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Status of Bilateral and Regional FTAs in the Asia-Pacific Region

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1. Continuity and change

Our world continues to be guided by a search for economic growth within increasing interdependence. Regional FTAs have become more important than bilaterals, and multilateral trade rules will be built on them. Asian processes and institutions will be increasingly prominent. Much of this has long been familiar, but there are new challenges to conventional understanding, and capacity building is required much more widely than only in developing countries.

Striking the right balance between change and continuity is often at the heart of academic enquiry. I am aware of the European public servant who had a successful 40-year career in the first half of the twentieth century and who began each year by predicting confidently that there would no major crisis in the ensuing year. He was wrong only twice.

The recent past is often the best available guide to the future. It is possible to exaggerate the significance of novelty. But to ignore the possibility of change is to incur the likelihood of making wrong decisions. We know perfectly well that we cannot know the future, but we still have to estimate the relative probability of various scenarios in order to make the best possible current decisions. However, I am confident that in economic issues, we often underestimate the underlying continuity. Marshall was right to use as the epigraph of his *Principles of Economics*, *Natura non facit saltum* - "nature does not make jumps".[1]

It might be thought that I begin with some indulgent introspection, and indeed when I look back over the papers I have contributed to the last three Japan Economic Foundation symposia before this one, Delhi in 2009, Wellington in 2010, and Taipei in 2011, I find a good deal of continuity. In Delhi, I emphasized the gradual widening of the agenda of economic integration through the years of GATT, and anticipated "agreements in smaller groups and on more confined agendas" rather than WTO rounds. In Wellington, I used similar thoughts and added the likely diminution in distinct treatment of real and financial integration, including in the context of the APEC growth agenda of "balanced, inclusive, innovative, sustainable and secure" growth. And in Taipei, I used the same foundations to discuss supply chains and the role of standards in integration which facilitated growth with those characteristics. Those remain key themes as we look at bilateral and plurilateral FTAs in the Asia Pacific Region now.

Perhaps continuity comes easily to those who look at Asia-Pacific developments from a New Zealand perspective. In 1993, the Ministry of Foreign Affairs and Trade issued the first formal statement of New Zealand's trade policy. New Zealand's top priority remained the multilateral trading system; the Uruguay Round had changed the situation in which GATT did not engage in any major way with agricultural trade. New Zealand was a far from enthusiastic participant in trade liberalization in the 1960s and 1970s, but the stance of economic policy changed in the 1980s. New Zealand trade was

1 It is sometimes thought that this relates to Marshall's conception of economics as more like biology than physics. However, the Latin tag captures axioms used by Leibnitz and Newton and although Marshall did indeed favour evolutionary conceptions, he probably also thought of justifying his use of calculus including its continuity assumptions.

widely distributed, and the most favoured nation principle was recognised as a key facilitator of the diversity of markets. Secondly, New Zealand was a keen supporter of APEC. Asia was clearly a growing economic partner and New Zealand was keen to participate in its growth. Furthermore, support of the multilateral system was supported by distaste for anything that looked like a division of the Pacific between Asia and the Americas. Thirdly, Australia was New Zealand’s most important bilateral partner. The 1983 Australia and New Zealand Closer Economic Relations Trade Agreement, ANZCERTA or CER was a thorough~~-~~g~~r~~o~~w~~ing FTA. By 1993, it covered virtually all trade in goods, and nearly all trade in services. CER was treated in New Zealand as much more than a trade agreement. Although the terminology of a “comprehensive economic partnership” had not become common, CER anticipated its conception~~,~~ and dealt with issues like mutual recognition. Over time~~,~~ it became sensible to think in terms of a “single economic market” although with each liberalization step~~,~~ there were always new boundaries to be discussed in an effort to determine what were justified differences between the economies and societies, and what were unnecessary barriers to trans-Tasman integration. Fourthly, the 1993 trade policy statement included a willingness to contemplate a free trade agreement with anybody who was willing to conclude an agreement which was compatible with WTO requirements, and in particular was “comprehensive” – i.e. did not have unreasonable exclusions or special provisions relating to agriculture.

These four elements of trade policy have remained constant since 1993 despite changes of government. New Zealand has participated in the mostly abortive WTO negotiations, and supported maintaining the standing of the WTO in international economic governance. Two of the famous “Four Firsts” of New Zealand’s relations with China were related to its inclusion in the WTO: New Zealand was the first developed country to recognise China as a market economy, and to complete negotiations to support China’s admission to the WTO. (The other two were for a developed country to begin negotiations with China for an FTA, and to complete a Free Trade Agreement.) New Zealand remained an enthusiastic participant in all aspects of APEC. CER was developed in many ways, perhaps most interestingly in relying on competition policy in each country rather than having any antidumping provisions and on normal processes of consultation rather than a disputes resolution provision. New Zealand completed a range of agreements: New Zealand-Singapore Closer Economic Partnership (2001); Trans-Pacific Strategic Economic Partnership (P4, Brunei, Chile, New Zealand, Singapore) (2005); New Zealand-Thailand Closer Economic Partnership (2005); New Zealand-China Free Trade Agreement (2008); ASEAN-Australia-New Zealand Free Trade Agreement (2010); New Zealand-Malaysia Free Trade Agreement (2010); and New Zealand-Hong Kong, China Closer Economic Partnership (2011). Further possible agreements are at various stages with the Gulf Cooperation Council; Russia, Belarus and Kazakhstan; India; South Korea; Japan; Chinese Taipei; and the Pacific Alliance; as well as the Trans-Pacific Strategic Economic Partnership (~~,~~TPP)~~,~~ and RCEP. Only Singapore (and perhaps Chile) might be more promiscuous than New Zealand although there is behind the apparent scattering of effort a coherent strategy of securing understanding with the great civilization-states, India, China, US, and Europe, and with the second layer of major economies like Japan, Russia, Brazil, and South Africa, as well as promoting trade with other economies willing to enter into deep integration even if only over time. For our immediate purposes, the point is that New Zealand trade policy exemplifies adaptation to changing circumstances within an essential continuity.

It was not, however, New Zealand’s experience which provoked my ruminations on continuity and change. Rather it was the title of our symposium, “FTAs as a Growth Strategy for Asia”, with its implicit suggestion that a growth strategy is a new element in economic diplomacy. FTAs have always been conceived as an instrument for economic growth and the more inclusive notion of economic integration makes that even more apparent. The objective has always been to facilitate the operation of economic activities throughout the region in such a way as to maximize their contribution to the welfare of the region as a whole. That conception is conventional in relation to economic thinking – the most fundamental question of economics since Adam Smith has been under what conditions self-interest achieves a social optimum – but it is less instinctive for thinkers accustomed to zero-sum games, whether sporting contests or national struggles for position and status. “Regional economic integration” points towards minimizing the impact of national boundaries whether by tariffs or other barriers while preserving rules and institutions which make private interests compatible with social ambitions.

This may not be obvious to trade negotiators and diplomats who, perhaps influenced by sporting metaphors, think in zero sum terms rather than instinctively turning to economic logic. And such negotiators and diplomats are more common when they emerge from political cultures steeped in "reciprocity". Unfortunately the heritage of the US includes the Reciprocal Trade Ageements Act 1934, a pre-Smithian piece of mercantilism, which is readily rationalized by the common sense but erroneous belief that "concessions" are justified only in return for something at least equivalent.

