

architecture

Full Report

NEW ZEALAND AND THE DEVELOPING FTA ARCHITECTURE OF THE ASIA-PACIFIC REGION

A report prepared for Asia New Zealand Foundation
and New Zealand Treasury

Robert Scollay
APEC Study Centre
University of Auckland

June 2006

ISBN – 978-0-9582781-1-9



DISCLAIMER: This document was commissioned, in part, by Asia New Zealand Foundation (Asia:NZ) and the New Zealand Treasury. However, the views, opinions, findings and conclusions or recommendations expressed in it are strictly those of the author, and do not necessarily represent and should not be reported as those of the Asia:NZ or New Zealand Treasury. Asia:NZ or the New Zealand Treasury takes no responsibility for any errors or omissions in, or for the correctness of, the information contained in this paper.

Table of Contents

1. Introduction	3
2. The Asia-Pacific Region in New Zealand's Overseas Trade.....	5
3. Preferential Trade in the Asia-Pacific Region: What Has Been Happening?	11
Background: Global Trends.....	11
PTAs in the Asia-Pacific Region: The Early and Mid 1990s.....	12
The Rush to Preferential Liberalisation in the Asia-Pacific Region.....	13
Characteristics of Recent PTAs Between Asia-Pacific Economies.....	15
"East Asian Regionalism"	18
New Zealand and Australia in the Developing FTA Architecture of the Asia-Pacific Region.....	21
Dominos and Hubs and Spokes.....	22
Coverage of Asia-Pacific Trade by PTAs	24
Gaps in the Pattern of Asia-Pacific PTAs	27
PTA Developments in the Americas.....	28
A Free Trade Area of the Asia Pacific?	28
Summary and Interpretation.....	29
4. The Spread of PTAs and New Zealand's International Trading Environment	32
5. Estimates of Economic Effects of Asia-Pacific PTAs	41
Note on Methodology.....	41
Limitations of CGE Modelling.....	42
Overview of the Simulations.....	43
Effects on New Zealand's Economic Welfare.....	45
Effects on Economic Welfare of Other East Asian Economies and Australia.....	47
Effects on the Output of New Zealand Industries.....	49
Effects on New Zealand's Bilateral Trade Flows.....	52
6. Negotiating Issues.....	54
7. The "Australia Factor"	60
8. Implications for APEC.....	63
9. Areas for Further Work.....	66
FTA Abbreviations	67

Tables and Figures

Table 1:	Share of Major Regions in New Zealand's Trade	5
Table 2:	Share of Asia-Pacific Economies and Sub-Regions in New Zealand's Trade	6
Table 3:	Shares of Major Regions in New Zealand Exports, 1981 and 2001, and Increases in Exports 1981-2001	7
Table 4:	Shares in New Zealand Exports of APEC, APEC Sub-Regions, and Other Regions, 1997-2005	8
Table 5:	Preferential Trading Agreements between APEC Economies	14
Table 6:	Major NZ Markets in the Asia-Pacific Region: FTA Status with New Zealand and other Partners	36
Figure 1:	New Zealand Share of Imports of Western Pacific APEC Members	9
Figure 2:	New Zealand Share of Imports of APEC Members in the Americas	10
Figure 3:	Percentage of Trade of APEC Economies in Bilateral Flows covered by concluded PTAs	26
Figure 4:	Percentage of Trade of APEC Economies in Bilateral Flows covered by Concluded PTAs and PTAs Under Negotiation	26
Figure 5:	Coverage by PTAs of APEC Member Exports to other APEC Economies	27
Figure 6:	Share of Intra-APEC Exports in Main Bilateral Flows not covered by Concluded PTAs or PTAs Under Negotiation	27
Figure 7:	Effect on New Zealand Economic Welfare of Selected FTAs	44
Figure 8:	Comparison of Welfare Effects of ASEAN + 3 FTA with ASEAN-China and ASEAN-Japan FTAs	45
Figure 9:	Welfare Effects of ASEAN+3 FTA with and without AANZFTA and NZ-China FTAs	47
Figure 10:	Welfare Effects of ASEAN-China and ASEAN-Japan FTAs with and without AANZFTA and NZ-China FTAs	47
Figure 11:	Output Changes in Selected New Zealand Industries: NZ-China and AANZFTA FTAs with/without ASEAN+3 or ASEAN-China and ASEAN-Japan FTAs	49
Figure 12:	Changes in Value of New Zealand's Bilateral Trade: NZ-China and AANZFTA FTAs with/without ASEAN+3 or ASEAN-China and ASEAN-Japan FTAs	51
Figure 13:	Changes in Value of New Zealand's Bilateral Trade: ASEAN+3 or ASEAN-China and ASEAN-Japan FTAs	51

1. Introduction

New Zealand's exports are very heavily concentrated in the Asia-Pacific region and there is no likelihood that this situation will change in the foreseeable future. At the same time New Zealand's trade performance in the region is by no means fully satisfactory. Although the Asia-Pacific region consistently accounts for around 70 percent of New Zealand's exports, New Zealand's share of key Asia-Pacific import markets has been steadily declining. The disturbing implication is that New Zealand has not fully shared in the dynamic expansion of Asia-Pacific trade.

Against this background of relatively weak performance in key Asia-Pacific markets, New Zealand's trading interests are now being further challenged by the rapid spread of preferential trading arrangements in the region. Also looming is the prospect of the creation of a large trading bloc in East Asia, with the risk that New Zealand may be excluded from this development. The seriousness of these challenges is compounded by the unfortunate loss of trade-liberalising momentum in the WTO and APEC, dramatically underlined by the recent suspension of WTO's Doha Development Agenda (DDA) negotiations.

New Zealand now faces the prospect of a fundamentally changed international trading environment, in which most trade liberalisation will take place on a preferential basis, with little or no offset from non-discriminatory liberalisation through the WTO or unilateral liberalisation processes.

New Zealand has of course been active in pursuing and concluding preferential agreements with partners in the region. New Zealand's efforts, however, are only a small part of the overall picture of preferential trading developments in the region, and there can be significant impacts on New Zealand from the preferential agreements in which it does not participate as well as those in which it does. This is because of the inherently discriminatory character of these agreements: they provide preferential access to their members, but by doing so they discriminate against all countries outside the agreement.

For New Zealand therefore the rush to preferential trade in the Asia-Pacific region potentially brings with it new market access opportunities but also the threat of being discriminated against in major markets where it fails to secure an agreement of its own. The defensive agenda of seeking to avoid being penalised by such discrimination can be just as important as the positive agenda of seeking new market access.

The proposed free trade agreement with China, for example, may open up new market opportunities for exporters, but it also has the important effect of ensuring that New Zealand retains parity in the Chinese markets with

competitors such as Chile and Australia that have already secured, or are in the process of securing, their own free trade agreements with China. Free trade agreements with China and other East Asian partners may also provide some insurance against the possibility that New Zealand might be excluded from an eventual East Asian trade bloc.

Understanding both the opportunities and threats faced by New Zealand is essential for prioritising future efforts in pursuing and negotiating trade agreements in the region. Success in these efforts in turn is vital for New Zealand's long-term trading future. It is critical that New Zealand achieves outcomes from its trade negotiations in the region that allow it to maintain or of possible improve its trading position in these vital Asia-Pacific markets. Failure to do so will inevitably reinforce the decline in New Zealand's market share in many East Asian markets that has been evident for some time.

This report aims to contribute to an understanding of the new preferential trading arrangements in the Asia-Pacific region, the opportunities and threats that they pose for New Zealand, and the negotiating issues that arise as a consequence.

The report is organised as follows. An initial section sketches the importance of the Asia-Pacific region in New Zealand trade and this is followed by an outline and analysis of the trends in preferential trading agreements that have emerged in recent years. The implications of these developments for New Zealand's international trading environment are then analysed, followed by reporting of the results of simulations that were undertaken of various alternative scenarios that might come about in the future. These include possible situations where agreements being pursued by New Zealand proceed in parallel with other agreements and situations where other agreements proceed but agreements being pursued by New Zealand do not. The purpose of the simulations is to assist in assessing the potential impact on New Zealand of the various possible scenarios.

Negotiating issues for New Zealand that emerge from the analyses are then discussed. The report concludes with discussion of issues raised by the parallel but separate pursuit of preferential agreements by Australia and New Zealand and of implications for APEC for the spread of preferential trading agreements in the Asia-Pacific region.

2. The Asia-Pacific Region in New Zealand's Overseas Trade

The Asia-Pacific region provides the major focus for New Zealand's overseas trade, as illustrated by the "snapshots" in Tables 1 and 2. Table 1 shows that in the 2005 June year APEC economies accounted for 71 percent of New Zealand exports and 72 percent of imports. Including the Pacific Islands and other non-APEC members, the Asia-Pacific region accounted for three quarters of New Zealand exports in that year.

Table 1: Share of Major Regions in New Zealand Trade
Year Ended June 2005

	Percent of NZ	
	Exports	Imports
APEC	71.25	71.70
Pacific Islands	3.22	0.23
EU-25	16.12	19.38
Other	9.41	8.69
Total	100.00	100.00

Source: Statistics NZ: NZ External Trade Statistics

Table 2 shows that New Zealand's trade is relatively widely distributed across the Asia-Pacific region. Australia, New Zealand's long-time Closer Economic Relations (CER) partner, accounts for 20 percent of exports and 22 percent of imports. The Northeast Asian region as a whole accounts for somewhat more of New Zealand's trade, accounting for 25 percent of exports and 27 percent of imports, and East Asia as a whole (Northeast Asia plus Southeast Asia) accounts for 33 percent of exports and 37 percent of imports. The western side of the Asia-Pacific (East Asia plus Australia) accounts for well over half of New Zealand trade: 53 percent of exports and 59 percent of imports. North America also retains an important share of New Zealand trade, accounting for 17 percent of exports and 12 percent of imports, with the USA alone accounting for 14 percent of exports and 10 percent of imports. Pacific Latin America's share of New Zealand trade is relatively minor.¹

¹ Among other regions that may be of interest for comparative purposes: South Asia (India, Pakistan, Bangladesh, Sri Lanka, Nepal, Maldives and Bhutan) accounted for 1.53 percent of New Zealand exports and 0.86 percent of imports, while non-Pacific Latin America (Brazil, Argentina, Uruguay, Paraguay, Venezuela and Bolivia) accounted for 0.62 percent of exports and 0.44 percent of imports. Middle Eastern countries accounted for 3.35 percent of exports and 4.16 percent of imports. African countries (excluding Egypt) and Caribbean countries accounted respectively for 1.38 percent and 0.76 percent of exports. Other regions that served as destinations for New Zealand exports included non-EU Europe (0.42 percent), Indian Ocean states (0.16 percent) and Central Asia (0.14 percent).

Table 2: Share of Asia-Pacific Economies and Sub- Regions in New Zealand Trade
Year Ended June 2005

	Percent of NZ	
	Exports	Imports
Australia	20.12	22.19
Northeast Asia		
Japan	11.73	10.96
China PRC	5.30	10.26
Korea	3.68	2.84
Taiwan	2.33	2.37
Hong Kong SAR	1.77	0.55
Total Northeast Asia	24.81	26.98
Southeast Asia (ASEAN)		
Philippines	1.85	0.32
Malaysia	1.64	2.10
Indonesia	1.52	1.59
Singapore	1.32	3.09
Thailand	1.18	2.23
Viet Nam	0.48	0.30
Brunei Darussalam	0.01	0.45
<i>Subtotal: ASEAN APEC members</i>	8.00	10.08
Myanmar	0.01	0.00
Laos	0.00	0.00
Cambodia	0.00	0.00
Total ASEAN	8.01	10.08
North America		
USA	14.24	10.17
Canada	1.78	1.25
Mexico	1.35	0.34
Total North America	17.37	11.76
Pacific Latin America		
Chile	0.14	0.12
Peru	0.09	0.04
Central America	0.29	0.02
Colombia and Ecuador	0.02	0.12
Total: Pacific Latin America	0.54	0.30

Source: Statistics NZ: NZ External Trade Statistics

Tables 3 and 4 provide a longer-term perspective. Table 3 shows that a major increase occurred between 1981 and 2001 in the share of New Zealand exports directed towards Australia, East Asia and North America, as the share of exports directed toward the United Kingdom and other European markets correspondingly declined, as did the share directed toward the Middle East.

Table 3: Shares of Major Regions in New Zealand's Exports, 1981 and 2001, and increases in exports 1981-2001

Source: http://www.treasury.govt.nz/working_papers/2004/twp04-18.pdf, p.2

	Share of NZ Exports		% increase in exports 1981-2001
	1981	2001	
Australia	14.3%	18.9%	361
East Asia and Pacific	28.6%	35.4%	237
North America	14.2%	16.8%	222
South America	2.3%	4.7%	462
United Kingdom	12.4%	4.8%	5
Europe and Central Asia	14.0%	10.2%	98
Mid-East and North Africa	7.4%	3.1%	16
South Asia	1.3%	1.3%	156
Sub-Saharan Africa	0.6%	0.6%	181
Unspecified	5.1%	4.2%	128
TOTAL	100.0%	100.0%	172

From Table 4 on the other hand, it is evident that the share of exports directed to the APEC economies had reached something of a plateau by the mid-1990s. From 1997 to 2005 APEC's share of New Zealand's exports was relatively stable in the range between 70 percent and 73 percent, peaking at just under 73 percent in 2001. ASEAN's share of New Zealand's exports was similarly stable. There appears to be a declining trend in the share of exports going to Northeast Asia, which stood at 28.4 percent in 1997 but declined steadily after 2001 to reach 24.8 percent in 2005. This was matched by a rising trend in North America's share of New Zealand exports from 1997 through to 2002, although the share declined somewhat after 2002.

Table 4 shows that the share of New Zealand exports directed to the EU is also relatively static and no other region accounted for more than 4 percent of New Zealand exports during the years covered by the table. It is clear that there is no possibility that APEC's position as the region providing the dominant focus for New Zealand exports could be challenged in the near future.

Table 4 also provides additional context by expressing total New Zealand exports as a percentage of GDP. This percentage rose through to 2001 and then fell away again. The rise and fall appears to be clearly correlated with movements in New Zealand's trade-weighted exchange rate index. This is also shown in Table 4. An inspection of the trends in these two indicators appears to support the inference that once the influence of the exchange rate is removed exports as a percentage of GDP rose only very modestly over the period shown.

Table 4: Shares in New Zealand Exports of APEC, APEC Subregions and Other regions, 1997-2005
 Source: <http://www.stats.govt.nz/NR/rdonlyres/B9A7BAFB-1458-4020-9088-FF3C85721D7/0/Section1.xls>. Table 1.01

	1997	1998	1999	2000	2001	2002	2003	2004	2005(P)
APEC	71.6%	70.4%	70.3%	73.3%	72.9%	72.4%	72.3%	71.3%	71.3%
Northeast Asia	28.4%	26.0%	25.0%	26.8%	27.0%	25.7%	25.4%	25.0%	24.8%
Southeast Asia	8.7%	7.7%	7.3%	8.0%	9.1%	8.6%	7.9%	7.6%	8.0%
East Asia	37.1%	33.6%	32.3%	34.8%	36.0%	34.2%	33.3%	32.5%	32.9%
North America	12.3%	14.0%	15.6%	16.7%	17.9%	19.2%	18.5%	17.8%	17.4%
Australia	19.6%	20.3%	20.7%	20.8%	18.1%	18.3%	19.7%	20.0%	20.1%
Central and South America	2.5%	2.6%	2.2%	1.9%	2.1%	1.8%	1.2%	1.3%	1.2%
Caribbean	0.6%	0.6%	0.7%	0.5%	0.8%	0.9%	0.8%	0.6%	0.8%
Pacific	2.8%	3.0%	3.0%	2.9%	2.5%	2.7%	3.0%	3.0%	3.2%
Middle East	3.7%	3.2%	3.5%	3.1%	3.6%	3.5%	3.3%	3.6%	3.9%
South Asia	1.5%	1.6%	1.8%	1.6%	1.4%	1.4%	1.4%	1.4%	1.6%
EU-25	16.5%	17.3%	17.6%	15.6%	15.6%	15.9%	16.5%	17.0%	16.1%
Other Europe and CEEC and N	1.8%	1.6%	1.0%	0.6%	0.5%	0.5%	0.7%	0.8%	0.9%
Africa	0.6%	0.7%	0.6%	0.5%	0.5%	0.7%	0.7%	1.0%	1.0%
Other	1.0%	1.3%	0.9%	1.1%	0.9%	0.9%	0.9%	0.9%	1.0%
Exports as % of GDP	21.0%	22.1%	21.5%	23.5%	28.5%	27.3%	23.9%	23.3%	23.2%
Exchange Rate: TWI (Base - June 1979 = 100)	66.3	58.2	56.9	51.4	50.0	54.1	62.0	66.4	70.4

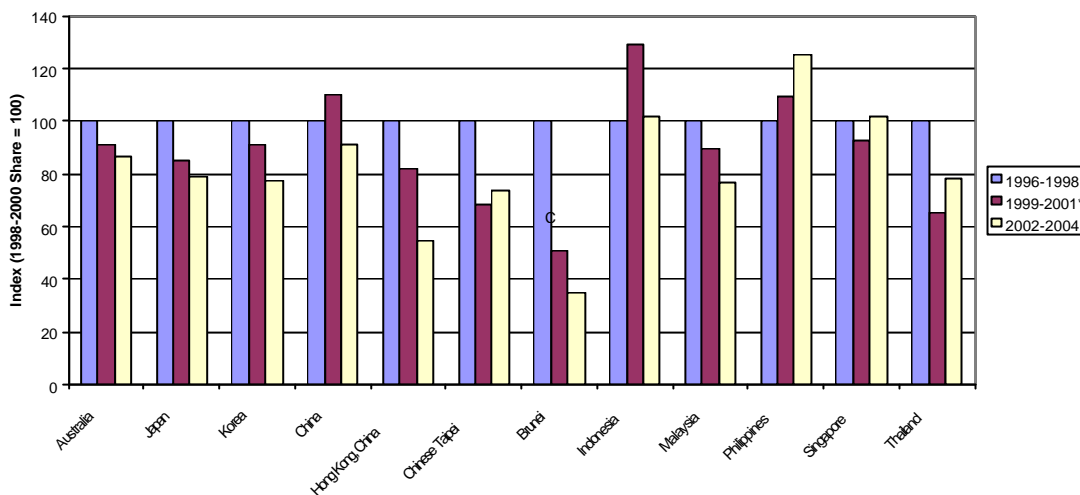
Figures 1 and 2 provide a different perspective, by showing trends in New Zealand's share of the imports of other APEC economies. The evidence for East Asia and Australia is somewhat disconcerting. New Zealand's share of the partner's import market appears to have declined significantly in several important markets, including Australia, Japan, Korea, China, Hong Kong, Taiwan, Brunei, Malaysia and Thailand, and also Chile and Peru in South America. In all these cases except China and Thailand the decline was continuous across the three periods covered.

