

Integration Options of ASEAN Transition Economies

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ABSTRACT

This paper looks into the relative merits of two approaches—participation in preferential trading agreements (PTAs) and multilateralism, as exemplified by membership in the World Trade Organization—both of which lead to the path of integration with the world economy. Four ASEAN transition countries with relatively large agricultural sectors are examined. Given the growing empirical evidence that trade openness is associated with higher economic growth and improved standards of living, as well as the upsurge in demand for agricultural products, these transition economies face potential benefits from increased exports.

The literature reviewed by the paper suggests that PTAs and the multilateral system complement each other, with the trade agreements forming part of the process in which PTAs create incentives for non-members to eventually join the WTO. PTAs, therefore, serve as the next-best path towards expanding world trade while negotiations for multilateral trade liberalization are still going on. On the other hand, findings also point out that regional trading agreements tend to divert trade toward its members, incur unnecessarily high administrative costs, and create opportunities for unproductive rent-seeking activities.

Policy makers are thus enjoined to innovate on their respective preferential trade arrangements, using these to help solve regional spillover problems and promote more trade among members.

INTRODUCTION

This paper aims to contribute to building the institutional capability of ASEAN transition countries to participate in the global trading system by discussing appropriate adjustment paths – from relative autarky to integration with the rest of the world economy. All of the four transition economies covered in this study, namely, Cambodia, Lao PDR, Myanmar and Vietnam (CLMV), have relatively large agricultural sectors, and it is likely that agriculture would dominate adjustment problems. While these countries tend to have a great potential of becoming important exporters of agricultural products, organizing their respective resources to realizing that potential remains to be an important challenge to each of them.

Integration with the world economy may have two paths and these approaches are explored in this paper for their relative advantage. Regionalism,

or trading with partners based on preferential rules benefiting only regional partners and excluding outsiders, may seem to be a natural course to pursue, as these countries may have more flexibility to manage any resistance to integration. The ASEAN Free Trade Agreement (AFTA), to which these transition economies are members, is one of the active regional trade agreements in the world today. ASEAN has extended its preferential trade with China, while some of its members are in the process of negotiating bilateral preferential trade agreements with selected countries. Among the transition countries, Vietnam has a bilateral free trade agreement with the United States.

There is the multilateral path, although this need not exclude regional trading arrangements. All these transition economies are either members or observers of the World Trade Organization (WTO), which regulates the world's trading system. Myanmar has been a founding member of the General Agreements on Tariff and Trade

(GATT) and of the WTO in 1995. Cambodia has just been accepted as the 148th member of the WTO. The remaining transition countries have observer status in the organization.

TRADE AND ECONOMIC DEVELOPMENT

There is growing empirical evidence that trade has contributed to overall economic growth and reduction of income disparities among trading countries. The conclusions emerging from these various empirical studies are broadly similar. Trade openness accompanies higher economic growth and improved standards of living.¹

Sachs and Warner (1995), in a study on a mixed group of economies, found that open economies grew faster compared to closed economies by 2 to 2.5 percentage points.² Open economies have higher investment ratios, better macroeconomic balance, and a larger role of the private sector as the engine of growth. Outward oriented economies experienced a growth premium of 0.2 to 1.4 percentage points (Syrquin and Chenery 1989). Dollar (1992) found that for the quartile of countries, mostly from Asia, which had the least distortions in their exchange rates, their average income per capita growth was 1 6/10 percentage points above the income of the quartile of countries with the most exchange rate distortion.

Open economies are found to converge to higher levels of income, even after controlling for disparities in investment (Proudman, Redding, and Bianchi 1997). Total factor productivity is higher because of trade openness (Edwards 1998).

Various authors explain why trade openness is perceived as necessary for economic development to take off. Through trade, domestic producers

are exposed to a variety of intermediate products, technologies embodied in capital goods, business management practices, and an expanded knowledge about what the world market wants to buy that they can produce (Sachs and Warner 1995; Coe, Helpman and Hoffmaister 1997; Edwards 1998; Dollar 1992). Open borders have been linked with positive macroeconomic outcomes such as increased growth, as well as microeconomic improvements in the efficiency of resource allocation, and level of competition among industries. Trade increases the variety of intermediate products and capital goods that are available and opens up communication channels for the exchange of production methods and business practices. The competitive environment of economic integration with the world has been shown to contribute to reducing corruption, increasing government responsiveness, and improving the quality of economic policies.

While the relationship is not as direct and immediate as other national policies aimed at reducing poverty, trade liberalization has good potential for improving the income opportunities of poorer nations by allowing people to realize their productive potential, reducing arbitrary policy interventions, insulating the economy against shocks, and assisting economic growth.

Another emerging pattern is that trade can reduce income disparities between trading countries. Poorer trade-liberalizing countries experience faster growth in the process of trade integration, largely because the institutions, programs and policies that permit the capture of knowledge spillovers of international trade are also the same measures that facilitate a move to faster growth and an alleviation of widespread poverty (Ben-David, Nordstrom, and Winters 1999).

As with any policy reform, trade liberalization induces adjustment costs, particularly the loss of jobs in previously protected sectors of the economy. That these adjustment costs are deep and long-lasting would be difficult to generalize as every case or sector is different. However, such costs tend to be larger the more protected the sector is and the greater the shock.

Reforms that offer the greatest long-run returns to the economy tend to induce larger transitional losses through labor unemployment than diffuse reforms. How long these losses endure

1 Michaely (1977) was among the first who assessed the empirical linkage between trade and economic growth. In the 1980s, additional empirical works were done by Feder (1982), Balassa (1985) and the World Bank (1987). More empirical works were completed in the 1990s, among them, Easterly (1993), Lee (1993), Harrison (1995), Matin (1993), and Levine and Renelt (1992).

