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Regional Trade Liberalization in East Asia and the Asia-Pacific: The Role of China

By Robert Scollay, University of Auckland

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REGIONAL TRADE LIBERALISATION IN EAST ASIA AND THE ASIA-PACIFIC: THE ROLE OF CHINA

Robert Scollay
PECC Trade Forum Coordinator,
Director, New Zealand APEC Study Centre,
University of Auckland

Introduction

The proliferation of preferential trading arrangements (PTAs) has been the most notable development in the trading environment of the Asia Pacific region in recent years. Since 1999 eleven new PTAs have been concluded between APEC members, and many more proposals are at various stages of negotiation, study or discussion. With the PTAs that were already in place before the new “wave” of PTAs began, and the initiatives currently under negotiation or study, the number of PTAs between APEC members could easily exceed 30 in the not too distant future.

Spread of Bilateral Agreements

The eleven recently-concluded PTAs have all been bilateral in nature. In terms of regional linkages, four have been trans-Pacific agreements (US-Singapore, US-Australia, Korea-Chile and Japan-Mexico), two have linked Northeast Asian to Southeast Asian economies (Japan-Singapore and China-Thailand), one has linked two Northeast Asian economies (Hong Kong S.A.R. – China), three have linked Southeast Asian to Australasian economies (Singapore-New Zealand, Singapore-Australia, and Australia-Thailand), and one has been intra-American (US-Chile). The initiatives under negotiation or study include examples of all five types of regional linkage. Notably absent from the agreements already concluded have been any agreements linking the US and the three major Northeast Asian economies (China, Japan, and Korea), or between Northeast Asian and Australasian economies, although China and New Zealand recently

announced that they will begin negotiations for a bilateral FTA in early 2005, and a similar announcement in relation to Australia is believed to be imminent.

In four cases both partners are small or medium-sized Asia-Pacific economies, while the other seven bilaterals link a small or medium-sized economy to one of the three economic giants of the region (the US, China and Japan). The initiatives under negotiation or study include examples of both types, and also an interesting example of an attempt to expand an existing bilateral into a trilateral arrangement (Singapore-Chile-New Zealand). There does however appear to be a trend for initiatives linking small or medium-sized economies to the three major economies to predominate.

There is a powerful “domino” effect encouraging the increasing trend towards bilateral agreements centred on the major powers. Successful conclusion of a PTA with a major economy by one small or medium-sized economy places pressure on its neighbours and competitors to seek a PTA of their own with the same major economy, to counter the discrimination they would otherwise face in the major economy’s market. The major economies are likely to prefer bilateral PTAs to a plurilateral agreement with a number of small or medium-sized economies, since their advantage in bargaining power is likely to be greatest in the bilateral scenario. Incumbent small or medium-sized economies in a bilateral with a major economy have an incentive to discourage the granting by the major power of parallel preferential access to their neighbours and competitors, since this would erode the economic benefit of the preferences they have already secured. While they may not be able to dissuade the major power from pursuing additional bilateral agreements, they may at least resist the addition of new partners to their own agreement with the major power. Australia for example made it very clear that it did not wish New Zealand to be included in its negotiations with the US.

“Hub and Spoke” Patterns

The outcome of the “domino” effect and related incentive effects is likely to be a series of “hub and spoke” configurations in the Asia-Pacific region, with the three major powers –

the US, China and Japan – established as the “hubs”, and their bilateral PTA partners in the role of “spokes”. A further complication in the emerging pattern of PTAs in the region is the ambition and in some cases success of a few small or medium-sized economies to establish their own networks of PTAs. These economies can be viewed as aspiring secondary “hubs” within the pattern of “spokes” centred on the primary or major “hubs”. Singapore is the most successful example of a “secondary hub” to date, with Chile, Korea, Australia and Thailand also seemingly bidding for “secondary hub” status. Singapore, which now has PTAs covering some 80% of its total trade, has a unique advantage in building a network of PTAs, namely the absence of an agricultural sector that could create difficulties in PTA negotiations. Australia and Korea have the advantage of relatively large market size in comparison to other potential “secondary hubs”.

