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Multitrack Integration in East Asian Trade: Noodle Bowl or Matrix?

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SUMMARY East Asian trade agreements are often described as a complicated "noodle bowl," which shows links in the region as a snarled, overlapping and intertwined mass. But this is a misleading representation—Asia's regional agreements may in fact be creating an order of a different sort, building the foundations for a stronger regional trading system. Asian trade arrangements can be more constructively seen in terms of a trade agreements matrix, in which multiple negotiations produce an orderly progression of agreements to liberalize all potential bilateral relationships and move the region toward a coherent system of freer trade. The various approaches to deeper economic integration—regional arrangements, trans-Pacific agreements, and global engagement—are complementary paths that should eventually lead to an open global trading system. East Asia is of growing importance in the global marketplace, and adopting an aggressive multitrack strategy—as the region appears to be doing—may be the fastest route toward a new global framework.

East Asia's options for deeper economic integration are often framed as exclusive alternatives: (a) initiatives to establish regional trade and monetary arrangements, (b) participation in trans-Pacific arrangements, such as the Free Trade Area of the Asia Pacific proposed by President Bush at the 2006 Asia-Pacific Economic Cooperation (APEC) meetings, or (c) global engagement, say, in the Doha Development Round and in strengthening international financial institutions. In practice, however, these different approaches are emerging as complementary paths to deeper international integration. East Asian countries have good reasons to strengthen their interactions with each other, to solidify their ties with North America (and with Europe), and to maintain a global framework through the World Trade Organization (WTO) and other institutions. The real policy challenge is to ensure that these efforts evolve consistently, without sacrificing continued integration with any key trading partner.

The Multitrack Strategy

Bi- and minilateral negotiations are already so advanced that an aggressive multitrack strategy—parallel regional, trans-Pacific, and global initiatives—may be the only way to create a new global framework and could potentially make that possible more rapidly than skeptics now anticipate. Nevertheless, this approach has been widely criticized in the economics literature. One important concern raised is that countries pursuing such a "promiscuous" strategy will make concessions on smaller deals and waste leverage that could have been used to promote global agreements. A second concern is that regional arrangements could coalesce into large, competing protectionist blocs.[1] A third concern is that smaller agreements will be inconsistent—famously described as a "spaghetti bowl" (Bhagwati 1995)—and will thus carve up, rather than integrate, world markets. The visual image of the spaghetti bowl—or noodle bowl, as it is often called in the East Asian context—implicitly suggests the chaotic disintegration of the global trading system (see figure 1).

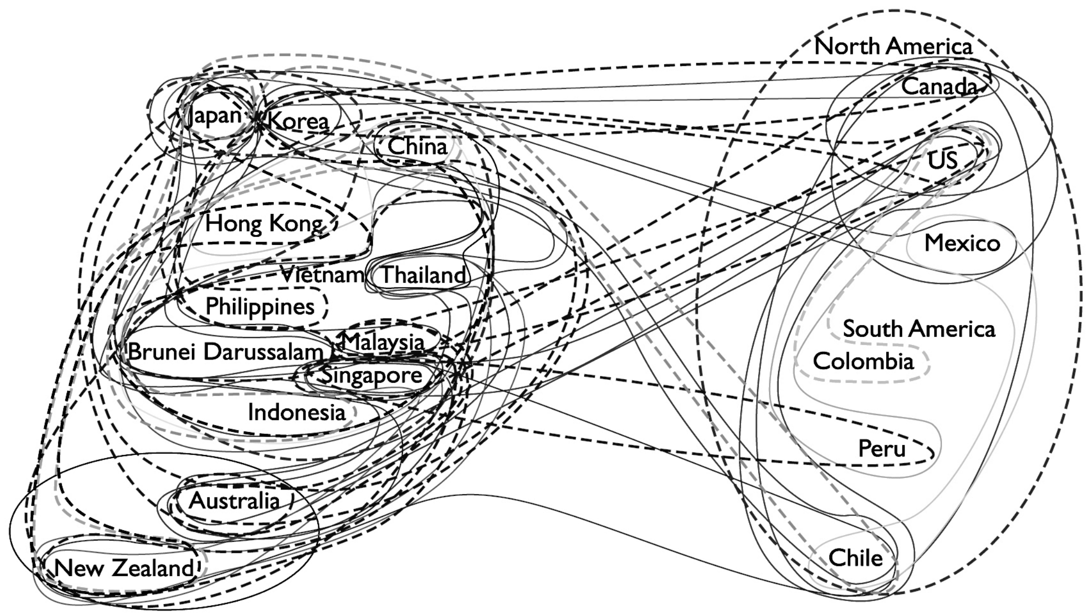
The process of multitrack negotiations is building a global trading system from the 'bottom up' instead of 'top down'

