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New Bilateralism in the Asia-Pacific

by

P. J. Lloyd

University of Melbourne

Address for Correspondence:
Department of Economics,
Faculty of Economics and commerce,
The University of Melbourne,
Parkville, Victoria 3010,
Australia

Phone: 61 3 83445291
Fax 61 3 83446899

Email: pjlloyd@unimelb.edu.au

In the last four years or so a number of new Regional Trading Agreements (RTAs) have been formed in the Asia-Pacific area and in other geographic areas of the world economy, and more are being negotiated or studied. This paper discusses the nature of these new developments and their significance for individual countries and for the world economy. It focuses on the role of bilateral agreements in these trends and their place in the dynamics of the movements towards regional and global free trade. The main conclusion is that bilateral agreements have negative effects on the world trading system when viewed from a short term perspective but, from a longer term perspective, they have dynamic effects which may be positive.

1. The New Bilateralism

The geographic area I shall focus on as an example of these trends is the Asia-Pacific. The Asia-Pacific can be taken as coincidental with the APEC area as all of the actual and proposed RTAs in East Asia (West Pacific) with links to those in the East Pacific are among countries that are also members of APEC, and the APEC area is tractable in terms of the pattern of trading relations.

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. These include two for which negotiations have been agreed by the parties but have not yet begun; the ASEAN-China proposal and the Australia-Thailand Free Trade Area proposal. In the case of the ASEAN-China proposal, the proposal was mooted at the Sixth ASEAN Summit in November 2000 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. 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 area and the other party is outside the area. There are a number of such agreements; for example, the Canada-Israel Free Trade Area or the agreements between Mexico on the one hand and the EC or EFTA 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 that are not yet subject to negotiations. Table 2 lists proposals for which all of the countries involved are in the Asia-Pacific. Again proposed RTAs in which one of the parties is in the Asia-Pacific area and the other party or parties is outside the area are excluded. 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. In the case of the Australia-US Free Trade Area, the two governments agreed in June 2002 to negotiate a free trade area but the proposal is waiting on the passage of trade promotion authority through the US Congress. In some other cases, studies have been commissioned and received but no action has been taken yet; for example, the Korea-Japan proposal.

The last two proposals in Table 2 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 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. This process began in 1997. In particular, there has been a sudden rush towards regionalism in the East Asian sub-area. 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 on ASEAN+1 and agreed to an intergovernmental study of a potential Northeast Asia Free Trade Area with Japan and Korea. Singapore has completed free trade agreements with New Zealand, Japan and the EFTA States and is negotiating four more currently.

These developments constitute an enormous change in the East Asia. Prior to them, Japan, Korea, Hong Kong and Mongolia, were the only four members of the more than 140 members of the WTO that had not participated in a reciprocal regional trading agreement. Indeed, North East

Asia was the only area of the world that had no RTAs. To this list, one should add China which is now a member of the WTO and is not a member of any RTA. 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 Mongolia, 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 early 1990s (WTO, 1998). We cannot use the term “new regionalism” to describe this movement as the previous surge in the number of RTAs during the 1980s and early 1990s is sometimes known as “new regionalism”.

Yet, recent RTAs and RTA proposals subject to negotiations in the Asia-Pacific have a number of significant new features:

- most of the new agreements are *bilaterals* (i.e. there are two parties to the Agreement)
- 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
- several of the new agreements are “*cross-regionals*” (i.e. the members span more than one of the world’s geographic regions¹): Korea-Chile; Singapore-US, Singapore-Canada, Singapore-Mexico
- in some agreements, one or both parties is itself a pre-existing RTA

All of these features relate to the geographic coverage of RTAs. Recent RTAs have other features too in terms of the expanding commodity coverage and instrument coverage. I shall concentrate on the geographic features. It is this new geographic pattern that I refer to by the phrase “new bilateralism”.

