Beyond Special and Differential Treatment: Regional Integration As a Means To Growth in East Asia

by

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A thesis submitted in conformity with the requirements for the degree of Masters of Laws (LL.M.)
Faculty of Law
University of Toronto

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ABSTRACT

Special and differential treatment (SDT) provisions in GATT were created to assist developing countries achieve economic progress while assimilating into the multilateral trading system. Despite these intentions, global trade imbalances still persist. Within this context, I focus on the region of East Asia which has experienced astounding growth in just several decades, propelling it far beyond other developing country regions. Although international trade continues to be the crucial factor driving growth in the region, reliance on SDT has in certain circumstances hindered development. As such, East Asia should seek alternatives to SDT. In that vein, I argue that sustainable growth and trade liberalization can be achieved by enhancing integration through a regional trade agreement. I further discuss various proposals for an East Asian trade agreement such as ASEAN+3, FTAAP, and EARTA. Finally, I highlight the importance of governance and identify several institutions essential for a successful regional arrangement.
Acknowledgements

I owe a debt of gratitude to:

My husband, Dave Allen – for your constant encouragement and unwavering support.

My supervisor, Michael Trebilcock – for your precise and invaluable guidance.
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INTRODUCTION

The past decade has witnessed an escalation in debates over globalization launched from varying perspectives such as human rights, the environment and labour rights. The most persistent anxieties however stem from concerns over the lack of economic growth in conjunction with increasing poverty in many developing countries. Free trade is often incriminated as the culprit of this problem and is thus subject to many critiques related to the problems of disadvantaged countries. Demonstrations at the Seattle Ministerial Conference and the failure of the Doha Round to date were consequences of the rampant systemic trade imbalance which had led to abject levels of poverty and lost opportunities for poorer countries. As Joseph Stiglitz has argued, it is clear that merely opening up markets by removing trade barriers is not by itself a solution to poverty; it could even make the situation worse. Developing countries continue to face serious challenges in the world trading system with regards to accessing foreign markets, lack of competitiveness in domestic products, and non-tariff measures such as anti-dumping actions.

The core premise of this thesis is that trade is a crucial tool to development. In the same way that it can promote rapid success, it can also be hugely detrimental to some countries if not managed with proper balance and foresight. Trade can propel economic growth which in turn is a conduit to improved welfare and poverty alleviation. This growth occurs as a result of the increase in productivity which in turn stems from the transfer of technology from more advanced states and raised levels of efficiency in domestic industries which are forced to become more competitive. It is evident that international trade plays a huge role in development as exemplified by Britain’s prosperity in the early nineteenth century due to trade with neighbouring states and colonies, Japan’s rapid industrialization in

the early twentieth century by trading with the West, Taiwan and Korea, Singapore, Hong Kong, and the
industrial development of North America and Australia in the nineteenth century. The rise of India and
China as formidable forces in the global economy is also an example of how openness to trade has
encouraged prosperity in countries which were previously insular. Indeed, the preamble of the
Marrakesh Agreement Establishing the World Trade Organization declares a commitment to the
overarching objectives of raising standards of living and ensuring that developing countries participate
commensurably in the growth of international trade.

The role of trade in achieving development goals has been enshrined in the mandates of
umerous international organizations including the United Nations Conference for Trade and
Development (UNCTAD), the World Bank, the International Monetary Fund (IMF), the International
Trade Centre (ITC), and the World Trade Organization (WTO). These organizations share the goals of
encouraging trade as a vehicle for economic development across all nations. The Doha Development
Agenda (commonly known as the Doha Round) was launched in 2001 with a focus on development. This
Round was intended to mark a “new era of negotiations which can and should provide real and lasting
opportunities for developing countries to participate in the multilateral trading system”.

Yet, as the collapse of the Doha Round indicates, developing countries are far from reaping benefits from the
multilateral trading system. The intractability seen in negotiations over the past nine years highlight the
dissatisfaction of developing countries with the current set of trade arrangements viewed as heavily
favouring richer nations, and the refusal of developing countries to acquiesce to the status quo.

During the Johannesburg Summit on Sustainable Development in 2002, US President Jimmy
Carter stated, ‘We cost the developing world three times as much in trade source restrictions as all the

4 As quoted from Mike Moore, Director-General of the WTO (as he was then), “Doha Development Agenda:
Symposium”, World Trade Organization, online: WTO

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overseas development assistance they receive from all sources.\(^5\) Developing countries account for one third of world trade\(^6\) and over eighty-five percent of the global population, but are inadequately represented in current governance arrangements for the global economy\(^7\). Agriculture remains an impenetrable sector for poorer countries due to unyielding protectionism from the US and Europe and international intellectual property rules have chained poorer countries to costly requirements in lifesaving medicines impacting public health. The worst of the failures have culminated in many poor countries being left behind and there has been a dramatic divergence in incomes due to the rise of between-country inequality.\(^8\) One sixth of the world’s population, termed the “bottom billion” by Paul Collier, is stuck in a quagmire of economic stagnation in states which are falling apart due to civil strife, bad governance and other traps which have severely impeded growth.\(^9\) The trading system has not significantly helped these countries, and to some extent increased barriers to economic growth by preventing market access for goods of export interest from these countries due to Western protectionism in sectors such as agriculture.

This thesis examines the economic challenges of developing countries within the multilateral trading framework of the WTO, with particular regard to the East Asian region. In Chapter One, the role of special and differential treatment (SDT) provisions is discussed. Numerous challenges inherent in the SDT scheme are outlined. Subsequently, various proposals and alternatives to improve economic conditions for developing nations are described and evaluated against the background of SDT principles. These proposals are: strengthening MFN obligations, unilateral liberalization, improving SDT within the

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\(^5\) Stiglitz & Charlton, \textit{supra} note 3 at 55.  
\(^6\) \textit{Ibid.} at 94.  
WTO framework, and participating in RTAs. I find that the first three options are not ideal for developing countries and argue instead that participation in RTAs may be a useful step forward to achieve growth via gradual liberalization. In that vein, I posit that despite the necessity for trade liberalization as a source of economic growth, liberalization in itself should not expand unchecked. Liberalization should be tailored to the realities of individual countries and may often take many different forms. As argued by Rodrik, there is no standard prescription for growth that applies uniformly across the globe. Instead, success is contingent upon liberalization at different paces for different nations, in combination with other factors such as foreign investment and reform of domestic institutions. These must be developed in tandem with the lowering of trade barriers so that gains can actually be reaped from liberalization.

Chapter II explores the potential of regionalism as a complement to multilateralism. Over the past two decades, there has been a dramatic proliferation of regional trading agreements which provide preferences to member parties outside of the multilateral system. These arrangements have provoked intense debate in academic and political circles regarding their advantages and disadvantages. At the centre of these debates is an examination of both the potential trade creation and trade diversion outcomes of regional agreements. While there are numerous rationales employed for the pursuit of regional trading agreements, the main question in Chapter II is whether regional trading agreements can be structured in a way that complements the multilateral system so that global free trade remains the long-term objective. The historical background and legal status of RTAs including the different types of trade agreements in existence and regional trends is reviewed. Subsequently, reasons for countries to form RTAs and the attendant problems that have arisen due to preferential arrangements are analysed. Finally, I examine several suggestions to mitigate the concerns engendered by RTAs and propose open

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regionalism as the most viable way forward to ensure that regionalism acts as a building block towards multilateral goals.

Chapter III discusses the experience of regionalism from an East Asian perspective. Proposals for trade reform in this thesis are focused on the region of East Asia which consists generally of developing countries in more advanced stages of economic development. Despite impressive growth over the past decades exemplified by countries such as Korea, China and Malaysia, the Asian economic crisis of 1997 caused severe challenges in the region which exposed systemic weaknesses in many countries. In some cases, excessive reliance on SDT caused some infant industries to turn into ‘perpetual children’\(^\text{11}\) as a result of protectionism, weak state regulation, and corruption\(^\text{12}\). Due to various factors such as intra-regional competition precipitated by the rise of China and the need for greater leverage in international negotiations, the 1990s reflected a trend of rampant FTA activity by East Asian countries. This chapter explores the history of economic development and trade engagement in East Asia, from pre-crisis to post-crisis. The unique challenges faced by East Asia coupled with the rapid rise of China as a global economic power are discussed. Subsequently, I look at the recent proliferation of RTAs in this region and describe the underlying reasons influencing this phenomenon. Finally, I argue that a logical next step for the East Asian region would be to enhance economic integration by consolidating the myriad of trade agreements into one comprehensive region-wide arrangement.

Chapter IV begins with an examination of the political and technical challenges to integration in East Asia. I then describe the existing efforts that the region has made regarding economic co-operation such as the East Asian Summit (EAS), Asia-Pacific Economic Co-operation (APEC) and the proposed Free Trade Area of the Asia-Pacific (FTAAP), and ASEAN Plus Three, all groupings which vary in terms of membership composition. I subsequently propose that an East Asian Regional Trade Agreement (EARTA)


should be formed with ASEAN situated at the hub of this arrangement, together with Japan, Korea, and China. In outlining the salient issues for this RTA, I discuss scope from the point of view of trade in goods. Significant emphasis is placed on resolving the problem of tangled rules of origin in the myriad of East Asian free trade agreements. I further argue that non-tariff barriers should be addressed to ensure that trade liberalization objectives can be achieved. Last, I discuss the importance of institutions for governance and propose that a Commission to implement the operations of the EARTA, together with an effective dispute settlement mechanism, are crucial elements of this agreement.
CHAPTER I: THE ROLE OF TRADE IN GLOBAL DEVELOPMENT

1 The Advent of a Formal Multilateral Trading System

In the days before the international trading system was encapsulated under the General Agreement on Trade and Tariffs (GATT) in the late 1940s, states managed their economies and cross-border trade in largely ad hoc ways. The late eighteenth to mid-nineteenth century heralded foundational economic theories by Adam Smith and David Ricardo which espoused the virtues of comparative advantage and trade liberalization, concepts which rapidly gained popularity. Feted as free trade’s ‘golden age’ in Britain, this era ushered in the concept of trade as an instrument for the promotion of international peace. Nonetheless, mercantilism and protectionism persisted across continental Europe and the United States leading to hugely detrimental beggar-thy-neighbour policies in the 1920s and 1930s. As a result of the role of these disastrous policies in exacerbating the Great Depression, the US and its trading partners commenced negotiations for trade liberalization in the mid-1930s via a series of bilateral agreements. These efforts were stymied by the Second World War but resurrected in 1944 by the victorious Allied Nations. Thus, the bedrock of the current trading system was laid by Britain and the US at that point in the Bretton-Woods Agreement. The influence of the United States coupled with a later unified European grouping would continue to dominate international co-operation initiatives in the decades to come.

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13 Ibid. at 14 – 16.
2  **GATT and Developing Countries: A Historical Overview**

In the post-war journey towards trade liberalization, the GATT was developed as a provisional agreement to implement preliminary tariff reductions. From the start, developing countries pushed for a system that would permit a relaxation of trade obligations. Special treatment in the form of infant industry protection, import substitution policies and preferential tariff options were desired as a type of ‘rule assistance’ to help the more disadvantaged\(^{15}\). The justifications for this have been described as follows\(^{16}\): First, exceptionalism from GATT requirements was needed to facilitate the move from agricultural to manufacturing industries. Second, many developed countries had pursued infant industry protectionism in their early days and this flexibility should not be denied to developing countries. Third, adjustment costs faced by transition economies would likely be prohibitive due to inadequate physical infrastructure and welfare safety nets in the liberalizing countries.

Despite the aforementioned reasons which ultimately led to some special treatment within the GATT/WTO, history indicates that developing countries have always struggled to have their voices heard within the global system devised and dominated by developed nations. The US position was unsympathetic to the views of developing countries largely because their prevailing economic policy at that time advocated the elimination of discrimination and trade protection which had led to the trade wars of the 1930s. As the strongest economy of that period, the gains the US would obtain from an open world market was evident. The two other major players, Britain and France were more supportive of preferential treatment for developing countries. This stemmed from their own preferential arrangements with favoured developing nations (typically former colonies) as a way of diversifying their own markets away from the US economy.\(^{17}\)

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\(^{16}\) Trebilcock, “Searching for Hope” *supra* note 8.

Ultimately, negotiations for the GATT culminated in a treaty that focused on reciprocity between member states with several exceptions for developing countries. Although special treatment was not contemplated in early drafts proposed by the US and Britain, small concessions were made by the US in the form of infant industry protection under Article XVIII in order to increase the membership of developing countries.\textsuperscript{18} Article XVIII was revised in the 1954 – 1955 Review Session to allow developing countries (1) to maintain flexible tariffs to promote certain industries; (2) to limit imports by quantitative restrictions to address balance of payments problems; and, (3) to impose tariff and quantitative restrictions to establish a particular industry in order to raise the general standard of living.\textsuperscript{19}

Additional special provisions for developing countries were added to the GATT in the subsequent decades. In 1954-55, due to continuous pressure from developing countries, a Review Session convened whereby Article XXVIII was expanded and legitimizing wording added to demonstrate the provisions’ adherence to the objectives of GATT despite its inherent protectionist policies. The revised Article permitted developing countries to deviate from tariff commitments for industry promotion and to institute certain trade restrictions when encountering balance of payment difficulties. Further, Article XVI exempted developing countries from the prohibition on export subsidies for manufactured products and Article XXVIII\textit{bis} allowed for flexibility in the use of tariff protection.\textsuperscript{20}

During the Kennedy Round of 1964, Part IV entitled Trade and Development was introduced in recognition of the right of developing countries to seek derogation from GATT rules for development purposes. Three new articles were added: First, Article XXXVI allowed developing countries preferential market access for products of export interest which could be non-reciprocal. This legitimised the

\textsuperscript{18} Hudec, \textit{supra} note 15 at 9, 18.
\textsuperscript{19} Trebilcock, “Searching for Hope”, \textit{supra} note 8 at 186.
practice of “free-riding” (getting the benefits of the system without having to pay for it) as developed countries gave up their right to ask developing countries to offer concessions during trade negotiations. Second, Article XXXVII called for restraint on duties and non-tariff barriers by developed nations towards products of export interest to developing countries. In the same vein, this Article urged Contracting Parties to give the highest priority to the elimination of trade restrictions which differentiate unreasonably between primary (usually raw materials from sectors such as agriculture and natural resources) and processed products so that developing countries could advance their manufacturing sectors and diversify their products. Third, Article XXXVIII encouraged joint action through the creation of international agreements, where appropriate, to improve market access for products of export interest to developing countries. Despite these noble goals, Part IV ‘was never more than a set of “best endeavour” undertakings with no legal force as the language it was couched in did not bind parties to any enforceable obligations.

From 1966 to 1997, additional efforts to solidify special measures for developing countries continued. A Generalized System of Preferences (GSP) was implemented in 1971 under the auspices of the United Nations Committee on Trade and Development (UNCTAD) by developed countries who agreed in principle to grant non-reciprocal trade preferences to developing countries. However, this measure was discretionary and developed countries were not legally bound to provide preferential treatment. Although this constituted a violation of the most-favored nation (MFN) obligation of GATT, a legal waiver was approved by GATT members. Preferences under GSP may sometimes be withdrawn if

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21 Ibid. at 18.
24 For example: “to the fullest extent possible … refrain from introducing … barriers” (Article XXXVII:1(b)); “have special regard to … the interests of less-developed contracting parties […] when considering the application of other measures permitted under this Agreement to meet particular problems” (Article XXXVIII:3(c)).
25 Hudec, supra note 15 at 64.
the granting country is displeased with the recipient country for any number of reasons. For example, the US threatened to revoke preferences for Brazil in 2004 due to inadequate protection of intellectual property rights (copyright piracy) in Brazil, an issue which is not directly related to the GSP scheme. The non-trade related nature of preference granting in this scheme was manifested more recently in a decision by the EU to remove Sri Lanka from its GSP Plus tariff preference program which cuts duties for selected imports from certain ‘vulnerable’ developing states that agree to implement various human rights treaties, citing Sri Lanka’s failure to honour important human rights.

Preferential treatment was officially solidified in the GATT text by the Enabling Clause adopted by contracting parties during the Tokyo Round of 1979. In this Round, numerous “opt-in” Codes were established whereby members were able to choose whether or not to participate. Hudec has opined that the creation of these side agreements arose out the desire to circumvent the incessant ‘nagging’, demands and particularly the veto power of developing countries which were insistent on obtaining special benefits for themselves to the point of blocking negotiations. These Codes regulated issues such as subsidies, anti-dumping, procurement, and contained separate provisions usually entitled “Special and Differential Treatment for Developing Countries”. Despite recognition of the special statuses and needs of developing countries, these provisions did not require any specific or quantifiable measures by developed countries to provide assistance. The difficulty of enforceability lies with the somewhat vague requirements for developed nations to “take into account special problems of developing countries”, “take such reasonable measures as may be available [to facilitate participation of

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28 Hudec, supra note 15 at 85.
developing countries in international standardizing]” and “take into account special development, financial and trade needs of developing countries”.  

Despite acknowledgements of the need to assist developing countries and to provide preferential treatment, developing countries were still subject to rampant contingent protection measures levied by developed countries on their exports. The Uruguay Round (1986 – 1995) was seen as an opportunity for developing countries to reset the balance and reinforce the most favoured nation (MFN) principle under the multilateral trading system. The “single undertaking” approach to negotiations ended up mapping the way to a weaker concept of SDT in exchange for improved market access. What developing countries received out of the Uruguay Round were essentially six categories of provisions intended to achieve the following: “increase trade opportunities; require WTO Members to safeguard the interests of developing countries; provide for greater flexibility of commitments; provide longer transitional time periods; provide for technical assistance to implement commitments; and provide special measures to assist least-developed countries.”

The ensuing sections explore the effects of SDT and criticisms directed at this strategy. The failure to resolve numerous challenges related to development culminating in the collapse of the Doha Round (2001 – 2009) will also be reviewed.

3 Challenges of Developing Countries vis-à-vis SDT

More than half a century has passed since the inception of GATT. In this time, many countries have developed economically, technology has progressed at a rapid pace, and the world has experienced the shocks of numerous financial crises. Trade liberalization measures have been

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29 These provisions are derived from the Tokyo Round Codes including: Subsidies and Countervailing Measures; Technical Barriers to Trade (Standards Code); Anti-Dumping; Import Licensing Procedures; Government Procurement; and Customs Valuation.
30 Hudec, supra note 15.
31 Ibid. at 20 – 21.
32 Pangestu, supra note 22.
implemented by most countries but at varying levels of openness. These events have affected different developing countries in varying ways. SDT has lost most of its lustre as an equalizing tool for poorer nations, provoking calls for reform instead in the multilateral system. As Hoekman et al. remark, “Many developing countries regard SDT provisions as being meaningless, while many developed countries regard them as bad economics and outdated.”

It is estimated that there are currently 155 SDT provisions in the WTO which range from preferred market access, dispensation from obligations, to financial support and technical assistance. The limitations and deficiencies of certain SDT provisions are examined in the following paragraphs.

3.1. Limitations of Preference Schemes

Several preferential schemes have enacted by developed countries expressly for the benefit of helping developing countries. The original scheme is called the Generalized System of Preferences (GSP). At present, there are thirteen national GSP schemes notified to the UNCTAD secretariat. There is also the African Growth and Opportunity Act (US) and the Everything But Arms Agreement (EU). Grossman and Sykes report that these tariff preferences have promoted trade volume and export earnings in preference-receiving countries and that the revenue gains have likely been ‘modest but not trivial’. Nevertheless, these benefits have been attenuated by several factors. First, compliance costs are high as beneficiaries are often required to source materials from specified countries due to restrictive rules of origin. EU schemes require direct shipment to the EU or specify that the goods must be supervised by

35 These are: Australia, Belarus, Bulgaria, Canada, Estonia, the European Union, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the United States of America. “About GSP”, online: UNCTAD <http://wwwunctadorgTemplatesPageaspintItemID=2309&lang=1>.
customs authorities in transit countries, ratcheting up costs for exporters.\textsuperscript{37} Second, many goods of export interest to developing countries are not captured by the various GSP schemes. Third, these preferences are unpredictable and also discriminate among countries as preferences may be withdrawn by the provider through its own system of ‘graduation’ or product exclusion.\textsuperscript{38} Epps and Trebilcock have noted the insecure nature of preferences, observing that higher income countries have been graduated out of programs, and that preferences have been made contingent upon conditions such as labour and human rights.\textsuperscript{39} Graduation is often implemented arbitrarily with countries withdrawing preferences for different countries at different times. Low points out, “By treating developing country status as a binary matter, developing countries have refused to engage in any discussion of graduation, and developed countries have largely maintained that any discussion of S&D will be unproductive as long as no differentiation is possible among developing countries at very different levels of development.”\textsuperscript{40} ‘Preference erosion’ also occurs whereby tariff rates are lowered via regional trade arrangements or the reduction in MFN rates which essentially devalues the worth of preferences under GSP. Fourth, preference schemes cause trade diversion from non-preference receiving countries to specified beneficiary countries. This may distort comparative advantage and is unlikely to benefit developing countries overall as the exports of some developing countries will be displaced by others.\textsuperscript{41}

According to Grossman and Sykes, all these factors have contributed to a decline in the utilization rate (the ratio of imports actually receiving preferential treatment to the total eligible imports
for various GSP schemes, reportedly, “less than 50 percent for the U.S. and European programs and barely more than 50 percent for Japan”.  

3.2. Disproportionately High Tariff Barriers – Market Access Problems

Products of export interest from developing countries encounter tariff rates that are much higher in both developed and developing countries alike. Wolf has noted that “In the U.S., 6.6 per cent of imports from developing countries are subject to tariffs over 15 per cent. The comparable figure for the EU is 4.9 per cent, for Canada 4.8 per cent and for Japan 2.8 per cent. While average tariffs on all manufactured imports into high-income countries are only 3 per cent, tariffs on labour-intensive manufactured imports from developing countries are 8 per cent and on imports of agricultural commodities from developing countries 14 per cent.” He goes on to point out that protectionism is also exhibited between developing countries by noting that “The average tariff applied by developing countries to their imports from other developing countries is more than three times higher than the average imposed by the high-income countries.”

Tariffs are also imposed disproportionately on processed items through a practice known as ‘tariff escalation’ or ‘tariff peaks’. For example, tariffs on fully processed food are 42 per cent (Canada), 65 per cent (Japan) and 24 per cent (EU). In comparison, the least processed products are subject to rates of 3, 35, and 15 per cent respectively in the aforementioned countries. As numerous authors

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42 Grossman & Sykes, supra note 36 at 275. This was sourced from UNCTAD (1981). See also an UNCTAD report in 2002 which states that the average utilization rate for Quad GSP rate of the Quad GSP schemes by LDCs does not, in many cases, reach 50 per cent of the value of their exports eligible for preferential access. “UNCTAD GSP Newsletter”, February 2002, online: UNCTAD <http://www.unctad.org/en/docs/poitcdtsbm65.en.pdf>.

43 Wolf, supra note 11 at 213.

44 Ibid.

45 Stiglitz & Charlton, supra note 3 at 51.

46 Ibid.
have remarked, this behaviour has impeded diversification of exports in the poorest countries by
discouraging those industries from processing raw materials before exporting.47

3.3. Impenetrability of the Agricultural Sector

The agriculture sector has consistently been the crux of controversy in free trade debates. Wolf
describes the treatment of this sector as ‘the greatest of all scandals’ for the staggering scale of
subsidies poured into assistance for rich country farmers48. Statistics are shocking. In 2008, total
assistance to OECD country farmers was US$265 billion49, more than twice the value of development aid
provided in the same year (US$119.8 billion)50. Stiglitz and Charlton note that farm subsidies in OECD
countries in 2003 account for 48 per cent of all farm production which have led to the suppression of
world prices for agricultural goods causing negative effects for poor farmers’ incomes and possible loss
of investment in countries whose trade is adversely affected by this support.51 The EU’s Common
Agriculture Policy (CAP) which provides subsidies and price support to European farmers to the tune of
approximately 43 billion euros annually (45.4 percent of the EU’s budget in 2006) is much maligned as
wasteful and disproportionate in light of the fact that only 1.6% of the EU’s GDP is generated by this
sector and only 5% of EU citizens are employed in agriculture.52

47 Collier, supra note 9, at 160; Stiglitz & Charlton, supra note 3 at 51.
48 Wolf, supra note 11 at 215.
49 “Agricultural Policies in OECD countries: Monitoring and Evaluation, 2009”, Organization for Economic Co-
50 “Development Aid at its Highest Level Ever in 2008”, Organization for Economic Co-operation and Development,
online: OECD <http://www.oecd.org/document/35/0,3343,fr_2649_34487_42458595_1_1_1_1,00.html>.
51 Stiglitz & Charlton, supra note 3 at 50.
52 “Q&A: Common Agriculture Policy” BBC News (20 November 2008), online: BBC News
Protectionist policies have also discouraged developing countries from attempting to develop their agricultural sectors by promoting industrialization. As described by Epps and Trebilcock\textsuperscript{53}, this has led to increased levels of rural poverty, worsened income distribution and increased unemployment.

3.4. “Best Endeavours” To Assist Clauses Not Binding

Many SDT provisions are known as “best endeavour” clauses as they are non-binding and couched in language that allows for voluntary, unenforceable action on the part of preference grantors. The clauses were drafted with the intent of helping governments build institutional capacity needed to implement WTO Agreements and ultimately increase participation in the multilateral trading system.\textsuperscript{54} For instance, the provision of technical assistance to developing countries has been enacted in such a manner. Article 12.3 of the Agreement on Technical Barriers to Trade (TBT) states that in the application of technical regulations, members shall “take account of the special development, financial and trade needs of developing country Members with a view to ensuring that [such regulations] do not create unnecessary obstacles to exports from developing country Members”. Kessie describes another example, Article 10(1) of the Agreement on Sanitary and Phytosanitary Measures (SPS) which stipulates that Members should “take account of the special needs of developing country members” when implementing SPS measures.\textsuperscript{55} The problem with these two provisions as Kessie argues, is that they only impose the duty to consider the impact of measures on developing countries but do not require developed Members to refrain from implementation or to withdraw measures when harm to developing countries can be demonstrated; “A duty to consider something cannot be equated with a duty to accept it.”\textsuperscript{56}

\textsuperscript{53} Epps & Trebilcock, \textit{supra} note 40.
\textsuperscript{55} Kessie, \textit{supra} note 20.
\textsuperscript{56} Ibid.
Keck and Low also cite Article XXXVII:3 of GATT which states that developed countries shall “give active consideration to the adoption of other measures designed to provide greater scope for the development of imports from less-developed contracting parties ...” and shall “have special regard to the trade interests of developing contracting parties when considering the application of other measures permitted under this Agreement to meet particular problems ...”. 57 This is criticized for its lack of legal force as again, the duty to consider does not impose any positive obligation to implement measures that are more advantageous to developing countries.

3.5. Trade-Related Aspects of Intellectual Property Rights (TRIPs)

The TRIPs agreement was introduced during the Uruguay Round, promoted by developed nations who wished to protect intellectual property-based industries, primarily pharmaceuticals and entertainment. 58 Protection of intellectual property rights here has been considered useful for developed nations but less appropriate for developing countries as it can ‘impede efforts to close the North-South knowledge gap’. 59 Further, access to lifesaving medicines have been prevented or made prohibitively expensive for developing countries as extended patent periods block generic drug manufacturers from producing the drugs needed. Recently, zealous implementation of TRIPs resulted in the seizure of a shipment of generic drugs manufactured in India by authorities in the Netherlands while in transit, en route to its final destination of Brazil. This led to criticisms that the measures were impinging upon national public health policies and that it was contrary to “the spirit of everything developing countries negotiated under TRIPS to get the flexibilities that would allow public health concerns of developing countries to be taken into consideration”. 60

57 Keck & Low, supra note 23 at 7.
59 Stiglitz & Charlton, supra note 3 at 51.
Even when it comes to the rights of developing countries towards their own resources, the intellectual property regime continues to engender unfairness. This relates to the problem of ‘bio-piracy’, a situation where developed country corporations claim ownership over the genetic resources, traditional medicines and knowledge of developing countries. Stiglitz notes that TRIPs did nothing to protect the intellectual property of the developing world, instead, ‘it gave U.S. and European corporate interests a license to steal their intellectual property – and then charge them for it’. Bio-piracy occurs when, for example, drug companies derive important knowledge about plant ingredients from examining traditional remedies and then patent these discoveries, thus securing the ‘legal right’ to control access to these resources. Efforts to overcome this problem have culminated in the Convention on Biological Diversity in 1993, but to date the United States remains one of the few countries that have not signed this convention.

3.6. Infant-Industry Protection Challenges

Many developing country governments have subsidized and protected infant industries in the hope that these industries will grow up to become competitive players on the global stage. This approach has not delivered in practice. As Sally observes of infant industry success,

“In east Asia, its record is mixed at best in Japan, South Korea, and Taiwan; nonexistent in free trade Hong Kong and Singapore; and failed in southeast Asia (e.g. national car policies in Malaysia and Indonesia). ... Finally, infant-industry protection in Latin America, south Asia and Africa has been a disaster not dissimilar to industrial planning in ex-command economies. Protected infants sooner or later ran into severe problems, and governments continued to subsidize and protect perpetual children. Such incestuous government-business links provided a fertile breeding ground for corruption. Besides, most developing-country markets are too small to support infant industry promotion, and their states are too weak, incompetent, and corrupt to efficiently administer the complex instruments required.”

Such protectionism is seldom beneficial for developing country consumers who are often forced to pay higher prices for substandard goods. As an example, the Malaysian government has provoked ire

61 Stiglitz, Making Globalization Work, supra note 1 at 125.
in its own citizens for a decades-long cossetting of its national car industry leading to exorbitant prices for imported vehicles. Public calls for dismantling the cloak of protectionism may soon inspire a change in policy as the government grapples with citizen discontent and competition for foreign investment from neighbouring Thailand which has now gained a reputation as the “Detroit of the East”.  

4. Proposals for Reform

4.1. Strengthening MFN Obligations

Proponents of this option argue that multilateral liberalization is the logical alternative to the SDT system and will create economic growth for developing countries. This approach suggests that developing countries should stop seeking preferences and move towards opening up their borders through reciprocal bargaining. In 1987, Hudec espoused the view that the MFN obligation is the only foundation appropriate for promoting market access for developing countries as the experience with preferential treatment for these countries have not been encouraging. He proposed that developed countries could use the ‘graduation’ doctrine to allow for some non-reciprocal benefits to developing countries but that ultimately, developing countries need to be the driving force behind MFN adoption.

Despite the passage of two decades since this argument was raised, the call to strengthen MFN is still heard among commentators today. Augmented market access has been described as the solution to problems of economic growth. Hoekman et al believe that GSP programmes for developing countries are of limited value and more sustainable gains can be obtained through MFN liberalization in areas of

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63 Hudec, supra note 15 at 232.

64 A system whereby preferences could be given to developing countries based on their varying levels of development in accordance with their capacities to make contributions or negotiate commitments. Keck and Low, supra note 23.

export interest for developing countries. These authors suggest that MFN-based market access will
have the greatest positive impact on development as special treatment for developed country industries
like agricultural export subsidies, textile import quotas and tariff peaks in footwear and apparel will be
removed. To facilitate this from a political perspective, developing countries would need to match
lowered barriers with reciprocal concessions in their own jurisdictions, that is, to reduce current tariff
bindings significantly. Hoekman et al. do not advocate the immediate elimination of preference
programs but state that preferences are not a long-term solution. They conclude that SDT should be
restricted to fewer countries in accordance with varying needs and differentiated eligibility criteria.