2. Changes in the international economy

New Zealand is far from the only economy to adapt in the last 30 years. Indeed, the history of CER is useful for reminding us that there are many national histories which contribute to general experience that we identify as international trends. And the general experience is the addition of FTAs (under various names) to a mostly static WTO. We have recently been reminded that Korea has moved from a country without FTAs at the start of the century to one with deals with major partners, US, EU, India and ASEAN although not yet China or Japan.[2] We could add that Korea is even more strategic than New Zealand, aiming at arrangements with principal participants in global affairs, China, EU, India, and US before worrying too much over secondary parties like ASEAN or Japan, let alone Australia and New Zealand. But the general experience of a proliferation of FTAs is well known.

We may think that the proliferation of significant traders is sufficient to explain this. More parties makes any negotiation more difficult so that the WTO is unable to move beyond what was agreed in the Uruguay Round and FTAs have provided an alternative. There is undoubtedly some weight in this argument but it is not complete. First, cge modelling generates an equally persuasive argument that in general the more parties there are to a trade agreement, the greater the aggregate gains available. Secondly, GATT and WTO bargaining was never a debate among an increasing number of equals. The fundamental dynamic of GATT was bargaining among the "Quad", Canada, EU, Japan and US, modified by adjustment to cater for undeniably important impacts on other economies. At the very least, we would amend the starting argument into changes in the relative significance of specific economies that have prevented the emergence in the WTO of a modified Quad.

However, there have also been major changes in the economic interdependence of economies, the subject of FTAs. In particular, there have been three interrelated changes: real and monetary interdependence have become less segregated, global trade world has changed from trade in goods to trade in tasks, and international production networks have become vastly more important.

The world has been dominated by floating exchange rates for over 30 years. Nevertheless, much commentary continues to assume fixed rates and a separation of economies other than for trade flows. Whenever we hear that cheaper export prices will reduce a balance of payments deficit, we should be aware of the need to check the analysis to see that exchange rate adjustments have been properly considered. Current account imbalances cannot be considered as necessarily a sign of impending crisis although they may signal macroeconomic and financial stresses, especially if accompanied by differences in maturity of assets and liabilities in holdings of leveraged entities.[3] The real economy has to be considered simultaneously with financial interdependence. Furthermore, the significance of financial flows, and FDI in particular, is not to be found in funding trade flows, but for impacts on the real economy, especially the transmission of technology and skills.[4]

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2 Shiro Armstrong "South Korean trade: beyond 'free' trade deals" *East Asia Forum* (19 December 2012)

3 Maurice Obstfeld "Does the current account still matter?" *CEPR Discussion Paper* No. DP8888 (March 2012) which is also available as *NBER Working Paper* No. w17877 (March 2012); see also Alan M. Taylor "External Imbalances and Financial Crises" *NBER Working Paper* No. w18606 (January 2013).

4 Stephen Grenville "Rethinking Capital Flows for Emerging East Asia" *ADBI Working Paper* No 362 (June 2012), p. 19.

Towards the end of 2012, some media commentators became excited in the belief that the IMF had dropped opposition to capital controls, which would reopen a gap between real and financial integration. However, the IMF decision, an authorized staff paper rather than a formal institutional decision,[5] and one careful to specify that it did not change any international commitments, was a cautious recognition that full liberalization may not always be optimal: "The degree of liberalization appropriate for a country at a given time depends on its specific circumstances, notably its financial and institutional development."[6] The significant conclusion was "While the choice of which CFM [capital flow management] to use would depend on the expected effectiveness and efficiency, the design and implementation of CFMs should be transparent, targeted, temporary, and preferably non-discriminatory".[7] An obvious response is, who could ever have thought otherwise? But just as commentators (and trade negotiators?) can misunderstand the role of reciprocity in the economic logic of interdependence, so they can oversimplify the analysis of capital flows. There is no likelihood of significant reversal of the trend through which real and financial integration has become inseparable. It will continue to be only too easy to forget that "quantitative easing" in major developed economies will have spill-over effects in developing markets.[8]

The more immediate implication in the present context is in analysis of international trade in services. While international trade in services can be through cross border supply directly as with some business services, through movement across borders to engage in consumption as with education and health services, or through movement of natural persons across borders to perform a service as with some engineering operations, much requires a commercial presence in the destination market, and commercial presence usually requires some supporting investment. There is a direct link between trade in services and an increasing flow of international investment. It is well-known that conventional statistical measurement of trade in services is understated because of conventions that record some transactions as investments rather than trade flows. Statistical mismeasurement is an inconvenience; international trade in services is a potential source of enhanced productivity in both source and destination economies. We know that gains are possible – since marginal equivalences across borders have not been realised.[9] We also know that the traditional practices of "offer and acceptance" in WTO negotiations have not been fruitful and that no alternative procedures have been adopted. For example, it might be fruitful to change the burden of proof, and require parties to reduce barriers to international service flows identified by possible trading partners unless a convincing rationale for the barrier can be generated. Obviously that would require a great deal of experience in developing the idea of "convincing" but it is no more than a development of the accepted idea of transparency, and the idea of a "bound" tariff rate was just as experimental in the 1950s.

The growth of services trade is therefore a reason for increasing dissatisfaction with reliance of conventional multilateral governance.

A second change in the international economy has been the relative growth of trade in intermediate products, which has generated the notion that "trade in goods" has given way to "trade in tasks".[10] We are now familiar with the concept of a "world car" assembled from parts made in many different

5 "The Liberalization and Management of Capital Flows" *IMF Staff Paper* (14 November 2012).

6 Ibid. para. 18, p. 13.

7 Ibid. para 33, p. 20.

8 Ruben Calderon http://www.pecc.org/blog/2012/12/04/the-unintended-consequences-of-quantitative-easing-on-emerging-markets/ It is also true that advanced economies can learn from Asian experience. Stephen S. Roach "Strategic Lesson From Asia for the West: Austerity Does Work" *Jakarta Globe* (2 March 2012) reflects on a panel discussion at Davos in which Asian panellists recalled their initial opposition to IMF conditionality and adjustment programs and their subsequent belief that austerity works. But the argument owes little to economic theorizing: "success or failure ultimately boils down to power politics — namely, a resolution of the tension between short-term palliatives and the commitment to a long-term strategy."

9 Jenny Corbett "Comment" in *Research Institutes Network Statement* No 1 (Jakarta: ERIA, 2012) pp. 41-2.

10 *Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks* (IDE-JETRO and WTO, 2011).

economies or the evidence assembled by Daisuke Hiratsuke of disk drives being assembled in Thailand using 43 components from 10 other countries and 11 components produced in Thailand, the disk drive then being combined with other components to produce a finished product in China.[11] There is as usual a lot of prehistory. It is many years since the standard description of world trade was that of scholars like Folke Hilgerdt and J.B. Condliffe in the middle of the twentieth century, an exchange for food or raw materials for manufactured goods. By the 1960s, we were aware that international trade between major economies included a substantial amount of intra-sector trade – small cars for large cars, cotton goods for other textiles, etc. Explanations in terms of more intensive exploitation of specialization were supplemented by theorizing about imperfect competition and product differentiations. Yet more intensive exchanges have generated recognition that there have recently been at least three important sources of gains from trade: differentiated goods produced subject to increasing returns, love of variety creating a trade-off with increasing scale of production; allocative efficiency as more efficient firms gain relative to less; and the positive impact of larger markets on innovation. A greater market permits more variety for consumers by a variant of the classic Ricardian argument, heterogeneous firms can coexist with different profitability and create a larger market which leads to all of entry, exit and reallocation, and if innovation involves some fixed costs, it can easily fit into an increasing returns framework. At the SITC most disaggregated level, 1161 industries, intraindustry trade grew from 10% of the total to about 30% from 1960 to the 1990s and then stabilized; at the 59-industry level it grew from 30% to 55% at the same period.[12] All of which might remind us that conventional sectoral and industrial classifications were created by statisticians in the nineteenth century and were adopted by economists, even those who accepted the classical injunction that the end purpose of production is consumption and should have been aware that it is easy to give too much prominence to producers and too little to consumers.

