

VISITING RESEARCHERS SERIES NO. 3(2002)

## **New Regionalism and New Bilateralism in the Asia-Pacific**

P.J. Lloyd

VISITING RESEARCHERS SERIES NO. 3(2002)  
May 2002

## **New Regionalism and New Bilateralism in the Asia-Pacific**

P.J. Lloyd  
ISEAS Visiting Professorial Fellow  
March-April 2002

## **NEW REGIONALISM AND NEW BILATERALISM IN THE ASIA-PACIFIC**

### **Abstract**

This paper reviews the development of new regional trading agreements (RTAs) in the Asia-Pacific in the last two years or so. This new regionalism shows new patterns with more countries joining in RTAs and several countries participating in more than one RTA. Many of these new agreements are bilaterals. New regionalism is explained chiefly in terms of the fear of exclusion from major markets. It has positive and negative effects; the latter include increasing discrimination against developing countries and hubs-and-spokes. However, viewed dynamically, bilaterals may play a new role in mitigating the effects of large RTAs and encouraging coalescence among RTAs.

In the last two years or so a number of new Regional Trading Agreements (RTAs) have been formed in the Asia-Pacific area and more are being negotiated or studied. This development is sometimes known as the “new regionalism”. This paper discusses the nature of these new developments and their significance for individual countries and for the world economy. It focuses on the dynamics of the movement towards regionalism and bilateralism.

### **1. The New Regionalism**

The geographic area studied here is the Asia-Pacific. It can be taken as coincidental with the APEC (Asia Pacific Economic Cooperation) region as all of the actual and proposed RTAs in East Asia (West Pacific) with links to those in the East Pacific are among countries which are also members of APEC, and APEC policy towards trade liberalization and RTAs is of some interest in itself.

Table 1 lists the RTAs in the Asia-Pacific that are in force or are currently being negotiated. Those in the left column are in force, the dates in parentheses are the years in which these agreements came into force. Those in the right column are currently being negotiated. It is presumed that each of the negotiations under way will result in a new agreement at some future date but this is not of course certain. The table does not

include RTAs in which one of the parties is in the region and the other party or parties is outside the region. There are a number of such agreements; for example, the Canada-Israel Free Trade Area (FTA) or the agreements between Mexico on the one hand and the EC (European Commission) or EFTA (European Free Trade Association) or Israel on the other.

In addition to the agreements listed in Table 1, there are a number of proposals involving countries in the Asia-Pacific. Table 2 lists the proposals for which all of the countries involved are in the Asia-Pacific. All of the listed proposals have reached the stage that they have been mooted by all governments concerned, rather than, say, by one government or by academic or business interests. However, the degree of government-to-government commitment varies greatly. For example, in the case of the ASEAN (Association of Southeast Asian Nations)-China proposal, the proposal was mooted at the Sixth ASEAN Summit in November 2001 and a study was commissioned. One year later at the Seventh ASEAN Summit, the ASEAN states and China considered the report of the ASEAN-China Expert Group and announced they had decided to create a free trade area within 10 years. Negotiations are to start as soon as possible. In other cases, studies have been commissioned and received but no action has been taken yet (for example, the Korea-Japan proposal) or studies have not yet been completed (for example, the Australia-Thailand proposal which is subject to a joint scoping study).

The last two proposals in Table 1 have lapsed, at least for the time being. ASEAN and the Closer Economic Relations countries discussed a link between the two areas in November 2000; however, the recommendation from a High-level Taskforce to proceed with negotiations was not adopted by the meeting of the ASEAN-CER (Closer Economic Relations Trade Agreement) Ministers. The P5 proposal involving the US, Australia, New Zealand, Chile and Singapore was made at the APEC Leaders meeting in Auckland in September 1999 but did not proceed further.

These two tables indicate that there has been a major development of regionalism in the Asia-Pacific since 1997. In particular, there has been a sudden rush towards regionalism in the East Asian sub-region. The first RTA involving a North East Asian country was the Japan-Singapore Economic Partnership Agreement that comes into force in the summer of 2002. At the 2001 meeting of the ASEAN+3

economic ministers, a new expert group was created to look at the possibility of an ASEAN-Japan FTA. At the 1998 APEC Summit Meeting, Korea and Chile agreed to pursue a free trade area with the goal of a complete opening of trade and elimination of all tariffs within 10 years. China has committed itself to negotiations with ASEAN for ASEAN+1 and agreed to an intergovernmental study of a potential Northeast Asia Free Trade Area with Japan and Korea. Singapore has completed two free trade agreements with New Zealand and Japan respectively and is negotiating four more currently.

These developments constitute an enormous change in the East Asia. Prior to them, Japan and Korea, along with Hong Kong and one other country, were the only four members of the more than 140 members of the WTO (World Trade Organization) that had not participated in a reciprocal regional trading agreement. Indeed, North East Asia was the only region of the world that had no RTAs. But that status is changing very rapidly. Now, among all of the current WTO members, only Hong Kong and Taiwan (a new member of the WTO) and one other country, have not joined or are not negotiating an RTA.

In some respects, these trends are a continuation of trends observed before 1997. The number of RTAs completed rose sharply in the 1980s and 1990s (WTO, 1998). Many of these agreements had provisions extending well beyond the traditional coverage of goods and services. The great majority of the RTAs completed in the last two decades have been free trade areas.

Yet, post -1997 RTAs in the Asia-Pacific have a number of significant new features:

- they include a number of countries that were not previously members of any free trade area or customs union (Japan, Korea and China)
- several countries in the Asia-Pacific are now members of more than one RTA (Singapore, the US, Canada, Mexico, Chile, Peru, Australia, New Zealand and Russia)
- several of the new agreements are “*cross-regionals*” (i.e. the members span more than one of the world’s geographic regions<sup>1</sup>): Korea-Chile; Singapore-US, Singapore-Canada, Singapore-Mexico. (The tables do not include RTAs involving an Asia-Pacific country and another country outside this area such as the Canada-Israel [1997] agreement, or the agreements between Mexico on the one hand and the EC [2000] or EFTA [2001] or Israel [2000]; and the Singapore -EFTA states agreement which is being negotiated.)