An emphasis on multilateral liberalization as the proposed catalyst for growth runs into the
problem of a ‘one-size-fits-all’ approach. Rapid and more liberalization may not be suitable to all
countries across the board as a myriad of factors impact on what will prove to be effective measures for
economic growth in an individual country, and whether some countries can even take advantage of
improved market access. Rodrik has contended that the speed at which developing countries are
expected to liberalize is inappropriate as they are deprived of the policy space needed to devise
individual paths out of poverty, and are expected to implement an agenda of reform that today’s
advanced countries accomplished over several generations. Hence, Rodrik argues for a shift in thinking
away from ‘market access’ to a ‘development’ mindset whereby the “trade regime is not evaluated from
the perspective of ‘whether it maximizes the flow of trade in goods and services’ but instead,
“developing countries have to articulate their needs not in terms of market access, but in terms of the
policy autonomy that will allow them to exercise institutional innovations that depart from prevailing

66 Hoekman et al., supra note 33 at 485.
70 Rodrik, supra note 10, at 240.
orthodoxies”. To illustrate his arguments, Rodrik compares the development of Latin American countries which followed the Washington Consensus method of liberalization, with dismal results, to several Asian countries such as China, Singapore, Taiwan and South Korea which grew impressively after pursuing policies deemed unorthodox and different from what Western-style laissez faire policies of the time recommended. Thus, Rodrik believes that growth is contingent upon a multitude of host country and external characteristics whereby effective domestic investment policies, strong domestic institutions, and the ability to combine these with gradually lowered barriers to imports and foreign investment make up the basic formula for success.

4.2. Unilateral Liberalization

Unilateral liberalization refers to the removal of trade barriers by a country without requiring any reciprocal concessions from other countries. In other words, countries that conduct unilateral liberalization will cut tariffs on imports without the need for reciprocal cuts in other countries. These tariff cuts however do not change the official bound rates that states are obliged to comply with and these bound rates will often stay at a higher figure unless modified through multilateral negotiations. This leads to a difference between ‘actual or applied rates’ and ‘bound rates’. In addition, unlike

71 Ibid. at 234.
72 Ibid. at 39-40.
73 Ibid. at 219-220.
74 Bound rates or binding tariffs represent commitments not to increase tariffs above the listed rates — the rates are “bound”. For developed countries, the bound rates are generally the rates actually charged. Most developing countries have bound the rates somewhat higher than the actual rates charged, so the bound rates serve as ceilings. Countries can break a commitment (i.e. raise a tariff above the bound rate), but only with difficulty. To do so they have to negotiate with the countries most concerned and that could result in compensation for trading partners’ loss of trade. Applied rates are the rates that governments actually charge on imports, which can be lower. “Tariffs: more bindings and closer to zero”, online: WTO <http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm2_e.htm#con>; and, “Get Tariff Data”, online: WTO <http://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm>.
multilateral liberalization where tariffs are set at the same rate for all WTO members, countries can unilaterally lower tariffs in a discriminatory fashion for selected partners.  

The experience of developing countries that have unilaterally liberalized trade may indicate to some extent that this could bring more benefits in comparison with relying heavily on SDT provisions. Sally has highlighted the practices of China and India which both opened their borders unilaterally as evidence for the following rationale:

“Compelling political and economic arguments favour unilateral liberalization, with governments freeing up international trade and flows of capital and labor independently, not in the first instance via international negotiations. As any student of trade economics knows, welfare gains result directly from import liberalization, which replaces comparatively costly domestic production and reallocates resources more efficiently. It also spurs capital accumulation and economies of scale, as well as longer-run dynamic gains such as the transfer of technology and skills. Among its many benefits, import liberalization provides cheaper inputs and reallocates resources to promising export sectors.”

Sally also describes the experience of multilateral liberalization as ‘spectacularly unsuccessful in the WTO’ due to the organization’s large and unwieldy agenda; the chaotic style of decision-making; and the lack of the military alliances of the cold war which was previously the adhesive which brought like-minded countries together.

The difficulty with unilateral liberalization is that it is often difficult to acquire domestic support for a scheme where there is no readily apparent quid pro quo. It is performed on a discretionary basis and the liberalizing country may decide at any time to retreat behind protectionist policies that it is

75 For example, the tariffs that the United States applies to products from some of the very poorest countries, like Bangladesh, Cambodia, and Sri Lanka range from 15.7-16.1%; for India, Pakistan, Indonesia and Vietnam the range is 11-14%. But it is only 1-2.5% for products from rich countries like Norway, Canada, The Netherlands, and the United Kingdom. Trineesh Biswas, “The Doha Round Negotiations on Non-Agricultural Market Access: An Overview”, (2007) online: German Marshall Fund of the United States <http://www.gmfus.org/doc/economics/The%20Doha%20Round%20Negotiations%20on%20NAMA,%20An%20Overview%20-%20Trineesh%20Biswas.pdf>

76 Sally, supra note 12 at 93.

77 Ibid. at 45.
entitled to under SDT. This could cause uncertainty in global markets and prove to be a disincentive to foreign investment if government decision-making is considered to be unpredictable. In addition, it does not solve the pressing problem of market access experienced by developing countries. However, it could be argued that unilateral liberalization may well be a precursor to improved multilateral commitments as seen in the example of China which reduced trade barriers dramatically since 1994, before it acceded to the WTO in 2001.\footnote{Ibid. at 102-103.} It is noted by Sally that China’s trade commitments exceed those of other developing countries by a wide margin and are almost as strong as those of developed countries.\footnote{Ibid. at 104.} Nevertheless, China is an extremely unique nation. Most developing countries do not have the comparative advantages (such as labour and production efficiencies) possessed by China and will likely not benefit greatly through unilateral liberalization if there are no accompanying methods to boost economic growth.

4.3. Improving SDT within the WTO Framework

Although SDT as it stands today suffers from many deficiencies, proponents of this approach insist that SDT is essential for developing countries, citing the need for developing countries to correct market failures (such as price uncertainties, inefficiencies due to imperfect competition, and varying learning costs) via some protectionism, as rich countries historically have done. The process of liberalization entails high implementation and adjustment costs in developing countries where “employment rates are likely to be higher, safety nets weaker, and risk markets poorer”\footnote{Stiglitz & Charlton, supra note 3 at 71.} leading to a need for time and space to accommodate these costs. While Stiglitz shares Rodrik’s opinion that trade liberalization does not automatically lead to more trade and growth, Stiglitz has charted another path to solving growth problems; he has proposed that rich countries should open up their markets to poorer countries without reciprocity and preferential treatment should move from being voluntary (as it is

today) to becoming a requirement. As such, SDT is recognized as playing an important role in enhancing trade, but needs to be reformed and enhanced to make commitments stronger and weak clauses binding upon developed nations.

In this vein, Stiglitz and Charlton have constructed a ‘Doha Market Access Proposal’ (MAP) where it is proposed that each country should provide free market access in all goods to all developing countries poorer than themselves. In addition, Hoekman et al. contend that current country groupings should be renegotiated and an “LDC+” group (Least Developed Countries) of the poorest developing countries would identify those countries in real need of SDT in order to alleviate the problem of arbitrary distinctions between countries. This classification should then be made broadly applicable across disciplines where there are substantial implementation issues.

The suggestion of renegotiating country groupings has not found favour with Keck and Low. These writers argue that this approach will still make the same group of countries eligible for SDT across all agreements and that eligibility for the scheme will still be subject to discretionary decision-making by members, hence maintaining the current elements of arbitrariness. Keck and Low believe that categorizing countries into groups according to developmental levels is unrealistic as the more advanced developing countries would fear subjection to more extensive demands in negotiations by virtue of their new categorizations. Instead, SDT should be reformed by creating threshold criteria that allow access to SDT on a provision-specific basis such as percentage of share in world agricultural exports. This proposal, although theoretically engaging, suffers from the problem that Keck and Low have self-identified – the challenge of defining analytical criteria that correspond to specific SDT concerns and are

81 Stiglitz, Making Globalization Work, supra note 1 at 82-83.
82 Stiglitz & Charlton, supra note 3 at 94.
83 Hoekman et al., supra note 33 at 493.
84 Ibid. at 494.
85 Keck & Low, supra note 23 at 25.
86 Ibid.
measurable with existing data. In my opinion, the myriad of variables involved in creating these criteria would render the exercise fruitless. With the rapid changes in today’s economic climate, studies would probably not be able to keep up to date with the current circumstances of each affected country.

The SDT pledge to provide technical assistance to developing countries in enforcing WTO obligations in areas such as sanitary and phytosanitary measures, lacks enforceability and requires only the undefined ‘best endeavours’ of developed countries. Calls for this to be made obligatory underscore the important point that lowering tariff barriers is not sufficient to promote trade. If the poorer country is not able to comply with high technical requirements such as health standards of industrialized countries, this ends up being another type of trade barrier.

The difficulty in SDT reform is apparent. The challenges go further as the situation for developing countries has been exacerbated by measures outside of the SDT framework. Many non-tariff barriers (NTBs) are outside the scope of SDT, and the Anti-Dumping Agreement (ADA) which does contain a provision for special treatment is couched in ineffective language. Article 15 of the ADA reads:

“It is recognized that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti dumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying anti dumping duties where they would affect the essential interests of developing country Members.”

This Article does not compel developed countries to make decisions that will assist developing countries in real terms. The suggestion of ‘special regard to special situations’ is subjective and easily ignored without repercussions. As Stiglitz observes, the reduction of tariffs does not eliminate protectionist sentiments but instead morphs into NTBs such as dumping duties, safeguards, technical barriers or rules of origin that have been repeatedly used and abused by the United States and other

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87 Ibid. at 27.
88 Stiglitz, Making Globalization Work, supra note 1 at 90-96.
advanced countries. As a result of this conundrum, I argue that reform of SDT alone will not be enough
to ensure a level playing field for developing countries.

The Doha Development Round which commenced in 2001 was ostensibly tasked with a
‘Development Agenda’. Among the stated objectives in the Doha Ministerial Declaration was a provision
for SDT reform as follows: “We reaffirm that provisions for special and differential treatment are an
integral part of the WTO Agreements. We note the concerns expressed regarding their operation in
addressing specific constraints faced by developing countries, particularly least-developed countries. [...] We therefore agree that all special and differential treatment provisions shall be reviewed with a view to
strengthening them and making them more precise, effective and operational.”89 Doha has now been
considered a failed endeavour by some90, or at best stalled after a breakdown in negotiations occurred
in 2008 over disagreements related to rich country agricultural subsidies and the proposed special
safeguard mechanism (SSM). Negotiations reached an impasse when India stood firm on its demands for
the right to raise tariffs to a level it deemed necessary to protect Indian farmers from import surges. The
US was concerned that this freedom of action could lead tariffs being raised beyond those agreed to
during the Uruguay Round, thus signifying a retreat from hard-won liberalization gains in agriculture.91
At the same time, the US refused to reduce subsidies for American farmers, a significant bone of
contention for China and India. Recent efforts regards to ameliorate the problem of US subsidies have
not met with success due to domestic political pressures. In 2009, when President Obama attempted to

89 See Article 44, Doha WTO Ministerial 2001: Ministerial Declaration, 20 November 2001, online: World Trade
90 Stiglitz, Making Globalization Work, supra note 1 at 81; Bronwen Maddox, “No Comfort in the Doha Failure”, The
Times, July 31, 2008, online: The Times Online.<http://www.timesonline.co.uk/tol/comment/columnists/bro
wen_maddox/article4432276.ece>; Mario Osava, “Doha Failure ‘A Triumph of Protectionism’ says Trade Sources” Inter Press Services News Agency (July 30, 2008)
91 Robert E. Baldwin, “The Botched Doha Round Negotiations on a Special Safeguard Mechanism” March 11, 2009,
limit US farming subsidies, these efforts died from a lack of support in both the White House and Senate.\textsuperscript{92}

It is clear that for the foreseeable future, agreement on significant issues between powerful developing countries like India and China, and the United States, is highly improbable. As history chronicles, economic success as exemplified by the Asian Tigers has never been dependent on orthodoxy. Since the 1990s, countries in the Asian region have been energetically pursuing free trade agreements, perhaps playing catch up with their European and American counterparts. It can be argued generally that these countries are keen for alternatives or complements to the multilateral system.

4.4. Participating in Regional Trading Arrangements

Access to markets is important but a host of other elements must be present to ensure that access properly translates into growth. In the nineteenth century, countries with low tariffs (e.g. Britain) grew slowly while others (US, Canada, Argentina) imposed high tariffs and grew rapidly. This generally indicates that more MFN or unilateral liberalization may not achieve more growth. As Irwin argues, no country has ever achieved success by bypassing stages of protectionism and all successful countries today have liberalized in gradual stages.\textsuperscript{93} Compelling arguments have been made by Rodrik, Unger, Bhagwati, among others for a shift in how we perceive trade.\textsuperscript{94} This perspective which asks us to see trade as a means to an end and not as the end itself is worth exploring seriously as many of the proposals for reform outlined in the previous pages suffer from intractable challenges.

Given the problems manifested by the multilateral system status quo and difficulties with unilateral liberalization, and reform of the special and differential treatment provisions, I suggest that an


\textsuperscript{93}Irwin, “Trade and Development”, \textit{supra} note 2.

alternative is required. I propose that participating in a regional trading arrangement can be a useful step forward in achieving growth via gradual liberalization. It is acknowledged that regional trading arrangements have been the brunt of many serious academic critiques for their perceived role in causing trade diversion. Nevertheless, I raise this option as a potentially promising approach – one that will seek to incorporate solutions to concerns outlined in this chapter and structure arrangements in a way that encourages trade creation in a way without engendering diversionary effects. A detailed analysis of regional trade agreements is conducted in the next two chapters which discuss existing trade arrangements and the individual needs of the East Asian region.

4 Summary

Despite the ostensible objectives of SDT to assist developing countries, numerous difficulties with the SDT scheme and the nature of the multilateral trading system as a whole continue to pose obstacles for developing countries. Preference schemes enacted by developed nations for the purpose of aiding poorer nations have not been significantly utilized due to limitations such as high compliance costs, non-inclusion of goods of product interest, and the insecure nature of preferences. Products of export interest to developing countries encounter high tariff rates, impeding the diversification of exports. The agricultural sector is impenetrable to poorer nations due to massive amounts of subsidies provided to rich country producers which have led to the suppression of world prices for agricultural goods. Many SDT provisions are not binding and impose no obligations upon developed countries to assist developing countries. TRIPs has resulted in disadvantages for developing countries vis-à-vis access to important medicines and further engendered unfairness by failing to address the problem of bio-piracy. Infant industry policies have impeded growth in some industries instead of promoting them to internationally competitive levels.

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95 Trade diversion occurs when a trade union redirects trade from lower-cost outside suppliers to within-union suppliers because of trade preferences given to union members. This issue is reviewed more extensively in Chapter II of this thesis.
Various proposals for reform have been advanced, ranging from the strengthening of MFN obligations for all WTO members to improving SDT within the WTO framework. I have argued that the challenges inherent in most of these options render them infeasible in many ways. As an alternative, I propose that developing countries may benefit from participation in an appropriately structured regional trading arrangement.
CHAPTER II: REGIONALISM AS A COMPLEMENT TO MULTILATERALISM

1 Historical Overview of Regional Trade Agreements

1.1 Different Levels of Regional Integration

A Regional Trade Agreement (RTA) is the generic term for a trade agreement outside the multilateral system between two or more countries. Regionalism thus refers to the activity of entering into RTAs. Despite the term ‘regional’, the parameters of RTAs are not limited to any specific geographic region and do often cross continents. Generally speaking, RTAs are preferential trade arrangements that favour their members by reducing trade barriers below the level of reduction under the multilateral system. There are four main forms of RTAs which differ depending on their particular features and depth of integration.

According to categories established by Balassa, regional integration starts first with a basic FTA in which tariffs and quotas are abolished for imports from within the area, such as NAFTA which is essentially an FTA with a few additional features. In this structure, member states eliminate internal trade barriers and tariffs between themselves but are allowed to pursue its own trade policy towards non-members of the RTA. This usually results in different external tariffs and measures for foreign goods and in each member state. As such, foreign exporters may try to overcome discrimination towards their products by using the member state with the lowest protection levels as an entry point into the region. In order to prevent this, FTAs will use rules of origin (ROO) to distinguish between products originating from member states and those which are sourced externally. ROOs are notoriously

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convoluted as they comprise a myriad of criteria utilized in determining origin. The complexity is further exacerbated by the fact that ROOs overlap and differ among the criss-crossing RTAs which exist today.

The second level of integration is a customs union (CU) which is an arrangement that abolishes both internal barriers between members and creates a common external tariff.\textsuperscript{99} Free trade agreements or customs unions are derogations from the MFN principle, permissible via Article XXIV of GATT\textsuperscript{100}.

Certain conditions have to be met in order for arrangements to constitute an FTA or CU. For a free trade area (or interim agreement leading to one), duties and other restrictive regulations imposed on non-free trade area members may not be higher than they were before integration, or the interim agreement.\textsuperscript{101} Within the free trade area itself, duties and restrictive regulations must be eliminated on ‘substantially all trade’ (Article XXIV:8(b)). For a CU, duties and restrictive regulations must not ‘on the whole be higher’ or more restrictive than they were before integration (Article XXIV:5(a)). Further, duties and other restrictive regulations must be eliminated on ‘substantially all the trade’ within the CU.\textsuperscript{102} For FTAs which comprise only developing countries, the rigours of Article XXIV can be bypassed under the 1979 Enabling Clause. More specifically, the Enabling Clause does not impose the requirement of eliminating barriers on “substantially all trade” on FTAs comprised only of developing countries (as per the standard for normal FTAs under Article XXIV. Its formulation of the external requirement is also weaker\textsuperscript{103}, allowing developing country RTAs to institute preferential tariffs as long as this does not “create undue difficulties” for other WTO members, or “constitute an impediment to tariff reduction or elimination on a MFN basis” (instead of the normal requirement for a common external tariff for CUs under Article XXIV).

\textsuperscript{99} Trachtman, supra note 97 at 4.
\textsuperscript{100} General Agreement on Tariffs and Trade, 30 October 1947, 58 U.N.T.S. 187, Can. T.S. 1947 No. 27 [GATT]. Article XXIV allows for the formation of a custom union, free trade area, or an interim agreement leading to one of the two. (Trebilcock and Howse, supra note 14 at 199.)
\textsuperscript{101} GATT, ibid. Article XXIV:5(b), Trebilcock and Howse, supra note 14 at 199.
\textsuperscript{102} Trebilcock and Howse, supra note 14 at 199.
\textsuperscript{103} Trachtman, supra note 97 at 19.
The third stage of economic integration is a common market (CM) which is deeper than a CU as it requires removal of barriers to movement of factors of production, namely capital and labour in addition to goods and services. Finally, an economic union will include some degree of harmonization of economic policy and subsequently unification of monetary, fiscal and social policy together with a supranational authority that can bind member states. The ‘gold standard’ today for regional integration is the European Union for its high level of coordination in policy, international relations, intra-region governance, and the freedom of movement of goods, services, labor and capital. The EU is however still an imperfect economic union as not all its member states have adopted its single currency (the euro) and the harmonization of its fiscal policy and government expenditure is also incomplete.

1.2 The Rise of Regionalism

Prior to the 1980s, effective RTAs were confined to two arrangements in Western Europe: the European Community (EC) and European Free Trade Area (EFTA). The US was strongly committed to the multilateral process and even publicly denounced bilateral arrangements for their role in restricting international trade in the postwar setting. This changed after 1982 when the EC (considered the originator of the RTA ‘pandemic’ by Bhagwati) refused to go along with multilateralism. Consequently, the US went on to conclude an FTA with Israel in 1985 and Canada in 1989. The US-Canada FTA later evolved into the North American Free Trade Agreement (NAFTA) in 1994 with Mexico included as a member. In the meantime, the EC, now renamed the European Union (EU), continued its expansion

104 ibid. at 4.
105 ibid.
106 ibid. at 3-4.
107 Perdikis, supra note 98 at 108.
110 Panagariya, supra note 108 at 7.
across the region and currently comprises twenty-seven member nations. Until the 1990s, the East Asian region refrained from RTA activity but is now playing catch-up with RTAs spreading ‘like wildfire’ in the past six years.111 Some have argued that this was sparked by the 1997 Asian financial crisis while others believe that a ‘domino effect’ was engendered by China’s WTO membership.112 Interestingly, these mostly bilateral FTAs in East Asia involve partners from all corners of the globe and have not been confined to the East Asian region. This transcontinental preference has been called ‘permeated regionalism’ by Katada et al.113 Asia’s experience in regionalism is explored in greater depth in Chapter III.

Today, there is a cumulative total of over 350 RTAs reported to the WTO114 and approximately 180 still in force. Only Mongolia does not belong to any RTA.

2 Why Do Countries Join RTAs?

2.1 Increased Market Access

Countries form RTAs among themselves for both economic and political reasons. The most common rationale is that countries are motivated principally by the “traditional trade gains” argument115. In other words, there is a prospect of increased market access for members’ own exports due to preferential tariff rates which favour goods from members of the RTA. Countries which decide to join RTAs in the early stages of union formation can acquire ‘first-mover advantages’, in that they are able to gain an edge in new markets and attract foreign investment116. This early participation leads to long-term benefits as companies will have made significant investments within the first-mover countries.

111 Sally, supra note 12 at 75.
113 Saori N. Katada & Mireya Solis, eds., Cross-Regional Trade Agreements: Understanding Permeated Regionalism in East Asia (Berlin: Springer, 2008).
Conversely, failure to grasp new opportunities can result in a country remaining outside the web of agreements and the ‘economic insider’ benefits that they confer. Related to that, it has been said that a large number of participants within the WTO has made trade negotiations harder and more complex. This is due to the sheer number of countries and their extreme divergences in economic development, as noted by Mathis who has argued that the severely uneven distribution of wealth among members make it difficult to agree on controversial issues in the multilateral framework, unlike the case where countries negotiate with economically compatible partners.

2.2 Defence Against Erosion of Market Access

From a more defensive stance, RTAs may also be formed by countries as a reaction to other RTAs. Estevadeordal et al. note, “Under Baldwin’s (1993, 2006) domino theory, the proliferation of trade agreements gives outsiders incentives to form new RTAs or to join existing ones, lest they see their market access erode. A complementary theory of competitive liberalization holds that especially developing countries are in a race for RTAs as tools to capture investment (Bergsten, 1997).”

RTAs may also provide flexibilities in arrangements which are not available in multilateral agreements. For example, Canada and Chile have agreed not to impose anti-dumping duties on products originating in either country, thus allowing for greater certainty of market access. In addition, NAFTA allows for private party investors to submit complaints of investment violations within the RTA and participate in binding arbitration. This ability for private parties to have standing in dispute settlement is a markedly different approach from that taken in WTO proceedings which allows only

\[\text{\textsuperscript{117} Ibid.}\]
\[\text{\textsuperscript{118} James H. Mathis, \textit{Regional Trade Agreements in the GATT/WTO} (The Hague: Asser Press, 2002), as cited in Nsour, \textit{supra} note 96 at 363.}\]
\[\text{\textsuperscript{119} Ibid.}\]
\[\text{\textsuperscript{120} Estevadeordal & Suominen, \textit{supra} note 116 at 12.}\]
\[\text{\textsuperscript{122} See NAFTA Chapter 11, \textit{Section B – Settlement of Disputes Between a Party and an Investor of Another Party}.}\]
governments to participate in disputes (with only narrow exceptions of *amicus curiae* provisions for interested private parties like NGOs).

### 2.3 Increased Bargaining Power in Multilateral Negotiations and Larger Regional Arrangements

Within the framework of a multilateral negotiating agenda, countries may also view RTAs as a way to form trading blocs with common interests in order to increase bargaining power vis-à-vis third countries. The objective of increasing bargaining power, specifically against the US, is considered one of the motivations which spurred the formation of the European Economic Community (EEC) in the late 1950s. It has been said that it was the creation of the EEC that propelled GATT negotiations. The United States initiated three negotiation rounds from 1959–1979 as it sought to deal with issues of access to a unified European market which had common external barriers. The need for bargaining power in negotiations is not limited to the multilateral scenario. Increase in bargaining power has also been outlined as a reason for the formation of MERCOSUR (Southern Common Market) among several Latin American countries with the objective of gaining more leverage in accession negotiations in NAFTA. Although the actual formation of RTAs may serve to increase bargaining power, it has been observed by Whalley that the mere threat of countries seeking to use regional agreements if multilateral negotiations prove unsuccessful has been employed as a tactic to influence the outcome of multilateral negotiations. For example, during the Uruguay Round, it was widely thought that the United States could threaten or play the bilateral card, and engage in active discussions with prospective regional partners in order to deal with recalcitrant multilateral trading partners.

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124 Whalley, *supra* note 115 at 72.
125 *Ibid*.
126 *Ibid*.
prove to be protracted or unsatisfactory, then regional negotiations would be initiated as an alternative to fall back on.

2.4 Strengthening Domestic Policy Reforms

Another reason why countries seek out RTAs is because this may a way to underpin domestic policy reforms and make them more secure.\textsuperscript{129} By binding a certain policy directly with the exigencies of an international trade treaty, domestic governments are better positioned to ensure that these policies remain in place. For example, Whalley observes that Mexico’s intent in pursuing NAFTA was focused on achieving domestic policy reform and not trade purposes.\textsuperscript{130} This led to an uneven bargaining position for Mexico who ended up making unilateral concessions.

2.5 Enhancing National and Regional Security

Countries which integrate economically are less likely to engage in war with each other as this would cause mutual detriment. The prevention of war was a prominent objective in early European integration in the 1950s espousing the logic that an RTA that produced increased trade flows between Germany and France would help prevent a fresh outbreak of European war and provide a foundation of security arrangements among the integrating countries\textsuperscript{131}.

2.6 Hegemonic Motivations

The “hegemonic motivation” covers both the economic and political spheres. To some extent, it relates to the rationales already discussed above but is distinguished by the specific desire of a country to be aligned with a global hegemon or to retain its own hegemonic status. It has been observed by Bhagwati that developing countries sometimes form RTAs with a hegemonic power for various

\textsuperscript{129} Ibid. at 71.
\textsuperscript{130} Ibid. at 71 – 72.
\textsuperscript{131} Ibid. at 73.
reasons. First, for the sake of protecting itself from another rising power, it may be wise for a smaller country to keep a hegemon like the United States close to its side (e.g. the example of Singapore protecting itself from China). Second, a RTA with a hegemon may provide credibility that the smaller country’s economic reforms will stay in place, thus attracting more capital. Third, the fear of trade diversion leads some developing countries to jump on the bandwagon when a hegemon is actively signing RTAs with others. Fourth, a hegemon may feel threatened by other emerging hegemons as shown by the US expansion of RTAs in parallel with the EU’s broadening membership. Recently, the US has been urging a Free Trade Area of the Asia Pacific (APEC) which knits together dynamic Asian nations with several powerful Western nations for similar reasons. Finally, hegemons sometimes favour the formation of RTAs over the multilateral route as it may allow for the advancement of agendas often considered unrelated to trade, such as intellectual property, labour laws, and environmental issues, by creating provisions in RTAs which oblige parties to adhere to onerous requirements.

3 Are RTAs Stumbling Blocks or Building Blocks To Multilateral Trade Liberalization?

3.1 Trade Diversion

In 1950, Jacob Viner first observed two diametrically opposing effects that could occur from the formation of a RTA. Viner noted that as RTAs liberalize trade in a preferential manner, on the one hand, they “create” new trade between union members while, on the other, they “divert” trade from lower-cost or more efficient outside suppliers to within-union suppliers. In other words, trade creation would result from a shift in production from a high-cost member to a low-cost member of an

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132 Bhagwati, supra note 114 at 44.
133 Ibid.
134 Ibid.
135 Ibid. at 45.
136 Ibid.
137 Ibid.
139 Panagariya, supra note 108 at 9.
RTA, and trade diversion from a redirection of imports from a low-cost non-member to a high-cost member of an RTA.\textsuperscript{140} As this thesis concurs with the argument that multilateral free trade should be the ultimate goal of all countries when optimal conditions exist, the question concerning RTAs is whether the trade creation effects can lead to improved multilateralism, or whether the potential diversionary tendencies and other concerns will undermine ongoing multilateral efforts. In recent times, this issue has taken centre stage in the question of whether RTAs are stumbling blocks or building blocks towards multilateral liberalisation.

The potential for RTAs to cause trade diversion is a serious concern that is acknowledged in this thesis. This phenomenon can stem from the preferences given by RTAs in a variety of ways. First, as observed by Bhagwati, competition in most industries is fierce today and there are few countries that possess ‘thick’ or significant margins of comparative advantage\textsuperscript{141}. As such, any preference on tariff rates, even if it is small can cause trade diversion. Second, even if preferences today do not lead to trade diversion, preferences may cause countries to lose their comparative advantage to close rivals\textsuperscript{142}. In that event, countries which have acquired comparative advantage in a variety of products as a result of preferences will benefit from the redirection of trade in their favour. Third, although a precaution is built into Article XXIV whereby members of a union may not raise their external tariffs to avoid harming non-members, tariffs may still be legitimately raised from actual levels up to bound levels without breaching this Article. To illustrate, Bhagwati gives the example of the Mexican peso crisis where Mexico raised external tariffs significantly on many imports from countries with whom it did not share a trade agreement, while preferential tariff reductions for U.S. and Canadian goods remained in place\textsuperscript{143}.

\textsuperscript{140} Sally, supra note 12 at 76.
\textsuperscript{141} Bhagwati, supra note 114 at 52.
\textsuperscript{142} ibid. at 52 – 53.
\textsuperscript{143} ibid. at 53.
Last, and perhaps the most crucial factor of trade diversion is the issue of rules of origin. These rules which prescribe determinations of origin for tariff imposition purposes exist in every trade agreement. It is the mechanism which establishes whether a given good is genuinely eligible for the preferential reduction or exemption from customs duties conferred by the RTA arrangements 144. Although rules of origin are fashioned by RTAs to bestow preferences upon goods originating from regional members, these rules are often complex and overlap or differentiate between themselves. Rules of origin typically contain product content or value-added requirements. For example, an RTA may stipulate that a product will qualify for duty-free movement within the region only if a specified proportion of its value-added has originated within the RTA or if the product has undergone a ‘substantial transformation’ in a country before being permitted to move across borders within the RTA free of duty 145. Such criteria for determining origin often contain inherent ambiguities that may lead to arbitrary or unpredictable decisions. Where a rule stipulates that the domestic content of a good must be no less than a certain proportion of the value of the final product, it runs into the difficulty of an endless regression into the product chain to determine where components and materials may have originated from 146. This is sometimes an impossible endeavour as goods can comprise raw materials and inputs from an array of countries that may or may not form part of the union. Bhagwati gives the example of a trade dispute between the United States and Canada where the United States refused to certify Hondas produced in Ontario as “North American” and therefore eligible for duty-free status as it did not allegedly meet the local content requirement of more than 50 percent imposed by CUFTA. By Honda’s own calculations, the content requirements were met 147. Thus, Bhagwati’s argument that there

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145 Panagariya, supra note 108 at 17.
146 Bhagwati, supra note 114 at 67.
147 Ibid. at 68.
is “no surefire, analytically respectable way to determine the truth” captures the confusion that rules of origin, or the application thereof, cause to the trading system.\footnote{Ibid.}

In addition, rules of origin which proliferate in tandem with the growing number of RTAs today lead to a criss-crossing and overlapping ‘spaghetti bowl’ of classifications, requirements, and valuation methods. Even minor differences in rules of origin can increase business costs. As a result, producers will tend to invest in countries within a certain RTA in order to take advantage of rules of origin or to circumvent the additional costs of not producing goods that do not originate from within the union. This can have the effect of diverting trade from a more efficient non-member country to a less efficient member country. Rules of origin are also susceptible to manipulation for protectionist purposes. For example, the ‘triple transformation’ rule used by the United States with respect to Mexican textiles and apparel extends preferential treatment to Mexican exports of apparel only if the raw material has been transformed into thread, the thread into cloth, and the cloth into a garment, all within the free trade area.\footnote{Anne O. Krueger, “Problems with Overlapping Free Trade Areas”, in Takatoshi Ito & Anne O. Krueger, eds., \textit{Regionalism versus Multilateral Trade Arrangements}, (Chicago: The University of Chicago Press, 1997) at 14.} Consequently, the United States’ protection of its textile industry is extended into Mexico as Mexican producers may now find it more advantageous to purchase textiles from the United States in order to qualify for duty-free entry into the U.S. market.\footnote{Ibid. at 16.}

Whenever complicated rules of origin exist, the costs of producers or exporters will increase as they attempt to comply with the documentation and valuation requirements. Krueger estimates that when producers from European Free Trade Association (EFTA) countries provided documentation on origin to enter EU markets duty-free, the costs of providing the documents were the equivalent of 3 – 5 per cent of the cost of the goods.\footnote{Ibid. at 14 – 15.} Other results show that compliance costs with NAFTA rules of origin
are around 6 percent of the value of goods traded\textsuperscript{152} and the perceived cost of compliance with ASEAN rules is approximately 5.2 percent of the value of goods.\textsuperscript{153} This has led to some producers choosing on occasion to pay the duties rather than provide the necessary documents to establish origin.\textsuperscript{154}

### 3.2 Trade Creation

From the opposite end of this debate, trade creation is often touted as a positive outcome of RTAs and chief among the reasons propelling countries towards these agreements. In general, trade creation means that an RTA creates trade that would not have existed otherwise.\textsuperscript{155} In other words, because of tariff elimination in the newly created free trade area or union, the price of goods of relevant member countries (producers) will become lower. As such, other countries within the union will now import from these producer countries and new trade flows are created between these countries that did not exist before the formation of the union. It follows that the effect of trade creation is to generate welfare enhancement for the participating countries.

