BILATERAL TRADE AGREEMENTS IN THE ASIA-PACIFIC: WISE OR FOOLISH POLICIES?

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Abstract:

Bilateralism is mushrooming in the Asia-Pacific, yet the motives for it remain puzzling. Why do countries devote substantial effort to bilateral free trade agreements that are providing limited additional benefits when compared both with unilateral liberalisation and with the multilateral regime? Furthermore, some of the deals recently implemented are less trade liberalising than the powerful rhetoric would suggest. For example, the free trade agreement between Australia and the United States is not including "substantially all the trade" and, on top of that, is asymmetric – Australia's access to the American market is more restricted than vice versa.

The paper first addresses some conceptual issues and analyses the disadvantages of bilateral free trade agreements. Here, the need for rules of origin is of particular concern. These have two effects. First, they result in additional costs to producers. Whilst the dismantling of tariffs reduces the cost of trade, the need to administer rules of origin increases them. Second, transnational production is made more complicated. In order to qualify for duty free trade, the region for the sourcing of inputs shrinks, with negative consequences for competitiveness. Subsequently, the bilateral agreements of Australia, Singapore and Thailand will be examined. At closer inspection, these preferential deals are not convincing. All of them require complex rules of origin and do not make a significant contribution to the liberalisation of trade.

Key words: Free trade agreements; bilateralism; rules of origin; protectionism

Contact Details:

Heribert Dieter
Senior Research Associate,
German Institute for International Affairs,
Berlin,
Germany

and

Associate Fellow,
Centre for the Study of Globalisation and Regionalisation,
University of Warwick.
Coventry
CV4 7AL
England

Email: heribert.dieter@swp-berlin.org.

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Abbreviations:

AUSFTA	Australia-US Free Trade Agreement
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GM	General Motors
HS	Harmonised System
JSEPA	Japan-Singapore Economic Partnership Agreement
NAFTA	North American Free Trade Agreement
PBAC	Pharmaceutical Benefits Advisory Committee
PBS	Pharmaceutical Benefit Scheme
USSFTA	United States Singapore Free Trade Agreement
WCO	World Customs Organisation
WTO	World Trade Organisation

1. Introduction

The character of regionalism in the Asia-Pacific is changing significantly. Whereas up to the turn of the century most countries in the region concentrated on participating in the multilateral trade regime, today there is a marked shift. Almost all countries in the Asia-Pacific have embarked on a new course for their trade policy. Bilateral trade agreements are mushrooming all over the world, but the Asia-Pacific is the region with the most prolific supporters of bilateralism. The superficial explanation for this trend is that in bilateral agreements, countries agree on measures that liberalise trade much faster than it would be possible in the multilateral regime, i.e. within the regulations of the World Trade Organisation WTO. At closer inspection, this explanation does not hold water. Bilateralism has to be evaluated not only in comparison with the multilateral regime, but also in comparison with unilateral liberalisation.

In this paper, I will analyse the utility of bilateral trade agreements. This requires understanding both the benefits as well as the costs of such agreements. Since both dimensions cannot be fully appreciated at an abstract theoretical level, I will examine the fine print of some trade agreements in the Asia-Pacific. It has to be asked whether there is a gap between the free trade rhetoric and the reality of such agreements.

Of course, the rapid growth of the number of bilateral agreements requires a selection of cases that can be analysed within the limits of an essay. I have decided to look at three cases in particular. First, the agreement between Australia and the USA will be considered. This is not only the first free trade agreement of Australia with another OECD-country apart from neighbouring New Zealand, but it is also the most important free trade agreement of the USA since the completion of the North American Free Trade Agreement NAFTA in the early 1990s. Although the United States have been negotiating a number of free trade agreements in recent years, the economies concerned are mostly relatively small, e.g. Jordan, Bahrain, Chile or Singapore. By contrast, Australia is a relatively large, developed economy with 20 million inhabitants and a GDP of over 600 billion US-dollars (2004). The free trade agreement between Australia and the USA was discussed controversially in Australia, but the concerns raised were hardly considered in the final document. This agreement, an example of a North-North agreement, will have repercussions not only for trade in goods, but also for trade in services. Furthermore, this

agreement demonstrates that bilateralism can change the location of dispute settlement, which can be shifted from the multilateral level to the bilateral one.

The second case to be considered is Singapore, which has probably been the most active proponent of bilateral trade agreements in the Asia-Pacific. Singapore has not only concluded agreements with Australia, New Zealand and the United States, but succeeded in concluding an FTA with Japan, which continued to put priority on the multilateral regime longer than most other countries in the region. Singapore is a particularly interesting case: The country has one of the most liberal trade regimes of all 148 WTO member countries. Since Singapore functions as a trading hub for the entire Southeast Asian region, tariffs and other restrictions on imports have traditionally been low. Consequently, very few economic benefits from the liberalisation of its import regime could have been expected. Whilst Singapore clearly has a motive to secure market access to, say, the American market, what rationale drove the United States? In the absence of significant tariffs, there could have been hardly any benefit from the liberalisation of bilateral trade in goods. Other factors, in particular trade in services, apparently played a more important role.

Thirdly, Thailand's initiatives are analysed. Thailand is – in a different way – as much a pioneer of bilateral trade agreements as Singapore. It has been taking advantage from an early harvest program under the ASEAN-China Free Trade agreement, and this measure has been implemented with astonishing swiftness. Thailand has concluded agreements with Australia, New Zealand and Japan and is currently negotiating an agreement with the United States. The latter two agreements show that free trade agreements can have a very protectionist dimension. They are – more often than not – preferential rather than free trade agreements.

Before examining those three country cases, I will briefly lay out the logic of bilateral trade agreements and some issues that have to be considered. In the next chapter, I will therefore discuss advantages and disadvantages of bilateral trade agreements. Are these agreements positional goods, i.e. do they loose utility if more and more countries implement them? All free trade agreements require rules and certificates of origin. Without a certificate of origin, no product qualifies for duty-free access in a bilateral free trade agreement. But what exactly are the consequences of rules and certificates of origin? These general reflections on bilateral free trade agreements will be followed by the three case studies Australia, Singapore and Thailand. In conclusion I will sum up the findings and make

recommendation for an improvement of the rules on bilateral agreements under the roof of the WTO.

2. The debatable logic of bilateral trade agreements

In the Asia-Pacific, the financial crisis of 1997 and 1998 continues to be a watershed. Since that crisis, the strategies for shaping external economic relations have changed, both in trade and in finance. Before 1997, the emphasis was on multilateral organisations, i.e. on the International Monetary Fund and on the World Trade Organisation. Today, two trends are emerging – monetary regionalism in finance and bilateralism in trade (Dieter/Higgott 2003), and the latter will be analysed in this article. In trade the change is more visible than in finance, where progress to date is somewhat limited (Dieter 2005: 302-317). By contrast, bilateral trade agreements are truly mushrooming in East Asia. For instance, China has already sealed or is currently negotiating free trade agreements with 25 countries – up from zero two years ago (The Wall Street Journal, 3 October 2005: 1).

Conventional regional integration, i.e. free trade areas and customs unions with more than two participating countries, is in decline in the region. APEC in particular is no longer exhibiting the dynamics of the early 1990s. APEC is too large to be effective, and it suffers from American dominance. By contrast, both bilateral trade agreements and the emerging monetary cooperation scheme in the Asia-Pacific are implemented without US participation. Notable exceptions are the Australian-American and the Singapore-US free trade agreement, both of which will be discussed later in this paper.

The current wave of bilateral and other preferential trade agreements is having severe repercussions for the WTO. In 2005, for the first time ever more trade will happen in preferential agreements than under the most-favoured-nation clause, the article one of the General Agreement on Tariffs and Trade.[1] The most-favoured-nation clause has degenerated into the least-favoured-nation clause, as the American trade economist Jagdish Bhagwati has been proclaiming (The Wall Street Journal, 18 January 2005:8.). The European Union has been the original culprit. Although the EU has not been implementing new free trade agreements in recent years, due to a number of initiatives, some of them overlapping, the EU has contributed to the undermining of the multilateral regime. As a result of the generalised system of preferences, the everything but arms initiative, and free

[1] Although the GATT Secretariat does no longer exist and has been replaced by the WTO, the GATT treaty – in its 1994 version – continues to be the legal basis of the multilateral trading regime. The General Agreement on Trade in Services (GATS) regulates services, including financial services.

trade agreements, the EU trades with just eight – out of 148 WTO member countries – under the most-favoured nation clause. These are the United States, Canada, Australia, Japan, New Zealand, Hong Kong, Singapore and South Korea (World Trade Organisation 2004: 21).