- many of the new agreements are *bilaterals* (i.e. involving a pair of countries)

It is these new developments that I refer to by the phrase “new regionalism”. All of these features relate to the geographic coverage of RTAs. I shall try to draw out the implications of these features.

It is useful to draw a distinction between bilateral agreements, which involve two parties, and those that involve three or more. The latter are called *plurilateral s* by the WTO (2000).<sup>2</sup> One or even both of the parties to a bilateral may itself be an RTA; for example, the proposed agreements between ASEAN on the one hand and China and Japan respectively on the other.

From Table 1, one can construct a list of individual APEC countries that are parties to one or more bilaterals. This list is given in Table 3. The list does not include countries that have indicated an interest in a bilateral proposal but have not yet begun negotiations; for example, Thailand. It shows that nine of the 21 APEC countries have completed or are negotiating a bilateral agreement. Nor does the list include countries in the Asia-Pacific that have formed a bilateral with a country outside the region; Russia (which has agreements with the Kyrgyz Republic and with Georgia). Including Russia, there is a total of 10 out of 21 members of APEC. Thus, a large part of the new regionalism is new bilateralism.

One should note that of the 11 countries in APEC that do not have a bilateral agreement, seven are ASEAN countries. (The other four are Hong Kong, Taiwan, Papua New Guinea and Peru). Thus the ASEAN states, with the exception of Singapore, stand out in the Asia-Pacific region as the states that have not formed or are negotiating bilaterals.

One should also note that the trend towards new RTAs is not peculiar to the Asia-Pacific. WTO (2000) enumerates 240 RTAs in force or under negotiation as of July 2000. Indeed, the East Asian region is a latecomer in this trend. The trend has progressed further in terms of the number of RTAs and the percentage of countries that are members in other regions, above all in Europe-Mediterranean area. In other regions too, the new RTAs share the features that there are many bilaterals and many countries are party to more than one RTA (and most new RTAs extend to issues of “deep” integration). In terms of bilaterals, Israel and Mexico are a party to many.

Unfortunately, the WTO enumeration does not separate bilateral from plurilateral RTAs. They do, however, report that there were 15 cross-regional RTAs in force at July 2000 and another 14 under negotiation (WTO, 2000, para 11).

Another feature of the emerging world pattern of RTAs is the emergence of large continental-sized RTAs. The EU (European Union) is in its fourth enlargement. The FTAA (Free Trade Area of the Americas) will create an area of 34 nations if the negotiations are successfully concluded. An East Asian RTA is another possibility. Thus, we have the rather odd pattern of many new bilaterals coexisting with very large continental RTAs.

One way of measuring crudely the significance of RTAs is to compute the percentage of world trade which takes place between countries that are members of RTAs. The WTO estimated that in 1999, 57 per cent of world goods trade was covered by RTAs in this sense. (This does not include non-reciprocal preference trade such as GSP imports into Developed countries.) Of this, the intra-EC trade alone accounted for 25 per cent of total world trade and intra-NAFTA trade for another 11 per cent. Thus, trade between countries which trade on MFN (Most-Favored-Nation) terms is less than one half of world trade. It needs to be stated that not all intra-RTA trade takes place on preferential terms as a large part of the trade of all countries that are members of an RTA has a zero MFN rate and therefore, the RTA does not favour members for trade in these goods. Unfortunately, the WTO does not calculate the percentage of world trade that takes place on RTA-preferential terms.

## **2. Explaining New Regionalism**

Given the global nature and the rapid pace of new regionalism, it is important to understand the reasons behind it. Several reasons have been advanced:

- gains from trade and factor flows and greater competition in markets
- binding of market access for goods (binding of tariffs at zero under duty-free entry provisions within the RTA and, in some cases, prevention of contingent protection actions by fellow members [anti-dumping, countervailing actions and safeguard action])
- ease of negotiations with fewer parties
- benefits of deep integration resulting from the cross-border harmonization of national economic policies and regulations
- regional security
- fear of exclusion from major markets

Still other reasons have been advanced.

It is difficult to assign relative weights to these factors. All of them have played a part in the formation of some RTAs but the relative weights have no doubt differed among them. For example, in Canada a major declared motive for regional association with its large and powerful neighbour was the desire to secure access to markets. Canada has sought to have a provision in NAFTA (North American Free Trade Agreement) to prevent one member from taking anti-dumping actions against another member. A small number of other RTAs have a prohibition on these actions; the EU, the European Economic Area, Australia-New Zealand CER and the Canada-Chile Agreement. However, the US has refused to accept this limitation on its freedom to take such actions. But Canada has had some success in the area of safeguard action as both Canada and Mexico were exempted from the additional tariffs imposed recently on steel products. As another example, regional security issues have been especially weighted in the EC/EU and also in ASEAN.

Other factors have contributed to new regionalism. The failure of the WTO to begin a new round of multilateral negotiations in Seattle in 1999 illustrated the difficulty of comprehensive multilateral liberalization of market access. The difficulty of reaching agreement at the Doha Ministerial and the complexity of the current negotiations have continued this problem. In the Asia-Pacific, APEC trade liberalization has stalled and “open regionalism” is a failure as a strategy to counter the effects of the formation of more and more RTAs. Another factor in East Asia is the East Asian financial crisis of 1997-98, which demonstrated the risks of contagion in financial markets and exchange rate volatility in an era of flexible exchange rates. Asian leaders are searching for homegrown defenses against these market risks. This explains why the new regionalism in East Asia has been proceeding more rapidly on the financial market side than on trade.

My belief is that one factor is common to all new RTAs and is becoming more important relative to the other factors. This is the fear of exclusion from major markets. In this context, exclusion does not mean that a country is denied access to a market, that is, total exclusion. It means that it has access on terms less favourable than some other country or countries.

This fear is a product of the formation of RTAs such as NAFTA, MERCOSUR (Common Market of the South) and the Andean Community in the 1980s and early 1990s. As more RTAs were formed, the share of a country's export trade that may enter foreign markets on less favourable terms than its competitors located in the area increases. This leads to a domino effect. Hence, the trend towards RTAs is self-reinforcing and becomes ever stronger. This process is discussed further in Section 4 below.