Yet a growing minority of analysis suggests that regional integration can build foundations for a stronger global trading system. Broadly, these models argue that regional agreements (a) generate pressure for beneficial deals with countries that are left out of free-trade areas (FTAs), and (b) increase the political weight of pro-trade interests within FTAs by making each bloc's economic structure more competitive (see for example Baldwin 1995, McCulloch and Petri 1997). These arguments have been recently collected and strengthened by Baldwin (2006b) and applied to analyze the pattern of global liberalization since 1934. In this process, Baldwin has come to see "spaghetti bowls as building blocks on the path to free trade." Building on Baldwin's analysis, there is also one additional consideration: the idea that the accumulation of FTAs erodes the value of "exclusivity" in bilateral or plurilateral agreements, and thus makes it harder to justify the rising cost of maintaining multiple agreements as compared to a few consolidated regional or global ones.

An important characteristic of a multitrack strategy is that no sequence or geographic limit is imposed on negotiations—in contrast, say, to the more focused Europe-centric model. In other words, a country accepts satisfactory agreements from all comers, according to the perceived value of the agreement, including with far-flung partners. The strategy leads to networks without strong geographic definitions, and is sometimes described as cross-regionalism (Tovias 2008). Operating an aggressive multitrack strategy requires ample negotiating resources and steady nerves, but as shown by the experiences of Singapore and South Korea—the best current models of such a strategy at work—it is feasible even for small and medium-sized economies.[2] Such a strategy—consistent with East Asia's general outward orientation—is more likely to lead to accelerating competitive liberalization than to coalescing protectionist blocs.

All this suggests a much more constructive way to view the proliferation of bilateral and plurilateral agreements. Instead of visualizing Asia's smaller deals as confusing squiggles, it is more instructive to view them as creating a matrix of connections among the key nodes of a regional (or global) economy. In this

Fig. 1. The trans-Pacific "noodle bowl"



Solid lines = In force.
Dashed lines = Under negotiation.

Source: Adapted with permission from PECC State of the Region Report 2006.

alternative view, the multiple negotiations underway are not multiplying complexity but, on the contrary, gradually helping to reduce it by "filling in" the range of possible bilateral linkages among countries and thus helping to erase an increasingly comprehensive set of barriers. At the logical endpoint of this process—with all countries connected by free trade agreements—a new symmetry emerges in regional trade policy.

The trade agreements matrix (TRAM) that summarizes existing agreements is already densely populated. Once this matrix is reasonably full, the steps to a coherent global system are not large—and indeed, offer an increasingly compelling improvement on maintaining separate agreements. So, after the current flurry of smaller negotiations runs its course, there is reason to expect a phase of discussions in which agreements are consolidated into wider regional and eventually global FTAs (indeed, some of that discussion has already begun in APEC and other regional bodies). The technical form of those negotiations will be to liberalize rules of origin (ROOs), a key feature of a set of bilateral trade agreements that separates them from a global agreement. In effect, this process amounts to building a global trading system from the "bottom up" rather than from the "top down" through conventional trade rounds.

The Case for Regional Agreements

The case for regional agreements rests in part on facilitating the continued, rapid progress of this market-driven integration, and in part on managing its consequences. By cooperating more closely, East Asian governments can eliminate remaining barriers to trade and investment transactions, encourage "behind the border" regulatory changes that affect integration, manage the spillovers generated by their close links, and coordinate positions to secure the best possible terms in wider regional and global negotiations.[3]

Much of the increase in East Asia's intra-regional trade is due to the region's growth as a source and destination for traded goods. But in recent years, the intra-regional *bias* of economic integration—the share

There is a case for stronger regional trading relations, but Asia's export and import requirements are ultimately too large to be confined to any market short of global markets

of the region's trade conducted with itself divided by its share in world trade—has also begun to increase (Petri 2006). This development is driven by production networks—the gradual subdivision of production chains into steps located in varied regional economies. Due to its diversity and trade orientation, East Asia provides the world's best environment for building production networks. This, in turn, generates comparative advantage in industries such as electronics and automobiles, where production networks are critical. Regional cooperation can ensure connectivity and low linkage costs, further enhancing the productivity of each regional economy.