In the major markets of Australia, Japan, Korea and China New Zealand's share of the import market in 2002-4 was below its share in 1996-8 respectively by 13 percent, 21 percent, 23 percent and 9 percent. These changes relate to periods before the new PTAs in the Asia-Pacific region could have had any significant effect on trade flows, with the possible exception of Singapore's FTAs with New Zealand and Japan. Figure 2 shows that by contrast with its performance in East Asian markets New Zealand has maintained and even improved its share of the import markets in the North

American markets, albeit with a slight dip during the high exchange rate period of 1999-2001.

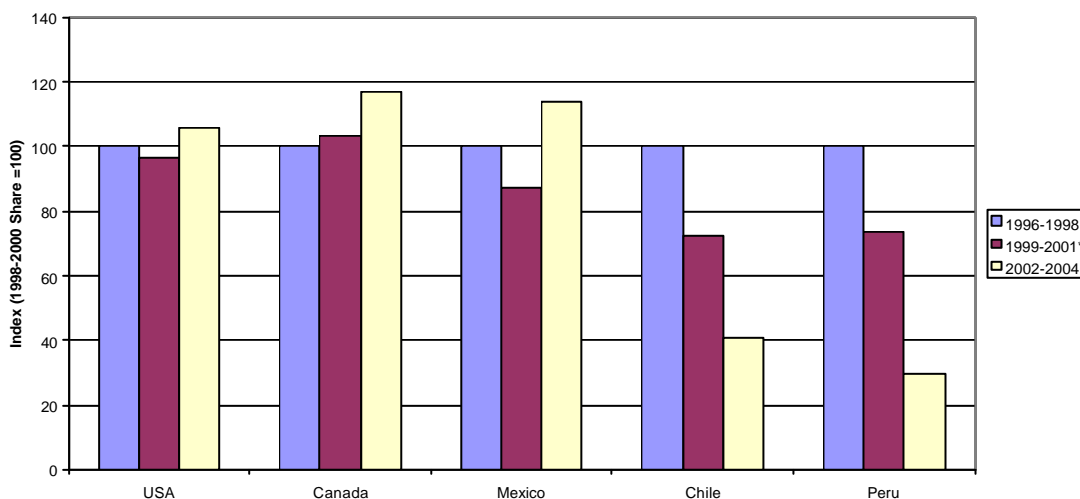
**Figure 1: New Zealand Share of Imports of Western Pacific APEC Members
Successive Three Year Periods (1998-2000, 1999-2001*, 2002-2004)**
1998-2000 = 100

(Source: IMF Direction of Trade Statistics)
* 1998-2000 for Chinese Taipei



**Figure 2: New Zealand Share of Imports of APEC Members in the Americas
Successive Three Year Periods (1998-2000, 1999-2001, 2002-2004)**
1998-2000 = 100

(Source: IMF Direction of Trade Statistics)



It is clear that New Zealand has not shared fully in the dynamic expansion of the trade of East Asian economies. For present purposes the figures show

that any impact on New Zealand of new FTAs in the Asia-Pacific region will not occur against a background of strong New Zealand export performance in Australia and East Asian markets. Rather, assessment of the impacts of the new FTAs will indicate whether they can be expected to accelerate or help to arrest the decline in New Zealand's penetration of these markets.

3. Preferential Trade in the Asia-Pacific Region: What Has Been Happening?

Background: Global Trends

Since the early 1990s there has been a dramatic acceleration in the number of PTAs being introduced to the world economy and a corresponding increase in the proportion of the world's bilateral trade flows that are subject to preferential trade agreements.²

Information provided recently by the WTO Secretariat indicates that globally there are some 255 PTAs currently in force or about to enter into force following ratification, and this number could rise to 325 if all PTAs currently under negotiation or discussion proceed to the stage of operational agreements. The majority of these agreements are notified to the WTO as FTAs, although some are notified as customs unions (CUs)³.

² This is not the same thing as the proportion of world trade that is occurring under preferential arrangements, which is a very difficult number to ascertain. Not only do most FTAs exclude trade in some products from their coverage, but there is also an undetermined proportion of trade taking place at non-preferential duty rates even though preferential rates are available.

³ Terminology used to describe these agreements can be confusing. Sometimes a distinction is made between bilateral trade agreements (BTAs), involving pairs of countries, and regional trade agreements (RTAs) involving groups of countries located in the same geographic region, although it is also possible to have plurilateral agreements among several countries that do not belong to the same geographic region. In the WTO the term RTA is used regardless of whether the agreement is bilateral or plurilateral. Some writers also recognise Sub-Regional Trade Agreements (SRTAs).

From an economic perspective, the common characteristic of all these agreements is that they involve the granting of preferential treatment by their members to each other and consequently discriminate against non-members, so that the generic term preferential trade agreement (PTA) can justifiably be used to cover all such agreements. Free trade agreements (FTAs) and customs unions (CUs) are the two types of PTA explicitly sanctioned by the WTO rules contained in the General Agreement on Tariffs and Trade (GATT) Article XXIV.

In both cases the members eliminate tariffs on trade with each other. In a customs union they also harmonise their tariffs on imports from non-members by establishing a Common External Tariff (CET), whereas in an FTA each member maintains separate tariffs on imports from non-members. Some authors understandably object to the use of the term "free trade" in describing such agreements, because of the discrimination that is inherent in such agreements. In this report the term PTA will be used when the discussion is about preferential agreements in general, while the term FTA will be used when the discussion refers specifically to free trade agreements. Even this usage is not free from possible confusion, because the term Preferential Trade Agreement (PTA) is sometimes also used elsewhere to describe

PTAs in the Asia-Pacific Region: The Early and Mid 1990s

In the Asia-Pacific region two new FTAs were launched in the early 1990s. NAFTA between the US, Canada and Mexico entered into force in 1994, in the process incorporating the Canada-US FTA (CUSFTA) that had been concluded five years earlier. US-Canada trade constitutes the world's largest bilateral trade flow and the US-Mexico trade flow is also very large. An unsuccessful effort was made in the mid-1990s to bring Chile into NAFTA, although Canada and Mexico subsequently concluded bilateral FTAs with Chile. The US eventually concluded a bilateral FTA with Chile in 2004.

The early 1990s also saw the launch by ASEAN (Association of Southeast Asian Nations) of the ASEAN Free Trade Agreement (AFTA) between the then six members of ASEAN (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand), which entered into force in 1992. The so-called "CLMV" countries (Cambodia, Laos, Myanmar and Viet Nam) progressively acceded to AFTA following their admission to ASEAN. Implementation of AFTA has been spread over many years and is still ongoing.

Thus by the mid-1990s three of the Asia-Pacific sub-regions had established their own FTAs: the CER agreement earlier launched in Australasia in 1983, NAFTA in North America and AFTA in Southeast Asia. Northeast Asia by contrast was an "empty box" in the regional and global maps of FTAs: Japan and Korea remained opposed to participation in PTAs and China was preoccupied with its own internal economic reforms and its application for WTO membership. A Malaysian proposal for an East Asia-wide economic bloc, the East Asian Economic Grouping (EAEG) failed at that time principally for lack of support from Northeast Asia. Nor was any serious effort being made to develop proposals for FTAs linking the other three main Asia-Pacific sub-regions.

The impetus for building on the already intense region-wide trade and investment linkages was being channelled into the APEC (Asia Pacific Economic Cooperation) enterprise, involving a commitment to move towards free and open trade and investment in the Asia-Pacific region on a non-preferential basis. This architecture – three sub-regional FTAs complementing a region-wide effort to progressively establish free trade and investment on a non-preferential basis – initially appeared relatively stable. The relative lack of interest in new PTAs in the Asia-Pacific region was in contrast to the situation elsewhere in the world, where PTAs were already proliferating rapidly.

agreements in which tariffs on trade between the members are reduced but not eliminated. WTO rules do not allow developed countries to engage in such arrangements, but a special provision known as the "Enabling Clause of 1979" allows such agreements between developing countries. This latter meaning of PTA is not used in this report.

The Rush to Preferential Liberalisation in the Asia-Pacific Region

Since 1998 there has been a dramatic explosion of interest and activity in preferential trading arrangements in the region. A key first step was the announcement in that year by Japan and Korea that they would begin working toward negotiation of a bilateral FTA. At the time this sent shock waves around the region, although the Japan-Korea FTA has yet to materialise in practice.

The new willingness of Northeast Asian economies to become involved in preferential trade, marking a decisive shift in their previous stance, has been a key factor in the subsequent spread of PTAs in the region. A second important trend began with the announcement by New Zealand and Singapore in late 1999 of agreement in principle on a bilateral FTA. This was the first of what has since become an avalanche of initiatives to establish bilateral PTAs between economies in the different Asia-Pacific sub-regions.

Table 5 indicates that in the early years of the 21st century at least 18 PTAs between APEC members have been concluded, with at least a further 20 under negotiation. All but two of the concluded agreements are bilateral in character. A number of others are at various stages of study or discussion, and in some of these cases the opening of negotiations is believed to be imminent. Adding in the five agreements that were already in existence before 1999, a realistic assessment of current initiatives suggests therefore that there could be over 40 PTAs operating in the APEC region in the near future, possibly more. This is in addition to the PTAs that APEC members have been pursuing and concluding with partners outside the APEC region.

Table 5: Preferential Trading Agreements between APEC Economies
(Listed by participant members rather than official name of the agreement)

(a) Initiatives Active Since 1999

Agreements Concluded	Agreements Under Negotiation ⁴
<i>Bilateral</i>	
<u>Singapore-New Zealand</u>	<u>Japan-Korea</u>
<u>Singapore-Australia</u>	<u>Japan-Thailand (substantially agreed)</u>
<u>Singapore-Japan</u>	<u>Japan-Philippines (substantially agreed)</u>
<u>Singapore-USA</u>	<u>Japan-Indonesia</u>
<u>Singapore-Korea</u>	<u>Korea-Thailand</u>
<u>Chile-USA</u>	<u>USA-Thailand</u>
<u>Chile-Korea</u>	<u>Australia-China</u>
<u>Chile-China</u>	<u>Australia-Malaysia</u>
<u>Mexico-Japan</u>	<u>New Zealand-China</u>
<u>US-Australia</u>	<u>New Zealand-Malaysia</u>
<u>Peru-USA</u>	<u>Peru-Thailand</u>
<u>Thailand-Australia</u>	<u>Singapore-Canada</u>
<u>Thailand-New Zealand</u>	<u>Korea-Mexico</u>
<u>China-Hong Kong SAR</u>	<u>US-Malaysia</u>
<u>Japan-Malaysia</u>	<u>US-Korea</u>
<u>Thailand-China⁵</u>	<u>Chile-Thailand</u>
	<u>Korea-Canada</u>
<i>Plurilateral</i>	

⁴ Agreements under study or discussion are not listed here, even if negotiations are believed to be imminent. Proposed agreements for which the negotiations appear to have been suspended without any apparent intention for them to be resumed are also not listed. The proposed New Zealand-Hong Kong and Singapore-Mexico agreements are in this category. On the other hand, the Japan-Korea proposal is listed because while negotiations are suspended they may not have broken down permanently. Likewise there is uncertainty as to whether the Free Trade Area of the Americas (FTAA) negotiations may be revived in the future. The FTAA is bracketed because of course most of the participants are not APEC members. The FTAA would cover the following trade flows between APEC members that are not currently covered by FTAs: Canada-Perú, Mexico-Perú, Chile-Perú (although the latter two are already covered by more limited preferential arrangements).

⁵ There is some doubt whether the Thailand-China FTA should be included in this list. Details are scarce and it is sometimes presented as an "early harvest" agreement, linked to the main ASEAN-China agreement.

<u>ASEAN-China</u>	<u>AANZFTA</u>
Chile-New Zealand-Singapore -Brunei (TPSEP) ⁶	<u>ASEAN-Japan</u>
	<u>ASEAN-Korea</u>
	<u>(FTAA)</u>

(b) Agreements In Existence Before 1999

NAFTA (USA, Canada, Mexico)
 CER (Australia, New Zealand)
 AFTA (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Viet Nam)
 Chile-Canada
 Chile-Mexico

Sources: APEC Secretariat, *Member Economies/ FTA/RTA Information* (www.apec.org/webapps/fta_rta_information.html)
 Okamoto, J. (2006)

Characteristics of Recent PTAs Between Asia-Pacific Economies

The recent PTAs between Asia-Pacific economies, like many modern PTAs, are much more than conventional free trade agreements. In addition to liberalisation of trade between the partners in goods and usually also services, they generally contain provisions on a range of other “trade-related”⁷ matters. These typically include investment, standards and conformance, customs procedures, intellectual property, government procurement, competition policy, and sometimes electronic commerce.

There are exceptions to this comprehensiveness of treatment. The ASEAN-China agreement for example focuses initially on trade in goods, with agreement on services, investment and dispute settlement planned to follow later. The Chile-China agreement covers only trade in goods at this stage. In some agreements, certain areas may not be covered because of failure to agree between the parties. There is no chapter on investment for example in the Trans-Pacific Strategic Economic Partnership or “P4” agreement between Chile, New Zealand, Singapore and Brunei Darussalam and there are no services trade provisions in the Thailand-New Zealand agreement.

There are also wide differences between the extent to which the provisions on “trade-related” matters contain “hard obligations”, imposing obligations on the partners to undertake specific actions or to refrain from specific

⁶ The TPSEP (Trans Pacific Strategic Economic Partnership) is sometimes known informally as the ‘P4’ (‘Pacific 4’) Agreement.

⁷ This term is used here purely for convenience, to distinguish provisions in this area from measures liberalising trade in goods and services.

actions, rather than being limited to “soft” obligations expressed in terms of agreement to “cooperate”, “consult”, “exchange information”, or to abide by agreed “principles” essentially on a “best endeavours” basis.⁸

Provisions on intellectual property range from reaffirmation of WTO TRIPs⁹ commitments, for example in the New Zealand-Singapore agreement, to the substantive “TRIPs-plus” obligations found in the US agreements with Chile, Singapore and Australia. Competition policy provisions range from general commitments such as addressing anti-competitive practices and promoting competition, as in the Australian and New Zealand agreements with Thailand, to introducing and implementing a competition law imposed on Singapore in the Singapore-US agreement.

Government procurement provisions impose substantive obligations in the Australian and New Zealand agreements with Singapore but not in their agreements with Thailand. Regarding investment, there are wide differences in the degree to which agreements oblige parties to modify their existing investment policies and in the approach taken to key issues such as investor-state disputes. Trade in services provisions of these agreements still await a detailed analysis.¹⁰

On trade in goods, virtually all agreements provide for eventual elimination of tariffs and other barriers on the majority of goods and on a high proportion of trade, although they nevertheless vary in the percentage of goods and services on which barriers are eliminated, the period over which the elimination takes place and the use of supplementary measures such as safeguards and tariff rate quotas.¹¹

⁸ The agreements often specifically state that these “soft” provisions are not subject to dispute settlement.

⁹ The TRIPs (Trade-Related Intellectual Property) agreement is the WTO agreement containing multilateral rules on intellectual property protection.

¹⁰ A pilot study by Stephenson (2005), covering the treatment of just three service sectors (telecommunications, distribution and construction/engineering), found that PTAs among APEC members contain significantly more extensive liberalisation commitments than the commitments of the same members in either the WTO’s GATS (General Agreement on Trade in Services) or their APEC IAPs (Individual Action Plans). Stephenson’s study is available at www.pecc.org. CER, the New Zealand-Singapore FTA and the TPSEP are among the FTAs covered in the study. Further research would be needed to extend the analysis to other services sectors and to assess both the precise degree of liberalisation involved in the FTA commitments, and the degree to which such liberalisation is preferential.

¹¹ There are also varying approaches to anti-dumping. In the Australia New Zealand Closer Economic Relations Trade Agreement (CER) and the Canada-Chile FTA anti-dumping actions between the parties are not allowed, while in the Singapore-New Zealand FTA there is some relaxation of certain WTO provisions. Generally, however, the agreements do not deal with anti-dumping.

At one end of the scale the Australian and New Zealand agreements with Singapore provide for immediate duty free treatment of all goods,¹² while at the other end of the scale, in their agreements with Thailand elimination of tariffs by Australia and New Zealand occurs over 10 years and by Thailand over 20 years, with significant use by Thailand of special safeguards and tariff rate quotas¹³ over that 20 year period. In the Australia-US agreement, elimination of duties by the US occurs over 18 years, again with substantial availability during this period of special safeguards, tariff rate quotas and bilateral emergency actions,¹⁴ which for some products remain available even after duties have been eliminated.

Rules of origin¹⁵ in these agreements are often complex, and there is anecdotal evidence that at least in some cases they may offset the liberalising effects of the tariff provisions to a considerable extent. One indication of this may be the proportion of trade that continues to occur under Most Favoured Nation (MFN)¹⁶ tariffs even when preferential duty rates are available - which anecdotal evidence again suggests may be significant in some cases. Comprehensive data that would allow an overall assessment of the impact of rules of origin is, however, lacking.

¹² Almost all imports into Singapore were of course already duty-free but the agreement required Australia and New Zealand to remove duties immediately on 54 percent and 47 percent of tariff items respectively (Casasnovas 2005).

¹³ Tariff rate quotas (TRQs) limit the volume of imports of specified products to which preferential treatment provided in the agreement is applicable. Special safeguards (SSGs) allow tariffs on specified products to be raised above the level provided under the agreement in certain circumstances, for example if imports exceed some specified level or if the price of imports falls below some specified level.