Today, there are more than 300 free trade agreements and a few customs unions either already implemented or being negotiated. Until a few years ago, the entire Asia-Pacific region was not contributing to this trend. Countries like Japan and South Korea were staunch supporters of the multilateral regime. This, however, has changed dramatically. Partly because there continues to be a momentum for bilateral agreements, partly because some countries in the region are using these agreements to fast-forward their economic and political position in the region, no country in the Asia-Pacific is willing to abstain from the current fashion.

Although the analysis of the systemic consequences of this trend, i.e. the consequences for the WTO, is not the main goal of this paper, we should consider them briefly. The traditional debate on this issue has been characterised by the stepping-stone or stumbling bloc argument. Bilateral or minilateral agreements could be either: Contributing to improvements of the multilateral regime or undermining it. Until today, it appears fair to say that the multilateral regime has received very little, if any, stimulus from bilateral agreements. They exist parallel to the WTO, and there are features of bilateral agreements that suggest that they undermine the multilateral order. For instance, many bilateral deals contain dispute settlement mechanisms outside the WTO. This feature of bilateral agreements would not be necessary, because dispute settlement could continue to be conducted in Geneva. The fact that this is not the case, in particular in agreements in which the USA participates, indicates that bilaterals are competing, not complementing the multilateral regime.

2.1. Bilateral trade agreements as positional goods

One aspect of bilateral trade agreements that has been somewhat overseen is the possibility that bilaterals are positional goods. Fred Hirsch has provided us with a definition: Positional goods are loosing their utility if others are using the same good. For instance, using a motor car has a higher utility when very few others are doing the same thing. If everybody drives a car, the utility of having a car declines sharply. Positional goods are

characterised by the irreproducibility of their value (Hirsch, Fred: Social Limits to Growth, Cambridge, Mass.: Harvard University Press 1976).

Bilateral trade agreements can also be positional goods. If all other countries rely on market access via the multilateral regime, then a bilateral free trade agreement could be beneficial, provided that market access is unrestricted in the bilateral agreement and is more restricted under WTO regulations. For instance, if Singapore were the only country that has successfully negotiated a free trade agreement with the United States, Singapore would have a benefit. If all other WTO member countries would also negotiate a similar free trade agreement with the US, there would not be any additional advantage from a bilateral trade agreement, whilst the disadvantages of free trade agreements would continue to exist. In other words: The more countries use bilateral agreements, the more limited is the utility of these. There continue to be advantages for early starters, but as other countries catch-up, the usefulness of bilateral agreements declines. Assuming a scenario in which all WTO member countries would have implemented a free trade agreement with the US, the utility of such an agreement – compared with the multilateral alternative – would not be large. Only if the United States would have a protectionist trade regime under WTO regulations and a significantly more open bilateral regime, would there be some continuing advantage.

However, a brief look at existing bilateral or regional agreements would induce the assumption that such a scenario is unlikely. For instance, there have been continuing quarrels between the US and Canada over the implementation of the NAFTA free trade agreement. Canada has frequently accused the US of protectionist policies in some sectors, most prominently in softwood lumber, but Canada was unable to secure free trade within NAFTA in specific areas.

Canada and the USA have been arguing over softwood lumber for decades. However, since 2001 the conflict has heated up. American producers of softwood lumber have argued that the fees collected by the Canadian national and provincial governments to harvest timber on publicly owned land fall below market rates and are therefore an illegal subsidy (Ikenson 2005: 1f). But at closer inspection, it appears fair to say that Canada has vast supply of forests and that the cultivation of these forests requires little – if any - investment. The availability of large areas of forests is Canada's comparative advantage.

All NAFTA and WTO dispute settlement panels that have examined the case have ruled that Canada's low stumpage fees cannot be considered a subsidy.[2]

The USA has collected a total of 5 billion dollars in duties from Canadian exporters. But Canadian producers have not contributed to the improvement of America's public finance. Under the Byrd Amendment of 2000 (the Continued Dumping and Subsidy Offset Act), these sums have been distributed to American softwood lumber producers. Canada has won several victories in NAFTA dispute settlement panels, but despite having exhausted its appeals under NAFTA, United States authorities have proclaimed that they will neither repeal nor refund the duties (Ikenson 2005: 1). Canadian politicians are infuriated. Prime Minister Paul Martin has branded the US position as nonsense and has called the approach a breach of faith. On 6 October 2005, he demanded the refund of the duties (Ikenson 2005: 1). However, some American politicians are not concerned by either the NAFTA dispute settlement or by Prime Minister Martin's claim. In a letter to Commerce Secretary Carlos Gutierrez on 20 October, 21 Senators have called for the preservation of the duties. They argued that "N AFTA panel decisions cannot and should not force the Department to deny legitimate relief under U.S. law to the domestic lumber industry and its workers" (quoted in Ikenson 2005: 5).

The Canadian-American clash on softwood lumber highlights the importance of multilateral dispute settlement. Prior to the creation of the WTO in 1995, dispute settlement could be blocked by the party accused of an illegitimate policy. This has changed. Today, the WTO is one of the few multilateral organisations where small countries can take the EU or the USA to court and have a fair chance of receiving justice, if after some years. No party can bloc the dispute settlement mechanism of the WTO. The implementation of the dispute settlement mechanism in the WTO was not only a milestone for the creation of a rules-based system of international trade, but can at the same time be interpreted as one of the few building blocs for global governance. If anything, an expansion of the WTO's mandate could be considered a useful step.

By contrast, transferring dispute settlement to the bilateral level is a deterioration. In many bilateral schemes, there is an option – either bilateral dispute settlement or multilateral dispute settlement. It is obvious that the bilateral route offers many possibilities for the more powerful partners to promote their case. Hierarchy and power – never fully absent in

[2] Canada has challenged different aspects of the lumber case in the NAFTA and in the WTO dispute settlement mechanisms.

international trade – have a more prominent role in bilateral trade agreements than in the multilateral regime. The existence of an alternative to the WTO dispute settlement mechanism provides the more powerful countries with an additional choice, but for weaker countries this is a drawback. In NAFTA, the dispute settlement mechanism is even stricter than the one in the WTO because it provides the equivalent of domestic judicial review – in theory. In the WTO, the country that wins a dispute can only retaliate by imposing duties – which affect its own consumers negatively. In NAFTA, Canada can ask for the repayment of duties, but since the US government does not pay, the weaker partner has no more policy options apart from terminating the FTA – an unrealistic option for Canada.

Another disadvantage of free trade agreements that will not disappear over time is the administrative burden that rules of origin cause. Even if there is no significant utility of bilateral free trade agreements because of widespread implementation of these treaties, these disadvantages will remain.

2.2. Cumbersome rules of origin: New non-tariff barriers to international trade?

In an entirely open world economy with no restrictions on the flow of goods, rules of origin would not matter because it would be irrelevant where goods originate. Today, however, the origin of a product matters, in particular in preferential agreements. All free trade areas including bilaterals require rules of origin to establish the "nationality" of a product. The reason is that in FTAs participating countries continue to have diverging external tariffs. One country might have a high tariff on, say, cars in order to protect domestic producers, whilst the other might have a low or no tariff on that product. Since only goods produced within the free trade area qualify for duty free trade, there have to be procedures that differentiate between goods produced with the FTA and goods from the rest of the world. The preferential system becomes complicated. And expensive: On average, the cost of issuing and administering certificates of origin is estimated to be five percent of the value of a product (Dieter 2004).

In the past 40 years, the use of rules of origin have changed significantly. After decolonisation, many developing countries used rules of origin as instruments to enhance their economic development. Rules of origin were used to increase the local content of manufactured products and to protect the infant industries in those economies against foreign protection. This function of rules of origin is of minor importance today. Rather, developed countries use strict rules of origin to protect their aging domestic industries.

When criticising the negative consequences of rules of origin, there is a caveat. By paying the appropriate tariff, they can be easily overcome. Since peak tariffs continue to cause difficulties in some sectors, the protectionist effect of rules of origin should nevertheless not be underestimated.

2.2.1. Methods for establishing origin

First, it is important to understand that there are two categories of certificates of origin, non-preferential and preferential ones. The former are used to differentiate between foreign and domestic products, for instance for statistical purposes, for anti-dumping or counterveilling duties or for the application of labelling or marketing requirements (Jakob and Fiebinger 2003: 138). The second type is the one that can distort trade because it provides preferential access to a market.

To begin with, customs regulations do not permit multiple origin of a product. Current customs regulations require that a single country of origin is established (Jakob and Fiebinger 2003: 138). There are four methods to establish the "nationality" of a product, to establish origin. There is natural origin and origin due to substantial transformation, this category being subdivided into three other forms: a change in the tariff heading, a minimum percentage of value added and specific production processes (Estvadeordal and Suominen 2003). Natural origin (wholly produced or obtained) is the least complicated approach. This applies to raw materials and agricultural products, i.e. to a relatively small part of international trade.

