions recognized by the WTO. More are currently being negotiated and all regions of the global economy are participating. Yet just a few years ago the entire Asia-Pacific region largely avoided these agreements. Countries like Japan and South Korea, and even Australia, were staunch supporters of the multilateral regime. Only ASEAN countries were advancing preferential trade within their ASEAN Free Trade Area (AFTA), which started in 1992. However, this pattern has changed dramatically. In recent years, no major economy has been willing to abstain from the current trend toward preferential trade agreements.

Both the US and the European Union have actively contributed to the weakening of the World Trade Organization's position in economic governance. While both continue to rhetorically support the WTO, in practice neither is providing the leadership in trade governance that characterized earlier periods, in particular the 1970's, 1980's and 1990's. Immediately after 1945, the global economic order was established under American hegemony. In the aftermath of World War II, the US used its then unchallenged material and ideological power to set in place an institutional framework for global economic governance. Although underwritten by US hegemony, the Bretton Woods System and the General Agreement on Tariffs and Trade (GATT) were multilateral in both tone and practice. Though many countries were excluded or excluded themselves from the Bretton Woods regime, such as most countries of the Warsaw Pact, the regime was open and inclusive. The GATT in particular was a tremendous success. Starting with twenty-three countries in 1948, the list reached 128 in 1994. The GATT quickly became a central pillar of global economic governance.

The US saw the GATT as beneficial to its national interest and its view of world order. However, in the first decades after 1945, the US defined its interests broadly and inclusively. Other countries felt able to sign onto a vision that stressed due process and the rule of law. Europe, an important player in trade policy after the completion of the customs union of the European Economic Community in 1968, by and large was a constructive force in supporting the further development of the multilateral trade regime. Asian players, particularly Japan and subsequently the rapidly emerging economies of Southeast and East Asia, were loyal supporters of the GATT and later the WTO. This is best exemplified by the

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

fact that there were hardly any preferential trade agreements in Asia prior to the year 2000.

Nowadays, at the end of the first decade of the 21st century, the situation has changed significantly. Since the days of the administration of George Bush Senior, the US has defined its national interest much more narrowly. Whilst the rhetoric of the Clinton Administration may have been more benign and gentle, it nevertheless pushed its own agenda in international affairs (Dieter and Higgott 2007: 151-174). This pattern continues in the first years of the Obama Administration, although with a change in rhetoric as not all policy is overshadowed by security concerns as in that of his predecessor. Whilst President Obama has so far refrained from implementing trade restrictions, the continuing weakness of the American economy, particularly high unemployment, may well result in a protectionist policy shift before the presidential elections in 2012. Moreover, resentment towards multilateral, rule-based regimes is still a prevalent sentiment within most US policy circles.

Even more importantly, in recent years Asian economies have firmly embraced preferential trade agreements (Pempel 2006: 239-254), although these policies have been causing some friction in the transnational production networks in the region. Nevertheless, the changing policy choices of Asian governments have resulted in a further weakening of support for the multilateral trade regime.

Of course, the multilateral trading system has always depended on the support of major players. The US was the single most important supporter of the GATT in the first two decades after its implementation, nurturing a rules-based world trading system (Irwin 2002: 225). When the European Economic Community completed the creation of a customs union in 1968, Europe became the second major player in the multilateral trading regime. Some of today's important trading nations, China in particular, were not yet members at that time, while the countries under the influence of the USSR primarily traded with each other.

The US and the EU continued to shape and further the multilateral trading regime in the three decades after 1968. While the evolution of the trading regime was neither linear nor without contradictions, it is clear that the GATT can be considered a success, both with regard to liberalization of trade and continuously expanding membership. Furthermore, during the bipolar era, all GATT negotiation rounds were eventually completed, though often after long negotiations. The most important development, however, was the creation of the World Trade Organization in 1995, which has provided member countries with a substantially improved dispute settlement mechanism. Prior to the creation of the WTO, dispute settlement could be blocked by the party accused of an illegitimate policy. This changed with the WTO; it is one of the few multilateral organizations in which any country can take the EU or the US to court and have a legitimate chance of rectifying the situation, though it may take time. The implementation of the dispute settlement mechanism was not only a milestone for the creation of a rules-based system of international trade, but it can also be interpreted as one of the few building blocks of global governance.

The mushrooming of trade agreements in Asia

While the free trade agreements as instruments of foreign economic policy were pioneered by the EU and the US, they have spread to other regions. Asian nations, which had long avoided such agreements, have rapidly implemented numerous FTAs in recent years. Of course, this in part reflects the unresolved rivalry between China and Japan for leadership in Asia.

