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Regional Integration in Global Contexts: Issues and Challenges

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Over the last twenty years since the last Uruguay Round was completed, world trade has evolved dramatically, not only in terms of values but also in terms of participants, and even in the characteristics of products traded. The interdependence of trade with investment, production, and services development is another crucial development that has not been managed well in the current trade governance, especially at multilateral level. The situation has encouraged countries to find alternative way to deal with the increasing needs of new trade governance, of which by relying to regional trade agreement.

This short paper discusses the recent development on global trade environment and its consequences. The note highlights the role of regional trade agreements in delivering trade governance, but also underlines some of the limitations.

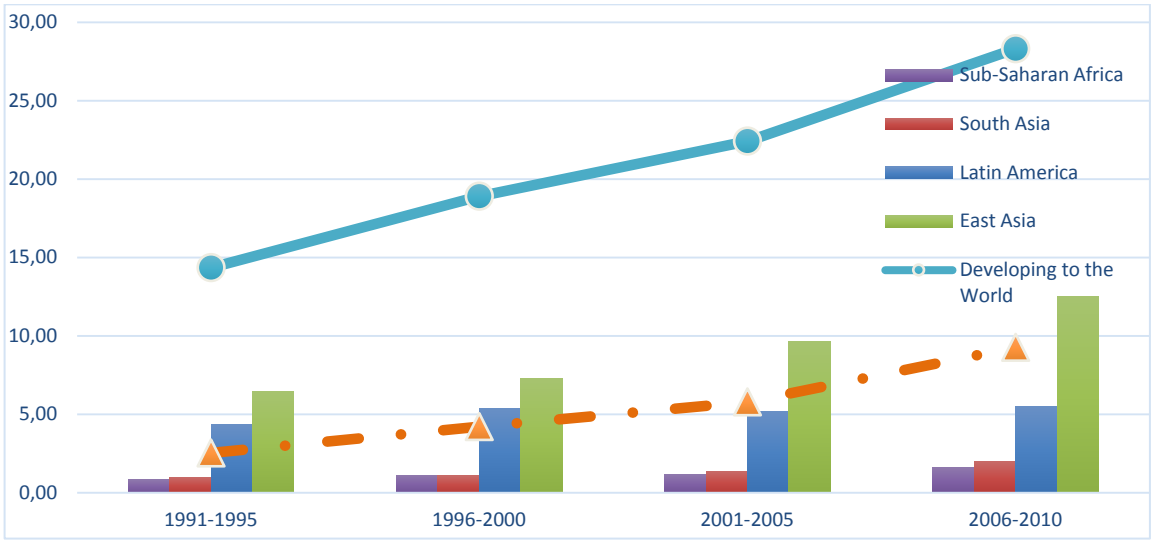
New Situation of Global Trade Environment

In the last two decades since the GATT's Uruguay Round was completed, there has been significant changes in the global trade environment. These changes have shifted bargaining power between members of the WTO, have caused strategic distrust, and have altered members' perspectives on the costs and benefits of global trade negotiations.

First is the increasing participation of developing and less developed countries. The majority of developing countries, including even the poorest, are increasingly become more important in shaping the world trade. In late 2000s those countries' contribution to global trade was around 28%, almost double of the same figure in early 1990s (Figure 1). But not only in terms of their share, there has been significant shift in the direction of trade. Nowadays, the share of trade among developing economies is three times higher than in mid 1990s.

Successful developing countries have normally pursued more aggressive trade promotion by diversifying from primary commodities to manufactured goods (Tybout 2000). Following this pattern, nowadays developing countries have increased their presence in manufactured goods exports. Diversification of exports is quite obvious. Exports of manufactured goods have increased from 48% of the South's countries exports to 58% recently. More strikingly is the decline of resource-intensive manufacture and the raise of medium and high-skilled intensive manufacture goods in the composition of developing countries' exports.