One can say more about the incentives to join or form RTAs. For a country, the incentive is strongest for a trading partner that is one of its major markets and has joined an RTA with other countries. The incentive is particularly strong if the trading partner has joined more than one RTA or is a member of an RTA with a large number of members which enjoy preferences over the exports of the country concerned. This aspect can explain in part the movement towards bilaterals and the pattern of bilaterals. Many countries are seeking to obtain a bilateral agreement with the US and the EU in particular, where there is no or little prospect of them becoming part of the major regional trading bloc, NAFTA and the EU respectively. This explains why the EU and the US are the centers of regional preferential trading.

### **3. Systemic Effects of New Regionalism**

As well as being a major trend that directly affects market access, new regionalism is having significant effects on the world trading system.

Some of these effects are positive. For example, one motive for a country that is a member of a multi-country RTA engaging in bilaterals on its own account might be to force other members of the bilateral to make more progress in trade liberalization and thereby promote deeper integration in the RTA. Rajan *et al* (2001, chapter 2) give this as one reason behind Singapore's pursuit of bilaterals. They refer to the "convoy problem" whereby the pace of integration is held back by the "least willing member". Another benefit is that RTAs can set precedents and develop negotiation modalities that can be adopted later in multilateral negotiations. There a number of examples of this. The Canada-US FTA in particular developed concepts and modalities in the service trade area that were important in the development of GATS (General Agreement on Trade and Services).

Some of the effects are negative. These include

- multiple systems of rules
- creating a scarcity of negotiation resources at the national level and negotiation fatigue
- bad precedents
- hubs and spokes
- unequal access to world market
- undermining the MFN principle further

Some comments will be made on each of these. The last is usually regarded as the big issue or the only issue. I shall argue that the question of unequal access to world markets is also important. In fact, the last three aspects are all aspects of the geographic coverage of RTAs and display some of the effects of new regionalism. I shall concentrate on these effects.

RTAs certainly create multiple systems of rules for many of the sets of rules they cover. These rules differ among RTAs and they also differ from the rules of the WTO, whereas the WTO has rules that cover features of an RTA. This multiplicity may pose a problem for the governments and the traders of one country that is a member of more than one RTA. In areas such as rules of origin and industrial and sanitary and phytosanitary standards, export traders may face different rules depending on the destination of their exports.

Simultaneous negotiations may pose a problem for government negotiators. This is probably a problem more for developing countries that have a limited pool of such resources but it can be overcome by training and technical assistance from developed countries and multilateral organizations, chiefly the WTO and the World Bank.

The precedents set by RTAs may be bad as well as good. There has been concern over some of the RTA precedents. One example is the exclusion of some agricultural products from the trade liberalization under the Japan-Singapore EPA; specifically, the Agreement excludes cut flowers and ornamental fish, Singapore's principal exports of agricultural products to Japan, from the list of products imported under the terms of the agreement into Japan. It has been reported that Japan is pushing for a similar exclusion in the negotiations with Mexico, Korea and Australia. Another example is the US predilection for side agreements on environment and labour

standards. Having succeeded in embedding these in NAFTA, the US is now pursuing such agreements in other bilaterals and in the FTAA. Of course, there are differences among countries as to the worth of such precedents, some regard them as good and some as bad. In evaluating such precedents, one should adopt a global welfare point of view and ask if they have a positive effect on world welfare. This bad precedent argument is one of the grounds on which the eminent trade economist, Jagdish Bhagwati, has been opposed to regionalism. It has been recognized in the Singapore context (see Rajan *et al*, 2001, chapter 6 and Rajan and Sen, 2002).

In terms of geographic coverage, new regional developments have fundamentally changed the pattern of RTAs. Up to the early 1990s, RTAs were a set of non-intersecting areas with only a few exceptions but this is no longer true. Many countries are now members of more than one RTA. This has come about partly because one country that is a member of one RTA has formed a bilateral agreement with one or more countries outside the area, and partly because of links between RTAs. This is what Bhagwati (1995) picturesquely called the “spaghetti bowl”.

Wonnacott (1996) introduced the terminology of hubs and spokes. A hub arises where one country (customs territory) is a member of two distinct RTAs. Since the development of the new regionalism, many countries are now hubs. In the Asia-Pacific area, Singapore, the US, Canada, Mexico, Chile, Peru, Australia, New Zealand and Russia are now hubs on the basis of RTAs already in force and others such as Japan and Thailand may join them soon. One can measure this effect crudely by considering the number of spokes for each hub, that is, the number of countries with which one hub country has separate bilateral free trade agreements (excluding plurilateral RTAs of which it is a member as these have connections across spokes). One might describe the EU as a *super-hub* because of the large number of spokes; 25 from my count.<sup>3</sup> By comparison the US has only four (the US-Israel and US-Jordan agreements and the agreements currently being negotiated with Singapore and Chile).

Hubs create multi-layered preference schemes. One consequence is that the spokes have less market access than the hub as the hub enjoys preferential access to all spokes but a spoke has preferential access to the hub only and, for the reverse trade, a hub gets unrestricted imports from the spokes but each spoke gets unrestricted access only from its spoke partner.

There are further complications in the case where a country that is a member of a multi-country RTA forms bilaterals with a country or countries outside the area. Singapore is one example. In such cases, the country with the additional bilateral is a hub. It has preferential access to the markets of its bilateral partner which the fellow members of the RTA do not enjoy, and, conversely, the outside bilateral partner has preferential access to markets of its inside bilateral partner but not to the markets of the other members.

New regionalism has created unequal access to world markets. Most of the bilaterals are between developed countries or in a few cases between a developed and a developing country; examples of the latter are the agreements Mexico has with the EC and EFTA countries. When the larger size of the markets in developed countries and especially the US and the EU is taken into account, there is no doubt that the increase in market access resulting from bilaterals has gone overwhelmingly to developed countries and not to developing countries. The one significant exception among the developing countries appears to be Mexico which has secured mostly free access to its major markets in both North America and Europe. In the APEC area, the countries that have gained improved market access from the bilaterals are all the higher income countries of the region, again with the exception of Mexico. Of greatest concern, none of the bilaterals links a Least Developed Country to a Developed Country.

