Ripening Regional Economic Architecture in Asia

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Abstract

The objective of this working paper is to examine the evolution and maturing of Asia's regional architecture. After initial delays it developed at an exceedingly fast clip. Asian economies were not known for government-led or formal regionalism. By adopting *de jure* regionalism they made a tactical shift in the regional trade and integration strategy. At the turn of the 21st century multilateral trade liberalization took the backseat and regional liberalization became increasingly prominent. Also, several fundamental changes took place in the regional economic structure. A China-centric regional economic structure began to evolve in Asia. China also took a great deal of initiative in the post-2000 evolution of regionalism and influenced it significantly. China showed continuous and proactive interest in the development of ASEAN-Plus-One BTAs, particularly the APT fora. At the end of the first decade of the 21st century, most small Asian economies and even more the large ones had accepted regionalism as a policy instrument for pursuing regional and global trade expansion and economic integration. This applies particularly to China, Japan and Korea. Importance of regionalism in the multilateral trade has been on the rise. Also, trade-investment-services nexus were formed and grew increasingly important.

RIPENING REGIONAL ECONOMIC ARCHITECTURE IN ASIA

1. Introduction

This working paper essentially delves into the progress of institution-led or formal or *de jure* regionalism in Asia. After pursuing multilateral or non-discriminatory liberalization, Asian economies turned energetically toward institution-led or discriminatory regionalism. It gradually became a strong regional trend. This was a major tactical shift in their trade and regional integration strategy. This paper traces the evolution of Asia's economic architecture. It demonstrates how in a short span of a decade-and-a-half the region underwent a sea change in this regard. This trend largely materialized in the post-2000 period. Its growth during the 21st century is the first focus of this chapter.

China is the largest trader and the hub of production networks in Asia. As an economic driving force it was expected to play an active role in the expansion of institutionalized regionalism in Asia. Although a China-centric economic structure has been emerging in Asia, the *de jure* regionalism in Asia is far from China-centric. Other Asian emerging-market and newly industrialized economies (NIEs) also negotiated and signed free trade agreements (FTAs) or regional trade agreements (RTAs).[1] Arguably the most notable characteristic of its evolution was that the Association of Southeast Asian Nations (ASEAN) bloc became the locus of Asian regionalism. Quantitatively regional economies succeeded in entering an impressive array of agreements of different kind. A variety of regional integration agreements proliferated fast; so much so that after a decade these agreements needed consolidation. Recent endeavors in the direction of consolidation and various plausible alternatives have been discussed in this chapter.

2. Asian Regionalism: Vintage 21st Century

The conduct of multilateral trade has undergone a discernible transformation during the first decade of the 21st century, and *pari passu* so has the nature of regionalism. Contemporary regionalism is different from that in the 20th century and in turn it has influenced multilateral trade. The 21st century regionalism is not principally and primarily

[1] These two terms are often used interchangeably.

about preferential market access, which was the case with the 20th century regionalism. This transformation was aided by two important factors: First, the advances in the information and communication technology and second vertical specialization of trade and expansion of supply chains. Together they have created a "trade-investment-services nexus" (Baldwin, 2011, p. 1), which in turn gave Asia an appearance of a regional factory. This nexus has become highly relevant for the contemporary international commerce. Therefore contemporary regionalism is more concerned about supporting it than simply emphasizing market access.

The trade-investment-services nexus evolved because multilateral trade was no longer merely confined to goods. The nexus came into being sequentially in a rational and somewhat intricate manner. The process worked as follows: First, trade expanded to trade in goods and services, and it combined with cross-border investment in production facilities. To that technology transfer and use of high-technology infrastructure for coordinating dispersed production activities were added. Trading activity was no longer simple. The next development was trade in parts, components and sub-assemblies, which increased progressively and became a high proportion of total trade in several Asian economies. The relevant services needed for the 21st century trading practices include telecommunications, internet, express package delivery, increased use of air cargo facilities, trade finance, customs clearance services and the other business services. This new dimension as well as technique and mode of trading have affected the evolving makeup of FTAs or RTAs.

The evolution of trade on the above-mentioned lines in the 21st century made trade more complex than that in the past and it needed to be governed by a different set of equally intricate rules. The novelty of the 21st century regionalism is that it is not so much about the conventional preferential market access in the FTA partner economies, but about the policy framework that supports the trade-investment-service nexus and keeps it proficiently operating. This implies that the 21st century regionalism is driven by different politico-economic forces from those that drove the 20th century.

Unlike the FTAs or RTAs of the 21th century, the older ones were simpler and shallower in their composition, frequently dealing merely with phased tariffs slashing and the ROOs. The agreements of the present period need to respond to the needs of business firms that either produce part of their product in the neighboring countries or have a quasi-permanent relationship with suppliers in the neighboring countries. By making their operations international, business firms are exposing themselves, their capital, technological prowess, marketing knowhow to international risks. According to Baldwin (2011) this mode of operations entails hazards for tangible and intangible property rights. Such threats work as the new kind of trade barriers.

2.1 Stylized Features of the Growth of FTAs

Unlike the BTAs, FTAs of the earlier period, the ones that are being formed in the present period need to take these barriers into account. Another requirement of the current period is coordination in production facilities in two or more neighboring countries in such a way that customers receive quality goods at competitive prices. This would call for a well thought-out business plan on trade in parts, components and intermediate goods as well as a range of commercial services. To be effective, applicable and functional the 21st century BTAs and FTAs need to ensure that their operations facilitate the new mode of conducting businesses, in turn making them more efficient and profitable. An increasing number of the 21st century FTAs have been so negotiated that they respond to the emerging needs of the time and therefore they tend to be different and deeper compared to the ones that were negotiated in the past.

Given the new business and economic environment and changing industrial structure, let us first examine the idiosyncratic features of FTAs in Asia. The first one is that they differ widely in terms of design, objective, intent, scope and purpose. They can be arrayed on a continuum from the narrow FTAs, which are focused only on trade in goods and therefore trade liberalization attempted by them is minimal to those that are more comprehensive and entailing deep liberalization and regulatory cooperation and harmonization characteristically needed by a contemporary FTA. Some FTAs still emphasize economic objectives more, while others are basically inclined towards political objectives. This wide diversity in FTAs is essentially attributed to the level of economic development of the FTA forming countries, the development strategy followed and the basic motivation for entering into a trade agreement (Capling and Ravenhill, 2011).

The second one is the concern of the potential partner economies at the time of FTA formation regarding coming to an agreement with the least discord, keeping the negotiations cost-effective and complete negotiations proficiently in a small number of negotiation rounds, in a reasonable time. This concern led to formulation of a large number of BTAs in Asia that could be negotiated relatively faster. A general reason behind the proliferation of FTAs is that negotiating plurilateral RTAs is always a complex and time-consuming process. The partners may also have to settle intricate and controversial issues on which accord may take a long while. There have been cases when after prolonged negations an agreement eluded. In 2000, Asian economies were a part of 46 FTAs, 8 of which were plurilateral RTAs. In 2010, this numbers shot up to 180, of these 58 were plurilateral.

2.2 Limitations Originating from Rapid Growth in Regionalism

Asian economies formed a good number of BTAs and FTAs, many of them were of shallow variety. Consequently they remained limited and uneven in their impact (Mercurio, 2011). Policy makers in Asia did so despite being fully cognizant of the fact that many agreements that covered mere border trade measures and were made between two partners have a limited payoff in terms of increasing trade. Also, welfare implications of such BTAs were not high. Still emphasis on BTAs in Asia continued to be high. A multiplicity of BTAs promoting formal regional integration evolved as a characteristic feature and an accepted mode to progress towards regionalism. For instance, when the APT finance ministers met in the aftermath of the Asian crisis, to establish the framework of currency swaps, the agreement was for the region. However, the swaps themselves were to be negotiated bilaterally.

There was excessive importance on market access for goods in the Asian FTAs. Low level of ambition and motivation in designing them was another drawback of Asian

BTAs and FTAs. In many cases liberalization rates are low, which limits integration of the member economies. The Asian agreements also suffer from a significant range of exclusions, which also limits the payoff from forming a BTA or an FTA. In addition, the persisting NTBs go a long way in reducing the impact of regional integration. Impediments like these tend to restrict the coverage, depth and scope of Asian BTAs and FTAs. Mercurio (2011, p. 121) asserted that they simply are not “broad enough to have a meaningful impact on the business community or broader economy”.

Another much-debated characteristic of the Asian FTAs is that majority of them tend to be of the hub-and-spoke variety. Many BTAs and FTAs overlap. They create the problem of what Bhagwati, *et al*, (1998) termed the “noodle bowl” or “spaghetti bowl” syndrome. As there is a profusion of bilateral agreements in Asia, it tends to exacerbate the ‘noodle bowl’ effect. This effect is caused by overlapping or criss-crossing of BTAs and FTAs. Overlapping agreements, no matter what kind, create a complicated web, which in turn become a serious operational snag. The overlapping agreements are usually inconsistent with respect to tariff phasing-out schedules, exclusions, standards and rules dealing with antidumping and other mutually agreed regulations. Their conflicting provisions could generate complex patterns of discrimination and exclusion in the region.

This effect results in inefficiency and high costs due to multiple ROOs. They pose a severe burden on business firms, eventually increasing the cost of doing business and rendering BTAs welfare-reducing. Such “noodle bowl” or “spaghetti bowl” effect may well spawn greater distortion in multilateral trading system (Bhagwati, 2008; Menon, 2009). There are many other problems that noodle bowl effect can potentially create. For instance, they can encourage protectionism.

3.3 GATT/WTO Paradigm

FTAs following the GATT/WTO paradigm were regarded as narrow in scope because their essential focus was on the border liberalization measures, which implies phased reduction or elimination of tariffs. They were usually limited to trade in goods, or sometimes extended to services. It was not appreciated that mere reduction of tariffs could not be helpful in providing a level field to the firms of two or more trade partner economies. In general the agreements made by China and ASEAN are of this kind. They are low in ambition and narrow in coverage. For the most part they were limited to trade in goods and infrequently trade in services was included. With a few exceptions, they followed the GATT/WTO paradigm. Their detailed features are elaborated in the following paragraph.

Characteristically Japan and Korea are known for making relatively more comprehensive agreements, which did not stay confined to the GATT/WTO Paradigm. The agreements in which the US is a partner are the most comprehensive of all in terms of their coverage. Not only their coverage is wide but also they have the largest WTO-Plus provisions, including labor and environmental standards. As a rule, BTAs and FTAs in the Asia-Pacific region are more comprehensive in compared to those within Asia. Australia and New Zealand follow the US model, but less WTO-Plus provisions than the US. Close scrutiny of FTAs negotiated since 2000 in Asia makes it obvious that Asian policy mandarins were not fixated on matching their efforts with those of the EU and were not advancing towards a common market and deeper economic integration.

2.4 WTO-Plus FTAs

The realization of Asian policy makers regarding WTO-Plus FTA being more functional, result-oriented and potentially more rewarding was somewhat late to dawn. Therefore they turned belatedly towards the WTO-Plus kind of BTAs and FTAs. The US became a trend setter in this regard. The blueprint and norms followed by the US had a demonstration effect. Therefore many Asian BTAs and FTAs that were negotiated during the recent years went beyond the GATT/WTO model. Asian economies that negotiated agreements during the recent years preferred to enter into what became known as the “new age” or “WTO-Plus” FTAs, which had rationally wider scope and therefore comprehensive ramifications for the FTA partners. They eventually led to higher welfare gains.