Figure 1. Developing Countries in the World Trade



Source: UN Comtrade

This change has brought significant consequences in the negotiation and implementation of global trade system. Unlike in the last Uruguay Round, in the current Doha Round negotiation developing countries have voiced their interests more strongly, which often are different than developed countries' stances. This North-South tension has led to difficulties in concluding the current round of multilateral negotiation. In addition, the tension between developing economies is increasing. Increasing competition for market of similar products, race for FDI, and struggle for access to raw materials have resulted to frequent trade and economic disputes between developing and even less developed countries.

Second is the emerging of global value chain and international production network. One of the reasons behind greater involvement of developing economies in global trade is the increasing practice of placing and sourcing different tasks of production in different places according to the intensity each task and the abundance of factors of production. Placing production bases in different countries require firms to conduct international business activities, normally performed through foreign direct investments (FDI) or outsourcing contracts. The dispersed production bases require organizational management and coordination, as well as cross-border movement of goods, people and ideas to form a global value chain. The availability of excellent services industry, e.g. logistics, telecommunication and finance, is necessary to ensure that such interconnection can take place in efficient and timely manner.

Figure 2 shows some related indicators of the importance of global value chain, namely the share of machinery, electronics and motor vehicle where global

production networks normally take place. In early 1990s, the share of these products in World manufacturing trade was only around 45%. Within less than two decades, the share increases to 50%. Moreover, trade in parts and components, another measure of international production networks, increase from 19% to 27%. This pattern is more obvious in several regions, including East Asia. The share of network products in manufacturing trade of this region increased by 10 percentage points, while parts and components contributed to around 35% of manufacturing trade. The importance of parts and components trade, and regional value chain, in East Asia has coined the term Factory Asia to describe that the region has become a single production base for various manufacturing industries.

Figure 2. Share of Products with Strong Production Networks in Manufacturing Exports

	Parts and components		Final assembly		Total network products	
	1992-93	2007-08	1992-93	2007-08	1992-93	2007-08
(a) Exports						
East Asia	20.2	34.3	31.6	26.4	51.8	60.7
Japan	23.9	34.3	44.5	32.3	68.4	66.6
Developing East Asia (DEA)	17.3	34.0	21.8	25.2	39.1	59.2
People's Republic of China (PRC)	7.4	25.5	13.7	26.6	21.1	52.1
Hong Kong, China	15.8	33.3	18.0	17.8	33.8	51.1
Taiwan	24.7	44.2	17.6	21.5	42.3	65.7
Republic of Korea	18.1	44.2	22.2	25.4	40.3	69.5
ASEAN	22.7	44.2	34.1	22.0	56.8	66.2
Indonesia	3.8	21.5	5.6	16.8	9.3	38.4
Malaysia	27.7	53.6	40.7	25.1	68.4	78.8
The Philippines	32.9	71.7	20.5	15.6	53.4	87.3
Singapore	29.0	49.3	45.9	17.2	74.9	66.5
Thailand	14.1	29.9	29.0	33.0	43.1	62.9
Viet Nam	---	11.0	---	7.6	---	18.5
South Asia	2.3	8.2	2.9	3.1	5.1	11.3
India	3.0	10.4	3.4	3.8	6.4	14.2
North American Free Trade Area (NAFTA)	28.4	31.2	31.4	28.1	59.7	59.3
Mexico	42.1	34.6	30.8	42.1	72.9	76.6
European Union (EU) 15	18.3	22.4	22.4	21.1	40.7	43.5
Developed countries	20.4	25.2	28.5	23.6	48.9	48.8
Developing countries	14.6	29.2	21.8	24.3	36.4	53.6
World	19.3	27.1	26.3	23.8	45.5	50.9

Source: Athukorala (2013)

The intertwined between trade-investment-services has brought the complexity of production, flows of knowledge and flows of goods, previously took place within proximity, to the global venue in a much bigger scale, and introduced many new problems previously unknown in the traditional model of production. One of the most

important problems is related to the issues about protection of business activities, both for physical and intellectual assets. There are also problems related with market failures such as information asymmetry and anti-competitive behaviors. Moreover, more intensive cross-border activities require greater facilitation and frictionless trade, both in goods and services, as well as freer movement of capital, people and ideas. It is imperative for global trade governance to provide rules that encompass all those issues and answer problems related to global value chain.