A change of tariff heading is already much more complicated. The Harmonized System (HS) is a set of regulations that has been agreed upon in the World Customs Organisation (WCO). It consists of 1241 categories on the four-digit level and more than 5000 categories on the six-digit level. If a product receives a different tariff heading after the production process, this can be used to qualify for origin. This method has considerable advantages. It is both transparent and easily established. Using the Harmonized System is simple, easy to implement and causing relatively little cost. The necessary documentation is undemanding. The trouble is that a change of tariff heading does not necessarily constitute a significant step in the production process. Minor changes to a product can lead to a change of tariff heading. Furthermore, if a final product consists of a large number of components, documenting origin becomes complicated, and therefore costly (Woolcock

1996: 200). Therefore, purely requiring a change of tariff heading to establish origin is the exception in FTAs.

The minimum value-added rule is probably the most complicated method to establish origin. Incidentally, it is also the most widely used scheme. A certain percentage of the value of the product has to be produced within the FTA to qualify for duty free trade. For instance, in the ASEAN Free Trade Area (AFTA) there is a minimum requirement of 40 percent of the value (free on board) of a product. Conversely, it is also possible to set a ceiling for maximum input sourced from outside the FTA.

The calculation of minimum value added is difficult and varies between different free trade areas. It also varies between product categories. For instance, in NAFTA there is a minimum content requirement of between 50 and 62.5 percent. Furthermore, technical details have to be considered. Which methods to calculate local content are accepted? For instance, are capital costs counted as local content? [3] If yes, up to which percentage? In FTAs between developing and developed countries, the lower wages in the poorer countries ironically result in a disadvantage, because the minimum value added can be reached more easily if wages are higher.

In AFTA, complicated rules of origin have resulted in less trade facilitation than expected. Furthermore, there have been bitter disputes between ASEAN countries over the implementation and interpretation of rules of origin, plus problems in day-to-day customs routine s:

> In the absence of clear and unambiguous rules, even the best intentions and the skills of an experienced customs officer get frustrated by rules that are inadequate to regulate the intra-industry trade flows of the fastest growing trade region of the world *(Inama 2005: 571f).*[4]

Other free trade agreements have demonstrated how complex rules of origin can be. The NAFTA rules of origin cover more than 200 pages. There are byzantine regulations on local content, for instance a 62.5 percent local content requirement for motor cars (for more details Dieter 2004).

Rules of origin are particularly cumbersome for a country like Singapore. Certain stages of production are outsourced to production sites elsewhere in the region. Consequently, the need for certificates of origin can be a problem. Take, for example, the FTA between

[3] In NAFTA, the cost of capital for machinery can be included (Krueger 1995: 8).
[4] Similar regulations will be used in the ASEAN-China free trade agreement (Tongzon 2005: 193).

Singapore and EFTA. The rules of origin agreed upon in this FTA are knotty. They may be several rules for each product. Depending on the good, the specific local content requirement ranges from 40 to 80 percent (Low 2003: 8). Nevertheless, FTA aficionados claim that these rules of origin "take into consideration current and future production trends in Singapore" (Low 2003: 7). Even the documentation of origin is considered to be "bearing in mind ease of implementation and being trade facilitating" (Low 2003: 8). For producers, these rules of origin result in an additional administrative effort rather than a facilitation of trade.

2.2.2. The cumulation of origin

One of the most important issues for competitiveness is the question of whether the cumulation of origin from different FTAs is possible. Cumulation of origin is an important exception from the principle of giving preference only to products produced within an FTA (Jakob and Fiebinger 2003: 144). The underlying question is whether overlapping FTAs inputs can be sourced from various member countries and still achieve origin?

The European Union has been actively promoting free trade areas both with other European as well as with non-European countries. This has resulted in complicated rules of origin that potentially harm transnational production processes and could reduce the competitiveness of European manufacturers. In Europe, this awareness has led to the Paneuropean cumulation of origin. In 1997, PANEURO was established, which permits the cumulation of origin between the free trade areas of the EU and the European Free Trade Area (EFTA). PANEURO today covers as many as 50 FTAs (Estevadeordal and Suominen 2003: 16).

What is the cumulation of origin? Bilateral cumulation is the conventional version: It permits the use of intermediate products coming from the other country in an FTA. Diagonal cumulation permits the use of intermediate products from all countries that are participating in the cumulation scheme without risking origin. Diagonal cumulation can also be called the cumulation of origin between free trade areas. Full cumulation of origin is more comprehensive still, because it allows the use of intermediate products from all countries, but this type of cumulation is rare in customs administration (Estevadeordal and Suominen 2003: 5; Priess and Pethke 1997: 782). Full cumulation would dilute any preferential arrangements, because from wherever an input would be sourced, this would count as an input from within the free trade area.

In Europe, PANEURO means that a television set assembled in Belgium using inputs from Poland, Switzerland and Turkey will have EU origin and can therefore be traded duty-free between, for example, the EU and the EFTA (Dieter 2004: 289). Outside Europe, hitherto there are only limited attempts to permit the diagonal cumulation of origin. To date, there are some early attempts in South-East Asia. But the rapid increase of bilateral and plurilateral free trade agreements in the region calls for a Pacific-wide diagonal cumulation of origin, if increasing welfare indeed is the main goal of the free trade agreements.

For companies in Asia, this poses a challenge of increasing relevance. Transnational production requires the sourcing of inputs from the cheapest producer worldwide. If bilateral FTAs result in the limitation of inputs from these two countries, the consequence is potentially a welfare-reducing diversion of trade. Take the FTA between Singapore and the USA. If a manufacturer in Singapore will have to use intermediate products from either Singapore or the USA to achieve origin, but the cheapest provider of inputs comes from, say, Thailand, this would be trade diversion. To use another example: Australian clothing manufacturers that used to source their fibre and cloth from Asian producers may switch to more expensive American producers in order to qualify for duty free access to the USA. Rather than using the cheapest supplier worldwide, the cheapest supplier from within the free trade area is used. In other words: Trade is diverted, which results in – following conventional trade economics – a welfare reduction.

Since this rationality has to be applied for each and every individual bilateral free trade area, it is obvious that this situation undermines the competitiveness of producers in a region where free trade agreements are mushrooming. Rather than working towards the increase of efficiency, companies get preoccupied with achieving origin – a waste of time and resources.

Finally, specific production processes can be identified and agreed upon in order to establish origin. The trouble is that this method both requires complex negotiations on agreed production processes and continuous updating. Due to the changing patterns of production, new forms of production emerge that would constitute substantial transformation, but unless they are listed in the catalogue of agreed production processes, they would not qualify for duty free trade.

Rules of origin and their application have to be taken into consideration when evaluating the usefulness of free trade areas. They make transnational production processes more

complicated, if not impossible. The inherent need for documentation of the production process is resulting in additional bureaucratic procedures. They may contribute to trade diversion, because manufacturers may use the cheapest supplier from within the free trade area rather than the cheapest supplier.

Rules of origin, indispensable parts of free trade agreements, do not contribute to trade facilitation. Rather, they can be used as protectionist devices (see Dieter 2004 for a detailed discussion). In particular, badly designed rules of origin can create barriers to intra-industry trade (Inama 2005: 577). Of course, there is considerable variation between free trade agreements with regard to the stringency of their rules of origin. But even when generous limits for establishing origin are chosen, the complex administration remains. Clearly, companies that are unwilling to meet the requirements of rules of origin can always opt out and simply pay the appropriate tariff, which in turn would reduce the utility of the free trade agreement to zero.

3. The limited utility of the Australia-US Free Trade Agreement (AUSFTA)

The Australian-American Free Trade Agreement was signed in February 2004. In 2003, Australia had been supporting the US invasion in Iraq, and Prime Minister John Howard seemingly wanted to benefit from the backing he had provided to George W. Bush' s government. Australia got a free trade agreement, but surprisingly the deal is asymmetric in favour of America, not Australia. Rather than benefiting from the good political relationship between the two conservative governments, Australia got a lopsided deal. The richer country, the USA, got superior access to the Australian market, whilst Canberra accepted some important restrictions.

In previous years, the United States had approached Australia twice before with the proposal to establish a free trade area (Weiss et al. 2004: 6). In 1997, today's Prime Minister John Howard rejected an offer by the Clinton government, citing the unwillingness of the USA to open its markets for sugar, dairy products and ferries as reasons (Capling 2004: 7f). The Howard government emphasised the importance of the multilateral regime for a small, relatively open economy such as Australia's. In a white paper on Australia's foreign policy, aptly named 'In the National Interest', the government of John Howard criticised preferential trade agreements in 1997 openly.

> Of particular concern is the potential fragmentation of the non-discriminatory trading system which could arise from discriminatory arrangements … The government will also

> seek to make the multilateral system … move faster to reduce the incentive for discriminatory regional solutions to market access *(Australian Government 1997: 42).*

The same government that saw the dangers arising from preferential trade arrangements in 1997 pushed such an agreement in 2004. Australia, the first OECD-country to form a free trade area with the USA outside the American continent, has embraced bilateralism since 2000. In contrast to the previous approach, Australia is moving fast to create a dense network of bilateral arrangements, inter alia with China, Japan and the ASEAN countries. The explanation given by the Howard government in 2003 stresses the advantages of bilateralism.