China has become one of the most active

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

players pushing bilateral agreements. According to the Asian Development Bank's Asia Regional Integration Center, as of July 2010, China is participating in twenty-five FTA s (both bilateral and plurilateral). In 2010, China and the ASEAN countries have created the world's largest free trade zone in terms of the number of inhabitants, the ASEAN-China Free Trade Area ACFTA. However, beyond that FTA, China has not been able to conclude an agreement with an important economic player. China has mainly concluded FTAs with smaller economies, such as Chile, Costa Rica, Peru and Singapore. Negotiations concerning FTAs with India, Japan and South Korea show little signs of progress. The China-Japan-South Korea FTA, proposed in 2003, would have significant impact. However, the project has not been pursued with any vigor and should be considered a failure. However, FTA negotiations are rarely abandoned, rather they may hibernate for years. From a diplomatic perspective, not completing a project is less problematic than officially abandoning one.

At the turn of the century, Asian economies by and large showed very little interest in trade regimes outside the WTO. This has changed dramatically. Today, myriad initiatives can be observed. Although the effects of these preferential agreements, most of them bilateral, may be negative both for the welfare of the participating countries and for the stability of the multilateral trade regime, the frenetic activities of policy makers reveal their concerns about the current regime of global economic governance.

Prior to the Asian crisis of 1997/98, Asian countries were not closely tied together in the economic domain. In both Southeast and East Asia, the dominant model of development was characterised by a unilateral opening to the world market, primarily for exports, and there was virtually no regional cooperation with regard to joint macroeconomic or monetary policies. One expression of the dominance of unilateral economic policies is the fact that the finance ministers of the ASEAN countries had never met in their official capacity prior to 1997. The linkage between economic instability and regional stability emerged during the Asian crisis, and policy makers have moved to accept this new reality surprisingly quickly. For instance between 1998 and 2010, in trade alone, there has been an 80 percent rise in the number of bilateral FTAs and a ninety percent increase in the number of plurilateral (arrangements with more than two parties) FTAs in Asia (ADB Asia Regional Integration Center, data for 2010).

The reasons for these changes in priorities are manifold. First, traditional security issues are no longer as pressing as they used to be. Whilst some tensions persist, there has been a remarkable reduction in armed conflict in the whole of the Asia-Pacific. The numerous conflicts that shaped foreign policy in the past – from the Korean and Vietnam Wars to the conflicts in Southeast Asia in the 1970s and 1980s – have either been solved or are are being dealt with diplomatically. Secondly, the countries in the Asia-Pacific, in particular the countries in Southeast and Northeast Asia, have learned that economic instability may be a greater concern to them than classical security risks. The Asian crisis of 1997/98 has demonstrated that the lives of millions of people can be severely affected by economic turbulence. Moreover, the stability of some political systems in the region depends on economic growth and a period of no or limited growth may call into question the legitimacy of governments. Thirdly, the economies in Asia are growing ever closely integrated. The deepening of transnational production networks, the growing share of intraregional trade and substantial investment flows provide the basis on which a process of regional political cooperation, resulting in regional governance of economic affairs, is gradually being built. Fourthly, the political rivalry between China and Japan has been a major

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

factor stimulating Asian regionalism in general and preferential trade agreements in particular.

The ties among Asian economies have significantly deepened over the last two decades, and this growing economic interdependence has fuelled a range of political activities to strengthen cooperation. Initially, market processes drove the deepening ties, but in recent years, de facto integration processes have been augmented by political initiatives. Integration by markets forces and integration by agreements are certainly not mutually exclusive, but are related and complementary (Aminian et al. 2008: 3).

Table 2: Preferential trade agreements by status across Asia and Asia-Pacific as of August 2012

COUNTRY	Consultation and Study	Under Negotiation	Signed and in Effect*	TOTAL
Australia	3	10	8	21
Brunei Darussalam	4	4	8	16
Cambodia	3	1	6	10
China, P.R.	8	5	12	25
Hong Kong	1	1	2	4
India	7	13	13	33
Indonesia	6	5	9	20
Japan	8	2	13	23
Korea, Republic of	16	7	10	32
Lao PDR	3	1	8	12
Malaysia	8	6	12	26
Myanmar	4	1	6	11
New Zealand	5	5	9	19
Philippines	5	1	7	13
Singapore	5	10	21	36
Taipei	2	2	5	9
Thailand	6	7	12	25
Vietnam	7	2	8	17

Source: Asian Development Bank, Asia Regional Integration Centre Data, available here (last accessed on 15 August 2012).
* Includes FTAs signed but not yet in effect.

