

CHINA, INDIA, AND REGIONAL ECONOMIC INTEGRATION IN ASIA: THE POLICY AND
LEGAL DOMENSIONS

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Trade regionalism, through regional cooperation and integration and in the form of regional trade agreements (R.T.As), is rising globally, although Asia has jumped on the bandwagon only recently. Asian economic integration is the “second-best” approach which Asian countries unfortunately have to follow. In the process of integration, China and India, given the size of their population, as well as their central strategic position in international and regional relations, will inevitably play fundamentally important, and sometimes even dominating, roles. This paper argues that regional economic integration in Asia should first of all seek to achieve sub-regional integration in East Asia and South Asia, while linking up the two sub-regions with bilateral F.T.As, amongst which the most important one should be a China-India F.T.A. Eventually, all the F.T.As will be consolidated into one pan-Asian F.T.A. China and India must take the lead in promoting Asian economic integration. They are advised to lead the region in the practice of open regionalism (with whatever Asian identity) and conduct deeper integration. Lastly, it is suggested that Asian countries should, at this stage, establish an institution to develop (non-binding) common principles and guidelines for the sub-regional and bilateral F.T.As.

I. INTRODUCTION TO REGIONAL ECONOMIC INTEGRATION AND REGIONALISM

A. *The Conceptual Definitions*

Regionalism, regionalisation, regional economic integration, regional economic cooperation, regional trade agreements, free trade agreements ..., these and other similar terms appear frequently on newspapers, academic articles, and official documents when international trade, investment, or finance is concerned. In essence, they all refer to one phenomenon: the cross-border preferential economic initiatives undertaken by national governments or private sectors at regional or bilateral level, as opposed to multilateral initiatives which are conducted on the basis of non-discrimination under the auspice of the World Trade Organisation (WTO).¹

Although these terms can be understood loosely and used interchangeably, it is important and useful to distinguish one term from another conceptually. Winters, when discussing the regionalism versus multilateralism debate, defines regionalism “loosely as any policy designed to reduce trade barriers between a subset of countries regardless of whether those countries are

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¹ Alan Winters, “Regionalism versus Multilateralism” World Bank Policy Research Working Paper 1687 (Washington D.C.: The World Bank, 1996).

actually contiguous or even close to each other”.² According to Lamberte, regionalism refers to “formal economic cooperation and economic arrangements of a group of countries aimed at facilitating or enhancing regional integration.”³ Regionalism is to be distinguished from regionalisation, which is “market-driven integration, spurred by unilateral reforms in individual economies within a particular region”.⁴ Literally, regionalisation also refers to the actions of building regionalism through public and/or official efforts. According to the Dictionary of Trade Policy terms developed by the WTO, regionalism is described as “actions by governments to liberalise or facilitate trade on regional basis, sometimes through free-trade areas or customs unions.”⁵ Following these inspirations, economic regionalism can be roughly understood as (a) formal economic cooperative measures (b) undertaken by governments (c) to facilitate regional economic integration (d) which however is not necessarily confined to a geographical region. Put differently, regionalism can now be broadly characterised as the tendency towards the creation of preferential trade arrangements between a number of countries located in the same or even different regions, which discriminate against third countries.

This naturally leads to the definition of economic integration. Bela Balassa, in his seminal work *The Theory of Economic Integration*, defines economic integration as a process and a state of affairs: “Regarded as a process, it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies”.⁶ Balassa further explains the different forms of integration

Economic integration ... can take several forms that represent varying degrees of integration. There are free-trade area, a customs union, a common market, an economic union, and complete economic integration. In a free-trade area, tariffs (and quantitative restrictions) between the participating countries are abolished, but each country retains its own tariff against nonmembers. Establishing a custom union involves, besides the suppression of discrimination in the field of commodity movements within the union, the equalization of tariffs in trade with nonmember countries. A higher form of economic integration is attained in a common market, where not only trade restrictions but also restrictions on factor movements are abolished. An economic union, as distinct from a common market, combines the suppression of restrictions on commodity and factor movements with some degree of harmonization of national economic policies, in order to remove discrimination that was due to disparities in these policies. Finally, total economic integration presupposes the unification of monetary, fiscal, social, and countercyclical policies and requires the setting-up of a supra-national authority whose decisions are binding for the member states.⁷

² *Ibid.*, at 2-3.

³ Mario B. Lamberte, “An Overview of Economic Cooperation and Integration in Asia” in Asian Development Bank, *Asian Economic Cooperation and Integration: Progress, Prospects, and Challenges* (Manila: Asian Development Bank, 2005) at 4.

⁴ *Ibid.*

⁵ WTO Secretariat, “Scope of RTAs”, online: <http://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm>.

⁶ Bela Balassa, *The Theory of Economic Integration* (Homewood, Illinois: Richard D. Irwin Inc., 1961) at 1.

⁷ *Ibid.* at 2.

Since its introduction, the Balassa-stages approach has been indispensable for an understanding of both the literature and practice of economic integration. The usage of this approach is widespread and the terms contained therein for describing the different degrees of integration, especially the free-trade area and customs union, have hence come into fairly standard usage. It is nonetheless important to note that, in light of the later theoretical and practical development of regionalism, the Balassa-stages approach should be amended and clarified in order to provide a more precise analytical framework for economic integration. For example, it should be understood that the Balassa-stages are presented sequentially for the purpose of analysis, and hence the sequence is not to be followed rigidly.⁸ Economic integration in Europe, for instance, started directly with a customs union instead of a free-trade area. Balassa's distinction between a common market and an economic union also presents a conceptual problem. The European Union's experience shows that integration beyond custom union is difficult to define and conceptualise, and in this sense Balassa's third and fourth stages (common market and economic union) should be taken together.⁹ Furthermore, it is probably not necessary – or useful – to define the final stage as “total economic integration” with a supranational authority. It is more realistic to “envisage several partial ‘unions’ beyond the economic union, such as a tax union, a social union, a monetary union and a political union”.¹⁰ Whether these sub-unions will work together toward the formation of a unitary state, as Balassa's final stage implies, is currently beyond the theoretical studies as well as the practice of economic integration.

In both the literature and legal instruments of economic integration, the term “single market” is becoming increasingly popular. The Single European Act of 1987 formally created a Single Market in Europe that came into operation on 1 July 1987.¹¹ In the 2003 Declaration of Association of South East Asian Nations (ASEAN) Concord II (Bali Concord II), the heads of ASEAN countries adopted the goal that the “ASEAN Economic Community shall establish ASEAN as a single market and production base.”¹²

Apparently, a single market is more than a common market, but how much more is an interesting question. The Single European Act describes it as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”. Criticising the imprecision of this definition, Lloyd defines a single market “as one in which the Law of One Price must hold in all goods, services and factor markets”, which means that “there should be a single price in the regionwide market for every tradable commodity and factor, expressing all prices in a common currency and adjusting for the real costs of moving goods or factors between locations”.¹³ In essence, a single market requires not only the elimination of border measures and full national treatment of beyond-the-border measures applying to imports, but also harmonisation of rules and procedures across participating states. “Hence, a single market is

⁸ Jacques Pelkmans, *European Integration: Methods and Economic Analysis*, 2nd ed. (London: Financial Times Prentice Hall, 2001) at 7.

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ The *Single European Act*, OJ L 169 of 29.06.1987.

¹² The text of the Bali Concord II is available online at <<http://www.aseansec.org/15159.htm>>.

¹³ Peter Lloyd, “What is a Single Market? An Application to the Case of ASEAN” (2005) 22:3 *ASEAN Economic Bulletin* 251 at 252 and 254.

synonymous with complete economic integration of the area”.¹⁴ However, without becoming a unitary state, how complete the market can be remains a question beyond the reach of this paper.

Regionalism, as noted above, can be a cross-region phenomenon. For analytical purposes, it is useful to define regional economic integration as a dynamic process encompassing the integration of economies within a geographic region. Hence in this paper, “regional economic integration in Asia”, “Asian regionalism” or “East Asian regionalism”, or other similar terms, are all used to refer to the integration activities in the particular Asian region concerned.

Economic integration is conducted through trade agreements. It is important to define the concepts of “regional trade agreements” (“R.T.As”) and “free trade agreements” (“F.T.As”) which are to be used frequently in this paper. Following the usage of the WTO, this paper does not distinguish between regional trade agreements or free trade agreements, as, “[i]n the WTO context ... RTAs may be agreements concluded between countries not necessarily belonging to the same geographical region.”¹⁵ There is also no distinction made between bilateral trade agreements concluded between two parties and those agreements between more than two parties. They are instead all referred to as regional trade agreements or free trade agreements, with the two terms used interchangeably in this paper.¹⁶ However, to the extent that R.T.As also cover agreements between countries in different regions, Asian R.T.As are used to mean those arrangements between countries in Asia.

Economic integration may be conducted through different approaches, each of which however also represents a different degree of integration. Three approaches may be distinguished in this regard.¹⁷ First, there is *sectoral* integration, which is used to mean integration which is “(i) limited to particular industries or sectors of the economy or economies concerned; (ii) gradual, proceeding successively from sector to sector.” Second, *functional* integration refers to integration which is “(i) gradual, proceeding successively from sector to sector; (ii) by means of price incentives operating in a free market.” In its first aspect, functional integration is identical to the second sense of sectoral integration. However, the latter is more inclined to be used as distinct from general across-the-board integration. The last one is *institutional* integration, used to mean integration which is “by means of adaptations of national or international institutions (in the widest sense of the word, for example, monetary practices and arrangements)”. In the regionalism literature, the second sense of institutional has been more customary.

Sectoral and/or functional integration is often characterised as “market-driven” integration whilst institutional integration is known as “policy-driven.” It has been observed that regional

¹⁴ Peter Lloyd & Penny Smith, “Global Economic Challenges to ASEAN Integration and Competitiveness: A Prospective Look” REPSF Project 03/006a, at 11, online: <<http://www.aadcp-repsf.org/cgi/axs/ax.pl?http://www.aadcp-repsf.org/docs/03-006a-FinalReport.pdf>> .

¹⁵ *Ibid.*

¹⁶ Jagdish Bhagwati has suggested the use of “preferential trade agreements” instead of free trade agreements and custom unions because the latter two phrases can mislead the public to equate them with nonpreferential free trade. See Jagdish Bhagwati, Pravin Krishna & Arvind Panagariya, eds., *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* (Cambridge, Massachusetts: The MIT Press, 1999) at 33.

¹⁷ F. Machlup, “Economic Integration” in Miroslav N. Jovanovic, ed., *International Economic Integration: Critical Perspectives on the World Economy, Volume I: Theory and Measurement* (London and New York: Routledge, 1998) at 142.

economic integration in Europe under the auspice of the European Union (EU) corresponds more to the policy-driven model of institutional integration as, in Europe, “the origins of integration have been institutional in nature, and the development of institutions has been prominent throughout the process”.¹⁸ In contrast, integration in East Asia has been market-driven. Although the existing institutions in this region are fairly weak and ineffective, “[i]ntra-industry trade in parts and components and foreign direct investment – conducted by corporations and encouraged by significant liberalisation – have been and continue to be the key driving forces of the established production-sharing system, of the evolution of these cross-border networks and of the fostering of regional cooperation and integration”.¹⁹ As will be discussed below, China is a major player in this production-sharing regime and plays a key role in shaping the market-driven integration in Asia.

It is, however, over-simplistic to characterise any of the two integration model as entirely market-driven or policy-driven. The role of market forces in European integration should never be underestimated. For instance, in the sense that the extent of regionalisation is commonly measured by the share of intra-regional trade in total trade, intra-regional trade in Western Europe (EU-15) had amounted to over 50 per cent long of total volume of trade before the Single Market was formed in 1992.²⁰ On the other hand, national governments in Asia, through inter-governmental cooperation, have been playing a significant role in the integration process, albeit Asian supranational institutions have not yet developed.

Lastly, it is fundamentally important to stress that, although regional integration requires the existence of substantial political will to cooperate, it does not necessarily include the political commitment to political integration or political union. In other words, “aspirations for political union are not a necessary precondition for building regional institutions that foster economic integration”.²¹ This is of course the experience of Europe, but it would be highly relevant in the Asian context as political integration in Asia is almost unattainable in the foreseeable future.

B. *The Regionalism v. Multilateralism Debate in the Asian Context*

1. *Economic Impact of R.T.As: Trade Creating or Trade Diverting?*

Regionalism, practiced mainly through R.T.As/F.T.As at this stage, is questioned by conventional economic theory for its benefits to both the contracting parties and the third countries outside the agreements. Using the words of Jacob Viner in his pioneering analysis of

¹⁸ Eisuke Sakakibara & Sharon Yamakawa, “Market-driven Regional Integration in East Asia” in Julie McKay, Maria Oliva Armengol & Georges Pineau, eds., *Regional Economic Integration in a Global Framework* 35-78 (Proceedings of the G20 Workshop, 22-23 September 2004, Beijing, China) (Frankfurt: European Central Bank, 2005) at 35.

¹⁹ Julie McKay, Maria Oliva Armengol & Georges Pineau, eds., *Regional Economic Integration in a Global Framework* (Proceedings of the G20 Workshop held in Beijing, China, 22-23 September 2004) (Frankfurt: European Central Bank, 2005) at 12.

²⁰ See Table 1 below.

²¹ C. Randall Henning, “Regional Economic Integration and Institution Building” in Julie McKay, Maria Oliva Armengol & Georges Pineau, eds., *Regional Economic Integration in a Global Framework* (Proceedings of the G20 Workshop held in Beijing, China, 22-23 September 2004) (Frankfurt: European Central Bank, 2005) at 79.

the economics of customs unions, the question is about the economic costs and/or benefits of a R.T.A “(a) for each of the [RTA participating] countries taken separately; (b) for the two combined; (c) for the outside world; and (d) for the world as a whole”.²²

The analytical framework of the economics of R.T.As is still based on the key concepts of trade creation and trade diversion introduced by Viner. Trade creation takes place when, as a result of the removal of tariffs on intra-area trade, domestic production of a product is displaced by imports from another member of the R.T.A whose comparative advantage enables it to produce the goods at a lower cost. The preferential tariff rate established by a R.T.A. might also cause trade diversion, defined as a shift of production away from a lower-cost producer outside the R.T.A. to a higher-cost source of supply within it.²³

Both the economic literature and empirical studies of the impact of R.T.As lead to notoriously ambiguous results. With regard to the trade stimulating effects of R.T.As on the participating members, the findings generally suggest that R.T.As have a positive welfare consequence on the members.²⁴ This is because regional cooperation in the R.T.As “offers one route to overcome the disadvantages of smallness, by pooling resources or combining markets”.²⁵ R.T.As can first of all foster competition in an enlarged market, and as such they can increase efficiency of domestic firms which have to face greater competition brought about by the entry of foreign competitors in previously trade-protected sectors. There are also market-size effects associated with R.T.As, in the sense that the combined size of the consumer base and the suppliers can offer significant scale effects. Further, R.T.A. membership can make the participating countries more attractive to FDI as foreign investors will be induced to invest in the integrated market.²⁶

Trade-diversion of R.T.As is an issue that economists and policy-makers have long studied and debated. In this regard, Viner’s seminal contribution was in showing that the formation of a R.T.A. is not necessarily welfare-improving. As Bhagwati puts it, this serves to “destroy the common fallacy that a preferential move toward (total) free trade was necessarily welfare improving and thus to demonstrate that all preferential paths to (total) free trade were not monotonic in welfare”.²⁷ However, the voluminous literature generated thereafter does not offer conclusive evidence as to whether, in any particular R.T.A. or all the R.T.As overall, trade creation will exceed trade diversion or *vice versa*.²⁸ For instance, regarding the enlargement of the European Union (to include Greece, Portugal, and Spain), the study of Bayoumi and Eichengreen finds no evidence of trade diversion, while another study by Wei and Frankel

²² J. Viner, “The Economics of Customs Unions”, in Miroslav N. Jovanovic, ed., *International Economic Integration: Critical Perspectives on the World Economy, Volume I: Theory and Measurement* (London and New York: Routledge, 1998) at 169.