An alternative perspective of the relationship between RTAs and multilateralism advanced by Reich\textsuperscript{156} is premised upon the principle of “subsidiarity”, as conceptualized in European Union law. Reich argues that the subsidiarity principle which dictates that actions should be taken on less centralized levels where possible, could be more effective than the current regime based on GATT Article XXIV.\textsuperscript{157} This is because regional agreements are ‘more sensitive to the particular needs of states and allow


\textsuperscript{153} This is not a direct measure but was based on a survey of Japanese exporters. Real costs are expected to be higher. Erlinda M. Medalla & Jenny Balboa, “ASEAN Rules of Origin: Lessons and Recommendations for Best Practice” (2009) ERIA Discussion Paper Series, ERIA-DP-2009-17, Philippine Institute for Development Studies at 30.

\textsuperscript{154} Krueger, supra note 149 at 16.

\textsuperscript{155} Steven M. Suranovic, “Trade Diversion and Trade Creation” online: The International Economics Study Center <http://internationalecon.com/Trade/Tch110/T110-2A.php>


\textsuperscript{157} Ibid.
decisions to be taken on a level closer to the people’.\footnote{158} Casting the concept of multilateralism in an entirely different light, Reich opines that by applying a subsidiarity approach to trade agreements, this could justify ‘making bilateral arrangements the default and engaging multilateralism only where goals could not be attained on a regional or bilateral basis’.\footnote{159} Although this thesis does not adopt the subsidiarity approach, Reich’s argument has been noted as an example of how RTAs may not always be characterized as trade diverting.

Bhagwati and Panagariya, among others, have argued forcefully that despite any expansion effects of RTAs, there will be accompanying harmful and worrisome effects of trade diversion which outweigh any trade creation engendered. Panagariya posits that because uncompetitive industries are usually the ones that succeed in lobbying against foreign competition, RTAs are formed ‘precisely when trade diversion is the dominant force’.\footnote{160}

Although the potential problems and disadvantages of existing RTAs are acknowledged from the outset, the question of whether RTAs are trade creating or diverting \textit{per se} may be too simplistic without taking into account the myriad of ways that these agreements can be shaped. There is a wide diversity in content and form between RTAs among both developing and industrialized countries. Differences commonly exist on issues such as quantitative restrictions, positive or negative list approaches\footnote{161}, rules

\begin{itemize}
\item \textbf{Positive list approach:} The voluntary inclusion of a designated number of sectors in a national schedule indicating what type of access and what type of treatment for each sector and for each mode of supply a country is prepared to contractually offer service suppliers from other countries.
\item \textbf{Negative list approach:} The comprehensive inclusion of all service sectors, unless otherwise specified in the list of reservations, under the specific disciplines of the services chapter and the general disciplines of the trade agreement. A negative list approach requires that discriminatory measures affecting all included sectors be liberalized unless specific measures are set out in the list of reservations.
\end{itemize}

\footnote{158}{\textit{Ibid.} at 286.}\footnote{159}{\textit{Ibid.}}\footnote{160}{Panagariya, \textit{supra} note 108 at 14.}\footnote{161}{\textit{Positive list approach:}} The voluntary inclusion of a designated number of sectors in a national schedule indicating what type of access and what type of treatment for each sector and for each mode of supply a country is prepared to contractually offer service suppliers from other countries. \textit{Negative list approach:} The comprehensive inclusion of all service sectors, unless otherwise specified in the list of reservations, under the specific disciplines of the services chapter and the general disciplines of the trade agreement. A negative list approach requires that discriminatory measures affecting all included sectors be liberalized unless specific measures are set out in the list of reservations. “Dictionary of Trade Terms” online: SICE Foreign Trade Information System. <http://www.sice.oas.org/dictionary/SV_e.asp>
of origin, external tariffs, timetables for liberalization, trade in services, movement of labour and capital, and promotion of trade objectives.\textsuperscript{162}

In the most encompassing global study of RTAs to date, covering over a hundred RTAs and 155 countries over the period 1981 – 2001, Estevadeordal and Suominen have concluded that whereas RTAs help create trade, restrictive rules of origin in them dampen their trade-creating potential.\textsuperscript{163} The authors point out that different provisions within RTAs can lead to different trade effects as tariff lowering and the liberalization of services and investment tend to weigh in favour of trade creation while restrictive rules of origin tend to pull in the direction of trade diversion\textsuperscript{164}. Numerous studies including those by Laird, Schiff, and Rutherford and Martinez have demonstrated that RTAs can be welfare enhancing under certain conditions.\textsuperscript{165} According to an analysis by Das, when RTAs are welfare enhancing, welfare gains are higher (1) the higher the trade barriers being reduced, (2) the higher the share of pre-existing trade between the partners, (3) the larger the trade partner, (4) the more diversified the partner countries’ economies are, and (5) the more closely the partners’ domestic prices resemble world prices.\textsuperscript{166} Further, as RTAs lead to the formation of trading blocs\textsuperscript{167}, this can have an impact on international trade flows. Through an economic modelling study of trading blocs, Riezman concludes, “If there is one large trading block along with some smaller ones then bilateral trade

\textsuperscript{162} Das, supra note 123 at 13.
\textsuperscript{163} Estevadeordal & Suominen, supra note 116 at 39.
\textsuperscript{164} \textit{Ibid.} at 42.
\textsuperscript{166} Das, supra note 123 at 46.
\textsuperscript{167} Definition of trading bloc: A trade bloc can be defined as a ‘preferential trade agreement’ between a subset of countries, designed to significantly reduce or remove trade barriers within member countries. The two principal characteristics of a trade bloc are that: (1) It implies a reduction or elimination of barriers to trade; (2) This trade liberalization is discriminatory in the sense that it applies only to member countries of the trade bloc, outside countries being discriminated against in their trade relations with trade bloc members. Sanoussi Bilal, “Trade Blocs”, European Centre for Development Policy Management, online: ECDPM <http://www.ecdpm.org/Web_ECDPM/Web/Content/Download.nsf/0/7063A1D7D8686243C12574980049FDAD/$FILE/Trade%20Blocs.pdf>. 
agreements allow the smaller trading blocks to coalesce and block the monopoly power of large trading blocks. In other words, when trading blocs (fashioned out of bilateral agreements) are more of less equal in size, they will likely be welfare enhancing especially where they allow smaller blocs to merge and successfully oppose larger blocs. Ultimately, whether trade diversion or creation ensues out of an RTA will depend on numerous factors including the sizes of the partner economies, and the relative similarities and competitiveness among them. There is no categorical answer as the effects will vary for each RTA.

In light of these context specific outcomes of trade agreements, it is perhaps more appropriate to reframe the question to ask which RTAs have trade-creating or diverting effects, for which countries and actors, and why. In the following sections, I argue that trade creation which outweighs diversionary effects can plausibly result under carefully constructed arrangements that emphasize both open regionalism and harmonization of rules of origin. As a thorough overview of all the relevant influences on trade creation is beyond the scope of this thesis, the analysis here is limited to rules of origin and trade openness. These concepts are discussed below.

4 Resolving Rules of Origin

The paragraphs above have illustrated the challenges that complex and overlapping rules of origin can cause. This section describes on the one side, the specific circumstances where diversionary effects may occur, and on the other side, examines arrangements where rules of origin can lead to welfare enhancing trade creation. Subsequently, I propose that RTAs need not cause trade diversion and can


\[169\] Ibid.

\[170\] Das, supra note 123 at 47.

\[171\] Estevadeordal & Suominen, supra note 116 at 42.
lead to sturdier building blocks towards multilateral free trade if rules of origin are harmonized in existing and new trade arrangements.

Trade diversion has been shown to occur as a result of a phenomenon known as ‘hub-and-spoke’ RTAs or bilateral agreements. Generally speaking, certain countries in a given region will naturally constitute ‘hubs’ which attract trade flows due to reasons such as their geographic location as a ‘transport hub’\textsuperscript{172}, the large size of their economies and consumer markets, their status as a customs union, and the low cost of factors of production. Spokes are the rest of the countries in the region which position themselves around the hub nation by entering into bilateral agreements with the hub. Trade agreements can be formed as ‘spoke-spoke’, ‘hub-spoke’, or encompassing the hub and all spokes. In Asia, Japan and China are commonly considered hub nations, while across the whole of Europe, it is clear that the EU, as it constitutes a powerful customs union, forms the central hub of this region. A hub-spoke trade arrangement will favour industry in the hub nation at the expense of industry in the spoke nations.\textsuperscript{173} Assuming equal trade and production costs for simplicity, foreign investment will be most attracted to the hub nation. Producers who produce or manufacture out of the hub region will obtain the largest preferential market access as a hub-spoke deal confers preferences to the hub market as well as all the individual spoke markets. This can divert trade away from spokes to the advantage of hubs. In other words, hub-spoke FTAs tend to marginalize the spoke economies, since producers in the spokes have artificially lower market access than producers in the hub.\textsuperscript{174}

In order to resolve the problem of marginalization of spokes in RTAs, barriers to spoke-spoke trade have to be removed. With equal access to intra-regional preferences, producers who locate in spoke countries would not end up facing disadvantages in terms of market access. These barriers can be


\textsuperscript{174} \textit{Ibid}. at 6.
dissolved through convergence of the individual regional RTAs. The most effective method of convergence is via cumulation of rules of origin between criss-crossing RTAs, leading to a common set of rules for all implicated countries. In principle, there are three types of cumulation: bilateral, diagonal and full. Bilateral cumulation means that where there is an agreement between two trading partners, materials originating in one country shall be considered as materials originating in the other country. Virtually all trade agreements feature bilateral cumulation. This arrangement manifests the hub-and-spoke problem previously discussed (see Figure 1).

![Figure 1: RTA Divergence Problem](image)

Diagonal cumulation applies to trade between three or more trading partners normally linked by RTAs with identical rules of origin. Here, member countries agree through bilateral agreements with each other that materials originating in one country shall be considered as materials originating in all the other countries. In a variation of diagonal cumulation form, extended cumulation allows countries

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that are linked via a bilateral or plurilateral RTA to use inputs from third parties that do not have an RTA with any (or all) of the parties to that RTA (see Figure 2).\textsuperscript{176}

![Figure 2: Extended Cumulation (Source: International Development Bank)](image)

Full cumulation extends diagonal cumulation. It allows countries that share a common set of rules of origin to use goods produced in any part of the common zone even if these were not originating products (see Figure 1). Any processing done in the zone is considered as if it had taken place in the final country of manufacture.\textsuperscript{177} As such, full cumulation can significantly expand the product pool that qualifies for preferential status.

\textsuperscript{176} Estevadeordal & Suominen, \textit{supra} note 116 at 85.

\textsuperscript{177} \textit{Ibid}.
The most notable example of cumulation is the Pan-European Cumulation System (PECS) instituted in the 1990s. Baldwin has framed PECS as a building block towards the creation of a coherent European free-trade zone by its success in taming the tangle of trade agreements in Europe. As free trade agreements had proliferated in the European continent from the 1970s to the 1990s, the EU decided to launch a harmonization drive via PECS in order to create a common set of rules of origin among these agreements. In 1999, these efforts culminated in the establishment of the ‘Single List’ which comprised rules of origin that combined change of tariff classifications with exceptions, value content rules, and technical requirements. The Single List was incorporated in the Euro-Mediterranean Association Agreements between the EU and various southern Mediterranean countries. Although the aim of this Pan-Euro cumulation system is to enable goods that fulfil the origin requirements of one agreement to qualify automatically in other agreements within the system,

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178 Baldwin, “Multilateralising Regionalism”, supra note 112 at 1498.
179 Estevadeordal & Suominen, supra note 116 at 91.
180 Ibid.
this method does require all countries within the system to have RTAs in force with the other member countries.\footnote{Ibid. at 91 – 92.}

Economic convergence efforts that centre around cumulation are not exclusive to Europe. Over the past few years, countries have increasingly recognized the need to galvanize action for deeper integration. Within the Americas, preliminary efforts to expand cumulation areas include DR-CAFTA (agreement between United States, Central America, and the Dominican Republic) which contains provisions for cumulation; and, in September 2008, 12 Pacific countries of the Americas (Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Panama, Peru, and the United States) announced an initiative to further convergence of free trade efforts. In the Asia-Pacific region, talks between APEC members over the last few years have frequently addressed the potential of a trans-Pacific trade agreement with the longer-term goal of a Free Trade Area of the Asia Pacific (FTAAP) in mind.\footnote{“US Looks to Join Trans-Pacific Trade Agreement”, September 25, 2008, International Centre for Trade and Sustainable Development (ICTSD), online: ICTSD <http://ictsd.org/i/news/bridgesweekly/29777/>; “APEC Leaders Call for Doha Deal, Deeper Regional Integration”, November 18, 2009, online: ICTSD <http://ictsd.org/i/news/bridgesweekly/61067/>.

Similarly, the fact that El Salvador and the Dominican Republic can source inputs from the United States and other Central American countries under DR-CAFTA, and that Estonia and Iceland’s membership in the EU’s Pan-Euro cumulation zone has allowed them access to an area from which they can source inputs or perform operations related to goods in their bilateral trade which is more than 450 times their combined GDP.\footnote{Estevadeordal & Suominen, supra note 116 at 96.}
CAFTA means that their effective input pool is more than 250 times their combined GDP.184 The effects of cumulation in the Pan-Euro system have also been examined by Augier et al. who found that the introduction of cumulation in the region increased trade between the Eastern European spokes by between 7 percent and 22 percent.185 Conversely, trade is potentially up to 70 percent lower between the countries that are not part of this system.186

5 Open Regionalism

The formation of RTAs may engender positive results if these agreements are structured with multilateralism as the ultimate goal. Proponents of RTAs believe that regionalism can serve as ‘building blocks’ toward multilateral freeing of trade as these two concepts are complementary (also called ‘competitive liberalization’).187 Nonetheless, one needs to view the trading system and international politics pragmatically to attain solutions that are realistic in the short-term, without losing track of the end goal. Ideally, multilateralism is a ‘first-best’ approach for efficient allocation of resources and freer trade in the world economy188 in a perfect environment without market failures. In other words, as Trebilcock and Howse indicate, if seen in comparison to a perfect, undistorted trading system, regional trading blocs are ‘second-best’189 but if it is compared with the trading system as it prevails today, the case against RTAs may be less compelling.190 Within this ‘second-best’ framework, I argue that RTAs have an important role to play in the advancement of freer trade, improved welfare for developing

184 Ibid.
186 Ibid.
187 Bhagwati, supra note 113 at 82.
188 “Liberalising trade in food and agriculture: what is the best way forward?” Organization for Economic Co-operation and Development, online: OECD <http://www.oecd.org/document/18/0,3343,en_21571361_43893445_44365330_1_1_1_1,00.html>.
189 The second-best theory suggests that when there are distortions or imperfections in a market, then the addition of another distortion (like a trade policy) could actually raise welfare, or economic efficiency. Steven M. Suranovic, “Trade Diversion and Trade Creation”, online: International Economics Study Center <http://internationalecon.com/Trade/Tch110/T110-2A.php>.
190 Trebilcock & Howse, supra note 14 at 195.
nations, and that it is possible to structure regionalism in a way that complements the multilateral trading system.

Multilateralism does not have to be achieved purely via WTO-level negotiations to the exclusion of other intermediary roads that can lead ultimately to the same end. There are benefits to the attainment of multilateral goals via the path of regionalism. For example, governments may agree to commit to a free-trade agreement in order to deter inefficient investments that would otherwise be made by private sector businesses who continue to expect more protection, in lieu of full multilateral liberalization which would be politically unacceptable. The creation of a regional agreement between a developed and developing country can increase foreign investment into the developing country because foreign investors want preferential access to the markets of the developed country. Bagwell and Staiger state: “According to this argument, then, regional agreements can be used by reforming developing countries to attract foreign direct investment, and in this way to ensure that their reform efforts – and thereby their attempts to join the multilateral system – succeed. And the growth in regional agreements can be interpreted as indicative of the growing attractiveness of being part of the multilateral system, which is itself an indication of the success of multilateral trade liberalization.”

Another way to enhance the convergence between RTAs and the multilateral system may be to introduce sunset clauses of substantial length into RTAs whereby preferences available to members of the regional agreement could be extended to all WTO members within fifteen years on an MFN basis (or whichever period is most suitable) after the RTA comes into force. Lee has argued that by setting a period of sufficient length for the expiration of exclusive trade preferences, political resistance to a

192 Ibid., at 123.
193 Yong-Shik Lee, “Reconciling RTAs with the WTO Multilateral Trading System: Case for a New Sunset Requirement on RTAs and Development Facilitation” (2010) [Unpublished draft].
sunset policy can be minimized.\textsuperscript{194} With regards to developing countries, Lee opines that a shorter sunset period could be implemented in favour of countries with dire economic needs, excluding those such as China, which have already captured substantial shares in export markets.\textsuperscript{195}

In a study that compares free trade which is reached through RTAs, with free trade reached via multilateral liberalization, Freund has shown that world welfare during free trade is greater when it is achieved through expanding regional agreements.\textsuperscript{196} Trade that commences via RTAs followed subsequently by free trade leads to permanently greater trade among the member nations because firms undertake irreversible investment (‘sunk costs’) before free trade is achieved.\textsuperscript{197} Sunk costs allow firms from a member nation to commit to exporting more to their partners and because of this expansion in output, consumer surplus and profits from exports will be greater.\textsuperscript{198}

Many authors have explored the ways in which regionalism can advance the path towards multilateral free trade. A key recurring theme in proposals for enhancing multilateralism is the argument that RTAs should allow members to reduce barriers between each other without creating new discrimination against countries outside the agreement.\textsuperscript{199} This structure known as ‘open regionalism’ leads to open regional blocs which can promote external liberalization (trade with parties outside the blocs). Lawrence and Litan opine that stronger regional integration could have positive effects if the regional blocs are ‘open’ to trade from outside, thus possibly leading to trade creation effects.

\textsuperscript{194} Ibid.
\textsuperscript{195} Ibid.
\textsuperscript{198} Freund, supra note 197 at 1340.
outweighing any trade diversion that arise.\textsuperscript{200} Open regionalism has also been defined by Wei and Frankel as, “external liberalization by trade blocs, that is, the reduction in barriers on imports from nonmember countries that is undertaken when member countries liberalize the trade among themselves. The degree of liberalization on imports from nonmembers need not be as high as that for member countries.”\textsuperscript{201}

Although open regionalism is now discussed in varying forms and contexts, this term first emerged in the 1980s during Asia Pacific discussions for deeper integration of regional trade expansion. The precise meaning of this term was “the removal of barriers to and the encouragement of regional cooperation without discrimination against outsiders”.\textsuperscript{202}

To attain this, external tariffs should be as non-discriminatory as possible. Bagwell and Staiger note, “if the customs union satisfies the principle of non-discrimination when setting its external tariffs and if the customs union and the remaining foreign countries also set politically optimal tariffs, then the resulting tariffs will be efficient and robust to the possibility of renegotiation under the principle of reciprocity …”.\textsuperscript{203} These authors also observe that emerging RTAs may enhance multilateral cooperation during the transition period by pointing to the EC customs union as an example. They note that the twelve year period of union formation and expansion in Europe corresponded with periods of enhanced multilateral tariff cooperation and were factors behind the launching of the three multilateral negotiation rounds between 1960 – 1973.\textsuperscript{204}

\textsuperscript{201} Shang-Jin Wei & Jeffrey A. Frankel, “Open Regionalism in a World of Continental Trade Blocs” (1998) 45:3 International Monetary Fund Staff Papers at 441.
\textsuperscript{203} Bagwell & Staiger, supra note 191 at 115.
\textsuperscript{204} Ibid., at 116.
Bagwell and Staiger have posited that the augmented market power of the EC spurred the US and others towards greater multilateral cooperation to avoid the dire consequences of any breakdown in trade relations. This was a pressing concern caused by the increased power attained by a united group of European countries. The authors argue that this market-power effect was present for the EC because it was structured as a customs union, as opposed to a free trade area. They point out that many recent RTAs are free trade areas where such a market-power effect would be absent. Instead, a trade diverting effect will be emphasized.

In more quantifiable terms, an analysis conducted by McMillan in 1993 posited that where a single trade bloc is formed, there should be no decrease in trade volume between member and non-member countries to ensure that world welfare continues to improve. This essentially requires a very high degree of external liberalization wherein external tariffs of the bloc would have to be lowered by 40 per cent. Naturally, such drastic liberalization would cause consternation among member countries, especially those with developing country status. On the other hand, in a world of simultaneous trade blocs as exists today, Wei and Frankel show that an open regionalism in which trade blocs undertake relatively modest external liberalization can usually produce Pareto improvements. As a rough rule, as long as trade volume with non-members does not fall below 14–15 percent, trade blocs are likely to be welfare improving. This lower level of liberalization is more likely to be politically acceptable within domestic spheres and feasible as a method of advancing the goals of free trade at a pace that is appropriate for less developed countries still struggling to compete with fully industrialized nations.

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205 Ibid., at 119.
206 Ibid.
208 Ibid.
209 Wei & Frankel, supra note 201 at 440. Pareto improvement occurs when at least one participant in the trading system will be ‘better off’ (as a result of the change) with no participant ‘worse off’.
210 Wei & Frankel, supra note 201 at 452.
6 Summary

It is clear that ‘regionalism is here to stay’ as evidenced by the proliferation of RTAs across continents. Significant attention should be given to fostering the multilateralisation of these agreements so that the challenges caused by discriminatory provisions and confusing rules of origin can be turned into opportunities for the enhancement of global free trade. Baldwin has proposed that regionalism can be a way to promote multilateralism if proper harmonization of rules is undertaken and the WTO in turn provides assistance to regional blocs in the form of research and identification of critical issues like rules of origin, rules of cumulation, and the economic spillovers on third nations early on.  

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211 Baldwin, “Multilateralising Regionalism” supra note 112, at 1512.
212 Ibid. at 1509.
CHAPTER III: REGIONALISM WITHIN THE EAST ASIAN CONTEXT

The impressive growth of East Asian countries and the rapid ascend of China as an economic hegemon in a few short decades have changed the economic landscape in this region drastically. China has now overtaken Germany’s status as the world’s largest exporter\(^\text{213}\) and proved resilient in the face of both the 1997 Asian crisis and the current global economic crisis. This chapter analyses the strengths and challenges of several East Asian case studies and goes on to explore the rise of China and its implications for regional trade. The benefits of deepening regional integration are described in advancing the case for consolidating the region’s ‘noodle bowl’ of RTAs into a region-wide free trade area.

1  History of Economic and Trade Engagement in East Asia: From Miracle to Crisis and Beyond

The region of East Asia has progressed rapidly over the past decades and is now the most advanced developing country region in the world. There has been significant interest in East Asia due to the unprecedented economic advancement in this region. In four decades (from 1956 to 1996), East Asian living standards rose at a rate faster than has ever been sustained anywhere else, growing at an average rate of 5.0% a year, while the world as a whole averaged only 1.9%.\(^\text{214}\) This chapter charts the experiences of East Asia from its ‘miracle’ growth years to the dramatic economic crisis in 1997. It then examines the renaissance of the region in the context of trade-driven growth.

\(^{213}\) “China ‘overtakes Germany as world’s largest exporter’” BBC News (10 January 2010), online: BBC <http://news.bbc.co.uk/2/hi/business/8450434.stm>.

In this thesis, East Asia generally refers to Indonesia, Malaysia, Philippines, Thailand, Singapore, Brunei, Myanmar, Cambodia, Laos, and Vietnam, China, Japan, South Korea, Taiwan (Chinese Taipei), and Hong Kong. This categorization will influence the later consideration of membership in a proposed RTA for the region. The analysis and recommendations in this thesis do not include the South Asian countries (i.e. India, Bangladesh, Bhutan, Nepal, the Maldives, Pakistan, and Sri Lanka). The absence of India is particularly notable because India is currently one of the world’s largest emerging economies and wields significant influence in international trade negotiations. Despite this, I argue that, first, issues of regional leadership and rivalry for power may be intensified to the point of negotiation stalemate if another possible hegemon was included at this stage. Second, the need for deeper integration in East Asia builds upon the existing integrated production network – the ‘Factory Asia’ – which has knit together the East Asian region. Developing an RTA between countries that already have close and existing interdependencies may make it easier to achieve agreement on core issues. Third, a framework for regional political and economic co-operation in the form of ASEAN Plus Three (ASEAN plus Japan, Korea, and China) is already in existence. Again, by building on existing frameworks of co-operation the task of resolving differences in objectives may be made somewhat easier by their previously shared experiences. Dobson has noted that, ‘As a latecomer [to regional institutional initiatives], however, India does not fit easily into the prevailing ‘east’ Asian institutional model ...’ 215 The participation of India in a proposed regional trade agreement is anticipated at a later stage of development. The issue of membership in the RTA is discussed in greater detail in Chapter IV.


1.1 The Miracle

In 1993, the World Bank hailed the high economic growth in East Asia as the “East Asian Miracle”. Newly industrializing economies (“NIEs”; Korea, Taiwan, Singapore, and Hong Kong) averaged about 7 percent growth annually between 1986 and 1997 with per capita income levels reaching those of industrial countries. Thailand, Indonesia, Malaysia, and China also experienced nearly 10 percent growth in the same period. The World Bank Study and several other studies cited the following factors as causes of the Asian Miracle: a stable macroeconomic environment; high saving and investment rates; export promotion; successful industrialization; and, the volume of foreign direct investment (FDI) and associated transfer of technological capacities. This study did not include China. The following analysis recites Ito’s categorization of commonly posited factors of the East Asian miracle:

Stable Macroeconomic Environment: Monetary policies in East Asia were prudent, and fiscal deficits contained. None of the Asian countries – except Indonesia – has experienced devastating hyperinflation over the past 40 years.

High Savings and Investment Rates: Domestic saving / GDP ratios are more than 40 percent for China, Malaysia, and Singapore; between 30 percent and 40 percent for Korea, Thailand, and Indonesia; and between 20 and 30 percent for Taiwan. A high savings rate, accompanied by high investment, made it

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217 In this thesis, ‘Korea’ refers to the Republic of Korea (South Korea).
219 Ibid. at 56.
220 Foreign direct investment refers to long term participation by country A into country B. It usually involves participation in management, joint-venture, transfer of technology and “know-how”. “Foreign Direct Investment” online: Wikipedia <http://en.wikipedia.org/wiki/Foreign_direct_investment>
221 Ito, supra note 218 at 59.
222 Ito, supra note 218 at 57-61.
possible to achieve rapid economic growth without incurring current account deficits financed by foreign capital. The rate of savings appeared to be linked with growth.

**High Quality Human Capital**: Asian economies have high literacy rates, and better educated populations than many other countries at similar stages of development. This makes it possible to promote further industrialization without being constrained by a lack of skilled workers. Many Asian countries have moved up the industrial ladder from textiles to simple assembly of machines, to electronics, and to high-tech industries.

**Export Promotion**: This has been key in East Asian economic development. It earns foreign currencies that are needed to import natural resources, capital goods, and parts for assembly. Because domestic markets are relatively small for many countries (except China and Indonesia), overseas markets are crucial in achieving efficient production scales. Many countries engaged in import substitution\(^\text{223}\) in the 1950s and 1960s, but those that moved on to export promotion were in a better position to strengthen economic performance. Korea, Taiwan, Malaysia, and Singapore provided strong incentives for exports and the composition of exports has also dramatically altered. For example, Malaysia, progressed from a primary goods exporter to an electronics exporter within 15 years.

**Successful Industrialization**: Any economy that sustained high economic growth for decades (e.g. Japan from 1950 to 1973 or Korea from 1980 to 1995, or Malaysia after 1985) experienced rapid changes in its industrial structure. Korea and Taiwan followed Japan in transforming from light industries to more advanced industries like chemical, electronics and hi-tech industries. Singapore, Hong Kong, Thailand, Malaysia, and Indonesia also industrialized quickly in a pattern that started off with agriculture, then

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\(^{223}\) Import substitution industrialization or "Import-substituting Industrialization" (called ISI) is a trade and economic policy based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products. “Import Substitution Industrialization” online: Wikipedia <http://en.wikipedia.org/wiki/Import_substitution_industrialization>
industry, and then to services. Many of these countries developed due to government intervention via industrial policies of subsidies, credit financing, and foreign direct investment (FDI) in selected sectors.

**Foreign Direct Investment and Technological Transfer:** Except for Japan and Korea, most Asian economies have industrialized by attracting FDI. Singapore, Malaysia, Taiwan, and China are examples of countries that grew as a result of controlled FDI. Growth in this case depended not only on the establishment of industrial bases by foreign firms, but also the rate of technological transfers to firms and workers within the host country.