2 Closed economies are defined as those with any of the following attributes: (1) average tariff rate above 40%; (2) at least 40% of imports are covered by non-tariff import restrictions; (3) socialist economic system; (4) state monopoly on major exports, and (5) at least 20% black market premium on the exchange rate.

will depend upon the institutional structures available to stimulate new activity, i.e., measures such as the ease to establish new firms, the ability to obtain service by utility companies, the security of property rights, and the existence of credit markets. Policies that delay change by protecting employment and existing employers except, possibly in the very short run, undermine the credibility of reform and hinder the development of new activities (Winters 1997). Though there is substantial debate about the extent of the short-term adjustment costs of reducing barriers to trade, there is near-unanimity that increased trade openness has substantial, positive, long-term effects on economic development.

TRADE, POVERTY, AND INEQUALITY

Winters, MuCulloch and McKay (2004), reviewing studies on the impact of trade liberalization on poverty, found that while evidence points to a positive relationship between trade openness and productivity at an economic sector level, this relationship is rather weak at the firm level. It is thus conceptually and empirically difficult to settle beyond reproach whether trade liberalization reduces poverty through improving economic growth and productivity, promoting macro-economic stability, better prices and wider export market access or through reduced unemployment or higher real wages.

According to Winters et al., the evidence indicates that reduced trade barriers improved farm-gate prices. It is likely however that farmers in remote areas failed to observe this effect, which could explain the mixed responses of households to trade liberalization.

Many of the studies that the authors examined associated trade liberalization with transitional unemployment, although the evidence on the nature and incidence of that unemployment among the poor is rather scanty. While the empirical evidence supports the theoretical argument that trade liberalization will be poverty- alleviating in the long-run and on the average, it does not assert that trade policy will always be beneficial to the poor particularly in the short run. Adjustment-reducing interventions nonetheless are called for to address the problem of transitional unemployment and the vulnerability of the poor to increased trade.

From empirical studies of countries going through a trade liberalization process, authors documented that more trade increased wage inequalities. Arbache, Dickinson and Green (2003), writing about Brazil's experience with trade reforms in the 1990s, found that wages in the tradable sector substantially went down, and this is where most lower-skilled jobs were generated.

Having examined data on 2,354 Mexican manufacturing plants for the years 1984 to 1989, Hanson and Harrison (1999) found that the reduction in tariff protection in 1985 disproportionately reduced wages in low-skilled industries because of increased competition through trade. In the Philippines, Lanzona (1999) also observed rising wage inequality following trade liberalization.

If the relationship between trade and poverty is difficult to pin down based on empirical studies, then that between trade and inequality poses an even greater challenge. Winters, McCulloch, and McKay (2003) noted that there are fewer empirical studies on the matter. However, the available studies indicate that trade does not affect the income distribution of a country (Dollar and Kraay 2000; Adams 2003; Birdsall and Londono 1997; Li, Squire and Zou 1998). Dollar and Kraay (2000) found that the trade to GDP ratio did not change the share of income of the poorest quintile.

Using data from 50 low-income and low-middle income countries from the World Bank Poverty Monitoring and Development Indicators databases, Adams (2003) observed that trade did not have any impact on inequality. Li, Squire and Zou (1998) documented that in a regression analysis, the independent variable export to GDP ratio, did not have any statistically significant effect on the Gini coefficient. It is the initial distribution of factor endowments, land, and education access which determine how income is distributed rather than economic growth (Birdsall and Londono, 1997).

Other empirical studies, however, which delve into the dynamics of the impact of trade openness or growth on income distribution, suggest that the poor would be adversely affected first before they benefit from any trade openness. The relationship between trade and equity appears to follow an inverted U curve. Using a panel data of 125 countries covering the 1960-1998 period, Lundberg

and Squire (1999) observed that the effect of trade openness rises with income. Agenor (2002) also found that at lower levels of income, countries tend to experience an increase in poverty incidence with higher levels of openness, and an alleviation of poverty after reaching some higher income level.

Looking into the dynamics of the process of how trade affects incomes, Milanovic (2003) noted that in poorer countries, the rich benefit from trade openness. As the country's income level rises, the author found it is the poor rather than the richer income groups who benefit more from trade liberalization. The author suggested that trade makes income distribution worse before making it better, affirming earlier studies (Barro 1999; Ravallion 2001) which have documented that trade liberalization is associated with increased inequality in poorer developing countries.

WORLD TRADE IN AGRICULTURE

Agricultural products are an important part of the world's merchandise trade. According to the WTO, the exports and imports of agricultural

products in the world were about 9% of world merchandise in 2002, and about 42% of world trade of primary products, as shown in Table 1. In the analysis of world trade trends by the WTO Secretariat, Asia is found to be importing agricultural products by more than what the world is doing so, but exporting by less than the world. This implies that Asia as a region is on a path to becoming a net importer of agricultural products, just as it is exporting non-agricultural products more intensely than the world is. As a share of all primary exports, Asia's import basket of primary products is more diverse, and exports more agricultural products compared to the world. North America comes out in the analysis as having a stronger agriculture export interest, thereby explaining that region's focus on getting the rest of the world to liberalize their respective agricultural import markets.

Western Europe is ahead of all the other regions in terms of its share in agricultural trade. About 42% is Western Europe's share in total agriculture exports of the world, while its imports account for nearly 43%. Asia's share is around

Table 1. Share of traded agricultural products in total merchandise and in primary products by region, 2002 (in percent)

	Exports	Imports
Share of agricultural products in total merchandise		
World	9.3	9.3
North America	10.7	6.2
Latin America	19.3	9.8
Western Europe	9.4	10.2
C./E. Europe/Baltic States/CIS	8.9	10.2
Africa	15.8	15.9
Middle East	3.5	13.4
Asia	6.6	9.5
Share of agricultural products in primary products		
World	42.5	42.5
North America	59.9	35.1
Latin America	48.7	47.4
Western Europe	57.6	48.5
C./E. Europe/Baltic States/CIS	22.1	43
Africa	22.3	59.5
Middle East	4.7	69
Asia	48.1	36

Source: World Trade Organization

half of the world's agricultural trade. This is higher compared to that of North America, Latin America, and definitely Africa, Middle East, and the transition economies in Central Asia, Central Europe, and the Baltic States.