Third is related to threat of protectionism, especially during the crisis. The global financial crisis has brought a new perspective on global trade governance. A sharp contraction in global growth following the crisis has caused even sharper contractions in trade and FDI. But even more worrying picture in the wake of the global financial crisis was the increasing tendency towards protectionism (Evenett 2012). Government interventions in terms out bailouts and fiscal stimulus were often followed by application of various restrictive measures to trade. Moreover, the global economic crisis has constrained WTO members to keep the MTS going on and from making further concessions in completing the current Doha round.

Regionalism as an Alternative

There is an increasing need to address those shifts in global trading environment in order to increase certainty for cross-border trading and investment activities. Unfortunately, multilateral trading system (MTS) has failed to deliver sufficient solutions to issues related to the changing nature of global trading situation. While the WTO is functioning well in implementing multilateral trading rules, which are being respected with strong supporting institutions, the multilateral liberalization initiatives and rule making process have been stalled for a while.

The current negotiation of Doha Development Agenda (DDA) has just recently shown some improvement with the acceptance of Bali package. Moreover, the DDA itself has been criticized for not including a number of trade-related issues that need to be addressed for the 21st century trade, which is dominated with strong linkage between trade, services and development as discussed above.

In order to deal with increasingly complex trade-related problems, countries have resorted to regional or bilateral agreements involving limited numbers of participants. In the last twenty years, we have seen more intensive regionalism initiatives. East Asian countries, as some of the most important participants of global value chain, are no exception. Currently, ASEAN is pursuing to have an East Asia-wide trade agreement, the Regional Comprehensive Economic Partnership, with their trading

partners that would become one of the mega-regional arrangements besides Trans Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP).

Not only that regionalism has become prevalent, RTAs have also included various measures outside traditional elimination of trade barriers, such as investment provisions, competition policy and protection of intellectual property rights. Those are common features normally found in new generation of trade agreements that address a range of behind-the-border issues related to internationalization of production, currently not even discussed at MTS. Figure 3 provides example on how FTAs in East Asia have evolved to cover deeper commitments and substantial issues beyond simple trade barriers.

Figure 3. Provisions in FTAs between Japan and ASEAN Members

Column1	Singapore	Malaysia	Philippines	Brunei	Indonesia	Thailand	Vietnam	ASEAN
Border Issues								
Tariff elimination	√	√	√	√	√	√	√	√
Rules of origin	√	√	√	√	√	√	√	√
Services trade	√	√	√	√	√	√	√	√
Customs cooperation and trade facilitation	√	√	√	√	√	√	√	√
Sanitary and phytosanitary measures	√	√					√	√
TBTs and standard conformity	√	√					√	√
Behind-Border Issues								
Intellectual property	√	√	√	√	√	√	√	
Investment	√	√	√	√	√	√		
Government procurement	√		√	√	√	√		
Competition policy	√	√	√		√	√	√	
Environment standards								
Sustainable development								
Labour standards								
Financial services	√	√	√	√	√		√	
Telecommunications	√							
E-commerce	√							
Economic Co-operation	√	√	√	√	√	√	√	√

Source: Damuri (2013)

In short, regional integrations have served as an alternative to MTS to provide governance on the ever changing global trade environment. While those regional agreements have increased assurance and reduce risks related to cross-border exchange and investments, does not mean it comes without costs.