The behind-the-border issues that come under WTO-Plus agreements include NTBs, FDI regulations, trade in services, mobility of labor, IPRs and the like. Competition policy is yet another area that needs to be settled in such a manner that the firms in FTA partner economies are able to fairly compete in the countries which negotiated a FTA. The WTO-Plus agreements commonly include the four Singapore issues as well.[2] This kind of coverage can potentially create new business opportunities for the firms in the FTA partner economies (Freund and Ornelas, 2010). The eventual impact is deeper integration among the regional economies.

Three ASEAN-Plus-One agreements, with China, Japan and Korea, are WTO-Plus. It is indicated by their formal names and by their comprehensive scope.[3] Conversely, China preferred to have limited scope FTA agreements that cover merely trade in goods and services. However, this has lately changed and the more recent agreements made by China have the WTO-Plus elements in it. Of late, other Asian economies have also changed their approach and they begun favoring the WTO-Plus agreements rather than the narrowly limited ones. Indonesia, Korea, Malaysia, the Philippines and Vietnam all have recently turned towards the WTO-Plus kind of agreements.[4]

Numerous large MNCs, which made Asia their home, played a significant role in making Asia more conscious of the WTO-Plus FTAs. They were absolutely *au point* in hypothesizing that a policy environment of free trade and investment in neighboring Asian economies would benefit them by making it efficient for them to operate in Asia. It would be more lucrative, effectual and efficacious for the MNCs to operate in the Asia if Asian agreements are negotiated WTO-Plus. As more and more economies in Asia are linked through the WTO-Plus kind of BTAs and FTAs, deepening their regionalism, MNCs' production networks could be expanded and deepened. Furthermore,

[2]The four so-called Singapore issues are investment, competition policy and transparency in government procurement. The fourth issue is simplification of trade procedures, an issue sometimes referred to as "trade facilitation".
[3] Their formal names are as follows: (1) ASEAN-China Framework Agreement and Comprehensive Economic Cooperation, (2) ASEAN-Japan Framework Agreement and Comprehensive Economic Partnership and ASEAN-Korea Comprehensive Economic Partnership.
[4]This section draws on Kawai and Wignaraja (2010).

investment liberalization under this kind of FTAs could be more welfare enhancing for the region. Thus the gains are mutual.

2.5 Under-utilization of FTAs

Theoretically it is a valid belief that FTAs unify a region and usher in free trade in the unified region. Whether it really happens in regional trade is open to question. Mercurio (2011) compiled and compared the utilization rates from multiple surveys. A survey of Japanese firms all over Asia reported that 31.8 percent of them in Singapore made use of the provisions of the ASEAN agreement. This was the highest use of reported. Only 5.0 percent Japanese firms in Malaysia reported using the ASEAN agreement. Low utilization rates imply that the increase in intra-trade was not the direct result of trade agreements.

The Asian utilization rates compare unfavorably to those of other FTAs like NAFTA. The US firms importing from Canada reported 54 percent utilization and those exporting to Canada reported 50 percent utilization. Mexican firms exporting to the US reported 62 percent utilization. The reason why these rates are not still higher is that a large number of tariff lines receive duty free treatment under the most-favored-nation (MFN) clause. Therefore 45 percent of Canadian exports to the US and 37 per percent from Mexico enter the US markets free of any tariffs. Therefore these exports did not need any preferential treatment engendered by NAFTA.

Hiratsuka, *et al*, (2009) investigated Japanese MNCs and large firms' behavior while dealing with Asian FTAs. Their study included the affiliates of the Japanese MNCs that operated in Asia. Their conclusion regarding utilization of FTA was negative, that is, the Japanese MNCs or large firms had not only inadequate knowledge regarding the current FTAs in Asia but also they infrequently utilized by them. A JETRO (2009) survey of Japanese MNCs corroborated this conclusion regarding the underutilization. It put the finger on the rationale behind underutilization of FTAs. Japanese MNCs found that the difference between preferential tariff rates under the FTA and the MFN tariff rates was so minuscule that it was not worth their while to utilize the former. Besides, the duty drawback system managed to recover their tariff payments. The JETRO (2009) survey did not mention lack of knowledge of FTAs or complexities in their operations as the reasons behind underutilization.

Large micro data generated by the JETRO (2009) survey was utilized by other analysts. Hiratsuka, *et al*, (2009) used these micro data to further analyze the pattern of FTA utilization by the Japanese MNCs and affiliates. One generalized conclusion they arrived at was that the smaller the affiliate or business firm, the less likely was its utilization of FTAs in exporting its goods and services. Be it noted that a smaller firm also had less diversified sources of procurement. Additionally, complications created by overlapping FTAs in Asia due to the 'noodle bowl' effect could well deter firms from utilizing them. But based on a large firm level survey in Japan, Korea, the Philippines, Singapore and Thailand, Kawai and Wignaraja (2009) inferred that business firms did not see these complications as serious and therefore the overlapping FTAs were not deterrents in the utilization of FTAs. For sure more facilitation in dealing with FTA operations was considered necessary.

Recent country level and industry level studies indicated businesses not utilizing those preferential arrangements adequately (Kawai and Wignaraja, 2011). Share of export value benefitting from the preferential arrangements remained low. This is a good measure of FTA utilization. Inadequate utilization remained the biggest problematic issue for the Asian BTAs and FTAs. One reason for underutilization of Asian FTAs was low trade volumes between the BTA or FTA partners. FTA partners of Japan often reported low utilization due to this reason. A primary survey of 841 of exporting firms conducted in 2007-08 in six Asian economies by ADB showed that the Chinese (45.1 percent) and Japanese firms (29.0) were the highest users of FTA preferences, while those from Korea (20.8 percent), the Philippines 20.0 percent), Thailand (24.9 percent) and Singapore (17.3 percent) made low use of the FTA preferences. Insufficiency of information regarding the FTA and its provisions was given as the most frequent reason behind underutilization of FTAs. Low preference rates was the second most frequent answer. The ADB survey also indicated that 25 percent of the Asian business firms did intend to utilize the FTA preferences more in future. They have plans in place to achieve this objective.[5]

As regards industry-wise FTA utilization, available data reveal that firms in food, electronics, textiles and garment industries are low users of FTA, while those in machinery and automotive industries use them relatively more. Also, a larger proportion of firms in the latter industries try to make us of the FTA preferences. Approximately half of the firms in the machinery sector and a third in the automotive sector made use of the FTA preferences. In the textile and garment sector this proportion did not rise above a third, while in the food and electronics it was the lowest. Only a fifth of the total number of firms reported utilizing FTA preferences. This pattern of industry-wise utilization confirms the fact that more protected industries with higher margins of preference tend to use FTAs more than other firms which are in industries that are less protected and face lesser margins of preference.

A greater proportion of Chinese firms were able to use FTAs because of the rapid ascendance of China and its firms in the global economy as well as fast build up of production networks in important industrial sectors like automotive and electronics. Similarly better utilization by Japanese firms was essentially due to a sophisticated industrial structure in Japan, which is based on large MNC activities. These MNCs function as anchors for production networks in the region. The Japanese business firms and MNCs also enjoy the benefit of private sector industry associations as well as public trade support institutions. In contrast to these, the Korean firms' utilization of FTAs was much lower because Korea began negotiating FTAs late, in 2004. Also, its initial FTAs were made with smaller economies like Chile and Singapore. In Korean FTAs, the margins of preference were also low.

An array of firm-level factors adversely affected utilization of FTAs. For one, firm size was found to have a decisive impact over the use or non-use of an FTA. Kawai and

[5] Kawai and Wignaraja (2011) chapter 2 extensively reposts and analyzes the ADB survey results. See pp. 33-73 for details. A total of 841 firms were surveyed in six Asian economies.

Wignaraja, (2011) inferred that larger firms and MNCs were greater users of FTAs than the smaller ones. This corroborated the conclusions reached by Hiratsuka, *et al*, (2009). This pattern of FTA use can be explained by the fact that there are fixed costs of using FTAs. First, acquiring knowledge regarding the FTA provisions, then adapting production patterns and business plans according to the complex tariff schedules and obtaining certificates of origin are all processes that require financial and human resources. Large business firms and MNCs are able to cope with these requirements much better than the small firms.

In the ADB survey noted the complex set of ROOs as a deterrent. It caused delays and high administrative costs. It is generally acknowledged that complexities related to ROOs is a challenging characteristic of Asian FTAs. ROOs are mutually agreed regulations that determine the country of origin of a product for the purpose of trade. In their ROOs partner countries determine and record the proportion of non-originating input in a product in order for it to qualify for preferential access under a FTA. In addition, a “cumulative zone” is determined in the ROO, which specifies the countries whose products can be considered to have originating status for the purpose of the agreement.

Opinions regarding the ROO related problems in Asia vary. There are some who believe that the ROO in Asia are complicated and have high administrative costs. However consensus on this issue is missing and Chia (2010) argued the opposite. According to this view, Asian ROOs are not only orderly and logical but they have created a foundation for a strong regional trading system. The survey referred to above in this section also provided some information on this issue (Kawai and Wignaraja, 2011). Owing to the “spaghetti bowl” of overlapping FTAs in Asia, multiple ROOs do impose some burden on firms. Only 20 percent firms reported significant cost of multiple ROOs. As regards the countrywide perception, in the ADB survey highest (38 percent) negative experiences were reported by Singaporean firms. Chinese firms were on the other extreme, with only 6 percent firms reporting negative experiences of the ROOs. As regards the firm-wise experiences, the larger firms had higher levels of complaints regarding the multiple ROOs than small- and medium ones. The number of concluded agreements in the region increases is sure to increase with time, the ROO may become increasingly problematic for the trading firms. Therefore administrative efforts to rationalize ROOs are needed to mitigate the negative effects of the “noodle bowl”.

2.6 Persisting Challenging Issues and Inadequacies

Notwithstanding the fact that regionalism in Asia was adopted late and became operational relatively recently it is facing several challenges. As decision-making in most Asian FTAs is based on forming a consensus, substantial and bold decisions are usually not attempted. Agreements in summits and conventions can be obtained easily if the agendas are kept lightweight. In addition, members’ commitments are frequently non-binding and voluntary. When international secretariats were created, the powers delegated to bureaucracies were limited and closely scrutinized by the member governments. There was little institutional independence for these secretariats (Haggard, 2011).

As initially Asian FTAs were excessively focused on market access and did not engage in negotiating comprehensive and deep FTAs, lowering or eliminating tariff barriers was their customary beginning. Gradually comprehension and knowledge developed, the negotiation process matured and advanced towards the so-called behind-the-border issues. NTBs, trade in services, investment, IPRs, competition policy, government procurement and dispute settlement fell under this category. Although these issues have become increasingly important in multilateral trade and relationships between important trade partners, they made limited progress in the Asian FTA. This is a serious blemish of the Asian FTAs. The reason is that under the sponsorship of the GATT/WTO system, tariffs incessantly came down to a low level over the last six decades. The FTA negotiating countries need to know that benefits of an FTA now have to come through the behind-the-border measures, not from lowering or eliminating the tariffs.

Although recently negotiated agreements do go beyond liberalization of trade in goods only, Mercurio (2011) contended that the tariff line coverage of most agreements was not large. Lack of comprehensiveness of Asian FTAs is a widespread problem. This means that the condition stipulated by Article XXIV of the GATT is not met by the Asian FTAs. Article XXIV is the basis of all the FTAs and emphasizes that trade barriers be eliminated on “substantially all trade”. It does not consent to exclusion of any sector of a FTA forming economy. Majority of agreements also have a long list of “sensitive” products, excluding them from the coverage. When they are not excluded, the tariff reductions are only meager. Often these sensitive products are those that are principal export items of the FTA partner economy. The inadequacy of coverage led to just criticism by the UNCTAD/JETRO (2008) study that regarded Asian FTAs as not being genuine free trade agreements.