²³ *Ibid.* at 170.

²⁴ Asian Development Bank (ADB), *Asian Development Outlook 2002* (Manila: Asian Development Bank 2002) at 176; World Bank, *Global Economic Prospects 2005* (Washington DC: World Bank, 2005) at 57-65.

²⁵ World Bank, *Trade Blocs* (Oxford: Oxford University Press, 2000) at 30-31.

²⁶ ADB, *supra* note 24 at 175-176.

²⁷ Jagdish Bhagwati, *The World Trading System at Risk* (Princeton, New Jersey: Princeton University Press, 1991) at 59.

²⁸ Jiangyu Wang, “China’s Regional Trade Agreements: The Law, Geopolitics, and Impact on the Multilateral Trading System.” (2004) S.Y.B.I.L. 119 at 143.

discovers “massive trade diversion”.²⁹ Not surprisingly, former U.S. Treasury Secretary Lawrence Summers, who is also a distinguished economist, offered the opinion that “[t]rade diverting regional arrangements may be desirable despite their trade diverting effects”, and concluded that that he found “it surprising that this issue is taken so seriously – in most other situations, economists laugh off second best considerations and focus on direct impacts”³⁰

A very recent staff study of the International Monetary Fund (IMF), using a widely adopted gravity model, suggests that Asian R.T.As have not led to trade diversion as the rapid trade growth among members for R.T.As was not associated with any decrease in trade with nonmembers.³¹ Further, compared to R.T.As in other regions of the world, the study suggests that “the members of RTAs in Asia - especially ASEAN - showed a higher degree of openness with nonmembers than other RTA countries outside the region do”.³² According to the IMF study, the fact that R.T.As in Asia have been more trade-creating than other R.T.As to date can be explained by another fact, which is that “regional trade integration in Asia followed a long period of unilateral liberalization during the 1980s and 1990s”.³³ This is in line with the economic theory that, to avoid the asymmetric distribution of the gains and losses of integration between regional members, the best solution is to lower the external trade barriers.³⁴

2. WTO Constraints on R.T.As

A R.T.A. must comply with WTO rules if any of its contracting parties is a WTO Member. However, any R.T.A, because it incurs preferential treatments only amongst its members inter se, is, by definition, a violation of the principle of non-discrimination of the WTO, embodied in the most-favoured-nation clause in WTO Agreements such as the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS). The draftsmen of the GATT and the WTO Agreements were well aware of this and therefore created several safe harbours to accommodate R.T.As. Under the current WTO regime, R.T.As are subject to three sets of rules. The first is Article XXIV of GATT 1947 which, as clarified in the *Understanding on the Interpretation of Article XXIV* of the GATT 1994, provides for the formation and operation of customs unions and F.T.As on trade in goods. The so-called “Enabling Clause”, formally called the *Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries* passed by the GATT Council in 1979,³⁵ permits preferential trade arrangements in trade

²⁹ *Supra* note 24 at 61.

³⁰ Lawrence H. Summers, “Regionalism and World Trading System” in *Policy Implications of Trade and Currency Zones* (Kansas City: Federal Reserve Bank, 1991) 299, online: <<http://www.kansascityfed.org/publicat/Sympos/1991/SYM91.HTM>>.

³¹ International Monetary Fund, *Asia and Pacific Regional Economic Outlook* (Washington D.C.: IMF, 2006) at 75, online: <<http://www.imf.org/external/pubs/ft/reo/2006/eng/01/areo0506.htm>> .

³² *Ibid.* at 76.

³³ *Ibid.* at 77.

³⁴ Bernard Hoekman & Maurice Schiff, “Benefiting from Regional Integration” in Bernard Hoekman, Aaditya Mattoo & Philip English, eds., *Development, Trade, and the WTO* (Washington D.C.: the World Bank, 2002) at 552. Three reasons as to why a RTA should lower external trade barriers are suggested: “(a) to generate classical gains from trade; (b) to lessen the chances that trade diversion will occur; and (c) to reduce income transfers between member countries resulting from the [RTA] and the tensions that can arise from such transfer”.

³⁵ *The Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries*, (1979), GATT Doc. L/4903 [hereinafter the Enabling Clause].

in goods between developing country Members. Finally, Article V of GATS, entitled “Economic Integration”, governs the formation of R.T.As in the area of trade in services.³⁶

Are the above rules effective in terms of judging the WTO-consistency of any R.T.A? It is noted that “RTAs are generally WTO-consistent”, albeit “this is because the requirements of Article XXIV and the Enabling Clause and GATS are very weak and have never been enforced”.³⁷ This statement reveals the poverty of the WTO rules in containing regionalism, despite the WTO’s view that it is an adversary of the multilateral trading system. Regarding whether R.T.As can comply with WTO Rules, one commentator observes

Theoretically, the answer is yes. After all, if a country is a Member of the WTO, the obligation to comply with the rules of the multilateral trading system is mandatory. However, a more useful answer is probably “no”, because of the reasons implied in the above analysis. To summarise, firstly, the WTO rules on the introduction of R.T.As are troublesomely ambiguous and cannot be followed in an operational way. It is the inadequacy of the WTO rules that is principally to blame, as opposed to Members’ non-compliance (if any). Secondly, the nature of the WTO as a consensus-based institution prevents it from strengthening the enforcement of the existing rules. Roughly starting with the examination of the EEC, which was given up in early GATT days due to a clash of political interests, and was never picked up again. Although the reason behind the failure of enforcement is the divergent interpretations of WTO rules by Members, the real implication seems to be that almost no R.T.A. can ever be declared unlawful under the current WTO regime and that the process of CRTA examination can, in practice, be ignored.³⁸

Experience shows that, to comply literally with GATT/WTO rules governing R.T.As, Members involved in R.T.As need only to notify the agreements to the WTO in a timely fashion either before or after their taking effect. Until the WTO substantially revises its rules governing regional economic integration, there is no imminent need for R.T.A. members to worry about compliance with the substantive WTO requirements. In this sense, since China has already notified the WTO of its R.T.As, it can be assumed that those R.T.As are to be deemed compatible by the WTO unless the WTO can render adverse reports and recommendations.

3. *The Systemic Problems*

³⁶ *Marrakesh Agreement Establishing the World Trade Organization*, 15 April 1994, 1867 U.N.T.S. 3 at Annex 1B, Art. V [hereinafter WTO Agreement].

³⁷ Peter Lloyd, “Implications for the Multilateral Trading System of the New Preferential Trading Arrangements in the Asia Pacific Region” (Paper presented at the Pacific Economic Cooperation Council (PECC) Trade Forum, November 2002), online: <<http://www.pecc.org>>.

³⁸ *Supra* note 28 at 138.

The explosive proliferation of R.T.As is constructing an extremely network of different trading rules. The existence of several hundreds regional agreements has meant overlapping members for many countries, some of which are parties to dozens of agreements.³⁹

However, the fear of Asian R.T.As being detrimental to the interests of trading nations has caused the ADB, an enthusiastic promoter of Asian regionalism, to point out that

[T]he proliferation of a large number of bilateral FTAs can lead to the “Asian noodle bowl effect” highlighted by [ADB] President Kuroda following Professor Bhagwati’s initial observation. There can be harmful effects caused by multiple rules of origin arising from overlapping agreements among members of different FTAs. Complex rules increase administrative and business costs, particularly for small and medium enterprises which have limited capacity to deal with them. Furthermore, if they have large transactions costs, such rules can deter foreign investment and trade.⁴⁰

The complex rules and procedures for trade related policies in R.T.As have also caused grave concerns in the private sector. In a trade conference of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), a Hong Kong businessman pointed out the troublesome consequences for the global production system created by R.T.As:

I am deeply concerned that the proliferation of bilateral agreements is forcing businesses to sub-optimize. Imagine the situation facing the supply chain manager. You have thousands of products in tens of countries, and hundreds of factories. In structuring the supply chain, every country of origin and every bilateral has to be tacked on as an additional consideration. With each new bilateral, the considerations related to “rules of origin” multiply and become more complex.... Even larger companies have a hard time keeping the track. For small firms, it is impossible. That is why the multilateral system is so important. It defines rules of universal application. It is necessary to understand only one guiding set of rules.⁴¹

He further observed

From a business standpoint, the question in instructing the supply chain should not be how to qualify for favourable “rules of origin” treatment. Instead, the question should be “what is the optimal way to create a product?” I should do this in the most cost-effective way for the final consumer. That is the only thing about which I should be worried. Why

³⁹ Singapore, for example, has concluded 11 F.T.As and is in the process of negotiating another 15 more. See Singapore’s F.T.A. Network at <http://www.fta.gov.sg>. The EU has concluded over 30 preferential trade agreements, and the U.S. has concluded over 20.

⁴⁰ Liquin Jin, “Issues and Challenges in Designing Free Trade Agreements in Asia – Welcome Remarks by Liquin Jin, Vice-President, Operation 1, Asian Development Bank, at the Brainstorming on Free Trade Agreements” (20 March 2006), online: <<http://www.adb.org/Documents/Speeches/2006/ms2006016.asp>>.

⁴¹ Victor Fung, “Luncheon Address by Mr. Victor Fung, Chairman, Li & Fung Group Ltd., On Business Perceptions and Expectations Regarding the WTO Doha Negotiations” in United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Delivering on the WTO Round: A High-level Government-Business Dialogue* (Proceedings of the Conference on Delivering on the WTO Round: A High-Level Government-Business Dialogue for Development, organised by ESCAP in collaboration with the International Trade Centre, UNCTAD/WTO and the Government of Macao, China, 4-6 October 2005, Macao, China.

should I worry about where is the point of “substantive transformation”? Why should I worry about it occurring in any particular location in order to qualify for duty-free treatment? The whole world should do it based on economics...⁴²

It is however politically unrealistic to expect the trading nations to call a stop to the proliferation of R.T.As, especially in light of the domino effect of regionalism, whereby countries participate in bilateral or regional trade arrangements to avoid marginalisation as more and more countries become members of – in many situations more than one – R.T.As.⁴³ Further, the formation of rules of origin and other rules or procedures in a R.T.A. is influenced by many factors, including, significantly, the interest of domestic producers who expect exclusive protection from those rules that may help to prevent competition from foreign exporters. It is important to bear in mind that, for many domestic interests, the philosophy of trade is not yet “the freer, the better.”

In the global context, the burgeoning number of R.T.As has contributed to the trend of adding greatly to the complexity of international trade and to the costs of trade. Realistically, it is impossible to avert the problems entirely, as, by definition, R.T.As have different rules and systems. A more practical solution might lie in synthesising R.T.As with the multilateral, namely the WTO, system, including the harmonisation of rules and convergence of procedures and standards. The general idea is that, under the guidance of the principles of the WTO, Asian R.T.As should adopt common rules and procedures to the maximum extent, and conduct most-favored-nation (MFN) based liberalisation whenever possible.

4. *Concluding Remarks: Making Regionalism Complementary to Multilateralism*

There is little doubt that multilateral liberalisation is still the best approach to international trade and development. Without challenging this, regionalists argue that regionalism is the second-best approach for liberalisation, especially given the frustration caused by the slow and halting pace of multilateral trade negotiations conducted under the auspices of the WTO.

The fact that WTO constraints on R.T.As are ineffective does not entail that R.T.As should be WTO-inconsistent. On the contrary, efforts should be made to ensure that R.T.As are “building blocks” rather than “stumbling blocks” to the goal of multilateral freeing of trade.⁴⁴ In this regard, the following recommendations are made:

- (a) R.T.A. members should reduce external trade barriers while participating in regional initiatives. Both theory and empirical evidence suggest that the lower the external trade barriers, the lesser the possibility of trade diversion.
- (b) Solving the systemic problem represented by the “spaghetti bowl” is a rather urgent problem for global R.T.As.⁴⁵ The complex rules of origin, used beyond what is necessary to prevent trade deflection or the transshipment of goods from third

⁴² *Ibid.*

⁴³ Regarding the domino effect of regionalism, see *e.g.*, Richard Baldwin, “A Domino Theory of Regionalism”, National Bureau of Economic Research (NBER) Working Paper No. 4465 (Cambridge, MA: NBER, 1993).

⁴⁴ *Supra* note 16 at 36.

⁴⁵ The “spaghetti bowl” problem, first coined by Jagdish Bhagwati, refers to “a messy maze of preferences as [F.T.As] formed between two countries, with each having bilaterals with other and different countries, the latter in turn bonding with yet others, each in turn having different rules of origin for different sectors.” Jagdish Bhagwati, *Free Trade Today* (Princeton and Oxford: Princeton University Press, 2002) at 112-113.

countries through a member for the purpose of obtaining preferential R.T.A. tariffs, have indeed been evolving toward protectionism. While it is unrealistic to abolish the rules of origin in R.T.As, it is highly advisable to harmonise them, although the process is doomed to be difficult. At the minimum, in the interest of regional integration, Asian countries, while negotiating R.T.As, should reach an informal common understanding on adopting same or similar rules of origin.

- (c) Apart from rules of origin, other trade institutions, including national policies, should also be harmonised or coordinated at the regional level to further economic integration, provided that the harmonisation is beneficial. This would involve domestic competition policies, product standards, regulatory regimes, investment laws, services rules, environmental polices, and so on.⁴⁶ Policymakers should however be careful about this as, in some situations, “there are good reasons for diversity in domestic policies across nations and that harmonization is ... not a welfare-enhancing proposition”.⁴⁷ (Further, harmonisation on the wrong policy can prove counterproductive, if not disastrous.⁴⁸
- (d) In any event, a R.T.A. should be WTO-plus and should adopt the common trade rules already established by the WTO.
- (e) Open regionalism is integral to the success of R.T.As which are building blocks of the multilateral trading system. “Open regionalism” is defined as having the following characteristics: (1) open membership, with membership extended to non-members on a mutually reciprocal basis; (2) commitment of members to lower external trade barriers while trade is liberalised internally on an MFN basis; (3) encouragement of unilateral liberalisation by members to other members or nonmembers.⁴⁹ Although Asian countries are encouraged to conduct unilateral liberalisation in any event, it is however doubtful that, in the interest of Asian economic integration, an Asian F.T.A. or East Asian Economic Community should extend its membership to countries outside the region.