Issues and Challenges of Regionalism

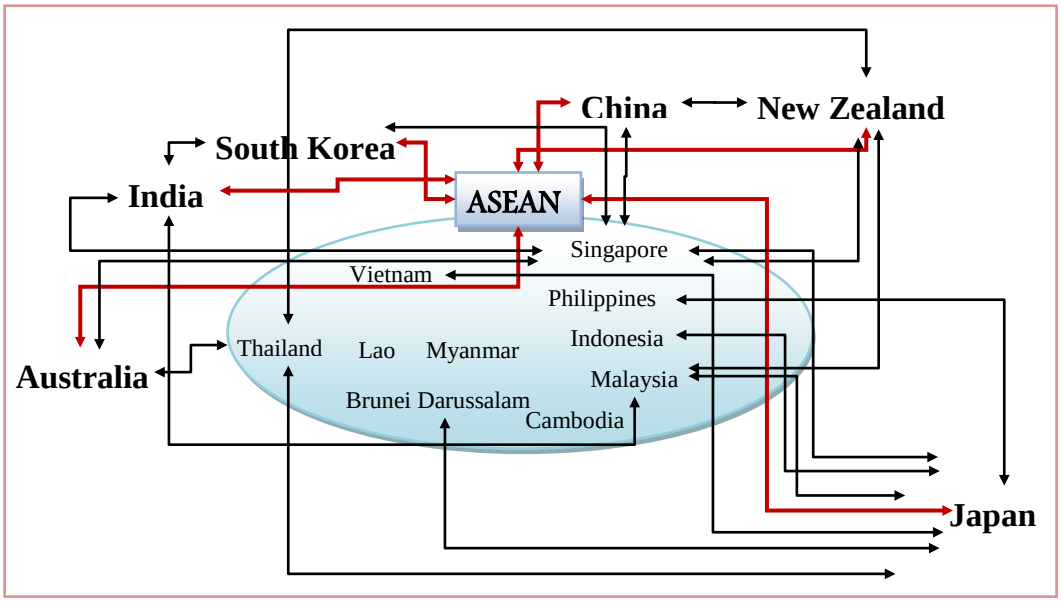
The emergence of regionalism has raised concerns over preferential concessions and other related aspects of FTA. Take East Asian case as an example of regionalism

going awry. Currently there are 17 bilateral FTAs among countries in East Asia. While ASEAN as a group has formed five trade agreements with six trading partners in the region, several individual members also conducted bilateral agreements with those other countries (Figure 1). Some individual members, such as Singapore, even perform bilateral FTAs with all six partners.

This overlapping arrangement of bilateral and regional FTAs has been the source of many difficulties in realizing the potential benefits of trade liberalization. One frequent feature of trade agreements in the region is low utilization rate of preferential facilities. Several firm-level surveys to see the use of preferential treatments of East Asian FTAs found that firms in the region do not use FTA optimally (see for example Kawai and Wignaraja 2011).

Various reasons can be associated with this, ranging from lack of information and difficulties in complying with requirements. All of them is boiled down to the fact that preferential treatments require certain rules to ensure that preferential tariffs only apply to product from trading partners. Those rules of origin (ROO) have to be satisfied and be proven before the benefits can be obtained. This normally incurs costs either to acquire necessary documents, to collect and make use of relevant information or to comply with relevant rules. It becomes more tedious and costly when overlapping agreements as described in Figure 1 use different types of ROO, especially when regional supply chain requires intermediate goods to cross border several times in the process of production.

Figure 4. Bilateral and Regional FTAs in East Asia



Less obvious adverse effect of preferential treatments is that they probably are not making the members better off. The reason is that the preferential removal of tariffs may lead to trade diversion, where the source of some imports changes from the most efficient supplier to the country receiving preferential treatment. Political economics theory even suggests that FTAs are likely to happen when it leads to more trade diversion which often enhance protection and hurt social welfare (Grossman and Helpman 1995). Empirical studies on this subject on East Asia FTAs reveal that trade diversion cannot be neglected, although positive effect of trade creation also takes place (see for example Urata and Okabe 2010).