Furthermore, the liberalization commitments in majority of the Asian FTAs are usually shallow. Too many exclusions and NTBs watering down their effectiveness and utility and they fail to enhance trade. Due to these limitations, the coverage and scope of FTAs becomes narrow, not very useful from the perspectives of regional trading firms. This discourages the intended beneficiaries and they ignore the FTAs in effect and their utilization rate suffers. The FTAs have limited utility for the exporters and importers or the broader partner economies in general.

Asian FTAs have also been criticized for uneven coverage in their trade in goods. In a majority of them agriculture is not covered significantly and sufficiently. As the farm lobby in most Asian countries has a lot of political clout, it has frequently succeeded in pressurizing negotiating governments and keeping trade in agricultural products out of the agreements. This is another feature that goes counter to the grain of Article XXIV of the GATT/WTO and Article V of the General Agreement in Trade in Services (GATS). The WTO failed to prevent the proliferation of low quality trade agreements. Trade in agricultural products needs to be gradually liberalized and its coverage in future Asian FTAs needs to increase. By advancing in stages this coverage should be made comprehensive.

Although exhaustive country-wise information on the scope of Asian FTAs is sparse, inadequacy of data and information has been a matter of question. In general the Asian

FTAs are an unusual mix of simple and limited ones, coexisting with a small number of comprehensive, mature and intricate ones. That being said, on balance a large number of Asian FTAs lack “WTO-Plus” orientation. The fact that many of them are not what is called “new age” FTAs is regarded as their persisting weakness. Apparently they were slow in keeping up with the global trend in this regard.

Considering FTAs for individual Asian economies, each one of them curiously has both, narrow FTA agreements that deal only with trade in goods, or trade in goods and services trade and the more in-depth WTO-Plus agreements. Two countries are exceptions to this generalization. First, Japan has all its agreements following the WTO-Plus format. Second, Singapore has the largest number of its agreements falling in the WTO-Plus category. An overwhelming majority of its BTAs and FTAs follow the WTO-Plus format. Korea and Malaysia also displayed an increasing propensity to form WTO-Plus kind of FTAs.

3. Role and Participation of China in *De Jure* Regional Integration in Asia

During the 1990s China’s relationship with its Southeast Asian neighbors was much more conciliatory and assuaging than that with the North Eastern ones. This was partly due to the fact that the latter group did not reciprocate China’s regionalist intentions and overtures. Regional role of an ascendant economy like China was bound to increase. It gradually became proactive in *de jure* regionalism in Asia. China signed FTAs with ASEAN and Singapore, has closer economic and partnership agreements (CEPA) with Hong Kong and Macau and economic cooperation framework agreement (ECFA) with Taiwan. In academic debate there are proponents and opponents of China-centric Asian regionalism. Ye (2011) divided China’s regionalism into three temporal phases, 1978-89, 1990-97, and 1998 and thereafter. In each one of the three phases scope and depth of China’s regional involvement differed, albeit they remained consistent with its economic prowess and degree of openness.

During the first period (1978-89) market-led or *de facto* regional integration in Asia progressed in a vibrant manner. However China remained wary and aloof because the leadership did not regard it good for China's on-going reforms and restructuring. During the second period (1990-97) China's interest in regionalism increased. The Tiananmen Square episode had turned China into a pariah for the advance industrial economies of the West. Strong condemnation from them made the Chinese leaders concerned (Hu, 1996). They considered possibility of international isolation, both economic and political. Western countries imposed economic sanctions on China. Therefore China needed and worked hard at improving relations with its Asian neighbors. Somewhat muted denunciation from its regional neighbors encouraged China to turn towards them. The Asian regionalism of the second period was dominated by the doctrine of "open regionalism", which originated in the Asia-Pacific economies like Australia, New Zealand and the US. The concepts advocated by the APEC forum exemplified open regionalism.

In the early 1990s, China's political leadership began to recalibrate its relations with its neighbors. China's overtures in regionalism began in the early 1990s, with its approach to the ASEAN bloc in 1991 and membership in Asia Pacific Economic Cooperation (APEC) forum. APEC includes members from outside the region. Although China was not a founding member of APEC, it joined in 1991. At this point China was not as confident regarding its role in Asian regionalism as China appears at present. Essentially due to its rapid GDP growth its relationship with its southern neighbors developed rapidly. China's joining APEC was an admirably logical economic decision because this region dominated both China's trade (80 percent) and FDI (90 percent) in 1990 (Ye, 2011). It was also a turning point for China. During this period the limited and weak Asian economic cooperation was continuing under the APEC framework. By the end of this period, the APEC ran out of steam in its trade liberalization endeavors. China did not take any leadership positions, it followed the "open regionalism" banner of APEC.

China was more of a latecomer to regionalism than the other Asian economies. Under the leadership of Deng Xiaoping, its regional and global policies had an economic orientation. According to Yuzhu (2011) the fundamental Chinese strategic premise in this regard was economy-centered. In adopting regionalism, Chinese policy mandarins tried to primarily identify economic costs and benefits. Their simple logic was that if an

FTA is formed, it should economically benefit the partners. Economic gains, reflected in real GDP growth rate and welfare gains, have continued to be the principal target of regional economic cooperation for China. Yuzhu (2011, p. 199) noted that by "establishing FTAs or other arrangements, China seeks to develop or foster stable markets that can help diversify its export destinations on the one hand, and exploit more material resources on the other". Both of these objectives became more important for growth in the third period (1998-and beyond). As widely recognized, Asian regional cooperation and regionalism and China's association, participation and contribution to it grew more intense after this critical juncture. China became suddenly more active in regionalism after the Asian crisis and took a great deal of initiative in the CMI and its subsequent expansion into CMIM. China's regional image improved during the Asian crisis (1997-98) when it decided not to devalue its currency. Both the regional leaders and the Group-of-Seven (G-7) countries respected China's responsible and clairvoyant gesture.

Since the WTO accession in 2001, China turned to regionalism more energetically and became an engine of institutional regionalism in Asia. In collaboration with its neighbors to the east and south, it actively began carving a new regional order. It is difficult to put behind that China's relationship with its neighbors until the recent past was that of mistrust and hostility. Many of them did not have diplomatic ties with China until the early 1990s. China regarded many of them as close US allies and therefore its relationship with them was that of distrust and suspicion.

ASEAN and China first developed bilateral economic ties, which subsequently grew. China's concept of regionalism and its ambitions in this realm changed since the formation of the ASEAN-China FTA (ACFTA). It was christened Framework Agreement on Comprehensive Economic Cooperation. ACFTA was the initiative of Premier Zhu Rongji, who proposed it in 2000. Although official efforts began in 2001, the so-called framework agreement of ACFTA was signed in 2002. At the time of signing China considered it a major diplomatic triumph (Ravenhill, 2008). The two partners developed an economic, political and legal framework for their comprehensive cooperation. China was more self-assured in negotiating this FTA than that it could possibly be with Japan or Korea. The reason was that it had greater similarities with the ASEAN economies. Tariffs between the five founding members of ASEAN and Brunei (or the so-called ASEAN-6) and China were declining since 2005.

In January 1, 2010, when ACFTA came into effect, it was one of the world's largest FTAs. The ACFTA encompassed 1.9 billion population, had a combined GDP of $6.6 trillion and total trade volume of $4.3 trillion in 2010. By population ACFTA is the largest FTA and by value the third largest in the world. Four of the ASEAN members (Singapore, Malaysia, Indonesia and the Philippines) were China's major trading partners even before the ACFTA came in force. China's trade with the ASEAN was robust in 2010. In 2011 it surpassed Japan to be China's third largest trading partner, after the EU and the US. Zero tariffs and preferential trade policies as well as vertically integrated trade and cross-border supply chains contributed to this fast-paced rise in ASEAN-China trade. Owing to geographical proximity, the Southern and Western provinces of China benefitted relatively more and integrated with the ASEAN economies across the border.

In 2010 zero-tariff began to apply for 90 percent of all trade between China and the ASEAN-6. This covered around 7,000 traded items. By 2015, tariffs on the "highly sensitive" products will be cut to no more than 50 percent. China and many of the ASEAN-6 countries specialize in low-cost manufactured products. As the trade structure between them is competitive rather than complementary, they are facing implementation problems. In the medium-term, both consumers and producers in the ASEAN-6 will benefit from less expensive imports from China. Businesses in this sub-group of economies will pay less for the intermediate inputs imported from China without tariffs. Fast growing middle class in China will also create markets for goods and services which can be exported from the ASEAN-6 countries. However, there is a downside. The ASEAN-6 economies should expect short-term disadvantages in their labor intensive industries being displaced by Chinese exports in the third-country markets. This category of industries would include textiles, garments, footwear, toys and foodstuff processing. Some capital-intensive production, like steel and machinery, will also be adversely affected (Thangavelu, 2010).

Southwestern provinces of China, namely, Guangxi, Yunnan, Chongqing and Sichuan were highly interested in entering into the ACFTA because of their geographical proximity to the ASEAN countries. The provincial governments persuaded the central government to negotiate an FTA with their neighbor. Logistic costs for products produced for export from these provinces are higher than those from the coastal cities, which reduces the competitiveness of their exportables. This was an incentive to trade with the neighboring ASEAN economies. Construction of highways in the southwest provinces was an evidence of the government's intention to reduce logistics costs in the region. As the ACFTA came into effect, business firms in the southern provinces of China began exploring trade opportunities with the adjoining ASEAN economies.

ACFTA has recently deepened more than it was. This has happened despite the apparent formidable competitiveness of the Chinese economy. This was due to the long-term perspective taken by the ASEAN decision-makers. They saw the potential of the large China market and gave precedence to the interests of their exporters over the possible loss of those who feared Chinese competition—an astute and spirited policy measure indeed. In addition, they seem to have taken a futurist perspective. In the medium term China is slated to be not only an inevitable regional power but also a global one. Integrating with it and thereby reaping the benefits from its ascendance is a pragmatic, functional and sagacious strategy. Closer economic relations would mutually beneficial economically both for ASEAN and China. Escalating trade, investment and financial ties can not only become an additional source of economic growth but also would stimulate the process of economic integration. The final outcome would be welfare gains for both the partners.

China is important to its Asian neighbors because *inter alia* it is a large and growing market for their products. Other Asian economies successfully found their niches in Chinese markets and increased their share of China's imports (Krumm and Kharas, 2004). Since the early 1990s, many medium-sized and large Asian economies managed to markedly increase China's share in their exports. Gradually China's imports became a key factor supporting sustained growth for Japan, Korea and Taiwan. Besides, China's growing market holds great potential for their future. By 2005 China had become the largest regional importer. According to an estimate, by 2020 China's trade may significantly exceed that of Japan and equal that of the US. At that time, China may rely on its Asian neighbors for half of its imports, if not more (Zhang, 2006).

As the triangular trade pattern evolved, China maintained large trade deficits with its Asian neighbors and surpluses vis-à-vis the EU and the US. The global financial crisis and the Eurozone sovereign debt crisis steadily reduced the magnitude of China's trade surpluses. The trade surplus was 7.3 percent of GDP in 2007, in 2011 it shriveled to 2.1 percent. Once the global economy recovers from these crises, China's trade surpluses is likely to return, albeit it seems unlikely that will reach the pre-crises levels. Various simulation exercises support this inference (see for instance Roland-Holst, *at el*, 2003). China will recycle its trade surpluses regionally. China is uniquely integrated with its neighbors through *inter alia* vertically integrated production networks. This distinctive relationship is also likely to strengthen and mature with the passage of time.