East Asia’s development began with the rapid rise of Japan as an economic force in the region. Japan was able to develop in the late 1950s with the blessing of the U.S. by using war reparations, aid, and investment to secure a stable supply of resources for Japanese industry as well as expanding its market shares. Foreign investment was limited and domestic markets were kept closed. When external shocks, such as the two oil shocks of 1973-74 and 1978-79 and the later yen shocks of the 1980s and 1990s, forced Japanese industries to relocate abroad, this drastically changed the division of labor in East Asia. The yen appreciation in 1985 caused a price increase of Japanese products vis-à-vis the price of products produced in countries experiencing simultaneous currency depreciation. To cope with this loss in international competitiveness, many Japanese firms moved their production bases to developing East Asian countries like Indonesia, Malaysia and Thailand. Japan’s trade friction with developed economies such as the United States and the European Union due to protectionist sentiment in these Western economies discouraged Japanese exports to these regions, creating additional opportunities for developing East Asia. In order to secure their markets in other developed economies,

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Japanese firms began to invest in East Asian economies, setting up export platforms to enable them to get around the import barriers in developed countries.\footnote{Ibid. at 424.}

With the view of Japan as the leading player in Asian development, the Japanese scholar, Akamatsu (1962) posited a model of growth based on a formation of flying geese.\footnote{Kaname Akamatsu, “A historical pattern of economic growth in developing countries” (1962) 1:1 Journal of Developing Economies 3. See also Emerging Asian Regionalism, supra note 214 at 26.} To elaborate, in the early stages of Asia’s economic development, East Asian economies initially specialized in simple, labor-intensive manufactures. As the more advanced countries graduated to more sophisticated products, less developed economies filled the gaps that were left behind. In the flying geese model, economies moved in formation because they followed similar paths of development. In other words, a “follower” country first imports a product from a more “advanced” country, then it produces the good for itself, and finally, it exports the product to other countries.\footnote{Jomo, supra note 224 at 476.} In concrete terms, Kasahara describes the lead goose in this pattern as Japan itself, and the second-tier of nations as South Korea, Taiwan (China), Singapore and Hong Kong. After these two groups come the main ASEAN countries: Philippines, Indonesia, Thailand and Malaysia. Finally the least developed major nations in the region: China, Vietnam etc. make up the rear guard in the formation.\footnote{Shigehisa Kasahara, “The Flying Geese Paradigm: A Critical study of Its Application to East Asian Regional Development” (2004) United Nations Conference on Trade and Development, Discussion Paper # 169, as cited in “Flying Geese Paradigm” online: Wikipedia <http://en.wikipedia.org/wiki/Flying_Geese_Paradigm>.
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\subsection*{1.2 The Crisis}

After a rapid growth period of about five years in the 1990s, the “tiger” economies\footnote{A tiger economy refers to a country that has undergone rapid economic growth, usually accompanied by an increase in the standard of living. The term was initially used for South Korea, Singapore, Hong Kong and Taiwan (East Asian Tigers). “Tiger Economy” online: Wikipedia <http://en.wikipedia.org/wiki/Tiger_economy>.
} of East Asia started to show signs of strain in 1996. The region’s economic crisis started with stress in Thailand’s real estate and financial sectors coupled with the swift devaluation of the Thai baht which lost 50% of its
value between July 1997 and January 1998. This quickly spread into a full blown economic downturn of catastrophic proportions within the region by 1997. That same year, Indonesia saw the value of the rupiah spiral downwards by 70%\(^{231}\) and its government bond categorization was demoted to “junk bond” status.\(^{232}\) Essential food prices soared and the rate of unemployment increased.\(^{233}\) In Korea, the won devalued by 50%\(^{234}\) between July 1997 to January 1998. Korea’s banking sector accumulated an excessive amount of non-performing loans due to the granting of credit to fund aggressive expansions of industries without adequately assessing risk factors. Consequently, several chaebol\(^{235}\) (Korean-type conglomerates) were forced into bankruptcy. These companies had a combined workforce of over 100,000 employees and 26.7 trillion won in assets. More than half of the 30 largest chaebol (with combined employment exceeding a quarter million people and liabilities of 103.4 trillion won) teetered dangerously on the brink of bankruptcy, leading to massive bailouts and regulatory intervention by the Korean government.\(^{236}\) In Malaysia, the ringgit experienced sharp devaluation (from RM2.50 for USD1 in mid-2007 to half that value by January 1998)\(^{237}\), the stock market had fallen to its lowest levels since recent history, and the Malaysian corporate sector saw huge losses of wealth.\(^{238}\)


\(^{234}\) Chen, supra note 231.

\(^{235}\) Chaebol refers to a South Korean form of business conglomerate. They are powerful global multinationals owning numerous international enterprises. The Korean word means “business family” or “monopoly” and is often used the way “conglomerate” is used in English. “Chaebol” online: Wikipedia <http://en.wikipedia.org/wiki/Chaebol> There are several dozen large Korean family-controlled corporate groups which fall under this definition. Through aggressive governmental support and finance, some have become well-known international brand names, such as Samsung, Hyundai and LG.


The experiences of the four worse-hit countries described above (Korea, Indonesia, Thailand, and Malaysia) took on more muted forms of severity in the rest of East Asia. The Philippines, Hong Kong, and Singapore were affected by a loss of confidence in regional markets, but were not as badly hit. Growth also slowed in China and Taiwan, and Taiwan’s New Taiwan dollar declined relatively modestly, but these two countries were the least hard-hit due to high rates of domestic savings and stringent capital control measures.

2 CAUSES OF THE EAST ASIAN CRISIS

Numerous causes, both domestic and external, contributed to the 1997 crisis in Asia. An analysis provided by Ito categorizes these into common and idiosyncratic factors as summarized below.239

2.1 Common Factors

Overvaluation of Currencies (all dollar peg countries): Since many Asian countries trade substantially with Japan, the yen depreciation relative to the dollar caused those countries with currency pegs to the dollar to become less competitive. Thai firms also lost competitiveness when China devalued its currency in 1994. Thailand’s currency crisis was likely prompted be declining exports as a result of the baht’s overvaluation.

The Twin Crises – Banking and Currency: The Asian meltdown was simultaneously a currency crisis and a banking crisis that reinforced the negative effects of each other. The circumstances which led to the twin crises in Asia are described succinctly by Corsetti et al. They state:

“To the extent that foreign creditors are willing to lend to domestic agents against future bail-out revenue from the government, unprofitable projects and cash shortfalls are re-financed through external borrowing. While public deficits need not be high before a crisis, the eventual refusal of foreign creditors to refinance the country’s cumulative losses forces the government to step in and guarantee the outstanding stock of external liabilities. To satisfy solvency, the government must then undertake appropriate domestic fiscal reforms, possibly involving

239 Ito, supra note 218.
recourse to seigniorage revenues. Expectations of inflationary financing thus cause a collapse of the currency and anticipate the event of a financial crisis.”

In other words, the weakening performances of Asian industries, coupled with low foreign exchange reserves, and high levels of non-performing loans precipitated the Asian collapse. The banking sector in many developing East Asian economies did not have stringent security measures to mitigate the risk of bad debts. In order to fund booming growth before the crisis set in, governments encouraged short-term loans from foreigners to raise capital for development. National banks borrowed excessively from abroad and lent excessively at home. Although capital from abroad can support economic development, when capital is provided through short-term instruments such as bank certificates of deposit, short-term securities (such as six-month government securities), very high levels of short-term inflows may lead to a liquidity problem. Most of these loans were borrowed in foreign currencies, normally US dollars. Unfortunately, a system of capital controls was not in place in many of these economies. At the same time, distortions in the pre-crisis Asian financial and banking sectors manifested themselves in lax supervision and weak regulation; biased incentives for project selection and monitoring, outright corrupt lending practices, and non-market criteria of credit allocation. When growth decelerated in Asia, (in hindsight an unsurprising event as much growth was based on government directed practices that did not correspond with market demand or competitiveness) many debtors defaulted on their loans. This provoked fear among investors that their debts would not be repaid, in tandem with intense speculative attacks on currencies. Capital took flight from the Asian economies which further prompted rapid devaluation of domestic currencies. The lack of capital

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240 Seigniorage is the difference between the value of money and the cost to produce it - in other words, the economic cost of producing a currency within a given economy or country. If the seigniorage is positive, then the government will make an economic profit; a negative seigniorage will result in an economic loss. “Seigniorage” online:Investopedia <http://www.investopedia.com/terms/s/seigniorage.asp>.
242 Ito, supra note 218 at 79.
243 Corsetti et al., supra note 241 at 24.
controls in these countries rendered them vulnerable to the departure of foreign funds en masse. This
devaluation exacerbated the debt problem as the real terms of repayment for domestic bank borrowers
who would have to repay loans in US dollars, had now increased significantly.

2.2 Idiosyncratic Factors

Mismanagement of Foreign Reserves (Thailand and Korea): Governmental responses to the fall of
property prices in Thailand and the erosion of capital in Korea due to the decline of the stock market
could have been better managed. Radelet and Sachs argue that if Thailand and Korea had floated their
currencies and tightened monetary policies instead of defending their exchange rate pegs until virtually
all the foreign exchange resources had been exhausted, the crisis could have been largely avoided.\textsuperscript{244}

Excessive Foreign Currency Denominated Borrowings Among Banks (Thailand and Korea): The dollar
peg encouraged corporations and banks to amass liabilities in dollar-denominations as the interest rates
on dollar loans were typically lower than domestic currency loans. After local currencies depreciated
significantly, the problems of debtor countries were significantly exacerbated.\textsuperscript{245}

Weak Corporate Governance (Korea and Indonesia): In Korea, conglomerates expanded their
businesses into sectors where they did not have competitive advantages. Overinvestment resulted in
the collapse of several chaebol in early 1997 leading to pressure on the Korean won in late 1997. In
Indonesia, firms borrowed directly from abroad, without being required to manage currency risks.\textsuperscript{246}

Contagion: This phenomenon is particularly significant as it highlights the global view and treatment of
East Asia as a somewhat integrated entity. In fact, the strength of contagion was the most prominent
aspect in the currency crises, spreading from Thailand to Indonesia to Korea as well as Malaysia and the

\textsuperscript{244} Radelet & Sachs, supra note 232 at 35.
\textsuperscript{245} Ito, supra note 218 at 80.
\textsuperscript{246} Ibid.
Philippines, and so forth.\textsuperscript{247} It would seem that damage in the economic reputations of one or several neighbours could lead to the tainting of the overall region. Apart from genuine causes of economic meltdown, the East Asian region suffered from the effects of panic and ill-informed perceptions of regional circumstances. Several countries as described above definitely had severe problems inherent in the way their economies were being run. Others, however, were not as substantively vulnerable. Nonetheless, the crisis spread like a regional pandemic.

The clearest case of an economy declining rapidly as a result of catching the crisis contagion was Indonesia. Although Indonesia suffered from its own fiscal and political shortcomings, these issues were considered to be among the least severe in the region.\textsuperscript{248} As the crisis began permeating the region, observers believed that Indonesia would be the least affected due to its small current account deficit, high export growth in 1996, budget surplus of over 1 percent of GDP for four years, relatively low foreign liabilities of commercial banks, and continued rise of its stock market through early 1997.\textsuperscript{249} However, a series of unfortunate incidents would cause Indonesia to tumble headlong into the financial crisis. First, the abrupt closure of sixteen private banks amidst protests from President Suharto’s relatives led to great confusion and panic instead of confidence building in the region. Next, a severe drought in the country caused food prices to increase sharply and displaced urban labourers, and a decline in world petroleum prices reduced Indonesia’s export receipts, leading to further pressure on the exchange rate.\textsuperscript{250} The stressful circumstances were further exacerbated when the illness of President Suharto was announced. With no successor in sight, panic mounted. Radelet and Sachs have argued that the culmination of these factors engendered by the contagious effect of confusion and panic plunged

\begin{itemize}
\item \textsuperscript{247} Ibid.
\item \textsuperscript{248} Radelet & Sachs, \textit{supra} note 232 at 37.
\item \textsuperscript{249} \textit{ibid.} at 37-38.
\item \textsuperscript{250} \textit{ibid.} at 39.
\end{itemize}
Indonesia into a severe, unnecessary economic contraction disproportionate to its real economic flaws, which were not especially severe.\textsuperscript{251}

Generally in East Asia, several different factors generated the regional contagion effect. First, the initial baht devaluation and the Thai government’s refusal to continue supporting a major finance company (Finance One) leading to losses incurred by foreign creditors, shook the confidence of investors in the economy of the Asian region. Investors started looking for countries with similar weaknesses as Thailand (large current account deficits, a fixed exchange rate, loss of foreign reserves).\textsuperscript{252} The baht devaluation led to a sudden loss of confidence in government credibility as it came on the heels of declarations by Thai officials for months that Finance One was in good shape, foreign reserves were abundant, and the baht would not be devalued.\textsuperscript{253} Speculators subsequently attacked countries that did not float their currencies. For example in Hong Kong, the government tried to defend its currency by increasing the interest rate, which caused stock prices to decline. Speculators engaged in “double play”\textsuperscript{254} by selling both foreign exchange and stocks in Hong Kong, causing a shock which transcended regions, affecting stock markets in the United States and United Kingdom as well. In the end, Hong Kong intervened by buying heavily in the stock market and forcing share prices up, thus resolving the crisis by “burning the speculators”.\textsuperscript{255}

\textsuperscript{251} Ibid. at 40.
\textsuperscript{252} Ito, supra note 218 at 81.
\textsuperscript{253} Radelet & Sachs, supra note 232 at 33.
\textsuperscript{254} Double play is when speculators simultaneously attack the currency market and the stock market. Governments are faced with two conflicting objectives: exchange rate stability and low interest rates. These speculators believe that if the currency under attack is not defended, they will profit. If the currency is defended, then they will profit instead from the stock market. Sources: Sujit Chakravorti & Subir Lall, “The double play: simultaneous speculative attacks on currency and equity markets” (2000) Federal Reserve Bank of Chicago Working Paper WP-00-17.
3 Post Crisis Systemic Challenges and the Rise of China

In the past decade, East Asian countries have been forced to re-evaluate their old ways of doing business, and the institutions required to ensure that growth is sustainable. China’s new role as a regional hegemon has also attracted immense attention. This economy of 1.3 billion people has for the past 30 years grown at an annual rate of 9.7% - over three times faster than world growth\(^\text{256}\), and displayed impressive fortitude in withstanding the panic of the East Asian crisis. The lessons learned from analyses of the crisis together with China’s rapid ascent are discussed below.

3.1 Industrial Policies

In this section, I examine industrial policies in Korea and Malaysia for their roles in contributing to the economic crisis or general economic stagnation in their countries. The problems in the industries described below warrant attention as the failure to resolve systemic problems may well push these countries into another stage of economic decline, irrespective of whether or not another currency crisis occurs.

3.1.1 Korea

The slowdown in growth in the late 1990s exposed numerous inefficient government practices that made long-term advancement unsustainable. Government intervention in various milieus is acknowledged as an important agent of growth, indeed, all successfully industrialized countries today (e.g. Japan, UK, and US) implemented some form of government assistance before their industries could rise to the challenges of market forces and competition. It is however a double edged sword that can cut both ways.

Perhaps the most striking example of industrial policy gone wrong can be seen from Korea’s experience with the *chaebol* (family-type conglomerate). In the 1960s, Korea adopted an industrial

\(^{256}\) *Emerging Asian Regionalism*, supra note 214 at 36.
policy which created a system of state-business relationships, concentrating control of conglomerates known as *chaebol* in the hands of owner families. The state created *chaebol* groups by using a credit-based system of industrial financed which allocated great resources to these designated groups. In this oligopolistic market environment, the implicit guarantees of bank lending by the government induced banks to lend rampantly and encouraged firms to invest in risky projects. These firms expanded at an astonishing rate, growing by over 30 percent annually between 1970 and 1975. In order to fund these expansions, the *chaebol* had become severely indebted. Sensing problems, Korean authorities tried to introduce regulatory measures in the mid-1970s in an attempt to contain the level of *chaebol*-incurred debt in the banking system. For example, selected “blue chip firms” were suddenly forced to go public or face punitive tax rates, and the government tried to limit *chaebol* access to bank credit. When that did not work, the government opted in the 1990s for a ‘laissez-faire’ market-oriented approach by not rescuing 11 *chaebol* from collapse, thus contributing to the financial crisis.

In the past decade however, the *chaebols*’ business practices have appeared to improve. Their balance sheets have been rebuilt and investments in technology, design and branding have propelled them ahead of low-cost competitors in China. Nevertheless, as the *Economist* opines, “they face competition in new forms for which their hierarchical management structures and complicated, dynastic ownership are ill suited. Apple’s iPhone and the ubiquitous BlackBerry crept up on Samsung Electronics, exposing its shortcoming in smart-phones. Second, the size and strength of the *chaebol* risk stifling entrepreneurialism elsewhere. By and large, their local suppliers are the only medium-sized South Korean companies to have thrived in recent years. Some young businesses such as internet search and gaming

257 Woo-Cumings, supra note 236 at 349.
259 Ibid. supra note 236 at 353.
260 Ibid. at 373.
261 Ibid.
262 Ibid.
have done well, but these are in fields where the chaebol cannot yet be bothered to tread. If they ever do, they may smother rather than nurture independent talent.” These concerns should be considered seriously by the Korean government which appears to still be promoting chaebol-driven economics as exemplified by a presidential pardon to the head of Samsung convicted for tax evasion in 2008, and the potential relaxation of holding-company laws to allow chaebols to own financial firms.\textsuperscript{264} The cost of escaping the crisis through a return to old practices may prove to be significantly more prohibitive and long-lasting than the benefits.\textsuperscript{265}

### 3.1.2 Malaysia

This country’s government has embraced industrial policy and government intervention in many sectors of its economy. The most maligned example intervention and protectionism is the Malaysian auto industry which has been protected from external competition for over two decades on the basis of import-substitution and infant industry philosophies. The survival of the two Malaysian car companies (Proton and Perodua) has relied on tariffs of 140 to 300 percent on vehicles and 42 to 70 percent on imported kits and components.\textsuperscript{266} Proton’s dependence on protection for its price advantage in the domestic market was reflected in a loss of market share from 74 percent in 1993 to 43 percent in 2003 when the government relaxed its grip over new car prices (non-national cars) and allowed distributors of foreign makes to cut their prices.\textsuperscript{267}

In the Fourth Malaysia Plan (1981 – 1985), the government promoted heavy industries by a program of public sector investment. However, Malaysia has been unable to make these industries internationally competitive due to its continued use of tariff protection to nurture the ‘infants’, mainly in

\textsuperscript{264} Ibid.
\textsuperscript{266} “Moment of Truth”, Far Eastern Economic Review, November 23, 2000, as cited in Yusuf, supra note 258.  
car manufacturing, steel mills, petrochemical plants, and cement factories. Companies in these industries are controlled primarily by ethnic Malay nationals who have forged close alliances with politicians in the long-standing ruling party, UMNO. This narrow base of wealthy Malay businessmen has been called ‘crony capitalists’ by Yoshihara. These individuals benefited greatly from the awards of economic rents, monopolies, protectionist policies, licences, and government subsidies, yielding significant market distortions as a consequence.

To date, more than twenty years later, these industries still enjoy some form of protection which is clearly ‘an impediment to the critical structural transformation of Malaysia’s economy, yet a political necessity to sustain UMNO’s dominance’. Malaysia’s trend of GDP growth over the past thirty-five years reveals much greater success during periods of export-oriented industrialization (FDI-led) which saw the emergence of the electronics and textiles sectors as leading exporters, than during the import substituting industrialization (government-led) era.

As Malaysia is one of the world’s most export-dependent economies, it would be essential to ensure that its products keep pace with the demands that global competition poses. Otherwise, it should admit that it has not harnessed a significant comparative advantage in industries such as car manufacturing, and cut its losses now. In the past, Proton exported minimally and enjoyed protection in the form of 70 percent ad valorem tariffs on the imports of competitors. Despite the auto industry’s

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269 UMNO (The United Malays National Organisation) is Malaysia’s largest political party; a founding member of the Barisan Nasional coalition, which has played a dominant role in Malaysian politics since independence. UMNO emphasizes protecting Malay culture, Islamic values and pro-business policies. Online: Wikipedia <http://en.wikipedia.org/wiki/United_Malays_National_Organisation>.
271 Charette, supra note 268 at 9.
272 ibid. at 7.
273 ibid.
failure to produce vehicles that are competitive in terms of quality\textsuperscript{274}, Proton has announced that it aims to increase exports. In 2009-2010, Proton exported 24 per cent of its production (26,000 cars) abroad and aims to export 50 percent of production by 2012.\textsuperscript{275} Nonetheless, government subsidies are still very much alive for the auto industry such as financial assistance schemes for Proton vendors (2008)\textsuperscript{276}, and a vehicle scrappage subsidy for buyers of national cars who turn in their old vehicles (2009)\textsuperscript{277}. In the face of fierce competition with Thailand, Japan, India, not to mention Western auto manufacturers, much has to be done to accelerate the competitiveness of Malaysia’s auto industry to avoid a massive collapse that could well usher in a new financial crisis.

\subsection*{3.2 The Rise of China}

China’s economic dominance has grown from strength to strength in the matter of three decades. Today, this ‘sleeping dragon’ has awakened. China has emerged as the world’s largest exporter, it captures huge amounts of foreign direct investment annually (over US$92 billion in 2008)\textsuperscript{278}, holds over $2 trillion in foreign exchange reserves\textsuperscript{279}, and is currently the world’s third largest economy, after the United States and Japan. When the financial crisis hit the region, China’s economy still grew by 7.8\% in 1998 while most other Asian countries registered negative growth.\textsuperscript{280} This has been attributed to the large amount of foreign exchange reserves held by China and its capital control measures that

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\textsuperscript{274} Tan, supra note 267 at 167.
\textsuperscript{275} “Proton Aims to Export 50 percent of its Production”, December 2, 2009, Carmaker Malaysia, online: Carmaker Malaysia \texttt{<http://carmakermalaysia.blogspot.com/2009/12/proton-aims-to-export-50-percent-of.html>}.  
\textsuperscript{276} Paul Tan, “RM400 million for Proton vendor development” 18 April 2008, online: Paul Tan \texttt{<http://paultan.org/2008/04/18/rm400-million-for-proton-vendor-development/>}.  
\textsuperscript{277} Alan Harman, “Malaysia Launches Scrappage Subsidy to Aid Struggling Auto Industry” 16 March 2009, Ward’s Auto, online: Wards Auto \texttt{<http://wardsauto.com/ar/malaysia_scrappage_subsidy_090316/>}.  
\textsuperscript{278} “FDI Inflows into China, 1994-2009” online: Chinability \texttt{<http://www.chinability.com/FDI.htm>}.  
\end{flushleft}
prevented capital flight from the country. Instead of devaluing its currency, China sustained aggregate
demand by replacing exports with public investment.\footnote{Emerging Asian Regionalism, supra note 214 at 34.}

The rapidity of China’s economic progress is astonishing. Just in 1961, the country was suffering
from famine that resulted in millions of deaths due to a disastrous experiment with mass agricultural
communes. Conceptualized by Mao Zedong, this attempt to develop industry and culture was called
‘The Great Leap Forward’ and aimed to turn China into a leading industrial power. This plan fell apart
shortly as a result of poor quality equipment, workers falling ill due to overwork and exhaustion,
drought and flood conditions, severe shortage of food and eventual starvation of the masses.\footnote{“Great
Leap Forward”, online: Wikipedia \(<\text{http://en.wikipedia.org/wiki/Great_Leap_Forward#cite_note-0}\>\)} Further
chaos and economic decline ensued as a result of the subsequent ‘Cultural Revolution’ between 1966-
1976 where many universities were effectively shut down, a generation of youth sent to the countryside
to learn about proletarian values, and religious expression was suppressed.\footnote{“The Cultural Revolution”, Oracle
Thinkquest Education Foundation, online: Thinkquest Library \(<\text{http://library.thinkquest.org/26469/cultural-

Economic reform came to China in 1976 under Deng Xiaoping. This prompted the growth of a
rural industrial sector, comprising small-scale rural enterprises (REs) established by townships, villages,
increased significantly from 10 percent in 1978 to 30 percent in 1996.\footnote{Ibid.} Property rights were expanded
which led to a race to form small non-agricultural businesses in rural areas.\footnote{Zuliu Hu & Mohsin S. Khan, “Why is China Growing So Fast?” (1997) Economic Issues Series No. 8, International Monetary Fund.} Decollectivization and
higher prices for agricultural products also encouraged greater productivity in agriculture and the
efficient use of labour. The increase in agricultural output and income in the first half of the 1980s resulted in large rural savings (the total amount of deposits made in 1993 was 26 times that in 1978).

Further reforms in China engendered an open door policy that emphasized foreign investment trade initiatives, and technology transfers. A joint-venture law enacted in 1979 established several special economic zones in the Guangdong and Fujian provinces. Rules on foreign direct investment were liberalized. The low labour costs, cheap yuan, and preferential treatment regarding import controls, taxes, foreign exchange retentions and repatriation of profits, were all factors that encouraged the flow of foreign investment into China.

After 1978, real growth averaged around 9 percent per year and in several peak years, China’s economy grew by more than 13 percent. China has continuously capitalized on its clear comparative advantage in labour-intensive industries and relied heavily on FDI to spur development. Further, since the late 1980s, China has pursued an increasingly export-oriented trade policy and has successfully penetrated markets of advanced economies and developing countries alike. The structure of China’s exports have changed as well, from the clothing, footwear, fuels, and light manufacturing that flourished in the 1980s and early 1990s, towards industrial supplies, electronics, furniture, telecommunications, and office machinery in recent years. Chinese exports in machinery today are now generally more sophisticated and more hi-tech than in previous years. China has successfully evolved into a production and final assembly hub for advanced, high-productivity exports beyond what is normally expected of a

\[\text{\textsuperscript{287}}\] Ibid.
\[\text{\textsuperscript{288}}\] Lin & Yao, supra note 284 at 152.
\[\text{\textsuperscript{290}}\] Ibid.
\[\text{\textsuperscript{291}}\] Hu & Khan, supra note 286.
poor, labour-abundant country. Its position as a major manufacturing base in East Asia for international processing activities for the expanding industry of parts and components trade has also spurred growth in modern-day China.

Despite China’s strong economic performance and remarkable fortitude in withstanding the Asian financial crisis, several areas of concern have arisen. First, it is noted that there is an alarming amount of non-performing loans accumulating on the books of Chinese banks. This amount is estimated to exceed over US$1 trillion, or 40 percent of China’s GDP. A critic of China’s practices states:

“Systemic economic waste, bank lending practices, political patronage and the survival of a one—party state are inseparably intertwined in China [...] after nearly 30 years of economic reform, the state still owns 56 per cent of the fixed capital stock. The unreformed core of the economy is the base of political patronage. Government figures show that, in 2003, 5.3 million party officials held executive positions in SOEs. The party appoints about 80 per cent of the chief executives in SOEs and 56 per cent of all senior corporate executives. Recent corporate governance reforms, Western—style on paper but not in substance, have made no difference. At 70 per cent of the large and medium—sized SOEs ostensibly restructured into Western—style companies, members of party committees were appointed to the boards. Painful restructuring appears to have spared this elite. China has shed more than 30 million industrial jobs since the late 1990s but few party officials have become jobless.”

Woo-Cumings has drawn a parallel between China’s state-owned enterprises (SOEs) with Korea’s chaebol which faces the same predicament. Given the magnitude of the Asian financial crisis and the disaster which befell Korea, delayed reform in debt-laden state-owned enterprises would make the problem much more unmanageable.

Clearly, there is still need for corporate governance reform in China. Privatization of SOEs may ameliorate conditions. However, this requires careful planning and supporting institutions to address three main challenges: First, there is a lack of a social safety net for the public. SOEs generally provide

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293 Ibid.
295 Ibid. (citing ‘The Australian’ - original source not traceable)
296 Woo-Cumings, supra note 236 at 369.
housing, health care, and retirement benefits. Without these provisions, protests by laid-off workers could directly threaten political administration and cause instability in the country.  

Second, there is no adequate legal framework for corporate governance. The regulation of relationships among investors, boards of directors, and managers, creditor prioritization, and obligations under fiduciary duties, is weak. Third, there is a lack of effective regulatory institutions for the financial and banking industries. Currently, if there is a problem with management, the government retains the power to dismiss and replace. If power was devolved by means of privatization, strong regulatory institutions in lieu of direct government intervention would be essential to ensure that any illicit activities are discovered by means of disclosure or investigation, and that persons responsible would be subject to appropriate sanctions.

The final and perhaps most controversial issue related to Chinese economic growth today is the impact of the low yuan on international economies. An undervalued currency encourages export development in China as labour and overhead costs are reduced. This comes at a cost to other producers outside China as they lose competitiveness. This issue has been a cause of consternation in the international trade domain as critics from not only the U.S., but also developing countries like India and Brazil, have alleged that China is unfairly using currency manipulation to keep the value of the yuan low by pegging it tightly to the US dollar since July 2008. The Obama administration faces increasing pressure from American producers to take trade action against China on the grounds that the value of the yuan comprises an illegal trade barrier. No such challenge on currency policy has ever been mounted before the WTO and it is unclear how such a dispute will turn out. Nevertheless, it is clear that any dispute leading to a trade war between two world hegemons would prove extremely detrimental to trade and economic welfare around the globe. At the time of writing, the United States has postponed a

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298 Ibid. at 313.
299 Ibid. at 315.
decision on whether or not to officially declare China a currency manipulator. China’s next steps regarding its currency are as yet undetermined but any decision it makes will significantly influence the trajectory of international trade.

4 **EAST ASIA’S RENAISSANCE**

In 1999, markets in East Asia began to recover from the ill-effects of the crisis. Since then, this region has resurfaced as the world’s most dynamic region, experiencing an ‘East Asian Renaissance’. Before the crisis, export promotion had been a crucial part of East Asia’s growth. In the new era, the focus has shifted even more strongly towards trade activities, incorporating not only exports, but imports as an important driving force in the economy. The challenge for contemporary East Asia is how to address the necessary and inevitable regional integration in the most effective way in an environment where trade tensions are often high due to protectionism, institutional safeguards lacking, and special and differential treatment in the WTO system increasingly irrelevant to the needs of this region.

4.1 **Trade and Regionalism**

East Asian success from the beginning has been attributed to its high performance in exports as well as trade openness, from export-led growth in Japan, to liberal foreign investment policies in Singapore. The modern, post-crisis approach required an evolution in trade and international financial policies to ensure that growth is sustainable and equitable. The trend is leaning towards increasing regional efforts as the countries in East Asia are inextricably linked together through various factors.

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300 “China, America and the yuan” *The Economist* (8 April 2010), online: The Economist <http://www.economist.com/).


303 Jomo, *supra* note 224 at 494.
4.1.1  Trade Initiatives of East Asian Countries

Most of the East Asian countries were contracting parties of the original GATT and automatically gained membership in the WTO when it was established in 1995. Subsequently, China acceded to the WTO in 2001, Taiwan (Chinese Taipei) in 2002, Cambodia in 2004, and Vietnam in 2007. The first RTA in East Asia was the Association of Southeast Asian Nations (ASEAN). The original members of ASEAN were Thailand, Indonesia, Malaysia, Singapore, and the Philippines. Later, membership was expanded to include Brunei, Myanmar, Cambodia, Laos, and Vietnam. It was not until the late 1990s however, that East Asian countries commenced negotiations for additional regional arrangements. Regional negotiations exploded as a frenzy of intra-regional and cross-regional co-operative initiatives were quickly established. The architecture of regional cooperation is broad in scope, overlapping as to subject matter (which may include macroeconomics, market access, security, culture, etc.) and involves a wide variety of partner countries. Figure 4 and Table 1 depict the general architecture of regional arrangements which will be discussed in the subsequent paragraphs.
Figure 4: Economic architecture: regional and transregional forums

Source: Asian Development Bank
<table>
<thead>
<tr>
<th>Countries</th>
<th>Type of Agreement/Forum</th>
<th>Status</th>
<th>Year</th>
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<td>ASEAN-New Zealand-Australia</td>
<td>CRTA&lt;sup&gt;305&lt;/sup&gt;</td>
<td>In effect</td>
<td>2010</td>
</tr>
<tr>
<td>ASEAN-India</td>
<td>CRTA</td>
<td>In effect</td>
<td>2004</td>
</tr>
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<td>ASEAN-Japan</td>
<td>RTA</td>
<td>Signed</td>
<td>2008</td>
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<td>ASEAN-Korea</td>
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<td>ASEAN+3</td>
<td>General Cooperation Forum</td>
<td>Active</td>
<td>1997</td>
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<td>ASEM (Asia Europe Meeting)</td>
<td>Dialogue Forum</td>
<td>Active</td>
<td>1996</td>
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<td>APEC (Asia-Pacific Economic Co-operation)</td>
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<td>Singapore-Pakistan</td>
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<sup>304</sup> Source: Adapted from Saori N. Katada & Mireya Solis, eds., *Cross-Regional Trade Agreements: Understanding Permeated Regionalism in East Asia* (Berlin: Springer, 2008).