The data on agricultural exports suggest the concentration of exports in the exporting region. Regions export agricultural commodities among their respective member countries and to the rest of the world. If they export to themselves by a proportion higher than that of their total exports to the world, they will more likely tend to divert their exports away from destinations outside their region. The trade intensity indices for agricultural exports by major regions of the world are shown in Table 2 for the years 1995 and 2002. They all exceed one, indicating that preferred destinations of agricultural exports lie within the region. One possible explanation for this is that agricultural exports are perishable products whose transit costs are high and thus need to be disposed of as quickly as possible. But it may also be that agricultural

exports are not rising fast enough with demand.

Table 3 looks into the growth of the net agricultural imports of selected economies. The countries selected in the analysis are those contained in WTO's two tables on agriculture imports and exports of selected economies.³ The agricultural trade of these economies account for at least 90% of that of the world. Net imports are computed for each of these economies and are summed up by region. In Table 3, agriculture net imports of the world have been growing since the 1990s. Western Europe, Asia, and the Middle East are the top net importers of agricultural products. North and Latin America are the top net exporters. Africa and the Central and Eastern European countries are net importers, although their respective volumes are smaller compared to Asia, and to some extent, Western Europe. Net agricultural export in the North America is declining but is growing in Latin America.

The point being made here is that there is growing demand for agricultural and food products

Table 2. Intensity indices of agricultural exports, by region (1995 and 2002)

	1995	2002
Western Europe	1.75	1.78
Asia	3.49	3.34
North America	1.20	1.92
Latin America	1.74	1.34
C/E Europe	5.82	6.80
Africa	2.86	3.47
Middle East	34.77	34.00

Source of Basic Data: World Trade Organization

Table 3. Net agricultural imports, by region: 1990, 1995, 2000, and 2001 (in million US dollars)

	1990	1995	2000	2001
Western Europe	33,980.71	30,311.00	23,201.18	22,148.02
Asia	30,519.55	55,453.28	47,938.82	44,119.29
North America	-32,767.09	-47,389.00	-21,810.80	-19,625.27
Latin America	-21,417.29	-32,665.90	-30,912.22	-33,124.04
C/E Europe	-1,350.00	14,315.00	3,889.35	6,129.69
Africa	3,109.52	4,218.45	3,171.08	2,895.14
Middle East	7,336.12	11,000.74	17,091.26	16,295.52
Total	19,411.51	35,243.56	42,568.68	38,838.35

Source of Basic Data: World Trade Organization

3 These tables are Tables IV.10 and IV.9 of the *World Trade Statistics*.

in the world, and the potential for increased agricultural exports of transition countries such as the CLMV appears high. In the next section, the recent trends of CLMV exports are discussed.

CLMV MERCHANDISE EXPORTS

After hardly showing growth in the 1980s, CLMV exports grew dramatically in the 1990s. As shown in Table 4, nearly 8% of the overall export performance of the four economies in transition is accounted for by Vietnam's exports. In the first few years of the 1980s, Myanmar accounted for 67% to 70% of all exports from CLMV. Its share however declined starting in the middle of the 1980s and it lost its dominant position in the region to Vietnam. Exports coming from Cambodia and Lao PDR were smaller in value but showed high, though erratic, growth. In contrast, Vietnam's growth had been consistent, averaging at about 28%, which exceeded substantially Myanmar's export growth performance of 11% from 1985 to 2000. In terms of average share to

total CLMV exports over the two decades ending in 2000, Cambodia and Lao PDR had average shares at 3.27% and 3.6%, respectively. The two other larger countries, Myanmar and Vietnam, accounted for 34% and 58%, respectively. Figure 1 shows the dramatic growth of Vietnam's exports. The other three countries' exports fluctuated around half a billion US dollars over a 20-year period.

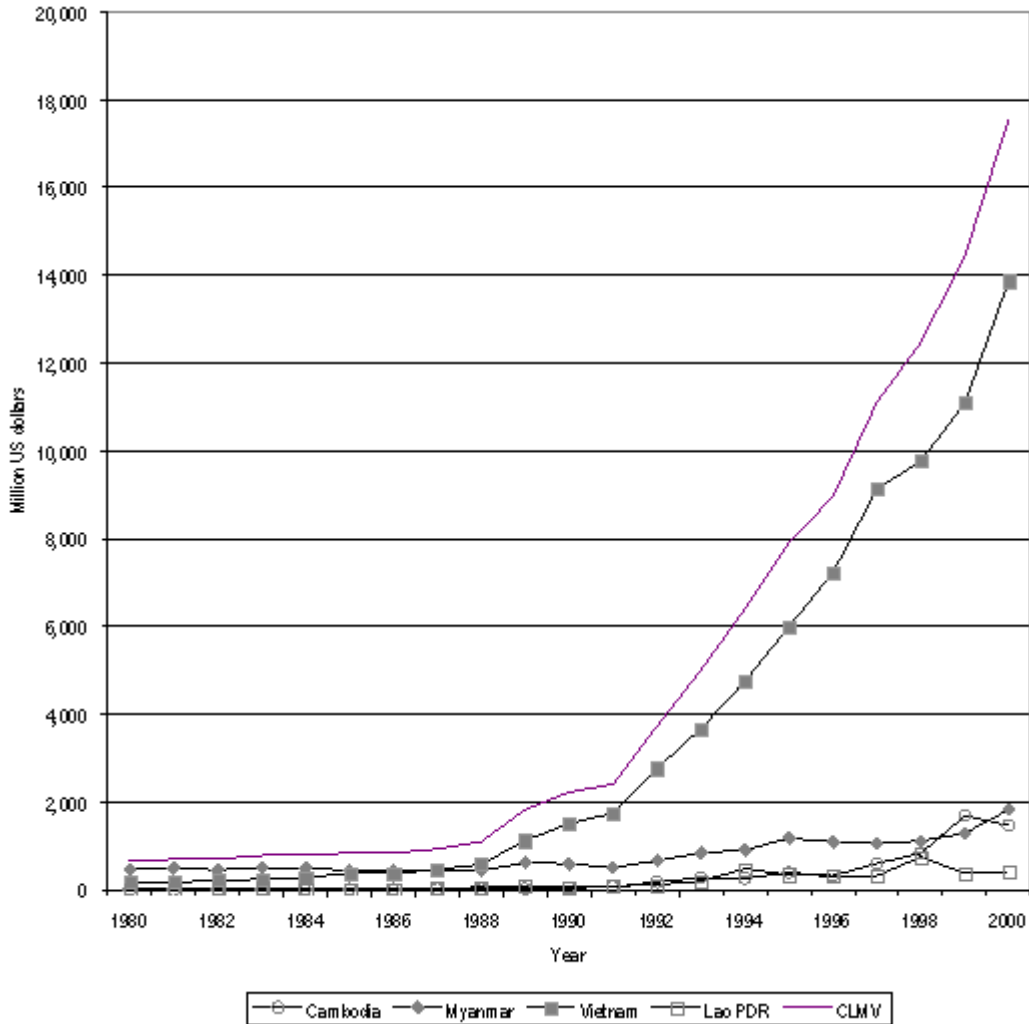
CLMV countries hardly diversified their export markets in the 1990s, as shown in Table 5. While Cambodia found Europe, North America, China, and Hong Kong to be good destinations for their exports, it reduced the shares of its exports going to Japan, Southeast Asia, South Asia and the rest of the world. As for Lao PDR, its exports got diverted to Europe, North America, and the rest of the world from destinations such as Japan, Southeast Asia, China, Hong Kong, and South Asia.