China showed continuous and proactive interest in the ASEAN-Plus-One BTAs, as well as the APT framework. Its interest and involvement in the establishment of the APT in Kuala Lumpur in 1997 brought China goodwill of its Asian neighbors, particularly the ASEAN. The ACFTA is expected to catalyze these China-related or China-centric FTAs, in particular the APT and ASEAN-Plus-Six (APS)[6]. The latter is also known as the Comprehensive Economic Partnership of East Asia (CEPEA). Australia, New Zealand and India were the last three countries to form BTAs with ASEAN. They were invited for the first time in the ASEAN Summit of December 2005 in Kuala Lumpur. Recently these six economies took steps to deepen their relationship. Under these cooperation

[6] The ASEAN-Plus-Six (APS) economies comprise the ten members of the ASEAN bloc, plus Australia, China, India, Japan, Korea and New Zealand. It is also referred to as the ASEAN+3+3.

frameworks top political leaders of China and ASEAN met annually. China also signed numerous bilateral agreements with several economies both intra-regionally and extra-regionally. More efforts were afoot in 2011. APS or CEPEA is a vision, or a possible future blueprint, of a wider future Asia-Oceania market. Although it is far from being a reality, if it does materialize, it will provide prospects of forming an EU-like economic community in the Asia-Oceania region.

From the Chinese perspective, if something extraordinary happened it was the Asian crisis, which radically changed the situation in favor of China. It also styled its future regional role. Regional debate on the economic rise of China and the so-called China threat to the neighboring economies was heating up in the mid-1990s. While the Asian crisis affected several Asian economies and the region adversely, it did not harm the Chinese economy much. This made China loom larger in the post-Asian crisis period. The neighboring Asian economies agreeably found China playing a congenial and assuaging role, promoting Asian cooperation. This logically made China important to its Asian neighbors. Following its principle of economic regionalism, China began actively engaging with the Asian economies making bilateral and plurilateral agreements.

China emerged an important player in the Asian production networks stretched across the region. This increased involvement was not only in terms of increased trade value but also a large number of exported products. Its regional diversity is reflected in the degree of its participation in the intra-regional production networks. As factor prices widely differ across the regions, they affect the comparative advantage of each region. Imperfect mobility the factors of production is another reason behind the marked regional diversity in China. Also, high cost of services is crucial in explaining differences between the coastal and inland provinces. However, these regional differences are diminishing. The latecomer provinces are gradually catching up with those that were in the lead.

Using comparable general equilibrium (CGE) model, Estrada, et al, (2012) quantitatively assessed which FTA arrangement, existing or potential, would benefit the members more. Four FTAs were taken into consideration in this CGE study, China-ASEAN, China-Japan, China-Korea and the APT. Output and welfare effects were computed for all the four. Results show that member countries would benefit most from the APT, which is the largest Asian FTA. This result is in accordance with the trade theory, which posits that the larger the FTA the greater the benefits in terms of welfare and output gains. As for the bilateral FTAs, the results show that China will benefit more from the ACFTA than from the other two FTAs, between China and Japan and China and Korea. This quantitative exercise demonstrates that ACFTA should have greater policy significance for the members. China's income level is closer to many ASEAN members and its trade structure is more complementary with many of them than with the other two potential FTA partners, Japan and Korea. Furthermore, an analysis of the pre-FTA trade structure reveals that China's net trade position with ASEAN is more favorable than its position with Japan or Korea.

4. ASEAN Bloc as the Nucleus of Regional Integration

After delays and dormancy the ASEAN members began endeavors to integrate not only economically but also politically and socially. The ASEAN bloc is a fairly successful case of sub-regional merger, after two not-so-successful attempts at cooperation and integration. The first attempt took place in 1961 between Malaysia, the Philippines and Thailand, and called the Association of Southeast Asia (ASA). The second one took place in 1962 between Malaysia, the Philippines and Indonesia in 1962. It was christened MAPHINDO. Although ASEAN started as a political and strategic grouping, its activities shifted in economic direction in the 1970s with agreements on joint industrial projects. Economic cooperation increased in the second half of the 1980s and 1990s (Severino, 2011; Chia, 2011; Ito, *et al*, 2011). It followed a gradual approach to building regional cooperation and legally binding institutionalized agreements.

The member countries of ASEAN are characterized by very high diversity in a number of respects, particularly stages of growth. Although not all, several of the ASEAN economies highly open economies. They also have locational, infrastructure and logistics advantages. Singapore is the richest (2010 per capita GDP $43,867) economy in the sub-region as well as in Asia. As it is one of the most open economies in the world and has an outstanding business infrastructure and efficient government, Singapore is the headquarters or regional headquarters of many MNCs. The ASEAN strategy to regionalize was slow and deliberate. By the early 1990s these economies had begun adopting market-driven and export-led policy framework and also signed an FTA (in 1992) of their own. The basic objective of the ASEAN Free Trade Area (AFTA) was to reduce transactions costs associated with intra-regional integration. Initially AFTA merely covered trade in manufactures and was to come in force in 15 years. Originally it also defined trade liberalization loosely, implying 0 to 5 percent tariffs, in lieu of no tariffs. It blends well with the flexible and informal approach that characterized ASEAN since its inception. The objective of zero-tariff will take time to achieve. Although its membership is not open, it does practice ‘open regionalism’.

However, the pace of implementation of AFTA was subsequently accelerated and the scope was broadened. It came in effect in the beginning of 2004 for the five founding members and Brunei Darussalam, the so-called ASEAN-6. As agriculture was a sensitive area for them, they provisionally put several agricultural and food products on exclusion list from time to time. An important development in this regard was that AFTA also became a part of numerous BTAs and FTAs made by the ASEAN bloc. *Prima facie* AFTA is a purilateral agreement but it was so designed that each member was to maintain its own tariff schedule with its own list of exclusions. This model made AFTA look like a web of separate bilateral agreements among its ten members.

AFTA was negotiated as an FTA made under the 1979 Enabling Clause of the GATT. Therefore it was not obliged to follow all the disciplining measures that the WTO imposed. The principal criticism was regarding not complying with “substantially all” the trade liberalization within ten years, as prescribed by Article XXIV 5(c) of the WTO. One saving grace is that the liberalization coverage under the Common Effective Preferential Tariff (CEPT) is high. The CEPT specifies gradual tariff reduction schedule for the member countries. ASEAN also recently harmonized traded commodity classification, which was a useful achievement.

From January 2010, ASEAN-6 eliminated intra-ASEAN import tariffs on 99.65 of their tariff lines. In addition, the remaining four members reduced their tariffs to 0 to 5 percent on 98.86 of their tariff lines. This implies that trade in goods in the ASEAN region is almost tariff-free. This was followed by liberalization of trade in services in 1995 under the aegis of ASEAN Framework Agreement on Services (AFAS) and liberalization of investment flows in 1998 under the aegis of ASEAN Investment Area (AIA) initiative. The AIA was the first agreement to promote ASEAN as a single investment area and increase regional cooperation on investment issues. It also provided guarantees of national treatment and transparency in investment relations to investors. AIA covered a wide range of industries and "One-stop investment centers" were also started under the AIA. Together they enabled ASEAN economies to make significant strides in investment cooperation. In two important areas of regional policy, namely trade and investment, the ASEAN bloc has emerged as the *de facto* fulcrum of Asian cooperation arrangements (section 4.1).

In addition these economies have gradually integrated with each other. Share of intra-trade among the ASEAN economies nearly doubled over the last two decades. In 2009 it was a quarter of the sub-region's total trade. For Singapore this share was the highest (36 percent), which reflects its importance as a port and trans-shipment point. Trade and FDI within the sub-region and with the neighboring Asian economies have been mutually reinforcing. Consequently business cycles in the ASEAN economies have been growing increasingly synchronized. It is partly caused by intensifying economic linkages through trade and investment flows among this sub-group of economies (Tanaka, 2009). Three of the new members of ASEAN, namely Cambodia, Laos and Vietnam, recorded higher GDP growth rates since the 1990s (Menon, 2012). It was essentially driven by trade, investment and other market reforms. It succeeded in reducing income disparities between these members and the original ASEAN-6. Although the development divide has narrowed, huge gaps persist.

Of particular relevance in this regard was forging of a series of ASEAN-Plus-One agreements made by ASEAN, which were BTAs. The APT were the first three. They were followed by an ASEAN-Plus-One agreement with India. Most recently Australia and New Zealand also entered into the similar ASEAN-Plus-One agreements. ASEAN has ASEAN-Plus-One agreements, or BTAs, with all the important regional economies. The surge in these AEAN-Plus-One agreements is considered a case of what is known as the domino effect (Ravenhill, 2010). Negotiations for two more ASEAN-Plus-One agreements, with Russian Federation and the US, are to be launched. The regional economies are linked together through multiple BTAs. Both financial and trade regionalism processes are driven by them. When this network of BTAs comes into force, it would create some semblance of an economically integrated Asia-Pacific region (Brestlin, 2010).

So many ASEAN-Plus-One agreements turned ASEAN into a hub. That is the ASEAN members were acting collectively as a group. This is termed a "hub-and-spoke" arrangement. ASEAN-China FTA (ACFTA) and ASEAN-Korea FTA (AKFTA) apply comparable tariff reduction schemes to the CEPT, while ASEAN-Japan FTA (AJFTA) adopted higher standards in tariff reduction. Not only APT is an important intra-regional regional grouping, but a combination or amalgamation of these three BTAs can also serve as a modality of a broader Asian FTA.

In this hub-and-spokes arrangement it is implicit that while connected to the hub, the spokes are separate. Therefore bilateral distortions can be phased out between the hub and spokes, whereas they will not be phased out between the spoke economies. To that extent trade and welfare gains from this hub-and-spoke arrangement will be limited. Thus uncoordinated bilateralism can amount to sacrificing welfare gain.

4.1 ASEAN as the Locus of Pan-Asian Integration

As described above, developments during the last decade prove that ASEAN bloc is fast developing into a possible locus of a prospective pan-Asian institution-led integration. It has formed trade and economic alliances with several large Asian as well as Oceania[7] economies. The ASEAN-Japan Comprehensive Economic Partnership

[7] Oceania is the term that is used to denote Australia, New Zealand and the proximate Pacific islands.

(AJCEP) came in effect on December 1, 2008. It was followed by the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA), which came in effect on February 27, 2009. Next, the ASEAN-China Free Trade Area (ACFTA), the ASEAN-India Free Trade Area (AIFTA) and the ASEAN-Korea Free Trade Area (AKFTA) came in effect as of January 1, 2010.

This inventory of completed FTAs by the ASEAN bloc is highly impressive and made it an imperious regional grouping. These five FTAs have prepared the ground for an East, Southeast and South Asian integration, which is an invaluable accomplishment. Furthermore, the network of BTAs and FTAs of individual members in these five FTAs is sure to weave these economies and sub-regions closely. Therefore, it is reasonable to expect that the ASEAN bloc together with its five FTAs can potentially develop into a comprehensive regional partnership. It can facilitate free pan-Asian flow of goods, services, factors of production, technology and ideas. It can also smooth the operation of vertically integrated production networks.