II. REGIONAL ECONOMIC INTEGRATION IN ASIA AND THE ROLE OF CHINA AND INDIA

A. Regional Economic Integration in Asia

The rise of Asia is no longer an *id⁵⁰ea* – it has become a sustaining reality. The *Asian Development Outlook 2006*, the flagship publication of the ADB, notes that developing Asia (excluding Japan) had expanded its export almost ten-fold from 1984 to 2004, while world exports grew just fivefold over the same period. Developing Asia’s share of world exports doubled over the past two decades, reaching 21.3% by 2004. Asia not only expanded its share globally, but it also increased intraregional trade. As Table 1 shows, in 2004, intra-regional trade

⁴⁶ Robert Z. Lawrence, *Regionalism, Multilateralism, and Deeper Integration* (Washington D.C.: The Brookings Institution, 1996) at 17.

⁴⁷ Arvind Panagaria, “The Regionalism Debate: An Overview” (1999) 22(4) *World Economy* 477 at 506.

⁴⁸ *Supra* note 46 at 33.

⁴⁹ C. Fred Bergsten, “Open Regionalism” Working Paper 97-3 (Washington D.C.: Institute for International Economics, 1997), online: <http://www.iie.com/publications/wp/wp.cfm?ResearchID=152>.

⁵⁰ Asian Development Bank (ADB), *Asian Development Outlook 2006* (Manila: Asian Development Bank 2006) at 269.

in developing Asia accounted for 44% of the region's total trade, jumped from just 21.6% in 1980. Needless to say, this magnitude of intra-regional trade has given rise to lofty aspirations for pushing further economic integration in Asia, ideally (or idealistically) toward an Asian free trade area or something more (such as an Asian Monetary Union).⁵¹

Table 1: Intraregional Trade Share (%) of Selected Regions

Region	1980	1985	1990	1995	2000	2001	2002	2003
East Asia, including Japan	34.7	40.2	45.6	55.5	54.0	55.4	57.3	54.0
Developing East Asia	21.6	29.1	36.4	43.7	43.4	45.6	47.5	44.1
NIEs	7.7	10.7	14.3	18.1	16.4	17.5	17.1	16.1
ASEAN	18.0	20.3	18.9	24.1	25.7	24.1	24.4	24.0
NAFTA	33.8	38.7	37.9	43.2	48.7	49.0	48.3	46.0
European Union 15	52.4	52.5	58.6	56.8	62.2	62.1	62.4	64.4

ASEAN = Association of Southeast Asian Nations, NAFTA = North American Free Trade Agreement.
 Notes: East Asia comprises Japan, ASEAN, PRC, newly industrialized economies (NIEs) of Hong Kong, China; Korea; Singapore; and Taipei, China. Developing East Asia excludes Japan.

Source: ADB 2006

Although there is already a rather large amount of intraregional trade in Asia, a recent ADB study shows there is still room for Asia countries to gain from further regional economic integration in Asia.⁵² Using the new Global Trade Analysis Project (Version 6) database with a dynamic global model, the study concludes, among others,

- (i) *Trade within the Asian region is far from reaching its potential, and policies that facilitate integration and more efficient regional trade accelerate growth and expand its basis, especially for lower-income Asia.*
- (ii) *Tariff barriers are only part of the challenge to further economic integration and trade expansion in the region.... A deeper and more inclusive Asian Free Trade Area can achieve for its members larger benefits than that would arise from global trade liberalization along [WTO] lines.*
- (iii) *The economies of the [ASEAN] have the most to gain (in domestic terms) from Asian economic integration, provided that this happens in a relatively uniform way.*

⁵¹ See Haruhiko Kuroda, "Towards a Borderless Asia: A Perspective on Asian Economic Integration" (Speech given at The Emerging Markets Forum, 10 December 2005, Oxford, UK), online: <<http://www.adb.org/Documents/Speeches/2005/ms2005088.asp>>. In his speech the ADB President envisages a vision of Asia "free of poverty – diverse yet united, well integrated within itself and with the global economy, and contributing profoundly to the ongoing progress of humankind." He further remarks that, "Some skeptics may call this vision of deeply integrated Asia a pipe dream. Some say the disparities are too wide, the political divides too deep. But strong bridges for a united Asia, open to the world, are already being built".

⁵² David Roland-Holst, Jean-Pierre Verbieft & Fan Zhai, "Growth and Trade Horizon for Asia: Long-term Forecasts for Regional Integration" (2005) 25(2) *Asian Development Review* 76.

Apparently, this study suggests that a R.T.A. aiming at a deeply integrated Asia would bring substantial benefits to Asian countries regardless of whether the multilateral trading system ever delivers results.⁵³

The fast growth of Asian trade and accelerated regional integration was, in substantial measure, due to the locomotive economic performance of East Asia. If Japan is included, intra-regional trade makes up for 54% of total trade in East Asia. The President of the ADB has remarked that this is “higher than the 46% intraregional trade in the NAFTA region and is very much comparable to intraregional trade in the European Union before the 1992 Maastricht treaty”.⁵⁴

There is a trade-foreign direct investment (FDI) nexus in Asia which, understood as the mutual reinforcement between trade and FDI, is a strong boost to regional economic integration in this area.⁵⁵ FDI to the Asian developing countries from the more developed economies (Japan; Korea; Taiwan, China; Hong Kong, China) has helped shape totally new Asian production networks, in which cross-border production sharing is featured, with a high and increasing amount of intraregional trade in parts and components that are produced and assembled into final goods within Asia.

Apart from trade investment, Asian economic integration has also been seen in monetary and financial cooperation, and sub-regional cooperation in infrastructure. As noted by Kawai, in East Asia, “[m]arket-driven financial integration has also been underway as a result of the increased deregulation of the financial system, opening of financial services to foreign institutions, and liberalization of the capital account”.⁵⁶ Regional financial cooperation, through the Chiang Mai Initiative (CMI), the ASEAN+3 economic surveillance process, and the Asian Bond Markets Initiative, has been taking root firmly in Asia. Although these efforts are being mainly undertaken in East Asia, South Asian countries have also started regional policy dialogue on financial cooperation.⁵⁷

Sub-regional cooperation on infrastructure is a key part of the economic integration process in Asia. Roland-Holst, Verbiest and Zhai observe that “if trade within the Asian region can be made more efficient, even by small by continuing improvements in reducing distribution costs, the gains would be much greater than those resulting from tariff or other trade policy reform”.⁵⁸ In this regard, connecting Asian countries through roads, ports, bridges, power and telecommunication networks is fundamentally important for another wave of income and growth and employment creation in Asia. One of the remarkable achievements in this regard is the Greater Mekong Sub-region Programme (GMS). Involving Cambodia, China, Laos, Myanmar, Thailand and Vietnam, the GMS has achieved international recognition with regard to the

⁵³ See also *supra* note 51.

⁵⁴ Haruhiko Kuroda, “New Dynamics, New Opportunities: Toward Deeper Asian Economic Integration.” (Speech given at the 31st ASEAN-Japan Business Meeting, 24 November 2005, Bangkok, Thailand), online: <<http://www.adb.org/Documents/Speeches/2005/ms2005084.asp>>.

⁵⁵ Asian Development Bank (ADB), *Asian Development Outlook 2006* (Manila: Asian Development Bank 2006) at 272.

⁵⁶ Masahiro Kawai, “East Asian Economic Regionalism: Progress and Challenges” (2005) 16 *Journal of Asia Economics* 29 at 34.

⁵⁷ *Supra* note 51.

⁵⁸ *Supra* note 52 at 77.

development of infrastructure to enable the development and sharing of the resource base, and promote the freer flow of goods and people in the sub-region.⁵⁹

B. The Economic Role of China and India in Asia Economic Integration

China's rapid and massive rise as an economic power has an enormous impact on the global and regional economy. In terms of regional integration, China is playing the leading role in two aspects. First, China's import capacity has created the new basis for Asian regional growth: internal demand.⁶⁰ With many Asian economies' exports to China rising by double-digit percentages over the recent years, that country has consolidated its position as the leading market for Asian traders (see Chart 1). In 2003, China replaced Japan as the third largest importer in the world for merchandise trade and the biggest Asian market for both Asian and EU exporters. The result is that Asian countries are becoming less dependent on the North American and European markets, and more on the Chinese market,⁶¹ although the increasing Chinese demand for raw materials has been regarded as an important factor in reversing the long-term downward trend in the prices of non-oil commodities.⁶²

⁵⁹ For details of the GMS, see the "GMS Economic Cooperation Strategy and Programme (RCSP)" at <http://www.adb.org/Documents/CSPs/GMS/2004/default.asp>.

⁶⁰ *Supra* note 52 at 78.

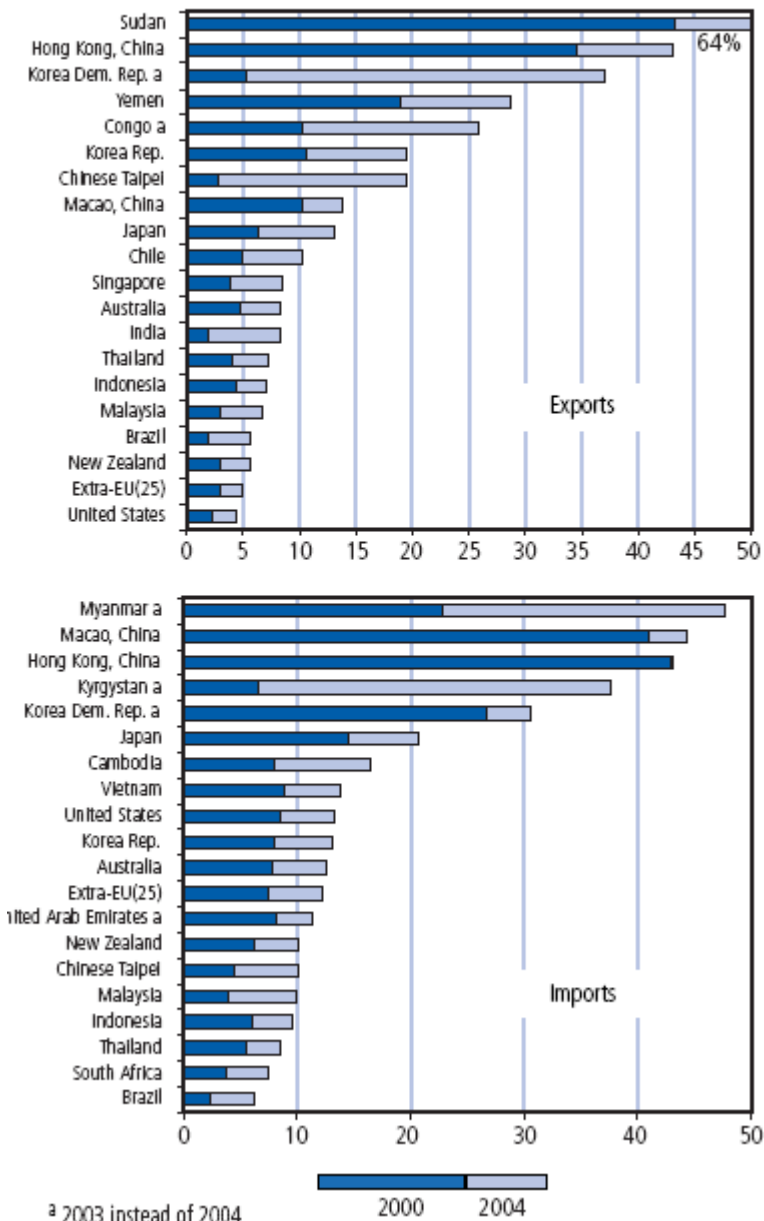
⁶¹ As Chart 1 shows, from 2000-04, China had doubled its share of the imports and exports of a number of Asian economies. Over the same period, although Asia's exports to North America and Europe continued to increase by 20 percent and 24 percent, respectively, the share of North America in Asia's exports went down to 22.3 percent from a higher figure, while the share of Europe remained unchanged at 17.5 percent. See World Trade Organisation, *International Trade Statistics 2005* (Geneva: WTO, 2005) at 15.

⁶² UNDPPO (United Nations Development Policy and Planning Office), *World Economic Situation and Prospects 2005* (Geneva: The United Nations, 2005) at 28-29.

Chart 1:

Share of China in selected economies' merchandise exports and imports, 2000 and 2004

(Percentage share)



Source: WTO 2005.

A second profound impact of China's rise on Asian economic integration is that China plays a major role in shaping the new division of labor in Asia, largely as a result of the trade-FDI nexus mentioned previously. As a UNCTAD report observes,

Deeper production-sharing practices within the [East Asia] region have contributed substantially to the rise of intraregional trade flows. In particular, China's emergence as a major production site for labor-intensive stages of production and assembly has exerted a huge impact on such flows, both within Asia and between Asian and the rest of the world. Goods that were previously processed and exported by other Asian countries are now finalised in China for export. This phenomenon explains, in large part, the increasing bilateral trade imbalances between China and its major trading partners; China has recorded growing trade surpluses with North America and Europe, while widening its trade deficit with the rest of Asia.⁶³

Compared with China, India as a trader is much less significant. As Table 2 demonstrates, China's economy is 2.7 times larger than that of India's, and the annual FDI received by China is more than 10 times as large. China's share in world merchandise trade is roughly 6 times of India's. Needless to say, India, unlike China, is not yet a market important enough for Asian traders. However, there are two developments in India's foreign trade which deserve special attention. First, India's merchandise trade has experienced a strong growth in recent years. Its merchandise exports grew 33 percent and 19 percent in 2004 and 2005 respectively, and import levels rose at even higher rates of 37 percent and 35 percent respectively (WTO 2005). India's merchandise trade with East Asian economies more than doubled from US\$ 13 billion in 1997-98 to about US\$ 27 billion in 2003-04. In fact, India expanded its trade with all East Asian countries except Japan over the same period.

A UN report reveals that, although India is still far from having manufacturing-driven growth that has characterised the other rapidly growing Asia economies, the "structure of India's merchandise trade is likely to follow a sequence of changes similar to that of China, but with a lag of one or two decades," provided "the role of industrialization in India's further economic ascent is similar to that in the other fast growing Asian economies".⁶⁴

Secondly, the recent growth of India's trade in services is almost unparalleled. The growth rate for the exports and imports of services were 66 percent and 53 percent in 2004, and 76 percent and 73 percent in 2005.⁶⁵ In about five years since 2001, India moved from the 19th to the 10th position in the ranking of the largest traders of commercial services in the world. If such rapid growth rates are sustained, India is likely to overtake several countries, including China, in trade in services in a few years. No other major trading nation has enjoyed such remarkable growth in trade in services in the past few decades.