> The Government is determined to pursue pragmatically the advantages the free trade agreements offer to Australia. Such agreements can deliver important market access gains faster than a multilateral round … The free trade agreements that the Government negotiates will be comprehensive, not leaving out areas that our partners might find difficult, such as agriculture *(Australian Government 2003: 58-59).*

Evidently, John Howard's government did not initiate the policy with regard to bilateral trade arrangements, but it did not oppose the about turn on bilateralism either. In contrast to most other bilateral trade agreements, there has been a substantial debate in the Australian public on the merits and disadvantages of the bilateral deal with the US. Some prominent Australian economists, namely Ross Garnaut, former advisor to the Hawke and Keating governments and an economist at the Australian National University, denounced the agreement as "not passing the laugh test". Even the negotiating team itself was surprised by the deal the American government was suggesting.

> Australia's trade negotiators knew how difficult a negotiation with the United States would be, but even they were shocked at the lousy deal Washington offered Australia. Yet their recommendation that the deal not to be signed was overridden by the prime minister, who clearly was of the view that a bad dealwas better than no deal at all *(Capling 2004: 73).*

Against this background, several questions have to be asked. First, is the agreement as bad as its critics suggest? Second, what might have been the motives of the Howard government to agree to this deal? Third, is this new strategy providing Australia with the appropriate trade regime for the 21st century? In particular, are bilateral deals enabling Australian companies to intensify their integration into the Asian markets?

Some Australian observers, namely Linda Weiss et al., have argued that the agreement is "killing the country" (Weiss et al. 2004). These authors argue that the agreement does not contribute to free trade, puts Australia at a disadvantage and even endangers a cornerstone of Australia's social security system, the so-called Pharmaceutical Benefit Scheme (PBS).

Others, like Ann Capling, have been very critical of the contract without using a language as drastic as that of Weiss et al. But are there substantial shortcomings? In February 2004, the Australian trade delegation came to that conclusion. They wanted to walk away from the negotiating table in Washington. Apparently, it was John Howard solitary decision to sign the agreement in its current form. He probably expected reciprocal mateship from George Bush, and once the negotiations had reached quite an advanced stage, Prime Minister Howard did apparently not want to cancel the deal – just a few months before a federal election.

It is interesting to consider the developments in the last days before the deal was struck. Australian politicians had publicly raised the expectation that agricultural products, including sugar, would be freely tradable under the FTA. As it became clear that the US government was unwilling to grant market access in that segment, the Australian trade negotiators wanted to walk away from the negotiating table. On 7 February 2004, Mark Vaile, the Australian Minister for Trade, called Prime Minister Howard and suggested not to sign the deal. Howard single-handedly overruled, and the following day Mark Vaile and Robert Zoellick, the then US Trade Representative, signed the Australia-United States Free Trade Agreement (Capling 2004: 56; and personal communication in Canberra).

The proximity of the election and the negotiations partly explains why the deal was struck. The agreement did not receive much support from the Labor Party, which is not surprising when considering the weaknesses of the deal. Howard used any move of the Labor Party against the agreement as evidence of Labor's Anti-Americanism as well as Labor's inability to consider Australia's future prosperity. Furthermore, Howard argued that Labor would be an unreliable partner of the US (Capling 2004: 74). Whether or not the FTA played an important role in the 2004 elections is difficult to say, but it certainly did not cause a shift of the voters away from John Howard's government.

The disadvantages for Australia are most visible in agriculture. Sugar, which can be produced competitively in Australia's tropical regions, is excluded from imports into the United States, apart from a quota of 87,402 tons per year which existed before the FTA. For beef and dairy products there are surprisingly long transitional periods of up to 18 years before Australian producers will have unrestricted access to the American market.

Table 1: Some asymmetries in the Australian-American Free Trade Agreement

Consequences for Australian Producers	Consequences for American Producers
Agriculture: Tariffs, quotas and seasonal restrictions remain, tariffs continue to exist for wool (10 years), wine (11 years), dairy products, beef, cotton and cut flowers (18 years, conditions for application required) Sugar continues to be excluded from free trade indefinitely	Agriculture: No restrictions for imports from the USA from the day the treaty becomes effective, no seasonal restrictions, sugar imports unrestricted
Manufacturing: In general, no restrictions on exports to the USA, but the same rules of origin apply, which are more difficult to comply with for Australian manufacturers Restrictions on the use of Australian-made ferries in the US continue: Jones Act of 1920 requires the use of American-made ferries for national shipping (passengers and freight) Cancellation of all "Buy Australian" campaigns Exceptions for small companies (less than 200 employees)	Rules of origin more easily comply with due to larger supplier base Public procurement may contain minimum US-content requirement Exceptions for small companies (less than 1500 employees)
Consular Affairs: Australian citizens have no right to be granted a US visa if that is necessary for foreign direct investment	Consular Affairs: American citizens have the automatic right to be granted an Australian visa if that is necessary for foreign direct investment

Source: Weiss et al. 2004: 7-13.

Australian trade negotiators apparently were unable to open up the US market for sugar. The Australian Government, which had campaigned for the free trade agreement citing agriculture as a potential benefit for Australia, subsequently had to provide compensation to the domestic sugar producers that will receive 444 million Australian dollars, a rather hefty sum of 70,000 Australian dollars for each of the 6,500 sugar farmers in Australia (Capling 2004: 67; Weiss et al. 2004: 147).

Equally problematic is the deal on beef. The US can stop Australian imports if American farmers are threatened by this competition. For more than 30 years, Australia fought a

similar approach of the European Union, only to accept it now in the case of the United States (Capling 2004: 82). Both the exclusion of sugar and the arbitrary regulation of beef imports are violations of the principles that Australian governments had been publicly supporting for decades.

Regarding ferries, the United States continues to apply the Jones Act of 1920. This act requires that all vessels used for shipping between two US ports have to be built in the United States. Australia, which has developed a competitive industry for fast ferries, does not benefit from free trade in this sector. The irony is that Australian-made fast ferries may be imported duty-free into the US, but they may not be used, either for the transportation of goods nor of people.[5]

The rules of origin in the AUSFTA are as complex as those in many other FTAs. In principle, a combination of methods is used. For products that require a minimum local content the thresholds are 35 percent (build-up method), 45 percent (built-down approach) and for cars the threshold is 50 percent, the only method being the so-called net cost method.[6] The only cumulation of origin that is permitted is the bilateral variety, i.e. inputs must be sourced from either Australia or the US to qualify for duty free treatment. For textiles, there are separate regulations. The complexity of the rules of origin in AUSFTA does not differ from NAFTA or other agreements with US participation. Rather than facilitating trade, these measures are making trade more complicated. Even if there is some reduction of costs due to lower tariffs, this cost-saving is probably more than compensated for by an increase in administrative expenses.

For years, American governments have complained about the Australian regulations on quarantine. The authorities in Australia have been very restrictive with the import of fruit, vegetables and meat because of the fear of an import of diseases. For instance, foot and mouth disease does not yet exist in Australia. Agricultural authorities are trying to prevent the importation of the disease, which affects most animals that are commercially held in Australia.[7] The USA had – without success – tried to weaken the Australian regime by having them evaluating by the WTO, which declared them in conformity with WTO regulations (Weiss et al. 2004: 34). With the introduction of the bilateral FTA, new

[5] During the weeks following hurricane Katrina, President Bush suspended the Jones ACT to permit the use of Mexican and Canadian fuel tankers for coastal shipping in the USA.
[6] For details see the agreement and explanations at http://www.dfat.gov.au/trade/negotiations/us_fta/guide/5.htm.
[7] These are mainly pigs, cattle and sheep. For further information on import restrictions see the website of the NSW Department of Primary Industries at http://www.agric.nsw.gov.au/reader/6543.

institutions have been created. Sanitary and phytosanitary measures will be negotiated in either the "Australia-US Committee on Sanitary and Phytosanitary Matters" or the "Australia-US Standing Technical Working Group on Animal and Plant Health Measures". All bilateral conflicts are supposed to be dealt with in these two groups. The conventional procedures will be that the Committee will ask the Working Group to provide a consensual solution to the conflict within 60 days. From the Australian perspective, there has not been any reason to introduce these two fora that exist parallel to the WTO procedures (Weiss et al. 2004: 55f).