Myanmar and Vietnam had more diversified export markets. Europe, North America, and Japan were important destinations and became even more so in 2000. Vietnam has been trading more with

Table 4. CMLV exports: 1980-2000

Year	Cambodia	Lao PDR	Myanmar	Vietnam	CLMV
	Percent Share to total CMLV Exports				Value (in mln USD)
1980	0.99	3.52	69.63	25.86	670.66
1981	0.37	2.38	71.88	25.37	699.39
1982	0.77	3.94	64.90	30.39	700.32
1983	0.39	3.56	64.64	31.41	783.83
1984	0.55	1.41	63.33	34.71	792.08
1985	0.78	2.62	51.94	44.66	844.22
1986	0.82	2.13	52.37	44.67	839.59
1987	1.49	2.94	46.10	49.46	931.73
1988	1.18	5.83	40.03	52.96	1,098.87
1989	1.23	4.06	33.41	61.29	1,835.32
1990	2.06	3.19	26.85	67.90	2,226.47
1991	2.62	3.75	21.02	72.60	2,404.95
1992	4.96	3.17	17.78	74.09	3,731.48
1993	5.57	4.06	16.92	73.45	5,009.43
1994	4.17	7.51	14.10	74.21	6,402.87
1995	4.97	4.36	14.84	75.83	7,906.54
1996	3.60	3.56	12.19	80.65	8,962.29
1997	5.42	2.84	9.54	82.20	11,107.35
1998	6.68	6.03	8.95	78.33	12,469.36
1999	11.72	2.56	8.96	76.76	14,448.20
2000	8.36	2.27	10.40	78.98	17,564.94

Source: IMF Direction of Trade Statistics



Europe, Japan, and Southeast Asia, and Myanmar has the bulk of its exports going to North America. It is important to note that of all four countries, Vietnam has stayed and even strengthened its trade ties with its Southeast Asian neighbors.

There is hardly any trade between these four countries since the 1980s as indicated by the intra-region trade share in Figure 2. The intra-regional trade index is useful for comparing regional trade flows over time for a group of countries. A rise in the indicator means that members of the group are increasingly trading with one another. An index of one indicates that all its trade has been completely diverted to the region at the expense of the rest of the world. The shares in the Figure are less than 5%, indicating meager trade contacts among the countries in the group. However, the

average intra-regional trade share rose from its level in the 1980s to that in the 1990s.

REGIONALISM VS. MULTILATERALISM

Regional trading agreements (RTA) or preferential trade agreements (PTA) are aimed at fostering trade between trading partners usually belonging to a geographical region by means of preferential trade access such as lower tariff rates on each other's imports. At their core, these agreements are either a free trade agreement (FTA) or a customs union agreement. A typical FTA binds PTA members to accord their partners the same low intra-region import customs duties, but allows the members to maintain their respective external import tariffs on imports of non-members.

Table 5. Destinations of CLMV Exports

	1990	2000	1990	2000
	<i>From Cambodia to:</i>		<i>From Myanmar to:</i>	
World (in million US \$)	41.72	1,357.64	408.74	1,883.61
Other developed countries	0.24	0.14	0.67	0.51
Europe	4.92	16.43	7.18	17.31
North America	0.00	54.84	2.45	25.68
Japan	7.58	0.79	6.94	5.76
Other Asia	0.00	0.00	2.70	1.10
China and Hong Kong	1.19	21.07	13.74	7.55
Southeast Asia	74.56	4.88	28.21	9.92
South Asia	7.57	0.07	14.95	15.99
Central Asia	0.00	0.03	0.00	0.03
South America	0.38	0.00	0.00	0.00
□ Rest of the World	3.55	1.74	23.17	16.16

	<i>From Lao P.D.R. to:</i>		<i>From Vietnam to:</i>	
World (in million US \$)	64.42	444.43	2,524.64	12,597.20
Other developed countries	0.06	0.11	0.31	10.19
Europe	10.14	23.23	6.94	27.17
North America	1.58	2.31	0.14	7.34
Japan	7.08	2.46	13.48	19.03
Other Asia	0.00	0.12	1.08	2.41
China and Hong Kong	9.08	1.41	9.94	8.43
Southeast Asia	68.41	49.36	13.81	16.32
South Asia	0.61	0.06	0.81	0.32
Central Asia	0.00	0.12	0.00	0.19
South America	0.00	0.00	0.00	0.00
Rest of the World	3.04	20.81	53.50	8.61

Source of basic data: IMF Direction of Trade Statistics

A customs union is an FTA with a common external tariff. Less advanced forms of RTAs provide tariff discounts on members' imports, and usually precede the formation of free trade agreements.