¹⁴ Bilateral Emergency Actions (BEAs) are typically applied to textile and clothing products and are similar in their effects to special safeguards.

¹⁵ Rules of origin set out the criteria for products that are eligible for preferential treatment under a PTA. They are important for manufactured goods that may incorporate a significant proportion of materials imported from outside the FTA. Typically they require a specified level of regional value content or RVC (proportion of the value of the finished product attributable to the manufacturing process within the FTA member), or a specified change in tariff classification (CTC) between the import of the materials and the export of the finished product. Sometimes they require that a specified part of the manufacturing process be performed within the FTA member. Rules of origin can be permissive and flexible, designed to facilitate trade, or they can be restrictive, designed to make it difficult for exporters from one partner to gain duty-free access to the market of the other partner, in effect partly negating the effect of the tariff provisions of the FTA. Today it is widely understood that rules of origin can be as important as, or even more important than the tariff provisions of an FTA in determining the extent to which new trade is generated by the FTA.

¹⁶ Most Favoured Nation (MFN) is the term used to describe the tariffs that WTO members undertake to apply to imports from each other. Under the WTO principle of non-discrimination the tariff applied to imports from any one WTO member must be as favourable as that applied to any other member, hence the term "most favoured nation". PTAs are an exception to the non-discrimination principle, legitimised by GATT Article XXIV.

In summary, while acknowledging the diversity of the provisions in PTAs between APEC economies, it is nevertheless possible to conclude, first that they do formally provide for eventual duty-free trade in goods between the partners in a substantial proportion of products, although the effectiveness of these provisions may be offset to an unknown degree by restrictive rules of origin.

Second, their "trade-related" provisions can be viewed as "WTO-Plus" both in the sense that in some cases they extend beyond WTO commitments (as in the case of intellectual property in some agreements) and in the sense that they cover subjects that are currently not included in WTO agreements (such as competition policy), are covered in WTO agreements to which not all APEC members are party (such as government procurement), or are covered only partially and piecemeal in WTO agreements (such as investment).

"East Asian Regionalism"

The accelerating proliferation of bilateral FTAs in the Asia-Pacific region proceeded in parallel with an upsurge of interest in East Asian regionalism. This was sparked initially by East Asian responses to the experience of the economic crisis of 1997/98. A strong sense developed of a need to create an institutional capability and economic identity within East Asia, that would allow it to deal with future events like the financial crisis from within its own resources, and to compete on equal economic terms with the blocs already seen to have formed in Europe and North America.

Initially this new spirit of East Asian regionalism focused, naturally enough in the wake of the crisis, on monetary issues. Attention quickly turned, however, to the possibility of establishing a free trade bloc in East Asia.

Attention first focused on the "ASEAN Plus Three" (the ten members of ASEAN plus China, Japan and Korea) grouping formed immediately after the East Asian crisis. An East Asian Vision Group established in 1999 by the "ASEAN Plus Three" leaders included in its 2001 report to the leaders a recommendation that an East Asian Free Trade Area (EAFTA) be established as one of the steps toward realisation of an "East Asian Community". The proposal was then further assessed by an East Asian Study Group, which reaffirmed the recommendation of EAFTA as a medium to long-term objective. A further study of the EAFTA proposal was commissioned by leaders in 2005.

In the meantime the Northeast Asian economies began to pursue their own separate trade and economic agendas with ASEAN, leading to a new trend toward "ASEAN Plus One" trade initiatives. In late 2000 China proposed its own FTA with ASEAN and a year later China and ASEAN agreed to enter negotiations. China encouraged the participation of the full ASEAN group by offering an "early harvest" whereby tariffs on goods of interest to ASEAN's new members would be reduced early. The provisions of the agreement on

trade in goods were finalised in late 2004 and negotiations have subsequently been focused on services, investment and dispute settlement provisions.

Only two months after China's initial proposal, Japan proposed a Japan-ASEAN Comprehensive Economic Partnership, although leaving open whether the partnership would include an FTA. Korea was slower to react but has since initiated and apparently concluded its own FTA with ASEAN. ASEAN has also followed the "ASEAN Plus" model in launching negotiations for an ASEAN-CER FTA (the Australia-New Zealand ASEAN FTA, or AANZFTA) and an ASEAN-India FTA.

ASEAN welcomed the "ASEAN Plus" initiatives because of the apparent opportunity they offered to place itself at the centre of evolving trade and economic arrangements in East Asia. ASEAN's ability to take full advantage of this opportunity has, however, been compromised by the willingness of some ASEAN members to negotiate and conclude bilateral agreements with the intended partners of the "ASEAN Plus" arrangements and by the readiness of some of the partners to move ahead with such bilateral arrangements.

Japan in particular has negotiated bilaterally with Singapore, Thailand, Malaysia and the Philippines, has commenced negotiations with Indonesia, and has been exploring the possibility of an FTA with Viet Nam, but has only recently decided to open negotiations for an FTA with ASEAN as a group. In addition to Japan, Singapore has concluded FTAs with New Zealand, Australia and Korea, and has been in negotiations with India. Thailand negotiated a limited bilateral agreement with China in advance of the ASEAN-China FTA, and has also concluded bilateral deals with Australia and New Zealand, is at an advanced stage in negotiations with Japan and has also entered bilateral negotiations with Korea and India.

The question of whether and how bilateral and ASEAN-wide agreements with the same partner are expected to co-exist is an obvious one to ask, but no clear answer has yet been given.

The East Asian Vision and Study Groups mentioned above had also recommended that the ASEAN Plus Three summit process should be allowed to evolve into an East Asian Summit (EAS). An East Asian Summit was seen as a way to signal the evolution of the process from one that existed essentially on the margins of the ASEAN process to one that would become the central process for development of an East Asian Community. The first East Asian Summit was held in Kuala Lumpur in December 2005. After much discussion and some negotiations, Australia, New Zealand and India were invited to attend, along with the original ASEAN Plus Three members, forming a group which was dubbed by some as ASEAN Plus Three Plus Two Plus One.

The ASEAN Plus Three Summits have not been discontinued and it remains to be seen what relative influence the two processes will have on the evolution of trade arrangements in East Asia. A proposal by the Indian Prime Minister for an FTA based on the ASEAN Plus Three Plus Two Plus One group has not so far been taken up by East Asian leaders, while in the meantime a further study on EAFTA has been commissioned by the ASEAN Plus Three leaders, as noted earlier. More recently Japan has also proposed an FTA based on the ASEAN Plus Three Plus Two Plus One group, although this was widely seen as motivated by a desire to find counterweights to the growing influence of China in the region and some scepticism has been voiced as to whether Japan really wants such an FTA to materialise.

The position of the US in relation to an integrating East Asian region is a vitally important unresolved issue. The US remains the major export market for East Asian production networks, an important source of foreign direct investment in the region and a key player in the security architecture of the region. East Asian policymakers are acutely aware of the need for a policy accommodation with the US if EAFTA were to proceed, but there is no consensus on what kind of accommodation might be sought or achieved.

US policymakers have begun to show clear signs of concern at increasing Chinese influence in the region and this is reflected in moves to strengthen relations with some of the larger countries on China's perimeter, including India and Indonesia. To date the US has not felt impelled to react to the proposals for EAFTA, seemingly because it considers EAFTA unlikely to be realised in the foreseeable future. If establishment of EAFTA began to appear more imminent it is likely that the US would react and its reaction would be an important factor in the situation as it evolved, although it is not clear at this point what form that reaction would take.

While the future configuration of East Asian trade arrangements continues to be discussed and debated, East Asian economies have also been moving to establish preferential linkages with other regions and sub-regions. Several initiatives link East Asian and Australasian economies. Most of these involve links between Southeast Asia and Australasia (Singapore's and Thailand's FTAs with Australia and New Zealand, Malaysia's FTA negotiations with the same two partners, and the AANZFTA negotiations). The opening by China of negotiations with both Australia and New Zealand offers the prospect of the first preferential trade link between Australasia and Northeast Asia. There have been recent discussions and a study commissioned on possible new trade arrangements between Australia and Japan. Earlier negotiations between New Zealand and Hong Kong SAR appear to have been suspended indefinitely.

Individual East Asian economies have also been pursuing bilateral trans-Pacific FTAs. Singapore took the lead by concluding an FTA with the US and this lead has been followed within ASEAN by both Thailand and Malaysia, the former having been in negotiations with the US for some time while Malaysia

has just agreed to open negotiations with the US. The US responded to the ASEAN-China and ASEAN-Japan initiatives with its own Enterprise for ASEAN Initiative, although there has so far been no formal proposal for an ASEAN-US FTA.

In early 2006 the US and Korea agreed to open negotiations for a bilateral FTA. Japan and Korea have concluded bilateral agreements with Mexico and Chile respectively and China has also just concluded an FTA on goods trade only with Chile. Korea has been pursuing an FTA with Mexico, but so far Mexico has apparently agreed to negotiate only a more limited preferential trade agreement with Korea. Thailand and more recently also Chile have been engaged in FTA negotiations with Peru.

The FTA negotiations with India by ASEAN as well as by some individual ASEAN members have been the most prominent manifestation of East Asia's growing interest in trade links with South Asia, but there are others. ASEAN has been in discussion with Pakistan about possible FTA negotiations and China and Pakistan have also held talks and may have begun FTA negotiations. An existing PTA, the Asia Pacific Trade Agreement (APTA, formerly called the "Bangkok Agreement") includes as members China, India, Korea, Bangladesh, Sri Lanka and Laos. To date APTA has been a somewhat limited positive list agreement providing for tariff reductions rather than tariff elimination, but there are discussions on turning it into a more comprehensive agreement. The members of BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka, Thailand, Nepal and Bhutan) are also reported to be close to agreement on establishing a BIMSTEC FTA.

The Asia-Europe (ASEM) process established some years ago has not yet produced any formal trade linkages between the EU and East Asia. Singapore and Korea have however concluded FTAs with the EFTA (European Free Trade Agreement) countries (Switzerland, Norway, Iceland and Lichtenstein). Singapore also proposed an FTA with the EU, but the EU indicated a preference to deal with ASEAN as a group. There have been indications that ASEAN may be ready to pursue this.

New Zealand and Australia in the Developing FTA Architecture of the Asia-Pacific Region

New Zealand and Australia have tended to "shadow" each other's FTA initiatives. This reflects the similarity of their economic interests, the close integration of their economies through CER and the fact that they are among each other's main competitors in some important export product markets.

The "shadowing" phenomenon is most obvious in East Asia, where both countries have concluded separate FTAs with Singapore and Thailand, both are separately negotiating FTAs with China and Malaysia, and the two countries are jointly negotiating an FTA with ASEAN. For both countries Japan and Korea, as well as Taiwan and Hong Kong are the obvious gaps in their

East Asian FTA “portfolios”. Australia has moved further than New Zealand with Japan, which has agreed to a study on future Australia-Japan trade arrangements, although it is not clear that this will lead to formal FTA negotiations.

New Zealand conducted a joint study with Korea some years ago, but no formal proposal for an FTA negotiation materialised from this. As noted above New Zealand was in negotiations some years ago for an FTA with Hong Kong and there were also discussions at one time about a possible FTA with Taiwan, but there has been no recent activity on either of these possibilities.

Agricultural trade issues are clearly a major obstacle to FTAs with Japan and Korea. It is understood that Korea has agreed to include agriculture in its FTA negotiations with the US, and it remains to be seen whether this may lead indirectly to any softening of its attitude to FTAs with New Zealand and Australia.

The most obvious divergence between Australian and New Zealand FTA developments has been Australia’s success in concluding an FTA with the US, and New Zealand’s inability to persuade the US to negotiate a matching US-New Zealand FTA. New Zealand has been interested for some time in a possible FTA with Mexico. Australia, which earlier showed little interest in an FTA with Mexico, has apparently been showing more interest recently.

Other minor divergences between the two countries’ FTA initiatives are the conclusion by New Zealand of a “quadrilateral” FTA, the TPSEP with Chile, Singapore and Brunei Darussalam, and the opening of negotiations by Australia for an FTA with the United Arab Emirates. New Zealand has meantime indicated some interest in a possible FTA with the Gulf Cooperation Council (GCC) states (Saudi Arabia, United Arab Emirates, Bahrain, Kuwait, Qatar and Oman).

Dominos and Hubs and Spokes

A powerful “domino effect” is helping to fuel the spread of PTAs in the Asia-Pacific region. A small economy in particular, faced with success by a competitor in securing an FTA with a country that is one of its major markets, will typically consider it has little option but to seek its own FTA with the same partner, in order to protect its position in that partner’s market and to maintain its relative attractiveness as a destination for foreign direct investment aimed at exporting to that market. The larger the market, the more powerful the domino effect. It is notable that of the bilateral agreements listed in Table 3, nine out of 16 concluded agreements and nine out of 17 agreements under negotiation have either the US, Japan or China as one of the parties. Once this trend becomes established larger economies may also feel pressure to match their major competitors by continuing to add new partners to their networks of bilateral PTAs. A very noticeable feature is a lack of initiatives aimed at establishing FTAs between the major powers

themselves. Various difficulties stand in the way of such initiatives, including historical grievances (Japan-China), sensitivities over agriculture (Japan-US) and commercial and geopolitical rivalries (US-China and Japan-China).

Wider ramifications of the “domino effect” may also be observable. Pursuit by smaller economies in the region of bilateral PTAs with other like-minded small economies may be motivated in part by frustration at the pace of liberalisation in wider regional and multilateral processes, but may also be partly explainable as a defensive strategy in the face of uncertainties and possible threats of exclusion, created by the sudden increase in emphasis on the preferential approach to trade liberalisation in the region.

In addition to the minor trade gains that they offer, such arrangements may be pursued by small economies partly in the hope that they may serve as “building blocks” towards larger, more comprehensive arrangements in which the initiating economy might be included and more specifically in the hope that they may eventually serve as entry routes into arrangements in which the prospective partner may have already gained membership or may have strong prospects of gaining membership in the near future. New Zealand’s pursuit of PTAs with Singapore, Chile, and Hong Kong for example could well be partly explained in this way.

The logical outcome of the magnetism exerted by major economies of the region through the “domino” effect and related incentive effects is a series of “hub and spoke” configurations in the Asia-Pacific region, with the three major powers – the US, China and Japan – established as the “hubs”, and their smaller bilateral PTA partners in the role of “spokes”.

The US in fact is establishing itself as a “global hub”. It already has FTAs with 17 partners¹⁷, including six Asia-Pacific economies and is in negotiations with a further seven partners. Japan and China are on the way to establishing themselves as “regional hubs”. Japan has concluded FTAs with three Asia-Pacific partners and is in negotiation with four more on a bilateral basis, while China has an FTA with the ten ASEAN members as well as FTAs with Chile, Hong Kong and Macao and is also in negotiation with Australia and New Zealand (as well as holding discussions on possible FTAs with the Gulf Cooperation Council states and with India, Pakistan and South Africa).

The disadvantages faced by “spokes” in a “hub and spoke” configuration have been widely canvassed. The “hub” secures access to the markets and intermediate goods supplies of all the “spokes”, whereas the “spokes” gain

¹⁷ The US’ FTA partners are Canada and Mexico (NAFTA), Israel, Chile, Singapore, Australia, Peru, Jordan, Morocco, Bahrain, Oman, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic. It is currently in negotiations with Colombia, Ecuador, Panama, Thailand, United Arab Emirates and the South African Customs Union. The US has also announced that it is about to open negotiations with Korea and Malaysia.

access only to the “hub”, unless they establish FTAs with each other. The relative attractiveness of the “hub” as a destination for investment may increase as a result. Perhaps most significantly, the “hub” can enhance its bargaining power by playing the “spokes” against each other, so as to secure its desired terms and conditions to the maximum extent possible.

As indicated in the preceding paragraph, one obvious defence open to “spokes” against the disadvantages inherent in “spoke” status is to form FTAs with each other, and this may be another partial interpretation of bilateral FTAs among the smaller Asia-Pacific economies. The relationship of a “spoke” with the “hub” is nevertheless in practice likely to be more important to the “spoke” than its relationship with other “spokes”.

Some smaller Asia-Pacific economies have taken this approach further by following a strategy of pursuing FTAs with all their major trading partners, including the major “hubs” if possible. One commentator has called this strategy “additive regionalism”. These smaller economies could also be viewed as seeking to establish themselves as “secondary hubs”. The most successful exponents of this strategy in the Asia-Pacific region have been Singapore, Chile and Mexico. Empirical analysis suggests that this strategy can succeed as long as not too many other smaller economies follow suit, but it does so at the expense of the other smaller economies.

ASEAN’s pursuit of the various “ASEAN Plus One” agreements can also be interpreted as an attempt by ASEAN to establish itself as an “alternative hub” to the three major regional powers and thereby reverse the normal advantage in bargaining power. This effort by a group of smaller economies to establish itself as the regional “hub” is somewhat unique. Success obviously depends on the ability of ASEAN economies to arrive at and sustain common negotiating positions on all import issues.

So far ASEAN has successfully concluded FTAs with China and Korea, while the outcome of negotiations with Japan, the CER economies and India remains uncertain, and no ASEAN-wide negotiations with the US have yet commenced. Meanwhile, as already noted earlier, ASEAN solidarity continues to be undermined by the pursuit by some individual ASEAN members of bilateral FTAs with the intended partners of the “ASEAN Plus One” agreements.

Coverage of Asia-Pacific Trade by PTAs

Figure 3 depicts the share of the goods trade flows of APEC economies currently covered by PTAs already concluded, and Figure 4 depicts the share that would be covered if negotiations now in progress are successfully

concluded.¹⁸ For the majority of APEC members the percentage of goods trade flows covered by concluded agreements is between 20 percent and 43 percent.