This characterisation of recent developments draws a distinction between bilateral agreements, which involve two parties, and those that involve three or more. The latter are called *plurilaterals* by the WTO (2000).² In relation to bilaterals, one 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. Indeed, both parties to an RTA may themselves be RTAs; for example, EC-MERCOSUR, CARICOM-CACM, SACU-SADC. In Section 3, for the subset of bilateral agreements which are a part of hub-and-spoke arrangements, a similar distinction is made between bilateral and plurilateral spokes.

From Table 1, one can construct a list of individual APEC countries that are parties or are negotiating to become parties to one or more bilaterals: Japan, Korea, Singapore, Thailand, the US, Canada, Mexico, Chile, Australia and New Zealand. This list does not include countries that have indicated an interest in a bilateral proposal but have not yet begun negotiations. It shows that 10 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 area; Russia (which has agreements with the Kyrgyz Republic and with Georgia). Including Russia, this is a total of 11 out of 21 members of APEC. Thus, a large part of the recent movement towards regionalism in the Asia-Pacific is bilateralism.

One should note that of the 10 countries in APEC that do not have a bilateral agreement, six are ASEAN countries. (The other four are Hong Kong, Taiwan, Papua New Guinea and Peru). Thus the ASEAN states, with the exception of Singapore and now Thailand, stand out in the Asia-Pacific region as the states that have not formed or are not negotiating bilaterals.

The trend towards bilateralism is not peculiar to the Asia-Pacific. Indeed, the East Asian region is a latecomer in this trend. WTO (2000) enumerates 172 RTAs known to the WTO in force on 31 July 2000, and WTO (2002) updates this to March 2002 at which time there were 197 customs unions and free trade areas. 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 areas too, the new RTAs share the features that there are many bilaterals and many countries are party to more than one RTA. 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). Estevadeordal (2002) reviews RTAs in the Americas.

Another feature of the emerging world pattern of RTAs is the emergence of large continental RTAs. The EU is in its fourth enlargement. The FTAA will create an area of 34 nations if the negotiations are successfully concluded. An East Asian RTA is a possibility. Thus, we are likely to have the rather odd pattern of many new bilaterals coexisting with very large continental RTAs, that is, bilateralism combined with continentalism.

2. Explaining New Bilateralism

Given the global nature and the rapid pace of formation of new bilateral RTAs, it is important to understand the reasons behind bilateralism. Several reasons have been advanced for the formation of RTAs in general. The main reasons advanced are:

- gains from trade and factor flows and greater competition in regional 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 and dissatisfaction with slow progress in the WTO multilateral negotiations
- benefits of deep integration resulting from the cross-border harmonization of national economic policies and regulations
- attraction of FDI to the region
- regional security
- fear of exclusion from major markets

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. As an illustration of the second motive, 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 to prevent one member from taking anti-dumping actions against another member.

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.

These factors apply to plurilateral RTAs as well as to bilateral RTAs. Several countries have signaled their intention to add a policy of pursuing new bilateral agreements to a former policy of

strict multilateralism. But few have been explicit about the reasons. Singapore has been most explicit. Rajan *et al* (2001, chapter 2) give dissatisfaction with the slow progress of ASEAN as the 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". Australia began to move away from a policy of strict multilateralism, apart from one RTA with the neighbour with whom it has been close linked historically, in the late 1990s. The 1997 White Paper on Australia's Foreign and Trade Policy signaled a change and explained it in terms of improving market access (Commonwealth of Australia, 1997). Japan has explained its radical change of policy in terms of promoting closer economic partnerships with Asian countries (METI, 2002).

My belief is that one factor is common to all new *bilateral* 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 and especially of large continental sized RTAs such as NAFTA and the expanded EU in the 1980s and early 1990s. As more RTAs were formed, the share of a country's export trade that entered foreign markets on less favourable terms than its competitors located in the area increased. This leads to a domino effect. Hence, the trend towards RTAs is self-reinforcing and becomes ever stronger.

One can say more about the incentives to join or form bilateral 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 pattern of bilaterals as well as the movement towards 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/FTAA and the EU respectively. This explains why the EU and the US are the centres of bilateral RTAs. This process is discussed further in Section 4 below.