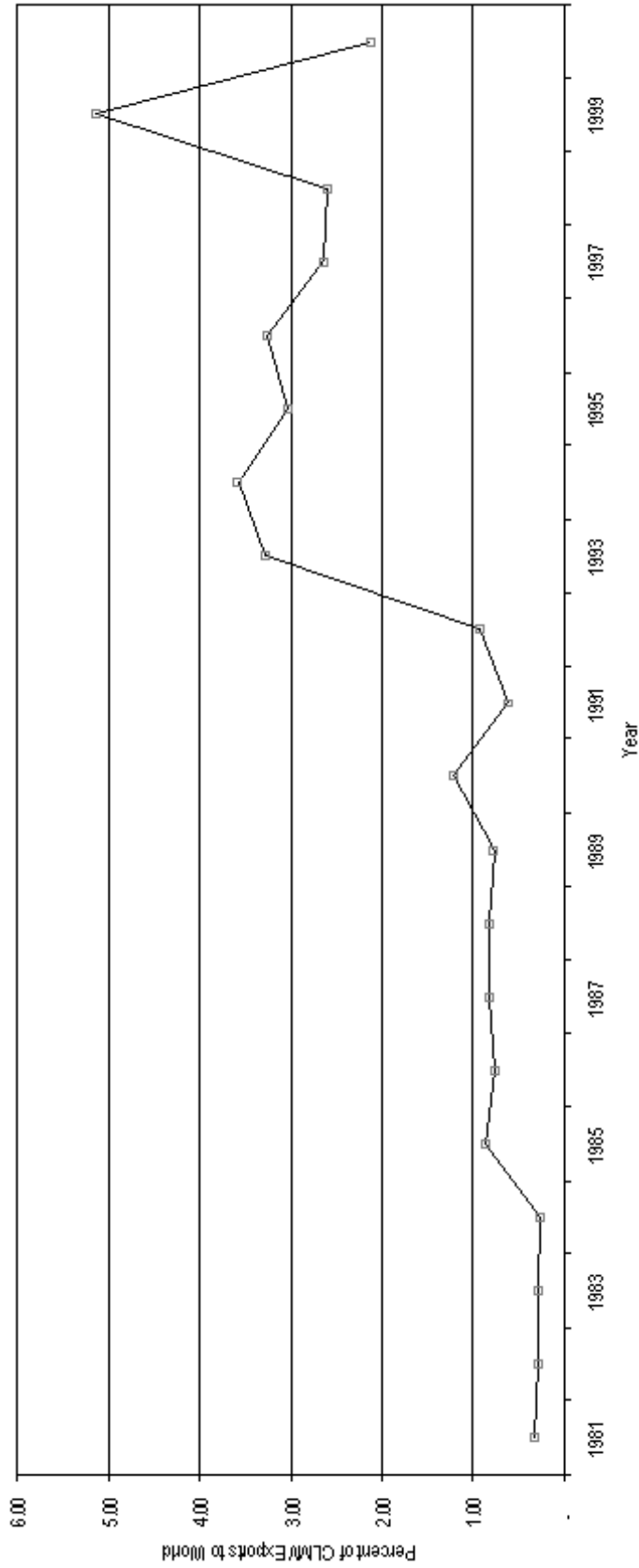
Because RTAs provide discriminatory privileges to members, the WTO requires its members to notify the body regarding their involvement in RTAs. Nearly all of the 147 members of the WTO participate in one or more RTAs, with a few belonging to at least twenty accords. Since 1948, over 254 such agreements have been formed. Most of these occurred in the 1990s. Since the creation of the WTO in 1995, the WTO has received notifications regarding the formation and involvement of its members in over 130 new arrangements covering trade in goods or services (www.wto.org).

Given all these, is participating in one PTA or another preferable for transition countries such

as CLMV? Do these countries need to become members of the WTO, i.e. pursue instead a multilateral path towards economic integration? CLMV, being part of ASEAN, are members of the AFTA, and because these countries are in their various stages of integration, are allowed by their counterparts in AFTA a longer time period to become fully integrated with the binding trade preferences within ASEAN. Vietnam has a bilateral free trade agreement with the United States. Thus regionalism is not new to CLMV countries. But is this path preferable to joining the WTO?

The theoretical exchange among trade scholars on whether the RTAs increase or decrease global trade remains unresolved. Those who are not in favor of regional trade agreements have advanced various arguments, and it is useful to go over a few of these. Because a typical agreement discriminates against non-members, there is concern

Figure 2. Intra CMLV exports



that this type of trade liberalization is adequate to satisfy the free-trade lobby and thus prevents further trade liberalization at the global level. Levy (1997) shows how bilateral trade negotiations may alter domestic interest groups' payoffs and make them more likely to block further multilateral liberalization.

Discriminatory trade agreements such as RTAs have the potential to lead to inefficient patterns of specialization, creating vested groups opposed to further liberalization. Krishna (1998) points out that preferential access to large markets can create excess profits for producers in member countries. Fruend (1998) finds that free trade via expansion of regional agreements distributes the welfare gains from trade more unequally than free trade via multilateral negotiation. PTAs give members "first mover advantage" in their regional markets. Business firms that anticipate preferential access to foreign markets as the result of regional preferential negotiations invest in distributional networks. Having developed stakes in such discriminatory trading arrangements for private business, PTAs commit their members to trading only with each other.

Secondly, if the world trading system were to be populated by several major regional blocks, the risk of disruptive and costly trade wars would be high. The dramatic increase of the number of PTAs formed since the 1990s reflects the pressure on a few economic powers to form PTAs of their own to respond to the challenge posed by PTAs formed by their competitors.