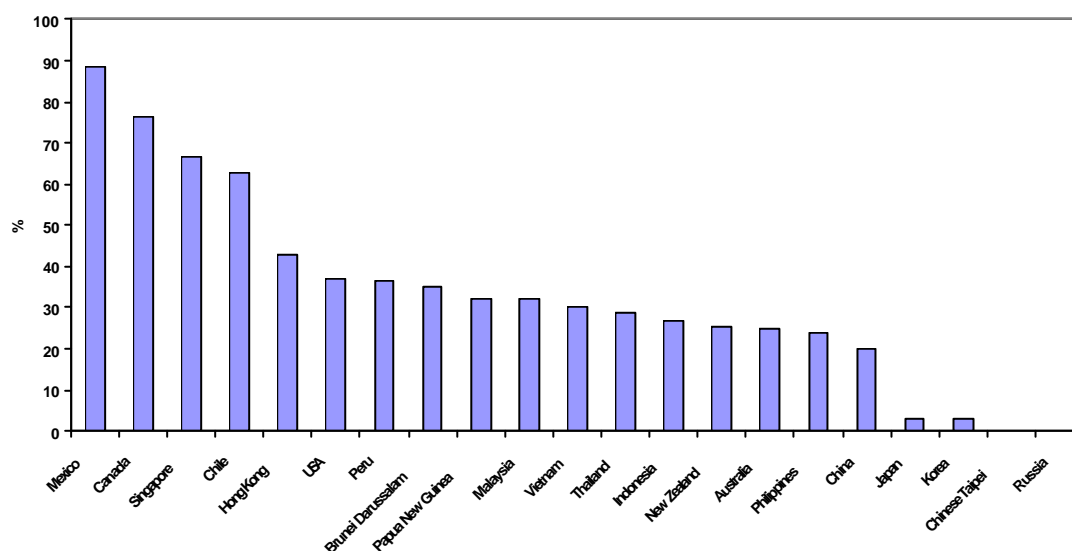
For a small group of economies, made up of Mexico, Canada, Singapore and Chile, the range of percentages is much higher, from 63 percent to 88 percent. The high percentages for Mexico and Canada are due almost entirely in Canada's case and largely in Mexico's case to the share of the trade of those countries conducted with the USA (74 percent and 76 percent respectively). Singapore and Chile, with much more diversified trade patterns, also appear well on the way to achieving the objective of concluding PTAs to cover the majority of all their significant trade flows. At the other end of the scale only very small shares of the trade of Japan and Korea are covered by PTAs concluded thus far, while Taiwan and Russia have little or no trade covered by concluded PTAs.

If all PTAs currently under negotiation are successfully completed the percentage of trade covered will rise to between 39 percent and 58 percent for the majority of APEC members. Brunei and Thailand will join Mexico, Canada, Singapore and Chile in the small group with a particularly large percentage of trade flows covered by PTAs, which will then range from 65 percent to 92 percent for this group.

Figure 3: Percentage of Trade of APEC Economies in Bilateral Flows Covered by Concluded PTAs

(2002-4 Trade Data)

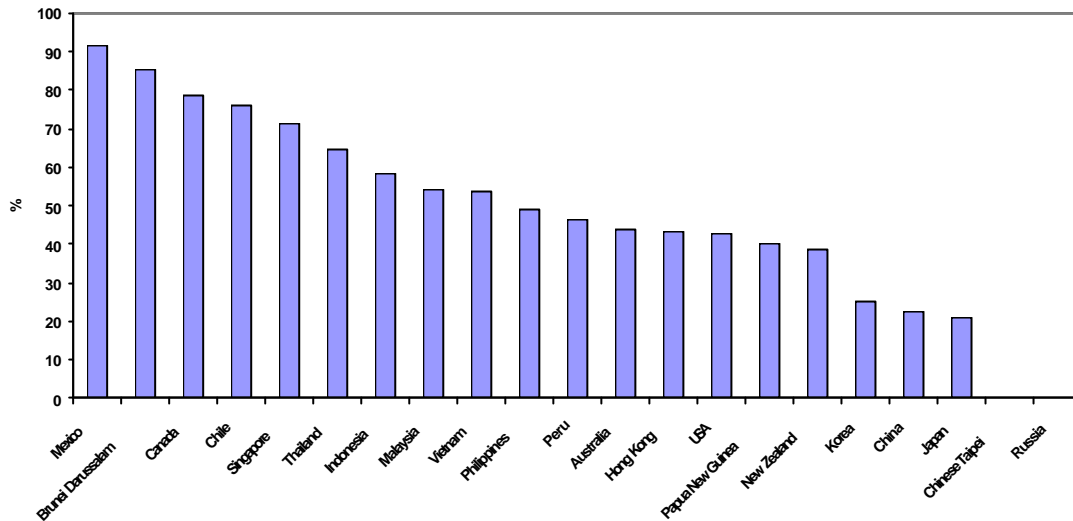
Source: IMF Direction of Trade Statistics



¹⁸ As already indicated earlier, this does not mean that all trade between PTA members is conducted under the preferences provided by the PTA.

Figure 4: Percentage of Trade of APEC Economies in Bilateral Flows Covered by Concluded PTAs and PTAs Under Negotiation

(2002-4 Trade Data)
 Source: IMF Direction of Trade Statistics



The percentages for Singapore and Chile will rise to 71 percent and 76 percent respectively. Japan and Korea will join China in a group of major Northeast Asian economies with 21-25 percent of trade covered by PTAs. The percentages for Russia and Taiwan will remain negligible.

Figure 5: Coverage by PTAs of APEC Member Exports to Other APEC Economies

(2002-4 Trade Data)
 Source: IMF Direction of Trade Statistics

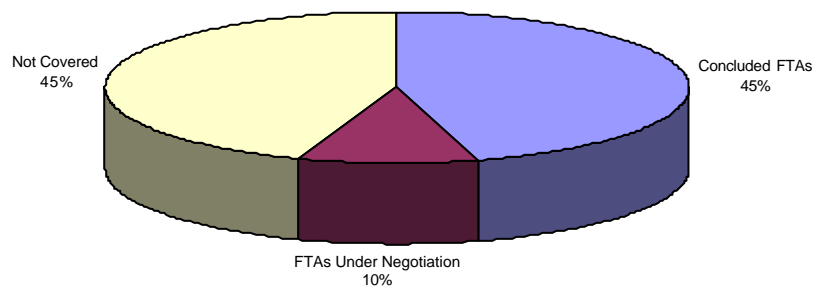
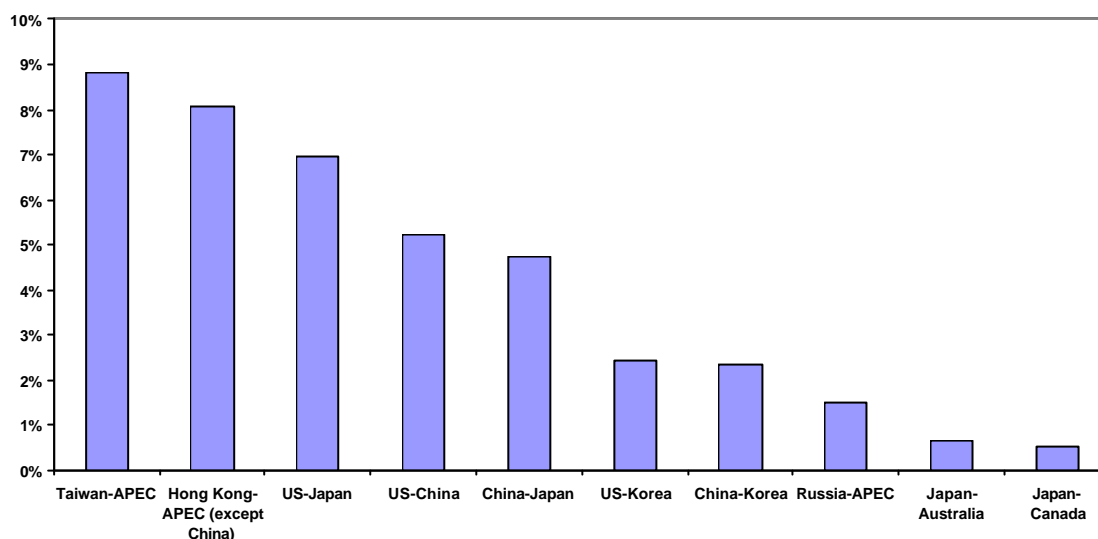


Figure 6: Share of Intra-APEC Exports in Main Bilateral Flows not Covered by Concluded PTAs or PTAs Under Negotiation

(2002-4 Trade Data)
Source: IMF Direction of Trade Statistics



Gaps in the Pattern of Asia-Pacific PTAs

Figure 5 shows that while PTAs have been spreading through the region, a large proportion of the region's trade flows remain unaffected by PTAs. PTAs already concluded cover 45 percent of intra-APEC export flows and this figure would rise to 55 percent if all PTAs currently under negotiation are successfully concluded. On the other hand, 45 percent or almost half of intra-APEC export flows remain untouched by PTAs.

Figure 6 makes clear that it is primarily the trade flows between the major "hub" economies and the flows involving Taiwan and Hong Kong that have remained outside the scope of the regional spread of PTAs. Trade flows between the US, China and Japan and all trade of Taiwan and Hong Kong except Hong Kong's trade with China and New Zealand have yet to be the subject of a serious PTA negotiation.

Korea and Japan have held negotiations but those negotiations are currently suspended. Prospects for establishment of free trade among the major Northeast Asian economies in the foreseeable future do not appear bright. It remains to be seen whether the recently announced commencement of FTA negotiations between the US and Korea will catalyse increased interest in PTAs between the major Northeast Asian and North American economies.

PTA Developments in the Americas

PTA developments in the Americas are also significant for New Zealand interests, primarily because of the presence there of several important competitors for New Zealand in its export markets. While the Americas have long been known for its "kaleidoscope" of FTAs, three features of the PTA architecture stand out.

First, the region is almost completely covered by five PTAs: NAFTA, the Central American Common Market, the Andean Community, the Caribbean Community (CARICOM), and Mercosur. Only Chile, Cuba and Panama do not belong to one of these PTAs.

Second, negotiations have been under way since 1998 for the creation of a Free Trade Area of the Americas (FTAA) embracing every nation in the Americas except Cuba. At the heart of these negotiations has been a clash between the USA and Brazil over the structure and character of the FTAA, with each promoting their own preferred "model". Following the 2005 Summit of the Americas in Mar del Plata, Argentina, the negotiations have been suspended indefinitely and it is unclear when or if they will resume.

Third, the US has in the meantime adopted an alternative strategy for spreading its preferred FTA "model" through the Americas, by negotiating a series of bilateral and plurilateral FTAs, first with Chile, then with Central America and the Dominican Republic, and most recently with three of the Andean countries. Among the latter the FTA with Peru has been concluded, conclusion of the FTA with Colombia is believed to be imminent, and negotiations with Ecuador are ongoing. The US is also well advanced in negotiation of an FTA with Panama. The spread of these US FTAs has strengthened the hand of the US against Brazil and its allies in Mercosur. There have been rumours from time to time that even some Mercosur members – Uruguay and possibly even Argentina – may be interested in negotiating an FTA with the US. On the other hand Venezuela has been attempting to forge a "Bolivarian alliance" of left-leaning Latin American governments against US political and economic hegemony in the region. Bolivia is one candidate for this "alliance". The recent announcement that Venezuela will join Mercosur is Venezuela's most significant step yet in its efforts to build this "alliance".

A Free Trade Area of the Asia Pacific?

As preferential trade agreements began to proliferate in the APEC region and the WTO negotiations appeared to be faltering, some members of the APEC Business Advisory Council (ABAC) became increasingly concerned at the consequences for business. In their view these consequences include inefficiencies arising from the fragmentation of markets and increased transaction costs for exporters who could be faced with meeting different rules of origin under different FTAs in each of their markets.

These ABAC members proposed that APEC members should consider establishing a Free Trade Area of the Asia-Pacific (FTAAP), in other words an APEC-wide FTA. ABAC has twice recommended that APEC leaders commission a feasibility study of the FTAAP proposal, but the leaders have not accepted these recommendations. While some smaller APEC economies including New Zealand have expressed varying degrees of enthusiasm for the proposal, it is clear that the FTAAP could proceed only with the support of the major APEC economies. The major economies have so appeared unenthusiastic toward the proposal.

Summary and Interpretation

The developments outlined above may be summarised as follows:

1. Two visions of region-wide integration are in play in the Asia-Pacific. One vision is of an integrated Asia-Pacific region, embracing both sides of the Pacific. This vision has been pursued through APEC, with its voluntary, non-binding processes and its emphasis on non-discriminatory liberalisation. The other vision is of an integrated East Asian region, and has been pursued to date through the "ASEAN-Plus-Three" process. A third vision, of Asia-wide integration embracing East Asia and South Asia, has begun to be promoted in some quarters. The future role of the East Asian Summit in relation to trade initiatives is unclear at this point.
2. Difficulties in the economic and in some cases also the political relations between the major powers of the region are a key obstacle to the realisation of either of these visions. In East Asia the principal obstacle lies in the China-Japan relationship and there are also significant problems in the Japan-Korea and China-Korea relationships. In addition to these relationship issues, problems in the US-China and US-Japan relationships are also important obstacles to wider integration across the Asia-Pacific region. There are also important obstacles to closer East Asia/South Asia integration, including relationship difficulties within South Asia as well as East Asia and divergences between East Asian and some South Asian governments in approaches to trade liberalisation.
3. In the face of the obstacles to region-wide integration there has been an explosion of bilateral FTA initiatives in the region. At least one of the partners in these FTA initiatives is invariably a smaller economy. The trends observed in these bilateral FTAs include:
 - Those smaller economies in a position to do so have given priority to negotiating FTAs with the major economies of the region. One consequence is that the major economies are emerging as "hubs" in a series of "hub and spoke" configurations of FTAs in the region. The US is emerging as a global "hub".
 - Some smaller economies, notably Chile, Singapore, Mexico and to a lesser extent Thailand clearly have a strategy of seeking FTAs with all their significant trade partners.

- In terms of regional orientation the bilateral FTAs are a mixture of intra-East Asian FTAs, trans-Pacific FTAs, and FTAs linking East Asia and Australasia.
 - A powerful “domino effect” is in operation and can be expected to continue to propel the proliferation of FTAs in the Asia-Pacific region for some time to come.
4. Rivalry between the major East Asian economies has led them each to pursue separate “ASEAN Plus One” trade initiatives: ASEAN-China, ASEAN-Japan and ASEAN-Korea. China and Korea have from the beginning emphasised FTA negotiations with ASEAN as a group, although Korea in particular has also negotiated bilaterally with some ASEAN members. Negotiations for an ASEAN-China FTA in goods have been completed and the ASEAN-Korea FTA has now apparently also been concluded. Japan on the other focused initially on negotiating bilateral FTAs with individual ASEAN countries, and is only now beginning to give serious consideration to negotiation of an FTA with ASEAN as a group.
 5. ASEAN has welcomed the “ASEAN Plus One” initiatives as an opportunity to place itself at the centre of evolving trade arrangements in the region. ASEAN’s difficulty in maintaining cohesion among its members in negotiation with the “Plus One” partners has, however, constrained its ability to take full advantage of the opportunity.
 6. ASEAN has also applied the “ASEAN Plus One” approach to negotiations currently under way for FTAs with India and with Australia and New Zealand. Further “ASEAN Plus One” initiatives, for example with Pakistan, are under consideration. The US launched an Enterprise for ASEAN initiative but has so far limited its negotiation of FTAs with ASEAN to negotiations with selected individual ASEAN members.
 7. East Asia is now looking further a field in spreading its FTA linkages, including to South Asia and Europe. A number of initiatives to promote closer East Asia-South Asia linkages are under way. Some East Asian and South Asian governments can be expected to continue pressing for further development and strengthening of these linkages.
 8. While there are several tendencies at work in the evolution of the PTA architecture of the Americas, one clear result is the growing number of Latin American countries, including some that are direct competitors of New Zealand, that enjoy preferential access to New Zealand’s important export markets in North America, especially the US and Mexico.
 9. New Zealand and Australia have tended to “shadow” each other in negotiating PTAs with the same partners. The major divergence has been Australia’s success and New Zealand’s failure to date in securing an FTA with the US.

10. A Free Trade Area of the Asia-Pacific (FTAAP) has been proposed by the APEC Business Advisory Council (ABAC), but appears unlikely to proceed in the near future, due to lack of support by major APEC economies.

4. The Spread of PTAs and New Zealand's International Trading Environment

New Zealand has traditionally placed a high priority on the WTO and APEC processes as mechanisms to increase its access to overseas markets. The rationale for this stance is both obvious and sound. Non-discriminatory liberalisation through the WTO provides a small country like New Zealand with the best assurance that markets will be opened in a way that maintains its competitive position relative to competing exporters. The WTO's dispute settlement process provides a reasonably effective means of enforcing the rights and obligations conferred by WTO membership.

WTO agreements, especially the Agreement on Agriculture, address issues of vital interest to New Zealand, such as export subsidies and domestic subsidisation of agriculture that would have been difficult to address effectively in any other forum. The Agreement on Agriculture has also assured New Zealand of the continuation and in many cases expansion of access on favourable terms to traditional markets, thus allowing traditional New Zealand export industries to maintain and often improve their positions while they continue to press for more far-reaching opening of global agricultural markets.

APEC's vision of non-discriminatory free trade and investment across the Asia-Pacific region was also highly attractive to New Zealand, since the region accounts for 70 percent of New Zealand's trade and includes all New Zealand's major trading partners except the European Union. In periods of economic conflict between East Asia and North America, such as occurred in the late 1980s and early 1990s – and may occur again in the future – APEC also provided New Zealand with means of engaging with its major partners on both sides while avoiding any appearance of taking sides with one against the other.

Both of these traditional mainstays of New Zealand trade policy have however unfortunately faltered in recent years. The latest round of WTO negotiations, the Doha Development Agenda, was launched with great difficulty in 2001. In the eyes of many commentators it was only the sense of the need to demonstrate a commitment to global solidarity in the wake of the "9/11" terrorist attacks of that year that created sufficient impetus for the round to be launched. Issues related to the setting of the agenda of the negotiations proved extraordinarily difficult before, during and after the Doha ministerial meeting in 2001, and led to the collapse of the subsequent ministerial meeting in Cancún in 2003.

Three issues – investment, competition policy and transparency in government procurement had to be removed from the agenda before negotiations could continue. The agenda now focuses heavily on the "basic" market access issues of agriculture, industrial products and services. A

number of other issues of importance to New Zealand also remain on the table, notably fisheries subsidies and geographical indications, the latter being mainly a defensive interest from New Zealand's perspective.