In the early 21st century there is increasing rivalry between a handful of major players who are competing for both political and economic influence. The new battlefields are preferential trade agreements. Leading powers such as the US, the EU, and China are no longer emphasizing multilateralism, but are instead pushing for preferential agreements. This reflects both the inability to cooperatively advance the multilateral regime and the weakened position of the previous hegemon, the US. Since the start of the global war on terror, US influence among many countries that traditionally supported it has declined. The unilateral moment of US hegemony may prove to have been briefer than some had predicted in the late 1990s (Zuckerman 1999). The financial crisis originating from the US has contributed further to at least a temporary weakening of the US position (Altmann 2009: 6).

In the first decade of the 21st century, China has been successfully pushing preferential agreements in its immediate neighborhood. Starting with the proposal for the ASEAN-China FTA in 2001, Beijing has been setting the pace in the region and has forced Japan in particular to offer comparable agreements. Despite the fact that in July 2010 Japan had even been able to have more PTAs in effect than China, there is little doubt that Japan's strategy is a defensive one.

At the beginning of the second decade of the 21st century, these trends in trade policy have led to a messy situation. A web of overlapping PTAs has resulted in the creation of a "noodle bowl" of regulations in Asia. Rather than facilitating inter-company trade, the proliferation of regional agreements has resulted in a less transparent, even opaque trading system. Companies are confronted with the choice either of trading on a most-favoured nation basis, which means paying the appropriate tariff, or establishing the origin of a product. Since most of the PTAs in Asia have only been in force for a few years, it is probably a bit early to establish a region-wide pattern of company's willingness to engage in the process of establishing origin. Evidence from ASEAN's

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

internal PTA shows that most trade is not conducted using the tariff-free option requiring a certificate of origin, but instead more than ninety percent of ASEAN-internal trade is conducted on a most-favoured nation basis (Corning 2009: 647). There is no reason to believe that utilization rates in other PTAs in Asia will be any higher, because ASEAN uses relatively simple and thus manageable rules of origin, whilst the rules in other PTAs tend to be more complex and use, for example, higher value-added requirements than the forty percent threshold used in ASEAN. In particular PTAs involving larger developed economies tend to have more complex rules (Corning 2009: 660).[3]

The proliferation of bilateral PTAs therefore represents the greatest divide between entrenched economic theory and short-term political practice in the global economy since the introduction of protectionist measures in the 1930's. Both economists and political scientists agree that bilateral trade deals are suboptimal and pose major threats to the multilateral trading system. When looking closely at some of the details, the disadvantages of bilateral deals become even more evident. One major drawback is that the important and useful dispute settlement mechanism of the WTO might be diluted because of the mushrooming of preferential agreements.[4]

The limited utility of preferential trade agreements

A major disadvantage of free trade agreements is the administrative burden caused by rules of origin. In an entirely open world economy with no restrictions on the flow of goods, these rules of origin would not matter because it would be irrelevant where goods originate. Today, however, the origin of a product matters, particularly in preferential agreements. All free trade agreements, including bilaterals, require rules of origin to establish the 'nationality' of a product. The reason is that in FTAs, participating countries continue to have diverging *external* tariffs. One country might have a high tariff on, say, cars in order to protect domestic producers, whilst the other might have a low or no tariff on that product. Since only goods produced within the free trade area qualify for duty free trade, there have to be procedures that differentiate between goods produced within the FTA and goods from the rest of the world. Thus, the preferential system becomes complicated and expensive. On average, the cost of issuing and administering certificates of origin is estimated to be five percent of the value of a product (Dieter 2004: 281; Roberts and Wehrheim 2001: 317).

In the past forty years, the use of rules of origin has changed significantly. After decolonisation, many developing countries used rules of origin as instruments to enhance their economic development. Rules of origin were used to increase the local content of manufactured products and to protect infant industries in those economies against competition from imports. This function of rules of origin is of relatively minor importance today. Rather, developed countries use strict rules of origin to protect their aging domestic industries or non-competitive agriculture.

First, it is important to understand that there are two categories of certificates of origin, non-preferential and preferential. The former are used to differentiate between foreign and domestic products, for instance for statistical purposes, for anti-dumping or countervailing duties or for the application of labelling or marketing requirements. The second type is the one that can distort trade because it provides preferential access to a market.