3. The effects of New Bilateralism

The formation of new bilateral RTAs is having significant effects on the world trading system. First, bilaterals and plurilaterals combined may have systemic effects.

The effect of regionalism that is usually regarded as the big issue is the effect it may have on the multilateral trading system, the building block or stumbling block debate as it has been called. Does the formation of new RTAs have a positive or a negative effect on multilateral trade negotiations? The effect of regionalism on multilateral negotiations has been examined many times, including detailed examinations by the OECD (1995) and the WTO (1995) itself. (For a recent review, see Panagariya, 1999.) The answer commonly given is that it does not. Discussants point out that regional liberalisation does not preclude the multilateral liberalisation and in fact both have gone on at the same time for long periods.

In addition to effects in common with plurilaterals, bilateral RTAs may have special effects on the world trading system. The effects include

- creating a scarcity of negotiation resources at the national level and negotiation fatigue
- precedents for later RTAs
- hubs and spokes
- multiple systems of rules in areas such as rules of origin and industrial and sanitary and phytosanitary standards

These effects have been portrayed as negative.

One example of a bad precedent 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, as well as some chemical, petroleum and plastic products from the list of products imported under the terms of the agreement into Japan. It has been reported that Japan will push for a similar exclusion in the future negotiations with countries such as Mexico, Korea and Australia. Another example is the US predilection for side agreements on environment and labour standards. In evaluating such precedents, one should adopt a global welfare point of view and ask if they have a positive effect on world welfare.

On the other hand, bilateral RTAs can set good precedents and develop negotiation modalities that can be adopted later in multilateral negotiations. There are 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.

In terms of geographic coverage, new bilateral 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 is what Bhagwati (1995) picturesquely called the “spaghetti bowl”.

Wonnacott (1996) introduced the terminology of hubs and spokes. Wonnacott described a hub as arising from the decision of an outside country to form a bilateral agreement with only one member of a multi-member pre-existing RTA. The inside country is called the hub. This definition of a hub is too narrow. The general phenomenon is one of *intersections* between RTAs. A hub arises where one country (customs territory) is a member of two or more distinct RTAs. This is a generalisation of the Wonnacott definition.

Intersections or hubs arise in several ways. Hubs may arise when one country is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another single country outside the original RTA, as Wonnacott discussed. These spokes may be described as *bilateral spokes*. Most hubs arise in this way. Hubs may also arise when one country is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another RTA; for example the US has an agreement with the CACM countries. In this case the spoke party is another plurilateral. Such spokes may be described as *plurilateral spokes*. Or hubs may arise when one country almost simultaneously negotiates bilaterals with a number of countries; for example, Chile. Or hubs may arise when one country is a member of more than one plurilateral; for example, Mexico is a member of the NAFTA and of the Group of Three, and Russia is a member of CIS and of the Eurasian Economic Community.

There are hubs now in all geographic areas of the world economy. Many hubs have multiple spokes. This effect can be measured by counting the number of spokes for each hub, that is, the number of parties with which one hub country has separate free trade agreements. Bilateral spokes can be separated from plurilateral spokes (and from membership in plurilateral RTAs). Many hubs have a policy of developing numerous spokes. The EU has 25 spokes by my count.³ EFTA has a similar strategy. MERCOSUR is engaged in regional trade negotiations with several neighbouring countries. The states of the former Yugoslavia are negotiating bilateral RTAs

among themselves within the framework of a Stability Pact. Some individual states have a similar multi-spoke strategy. Countries with a large number of spokes might be described as *super-hubs*.

In the Asia-Pacific area, Singapore, the US, Canada, Mexico, Chile, Peru, Australia, New Zealand and Russia are now hubs or are negotiating agreements that will make them hubs. Table 3 lists the hub countries in the Asia-Pacific. It identifies the first and primary RTA and the spokes. (As noted above, Mexico and Russia are actually members of two plurilateral RTAs.) Spokes outside the Asia-Pacific are included in this table. Plurilateral spokes are marked by an asterisk. Spokes currently under negotiation are listed in the right hand column. The table does not include spokes under discussion but not under negotiation. Most of the hubs in the Asia-Pacific area have multiple spokes. Only New Zealand and Peru have a single spoke. Chile is an unusual hub in that it does not have a primary RTA, rather it began negotiating simultaneously a number of bilaterals. Japan may follow this route.