In the agriculture negotiations a significant victory for New Zealand and its allies has been the agreement that export subsidies should eventually be eliminated, albeit with a phase-out period that stretches to 2013, and there appears to be a prospect of reasonable progress on domestic support. Market access however is proving much more difficult, and there is a risk that the package may be diluted to the point where few if any worthwhile gains in market access will remain for New Zealand. Furthermore, any progress provisionally agreed in agriculture will be implemented only if the round as a whole is successfully completed and this is by no means assured.

The negotiations on services and industrial products are also proving difficult, and there is a disturbing lack of will on the part of major players to make the significant concessions that could move the negotiations forward. Prognoses range from completion of the round by mid-2007, to a further delay in completion possibly until 2009, to a complete collapse of the round. If the round is to be completed by 2007 it appears unlikely that the very low level of ambition evident in offers currently on the table will be exceeded to any great extent. More worrying still from New Zealand's perspective, clear signs are emerging that there will be little appetite among the major players for further rounds of WTO negotiations after the Doha Round.

In the case of APEC, it was clear by the late 1990s that the APEC process itself could not contribute significantly to trade liberalisation, although it offers rather more potential for progress on trade facilitation.¹⁹ An important reason for APEC's ineffectiveness as a liberalising forum is that its voluntary, non-binding process does not provide the formal reciprocity in liberalisation commitments on which larger economies and even some smaller economies tend to insist.

Unilateral liberalisation and the WTO remained potentially open as avenues to non-discriminatory region-wide liberalisation, but the impetus for unilateral liberalisation diminished after the East Asian economic crisis of 1997/98 and declined still further once it became clear that governments of the region were shifting their focus to preferential liberalisation through FTAs. APEC continues to stress the WTO as a potential vehicle for progress towards its liberalisation objectives, but it is clear that the extent of liberalisation likely to be achievable in the WTO will fall far short of those objectives.

¹⁹ Trade facilitation in the WTO refers to proposed improvements in the GATT articles dealing with customs procedures. In APEC it has a wider meaning, covering not only the modernising and streamlining of customs procedures but also other issues such as standards and conformance, business mobility and electronic commerce.

The relatively poor outlook for non-discriminatory liberalisation through the WTO and APEC increases the importance and the severity of the challenge posed to New Zealand by the spread of preferential trading arrangements among its trading partners in the Asia-Pacific region. New Zealand may be entering a period where most liberalisation that occurs in the region will take place on a preferential basis, with little or no offset from non-discriminatory liberalisation through the WTO or unilateral liberalisation processes. The challenge to New Zealand can usefully be divided into two parts:

The first challenge is to take advantage of the market access opportunities available through PTAs. Bilateral FTAs offer New Zealand the prospect of duty-free access to the partner for most products, to be achieved over timeframes ranging from immediate to up to 20 years, as with dairy products in New Zealand's FTA with Thailand. Generally New Zealand's partners in these FTAs will be offering the same or similar access to a range of other partners as well, including New Zealand's competitors.

Thus in many cases New Zealand will be maintaining rather than improving its competitive position in the markets of its new FTA partners. While New Zealand or some of its competitors may obtain a temporary advantage through timing differences in the negotiations of PTAs – through being first out of the blocks in other words – the end result in the majority of cases is likely to be an approximation of the competitive position before the series of PTAs were negotiated.²⁰

Some improvement for New Zealand might be possible if a competitor fails to secure access to one of New Zealand's partners, or if New Zealand secures more advantageous terms than its competitors in some respects, but there is of course also the risk that it will be the competitors who secure the more advantageous terms. The latter risk highlights the importance of New Zealand negotiators pushing for "MFN" clauses with PTA partners, obliging the partner to extend to New Zealand any more favourable treatment that they subsequently grant to other PTA partners, especially where New Zealand expects that its prospective partner is likely to enter negotiations with competitors and/or other major economies that might be able to negotiate better deals than New Zealand.

The second challenge is to manage situations where New Zealand is unambiguously disadvantaged by new PTAs. These situations arise obviously where competitors secure an FTA with a partner that proves unwilling to negotiate an FTA with New Zealand, as in the case of Australia's FTA with the US. Less obviously they arise also where competitors gain access to the Australian market, where New Zealand was for many years the only APEC or

²⁰ Reduction of tariffs on imports will of course yield gains in economic welfare for the importing countries, and may also produce gains for the supplying countries if it results in an overall increase in imports, even if the competitive position of the supplying countries relative to each other does not change.

WTO member to receive preferential access. New Zealand's preferential access to the Australian market is being progressively eroded as more and more partners secure FTAs with Australia.

The Australia-US FTA (AUSFTA) illustrates both dimensions of this second type of challenge. Most attention has been focused on the resulting potential threat to New Zealand's exports. The availability of duty-free access to the US market for Australian but not New Zealand exports faces New Zealand exporters with the choice between losing business to their Australian competitors or lowering their prices in order to remain competitive. For products with access to the US market controlled by quotas, expansion of the quota allocated to Australia will in any case tend to drive down the US domestic market price, lowering returns to New Zealand exporters while Australia exporters are compensated by the opportunity to increase their export volumes.

Concerns on these grounds were partly but certainly not wholly allayed by the relatively unfavourable terms on which the US granted increased access to Australia for some products of interest to New Zealand. The access for beef and dairy products for example is phased in over 18 and 17 years respectively, with special safeguards in the case of beef and tariff rate quotas in the case of dairy products continuing to apply beyond the end of those periods. This latter experience highlights the more general point that the economic damage to New Zealand of PTAs negotiated by its competitors is likely to be less if those agreements are "dirty". There is a tension between New Zealand's preference for "high quality" PTAs in its own agreements and the likelihood that "high quality" PTAs negotiated by its competitors will be more economically damaging to New Zealand.

A less-noticed result of AUSFTA (which would arise regardless of whether New Zealand secured an FTA with the US) is that New Zealand manufacturers will lose the preferential advantage they have hitherto enjoyed over US manufacturers in the Australian market. A study undertaken for NZ Treasury²¹ on the effects of the AUSFTA on New Zealand concluded that the negative effect of the AUSFTA would be "much greater on New Zealand's exports to Australia than on exports to the US, suggesting that the loss of preferences in the Australian market is of greater significance for New Zealand exports than the intensified competition from Australia in the US market."

Consistent with this finding, the sectors in New Zealand whose exports would be most adversely affected by the AUSFTA were found to be textiles and clothing and "other manufacturing". Further competitive pressure on New Zealand exports to Australia – easily New Zealand's largest single export

²¹ Scollay, R. (200), "The Impact on New Zealand of a Free Trade Area Between Australia and the United States", report for NZ Treasury and Ministry of Foreign Affairs and Trade, October.

market, as Table 2 showed – is applied with each new FTA that Australia negotiates with a new partner.

A further negative impact of the AUSFTA on New Zealand arises through its rules of origin, which discriminate against the use of inputs sourced from New Zealand in products to be exported to the US under the AUSFTA preferences. Food products with dairy product ingredients for example must use only Australian milk if they are to be exported to the US under the AUSFTA preferences, whereas previously products containing milk from either country would have entered the US under the same US MFN duty rates.

This is a classic example of how a new FTA may undermine the degree of integration already achieved under an existing FTA. Even where the rules of origin in other FTAs does not explicitly affect the use of New Zealand-sourced inputs, an RVC-based rule for example may still discourage the use of New Zealand inputs if their use increases the difficulty of complying with the rule.

One further potential negative effect of AUSFTA on New Zealand is the diversion of investment from New Zealand to Australia to take advantage of the latter's preferential access to the US, in some cases motivated also by the desire to avoid problems with rules of origin of the kind outlined in the preceding paragraph.

Table 6 summarises the current state of FTA initiatives by New Zealand and other partners with the economies comprising New Zealand's major markets in the Asia-Pacific region. The economies listed in Table 4 account for 70 percent of New Zealand exports and comprise 14 of New Zealand's 20 fellow APEC members.

Table 6
Major NZ Markets in the Asia-Pacific Region
FTA Status with New Zealand and Other Partners

Market	% of NZ Exports	FTA Status With NZ	FTA Status with Other Partners		
			Concluded	Negotiating	Studying/ Discussing
Australia	20.1 %	FTA Since 1983	USA Singapore Thailand	Malaysia ASEAN UAE	Japan Mexico
USA	14.2 %	NZ Proposal not accepted	Canada Mexico Chile Australia Singapore Chile Peru Costa Rica El Salvador Guatemala Honduras Nicaragua Israel Jordan Morocco Bahrein Oman	Korea Malaysia Colombia Ecuador Panama Thailand S. Africa CU UAE FTAA	Egypt Switzerland
Japan	11.7 %	No formal proposal	Singapore Mexico Malaysia	Thailand Philippines Indonesia Korea	Australia Chile
China	5.3 %	Negotiating	Chile ASEAN-10 (Singapore, Indonesia Malaysia Philippines Thailand Viet Nam Brunei Cambodia Laos Myanmar)	Australia Pakistan Partial FTA (APTA) with India Korea Bangladesh Sri Lanka Laos)	India Pacific Is ASEAN + 3

Market	% of NZ Exports	FTA Status With NZ	FTA Status with Other Partners		
			Concluded	Negotiating	Studying/ Discussing
Korea	3.7 %	No formal proposal – study not followed up	Chile Singapore EFTA ASEAN-10 (Singapore, Indonesia Malaysia Philippines Thailand Viet Nam Brunei Cambodia Laos Myanmar)	Japan USA Mexico (partial FTA) Partial FTA (APTA) with India Korea Bangladesh Sri Lanka Laos)	ASEAN + 3
Taiwan	2.3 %	No formal proposal – earlier discussions not pursued	Panama		
Hong Kong	1.8 %	Negotiations suspended	China		
Philippines	1.9 %	NZ proposal not taken up	ASEAN China (with ASEAN) Korea (with ASEAN)	Japan India (with ASEAN)	USA
Malaysia	1.6 %	Negotiating (direct and via ASEAN)	ASEAN China (with ASEAN) Korea (with ASEAN) Japan	USA Australia India (with ASEAN)	
Indonesia	1.5 %	Negotiating (via ASEAN)	ASEAN China (with ASEAN) Korea (with ASEAN)	Japan	USA

Market	% of NZ Exports	FTA Status With NZ	FTA Status with Other Partners		
			Concluded	Negotiating	Studying/ Discussing
Singapore	1.3 %	FTA since 2001	USA Japan Australia Korea ASEAN China (with ASEAN) Chile (P4) EFTA	Canada Bahrain India (direct and with ASEAN) Egypt Jordan Bahrain Pakistan Sri Lanka South Africa Panama	
Thailand	1.2 %	FTA since 2005	Australia ASEAN China (with ASEAN) Korea (with ASEAN)	Japan USA Peru India (direct and with ASEAN) Bahrein BIMSTEC (India Bangladesh Sri Lanka Myanmar Nepal Bhutan)	
Canada	1.8 %	No proposal	USA Chile Costa Rica	Singapore FTAA	
Mexico	1.4 %	NZ proposal under study	USA Canada Japan Chile EU EFTA Colombia Venezuela Bolivia Costa Rica Israel	Korea Central America FTAA	

Based on Table 6, the situation facing New Zealand as a result of PTA activity in its main Asia Pacific markets can be summarised as follows:

- New Zealand is facing the progressive erosion of its preferential position in the Australian market (20.1 percent of exports) as new partners conclude FTAs with Australia. This trend is likely to continue.
- New Zealand has achieved market access parity, or is negotiating for market access parity with a wide range of competitors in several Asia-Pacific markets. This market access parity has already been achieved in Singapore, Thailand, and Brunei and is being sought with China and Malaysia through bilateral negotiations and with Philippines and Indonesia through joint negotiations with Australia for an FTA with ASEAN. New Zealand has also placed an FTA proposal before Mexico. These economies together account for 14.2 percent of New Zealand exports (14.7 percent with the addition of the remaining ASEAN members – Brunei Darussalam, Viet Nam, Cambodia, Laos and Myanmar).
- As a result of its inability to secure an FTA with the US New Zealand is unambiguously disadvantaged in the US market relative to Australia and several other competitors that have concluded FTAs with the US. Further disadvantage is likely as additional partners conclude FTAs with the US. The FTAA, which would provide preferential access to the US market to Brazil, Argentina and Uruguay among others, would be of particular concern, but appears unlikely to materialise in the near future. The US accounts for 14.2 percent of New Zealand exports.
- In Japan and Korea New Zealand is already at some disadvantage from existing FTAs and risks significant disadvantage if those countries conclude FTAs with partners more directly competitive with New Zealand, such as Australia. Japan and Korea account for 15.9 percent of New Zealand exports.
- New Zealand does not currently face significant competitive threats from new FTA activity by Canada, Hong Kong or Taiwan, although the older NAFTA agreement does of course provide preferences in the Canadian market for the US and Mexico over other trading partners such as New Zealand.

5. Estimates of Economic Effects of Asia-Pacific PTAs

One approach to assessing the potential impact of future PTA developments is to analyse quantitative estimates of the effects of different PTA combinations, derived from computable general equilibrium (CGE) simulation modelling. This allows comparisons to be made of different scenarios, in terms of dimensions such as the effect on New Zealand's overall economic welfare, the effect on production in different industry sectors, and the effect on New Zealand's bilateral trade with significant trading partners. This section of the report reviews and analyses the results of a number of simulations designed to provide insights into the outlook for New Zealand under various plausible scenarios.

In considering the future outlook for New Zealand in an Asia-Pacific region increasingly focused on negotiating PTAs, it is sensible to take existing agreements as given and to concentrate on the new agreements that might potentially emerge in the future. While it might seem natural from New Zealand's perspective to focus on future agreements involving New Zealand, it must be recognised that other agreements are likely to emerge regardless of what New Zealand does. It is therefore important to analyse scenarios that involve other agreements that might proceed in parallel with New Zealand's own possible agreements and to consider the possible effects if other agreements proceed while New Zealand's proposed agreements do not.

As a preliminary, to assist in interpreting the results some brief notes are provided on the methodology used in the simulations and on the limitations of the CGE modelling technique. The scenarios selected for modelling are then briefly described and explained, before proceeding to the discussion of the results.

Note on Methodology

In order to estimate the effects of new trade agreements, it is necessary to take account of the complex interdependencies both within and between national economies. Changes in protection structures in one country or a group of countries will not only have direct effects on the industries to which the changed protection levels apply, but will also have "ripple effects" throughout the economies concerned, because of the many ways in which the different sectors in a modern economy are interconnected. Trade flows with other trading partners will also be affected, and through changes in trade flows the "ripple effects" will spread to the economies of other trading partners.

Quantitative estimation of the effects of new trade agreements therefore requires a database containing sector-by-sector information on the production structures and protection structures of all economies as well as

the trade flows between them. Computable General Equilibrium (CGE) models make use of such databases, and also incorporate standard economic assumptions about the ways that firms and consumers respond to price changes. Beginning from a given status quo, or “baseline”, trade agreements are simulated by making the relevant changes in protection rates in the economies involved in the agreement, and then running the model to see how the database changes as a result of the changes in protection rates; the changes are then taken to be the economic effects of the trade agreement(s).

The databases used in the simulations contain literally hundreds of thousands of observations and relationships, all of which will potentially change in each simulation. Thus it is only the power of modern computers that makes such simulations possible. Each simulation generates an enormous amount of information, from which analysts extract the results that are relevant to their purposes.

Limitations of CGE Modelling

CGE models must be used with caution. Despite the enormous amount of data that they utilise the representations of economies that they contain are still only models. Even with modern computers there are practical limitations to the number of sectors and economies that can be handled in the models. In the analysis reported here each economy was divided into 30 sectors and the world was divided into 22 individual economies (including 19 of the 21 APEC economies) and six regions each of which is an amalgamation of multiple economies.

The time lag involved in collecting the data inevitably means that the database is several years out of date. The present analysis makes use of the latest version of the Global Trade Analysis Project (GTAP) database, GTAP6, which was released only recently, but which has a base year of 2001. Preliminary simulations were run to adjust the GTAP6 database to take account of China’s WTO accession, the phase out of textile and clothing quotas under the WTO Agreement on Textiles and Clothing, and several recently negotiated FTAs.²² This generated a modified “baseline” database, computed *as if* all of these developments had already taken place in 2001.

No account is taken of the time path for the phasing in of liberalisation commitments, either in the agreements included in the “baseline” or the agreements being simulated. Agreements are also simulated as “clean” FTAs, with no account taken of any exclusion of products from each agreement. From this perspective the simulations represent the upper bounds of the

²² Specifically, the adjustment included all the concluded bilateral FTAs listed in Table 3 except Chile-China, Perú-USA, Japan-Malaysia and China-Thailand, which were still under negotiation when the simulations were undertaken and also includes the Canada-Chile, Mexico-Chile, and Japan-Philippines FTAs.

liberalisation that could potentially take place, since in practice agreements typically provide for the exclusion of some products, and extensive phase-in periods for the elimination of tariffs on others.

It is a well-known property of the GTAP model that simulations based on the standard GTAP database tend to generate effects that some commentators regard as unrealistically small. This is particularly the case with GTAP6, in which protection rates are naturally lower than in the earlier versions (because of the liberalisation that has taken place since the database was last updated), so that the effect of removing the protection is likely to be correspondingly smaller.

The developments incorporated in our modified "baseline" database further reduce a number of the "baseline" protection rates and hence the likely size of the effects. A particular weakness of GTAP is the lack of detail in the modelling of the services sector, even though services account for 50 percent - 70 percent of GDP in many modern economies. The lack of protection data for services also means that it is not possible to model the effects of liberalising trade in services.

It is also well-known that changes to the assumptions used in the model can yield significant changes in the results. Some changes that could be made in the assumptions would be likely to generate substantially larger effects. No such changes in the assumptions have been made here however. The focus here is on comparing the effects of different possible configurations of agreements and for this purpose the most important requirement is that all the simulations be run from the same database using the same assumptions. Use of the standard GTAP model was considered satisfactory for this purpose. In interpreting the results therefore it is important to concentrate on the relative size of the effects across the various configurations, rather than their absolute size.