It has been observed that, given "the large size of the Chinese and Indian economies, and their specific patterns of demand, changes in the two countries' level and structure and demand

⁶³ UNCTAD (United Nations Conference on Trade and Development), *Trade and Development Report, 2004* (Geneva: The United Nations, 2004) at 46.

⁶⁴ UNCTAD (United Nations Conference on Trade and Development), *Trade and Development Report, 2005* (Geneva: The United Nations, 2005) at 43, 69.

⁶⁵ World Trade Organisation, *World Trade 2005, Prospects for 2006* (Geneva: WTO, 2006).

will tend to have a much larger impact on the composition of world trade than those of Japan and the Republic of Korea during the economic ascent".⁶⁶ China and India, with sustained rapid growth and rising living standards, will certainly play dominant roles in the process of economic integration in Asia.

		China		India	
		2001	2005	2001	2005
GDP (US\$ bn)		1324.8	2224.9	478.3	803.3
GDP growth rate (%)		8.3	9.9	5.8	8.1
GNI per capita (US\$)		1000	- (1,500 in 2004)	460	- (620 in 2004)
Value of Trade in Goods (US\$ bn)	Exports	266.2	762	43.6	89.8
	Imports	243.6	660.1	49.6	131.6
Share in world trade in goods (%)	Exports	4.3	7.3	0.7	0.9
	Imports	3.8	6.1	0.8	1.2
Annual percentage change: goods (%)	Exports	7	28	3	19
	Imports	8	18	-3	35
Value of trade in commercial service (US\$ bn)	Exports	32.9	81.2	20.4	68
	Imports	39.0	85.3	23.4	67
Share in world trade in services (%)	Exports	2.3	3.4	1.4	2.8
	Imports	2.7	3.6	1.6	2.9
Annual percentage change: services (%)	Exports	9	31	15	76
	Imports	9	19	19	73
Rank in world trade: goods	Exports	6	3	30	29
	Imports	6	3	27	17
Rank in world trade: services	Exports	12	8	19	10
	Imports	10	7	18	10
Foreign direct investment (US\$ bn)		46.8	60.3	4.7	- (3.2 in 2004)
Foreign exchange reserves (US\$ bn)		212.2	820	51	137.4
Tariff binding coverage (%)			100		73.8
Bound tariff (%)			10.0		49.8
Applied tariff (%)			10.4		29.1
Share of MFN duty free imports			34.0		2.1
GATS services sectors with commitments			93		37

Note: EU is not counted as a single trader and hence intro-EU trade is not excluded.

Source: The Economist Intelligence Unit, World Bank, Asian Development Bank, World Trade Organisation, International Monetary Fund.

⁶⁶ Supra note 64 at 42-43.

III. REGIONAL TRADE ARRANGEMENTS PARTICIPATED BY CHINA AND INDIA

R.T.As are proliferating in Asia and worldwide. At the global level, almost every WTO Member is now a party to one or more R.T.As. While Asia has jumped on the bandwagon of regionalism only recently, the current pace of development of R.T.A. initiatives in this region is nothing but daunting. The ADB⁶⁷ observes in its most recent report on Asian economic development that, by 2005, a total of 36 RTAs involving Asian members have been formally notified to the WTO, with a much bigger number of agreements are under negotiation.⁶⁷ The ADB has disclosed that “[i]n East Asia alone there are currently 16 FTAs under implementation, close to 22 under negotiation, and more than a dozen others proposed. Practically every East Asian economy has at least one bilateral agreement with its Asian neighbors in place and many have several overlapping accords”.⁶⁸ Although China and India jumped onto the bandwagon only recently, they can now be placed among the most active pursuers of R.T.As. The regional initiatives of China and India will be examined in the following subsections.

A. China’s Regional Trade Initiatives

1. The CEPAs with Hong Kong and Macau

Although China began embracing regionalism relatively recently, it appears to firmly believe that “a regional economic integration process consistent with WTO rules would not only promote regional but also worldwide liberalisation by achieving further tariff reduction and broader market access for services and investment”.⁶⁹ As Table 3 shows, China has been involved in over 15 R.T.As. The *Mainland and Hong Kong Closer Economic Partnership Arrangement* (China-HK CEPA), signed in June 2003, marked the start of China’s regional initiative, which was followed immediately by the signing of the *Mainland and Macau Closer Economic Partnership Arrangement* (China-Macau CEPA) three and half months later.⁷⁰ The Closer Economic Partnership Arrangements (C.E.P.As) contains substantial unilateral concessions from China to the two former Western colonies in merchandise and commercial services trade, and investment. Under the China-HK CEPA, China agreed to slash tariffs on imported goods of Hong Kong origin in stages, with full elimination of all tariffs no later than 1 January 2006. The CEPA rule of origin, which is relatively liberal, features a 30 per cent value-added of Hong Kong’s local content. In the area of trade in services, the mainland offers preferential treatment to Hong Kong and Macau service suppliers in 27 service areas, effectively granting business in these two economies the first-mover advantage.

2. China-ASEAN Free Trade Agreement

⁶⁷ *Supra* note 55 at 276.

⁶⁸ *Supra* note 40.

⁶⁹ World Trade Organisation, *Trade Policy Review: People’s Republic of China – Report by the Secretariat* (WTO Document No.: WT/TPR/S/161) (Geneva: WTO, 2006) at 45.

⁷⁰ In the China-HK CEPA, two supplements to CEPA, called CEPA II and CEPA III, were signed on 27 October 2004 and 18 October 2005 respectively. Details are available on <http://www.tid.gov.hk/english/cepa/index.html>.

Considering that Hong Kong and Macau are two special administrative regions under Chinese sovereignty, ostensibly the two C.E.P.As are less regarded as R.T.As. Among China's regional trade agreements, one of the most influential is the proposed *China-ASEAN Free Trade Agreement* (ACFTA). Coming almost as a surprise to his counterparts in the ASEAN countries, Chinese Premier Zhu Rongji proposed at the China-ASEAN Summit of November 2000 to form a "free trade agreement" between China and ASEAN. In November 2002, Chinese and ASEAN leaders signed the *Framework Agreement on Comprehensive Economic Co-operation* (hereinafter the Framework Agreement), which lays the groundwork for the eventual formation of a F.T.A. by 2010 for China and the six older members of ASEAN ("ASEAN 6", including Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand), and by 2015 for the newer ASEAN Members States (the "CLMV" countries including Cambodia, the Laos, Myanmar and Vietnam).⁷¹ The Framework Agreement was amended by a Protocol on 6 October 2003 by the contracting parties at their annual summit in Bali (hereinafter the "Protocol").⁷² On 29 November 2004, at the ASEAN + China summit in Vientiane, two agreements to implement the Framework Agreement were signed by ASEAN and Chinese leaders, the *Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation* (the "Trade in Goods Agreement" or "TIG Agreement"),⁷³ and the *Agreement on Dispute Settlement Mechanism of the Framework Agreement on Comprehensive Economic Co-operation* (the "Dispute Settlement Mechanism Agreement" or "DSM Agreement").⁷⁴

The Framework Agreement establishes only the preliminary measures for trade liberalisation between China and ASEAN countries as well as the agenda for further negotiations. The Framework Agreement commits the eleven countries have committed in the Framework Agreement to strengthen cooperation and to "progressively liberalize and promote trade in goods and services and services as well as create a transparent, liberal and facilitative investment regime."⁷⁵ This suggests that the proposed ACFTA will cover trade in goods and services, as well as, trade and investment facilitation.

The ACFTA Framework Agreement is known for its rather innovative Early Harvest Programme (EHP), under which the parties agreed to cut tariffs on certain products before the onset of the formal F.T.A. Briefly, eight categories of agricultural products and dozens of specific manufactured goods would be liberalised ahead of the planned establishment of free trade area. A key element of the EHP is that China has also given unilateral concessions to ASEAN members who feel they would not benefit as much from the EHP.⁷⁶ This is because, for ASEAN's exports to China, all the products in Chapters 1 - 8 of the Harmonised System (HS) are covered for preferential tariff rates, while for exports to ASEAN countries, not all of the products in Chapters 1 - 8 are covered. ASEAN countries are allowed to come up with exclusion lists indicating the items for which they would not grant tariff concessions to Chinese goods. In

⁷¹ *Supra* note 28 at 124. The text of the Framework Agreement is available at the ASEAN Secretariat's official website at <<http://www.aseansec.org/13196.htm>>.

⁷² The text of the Protocol is available at the ASEAN Secretariat's official website at <<http://www.aseansec.org/15157.htm>>.

⁷³ The text of the TIG Agreement is available at the ASEAN Secretariat's official website at <<http://www.aseansec.org/16646.htm>>.

⁷⁴ The text of the DSM Agreement is available at the ASEAN Secretariat's official website at <<http://www.aseansec.org/16635.htm>>.

⁷⁵ The Framework Agreement, *supra* note 71, Art. 1(b).

⁷⁶ Annex 2 of the Framework Agreement, *supra* note 71.

essence, the EHP “allows ASEAN products to be exported to China at significant concessionary rates so that ASEAN countries can actually benefit from the benefits of a free trade agreement even before the agreement itself is finalized.”⁷⁷

The TIG Agreement represents the important second phase of the formation of the ACFTA. From July 2005, China and the “ASEAN 6” have begun to reduce tariffs on commodities trade. On 20 July 2005, tariffs on more than 7,000 items, accounting for over 90 per cent of all goods traded between China and ASEAN 6, were slashed to five percent or less.

The DSM Agreement represents another landmark achievement in China-ASEAN bilateral trade relations. It provides, first of all, a formal institutional design for solving trade and investment disputes between China and an ASEAN Member State. The significance of this agreement lies in its establishment of a rule-based setting for the resolution of economic disputes between the nations concerned, without which the governments are likely to resort to unilateral and retaliatory measures if they feel – sometimes rightly – that the multilateral trading system like the WTO does not provide for efficient and fair dispute settlement methods.

3. *Other Signed R.T.As*

The Asia-Pacific Trade Agreement (APTA), known as the Bangkok Agreement between 1975 and 2005, is the first preferential trading arrangement among developing countries in the Asia-Pacific region, developed under the auspices of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP). China joined the agreement in 2001, and started offering concessions from 2002. Presently, 749 tariff lines carry lower rates than the MFN rates committed under the WTO, mostly those involving textile products.

The significance of the APTA does not lie in the almost insignificant tariff concessions, given that the overall average applied tariff rate is 9.5 percent under the APTA compared with an MFN rate of 9.7 per cent.⁷⁸ The APTA is important symbolically for two reasons: (1) it provides a mechanism for giving special and differential treatment to the least developed countries; (2) it serves as a platform to link sub-regional R.T.As. In an area where the countries are at very varied stages of development, regional economic integration must involve compensation to the lesser developed members through special and preferential treatment. In this regard, the APTA mechanism provides a useful example. Further, APTA is the only agreement that currently link South Asia and East Asia, the two most dynamic sub-regions both of which are core parts of Asia.⁷⁹ As such, it may serve an important role in consolidating the various sub-regional agreements in Asia.

China signed an F.T.A. with Chile on 18 November 2005, which has the effect of immediately eliminating 74 per cent of Chile’s tariffs, and 63 per cent of China’s tariffs within

⁷⁷ “ASEAN, China Launch First Stage of Free-Trade Plan” AFP, 7 October 2003 (on file).

⁷⁸ *Supra* note 69 at 47.

⁷⁹ Tiziana Bonapace & Mia Mikic “Multilateralising Regionalism: Towards an Integrated and Outward-oriented Asia-Pacific Economic Area.” in *Delivering on the WTO Round: A High-level Government-Business Dialogue* 85-110, *Studies in Trade and Investment* 56 (Bangkok, Thailand: United Nations Economic and Social Commission for Asia and the Pacific, 2005) at 96.

two years. By 2015, 97 percent of both countries' tariffs are to be eliminated.⁸⁰ With Pakistan, China concluded an F.T.A. Early Harvest Agreement on 5 April 2006, under which bilateral tariffs on certain products are to be gradually slashed and eventually eliminated between 1 January 2006 and 1 January 2008.⁸¹

4. *F.T.A. Negotiations with New Zealand and Australia, and Potential Agreements with Other Nations*

In China's pursuit of regionalism, the negotiations with New Zealand and Australia deserve special attention. For one reason, New Zealand and Australia are two developed OECD economies. More significantly, the contents of the negotiations are rather comprehensive, heralding the conclusion of final agreements which will bring about broader and deeper economic integration.

China and Australia signed the initial Trade and Economic Framework Agreement in October 2003. It sets out areas of strategic cooperation in areas including energy and mining, textile, agriculture, industrial products, IT, services, investment, intellectual property rights, and others. A joint feasibility study for a China-Australia F.T.A. by the two governments was completed in March 2005, concluding that the F.T.A. will bring tremendous benefits to both countries. Formal negotiations targeting for such an agreement were commenced on 18 April 2005.⁸² Negotiations for an F.T.A. between China and New Zealand started even earlier, in December 2004, following the conclusion of the China-New Zealand Trade and Economic Cooperation Framework on 28 May 2004, covering a broad range of economic areas, and a joint feasibility study completed in November 2004.⁸³ It is highly likely that the China-New Zealand F.T.A. will come into being before the China- Australia F.T.A.

In addition, China has initiated negotiations on bilateral F.T.As with the Southern African Customs Union (SACU) and the Gulf Cooperation Council (GCC). It has started conducting feasibility studies on bilateral F.T.As with India and Iceland.

⁸⁰ Supra note 69 at 49.

⁸¹ *Ibid.* at 49-50.

⁸² Further information is available at the Department of Foreign Affairs and Trade (Australian Government) website, online: <<http://www.dfat.gov.au/geo/china/fta/>>.

⁸³ Further information is available at the New Zealand Ministry of Foreign Affairs and Trade, online: <<http://www.mfat.govt.nz/tradeagreements/nzchinafta/nzchindex.html>>.