Hubs-and-spokes, or more generally intersections of RTAs, have generally been regarded as a negative feature of the proliferation of RTAs. They create multi-layered preference schemes. 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 imports only from its spoke partner. In a similar way, where other rules are required to determine entry conditions, they create multi-layered rules that may be regarded as another kind of hub-and-spoke effect; for example, rules of origin or standards.

However, this negative view of hubs-and-spokes arises from a static perspective of RTAs. When they are viewed in a longer term perspective, they may play a positive role in the evolution of trade liberalisation. This effect is considered in the next two sections.

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, plurilateral and multilateral fronts. With some understanding of the factors behind the new bilateralism 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. 200 countries can proceed from 200 separate regimes of restricting trade with other countries to the single grand coalition via three paths, 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. This overstates the liberalization of trade from the formation of RTAs, however, the commodity coverage of recent RTAs is much greater than earlier RTAs.)

To compare these alternatives paths, one can use sets of bilateral relations. Each type of RTA relationship can be expressed in terms of a set of bilaterals. Bilaterals are the building blocks of free trade connections.

First, if there are precisely n countries, the grand coalition can be achieved by forming bilaterals between all pairs of countries. The number of bilaterals is the number of combinations of countries, taken two at a time from n . This is $[n(n-1)/2]$. But this path requires a very large number of bilaterals: for 200 countries, it is 19,900.

As a variant, one can have a starting point with some multilateral RTAs along with countries that are not members of an RTA. The existence of plurilateral agreements at the starting point reduces the number of bilaterals required for free world trade. One can regard a plurilateral agreement as a set of bilaterals. For a plurilateral agreement with p members, the number of country combinations is $[p(p-1)/2]$. For example, the 15-member EU is equivalent to 105 (=

15.14/2) identical bilaterals. But the effect is not dramatic. A very large number of bilaterals is still needed.

The second path to global free trade is a series of enlargements of existing RTAs. An *enlargement* (to use the terminology of the EU) can be expressed in terms of bilaterals. An enlargement of a pre-existing multi-country RTA 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. Adding one new member to an RTA with n members is equivalent to adding n bilaterals.⁴

An enlargement of RTAs has a much more considerable effect on the number of countries trading freely (preferentially) among each other than one new bilateral. This holds because the number of bilateral spokes which is equivalent to the effects of an RTA increases very rapidly with the number of members. It is given by the function $S = [p(p-1)/2]$. For 2-, 3-, 4-, 5-, 6-member, etc RTAs, this goes 1, 3, 6, 10, 15, etc.

The third path to global free trade is through the coalescence of pre-existing RTAs. A *coalescence* of two pre-existing RTAs can also be regarded as a new set of bilaterals. A coalescence of two pre-existing RTAs has a considerable effect on the number of countries trading freely (preferentially) among each other. The precise effect depends on the number of parties to each of the two RTAs. For example, suppose there are two 5-member free trade areas that 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 $10 \cdot 9/2 = 45$ bilaterals whereas each of the 5-member bilaterals is equivalent to $5 \cdot 4/2 = 10$ bilaterals.)

In practice, coalescence takes two forms. It can take the form of a new encompassing RTA that replaces the existing RTAs among the members of the larger group.⁵ 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 name and rules. WTO (2000, para 13) lists this as a “new category” of RTAs.

Aads noted in Section 1 above, this group includes EC-MERCOSUR, CARICOM-CACM in the Caribbean and Central American area and SADC-SADU in Southern Africa. This 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 path towards the grand coalition will be a mixture of 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.) This is continentalism on an even larger scale.

To consider what might happen in the longer run, we need a model. 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. This proposition has recently been extended to free trade areas by Panagariya and Krishna (1997) and Ohyama (1999), provided in this case that the individual member countries adjust their external tariffs to maintain the level of imports from outside countries.