Consequentially, the gains from trade liberalization from bilateral agreements and from RTAs in general have gone largely, and probably overwhelmingly, to developed countries. There are two parts to this conclusion. One concerns the traditional fear of negative trade diversion effects for countries outside the preferential areas. (For some countries and some goods, these effects have been mitigated by non-reciprocal preferences for imports from Developing Countries.) Scollay and Gilbert (2001) carry out simulations of the effects of various bilateral and many-country RTAs in the Asia-Pacific. They find that all bilaterals have negative effects on the welfare of some outside countries<sup>4</sup> with the sole exception of the New Zealand-Singapore agreement which has a zero effect on all countries.<sup>5</sup> The second part is that Developing Countries have not shared in the positive benefits of freeing trade regionally. Indeed, this effect may be greater than the effects of unequal progress within the Uruguay

Round and prospectively from the current multilateral round that the Developing countries complain about. This market access effect does not seem to have received any attention.

The effect of regionalism which is usually regarded as the big issue is the effect it may have on the rate of multilateral liberalization, the building block or stumbling block debate as it has been called. Does the formation of new RTA have a positive or a negative effect on the multilateral trade system? And, as a particular issue, does the formation of bilateral agreements have a positive or a negative effect on multilateral trade negotiations?

First, one can note that RTAs are generally WTO-consistent. But this is because the requirements of Article XXIV and the Enabling Clause and GATS are very weak and have never been enforced. The meaning of “substantially all trade” has never been defined and has been interpreted in many ways.<sup>6</sup> The only effective restraint GATT/WTO rules have imposed on RTAs is that they have prevented trade barriers from being raised against third countries, with a few exceptions (see Panagariya, 1999, p. 499). This has not prevented the discrimination inherent in all RTAs. Moreover, almost all of the deep integration features of recent RTAs are altogether outside the WTO rules.

The effect of regionalism on multilateral negotiations has been examined many times, including detailed examinations by the OECD (1995) and the WTO (1995) itself. The answer commonly given is that it does not. Discussants point out that one does not preclude the other and in fact both have gone on at the same time for long periods. They also point out many positive interactions from RTAs to the multilateral trade negotiations such as the good precedents effect, and the “dipping the toe in the water” effect of RTAs which has prepared some reluctant countries to be more favourable towards multilateral liberalisation which forces them to lower or bind border barriers.

Singapore has explicitly adopted the building block view in justifying its bilateralism. Thus, in announcing the New Zealand Singapore CEP Agreement, Prime Minister Goh referred to an “intention to spin a web of interlocking free trade agreements between APEC members, which could help to move the organization toward achieving free trade in the Asia Pacific.” (2000)

One should note too that regionalism may have an effect on unilateralism, the lowering of barriers on an MFN basis by countries individually. Unilateralism has been an important part of trade liberalisation in the last two decades. The usual argument for unilateralism is that a country benefits from reducing its own-imposed barriers to trade. This argument would not be affected substantially by regionalism. It is even possible that the effect of regionalism may increase the benefits of unilateral reform because of regional trade diversion. On the other hand, preoccupation with bilateral trade opportunities may diminish unilateral actions.

#### **4. Where is it all Going?**

The international trade policy scene is changing rapidly. And it will continue to develop as negotiations proceed on various bilateral, regional and multilateral fronts. With some understanding of the factors behind the new regionalism and their effects, one can ask where it is all going?

New developments outside the multilateral negotiations could go in a number of possible directions:

- a host of new bilaterals
- the enlargement of existing RTAs
- the coalescence of existing multi-country RTAs and bilaterals through mergers and links

These are not of course mutually exclusive. We are likely to see some developments on each of these fronts.

One can view these three fronts as optional paths towards global free trade. There are around 200 countries (customs territories) in the world economy. Each historically has had its own external trade regime. Now consider the *grand coalition*, as it is called in game theory, of global free trade. Two hundred countries can proceed from 200 separate regimes of restricting trade with other countries to the single grand coalition in three ways, ruling out an agreement to proceed immediately to the grand coalition. These options assume that each RTA is itself a movement to completely free trade among the members, after a transition period. Of course, these methods may be and in reality have been combined. The fundamental building block in these options is

a bilateral between two countries (customs territories). Each option can be expressed in terms of a set of bilaterals.

First, if there are precisely  $n$  countries, they can form  $[n(n-1)/2]$  bilaterals. But this requires a very large number: for 200 countries, it is 19,900  $[200(200-1)/2]$  bilaterals. One can regard existing plurilateral agreements as a set of bilaterals; for example, the 15-member EU is equivalent to 105 identical bilaterals. Thus, the existence of plurilateral agreements at the starting point reduces the number of bilaterals required for free world trade but only slightly.

Second, if one or more RTAs are already formed, each can become larger and larger. An *enlargement* (to use the terminology of the EU) can be expressed in terms of bilaterals. An enlargement of a multi-country RTA on the one hand to take in a single new member is equivalent to a set of (identical) bilaterals between the new member and each of the existing members. To be precise, adding one new member to an RTA with  $n$  members is equivalent to adding  $n$  bilaterals.

Third, if there is more than one RTA, they must eventually coalesce or be supplemented by bilaterals linking all of the countries between which there is not free trade. In a famous paper Kemp and Wan (1976) argued that there was an incentive for more countries to join customs unions until they covered the entire world. Their argument is dependent upon intra-union transfers and the ability to choose the level of the common external tariff. It has recently been extended to free trade areas by Panagariya and Krishna (1997) and Ohyama (1999), provided in this case that each country adjusts its external tariffs.

A *coalescence* of two pre-existing RTAs can also be regarded as a set of bilaterals. For example, suppose there are two 5-member free trade areas which now coalesce into one 10-member free trade bloc. This coalescence is equivalent to 25 new bilaterals. (A free trade area with 10 members is equivalent to 45 bilaterals whereas each of the 5-member bilaterals is equivalent to 10 bilaterals.)