The number of small or medium-sized Asia-Pacific economies with the potential to become established as “secondary hubs” is probably rather small. Other small or medium-sized economies may be restricted to the role of “spokes” around the “primary hubs”, and will also face significant discrimination in the markets of the “hubs” with whom they cannot secure a PTA, for whatever reason.

The disadvantages of “hub and spoke” configurations for the “spokes” are well-known. The superior bargaining power of the “hub” in negotiations with a “spoke” is enhanced by the ability to play off one “spoke” against another. As a result, terms of the agreements are likely to disproportionately favour the interests of the “hub”. The benefits of these agreements also flow disproportionately to the “hub” since it gains access to all the “spoke” markets, whereas the “spokes”, unless they negotiate separate agreements with each other, gain access only to the “hub” market, where they must compete with each other for market share. This asymmetry of market access also gives the “hub” an advantage in attracting investment. “Secondary hubs” can also secure some of these advantages over their “spoke” competitors. Particularly important may be a greater ability to attract transport links and infrastructure developments as a result of their “secondary hub” status.

East Asian Regionalism: Plurilateral Agreements and Blocs

Parallel to the spread of bilateral agreements, the idea of East Asian regionalism has been gaining ground, after being given impetus by the reaction of East Asian policymakers to their experience of the East Asian economic crisis of 1997/98. A number of plurilateral PTAs have been proposed among East Asian economies that have the potential to give expression with varying degrees of completeness to the concept of an East Asian trade bloc as a building block in the evolution of an integrated East Asian region. The formation of the “ASEAN Plus Three” group (comprising China, Japan, Korea and the ten Southeast Asian economies of ASEAN) to explore possibilities for monetary cooperation within East Asia quickly led to suggestions that this grouping should provide the basis for an East Asian FTA. The desirability and feasibility of an ASEAN Plus Three FTA was the subject of a report commissioned from the East Asian Vision Group. No decision to proceed with the ASEAN Plus Three FTA has yet been made, although the concept appears to continue to enjoy widespread support within the region’s policy circles.

In the meantime attention has been captured first by China’s launch of a proposal for an FTA with ASEAN and then by Japan’s riposte in proposing its own economic partnership agreement with ASEAN. There has been uncertainty as to whether these proposed agreements are envisaged as genuine plurilateral FTAs between China or Japan and the ASEAN group as a whole, as pro-ASEAN thinkers in Southeast Asia clearly prefer, or whether the structure that is more likely to emerge is a series of bilateral agreements between China or Japan and individual ASEAN economies, linked to some kind of framework agreement with ASEAN as a whole. The early emphasis in the China-ASEAN case was on negotiations between China and ASEAN as a group, and these negotiations initially proceeded relatively quickly. The situation was then complicated by the negotiation of a separate bilateral agreement between China and Thailand, leading some observers to suggest that a structure involving separate bilateral agreements with individual ASEAN economies is likely to prevail in the end. Japan has moved more

decisively toward a structure based on bilateral FTAs, having already concluded a bilateral FTA with Singapore and more recently entered negotiations for bilateral FTAs with Thailand, Malaysia and the Philippines.

ASEAN has been pursuing other plurilateral initiatives as well. A proposal for an ASEAN-India economic partnership has been launched, and in 2005 a decision in principle was taken to open negotiations for conversion of the long-running AFTA-CER process between ASEAN and Australia and New Zealand into a genuine FTA.

The APEC Vision: Still Relevant?

The gathering impetus behind the concept of East Asian regionalism has tended to overshadow the earlier APEC vision of a zone of free trade and investment in the Asia-Pacific region, embracing both sides of the Pacific, to be achieved through a process of non-discriminatory liberalisation based on the principle of “open regionalism”. All APEC members remain formally committed to the so-called “Bogor goals” of free trade and investment in the Asia-Pacific region, to be achieved by APEC developed economies by 2010 and by APEC developing economies by 2020. As the first 2010 target date looms closer, however, and the pursuit of bilateral PTAs by APEC economies becomes more and more firmly entrenched, questions are increasingly being asked about both the seriousness and realism of that commitment. The APEC mid-term review scheduled for 2005 may well prove to be an occasion for soul-searching on these issues.