Analysts believed that APEC, the large open trading block of countries bordering the Pacific Ocean, was formed in the early 1990s in order to send a message to the European Union that the Asia Pacific region can fall under the sphere of the United States and its East Asian allies including Japan. This pressure is seen also here in East Asia.

In a speech by Japan's Prime Minister Junichiro Koizumi to a gathering of ASEAN leaders in Singapore in 2002, the Japanese government proposed the "Japan-ASEAN Comprehensive Economic Partnership". The said economic cooperation covers a broad range of economic policies—from trade and investment measures to such areas as science and technology, human resource development, and tourism. Japan's economic agreement with Singapore for a New Age

Partnership that both governments signed in 2002 illustrates such an economic partnership. The Japanese and Philippine governments are presently negotiating on the content of such a possible economic partnership. In offering this, Japan implicitly betrays its concern about China's emerging economic leadership in East Asia. A world trading system broken down into regional trading and monetary blocs runs a high risk of these blocs fighting out their economic differences with trade sanctions against each other.

A third argument claims that the net benefits of RTAs are negative. These agreements are said to distort patterns of world trade, and any gains from increased trade among members are offset by efficiency losses. Borrell (1999) finds that in the case of EU's trade preferences on banana to ACP countries, for every dollar of benefit that the banana policy brought to producers in ACP countries, the discriminatory concessions harmed non-ACP developing country producers by almost exactly one dollar, and EU consumers by more than thirteen dollars.

Thus EU's concessions represent an inefficient approach of helping its former colonies. EU citizens could have given the money to ACP producers, through direct payments thirteen times and not hurt non-ACP banana producers such as those in Latin America and the Philippines. The banana industry in ACP countries would likely not be there had it not been for EU's preferences. It is not established that these countries would eventually become as internationally competitive as Ecuador or the Philippines because of EU's preferences. Efforts to learn the skills needed and any fixed investments to introduce the technology used in the banana plantations in Latin America and Asia are not likely to earn any further rewards.

A fourth argument has to do with the high administration of overlapping PTAs. The proliferation of PTAs has the potential of making customs administration more complicated and of expanding opportunities for corruption. As the "spaghetti"-like interconnections of regional trade agreements swamp the world trading system, customs authorities would have to administer the rules of origin in order to apply the appropriate regional import customs duties on incoming shipments. In developing countries, where corruption is rampant, this works like a sure-fire

formula for aggravating graft and corruption. In order to confront this problem, governments would have to allocate additional resources compared to what they would set aside had their respective imports been governed by multilateral rules. Analysts argue that a multilateral institution such as the WTO is preferable to a web of bilateral or regional agreements.

Fifth, given that there is a multilateral trading system in place, the RTAs weaken the authority of the WTO, and this has dire consequences on how new market opportunities will be formed, how and how quickly trade disputes will be resolved, and how weaker trading countries are protected. The existence of PTAs weakens the incentive to secure new market access through the multilateral trading system. The WTO's dispute settlement procedure is more effective than the bilateral monitoring of violations because infractions are reported to the whole trading community rather than just the few members of the smaller agreement.

However, PTAs weaken this mechanism as many countries are flagrantly flouting the rules. Perroni and Whalley (2000) imply that the rise of PTAs reflects the rising fear that the multilateral trading system is becoming ineffective and that membership in some PTAs insures countries against the risk of getting one's trading interests victimized by opportunists.

Lastly, developing countries will likely find that negotiating outside of the multilateral trading system will ultimately be more disadvantageous because the larger countries will extract many concessions in return for few. The recent victory of developing countries with respect to agriculture export subsidies would be hard to imagine had these negotiations been conducted on a bilateral basis.

In the case of the preferential treatment given to ACP for the export of bananas, the scheme undermines the capacity of developing countries as a group to press for more access to EU markets. It divides them by creating a subset composed of those among them supporting the EU's trade-distorting policies. Anderson (2002) argues that if these preferences had not been offered in the first place, developing countries would have negotiated much more vigorously in previous GATT rounds for lower tariffs on agricultural, textile and other imports into the EU and Japan. Developing country producers, as a group, would have enjoyed higher

international prices for agricultural and textile products that may have been more than sufficient to offset the lower prices received in the EU market for a subset of those producers. If the disciplines of the WTO framework become irrelevant, major markets will be able to abuse their weaker partners.

PTAS IN THE ASIA PACIFIC REGION

Members of the WTO had notified the organization of the existence of 30 PTAs involving more than two countries and 58 bilateral arrangements over the past three decades ending in 2000. Most of these PTAs are between neighboring countries, and most fall short of being free-trade agreements, although they aspire to evolve to this form of PTA rather than to become customs unions (CU). Table 6 identifies some of the most important PTAs reported to the WTO, and lists their memberships, their types, and other characteristics.

These PTAs cover a wide area of trade-related concerns, but at their core are provisions for trade liberalization for the benefit only of their members. The type of trade liberalization ranges from tariff discounts, FTA tariff reductions, to the establishment of CUs. Other provisions, which are added to these agreements, mostly serve to deepen the nature of economic integration among its members.

Most PTAs explicitly recognize the need for trade facilitation, harmonization of quality and other regulatory issues, infrastructure development, and streamlining customs procedures, but the extent of tangible activity in these areas tends to be limited for all except a few PTAs. Liberalization of trade in services is comparatively rare; it is the liberalization of within-bloc investment policies that is more common. Agriculture is commonly excluded from the list of sectors where trade is liberalized.