Overview of the Simulations

The scenarios chosen for simulation here are as follows:

- Simulation of the two FTAs that New Zealand is currently negotiating, the New Zealand-China FTA and the Australia-New Zealand ASEAN FTA (AANZFTA). These two agreements are simulated as proceeding in parallel with each other. In modelling terms the AANZFTA extends the free trade arrangements of Australia and New Zealand with Singapore and Thailand to cover the remaining eight ASEAN economies, and subsumes the proposed FTAs of Australia and New Zealand with Malaysia.

- Two simulations of possible situations where New Zealand's competitors secure FTAs with some major trading partners but New Zealand does not:
 - Australia and Chile secure FTAs with China and Chile also secures an FTA with Japan.
 - An FTA between Australia and Japan.
- Simulations of alternative scenarios involving regional blocs in East Asia:
 - ASEAN China FTA together with an ASEAN-Japan FTA. Currently ASEAN has a recently concluded an FTA in goods with China and Japan is negotiating for FTAs with several ASEAN members. This simulation could therefore be seen as an approximation to present reality.²³
 - ASEAN Plus Three FTA (or EAFTA). This concept continues to be pursued within the ASEAN Plus Three group and so this FTA is modelled as a possible alternative to parallel FTAs between ASEAN and Japan and China. The difference between the two is that in EAFTA Korea as well as China and Japan establishes free trade with the ASEAN countries, and free trade is also established between the three Northeast Asian economies of China, Japan and Korea.

Both of these alternatives are simulated in conjunction with the New Zealand-China and AANZFTA FTAs, and in isolation, without the two FTAs involving New Zealand. This allows an assessment about how the conclusion or non-conclusion of those two FTAs will affect the impact on New Zealand of PTA developments in East Asia.

- ASEAN Plus Three FTA in parallel with the FTAAP. This simulation was undertaken out of interest, although at this stage the possibility that the FTAAP will go ahead in the near future would appear to be remote.

²³ Bearing in mind that in the modelling context an ASEAN-Japan FTA is equivalent to bilateral FTAs between Japan and each individual ASEAN member.

Effects on New Zealand's Economic Welfare

Figure 7: Effect on New Zealand Economic Welfare of Selected FTAs

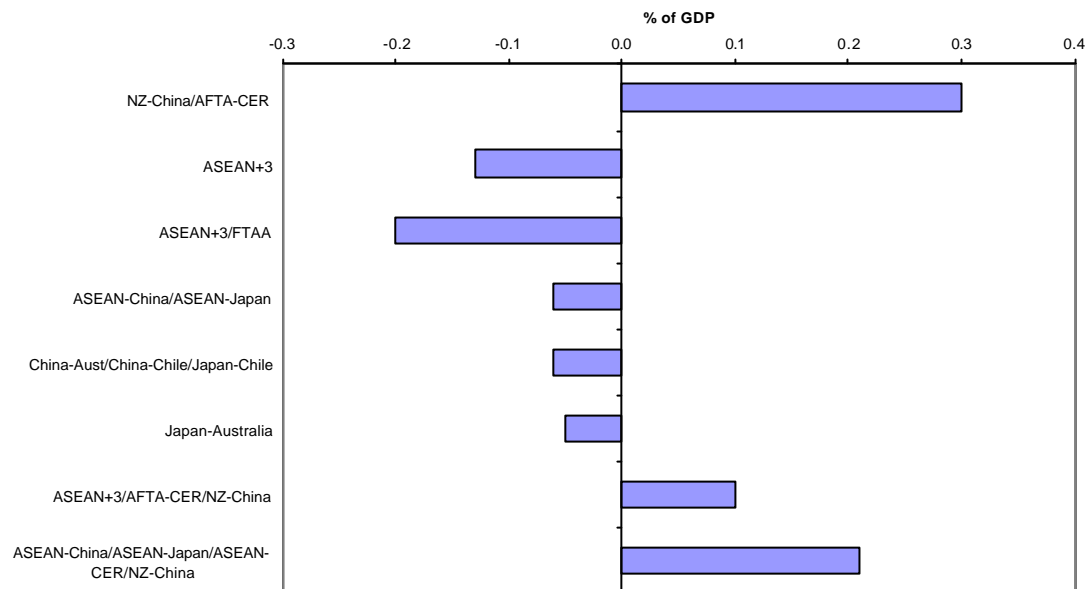


Figure 7 illustrates estimates from the simulation results of the effect on New Zealand's economic welfare of the FTAs and combinations of FTAs. The term economic welfare as used by economists can be interpreted as an increase in the real income of the community.

Of the combinations simulated it is clear that the highest welfare gain for New Zealand would occur if the New Zealand-China FTA and the AANZFTA were to proceed in isolation, without any other new FTAs forming in the region. This is an unlikely outcome, however. When these two FTAs are simulated in conjunction with the ASEAN-China/ASEAN-Japan FTA combination or an ASEAN Plus Three FTA (EAFTA), the welfare effect on New Zealand's shrinks somewhat, although it remains positive.

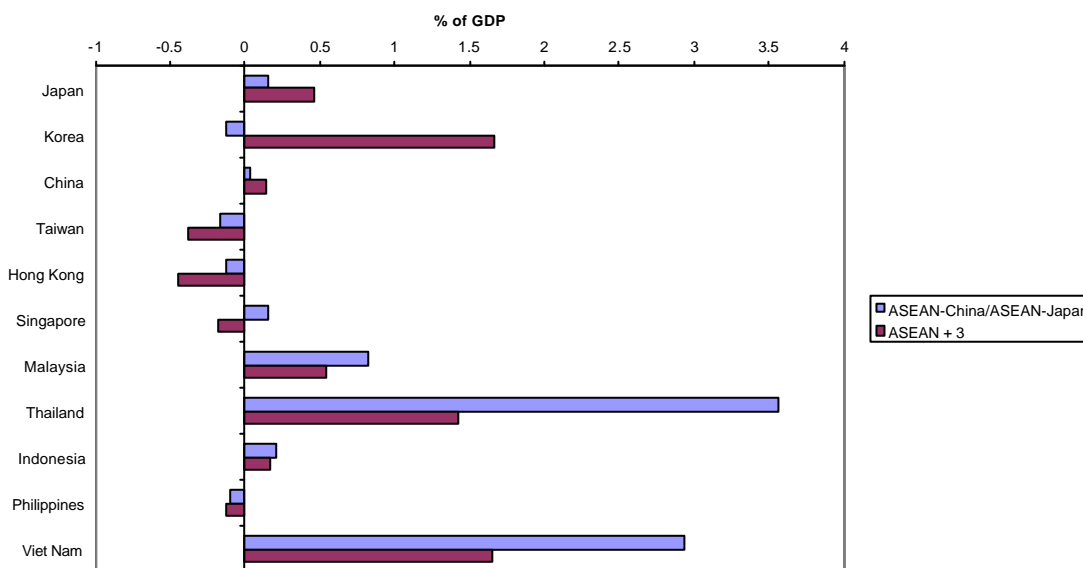
The welfare gain is greater with the ASEAN-China/ASEAN-Japan FTA combination than with the ASEAN Plus Three FTA. In other words, sharing preferential access to the ASEAN markets with China and Japan and access to the China market with the ASEAN economies reduces the gain to New Zealand. If preferential access to the China market is shared with Japan and Korea the gains shrink still further, although they remain positive.

These results must be contrasted with the impact on New Zealand welfare when the East Asian FTAs proceed without any parallel New Zealand-China and AANZFTA FTA. In these cases New Zealand suffers a loss in economic welfare, especially in the case of the ASEAN Plus Three FTA. The loss is still

greater in the probably unlikely event that the FTA goes ahead in parallel with the ASEAN Plus Three FTA. If New Zealand-China FTA and AANZFTA do not go ahead, New Zealand also suffers welfare losses in the simulations where Chile and Australia secure FTAs with Japan and Chile also secures an FTA with China, or where Australia secures an FTA with Japan. In general, the larger the preferential agreement, such as the ASEAN Plus Three FTA, that proceeds without any offsetting New Zealand involvement in new PTAs, the worse the outcome for New Zealand.

A key message from Figure 7 is that the cost to New Zealand of failure to realise the New Zealand-China and AANZFTA FTAs will in all likelihood not be limited to simply foregoing the potential welfare gains from these agreements, but is likely also to include greater vulnerability to economic damage from other PTA developments involving East Asian economies. In effect the New Zealand-China and AANZFTA FTAs represent a form of insurance for New Zealand against the possibility that it could be disadvantaged by being left out of East Asian preferential trading developments.

Figure 8: Comparison of Welfare Effects of ASEAN + 3 FTA with ASEAN-China and ASEAN-Japan FTAs



Effects on Economic Welfare of Other East Asian Economies and Australia

It is of course not only New Zealand that stands to be differentially affected by different preferential trading scenarios. All other economies involved will also be affected in different ways by the different scenarios and these differences will influence the incentives they face in prioritising the alternatives. It is of some interest therefore to analyse the welfare effects on the other economies in order to learn something about these incentives, recognising of course that other factors beside economic welfare effects will often be powerful motivations in the choice of strategy.

Figure 8 compares the welfare effects on East Asian economies of the ASEAN-China/ASEAN-Japan FTA combination and the ASEAN Plus Three FTA, assuming for the moment that the New Zealand-China FTA and AANZFTA (AANZFTA FTA) do not proceed.

The effects in Northeast Asia are interesting. As would be expected Korea does much better under the ASEAN Plus Three FTA, which turns an economic loss for Korea under the ASEAN-China/ASEAN-Japan FTA combination into a very substantial economic gain. Perhaps more surprising is that China and Japan both fare better under the ASEAN Plus Three FTA. These results can be taken as indications of the substantial gains possible for these three East Asian economies by economically integrating with each other, which for China and Japan outweigh the benefits from pursuing their separate preferential strategies with ASEAN. The other important outcome in East Asia is the economic losses for Taiwan and Hong Kong, especially under the ASEAN Plus Three FTA. These two economies stand to lose considerably more than New Zealand from being left out of East Asian preferential trading developments.

Southeast Asian economies generally gain from both FTAs, with the exception of Singapore in the case of the ASEAN Plus Three FTA and the Philippines under both scenarios. In contrast to the Northeast Asian economies their gains tend to be larger (or their losses smaller) when their FTA arrangements with the Northeast Asian powers are split between China and Japan in the China-ASEAN and Japan-ASEAN FTAs rather than integrated in the ASEAN Plus Three FTA. There are especially large welfare gains for Thailand and Viet Nam and substantial gains also for Malaysia.

Figures 9 and 10 indicate how the welfare outcomes for East Asian economies change if the China-New Zealand FTA and AANZFTA are added to the mix. In the case of the ASEAN Plus Three FTA (EAFTA) this worsens the welfare outcome for Korea, and surprisingly also China but improves the welfare outcome for Japan, Hong Kong and Taiwan. In Southeast Asia, the welfare outcome for Singapore switches from a small loss to a substantial gain but the welfare outcome for the Philippines deteriorates markedly. Welfare outcomes for Thailand, Viet Nam, Malaysia and Indonesia all

deteriorate somewhat, while remaining strongly positive for Thailand and Viet Nam. In the case of the China-ASEAN/Japan-ASEAN FTA combination, introduction of the China-New Zealand FTA and the AANZFTA has very little impact on the welfare outcome for any of the East Asian economies.

Figure 9: Welfare Effects of ASEAN+3 FTA (EAFTA) with and without ASEAN-CER and NZ-China FTAs

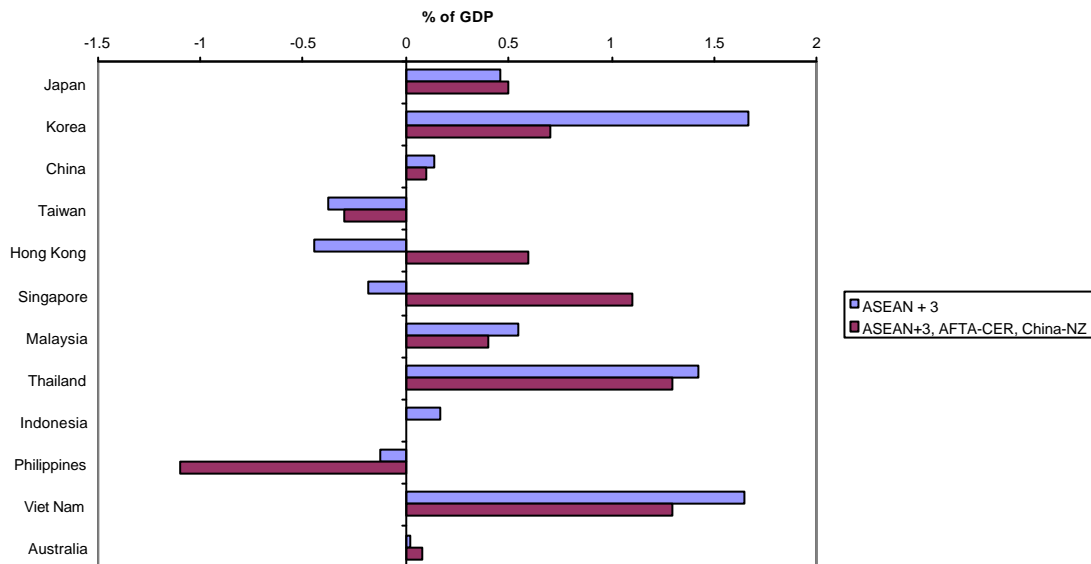
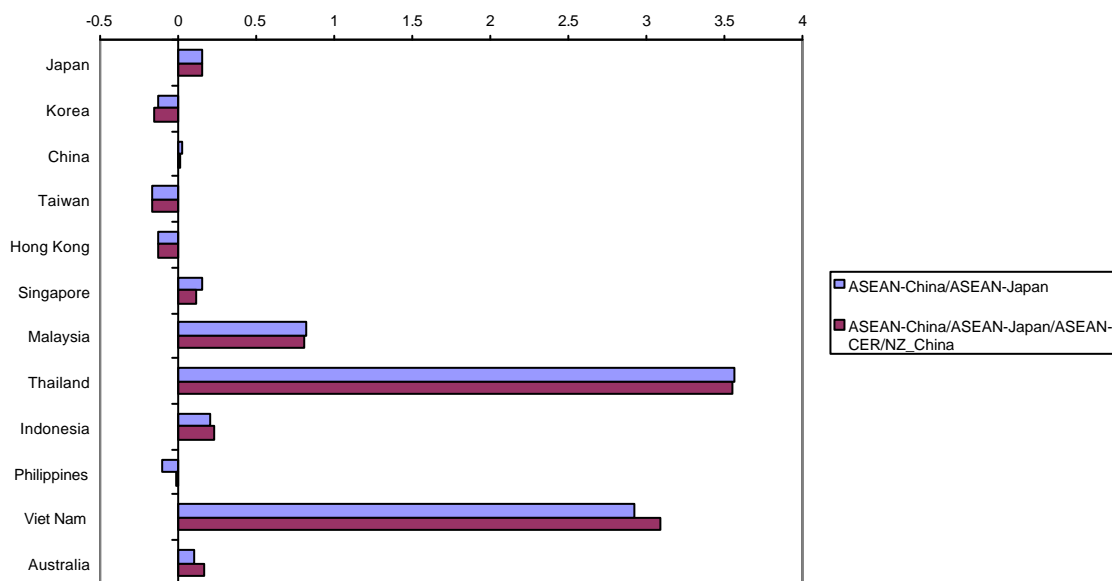


Figure 10: Welfare Effects of ASEAN-China and ASEAN-Japan FTAs with and without ASEAN-CER and NZ-China FTAs



In summary therefore, Southeast Asian economies for the most part do better from the China-ASEAN/Japan-ASEAN FTA combination, and adding in the two FTAs involving New Zealand has very little impact on their welfare outcome. The “big three” Northeast Asian economies on the other hand do better under the ASEAN Plus Three FTA (EAFTA). Put another way, there is a significant economic cost to the three Northeast Asian economies from their inability to reach agreement on economic integration with each other. Adding in the two FTAs involving New Zealand does not change this conclusion, although the outcome for Korea and China deteriorates a little in that case while the outcome for Japan improves slightly.

Taiwan and Hong Kong on the other hand do worse under the ASEAN Plus Three FTA and for Taiwan this remains the case when the two FTAs involving New Zealand are added, while the outcome for Hong Kong dramatically improves in that circumstance. Another point to note is that the welfare outcomes for many East Asian economies, whether positive or negative, are much larger than the welfare outcomes for New Zealand in the same scenario, indicating that these East Asian economies have more at stake than New Zealand in the new preferential arrangements under consideration. This partly reflects the fact that the East Asian economies have more trade barriers to eliminate, but also reflects the fact that their trade with each other is much more important to them than their trade with New Zealand.

Figures 9 and 10 also show the welfare effects for Australia from the two East Asian FTA configurations. Unlike New Zealand Australia registers a small welfare gain even when the AANZFTA and the China-New Zealand FTA are not included, indicating that the response of the East Asian economies to the two FTA configurations creates some new opportunities for Australia that are not available to New Zealand. When the AANZFTA and China-New Zealand FTA are added the welfare gains for Australia are similar to those of New Zealand and would no doubt improve if the proposed China-Australia FTA was included in the simulation as well.