Meantime the APEC Business Advisory Council (ABAC) has made a radical proposal for reviving impetus toward the establishment of free trade and investment across the entire Asia-Pacific region. ABAC proposed the creation of a Free Trade Area of the Asia-Pacific (FTAAP), envisaged as free trade agreement with a membership in principle embracing all APEC members. This ABAC proposal involves turning away from the original APEC concept of non-discriminatory liberalisation based on open regionalism and implemented through voluntary, non-binding commitments, in favour of an explicitly

preferential arrangement established through reciprocal negotiation of binding commitments. APEC leaders in 2005 did not accept ABAC's recommendation for the commissioning of a study on the FTAAP, and it remains to be seen whether the proposal will be taken further in 2005.

The Role of China

The Pivotal Position of Northeast Asia

Northeast Asia will inevitably have a pivotal role in determining the future course of economic integration in East Asia and the Asia-Pacific region as a whole. The Northeast Asian economies are the economic "core" of the western Pacific, accounting for over 20% of world GNP, compared to just under 2% for ASEAN and under 1.5% for Australasia. An East Asian trade bloc could not become a reality without the support and participation of the Northeast Asian economies. Likewise, the prospects for realising the APEC goal of free trade and investment in the Asia-Pacific region depend crucially on the willingness of the Northeast Asian economies, along with the US and its North American neighbours to liberalise their trade, in particular their trans-Pacific trade with each other.

Northeast Asia has already had a decisive impact on the evolution to date of the regional trade architecture. Prior to 1998 East Asia was an "empty box" in the regional and global maps of PTAs, as Japan and Korea maintained a policy of avoiding involvement in PTAs, preferring to rely on the GATT's non-discrimination principle, while China was preoccupied with its transition to a market economy. Under these conditions earlier proposals for an East Asian trade bloc, such as proposal in the mid-1990s for an East Asia Economic Grouping (EAEG), stood no chance of success. The decision of Japan and Korea in 1998 to pursue a bilateral FTA marked a policy watershed. PTAs became part of the trade strategy of both economies from that time, and a little later became part of China's trade strategy as well. The way was thus cleared for PTAs to become a central

part of the trade architecture of East Asia, and possibly of the entire Asia-Pacific region. Northeast Asia is now poised to play a decisive role in determining how preferential trade in the region will evolve, and its place in the overall regional trade architecture.

China's Strategic Options in the Evolution of East Asia's Trade Architecture

The nature of Northeast Asia's influence on the evolution of the trade architecture of the East Asian and Asia-Pacific regions will depend on the strategy adopted by the Northeast Asian economies, especially the three leading Northeast Asian economies of China, Japan and Korea, toward economic relations with each other as well as toward economic relations with the wider East Asian and Asia-Pacific regions. Decisions by China, Japan and Korea as to whether their regional trade strategies jointly or separately will interact with their preferences as to the eventual shape of the regional trade architectures. China's decisions and preferences in these two regards will obviously be a major factor, given China's large and rapidly growing weight in the regional economy.

China has already become established as a major player in the spread of bilateral PTAs. Initial apprehensions by potential partners, particularly the ASEAN economies, at the competitive threat posed by China have been quickly replaced by a resolve to focus on the opportunities offered by free trade with China. China is now well-placed to quickly develop an extensive network of bilateral PTAs. To its initial initiative with the ASEAN economies has been added announcements of negotiations soon to begin for PTAs with Chile and New Zealand, with negotiations with Australia likely to follow soon after.

A key strategic decision now facing China, along with its Northeast Asian neighbours, is whether to pursue their interests separately, as China and Japan are both doing in their separate initiatives with ASEAN, or whether to throw their weight behind East Asia-wide integration through support for the ASEAN Plus Three FTA. Emergence of an integrated East Asian region requires that East Asian economies reach mutually satisfactory accommodations on the economic and political issues relating to both regional leadership and the freeing of trade between each other, or in simplified terms,

that considerations of complementarity and partnership prevail over considerations of competition and rivalry. This will clearly not be easy, although as a hopeful sign it can be noted that business appears to be well ahead of governments in this regard.