There are four methods to establish the "nationality" of a product, to establish origin. There is natural origin and origin due to substantial transformation, this category being

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

subdivided into three other forms: a change in the tariff heading, a minimum percentage of value added, and specific production processes (Estvadeordal and Suominen 2003). Natural origin (wholly produced or obtained) is the least complicated. This applies to raw materials and non-processed agricultural products, i.e. to a relatively small part of international trade.

A change of tariff heading is already much more complicated. The Harmonized System (HS) is a set of regulations that has been agreed upon in the World Customs Organisation (WCO). It consists of 1241 categories on the four-digit level and more than five thousand categories on the six-digit level. If a product receives a different tariff heading after the production process, this can be used to qualify for origin. This method has considerable advantages. It is both transparent and easily established. The Harmonized System is easy to implement and causes relatively little cost. The necessary documentation is undemanding. The trouble is that a change of tariff heading does not necessarily constitute a significant step in the production process. Minor changes to a product can lead to a change of tariff heading. Therefore, merely requiring a change of tariff heading to establish origin is the exception in PTAs in Asia and elsewhere.

The minimum value-added rule is probably the most complicated method to establish origin. Incidentally, it is also the most widely used scheme in Asia. A certain percentage of the value of the product has to be produced within the FTA to qualify for duty free trade. Finally, specific production processes can be identified and agreed upon in order to establish origin. The trouble is that this method both requires complex negotiations on agreed production processes and continuous updating. Due to the changing patterns of production, new forms of production emerge that would constitute substantial transformation, but unless they are listed in the catalogue of agreed production processes, they would not qualify for duty free trade.

When criticising the negative consequences of rules of origin, there is a caveat. By paying the appropriate tariff, they can be easily overcome. Since peak tariffs continue to cause difficulties in some sectors, the protectionist effect of rules of origin should nevertheless not be underestimated. The combination of tariffs and stringent rules of origin can be an efficient instrument for the protection of a market. One example of that approach is the textile market in NAFTA, where rules of origin require the yarn to be spun in NAFTA (the yarn-forward rule) or even the fibre to be produced in NAFTA (the fibre-forward rule), which is used for many textiles containing cotton. The consequence is that Canadian or Mexican textile producers cannot source their cotton from, for example, African cotton producers, but instead have to buy cotton from US producers. Rules of origin are opaque protectionist instruments. They often render PTAs a useless endeavour, at least from an economic point of view.

Not surprisingly, the economic utility of preferential trade agreements in Asia continues to be limited. Corning suggests that the ASEAN-Japan Comprehensive Partnership Agreement (AJCEP), praised by its supporters as more wide-ranging than WTO agreements, has produced convincing results (Corning 2009: 640). Other observers have criticised preferential trade integration sharply. Ross Garnaut and David Vines have argued that the trend towards discriminatory bilateral agreements is "… an ill-thought-out early-twenty-first century response, and it is deeply disturbing" (Garnaut and Vines 2007). Richard Baldwin has also characterised the situation of East Asian regionalism harshly: "[w]hen it comes to East Asian regionalism, the state of play is easily summarised – it is a mess. Dozens if not hundreds of trade deals are under discussions, under negotiation, or already

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

signed" (Baldwin 2006: 3).

Baldwin has coined the term "noodle bowl" for Asian trade relations.[5] The consequence of the noodle bowl is an increasing fragility of production in East and Southeast Asia. The variation of rules between the various bilateral agreements is causing significant problems for the private sector. Baldwin identifies three factors that contribute to this fragility. First, each nation's industrial development and the competitive position of companies in these countries depend on the smooth functioning of intra-industry trade flows. Second, the tariff cutting that created Factory Asia was done unilaterally by most Asian countries. These tariff cuts were not 'bound' in the WTO, and consequently they are not subject to WTO discipline. This so-called bindings-overhang means that tariffs in Asia could go up overnight without violating WTO rules. Third and most important, there is no political regulation in the region that could substitute for WTO discipline. By contrast, European regulation has both top-level management, i.e. the European Commission, and WTO discipline, and European countries have bound their tariffs at very low levels (Baldwin 2006: 1f). Thus, the private sector in Europe has a better, more transparent political and trade environment than the private sector in Asia, at least when considering the conditions for trans-national production.

Which way forward? Should Asian economies consider a customs union?