The macroeconomic implications of integration reinforce the case for regional cooperation. The financial crisis of 1997–98 called harsh attention to macroeconomic and financial spillovers in East Asia, demonstrating every economy's stake in mutual stability. As a result, East Asian economies have established regional surveillance processes, including the ASEAN (Association of Southeast Asian Nations), ASEAN-Plus-Three (ASEAN with China, Japan, and South Korea) and EMEAP (Executives' Meeting of East-Asia and Pacific Central Banks) mechanisms, and a system of currency swaps for emergency access to foreign exchange reserves (the Chiang Mai Initiative). There has been talk, if little action so far, also about coordinating exchange rate policies.

The Case for Trans-Pacific Agreements

Despite rapid regional integration, North America remains a significant driver of the Asian economy. Athukorala and Yamashita (2005) find that the intensification of intra-regional trade is in part a side effect of production fragmentation: final goods exports to North America cause parts and components to cross borders repeatedly within East Asia, registering as intra-regional trade. In fact, production fragmentation has made Asia especially competitive in products that are typically sold in external markets—in other words, it has increased, not decreased, the importance of extra-regional demand. These findings are corroborated by international input-output tables. Shrestha and Hasebe (2006) find that East Asia's dependence—directly and indirectly through the components they incorporate—on final demand outside the region is still high, and falling only slowly. The Asian Development Bank (ADB) calculates that while less than half of Asian exports leave Asia, more than two-thirds of these exports are ultimately incorporated into final products consumed outside the region, principally in North America and Europe (ADB 2008).

North American and European partners are still more important for capital transactions. A disproportionate share of Asian assets—including the positions of central banks—is invested in North America. Asian firms are often listed on American markets, and U.S. and European investors play an active role in investing in Asian companies. In effect, Western financial markets intermediate much of Asian savings. For now, North American financial markets and financial firms play prominent roles in Asian finance.

While Asia's connections with North America are deeper than with Europe, this may change as global imbalances unwind and U.S. current account deficits diminish. The depreciation of the U.S. dollar relative to the Euro is already driving these adjustments, making Asian products less competitive in U.S. markets and more competitive elsewhere. Thus the case for strong trans-Pacific ties applies also to ties with Europe and other regional groupings, which are becoming more important over time.

The Case for Global Agreements

Asia's exceptional expanding export and import requirements are too large to be confined to any market short of global markets. To accommodate the large adjustments that will be needed elsewhere, non-Asian economies will need to be persuaded that they too benefit from Asian progress. Asian economies, in turn, will need to reach out actively, often against growing resistance, to build partnerships throughout the world.

Partnerships with the world's wealthiest markets will be important, but they should not be confined to them. Many emerging economies outside East Asia

East Asian Trade Agreements Matrix

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	China	Hong Kong	Taiwan	Japan	South Korea	United States	European Union
ASEAN													
Indonesia	X	Conc	Conc	Conc	Conc	Conc	Conc			Conc	Conc	Prop	Neg
Malaysia	Conc	X	Conc	Conc	Conc	Conc	Conc			Conc	Conc	Neg	Neg
Philippines	Conc	Conc	X	Conc	Conc	Conc	Conc			Conc	Conc	Prop	Neg
Singapore	Conc	Conc	Conc	X	Conc	Conc	Conc			Conc	Conc	Conc	Neg
Thailand	Conc	Conc	Conc	Conc	X	Conc	Conc			Conc	Conc	Neg	Neg
Vietnam	Conc	Conc	Conc	Conc	Conc	X	Conc			Conc	Conc		Neg
Other East Asia													
China	Conc	Conc	Conc	Conc	Conc	Conc	X	Conc		Prop	Prop		
Hong Kong							Conc	X					
Taiwan									X			Prop	
Japan	Conc	Conc	Conc	Conc	Conc	Conc	Prop			X	Neg		
South Korea	Conc	Conc	Conc	Conc	Conc	Conc	Prop			Neg	X	Neg	Neg
United States	Prop	Neg	Prop	Conc	Neg				Prop		Neg	X	
European Union	Neg	Neg	Neg	Neg	Neg	Neg					Neg		X
Other													
Concluded				Chile India Jordan Panama Peru New Zealand	Australia New Zealand		Chile Pakistan New Zealand		Guatemala Nicaragua Panama Honduras El Salvador		Chile EFTA	Various	Various
Under Negotiation	India Pakistan Australia New Zealand	India Pakistan Australia New Zealand	Australia India New Zealand	Canada Mexico Australia EFTA Pakistan China Egypt Kuwait Peru Qatar	Bengal India Bahrain EFTA New Zealand Peru	Australia India New Zealand Chile	Australia GCC Iceland	New Zealand	Dominican Republic Paraguay	Brunei Chile GCC	India	Various	Various
Proposed	EFTA	India	Pakistan	Sri Lanka Bahrain United Arab Emirates	Pakistan Chile Mercosur		Costa Rica Peru South Africa SCO India			Australia India Switzerland	Australia Mercosur New Zealand South Africa	Various	Various