More recently, we have been unable to avoid noticing that trade is increasingly in inputs to further processing and not just in more finely disaggregated consumer goods. Again, there is pre-history. Economic historians recall the history of the cotton industry even in the nineteenth century. The Lancashire industry was characterised by specialised firms – they were either spinners or weavers but not both. Elsewhere, especially in Germany and the USA, integrated firms prevailed. Analysis generally argued for a trade-off between gains from specialisation where transport costs were low against economies of scale and innovations derived from linkages between spinning and weaving processes. The latter seemed to prevail in the twentieth century although much development was pre-empted by changes in cotton markets in the First World War, interestingly especially international markets. But the scale of recent developments is much larger. The literature on "outsourcing" is enormous. Hong Kong industrialist Victor Fung has been quoted as saying. "You sourced in Asia, and you sold in America and Europe." Now, said Fung, the rule is: "'Source everywhere, manufacture everywhere, sell everywhere.' The whole notion of an 'export' is really disappearing."[13] We can easily underestimate the force of such observations. In many economies, strategy has been built for a number of years about achieving the best use of domestic resources by identifying consumers overseas and providing what they want. New Zealand is not alone in having literally for over a hundred of years attached importance to putting products in boxes and sending them to consumers abroad. Now we have to adapt to a world where we may never know the final consumers of local produce and the task is finding appropriate roles within a network of suppliers. It is only too easy to fall back into familiar ways of thinking. There is obviously some good sense in the comment,

> With Korea having opened up to US and European automobile companies, it should be relatively easy to eliminate tariffs toward Japanese and other auto suppliers so that the Korean automobile market is more open, competitive and able to improve Korean consumer welfare. There is no justification for making any potential innovative or

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11 Michael J. Ferrantino "Supply chains and behind-the-border trade barriers: Implications for developing nations" *Vox* (11 February 2012), www.voxeu.org/index.php?q=node/7611

12 Marc J. Melitz and Daniel Trefler "Gains from Trade when Firms Matter" *Journal of Economic Perspectives* 26(2) (Spring 2012), pp. 91-118

13 Thomas L. Friedman "Made in the World" *New York Times* (28 January 2012).

cheaper cars from Japan, China or elsewhere relatively more expensive in favour of US or European cars.

It is certainly correct that "The aim for Korea is to have well-regulated and competitive markets, not markets with barriers to entry and national treatment for preferred-country firms" but Korea's competition with Japan in the auto sector is not in finished products; trade also occurs in intermediate products and the auto industry is one where international production networks have flourished. Korea and Japan compete for places in international production networks.[14]

The third of the interrelated major changes in the international economy is the creation of cross-border supply chains, or cross-border value chains, or international production networks. International trade in intermediate products is not just in discrete transactions between anonymous buyers and sellers but takes place as repeated transactions within relationships between sequential producers. International production networks are more than vehicles for trade in intermediate products although writers are sometimes ambivalent about this. International production networks could not exist without international trade in intermediate products, but there could be trade in intermediate products without international production networks. Trade in intermediate goods means that it is now not possible to think of tariffs as simply part of an export-led growth strategy, but international production networks poses challenges to policy development which are much wider and deeper. Asian writers tend to see international production networks as related to Japanese FDI in South-east Asia and China, part of market-led integration, and generating changes in production methods which includes dissemination of innovation. Outsourcing may actually be greater for longer-distance trade, reflecting Japanese FDI in ASEAN, and international production networks may be more stable than most outsourcing – firms invest in sunk costs to establish relationships and work to maintain them.[15] European and American sources on the other hand tend to identify supply chains[16] with the presence of intermediate inputs.[17]

There is no doubt that much can be traced to the balance of agglomeration and dispersion. Japanese firms were attracted by lower wage costs elsewhere which more than outweighed increased transport costs on components and higher management costs. But that is merely a starting point for much variety. Modern value chains have different sources. Electronics and motor vehicles rely on specialization in production and increasingly in design, but in fish processing, supermarket chains demanded a complete product range - finfish, shrimp, tuna and aquaculture – which forced processors to form chains in order to assemble the required range. The result could be described as a market-based chain. Furthermore, chains are not static. Even a production network which began from a simple cost-minimizing exercise, balancing wage costs against the costs of transport and management, was likely to change over time. Production networks adopted just-in-time manufacturing, itself partly a trade-off between minimizing inventory costs versus the implicit or explicit costs of possible interruptions of supply, but soon a tool of modern management techniques. Just-in-time manufacturing turns any potential interruption into a crisis and demands highly motivated and informed management. A production network also requires

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14 Shiro Armstrong "South Korean trade: beyond 'free' trade deals" *East Asia Forum* (19 December 2012)

15 Fukunari Kimura and Ayako Obashi "Production Networks in East Asia: What We Know So Far" *ADBI Working Paper* No 320 (November 2011)

16 The terminology is far from uniform. "Supply chains" are sometimes seen in too mechanical a form, the logistics systems along which goods flow. "Value chains" tend to be associated with management literature and directs attention to the relative returns from research & development, production, and marketing. "International production networks" signals the range of relationships involved in cross-border manufacturing and marketing, including innovation, but tends to bias the discussion towards seeing Asian developments.

17 Ironically Richard E. Baldwin "Global Supply Chains: Why They Emerged, Why They Matter, and Where They are Going" *CEPR Discussion Paper* No DP9103 (August 2012) recognises the complexity of production networks, but while Richard Baldwin "WTO 2.0: Global governance of supply-chain trade" *Centre for Economic Policy Research: Policy Insight* No 64 (December 2012) recognises the same complexity it proceeds to analyse them in terms of intermediate imports which makes them prominent in Europe and leads to the conclusion that they are deterred by distance, which is not what the Asian evidence suggests. The OECD has also begun exploring international production networks but its early work gives excessive attention to intermediate imports alone.

interoperability, with components made with precision to the standards needed in the next stage of production. An international production network is likely to require professional services across borders – engineers from the "home" economy to solve problems encountered in a subsidiary supplier, legal services to define agreed standards, and so on. International production networks generate the importance attached to new topics in economic integration, standards, intellectual property, trade in services, movement of natural persons, investment. They are much more than the sources of trade in intermediate goods.