Ever since East Asian countries have been evaluating options for further integration, there has been debate on which form economic integration should take. In 1994, the APEC member countries agreed to create on open trading regime in the Asia-Pacific by 2010 for the more advanced and 2020 for the less developed economies. It was, however, unclear what precisely the 'open regionalism' advocates meant. Would the participating economies liberalise unilaterally and offer the reductions of their levels of protection on a most-favoured nation basis to all member countries of the WTO, including, say, the European Union? Or would 'open regionalism' permit other economies to join a scheme which would only provide the benefits to its member countries?

Since the APEC meeting at Bogor, the discussion has moved on and there is now much less ambiguity about the avenues open to policy makers. In essence, the creation of a discriminating preferential trade agreement is one option that is evaluated by policy makers. For example, the East Asia Study Group (EASG), formed as an advisory body in the year 2000, suggested the creation of an East Asian Free Trade Area in its report, presented to the ASEAN Plus Three Summit in November 2002 in Cambodia (EASG 2002).

Of course, the wave of preferential trade agreements that already have been created in the region and the above named proposal raise the question whether there aren't any more convincing alternatives, both from an economic and from a political perspective. The current system of preferential trade agreements with their divergent rules of origin and little economic utility are the third-best option. Bilateral PTAs do not contribute to the creation of a unified economic space, but instead create an administratively complex trade regime. Moreover, from a political perspective they are even counterproductive since PTAs contribute to the deepening of the rivalry between the two most important players in Asia rather than offering a possible co-operative solution.[6]

An Asia-wide free trade agreement would constitute an improvement with regard to both the economic and the political dimension. From an economic point of view, a region-wide PTA would at least reduce the complexity of the administration of trade. There would be one set of rules of origin instead of dozens of them, and

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

companies would potentially benefit from the creation of the world's largest PTA. At the same time, even a region-wide PTA would offer suboptimal results. Whilst the need for certificates of origin would be reduced, it would still be necessary to establish origin of any product traded duty-free in the region. Participating economies would continue to implement their own, country-specific trade policy and would be free to engage in other PTAs with third economies, e.g. the US or the EU. Given the complex nature of today's international production networks, the origin of inputs sourced from outside the PTA would still have to be subject to complicated administrative processes.

Politically, an Asia-wide FTA would eliminate the current competition between China and Japan with regard to trade policy. Since there would be only one PTA, neither country could engage in a beauty contest with the aim of demonstrating the attractiveness of its own scheme. However, an Asian PTA would still be suboptimal when compared with a customs union in the region, which would both reduce transactions costs due to the lower requirements for rules of origin and streamline the region's foreign economic relations. A customs union constitutes a higher level of integration than a free trade agreement and creates an economic space with a unified trade policy vis-à-vis the rest of the world. Thus, it is more difficult to agree on than an FTA, but also offers the greater benefits.

By definition a customs union contributes to the elimination of trade barriers, tariffs and quantitative restrictions on trade amongst partners and imposes a harmonised external tariff on trade with third countries. This is the key difference with a free trade area; however technically different, in notion and purpose a customs union is akin to a free trade area as are both are said to increase specialization and trade with welfare benefits for the parties involved. An important benefit of a customs union is that it contributes directly to trade creation, i.e. more expensive domestic products are readily replaced by cheaper imports from member countries.

In this context, it should be remembered that the European Economic Community never aimed at the creation of a free trade area, but from 1957 aimed at the establishment of a customs union, which was achieved in 1968. Ever since there has been only one trade policy, and Europe's weight in international trade has greatly risen since 1968. The economic utility is probably greater still: Once a product from a third country has entered the economic space and the duty is paid, the product can be used in production without requiring additional documentation processes.

The creation of a customs union in Asia, however defined, would certainly not be an easy task. The key stumbling bloc is the creation of a joint external tariff, which would have to consider the diverging political preferences of all member countries. In essence, most participating economies would have to liberalise trade in sectors they previously considered too problematic for liberalisation; Japanese agriculture is a case in point. Even if the more advanced economies could politically accept the opening of their hitherto protected agricultural sectors, the effects of a common external tariff on the less developed member countries of an Asian customs union need to be considered. For less developed economies, the creation of a customs union would result in a dramatic increase in competition, and most probably many industries would not survive such a shock.

Nevertheless, given the disadvantages of the current mess in Asian trade – characterised by overlapping and inefficient preferential trade agreements on the one side and lukewarm support for the multilateral system on the other – exploring the potential of an Asian customs union is a worthwhile endeavour. One potential

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

avenue for solving the obstacles outlined above would be a structured introduction of a customs union, with developed economies including China taking the lead and the poorer economies following five or ten years later.