Key: Conc = Concluded; Neg = Under negotiations; Prop = Proposed/under official study.

EFTA = European Free Trade Association
GCC = Gulf Cooperation Council
SCO = Shanghai Cooperation Organization

have ample resource endowments that make them obvious partners. In addition, these markets provide an important destination for Asian machinery and final goods exports, since their low- or middle-income requirements are similar to those of several East Asian internal markets.

Global liberalization benefits East Asia even if seen through a mercantilist lens, but it offers much more—it can stimulate the expansion of world productivity and output and solidify access to markets that the region already enjoys. If the WTO prospers, future rounds and the continued tightening of rules on dumping and subsidies will protect the region from others' arbitrary protectionism. Indeed, given its dynamism and widening geopolitical interest, East Asia has an unusually great stake in an open global trading system, and hence in providing leadership to sustain it.

Back to the Future: The Road to Multilateralism

Perhaps the strongest argument for the multitrack strategy is that it represents a pragmatic path to multilateralism. This argument rests on three elements: (a) that the network of bilateral agreements is already significant and may not be far from the tipping point that triggers a return to multilateralism, (b) that multiple forces, both internal and external, are driving countries to expand these bilateral and plurilateral agreements, and (c) that the benefit-cost calculations faced by countries tilt increasingly from bilateral to multilateral agreements as the number of bilateral agreements expands.

Bilateral agreements can be assessed systematically in the context of a TRAM, a country-by-country matrix of all possible agreements. A group of n countries could potentially form $P = n \cdot (n\text{-}1)/2$ distinct agreements. Let the actual number of agreements be A, then the density of agreements, D, can be defined as $D = A/P$. The density of the East Asian TRAM in 2008 is roughly 0.67 (see page 5 for full matrix).[4] Interestingly, every cell in the East Asian TRAM, with the exception of those involving Hong Kong and Taiwan, is at least under study. The condensed and expanded TRAM in figure 2 shows connections among major Asian economies as well as the United States and Europe. The trans-regional elements of the matrix include some agreements, but their density is notably lower.

Of course, FTAs vary in quality. The General Agreements on Tariffs and Trade (GATT) Article

Fig. 2. Trade agreements matrix (condensed and expanded)

	ASEAN	China	Japan	South Korea	United States	European Union
ASEAN	Conc	Conc	Conc	Conc	Prop	Neg
China	Conc	NA	Prop	Prop		
Japan	Conc	Prop	NA			
South Korea	Conc	Prop	Neg	NA	Neg	Neg
United States	Prop			Neg	NA	
European Union	Neg			Neg		Conc

KEY:

Conc	Concluded
Neg	Under negotiation
Prop	Proposed/under study

As the number of bilateral agreements multiplies, administrative costs grow, while the value of preferential agreements declines

XXIV permits FTAs only if they eliminate all barriers to trade among signatories, but in practice many modern FTAs do not cover all sectors or fully eliminate barriers. Such partial agreements are less likely to generate pressures for consolidation. (Their impact on trade will also be weaker, as will be their trade-distorting effects.) But if FTAs differ in sector coverage, they may generate more rapid movement toward the global track in those sectors in which there is wider overlap. This suggests that sectoral liberalization may become feasible on a global or at least on a plurilateral scale, along the lines of the Information Technology Agreement (ITA) of 1996, which provided for the global elimination of barriers to trade in the information technology sector.[5] Thus, an important direction of research is to construct TRAMs in three dimensions, with country-by-country-by-sector detail. This would provide information on how the TRAMs are filling in by sector, as a basis for a more nuanced assessment of the prospects for a return to a global framework.