The PTAs in the Asia and Pacific region tend to be fairly outward looking and a large percentage of members' trade goes to non-member countries. This reflects the region's strong ties to the US, Europe, and some Latin American markets. As noted in Frankel and Wei (1998), formal regional trading arrangements are less common in Asia than in other regions. At best, PTAs in the Asian and Pacific Region tend to have modest achievements

Table 6. Institutional arrangements under selected PTAs

Name	Type of Agreement	Supranational Institutions (including meeting frequency)	Provisions beyond tariff reduction
AFTA	FTA (within general cooperation agreement of ASEAN)	ASEAN institutions include Central Secretariat. For the FTA, no separate supranational institutions. Dispute settlement by bilateral negotiations, with presentation of case before a "Senior Economic Officials Meeting" as a means of resolving impasses	Trade facilitation, investment, industrial cooperation, services trade. FTA is part of larger regional cooperation plans under ASEAN.
ANDEAN	CU	Court of Justice (Dispute Settlement). General Secretariat (administers integration). Andean Parliament (deliberating body). Also annual meetings of Andean Council of Presidents and Council of Foreign Ministers	Services, migration, investment, some foreign policy, trade facilitation
APEC	General Cooperation	No institutions. Annual meetings of heads of state, ministers. Provisions are not binding, so no mechanisms for dispute settlement	Trade facilitation, services, investment, intellectual property rights.
CER	FTA	"Australia-New Zealand Affairs Secretariat" under the control of the Ministries of Foreign Affairs (oversees implementation). Dispute settlement by bilateral negotiations. Annual meetings of economic and foreign affairs ministers	Trade facilitation, services, investment.
ECO	General Cooperation	ECO Secretariat, Regional Council, Council of Permanent Representatives, Regional Technical Agencies. Annual ministers' meetings, biennial meetings of heads of states	Investment, trade facilitation. Coordination of market-oriented reforms.
EFTA	FTA	EFTA Secretariat; Standing Committee	Trade facilitation, migration, investment
EU	CU	European Parliament, Council of the European Union, European Central Bank, Various Committees.	Trade facilitation, services, investment, migration, common market, common currency
MERCOSUR	CU	Secretariat, Mercosur Trade Commission. Council of the Common Market, Common Market Group. Primary dispute settlement by bilateral negotiation, referred to Common Market Group then Council of Common Market in case of impasse	Trade facilitation, investment, peace treaty, maintenance of democracy
NAFTA	FTA	Free Trade Commission, NAFTA Secretariat (dispute settlement). Periodic meetings of heads of state	Trade facilitation, investment, labor, environment
SAPTA	FTA	SAARC institutional structure includes Secretariat, regional centers for research, standing committee of foreign secretaries, standing committees on technical issues. Most decisions made at annual meetings of heads of government. No separate institutions	FTA is part of larger cooperation plans of SAARC
SPARTECA	Non-reciprocal Trade Preferences	Forum Secretariat, Australian and New Zealand Customs Agencies oversee agreement, primarily assessment of origin of goods traded	

Source: Clarete, R., C. Edmonds, and J. Wallack (2003)

in liberalizing trade between members. PTAs in Asia have generally made few tangible achievements in lowering tariffs, and tariff reductions cover only a fraction of the goods traded between members. ASEAN, for example, which can be considered as the PTA in the region which has expressed the clearest intention of becoming a

true Free Trade Area, achieved only modest liberalization in recent years.

The PTAs involving the majority of Asia's developing countries are a varied group. AFTA and SAPTA trade agreements started out as regional cooperation bodies (the South Asian Association for Regional Cooperation, SAARC, and the

Association of South East Asian Nations, ASEAN, respectively). These bodies were formed for largely political reasons and encompass a wider range of cross-national interaction in culture, health, environment, and other areas as well as trade. AFTA has been very active in drawing up a timetable whereby tariffs would be reduced in progressive steps, with the intention of eventually evolving to a Free Trade Area. It also has an active Secretariat that addresses a number of issues of interest to members.

The Melanesian Spearhead Group (MSG) and the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) are PTAs involving Pacific Island economies (the latter in association with Australia). Trade volume among member countries remains low and these economies remain oriented toward the larger Australian and New Zealand markets.

The Economic Cooperation Organization (ECO) is a trade bloc that the Central Asian countries participated in after the fall of the Soviet Union disrupted existing patterns of trade among themselves and Russia. It is a much weaker arrangement than most PTAs. The focus is on providing broader institutions that facilitate bilateral agreements, more than cementing a PTA in itself. The few formal diplomatic arrangements for trade agreements have been offset by unilateral policy barriers and unpredictable changes such as Uzbekistan's imposition of exchange controls in October 1996, after the decline in cotton prices triggered a balance of payments crisis, and Russia's imposition of special tariffs after its crisis in 1998 (Pomfret 2001).

The Australia-New Zealand Closer Economic Relations (CER), the industrial country PTA of the region is one of the most advanced free trade areas in terms of implementation: the agreement has eliminated nearly all policy barriers to trade in both goods and services. The agreement not only eliminates tariffs, but also contains provisions for customs harmonization and common product standards.

APEC, the largest trading arrangement in the Asia Pacific region, has few institutional structures as part of its overall philosophy of loose cooperation and "open" agreements. APEC's aspirations to create "open regionalism," while sometimes criticized as being unrealistic, offer a

unique policy orientation for a trading arrangement. While the exact nature of APEC's trade liberalization agenda has been unclear, some credit APEC's efforts with contributing to the formation of FTAs among some of its member countries.

Bilateral PTAs have also been common among developing countries in the Asia and Pacific region. In South Asia, India gives duty free access to products from Bhutan, Nepal, and concessionary customs duties to products from Bangladesh. In Southeast Asia, bilateral arrangements include those between Lao PDR and Thailand. CER itself is a bilateral agreement involving Australia and New Zealand, while the latter has a separate agreement with Singapore.

The list of Central Asian bilateral agreements is quite long. Bilateral agreements were negotiated in the second half of the 1990s between Georgia and Azerbaijan, Kazakhstan, and Turkmenistan to achieve economic cooperation across the Commonwealth of Independent States (CIS), but these did not materialize. The individual agreements borrow from the CIS institutions; rules of origin, for example, are based on CIS guidelines. The Kyrgyz Republic was also highly involved in bilateral agreements and has reported bilateral PTAs with Armenia, Kazakhstan, Moldova, Russia, Ukraine, Uzbekistan, and Tajikistan.