The attraction of the ASEAN bloc as the primary platform for regional cooperation and integration is due to the fact that some of its member economies are resource rich, have low wages and are presently enjoying a demographic dividend. Indonesia, Malaysia, Thailand and Myanmar come under this category. They cautiously and consciously try to exploit their comparative advantages. They utilized these advantages to be competitive economies and also took measures like strengthening their legal systems and promote social stability. Over the years, several of the ASEAN economies also took initiative to introduce a series of policies and regulations which are conducive to attracting investment and creating business friendly macroeconomic environment (Das, 2007).

Many MNCs operating in Asia do not consider it wise to invest too much in China and regard it a safe bet to diversify in the region. Besides, wages and other factor costs in China have been on the rise. This applies particularly to the coastal provinces of China. These factors make the ASEAN economies an appealing alternative to China. The next logical step for the ASEAN bloc is liberalizing investment regulations, unification of ROOs and harmonization of product and technical standards to facilitate ASEAN-wide trade and investment flows. They successfully took some of these policy measures. For instance, they proactively liberalized investment regulations in 2010 and benefitted by attracting larger FDI flows than those in the past (UNCTAD, 2011).

4.2 The ASEAN-Plus-Three Initiative

Formation of APT was a constructive and functional measure, having meaningful consequences for regional integration. Proposed by China, the APT provides the primary institutional framework for the Asian economic integration. The members met for the first time in Kuala Lumpur in 1997. The APT initiative gained unprecedented momentum in the wake of the Asian crisis. Creation of APT in 1998 was a first step toward financial and monetary cooperation in Asia. The APT economies became actively involved in various regional initiatives. Given the dynamism and significance of the three economies in the region, this could as well be named Three-Plus-ASEAN.

The three governments, China, Japan and Korea, led the initiative that worked as a unassailable stimulus to regionalism. Japan and Korea had tradition commitment to multilateralism. They radically altered their stance on trade policy to move towards formal regionalism. China began overtures on the ACFTA (or Framework Agreement on Comprehensive Economic Cooperation) with ASEAN in 2001. In the aftermath of the Asian Crisis, the political leaderships in the APT economies were cognizant of the fact that there was a compelling need for economic, monetary and financial cooperation and create regional economic architecture, which in turn stimulated camaraderie and team spirit in regional trade and investment.

The regional importance and significance of the APT continued to increase. It now works as a region-wide umbrella for devising new integration measures. The APT members developed a Cooperation Work Plan (2007-17) and adopted it in the November 2007 APT Summit in Singapore. This document deals with opportunities and challenges faced by APT cooperation and provides strategic guidelines for future APT cooperation. The guidelines to implement the Cooperative Work Plan (2007-17) were endorsed in the 13th Director-General meeting in July 2009 in Seoul. Over the years APT has developed slowly into an important mechanism for strengthening and deepening cooperation and support teamwork among Asian economies in economic, financial and other related areas. However some Asian economies were concerned about the negative impact on their sensitive sectors, which slowed the progress in implementation of APT.

To support the CMIM, the APT countries agreed to establish an independent regional surveillance unit in April 2010. It was christened the APT Macroecnomic Research Office (AMRO). Furthermore, the APT Finance Ministers and Central Bank Governors' met in May 2012 in Manila. As this meeting took place in the backdrop of the Eurozone sovereign debt crisis, the members agreed on strengthening CMIM, including doubling its total size to $240 billion. They also increased the IMF de-linked portion to 30 percent, introduced crisis prevention function and enhanced the ABMI by adopting New Roadmap+. The New Roadmap+ was proposed by Korea and covered directions to further develop the Asian bond markets. One negative aspect of CMIM is that the pledged amount of $240 is too small to stave off any potential crisis. This amount is close to 5 percent of the forex reserves of the APT countries. The CMIM was never activated. Whether it is ready for activation is an open question.

4.3 ASEAN-China Synergy

Since the mid-1990s China began cultivating its political and economic relationship with the ASEAN countries. It did not allow the old territorial disputes and rivalry to overshadow the new relationship of economic cooperation (Ye, 2011). China's importance as an ascendant economic power for ASEAN is enormous. A good deal of private sector-led integration between the large ASEAN economies and China took place during the last decade. It intensified particularly since the Asian crisis. Although Chinese economy had a lot of similarities with the larger members of ASEAN and the two did not have a great deal of natural economic complementarities, trade between China and ASEAN increased six fold during the decade of the 2000s. Reciprocal FDI also rose exceedingly fast. However, it needs to be pointed out that in comparison China's trade and FDI are much larger with Japan and the NIEs and their rate of expansion also remained much higher during the period under consideration. Also, the ASEAN markets were relatively less important for China.

Yet, China regarded it a priority to have an FTA with the ASEAN bloc than with Japan or the NIEs. One reason for prioritizing ASEAN in trade and economic ties was China's national interests. Securing a source of raw material and energy supplies and expanding its market of manufactured goods could well be the first motivation. A second important reason for China taking early and earnest steps and more positive approach to cultivate good-neighborly relations with the ASEAN bloc was its eagerness to be perceived by its neighbors as a peaceful and trustworthy neighbor, which could ease up the evolving China-as-a-threat assertion. It had caused economic security concerns among the smaller neighbors of China. Its acceptance of the so-called "ASEAN-Way" could well be due to the same reason.

While negotiating the ACFTA, the Chinese negotiators took a yielding, flexible and mature stance, to ensure that the negotiations were perceived as successful. They put forth a slogan, "giving six, taking four" and also came up with the "early harvest" programs. One such scheme was agricultural trade liberalization, which counteracted the hesitancy of some of the ASEAN countries in entering into the ACFTA. Also, under the early harvest scheme the ASEAN-6 got early access to the large Chinese market. Negotiations on the ACFTA progressed well and they were effectively reinforced during the last decade. The ACFTA soon became "entrenched within the institutional layout of the region" (Chin and Stubbs, 2011; p. 279).

The ASEAN economies became upstream suppliers of intermediate goods to China. With that their trade surplus with China increased. The trade relationship in intermediate goods evolved as follows: for each dollar worth of increase in intermediate goods export to China, ASEAN countries imported $0.60 worth of intermediate goods from China. Conversely, these economies have become net importers of consumer goods from

China. For each dollar worth of consumer goods exported to China, ASEAN economies imported almost $4 worth of consumer goods from China (IMF, 2011). Consequently China has had a trade deficit vis-à-vis the ASEAN economies for some time.

As China became the assembly hub of network production, it imported parts, components and intermediate goods from Japan, the Republic of Korea (hereinafter Korea) and Taiwan, which are three of the most industrialized economies of Asia. The final products which were assembled in China were then exported to North America and the Eurozone economies. Thus China's exports became dependent on economic climate in these advanced industrial economies. Regression analysis shows that this result holds for the electronics sector but not for the machinery sector. Due to the global financial and economic crisis, China's exports of electronics products to the advance industrial economies fell by 50 percent, which led to a simultaneous fall in China's imports from Japan, Korea and Taiwan by 60 percent (Zinabou, 2011).

4.4 ASEAN-Led Progress towards Institution Building

The Asian vision of an institutionalized regional community is different from that of the EU. So is the process of advancing towards this objective. Unlike the EU-type exceedingly institutionalized community, Asian economies prefer soft regionalism, which Hu (1996; p. 7) called "the ASEAN Way". This implies a relatively easy-going neighborly relationship among countries, which ultimately promotes economic cooperation. It is a consensus-based institution. The modality and operational code of this relationship is determined by the ASEAN Way. One characteristic of this process is that member states engage with each other at their own level of comfort. This was responsible for creating a unique intra-regional economic dialogue between the members of ASEAN, China, Japan and the four NIEs. In the post Asian crisis period ASEAN-led efforts became more substantive than in the past.

The ASEAN Way has had several notable successes. One of its important achievements is that it has made it possible for the small states to lead the big ones. In this case the ASEAN states are the small states while China and Japan are the big ones. Conversely, in the EU or NAFTA, the big states are accepted as the natural leaders and they throw their weight around. They believe that they are the natural leaders. In the incessant APT dialogue, the small ASEAN states succeeded in motivating China and Japan to participate in an ASEAN-led institution building. They came up with the novel ideas and initiatives and determined the direction and the path to take.

The small ASEAN members together showed the way and persuaded the larger economies to work in the interest of the region and abandon their narrow national goals. ASEAN kept both China and Japan informed about the small states' plans of regional prosperity and stability, and engaged them in achieving their goals as common regional goals. As the origin of majority of initiatives was ASEAN, response from China and Japan was promptly favorable. Without the ASEAN Way, mutual rivalry, mistrust and circumspection between China and Japan would have stalled negotiations towards institutionalized regionalism and progress towards any regional objectives.

The ASEAN culture naturally determined the idiosyncratic traits of the ASEAN Way of intra-regional economic diplomacy. The code of conduct is based on consultation and mutual respect. The ASEAN culture totally refrains from coercion of any kind and emphasizes consensus building. Some analysts believe that the ASEAN Way is the Malay cultural approach of handling serious situations and the Malay manner of interaction with people. It emphasizes a non-confrontational attitude and mandates a sincere readiness to appreciate the viewpoints of others. Patience and perseverance are regarded as highly valued attributes (Vermonte, 2005).

4.5 ASEAN Economic Community

When the two regional giants, China and India, recorded sustained and rapid GDP growth and their economic status began to rise, the ASEAN members reacted to this consequential regional development (Das, 2006). Geographically situate between these two rapidly growing EMEs, ASEAN members saw both opportunities and threats. If they felt competitive threat coming largely from China, they saw trading and other economic opportunities as well. The challenge for the ASEAN group was to initiate a policy and institutional environment which could enhance complementation and competition of each member economy.

A plan for ASEAN Economic Community (AEC) was broadly conceived in early 2002 during the ASEAN Summit in Phnom Penh. A decision to create an AEC was taken during the ASEAN Summit in October 2003, when the Bali Accord II was signed. This was a momentous development for the ASEAN group, which had moved slowly in the past. The AEC concept was to create a single unified market and production base for ASEAN. This decision underscored a need to establish a comprehensive integrated market. Sagacious vision of the ASEAN leaders was to create a competitive sub-regional economy that will also be globally integrated and competitive. Global integration was high on the priority of “The AEC Blueprint”. Among other imperatives, ASEAN economies needed to improve their investment regime, their trading environment, transport and logistics infrastructure and communications networks. There are constraints to cross-border trading in the ASEAN bloc. These measures would go a long way in reinforcing their supply side capabilities.

This group of countries is not only not homogeneous but their economic performance is also dissimilar. Indonesia is the largest economy of the sub-region. The AEC covers a population of 574 million and several rapidly growing economies. Many of the ASEAN economies are outward oriented and open to trade and investment. Their combined trade to GDP ratio was 131 percent in 2010, for Singapore it was 421 percent. At this point their combined GDP was $1.856 trillion and long term (1990-2010) average growth rate was 5 percent. The region is benefitting from competitive courting by economic giants like the EU and the US as well as the two largest regional economies, China and Japan (Chachavalpongpun, 2010). Establishing an AEC will take much hard work and face technical and political obstacles. In economics market size matters but ASEAN has so far failed to integrate into a single market or economic entity. The growth prospects of the middle class in economies like Indonesia, Malaysia and Thailand have not been fully realized.

In January 2007, the ASEAN members agreed to sign the AEC agreement. According to the plan, by 2015 there would be a free flow of goods, services, investment and skilled labor among the ASEAN economies (Ito, *et al* 2011). The Action plan for the implementation of the AEC was published in late 2007 and was christened "The ASEAN Blueprint". The ASEAN Charter was accordingly ratified by members in December 2008. This was an ambitious initiative by the ten ASEAN members. A successful development of AEC would go a long way in addressing obstacles to seamless trading in goods and services in the ASEAN region.