Table 3: China's Regional Trade Agreements

ID	Title	Scope	Type	Status	Year
ACFTA	ASEAN - China Free Trade Area (ACFTA)	Country - Bloc	Framework Agreement	In force since	2005
APTA	Asia-Pacific Trade Agreement (previously known as Bangkok Agreement)	Regional (ESCAP)	Non-reciprocal Agreement	In force since	1975
AUSCHNFTA	Australia - China Free Trade Agreement	Bilateral	Free Trade Agreement	Under negotiation since	2005
CHNCHLFTA	China-Chile Free Trade Agreement	Bilateral	Free Trade Agreement	In force since	2006
CHNHKGCEPA	China - Hong Kong SAR Closer Economic Partnership Arrangement (CEPA)	Bilateral	Free Trade Agreement	In force since	2004
CHNMAKCEPA	China - Macao, SAR Closer Economic Partnership Arrangement (CEPA)	Bilateral	Free Trade Agreement	In force since	2004
CHNNERFA	China-Niger Economic and Technological Cooperation Agreement	Cross - Continental Bilateral	Framework Agreement	In force since	2005
CHNPAKFTA	China-Pakistan Free Trade Agreement	Bilateral	Free Trade Agreement	In force since	2005
NZLCHNFTA	New Zealand - China Free Trade Agreement	Bilateral	Free Trade Agreement	Under negotiation since	2004
	China-Gulf Cooperation Council FTA	Country-Bloc	Free Trade Agreement	Under negotiation since	2005
	China-India Free Trade Agreement	Bilateral	Free Trade Agreement	Under study	
	China-Japan-Korea Free Trade Agreement	Regional	Free Trade Agreement	Under study	
	China-Korea Free Trade Agreement	Bilateral	Free Trade Agreement	Under study	
	China-South African Customs Union	Country-Bloc	Free Trade Agreement	Under negotiation	
	China-Iceland	Bilateral	Free Trade Agreement	Under study	

Source: UNESCAP: Online Preferential Trade Agreements Database in Asia and the Pacific, with update from other sources

B. *India's Regional Trade Initiatives*

1. *India's Involvement in Regional Integration in South Asia: SAARC/SAPTA/SAFTA/BIMSTEC*

India is also a member of the APTA but this section will focus on India's trade agreements in South Asia. India is the founding member of the South Asian Association for Regional Cooperation (SAARC), which comprises all South Asian countries with the exception of Afghanistan.⁸⁴ SAARC members signed the South Asian Preferential Trade Arrangement (SAPTA) in April 1993, with the view to creating the South Asian Free Trade Area (SAFTA). As a framework merely for the exchange of tariff concessions through product-by-product or positive-listing approach, the progress of SAPTA in terms of tariff liberalisation has been rather slow. For instance, intra-SAARC trade rose slightly from 2.42 per cent in 1990 to 4.7 percent in 2003, much of which was however attributed to unilateral, bilateral and multilateral (WTO) liberalisation, rather than to the SAPTA.⁸⁵

The SAPTA was made into a regional trade agreement by all members of SAARC at the Twelfth SAARC Summit in January 2004, and came into force from 1 January 2006. Under Rule 7 of the phased tariff liberalisation programme, in two years, the tariffs of India, Pakistan and Sri Lanka will be slashed to 20 per cent in two years, while Bangladesh, Bhutan, Maldives and Nepal (as Least Developed Countries) will reduce tariffs to 30 per cent. In five to eight years, the contracting parties will bring tariffs down to 0-5 per cent. The SAFTA includes also measures not covered by the SAPTA, such as the harmonisation of standards, mutual recognition of tests and accreditation of testing laboratories, trade facilitation measures such as simplification and harmonisation of customs clearance, important licensing, registration and banking procedures, and removal of intra-SAARC investment barriers.

The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) groups together Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand. In the first BIMSTEC Summit in July 2004, the leaders adopted a Declaration calling for the establishment of a free trade area covering trade in goods, services, and investment, as well as mutual recognition of standards, customs cooperation, business migration, among others. For India, BIMSTEC is highly politically motivated, as it "resolves the problem of slow movement in South Asian cooperation by eliminating Pakistan and including Myanmar and Thailand".⁸⁶ The BIMSTEC is nevertheless instrumental for regional economic integration in Asia as it serves as a formal link between South Asia and Southeast Asia.

2. *India – ASEAN F.T.A.*

Propelled by the ASEAN-China F.T.A. initiative, India and ASEAN signed a Framework Agreement on Comprehensive Economic Cooperation (CEPA) on 8 October 2003, which commits the parties to working towards the establishment of an ASEAN-India Regional Trade

⁸⁴ SAARC members hence include Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

⁸⁵ Jayanta Roy, "South Asian Regional Trade Agreements: Perspectives, Issues and Options" (Paper presented at the International Trade Roundtable "The WTO at 10 Years – The Regional Challenge to Multilateralism", Brussels, Belgium, 27 June 2005), online: <http://mba.tuck.dartmouth.edu/cib/news/itr_2005_pdf/Roy.pdf>.

⁸⁶ *Ibid.*

and Investment Area as a long-term objective. The CEPA includes a small list of exchanges of tariff concessions. Like the ASEAN-China F.T.A, it also has an Early Harvest Programme (EHP) as a confidence building measure. However, due to disagreement on rules of origin as well as protectionist pressure from domestic industries in India, the EHP could not be implemented.⁸⁷

A political aspect of the India-ASEAN CECP is India's ambition to compete with China for influence in Southeast Asia. As stated by Jayanta Roy, the Principle Advisor to the Confederation of Indian Industry, "[u]like China, India is not competing with [ASEAN] economies in trade and FDI. An agreement with India will also give ASEAN countries a chance to reduce their excessive dependence on China as a trading partner".⁸⁸

3. India's Bilateral F.T.A. Initiatives

India has signed a number of F.T.As with its Asian neighbours. The India-Sri Lanka F.T.A, signed in December 1998, is one of India's earliest bilateral trade arrangements. India and Singapore signed a Comprehensive Economic Cooperation Agreement in July 2005, under which trade in goods, services, investment protection, standard and technical regulation, and other areas of economic and regulatory cooperation are addressed. A Framework Agreement for establishing Free Trade between India and Thailand was signed in October 2003. In addition, India is negotiating F.T.As or joint exploring the possibilities of F.T.As with China, Malaysia, Indonesia, Korea, Mauritius, Chile, the SACU, the GCC, and the MERCOSUR.

⁸⁷ See Ministry of Commerce and Industry, Government of India, "India's Current Engagements in R.T.As.", (New Delhi, India: Ministry of Commerce and Industry, 2006), online: <http://commerce.nic.in/india_rta_main.htm> and Amita Batra, "Micro pains, macro gains" *Financial Express* (20 May 2006), online: <http://www.financialexpress.com/fe_full_story.php?content_id=127689>.

⁸⁸ *Supra* note 85.

Table 4: India's Regional Trade Agreements

ID	Title	Scope	Type	Status	Year
APTA	Asia-Pacific Trade Agreement (previously known as Bangkok Agreement)	Regional (ESCAP)	Non-reciprocal Agreement	In force since	1975
ASEANINDFA	ASEAN -India Framework Agreement on Comprehensive Economic Cooperation	Country – Bloc	Framework Agreement	In force since	2004
BHUINDFTA	Bhutan - India Free Trade Agreement	Bilateral	Free Trade Agreement	In force since	1995
BIMSTEC	Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation (BIMSTEC)	Regional (ESCAP)	Framework Agreement	In force since	2004
INDAFGPTA	India-Afghanistan Preferential Trade Agreement	Bilateral	Preferential Arrangement	In force since	2003
INDCHNPTA	India - Chile Preferential Trade Agreement	Cross - Continental Bilateral	Preferential Trade Agreement	Under negotiation since	2005
INDGCCFA	India - Gulf Cooperation Council (GCC) Framework Agreement	Country – Bloc	Framework Agreement	In force since	2004
INDLKABTA	India - Sri Lanka Bilateral Trade Agreement	Bilateral	Free Trade Agreement	In force since	2001
INDMERCPTA	India - Mercosur Preferential Trade Agreement	Country – Bloc	Framework Agreement	Pending country ratification	2005
INDNPLTOT	India - Nepal Indo-Nepal Treaty of Trade	Bilateral	Non-reciprocal Agreement	In force since	1991
INDSACUTA	India - South African Customs Union (SACU) Trade Agreement	Country – Bloc	Preferential Trade Agreement	Under negotiation since	2002
INDSGPCECA	India - Singapore Comprehensive Economic Cooperation Agreement	Bilateral	Free Trade Agreement	In force since	2005
INDTHAFA	India - Thailand Framework Agreement for establishing a FTA	Bilateral	Framework Agreement	In force since	2003
SAFTA	South Asian Association for Regional Cooperation Free Trade Arrangement (SAFTA)	Regional (ESCAP)	Free Trade Agreement	In force since	2006
SAPTA	SAARC Preferential Trading Arrangement (SAPTA)	Regional (ESCAP)	Preferential Arrangement	In force since	1995

Source: UNESCAP: Online Preferential Trade Agreements Database in Asia and the Pacific, with update from other sources

IV. ASIAN ECONOMIC INTEGRATION: CHOICES FOR CHINA AND INDIA

A. Different Types of Regionalism

In addition to unilateral and multilateral liberalisation, both China and India have intensified their regional initiatives. Countries have good reasons to embrace regionalism, as previously noted, including political and economic ones. This is however not to say that they should abuse their regional options. In a world economic interdependence is rapidly increasing, trading nations, while pursuing their national interests, must also consider their long-term interests by factoring regional, global, and even other countries' national interests into consideration.

As the above analyses demonstrate, China and India are crucial players in the regional economic integration process in Asia. It also seems that both countries are actively pursuing regionalism, mainly in the form of bilateral F.T.As. In promoting regional economic integration in Asia, China and India are faced with the following possible options:

- Bilateralism;
- Pan-Asian F.T.A.; or
- Sub-regional integration in East Asia and South Asia respectively, with the two sub-regions linked through ASEAN-India F.T.A. and China-India F.T.A.

This section discusses the various options, with a view to evaluating their different degrees of suitability for promoting regional economic integration in Asia.

B. Hub-and-Spokes Bilateralism

Both China and India are now obsessively negotiating and signing bilateral F.T.As. The number of R.T.As in which India is a party exceeds that of China. However, almost all of India's R.T.As involve only "shallow" integration, in the sense that there has neither been substantial tariff reduction nor broad coverage of issues in those R.T.As. They nevertheless deserve attention, not only because of India's recently demonstrated obsession with regional arrangements, but also because of the need to find an answer to the question of whether India can serve a leading role or as a hub in South Asia integration, which is obviously an important part of regional economic integration in Asia.

The bilateral initiatives of China and India are driven by both economic and political factors, including the so-called "domino effect" or "fear of exclusion".⁸⁹ The pursuit of bilateralism, if reaching its extreme, can lead to a hub-and-spoke situation. As the World Bank observes, in the hub-and-spoke pattern, "the largest markets sign individual agreements with a wide range of

⁸⁹ Richard Baldwin, *A Domino Theory of Regionalism* (Working Paper No. 4465) (Cambridge, Massachusetts: National Bureau of Economic Research, 1993).

peripheral countries among which market access remains restricted”.⁹⁰ However, such system “can marginalize the spokes, where market access conditions are usually less advantageous than in the hub, which enjoys improved access to all of the spokes.” In a region which accommodates several large economies, overlapping hub-and-spoke configurations tend to emerge. In the worst scenario, hubs have multiple F.T.As with smaller spokes, but the spokes do not liberalise between themselves.⁹¹ This will not only create multiple layers of discrimination through exclusive trade preference and complex rules of origin, but also place the spokes at a disadvantage as foreign investment tends to move to the hubs in order to gain more market access.

Using a global “computable general equilibrium” model (GEMAT) to trace the numerical impact of trade globalism, regionalism, and bilateralism, ADB finds that, if two hub-and-spoke configurations in Asia are stimulated, namely the “China hub” and the “ASEAN hub”,

Compared to the Asian free trade scenario that extends MFN status to countries outside Asia, the Asian hub-and-spoke scenario generates somewhere between one fifth and one quarter of the global gains. Within developing Asia [excluding Japan], hub-and-spoke systems are inferior to regional free trade and to multilateral liberalisation initiatives. A [China] hub generates just over half the benefits of Asian free trade for Asian developing countries, and an ASEAN hub, which implicitly entails the removal of more trade distortions, about 70% of the benefits.⁹²

However, in pursuing trade bilateralism, the hub economies –which are China and ASEAN in the ADB model – gain larger benefits. For instance, China’s welfare gains from having a regional hub position is almost four times that from pan-Asian free trade, and ASEAN is also better off by becoming a hub than under the Asian free trade scenario.

India is not treated as a hub in the ADB report, presumably because its foreign trade and investment is not comparable to that of China or ASEAN. According to the conventional hub-and-spoke theory, India, as the largest economy in South Asia, will benefit from a sub-regional hub position in that area. India however will lose 0.24 per cent of its GDP in the “China hub” system, and its GDP will negligibly increase by 0.08 per cent in the “ASEAN hub” system.⁹³ Put simply, India has none or little to gain if other big economies such as China and ASEAN are placed in the position of hubs.

C. Asian Free Trade or Asian Economic Community

The ADB report, consistent with the findings of Roland-Holst, Verbiest and Zhai, offers the conclusion that the “estimated benefits from free trade in Asia (with the extension of MFN to the rest of the world) are nearly as large as those from global free trade”.⁹⁴ Further, there will be no trade diversion as “no country or global region loses under the assumption of Asian free

⁹⁰ World Bank, *supra* note 24 at 40.

⁹¹ *Supra* note 50 at 281.

⁹² *Supra* note 50 at 288.

⁹³ *Ibid.*

⁹⁴ *Supra* note 50 at 286.

trade”.⁹⁵ This finding is reaffirmed by the IMF 2006 report, as discussed above. This is because, for most Asian developing countries, the bulk of gains from global free trade will still originate from trade liberalisation in Asia. However, given China’s foreign trade structure (i.e. its strong trading links with non-Asian markets), its gains from Asian free trade are less than half those from global trade liberalisation. India’s gain from pan-Asian free trade is a 1.15 percent expansion in its GDP, slightly higher than the projected benefits from global trade liberalisation.⁹⁶ Furthermore, in spite of overall gains, “Asian free trade could lead to a significant deterioration in the terms of trade for Asia’s two mammoth economies, the PRC and India”.⁹⁷ This is because these two nations now mainly trade with non-Asian countries, while their increased demand for goods produced in other parts of the world would not be compensated by increase in the demand for their exports outside Asia, thus creating lifted import prices relative to export prices.

India has been advocating an Asian Economic Community for years. As the Indian Prime Minister has enthusiastically indicated, “we envision an Asian Economic Community, which encompasses ASEAN, China, Japan, Korea and India.... This community of nations would constitute an ‘arc of advantage’, across which there would be large-scale movement of people, capital, ideals and creativity.”⁹⁸ The basic idea is to bring the major blocs in East and South Asia, including Japan, ASEAN, China, India and Korea, which are collectively called the JACIK economies, to create an F.T.A. or Asian Economic Community.⁹⁹ This community, with a combined population of 3 billion, Gross National Income (G.N.I.) of USD16 trillion, total exports of USD1.66 trillion, and foreign exchange reserves of USD1.6 trillion (in 2003), will be the largest trade bloc in the world. This F.T.A. based community will eventually force other Asian economies to join, thus eliminating the “noodle-bowl” problems.