A second element of the argument is that the growing density of bilateral agreements has dynamic effects—as more agreements are concluded, more become attractive. Baldwin (2006b) traces in some depth how the shocks generated by an FTA affect the political economy of other potential partners. He concludes that FTAs are likely to yield "domino" liberalization, as economies left out of an FTA seek to protect, or replace with regional agreements of their own, market access lost in countries that form the FTA. In other words, once the process of FTA formation gathers momentum, it is likely to generate forces that will sustain it as the TRAM fills in.

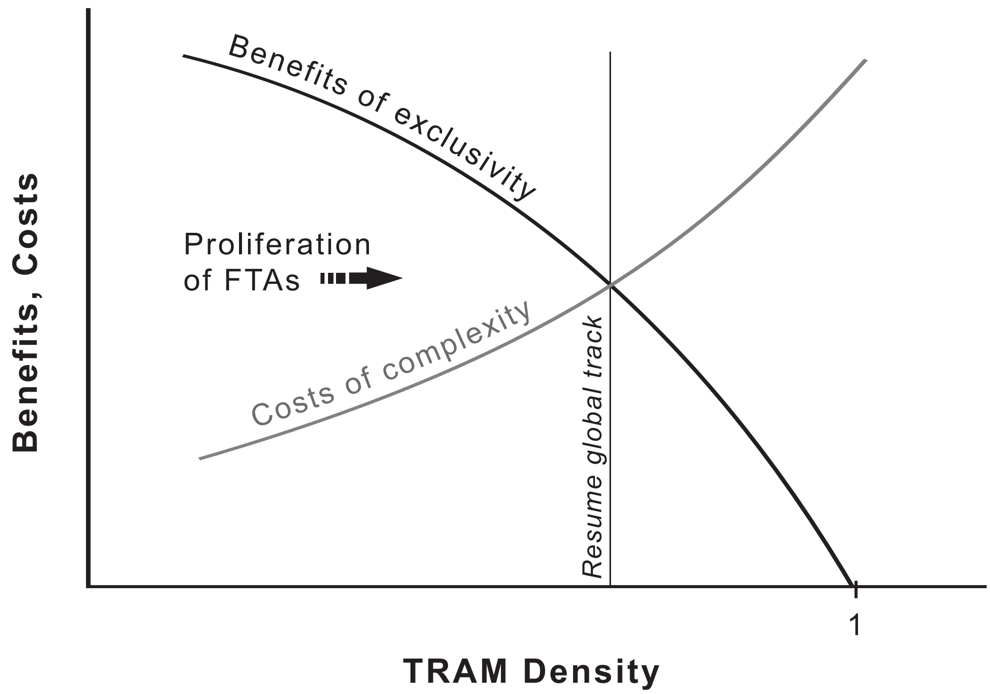
The third element of the argument is that benefit-cost comparisons of the bilateral/multilateral modalities shift from favoring bilateral agreements to favoring multilateral agreements as the density of the TRAM rises. This happens because (a) the costs involved in administering many agreements tend to rise with the number of agreements in force, while (b) the value of preferential access to various markets tend to fall as those markets provide similar preferential access to more competitors.

With regard to administrative costs, it is widely reported (Baldwin 2006b) that even large firms find it difficult to meet the reporting requirements of FTAs, which require tracking and reporting the classification of inputs and their origin, information that firms may not collect in the normal course of business. Tariff rebates involve compiling information that is nonproductive and costly—enough so that many businesses apparently forego the benefits. One would expect this calculation to be even less favorable for small businesses. Of course, these costs grow as the number of agreements multiplies.

As the number of agreements multiplies, not only do administrative costs grow, but the benefits that make preferential agreements attractive also diminish.[6] One reason is that each additional FTA brings a country (especially a small country) closer to its limit of specializing in its "best" export goods (or put another way, the relative production costs of its exports rise), reducing the benefits of further agreements (or maintaining any existing ones). Another is that the more FTAs a country's *partner* concludes with others, the less the value of preferential access to that partner's markets will be (the benefits of exclusivity diminish). Thus, as the density of agreements increases, the net benefits of preferential access decline, possibly sharply so, and eventually countries become interested in trading in their preferential agreements for multilateral agreements.