The overarching objective of the AEC is to reduce transaction costs in the sub-region by economically integrating and making it more attractive for FDI and the operations of MNCs. This has been the primary objective for the ASEAN policy makers. In a globalizing economy FDI inflows have become of paramount importance. They are a source of non-debt-creating capital, foreign exchange and technology. They also provide an easy access to larger foreign markets. In addition, they tend to strengthen institutions in the developing economies, particularly the financial sector (Prasad, et al, 2006).

Another important objective of AEC is to create a market for the free movement goods and services as well as capital and skilled labor. Formation of AEC would call for more endeavors in terms of policy harmonization among the ASEAN economies, which in turn would require willingness to cede sovereignty. This was a sensitive issue, something the ASEAN member states never considered seriously in the past. The belief of the ASEAN leaders was that the MNCs would see AEC as a profit-enhancing proposition, be drawn by the economic diversity of the integrated sub-region and choose to invest in and locate their vertically integrated production networks in it. This policy environment would eventually facilitate the emergence from the ASEAN sub-region. This strategy is in keeping with the outward-oriented regionalism, from which Asia has benefitted. It needs to be recalled that the past economic cooperation endeavors of this nature by ASEAN were somewhat disappointing. One of the reasons behind the failure was that they were top-down initiatives, in which the local business communities did not take interest.

For estimating the economic effects of the comprehensive AEC project, Petri, *et al* (2010) used a computable general equilibrium (CGE) model. Implications of reduction of trade barriers and liberalizing the trade in goods are clear and can be quantified easily, but the effects of liberalization of trade in services and investment is relatively difficult to quantify. The same can be said about the effects of movement of skilled labor and cooperation in the capital markets. This study was based on a comprehensive model. One of its principal conclusions was that the value of AEC for the ASEAN economies was large. Their welfare would rise by 5.3 percent, that is much more than the welfare gains from AFTA. Integration with the global economy would further increase the welfare gains to 11.6 percent. More than half of these gains would stem from the FTA formation with the large economies of East Asia and the remaining gains from the FTAs with the EU and the US.

Using a dynamic CGE model, Lee and Plummer (2011) also estimated the potential effects of the AEC on economic welfare, trade flows and sectoral output of the member economies of the AEC. This empirical exercise was less comprehensive than the one noted above. According to its results, elimination of trade barriers resulted in maximum welfare gains to Singapore, while Malaysia, the Philippines and Thailand are expected to realize welfare gains of 1 percent or more. However, estimates show that the remaining ASEAN members are likely to incur welfare losses. As noted above, one of the objectives of the AEC is to reduce transaction costs. The impact of trade costs reduction is direct and the result is trade-creation in the sub-region. When reduction in trade costs due to AEC creation is taken into account, the magnitude of welfare gains for the ASEAN members increases substantially. Lower administrative costs and trade barriers also result in generating more intra-ASEAN trade. As expected, this empirical exercise predicted a huge increase in intra-ASEAN trade. An intra-ASEAN average trade increase of 54 percent was estimated. Imports from the Non-ASEAN countries were found to contract by 6.1 percent. This study also showed a large increase in the

FDI stock for the individual ASEAN economies, ranging between 28 percent and 63 percent.

The AEC concept is a decade old. At this stage it must be more ambitious and needs to seek integration at more than mere trade level. Integration of financial markets, standards and compliance are some of the other significant areas where they need to step up efforts to come closer and try to seamlessly integrate. To this end, appropriate institutional architecture needs to be developed. An active and strong ASEAN Secretariat with trans-ASEAN jurisdiction and authority would go a long way in moving this county group towards becoming a single economic entity. To achieve this broader objective, ASEAN member states will need to change their mindset and give priority to the sub-regional interests over individual national interests.

4.6 Trilateral FTA: A Critical Missing Link

So far there is no trilateral FTA (or TFTA) between China, Japan and Korea (CJK), although over the years the three economies have broached different possibilities and approaches. Largely because of the size and openness of their economies, China, Japan and Korea, make their presence felt in any regional arrangement and agreement. Business corporations in these three economies increasingly became integrated, particularly since 2000. Their bilateral trade and other non-state-led economic exchanges grew at a swift pace. Their integration was further reinforced by production networks and related trade, which in turn accelerated intra-firm trade.

Trade among CJK group expanded rapidly over the preceding two decades. The share of intra-group trade between them expanded from 12.3 percent to 24.1 percent between 1990 and 2004, although it fell during the Asian financial crisis period (1997-98) to 21.5 percent. By 2010 it recovered somewhat to 22.5 percent. Over the same (1990-2010) period the share of intra-trade of NAFTA expanded from 37.2 percent to 40.5 percent while in case of the EU-15 it contracted from 64.5 percent to 56.3 percent. In comparison to the EU-15 and NAFTA, the share of CJK is evidently much lower, albeit its rate of increase was much faster. Over the same period Japan's intra-regional trade dependency on China and Korea recorded a steep rise, from 9.1 percent to 26.9 percent. Similarly Korea's dependency on China and Japan soared from 21.9 percent to 34.5 percent. However China's trade dependency with the other two rose from 15.0 percent to 27.6 percent between 1990 and 1996, but thereafter recorded a slow decline reaching 16.9 percent in 2010. This had happened due to China's rising trade with the EU and US. A fall in China's dependency on the other two explains the weakening of intra CJK trade in the recent years.[8]

China is a major investment destination for both Japan and Korea. It received substantial FDI from the Japanese and Korean firms in high- and medium-technology manufacturing industries. This provided an opportunity to China to develop its manufacturing sector and raise domestic technological standards, rendering its manufacturing industries more competitive. Japanese and Korean firms benefitted because China provided them with an opportunity to restructure their operations. Also, these firms were able to improve their competitiveness in the global market place. This was essentially a market-driven phenomenon, undertaken by business firms in the three countries to continue to be profitable and competitive. This rational, symbiotic and complimentary structural relationship between the three economies is like to continue and benefit them in the future.

During the Manila Summit in 1999, the leaders of the three countries launched a joint research project on "Strengthening the Economic Cooperation among China Japan Korea". The three nations had their first Trade Ministers' Talk on this issue in 2002. A joint feasibility study was submitted on a TFTA to the Trilateral Summit Meeting in 2003. This research focused on the impact of the TFTA on the macro-economies of the three countries. It computed gains for all the three potential partners and came to favorable conclusions for them. Yet since then policy priorities, emphases and interests among the three possible partners varied and there was little tangible progress. Academic scholars in the three countries continued to research on the TFTA and its benefits. FTAs are basically premised on political decisions. Weakness in political will to take

[8] The source of statistical data here is Lee (2011).

concrete steps was evident in the three countries. It seems that due to historical factors mutual trust between the three economies is still absent.

In 2004-06 the three economies conducted joint research on the "Sectoral Implications of a CJK FTA" which covered agricultural sector, fisheries and principal manufacturing sectors and services trade. Another trilateral feasibility study was launched in 2009 by a by a larger group of academics and business community members and trade bureaucrats. It took time to publicize its results and finalize its recommendations because the three potential members had sensitive issues to settle. Korea expressed concerned about trade in agriculture, fisheries and forestry sectors where China has comparative advantage. China's was alarmed about high-technology industries like semiconductors, smart phones and services sector as well as medium-technology industries like shipbuilding and steel, where Japan and Korea have strong comparative advantage. Similarly Japan is concerned about both China and Korea having comparative advantage in several industrial sectors. Opening trade in them will injure the domestic Japanese industries. The joint study was completed in December 2011, albeit the report was not made public but was to be released in early 2012.

Since 2008 four tripartite CJK summits took place and a fourth one on May, 2011 in Tokyo. These summits provided a platform for coordinating responses to immediate regional issues and concerns. The first summit was held in the background of the global financial crisis. Although delays, discord and disagreements persisted and progress towards forming a TFTA was glacial, these three economies have become closely economically intertwined over the preceding two decades. Absence of an FTA did not impede or slow their economic and business interactions and integration. Trade and investment among them increased at a rapid pace. Yet, there is an apparent need to build political trust between the three potential partners if TFTA has to be born and emerge as a serious and influential entity (Byun, 2011).

Although rapidly changing global economic environment, prolonged global financial crisis and stagnating EU and US markets may succeed in spurring this process in starting trilateral negotiations, they cannot be completed in a short while. The three economies need to start negotiations on a TFTA without delay. Even after TFTA negotiations are completed, ratification takes time. A joint statement of the Joint Study Committee, which met in Pyeongchang, Korea, on 16 December 2011, issued joint recommendations for the three governments to decide on how to proceed with a TFTA, to announce an appropriate course of action and time frame of for the negotiations. At their annual trilateral summit in Beijing in May 2012 the top political leaders agreed to launch negotiations for the TFTA before the end of 2012.

When completed, this TFTA will be the third largest in the world and the largest in Asia. These three economies have large size GDPs and trade volumes. In 2010, their combined GDP was $12.2 trillion and trade volume $5.3 trillion. Although these statistics are smaller than the corresponding figures for the EU and NAFTA, they were not far below their levels. China, Japan and Korea accounted for 22.3 percent of the global population, 17.6 percent of the world GDP and 47 percent of the forex reserves. Their active interact with each other went on increasingly progressively. During the last decade Korea's trade volume with China outgrew that with the US and Japan. China is Korea's largest export market and the largest source of its imports.

Results of a Trilateral Joint Research (TJR, 2008) project that quantified the economic impact of a CJK FTA by deploying a computable general equilibrium (CGE) model for 2003, 2005 and 2007, respectively, indicated the same direction and similar magnitude of economic effects. It demonstrated that the CJK FTA would be a win-win strategy to reap macro-economic benefits for the members. The simulation results indicated that the FTA will bring about large benefits to all the three CJK economies. It found that China's GDP will rise by 0.4 percent, Japan by 0.3 percent and Korea by 2.8 percent. No doubt to maximize benefits of the CJK FTA will call for industrial adjustments and cause labor dislocation in the damaged sectors. However, the TFTA can be carefully designed to reduce social costs of labor displacement by adopting mitigating measures, including sectoral exclusion and grace periods.

China has been the most actively interested in the TFTA negotiations, while Japan the most passive. Korea took the middle ground, although according to estimates made by the Ministry of Finance in Korea, it is likely to be the largest beneficiary of the TFTA. The results of this study show that Korea will see its GDP rise by 2.6 percent, while China GDP gains will be by 0.6 percent and Japan by 0.2 percent (KITA, 2010). The reason for larger benefits to of the FTA going to Korea is that it relies on trade much more than China and Japan. Trade between them is more focused on intermediate goods. They need to enlarge their market for final goods.

5. Consolidation for Pan-Asia Regional Economic Integration

The age-old neo-classical principle is that the larger the region, or the coverage in terms of the number of economies, the higher the welfare gains from regional integration. These gains are of both static and dynamic kind. Static gains are associated with reallocation of resources, that is, productive resources moving to sectors in which a country enjoys comparative advantage. The dynamic gains originate from the learning effect and additional capital accumulation. Trade creation or trade volume effect is another channel of welfare gains from regional economic integration. As regional integration directly increases comparative advantage-based trade, which leads to production moving from higher- to lower-cost production locations.

A larger integrated region covering many Asian economies necessarily implies that trade in goods and services will be higher in volume. Also, regional firms will have access to more skills and technology. Additionally, a larger integrated region integrates more markets resulting in a bigger final market size. This is an important variable because larger market in turn offers opportunities to business firms for greater specialization. Equally important are the scale and scope opportunities provided by the larger market size, which benefit firms from all the integrating partner economies. If a large number of economies come together in a pan-Asian RTA, the MNC operations in the region are sure to become easier, more productive and more profitable. This will necessarily include investments made by MNCs as well as technology transfer between firms and economies. Both are an important component of a dynamic regional economy.

