

Multilateralizing PTAs in the Asia-Pacific Region

John Ravenhill
Australian National University

I was asked by the Commission to make a brief presentation on the prospects for multilateralizing the preferential trade agreements (PTAs) that have been negotiated in the Asia-Pacific region over the last decade. This presentation draws from a forthcoming article in the *Review of International Political Economy*, a copy of which is appended to this document. It is part of a project financed by the Australian Research Council through Discovery Project grant DP0453077. I also take this opportunity to make a few brief comments relating to some of the other terms of reference for the Commission's enquiry.

Recent theoretical work on multilateralizing PTAs often rests on arguments developed by Richard Baldwin¹ on the spread and consolidation of discriminatory trade agreements in Europe. This elegant theoretical approach does appear to have substantial explanatory power in the European context: I argue that it has far less purchase in the Asia-Pacific region.

Baldwin's model begins with an "exogenous" shock to the trading system, such as the signature or deepening of a PTA involving a major economy. This shock triggers a "domino" effect through which PTAs proliferate and a virtuous circle is set in train in which pro-liberalization interests are strengthened. Exporting interests in countries that are not party to a PTA lobby their government to negotiate equivalent agreements to those that their competitors enjoy, leading to a proliferation of agreements. The liberalization that these agreements generate, in turn, strengthens exporting interests, providing them with both the motivation and means to lobby for further liberalization. With the proliferation of agreements, however, companies become increasingly concerned about the potentially damaging effects that divergent rules of origin have on the management of their supply chains: in turn, this problem leads business interests to lobby for a consolidation/multilateralization of the agreements.

This political economy model rests on a number of assumptions regarding the effects of PTAs and the relationship between business and government, assumptions that I argue often have little resonance in East Asia. These include:

- There are significant barriers to effective supply chain management that PTAs credibly address;
- Business interests are the effective drivers of PTAs (through their lobbying of governments).

In the Asia-Pacific region, however, it is often remarked that we have seen "regionalization without regionalism", that is, the development of region-wide supply chains in the absence of a formal process of regional inter-governmental trade agreements. Such regionalization has been facilitated by the unilateral actions that governments have taken in lowering their tariffs, in introducing duty-drawback arrangements and free trade zones that facilitate assembly operations, and in negotiating sectoral agreements at the global level that have freed trade (most importantly, the Information

1 R. Baldwin, 'A Domino Theory of Regionalism', (Cambridge, Ma.: National Bureau of Economic Research, September 1993) Working Paper 4465; R. E. Baldwin, 'Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade', *World Economy* 29 (2006): 1451-1518.

Technology Agreement, that covers the single most important export sector in the region). Consequently, applied tariffs across the region in most sectors of manufacturing trade are low.

The assumptions of the political economy model of PTAs rest on characteristics of Western political systems (especially that of the US): governments respond to exporting interests because they depend on them for campaign contributions, and on those employed in exporting sectors for votes. There is also an acknowledgement, however, that governments find PTAs to be an attractive trade policy option because the lax WTO disciplines over PTAs (the lack of an agreed interpretation of the requirements of Article XXIV.8) enable governments to exclude politically-sensitive domestic sectors from these agreements.

Research that I have completed in East Asia, detailed in the attached paper, finds very little evidence that exporting interests have been actively involved in the negotiation of PTAs. These have been predominantly driven by governments, primarily for diplomatic-strategic rather than economic reasons. To the extent that business interests have been active in lobbying on PTAs, it is typically the import-competing protectionist interests that have been most vigorous.

The primacy of the political over the economic has the consequence that the majority of PTAs in East Asia are “trade-lite”. They have often been signed with countries that are relatively insignificant trading partners. Their coverage, even of merchandise trade, is far from complete; significant sectors are carved out of the agreements; they are often vague in their provisions and have extended time periods for implementation. Few are WTO-Plus even in their coverage of services.