<sup>305</sup> CRTA refers to Cross-Regional Trade Agreements (agreements that include partners from outside East Asia).
<table>
<thead>
<tr>
<th>Countries</th>
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The process of trade liberalization in East Asia has undergone a dramatic transformation over two decades. Baldwin categorizes the changes in three phases: In Phase 1 which he entitles ‘Rampant Unilateralism’ (mid-1980s to 1990), East Asian countries unilaterally cut their tariffs on trade because of competition for investments and jobs. In Phase 2, called ‘Regionalism Delayed, Unilateralism Accelerated’ (1990-2000), China emerged as a strong competitor for jobs and investment. This led to an acceleration of unilateral tariff cuts by neighbouring East Asian countries. Phase 3 (2000 onwards) labelled ‘Rampant Regionalism’, witnessed an explosion of regional trade agreement activity prompted by China’s expressed interest in trade talks with ASEAN.

Figure 4 depicts the regional and transregional co-operative efforts that Asian countries have engaged in. ASEAN is at the core of broader regional arrangements. Although the variety of forums have both contrasting and overlapping objectives of economic integration, political dialogue, security concerns, welfare and development, investment, and trade, both Asian and non-Asian countries focus on ASEAN as a dominant partner in these endeavours. Although FTAs and regional forums abound, none

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of these arrangements have yet evolved into fully comprehensive free trade between members that include full coverage of goods, services and investment.

Table 1 lists in chronological order the FTAs and significant forums for cooperation that East Asian countries have participated in. The initiatives are both intra-regional and cross-regional. According to the Asian Development Bank (ADB), Singapore, China, and Korea have been the most active in negotiating FTAs probably because of their superior trade negotiating capacity. Less developed economies (Cambodia, Laos, Myanmar, and Vietnam) have tended to rely more on ASEAN-negotiated FTAs instead. The coverage of these FTAs also vary significantly in coverage and depth. Typically, the deepest and widest deals are bilateral with developed countries, in particular, Japan and the US.

The two major forums which could potentially have the largest impact on trade flows going forward are arguably ASEAN and APEC. ASEAN was founded in 1967 with five original members: Indonesia, Malaysia, Philippines, Singapore, and Thailand, with primarily political objectives in mind. Since then, it has admitted another five members (Brunei Darussalam, Cambodia, Laos, Myanmar, and Vietnam), and expanded its focus on economic and social issues. In 1992, members established the ASEAN Free Trade Area (AFTA), pledging to liberalize manufacturing trade within 15 years. As the only major exclusively East Asian initiative, AFTA established a free trade area for members. Nonetheless, as it currently stands, there may be room for improvement in AFTA. Preferences under this agreement have not been extensively utilized according to Baldwin, as well as a study by Manchin et al. The definition of ‘free trade’ in ASEAN is also somewhat loose, as it includes tariffs in the range of 0-5%.

307 Emerging Asian Regionalism, supra note 214 at 88.
308 Ibid. at 88.
309 Ibid. at 244.
310 Ibid.
311 Baldwin, “Managing the Noodle Bowl” supra note 306 at 9.
rather than the traditional 0%. In 2002, only 11.2% of Thailand’s imports from AFTA took advantage of preferences under the Common Effective Preferential Tariff (CEPT) while Malaysia’s data suggest that just 4.1% of its exports within the region enjoyed the CEPT preference. Manchin and Pelkmans-Balaoing’s recent study of intra-ASEAN trade under AFTA indicates that Singapore and Brunei have such low tariffs that preferential treatment is trivial, and for the other four (Indonesia, Philippines, Malaysia, and Thailand), preference margins were less than 5% on 84% of total intra-ASEAN trade in 2001-2003. They found that countries that confer the highest margins have also imposed non-tariff measures (NTMs) on the same products as demonstrated by the high margins for vehicles (HS 870310 category) offered by Malaysia, Thailand, Indonesia, Philippines, and Thailand, that also experience the concurrent imposition of NTMs on these products. This study indicates that the coincidence of large tariff discounts and NTMs reveal areas of import substitution which remain resistant to liberalisation even when limited to just AFTA countries.

Underutilization of preferences is not just limited to ASEAN. Despite the proliferation of East Asian FTAs, the agreements may not in practice be leading to increased preferences for these member parties across the board. The Economist reports that only 22% of firms are taking advantage of trading preferences offered by these agreements. This could be due to the complexities related to rules-of-origin requirements and the continued protection of sensitive domestic sectors.

The other major forum or alliance involving East Asian countries is APEC (Asia-Pacific Economic Co-operation). Formed in 1989, its membership composition is different from ASEAN in that it comprises 21 countries from across East Asia, Oceania, North America and Europe. These are: Australia, Brunei

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314 Baldwin, “Managing the Noodle Bowl” supra note 306 at 10.
316 Manchin & Pelkmans-Balaoing, supra note 312 at 221.
Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, United States, and Vietnam. APEC’s primary goals focus on the advancement of economic prosperity and growth in the Asia-Pacific region via the channels of ‘trade and investment liberalization, business facilitation, and economic and technical cooperation’.318 Although it was not created as a trade agreement, APEC members have been discussing the possibility of a Free Trade Area of the Asia Pacific (FTAAP) since 2006. Spurred by their joint adoption of the ‘Bogor Goals’ in 1994, APEC members are continuously seeking ways to achieve these goals, which include the goal of free trade and open investment for industrialized countries by 2010, and for developing economies by 2020.319

4.1.2 Rationale for the Spread of East Asian RTAs

In this section, I focus on the aforementioned era of ‘Rampant Regionalism’ as it is instructive to understand the motivations of most East Asian countries over the past decade, that are still very pertinent to today’s political and trade environment. The general reasons for pursuing RTAs have already been described in Chapter II. In addition to that, East Asia, just as any other region, has its own individual reasons for pursuing trade agreements. RTAs in East Asia encompass bilateral agreements, plurilateral agreements, and regional agreements. The ‘regional agreement’ context refers to efforts made to deepen integration across a group of countries with common purposes. Bilaterals and regional initiatives alike have multiplied. The main factors influencing this trend are analyzed in below.

4.1.2.1 General Economic Motivations

Economic factors are by far the most significant driving force of RTAs. East Asia consists of numerous emerging and fast-developing economies like China, Korea and Malaysia that are part of a

318 “Scope of Work”, APEC, online: APEC <http://www.apec.org/apec/about_apec/scope_of_work.html>
rapidly expanding production network. As such, the market drives the requirement for economic integration measures in order to facilitate trade and FDI.\footnote{Masahiro Kawai & Ganeshan Wignaraja, “Regionalism as an Engine of Multilateralism: A Case for a Single East Asian FTA” (2008) Asian Development Bank, Working Paper Series on Regional Economic Integration No. 14, at 5 [Kawai & Wignaraja, “Regionalism as an Engine of Multilateralism”].} By using trade agreements to eliminate cross-border impediments and harmonize rules and procedures, governments advance the economic growth of their countries. The progress of European Union integration and the successful launch of NAFTA also caused East Asian government to fear that two giant blocs might dominate the rule-setting within the global trading system while reducing the importance of Asia in multilateral negotiations.\footnote{Ibid. at 6.} To combat this potential loss of power in economic decision-making, East Asian countries are increasingly looking to consolidate regional strength to increase their bargaining positions in the multilateral realm. In addition, concurrent pessimism towards the slow progress and disillusionment of the Doha Development Agenda have caused many to look at regionalism as an insurance policy against the potential breakdown of multilateral negotiations.\footnote{Ibid.} The contagion effect of the 1997 Asian financial crisis across neighbouring countries was a drastic reminder of the need to strengthen economic cooperation within the East Asian region. The analysis in the preceding sections demonstrated how countries could be severely impacted by negative investor perception of the region as a whole, and also how unsound economic and business practices can easily replicate themselves in neighbouring countries. There has also been an appreciation of an individualized ‘Asian’ approach towards dealing with the crisis due to what is now considered the inappropriate recommendations of the International Monetary Fund (IMF) during the Asian crisis. In exchange for financial aid to ailing countries, the IMF had required recipients such as Thailand to implement fiscal austerity and tighter monetary policies. Critics such as Stiglitz argue that the IMF’s policies deepened East Asia’s recession as exemplified by the case of
Thailand which implemented IMF recommendations and performed worse than Korea or Malaysia, which had pursued more independent courses to lift themselves out of crisis.  

Governments are constantly in search of new and expanded market access opportunities globally for their domestic exporters. By entering into agreements to liberalize trade with partner countries, these governments stand a better chance of increasing trade flows and business opportunities for their own stakeholders. This is true of East Asian motivations, but additionally, agreements have also been forged as a defensive mechanism due to the ‘domino effect’ of RTA creation in this region. Chia (2010) argues that the economic rivalry between the two great East Asian powers, China and Japan, led to both states rushing into trade agreements with ASEAN. This trend caught on quickly as other Asian countries stepped up their efforts to create bilateral and plurilateral agreements with a myriad of partners out of concern for their own competitiveness and the desire to prevent the diversion of trade flows away from their own countries.

4.1.2.2 Cross-Regionalism of East Asian Trade Agreements

East Asia’s RTAs are unique in comparison with those formed by European and North American counterparts in terms of their early involvement in cross-regional trade initiatives. Katada et al. have demonstrated that cross-regionalism started much earlier for East Asia, when they occurred at the beginning of their FTA initiatives, whereas for Europe and North America, extra-regional partnerships were pursued only after their regional blocs had been consolidated (with one exception, the US-Israel FTA).  

In this section, the empirical studies of Katada et al. are drawn upon for case studies of Singapore, Japan, Thailand, Malaysia, Korea. These studies demonstrate the variety of reasons leading

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to proliferation of East Asian trade agreements beyond straightforward economic calculations. The overarching hypothesis posited by these authors are that East Asian countries have been more prone to select RTA partners from outside the region because of real constraints they feel in advancing a regional integration agenda.\textsuperscript{325}

\textit{Korea}

Korea pioneered cross-regionalism as the first East Asian country to strike a trade deal with a transpacific country. The Korea-Chile Free Trade Agreement was signed in 2003, five years after negotiations were first commenced in 1998. In the aftermath of the Asian financial crisis, policy decision-makers in Korea started viewing FTAs as crucial to its economic survival in a world of uncertainties.\textsuperscript{326} Park and Koo argue that Chile was selected as Korea’s first FTA partner as it would have minimal costs for Korea’s uncompetitive sectors, such as agriculture.\textsuperscript{327} Further, in order for Korea to gain bilateral trading experience and negotiation skills while minimizing risks and potential losses, Korea had to select a country with an open trade policy and solid experience in trade negotiations.\textsuperscript{328} Chile fit the bill.

\textit{Singapore}

Singapore has been extremely active in the pursuit of bilateral agreements with both intra-regional and inter-regional partners. Sally has described Singapore’s RTAs as virtually the only reasonably strong agreements among the ASEAN countries.\textsuperscript{329} He further opines that in terms of quality of RTAs, ‘Singapore, with its free-port economy, centralized city-state politics, efficient administration, and world-class regulatory standards, is a misleading indicator for the region’.\textsuperscript{330} Singapore’s first five

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{325} \textit{Ibid.}
\item \textsuperscript{326} Sung-Hoon Park & Min Gyo Koo, “Forming a Cross-Regional Partnership: The South Korea-Chile FTA and Its Implications” in Saori N. Katada & Mireya Solis, eds., \textit{Cross-Regional Trade Agreements: Understanding Permeated Regionalism in East Asia} (Berlin: Springer, 2008) 27 at 34.
\item \textsuperscript{327} \textit{Ibid.} at 45.
\item \textsuperscript{328} \textit{Ibid.}
\item \textsuperscript{329} Sally, \textit{supra} note 12, at 84.
\item \textsuperscript{330} \textit{Ibid.}, at 84.
\end{enumerate}
\end{footnotesize}
trading partners were all OECD members (Organization for Economic Co-operation and Development; New Zealand, Japan, Australia, EFTA members, and United States) and were also Singapore’s main trade and foreign direct investment partners. The Singapore-US agreement is considered a ‘landmark agreement’ with its comprehensive coverage including WTO-plus and NAFTA-plus obligations, intellectual property rights, e-commerce, advanced rules of origin, and customs cooperation for trade facilitation. Singapore was also the United States’ first partner in the Asian region.

Singapore was eager to take advantage of RTAs because of its status as a knowledge-based economy (it is small in land mass and resource deficient) and consequently depends on advanced countries as major sources of trade, FDI and technology transfer. Singapore extended its initiatives across the region as the ASEAN Free Trade Area (AFTA) was ultimately not liberalized enough for Singapore’s own desires to achieve free and fast trade deals.

Japan

Japan’s second free trade agreement also constituted its first cross-regional agreement. In 2004, Japan signed the Japan-Mexico free trade agreement, approximately six years after bilateral trade talks first commenced in late 1998. One key motivation stemmed from the effect of NAFTA on Japanese industrial interests vis-à-vis Mexico. The business sector in Japan suffered losses as a result of NAFTA’s trade and investment diversion effects, and promptly pressured the Japanese government to negotiate for its own free trade agreement. Losses were felt by Japanese suppliers in the market for

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332 ‘WTO-plus’ and ‘NAFTA-plus’ refer to obligations exceeding the existing requirements of these two bodies.
333 Low, supra note 331 at 51.
334 Ibid.
Mexican government contracts when Mexico abruptly announced in 2003 that government procurement bids would be restricted to firms headquartered in its NAFTA partners (note that Mexico is not a signatory to the WTO’s Agreement on Government Procurement). In addition, Japanese electronics firms who were benefiting from tariff advantages such as duty exemption on the importation of machinery through the ‘maquiladora program’ saw these benefits diminish as NAFTA required Mexico to phase out duty drawbacks under this program. Finally, high tariffs on imported finished vehicles in Mexico severely limited Japanese exports as companies in the United States and Europe enjoyed duty-free benefits to this market. Japanese auto companies were eager to gain a foothold in this sector which could be feasible if a bilateral agreement between Japan and Mexico eliminated tariffs and performance requirements for Japanese vehicles.

In addition to these economic rationales, Solis and Katada posit that Japanese bureaucrats desirous of increasing Japan’s FTA diplomacy policies hoped that an agreement with Mexico would help them increase political support for FTAs and weaken the clout of the Japanese agricultural lobby over trade policy. This led to significant efforts by Japanese leadership to attain compromise and accommodation within competing political interests towards agricultural liberalization. Subsequently, this agreement was considered a success by the Japanese government as the Japanese agricultural lobby made a substantial concession from its original position of negotiating only at the multilateral level and agreed to modest liberalization in 43% of tariff lines. It also marked the first case where agricultural liberalization (although limited) was explicitly included in an FTA. Overall, this experience was extremely valuable to Japan’s bureaucracy as Japanese negotiators were able to utilize this

336 Ibid.
337 A maquiladora or maquila is a factory in Latin America that imports materials and equipment on a duty-free and tariff-free basis for assembly or manufacturing, and then re-exports the assembled products, usually back to the originating country. “Maquiladora”, online: Wikipedia <http://en.wikipedia.org/wiki/Maquiladora>.
338 Solis & Katada, supra note 335 at 80.
339 Ibid. at 79.
340 Ibid. at 91.
341 Ibid. at 89.
opportunity to obtain FTA “know-how” from their seasoned Mexican counterparts. The Japan-Mexico agreement is also considered the benchmark text for Japan in trade negotiations with Asian countries.  

*Thailand and Malaysia*

The proliferation of trading arrangements around the globe as well as China’s entry into the WTO galvanized Thailand to consider FTAs as a way to minimize trade diversion and improve global market access.  

Thailand’s FTA policy also correlates with foreign diplomacy interests in order to establish broader relations of cooperation with key partners. It was noted by Tulyanond that ‘trade deals with India and China are more significant politically than economically and were completed so as to provide Thailand with ‘political credit’ prior to the APEC leaders’ summit in late-2003’.  

Thailand also sequenced its trade deals to begin with smaller partners that are of relatively minor economic value, such as its first FTA with Bahrain in order to build capacity in trade negotiations with less risks attached.  

However, Thai FTAs have not been regarded as particularly high in quality as ‘carve-outs to protect Thai agriculture, services, and state enterprises, and weak investment, procurement, sanitary and phytosanitary measures, and labor and environment provisions are arguably not up to the WTO standards. For example, in the FTA with New Zealand, Thailand was able to defer for later consultation the liberalization of services and government procurement, delay selected manufacturing and agricultural tariff reductions for as long as 10 years, and subordinate labor and environmental safeguards to non-binding side agreements’.

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342 *Ibid.* at 92. The authors cite information derived from interviews with Japanese officials in 2005.  
Before 2005, Malaysia was less than enthusiastic about FTA deal-making, compared with Thailand. In 2005, the Minister of International Trade, Rafidah Aziz, announced Malaysia’s trade policy which comprised for the first time FTAs as a policy element. Partners selected for negotiation discussions were Australia, New Zealand, India and Pakistan. Malaysia’s first bilateral agreement, the Japan-Malaysia Economic Partnership Agreement (JMEPA) took effect in 2006 and contained provisions for Malaysia to reduce tariffs on Japanese cars and for Japan to remove tariffs on most agricultural and fishery exports. Since then, Malaysia has signed only one other bilateral treaty, with Pakistan in 2007. Hoadley opines that comprehensive FTAs cannot be expected of Malaysia as it has shown no signs of relinquishing protection of ‘state-mentored’ automobile and steel industries, the Bumiputra (Malay) enterprises, and government procurement.  

He argues that the JMEPA may not properly be characterized as an FTA as although it liberalizes trade in some goods and services, it is filled with major exclusions requiring future resolution and its execution is delayed by a 10-year period to allow domestic industries to adjust. Hoadley is similarly pessimistic about the success of other bilateral negotiations involving Malaysia.

**China**

Although a late entrant to the FTA scene, China has pursued regional and cross-regional FTAs over the past decade with vigour. Of note, on January 1\(^{st}\), 2010, the China-ASEAN FTA (CAFTA) came into force. This agreement constitutes the world’s largest free trade area in size (with 1.9 billion people) and the third largest according to GDP ($6 trillion in combined GDP). The agreement eliminated tariffs and barriers on 90% of products. Exceptions were made for the poorest four ASEAN members, Vietnam, Cambodia, Laos and Myanmar, who will not need to cut tariffs to the same levels until 2015. CAFTA

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347 Hoadley, *supra* note 343 at 115.

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suffers from several deficiencies that have marked East Asian FTAs and many FTAs around the world. It lacks solid institutions. There is no rigorous mechanism for dispute settlement which has caused doubts about whether the deal will have real teeth.\(^\text{351}\)

China’s interest in regional liberalization was prompted partly by its realization that it had limited influence in multilateral talks and would be able to play a stronger role at a regional level.\(^\text{352}\) It has publicly promoted a vision of ‘peaceful development’ that portrays China’s development as an opportunity rather than a threat to other countries.\(^\text{353}\) Hoadley and Yang propose that China’s key motivations in pursuing FTAs include ‘frustration at the lack of progress in multilateral trade organizations and forums, anxiety regarding the increasing momentum of FTA talks in other parts of the world, and the risk of discrimination against China’s exports.’\(^\text{354}\) Beyond that, China perceives economic development as the central core of comprehensive national power, including national security. As such, Hoadley and Yang argue that China’s FTA talks are related to its security strategy inasmuch as it pertains to economic growth.\(^\text{355}\) They illustrate this argument with the example of China’s interest in FTA talks with Australia, given that Australia could be an intermediary between the United States and China in security matters.\(^\text{356}\) For their part, China has publicly declared its intentions for a ‘peaceful rise’ with the noble goal of contributing to the world’s ‘long-term prosperity and stability’ by providing ‘every country with development opportunities and practical interests.’\(^\text{357}\) Although this makes for interesting rhetoric, other countries, including hegemons such as the United States, are not likely to feel any less threatened

\(^{351}\) “The China-ASEAN free-trade agreement: Ajar for business” The Economist (January 9, 2010) 44.


\(^{353}\) Ibid. at 146.

\(^{354}\) Ibid. at 142.

\(^{355}\) Ibid. at 143.

\(^{356}\) Ibid.

\(^{357}\) Ibid.
by the vigorous competition that China poses to their own economies as illustrated by the growing number of WTO trade disputes with China over the past several years.\footnote{Ding Qingfen, “China to see more trade disputes this year” 6 March 2010, China Daily, online: China Daily <http://www.chinadaily.com.cn/china/2010npc/2010-03/06/content_9546712.htm>.

5  THE CASE FOR DEEPER REGIONAL INTEGRATION

5.1  General Arguments

The reality is that regionalism will remain prevalent for the foreseeable future and the spaghetti bowl will likely become increasingly intricate if the proliferation of RTAs is left unchecked. Although the potential diversionary effects of RTAs as examined in Chapter II have been acknowledged, the intention of this thesis is to explore ways in which these effects can be mitigated in East Asia. Given the political impossibility of completely overhauling the multilateral system in favour of developing countries, a properly designed and managed regional arrangement is potentially the alternative most likely to succeed. This section proposes a move towards deeper economic, social and political integration within the East Asian region via one cohesive arrangement that amalgamates most of the existing East Asian bilateral and plurilateral trade agreements.

Lawrence has advocated regional arrangements by arguing that they promote ‘deeper integration’ through coordination or harmonization of policies including competition, product standards, regulatory regimes, investment codes and labour standards.\footnote{Robert Lawrence, “Regionalism, Multilateralism and Deeper Integration” (1997), Washington: Brookings Institution, as cited in Arvind Panagariya, “The Regionalism Debate”, supra note 108 at 43.} In the same light, Wolf posits that ‘jurisdictional integration’ is the most powerful mechanism for ensuring that the forces of economic convergence overwhelm those of divergence.\footnote{Wolf, supra note 11, at 315.} He cites the European Union as the prototype of ‘credible commitments’ to regional freedom of movement to trade, people, and capital. Wolf considers these elements of integration crucial for the generation of development for poorer countries in the
union, leading to the lessening of inequality and extreme poverty.\textsuperscript{361} He is not alone in this argument. Freedom of labour movement has also been considered by Unger as a crucial element to achieving an open world economy and for the attenuation of extreme inequalities among nations.\textsuperscript{362}

Some developing countries appear willing to assume commitments under regional arrangements that are resisted at the multilateral level. In a study by Low, the author finds that 37 regional agreements between developed and developing countries include provisions on competition, investment, government procurement, environment and labour – issues that still do not have consensus in the WTO agenda.\textsuperscript{363} As such, Low questions whether the WTO process adequately reflects the interests of all developing countries.\textsuperscript{364} This statistic is a useful foundation for the argument that more multilateralism could be achieved in the long run if developing countries are allowed the freedom to approach liberalization gradually.

A key reason for deeper regional integration is enhanced leverage or bargaining power that can be acquired by weaker nations on the multilateral negotiation stage. Trachtman has surmised that states may cultivate regional integration agreements as an alternative to multilateral integration and in the process enhance their leverage in multilateral negotiations.\textsuperscript{365} This was a motivating factor behind the formation of the Southern Common Market (MERCOSUR). Further, Katada et al. have also observed that East Asian countries frequently choose an extra-regional FTA partner in order to ‘break regional inertias that hinder integration, to win domestic battles and to appropriate extra-regional modalities that they can use in their subsequent intra-regional FTA negotiations’.\textsuperscript{366} However, the leverage

\begin{footnotesize}
\begin{enumerate}
\item Wolf, supra note 11, at 315.
\item Unger, supra note 94 at 163.
\item Low, supra note 40 at 341.
\item Ibid.
\item Trachtman, supra note 97, at 9 – 10.
\item Solis & Katada, supra note 324 at 5.
\end{enumerate}
\end{footnotesize}
argument works both ways. RTAs can conversely be used by powerful countries to acquire support from weaker trading partners in WTO negotiations.\textsuperscript{367}

Hamada has also suggested that merging the criss-crossing RTAs could turn the bilateral spaghetti into a (regional) lasagne. It is noted that the WTO together with the Global Economic Governance Programme (GEG) at Oxford University, have embarked on efforts to harmonize the array of existing RTAs.\textsuperscript{368} Such efforts may assist in mitigating problems for an East Asian RTA.

Having discussed the reasons in general for deepening regional relationships, I turn now to the specific case of East Asia.

### 5.2 The Reasons for Strengthening East Asian Regionalism

The network of RTAs involving East Asian countries, whether intra-regional or cross-regional, has been termed the ‘noodle bowl’ by analogy to the ‘spaghetti-bowl’ concept. However, there is still no cohesive RTA unifying countries in this region. The proposal of regional integration had been suggested before by former Malaysian Prime Minister Mahathir Mohamad who called for an East Asian Economic Community in 1991.\textsuperscript{369} It was effectively blocked by the US who countered this proposal by pushing for the Asian Pacific Economic Cooperation (APEC) in 1993.\textsuperscript{370} Although the ASEAN FTA (AFTA) was ultimately created, a broader region-wide community did not get off the ground as East Asian nations cared more about the US market, and the US’ security role in the region was considered important.\textsuperscript{371} The ‘exclusively Asian’ theme of Mahathir’s proposal seemed too risky to many in the region.\textsuperscript{372}

\textsuperscript{367} Wolf, supra note 11, at 214.
\textsuperscript{369} Baldwin, "Managing the Noodle Bowl", supra note 306 at 8.
\textsuperscript{370} ibid.
\textsuperscript{371} ibid. at 9.
\textsuperscript{372} ibid.
As depicted in Figure 5 below, the trading landscape in East Asia resembles a noodle bowl of bilateral and plurilateral trade agreements, coalitions, formal and informal ‘cooperation efforts’, forums, and dialogues. With each year that passes, the strands of noodles multiply as more and more agreements are reached between countries.

Figure 5: The Noodle Bowl of East Asian RTAs
(Source: Baldwin, 2006)

In this thesis, I argue that the integration of these RTAs into one comprehensive arrangement is essential. Although integration may also desirable in other aspects such as political decision-making and security, the scope of the arguments here focus primarily on trade arrangements. The reasons propelling the need for integration and potential benefits for the East Asian region and global environment alike are summarized in the following paragraphs.

5.3 The Need for Integration

First, the Asian financial crisis highlighted the negative effects of contagion on the whole region as exemplified by the case of Indonesia. Foreign investors often perceive East Asian countries as almost
a common entity, sharing many common economic and cultural features. The crisis highlighted Asia’s growing interdependence as the global financial panic left no country in this region untouched. The Asian Development Bank (ADB) strongly advances the view that regional integration is important to build more resilient economies and argues that an Asian financing-facility would have been beneficial to provide more timely and better-tailored support.\(^{373}\)

Second, industries in East Asia have evolved in terms of production processes and capabilities. A regional ‘Factory Asia’ has emerged with Japan’s manufacturing industry as the catalyst. Due to rising labour costs in Japan starting in the mid 1980s, Japanese firms increasingly sought lower cost production sites which resulted in the ‘hollowing out’\(^ {374}\) (deindustrialization) of the Japanese economy.\(^ {375}\) Firms based in Japan would produce certain hi-tech parts in Japan, ship them to factories in ASEAN partner countries for further production stages (including assembly) and then export the final products to overseas markets or back to Japan.\(^ {376}\) To sum this up, Asia has ‘vertically integrated production networks’ that operate by ‘separating a production chain into small steps and then assigning each to the most cost-efficient location’.\(^ {377}\) As these production processes become more fragmented, the region becomes further integrated because of the enhanced mutual reliance on each other to achieve the final product. World trade in parts and components has risen in value from US$400 billion in 1992 to over US$1,000 billion in 2003.\(^ {378}\) East Asia plays a major role in the provision of international processing activities, with China as a major manufacturing hub that relies on inputs originating in other Asian countries. In this network of production sharing, countries have developed individual niches of

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\(^{373}\) *Emerging Asian Regionalism*, *supra* note 214 at 33.

\(^{374}\) ‘Hollowing out’ is also known as deindustrialization. This phenomenon refers to the process whereby there is a significant reduction in the industrial capacity of a nation brought on by the increasing weakness of the domestic manufacturing sector. See Roblyn Simeon & Yumi Ikeda, “The Hollowing Out Phenomenon in Japan” (2003) 1:6 Journal of Business and Economics Research 1.

\(^{375}\) Baldwin, “Managing the Noodle Bowl”, *supra* note 306 at 5.

\(^{376}\) *Ibid.*

\(^{377}\) *Emerging Asian Regionalism*, *supra* note 214 at 61.

\(^{378}\) Haddad, *supra* note 292 at 12.
comparative advantage in order to specialize in their respective areas of expertise. Malaysia, Philippines and Thailand have performed very well in exports of finished or assembled machinery and Japan accounts for over half of East Asia’s machinery exports. Korea and Taiwan which initially conducted low-skill assembly activities have gradually transferred this specialization over to lower-wage countries such as Malaysia and Thailand, and then on to China and Vietnam.

Figure 6 below depicts the intra-regional relationships engendered by production networks in East Asia. This supply chain for the manufacture of disk drives in Thailand spans nine Asian economies as well as Mexico and the US. A region-wide integration agreement may further encourage production and trade by establishing compatible rules of origin, product and technical standards and regulatory obligations by countering the noodle bowl effect of overlapping requirements which have led to severe costs and confusion.

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379 Ibid.
380 Ibid.
A third reason why deeper integration is necessary relates to the uncertainty of outcomes in the Doha Round. Multilateral discussions have yielded very little progress in the span of over eight years. The rift between developed and developing nations over the issue of rich country agricultural subsidies, the rise of anti-dumping measures and technical barriers to trade against poorer countries, and the special safeguard mechanism for developing country farmers to protect against agricultural import surges, remains wide. The most recent ‘stock taking’ talks in March 2010 announced that the much-touted objective of concluding this round of negotiations by 2010 has been set aside.\(^\text{381}\) This is not to say that East Asia should abandon negotiations at the WTO level. My argument is that while efforts to break...
the Doha impasse continue, East Asian countries should take advantage of the opportunities to improve their own economic prospects afforded by integration. This will also have the effect of increasing their bargaining strength in future multilateral negotiations, which assist in resolving issues with developed nations.

Fourth, there is a need to increase the diversification of exports to regions beyond Europe and North America. The trajectory of exports from East Asia between 2000 and 2007 has shown a declining dependence on European and American markets, as market shares in Asia have risen. Nevertheless, East Asian exports still rely heavily on Western markets, with 61% of Asian exports (including India) going to the G3 economies of Europe, Japan, and the US. Chia (2010) posits that ‘excessive dependence on external demand and the unsustainable nature of overproduction in developing Asia that is sustained by overconsumption in the US’ is a risky course to follow. She argues that East Asia, particularly China, should emphasize domestic demand and take steps to re-orient trade in final goods within the region to rebalance regional growth by way of strengthening domestic consumption. The US credit crunch crisis which started in 2007 and is currently still plaguing the American economy, has transmitted negative effects to East Asian economies through the collapse in demand for East Asian exports. Asian stock markets suffered losses as many Asian firms in industries like heavy manufacturing and electronics are extremely dependent on US demand. Japan, Korea, Hong Kong and Singapore are likely to be the hardest hit due to their significant reliance on export driven growth. With a larger regional market, economies of scale, specialization, and ultimately the creation of trade in many different products will

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383 Ibid. 10.
be greatly encouraged. The goal of increased intra-regional trade can also be facilitated with strengthened cooperation in the removal of trade barriers.