In the last decade, dynamic processes have emerged that may lead to the creation of an integrated economic space in Asia. Of course, it is highly speculative to engage in a debate on the potential shape of such a regime, its membership and its relationship with non-participating economies. Nevertheless, given the high level of economic interdependence that can be observed already, interest in a formalised, de jure integration project in Asia seems to be quite high. A potential venue for this pan-Asian project could be the ASEAN-China FTA (ACFTA), which has took effect in 2010. This large group, comprising more than 1.7 billion people, can over time alter the nature of economic relations in Asia and may possibly also change political and security relations throughout the region (Narine 2007: 205).

Whilst there are numerous bilateral preferential trade agreements either in force or currently being negotiated in Asia, ACFTA has the economic potential to serve as the nucleus of an Asian integration project. China has not only made sure that the FTA offers sufficient rewards to the less-developed members of ASEAN (Vietnam, Cambodia, Laos, Burma), but has also succeeded in attracting support of the more advanced economies, e.g. by providing so-called early harvest programmes for agricultural exports from Thailand. Given the importance of China in Asian trade, the expansion of the existing preferential trade agreement into a region-wide customs union would, from an economic perspective, be a sensible step forward.

However, from a political perspective it appears naïve to expect both Japan and South Korea as well as ASEAN to agree to such a proposal. Suspicion of Beijing's long-term goals continues to exist in the region, and given the recent assertiveness of Chinese policy makers in international affairs this suspicion may have grown of late. If China earlier achieved a measure of success in portraying its rise as an opportunity to Asian and other countries, China today appears to be perceived more critically than, say, before 2010. Whilst it is difficult to name a single incident that may have contributed to the change in perception, the cumulative effect of the continuing production of current account surpluses, the buying of agricultural land and other natural resources in Africa and elsewhere, the unwillingness to consider a more robust appreciation of the exchange rate of the yuan vis-à-vis the dollar, the sabotaging of the Copenhagen climate talks, and China's expansive claims in the South China Sea have all contributed to a deteriorating image of China in Asia. Considering, moreover, the increasing bullishness of Chinese foreign economic policy, the creation of an Asia-wide customs union appears to be a rather distant prospect.

Conclusions

Following the departure from a security-driven agenda in international relations after the Asian crisis, countries in the region continue to search for an improvement of both their trade and other economic policies. Pempel has suggested that this process constitutes what he terms 'institutional Darwinism', a process of institutional competition and selection (Pempel 2010a: 233). Some forms of co-operation will flourish; others will probably languish and become irrelevant. Preferential trade agreements most probably belong to the latter category.

The arguments and evidence in this article show that, taken together, preferential trade agreements have very few advantages for Asia. They are inferior to regulating trade in the WTO, and they are less useful than large

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

regional agreements can be. Bilateral free trade agreements are a third-best solution for regulating international trade. They violate conditions for economic efficiency and they disadvantage the poorer players and systemically strengthen the more developed players.

The trend towards bilateralism is often justified on the grounds that simply relying on the WTO is like doing nothing. This is not the case. Multilateralism continues to function and to represent a superior form of regulation compared to preferential trade agreements. In trade policy, pushing preferential agreements is a second-best solution, if that. Furthermore, bilateral trade agreements contain an element of discrimination which is a cause for concern. In the 1930s, discriminatory preferential regimes dominated international trade. Today, economies are returning to a regime where goods originating from befriended countries have easier access to a national market than others. There is discrimination between friends and foes. The postwar trading regime had the explicit goal of non-discrimination, and today's policy makers are sacrificing this philosophy for quick, but uneven and unsustainable, economic gains.

The irony is that Asian economies, which have been major beneficiaries of today's open trade regime, have firmly embraced the trend towards preferential trade agreements. This may be due to the perception that the World Trade Organisation has, in essence, been a transatlantic organisation. Whilst it is true that the GATT and subsequently the WTO have been shaped by the transatlantic powers, preferential trade agreements are not a sound alternative to the WTO. They cause high administrative costs, do not support the creation of intra-regional production networks, and ultimately do not lead to a sustainable trade regime.

For Asian and other economies, including the European Union, the current trend towards preferential trade agreements is a policy error of massive dimensions. Beyond the ever-lasting rhetoric, major players, in particular China, the EU, Japan and the USA, should abandon preferential agreements and should return to the WTO as the main platform for regulating international trade. For Asia in particular, the current noodle bowl of trade agreements is not efficient economics, nor does it provide participating economies enhanced political influence. The only preferential trade agreement in the region that appears sensible from an economic perspective is an Asia-wide customs union, which would reduce transactions costs significantly and stimulate intra-regional trade beyond existing levels. At the same time, increasing distrust of other countries in Asia vis-à-vis China and its long-term goals will probably impede the creation of such an economically sound, but politically problematic, measure.