Elements of the bilateral agreement that received a lot of attention in the Australian debate have been the regulations on the Pharmaceutical Benefit Scheme (PBS). For many Australians, this is a model health care institution that provides low-cost access to most important medicines. For American pharmaceutical companies, PBS is a trade barrier. The scheme was founded in 1953 and subsidises medication that has been listed in a catalogue, which in turn had been agreed upon by a group of medical advisors, the Pharmaceutical Benefits Advisory Committee (PBAC). In 2004, some 2,500 medications were available under PBS, and the Australian Federal Government has provided subsidies to PBS in the order of 6.2 billion Australian dollars in that year. PBS could be described as a wholesaler and negotiates directly with pharmaceutical companies. It also selects the drugs that receive a government subsidy. Other medication, i.e. which is not on the list, can be sold in Australia, but without the subsidy component (Weiss et al. 2004: 60).

The PBS is now directly attackable by American Pharmaceutical companies that do not agree with the decisions of the advisory committee. The "Medicines Working Group", agreed upon under the free trade agreement, can review the decisions of PBAC. This new avenue for dispute settlement reduces the independence of the health policy of the Australian government.

Weiss et al. have pointed out that the bilateral free trade agreement is a combination of two different treaties: The first is a trade agreement, characterised by many exceptions. The second is an agreement on investment and intellectual property, in which the Australian side has more or less acceded to American regulations on intellectual property (Weiss et al. 2004: 116).

Intellectual property rights are covered in Chapter 17 of the Australia-US Free Trade Agreement (AUSFTA). The provisions of the agreement are rather complex and cover 29

pages. Kim Weatherall has described them as "breathtakingly long, detailed, and opaque" (Weatherall 2004: 19). The reason for this convoluted deal is not that intellectual property was previously badly protected in Australia. Rather, the USA has been unsuccessful with attempts to raise intellectual property rights through the WTO. Faced with opposition there, as well as in other multilateral fora dealing with intellectual property like UNESCO, the US has gone bilateral.[8] It has moved to impose its preferred standards through a template approach – the chapter on intellectual property is negotiated according to a template used in previous agreements, with the same provisions in all of them (Weatherall 2004: 19).

The downside of the new standards agreed upon with the US is that the regime has become more complicated. Further, adopting US standards implies adopting an important element of US economic policy, which may not suit the interests of Australia. The tightening of intellectual property rights in Australia, which is a net importer of intellectual property, is resulting in additional cost to Australian consumers and producers alike (Weatherall 2004: 20).[9] America, by contrast, benefits. There will not be significant additional costs to American consumers, but American innovators selling their products abroad will reap the reward.

The copyright term has also been extended, resulting in a copyright term of life of the author plus 70 years. This innovation, pushed by the EU in 1998 and subsequently adopted by the US, is applicable to new and old literature. It does not create new incentives, because, as Kim Weatherall observes, 'dead men do not write poetry' (Weatherall 2004: 22). Again, as Australia is also a net importer in literature, this is an additional cost to Australia.

As mentioned in the introduction, one of the most disturbing aspects of bilateral trade agreements is that they contribute to a weakening of the dispute settlement mechanism of the WTO. This applies to AUSFTA as well. Article 21.4 stipulates the following.

> 1) Where a dispute regarding any matter arises under this Agreement and under another trade agreement to which both Parties are party, including the WTO Agreement, the complaining Party may select the forum in which to settle the dispute.

[8] See, for instance, the speech of the US ambassador to UNESCO, Louise V. Oliver, on 17 October, 2005, on the convention of UNESCO on Cultural Diversity, in the web at http://www.amb-usa.fr/USUNESCO/texts/GenConf33_Amb_Intervention_CD_Amendments.pdf.

[9] In 2002-2003, Australia has spent 1.82 million Australian dollars on royalties, but has only received $ 618 million from abroad (Weatherall 2004: 20).

> 2) Once the complaining Party has requested a panel under an agreement referred to in paragraph 1, the forum selected shall be used to the exclusion of the others *(Australia-United States Free Trade Agreement, Article 21.4).*

The consequences are far-reaching. There is a possibility to use the bilateral dispute settlement even for cases that affect the participation of the two countries in the multilateral regime. Although the weaker country has a choice of forum, in practice there will be considerable pressure by the more powerful country to use the bilateral mechanism. If this were not the case, it is hard to understand why the choice of dispute settlement has been suggested in the first place. Weaker countries do not have a motive to provide a choice between bilateral and multilateral, for it is those countries that benefit most from a rules-based multilateral dispute settlement mechanism.

One of the most damaging aspects of the free trade agreement is that it has dramatically reduced Australia's credibility in multilateral negotiations. From the beginning of the 20th century up to 1983, Australia was one of the most protectionist countries in the West, but that trade policy clearly was no longer sustainable. Change had become inevitable. At the time, there were comments that Australia had shown the "death-bed repentance of a tariff junkie" (Dieter 1990).[10] However, since 1983 Australian governments, notably those led by Bob Hawke from 1983 to 1991, showed a commitment to bring tariffs down substantially. Simultaneously, Australia increased its efforts to promote free trade in agriculture. In 1986, Australia and 13 other competitive producers of agricultural products, e.g. Brazil and Canada, founded the Cairns Group. Ever since, this group has been able to increase awareness for the negative consequences of protectionism in agriculture (Capling 2004: 23). But the Australian-American preferential trade agreement has resulted in severe damage for Australia's integrity. After all, if American protectionism with regard to sugar is acceptable to Australia, what is wrong with Japanese protectionism in rice or European protectionism in cheese?

One case in which the credibility and strength of the Australian bargaining position will be tested is the envisaged trade agreement with China. In March 2005, the Australian Minister for Trade, Mark Vaile, warned "China to bring agriculture to the bargaining table" (Sydney Morning Herald, 8 March 2005). In this context, one might argue that Australia could be pleasantly surprised by China's willingness to liberalise trade comprehensively. As the Wall Street Journal pointed out, the free trade agreement between China and ASEAN will eliminate tariffs on fruits and vegetables by 2010 (Wall Street Journal, 3 October 2005: 1).

[10] For instance, the tariff on motor cars was as high as 57.5 percent.

ASEAN has some competitive producers of agricultural goods, and China may be willing to open up its market more than some Australian observers assume.

By and large, it is quite unlikely that Australian companies will benefit from bilateral trade agreements with other countries in the region, namely with China and Japan. For decades, despite substantial liberalisation efforts, the weakness of Australian manufacturing has not been reduced. It is hard to envisage the emergence of Australia as a manufacturing centre for Asian and world markets due to, say, a free trade agreement with China. Today, manufactured products constitute only 25 percent of Australian exports, and that category of exports tends to be liberalised in FTAs. Raw materials, the largest component of Australian exports, have usually not been affected by import tariffs, and thus nothing will change in free trade areas.

The situation might be somewhat different in services, a sector in which Australian financial companies are competitive and can probably benefit significantly from free trade. This would be particularly the case if Australia and ASEAN would agree on comprehensive free trade in goods as well as in services. However, some ASEAN countries, e.g. Thailand, are unwilling to open their financial sectors to foreign competition after the devastating experiences of the Asian crisis.

It has been demonstrated that the Australian government has made a remarkable policy shift between 1997 and 2003. However, the earlier approach continues to be more convincing. Australia, an exporter of raw materials and agricultural products, cannot benefit very much from free trade in manufactured products unless dynamic effects would lead to an increase in competitiveness of Australian manufacturers. The country would benefit from free trade in agriculture, but the agreement with the USA has set an unfavourable precedent for other FTAs. Linda Weiss et al. consider Australia to be betrayed in the agreement. They argue that the two partners have been negotiating on the basis of diverging norms and values.

> Our misguided faith in our friendship with the USA, however, is not only symbolic of our naivety. It also reveals the yawning gulf between Australian values and those of our trading partners *(Weiss et al. 2004: 145).*

Although this view – portraying Australia as an honest player in international affairs – is rather popular in the country, the reality has been rather different. Benign Australian attitudes have not always been important in recent times. East Timor, which only secured independence in 2002, has been suffering from Australia's rather malign behaviour in a

dispute over oil and gas revenues. Australia had been supporting East Timor's independence and was the leading country in the multilateral force that oversaw East Timor's transition to independence. But once that independence was achieved, Australia disputed East Timor's claim on some lucrative oil and gas fields. According to the UN's Law of the Sea, East Timor rather than Australia would be entitled to receive most of the revenue from the so called Timor Gap. But in 2002, the year of East Timor's independence, the Howard government withdrew from the Law of the Sea convention, and recognised a boundary that had been defined between Australia and Indonesia in 1972 (The Economist, 15th March 2003: 61). Foreign Minister Alexander Downer criticised East Timor's ungratefulness and was surprised by the claims "when you consider all we've done for East Timor" (The Economist, 5th June 2003: 52). In the region, however, the perception was different. To many observers in the Asia-Pacific, a large country was strong-arming a small impoverished neighbouring state. The Australian policy was not exactly perceived as a "fair go" (Far Eastern Economic Review, 8th July 2004: 42). In 2005, the matter was settled consensually, giving East Timor a reasonable share of the revenues. Nevertheless, this incident has damaged Australia's reputation in international economic affairs.