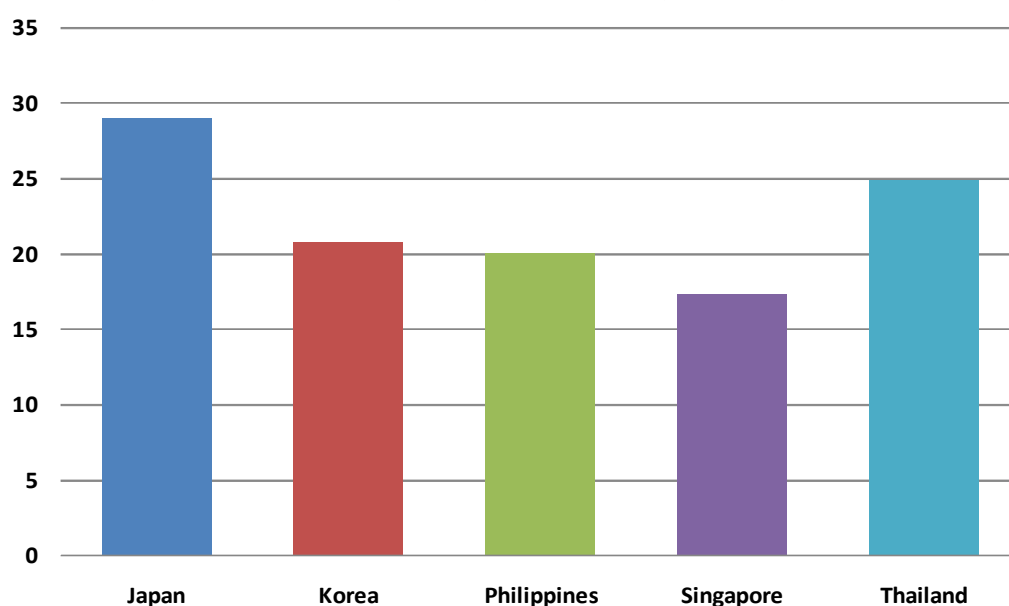
The combination of relatively low barriers to the operation of regional supply chains plus agreements that generate few advantages has led to business indifference towards the agreements. Various estimates suggest that the costs of compliance with rules of origin may be as much as 8% of the value of a shipment: the preferential tariff has to be substantial for business to take the trouble to complete the documentation required for compliance with the rules of origin (and there are also frequent reports that processing of this documentation is not swift in many countries in the region).

The consequences of low tariffs plus trade lite agreements are seen in the data that are available on utilization rates of the preferential tariffs. Unfortunately, only a few countries in the region regularly publish the customs data that enable examination of the total value of imports/exports that take advantage of the provisions of PTAs. In the absence of such data, estimation of the usage of agreements is typically calculated from surveys of firms. Even leaving aside all of the problems of sample bias associated with such surveys, the surveys tell us nothing about the actual value of trade that takes advantage of the preferential agreements. The table and figure below report data on utilization rates, the first from customs data, the second from firm surveys (for the sources see the attached paper).

Table 1 Share of Country Exports to other ASEAN Making Use of AFTA

Indonesia	< 4%
Laos	< 0.1%
Malaysia	19.1%
Philippines	14%
Thailand	30.9%
Vietnam	< 8%

Figure 1: Share of Exporting Firms Surveyed Using PTAs (%)



The relatively high rates of utilization for Thailand are largely explained by one industrial sector—automobiles and auto components—where tariffs (and NTBs) around the region have remained high.

The low utilization rates suggest a great deal of indifference on the part of business to these agreements: they simply do not provide sufficient advantages for business to take the trouble to complete the documentation required for compliance with the rules of origin.

If the agreements do not create significant advantages for exporters in the partner economies, the corollary is that they do not generate significant disadvantages for exporting interests based in countries that are not parties to an agreement. Such a conclusion substantially undermines the logic of the “domino” effect. In reality, we see little evidence around the region of business clamouring for PTAs to “level the playing field”. The character of PTAs in the region is not such, therefore, that they

are likely to generate any automatic, self-sustaining momentum towards consolidation/multilateralization. And because political factors have often been prominent in government considerations, we see agreements that are tailored to domestic protectionist interests but accepted nonetheless by partners because of the diplomatic priority given to reaching an agreement (not least in the Australian treaty with the US).

The tailoring of agreements to accommodate domestic interests across the region has produced substantial variation in agreements—even those negotiated by relatively advanced economies such as Korea. They provide little foundation, consequently, for multilateralization.

A partial exception are the agreements negotiated by the US because these typically are based on a common template. The US now has agreements with Australia, Canada, Chile, Mexico, Peru and Singapore: it has signed but not ratified an agreement with Korea, and has been negotiating with Malaysia. These are the most comprehensive agreements in the region and could provide a foundation and framework for multilateralization (although they contain provisions that arguably are not welfare-enhancing, including some on intellectual property rights and the exceptions granted to US agricultural production).

Estimating the welfare effects of PTAs is a matter of considerable complexity, a problem that needs to be acknowledged much more in official reports. Similarly, the weaknesses of CGE modelling (see the attached paper) that produce reports of welfare gains that are frequently little more than “guesstimates”, given the assumptions built into the models, need to be made clear to the Australian public. And whereas the terms of reference given for such studies include the assumption that such agreements will be comprehensive and “cleanly” implemented, we need a far more cautious approach given the experience of negotiating and implementing these arrangements around the region.

What the analyst of PTAs should really be interested in is where the agreements may create advantages for the partners—and, today, as far as merchandise trade is concerned, this often will be in a minority of tariff lines. In Malaysia, historically a relatively high tariff country, for instance, the December 2009 WTO Trade Policy Review reported that 60% of [applied] tariff lines were duty-free. Few researchers, however, are willing to undertake the type of disaggregated study that focuses solely on those areas where PTAs create a potential advantage.