In practice, coalescence can take two forms. It can take the form of a new encompassing RTA that replaces the existing RTAs among the members of the larger group.<sup>7</sup> There are a few examples. The most notable case is the European Economic Area under which the EFTA countries will eventually become a part of the EU. The FTA between Mexico and the Central American Common Market (CACM) will

replace the previous bilateral agreements between Mexico and the individual members of the CACM but in this case the pre-existing RTA, CACM, will remain.

The other form of coalescence is a link between two (or more) existing RTAs. Under this form, trade would be liberalised within the larger area but the existing RTAs would remain and would retain their own rules. WTO (2000, para 13) lists this as a “new category” of RTAs. This new group includes EC-MERCOSUR and the agreement between CARICOM (Caribbean Community) and CACM in the Caribbean and Central American region. It would have included ASEAN-CER if this had proceeded. These category is likely to increase rapidly in the future. “[These] account for 9 of the 68 RTAs under negotiation and are composed of both regional and cross-regional initiatives.” (WTO, 2000, para 13). This form is likely to be preferred if there are significant differences in the extent of deep integration.

At this time, it seems that the RTA route towards the grand coalition will be a mixture of two-country bilaterals, enlargements and coalescence. It is not clear which will dominate though there are definite signs that coalescence is becoming a major reality in some parts of the world. It has already taken place in the EU on a large scale. The FTAA will, if accomplished, bring about coalescence in the American hemisphere. At the Third African Development forum in March 2002, the African members of the Organization of African Unity agreed to pursue an African Union, modeled loosely on the lines of the EU. If this comes about, three of the four WTO regions (the Euro-Mediterranean, the Americas, and sub-Sahara Africa) would be covered by a single RTA). Such developments replace many bilaterals and mean that future negotiations between the countries in a large RTA and other countries are more likely to take the form of coalescence negotiations.

In the Asia-Pacific area, one may expect more bilaterals with coalescence at a later stage. In relation to new bilaterals, there are developments emerging all the time. For example, during the visit of the Indian Prime Minister to Singapore in April 2002, Prime Minister Vajpayee and Prime Minister Goh Chok Tong agreed to study the possibility of a free trade deal. One can expect growing interest in countries seeking to negotiate bilaterals with Japan and ASEAN, both of which are parties in negotiations with several partners, for reasons noted above. In 2001, Japan proposes an ASEAN+5

free trade area involving the ASEAN nations, Japan, China, Korea, Taiwan and Hong Kong. This would be another plurilateral agreement.

Another possibility is for APEC to abandon its open regionalism rhetoric and become a free trade area covering all 21 member countries. If this new agreement moved to completely free trade, there would be no need, as far as cross-border trade was concerned, to maintain the existing RTAs whose members are all in the larger APEC group; NAFTA, ASEAN and CER. (In practice, the existing groups are likely to be maintained as the trade may not be completely free or other features such as deep integration or dispute settlement in the existing RTAs go beyond those in the new agreement.) The FTAA could in principle achieve the same result for the Hemisphere countries.

There have been some attempts to model the process of RTA formation, beginning with Krugman (1991). Unfortunately, the models used have had to be simple in structure in order to model trade between a number of countries and the effects of RTAs among subsets of them.

Krugman used a symmetric “love of variety” type model with increasing returns and Chamberlinian imperfect competition. There are a number of trading blocs, actually customs unions with union-welfare-maximising common external tariffs. Each bloc is the same size. Each country is in one trading bloc only, that is, there are no intersections between RTAs. The number of blocs, and therefore also the size of each bloc, is varied.

Baldwin (1996) develops a Krugman-type model with costs of entry and an integration effect that lowers unit costs. He does not explicitly model tariff preferences. Instead he uses a Samuelson-type iceberg function to model transport costs and trade costs. There is one RTA and it is assumed willing to allow any country to join. Each outsider considers whether it wants to join. Membership is here a mechanism for exporters to avoid profit losses in their existing markets resulting from new regional discrimination and lower intra-area costs. Thus, the effect of joining is to raise the welfare of outside countries. As more countries join, the profit effect increases as more of the world trade takes place within the RTA and eventually the grand coalition is achieved.

Adriamananjara (2000) uses a Cournot oligopoly model with a single homogeneous good. At the initial stage, there is one or more blocs. Then he models tariff preferences. In this model, countries outside the trading blocs move sequentially. He considers the incentives to both the outside country and the member countries of an outside country joining one bloc. The member countries will not accept new members if it is not in the interests of the incumbents to do so. This is a much more realistic view of the dynamic process. As a regional trading area expands, there are incentives for members to block the entry of additional prospective members in order to protect their preferences. This is inherent in the nature of RTAs as preferential or discriminatory areas. “The key lesson to take away from this paper is that there is a real possibility that, left on its own, the current wave of regionalism will not lead to global free trade.” (Andriamananjara, 2000, p. 2)

Adriamananjara (2000) and Scollay and Gilbert (2001) suggest two criteria for assessing whether the RTA building-process will lead to eventual free trade. One is the criterion of whether the RTAs lowers the levels of barriers *vis-a-vis* outside countries and thereby prevent injury to outsiders. The second is whether the RTAs are willing to take in new members. The larger many-country agreements tend to have fewer negative effects and larger positive net welfare effects on the region as a whole and on the world. (Scollay and Gilbert, 2001, Table 3 a-f). One possibility is to have an “open” agreement in which the existing members are obliged to accept new members.

The difficulty with these proposals is that there is no mechanism in the world trading system to ensure these criteria are met. Article XXIV and the notification process of the GATT/WTO have failed completely on this score. There is a low probability that the examination of RTAs under the rules provisions of the Doha Ministerial Agreement will progress far in this direction. In the absence of WTO rules, the members may not have an incentive to lower barriers to trade with outside countries. Nor do they have an incentive to admit all new members. There are a large number of cases in which countries have sought to join an existing RTA, especially the EU or NAFTA, and have been rebuffed.