Effects on the Output of New Zealand Industries

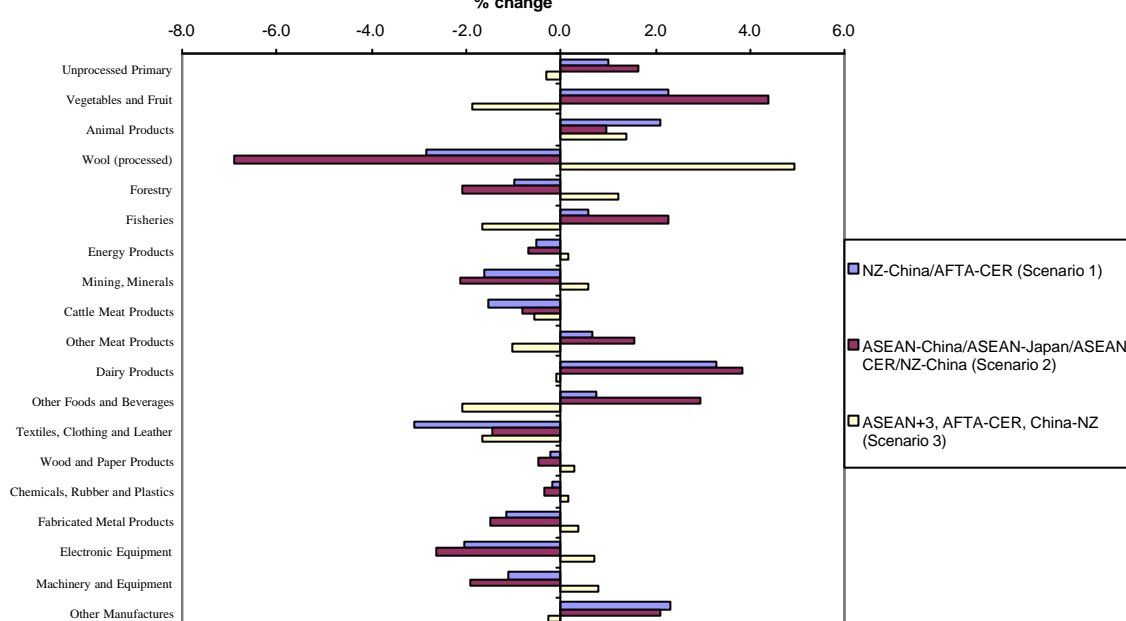
The emergence of new preferential arrangements in East Asia will also bring about significant adjustments in New Zealand industries. Some industries will be able to expand by taking advantage of new opportunities created by the new arrangements. Others will struggle to meet the additional competition and their output will decline.

Figure 11 aims to present a sense of the adjustments that may be in prospect. It summarises the adjustments in output of New Zealand sectors²⁴

²⁴ The sector definitions are based on the standard definition of sectors applied to all economies in the GTAP database. This classification does not correspond exactly with the traditional classification of New Zealand industries.

indicated by the simulations if the New Zealand-China FTA and AANZFTA proceed, both in isolation and in combination with either the ASEAN-China and ASEAN-Japan FTAs or the ASEAN Plus Three FTA. In order to keep its dimensions manageable the figure omits several industries that are very small and/or little engaged in trade. It also omits the services sector. As noted earlier one of the weaknesses of GTAP is that the services sector is included at a very aggregate level even though it is a very large part of the economy, and information on barriers to trade in services is relatively thin.

Figure 11: Output Changes in Selected New Zealand Industries: NZ-China and ASEAN-CER FTAs with/without ASEAN+3 or ASEAN-China and ASEAN-Japan FTAs



One interesting feature of Figure 11, is that for many sectors the change in output goes in the same direction for the New Zealand-China FTA and AANZFTA combination (labelled Scenario 1 for convenience) and for that combination implemented together with the ASEAN-China and ASEAN-Japan FTAs (scenario 2), but goes in the opposite direction when the New Zealand-China FTA and AANZFTA are combined with the ASEAN Plus Three FTA (scenario 3). The implication is that integration within Northeast Asia, which occurs in scenario 3 but not in the other two scenarios, has a significant impact on New Zealand industries.

In many agriculture and food-related sectors output rises under Scenarios 1 and 2 but falls under Scenario 3. Sectors affected in this way are unprocessed primary products, vegetables and fruit, fisheries, “non-beef” meat products, dairy products, other foods and beverages and other manufactures. The fall in New Zealand output under Scenario 3 may indicate that introduction of economic integration among the three major Northeast

Asian economies sets up trade diversionary effects which impact negatively on the New Zealand sectors concerned. A possible pointer toward this interpretation is that output from these sectors in either Korea or China or both (not shown here but available from the simulation results) is substantially higher under Scenario 3 than under Scenario 1 or 2.

Conversely there are New Zealand sectors whose output rises under Scenario 3 but falls under Scenarios 1 and 2. These sectors are wool (processed), wood and paper, mining and minerals, energy products, chemicals, rubber and plastics, fabricated metal products, electronic equipment, and machinery and equipment. It is not intuitively obvious why output should rise in New Zealand in these sectors under Scenario 3. A possible pointer is that output in China (not shown here) generally falls in these sectors under Scenario 3 whereas it tends to rise under Scenario 2 and remain unaffected under Scenario 1.

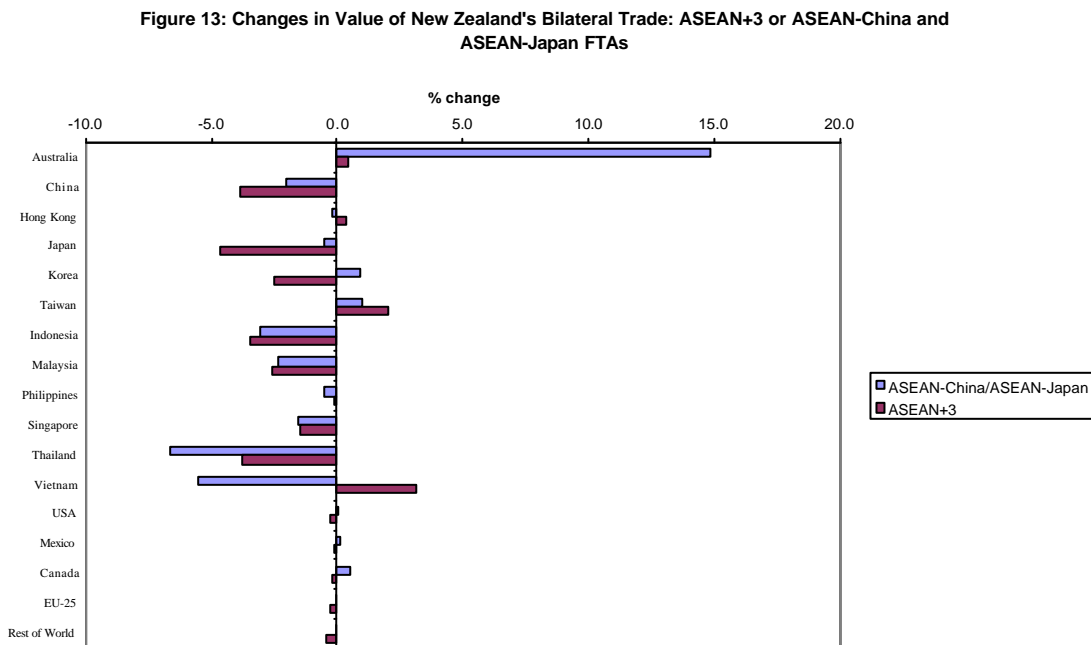
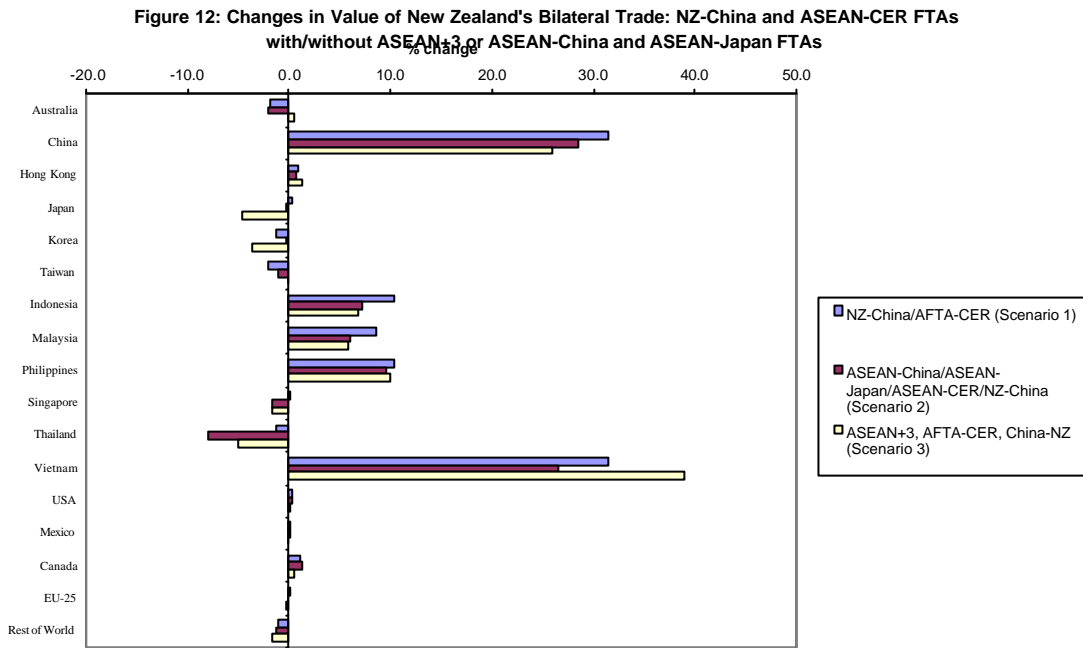
A significant fall in output in the New Zealand textiles, clothing and leather sector under all three scenarios is not surprising. Possibly a little more unexpected is the decline in New Zealand's beef sector under all three scenarios. Examination of simulation results for other countries (not shown here) suggests that competition from China and Korea may be a factor in Scenarios 2 and 3 respectively, while substitution with other meat products may be a factor under Scenario 1. Also surprising is that output in Australia's beef products sectors also declines under all three scenarios. On the other hand the animal products sector is the only sector in New Zealand where output rises under all three scenarios.

Not too much emphasis should be placed on the particular numbers yielded by the simulations for sectoral output changes in New Zealand. Perhaps the main point is that changes in New Zealand's trading arrangements involving East Asia are likely to induce significant upward and downward adjustments in sectoral output across the New Zealand economy and the direction of these adjustments will be significantly affected by whether economic integration occurs within Northeast Asia as part of the overall development of preferential trading arrangements in the region. These effects will interact with other influences affecting sectoral output, so that the actual pattern of direction of changes may vary somewhat from that indicated here.

It is perhaps also interesting to note that sectoral output changes for Australia and New Zealand are generally in the same direction under Scenarios 2 and 3, suggesting some similarity between the two countries in the political economy relating to trade agreements with East Asia. Notable exceptions are the dairy products, animal products and other manufactures sectors, where Australian output falls while New Zealand output rises under Scenario 2.

Effects on New Zealand's Bilateral Trade Flows

Involvement in new preferential arrangements in New Zealand will also influence the pattern of New Zealand's external trade. Figure 12 illustrates the changes indicated by the CGE simulations.



Under all three scenarios there are very substantial increases in trade with China and with Viet Nam, and substantial increases in trade also with Indonesia, Malaysia and the Philippines. On the other hand there is some decline under all three scenarios in trade with Singapore and Thailand, particularly the latter, suggesting some reversal of any initial boost to trade stimulated by the separate bilateral FTAs with that country. Thus the importance in New Zealand's trade with China and ASEAN countries other than Singapore and Thailand is likely to increase significantly as a result of the prospective new trade arrangements.

Trade with Hong Kong also increases slightly. At the same time there are also rather minor declines in New Zealand's trade with Korea and Taiwan, and with Japan and Australia under two of the three scenarios in each case. It is worth noticing also that under all three scenarios New Zealand's trade with North America does not decline and trade with the EU and the rest of the world declines only slightly.

Finally, Figure 13 illustrates the simulated effects on New Zealand's trade pattern if the ASEAN-China and ASEAN-Japan FTA or the ASEAN Plus Three FTAs proceed without any New Zealand involvement. Unsurprisingly there is a significant decline under these conditions in New Zealand's trade with most East Asian partners, with the exception of Taiwan (unsurprisingly), Korea under the ASEAN-China/ASEAN Japan FTA combination (again unsurprisingly) and Hong Kong and Viet Nam under the ASEAN Plus Three FTA. Trade with Australia increases, especially under the ASEAN-China/ASEAN Japan FTA combination.

It can thus be seen that the nature and direction of new preferential trade arrangements in East Asia will have a significant bearing in the pattern of New Zealand's trade with East Asia in particular. Failure by New Zealand to achieve participation in these new preferential arrangements will inevitably reinforce the decline in New Zealand's market share in many East Asian markets that has been evident for some time.

6. Negotiating Issues

In the negotiation of new preferential trading arrangements with East Asian partners New Zealand's "defensive agenda" of avoiding exclusion from the emerging preferential trading architecture of East Asia should be viewed as being of at least equal importance with the "positive agenda" of creating new market access opportunities. The benefits of FTAs with China and ASEAN are likely to be significant but the costs of being excluded from the evolving East Asian preferential trading architecture would also be substantial. Exclusion was looming as a significant threat earlier, but the prospect of negotiating FTAs with China and ASEAN is allaying fears on this score somewhat.

If these two FTAs can be successfully concluded, New Zealand will have secured preferential access, and therefore parity of access with competitors, in markets accounting for 40 percent of its exports to East Asia. Of the remaining East Asian markets, Taiwan is unlikely to develop a network of FTAs with Asia-Pacific partners in the near future and access to the Hong Kong market for goods is already duty-free. This leaves Japan and Korea as the two East Asian markets where New Zealand would remain vulnerable to the granting of preferential access to its competitors. These two countries are respectively New Zealand's largest and third-largest export markets in East Asia and together account for just under half (47 percent) of New Zealand's total exports to East Asia. The absence of proposals for FTAs with these two countries is thus a significant gap.

Agriculture is obviously a major factor inhibiting any willingness on the part of Japan and Korea to negotiate FTAs with New Zealand, as also with Australia. Both Northeast Asian countries have included some agricultural products in their respective recent FTAs with Mexico and Chile, but these arrangements fall considerably short of the challenges that would be posed to their agricultural sectors by FTAs with New Zealand and Australia.

Nevertheless the apparent willingness of Korea to include agriculture in its recently -announced FTA negotiations with the US may signal a breakthrough in Korea's case at least. Once agriculture has been included on a reasonably comprehensive basis in an FTA with the US, resistance to its inclusion in FTAs with Australia and New Zealand should logically diminish. At the same time Australian and New Zealand exporters would be significantly disadvantaged if they could not gain parity of access in the Korean market with their US competitors.

Japan is likely to be last of the East Asian economies to succumb to the pressures to open its agricultural sector, but even Japan may find itself impelled to move in this direction, for example as part of a proposal for an FTA with the US in response to the competitive threat that could be posed by a US-Korea FTA. New Zealand exporters would obviously be adversely

affected by a US FTA with Korea and an Australian FTA with Japan if New Zealand was not able to secure parallel FTAs with Korea and Japan.

The inclusion of Australia and New Zealand along with India in last year's East Asian Summit raised hopes that this inclusiveness might extend to offering a place to these countries in any new trading arrangements developed in East Asia. Certainly FTAs including Australia and New Zealand ("ASEAN Plus Three Plus Two") and possibly India as well ("ASEAN Plus Three Plus Two Plus One") have been unofficially proposed in some quarters, in the latter case including by Japan as well as apparently by the Indian Prime Minister.

At this point, however, East Asian leaders are apparently continuing to give priority to exploration of an ASEAN Plus Three FTA (EAFTA), although a change in this prioritisation is still not impossible. This is worrying, but not as worrying as it would be if New Zealand did not have the prospect of FTAs with China and ASEAN. Proposals in some quarters for an "Asian FTA" embracing South Asia as well as East Asia but implicitly or even explicitly excluding Australia and New Zealand will be of concern if they develop momentum. India's stance will also bear close watching. India is understandably giving priority to achieving its own breakthrough into the web of East Asian trade agreements and clearly will not hesitate to attempt to shoulder Australia and New Zealand out of the way if it finds this to be necessary in order to achieve its objectives.

Negotiation of FTAs with China and ASEAN will inevitably be difficult. In the FTA negotiations with ASEAN frustrations will arise not only because of divergences on both sides of as well as across the negotiating table but also because of the very large differences in development levels among the ASEAN members, and in particular the lower capacity and therefore willingness of the four less developed members (Cambodia, Laos, Myanmar and Viet Nam) to adjust to the opening of their markets.

Nevertheless it is important that New Zealand persevere with the AANZFTA negotiations, for two reasons. First, the larger ASEAN members with which New Zealand does not have an FTA in place or on the drawing board – Indonesia and the Philippines – are of comparable importance as export markets to Singapore, Thailand and Malaysia. Viet Nam also has the potential to develop to a similar level of importance as an export market. Second, conclusion of the AANZFTA along with a New Zealand-China FTA ties New Zealand more closely into the East Asian preferential trading orbit and will be an important if intangible insurance against future long-term exclusion from East Asian trading arrangements.

There will be understandable concern that sensitivities associated with the lower development status of Cambodia, Laos and Myanmar could make them reluctant to build the level of commitments that New Zealand would prefer. However, given the very low levels of trade with these countries New

Zealand would lose little by allowing them to make much “softer” commitments than the other ASEAN countries. There is a need to ensure that the resulting agreement can be defended as compliant with GATT Article XXIV, but it should not be unduly difficult to craft a set of commitments for these three countries that can readily be defended in this respect.

Existing agreements provide ample precedent for allowing some products to be excluded and/or lengthy phase-in periods for tariff reductions of up to 20 years, together with recourse to tariff rate quotas and special safeguards. It might also be possible to allow a provision for suspension of the commitments of these three countries at some point during the phase-in period, should circumstances arise that render them unduly onerous.

Rules of origin become a vitally important negotiating issue in a world or region of multiple PTAs. Much attention has been given to the so-called “spaghetti bowl” – the phenomenon of multiple overlapping and intersecting PTAs with rules of origin and possibly other provisions as well that are inconsistent with each other. The concern is over the compliance and other transactions costs imposed on businesses facing different rules in each of their export markets, which may prove especially onerous for small and medium sized enterprises (SMEs). The benefits to New Zealand exporters from FTAs with multiple East Asian partners, for example, could be partly negated if they have to satisfy different rules in each market.

One of the most acute versions of the “spaghetti bowl” in the Asia-Pacific region is that currently being faced by individual ASEAN economies that have been negotiating bilateral FTAs with several trading partners. Exporters in these economies may have to satisfy different rules of origin in each of their agreements or prospective agreements with Japan, the US, China and Korea, Australia, New Zealand, and India.