3 Implications for Economic Diplomacy

The issue has always been economic interdependence, not "trade", and the range of explicit agreements has been widening ever since tariff reduction was initiated. The fundamental argument, almost a mathematical truism, is that the process of maximization generates the greatest aggregate when the number of constraints on the process is minimized. National borders are constraints on the use of resources to generate consumer welfare and reducing their impact can be expected to facilitate increased consumer welfare. (It is "almost" a truism because it is subject to some important qualifications, notably that increased aggregate welfare leaves open the distribution of gains between parties, that the distribution of welfare within each economy is also changed; and that the amount of resources whose use is being optimized may be changed by learning, including learning facilitated by the process of integration.) The argument has always been about "constraints", not about tariffs. It has always been about interdependence, not about "trade", let alone "trade in goods".

In the 1940s, after the experience of the 1930s, it was not entirely foolish to focus on tariffs and trade in goods although it was unfortunate that a choice for convenience was not clearly distinguished from a matter of principle. As tariffs were reduced, attention naturally focused on other barriers – anti-dumping processes, subsidies, nontariff measures with the effect of barriers including standards and sanitary & phyto-sanitary requirements, government procurement processes, and so on. Regrettably, the process of liberalization had become dominated by negotiators and lawyers,[18] and the widening agenda was treated as adding new topics (and often as aiming for fairness in how agreements for tariffs were implemented). Rather, an inappropriate concentration on one aspect of economic integration was gradually removed.

We are now witnessing the gradual acceptance that economic integration has to be conceived within the major international trends of increased linking of real and financial integration, the relative growth of trade in intermediate products, and the enhanced prominence of international production networks.

There will always be debate about the appropriate limits to integration. Any difference between economies can be represented as reducing the capacity of agents from one economy to operate in another. Societies and cultures differ, and few would subscribe to the notion that a homogeneous world is desirable. So judgment is required as to what constitutes an undesirable barrier to integration and what is an inevitable consequences of different social and cultural identities. While this is disturbing to those who seek simplicity at all costs, it poses no challenge to economic logic since it is exactly paralleled by the conception of economic policy as constructing a framework within which self-interest can be relied on to generate a social optimum; the existence of a framework precludes unlimited freedom.

The boundary will be determined in each economy or group of economies. New Zealand and Australia have adopted a pragmatic approach. Regulatory harmonization is understood not as identical regulations but making them consistent or compatible so that they do not result in barriers to trade, investment or labour mobility, a more integrated method of regulatory coordination than mutual recognition. And that has to be defined further on a case by case basis. In the case of therapeutics, the two countries have

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[18] Essentially because of the US Reciprocal Trade Agreements Act 1934, the instrument by which control of the US tariff schedule was shifted from Congress to the Executive and which was important in shifting the trend from protectionism to liberalization in the 1930s and 1940s but which became an impediment to clear international thinking thereafter.

agreed to establish a single regulatory authority with jurisdiction in both countries but most regulatory integration will be less thorough-going than that. An earlier statement appeared to say that the best approach should be determined by "trans Tasman net benefits" but the apparent espousal of ignoring the distribution of benefits between Australia and New Zealand has been modified and the term is now understood as ignoring the distribution of benefits provided they are positive in both jurisdictions.[19] Few countries are as close in history, political and judicial systems, and cultures as Australia and New Zealand, although those who recall the distaste for each other of prime ministers Fraser and Muldoon at the signing of CER, or the depth of hostility over ANZUS at the time of the major CER intensification in 1988, are not surprised that Asian leaders can continue economic integration while disagreeing over other issues - but we can expect the boundary of integration to be determined in a similarly pragmatic way.

It will, however, be contested. The European Union's Treaty of Lisbon provides that EU foreign policy should be "guided by the principles which inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law … human rights and fundamental freedoms" meaning European views of good governance, democracy, environmental protection, combating organised crime and anti-terrorism. This extends to external economic policy. The EU negotiated an FTA with Korea in 2009 and completed an overarching "framework agreement" in 2010. The impact will be tested only when European and Korean interpretations of agreed abstractions collide.[20] US trade policy is usually seen to involve a template which includes provisions about labour standards and environmental standards but the EU is pressing the boundary of economic integration further.

Where does economic growth fit? The abstract argument for economic integration presented above is expressed in terms of consumer welfare. But so is the economic argument for economic growth – specifically, it is about extending the range of opportunities through which welfare can be derived. So there is nothing new in relating FTAs to economic growth. The new element in Asian discussion – and in the APEC growth agenda which Japan introduced to Asia-Pacific discussion in 2010[21] and which will be prominent in APEC under the successive chairs, Indonesia, China and Philippines in 2013-15 – is the highlighting of *inclusive* growth. ("Balanced", "sustainable" and "secure" are by comparison standard aspects of economic growth although 'innovative" also introduced some novelty.)

The core of "inclusive growth" is a concern with inequality, both between economies and within economies. This may be either a principal objective of policy or an instrument for avoiding political opposition to the economic agenda. It poses problems. Progress of any kind requires change and change can be uncomfortable. Advocacy of inclusive growth can become a vehicle for resisting change – under any of a range of names – social justice, community development, etc.[22] But it can also denote a

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[19] Australian Productivity Commission and New Zealand Productivity Commission *Strengthening trans-Tasman economic relations; Joint Study, Final Report* (2012).

[20] Don Kenyon and Pierre van der Eng "What is special about the EU's interest in FTAs in Asia?" *East Asia Forum* (20 December 2012)

[21] Which reminds us that there is often a domestic element to an international economic initiative. For New Zealand CER was an instrument for changing domestic economic policy as much as a vehicle for integration with Australia. For Japan, the "growth agenda" is part of an effort to revise Japanese economic policy. "… changing deep preferences for making things (monozukuri) over providing efficient services as the basis for the economy, and convincing embattled workers, students and managers that their services future will require good language skills and familiarity with the outside world, is a genuine problem that needs to be tackled now. Japan's future growth potential is tied to its people's commitment to internationalisation." Jenny Corbett "Growth: getting Japan back on track" *East Asia Forum* (28 November 2012). "For more than a century Japan defined its national goals in terms of catching up with the West. Since the late 1980s, having reached that goal, it has been flailing about trying to decide what to do for an encore." Gerald Curtis "Can Japanese politics be saved?" *East Asia Forum* (13 November 2012).

[22] In New Zealand in the 1980s, when economic strategy imposed considerable change on some sectors of society, the entirely reasonable "community development" movement was hijacked for the purposes of

concern with adjustment paths, facilitating subsidiary change so as to avoid an unnecessary concentration of the costs of change. This was, after all, the core of the "Asian Miracle", government policies which h facilitated change and adjustment, and refused protection to the outdated.[23]

With or without an emphasis on inclusive growth, and recognising that the boundaries of economic integration are a matter for judgement and international debates, economic integration in the modern international economy will extend over a wide area of policy. This poses problems for officials. Regulators who have been used to judging issues about competition policy or a range of similar issues entirely from a domestic viewpoint have to learn to use a regional or global perspective. It may mean discarding a legal perspective of "fairness" in favour of an economic perspective of "efficiency"; it also requires understanding among the regulators from different jurisdictions, one of the principal reasons why economic integration proceeds by intergovernmental agreements.