This is rather unfortunate, because Australia cannot bully too many countries around and depends on the rule of law in international relations. Australia is a country that is not closely affiliated with any large bloc. Consequently, the country vitally depends on a functioning multilateral trading regime. Of course, if one concludes that the multilateral regime is already collapsing, then bilateral trade agreements would offer a second best solution. Australia is certainly not the main culprit, but the country's trade policy shift has contributed to a disturbing trend. Further, the limited resources that the Australian government – and most others – can provide for trade negotiations have an effect on the country's ability to push multilateral negotiations. It is an illusion to assume that both approaches can be pursued with equal vigour.

With the FTA with America, Australia does not enjoy the best of both worlds. The bilateral agreement shows very few benefits for Australian companies, but it has damaged the reputation of the country in international groupings. The Cairns Group is now very weak and major players within that organisation, Brazil in particular, are today using other fora to promote their cases, e.g. the G-21 founded during the failed WTO ministerial round in

Cancún. Bilateral trade agreements in general and the deal with the United States in particular are not in Australia's national interest.

4. Singapore's trade policy revisited

Singapore has been the most active proponent of bilateral free trade agreements in the entire Asia-Pacific region. The country, a founding member of ASEAN, has been implementing a three-tiered trade policy in recent years: bilateral, regional and multilateral. Singapore's bilateral free trade agreements have been presented as new generation, WTO-plus agreements. The scope of these agreements is more comprehensive than the approach of ASEAN. However, the traditional attempts to liberalise trade and investment in South East Asia have only shown modest improvements (Inama 2005: 561). Therefore, the question is why an approach that has not generated much progress at a plurilateral level, i.e. the ASEAN group, is expected to perform so much better bilaterally.

Margaret Liang has suggested that bilateral agreements have advantages that are quite universal. Firstly, she argues that FTAs provide impetus to multilateral liberalisation, because FTAs allow countries to identify compatible partners with whom to implement faster and more comprehensive liberalisation. This, in turn, would work as a catalyst for multilateral trade liberalisation. Secondly, FTAs could be used as scapegoats in domestic policy processes. Resistance to reform is supposed to be overcome more easily if external pressure – by the other country in the FTA – is portrayed as a necessary condition for the conclusion of an agreement. Thirdly, the competitiveness of businesses is believed to benefit because of improved market access (Liang 2005: 57f).

Considered in turn, none of these perceived advantages withstands scrutiny. The positive impetus of FTAs for the further development of the WTO is yet to be noticed. Rather, the Doha Round suffers from a lack of determination of WTO member countries because an alternative – bilateral agreements – exists. Using bilateral agreements as a scapegoat for reform processes that would otherwise not be accepted by democratic society is a risky strategy. Indeed, a deterioration of economic development could then be blamed on bilateral agreements. As we have experienced in Europe, some governments have been so successful in using the European integration process as a scapegoat that in those countries Europe has become a label for all sorts of evils. Thirdly, market access due to bilateral agreements is always somewhat limited. Regional or global improvements of market access are superior.

Table 2: Singapore's Bilateral Free Trade Agreements

In force/ratified (date implemented)	Negotiations (year started)
New Zealand (January 2001) Japan (30 November 2002)	Mexico (2000) Canada (2001)
EFTA (1 January 2003)	Pakistan (2004)
Australia (28 July 2003)	Feasibility studies and/or negotiations with Bahrain, Egypt, Panama, Sri Lanka, Peru, Taiwan, United Arab Emirates, Qatar, Kuwait
USA (January 2004)	
Jordan (16 June 2004- conclusion of negotiations)	
India (29 June 2005 – deal signed)	
Trans-Pacific (Brunei/New Zealand/Chile) (3 June 2005 – deal signed)	
South Korea (4 August 2005 - deal signed)	

Source: The Government of Singapore's website on FTAs, in the web http://app.fta.gov.sg/asp/index.asp.

Linda Low praised Singapore's departure from the joint ASEAN approach and has suggested that the country has been embracing a strategy well-suited for the 21st century.

> Singapore has made no apologies with the fast and furious pace and ambition of its bilateral FTAs. It meant to stir ASEAN lethargy, especially since the Asian crisis, even circumvent mismanagement at the WTO multilateral level which is as painfully slow and bogged down and take Singapore into the new millennium economy (Low 2003: 2).[11]

This statement probably expresses the atmosphere in Singapore's policy-making circles quite well. ASEAN had failed in the Asian crisis and therefore lost some of its appeal. The strategy of Singapore apparently is to complete many bilateral arrangements and to become a hub for the region. Margaret Liang, who was Singapore's Deputy Permanent Representative to the WTO from 1998 to 2002, has suggested that Singapore's trade policy

[11] Liang has argued similarly and thus provided an example of the extremely positive expectations prevailing amongst trade policy makers in Singapore: "This web of interlocking economic and strategic interests help(s) contribute to regional stability, security, and prosperity" (Liang 2005: 58).

aims at "expanding its economic and political space" (Liang 2005: 53). Beyond the rhetoric, both dimensions are hardly promoted by bilateralism. The case is evident in the political domain, where bilateralism results in a departure form regionalism and consequently a reduction of the political space in which Singapore operates. Rather than building on deepening the integration in the ASEAN group, Singapore has decided to go alone, which deprives the country of the additional backing of the other ASEAN countries. The economic benefits are similarly ambiguous. Bilateral agreements, even if they go beyond a preferential trade agreement, at best result in the deepening of the bilateral economic space. A regional approach, i.e. the development of regional regulation and a regional common market is evidently the superior concept.

Prime Minister Goh said in 2002 that through its FTAs, Singapore wanted "to be the pathfinder" for the region (Daquila and Huy 2003: 919). The trouble is that the region did not ask for a (self-declared) pathfinder. Enthusiasts of Singapore's bilateral approach are nevertheless unapologetic about the policy shift.

> In tune with the business community interests and market forces, Singapore adopts a multi-pronged approach in advancing trade interests through the multilateral, regional trade for a and FTA linkages with its key overseas markets *(Low 2003: 3)*.

The strategy of Singapore is to seek as many bilateral arrangements as possible in order to become a hub for the region. Singapore does not only want to liberalise its own trading relations, but the expectation is that it can transform its previous status as an entrepot trader. This concept is not received too well by Singapore's ASEAN partners, because there is in inherent hierarchy in Singapore's concept.

> Singapore … seeks to forge as many bilateral trade arrangements as possible in an effort to maximise gains from freer trade by becoming a 'hub' country regardless of criticisms from other ASEAN member nations for violating its unanimous and collective approach to non-members. Other ASEAN members do not seem to be satisfied with the limited gains from freer trade as a 'spoke' country. They appear not to want to open their markets unilaterally to non-members who are indirectly coming form the hub country *(Lee and Park 2005: 23f)*.

This reluctance of Singapore's neighbours is understandable. If they had the intention to liberalise their import regime, they could do so without being aided by the small city-state. In particular, important ASEAN countries (Malaysia, Indonesia, Thailand, the Philippines) have been negatively affected by the Asian crisis and are therefore reluctant to liberalise trade in services in general and financial services in particular (Thangavelu and Toh 2005:

1218). Those countries fear that Singapore's FTA strategy will open their economies to foreign competition, and that assumption is dampening further integration in ASEAN.

Nevertheless, not only the hierarchy between hub and spoke is disturbing the neighbouring countries. In history, there have been many countries foolishly thinking they could function as a bridge between two other countries. In reality, the concept of a bridge in international relations and in economic relations even more so is fundamentally flawed. What is the additional benefit for the two countries that are using Singapore as a bridge?

But even the technical side of Singapore's hub-and-spoke concept does not work well. Singapore's bilateral FTAs with, say, the United States require substantial local content in order to qualify for duty free trade. Products that have received most of the value added in other ASEAN countries do not qualify for duty free access to the American market. Where there is no substantial American import duty there is no need to use the detour via Singapore.

Consequently, Singapore's concept of establishing itself as the free trade hub in the region does not make sense. The country tries to punch way above its weight. In order to be attractive as a hub, an economy ought to have a sizable internal market, and Singapore does not have that. The USA or the EU can try to establish themselves as hubs, but that function differs sharply from the entrepot trader role that Singapore had in the past.

Singapore's partners in ASEAN were ostensibly not at all delighted by the change in trade policy. There have been concerns that the ASEAN Free Trade Area (AFTA) is severely weakened by Singapore's strategy. Malaysia's Foreign Minister remarked that although Singapore may not have done anything incorrect in legal terms, morally the country had undermined friendship in ASEAN (Daquila and Huy 2003: 914).