China will also have a major influence on the evolution of the Asia-Pacific trade architecture, which brings into play economic and political relations not only within East Asia, but also between the Northeast Asian economies and the United States. One of the essential condition for achieving APEC's trade and investment goals, whether by APEC's original non-discriminatory non-binding approach or by the preferential route envisaged in the FTAAP proposal, is that each of the three major Northeast Asian economies and the United States should reach mutually satisfactory accommodations on the economic and political issues relating to the freeing of trans-Pacific trade, including the complex factors underlying their political and strategic relationships. It is again stating the obvious to say that this represents a major challenge both for the Northeast Asian economies and the United States.

Economic Implications for China: Indications From CGE Analysis

One way of discussing these questions is to analyse China's economic self-interest along with the self-interest of its East Asian neighbours, and one approach to this is provided by the results of CGE analysis. Table 1 presents results from one set of simulations of various regional and global trade liberalisation initiatives. The figures shown are estimates of total changes in economic welfare (equivalent variation basis) for China, other APEC economies, and key economies or economic groupings in the rest of the world. The change of in economic welfare is a single statistics summarising overall economic effects, and does not of course purport the complex economic adjustments that in reality would be made on the way to realising these results.

The simulations reported utilised the GTAP5 database and a standard, multi-region comparative static formulation of the basic CGE model is used, assuming perfectly competitive markets and constant returns to scale technology. The database was aggregated in each case to 20 commodities and 26 regions. Product differentiation by national origin is provided in the usual manner by using a set of “Armington” substitution elasticities. All model equations are as in the standard GTAP model and are discussed in detail in Hertel (1997). No claim is made that the results reported here represent accurate predictions of the absolute value of economic welfare changes. The aim is rather to assess the relative size of effects across the different trade liberalisation initiatives, and this is facilitated by use of an identical methodology and database in all six cases.

The results indicate that China’s economic welfare is best promoted by larger, more inclusive trade arrangements. The ASEAN Plus Three FTA yields a more favourable welfare outcome for China than not only the ASEAN-Japan FTA, as would be expected, but also the ASEAN-China FTA. The outcome from the ASEAN Plus Three FTA relative to the two ASEAN Plus One initiatives is even more favourable for Japan and Korea. Thus all three major Northeast Asian economies benefit more from preferential trade liberalisation in East Asia if trade is freed among themselves as well as with Southeast Asia, although Japan and Korea benefit proportionately more than China. Among the Southeast Asian economies Indonesia and Viet Nam gain more from the ASEAN Plus Three FTA, while the comparison gives more ambiguous results for the other Southeast Asian economies.

A larger margin of increased economic welfare is observed for China under APEC-wide liberalisation, embracing a wider range of its trading partners. The welfare gain to China is also relatively greater from the FTAAP than from APEC MFN liberalisation. Its Northeast Asian neighbours, Japan and Korea also gain more from the FTAAP than from the ASEAN Plus Three FTA (and Japan also gains more from APEC MFN liberalisation), and once again their gains are greater than those of China. Unsurprisingly, APEC-wide liberalisation is more beneficial to Hong Kong and Chinese Taipei than East Asian trade arrangements from which they are excluded. Southeast Asian economies generally do

better under the ASEAN Plus Three FTA than under APEC MFN liberalisation, while a comparison between the ASEAN Plus Three FTA and the FTAAP produces mixed results: Indonesia and Viet Nam gain more from the FTAAP while other Southeast Asian economies gain more from the ASEAN Plus Three FTA or even from one of the ASEAN Plus One FTAs, an outcome reflecting the benefit to smaller economies of gaining preferential access to major markets.