Within the Asian region there is no common pattern in the extent of overlapping PTA memberships. Aside from common membership in APEC, most of the other common memberships involve bilateral agreements. SPARTECA and SAPTA members have relatively few commitments to other PTAs, most likely because these two agreements involve least developed countries. APEC, AFTA, and ECO have a higher number of other commitments because of the extent of bilateral agreements among member countries and AFTA country membership in APEC.

The region's PTAs vary with respect to the average level of income and economic development of their constituent economies, a factor that is likely to affect the degree to which they promote intra-bloc trade. Some PTAs have members whose levels of economic development are fairly uniform—with average per capita incomes falling in a narrow range—while others have members that are highly heterogeneous economically.

AFTA brings the high-tech industrial Singapore together with the primarily rural economies of Cambodia, Vietnam, and Myanmar. SPARTECA's high coefficient of variation is due to the dispersion between the Pacific Islands, and the New Zealand and Australian economies. We would expect higher intra-bloc trade among the latter economies, all other things equal. SAPTA and ECO have members with roughly the same standards of living.

ASSESSMENT OF PTAs

PTAs and the multilateral trading system complement each other. Baldwin (no date) views the evolution of trade agreements as part of a process in which PTAs create incentives for nonmembers to join until the world economy is knit together. The WTO Secretariat states that RTAs have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally, and in due time, these regional agreements paved the way for a multilateral agreement under the WTO. Services, intellectual property, environmental standards, investment, and competition policies are all issues that were raised in regional negotiations and later developed into agreements or topics of discussion in the WTO.

The GATT and GATS recognize the presence of PTAs in the world today and had set forth conditions by which these agreements need to be observed if these become acceptable under the WTO agreement. GATT's Article 24 allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met. In particular, the PTA should help increase trade among the countries in the group without raising barriers to the group's trade with the rest of the world.

Moreover, the GATT says that if a free trade area or customs union is created, non-members should not find trade with the FTA or CU members any more restrictive than before the agreement was implemented. Similarly, Article 5 of the GATT provides for economic integration agreements in services.

Clarete, Edmonds, and Wallack (2003) found that PTAs in the Asia-Pacific region create rather than divert trade, particularly for Asia. The finding

suggests that PTAs offer a next-best path toward expanding world trade if negotiations for multilateral trade liberalization take a longer time to get completed. It will be important to follow up macro-level cross-country research, such as this paper, with more focused studies on the dynamics of PTA members' policies toward trade with the rest of the world and participation in multilateral trading agreements such as the WTO. One claim that could be tested, for example, is whether negotiating for PTAs help developing countries gain experience with trade liberalization on a limited scale which later smoothens the way toward more general trade opening (Michalopoulos 1999).

Having noted this potential, policy makers need to be aware that PTAs vary. There are PTAs that tend to divert trade towards its members, be unnecessarily costly to administer, or create opportunities for unproductive rent-seeking activities. The challenge to policy makers is to continue to innovate on their respective regional trade arrangements. A few ideas include using the regional arrangement to solve for regional spillover problems or facilitate trade and capital movements among members, thereby reducing the cost of doing business, and increasing the investments and aggregate economic activity of its members.

Frankel (1997), studying the effect of APEC on trade, noted the tendency for greater intra-bloc trade to be accompanied by greater trade with the rest of the world, as well. He based this observation on the large share of total world trade accounted for by APEC member economies, and concluded that the "APEC effect is genuine", that is, trade-augmenting. Garnaut (1994) wrote that the trade-augmenting impact associated with APEC is consistent with the type of integration "where the initiative has remained primarily with enterprises acting separately from state decisions, and where official encouragement of regional integration does not include major elements of trade discrimination."

Soloaga and Winters (2001) found no indication that the 'new wave' of regionalism in the 1990s boosted intra-bloc trade significantly except for EU and EFTA. In Latin America, increasing propensities to export generally accompanied increasing propensities to import, suggesting strong effects from general trade liberalization except for MERCOSUR (the Common Market of the South), for which import

and export propensities displayed opposite movements.

CONCLUDING REMARKS

In a competitive global trading system, latecomers tend to have a disadvantage. Having spent decades of looking inward, the transition economies would need to surmount high adjustment costs more quickly. One important disadvantage of keeping trade down to a minimum is foregoing the opportunity to undergo competition, seen to be an important catalyst to increasing agricultural productivity. Thus, the structural features in agriculture that dampen productivity growth, get to be accommodated by the high local prices of agricultural and food products.

Farmers, on the other hand, are constrained from translating these high prices into more investments, technical improvements, and productivity because the markets of these products are rather limited due to the inward orientation of their governments and the high prices. As they progressively step out towards integration, the transition economies would need to identify the parts of the agriculture sector they each may need to focus their limited development resources on, identify the policy regime conducive to build on their respective competitive advantages, and implement programs which would reduce human and infrastructural bottlenecks.

Does participation in preferential trading arrangements spur economic development for the transition countries in Southeast Asia more than if they simply pursue multilateral trade rules by joining the WTO, as Cambodia just recently did? It turns out that these two paths complement each other in practice. Despite all the theoretical arguments against them, regional trade arrangements have mushroomed in the 1990s and their number continues to swell. Vietnam, among the four transition countries, was first to enter into a bilateral FTA with the United States. Authors of empirical studies create rather than divert trade. They suggest that PTAs offer a next-best path toward expanding world trade if negotiations for multilateral trade liberalization take some time to get completed.

Having noted this potential, authors cautioned about the tendency of PTAs to divert trade towards

its members, incur unnecessarily high administration costs, or create opportunities for unproductive rent-seeking activities. The challenge to policy makers is to continue to innovate on their respective preferential trade arrangements and use these arrangements to help solve regional spillover problems, facilitate trade, and promote more capital movements among members.

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