Heribert Dieter is Senior Fellow, German Institute for International Affairs, Berlin. An earlier version of this paper was published in Mark Beeson and Richard Stubbs (eds.): *Routledge Handbook of Asian Regionalism*, London and New York: Routledge, 2012, pp. 116-128.

Recommended Citation: Heribert Dieter, "The Advance—and the Limits—of Trade Integration in Asia," The Asia-Pacific Journal*, Vol. 10, Issue 34, No. 2, August 20, 2012.*

Bibliography

Aggarwal, Vinod K. and Min Gyo Moo, eds. (2008) *Asia's New Institutional Architecture:*

Evolving Structures for Managing Trade, Financial, and Security Relations, (Heidelberg/Berlin: Springer).

Altmann, Roger C. (2009) 'Globalization in

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

Retreat. Further Geopolitical Consequences of

the Financial Crisis', *Foreign Affairs* 88(4): 2-7.

Aminian, Nathalie, Fung, K.C., and NG, Francis (2008) 'Integration of Markets vs.

Integration by Agreements', *World Bank Policy Research Working Paper*, WPS4546 (March 2008).

Asian Development Bank, Asia Regional Integration Center (2010) *Trade and Investment*

Patterns, available here.

Baldwin, Richard (2006) 'Managing the Noodle Bowl: The Fragility of East Asian

Regionalism', *Centre for Economic Policy Research Working Paper* No. 5561 (March 2006), available here.

Breslin, S. (2004) 'Greater China and the Political Economy of Regionalism', *East Asia*

21(1): 7-23.

Corning, Gregory P. (2009) 'Between bilateralism and regionalism in East Asia: the ASEAN-

Japan Comprehensive Economic Partnership', *The Pacific Review* 22(2): 639-665.

Dee, Philippa (2005) 'The Australia-US Free Trade Agreement: An Assessment', *Pacific*

Economic Papers, No. 345, available here.

Dicken, Peter (2005) 'Tangled Webs: Transnational Production Networks and Regional

Integration', *SPACES (Spatial Aspects Concerning Economic Structures)*, (Marburg: Faculty of Geography, Philipps-University of Marburg, April 2005): 1-27.

Dieter, Heribert (2004) ‚Präferenzielle Ursprungsregeln in Freihandelszonen: Hemmnisse für

den internationalen Handel?', *Aussenwirtschaft. Schweizerische Zeitschrift für internationale Wirtschaftsbeziehungen* 59(3) (September 2004): 273-303.

---- (2006) 'Bilaterale Freihandelsabkommen im asiatisch-pazifischen Raum.

Effekte, Motive und Konsequenzen für die Europäischen Union', *SWP-Studie* S 8/06, (Berlin: Stiftung Wissenschaft und Politik).

---- (2007) 'Transnational Production Networks in the Automobile Industry and

the Function of Trade-Facilitating Measures', *Notre Europe (Paris), Studies and Research*, No. 58/2007.

---- (2009) 'The Multilateral Trading System and Preferential Trade Agreements:

Can Their Negative Effects be Minimised?', *Global Governance. A Review of Multilateralism and International Organizations* 15(3): 393-408.

---- and Higgott, Richard (1998) 'Verlierer Japan – Gewinner China? Außenpolitische

Konsequenzen der Asienkrise', *Internationale Politik*, 10/1998 (October): 45-52.

---- (2007) 'Linking Trade and Security in Asia: Has Washington's Policy Worked?',

Aussenwirtschaft. Schweizerische Zeitschrift für internationale Wirtschaftsbeziehungen 62(2): 151-174.

East Asian Study Group (2002) 'Final Report of the East Asia Study Group', prepared for the

ASEAN+3 Summit, (4 November 2002) (Phom Penh, Cambodia), available here.

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

Estewadeordal, Antoni and Suominen, Kati (2003) 'Rules of Origin: A World Map and Trade

Effects', Workshop: *The Origin of Goods: A Conceptual and Empirical Assessment Rules of Origin in PTAs*, (Paris, 23-24 May 2003).

Estrada, Gemma, Donghyun Park, Esther B. and Park, Innowon (2008) 'Prospects of an

ASEAN-PRC Free Trade Area: A Qualitative and Quantitative Analysis', *ADB Economics Working Paper Series*, (Asian Development Bank, October 2008).