In aggregate terms the welfare outcome from the ASEAN Plus Three FTA is superior to that from the ASEAN Plus One arrangements for both Northeast and Southeast Asia,

Table 1:
Selected Trade Agreements/Arrangements: Projected Changes in Economic Welfare
US\$ (1997) millions

	ASEAN- China	ASEAN- Japan	ASEAN Plus 3 FTA	FTAAP	APEC MFN	Global MFN
Australia	-118.7	-234.9	-690.0	1744.8	939.9	1742.2
New Zealand	-22.0	-49.9	-134.8	682.4	296.8	2240.7
China	209.5	-861.5	514.1	3275.1	1846.6	5180.0
Hong Kong	-267.1	-218.6	-1221.6	3038.7	2428.6	3272.7
Japan	-1628.5	528.1	6612.4	14931.7	12437.4	14578.4
Korea	-491.3	-706.9	5028.2	5658.1	4885.2	7764.8
Chinese Taipei	-429.3	-477.9	-2011.8	3100.0	2961.8	3091.3
Indonesia	461.0	842.2	2403.0	2658.5	2123.1	2750.4
Malaysia	1128.0	504.9	805.9	771.6	515.5	1305.9
Philippines	205.1	154.7	61.3	86.8	-218.2	-36.2
Singapore	2688.6	1947.1	2438.6	1933.0	1569.4	2585.5
Thailand	691.7	2983.2	2933.8	2497.1	1908.9	2963.3
Vietnam	429.8	877.8	1092.5	1278.8	489.9	1646.1
Canada	0.1	-25.0	-62.4	1111.4	570.5	1771.0
United States of America	-1166.3	-2035.9	-4266.3	1189.4	-6390.8	-569.2
Mexico	3.8	29.3	59.4	-317.9	-593.1	-484.8
Rest of South America	17.7	-62.0	-354.0	-1766.1	2652.9	2815.3
Columbia	8.4	-2.2	-50.8	-247.0	349.5	341.2
Peru	-61.0	-15.8	-88.2	66.1	-83.1	1602.9
Venezuela	17.4	6.8	-0.8	-73.4	122.2	646.7
Argentina	-75.3	-32.7	-195.6	-527.9	221.2	3145.3
Brazil	-219.3	-145.6	-591.3	-1908.0	2075.2	6067.7
Chile	4.0	-52.8	-118.9	310.0	74.3	621.0
Uruguay	-3.7	-1.8	-17.7	-37.9	29.0	770.9
Europe	-1255.3	-2055.9	-3282.5	-9178.3	4505.7	-1450.6
ROW	-155.0	-758.0	-2356.6	-6483.1	2855.7	23384.5
<i>Aggregations</i>						
18 APEC Economies	1637.1	3188.2	13355.0	44015.7	25762.7	52025.8
Northeast Asia-5	-2606.8	-1736.9	8921.2	30003.6	24559.6	33887.1
Southeast Asia-6	5604.0	7310.0	9735.1	9225.8	6388.7	11214.9
Australasia	-140.7	-284.7	-824.8	2427.2	1236.7	3982.9
North America-3	-1162.5	-2031.6	-4269.3	1983.0	-6413.4	717.0
Non-APEC	-1682.7	-2989.5	-6495.2	-18455.6	10158.5	32905.7

Source: Scollay 2004

though by a much greater margin for Northeast Asia than for Southeast, but less favourable for non-members. For Northeast Asia the outcome from APEC-wide liberalisation, especially under the FTAAP than under the ASEAN Plus Three FTAA, but Southeast Asia gains more from the ASEAN Plus Three FTA.

Thus if strategies were to be based on the welfare outcomes projected in these simulations, one would expect China and its Northeast Asian neighbours to be supporters of East Asia-wide liberalisation in preference to the more limited ASEAN Plus One arrangements, and to be even more strongly in favour of retaining a focus on APEC-wide liberalisation, with the FTAAP holding especial attraction for them. Southeast Asia on the hand could be expected to be more ambivalent about the choice between ASEAN Plus Three and ASEAN Plus One approaches, and to be relatively less interested in continuing to push for APEC-wide liberalisation, especially via the non-discriminatory modality. In other word, if larger, more inclusive trade liberalisation arrangements are to be preferred in East Asia, it is likely that the lead in this direction will have to be taken by China and its Northeast Asian neighbours. In this regard Northeast Asia's interests coincide most closely with those of the non-East Asian APEC members, who are also major beneficiaries of a choice for APEC-wide liberalisation over East Asia-only arrangements. The results also suggest that among East Asian economies China, along with Korea, Indonesia, Malaysia and Vietnam has the strongest incentive to maintain the ultimate focus on global liberalisation via the multilateral process.

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