D. An East Asia Bloc and a South Asian Bloc linked with bilateral F.T.As: A More Viable Route for Asian Economic Integration

East Asian economies have developed strong economic interdependence and integration with the global economy through external liberalisation and internal, market-driven, reforms. In recent decades, the independence is further strengthened by the newly developed Asian division of labor system centered on China which is on the top of vertical trade in East Asia. In addition to trade and FDI, East Asia economic integration is also linked by financial and macroeconomic interdependence.¹⁰⁰

⁹⁵ *Ibid.*

⁹⁶ *Supra* note 50 at 287,

⁹⁷ *Ibid.*

⁹⁸ Indian Prime Minister Manmohan Singh, speech at the Third India-ASEAN Business Summit (21 October 2004), online: <<http://pmindia.nic.in/speech/content.asp?id=35>>.

⁹⁹ Sachin Chaturvedi, John Humphrey, Nagesh Kumar & Hubert Schmitz, “Asian Economic Integration: Dynamics and Impacts” (Paper presented at the Seventh Annual Global Development workshop on *Asian and Other Drivers of Global Change*, St. Petersburg, 18-19 January 2006), online: <<http://www.ids.ac.uk/ids/global/AsianDriverpdfs/Chatur-Humph-Schmitz-Kumar.pdf>>.

¹⁰⁰ *Supra* note 56.

Economically, East Asian economic integration, via the creation of an East Asian trade bloc, is a viable option confirmed by numerous studies.¹⁰¹ Gilbert, Scollay and Bora, using the methods of both the CGE and gravity models, credibly demonstrated that East Asian economies are natural trading partners and hence integration agreements tend to be building blocks in moves to achieve free trade in the Asia-Pacific region.¹⁰² Specifically, it is argued that East Asian integration would be based on arrangements in which Northeast Asian economies would necessarily form the core. As such, the proposed Japan-Korea and China-Japan-Korea F.T.As, plus the proposed ASEAN+3 F.T.A. which serves as the link between Northeast Asia and Southeast Asia, are therefore essential elements in the construction of an East Asia F.T.A. With regard to the welfare-enhancing effects of the relevant F.T.As, the findings of Gilbert, Scollay and Bora are as follows:

A Japan-Korea F.T.A. produces relatively weak benefits for the two participating economies (0.3 percent of GDP for Korea and close to zero effect for Japan). The widespread negative effects on nonparticipants are negligible when expressed as a percentage of initial GDP, reaching 0.1 percent of GDP only in the case of Vietnam.

Including China in the proposed arrangement significantly improves the welfare outcome for Korea and Japan, to 0.7 percent and 0.1 percent of GDP, respectively. In China's case, however, the welfare gain is negligible With the inclusion of China in the FTA, the negative effects on nonmembers start to appear significant, particularly for Taiwan, China, and for the ASEAN economies, which compete directly with China in many markets.

The negative welfare effects on the ASEAN economies are converted into positive effects ... if the proposal is expanded into an ASEAN+3 FTA, comprising the 10 ASEAN economies plus China, Japan, and Korea. Proportionately to GDP, the ASEAN economies and Korea are the biggest gainers from this arrangement, although for Korea there is only a marginal improvement in the welfare outcome relative to the outcome from the China-Japan-Korea FTA. In comparison with the latter arrangement, Japan enjoys a slightly larger welfare gain, although as a percentage of GDP, the gain is still small....[T]he welfare effect on China is negligible, although very slightly inferior to that from the China-Japan-Korea FTA.¹⁰³

In the case of South Asia, it has been pointed out that enhanced regional cooperation, including regional integration, is an imperative if the countries in the region "are to strengthen their competitive position, both individually and as a group, so as to attract foreign private capital from outside and even within the region to widen and diversify their production base".¹⁰⁴ Because the trade barriers between South Asia countries are traditionally high, trade liberalisation through a

¹⁰¹ See, e.g. *supra* note 56; Suthiphand Chirathivat, "East Asia FTA: Economic Modalities, Prospects and Further Implications" (2004) 15 *Journal of Asian Economics* 889; Jong-Wha Lee & Innwon Park, "Free Trade Areas in East Asia: Discriminatory or Non-discriminatory?" (2005) 28(1) *World Economy* 21; John Gilbert, Robert Scollay & Bijit Bora "New Regional Trading Developments in the Asia-Pacific Region" in Shahid Yusuf, M. Anjum Altaf & Kaoru Nabeshima, eds., *Global Change and East Asian Policy Initiatives* (World Bank and Oxford University Press, 2004).

¹⁰² Gilbert, Scollay & Bora, *supra* note 101.

¹⁰³ Gilbert, Scollay & Bora, *supra* note 101 at 140.

¹⁰⁴ Research and Information System for the Non-Aligned and Other Developing Countries (RIS), *South Asia Development and Cooperation Report 2004* (New Delhi, India: RIS, 2004) at 48.

F.T.A. or custom union would substantially increase intra-regional trade and foreign investment. According to one study, the F.T.A. approach (*i.e.*, SAFTA), if removing all intra-regional tariff barriers, would lead to GDP growth, trade expansion, and welfare gains for all South Asian countries, although the extent of benefits would vary among the members. For instance, Sri Lanka would benefit the most from free trade in the region, with real GDP expanding by two percent. India and Bangladesh have lesser gains (0.8 percent and 0.3 percent GDP expansion respectively), while the rest of South Asian countries is projected to gain 0.9 percent in real GDP.¹⁰⁵ India's lesser gains in GDP growth can be compensated by benefits obtained in other aspects, as, for instance, "India appears to enjoy a positive contribution from terms of trade movements towards increase welfare gains in comparison to the other FTA members".¹⁰⁶ If South Asia opts to achieve regional integration via a custom union, the benefits are strikingly much more significant.¹⁰⁷ Needless to say, given the political economy in this region, a custom union is nearly impossible in the near future, although a preliminary F.T.A. (SAFTA) has already been instituted.

A possible route for Asian economic integration is that East Asia and South Asia progress to achieve sub-regional integration respectively, while developing bilateral F.T.As between countries in these two sub-regions simultaneously.

E. Concluding Analysis: Which Asian Regionalism is Acceptable to China, India, and Other Asian Economies?

As discussed above, the benefits from regionalism cannot be taken for granted. Countries have no incentives – not to mention obligations – to pursue regional economic integration unless immediate or long-term gains outweigh the costs.

As the preceding section shows, neither China nor India is among the largest economic beneficiaries of regional economic integration in Asia. Economically, China gains the most from a system of bilateral F.T.As in which it is a hub.¹⁰⁸ According to the ADB, China's welfare gains are projected to be 0.41 percent of its 2025 baseline G.D.P. from a PRC-hub regime, 0.22 percent of the same GDP from global trade liberalisation, and only 0.11 percent of it from Asian free trade.¹⁰⁹ Even in the scenario of China-Japan-Korea F.T.A. or ASEAN+3, China's welfare gains are at best "negligible". That is to say, for China, the gains from pan-Asian free trade (Asian regionalism) are less than half those from global free trade (multilateralism), and only a quarter of those from bilateral F.T.As (China regionalism). China also does not gain much from East Asian regionalism according to Gilbert, Scollay and Bora.¹¹⁰ Presumably, if India is put in a regional hub position, its incomes would rise much faster than that from other channels. Hence the question: Why a country such as China or India would pursue a regionwide R.T.A. such as an Asian F.T.A., or an East Asian F.T.A., or an Asian Economic Community?

¹⁰⁵ Mahinda Siriwardana, "Trade Liberalisation in South Asia: Free Trade Area or Customs Union?" (2003) 26(3) *Journal of South Asian Studies* 309 at 318.

¹⁰⁶ *Ibid.* at 321.

¹⁰⁷ *Ibid.* at 319-327.

¹⁰⁸ See section B, part IV above.

¹⁰⁹ See the stimulations results in *supra* note 50.

¹¹⁰ *Supra* note 103 and the accompanying text.

India might have a stronger incentive for an Asian Economic Community, as India will relatively gain more welfare from a pan-Asian free trade arrangement. However, it is not easy to convince China to sincerely endorse such an idea. It seems that the Chinese practice of R.T.As parallels both Chinese regionalism (centered on China as the hub) and multilateralism. This can be seen from China's active pursuit of WTO accession as well as the sheer number of bilateral R.T.As it has concluded and is negotiating. In Asia only, it is exploring bilateral arrangements with important economies such as ASEAN, Korea, Japan, India, and Pakistan. It has not demonstrated strong interest in regional economic integration in Asia, be it Asian Economic Community or Asian F.T.A. Where East Asian economic cooperation is concerned, China's Prime Minister Wen Jiabao has warned that the cooperation should not be "close, exclusive and directed against any particular country," indicating that "China takes the position that in pursuing regional cooperation, it is imperative to be open minded and promote open regionalism so as to achieve progress for all countries and development in all regions."¹¹¹ This type of open regionalism, as almost all other countries, including non-Asian countries such as U.S., EU, Russia, and arguably Australia and New Zealand, are equally welcomed and treated, will cause Asian regionalism to lose its distinctive identify and eventually the momentum to develop into full regional economic integration. This practice, featuring the parallels of multilateralism and Chinese bilateralism, is generally in line with China's economic interests, and is presumably not against its interests in other aspects.

Obviously the gains and costs have both economic and political dimensions. Trading nations have a wide range of considerations when they seek to negotiate R.T.As.¹¹² Apart from the traditional trade gains, countries might want to strengthen domestic policy reform, as is the case of the Mexican negotiating position on NAFTA. The underlying philosophy is that "a regional trade treaty can underpin domestic policy reforms and make it more secure; that is, by binding the country to the masthead of an international trade treaty, any future reversal of domestic policy reform becomes more difficult to implement."¹¹³ They might also pursue R.T.As to increase multilateral bargaining power with third countries by negotiating a preferential agreement, as the case of the European Community or MERCOSUR.¹¹⁴ R.T.As might also be used to make access to the larger economy's market more secure for the smaller economy. This was Canada's obvious purpose in forming the Canada-U.S. free trade agreement.¹¹⁵ A further objective is the formation of strategic linkages with trading partners in a R.T.A, which can help underpin security arrangements among the participating countries. The strategic objective was the central theme in early European integration which was aimed at preventing a fresh outbreak of European war by bringing Germany and France together through a trade agreement.¹¹⁶ Finally, regional agreements could be used tactically to achieve multilateral negotiating objectives. For example, in the Uruguay Round of GATT negotiations, "it was widely thought that it was to the U.S. advantage to have regional trade negotiations underway, so that in dealing with recalcitrant

¹¹¹ "East Asia cooperation should be transparent, open: Chinese Premier" *People's Daily Online* (14 December 2005), online: <http://english.people.com.cn/200512/14/eng20051214_227982.html>.

¹¹² John Whalley, "Why Do Countries Seek Regional Trade Agreements?" In Jeffrey A. Frankel, ed., *The Regionalization of the World Economy* (Chicago: The University of Chicago Press, 1998) at 63.

¹¹³ *Ibid.*, at 71.

¹¹⁴ *Ibid.*, at 72.

¹¹⁵ *Ibid.*, at 72-73.

¹¹⁶ *Ibid.*, at 73.

multilateral negotiating partners, the United States could threaten to actually play the bilateral card, and engage in active discussions with prospective regional partners.”¹¹⁷

Needless to say, not all the above objectives will apply to a country negotiating a R.T.A. One or two objectives might be dominant in some cases, while in others multiple objectives exist.¹¹⁸ Either way, it is often the case that non-economic, strategic, objectives quite rightly occupy the central place in R.T.A. negotiations.

Furthermore, although countries are not required to practice altruism in the international trade arena, big trading powers, as their policy would have tremendous impact on other countries, are expected to take into account not only their national interests, but also regional and global interests, in their policy-making. China and India, as the two most dynamic trading nations, shoulder such a responsibility.

But does this responsibility translate into an obligation not to pursue (self-interest oriented) bilateralism? Isn't it right that China or India can maximise its national interest by mainly focusing on bilateralism and, while possible, multilateralism? Obviously, China could achieve its economic and strategic goals through signing bilateral F.T.As with its Asian neighbours.¹¹⁹

For the following reasons, it is submitted that China and India should pursue regionalism on a broader basis – namely involving more Asian countries with fewer agreements – instead of focusing on hub-and-spoke regionalism.

First, both China and India, and undoubtedly all Asian economies, have a long-term interest in broader liberalisation on a multilateral basis which will lead to greater net benefits for all trading nations. In fact, China's projected gains from bilateralism and India's projected gains from pan-Asian free trade are also based on the assumption that multilateral trade liberalisation, which might move at unsatisfactorily slow pace, does not stop. As China and India – and especially China at this stage – are heavily dependent on non-Asian markets such as North America and Europe (both of which are unlikely to sign F.T.As with China and India in the foreseeable future), global trade liberalisation is actually crucial to their trade and economic growth. Therefore, countries like China and India should make sure that their regionalism supplements multilateralism despite the slow progress of the latter, but it should not stand in the way of global free trade. In this sense, bilateralism, featuring a hub-and-spoke system of F.T.As, is more likely to harm the multilateral trading system in the long run as they are more likely to become stumbling blocks for the global free trade. In contrast, as the above sections show, an Asian F.T.A, East Asian F.T.A, and South Asian F.T.A, are more likely to be building blocs with more trade-creating effects.

Second, the many bilateral F.T.As signed by the hubs, be it China, India, or ASEAN, contribute greatly to the complexity of trading rules and to the potential costs of trade. In essence, systemic problems such as the “spaghetti bowl phenomenon” should not be overlooked. By creating a large number of (overlapping) bilateral F.T.As, the hubs also create problems for the multilateral trading system. When the problems arise, they might hurt the hubs' long-term interests in global

¹¹⁷ *Ibid*, at 74.

¹¹⁸ *Supra* note 113.

¹¹⁹ *Supra* note 28 at 129.

free trade. As such, it is in the interest of the hubs, in this case China and India, to minimise the number of R.T.As by consolidating them into a regional one encompassing more countries.

Third, China's and India's fast growing trade frictions with non-Asian countries have generated the need for the two Asian giants to explore other markets. This is especially urgent for China, as its astronomical trade surpluses with the United States and EU have led to enormous protectionist pressure in the latter two trading powers. Building an alternative, integrated, market in Asia through Asian regional economic integration can strengthen the negotiating position of all Asian countries, most significantly China and India, with respect to their trade relations with the U.S. and EU.