These relationships are illustrated in figure 3. The horizontal axis measures the density of agreements in the TRAM, that is, the share of potential bilateral agreements that have been concluded. The vertical axis measures the costs and benefits of conducting business through bilateral FTAs relative to a multilateral approach. The rising curve measures the costs to business and government of complying with the reporting requirements of bilateral FTAs. The falling benefit curve measures the eroding value of exclusivity, namely the gains a country enjoys from exclusive access to a partner's market. As the partner becomes more promiscuous, the benefits relative to a multilateral agreement decline—once the partner has FTAs with all competitors, access to its markets would be unaffected by switching to a multilateral

Fig. 3. The effects of concluding more FTAs



FTA. The point in figure 3 where the falling benefit curve and the rising cost curve intersect is the point at which countries might profitably shift their attention from the FTA track to a global track.

While signing a new FTA in a mostly empty TRAM creates benefits from preferential access, as a country concludes more FTAs, the calculation flips, and it eventually becomes more advantageous to negotiate on the global track rather than to fill in missing bilateral agreements—or to sustain existing ones. In other words, saying yes drives the calculus of negotiations ultimately toward multilateral agreements.

As countries conclude more FTAs, it eventually becomes advantageous to consolidate bilateral agreements into multilateral ones

Of course, the steps required to multilateralize even a complete matrix of FTAs could require difficult negotiations. To begin with, many of the FTAs in place are far from comprehensive. Moreover, even a full set of comprehensive FTAs would differ from a global agreement in rules of origin (ROOs), which limit preferences to exports primarily produced in the exporting economy. ROOs could thus impose tariffs on products that result from production chains spanning several countries within a (bilateral) FTA network. But as Baldwin (2006b) notes, major international firms now run extensive arrays of production sites and so have strong interest in eliminating ROOs that limit their ability to allocate production efficiently among operations.

Self-Interest Parallels Global Responsibilities

The strategy of pursuing multiple parallel integration initiatives is driven by the narrow advantages countries see in each agreement. How these incremental steps might affect the global trading system plays a secondary—if any—role in negotiations, despite the fact that many economists argue that bilateral or small plurilateral agreements could harm the global integration process. But new agreements are also likely to create a dynamic that ultimately leads to consolidation. A strategy of pursuing integration at all levels can lead to deeper relations with key partners—and ultimately to a more secure global trading system.

Meanwhile, regions other than East Asia are also filling in TRAMs and have multilayered priorities. Most see significant economic and political benefits from regional integration, but few see these efforts as their sole policy objective. As in East Asia, there is interpenetration of regional TRAMs. Thus, there is little reason to expect negative global fallout from the current wave of regional initiatives. Regional integration is likely to improve productivity, make trade practices more consistent with international norms, and create better opportunities for international trade and investment. With creativity and leadership, it could also help to hasten the return of more comprehensive frameworks to guide the world trading system.

Notes

[1] One famous paper by Krugman (1991) proposed a dynamic that would yield three protections mega-blocs—and large global welfare losses.

[2] The multitrack strategy has been an objective for ASEAN since the conclusion of the ASEAN Free Trade Area (Petri 1997). It is difficult to demonstrate this analytically, but it seems likely that by being receptive to all comers, a country provides incentives to partners to provide earlier and better terms, and thus reduces the overall time required to conclude agreements with all major partners. For an alternative, sequence-based strategy, see Baldwin (2006a).

[3] A comprehensive analysis of the case for regional integration and specific policy proposals are presented in ADB 2008.

[4] In constructing the actual number of agreements, we counted agreements under implementation with a weight of *1.0*, those under negotiation with a weight of *0.5*, and those under study with a weight of *0.25*.

[5] In March 2007, WTO Director General Pascal Lamy explicitly cited the ITA model as a possible pathway for advancing global liberalization given the difficulties surrounding the Doha Round.

[6] Negotiations typically appear to be driven by mercantilist calculations rather than general equilibrium assessments of benefits. (The latter would usually favor unilateral liberalization.) One way to represent such an objective function is to imagine that a country's exports are fully substitutable for competitors' products in a foreign market, and thus get the full benefit of, say, a tariff reduction as rent, while their imports are complementary to domestic goods. In this setting, a foreign economy's preferential liberalization translates fully into a terms-of-trade gain.