Integration of trade agreements into a region-wide arrangement would likely result in more economic benefits for East Asian countries and the global market. Kawai and Wignaraja have utilized a modeling study to show that consolidation of rules of origin and harmonization of standards in an East Asian RTA can make a significant positive contribution. Their analysis indicates that an ASEAN plus Three (Japan, Korea, and China) free trade agreement would yield a gain in world income of $214 billion, and an even larger gain from an ASEAN plus 6 (Japan, Korea, China, India, Australia, and New Zealand) agreement would result to the value of $260 billion.

Asian regionalism is a theme that has recently gathered momentum in the Asian Development Bank which is preparing for a mission shift from a national focus to a regional and ultimately global focus. The opportunities and benefits of regionalism for Asia are considered to be significant and wide-ranging. From this Asian perspective, the ADB posits that regional cooperation that is effectively structured and implemented will be able to achieve the following benefits for the region:

- Link the competitive strengths of its diverse economies in order to boost their productivity and sustain the region’s growth;
- Connect the region’s capital markets to enhance financial stability, reduce the cost of capital, and improve opportunities for sharing risks;
- Cooperate in setting exchange rate and macroeconomic policies in order to minimize the effects of global and regional shocks and to facilitate the resolution of global imbalances;
- Pool the region’s foreign exchange reserves to make more resources available for investment and development;
- Exercise leadership in global decision making to sustain the open global trade and financial systems that have supported a half century of unparalleled economic development;

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385 Chia, “Regional Trade Policy”, supra note 382 at 11.
386 Kawai & Wignaraja, “Regionalism as an Engine of Multilateralism”, supra note 320 at 17.
387 Emerging Asian Regionalism, supra note 214 at Foreword.
Build connected infrastructure and collaborate on inclusive development to reduce inequalities within and across economies and thus to strengthen support for pro-growth policies; and,
Create regional mechanisms to manage cross-border health, safety, and environmental issues better.  

The ADB also highlights benefits of ‘outward-looking’ Asian regionalism for the world. It proposes that an integrated Asia has the incentive to keep global markets open and vibrant, and can accomplish the following:

- Generate productivity gains, new ideas, and competition that boost economic growth and raise incomes across the world;
- Contribute to the efficiency and stability of global financial markets by making Asian capital markets stronger and safer and by maximizing the productive use of Asian savings;
- Diversify sources of global demand, helping to stabilize the world economy and diminish the risks posed by global imbalances and downturns in other major economies;
- Provide leadership to help sustain open global trade and financial systems; and,
- Create regional mechanisms to manage health, safety, and environmental issues better, and thus contribute to more effective global solutions of these problems. 

6 Why East Asia Should Move Beyond Reliance on Special and Differential Treatment

East Asia is a region that is noted for its impressive economic growth, emerging economies, and is the locus of the world’s largest economies, Japan and China. Although two countries in this region, Myanmar and Cambodia, are still classified as ‘least-developed countries’, the region as a whole has developed to a level that no longer corresponds with the original aims of SDT provisions. It is acknowledged that East Asia is not as economically powerful as its North American or European counterparts but there are promising signs that further progress will propel this region to an equally dominant status. The question is whether special and differential treatment should continue to play an

388 ibid. at 13.
389 ibid. at 14.
important role in this development, or whether regionalism is a more viable vehicle to increased and sustained growth. I have argued that the East Asian region must make a concerted effort to work as a unified whole. Consequently, it would likely be counterproductive to attempt advancing both regionalism and SDT concurrently as this would inevitably lead to many exceptions and intrinsic protectionist efforts, which would in turn undermine the goals of open regionalism.

There are several reasons why East Asia is ready to detach itself from reliance on SDT. First, it is useful to note the differences in SDT provisions adopted before the Uruguay Round and those which came after. Whalley has pointed out that the former were designed to provide access to markets in advanced countries, while the latter concerns mainly assistance to developing countries in implementing WTO disciplines. However, these SDT provisions are in practice of no real help because some of the WTO disciplines themselves have anti-developmental impacts. For example, TRIPs has promoted the interests of developed countries over those of poorer nations due to the emphasis on patent holding and intellectual property rigidity leading to the denial of access to important generic medicines to developing countries. Additional WTO provisions allowing for restrictions on textile quotas and the massive scale of agricultural support in Western countries have hindered the growth of developing countries. Doha, as it presently stands, does not indicate that any change is imminent.

Many countries in East Asia have unilaterally liberalized tariffs on a wide range of goods (with the exception of certain sensitive sectors). China even undertook obligations that were more onerous than most other WTO members, and was not allowed to claim full SDT rights unlike other developing

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391 Singh, ibid. at 7.
392 Ibid.
countries, in acceding to the WTO.\textsuperscript{393} Thus, it is unlikely to require additional protection for its goods at this stage. Although some countries such as Malaysia still rely on infant-industry and import substitution policies, I have argued that this is detrimental to sustainable, long-term economic growth. Long-term protection against imports can result in domestic industries that are non-competitive, it encourages rent-seeking behaviour by government officials and businesses, and the inability to compete globally while expending large quantities of public funds on stagnant industries can lead to economic decline. In addition, the Doha Round has not seen significant demands from East Asian countries for further special treatment on their domestic products. Instead, these demands have chiefly been for improved market access in advanced countries.\textsuperscript{394} This signifies that East Asia does not need to retain the last vestiges of special treatment. Instead, demands at Doha for improved market access can be better achieved through a united front, while acting decisively to enhance domestic demand within the East Asian region.

7 \textbf{Summary}

The region of East Asia has been lauded as an economic miracle\textsuperscript{395} for its astounding pace of growth within the span of just four decades. In 1997 however, the region sustained a serious crisis that saw growth rates and profits plunge drastically in less than two years. Numerous factors such as the weakening of Asian industries, the twin crises of banking and currency precipitated the economic collapse. This was further exacerbated by mismanagement of foreign reserves, excessive foreign currency borrowings, and the contagion effects of investor panic across the region. There have been serious concerns over industrial policies in countries such as Korea and Malaysia which do not encourage growth which is sustainable. At the same time, China’s resilience during the crisis and

\textsuperscript{393} “Substance of Accession Negotiations” World Trade Organization, online: WTO <http://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c5s1p1_e.htm>.
\textsuperscript{395} \textit{The East Asian Miracle}, supra note 216.
dramatic ascent from years of starvation in the 1960s and 1970s, to its status today as the world’s largest exporter has significant implications for the region.

Since the crisis, markets in East Asia have rebounded due in large part to high levels of international exports originating from the region. East Asian countries have been extremely active in forming RTAs with each other as well as with cross-regional partners in a bid to expand market access and to strengthen their bargaining positions in multilateral negotiations. I argued that the spaghetti bowl problem of overlapping trade agreements should be mitigated by deepening regional integration. The existing interdependencies in the ‘Factory Asia’ production network have further increased mutual reliance between Asian countries. As such, firms in the region would benefit from closer coordination through an improved integration scheme that harmonizes rules of origin and technical standards.

In light of the concerns related to sustaining the rapid pace of East Asia’s economic growth, I have proposed that enhanced regionalism will be important for this region. This is also a useful complement to the multilateral system which is currently experiencing its own difficulties. The paralysis in multilateral negotiations coupled with the detrimental effects of overprotecting certain industries in developing countries provide further compelling reasons for East Asia to move beyond reliance on SDT, and towards a regional trade agreement.
CHAPTER IV: THE PATH TOWARDS A DEEPER REGIONAL TRADE AGREEMENT IN EAST ASIA

Regional integration is an endeavour which can be extremely broad in scope as it affects a myriad of issues and areas. If the long process of forming the European Union can be taken as an example, it is evident that complete integration in East Asia will be a highly ambitious project and will likely to take many years or decades, to fully realize. As a comprehensive review of all areas pertinent to regional integration is not possible within this thesis, the scope of this chapter will be limited to trade measures, in particular, trade in goods. In proposing several recommendations for an effective RTA, I review notable challenges to integration together with initiatives for co-operation in the region which have previously been undertaken.

1 Political and Technical Challenges to Integration in East Asia

As illustrated in Chapter III, there is a need for deeper integration in East Asia. Despite this, there are many challenges in the region that have the potential to impede progress in this regard. Again, as the breadth of issues and challenges concerning East Asia are too numerous for a complete taxonomy in this thesis, the following analysis will focus on what I consider to be the most significant political and technical obstacles.

First, the East Asian region suffers from a lack of a common vision. Countries do not agree on the level of need for economic integration and the potential benefits for states. There are different levels of interest in integration, and perceptions by some countries that integration may impinge upon sovereignty. Further, as Chia observes, the identification of East Asia in ‘community terms’ is still a new
concept, one which emerged only in the 1990s. Decades of colonization experienced by Southeast Asian countries have led to a strong sense of nationalism and state sovereignty that do not easily allow for the surrender of decision-making autonomy. In that vein, Nakamura states,

“Many East Asian countries are young nation-states and cherish the principles of state sovereignty and non-interference in the affairs of other states. Most of them regard the creation of macro-regional law and institutions as politically suspect, because they tend to associate such arrangements with the supra-national organization of the EC, and fear a consequent loss of national autonomy under such arrangements.”

Additionally, there is acute mistrust between the region’s most powerful states, China and Japan, due to historical military conflicts. Current Sino-Japanese relations are still tense owing to the ongoing Yasukuni shrine controversy as well as an increasing level of economic rivalry between the two states. Then, there is also the politically sensitive issue of Taiwan’s status where China has consistently disputed Taiwan’s claims of sovereignty, contributing to political friction in the region.

Nonetheless, political challenges are perhaps not surprising when it comes to the difficult task of regional economic integration. The most important structure of regional integration today, the European Union, began as an instrument for political integration based on the common desire to prevent future war between countries. This overarching political motivation for integration was accompanied by economic objectives that gradually began with the amalgamation of the European steel

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396 Siow Yue Chia, “Challenges and Configurations of a Region-wide FTA in East Asia” (Paper presented at the FONDAD Conference, August 2007) [unpublished], [Chia, “Challenges”].
398 Christopher Dent, China, Japan and Regional Leadership in East Asia, (Cheltenham Edward Elgar, 2008) at 78 [Dent, “Regional Leadership”]. The Yasukuni Shrine is dedicated to the souls of Japanese who died in the name of their country. This includes people involved in World War Two, and convicted war criminals. Past visits to the shrine by Japanese Prime Ministers have angered China and Korea, who were victims of Japan’s military aggression in the first half of the 20th century, although the intentions of the Japanese Premiers’ visits were not to glorify Japan’s role in the war. See “Japan’s Controversial Shrine” 15 August 2006, BBC News, online: BBC News <http://news.bbc.co.uk/2/hi/asia-pacific/1330223.stm>.
industry via the European Coal and Steel Community organization in 1952. Subsequently in 1957, a deeper agenda of economic integration was initiated in the Treaty Establishing the European Economic Community which led to the establishment of a common market and customs union. Based on the European integration experience, it can be said that the achievement of a common political vision is an important foundation to ensure the success of economic integration.

The next political challenge stems from the economic diversity of East Asian countries. There are approximately fourteen countries (as referred to in Chapter III) that could potentially play a role in this RTA. The spectrum of diversity ranges from the economic powerhouses of Japan and China at one end, and Cambodia, Laos, and Myanmar on at the other. The differences in wealth and development are illustrated by Chia in four ways as listed below:

- There is variation in population size between 1.3 billion for China and 300,000 for Brunei, and in Gross National Income (GNI) size between US$5 trillion for Japan, and less than US$2 billion for Cambodia and Laos.
- Development levels as proxied by GNI per capita ranges from US$39,000 for Japan, to under US$1,000 for Cambodia, Laos, Myanmar, and Vietnam.
- Total external trade exceeds US$1,000 billion for China and Japan, but only US$1 billion for Laos. East Asian economies also differ in their trade/GDP ratios, from over 300% for Singapore, over 100% for Malaysia, Thailand, Cambodia and Vietnam, to 25% for Japan and 36% for Laos.
- FDI inflows range from US$55 billion for China to US$17 million for Laos.

Consequently, such divergences are certain to impact upon consensus building among states as the welfare effects of trade liberalization have typically been unevenly distributed.

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399 Trebilcock & Howse, supra note 14, at 25.
400 Chia, “Challenges”, supra note 396.
402 Chia, “Challenges”, supra note 396.
403 Ibid.
Another political issue pertains to market openness and the sensitivities around protected industries. The clearest example of divergence in levels of openness between countries in the region lies within the agricultural sector. Several East Asian countries protect their agricultural industry with high applied tariff rates such as Korea (47.8%), Japan (24.3%), and Thailand (22.1%), while for many others, farm products account for a substantial share of their exports. The agricultural sectors of Japan, Korea and Taiwan are based on relatively uncompetitive small-scale farms and food security is a problem for these countries. This is important to note as the potential for the agricultural issue to lead to negotiation deadlock is a real and pressing concern. For example, in 1998, the refusal of Japan (supported by China, Korea, and Taiwan) to yield to pressure on agricultural liberalization partly led to the failure of the Early Voluntary Sectoral Liberalization (EVSL) initiative advanced by APEC. The EVSL initiative was intended to launch a broader trade liberalization process among Asia-Pacific countries but collapsed as a result of Japan’s veto. As Dent points out, reconciling differences on this topic will be crucial to the establishment of an RTA in East Asia.

Assuming that these political challenges could be surmounted, there is still the problem of how the region would go about designing a trade integration initiative. From a more technical perspective, the diversity in the myriad of trade agreements involving East Asian countries poses a practical challenge to integration and harmonization efforts, particularly in the areas of domestic regulations and standards, and rules of origin.

In terms of domestic regulations and policies that affect trade liberalization, differences exist in numerous areas such as customs procedures, product quality standards, technical specifications of

\footnotesize{\begin{verbatim}
404 Ibid.
405 Christopher Dent, East Asian Regionalism, (Oxon: Routledge, 2008) at 221 [Dent, “East Asian Regionalism”].
406 Ibid. at 129.
407 Ibid. at 128.
408 Ibid.
409 Ibid. at 221.
\end{verbatim}}
products, and competition laws. Further, trade agreements in East Asia have taken different approaches to determining origin of a product for tariff purposes. Three types of methods (change of tariff classification [CTC]; value added; and specific manufacturing process) are employed variably across the region. A recent study by Kawai and Wignaraja concludes that the majority of trade agreements in East Asia have adopted a combination of these three methods rather than applying a single rule exclusively.\(^{410}\) The ASEAN Free Trade Agreement (AFTA) and the ASEAN-China FTA use the simplest rule, that is, the value-added rule (40% regional value content across all tariffs), while the developed countries in the region, namely Japan, Korea, and Singapore, tend to use a combination of rules, thus increasing the complexity and costs for business.\(^{411}\) These overlapping and contrasting rules of origin will be difficult to harmonize as the myriad of differences will require consensus across the region on matters like the type of rule to be applied on a given product, and other practical issues with regards to implementation.

2 Notable Efforts in Trade integration

East Asia is not a stranger to the concept of economic integration. Various calls in past years for broader co-operation have led to a variety of summits, economic partnerships, and initiatives aimed at enhancing regional economic growth. Figure 7 below provides a snapshot of significant initiatives undertaken to date. These efforts have been undertaken both contemporaneously and also at varying periods of time, leading to implementation of co-operative efforts in a ‘multi-layered’ fashion.\(^{412}\)


\(^{411}\) Medalla & Supperamaniam, \textit{ibid.} at 10.

Regional co-operation in East Asia has been based upon summits and proposals launched by the ASEAN Plus Three (APT) grouping, the East Asia Summit (EAS), and the Asia-Pacific Economic Co-operation (APEC). The APT and EAS are not formal organizations but are essentially ‘frameworks’ providing for a system of intergovernmental meetings with the objective of fostering regional integration. The main focus of APT-led-cooperation has been the advance of East Asia’s ‘financial regionalism’ as exemplified by three main projects, namely the Chiang Mai Initiative (CMI, a system of bilateral currency swap agreements), the Asian Bond Market Initiative (ABMI) and the Asian Currency Unit (ACU) initiative. Although no trade agreement encompassing solely APT countries has yet been officially proposed or designed, China has clearly indicated a preference for a trade grouping limited to APT instead of an arrangement with broader membership scope.

The EAS, also known as ASEAN Plus Six, can be loosely considered a ‘spin-off’ of the APT framework. The EAS was conceptualized at the 2000 APT Summit in Singapore and was intended to

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413 Dent, “East Asian Regionalism” supra note 405 at 150.
414 ibid.
415 ibid. at 220.
embody a more holistic regional concept as opposed to APT which was often regarded as an appendage arrangement to ASEAN. Membership of the EAS comprises the ten ASEAN countries together with six other countries, that is, Australia, New Zealand, China, Japan, Korea, and India. Within this Summit, Japan advocated strongly for an EAS-based free trade area despite opposition from China which argued that broad ‘extra-regional’ proposal would end up being too unwieldy and incoherent if the disparate interests of a large number of nations were all to be accommodated. Nevertheless, Japan subsequently unveiled its proposal for an EAS-based RTA officially known as the Comprehensive Economic Partnership in East Asia (CEPEA) in 2007. The CEPEA received an overall lukewarm response from China and many East Asian countries and to date has not progressed beyond the proposal stages.

With regards to APEC, this forum has been active in recent years by continuously calling for a cross-regional Asia-Pacific agreement in the form of the Free Trade Area of the Asia Pacific (FTAAP). At the 14th APEC Leaders’ Meeting in 2006, an FTAAP was proposed by the United States, and member states agreed to undertake studies on this matter. Despite the apparent enthusiasm of the United States, the FTAAP has not gained momentum as numerous fundamental problems inherent to its membership have impeded concrete progress. The first and most obvious challenge to integration, diversity of membership, is exacerbated given that APEC’s members include some of the richest Western nations (U.S. and Canada) alongside Asian economies that are still relatively small on the global scale. As APEC also excludes some ASEAN countries (Cambodia, Laos and Myanmar), the FTAAP may end up splitting ASEAN, which would not be desirable from the ASEAN perspective. Further, the successful negotiation of an FTAAP is likely not politically feasible at present as the US Trade Promotion Authority

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416 Ibid. at 169.
417 Ibid. at 171.
418 Ibid. at 172.
419 Ibid. at 173.
421 Chia, “Regional Trade Policy Cooperation and Architecture in East Asia” supra note 382 at 41.
expired in July 2007. This Authority was a fast-track negotiating authority that had allowed the United States President to negotiate agreements to be approved or turned down by Congress, but without any opportunity for amendment. Without such a power, it is very likely that the negotiations and decision-making process will encounter more delays and complexities engendered by competing political interests in the US.

The FTAAP has not found favour with many academics. Sally opines that an APEC FTA which comprises a diverse and ‘unwieldy’ membership of countries will not succeed as political and economic divisions in such a large grouping are intractable. In criticizing an FTAAP, Chia argues: “In ASEAN, some countries are not at all prepared politically or otherwise to enter into an undertaking of the magnitude of FTAAP. Bhagwati has also remarked, “Can anyone seriously believe that an FTAAP – requiring free trade among countries as diverse as China, Japan and the US – can be agreed more easily than Doha can be concluded?” To be of high quality, the FTAAP must also cover highly sensitive sectors such as agriculture and complicated behind-the-border issues. However, the FTAAP is so large and diverse it encompasses many protectionist interests, and would be much more politically demanding than the goals of the Doha Round; hence, there is no particular advantage to the FTAAP. The FTAAP carries high risks of diverting rather than galvanizing the Doha Round.”

It is also noted that the APEC forum was based on voluntary commitments and adheres to the principle of non-compulsory rules. This poses difficulties to the formation of an RTA as any market

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423 Sally, supra note 12, at 87.


425 Chia, “Regional Trade Policy” supra note 382 at 41.

access rules, tariff commitments, dispute resolution mechanism, and enforcement measures would be rendered meaningless if they were considered to be non-binding. In other words, the non-binding nature of the APEC structure would seriously undermine the legitimacy of an APEC-based RTA as members would be free to unilaterally retract trade commitments.

The initiatives outlined above indicate that there is strong interest in regional economic integration on a much more profound level. The unresolved question is what form this should take and what would be the most beneficial arrangement for the East Asian nations together with the global community as a whole. Some of the aforementioned initiatives have multiple goals related to economic advancement, of which trade is a subset. As this thesis is chiefly concerned with integration within the realm of international trade, the analysis and proposals are focused on trade concerns, although it is acknowledged that concurrent issues like finance and development are equally important to the overall success of the region. In the ensuing sections of this thesis, I analyse several salient issues that must be resolved in order to successfully form an effective and non-diversionary East Asian regional trade agreement.

3 PROPOSED WAY FORWARD: EARTA

The proposal for deeper integration in this thesis anticipates the creation of a customs union. As outlined in Chapter I, different levels of integration bear different obligations and forms. In the case of East Asia, I suggest that a basic free trade agreement is insufficient to meet the rapidly growing needs of this region. The second level of integration, a customs union, whereby internal barriers must be abolished and a common external tariff established, is likely the most appropriate next step in this process. The long-term goal (beyond this proposed customs union) could potentially be a common market for East Asia similar to the European Union, and perhaps eventually this arrangement could
evolve into an economic union. However, the current political challenges in the region are too broad and intense to contemplate much beyond the creation of a second-level form of integration.

The sections below outline four areas that are imperative to the foundation of a successful RTA. A basic framework for each area is advanced with the purpose of developing an arrangement that is most appropriate for the region, and which complements the objectives of the multilateral trading system. For ease of reference, the discussions henceforth will allude to the regional agreement as an East Asian Regional Trade Agreement (EARTA) in order to differentiate it from other proposals that entail their own specific requirements.

3.1 Membership and Leadership

The right balance of both membership and leadership is essential to surmount the region’s problem of a lack of common vision. There is no clear consensus on what membership of a regional agreement in Asia should look like. The two most important powers in East Asia (and the ones most poised to act as regional leaders), China and Japan, are divided over the issue of membership for an East Asian RTA. China supports an ASEAN Plus Three composition (China, Japan, Korea) where only East Asians are included; Japan and Singapore are pushing for an ASEAN Plus Six structure (which includes the ASEAN countries together with China, Japan, Korea, Australia, New Zealand and India); while a cross-regional arrangement in the form of a Free Trade Area of the Asia-Pacific (FTAAP) is strongly advocated by the US to prevent its marginalization from East Asia.\(^\text{427}\) Kawai and Wignaraja note that ASEAN is a natural hub for the formation of an EARTA because key production networks are rooted in ASEAN and major economies are linking to ASEAN through bilateral free trade agreements known as ASEAN Plus

\[^{427}\text{Saori N. Katada & Mireya Solis, “Cross-Regional Trade Agreements in East Asia: Findings and Implications” in Saori N. Katada & Mireya Solis, eds., Cross-Regional Trade Agreements: Understanding Permeated Regionalism in East Asia (Berlin: Springer, 2008) 147 at 159.}\]
One FTAs. As a result of economic modelling and analysis, Kawai and Wignaraja argue that there is a large income gain from an ASEAN Plus Three trade agreement and an even larger gain from an ASEAN Plus Six agreement. However, they highlight the fact that there is usually a trade-off between the size and the depth of an FTA, in that as the number of participating countries increases, the scope of measures that can be addressed may be more limited. As such, an EARTA must seek a good balance between breadth (number of participants) and depth (number and scope of issues to be addressed).

Dent posits that Japan and China are reluctant to form an FTA which includes the other because this would entail significant economic burdens for both. Due to the similarity in crops produced by both these countries, China’s products have the potential to ruin Japanese farmers. For example, in 2001, Japan instituted safeguards against shiitake mushrooms, tatami mats and leeks from China. Dent argues that as the main exporters of these products were assisted by Japanese firms, China’s agricultural products are competitive enough in Japanese markets as long as their quality is improved by Japanese companies. On the other hand, China would experience significant constraints under an FTA which includes both Japan and China, as GATT Article XXIV requires the removal of barriers between members of the FTA. This potentially renders China unable to establish its own industries (such as the automobile industry) in the face of competition from Japanese goods. Consequently, it may be that both China and Japan have not pushed forcefully for regional trade liberalization, or to be leaders in this initiative due to their respective domestic concerns.

I argue that in the early stages, membership should be limited to ASEAN Plus Three, but that it should remain open to the possibility of admitting additional members in subsequent stages of

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428 Kawai & Wignaraja, “Regionalism as an Engine of Multilateralism” supra note 320 at 16.
429 Ibid. at 17.
430 Ibid.
431 Dent, “Regional Leadership” supra note 398 at 79.
432 Ibid. at 79.
433 Ibid.
evolution in the regional arrangement. Given the challenges and problems raised as a result of over-
diversity in membership, I argue that the ambitions of the EARTA must start off modestly and then
gradually expand in breadth. The impracticality and impossibility of negotiating among a wide array of
participants (as seen sometimes in the difficulties of WTO negotiations) and the need to prioritize
specific development interests particular to the region suggest that extra-regional participation may not
be ideal at this stage. This is in tandem with Chia’s suggestion that a phased approach should be
undertaken in the process of forming the RTA, starting first with the ‘EAFTA’ (ASEAN Plus Three) to be
followed by ‘CEPEA’ (ASEAN Plus Six).434

Assuming that the aforementioned membership composition finds general acceptance among
the proposed member states, the pressing issue of who will lead the region still remains. China and
Japan are the two most likely candidates in view of their size and economic strength which allow them
to wield significant influence in the region. Together, they account for almost 80% of East Asia’s GDP
and play crucial hub roles in the East Asian production network. East Asian economic success relies
heavily on the advances of Japanese technology, Japanese domestic demand, and the Chinese supply of
low-cost production factors, primarily labour. Despite keen economic rivalry and intense political
tension between these two countries, China and Japan continuously maintain an extremely
interdependent relationship. As Dent illustrates, by 2005, Japan-China bilateral trade had approached
US$200 billion per annum. Japan is an indispensable source of foreign capital and technology for China,
and China a crucial production base for many of Japan’s multinational enterprises.435 There may even be
some progress in the political realm. Dent observes that the ‘old frost in Sino-Japanese relations’
appears to be thawing with the 2007 address by Chinese Premier Wen Jiabao, who apologized for

434 Chia, “Regional Trade Policy” supra note 382 at 42.
435 Dent, “East Asian Regionalism” supra note 405 at 173.
Japan’s atrocities in Asia.\textsuperscript{436} More recently in 2010, Premier Wen called for increased dialogue and cooperation between the two countries\textsuperscript{437}, efforts which in the long run could potentially result in harmonious co-leadership in the region by China and Japan.

In the early 1990s, Malaysian Prime Minister Mahathir Mohamad proposed the idea of a more distinctive East Asian regional trade grouping to be known as the East Asian Economic Grouping (EAEG), envisioned as a parallel organization to APEC. This proposal led to intense opposition from the United States which successfully pressured Japan and South Korea and several other ASEAN countries to reject it. EAEG was not the only East Asian initiative effectively stymied by the United States and other Western Nations. In the early stages of the Asian economic crisis, Japan proposed an Asian Monetary Fund as a way to mitigate currency and foreign exchange concerns in the region, but this was opposed by the IMF and the United States.\textsuperscript{438} I have mentioned these two examples of unsuccessful regional cooperation to emphasize the likelihood that there will be external influences which may hamper efforts at East Asian integration. As such, leadership in this region will need to be powerful enough to advance the regional agenda in spite of potential pressures from abroad, while working to alleviate concerns of foreign states with regards to the emergence of an East Asian trading bloc.

Regional leadership is a crucial and complicated issue that will require extensive analysis and further research. In this limited section, I do not attempt a comprehensive treatment of the matter. Instead, I point briefly to several considerations that are important in order to determine suitability of a certain country (or countries) as a leader for the region. With regards to Japan, its developed country status and historical economic strength allow it to realistically take leadership. It has also demonstrated

\textsuperscript{436} Ibid. at 175.
\textsuperscript{438} Michael Plummer & Ganeshan Wignaraja, “The Post-Crisis Sequencing of Economic Integration in Asia: Trade as a Complement to a Monetary Future”, Asian Development Bank Working Paper Series on Regional Economic Integration No. 9, May 2007.
a commitment to regionalism by taking the initiative to launch the CEPEA proposal for integration. However, it must be noted that there is currently serious concern around Japan’s level of government debt and projections of an imminent bond crisis. Presently, Japan’s economy continues to operate far below capacity suggesting deflationary effects. In Japan’s 2010 budget, borrowing, at ¥487 trillion, is for the first time forecast to exceed taxes, at ¥37 trillion.\footnote{\textit{Japan’s debt-ridden economy: crisis in slow motion” The Economist} (8 April 2010), online: The Economist <\texttt{http://www.economist.com}>.} This also means that the gross-debt-to GDP ratio, already the highest among wealthy nations, at 190% will continue to rise.\footnote{\textit{Ibid.}} These circumstances have arguably positioned Japan on the edge of a crisis. As such, the contagion effects of Japan’s lessened economic credibility may lead to global investor concern for the economic health across the East Asian region, akin to the 1997 crisis which spread throughout Asia. Further, any financial problems in Japan may well lead to increased protectionist tendencies that would not augur well for the development of a regional liberalization arrangement.

There is no definitive answer as to which country should be the one to lead this region. Successful leadership requires economic clout, regional trust, and perhaps most of all, the willingness to assume such a role. At this stage, China may also be well suited for a leadership role in view of its position as a new economic hegemon and its deep links within the regional production networks. Certainly, partnership between Japan and China in advancing the EARTA would be ideal on all fronts and most likely to ensure success of the agreement. However, the issues outlined above must be resolved in order to achieve an EARTA that is cohesive and beneficial for all parties involved.
3.2 SCOPE

In order to constitute a ‘high-quality’ free trade agreement, the EARTA should be outward-oriented, multilateral-friendly and consistent with GATT Article XXIV and GATS Article V. A very sophisticated agreement with a fully comprehensive scope would include coverage of goods, services, investment (capital), labour, intellectual property, and WTO-plus issues such as competition and trade facilitation. In considering the forms of integration that may be suitable for EARTA, I briefly examine several examples that exist today.

The European Union is the regional arrangement that has progressed furthest towards integration with elimination of borders in all four markets (goods, services, labour, and capital). The EU has also integrated in a wide variety of regulatory areas such as competition law and has made some progress towards harmonization of taxes. This level of integration is normally seen in arrangements for single markets or monetary unions, and would probably be an overly ambitious agenda for the EARTA. Next, the CER (Closer Economic Relations), a free trade agreement between New Zealand and Australia is a distinctive arrangement where there is free trade for all goods and harmonization in some areas of business law, product standards, competition law and food standards. It has free movement of labour, but no provision for investment flows. Although the high level of integration in several areas provides a useful reference point, CER is dissimilar from East Asia in that CER comprises only two countries of very similar levels of economic development.