With the movement of integration beyond removal of tariffs, "new guidelines are needed which generalise the fundamental GATT principles of transparency, non-discrimination and national treatment to apply to the full range of international economic transactions". Furthermore, "it is not practical to apply the concept of MFN to many of the cooperative arrangements which address other impediments to international economic transactions",

> For example, the WTO prohibits the use of standards as devices intended to impede trade. But that, in itself, will not prevent the potential for standards adopted by groups of economies to divert economic trade or investment. When groups of governments agree to an arrangement for mutual recognition or harmonisation of certain product standards they cannot, in practice, simply give all other governments a MFN right to enter the arrangement. For a mutual recognition arrangement to work, all participating governments need to establish confidence in the integrity of the arrangement. There must be mutual confidence that all potential participants set standards to achieve compatible objectives and are willing and able to monitor compliance of domestic producers to those standards. In other words, an international arrangement for mutual recognition is a 'club' of two or more governments who have confidence in the standards-setting and monitoring procedures of other members.
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> … the policy norms needed to introduce a streamlined system for business travel are likely to include agreed and transparent procedures for the issue of visas and electronic processing of travellers with such visas. An arrangement for the mutual recognition of disclosure requirements and auditing standards for firms would need the economies involved to adopt some agreed norms, or minimum standards of accounting. Arrangements to facilitate trade in services or direct foreign investment among groups of economies often generalise the concept of national treatment to limit discrimination between producers as well as between products.[24]

It is for these reasons that neither the WTO nor unilateral policy formation has been able to cope with recent changes in the international economy. The agenda now requires a depth of understanding of the regulatory systems of other participating economies which goes well beyond knowledge of border controls the administration of which is much more similar across economies.

Economic logic suggests that each economy could respond by appropriate unilateral liberalization. The simplistic notion that removing barriers should be done only if the other party also removed barriers was

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opposing the basic stance of policy rather than promoted as a way of distributing the effects more equitably.

23 Cf Joshua Aizenman, Minsoo Lee, and Donghyun Park "The Relationship between Structural Change and Inequality: A Conceptual Overview with Special Reference to Developing Asia" *ADBI Working Paper* No 396 (November 2012) which elucidates various kinds of "structural change" important in Asia – sectoral shares, role of international trade and investment, technological progress, social and political changes - and reviews historical experience in Europe and elsewhere, from which the importance of adjustment can be inferred..

24 Andrew Elek "Open Regionalism Going Global: APEC and the New Transatlantic Economic Partnership" *Pacific Economic Papers* 286 (December 1998), pp. 3, 6-7.

too powerful, reinforced as it was by the US notion that only reciprocity justified US "concessions". Furthermore, political leaders were like members of Alcoholics Anonymous. They knew perfectly well that the best course of action rested entirely in their own hands, but they gained assurance from coming together with others in a similar situation, sharing experiences and encouraging one another to proceed on the path of righteousness.[25] In the early years of APEC, it was hoped that this would develop into "concerted unilateral liberalization", mutually supportive programmes of liberalization that were essentially unilateral. While the hopes of the most optimistic were not realised, there was considerable success, and the habits of sharing experiences and supporting analogous efforts have been carried into efforts to reduce behind-the-border barriers. But conventional ideas of trading concessions and preferring "legally binding" commitments clearly expressed in writing remain strong. They now hinder the interactions among governments – communication – which is required to develop a shared understanding of how business can be done in a way that is competitive and also compatible with reasonable national norms.

Ironically, a conventional bargaining approach to concessions had some beneficial effects whose loss is disadvantageous. While reduced barriers were presented as "concessions" justified by gaining through negotiation at least equivalent benefit in access to another market, they were really changes which promoted competition which were directly beneficial whatever happened elsewhere. When we turn to the wider agenda of economic integration this gap between the real and the apparent – the disguising of promotion of competition as an exchange of a sacrifice one set of benefits for another – is no longer so readily available. There is a danger that removal of a barrier may be achieved by adoption of regulatory policies which are known to be in use elsewhere but which are sub-optimal in the circumstances of the adopting economy. Furthermore, determining optimal regulatory policies requires expertise not always held by even experienced and highly competent negotiators, especially those who come with a conventional mix of legal and lobbying skills. In the modern world, economic diplomacy requires capacity building in developed economies as well as in developing economies.

Whether or not this is realised, the need for deep understanding of the regulatory policies and processes of partner economies ensures that economic integration will proceed not by optimal domestic policy, nor by adaptation of the WTO only, but in "clubs" of economies. This is the fundamental reason for the proliferation of FTAs in the modern world. We hear a great deal about complementary economies but that is an echo of the analysis of free trade agreements of the mid-twentieth century. Now economic integration is much more likely between economies which can trust one another's regulatory systems.

The success of the mid-twentieth century was to construct a multilateral trading system which avoided the division of the world into trading blocs. There is now a challenge to repeat that success. "Clubs" are unavoidable; governments vary in the extent to which they have regulatory systems which attract mutual confidence. The challenge is to replace "closed clubs" with "open clubs" which "do not seek to disadvantage outsiders; have transparent rules or norms, including transparent criteria for admitting new members; and actively promote wider membership."[26] Those principles are sound, but their inadequacy has been demonstrated by the need for negotiations to turn P4 into TPP. The notion that barriers may be reduced within clubs but not by raising barriers against outsiders was the basis of the provision for FTAs within GATT; it always depended on legal rather than economic reasoning since reduced barriers among members equate to increased *relative* barriers against others. But the problems are now much more stark. Optimal management of clubs now requires commitments to:

- *lowering* technical border barriers to trade in goods in the context of shared commitments to high health, safety and environment standards.
- *widening* mutual recognition of testing and approval procedures by progressive alignment of standards, wherever possible to existing internationally agreed standards.
- *reducing* impediments to trade in agriculture by closer scientific cooperation to set appropriate mutually recognised regulations.

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[25] The image was created by Bobby Romulo of the Philippines to refer to the "concerted unilateralism" developed by APEC.

[26] Ibid, p. 8.

- *facilitating* access to public procurement markets, including by enhancing the compatibility of electronic procurement information and government contracting systems."

In particular an open club should provide:

> *Accession:* (i) Any economy whose government accepts the responsibilities as well as the benefits of following policies compatible with any existing or proposed cooperative arrangements among groups of economies should be able to, and encouraged to, become parties to these arrangements. (ii) Existing parties to these cooperative arrangements should be willing to share the information, experience, expertise and technology needed to enable others to adopt the relevant policies.[27]

Implementation requires a great deal of elaboration of what this means, but the starting point is incompatible with the attitudes of many trade negotiators who adopt a literal if not simplistic reading of the US Reciprocal Trade Agreements Act.

4. Asian and Asia Pacific Economic Integration

The ideal institution for facilitating economic integration in the modern global economy would have a wide mandate. Its central focus would be promoting positive interactions that reconcile important social and cultural customs with removal of barriers to international commerce. It would seek to promote competition wherever it could be expected to enhance consumer welfare. It would look especially towards reducing impediments to the operation of international production networks. It would seek to resolve disputes and issues that arise in managing intellectual property rights including accessibility and dissemination of standards. It would deal with impediments to flows of services and therefore of investment which facilitate cross-border business. And its mandate would extend to movement of people, especially those with skills which are needed by international production networks in specific places but also as skill-acquisition in employment grows in significance relative to foundation education, to movement of people able to acquire new skills. The institution would understand that its task is not simply to implement well-understood rules but to evolve new rules as issues not foreseen are encountered. It would be an institution suited to a world of networks rather than established organizations and hierarchies, and a world of relational contracting rather than black-letter law.