In Singapore, the agreement with the US probably enjoyed most prominence in the debate on free trade agreements. The real document, however, was probably not seen by many citizens. It is a 1,200 page document, listing every detail of existing and potential bilateral economic relations (The Wall Street Journal, 3 October 2005: 1). The United States-Singapore Free Trade Agreement (USSFTA) is in force since January 2004 and is reviewed annually. As in the FTA with Australia, the United States has insisted on some asymmetries. Whilst Singapore has been eliminating all import tariffs on American goods on entry into force, the US has maintained some tariffs, which will be eliminated over a

period of three to ten years (Thangavelu and Toh 2005: 1224). With regard to intellectual property rights, Singapore has had to change its regulations. In particular, copyright has been extended to life of the author plus 70 years. Singapore also had to adopt measures against the circumvention of technologies that protect copyright works and change regulations on pharmaceutical products (Thangavelu and Toh 2005: 1226).

One of the more humorous aspects of the FTA with the United States are the regulations on chewing gum. Singapore had banned the sale of chewing gum, trying to keep the city state as clean as possible. However, the United States government insisted on liberalisation trade in chewing gum, and – after intense debate – the two parties agreed on a regulation that satisfies both sides. Article 2.11 of the free trade agreement between Singapore and the United States reads as follows.

> Singapore shall allow the importation of chewing gum with therapeutic value for sale and supply, and may subject such products to laws and regulations relating to health products.[12]

The consequence of this path-breaking regulation is that Singaporeans now have the option to see their dentist and get a prescription for buying chewing gum. But there are other, sovereignty-reducing aspects of the agreement. Perhaps the most disturbing issue of the agreement is the regulation of capital controls, something that has nothing to do with a free trade agreement.[13] The text of the agreement contains regulations on capital flows, which shall in principle be without restrictions on inflows or outflows.[14]

So why is that commitment of Singapore a sovereignty-reducing measure? To understand that, one has to consider the arrangements that Singapore imposed before the FTA with the US. Singapore imposed restrictions on borrowing by foreigners in Singapore dollars. The rationale for that measure was that if a player intends to speculate against the Singapore dollar, he has to create an open position, i.e. borrow in Singapore dollar and then transfer that money into dollars, yen or euro. Without an open position, speculating against a currency will not generate a profit. The measure that Singapore applied – a ceiling on borrowing by foreign individuals and financial institutions – provided the country with an

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[12] See the text of the treaty at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/asset_upload_file708_4036.pdf; p. 10)

[13] It is true that restrictions on current account may cause difficulties for international trade, but the same does not apply for restrictions on capital account. The need to have few restrictions on trade-related importation and exportation of capital probably is a useful measure. To reduce restrictions on capital flows is not necessary for unrestricted international trade. Just look at the Chinese example: The country is the world's third largest trader, yet implements rather comprehensive restrictions on capital account.

[14] See the text of the treaty, pp. 158ff.

efficient safety net. The United States insisted on the dismantling of this policy tool, just like in the FTA with Chile.

The rules of origin in the FTA are quite strict. Textiles and apparels qualify for duty free trade if they meet the yarn forward rule. This means the yarn can be sourced from two suppliers: either from Singapore or from the United States. Consequently, textile manufacturers in Singapore can no longer buy yarn in other parts of Asia if they want to export to the USA, they have to buy in America. This clear case of trade diversion is not a problem for supporters of the bilateral FTA. Linda Low suggests that "the industry will work with US yarn suppliers, and restructure their manufacturing operations to benefit from the US-Singapore FTA" (Low 2003: 12).

Singapore's agreement with Japan probably is as important as the deal with the USA. The Japan-Singapore Economic Partnership Agreement (JSEPA) is hailed as a 'new age' partnership agreement. It does not only cover trade in goods and services, but also the promotion of foreign direct investment as well as regulatory reform, facilitation of customs procedures, cooperation in science and technology, media and broadcasting, electronic commerce, movement of natural persons and human resource developments (Thangavelu and Toh 2005: 1211). Nevertheless, at scrutiny, there are several agreements that have received a joint label. The core continues to be the agreement on free trade in goods and services. The other agreements are side issues that could also be dealt with in different arenas. For instance, the agreement on the movement of people is a traditional consular affair between two countries, which agree on the reduction of restrictions for the movement of people. This assessment does not imply that JSEPA is not useful, but that it is important to differentiate between the several layers of the agreement.

Empirical evidence suggests that trade has not dramatically increased since JSEPA has come into force. In the first half of 2003, i.e. when the agreement was operational, bilateral trade actually shrank. This is hardly surprising, considering that Singapore reduced its tariffs to virtually zero unilaterally before the agreement became effective (Ziltener 2005: 294). The rules of origin are comparatively strict and require inter alia a local content of 60 percent of the selling price (Daquila and Huy 2003: 917).[15] Thus, there could not be significant amounts of additional trade from Japan to Singapore. Conversely, the increase

[15] Note that all of Singapore's FTAs have diverging rules of origin. Even advocates of Singapore's bilateralism have been admitting that the complex rules of origin are not facilitating trade. Nevertheless, Linda Low hopes that the complexity of establishing origin increases innovation, creativity and flexibility (Low 2003: 19).

in exports from Singapore to Japan apparently has been at the expense of other countries. Namely, imports from Taiwan have been replaced by imports from Singapore because of tariff preferences (Ziltener 2005: 295). Although these could be exceptional cases, it is nevertheless evident that bilateral preferences can lead to trade diversion.

Overall, the benefits that Singapore can expect from bilateral FTAs are modest. Gains in merchandise trade can be expected to be limited because of the rules of origin issue and the unresolved problem of transnational production without cumulation of origin. Furthermore, not too much should be expected from services. For the time being, Singapore is primarily trading goods. Total merchandise trade in 2003 was 473 billion Singapore dollars, much larger than trade is service, which was 105 billion (Liang 2003: 52f). More than half of the latter sum was due to transportation services and travel, and in those sectors no huge gains can be expected from bilateral agreements.

Singapore has embarked on a new trade policy that provides limited gains while undermining the country's credibility in the region. In particular, the lasting discord in ASEAN – a side-effect of Singapore's new policy – suggests that bilateralism is a rather short-sighted policy for a country of Singapore's size and political importance. Singapore has set a precedent which other ASEAN members feel compelled to follow. There is a danger that these countries draw the wrong lessons and create a messy patchwork of weak, market-distorting FTAs (Sally and Sen 2005: 102). Furthermore, Singapore has lost credibility it previously enjoyed as an honest broker in the WTO – not unlike the position Australia used to have.

Whilst ASEAN played an important role as a group in the Uruguay Round of trade negotiations, the recent emphasis on bilateralism has resulted in the reduced importance of ASEAN in the ongoing Doha Round. ASEAN co-operation in Geneva has all but broken down (Sally and Sen 2005: 111). Both the lack of co-operation in Geneva and the diverging trade policies in the region have resulted in several cracks within ASEAN. This is a short-sighted, even foolish approach. In the long run, each country in Southeast Asia needs an efficient and effective WTO, as Sally and Sen have stressed. The economies of the ASEAN countries are on a clear path towards further integration into the global economy, and this gives the region a stake in a liberal, non-discriminatory and rules-based multilateral trading system (Sally and Sen 2005: 111). Singapore may not have envisaged the grave consequences of its uncoordinated push for bilateralism, but the long-term consequences of neglecting the multilateral regime may put the entire ASEAN region at a

disadvantage compared to the emerging hubs of global trade – America, the EU, and China.

5. Thailand's preferential agreements and the strenuous negotiations with the USA

After Singapore had introduced its new emphasis on bilateral deals around the turn of the century, the Thai government followed soon thereafter. This policy shift has had negative effects on cooperation in ASEAN, and at the same time has been providing only limited gains. Nevertheless, the early harvest program – part of the ASEAN-China FTA – received a lot of attention, primarily because it was the first bilateral trade measures that China implemented after joining the WTO. The Chinese immediately opened their market for Thai agricultural products, which in the first six months of 2004 resulted in an increase of vegetable exports to China of 38 percent and of fruit exports of 80 percent (Hufbauer and Wong 2005: 8).[16] Other agreements, however, show a great degree of protectionism.

On 1 September 2005, Thailand concluded a free trade agreement with Japan. This deal is another example of the lack of free trade in the bilateral agreements in the Asia-Pacific. Rather than liberalising comprehensively, even if it is limited to bilateral trade, Japan and Thailand agreed not to hurt each other too badly. Thailand's automobile industry, which developed relatively well in recent years, continues to be protected against Japanese competition. For example, the tariff for cars with more than 3000 cc engine capacity has been reduced from 80 to 60 percent, whereas the level of protection for cars with smaller engines, i.e. the majority of cars, remains unchanged. Japanese steel producers will not get duty free access to the Thai market before 2015. As to be expected, Japan has wanted to protect its agricultural sector. Rice, beef, wheat, dairy products and fish are excluded from the free trade agreement.