Chia (2010) proposed that there are more benefits from expanding regional cooperation in Asia and consolidating the existing BTAs and FTAs. As markets grow larger and integrate and in the process lower or eliminate barriers to trade and investment, they provide incentives to both domestic and foreign investors to increase investment in productive resources, manufacturing activities, services and infrastructure development. The direct result is that the regional economies come closer together and become more closely connected. Furthermore, a larger pan-Asia RTA will not only increase the static and dynamic benefits of regional integration, but also reduce geopolitical regional tensions. Regional integration between the ASEAN economies is a testimony to this fact. In addition, it is axiomatic that a pan-regional integration is certain to give Asia a greater influence in various international fora and increase the regional clout as well as allow a greater say in the institutions of global economic governance, like the Bretton Woods twins and the WTO. This process would increase both Asia's global clout and contribution to global economic and business decision-making process.

A larger RTA entailing many regional economies will limit, or eliminate, the so-called spaghetti bowl or noodle bowl problem created by overlapping BTAs and FTAs. A pan-regional RTA can also eliminate multiple ROOs without much difficulty. Next step for the RTA members could be creating compatibility in product and technical standards. Although these measures will be time consuming, they will go a long way in avoiding market fragmentation in Asia. As seen in section 4, the consequence of the explosive post-2000 regional integration scenario is a surfeit of bilateral and multilateral agreements. As multiplicity and overlapping FTAs have a cost, thoughts of consolidation are normal, even necessary.

5.1 Geometry of Regionalism: Favorable BTA and FTA Configuration for Asia

With the rapid proliferation of BTAs in Asia, empirical literature on the welfare implication of formal regional integration has been expanding. Such empirical studies are essential for bringing to the fore the costs entailed in the proliferation of BTAs and FTAs. Now that the FTA-led regionalism has expanded at a rapid pace in Asia and it is believed to be here to stay, the next relevant question is how to further shape it. Several analysts took into consideration the present range of BTAs and FTAs and proposed consolidation of regionalism on varying lines.[9] Four broad alternative strategies to which empirical studies have frequently paid attention are:

(1) The ASEAN Free Trade Area (AFTA).
(2) ASEAN+One BTAs, the so-called "hub-and-spoke" approach. According to this approach three BTAs of essence can coexist in a parallel manner, that is ASEAN+China, ASEAN+Japan and ASEAN+Korea, or the APT.
(3) ASEAN coexisting together with a China-Japan-Korea FTA, which is yet to come in existence. These two may compete or collaborate.
(4) Expansion of the ASEAN to an APS grouping, in which the first three are China, Japan and Korea. To these, three more ASEAN+1 are added, which cover India and Oceania (Australia and New Zealand).

Static and dynamic computable general equilibrium (CGE) analysis is another powerful analytical tool. The CGE empirical studies not only can quantify the income effects but also have a great deal of practical use. Kawai and Wignaraja (2007; p. 17) noted that, "CGE studies can help in framing negotiation positions with FTA partners, indicate implementation schedules for trade and liberalization and suggest the need for appropriate structural reforms to mitigate adverse impacts". That said, they are not without their limitations. This analytical tool was utilized by Park (2006) and Lee and van der Mensbrugghe (2007), respectively, to quantitatively evaluated the impact of above mentioned RTA strategies. They concluded that the APT is the most productive and lucrative RTA strategy for the region. According to their conclusions this regional integration strategy will not have the detrimental effect of overlapping. Two more recent empirical studies that used Gravity model regression analysis concluded that a consolidated Asian RTAs will have trade creating effect on the region, they will not have trade diverting effect over the non-members from outside the region and even support global free trade (Lee and Park, 2005; Lee and Shin, 2006).

[9] For instance, see Baldwin (2004), Lee and van der Mensbrugghe (2007), McKibbin et al (2004), Kawai and Wignaraja (2007, 2008), Park (2009) and Urata and Kiyota (2003).

A CGE analysis was conducted by the ADB that used a variant of the Global Trade Analysis Project (GTAP) model (Kawai and Wignaraja, 2007). For the purpose of this empirical study, the dataset used was GTAP version 6.3, which had the advantage of including detailed national input-output, trade and final demand structures. This model was characterized by an input-output structure based on regional and national input-output tables. The notable conclusion of this study was that regionalism in the form of APT and APS offered the largest gains to the world income compared to the alternative strategies. Computations revealed that of the two, APS offered larger gains than APT. In the former case they were $214 billion, while in the latter $260 billion. The APT grouping minimized the negative effect arising from the noodle bowl phenomenon. This analysis expanded its recommendation to creation of an APS. The APT and APS were found to have dissimilar impacts on individual economies and sub-regions. As regards the influence on the non-participants, computations demonstrated that APT and APS had rather small impact. For a range of economies there were losses, but they were small. This category included South Asian economies, the Oceania, Central Asian economies and the US. In contrast, there were small gains for the EU, Canada, Mexico and the Sub-Saharan Africa. The largest regional economies have their preferences, that is, China has shown to prefer the APT, while Japan favored APS.

By applying CGE model analysis Park (2006) concluded that the static effect of an East Asian RTA between China-Japan-Koran will be positive on welfare of the member economies and that of the world economy. Also, it inferred that there will be an increase in nondiscriminatory free trade by setting off the domino effect n Asia. In a more recent study, Park (2009) further supported the old results by applying the traditional multi-country, multi-sector, static CGE model simulation. However, Park (2009) was a little ambivalent. It concluded that both APT and the China-Japan-Korea FTA were sustainable and desirable for the regional and global economies. There was no clear choice between the two.

5.2 Consolidation of BTAs and FTAs

Other than the partial consolidation of BTAs as APT and APS on the lines indicated above, a full regional consolidation can also be considered. Consolidation of gains of regional integration can be captured either through a cooperative multilateral approach or through non-discriminatory regional agreements or open regionalism. When economies in a larger region form a large multilateral RTA, the preexisting smaller BTAs can be consolidated as a solitary RTA. This makes the preexisting BTAs and FTAs redundant. This was found to have happened when the EU and NAFTA were formed. For instance, the Canada-US BTA that preceded NAFTA, was superseded by the formation of NAFTA.

A large region-wide RTA consolidates the smaller BTAs in the region by framing the rules of the RTA in such a manner that the previous BTAs can be accommodated. Pan-Asian regionalism and the optimal size of the RTA in the region have recently begun to generate a good deal of deliberations and weighing up. The reason is that the most welfare enhancing manners of shaping regional integration in Asia is formation of a Pan-Asian RTA. No doubt it will need a great deal of political will, skill and coordination. If a region-wide RTA can be formed, the myriad BTAs can be absorbed in it. This strategy can gradually eliminate the intra-regional BTAs completely. It also has the potential of deepening the regional integration for the economies involved.

This kind of regional consolidation would not be an easy and smooth process but may face several operational and technical difficulties. Its implementation may well be arduous and time-consuming. As the BTAs are highly heterogeneous, differing provisions of the BTAs in the region have different tariff rates phasing out schedules, different treatment of quantitative restrictions (QRs), different sector exemptions and ROOs. They would be really difficult to be merged in one large RTA. Under these circumstances, region-wide consolidation will necessarily imply an RTA with the “lowest common denominator” (Menon, 2009; p. 14). If a successful BTA in Asia, that started off with superior provisions, is consolidated in this manner, both the BTA partner economies would suffer. Given a choice they would prefer to continue to operate under their original BTA, which provided entry to higher proportion of their exports into the partner economy.

5.3 Multilateralization of Preferences

Multilateralization of preferences could work as a practical and constructive manner of consolidation of the existing BTAs and FTAs. This is a proposal to first equalize preferences across BTAs and second offer them to the non-BTA trade partners on a MFN basis, in a non-discriminatory manner. Such a move to multilateralize in turn can also remedy the problematic and welfare reducing noodle bowl effect. There are two principal avenues of achieving this objective: First, through expansion of the geographical scope of an FTA and inclusion of new member economies in the preexisting agreements. Second approach could be by substituting the existing agreements by new agreements, that further extend to new members. There is no *a priori* method of determining which one of the two methods is superior.

Assessment in this regard will have to be based on the premises of the preexisting architecture of the preferential arrangements. It will also depend on the economic and political policies of the member countries that drive them towards rationalizing the multiple overlapping agreements (Baldwin, 2006; Baldwin and Low, 2009). One of the large benefits of multilateralization is to bring down the administrative burden for the governments and eliminate trade distortions, both for the national economy and multilateral trade. This is not a mere theoretical concept, it has been tried and tested. There was a proposal to multilateralize AFTA accord and apply it to APEC.

6. The Trans-Pacific Partnership: A State-of-the-Art Agreement?

Although conceived earlier (in 2003), the Trans-Pacific Partnership (TPP) Agreement, or the Pacific-4 (P4) agreement, between Brunei, Chile, New Zealand and Singapore, entered into force in 2006. Since its setting up P4 was intended as a model avant-garde agreement, open to other economies. To attract more Asia-Pacific members, it provided a platform for negotiations. As Asia is regarded as an important region by the US, in 2008 the US announced that it will join the P4 fully in negotiations. Australia, Peru and

Vietnam followed suit. Negotiations for the expanded agreement began in March 2010. During the third round in Brunei in October 2010 Malaysia also decided to join in.

These nine countries are APEC members and the grouping is trans-Atlantic. They belong to four different regions: Asia, Oceania, Latin America and North America. The TPP is a newly emerging track of agreements in the Asia-Pacific region, which can help consolidate the multiplicity of FTAs and resolve the current noodle bowl malaise. As these economies are like-minded and open, the probabilities of success of TPP are high. China is a considerable trade partner of the TPP economies. It is a net exporter of manufactures to them and net importer of agricultural products. Although 23 percent of China's total trade was with the TPP economies in 2011, TPP negotiations did not include China. China was paying close attention to progress in TPP negotiations. A valid question in this regard is that given the regional significance of China, could the TPP succeed without it?

In terms of issues covered, the TPP is an ambitious agreement. An all-important objective of the TPP is to develop a premium, 21st century, comprehensive, trans-regional FTA. In its comprehensiveness it embraces provisions on market access for trade in goods and related rules, trade in services, intellectual property, government procurement, competition policy and dispute settlement. When it is finalized, it is expected to be ahead of its time. The USTR (2011) describes it as "the most credible pathway to Asia-Pacific regional economic integration." The intended objective of the TPP is to deepen economic ties between the nine diverse economies of the Asia-Pacific region. These countries are endeavoring to go beyond the WTO charter and conclude a state-of-the-art agreement which will address the contemporary needs of trading economies in the areas of trade and investment.

Members expect the TPP agreement to deal with the issues of modern trade, the kind that received little attention in the past. They believe that this could eventually pave the way for the formation of a broader free trade area for the wider Asia-Pacific region. The large coverage of the TPP will *inter alia* include regulatory coherence, transparency, competitiveness related issues, economic development and deeper production and supply chain linkages. Initiative for inclusion of these issues was taken by the US, with strong support from Australia and New Zealand. These proposed cross-cutting regulations will shape the behind-the-border regulatory barriers under the TPP. It is the inclusion of these regulatory issues that became the basis of calling the TPP a 21st century FTA.