There have been some attempts to model the process of RTA formation when the member countries do not make trade policy adjustments to compensate for the effects on third countries. This is much more realistic. In the present context, we require an explicit modeling of the sequence of RTAs from some initial situation.

Baldwin (1996) was the first to develop a model of sequential RTA formation. His model shares some of the features of the Krugman love of variety model. In his model, there are economies of scale and product differentiation in the manufacturing sector, and all products in this sector have the same input requirements. He does not explicitly model tariff preferences. Instead he uses a Samuelson-type iceberg function to model transport costs and trade costs.

There are several countries in the world economy but only one RTA and this is assumed to be willing to allow any country to join. There is an integration effect that lowers unit costs. Each outsider considers whether it wants to join. Joining is here a mechanism for exporters to avoid profit losses in their existing markets resulting from new regional discrimination and to lower intra-area costs. Thus, the effect of joining is to raise the welfare of joining countries. As more countries join, the profit effect increases as more of the world trade takes place within the RTA and there is a domino effect. Eventually the grand coalition is achieved.

Yi (1996) also models sequential RTA formation. Yi too uses a Krugman-type model with the love of variety form of goods differentiation. Each country produces one good. Countries may form one or more customs unions. When the rule determining the sequence of RTAs is that any country may join a pre-existing RTA, the sequence leads to the grand coalition, as in the Baldwin model. However, he also considers the rule that present members of an RTA will accept a new member if and only if it is in the interests of all incumbents to do so. This is a much more realistic view of the dynamic process than that of Baldwin. Under this rule, Yi finds endogenous RTA formation does not typically lead to the grand coalition.

Adriamananjara (2000) uses a Cournot oligopoly model with a single homogeneous good, and a numeraire good. Country tariffs on the homogeneous good segment markets and result in reciprocal dumping. In the initial situation there is one or more blocs but some countries are not in blocs. He adopts the unanimity rule used by Yi. In this model, 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 path depends on whether one or more bloc are allowed to accept new members. The final outcome may be one or two blocs with a number of countries left outside the blocs. “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).

These models show that several long run scenarios are possible. One is a bipolar or tripolar world. The poles would be based on the continents of Europe, the Americas, and Asia. If the expansion of existing RTAs and coalescence resulted in three continent-based poles, there may be competition between them for members. One possible outcome is that in which all countries are in one of the polar groups or at least linked to them by a spoke bilateral agreement.

Another scenario is that of a bipolar or tripolar world in which some countries are excluded from this process for economic and/or non-economic reasons. This might include some developed countries such as Japan, Korea, Australia and New Zealand. 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. This list could include countries such as India.

The difference between the paths when the formation of RTAs operate under different rules led Adrianamanjara (2000) and Scollay and Gilbert (2001) to suggest two criteria for assessing whether the RTA building-process will lead to eventual free trade. The first is whether the RTAs are willing to take in new members. This is described as an “open” agreement. 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). The second is the criterion of whether the RTAs lowers the levels of barriers *vis-a-vis* outside countries and thereby prevent injury to outsiders.

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 the direction of introducing rules to eliminate or reduce the negative effects on outside countries. In the absence of WTO rules, the members may not have an incentive to lower barriers to trade with outside countries. There is a near-zero probability that WTO members will agree to accept any outside country that applies. This would be a severe restriction on national sovereignty and the freedom of nations to choose their preferential trade partners. Nor do they have an economic 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.

One should note that these models of sequential RTA formation are unusual models of trade in that there is no comparative advantage. As Deardorff and Stern (1994) noted, the absence of comparative advantage biases the results in favour of trade diversion and gives fewer incentives to expand the number or membership of RTAs. They have a second omission which may be more important. The Baldwin--Yi-Adriamananjara-type analyses of the RTA formation 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 on its own with outside countries, in the style of hub countries. These are the types of agreement that have dominated recent regionalism. The next section considers this possibility.