Bilateral free trade agreements with such characteristics do not have much to do with the concept of free trade. Rather than increasing competition exactly in those areas where the producers in one country are less competitive than in the other, those sectors are excluded. Consequently, the potentially largest gains of the free trade agreement are left out. Furthermore, such agreements are a violation of article 24 of the GATT, which permits free trade areas and customs unions only if they cover "substantially all the trade". Agreements that exclude agriculture, cars and steel violate this regulation. Pointing to very

[16] Trade in 188 agricultural products was liberalised as part of the early harvest program (Talerngsri and Vonkhorporn 2005: 69).

low levels of trade in these sectors prior to the creation of the FTA does not help, because the dynamic effects of trade liberalisation ought to be considered.

Thailand and the United States have been negotiating a free trade agreement since 2004. Again, these negotiations demonstrate that free trade is not the main objective in many bilateral agreements. There are two main sectoral sensibilities, and both parties anxiously defend their respective industries. The negotiations also show how both the weakness of America's traditional industries and the strength of American services industries. The two disputes industries are motor vehicles and financial services (The Wall Street Journal, 3 October 2005:1).

Today, Thailand is the world's second largest producers of light commercial vehicles, also called light trucks. Japanese and Korean manufacturers have been using Thailand's strong competitive position in manufacturing and export light trucks from Thailand to the rapidly expanding Asian markets as well as to OECD countries, e.g. Australia. However, there are virtually no exports of light trucks to the United States. The reason for that is the high tariff of 25 percent that the United States is applying on light trucks ever since the legendary German-American chicken war of 1962/1963. Although this rather bizarre trade conflict between West-Germany and America is virtually forgotten today, it resulted in an increase of the tariff for imported light trucks from 8.5 percent to 25 percent.[17]

The important point is that this tariff continues to be applied, despite various initiatives to reduce it or abandon it all together. For the American car industry, this high tariff provided (temporary) shelter against foreign competition. In the last two decades, light trucks in general and pick-up trucks in particular have been promoted by General Motors, Ford and Chrysler as the appropriate vehicle for American males. In recent years, half of the cars sold in the United States have been light trucks, and for several years the two best-selling vehicles have been pick-up trucks. Without foreign competition, American car producers were able to secure profits in this segment of the market (for a detailed discussion see Dieter 2005, pp. 174-182). Whereas General Motors, Ford and Chrysler have had

[17] In the early 1960s, the newly created European Economic Community was harmonising its external tariff in order to create a customs union. The harmonisation resulted in rising tariffs in some areas. For instance, the tariff on frozen chicken in Germany had been lower before the uniform single tariff was implemented. This increase harmed American producers of frozen chicken, and also was breaching Art. 24 of the GATT, which inter alia demands that in a free trade agreement or customs union the level of protection should be lowered. The Kennedy government took legal action against the EEC countries, won the case and imposed a variety of sanctions, one of them being the increase of the tariff for light trucks, aimed at harming Volkswagen (see Dieter 2005: 174-182).

difficulties in competing with European, Japanese and other producers in passenger vehicles, there was an oligopoly in light trucks. As expected, this protectionism has done harm to American car producers over time. Today, with oil prices at all-time highs, the demand for these gas-guzzling trucks is comparatively low, and American producers are not able to satisfy the demand for small, stylish and efficient cars.

Unsurprisingly, the Thai government is asking for free trade in light trucks, but the American government is well aware of the fact that General Motors and Ford might become insolvent if competition would dramatically increase. The Chief economist of General Motors, Mustafa Mohatarem, has claimed that Thailand would become an "aircraft carrier" for foreign producers if free trade were permitted between the two countries (Financial Times, 18th February 2005: 2). Consequently, there is very limited willingness of the US Trade Representative to yield concessions in this sector.

At the same time, the Thai government is trying to protect its financial sector. The country suffered a severe blow when the financial crisis hit Thailand and other countries in the region in 1997. Ever since, the government has tried to strengthen the domestic financial sector. The American side is asking for a complete opening of the Thai market for financial services, which is understandable when considering the good competitive position of the American financial sectors.

The bottom line is simple: The American government fears Thai competition in trucks, and the Thai government fears American competition in financial services. If any of the two sides wished to increase competition in those sectors, they could do that unilaterally. Since both sides are apparently unwilling to make concessions, there will either be no agreement or the deal will be incomprehensive. More precisely, an agreement excluding both light trucks and services is a violation of both the letter and the spirit of the GATT, GATS and the WTO.

Whilst Thailand has not put as much emphasis on bilateral agreements as Singapore, the new priorities have resulted in weaker commitments to further development in the WTO. FTAs are today at the forefront of Thai trade policy, and the wisdom and effectiveness of shifting most resources to bilateral negotiations can be called into question (Sally and Sen 2005: 105). Two observers from Thailand's Ministry of Commerce admit the shift of resources quite openly, and they also suggest that Thailand fails in getting the desired results in bilateral FTAs.

> It is true that resources on international trade negotiations have been mobilized and redirected towards FTAs. Nevertheless, it is also apparent that Thailand is not getting anything she wants on the rule front under FTAs – no agricultural subsidies reduction, fragmented rules of origin, no reform on AD (Anti-Dumping) (Talerngsri and Vonkhorporn 2005: 73).

Thailand's quite sobering experience with FTAs might result in a reduced willingness for compromise in the WTO. Thailand may opt for tough positions on agricultural liberalisation and the reform of Anti-Dumping measures, reject any far-reaching changes in intellectual property rights and oppose an agreement on labour standards (Talerngsri and Vonkhorporn 2005: 73). If that were the case, one could argue that in Thailand's case bilateralism has resulted at least in a clarification of strategic positions in trade policy. Whether this justifies the bilateral detour is a separate question.

6. Conclusion: The puzzling logic of bilateral free trade agreements

The trend for bilateral trade agreements in the Asia-Pacific is difficult to comprehend. These preferential agreements are often not liberalising trade comprehensively, cause great administrative burden to producers and undermine the multilateral regime. Nevertheless, many countries are moving in that direction. What are their motivations?

The cases examined in this paper offer a range of explanations. In Australia's case, a major motive probably was the desire to forge close links with the United States *and* use this allegedly close relationship in the 2004 election campaign. Singapore's leadership – striving for modernity as ever – attempted to give the country the advantage of being the first economy in the region that established bilateral agreements. Systemic consequences were ignored. Thailand is joining the bilateral wave, but it has not conceded many preferences in its existing bilateral agreement with Japan and is unlikely to allow extensive competition in the agreement currently negotiated with the USA.

Bilateral trade agreements can negatively affect the competitiveness of companies in a region. Companies have to spend resources on documenting origin, and in the absence of diagonal cumulation of origin in the entire Asia-Pacific this is potentially welfare reducing. The administrative burden of certificates of origin results in an increase of costs to producers. Overall, emphasis on these preferential agreements deters manufacturers from remaining competitive on world markets.

There is, however, one case in which bilateralism is a wise strategy. If the old multilateral trade regime is going to collapse – an unlikely event at this stage but not entirely

impossible – then bilateral trade agreement would be a safeguard measure to avoid the breakdown of international trade. The irony is that bilateralism – despite many declarations that it is supposed to strengthen the WTO – actively contributes to the downfall of the multilateral order.

There are three potential developments in the medium term:

- Asian countries, the EU and the USA return to multilateralism and abandon bilateral trade agreements.

- All relevant players continue to engage in bilateral trade agreements. Additionally, at an unidentifiable stage one of the larger countries leaves the WTO or ignores vital commitments, e.g does not accept a ruling in the dispute settlement mechanism

- The WTO and its member countries manage to clarify the rules on FTAs and turn them into true stepping stones for the multilateral regime. A potential remedy would be to limit the use of free trade agreements to the Non-OECD world. Whilst developing countries could continue to form regional integration schemes, the more developed countries would lead by example and return to the multilateral regulation of trade.

At this stage, the second scenario appears to be more plausible than the other two. Today, the players that push a renaissance of multilateralism are nowhere to be seen. Rather, there is ample evidence for more bilateralism, and the analysis in this paper has shown that very divergent countries with completely different motives arrive at the same policy outcome, i.e. embrace bilateralism.

The bottom line is that bilateralism represents the third-best solution to a decisive problem of international economic relations. The multilateral regime – for all its failures and shortcomings – continues to be the first-best answer to the necessity of trade regulation. Regional approaches have some important benefits which make them a partially justifiable second-best approach. Bilateralism is – as has been demonstrated in this paper – the least desirable location for the regulation of international trade.

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Centre for the Study of Globalisation and Regionalisation
University of Warwick
Coventry CV4 7AL, UK

Tel: +44 (0)24 7657 2533
Fax: +44 (0)24 7657 2548
Email: csgr@warwick.ac.uk
Web address: http://www.csgr.org