The ideal is some distance away. We can be confident about the emergence of a specific "institution" in the economists' sense of norm or process with an understood mode of operation rather than a bricks-and-mortar organization. Economic integration necessarily involves more than one economy and it is most unlikely that domestic policy processes will foresee (let alone cater for) all the issues which interest existing and potential economic partners. So unilateral liberalization alone will not be sufficient, despite the correct economic logic which points towards unilateral liberalization as the principal way in which economic integration occurs.

Nor can we expect the WTO to manage the multilateral system in a way which precludes the need for any other governance system. The next director-general of the WTO is very likely to seek a way forward from the current impasse over Doha issues and might induce a focus on the issues of the current international economy rather than those of the past, but the needs of economic integration as enunciated above require collaborative efforts by governments such as are hard to conceive taking place simultaneously among 200 or so economies even with skilled negotiators rather than simplistic commentators. The WTO will remain important as the guardian of the multilateral system and in particular of the disputes resolution system, but it is likely to be a coordinator of a set of networks rather than a centralized institution.[28]

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[27] Ibid. (p.17)

[28] Which leaves ambiguous whether Bhagwati's characterization of FTAs as "termites" of the multilateral system was right or not. The multilateral system is certainly changing, but then the mfn system was always qualified – by the Art 14 provision for FTAs, and by the political adjustments for the "agricultural waiver" to suit US interests, acceptance of the EEC to serve the geo-strategic interests of the US and its allies, and the acceptance of "special and differential treatment" for developing countries. Modern FTA developments and now the move to economic integration clubs are merely the latest modifications, and

Collaborative efforts among governments will probably be known as "negotiations" – the word is used in the "Guiding Principles and Objectives" agreed among ASEAN and its trading partners and endorsed by ASEAN leaders as RCEP was launched, and it is standard terminology in the context of TPP. Because "trade" will continue to be used as shorthand for economic integration diplomacy - the misplaced concreteness with which "trade" has been used in much political and media commentary has become absurdly misleading but the word is too common to be displaced - we can be sure that "trade negotiations" will be part of the vocabulary used to discuss those collaborative efforts.[29] However, they need not resemble what have become standard practices in WTO Rounds or in FTA "studies" and "negotiations". ("Studies" have become the early stages of "negotiations" in which governments retain the option of withdrawing without investing political capital towards the achievement of a successful outcome.) In particular, conventional language with known relationship to legal precedents need not be used, and as there does not need to be a single document recording everything that is agreed, there may be no "single undertaking". This change should not be made lightly. Agreement that nothing is agreed until all is agreed, was central to the institution of "GATT rounds" by which trade liberalization was managed after they had been discovered more or less by accident. The single undertaking was formalized in the Uruguay Round in response to unhappiness about the decision of many members of GATT to remain aloof from various codes which had been negotiated in previous rounds, to prevent opting out from agreements on new agenda items, and to dignify the transition from GATT to WTO. However, its essentials go back to the origins of GATT and the idea that a comprehensive package allowed tradeoffs among components and facilitated consensus.[30] The idea remains attractive, not least to participants who give high importance to a component which other participants find especially difficult, notably agriculture. However, it cannot be accommodated in a rolling agenda of collaboration in which new issues arise and are incorporated. In a continuous process, there is no place for a "single" conclusion. Negotiators have to find new ways to ensure that their particular concerns do not slip off the international agenda. This is one of several ways in which "trade negotiators" will have to adapt to major changes in their task. And we will have to expect that the continuation of "trade negotiations" will disguise from many commentators how much the agenda of economic diplomacy has changed. (And overcome the nostalgia for the familiar which leads to comments such as "you cannot negotiate trade facilitation" or "I don't know how to negotiate for supply chain operation. To which the appropriate reply is, "the modern international economy requires lifetime learning everywhere".) While we might well criticise the content of many "trade negotiations" it is unwise to overlook the continued potential contribution to desirable economic integration of interactions which are so labelled.[31]

Some kind of club management will emerge. In the Asia and Asia Pacific regions, the leading candidates are TPP and RCEP. How well do they compare with the kind of institution defined above?

TPP is the club on which most work has been done on membership rules. It is proceeding through a sequence of rounds in a conventional manner and it is usually discussed as leading to a single

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the crucial issue is preserving what remains relevant in conventional understanding of multilateralism. Bhagwati continues to make his case with as much power as is possible: see the interview at http://www.scoop.co.nz/stories/HL1211/S00205.htm, Jagdish N. Bhagwati "America's threat to trans-Pacific trade" *East Asia Forum* (10 January 2012), and Jagdish Bhagwati "Why the TPP is undermining the Doha Round" *EABER-SABER Newsletter* (January 2013) where, however, he seems to be accommodating change, "Membership of the TPP should be open to countries willing to make trade concessions, and members should not be required to sign onto all of the TPP's provisions" and "where the ASEAN+6 grouping could play a role, by demonstrating to the United States that it is welcome, but only within a genuine trade grouping" although as he continues to confine "trade" to a narrow meaning, the last provision is ambiguous.

29 Cf. Andrew Elek "US commits to ASEAN integration" *East Asia Forum* (25 November 2012)

30 Like the purity of the multilateral mfn system, it has been qualified in practice through the use of variable transitional periods.

31 "Whatever damage these PTAs do to the multilateral system, some of them are potentially valuable as the framework for negotiating 'second unbundling' issues." Stephen Grenville "The future of international trade" *Lowy Institute Interpreter* (26 June 2012)

undertaking although it is also seen by at least some participants as a step towards a wider Free Trade Area of the Asia Pacific. It is often referred to as "leading edge", or a "twentyfirst century" agreement, or setting the "platinum standard"[32]. But it is structured with conventional chapters, goods, services, investment, intellectual property, etc. It extends to "supply chain issues" but the content of that chapter is not known and the information available does not suggest that it goes far towards seeing the world in terms of international production networks. (It is the conception of integration for a world of international production networks which is at stake, not the chapter headings of a finished agreement.) One suspects that the rhetoric about TPP is determined by the desire of USTR to persuade the US Congress that it leads in advancing all US policy aims. Certainly one well-placed observer[33] describes TPP negotiating rounds in those terms. USTR wants no new market access for TPP parties with FTAs in course of implementation which neatly excludes Australian sugar but gives US access to the Canadian dairy market and is hardly compatible with a common market access schedule. USTR wants an SOE chapter with stiff competitive neutrality but excludes subsidies from FTAs so preserving its farm product treatments. And USTR rules of origin proposals are straight mercantilism which would extend to Asia what has generated US textiles export surpluses with Latin American partners. The US is not market-led in an Asian fashion - intra-firm trade constitutes a small and declining share of U.S. imports and U.S. overseas affiliates tend to be far more local market-oriented than their Japanese, Korean and German counterparts. Furthermore, USTR remains keen to exclude China or any other country transitioning between low-wage industries to technologically-intensive products, the essence of international production networks. The USTR conception of an SOE chapter has provoked the thoughts,"while state-controlled entities receive support from their governments, so too do privately-owned MNEs" and "There is no need for special treatment of state-controlled entities beyond addressing national security concerns."[34] And the USTR conception of intellectual property rights seems to be to maximize the flow of royalties to the US rather than any balancing of the rights of innovators and potential users.[35]

USTR is not the same as the US. Should the reported USTR position on intellectual property rights be accepted, there would be many complaints from within US industry since their interests are varied – between providers of internet services whose operations depend on temporary storage of information they do not own, and pharmaceutical and movie producers or beneficiaries from royalties, for example. But USTR is negotiating TPP for the US, and it is generally accepted that TPP is a US-led initiative.

