

## **Noodle soup**

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The Diplomat, Vol. 5 No. 1, April/May 2006, pp. 37-38

Hong Kong hosted the sixth World Trade Organisation ministerial meeting last December. Initially billed as a make-or-break affair for the Doha round of international trade talks, once it became clear the meeting would fail to deliver much substance its status was lowered to that of just another way station on the long and winding road of multilateral trade negotiations.

Still, December's meeting did produce two outcomes: it met the minimalist requirement of avoiding another Cancun-style collapse, and so kept the negotiating process alive; and by illustrating yet again how painfully difficult it is to secure advances at the multilateral level, it gave another push to the preferential trade bandwagon.

Hard on the heels of Hong Kong, the US administration moved to stitch up more deals: in February it announced it would negotiate a trade agreement with Korea, its seventh-largest trading partner, in what US trade representative Rob Portman described as the nation's most commercially significant trade deal for 15 years; in March it announced a deal with Malaysia, its 10th largest trading partner. The European Union is meanwhile reportedly considering a more aggressive approach to bilateral and regional agreements, focusing on Asia. Japan is busy trying to negotiate regional trade deals of its own.

This renewed push for preferential trade deals – of which bilateral agreements and broader regional trade arrangements are examples – has created a growing global network of interlocking agreements, the complexity of which has been colourfully described as a spaghetti bowl. This global trend is increasingly set to influence the trading environment in East Asia.

Historically the region has been a reluctant participant in the global rush to preferential trade. Before 1998, the only significant deal within the region was the ASEAN Free Trade Area (AFTA). In 2000 less than 6 per cent of the region's trade occurred within the framework of preferential trade deals, compared to an estimated 40 per cent of global trade

Since then, however, East Asia has joined the herd with a vengeance. On one count there are now 16 trade agreements in the region, with at least 20 more being negotiated and more than a dozen on the drawing board.

If all of the separate bilateral links within AFTA and between the AFTA signatories and China are counted, then the region has almost 60 preferential trade agreements. Virtually every regional economy now has at least one deal in place. The region is generating its own overlapping network of agreements, an Asian noodle soup to complement the global spaghetti bowl.

The embrace of such agreements may be a natural side effect of the deeper integration associated with rising intra-regional trade and investment. The former now accounts for more than half of total regional trade – more than that recorded by the North American trade zone and comparable to the level reached by EU members prior to Maastricht Treaty of 1992. East Asian trade, though, has been accelerating since the mid-1980s, and so predates the turn to preferential trade deals.

Other explanatory factors therefore include a growing sense of regionalism fostered by the Asian financial crisis, the demonstration effect of proliferating trade deals outside the region, the reaction to China's economic rise, and disappointment with the progress on trade liberalisation through broader approaches such as the Asia - Pacific Economic Cooperation forum and multilateral talks. There is also a domino effect, with one economy's decision to negotiate a deal increasing the incentive for others to follow.

Does the region's brimming bowl of noodle soup pose a problem? When trade is liberalised on a preferential basis, the basic result is a combination of trade creation (good) and trade diversion (bad). Which effect dominates depends on the specifics of individual agreements. A clear assessment in the East Asia's case is complicated by the fact there is a dearth of hard data, with many of the new agreements yet to take effect.

The one regional agreement that has been around for some time is AFTA. If its experience is anything to go by, East Asia's noodle soup might turn out not to be a big deal after all. In terms of delivering preferential access, it has turned out to be something of a damp squib. It is estimated that by the late 1990s less than 3 per cent of trade between ASEAN members used AFTA's preferential tariff rate; more recent judgements suggest that proportion of trade benefiting from preferential access is still in the single digits.

Aside from AFTA, most assessments of the likely consequences of preferential deals for East Asia rest on economic modelling. While these exercises are highly sensitive to the assumptions made by the modellers, there are some fairly consistent results: they suggest that members of regional trade deals will tend create more trade than it diverts, with these gains growing as the number of signatories to such preferential agreements rises and that non-members tend to suffer, in inverse relation to the benefits accruing to those with deals in place. In other words, there are strong economic incentives to rationalise the current web of agreements and eventually move to a region-wide trade zone.

The key question is whether the economic incentives are strong enough to overcome major political obstacles. To date, for example, there is no sign of a bilateral agreement between Japan and China, despite them having by far the biggest trading relationship in East Asia.

If politics does trump economics, the risk is the region will be left with a mess of often-inconsistent agreements. Pessimists invoke the experience following World War I, when the international trading system splintered into protectionist-minded trade blocs. Fragmenting world trade contributed to growing economic dislocation and the political extremism that led to World War II. Such a scenario, the pessimists warn, could be the dangerous result of rushing into competing trade arrangements.

Nonsense, retort the optimists, who note the current enthusiastic bout of bilateral deals is the third wave of preferential trade agreements to wash over the world economy since the end of WWII, an apocalyptic effects have yet to materialise.

While the worst fears of the pessimists are unlikely to be realised, there are two important risks for East Asia that will need to be managed.

First, as all of these new trade deals come into force, there is at least some danger that the adverse consequences of discriminatory trade on non-members will exacerbate existing political tensions. Second, the rapidly expanding web of inconsistent agreements is likely to create major economic inefficiencies for regional trade. As the bandwagon gathers pace, therefore, there is a pressing need for regional policymakers to create mechanisms to mitigate these two threats.

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