From political point of view the emergence of regional trade agreement might potentially increase tension between countries in the same region as FTAs can be divisive and exclusive, especially when some countries are excluded from potentially trade-diverted FTAs. This partly comes into effect in the case of "US-led" TPP and "China-supported" RCEP[1]. FTAs between countries of different level of economic development and power are also perceived to be in favor of bigger and more powerful countries. Trade agreements at bilateral and regional level also runs the risk of domino effects, where countries tend to form trade agreements based on the fear of trade-diversion effect, instead out of necessities and advantages of greater trade relations[2].

Taking Back Multilateral Trading System on Track: Lessons from ASEAN

The aforementioned issues emphasize the importance of multilateral initiatives in shaping global governance on cross-border trade and investments. The benefits of MTS are unlikely being replaced by bilateral and regional agreements. The multilateral trading system minimizes discriminatory concessions toward different trading partners that reduce the likelihood of countries being trapped in trade war and tariff retaliation. While there are several countries are currently not member of WTO, those countries might also benefit from the implementation of multilateral trading

1 TPP was originally formed by four relatively small countries of New Zealand, Brunei Darussalam, Singapore and Chile, but has been transformed since 2010 into a mega RTA. Dominance of the US in negotiation has led an impression that TPP is led by the US. RCEP is an initiative of ASEAN to harmonize RTAs in East Asia, but have been regarded to get full support from China.

2 Most of empirical evidences, however, have pointed out that regional trade agreement reduce the potential conflicts and military actions, see for example Mansfield and Pevehouse (2000) and Vicard (2012). Nevertheless, "fear" of being excluded and domino effect can also be observed empirically, see for example Baldwin and Jaimovich (2013).

system. The question is how amidst the waves of regionalism, multilateral trading system under the WTO can find the way to address problems related to the changing nature of global economic environment.

One important thing to do is to complete the current Doha Development Agenda. It is important to keep up the momentum for trade governance and liberalization, despite that the completion the negotiation round is unlikely to offer significant result towards global economic integration. Another is to redefining its position in global trading activities. One of the reasons why FTA is so attractive is that the regional trade agreements offer many areas that have not been discussed multilaterally. Current global trading environment has moved away from just traditional trade in good liberalization to behind the border commitments. To win back the heart of its members, WTO should also offer coverage of those areas, perhaps even encompassing what has been discussed under FTAs. One way to achieve greater coverage of negotiation in Geneva, plurilateral initiatives on many behind border issues currently take place in parallel with multilateral negotiation, e.g. Trade in Services Agreement, need to be promoted to gain supports from more members of the WTO.

The multilateral trade negotiation can also learn from what ASEAN and its trading partners have accomplished in the region. First, it is important to take into account variation of member countries. Special and differential treatment enables less developed members to be engaged in various commitments. However, longer transition and implementation period for those countries need to be determined strictly. Together with more advanced commitments of the most developed countries, it will allow sensitive issues to be discussed in the negotiation. Such practice may also be employed in the multilateral trading system.

Second, integration in ASEAN also told us that some issues can be addressed by several interested participants only, much like the plurilateral approach of MTS. The use of consensus in ASEAN integration process is overwhelming, just like in WTO, but in few cases some members were willing to go for selective issues while waiting for others to join.

Third, single undertaking may be beneficial to keep the result of negotiation coherence and the bargaining process takes place. But integration in East Asia shows that separate discussions on various issues can also lead to coherence results as long as big framework can be determined at the first place.

Efforts toward greater coherence and harmonization of rules among regional trade agreements, such as what ASEAN countries and trading partners is currently done with the RCEP, also need to be intensified. Other regional FTAs need to come up with similar initiative in order to proceed for multilateral-friendlier regionalism.

These efforts need to be complemented by increasing capacity of the WTO in monitoring regional trading system.

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