Additionally, both China and India have political and security interests in a more integrated, economically interdependent Asia. Take the ASEAN-China F.T.A. as an example: although it is believed that the long-term benefit of the ACFTA will be enormous to both sides, commentators have observed that "China's [RTA] approach, as a strategic movement, must be viewed in a larger context that embraces both economic and geopolitical considerations, with the latter playing a relatively more important role at this stage."¹²⁰ Specifically, "China's worldwide [RTA] movement, which has primarily engaged its Asian neighbours at this stage, is aimed at expanding its political influence through peaceful economic exchange and cooperation."¹²¹ On the part of ASEAN, China's proactive pursuit of a regional trade pact offers a "win-win" opportunity which ASEAN cannot afford to reject, as remarked by ASEAN's spokesman: "there is no other way [for ASEAN] to deal with China but to engage it in regional process. China is important as a neighbor politically, in terms of security and is also important as an emerging economic power."¹²²

Especially in recent years, China has made gestures, accompanied by many concrete measures, to allay the fears of its neighbours about the growing Chinese economic and military power. China has emphasised that its major objective at this stage is to seek a friendly international and regional environment to facilitate its endeavours at economic development.¹²³ But for China's small neighbours, they would like the added reassurance that the bilateral relations with China are contained in a multilateral and, if possible, regional framework.¹²⁴ Consequentially, if China is to succeed in its "good neighbour" policy, it has to help create a regional economic architecture to support it. The same logic can also be applied to China's bilateral relations with other Asian countries, even including Japan.

India is also located in a region (South Asia) where political relations are tense and there is significant distrust between countries. India and Pakistan have long-standing hostilities towards each other. Serious political differences also exist between India and other smaller South Asian

¹²⁰ *Ibid.* See also, Wang Gungwu, "China and Southeast Asia: Changes in Strategic Perceptions", Vincent Weicheng Wang, "The Logic of China-ASEAN FTA: Economic Statecraft of 'Peaceful Ascendancy'", and Alice D. Ba, "The Politics and Economics of 'East Asia' in ASEAN-China Relations", all in Ho Khai Leong & Samuel C.Y. Ku, eds., *China and Southeast Asia: Global Changes and Regional Challenges* (Singapore: Institute of Southeast Asia Studies, 2005).

¹²¹ *Supra* note 28 at 132.

¹²² Isaqani de Castro, "China snuggles up to Southeast Asia" *Asia Times* (7 October 2003), online: <<http://www.atimes.com>>.

¹²³ "Chinese premier delivers speech at East Asia Summit Leaders Dialogue" People's Daily Online (13 December 2005), online: <http://english.people.com.cn/200512/12/eng20051212_227412.html>.

¹²⁴ Wang Gungwu, *supra* note 120 at 10.

countries, which are reinforced by the rigid positions of political and military leaders toward each other in this area. There is, in addition, a fear of Indian dominance in bilateral relations. Like China, India also has the crucial task of introducing a regional framework which is open to other regions as well as to the multilateral system in order to create a harmonious regional setting for its economic development.

In brief, although the economic gains from regionalism (based on a China and India playing the role of hubs in their respective regions) are not necessarily larger than bilateralism, leading Asian giants like China and India do have a long-term interest in regional economic integration in Asia if non-economic objectives are taken into consideration. As to the type of regionalism to be adopted, it is submitted that the best route for the realisation of Asian integration is sub-regional integration in East Asia and South Asia, while linking the two by bilateral F.T.As. The next section presents an analysis of this approach and puts forward policy recommendations for China and India on Asian economic integration.

V. POLICY RECOMMENDATIONS

China and India are among the most important economies in Asia. Since the 1997 Asian financial crisis, regional trade in Asia has become increasingly integrated, particularly with China, since China's rise as both a production centre and a final export market for the region has been a key factor in boosting intra-Asian trade and investment. China and India are also active participants in the growing number of regional economic cooperation initiatives, including bilateral and regional trade agreements as well as Asian cooperative measures in the areas of finance and investment.

China and India, together with other Asian countries, share the imperative to promote regional economic integration in this continent. Given the size of their economies and the central location of their development in international politics and economy, China and India should take the lead in this endeavour. The scope of gains from Asian regionalism can be formidable if it is realised through well-designed R.T.As which complement the unilateral and multilateral liberalisation approach and anchor domestic reform programmes to increase economic efficiency and improve competitiveness. In light of the above, the following policy recommendations regarding Asian economic integration are made, with a special focus on the role of China and India.

1. *The routes for Asian economic integration: East Asian F.T.A. + South Asian F.T.A. + others = Asian free trade.*

While it is unlikely that the trend of bilateral initiatives in Asia will stop, it is wise for the region as a whole to have a coordinated regionalisation policy. As noted above, the hubs and spokes systems, while inducing larger benefits for the hubs, may damage the spokes because of discrimination in other spoke markets. Hubs and spokes regimes not only add layers of discrimination in the region, but also lead to greater resistance to multilateral liberalisation. This is not in the long-run interest of the economies which have the potential to be – or already are – hubs, including China, India, Japan, and ASEAN, as all of them are still heavily dependent on markets outside Asia.

A pan-Asian free trade area or an Asian economic community is unlikely to be achieved or even seriously discussed. Asia is no more than a geographic concept, with the sub-regions sharing no common heritage. Countries in each sub-region, including East Asia, South Asia, Central Asia, however share not only geographic contiguity but also common cultural, social and economic characteristics. Furthermore, the numerous sub-regional initiatives have demonstrated that the countries involved are preparing for economic and financial integration at the sub-regional level. It is hence submitted that East Asia and South Asia should strive to realise their sub-regional integration respectively, while linking the two sub-regions with bilateral integration agreements between individual countries.

Economic integration in East Asia should aim at creating an East-Asia wide F.T.A. (EAFTA) comprising ASEAN, China, Japan and Korea. East Asia is now in a better position to achieve integration ahead of other sub-regions, because its intra-regional trade had reached 55 percent in 2004. There has also been a rapid rise in intra-regional investment flows, shaping a visible trade-investment nexus.¹²⁵ As discussed in the previous section, various studies conclude that an EAFTA offers visible and meaningful benefits to all participating countries while generating little trade diversion. Although China may not gain as much as other East Asian countries do, it however has a long-term strategic interest in such an arrangement. For one, China would profit from the costs advantages of input imports from the regional partners in the EAFTA community, which will make the Chinese products more competitive in third markets. Being part of an integrated regional market can also strengthen China's negotiating position vis-à-vis other global trading powers.

Despite possessing enormous physical resources and comprising 22 percent of the global population, South Asia is the least integrated economic region of the world. The largest economy accounting for 70 percent of the total sub-regional GDP, India should take the lead in South Asia integration under the auspices of the SAFTA. Although the businesses in this area believe that intra-regional trade will triple in five years if South Asia regional integration is facilitated, especially in the areas of trade, traffic and transport, integration in this sub-region has been hampered by long-standing political hostility and the existence of a protectionist mentality.¹²⁶ However, as a business leader of Pakistan has remarked, “[i]f USA could allow MFN status to China whom it considered archenemy for five decades and Russia and USA having long standing conflicts in social, political and economic fields could become allies, what is restraining the countries of South Asia from economic integration?” (id, p. 16). Furthermore, South Asia countries, most importantly India, should conduct significant reduction in tariff and non-tariff barriers. India is one of the most protected major markets in the world, with high level of tariff

¹²⁵ Haruhiko Kuroda, “New Visions and Models for Economic Cooperation” (Speech given at the Plenary Session II of the Annual Conference of the Boao Forum of Asia, 22-23 April 2006, Boao, Hainan), online: <<http://www.adb.org/Documents/Speeches/2006/ms2006025.asp>>.

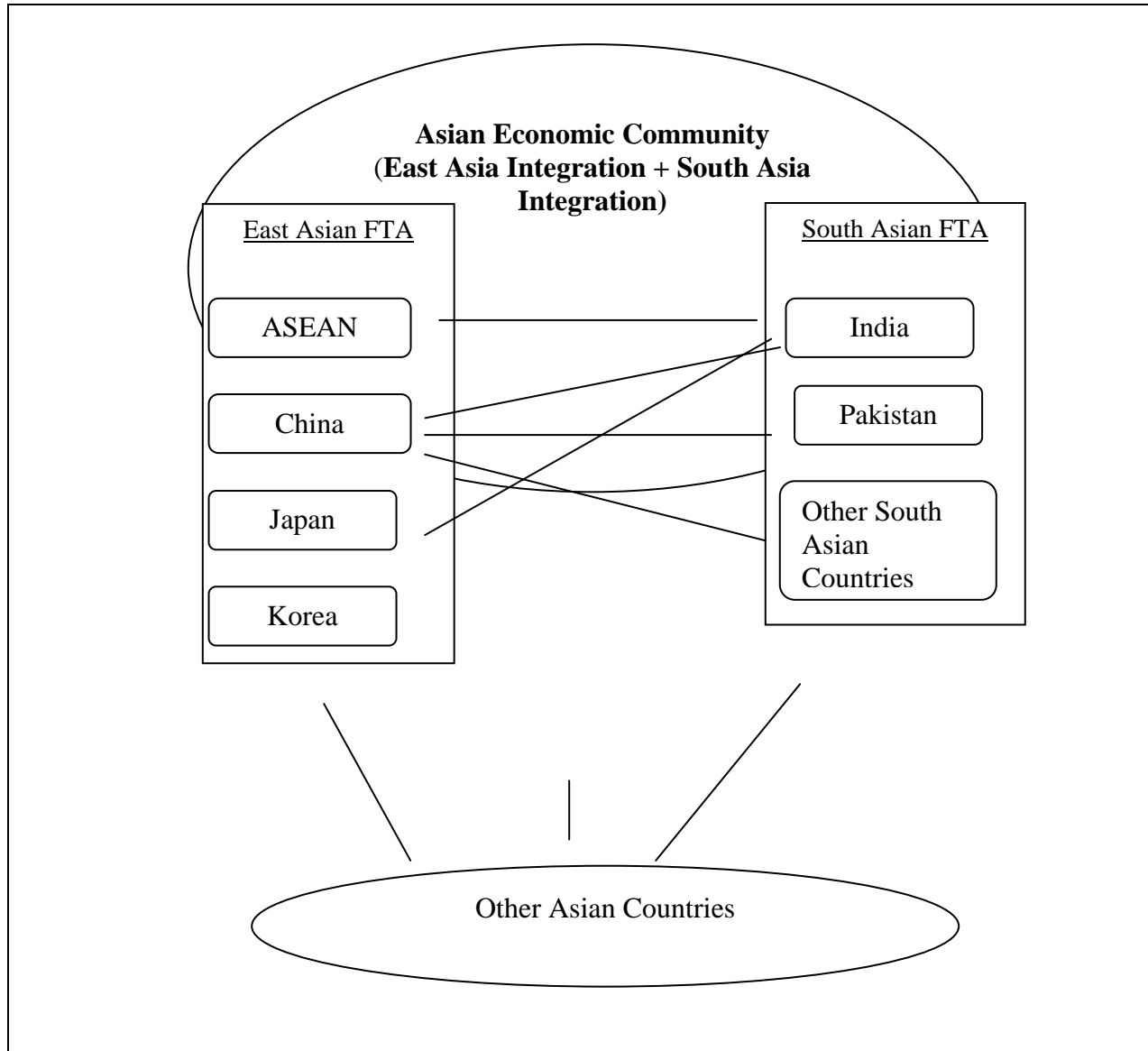
¹²⁶ Khalid Amin, “South Asia Regional Integration: Pakistan Country Note” (Paper presented to the World Bank/International Monetary Fund 2004 Annual Meetings, Program of Seminars, 1 October 2004. Washington D.C.), online: <http://siteresources.worldbank.org/INTSOUTHASIA/Resources/Pakistan-Final.pdf>.

and non-tariff protection for its domestic industry. India's vibrant economic growth in the recent decades, mainly as a result of trade and investment liberalisation, is however a strong proof that liberalisation, not protection, is the engine for economic growth.

The two sub-regions should not pursue integration separated and isolated from each other. Rather, the two, before the time is right to consolidate them into one, should be connected by bilateral arrangements between countries in the two regions. Most notably, India is negotiating an F.T.A. with ASEAN and has concluded a F.T.A. with Singapore. China and Pakistan has signed an early harvest agreement and have started negotiating a comprehensive F.T.A. More link-ups between the two sides should be encouraged provided that the bilateral arrangements follow the guidelines discussed below and serve as building blocks for global trade.

If an Asian Economic Community is formed by consolidating the East Asian F.T.A. and the SAFTA, other Asian countries will be compelled to join it. Eventually, a pan-Asian economic community will be accomplished through these routes.

Chart 2: Routes for Asian Economic Integration



2. *Establishing A China-India F.T.A. to link up the two sub-regions*

In terms of using bilateral F.T.As to link East Asia and South Asia, a China-India F.T.A. will be most helpful in this regard. China-India trade is one of the most rapidly growing bilateral trade relationships in the world. During 1995-2003, the average annual growth of merchandise trade between the two countries was 26.4 percent, a figure higher than each country's growth rate with other trading partners. In 2003, the growth rate of bilateral trade in services was 125.5 percent. Still, the small share of the two countries in each other's foreign trade suggests enormous potential for trade expansion.¹²⁷

Arvind Panagaria, a distinguished economist who has generally been "critical the discriminatory trade blocs not just because such arrangements fragment the global trading system but also because they often hurt economic efficiency within the countries forging the arrangements", nevertheless favors an India-China F.T.A.¹²⁸ Panagaria has beautifully stated the following reasons in support of a Sino-India deal in the interest of both Asian economic integration and global free trade, as well as China's and India's national competitiveness:

The case for an India-China FTA is based principally on its strategic value. During the last decade, with the creation of the NAFTA, several expansions of the EU and a host of smaller FTAs in Latin America, Asia has suffered from a diversion of these regions' trade away from it. One response to this trade diversion for Asia would be to move towards a bloc of its own. Such a bloc may give Asia the necessary leverage to pry open the NAFTA and EU blocs to outsiders through multilateral liberalisation.

If one accepts this argument, an India-China FTA is probably the best starting point for such an Asian bloc. For example, as an alternative, even if India and China both make good on their respective framework agreements with the members of the Association of Southeast Asian Nations (ASEAN) to forge FTAs with them, an effective Asian bloc will not form without these two countries signing an FTA agreement with each other. On the other hand, if India and China signed an agreement, chances are much higher that the remaining countries in Asia will rush to sign agreements with them. Presently, the ASEAN is driving the integration process in Asia but with the emergence of India and China as major economic powerhouses and the relative stagnation faced by the most populous ASEAN country, Indonesia, its ability to serve as the engine of the Asian integration has substantially diminished.

An India-China FTA also has the advantage that it will help promote an alternative FTA template that focuses on trade integration rather than non-trade subjects including labor standards, intellectual property rights and even restrictions on the use of capital controls. These subjects are integral parts of the US FTA template that the US may eventually want

¹²⁷ *Report of the India-China Joint Study Group on Comprehensive Trade and Economic Cooperation* (New Delhi, India: India-China Joint Study Group, 2005) at 20, online: Ministry of External Affairs (India) <<http://meaindia.nic.in/treatiesagreement/2005/11ta1104200504.pdf>>.