Most worrying is the likely provision in TPP for widening its membership. US leadership really matters here. While several parties to the TPP negotiation support it only as a step towards a Free Trade Area of the Asia Pacific and so look forward to membership by the North Asian economies of China, Japan and Korea, some observers of US political processes see Chinese and even Japanese membership as unlikely. (This is distinct from the point that several noneconomic commentators, in the US and elsewhere, see TPP as an instrument for the containment of China. While there are certainly proponents of such a position, it is not supported by the Administration.) But US processes require Congressional endorsement of economic agreements, and

> If the TPP ends up being a set of related bilateral agreements (a bowl of noodles *within* a bowl of noodles), for which the US has thus far revealed a preference, China will have to negotiate bilaterally with the US in order to join a broader TPP — no matter what the wishes of other members; and any agreement would require separate approval by the United States Congress. That is rightly viewed by China as a set-up.[36]

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32 Stephen Grenville "The future of international trade" *Lowy Institute Interpreter* (26 June 2012)

33 Sourabh Gupta "U.S. and TPP: facilitating or disrupting supply chains?" *East Asia Forum* (6 January 2013)

34 Karl P. Sauvant "Equal treatment for outward investors" *East Asia Forum* (7 July 2012)

35 Stephen Grenville "The future of international trade" *Lowy Institute Interpreter* (26 June 2012)

36 Shiro Armstrong "China's Participation in TPP" *APEC Economies Newsletter* Vol.16 No. 05 (July 2012). Sourabh Gupta has also commented, "Once/if TPP is signed and implemented, inviting new members (China) will require a change in existing law ... which means a vote in Congress to change the law ... which will not happen because in White House-Congress consultations, the former will not be given

It is somewhat ironic given the political situation in Washington, that to get TPP to the starting line as a potential positive step towards economic integration in the modern world, a major change in US legal procedures (and probably in US law) is required.

RCEP is less advanced that TPP. The modalities which will be used are not yet obvious. The agreed objectives which were negotiated by all ASEAN members with the existing ASAN FTA partners espouse liberalization of all trade in goods, "to substantially eliminate restrictions and/or discriminatory measures with respect to trade in services", to create "a liberal, facilitative and competitive investment environment" to "reduce IP-related barriers to trade and investment by promoting economic integration and cooperation in the utilization, protection and enforcement of intellectual property rights", and to promote competition and "the curtailment of anti-competitive practice". There are some caveats, especially for the CLM economies, but it is generally agreed that they should be managed by differential implementation phases rather than by differences in objectives. Especially interesting are agreement on "an effective, efficient and transparent process for consultations and dispute resolution" and provision for delayed entry by an ASEAN FTA partner that did not participate at the outset and for entry to a completed RCEP by "any other economic partners".

The basic conception of RCEP is to achieve an appropriate location of the ASEAN Economic Community in its regional and global setting. This poses challenges. There is tension between the ideas of "docking" existing FTAs, agreement that there should be no retreat from the provisions of any of the existing ASEAN or ASEAN + 1 agreements, and realization that a business-friendly RCEP requires something close to a common tariff schedule among ASEAN and its partners.[37]

The modalities of RCEP are likely to draw on the experience of the "ASEAN way" and in particular on the way in which the ASEAN Economic Community was developed. There would then be even more emphasis on agreed end-points and flexibility on the duration of transitions by individual members to those end-points than has become customary with FTAs. RCEP is likely to rely more reliance on peer review and less on formal monitoring than TPP, and there is probably considerable difference in understandings of the initial position on disputes resolution as quoted above. Journalistic and public commentary on "legally enforceable" is surprisingly resilient in the face of the debacle of legally-binding agreements in Europe. In any case, thinking in terms of national justice system is too readily transferred to the international arena where there is no enforcement mechanism. Even the WTO rests eventually on peer esteem, and the desire to be credible in further international interactions. Game theory has taught us the enormous difference between one-off and repeated transactions, and ASEAN has the enormous advantage of a history of continual interactions. International terminology will eventually catch up with Asian emphasis on relationship maintenance.

Because of its continuity from the ASEAN Economic Community, RCEP starts with a better understanding of international production networks in Asia. It will more readily see the movement of skilled labour as part of the just-in-time strategy of regional manufacturing enterprises and not as belonging in a "migration" category. It will more readily adopt an "ease of doing business" strategy and be less constrained by conventional thinking about the standard chapters of an FTA. But the differences between TPP and RCEP in these regards are matters of degree rather than of principle, or even of procedure rather than substance.

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formal or informal authority to negotiate in the first place.) And to suggest that it could, or should, will be seen as unrealistic, and ultimately therefore, unserious." (I am grateful for permission to quote this extract from private correspondence,)

[37] Hank Lim "The way forward for RCEP negotiations" *EABER/SABER Newsletter* (December 2012); Hank Lim "The way forward for RCEP negotiations" *East Asia Forum* (3 December 2012); Yoshifumi Fukunaga and Arata Kuno "Toward a Consolidated Preferential Tariff Structure in East Asia: Going beyond ASEAN+1 FTAs" *ERIA Policy Brief* No 2102-03 (May 2012); Hikari Ishido & Yoshifumi Fukunaga "Liberalization of Trade in Services: Toward a Harmonized ASEAN++ FTA" *ERIA Policy Brief* No 2102-02 (March 2012).

RCEP will take a more determined approach to ensuring that it contributes to "narrowing development gaps" and to a collegial approach to capability development. TPP will see development as an automatic implication of liberalization, with supplementary efforts conceived essentially as official development assistance. An Asian approach will see much more relevance in the spreading of international production networks to areas which are still marginal to the process of Asian economic integration – such as Laos and Myanmar, to sectors of the economy other than those where they are already prominent, textiles, motor vehicles, and electronics (including food), and to more specialization on innovation and marketing in relatively developed economies. The "business-led" nature of economic integration in Asia is much more at home in an RCEP context than it is in TPP (even though this too is a matter of degree). The emphasis on facilitating innovation will create a bridge between harnessing international production networks to consumer welfare and simultaneously between economic integration and inclusive growth (while also necessitating a welcome return to a sensible approach to intellectual policy rights in place of rent-extraction for patent-holders), and it will renew the link between fostering competitive business as an instrument of strategy fpr growth and development.

The biggest difference been TPP and RCEP is likely to be in the extent to which participants understand and support regional aspirations for inclusive growth, with the next most obvious difference being in the extent of participants' commitment to seeing integration and liberalization as a means to sustainable, resilient and innovative growth in a world characterized by international production networks.