Garnaut, Ross and Vines, David (2007) 'Regional free-trade areas: sorting out the tangled

spaghetti',*Oxford Review of Economic Policy* 23(3): 508-527.

Ikenberry, G. John (2008) 'The Rise of China and the Future of the West', *Foreign Affairs*

87(1): 23-37.

International Monetary Fund (2009) *Regional Economic Outlook, Asia and Pacific*, (May).

International Monetary Fund (2007) *Regional Economic Outlook Asia and Pacific*, (October).

International Monetary Fund Direction of Trade (2009) *Yearbook 2009*, available here.

Irwin 2002: Free Trade Under Fire, Princeton and Oxford: Princeton University Press.

Narine, Shaun (2007) 'Economic Security and Regional Cooperation in the Asia-Pacific:

Evaluating the Economics-Security Nexus' Amitav Acharya and Evelyn Goh, eds., *Reassessing Security Cooperation in the Asia-Pacific: Competition, Congruence and Transformation*, (Cambridge, Mass.: The MIT Press): 195-217.

Oba, Mie (2008) 'Regional Arrangements for Trade in Northeast Asia: Multilateral Responses

to Structural Changes', Vinod K. Aggarwal and Min Gyo Moo, eds., *Asia's New Institutional Architecture: Evolving Structures for Managing Trade, Financial, and Security Relations*, (Heidelberg/Berlin: Springer): 89-119.

Pempel, T.J. (2006) 'The Race to Connect East Asia: An Unending Steeplechase', *Asian*

Economic Policy Review No 1: 239-254.

---- (2010a) 'Soft Balancing, Hedging and Institutional Darwinism: The Economic

Security Nexus and East Asian Regionalism', *Journal of East Asian Studies* 10: 209-

238.

---- (2010b) 'More Pax, Less Americana in Asia', *International Relations of the Asia-*

Pacific 10: 465-490.

Ravenhill, John (2008) 'Asia's New Economic Institutions', Vinod K. Aggarwal and Min Gyo

Moo, eds., *Asia's New Institutional Architecture: Evolving Structures for Managing Trade, Financial, and Security Relations*, (Heidelberg/Berlin: Springer): 35-58.

Roberts, Michael and Wehrheim, Peter (2001) 'Regional Trade Agreements and WTO

Accession of CIS Countries', *Intereconomics* (November/December): 315-323.

Shambaugh, David (2004) 'China Engages Asia', *International Security* 29 (Winter

2004/2005): 64-99.

Tongzon, J.L (2005) 'ASEAN-China Free Trade Area: A Bane or Boon for ASEAN

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press

Countries?', *The World Economy* 28(2): 191-210.

United Nations ESCAP (2009) *Asia Pacific Trade and Investment Report: Trade led recovery*

and beyond.

Webber, Douglas (2007) 'Trade and Security in East Asia: Political (Non-?) Integration in an

Insecure Region', Heribert Dieter, ed., *The Evolution of Regionalism in Asia: Economic and Security Issues*, (London: Routledge): 145-159.

Zuckerman, Mortimer (1999) 'A Second American Century', *Foreign Affairs* 73(3): 8-31.

Notes

[1] Emerging Asia, following IMF definitions, includes China, India, Hong Kong, South Korea, Singapore, Taiwan, Indonesia, Malaysia, the Philippines, Thailand and Vietnam (IMF 2007: vi).

[2] One of the key foreign policy questions in the coming two decades will be the modernization of the current regime of global economic governance. John Ikenberry has pointed out that while the rise of China is a challenge, so far the Chinese have operated within the existing order and refrained from staging a full-fledged confrontation (Ikenberry 2008: 37). However, the effects of the rise of China for global economic governance are not a key question of this article.

[3] It should be noted that there is a bias against smaller companies in PTAS. Whilst transnational corporations tend to have large, competent administrations that are able to handle the complexities of rules of origin, smaller companies are often less well placed to master the administrative requirements.

[4] Whilst parties to preferential trade agreements can continue to use the WTO's dispute resolution mechanism, many prefer not to use this option and implement dispute settlement mechanisms within the PTA.

[5] Alternatively, the term "spaghetti bowl" is used. Both mean the same thing – a system of unconnected preferential trade agreements.

[6] Of course, there are other arenas in Asia where China and Japan do co-operate meaningfully, e.g. monetary regionalism in the context of the Chiang Mai initiative.

https://doi.org/10.1017/S1557466012032974 Published online by Cambridge University Press