5. The dynamic role of New Bilateralism

The introduction of bilateral RTAs may fundamentally change the dynamics of RTA formation. Progress towards the grand coalition comes to a halt in the models of the previous section because of the rule that a new member may be vetoed by any one of the existing members. This unanimity rule is a strong one. In reality different members of an RTA have different export – import patterns because of different comparative advantages because of differences in natural endowments and technologies. 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 an outsider. This is because the pattern of comparative advantage may produce a higher degree of complementarity between these two economies.

One such bilateral may have flow on effects. One bilateral may encourage further bilaterals. When one bilateral happens, there is a greater incentive for other members of an RTA to form bilaterals with the outside country in order to compete equally in the markets of the spoke country.

Alternatively, one bilateral creates new incentives for the RTA as a group to take in the spoke country as a new member of an enlarged RTA. All of the existing members then compete in the markets of the spoke country on equal terms and obtain imports from the country on equal terms.

In cases where the outside country is itself a member of another RTA, a series of bilaterals could lead to coalescence of the two areas.

In fact, the present pattern of RTAs already exhibits these features. Bilaterals are proliferating. Table 3 showed an increasing number of Asia-Pacific countries gaining preferential access to the markets in North America and the EU through bilaterals. A number of countries have clearly followed a strategy of gaining access to markets all over the world via bilateral RTAs; for

example, Mexico, Chile, Singapore and Israel. Several of the cross-regional agreements connect individual countries outside the polar regions to one or more of the three possible poles.

Conversely, we noted in Section 3 that some RTAs themselves have deliberately built free trade connections in many different parts of the world. This is particularly true of the EU and the EFTA states but now the US is negotiating bilateral free trade arrangements with countries outside the Americas. Some enlargements incorporate members who previously had bilateral links with one or more of the enlargening RTA.

Viewed dynamically, the Bhagwati “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 in and may lead to coalescence or enlargement of RTAs in the ways outlined above.

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 Chock 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.

One coalescence 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 goods 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.

Thus, in many ways, bilateralism is transforming the global pattern of regional trading agreements.

FOOTNOTES

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 (2002).
4. The algebra of bilateral links is the same as the algebra of networks, which is now used to explain the economics of networks such as telecommunications line networks or water reticulation systems.
5. 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.

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Table 1: RTAs in the Asia-PacificActualsUnder Negotiation**I Arrangements including countries in ASEAN**

ASEAN (1977)

ASEAN-China Free Trade Area

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

Chile-Peru (1998)

Canada-Singapore

Mexico-Chile (1998)

Mexico-Singapore

Australia-Singapore

Korea-Chile

Australia-Thailand

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

CER (1983)

US-Chile

NAFTA (1994)

Canada-Chile (1997)

Chile-Mexico (1999)

Table 2

Definite Proposals in the Asia-Pacific**Bilaterals**

Japan-Korea

US-Australia

Plurilaterals

	(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: Hub Countries in the Asia-Pacific with their Spokes

<u>Actuals</u>	<u>Under Negotiation</u>
Singapore, in ASEAN with spokes to	
Japan, New Zealand	USA, Canada, Mexico, Australia
EFTA States*	
Thailand, in ASEAN with spoke to	
	Australia
USA, in NAFTA with spokes to	
Israel, Jordan	Singapore, Chile
CACM*	
Canada, in NAFTA with spokes to	
Chile, Costa Rica, Israel	Singapore
	CA-4*
Mexico, in NAFTA with spokes to	
Nicaragua, Costa Rica, Bolivia, Chile, Israel	
EU*, EFTA*, CACM*, Northern Triangle*	
Chile with spokes to	
Canada, Mexico, Colombia, Venezuela	
Peru, Ecuador, Bolivia	
Peru, in Andean Community with spoke to	
Chile	
Australia, in CER with spokes to	
	Singapore, Thailand
New Zealand in CER with spokes to	
Singapore	
Russia, in CIS with spokes to	
Kyrgyz Republic, Georgia	

* denotes a plurilateral spoke

Figure 1. RTA's in Force in the²⁵APEC Area, 2002