The “spaghetti bowl” facing New Zealand exporters is not yet as tangled as this. The rules in CER differ from those in the FTA with Singapore, and both of these differ from the rules in the FTA with Thailand and the TPSEP. Once the TPSEP comes into force New Zealand exporters to Singapore will apparently have the choice of using either the TPSEP rules or the rules in the original FTA with Singapore. As further PTAs are negotiated however New Zealand can expect to face demands from its prospective partners for an increasing variety of rules of origin.

If the benefits offered by trade agreements are to be realised it is important that rules of origin should be as straightforward and non-restrictive as possible. Achieving this result should be a key objective in all of New Zealand’s FTA negotiations. In an environment of multiple FTAs it would obviously encourage beneficial trade to take place if a common set of preferential rules of origin could be agreed, provided the common rules satisfy the criteria just set out. In the East Asian context the best hope of achieving this in principle lay with ASEAN, which ideally could have insisted

on common rules of origin with all its FTA partners. In practice however there have been at least two problems with ASEAN's approach to negotiating rules of origin.

First, each of ASEAN's partners has indicated a preference for different rules of origin (and the bilateral FTAs of individual ASEAN members also have their own rules of origin) and so far ASEAN has not had the capacity, confidence or unity of purpose needed to insist on common rules in all agreements, although it has persuaded China and apparently now also Korea to accept rules modelled on the RVC (Regional Value Content) based rules in AFTA.

Second, a significant divergence has emerged between the preferred approach to rules of origin by ASEAN and the CER countries. ASEAN continues to favour RVC-based rules with an RVC requirement of 40 percent and full cumulation within the ASEAN membership, although it has introduced CTC-based rules as an option for some products. Australia and New Zealand also traditionally favoured rules based on regional value content, which were used in CER (essentially a 50 percent RVC requirement) and also in their FTAs with Singapore. The preference for RVC-based rules was based on their apparent simplicity. More recently however Australia and New Zealand have fallen into line with the increasingly widely-accepted view that the apparent simplicity of RVC-based rules is generally an illusion, and that CTC-based rules provide greater certainty and are thus more trade-facilitating.

Australia and New Zealand are accordingly in the process of changing the basis of the CER rules of origin to CTC and CTC-based rules have also been introduced in their respective agreements with Thailand and in the TPSEP. The two countries now have the difficult job of persuading ASEAN that CTC rules rather than the RVC-based rules that they have hitherto considered "best practice" are the appropriate model for the AANZFTA. In the meantime ASEAN has been pressing its other FTA partners and prospective partners to accept 40 percent RVC-based rules, with varying degrees of success. China and apparently Korea have fallen into line, but Japan is still considering whether to deviate from the 60 percent RVC-based rule that it has insisted upon in its bilateral FTA negotiations with individual ASEAN members. Negotiations between ASEAN and India are reported to have broken down at least temporarily over the rules of origin issue.

Given the divergence of approach that has emerged it will obviously be difficult to reach agreement on the rules of origin to be used in AANZFTA, or indeed in the proposed China-New Zealand FTA. This does not lessen the importance of the issue nor the desirability of using the best possible rules of origin and seeking their adoption wherever possible as the common standard for Asia-Pacific FTAs.

It has to be acknowledged that CTC-based rules of origin are not without their own problems. The certainty they provide is a necessary but not a

sufficient condition for facilitating trade. CTC-based rules can readily be made industry-specific and in the process can be designed to facilitate trade or to restrict it in order to protect particular industrial vested interests. They also tend to be non-transparent, in the sense that the rules applying to a particular industry tend to be understood only by the participants in that industry. This non-transparency is of assistance to vested interests in pressing for rules favourable to themselves. The effect of this can be cumulative, since an industry that secures rules protective of itself in one FTA may be encouraged by this success to insist on the same rules in each subsequent FTA negotiated by its government. Negotiation of trade-facilitative rules of origin therefore requires vigilance in these matters on the part of trade negotiators and businesses seeking to expand their market access.

Australia's and New Zealand's case for adoption of CTC-based rules is weakened by the very restrictive approach they have taken to rules of origin for products sensitive to themselves in their respective agreements with Thailand and in the TPSEP. For many textiles and clothing products the rules in these agreements have been made very restrictive by combining the CTC rule with an RVC requirement of 55 per cent in Australia's case and 50 per cent in New Zealand's case. Australia has also combined a CTC rule with an RVC requirement for a wide range of other manufactured products.

There is an urgent need for additional work aimed at improving the approach to rules of origin in New Zealand's FTAs with East Asian (and other) partners. At least four lines of enquiry need to be pursued:

- There has been much anecdotal but little hard empirical evidence on the costs imposed on business by the "spaghetti bowl" effect. Detailed work in this area is urgently needed. It is already known, however, that in some cases the costs are high enough to deter business from utilising available FTA preferences, preferring to export and import at MFN duty rates instead. The extent both of the additional costs and of the resulting non-utilisation of preferences need to be quantified.
- There is an urgent need for a definitive assessment of the relative merits of CTC-based and RVC-based rules of origin. If the assessment favours CTC-based rules, then Australia and New Zealand should not only continue to press for their adoption in AANZFTA but also should also endeavour to persuade ASEAN of the merits of switching to this approach in other agreements as well. If RVC-based rules are shown to be substantially inferior it would be very unfortunate if they became further entrenched as the standard approach to rules of origin in FTAs involving East Asian economies.
- If CTC-based rules are to be advocated there is also a need to assess the precise form of CTC rules that should be adopted. The combination of CTC-based and RVC-based requirements used for some products by

Australia and New Zealand in their agreements with Thailand is clearly not desirable if the aim is to facilitate trade, but it may be that the CTC-only rules used for other products in those same agreements could provide suitable models. In general there are likely to be differences between products as to the precise form of CTC-rule that will be most suitable in each case.

- Once the TPSEP has entered into force it will be useful to assess the experience of allowing New Zealand and Singapore exporters to choose between alternative rules of origin for their exports to each other. If the experiment proves successful it may offer a way out in a situation where a change in approach is considered desirable but where it is also difficult to change the existing rules,

Another potentially important issue is the extent to which market access within FTAs is impeded by regulatory differences between the partners. Where this is the case it is important that as part of the negotiating process the regulatory authorities in the respective partners should be brought into contact with each other, for the purpose of resolving the problems that have been identified.

7. The “Australia Factor”

It has become standard practice for Australia and New Zealand to go their own ways in negotiating separate bilateral FTAs. This trend began in 1979, when New Zealand opted to negotiate a bilateral FTA with Singapore without waiting for possible Australian participation. The AANZFTA FTA negotiation is the one case where the two countries have decided to negotiate jointly. At the same time the two countries have developed a pronounced pattern of negotiating FTAs with the same partner. They each have concluded FTAs with Singapore and Thailand, they are each negotiating with China and Malaysia and as noted above there are the joint negotiations with ASEAN. The glaring exception is Australia’s FTA with the US (AUSFTA). Two other less important exceptions are Australia’s negotiation of an FTA with the United Arab Emirates and New Zealand’s conclusion of the Trans-Pacific Strategic Economic Partnership (TPSEP) with Chile and Brunei as well as Singapore (in which Australia declined to participate despite being invited to do so).

Maintaining parallelism in FTA partners obviously assists in managing the risks associated with the fact that New Zealand and Australia are direct competitors in a number of markets (both product and geographic). Either CER partner would obviously be disadvantaged through being exposed to discrimination wherever it is unable, for whatever reason, to follow the other CER partner in securing an FTA with a country that is an important market for both. The conclusion of AUSFTA and New Zealand’s inability to secure an FTA with the US is the only significant example of this type of situation to date.

However, parallelism in partners does not entirely eliminate the risk for New Zealand. Since Australia is a more attractive FTA partner than New Zealand, due to its much greater market size and the wider range of products that it continues to protect, there must always be the risk that Australia will use its greater negotiating power to secure more advantageous terms than New Zealand from the same partner, to New Zealand’s obvious detriment. In this connection it can be noted for example that the Australia-Thailand FTA contains provisions on services trade whereas the New Zealand-Thailand FTA does not, although further analysis would be needed to establish whether and to what extent New Zealand is disadvantaged by this. Australia might even be tempted in some circumstances to discourage its prospective partners from negotiating a parallel FTA with New Zealand. There have been varying accounts of the Australian and New Zealand approaches to the US, but it is clear that at the very least Australia did nothing to encourage the US to respond positively to New Zealand’s proposal for an FTA.

Another potential disadvantage of the separate pursuit of FTAs by the two CER partners is the potential for rules of origin in their separate FTAs to undermine economic integration already achieved under CER, as in the example of AUSFTA quoted earlier. Also noted earlier was the erosion of preferences in the Australian market as Australia negotiates progressively

more FTAs and of course Australia suffers the same effect in reverse of the New Zealand market, although the impact on New Zealand is more substantial because of its greater dependence on the larger Australian market.

It is clear that it will be difficult now to persuade Australia to adopt as standard practice the negotiation of FTAs jointly with New Zealand, although in principle there would appear to be little to stop this from happening. The argument that divergent interests prevent joint negotiations is not at all convincing. The AANZFTA negotiations with multiple partners on both sides of the table provides one counter-example and there are others involving other country groupings: the ten ASEAN countries themselves are jointly negotiating FTAs with four other separate partners, five Central American countries recently jointly negotiated an FTA with the US and the EFTA countries in Europe routinely negotiate jointly for FTAs with selected partners.

The ASEAN and EFTA examples also negate the argument that countries need to form themselves into customs unions in order to jointly negotiate FTAs with third parties, although it is certainly true that establishment of a customs union makes joint negotiations easier at least in a formal legal sense, because the members of the customs union can negotiate and conclude trade agreements as a single entity. A customs union between Australia and New Zealand was proposed 15 years ago by Peter Lloyd as an essential step towards completing a "single trans-Tasman market", but little serious attention has been given to this possibility.

The members of customs unions must harmonise their tariffs in order to establish a common external tariff and the divergence between Australian and New Zealand tariff structures has traditionally been regarded as too great to allow this to happen easily. Tariff reform in both countries has greatly reduced the degree of divergence, although some potentially intractable issues remain, such as Australia's continued protection of its motor industry against the duty-free entry allowed in New Zealand for both new and used vehicles. Continuation of tariff reform in both countries could easily reduce divergences to the point where a customs union could be more readily considered, although by that time the rationale for such a move may have largely evaporated.

In the meantime a practical measure that the two countries could adopt, which would safeguard existing trans-Tasman integration, would be to reach agreement to negotiate for cumulation to be extended to each other in the rules of origin of their respective FTAs with third parties. In the case of RVC-based rules this would mean that New Zealand content would be treated as equivalent to Australian content for purposes of claiming origin under the rules of origin in Australia's FTAs and similarly Australian content would be treated as equivalent to New Zealand content in New Zealand's FTAs.

In the case of CTC based rules it would mean that the requirement would be applied to the change between the tariff classification of the exported finished product and the tariff classification of inputs imported into either Australia or New Zealand.

8. Implications for APEC

The rapid embrace of preferential trade by APEC members seemed to run counter to the APEC vision of an Asia-Pacific region integrated on the basis of "open regionalism" especially if "open regionalism" is understood in the sense of non-discriminatory free trade and investment. As a consensus-based institution organised around voluntary and non-binding commitments by its members APEC, however, had no power to oppose or even question member governments who decided that pursuit of preferential trading agreements was in their country's best interests.

Initially APEC largely ignored the trend to preferential trade. By 2003, however, APEC members began to express concern at the unconstrained proliferation of free trade agreements in the Asia-Pacific and the fragmentation of markets and potential "spaghetti bowl" effects that were likely to follow as a consequence. The APEC Business Advisory Council (ABAC) became increasingly vocal in expressing concerns over these same issues on behalf of the business community. There was no suggestion that the move to free trade agreements could be stopped, but thought was given to ways of imparting greater order and discipline to preferential trading developments in the region. The accepted focus for these discussions became the identification of the properties of FTAs in the region that would be consistent with the achievement of APEC's Bogor goals.

Although FTAs among APEC members are routinely heralded as "WTO-consistent" it was well understood that for APEC purposes WTO rules on FTAs do not impose adequate discipline on FTA design. On the other hand APEC has no power or capacity to impose or enforce rules of its own. Accordingly APEC members focused on the development of "best practice guidelines" for FTAs that would be consistent with APEC's objectives. A set of such guidelines was adopted by APEC leaders at their 2004 meeting. These guidelines were expressed in fairly general terms, and APEC leaders also made clear that they expected further development of the guidelines to provide greater specificity.

The response of APEC officials has been to initiate a programme for developing "model FTA chapters" to be offered for adoption by APEC members on a voluntary basis. Different member economies are to be assigned responsibility for each chapter, again on a voluntary basis. It remains to be seen whether this process will produce a satisfactory outcome. One risk is that members will develop chapters that reflect their own interests and sensitivities, rather than some objective standard of best practice.

There will also be chapters where members' views on the appropriate approach are in direct conflict with each other. The US for example has clearly used its negotiating strength in bilateral FTA negotiations as a vehicle for securing concessions from its bilateral partners that it has been unable to secure from the wider WTO membership, for example on intellectual property, investment, labour and environmental standards, and capital controls. It would be unlikely to agree to "model chapters" on these matters that did not reflect its preferred approaches, but on the other hand some other APEC members would be unlikely to accept the "US model".

As noted earlier ABAC has put forward a more ambitious proposal that would bypass the "spaghetti bowl" by establishing a Free Trade Area of the Asia Pacific (FTAAP), but the proposal has not so far been taken up by APEC leaders and officials. The FTAAP would be an effective mechanism for safeguarding New Zealand's market access interests in the Asia-Pacific region and it is not surprising that New Zealand has been one of the more enthusiastic supporters of the concept, along with some other smaller APEC economies.

In order to be viable however the FTAAP needs support from the larger APEC economies, and this has so far been conspicuously lacking. The inhibitions over liberalising bilateral trade with each other that have prevented the major economies from establishing bilateral FTAs with each other are also a powerful impediment to the FTAAP. It is also not clear whether East Asian economies would be willing at this stage to subordinate their ambitions for some form of East Asia-wide FTA to the establishment of an APEC-wide FTAAP.

A less ambitious, more gradualist approach to rationalising the Asia-Pacific "spaghetti bowl" has been proposed by the group of smaller economies – New Zealand, Singapore, Chile and Brunei Darussalam – that have established the Trans Pacific Strategic Economic Partnership (TPSEP). This is a high-quality plurilateral agreement that effectively extends the existing bilateral FTA between New Zealand and Singapore. It is designed for relatively easy accession by new members. Accession by other APEC economies is being encouraged and some interest in this has been reported already.

The concept behind this is that by gradually adding new members an agreement like this could gradually build up into a plurilateral FTA covering a significant proportion of the APEC membership. The difficulty in realising this concept is likely to lie once again with the larger APEC economies. Even if TPSEP successfully attracts a number of smaller APEC economies, it is difficult to see larger APEC economies signing on to an agreement that they have had no part in negotiating. Even Australia has held back so far from joining the TPSEP, even though it has a bilateral FTA of its own with Singapore.

Nevertheless the FTAAP proposal and TPSEP do point to possible ways forward towards the rationalisation of preferential trading arrangements in the Asia-Pacific region. They also indicate a recognition, which will surely grow as the proliferation of bilateral FTAs continues that some steps toward such rationalisation are desirable. A key unanswered question, however, is whether the East Asian economies as a group will be willing to entertain APEC-wide approaches to this issue, or whether they will give priority to seeking an East Asia-wide solution, as they currently appear to be doing.

9. Areas for Further Work

In addition to the work programme on rules of origin advocated in the previous section, a number of other areas for further work can be identified from the report:

- As part of the ongoing development of New Zealand's FTA strategy it is important to identify where New Zealand might be most vulnerable to FTA activity by its competitors, to monitor the emergence of threats that might expose those vulnerabilities, and to formulate effective responses to those threats.
- Japan and Korea are key gaps in New Zealand's current FTA initiatives. The obstacles to FTAs with both countries are well-known, but it is important to continue monitoring possible opportunities for progress as well as competitor activity directed towards FTAs with those two countries.
- Promotion of more inclusive approaches to PTA architecture in the Asia-Pacific region is very much in New Zealand's interest. Two avenues currently receiving attention are the proposed FTAAP, and expansion of the membership of existing initiatives along the lines pioneered by the TPSEP. Research directed towards supporting both these approaches should be strongly supported by New Zealand.
- APEC's work programme on model provisions for FTAs should be strongly supported by New Zealand.
- It is important to explore opportunities for greater coordination of FTA activity with Australia, despite the difficulties of doing so. One possibility suggested in the report is the development of a common approach to rules of origin that would involve cumulation, and would safeguard rather than undermine the existing degree of integration achieved between the two countries. Another possibility that could be explored is the establishment of a customs union with Australia, although it is recognised that this might prove difficult in practice.
- Assessment of the provisions for liberalisation of services trade, both in New Zealand's FTAs and FTAs entered into by its competitors is a major undertaking. The pilot study by Sherry Stephenson of Pacific Economic Cooperation Council (PECC) offers an approach that could be extended to additional sectors and FTAs.

FTA Abbreviations

AANZFTA:	ASEAN-New Zealand-Australia Free Trade Agreement
AFTA:	ASEAN Free Trade Agreement covering Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, Cambodia, Laos, Myanmar and Viet Nam.
CER:	Closer Economic Relations between Australia and New Zealand.
CUSFTA	Canada-US FTA
EAFTA:	East Asian Free Trade Area covering ASEAN, China, Japan and South Korea.
FTAA:	Free Trade Area of the Americas embracing every nation in the Americas except Cuba.
FTAAP:	Free Trade Area of the Asia-Pacific, an APEC wide FTA.
NAFTA:	North American Free Trade Area between the US, Canada and Mexico
TPSEP:	Trans-Pacific Strategic Economic Partnership Agreement between Chile-New Zealand-Singapore -Brunei.

Level 7
36 Customhouse Quay
PO Box 10 144
Wellington 6143
New Zealand
Telephone: 64 4 471 2320
Facsimile: 64 4 471 2330
Email: asianz@asianz.org.nz
www.asianz.org.nz