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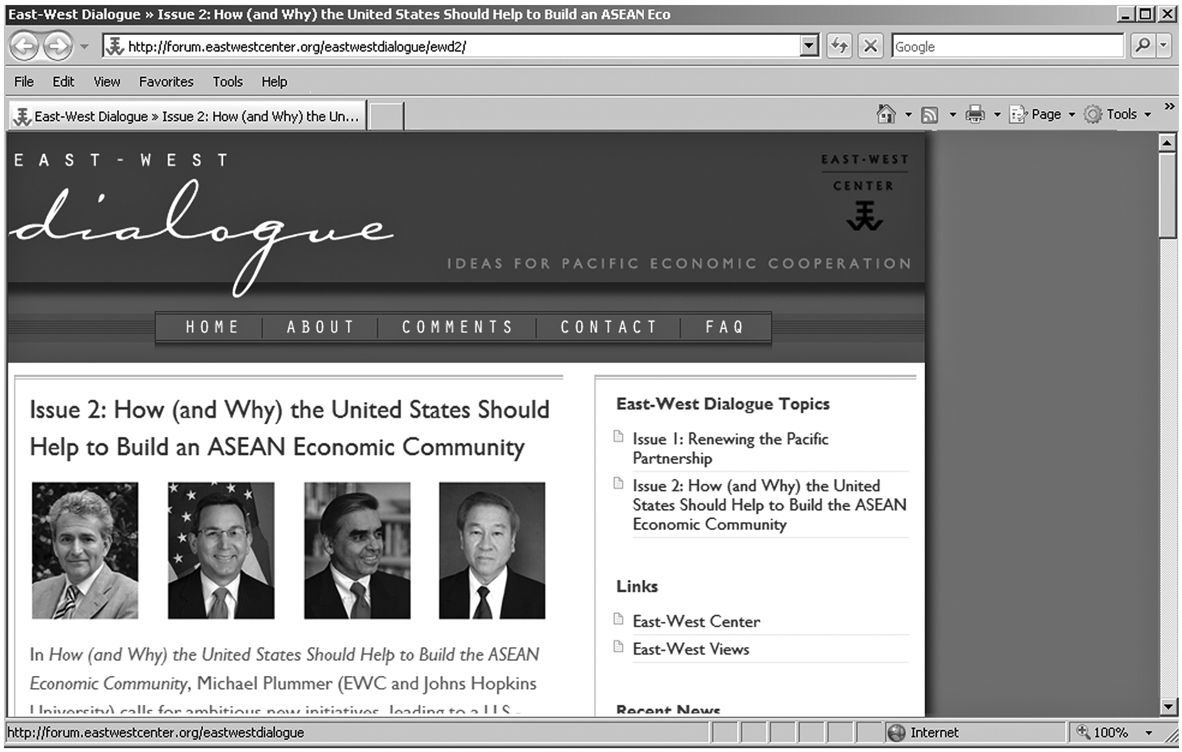

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CHARLES E. MORRISON *President, East-West Center*
PETER A. PETRI

Renewing the Pacific Partnership

The rise of China, India, and other Asian nations is creating a new "core" of the world economy centered on the Pacific. It is essential for the United States to remain vigorously engaged in this region, yet the climate of our relations with Asian partners is cooling. The United States and Asia have yet to find a way to cooperate effectively on any significant global issue. This dilemma, we argue, requires urgent attention on both sides of the Pacific, and specifically a U.S. strategy that features innovative civil diplomacy alongside official initiatives….

WITH COMMENTARIES BY

TAEHO BARK *Chairman of the Korea International Trade Commission; Dean, Graduate School of International Studies (GSIS), Seoul National University*

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Issue 2
How (and Why) the United States Should Help to Build an ASEAN Economic Community

http://forum.eastwestcenter.org/eastwestdialogue/ewd2/

MICHAEL G. PLUMMER *Professor of International Economics, The Johns Hopkins University, SAIS-Bologna, and Senior Fellow, East-West Center*
The Association of Southeast Asian Nations (ASEAN) is coming of age. Initially focused on diplomacy, ASEAN did not really discover economics until the early 1990s. But it has made rapid progress since then and is now committed to building an ASEAN Community based on three pillars: the ASEAN Economic Community (AEC), the ASEAN Security-Political Community, and the ASEAN Socio-Political Community….

WITH COMMENTARIES BY

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