¹²⁸ Arvind Panagaria, "An India-China Free Trade Area?" (*The Economic Times*, 20 April 2005), online: <http://www.columbia.edu/~ap2231/ET/et77_April20_05.htm>.

to turn into the WTO template. An Asian bloc that relies on a "trade only" template will be an effective instrument of countering the US template in the future WTO negotiations.

Internally, India can surely benefit from cooperation with China in shaping its labor-intensive industry. In particular, direct competition with China may help push some of the key reforms necessary to stimulate the expansion of the labor-intensive industry. With the wages in China now rising, the time for India could not be more opportune for moving in a big way into such labor-intensive sectors as apparel, footwear and toys. Likewise, China could gain from increased interaction with India in the information technology sector.

3. *China and India should lead Asia in the practice of open regionalism (with a distinctive Asian identity).*

China and India, as well as some of their Asian neighbours, all have crucial interests in global trade liberalisation, partly because their exports mainly go to markets outside Asia. In this sense, Asian regionalism is merely adopted as the "second-best" strategy due to the stalemate in the multilateral trade negotiations. The best framework for harvesting sustainable benefits from liberalisation is still the global one, while regional arrangements represent the middle ground on the spectrum of frameworks. Nevertheless, in the current situation of world trade, there seems to be no viable alternative to regionalism for trading nations.

It is widely recognised that Asian regionalism must be, first of all, "open regionalism". There is however no fixed definition on what constitutes open regionalism.¹²⁹ Difficult questions will be raised if open regionalism must mean, as some commentators suggest, open membership, which means that every country, be it geographically located in the region or not, can join on the same terms. This renders it possible that a R.T.A. can eventually encompass the entire world and hence – at least theoretically – lead to multilateral liberalisation.¹³⁰ This will render the concept of Asian economic integration senseless (or make it become global economic integration) as it is, by definition, economic integration in Asia, which is pursued because of the very reason that global integration is halted by slow negotiations at the multilateral level. As such, it is inconceivable that membership of a regional arrangement is "open" for all countries of the world. More often, the membership of a regional integration group is strictly confined to a given geographic area.¹³¹ The openness of regional groupings, in a more practical way, should lie in its willingness to extend intra-regional concessions and preferential treatment to non-members. As such, Wei and Frankel define open regionalism concisely as "external liberalisation by trade blocs, that is, the reduction in barriers on imports from nonmember countries that is undertaken when member countries liberalize the trade among themselves".¹³² This is not to say that all the concessions and privileges must be offered to nonmembers on an MFN basis – this would probably cause the regional integration arrangement to lose its regional nature. As Wei and Frankel points out, the

¹²⁹ See Part I of this article on the general definition of open regionalism.

¹³⁰ *Supra* note 47 at 503.

¹³¹ Chirathivat, *supra* note 101 at 906.

¹³² Shang-jin Wei & Jeffrey A. Frankel, "Open Regionalism in a World of Continental Trade Blocs" (1998) 45(3) IMF Staff Papers 440 at 441.

“degree of liberalization on imports from nonmembers need not be as high as that from member countries”.¹³³

Therefore, developing countries are encouraged to adopt a three-pronged strategy that integrates unilateral, regional, and multilateral liberalisation initiatives.¹³⁴ The success of Asian emerging economies, including East Asia economies and India, is to a large extent attributed to the unilateral government reform programs. In the practice of open regionalism, Asian countries are encouraged to reduce their trade and investment barriers unilaterally to the maximum extent possible in order to improve their competitiveness and reduce poverty, as well as to avoid trade diversion effects. Although it is not an obligation embodied in the regional integration agreement, members are free to extend its regional liberalisation to non-members on a mutually reciprocal or even unconditional basis. Further, Asian countries participating in the integration process should take this as an opportunity to consolidate their diverse views and form consensus to push the multilateral trade negotiations ahead.

4. *It is time for Asian countries, notably China and India, to conduct deeper integration.*

It has been advocated that the new wave of regionalism should practice “deep integration” as opposed to “shallow integration”. In the scenario of shallow integration, mainly trade in goods is liberalised among members. “Deep integration” goes beyond trade, involving investment, services, product standards and technical regulations, competition policy, and even environmental and labour standards, among others. In short, deep integration may induce welfare gains for participating countries by lowering the costs of production and improving efficiency in general, and for non-participating countries by avoiding trade diversion through stimulating trade.¹³⁵

Regional agreements in Asia are increasingly comprehensive in scope, going beyond reduction/elimination of tariffs and tariff barriers. In the Asian context, deep integration should be achieved through investment liberalisation, financial cooperation, and trade facilitation. Asian countries either heavily rely on foreign investment for economic development or aspire to attract foreign investment. Hence Lee and Park observe that “the movement of East Asian countries toward R.T.As has been motivated by facilitating investment and providing a more flexible environment for the operation of multinational firms”.¹³⁶ In most Asian F.T.As, investment commitments are centered on national treatment and/or MFN treatment for foreign investors alongside rules on expropriation, compensation and repatriation of earnings. Countries have also committed to the creation of liberal and competitive environments for investment, as well as improve transparency in their legal systems.¹³⁷ Frankly, in China’s and India’s regional initiatives, the investment commitments are rather general, with little details to guide the practice. If Asian countries wish to continue to draw investment from each other and from outside the region, they should take efforts to liberalise their investment regime, relax restrictions on foreign ownership,

¹³³ *Ibid.*

¹³⁴ World Bank, *supra* note 24 at 147.

¹³⁵ *Supra* note 46 at 28-33.

¹³⁶ Jong-Wha Lee & Innwon Park, *supra* note 101 at 41.

¹³⁷ O. G. Dayaratna Banda & John Whalley, “Beyond Goods and Services: Competition Policy, Investment, Mutual Recognition, Movement of Person, and Broader Operation Provisions of Recent FTAs Involving ASEAN Countries” NBER Working Paper 11232 (Cambridge, Massachusetts: National Bureau of Economic Research, 2005) at 15-17.

remove discriminative performance requirements, and provide impartial dispute settlement procedures. It is important to stress that these countries should however seek to strike a balance between investment liberalisation and promotion of competitiveness of domestic industries.

Trade in services is another important area in which deep integration should be sought. Unfortunately, Asian integration in the trade in services is very shallow. SAFTA does not even have a service dimension. In East Asia, although ASEAN's F.T.A. initiatives, including ASEAN-China, ASEAN-India, ASEAN-Japan, and ASEAN-Korea, commit the parties to conduct GATS-plus liberalisation, it is questionable that the voluntary nature of the commitment will lead to significant progress.¹³⁸ Again, China and India, with growing comparative advantage in certain services sectors, should take the lead in liberalising regional services. Initial liberalisation at the regional level may help create economies of scale, nurturing efficient and competitive domestic and regional firms which can stand up to competition from outside the region, and provide opportunities for learning-by-doing. Further, as some commentator correctly noted, "regulatory co-operation, such as harmonisation and mutual recognition of domestic regulations in financial, professional and a range of other services, may be more feasible in a regional context".¹³⁹ Needless to say, the building of a strong and flexible regulatory framework, which ensures fair competition, and regulates and remedies market failures, should accompany the whole liberalisation process.

A danger of regional agreements is that countries will tend to avoid making tough liberalisation decisions by excluding whole sectors from preferential arrangements. This can happen to trade in both merchandise (especially the agricultural sector) and services. For instance, the Japan-Singapore F.T.A. totally excludes the agricultural sector. Although it is widely recognised that reduction of trade barriers in agriculture is particularly important for poverty reduction, whereby tremendous gains can be conferred on the poor households of the less developed countries in this region, for most of the major Asian economies, including ASEAN, Japan, Korea and India, agriculture is still viewed as a sensitive sector placed outside the liberalisation agenda. In this regard, China's commitment to a regime of low protection in agriculture demonstrates that the country is taking the lead on some issues relating to regional liberalisation. China's WTO commitments in agriculture are already impressive, and its stance toward agricultural trade at the regional level warrants further attention. Under the E.H.P. of the ASEAN-China F.T.A. framework agreement, China undertakes to grant unilateral concessions to agricultural products (Chapter 1-8 of the HS Code) of ASEAN countries provided that the latter also commit to some degree of agricultural liberalisation. It is remarked that "China's binding to low tariff levels as part of its agricultural policy therefore offers scope for the liberalization of agriculture in a regional setting, which could set in place a favorable political dynamic for more open agricultural sectors through East Asia".¹⁴⁰ One would question the effectiveness of this approach as the Chinese method is to "induce" – with the imposition of no compulsory

¹³⁸ Tubagus Feridhanusetyawan, "Preferential Trade Agreements in the Asia-Pacific" IMF Working Paper WP/05/149 (Washington D.C.: IMF, 2005) at 24.

¹³⁹ Kathie Krumm & Homi Kharas, eds., *East Asia Integrates: A Trade Policy Agenda for Shared Growth* (Singapore: the World Bank and Oxford University Press, 2003) at xxxii, online: <<http://web.worldbank.org>>.

¹⁴⁰ Homi Kharas, "Trade and Economic Integration in the Asia Pacific Region" in Organisation for Economic Co-operation and Development (OECD), ed., *Regional Integration in the Asia Pacific: Issues and Prospects* (Paris: OECD, 2005) at 107.

obligations – trading partners to liberalise by offering unilateral concessions. The fact that this approach cannot readily deliver reciprocal commitments implies that it may have a limited potential as a vehicle for trade liberalisation. Without a more formal and institutionalised approach, the liberalisation process in sensitive sectors such as agriculture and financial sector can be unsatisfactorily slow.

5. *Asian countries should develop “common guidelines” or “best practice” for bilateral F.T.As.*

As analysed above, regional integration in Asia will have to be achieved through a web of regional and bilateral F.T.As. Every agreement adds to the layers of discrimination and worsens the systemic problems of regionalism. For example, on rules of origin alone, a survey of several R.T.As in Asia demonstrates that the “spaghetti bowl” effect is apparent. For instance, under the Singapore-Australia F.T.A, the general rule of a specified threshold of local value content is either 30% or 50%. In the Japan-Singapore FTA, each product has one corresponding specific rule of origin, although a significant portion of the rules require 60% of local content. Such a world of complex clauses governing rules of origin, criticised the President of the Asian Development Bank, “could create a bureaucratic tangle that might put individual companies off trading together.”¹⁴¹

It is suggested that, to cure the systemic problems and facilitate deeper integration, East Asian and South Asian countries should establish an institution to develop common standards and best practices to guide the regional F.T.As. This body, with the participation of all interested Asian countries and under the auspices of a regional forum such as the East Asia Summit or ASEAN+3 cooperation, should produce a set of guidelines and principles for Asian F.T.As, with a view to ensuring that the regional F.T.As lead to integration rather than fragmentation of trading relations in Asia. It is highly possible that bilateral and sub-regional arrangements, if designed with measures incorporated to mitigate distortions and inefficiencies, can deepen regional economic integration and even “present additional opportunities to those currently accommodated within the multilateral framework”.¹⁴²

The suggested guidelines for sub-regional and bilateral trade agreements in Asia should include the following which is nevertheless not an exhaustive list:

First, Asian F.T.As should at least be WTO-consistent. This not only refers to compliance with GATT Article XXIV and GATS Article V. The bottom line is that every FTA should be WTO-plus. Further, they must follow, to the widest extent, the principles, terminologies, concepts and rules embodied in the WTO, although they are encouraged to develop liberalisation-oriented rules for areas not covered by the WTO.

Second, deeper integration and comprehensiveness in Asian F.T.As should be sought. Numerous studies show that agreements with deeper and broader integration can lead to larger trade and income effects. WTO disciplines also require regional F.T.As to eliminate barriers to trade and investment between the parties, including tariffs and non-tariff restrictions in goods, services, and investment. Furthermore, given Asia’s relatively backwardness in infrastructure, comprehensive cooperation in trade facilitation should be the focus of any F.T.A. in this region.

Third, Asian F.T.As should adopt liberal, or at least nonrestrictive, rules of origin. The best solution is to have an Asia-wide set of rules of origin. If this is not possible, the rules of origin in

¹⁴¹ David Pilling, “ADB chief hits out at ‘noodle bowl’ trade” *Financial Times (Asia)* (2 February 2006) 1.

¹⁴² *Supra* note 50 at 290.

Asian F.T.As should at least be transparent, clear, and consistent, and have “transparent and consistent implementing regulations (e.g. accounting practices, paperwork for certification of origin) that are chosen at the minimum level needed to prevent trade deflection”.¹⁴³ As the bottom line, they should not serve as trade policy mechanism for protecting “sensitive sectors” or special interest. In brief, a set of Asian “best practice guidelines” for rules of origin can be an invaluable contribution to Asian economic integration.

Fourth, there should be clear rules on how technical barriers to trade can be employed for legitimate purposes such as the protection of public health and safety. There should be “[c]lear and simple codes that guide technical barriers to trade, such as product standards and phytosanitary standards to protect public health and safety (based on the WTO agreements on standards). Likewise, agreements that cover environmental and labor standards should embrace the rights of partners to establish and implement their own laws and regulations in conformity with existing international obligations in the areas of environmental protection and labor rights and conditions”.¹⁴⁴

Fifth, harmonisation of regulatory standards may or may not be required in Asian F.T.As, depending on the readiness of the participating economies. Countries are encouraged to adopt international standards provided that all parties have the capacity to implement it. Mutual recognition is also encouraged. However, it is important to realise that, given the diverse backgrounds of the Asian countries, regional cooperation in standards can be very difficult. The best starting point is that all members of the F.T.A. should maintain an open and transparent system, with standards published and easily accessible to businesses and the public.

Finally, dispute settlement procedures should be established in Asian F.T.As to promote legalism in trade relations. Disputes should be resolved, first, through amicable consultations. If bilateral consultations do not offer solutions, then an independent third party should be established to resolve the disputes in an impartial, expeditious manner, and its decisions should be fully implemented. Mediation should be allowed in the whole process of dispute resolution. Further, the parties should avoid duplication with the WTO dispute settlement mechanism where appropriate.

VI. CONCLUSION

Asian economic integration is caused and pushed forward by the painful experience from the Asian financial crisis, the delay in global trade negotiations of the Doha Round, concern at the rise of the giant Chinese and India economies, as well as some strategic and political considerations. It is a “second-best” approach which Asian countries unfortunately have to follow. In the process of regional economic integration, China and India, given the size of their populations, as well as their central strategic positions in international and regional relations, will inevitably play fundamentally important, if not entirely dominating, roles. This paper has suggested that regional economic integration in Asia should first of all realise sub-regional integration in East Asia and Southeast Asia, while linking up these two sub-regions with bilateral F.T.As, among which the most important one should be a China-India F.T.A. Eventually, all the F.T.As will be consolidated into one pan-Asian F.T.A. China and India must take the lead in promoting Asian economic integration. They are advised to lead the region to practice open regionalism (with whatever Asian identity) and conduct deeper integration. Lastly, it is suggested

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

that Asian countries should, at this stage, establish an institution to develop common principles and guidelines for the sub-regional and bilateral F.T.As.