One challenging issue is that the nine member countries are part of other BTAs and FTAs as well. This complicated the on-going negotiations. For the present this issue was resolved by permitting a somewhat untidy hybrid approach. The members have a choice to continue with the existing FTA or to make a new offer on a bilateral or multilateral basis (Barfield, 2011). A noteworthy point is that the negotiations of the TPP took place when the multilateral trade negotiations failed to progress, the US economy was recovering was anemic and the Eurozone sovereign debt crisis was unresolved.

By liberalizing trade in goods and services, raising FDI flows as well as promoting closer links across a range of economic policy and regulatory issues, the TPP is to be made into a deep-integration agreement. This is one of the strategic objectives of the TPP. During the Asia-Pacific Economic Cooperation (APEC) Forum in November 2011, the leaders from the nine countries endorsed a report from their trade ministers. This report defined the broad contour of a nine-member TPP agreement. The TPP will remove 11,000 tariff lines. It is also designed as a template for future agreements entailing the other APEC members. In 2012 it was a work in progress and it was expected that the agreement will come in force in 2012. At this point Canada, Japan and Mexico announced their intentions to be the members of TPP in future.

The immediate impact of the TPP cannot be large. The reason is that the partner economies are both open and small. The US is the only exception to this generalization. Besides, many TPP members are parts of existing BTAs and FTAs. In addition, the US has FTA agreements with four of the TPP members. The ability of the TPP members to liberalize further is limited. This is not to imply that the TPP does not have utility and value. It could be useful first, in mitigating effect of the tangle of FTAs with different rules and second in achieving greater regulatory coherence by promoting greater integration in such a way that it supports multilateral trading system. It can be an instrument of “multilateralizing regionalism” in Asia-Pacific region. Furthermore, it could help salvage the region from its present noodle bowl and a flood of ROOs (Barfield, 2011).

The US decision to be included in the TPP has given it an added significance and created notable dynamics. Notwithstanding its recent fiscal difficulties and international financial predicament, it is still the largest economy and one of the top traders in the world. Its membership of the TPP will work as a catalyst for the other APEC economies to join in. If this comes to pass, TPP will prove to be a seed for a larger free trade area, like a Free Trade Area of the Asia-Pacific (FTAAP). It will enable the US to enhance its economic and strategic linkages with the dynamic Asian region. As the US becomes a part of the integrating Asian economy, it will be mutually beneficial for the two and create synergy of its own (Fergusson and Vaughn, 2011).

The TPP could possibly take assistance from the WTO framework. If it is made as a “plurilateral” agreement under the enforceable WTO regulations, it could proceed more smoothly and accomplish more for the Asia-Pacific region as well as the global economy. The new framework of rules can benefit the members only when it can be enforced. Two such agreements have been signed under the WTO. The first one was on government procurement and the second on information technology (Bacchus, 2011).

A quantitative analysis of TPP conducted by Petri, et al (2011) reported benefit for all the members, essentially because this agreement calls for deep liberalization. Their simulations for the 2010—2025 period emphasized that the benefits would be initially small, but will enlarge as TPP expands. In the early stages the TPP will benefit small, low-income, economies like Vietnam more. Subsequently, it will benefit relatively larger economies like Korea and Japan. Only in the final stages benefits will accrue to the large economies like the US. The largest source of gains for the TPP members will be from trade creation. The reason is that various groups of TPP economies have the traits of being natural trading blocs that are based on efficient specialization. One good piece of news from this simulation exercise is that it found adjustment cost for the member countries to be manageable. This applies even to the short term, when economies experience greatest impact of integration and therefore adjustment costs are steep. These are indubitably encouraging results.

7. Summary and Conclusions

The objective of this working paper is to examine the evolution of Asia's regional architecture, which developed at an exceedingly fast clip. Government-led or formal regionalism was a major tactical shift in the regional trade and integration strategy. At the turn of the century multilateral trade liberalization took the backseat and regional liberalization became increasingly prominent. A China-centric regional economic structure began to evolve in Asia. China also took a great deal of initiative in the post-2000 evolution of regionalism and influenced it significantly. China showed continuous and proactive interest in the development of ASEAN-Plus-One BTAs, particularly the APT fora.

At the end of the first decade of the 21st century, most small Asian economies and even more the large ones had accepted regionalism as a policy instrument for pursuing regional and global trade expansion and economic integration. This applies particularly to China, Japan and Korea.

The mode and conduct multilateral trade has been significantly transformed during the first decade of the 21st century, Asia could not possibly remain immune from it. Importance of regionalism in the multilateral trade has been on the rise. Also, trade-investment-services nexus were formed and grew increasingly important. It combined with cross-border investment in production facilities. The next development was trade in parts, components and sub-assemblies, which increased progressively and became a high proportion of total trade in several Asian economies. These new dimensions of trade affected formation of FTAs. The 21th century BTAs and FTAs were different from the older ones, which were shallower in their composition, frequently dealing merely with phased tariffs.

As business firms now manufacture parts of their products across the border, the BTAs, FTAs and RTAs of the contemporary period need to take into account the new kind of trade barriers that have been created due to the changing mode of trade. The contemporary regional agreements need to be so designed as to facilitate the new modes of conducting business and trade. As regionalism grew in Asia, Asian economies formed a good number of BTAs and FTAs, many of them were of shallow variety. Consequently they remained limited and uneven in their impact. This policy error was made despite being cognizant of the fact that agreements that covered mere border trade measures and were made between two partners have a limited payoff in terms of increasing trade. Also, many of the FTAs are of hub-and-spoke variety and overlap each other. This leads to operational inefficiency. Numerous Asian agreements followed the GATT/WTO paradigm and focused more on border measures in liberalization. These entered into by ASEAN and China characteristically come in this category. As opposed to them, the ones formulated by Japan and Korea are known for being more comprehensive. They did not stay restricted to the GATT/WTO paradigm.

That the WTO-Plus FTAs are more functional and result-oriented was understood somewhat late in Asia. This explains the delay in turning toward them. An important trend setter in this regard was the US. The blueprint and norms followed by the US had a demonstration effect. Therefore many Asian BTAs and FTAs that were negotiated during the recent years went beyond the GATT/WTO model. Asian economies that negotiated agreements during the recent years preferred to enter into what became known as the “new age” or “WTO-Plus” FTAs, which had rationally wider scope and therefore comprehensive ramifications for the FTA partners. The behind-the-border issues were covered well under the WTO-Plus FTAs. With the spread of this trend the three ASEAN-Plus-One agreements, negotiated with China, Japan and Korea, were WTO-Plus. The MNCs, that have been playing active roles in Asia, made Asian countries conscious of the added value of the WTO-Plus FTAs.

Numerous surveys reveal that the utilization rates of the FTAs in Asia are usually low. They compare unfavorably to that of NAFTA. This implies that the increasing intra-regional trade in Asia was not the direct result of progress in regionalism. Recent country level and industry level studies have indicated several clear and cogent reasons behind the underutilization of FTAs in the region.

BTAs and FTAs in Asia have several shortcomings which often rendered them lightweight and insubstantial. Many of them stem from their initiation and negotiations. As frequently market access was their goal, they did not consider it necessary to engage in negotiating comprehensive and deep FTAs. Also, tariff line coverage in most FTAs was not large. Many of them have long lists of “sensitive” products. Liberalization commitments in many of them are shallow and do not go far. They are also uneven in their coverage of trade in goods. For instance, in many of them agricultural sector is inadequately covered. This is one characteristic that goes counter to the grain of Article XXIV of the GATT/WTO and Article V of the GATS. There is also a dearth of statistical data regarding the Asian FTAs.

Although China was a latecomer to regionalism, it sought to develop FTAs with the regional partners to foster stable markets as well as diversify export destinations. China suddenly became more active in regionalism after the Asian crisis. Since its WTO accession it turned to it more energetically. It even took lead in promoting institutional regionalism. ASEAN and china first developed bilateral ties, which further developed into ACFTA. China subsequently developed FTAs with several regional economies. China is important to its neighbors because it is a large and growing market.

After long delays, the members of ASEAN began to integrate economically. By the late 1990s it became obvious that the ASEAN bloc is a fairly successful case of sub-regional integration. AFTA came into being in 1992. Although it took off to an indifferent start, its scope was subsequently broadened and it came in effect in 2004. Regionalism picked up momentum in the post-2000 period. Since the turn of the century a China-centric economic structure of the regional economy began to evolve, with that formal regionalism progressed in Asia. A surfeit of reciprocal or bilateral trade agreements and FTAs were negotiated in Asia after 2000, which was seen by some as having low utility in increasing trade and welfare in the region.

One of the most important developments was the formation of ASEAN-Plus-Three agreements, with China, Japan and Korea. All three were BTAs. Subsequently more such BTAs followed with India and Oceania (Australia and New Zealand). ASEAN became a hub of Asian regionalism. When this network of BTAs comes into force it will create some semblance of an economically integrated Asia-Pacific region. By 2010 many of these BTAs came in effect. Since this juncture sub-regional integration in the areas of trade and investment intensified further. Similar BTAs with the Russian Federation and the US were in the early stages of conceptualization.

With expansion in hub-and spokes BTAs, ASEAN became an imperious sub-regional grouping. Developments during the last decade prove that ASEAN bloc is fast developing into a locus of a prospective pan-Asian institution-led integration. It has formed trade and economic alliances with several large Asian as well as Oceania economies. Many important BTAs in which ASEAN was the hub came in effect by January 2010. These five regional agreements put down the ground work for an East, Southeast and South Asian integration. For advancing towards the goal of regionalization, it is undoubtedly a valuable achievement. Various sub-regions of Asia would be woven closely by this network of BTAs.

Formation of APT was a constructive and functional measure, having meaningful consequences for regional integration. This inter-governmental initiative worked as a real stimulus to regionalism. The regional significance of APT continued to increase and it became a regional umbrella establishment for integration initiatives. China’s importance as an ascendant economic power was high for the ASEAN bloc. A great deal of private-sector led integration between China and the large ASEAN economies took place during the last decade. Their trade relationship, particularly in intermediate goods, evolved at a fast pace.

The ASEAN economies had a unique manner of operating in their endeavors to regionalize. Their so-called “ASEAN Way” implied a relatively easy-going neighborly relationship among the member countries. Member states engage with each other at their own level of comfort. It enabled the regional economies to dialogue, negotiate and reach common goals. It also succeeded in making it possible for small states to lead the large ones. When the two regional giants, China and India, sustained a period of rapid growth, this sub-group of economies launched a plan for creating an ASEAN Economic Community.

The missing trilateral FTA (or TFTA) between China, Japan and Korea is something that is greatly needed for completing the regional integration arrangement. In spite of being bilaterally linked to the ASEAN bloc, so far there is no TFTA between the CJK economies. Over the years the three economies have broached different possibilities and approaches for integrating, but they failed to come to a mutually agreed arrangement. Since 2008 four tripartite CJK summits took place and a fourth one in 2011 in Tokyo. These summits provided a platform for coordinating responses to immediate regional issues and concerns. China has been the most actively interested in the TFTA negotiations, while Japan has been the most passive. Korea took the middle ground, although it is likely to be the largest beneficiary of the TFTA.

A larger integrated region covering many Asian economies implies higher volume of trade. There are benefits from consolidating the existing BTAs and FTAs in Asia. As markets grow larger and integrate and in the process lower or eliminate barriers to trade and investment, they provide incentives to both domestic and foreign investors to increase investment in productive resources, manufacturing activities, services and infrastructure development. The direct result is that the regional economies come closer together and become more closely connected. Therefore, several modes of consolidation have been suggested and discussed in this chapter.

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