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441 GATS (General Agreement on Trade in Services) Article V requires members that form agreements which liberalize trade in services to do so in a way that eliminates substantially all discrimination between parties. Kawai & Wignaraja, “Regionalism as an Engine of Multilateralism” supra note 320 at 16.
443 Ibid. at 29.
444 Ibid. at 34 – 35.
445 Ibid. at 36.
On the other hand, ASEAN together with MERCOSUR have been considered as the least integrated agreements in a comparison of six RTAs.\textsuperscript{446} Lloyd notes that ASEAN has made some progress in eliminating tariffs and NTBs, but has not eliminated government procurement barriers, prohibited export subsidies or prohibited anti-dumping actions between members.\textsuperscript{447} Further, there is no national treatment or prohibition of trade-distorting production subsidies in ASEAN.\textsuperscript{448} For labour markets, ASEAN has not provided for the temporary or permanent movement of natural persons, or instituted harmonization of labour standards between states.\textsuperscript{449} In capital markets, ASEAN does provide for numerous integration actions, but still maintains a low degree of integration for services markets.\textsuperscript{450}

Finally, NAFTA provides a good illustration of a comprehensive agreement for goods and services between several diverse economies. This agreement comprises Canada, the US, and Mexico as members. Certain aspects of NAFTA can form useful precedents or lessons for EARTA as despite a difference in number of members (or proposed members), these two arrangements share parallel concerns with regards to diversity of membership. As noted by McKinney, “\textit{NAFTA has been one of the more controversial pieces of trade legislation in recent history. Not only did it link in a regional economic integration scheme countries of widely disparate size, but it also brought together countries having very different income levels, legal traditions, regulatory regimes, and cultural traditions}”.\textsuperscript{451} In terms of integration depth, NAFTA incorporates the GATT principle of national treatment for goods and services but is more limited with regards to liberalization of measures in the capital and labour markets.\textsuperscript{452} For example, Chapter 16 of NAFTA (“Temporary Entry of Business Persons”) allows only for limited and temporary entry of persons for business purposes among the member countries and does not envision a

\textsuperscript{446} Ibid. at 24.
\textsuperscript{447} Ibid. at 25.
\textsuperscript{448} Ibid.
\textsuperscript{449} Ibid. at 26.
\textsuperscript{450} Ibid, at 26 – 27.
\textsuperscript{451} ibid. at 32.
\textsuperscript{452} Lloyd, supra note 442 at 32.
broad freedom of movement for all citizens. With regards to the harmonization of standards to facilitate trade, several efforts have been undertaken. While not going as far as to prescribe specific standards for parties, Chapter 7 of NAFTA contemplates the utilization of international standards, guidelines and recommendations for sanitary and phytosanitary measures where possible, and where appropriate, these standards should be identical to those of the other parties.\textsuperscript{453} Chapter 7 further encourages the participation of each party in relevant international and North American standardizing organizations including the \textit{Codex Alimentarius Commission} and the \textit{International Plant Protection Convention}.\textsuperscript{454} Further, there are provisions for technical barriers to trade in Chapter 9 directed at standards-related measures between the three countries that parallel the WTO Agreement on Technical Barriers to Trade.\textsuperscript{455} This NAFTA provision is concerned with MFN treatment in the specific areas of technical regulations, conformity assessment, and unnecessary barriers to trade.\textsuperscript{456} Chapter 9 of NAFTA requires parties to use “as a basis for its standards-related measures, relevant international standards or international standards whose completion are imminent”\textsuperscript{457}, to “make compatible their respective standards-related measures”\textsuperscript{458}, and to “promote the compatibility of a specific standard or conformity assessment procedure that is maintained in its territory with the standards and conformity assessment procedures maintained in the territory of the other Party”\textsuperscript{459}.

Given the wide scope of issues that deep integration in East Asia implies, rigorous analysis will be required in a wide range of areas mentioned above. However, a holistic review of all these aspects is impossible within the limited confines of this thesis. Consequently, I have opted to focus on the integration of trade in goods as a starting point for the EARTA. The following sections will examine

\textsuperscript{453} See Article 713(1), Chapter 7, NAFTA.  
\textsuperscript{454} See Article 713(5), Chapter 7, NAFTA.  
\textsuperscript{455} Lloyd, \textit{supra} note 442 at 32.  
\textsuperscript{456} \textit{Ibid}.  
\textsuperscript{457} See Article 905(1), Chapter 9, NAFTA.  
\textsuperscript{458} See Article 906(2), Chapter 9, NAFTA.  
\textsuperscript{459} See Article 906 (3), Chapter 9, NAFTA.
selected issues related to trade in goods, in particular, product coverage; rules of origin; and, market access standards.

3.2.1 Coverage: Trade in Goods

Coverage in trade agreements can involve some or all factor of production markets. These markets typically refer to goods, services, capital, and labour. The level of integration achieved by a specific RTA can be measured in terms of how far it goes in encompassing all four markets, as well as how deeply it product coverage within a specific market. In a study that compares the level of integration across six different RTAs (EU, NAFTA, CER, MERCOSUR, ASEAN, and AUSFTA), Lloyd observes that ASEAN and MERCOSUR are the least integrated of these agreements, while the EU is the only RTA to approach the status of a single market.\textsuperscript{460} The European region was successful in achieving integration across the board as the original European Economic Community established by the 1957 Treaty of Rome applied to all four goods, services, capital and labour markets. Conversely, in the case of East Asia, no such formal legal instrument exists for integration on a similar level. The ASEAN Free Trade Area (AFTA) has made some progress in formal liberalization but is still deficient in many respects. Services liberalization has been targeted under the 1995 ASEAN Framework Agreement on Services (AFAS); investment provisions are contained in the 1998 ASEAN Framework Agreement on the ASEAN Investment Area (AIA), but there are no significant provisions for labour market integration. At this juncture, I note that while integration efforts across all four markets are desirable, to effect this simultaneously will likely not be feasible given the lack of a formal legal framework like the Treaty of Rome for the EEC. As such, I propose that emphasis should be placed on achieving a comprehensive agreement in the liberalization of trade in goods as a starting point.

\textsuperscript{460} Lloyd \textit{supra} note 442 at 24.
According to Plummer, the best-practice approach to product coverage is to have comprehensive coverage, to be included within a reasonable period of time (defined as ten years under Article XXIV of GATT\(^{461}\)).\(^{462}\) Despite the stipulation in Article XXIV of GATT which requires product coverage in an FTA or customs union to include “substantially all goods”, Plummer observes that few FTAs cover all goods, citing as examples, the omission of tomatoes in NAFTA, the omission of sugar and the 17 year implementation period for beef within the US-Australia FTA.\(^{463}\) In arguing that an FTA should include all goods with as few exemptions as possible, Plummer raises the following concerns:

“Exclusions of individual products can be problematic in terms of efficiency, particularly when they involve products that are used as inputs in the productive chain. For example, duty free inputs on steel will cause exaggerated protection of value added (the “effective rate of protection”) in the automotive sector. Exclusion of tariffs on imported lumber will do the same in the furniture industry if the latter is excluded from liberalization. “Positive list” approaches tend to be the worst possible mechanisms in this regard, as items that would generate trade creation are excluded and those that would generate trade diversion would be included.”\(^{464}\)

The two main challenges with regards to the coverage of goods trade in East Asian FTAs are; first, provisions and tariffs differ markedly across the various FTAs; and second, agricultural products are often excluded due to pressures from farm lobbies or social concerns over the rural sector.\(^{465}\) The differences across numerous Asian trade agreements have been examined by Feridhanusetyawan who observes that there is no standard approach to undertaking tariff reductions – some are based on positive lists and others negative lists; transitional periods for liberalization in each agreement differ; and product coverage varies from FTA to FTA.\(^{466}\) Feridhanusetyawan notes:

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\(^{461}\) See GATT Article XXIV, paragraph 5(c): The interim agreement must be completed within a ‘reasonable length of time’. See GATT Article XXIV:5, paragraph 3: The ‘reasonable length of time’ referred to in paragraph 5(c) should exceed 10 years only in exceptional cases.

\(^{462}\) Plummer, supra note 313 at 37.

\(^{463}\) Ibid.

\(^{464}\) Ibid.


\(^{466}\) Tubagus Feridhanusetyawan, “Preferential Trade Agreements in the Asia-Pacific Region” (2005) International Monetary Fund Working Paper WP/05/149 at 17.
‘Every trade agreement has a list of exemptions, and in some agreements the list is long and complicated. All agreements make provision for sectors considered sensitive by the negotiating parties. Agriculture generally receives special treatment and in many cases is totally excluded from the scheme. The Singapore-Japan comprehensive partnership excludes some agriculture and fisheries products even though Singapore has no significant agriculture or fisheries sectors. Many agreements also exclude some non-agricultural products. The Korea-Chile agreement for example excludes specific items such as refrigerators and washing machines. AFTA also excludes from tariff reductions Indonesia’s textile and petro-chemical products, Malaysia’s automotive products, and the Philippines’ cement sector.’

Kawai and Wignaraja have provided additional statistics on the differences in agricultural product coverage in Asian FTAs, including those with cross-regional partners. In a study of fifty FTAs, these authors found that 50% can be regarded as comprehensive in terms of coverage of agricultural products, while another 26% have some coverage of these items. The remaining 24% have limited or no coverage. With regards to the AFTA, member states have agreed upon a Common Effective Preferential Tariff Scheme (CEPT) that aims to reduce tariffs on all manufactured goods to 0 – 5% by 2003. Products that are excluded from this liberalization plan are goods deemed sensitive by individual countries and are excluded on a temporary basis.

The observations above indicate that agricultural coverage among FTAs is lacking and exclusions for sensitive sectors in individual countries still exist. To mitigate the protectionist effects of these exclusions, the proposed EARTA should ensure that there is better coverage of agricultural trade and more stringent requirements for countries to phase out or eliminate protection of sensitive sectors. As Kawai and Wignaraja suggest, the benchmark for comprehensiveness should be coverage of at least 85% of all agricultural product lines and the minimization of exclusions to not more than 150 product lines.

In that vein, I concur with Kawai and Wignaraja’s suggestion that a negative list approach for exclusions

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467 Ibid. at 18.
469 Ibid.
470 Ibid. at 16.
to liberalization should be adopted, with room for a few sensitive items. Agriculture is historically a
controversial and sensitive issue for all countries and most trade agreements. Care should be taken to
avoid the negative effects of agriculture protectionism in the EU which have led to hugely
disproportionate expense for the EU and caused significant detriment to farmers in developing countries.
In addition, the 0 – 5% tariff range targeted by the AFTA may not be a figure suitable for exact
replication in an EARTA. As multilateral tariff rates continue to fall, even a small tariff percentage may
lead to protectionist results. To resolve the problem of diversity in market openness, where possible,
members of an EARTA should seek to liberalize fully towards the goal of 0% tariff rates on all goods.

3.3 Converging Rules of Origin

In Chapter II, I examined the general problem of overlapping rules of origin caused by the
spaghetti bowl of trade agreements. In Chapter III, I described similar problems experienced in East Asia
by looking at the Asian ‘noodle-bowl’ of agreements. The rules of origin utilized in East Asian trade
agreements generally encompass three types. The first is the value-added measure (VA), also known as
the ‘domestic content test’ which refers to the minimum percentage of value added created at the last
stage of the production process.\footnote{Medalla & Supperamaniam, supra note 411 at 4.}

This measure is found in the AFTA which stipulates that 40% of the
value added of a good has to originate from within ASEAN. The second is the change in tariff
classification (CTC), whereby origin is conferred if the exporting country activity results in a product
classified under a different heading of the customs tariff classification of the Harmonized System of
Tariff Nomenclatures\footnote{The Harmonized System: Product nomenclature refers to the classification of goods using some criteria of
description e.g., usage, function, or measurement. It becomes Tariff Nomenclature (or tariff lines) when tariff rates
are attached to the classification of goods. In international trade, harmonisation and refinement of tariff
nomenclature is necessary to ease the process of making products comparable. The Harmonised System (HS) is a
system which classifies and describes products based on various criteria (i.e. a nomenclature). The Customs

\textsuperscript{473} Medalla & Supperamaniam, supra note 411 at 4.
\textsuperscript{474} The Harmonized System: Product nomenclature refers to the classification of goods using some criteria of
description e.g., usage, function, or measurement. It becomes Tariff Nomenclature (or tariff lines) when tariff rates
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\textsuperscript{475} Medalla & Supperamaniam, supra note 411 at 4.
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system which classifies and describes products based on various criteria (i.e. a nomenclature). The Customs
In Table 2 below, the variances in rules of origin across FTAs and products are illustrated. AFTA specifies a single regional value content (RVC) across all tariffs together with alternatives such as the CTC rule. The ASEAN-PRC FTA uses the RVC rule, while the rest of the identified FTAs use a combination of methods.

<table>
<thead>
<tr>
<th>Product (HS Code)</th>
<th>AFTA</th>
<th>ASEAN-PRC FTA</th>
<th>ASEAN-Korea FTA</th>
<th>ASEAN-Japan FTA</th>
<th>Japan-Thailand EPA</th>
<th>US-Singapore FTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic integrated circuits (85.42)</td>
<td>CTC or 40% RVC</td>
<td>40% RVC</td>
<td>CTC or 40% RVC</td>
<td>CTC or 40% RVC</td>
<td>CTC or 40% RVC</td>
<td>CTC</td>
</tr>
<tr>
<td>Parts and accessories for motor vehicles (87.08)</td>
<td>40% RVC</td>
<td>40% RVC</td>
<td>45% RVC</td>
<td>40% RVC</td>
<td>CTC or 40% RVC</td>
<td>6 digit CTC or CTC plus 30% RVC (build-up)</td>
</tr>
<tr>
<td>Woven fabrics of cotton (52.09)</td>
<td>CTC; or 40% RVC; or process criterion for textile products</td>
<td>40% RVC; or process criterion for textile and textile products</td>
<td>CTC or 40% RVC</td>
<td>CTH or CTC plus material is dyed or printed in either party’s area; or non-originating material is woven entirely in any party’s area</td>
<td>CTH or CTC plus fabric/yarn is dyed or printed in either party’s area</td>
<td>CTH</td>
</tr>
<tr>
<td>Men’s or Boy’s suits, blazers, etc. (62.03)</td>
<td>40% RVC; or CTC plus good is both cut (or knit to shape) and sewn in any party’s area; or process criterion for textile products</td>
<td>40% RVC; or process criterion for textile and textile products</td>
<td>40% RVC; or CTC plus good is both cut and sewn in any party’s area</td>
<td>CTC plus non-originating material is woven entirely in any party’s area</td>
<td>CTC plus non-originating material is knitted or crocheted in either party’s area or any ASEAN member’s area</td>
<td>CTC plus good is both cut (or knit to shape) and sewn or otherwise assembled in the territory of one or both of the parties</td>
</tr>
</tbody>
</table>

Notes: HS = Harmonized System; CTC = Change in Tariff Classifications; CTH = Change of Tariff Heading; VC = Value Content; RVC = Regional Value Content

Table 2: Varying Rules of Origin in FTAs: Selected Products Source: Kawai and Wignaraja (2008)
In a study of thirty FTAs in East Asia, Kawai and Wignaraja provide an overview of the main rules of origin utilized in these agreements. The summary table is reproduced as Table 3 below. This study notes that the majority of FTAs with East Asian partners have adopted a combination of three rules rather than applying a single one. The authors also observe that the developed countries in East Asia, namely Japan, Korea, and Singapore, tend to prefer a combination of rules of origin, leading to additional complexities and costs for business.

<table>
<thead>
<tr>
<th>AGREEMENT</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Value-Added Rule (VA) only (3 FTAs)</strong></td>
<td></td>
</tr>
<tr>
<td>1. Singapore-New Zealand Closer Economic Partnership Agreement</td>
<td>At least 40% of the cost is of New Zealand or Singapore origin, and the last place of manufacture is in New Zealand or Singapore.</td>
</tr>
<tr>
<td>2. Singapore-Australia FTA</td>
<td>For manufactured products: (a) Local value-added (VA) content of 50% or (b) VA content of 30% for 114 tariff subheadings. These include electrical &amp; electronic equipment and precision instruments.</td>
</tr>
<tr>
<td>3. Singapore-Jordan FTA</td>
<td>All products, with the exception of textile and apparel goods, need only fulfill a general rule of origin of a relatively low threshold of 35% local VA content. For textile and apparel goods, specific process rules apply.</td>
</tr>
<tr>
<td><strong>VA and/or Change of Tariff Classification (CTC) Rules (3 FTAs)</strong></td>
<td></td>
</tr>
<tr>
<td>1. Taiwan-Panama FTA</td>
<td>Regional VA content requirement: 35%, 40%, 45%</td>
</tr>
<tr>
<td>2. Thailand-New Zealand Closer Economic Partnership Agreement</td>
<td>Regional VA content requirement: 50%</td>
</tr>
<tr>
<td>3. China-Chile FTA</td>
<td>Regional VA content requirement: 40% or 50%</td>
</tr>
<tr>
<td><strong>VA and/or Specific Product Rules (4 FTAs)</strong></td>
<td></td>
</tr>
<tr>
<td>1. Asia-Pacific Trade Agreement</td>
<td>Regional VA content requirement: 45% for most products. Special Criteria Percentage: Products originating in Least Developed Participating States can be allowed a favourable 10 percentage points applied to the percentages established in Rules 3 and 4 of APTA</td>
</tr>
<tr>
<td>2. ASEAN FTA</td>
<td>Local or regional VA content of 40% or product specific rule for the following sectors: (a) Process criterion for textiles and textile products; (b) Change in chapter rule for wheat flour; (c) CTC for wood-based products; (d) CTC for certain aluminium and articles thereof.</td>
</tr>
</tbody>
</table>

477 Kawai & Wignaraja (2007), as cited in Medalla & Supperamaniam, supra note 410 at 10.
478 Ibid.
<table>
<thead>
<tr>
<th>AGREEMENT</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. ASEAN-China FTA</td>
<td>Regional or local VA content of 40% or product specific rule. Process criterion required for textiles and textile products.</td>
</tr>
<tr>
<td>4. China-Pakistan FTA</td>
<td>Regional VA content requirement: 40%</td>
</tr>
<tr>
<td><strong>Combination of all Rules (VA, CTC, SP, others) (20 FTAs)</strong></td>
<td></td>
</tr>
<tr>
<td>1. Singapore-European Free Trade Association FTA</td>
<td>Regional VA content requirement: 40% or 50%</td>
</tr>
<tr>
<td>2. Japan-Singapore Economic Agreement for a New-Age Partnership</td>
<td>For manufactured products, change in tariff heading (CTH) for all imported inputs used in the manufacture of the product; Singapore must be the place where the last substantial manufacture takes place. Additional flexibility for 264 products; CTH or local value-added content (VA) of 60%.</td>
</tr>
<tr>
<td>3. Korea-Chile FTA</td>
<td>Regional or local VAV content requirement: 30% or 45%</td>
</tr>
<tr>
<td>4. China-Hong Kong Closer Economic Partnership</td>
<td>Local VA content requirement: 30%</td>
</tr>
<tr>
<td>5. China-Macao Closer Economic Partnership Arrangement</td>
<td>Local VA content requirement: 30%</td>
</tr>
<tr>
<td>6. Singapore-United States FTA</td>
<td>For manufactured products, (a) CTC for all imported inputs used in the manufacture of the product; Singapore must be the place where the last substantial manufacture takes place; (b) Regional value-added content (VA) of 35-60% (applies mainly to electronic products; (c) Process rule (applies mainly to chemicals and petrochemicals).</td>
</tr>
<tr>
<td>7. Korea-European Free Trade Association FTA</td>
<td>Regional VA content requirement: 25%, 30%, 45%, 50%, or 60%.</td>
</tr>
<tr>
<td>8. Singapore-India Comprehensive Economic Cooperation Agreement</td>
<td>Local VA content requirement: 40%</td>
</tr>
<tr>
<td>9. Japan-Mexico Economic Partnership Agreement</td>
<td>Regional or local VA content requirement: 50%, 65%, or 70%.</td>
</tr>
<tr>
<td>10. Thailand-Australia FTA</td>
<td>Regional VA content requirement: 40-45 or 55%</td>
</tr>
<tr>
<td>11. ASEAN-Korea FTA</td>
<td>Regional VA content requirement: 40%, 50%, or 60%. Specific manufacturing process for textiles and garments.</td>
</tr>
<tr>
<td>12. Japan-Malaysia Economic Partnership Agreement</td>
<td>Regional VA content requirement: 40%</td>
</tr>
<tr>
<td>13. Japan-Philippines Economic Partnership Agreement</td>
<td>Regional VA content requirement: 40%</td>
</tr>
</tbody>
</table>
Table 3: Rules of Origin in Selected FTAs in East Asia  (Source: Kawai and Wignaraja, 2007)

<table>
<thead>
<tr>
<th>AGREEMENT</th>
<th>NOTES</th>
</tr>
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<tbody>
<tr>
<td>14. Trans-Pacific Strategic Economic Partnership Agreement</td>
<td>A product will qualify for preferential treatment if (a) it meets the</td>
</tr>
<tr>
<td></td>
<td>specific rule of origin applicable to it (in many cases, this is a</td>
</tr>
<tr>
<td></td>
<td>liberal CTH rule) or (b) where so stipulated, if at least 45% of the</td>
</tr>
<tr>
<td></td>
<td>cost originate from the party.</td>
</tr>
<tr>
<td>15. Singapore-Panama FTA</td>
<td>Local VA content requirement: 35%</td>
</tr>
<tr>
<td>16. Korea-Singapore FTA</td>
<td>Regional VA content requirement: 55%</td>
</tr>
<tr>
<td>17. Japan-Thailand Economic Partnership Agreement</td>
<td>Regional VA content requirement: 40%</td>
</tr>
<tr>
<td>18. Japan-Chile Strategic Economic Partnership Agreement</td>
<td>Local VA content requirement: 30% or 45%</td>
</tr>
<tr>
<td>19. Japan-Brunei Economic Partnership Agreement</td>
<td>Regional VA content requirement: 40%</td>
</tr>
<tr>
<td>20. Korea-United States FTA</td>
<td>Regional VA content requirement: 35/45%; 40/50%; 55% (build-up/build-</td>
</tr>
<tr>
<td></td>
<td>down method)</td>
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</table>

In light of the myriad of overlapping and opposing rules of origin in East Asian agreements, a common standard will be required in harmonizing these rules under an umbrella trade arrangement. The rules of origin regime for the EARTA should be principally target the reduction of business costs, and promote seamless trade and production.\(^{479}\) To this end, Medalla and Supperamaniam, and Choi, have identified several useful key considerations that are summarized in the following paragraphs.

The goals of simplicity, efficacy and transparency must be prioritized to reduce the costs of compliance and administration of customs procedures, and to minimize the potential for rent-seeking and corruption.\(^{480}\) Ideally, all countries would adhere to a single, identical rule. However, this is not the most realistic or practical method for the short-term. The first, ad-hoc, option is for countries to use an alternative rule which is simpler than the existing systems in the respective trade agreements. Medalla and Supperamaniam propose using the CTC method as an alternative to the VA rule because the CTC

\(^{479}\) Medalla & Supperamaniam, supra note 411 at 20.

\(^{480}\) Ibid.
method is clear, unambiguous and easier for customs authorities to implement.\textsuperscript{481} However, the CTC method (based on the Harmonised System) does not have any mechanism to distinguish substantial transformation and often leads to many individual product specific rules, which can be influenced by domestic industries.\textsuperscript{482} On the other hand, while the VA rule has the advantage of being clear and simple to specify, it can be complex to apply as it requires sophisticated accounting systems and suffers from the problem of uncertainty in value due to ongoing changes in wages, commodity prices and exchange rates.\textsuperscript{483} Medalla and Supperamaniam observe that reforms in ASEAN rules of origin appear to be moving towards CTC as a substitute criterion for determining origin.\textsuperscript{484} An increasing number of products now fall under CTC as alternative criteria to the VA rule for additional priority sectors such as: (i) agro-based products; (ii) automotives; (iii) electronics; (iv) fisheries; (v) rubber-based products; (vi) textiles and apparels; and (vii) wood-based products.\textsuperscript{485}

Although the adoption of alternative rules (for example, using the CTC rule as an alternative to the VA rule) can be a useful temporary aid to rules of origin complications, systematic harmonization of all the existing rules would be a more appropriate long-term measure. Such harmonization or formal convergence of rules of origin regimes can be instituted through diagonal or extended cumulation\textsuperscript{486} on a regional scale. As discussed in Chapter II, when materials or parts originating in one or more member states to the RTA are further processed in another country within the group, the items are considered to

\textsuperscript{481} Ibid.
\textsuperscript{482} Ibid. at 5.
\textsuperscript{483} Ibid.
\textsuperscript{484} Ibid. at 21.
\textsuperscript{485} Ibid.
\textsuperscript{486} (Section 4: Resolving Rules of Origin). In brief, diagonal cumulation applies to trade between three or more trading partners normally linked by RTAs with identical rules of origin. Here, member countries agree through bilateral agreements with each other that materials originating in one country shall be considered as materials originating in all the other countries. In a variation of diagonal cumulation form, extended cumulation allows countries that are linked via a bilateral or plurilateral RTA to use inputs from third parties that do not have an RTA with any (or all) of the parties to that RTA. For a more comprehensive discussion of cumulation, see Chapter II (Section 4: Resolving Rules of Origin) in this thesis.
have originated in the country where they were processed, if there is a system of cumulation in place.487

As diagonal cumulation requires the existence of ‘one-on-one’ RTA relationships among all the participating countries, I suggest that the EARTA will require a system of full or extended cumulation. This is to ensure that harmonization includes all pertinent countries, even those that do not have bilateral agreements with each other. So far, rules allowing for the cumulation of inputs have not been widespread in East Asia. Choi observes that although the Japan-Malaysia Economic Partnership Agreement includes rules that specifically allow for cumulation with ASEAN countries, these rules are concentrated among just a few agricultural products, textiles and apparel.488

In order to determine the most desirable rule for the RTA, a process to develop benchmarks or best-practices should be undertaken. Complete harmonization within a short period of time may not be technically possible given the diversity of rules in the region as well as potential political backlash from sectors that currently benefit from their more advantageous status quo conditions.489 Choi recommends that in developing such a benchmark, co-equality arrangements between the CTC and VA rules need to be made as far as possible.490 Co-equal rules would allow the exporter to choose among different rules in order to claim origin. According to surveys of numerous Asian firms, 52% wanted the option to choose between a VC rule and a CTC rule.491 Large firms are particularly in favour of having the option to choose

488 Ibid. at 130. Choi provides an example: ‘a product-specific ROO for a meat item (1604.13) is prescribed as follows in the Japan-Malaysia EPA: A change to subheading 1604.13 from any other chapter, provided that, where non-originating materials of chapter 3 are used, each of the non-originating materials is obtained by fishing in the territory of a third State which is a member country of the ASEAN or taken by vessels, which are registered in and sail under the flag of a third State which is a member country of the ASEAN, from the sea outside the territorial sea of that third State.’
489 Ibid. at 133.
490 Ibid.
because they use preferences in RTAs more and encounter multiple rule issues more frequently.\footnote{492} In this regard, AFTA, the ASEAN-Korea and ASEAN-Japan agreements have recently adopted a co-equal recognition approach of rules of origin, with AFTA incorporating the most comprehensive list of products.\footnote{493} In order to advance integration in rules of origin, the region’s remaining FTAs should take steps to implement similar co-equal arrangements.

With regards to the issue of economic diversity in the region, it is noted that East Asia includes four countries that are significantly less-developed than their regional counterparts. These countries are Cambodia, Laos, Vietnam and Myanmar (CLMV). In regionalizing the rules of origin system, care must be taken to ensure that the CLMV countries do not suffer disproportionately as a result of their inability to compete with the emerging economies. To address this concern, one possibility would be to lower the VA criteria for exporters in these countries for a period of time as an incentive to increase utilization of preferences.\footnote{494} This form of special and differential treatment must be engineered in a way that avoids the general problems of SDT (e.g. perpetual infant industries as discussed in earlier chapters). More importantly, significant emphasis should be placed on capacity building for exporters, importers and administrators in these countries.\footnote{495} Development-friendly practices may include training and technical assistance to improve evaluation, information flows, monitoring of compliance, and permitting alternative means of proving origin where it is more convenient for the less-developed country.\footnote{496}

3.4 The Relevance of Non-Tariff Barriers

The elimination of barriers to trade goes beyond liberalizing tariffs and simplifying rules of origin. There are numerous types of non-tariff barriers (NTBs) within each domestic jurisdiction that could pose

\footnote{492} Choi, \textit{supra} note 487 at 133.  
\footnote{493} Kawai & Wignaraja, “Asian Noodle Bowl”, \textit{supra} note 491.  
\footnote{494} Medalla & Supperamaniam, \textit{supra} note 411 at 23.  
\footnote{495} \textit{Ibid.} at 23.  
\footnote{496} \textit{Ibid.}
obstacles to foreign exporters trying to gain access to a particular market. The NTB problem relates to the challenge of diverse levels of market openness within the region. Some examples of NTBs are quotas, customs procedures and valuation systems, anti-dumping practices, disparities in product standards, government procurement policies, and border taxes. Within the framework of the ASEAN Economic Community (AEC) that was proposed in 2003, ASEAN countries acknowledged the need to remove non-tariff barriers to achieve the aims of a single market which include the free flow of goods.\footnote{ASEAN Economic Community Blueprint”, ASEAN, online: ASEAN Secretariat <http://www.aseansec.org/21083.pdf>}

While a comprehensive analysis of all non-tariff barriers vis-à-vis the formation of the EARTA would be ideal, the parameters of this thesis allow only for the examination of a narrow selection of such barriers. This section will briefly review the possible approaches for the EARTA to mitigate two types of non-tariff barriers; (i) technical measures and product standards; and, (ii) customs procedures. I have selected these barriers as focus points based on ASEAN’s identification of the most significant measures affecting trade for their members.\footnote{The most significant non-tariff barriers of ASEAN were identified as customs surcharges, technical measures, product characteristic requirements, and monopolistic measures. See “Non-Tariff Barriers”, ASEAN Secretariat, online: ASEAN Secretariat <http://www.aseansec.org/10114.htm>.}

3.4.1 Technical Measures and Product Characteristic Requirements

Countries frequently have different product standards or technical requirements for goods sold in their domestic markets. In general, technical measures are those which refer to ‘product characteristics such as safety, quality or dimensions, including the applicable administrative provisions, terminology symbols, testing and test methods, packaging, marking and labelling requirements as they relate to a product’.\footnote{‘Non-Tariff Barriers’, ASEAN Secretariat Website, at http://www.aseansec.org/10114.htm.}

For example, hormone-treated beef has been banned by the EU\footnote{During the 1990s mad cow disease crisis, the EU banned the import of meat that contained certain types of hormones. The EU claimed the health and safety exception under the SPS Agreement but lost this challenge to the US and Canada in disputes before the WTO Panel and Appellate Body. See EC – Measures Concerning Meat and Meat Products (Hormones) (Complaint by the United States) (1996), online: WTO <http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds26_e.htm>.}, products
containing asbestos were prohibited by France, and most recently, Canada has banned the sale of cigarettes which contain certain types of additives. These examples constitute grounds of actual trade disputes or concerns that have been raised before the WTO in relation to their effects as NTBs. Technical regulations, standards and policies that exist to create unnecessary obstacles to trade are prohibited under two WTO Agreements – the Agreement on Technical Barriers to Trade (TBT), and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). In addition, these agreements were also crafted to encourage the harmonization of technical and sanitary-related measures between member states. The principle of ‘national treatment’ (Article 3 of GATT) where discriminatory measures are prohibited once foreign goods have entered the importing jurisdiction is strongly espoused within the TBT and SPS Agreements. It is noted that regional harmonization arrangements could potentially create exclusive blocs where adopted standards are particularly high or totally unique to the region. Due to this concern, WTO rules attempt to mitigate such exclusionary effects by encouraging harmonization or standardization in accordance with internationally accepted standards.

The NTB challenge of technical measures and product characteristic requirements has been identified by the ASEAN Secretariat as one of the principal barriers to trade in the region. ASEAN is now moving towards a concerted effort to remove NTBs between member states and is currently still in the process of verifying the list of barriers compiled by the Secretariat. It has also convened several committees to address NTBs, namely, the Interim Technical Working Group on CEPT for AFTA, the ASEAN Consultative Committee for Standards and Quality, and an ASEAN Working Group on sanitary

503 Kodama, supra note 426 at 272.
504 Article 2.6 of the Agreement on Technical Barriers to Trade states that ‘[w]ith a view to harmonizing technical regulations on as wide a basis as possible, Members shall play a full part … in the preparation by appropriate international standardizing bodies of international standards …’ A similar provision exists in Article 3 of the Agreement on Sanitary and Phytosanitary Measures. (See Kodama, supra note 426 at 272.)
and phytosanitary measures for agricultural products. Despite this, Chia notes that the process of removal of these barriers has occurred at a slower pace compared to the elimination of tariffs.\footnote{Chia, “Regional Trade Policy” supra note 382 at 16.}

### 3.4.2 Customs Procedures

According to an analysis by the ASEAN Secretariat of the most prevalent NTBs to the region, the issue of customs procedures has been identified numerous times as a significant barrier.\footnote{“Non-Tariff Barriers”, ASEAN Secretariat, online: ASEAN Secretariat <http://www.aseansec.org/10114.htm>.