It is here that bilateral agreements may play another role. The Krugman-Baldwin-Adriamananjara-type analyses of the bloc-building process have been confined to analyses of non-intersecting areas. That is, they allow a regional trading area to

expand sequentially and, in some cases, they allow two or more blocs to coalesce. But they ignore the bilateralism possibilities of one country that is a member of a multi-country RTA linking with outside countries, in the style of hub countries. While it may not be in the interests of a set of countries collectively to admit a new member, it may be in the interest of one member to engage in bilaterals with outsiders. When this happens, there is a greater incentive for other members to form bilaterals with the outside country. In turn this may improve the benefits to members of admitting the country to membership or, in cases where the outside country is itself a member of another RTA, a bilateral could lead to coalescence of two areas. Thus this adds new possibilities. These possibilities need modeling and numerical analysis.

Another consequence is that, viewed dynamically, the Bhagwati (1995) “spaghetti bowl” may not be bad. The feature of the spaghetti bowl that produces the complexity, is the intersections between different RTA areas. Even though it results in hubs-and-spokes, spoke bilaterals mitigate the effect of large RTAs and they may lead subsequently to coalescence of areas.

There is still a distinct possibility that some countries may be excluded from this process for economic and/or non-economic reasons. In particular, developing countries are less attractive as members of RTAs with developed countries because of their smaller markets, demands for unequal transition periods and general reluctance to accept commitments to deep integration. Even if new regionalism is a building block to global trade liberalisation, it must be accompanied by multilateral trade liberalisation.

## NOTES

1. For the purpose of identifying the major “regions” of the world, I follow the geographic classification of the WTO (2000) which identifies five “regions”: the Euro-Mediterranean, Sub-Sahara Africa, East Europe and Central Asia, the Asia-Pacific, and the Americas.
2. This terminology should not be confused with the meaning of “plurilateral” in the Uruguay Round. There it is related to the four agreements which were not part of the Single Undertaking and which individual members could opt out of.
3. These are the 13 accession countries plus 12 agreements with Developing Countries in the Mediterranean and Africa already in force or being negotiated. The agreements with the accession countries will lapse if and when they become full members. This number does not include the 77 African, Caribbean and Pacific countries with which the EU hopes to replace non-reciprocal agreements with reciprocal FTAs. See McQueen (forthcoming).
4. Some have a negative effect on one partner; for example, the Australia-Singapore agreement is estimated to have a negative effect on aggregate Australian welfare.
5. One cannot expect any trade diversion in the case of agreements with a country that already has zero MFN tariff rates or tariff rate equivalent of nts.
6. WTO (1995) provides a critical review of the rules.
7. Within this form there are choices. An encompassing union of, say two, pre-existing RTAs can follow the rules of one or the other. In such a case one RTA acquires the other, to use the language of mergers and acquisitions. Or, a new agreement with its own new rules can replace the previous agreements and rules.

## REFERENCES

- Adrianamanjara, S. (2000), “On the Size and Number of Regional Integration Arrangements: A Political Economy Model”, Department of Economics, University of Maryland at College Park..
- Baldwin, R. E. (1996), “A Domino Theory of Regionalism” in Richard E. Baldwin, P. Haaparanta and J. Kiander, *Expanding Membership of the EU*, Cambridge University press, Cambridge.
- Bhagwati, J. (1995), “US Trade Policy: The Infatuation with Free Trade Areas” in J. Bhagwati and A.O. Krueger (eds.), *The Dangerous Drift to Preferential Trade Agreements*, American Enterprise Institute for Public Policy Research, Washington, D.C.
- Goh Chok Tong, (2000), “Remarks by Prime Minister Goh Chok Tong at the ANZSCEP (Agreement between New Zealand and Singapore on a Closer Economic Partnership) Signing Ceremony”, [www.mti.gov.sg/public/](http://www.mti.gov.sg/public/)
- Kemp, M. and H. Wan (1976), “An Elementary Proposition concerning the Formation of Customs Unions”, *Journal of International Economics*, 6 (1), 95-97.
- Krugman, P. R. (1991), “Is Bilateralism Bad?” in E. Helpman and A. Razin (eds.), *International Trade and Trade Policy*, MIT Press, Cambridge, MA.
- McQueen, M. (forthcoming), “The EU’s Free-Trade Agreements with Developing Countries: A Case of Wishful thinking?”, *The World Economy*.
- Ohyama, M. (1999), “The Economic Significance of the GATT/WTO Rules”, *Economic Review* (in Japanese), 50, January, 2-10. (English translation)

- Organisation for Economic Cooperation and Development (OECD) (1995), *Regional Integration and the Multilateral Trading System: Synergy and Divergence*, OECD, Paris.
- Panagariya, A. and K. Krishna (1997), "On the Existence of Necessarily Welfare-enhancing Free Trade Areas", Department of Economics, University of Maryland, N0. 32.
- Panagariya, A. (1999), "The Regionalism Debate: An Overview", *The World Economy*, 22, 477-511.
- Rajan, R., R. Sen and R. Siregar (2001), *Singapore and Free Trade Agreements*, Institute of Southeast Asian Studies, Singapore.
- Rajan, S and R. Sen (2002), "Singapore's New Commercial Trade strategy: the Pros and Cons of Bilateralism", Centre for International Studies, Adelaide University, Discussion Paper No. 0202.
- Scollay, R. and J. P. Gilbert (2001), *New Regional Trading Arrangements in the Asia Pacific?*, Institute for International Economics, Washington, D. C.
- Wonnacott, R. J. (1996), "Trade and Investment in a Hub-and-spoke System versus a Free Trade Area", *The World Economy*, 19 (3), 237-252.
- World Trade Organisation (WTO) (1995), *Regional Trading Arrangements and the World Trading System*, WTO, Geneva.
- World Trade Organisation (WTO) (1998), "Mapping of Regional Trade Agreements". This document can be downloaded from the WTO website.
- World Trade Organisation (WTO) (2000), "Mapping of Regional Trade Agreements", WT/REG/W/41. This document can be downloaded from the WTO website.