Many commentators are sceptical of the prospects for RCEP, often for non-economic reasons.[38] Indeed, there sometimes seems to be a contest between searching for reasons to continue being sceptical of the ability of relatively small economies to solve problems, or to reassert the primacy of analysis not based in economics. While there are clearly tensions among Asian countries as there are elsewhere, Asian leaders have generally not allowed economic integration to be disrupted for extraneous reasons.[39] There is no basis in the "Guiding Principles and Objectives" for thinking that RCEP has lower objectives than TPP at the level of ambition,[40] and while ASEAN has a reputation for making progress slowly, it is not only in Aesop's *Fables* that the tortoise can beat the hare. Much will depend on whether ASEAN negotiators can turn their minds from familiar wrangling over tariff lines and conceptualize the internationalization of the ASEAN Economic Community, and especially whether they can focus on the structural reform agenda. But then in the case of TPP, much will depend on whether USTR can be diverted from a fixed mindset of pursuing US interests exclusively rather than promoting economic integration by finding reconciliation between US interests and those of partners. ASEAN governments might mistake infrastructure projects which contribute to regional

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38 e.g. Claude Barfield "Crunch time for the TPP" *East Asia Forum* (10 January 2013). Cf also Jagdish Bhagwati http://www.scoop.co.nz/stories/HL1211/S00205.htm "I don't think it will happen. For the simple reason that you have to take the geo-politics into consideration." See also Beginda Pakpahan, University of Indonesia "Will RCEP compete with the TPP?" *East Asia Forum* (28 November 2012).

39 Rodolfo C. Severino "The United States and ASEAN" (30 November 2012). There nearest there is to a high visibility counterexample is the absence of China's representative from the IMF annual meeting in Tokyo and that may well have been due to domestic commitments. See also Brad Glosserman "A problem bigger than the Senkakus" *PacNet* #62A (9 Oct. 2012). There are some confusing signals; cf the continued meetings on C-J-K but also interruptions to monetary developments reported in Gregory Chin "Currency internationalisation in Asia" *East Asia Forum* (8 January 2013). The launching of RCEP is the clearest evidence of intent.

40 Cf. Donald K. Emmerson **"**Challenging ASEAN: the American pivot in Southeast Asia" *East Asia Forum* (13 January 2013) with its "non-American, loosely declarative RCEP that subsumes existing arrangements, versus the American-promoted, intrusively 'gold-standard' TPP that requires domestic reform" where one suspects that the claimed differences are simply assumed on the basis of "American" or not. One of the interesting puzzles of the modern world is why the determined Japanese opposition to membership of TPP does not extent to RCEP. Contrary to some assertions, the modalities of the two do not differ materially on agriculture. Japan has a considerable investment in any development of an Asian community, and it has long found negotiations with the US difficult.

connectivity for "populist measures, such as subsidies and cash dole-outs, which are not only aimed at inducing domestic spending, but also boosting the popularity of ruling political parties",[41] but then political frustration of sensible policy is far from unknown in the non-ASEAN parties to TPP. It is hard to resist the conclusion that there is simply ignorance of the achievements of ASEAN and an unwillingness to distinguish "leadership" from furtherance of the ambitions of the current leading power, the US. Certainly, allegations of "talkfests only" levelled at Asian institutions are often really complaints that Asian countries do not share the wishes of the accusers.

The difference in membership is much wider than China being in RCEP and the US in TPP. Perhaps most importantly, TPP is "Asia Pacific" in orientation while RCEP is East Asian, and for countries giving priority to avoiding any division in the Pacific – Australia, India and Japan as well as New Zealand – that is important. But the role of the US is central because of the problems posed by its political system to adapting to modern economic integration. Furthermore, the US is crucial for the issue of whether TPP can evolve into FTAAP.

The US initiative to seek closer engagement with ASEAN announced late in 2012 may be an indication of a more positive approach to this issue. The "Expanded Economic Engagement with ASEAN" has an emphasis on facilitation and collaboration on evolving appropriate regulatory regimes, but it also suggests a focus on investment and standards that could easily distract ASEAN as a whole to the kind of wrangling already found in TPP. The balance of positive and negative effects is far from obvious.[42]

The prospect of managing conflict with Congress mandated a lukewarm response by the Administration to Japan's interest in TPP[43] and as we have seen it is thought to preclude inclusion of China. Although Administrations have won surprising victories in Congress before now, and the economic logic of moving beyond TPP to FTAAP is strong, the ability of TPP to include the kind of accessions clause that is needed in the modern international economy is hard to reconcile with US participation. This is especially important for the process of forming international rules and norms. "Any set of international rule making which excludes the Chinese will not be a relevant basis for the 'second unbundling'."[44] President Obama has said that China would be a welcome participant in economic integration processes, as would any economy which "plays by the rules" but the assumption seems to be that US rules are all that is required.[45] It has been suggested that a prime motivation for moves towards a US-EU trade agreement is to act while the US and EU have a large enough share of world trade to be confident that they can establish international rules,[46] but it is surely already too late. There cannot even now be any enunciation of world rules and norms that does not involve Chinese participation in their formulation.

More pragmatically, we can note that the P4 agreement from which TPP is being evolved includes a very permissive accessions clause. The US did not even consider acceding to P4 rather than initiate TPP negotiations. No difference in behaviour can be expected of China.

We can make equivalent observations about RCEP. The assertion of an intention to include an "open accessions clause" is a welcome starting point but it is consistent with several final products and we concluded above that economic integration now requires close interaction among governments to

41 Julius Cesar I. Trajano "Between Developmentalism and Populism: Walking a Tightrope in Southeast Asia" *RSIS Commentaries* No. 227/2012 (17 December 2012)

42 Cf. Andrew Elek "US commits to ASEAN integration" *East Asia Forum* (25 November 2012)

43 Edward Luce "Obama's coming leap of faith on Europe" *FT.com* (23 December 2012)

44 Stephen Grenville "The future of international trade" *Lowy Institute Interpreter* (26 June 2012).

45 RIN *Statement No 1*, n. 51.

46 Edward Luce "Obama's coming leap of faith on Europe" *FT.com* (23 December 2012); some other observers have no doubt that TPP will set international rules, e.g. "joining TPP would allow Japan to have a seat at the table in shaping the rules that will govern international economic behavior in the twenty-first century." Matthew P. Goodman "Not Beyond Hope: Japan and TPP" *PacNet* #3 (9 Jan. 2013).

assess how individual regulatory provisions are to be reconciled with a plurilateral agreement. No major economy is going to adhere to an existing agreement without further consideration,[47] and there is already recognition of that in the provision of the RCEP "Guiding Principles and Objectives" that an ASEAN FTA partner which chose not to participate from the beginning would be able to join the negotiations "subject to terms and conditions that would be agreed with all other participating countries". It is hard to believe that all would change once negotiations were completed, especially as economic integration is a never-ending process, and that is similar to what governs TPP, differing only in that there would not be an absolute bar flowing from US Congressional procedures. Neither RCEP nor TPP offers a solution to the issue of how to manage multilateralization of economic integration although both may provide a useful precedent, and RCEP is more likely to do so than TPP is.

5. Conclusion

We are therefore in a state of transition regarding the status of bilateral and regional FTAs in the Asia-Pacific Region – but so we will always be. History is continuous rather than episodic.

The most important transition taking place is from "trade agreements" to economic integration. Decisions about economic integration will resolve how inclusive (and innovative) economic growth will be. The most important decisions will probably be in groupings of countries, and plurilateral agreements in the form of an adaptation of current Regional Trade Agreements are likely to be basis of governance of those groupings with the WTO having a continued oversight role. RCEP is likely to be the leading edge of this development.

[47] The Treaty of Amity and Cooperation and various other international instruments are not counterarguments because they do not constrain the behaviour of private sector entities in the same way as economic integration does.