\textit{Ibid.}} Many of the customs-related barriers can also be considered ‘technical measures’ or technical barriers but are treated separately in this section due to the particular nature of customs procedures. The identified customs issues are as follows: (a) technical compliance with customs procedures, including administrative requirements such as prior registration of the importer or the obligation to present a certificate with regards to the country of origin; (b) marking requirements (e.g. weight, country of origin, dangerous substances) specifically for customs; (c) customs duties, and, (d) specific customs formalities, such as the obligation to provide very detailed product information, or the requirement to use specific points of entry.\footnote{Plummer, \textit{supra} note 313 at 39.}

The importance of customs procedures has been highlighted by Plummer who recommends that RTAs provide for customs procedures that follow global best practices and WTO-consistent protocols as they are crucial to facilitating trade, and are closely related to the issue of rules of origin.\footnote{\textit{Ibid.}} Plummer further notes that ‘best-practices’ under the WTO pertain to the Agreement on Customs Valuation, which provides for private sector access to review and appeal of customs decisions.\footnote{\textit{Ibid.}}

To address the issue of customs harmonization, ASEAN members collectively agreed upon a Single Window Program in 2005 that was later implemented in 2008. The ASEAN Single Window (ASW)
is intended to strengthen the implementation of economic activities through the synchronization of customs procedures and data processing in line with internationally recognized standards. Each member state will implement its own National Single Window (NSW) which will be integrated in the ASW environment. The key work areas identified for the ASW program are as follows: (1) Operationalize the electronic exchange of live data through an ASW Pilot Project; (2) Identify ASW standard business process flows for the clearance of goods and shipments; (3) Develop an ASEAN standard data set for trade transactions based on the World Customs Organization data set and other data standards; (4) Establish ASW standards for messaging protocols for the exchange of e-documents to facilitate trade and trained experts on these protocols and their use; and, (5) Increase technical and legal expertise within ASEAN as related to the ASW and e-commerce generally.

3.4.3 Proposals to Mitigate Non-Trade Barriers under the EARTA

The NTBs identified above create negative effects on trade because exporters are forced to comply with individual product requirements that vary from state to state. These issues coupled with complicated customs procedures lead to increased costs and the potential for exporters to withdraw from markets that they have difficulty accessing. The most obvious solution to this problem is for states to initiate harmonization for technical measures, product requirements and customs facilitation processes. However, to what extent should the harmonization of standards and procedures under the EARTA be undertaken? Harmonization is encouraged but not required under the SPS and TBT Agreements. The obligation to provide national treatment for goods is enshrined in GATT, but Article XX of GATT allows for derogations from such obligations when it is necessary for countries to protect human, animal or plant life or health, among other exceptions. The utilization of these exceptions has

510 “Agreement to Establish and Implement the ASEAN Single Window (2005)”, ASEAN Secretariat, online: ASEAN Secretariat <http://www.aseansec.org/18005.htm>.

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been the subject of disputes before the WTO as they are often perceived as a form of ‘disguised restrictions on trade’. As these NTBs have the serious potential to cause market access problems, the EARTA should provide for the harmonization of technical requirements for as many products as possible, ranging from electronic equipment, alcohol, to livestock. Where possible, harmonization in accordance with international standards should take place to prevent discriminatory regulations from emerging in the future. Adoption of international criteria will also encourage integration of the region with the rest of the world as East Asian and extra-regional firms alike find it easier to move their products across each others’ borders.

Harmonization of regulations and standards is a challenging endeavour. East Asia has no formal treaty in existence allowing for the harmonization of laws unlike the Treaty of Rome which provided for the development of European Union law, and officially declared EU law primacy over domestic laws. Without agreement across the region to provide the EARTA with formal competence to introduce or modify laws and regulations, I suggest that harmonization efforts should be limited to specific areas closely related to trade facilitation, at least in the early stages of integration. The integration of standards and administrative procedures may be somewhat easier as standards and procedures are not formal legal obligations that require the lengthy and complex process of legislative enactment. Unlike areas such as contracts, torts, human rights, and constitutional law which affect deeply embedded legislative histories as well as cultural and political norms, the area of trade facilitation is simpler and less likely to cause controversy in its reform.

Given ASEAN’s position as the hub for this regional arrangement, I argue that it would be logical to build on the efforts undertaken by ASEAN as there is already general agreement between these ten

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512 GATT Article XX specifically addresses this in its preamble: “Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: [..]’
countries with regards to the scope of harmonization and the methods to implement it. In that vein, the
ASEAN Single Window initiative could be extended to the additional three proposed member states
(Japan, China, and Korea) in the area of customs procedures harmonization.

As noted previously, the process of standardization of product requirements has not progressed
significantly beyond the early stages of discussion and review. Members of the EARTA would likely
benefit from collaborative efforts in designing standards and in the selection of product lines for
harmonization. The participation of China and Japan is crucial as China is the main engine behind the
Asian integrated production network, while Japan is a global leader in product standards.

Harmonization of standards is often effected via ‘mutual recognition’, a concept which is also
described in the TBT Agreement.\textsuperscript{513} Mutual recognition is the instrument employed by the European
Union to harmonize domestic standards. Article 100a of the Rome Treaty allows member states to
maintain their national standards, even after the European Council has adopted harmonization
legislation, as long as the European Commission confirms the non-discriminatory nature of such national
provisions.\textsuperscript{514} In the \textit{Cassis de Dijon} case\textsuperscript{515}, the European Court of Justice (ECJ) developed the principle
of mutual recognition by ruling that the minimum alcohol content required by German law for certain
liquor products had the effect of restricting trade of the French \textit{crème de cassis} liqueur. The essence of
the decision as summarized by the European Parliament reads as follows:

“ [...] imposing the technical rules of the importing State on products from other Member States
is tantamount to introducing an equivalent measure\textsuperscript{516} since the imported products are
penalised by being forced to undergo costly adjustments. The fact that there is no Community
harmonisation of the rules cannot be used to justify this attitude, which effectively hinders
freedom of movement, and the Court therefore laid down the principle that any product legally
manufactured and marketed in a Member State in accordance with the fair and traditional rules

\textsuperscript{513} See Article 6.1 of the TBT Agreement.
\textsuperscript{516} A measure equivalent to a quantitative restriction.
and manufacturing processes of that country must be allowed onto the market of any other Member State. This is the principle of mutual recognition by the Member States of their respective rules in the absence of harmonisation.\textsuperscript{517}

It is important to draw a distinction between the EU’s extensive levels of integration and the goal of complete freedom of movement of goods (subject to certain specific exceptions), with the more modest goals of the EARTA. Extremely comprehensive mutual recognition schemes would likely be premature in light of the EARTA’s more modest scope, the diversity of economies in the region, the different levels of efficient administrative practices in each country\textsuperscript{518}, and the concerns of infringement on national sovereignty. As such, I propose that member states of the EARTA should identify and agree upon specific areas where harmonization of standards can be feasible. States can then adopt mutual recognition schemes as an interim measure while pursuing formal harmonization structures. In the long run, I anticipate that there will be pressing needs to harmonize more quickly and comprehensively across product lines as business relationships across the region increase their interdependencies with each other. This ‘pilot-style’ effort at harmonization may be beneficial as a starting point for deeper levels of integration in the future as states may become more accustomed to the gradual relaxation of their national competences in the realm of regulatory measures.

\textbf{3.5 INSTITUTIONS FOR GOVERNANCE}

A regional trade agreement creates new rights, obligations, and expectations for all countries that are party to it. In order to implement commitments of the agreement, it is often necessary for the region to develop international institutions. International Institutions can be described as “explicit arrangements, negotiated among international actors that prescribe, proscribe, and/or authorize

\footnote{517} {European Parliament Fact Sheet”, European Parliament, online: European Parliament \texttt{<http://www.europarl.europa.eu/factsheets/3_2_1_en.htm>}.} 

\footnote{518} {Kodama, supra note 426 at 277.}
behaviour". Generally speaking, good institutions contribute to economic growth by reducing uncertainty and improving efficiency. They usually incorporate power sharing arrangements and are subject to checks and balances to prevent one group from extracting economic gain at the expense of others. The supranational aspect of the regional institutions refers to the circumstances where sovereign states agree to abide by norms which are adopted at a higher level of organization. This may or may not be based on an agreement to ‘transfer sovereignty’ to the supranational institution. At this juncture, I do not anticipate that the transfer of sovereign powers will be necessary or appropriate to the vision of the EARTA as set out in this thesis.

There are several reasons why EARTA will require some form of regional institutional arrangement. First, institutions will be necessary to sustain commitments to regional economic objectives and to ensure continuity even in the event of future political differences. According to McKinney, “As economic interrelationships among the countries become more intense, and particularly as they move beyond border restrictions to deal with matters of domestic regulation, an increasing number of issues arise that require resolution in one way or another [...] the existence of institutions can greatly increase the likelihood of cooperation among states by establishing working relationships among them, so that they have a clearer idea of what to expect from each other, and so that they can adapt more easily to new situations.” Second, when there is an increase in the degree of economic interdependence, institutions are particularly important to simplify procedures such as rules,

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520 Dobson, supra note 215 at 10.
521 Ibid.
523 Ibid.
524 Best, supra note 522 at 45.
procedures, and provide for dispute settlement mechanisms. This may reduce the transaction costs of future interactions as institutions which have the right and duty to adopt decisions will preclude the need to reconvene intergovernmental conferences every time a decision has to be taken. In addition, institutions can contribute to economies of scale in decision-making. As the institutions deal with different matters that arise, the cost of subsequent issues will decrease because the mechanisms for dealing with these issues have already been established. Noting that the EARTA’s membership will be economically diverse, institutions are also important to give weaker states ‘voice opportunities’ to make their views known and to give these views more effect. Third, institutions can provide potential economies of scope. As McKinney notes,

“When an institution deals with different types of issues, the possibility exists for trade-offs among issues, and side-payments among members, which make possible agreements that would be unattainable in the absence of the institution. For example, agreement in international trade negotiations is more easily obtained in a comprehensive round of trade talks than in sectoral negotiations because countries can make concessions to trading partners in one sector in order to gain concessions in different sector. Linkages among issues within an institutional context reduce the costs of reaching agreements of different types of issues, and raise the costs of failing to live up to the terms of an agreement because failure to do so affects several other issues as well.”

As an example of the value of institutions in assisting the process of trade negotiations, agreement among the NAFTA members to accelerate tariff phaseout was facilitated by the fact that the Free Trade Commission (of NAFTA) could consider the situation simultaneously across different sectors. The importance of institutions can perhaps be summed up by the central influence they have in promoting development. In an econometric study of determinants of growth, Rodrik. Subramaniam,

\[^{526}\text{Ibid. at 14.}\]
\[^{527}\text{Best, supra note 522 at 12.}\]
\[^{528}\text{McKinney, supra note 525 at 17.}\]
\[^{530}\text{McKinney, ibid. at 17 – 18.}\]
\[^{531}\text{Ibid. at 18.}\]
and Trebbi conclude that, “the quality of institutions ‘trumps’ everything else.”\textsuperscript{532} In other words, good quality institutions play a primary role in influencing economic growth. 

In order to determine the most appropriate institutional arrangement for East Asia, it is essential to examine the particular needs and limits of the regional scheme.\textsuperscript{533} A checklist provided by Best outlines the relevant considerations as follows:

- The number of member states
- The relative sizes of the participating countries
- Different levels of development
- Scope of coverage
- Type of impact
- Time perspectives
- Degree of real interdependence
- The political framework
- Perceptions, values, and norms\textsuperscript{534}

In consideration of the points above, I argue that the institutional structure for EARTA should reflect modest goals of governance in the initial stages but can be expected to evolve as the scope and levels of co-operation increase in the region. The large number of member states, varying levels of development, and diverse perceptions and norms manifested in East Asia require a less intrusive form of governance than a more cohesive organization would demand. A certain level of ‘softness’ or flexibility needs to be retained due to the region’s diversity, but a level of ‘hard elements’ may be necessary with an increase in specific commitments.\textsuperscript{535} This flexibility can manifest itself in “escape clauses”, clauses that permit renegotiation, or sunset clauses. Although flexibility can help members respond to unanticipated shocks, it should be incorporated with care as a larger number of members increase the


\textsuperscript{533} Best, \textit{supra} note 522 at 11.

\textsuperscript{534} \textit{ibid.}

\textsuperscript{535} Kodama, \textit{supra} note 426 at 221 – 222.
costs of flexibility more than they increase its benefits. For example, flexibility can be more costly when it is related to periodic renegotiation of provisions as larger numbers will increase associated bargaining costs. Further, as Koremenos et al. observe, “Flexibility has a downside. Renegotiation of treaty terms, as well as dealing with unilateral invocations of flexibility such as escape clauses, is costly. Moreover, individual states have incentives to free ride on an agreement by developing self-serving interpretations of escape clauses that are broader than originally intended by treaty drafters. Renegotiation also provides an opportunity for states to “hold up” the cooperative bargain in an effort to increase their own share”. In other words, the more flexible or broad an arrangement is, the more it can be susceptible to manipulation by parties to advance their individual interests.

The increasing number of economic transactions in the region and the need of the business community for stable and predictable procedures will necessitate more robust institutions. As such, a balance must be struck between flexibility and rigidity in the institutional structure. There are three general areas where institutions are commonly required: division of powers; rule-making; and, enforcement and supervision. In the analysis below, I set out the framework for two institutions that are essential to this RTA, that is, a secretariat for operations and a dispute settlement body. As the level of integration increases in sophistication in the long term, future consideration must be given to additional institutions that will be necessary to support an evolving mandate of the regional organization.

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536 Koremenos et al, supra note 519 at 794.
537 Ibid.
538 Ibid.
539 Kodama, supra note 426 at 222.
540 Ibid.
541 Ibid. at 229 – 246.
Division of Powers

There are generally two types of institutional arrangements which govern the allocation of powers in any given supranational grouping. One concerns the interactions between governments and is known as the ‘pooling of sovereignty’. Sovereignty is pooled when member states make decisions through a variety of voting procedures other than unanimity, and/or, when members agree to act jointly or not at all (exclusive competence). In such a system, members give up a portion of sovereignty to facilitate decision-making, as the alternative system, that is, unanimity with each state retaining the power to veto decisions, would engender serious inefficiencies. The most prominent example of pooled sovereignty is the European Union which introduced qualified majority voting for decision-making in specified issues such as employment and industrial relations, while retaining unanimity for important issues like treaty amendment and membership in the EU.

The other institutional arrangement refers to the delegation of powers to autonomous institutions with specific competences allocated to it. The autonomy of institutions in this arrangement can vary depending on whether approval from member states is required before the institutions can make rules or adopt decisions.

With regards to institutionalism in the Asian region, Best observes that ASEAN has traditionally rejected supranationalism and the concept of strong regional institutions. The ASEAN agreements do not provide for any pooling of sovereignty. In the case of APEC, member states are even less inclined

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542 Best, supra note 522 at 8.
543 Ibid.
546 Best, supra note 522 at 8.
547 Ibid.
548 Ibid. at 39.
549 Ibid.
towards the sharing of sovereign powers as it is based entirely on voluntary and non-binding instruments such as ministerial statements, declarations, and guidelines.\(^{550}\) In light of these circumstances and the diversity within the East Asian region, I suggest that it would be premature to introduce pooling of sovereignty and voting procedures for decision-making. Further, the EARTA is not anticipated to parallel the EU in breadth and scope and will consequently not require such a sophisticated structure at this point. Even with a hybrid system incorporating a component of sovereignty-pooling while allowing for national sovereignty over the other areas, it is unclear what areas would be suitable for the sharing of sovereign power. Instead, I propose that the EARTA’s institutions be kept generally simple and straightforward, with clearly defined mandates.

**A Commission or Secretariat**

A regional arrangement like the EARTA requires institutions to make decisions and carry out the operations associated with its mandate. The operational institution will likely be tasked with developing general policies or rules, and implementing them. The role that the institution will play depends on how competence or powers are divided between sovereign states and the institution. A secretariat is a technical supporting body that performs tasks such as information collection and analysis in order to facilitate policy implementation.\(^{551}\) ASEAN did not favour the creation of a large permanent secretariat and implemented a ‘rotating secretariat system’ which uses each member’s national secretary general as a technical support body in rotation.

A secretariat can also be allocated stronger decision-making and operational powers as desired by member states. In the case of NAFTA, the overall governing body for the agreement is the Free Trade Commission which is assisted by the NAFTA secretariat. The NAFTA secretariat is also responsible for the dispute settlement provisions of NAFTA. I propose that the EARTA would benefit from the formation of a

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\(^{550}\) Kodama, *supra* note 426 at 239.

\(^{551}\) *Ibid.* at 237.
Commission (akin to NAFTA’s Free Trade Commission) to carry out secretariat and governance functions, separate from dispute settlement functions. This Commission could go beyond the technical duties of a basic secretariat and be delegated supervision and governance responsibilities. The design of EARTA’s Commission could be structured in a way that establishes a coordinating Commission in one central location, in addition to national sections located within each member state. In an arrangement which anticipates participation from many countries, the existence of domestic sections of EARTA could assist in promoting the goals of the RTA by improving accessibility and information dissemination.

Like NAFTA’s Commission, the EARTA Commission (or Secretaria) could be given a mandate to approve further agreements on tariff and non-tariff barriers, conduct work program reviews of EARTA, and provide assessments on technical barriers to trade. The creation of working groups on issues related to a broader scope, such as integration in investment or labour, could also fall under the oversight of this Commission. The goal of this would be to maintain a level of institutional coherence, and to avoid the further proliferation of overlapping summits and ad hoc regional arrangements in East Asia, as described in Chapter III.

In comparison with the EU, a broad mandate like that of the European Commission and European Council would not likely be suitable for East Asia at this time. The European Commission acts as a cabinet of government and has the power to initiate legislative proposals, enforce laws, and implement the EU budget, among other functions. Clearly, without the collective agreement of East Asian leadership, such an institution would not be appropriate for EARTA. Nonetheless, this type of structure may be a plausible long-term goal for the region’s institutional evolution.

**Dispute Settlement Mechanism**

In order to provide credibility and certainty to the provisions of EARTA, there must be an organ specifically tasked with adjudicating disputes between members. It is important to first note that Article
23 of the WTO’s Dispute Settlement Understanding (DSU) sets out the rule that WTO members ‘... shall not make a determination to the effect that a violation [of the WTO Agreement] has occurred ... except through the dispute settlement in accordance with [WTO rules]’. Kodama explains that this provision was meant to prohibit unilateral interpretation and application of the WTO rules by any one country. 552 Read one way, it could mean that the DSU prohibits application or interpretation of the rules by a group of countries, like those in an RTA. 553 But when there are rules unique to the region, the regional body is free to deal with disputes arising from those rules. 554 Read another way, Article 23 may be interpreted more realistically to mean that regional dispute settlement bodies may be allowed to deal with trade-related rules as long as their decisions are not final. 555 For example, NAFTA’s Article 2005 allows for parties to a dispute to select to be governed either under NAFTA procedures or under the WTO regime. Therefore, resort to the WTO procedures can be prohibited if parties mutually agree to exclude it. Further, if this text is strictly interpreted, it could mean that any other separate DSMs on WTO matters are prohibited, thus assisting in the preservation of the multilateral trading system. 556 However, Kodama argues that a more ‘realistic approach is to seek the mutually supplementary co-existence of different dispute settlement procedures’ 557, similar to that which exists under NAFTA. With that in mind, I suggest that dispute settlement clauses for EARTA should contain language providing for the choice of forum (either EARTA or WTO) as this can enhance the WTO-complementary nature of the RTA, instead of making it an alternative to the multilateral system.

Dispute settlement mechanisms (DSM) can appear in many different manifestations. The WTO’s DSM has been use as a template for several RTAs. For example, NAFTA and ASEAN both utilize the

552 Ibid. at 294.  
553 Ibid.  
554 Ibid.  
555 Ibid. at 295.  
556 Ibid.  
557 Ibid.
The ASEAN Dispute Settlement Mechanism

In ASEAN, members have agreed upon the Protocol on Dispute Settlement Mechanism (1996) which covers disputes arising out of several of the ASEAN Agreements.\footnote{This includes the 1977 Agreement on ASEAN Preferential Trading Arrangements, the 1987 Agreement on ASEAN Industrial Joint Ventures, and the 1992 Agreement on the Common Effective Preferential Tariff Schemes for the ASEAN Free Trade Area. \textit{Source:} Kodama, \textit{supra} note 426 at 308.} This is illustrated below at Figure 8.

![Dispute Settlement Procedure under the ASEAN Protocol on Dispute Settlement Mechanism](image)

Figure 8: The Dispute Settlement Procedure under the ASEAN Protocol on Dispute Settlement Mechanism

\textit{Source: Adapted from Kodama, 2000}
The ASEAN dispute settlement procedure comprises strict deadlines at every stage. First, parties engage in bilateral consultations. If these fail within sixty days, the second process, the Senior Economic Officials’ Meeting (SEOM) starts. In this process, the SEOM which is a political plenary body, has the option of either establishing an arbitral panel within thirty days or referring the dispute to a special body for further consideration. The SEOM will make a ruling on a panel result, and submit a report within sixty days after panel formation. Finally, parties have the right of appeal to a superior political body called the ASEAN Economic Ministers, within thirty days after the ruling.

The NAFTA Dispute Settlement Mechanism

In NAFTA, dispute settlement is regulated by Chapter 20 of the agreement for disputes arising from the general agreement, except for those related to investment, financial services, or trade remedies (see Figure 9 below). These exceptions are covered in separate sections of NAFTA; investment disputes are provided for in Chapter 11, anti-dumping and countervailing duty cases are covered in Chapter 19, and financial services issues are regulated in Chapter 14. NAFTA provides for a step-by-step approach to dispute resolution which starts with political measures and provides for legal methods as a final resort. Under Chapter 20, the process starts with bilateral consultations and if the dispute is not settled within thirty days from the time of request for consultations, then either party may request a meeting of the Free Trade Commission. In the second step, the Commission will then pursue various non-binding political methods, such as good offices, mediation, and conciliation. The Commission may draw upon the advice of experts, and can make recommendations to the parties for

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559 Kodama, supra note 426 at 308.
560 Ibid.
561 Ibid.
562 McKinney, supra note 525 at 28.
563 Ibid. at 29.
564 Kodama, supra note 426 at 299.
If this fails, the third step is invoked wherein an arbitration process will be convened as a final resort for dispute settlement.

As a side note, I point to a unique feature in NAFTA’s DSM which is the provision for private parties to have standing in investment disputes (under Chapter 11), a right that is not available in the WTO and also not usually allowed in RTAs. In NAFTA investment disputes, investors may bring claims against the governments of their host countries. Article 1118 of NAFTA requires parties to first attempt consultations or negotiations in the early stages. After six months have elapsed ‘since the events giving

\[ \text{McKinney, supra note 525 at 29.} \]
rise to the claim’, the complainant investor may submit the claim to arbitration under the ICSID Convention, or the UNCITRAL Arbitration Rules.\footnote{ICSID – International Centre for Settlement of Investment Disputes; UNCITRAL – United Nations Commission on International Trade Law.} Although this thesis does not contemplate investment issues, the concept of permitting standing to private entities or persons in a trade dispute (related to goods or other markets) may still be worth consideration.

The EARTA’s dispute settlement mechanism should reflect a balance between the stability and clarity of rules that are required for business purposes, and the high level of importance accorded to the protection of state sovereignty by some countries in the region.\footnote{Kodama, supra note 426 at 304 – 305.} To that end, Kodama has argued for a ‘state-oriented mechanism’ stating,

“Some countries in the [Asia-Pacific] region still strongly protect their sovereignty, and thus strong institutionalised dispute settlement needs careful consideration. A regional dispute settlement mechanism should be State-oriented, thus reasonably excluding cases brought by individual persons. The initiation of legal procedures by individuals may be premature at the current stage.”\footnote{Ibid. at 305.}

In my view, the argument outlined above is not entirely convincing as an accurate summation of the needs of East Asia. There is a lack of substantial evidence to indicate that private party standing should be excluded from a proposed DSM and that a mechanism for formal complaints initiated by individual personalities will be opposed by states. I suggest that private party standing may be a very innovation in ensuring that cases are quickly brought into the process of dispute settlement. Without arguing for or against the inclusion of this right into EARTA, I suggest that deeper research should be conducted on the issue of whether private party rights to initiate actions would be beneficial and politically acceptable in the early stages of this RTA.
Further investigation should also be undertaken on the subject of the most appropriate level of flexibility for a dispute settlement body in EARTA. How much flexibility and options for political remedies should there be before parties have to resort to the ‘hard elements’ of a formal legal process? In this sense, ‘hard elements’ refer to specific legal rules which would require states to submit sovereignty to a supranational adjudicative body in a dispute.

In my opinion, despite concerns over national sovereignty, members of the EARTA would need to support a quasi-judicial organ that has genuine powers to override the will of any individual state. This is precisely the value of forming a regional trade agreement – that states are bound to abide by the agreed conditions and that they would not be able to unduly influence results by political means. In fact, this may be a reason for economically diverse countries to implement stronger DSMs as the richer countries would be less likely to end up intimidating the poorer ones into submission. Too much softness in the system would lead to a lack of enforcement of rules and cause legitimacy and predictability concerns for international businesses. This subsequently would serve to hamper rather than advance economic growth.

I consider that certain elements of both the ASEAN and NAFTA approaches are favourable and should be incorporated in EARTA. For instance, strict timelines between each step of the process will encourage efficiency and minimize the effects of prohibited activities that may still be ongoing at the time the dispute is initiated. Further, the provision for consulting expert working groups in NAFTA is a valuable tool as adjudicators may often not be technical experts in a wide range of fields. A final issue that should be considered is the provision of technical and legal assistance to countries with greater financial needs. This could be a form of ‘legal aid’, drawn from a fund that member states contribute to. Consequently, this would assist in mitigating the disadvantages faced by the poorest countries that would not have the resources to invoke legal disputes against much larger countries.
4 Summary

There are several significant challenges in the journey towards deeper regional integration. East Asian countries suffer from a lack of cohesiveness in political vision and in perceiving themselves as a unified community. Although states in the Asian continent have been embarking upon co-operation initiatives for many years, the nature of these arrangements have generally been loose, ad hoc, and informal. The myriad of Asian summits, economic groupings, and financial initiatives support the argument that integration is considered necessary. Despite the common goal of economic growth inherent in the regional groupings, these initiatives have led to criss-crossing paths with different structural arrangements, membership, and levels of commitment.

In this chapter, I have proposed the EARTA as a way to deepen integration between states in East Asia. With regards to membership, the countries in ASEAN Plus Three would logically be an effective starting point for the agreement, with the long-term vision of increasing participation by other countries. From the perspective of trade in goods, I have argued that the differences in rules of origin for goods should be harmonized by using benchmarks to select the appropriate common measure, and also by implementing the concept of co-equality among rules. Non-tariff barriers should also be seriously examined as they can significantly impede trade. The EARTA should build upon existing efforts in ASEAN to harmonize technical standards and customs procedures.

Finally, the important role of institutions in governing and promoting economic development has been emphasized. As a start, EARTA will need to establish a Commission that carries out operational and secretariat functions. A dispute settlement mechanism that is tailored to the particular political and legal needs of the region will also constitute a crucial institution for the success of this RTA.
Conclusion

East Asia’s impact on the world economy is unquestionably enormous. Home to the world’s largest exporter (China), third largest economy (Japan), and numerous other emerging economies, it is evident that trade has been key to the region’s economic robustness. At the same time, most of the countries in the region are still officially considered ‘developing countries’ and consequently have the right to special treatment under WTO rules. The opportunity to protect industries from foreign competition may have assisted growth in some states, but has also proven to be extremely detrimental when governments rely too heavily on it and implement protection in non-transparent ways.

I have argued that East Asia is ready to move beyond special and differential treatment, and must seek an alternative to achieve sustainable growth. By deepening trade and economic integration in an RTA, this region can benefit from enhanced efficiencies and simultaneously form a stronger negotiating position in multilateral talks. As there are legitimate concerns that RTAs may cause trade diversion, I have suggested that the EARTA should mitigate this by pursuing the path of open regionalism. Proper design and implementation of the agreement can lead to trade creation and encourage the region’s participation in multilateral liberalization.

East Asian countries have been actively pursuing free trade agreements over the past decade. In addition to regional initiatives, these countries have also been active in forming partnerships with cross-regional states. This has led to a noodle bowl of overlapping rules of origin that has the potential to seriously impede goals of trade liberalization. The harmonization of these rules is probably one of the most pressing issues in deepening integration. In addition, non-tariff barriers should be eliminated and domestic standards mutually recognized where possible.
Although the co-operative initiatives in East Asia have been characterized by arrangements that are generally informal and non-binding, ASEAN has made some progress towards developing more tangible trade commitments, non-tariff barrier harmonization programs, and institutional organs. Many of the proposals I have advanced build upon the designation of ASEAN as a hub for EARTA. In particular, proposed membership of EARTA would comprise the ten ASEAN countries plus Japan, China, and Korea (ASEAN Plus Three). Additional membership is anticipated as the RTA evolves.

In order to ensure credible commitments to the RTA, a certain level of supranational governance is required. Although states in East Asia are generally protective of national sovereignty, there is still a need to build institutions to govern the actions of members. At the most basic level, a Commission that carries out operational functions should be established. A dispute settlement mechanism with the authority to issue binding decisions is also essential. If members are to fully reap the benefits of this RTA, they cannot be reluctant to share some decision-making powers and to consistently abide by a set of agreed norms.

Within this thesis, I have examined selected issues relevant to a proposal for deeper East Asian integration. However, deeper and broader integration as a whole necessarily goes beyond trade issues and will have to eventually include areas like investment, currency, labour, and services. In addition, the Asian economic crisis of 1997 was partially attributed to poor corporate governance and the imprudent behaviour of state-owned enterprises. It is possible that present-day China may experience troubles similar to Korean enterprises due to the large amount of non-performing loans on the balance sheets of Chinese banks. As such, the development and integration of high quality corporate governance measures in the region would also merit further consideration.

In conclusion, there is much that East Asia can learn from the experiences of other RTAs like NAFTA and the EU. As this region is extremely unique in many ways, the form of other RTAs should not
be replicated without customization to the particular needs of the East Asia. The European Union is the most highly integrated regional arrangement that exists today. The EU’s core principles, the four freedoms of factors of production, as well as its sophisticated institutional structure, are worthy of close study. However, there have been significant difficulties in the union recently due to Greece’s extreme level of indebtedness, accusations that Greece had used ‘creative accounting’ to join the monetary union, and the reluctance of some EU members to bail out the ‘profligate state’.\footnote{\textit{Let the Greeks Ruin Themselves}, \textit{The Economist} (18 February 2010), online: The Economist <http://www.economist.com/>.} As economic growth in the EU has not occurred equally in all member states, there can be large burdens on successful countries to provide support where they may not have anticipated doing so. Circumstances like these may cause East Asian countries to hesitate in advancing the evolution of EARTA into an economic union. To address these concerns, I propose that research will be required to develop measures which encourage growth as uniformly as possible in all states, and which will impose a rigorous system of financial accountability on members of EARTA.
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