About the author:

Professor P. J. Lloyd is Ritchie Professor of Economics, Faculty of Economics and Commerce at the University of Melbourne; and Visiting Professorial Fellow at the Institute of Southeast Asian Studies. E-mail: <pjllloyd@unimelb.edu.au>

**Table 1: RTAs in the Asia-Pacific**

**I Arrangements including countries in ASEAN**

ASEAN (1977)  
Japan-Singapore EPA (2002)

**II Arrangements between countries in East Asia and the Rest of the Asia-Pacific**

Singapore-New Zealand CEP (2001)	US-Singapore Canada-Singapore Mexico-Singapore Australia-Singapore Korea-Chile
----------------------------------	--

**III Arrangements involving countries inside the Asia-Pacific but outside East Asia**

CER (1983) Andean Community (1969/1989) NAFTA (1994) Canada-Chile (1997) Chile-Mexico (1999)	US-Chile
--	----------

**Table 2: Definite Proposals in the Asia-Pacific**

**Bilaterals**

eg. Japan-Korea,  
Australia-Thailand

**Regionals**

ASEAN-China Free Trade Area	(ASEAN-10, China)
ASEAN-Japan Free Trade Area	(ASEAN-10, Japan)
ASEAN +3	(ASEAN-10, China, Japan, Korea)
North East Asian Free Trade Area	(China, Japan, Korea)
Pacific Island Countries Trade Agreement	(Papua New Guinea, Pacific Islands)
P5	US, Australia, New Zealand, Singapore,
Chile	
AFTA- CER	(AFTA-10, CER-2)

**Table 3: Countries in the Asia-Pacific with Bilaterals**

Japan  
Korea  
Singapore  
USA  
Canada  
Mexico  
Chile  
Australia  
New Zealand

## ISEAS WORKING PAPERS

### **I. ISEAS Working Papers on Economics and Finance**

(ISSN 0218-8937)

1(96): Nick J. Freeman, *Portfolio Investment in Vietnam: Coping Without a Bourse*, February 1996.

2(96): Reza Y. Siregar, *Inflows of Portfolio Investment to Indonesia: Anticipating the Challenges Facing the Management of Macroeconomy*, March 1996.

3(96): Helen Hughes, *Perspectives for an Integrating World Economy: Implications for Reform and Development*, May 1996.

4(96): Carolyn L. Gates, *Enterprise Adjustment and Economic Transformation: Industrial Enterprise Behaviour and Performance in Vietnam during Stabilization and Liberalization*, June 1996.

5(96): Mya Than, *The Golden Quadrangle of Mainland Southeast Asia: A Myanmar Perspective*, July 1996.

1(99): Myat Thein, *Improving Resource Mobilization in Myanmar*, January 1999.

2(99): Anita G. Doraisami, *The Malaysian Currency Crisis: Causes, Policy Response and Future Implications*, February 1999.

3(99): George Abonyi, *Thailand: From Financial Crisis to Economic Renewal*, March 1999.

4(99): Carolyn L. Gates, *The East Asian Crisis and Global Integration: Mismanagement and Panic Revisited or a New Beast?*, March 1999.

5(99): Tin Maung Maung Than, *The Political Economy of Burma's (Myanmar's) Development Failure 1948-1988*, March 1999.

6(99): Kim Ong-Giger, *Southeast Asian Economies in Crisis: The Emergence of Pax Capitalia*, April 1999.

7(99): Carolyn L. Gates, *ASEAN's Foreign Economic Relations: An Evolutionary and Neo-Institutional Analysis*, May 1999.

8(99): Kim Ong-Giger, *Japanese IT Development: Implications for FDI in Southeast Asia*, September 1999.

9(99): Frank L. Bartels and Nick J. Freeman, *Multinational Firms and FDI in Southeast Asia: Post-Crisis Perception Changes in the Retail-Oriented Manufacturing Sector*, December 1999.

1(2000): Nick J. Freeman, *Constraints on Thailand's Equity Market as an Allocator of Foreign Investment Capital: Some Implications for Post-Crisis Southeast Asia*, January 2000.

2(2000): Nick J. Freeman, *Foreign Portfolio Investors' Approaches to Thailand's Equity Market: Survey Findings and Preliminary Analysis*, March 2000.

3(2000): Nick J. Freeman and Frank L. Bartels, *Portfolio Investment in Southeast Asia's Stock Markets: A Survey of Institutional Investors' Current Perceptions and Practices*, April 2000.

4(2000): Nick J. Freeman, *A Regional Platform for Trading Southeast Asian Equities: Viable Option or Lofty 'Red Herring'?*, July 2000.

5(2000): Sakulrat Montreevat, *Impact of Foreign Entry on the Thai Banking Sector: Initial Stage of Bank Restructuring*, August 2000.

6(2000): Ramkishen S. Rajan and Tracy Yang, *Devaluation of the Baht and Economic Contraction in Thailand*, December 2000.

7(2000): Tracy Yang and Paul Vandenberg, *Selected East Asian Stock Markets in the Context of Financial Liberalization: Prior to the Crisis*, December 2000.

1(2001): Tracy Yang and Reza Siregar, *An Empirical Examination of the Stock Market Returns in Selected Asia-Pacific Economies in the Pre- and Post-Financial Reform Period*, February 2001.

1(2002): Tracy Yang, *Crisis, Contagion, and East Asian Stock Markets*, February 2002.

## **II. ISEAS Working Papers on International Politics and Security Issues** (ISSN 0218-8953)

1(96): Derek da Cunha, *The Need for Weapons Upgrading in Southeast Asia: Present and Future*, March 1996.

1(97): Simon J. Hay, *ASEAN's Regional Security Dialogue Process: From Expectation to Reality?*, March 1997.

1(99): Sorpong Peou, *The ASEAN Regional Forum and Post-Cold War IR Theories: A Case for Constructive Realism?*, January 1999.

2(99): Sheng Li Jun, *China and the United States as Strategic Partners into the Next Century*, February 1999.

3(99): Jürgen Haacke, *'Flexible Engagement': On the Significance, Origins and Prospects of a Spurned Policy Proposal*, February 1999.

4(99): Derek da Cunha, *Southeast Asia's Security Dynamics: A Multiplicity of Approaches Amidst Changing Geopolitical Circumstances*, July 1999.

1(2001): Anthony L. Smith, *Indonesia: One State, Many States, Chaotic State?*, September 2001.

2(2001): Sheng Lijun, *One Year of the Chen Shui-Bian Government: Ice Across the Taiwan Strait*, September 2001.

3(2001): Derek da Cunha, *Renewed Military Buildups Post-Asian Crisis: The Effect on Two Key Southeast Asian Bilateral Military Balances*, December 2001.

### **III. ISEAS Working Papers on Social and Cultural Issues**

(ISSN 0218-8961)

1(96): Federico V. Magdalena, *Ethnicity, Identity and Conflict: The Case of the Philippine Moros*, April 1996.

1(98): Patricia Lim, *Myth and Reality: Researching the Huang Genealogies*, June 1998.

2(98): M. Thien Do, *Charity and Charisma: The Dual Path of the Tinh Dô Cu Si, a Popular Buddhist Group in Southern Vietnam*, September 1998.

1(99): JoAnn Aviel, *Social and Environmental NGOs in ASEAN*, August 1999.

1(2000): Lee Hock Guan, *Ethnic Relations in Peninsular Malaysia: The Cultural and Economic Dimensions*, August 2000.

1(2001): Aris Ananta, *The Impact of Migration Status on Household Financial Resilience During the Indonesian Crisis: A Case Study*, May 2001.

2(2001): Lee Hock Guan, *Political Parties and the Politics of Citizenship and Ethnicity in Peninsular Malay(sia), 1957-1968*, September 2001.

### **IV. ISEAS Working Papers by Visiting Researchers**

(ISSN 0219-3582)

1(2000): Ramkishan S Rajan, *Examining the Case for Currency Basket Regimes for Southeast Asia*, January 2000.

2(2000): P Lim Pui Huen, *Continuity and Connectedness: The Ngee Heng Kongsis of Johor, 1844-1916*, January 2000.

- 3(2000): Ramkishen S Rajan, *Examining the Case for an Asian Monetary Fund*, February 2000.
- 4(2000): Thawatchai Jittrapanun, *The SIMEX Experience: Implications for Thailand's Futures Exchange*, February 2000.  
[Also published as EADN Working Paper, No 1, November 2001.]
- 5(2000): Le Minh Tam, *Reforming Vietnam's Banking System: Learning from Singapore's Model*, February 2000.  
[Also published as EADN Working Paper, No 2, November 2001.]
- 6(2000): Gao Haihong, *Liberalising China's Capital Account: Lessons Drawn From Thailand's Experience*, February 2000.  
[Also published as EADN Working Paper, No 3, November 2001.]
- 7(2000): Liliana Halim, *Reviving the Indonesian Banking Sector? Indonesia's Economic Crisis: Impact on Financial and Corporate Sectors 1997-1999*, February 2000.  
[Also published as EADN Working Paper, No 4, November 2001.]
- 8(2000): Ngiam Kee Jin, *Coping with the Asian Financial Crisis: The Singapore Experience*, March 2000.
- 9(2000): Ramkishen S. Rajan and Iman Sugema, *Capital Flows, Credit Transmission and the Currency Crisis in Southeast Asia*, March 2000.
- 10(2000): Wang Xiaomin, *Zhongguancun Science Park: A SWOT Analysis*, May 2000.  
[Also published as EADN Working Paper, No 5, November 2001.]
- 11(2000): Doan Phuong Lan, *The Asian Financial Crisis and its Implication for Vietnam's Financial System*, May 2000.  
[Also published as EADN Working Paper, No 6, November 2001.]
- 12(2000): Tracy Yang Su-Chin, *Regulatory Reforms in the Asia-Pacific Region: A Preliminary Study*, May 2000.  
[Also published as EADN Working Paper, No 7, November 2001.]
- 13(2000): Akhmad Bayhaqi, *Education and Macroeconomic Performance in Indonesia: A Comparison with Other ASEAN Economies*, May 2000.  
[Also published as EADN Working Paper, No 8, November 2001.]
- 14(2000): Ai-Gek Beh and George Abonyi, *Structure of the Asset Management Industry: Organizational Factors in Portfolio Investment Decisions*, June 2000.
- 15(2000): Paul Vandenberg, *The Evolution of SMI Policy in Malaysia*, December 2000.
- 1(2001): Anis Chowdhury and Iyanatul Islam, *The East Asian Crisis — A Political Economy Explanation*, March 2001.

2(2001): Irman G. Lanti, *Back to the (Slightly Different) Future: Continuity and Change in Indonesian Politics*, April 2001.

3(2001): Bruce Matthews, *Ethnic and Religious Diversity: Myanmar's Unfolding Nemesis*, May 2001.

4(2001): Porametee Vimolsiri, *Role of Foreign Investors in the Thai Currency Crisis of 1997*, October 2001.

5(2001): Ramkishan S. Rajan and Chung-Hua Shen, *Are Crisis-Induced Devaluations Contractionary?* November 2001.

6(2001): Graham Bird and Ramkishan S. Rajan, *Financial Crises and the Composition of International Capital Flows: Does FDI Guarantee Stability?*, November 2001.

1(2002): Ramkishan S. Rajan and Rahul Sen, *Trade Reforms In India Ten Years On: How Has It Fared Compared To Its East Asian Neighbours?*, March 2002.

2(2002): Muhammad Chatib Basri, *Why Trends of Protection Changed Over Time in Indonesia?*, March 2002.

3(2002): P.J. Lloyd, *New Regionalism and New Bilateralism in the Asia-Pacific*, May 2002.

**Editor**

Tin Maung Maung Than

**Assistant Editor**

Han Mui Ling

**Editorial Committee**

Derek da Cunha

Lee Hock Guan

Lee Poh Onn

Sakulrat Montreevat

Papers in this series are preliminary in nature and are intended to stimulate discussion and critical comment. The Editorial Committee accepts no responsibility for facts presented and views expressed, which rests exclusively with the individual author. No part of this publication may be produced in any form without permission.

Comments are welcomed and may be sent to the author.



