

# **WTO AND REGIONAL TRADE LIBERALISATION: IMPLICATIONS ON ASEAN**

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## **1. INTRODUCTION**

Until the late 1990s, countries traded more with each other through a multilateral trading system known as the World Trade Organisation. Its main aim was to achieve free trade across the globe based on the principle of non-discrimination. However, during the recent years we have seen more and more countries shifting towards regional trade liberalisation. This is evident by the increasing number of Regional Trade Agreement (RTAs) concluded over the years<sup>1</sup>.

ASEAN is no exception to this growing trend. In last 15 years there have been series negotiations and conclusions of Regional Trade Arrangements. It began with the formation of the ASEAN Free Trade Area (AFTA) in 1992 and following that we have seen a number of Free Trade Agreements (FTAs) concluded between ASEAN and other countries and also a number of bilateral agreements concluded between individually ASEAN Member countries with other countries.

Why the trend towards regionalism? And what implications does RTA have on WTO and ASEAN? These can be answered by understanding the workings of WTO and its relationship with RTAs.

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<sup>1</sup> As of January 2005, 312 RTAs had been notified to the WTO, 170 of which are currently in force (Crawford and Fiorentino 2005)

## 2. BASIC PRINCIPLES OF THE WTO

Before I begin to say further on the benefits and consequences of RTAs, let's examine the current multilateral trading system. The World Trade Organisation, commonly known by its acronym WTO, was founded in 1995 after the "Uruguay Round". It is the successor to the General Agreement on Tariff and Trade (or "GATT"), which was created in 1948. WTO administers the trade arrangements negotiated by its members, in particular the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), and Trade-Related Aspect of Intellectual Property Rights (TRIPS) agreement.

The workings of the multilateral trading system are based on a few important principles, which are as follows:

- **Non-discrimination**

Non-discrimination has two major components: the most-favoured nation (MFN) rule, and the national treatment principle. MFN rule requires that a product made in one member country be treated no less favourably than a "like" good that originates in any other country (Article I of GATT). MFN is the *basic* pillar of the WTO. One of the reasons for this is economic; if policy does not discriminate between foreign suppliers, importers and consumers will have an incentive to use lowest-cost foreign supplier. It also helps enforce multilateral rules by raising the costs to a country of defecting from the trade regime to which it committed itself in an earlier multilateral trade negotiation. If the country desires to raise barriers, it must apply the changes regime to all WTO members.

National treatment requires that foreign goods, once they have satisfied whatever border measures are applied, to be treated no less favourably, in term of internal (indirect) taxation than or directly competitive domestically produces goods (Article III GATT). National treatment ensures that liberalisation commitments are not

offset through the imposition of domestic taxes and similar measures. The requirement that foreign products be treated no less favourably than competing domestically produced products gives foreign suppliers greater certainty regarding the regulatory environment in which they must operate.

- **Reciprocity**

Nations try to provide similar concessions for each other. This is a fundamental element of the negotiating process. It reflects the desire to limit the scope of free-riding that may arise because of the MFAN rule and desire to obtain “payment” for trade liberalisation in the form of better access to foreign markets.

- **Transparency**

Negotiations and process must be fair and open with rules equal for all. Transparency is the basic pillar of the WTO, and it is a legal obligation, embedded in Article X of the GATT and Article III of the GATS. WTO members are required to publish their trade regulations, to establish and maintain institutions allowing for the review of administrative decisions affecting trade, to respond to requests for information by other members, and to notify changes in trade policies to the WTO.

- **Special and Differential Treatment**

Recognition that developing countries may require “positive discrimination” because of historic unequal trade.

- **Binding and Enforceable Commitments**

Liberalisation commitments and agreements must abide by certain rules and be enforced. The non-discrimination principle, embodied in Article 1 (on MFN) and III (on national treatment) of the GATT, is important in ensuring the market access commitments are implemented and maintained.

### **3. REALITY DIFFERENT FROM IDEALISM**

Theoretically, these principles sound good. Indeed, a majority of nations believed so as evident from the substantial number of countries that has become member of the WTO<sup>2</sup>. With the exception of Laos PDR and Viet Nam, all the ASEAN member countries are member of this multilateral trading system which also emphasises the fact that this region considers WTO to be an important international forum for negotiating trade between countries.

However, in practice, political, economical and security considerations have made the multilateral trading system a different reality altogether. No doubt the membership of over a hundred countries in the WTO is an attribute to this factor. The large number makes negotiations more complicated and difficult to resolve particularly the attainment of agreements and resolutions under the most Favour Nation (MFN). This has slowed the process of trade negotiations and consequently has left countries to become more disillusioned leaving numerous important unresolved issues<sup>3</sup> in the WTO negotiations. It is expected that the recent indefinite suspension of the long-faltering Doha round negotiations<sup>4</sup> will lead to more practice of regionalism round the globe.

### **4. WTO RULE ON REGIONAL TRADE LIBERALISATION**

The practice of having regional trade liberalisation has existed way before the establishment of the WTO. The provision for RTAs has been embodied in the original agreement denoting that even prior to WTO, this trend has been recognised.

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<sup>2</sup> To date, there are 149 countries who are member of the WTO

<sup>3</sup> the so-called “Singapore Issues”: trade and investment, trade and competition policy, and transparency in government procurement.

<sup>4</sup> WTO Director-General, Pascal Lamy, had recommended to suspend the Doha Round trade negotiations because of persistent differences at its 27-28 July General Council meeting.

Regional trade liberalisation are provided under Article XXIV of GATT is considered to be an exception to the MFN clause. This article allows for FTAs and customs union if trade barriers after integration do not rise on average (Article XXIV: 5); all tariffs and other regulations of commerce are removed on substantially all intra-regional exchanges of goods within a reasonable length of time (Article XXIV:8) and they are notified to the WTO council.

Similarly, Article V of GATS<sup>5</sup> allows for Regional Trade Agreements on a discriminatory basis, subject to conditions and surveillance. These conditions include substantial sector coverage, elimination of discriminatory measures, notification and examination and flexibility for least developed countries.

Since the notion of the non-discrimination as specified by the MFN clause is at the heart of the WTO system, the existence of RTAs is not without controversy. However, WTO members still recognise<sup>6</sup> the important role of RTAs in promoting trade liberalization and in fostering economic development, and the need for a cordial relationship between the multilateral and regional processes<sup>7</sup>.

## 5. NATURE OF REGIONAL TRADE LIBERALIZATION

According to the Dictionary of Trade Policy Terms, Regionalism is described as “actions by governments to liberalize or facilitate trade on a regional basis, sometimes through free-trade areas or customs”.

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<sup>5</sup> The provision is entitled Economic Integration , not Free Trade Areas and Customs Unions (as in Article XXIV GATT), reflecting the fact that the GATS covers not only cross-border trade in services but three other modes of supply.

<sup>6</sup> at the 4<sup>th</sup> Ministerial Conference in Doha.

<sup>7</sup> The Changing Landscape of Regional Trade Agreements *by Jo-Ann Cranford and Roberto V.Fiorentino*

In the WTO context, regional trade agreements (RTA) have both a more general and a more specific meaning: more general because RTAs may be agreement concluded between countries not necessarily belonging to the same geographical region; more specifically, because the WTO provisions which relate specifically to conditions of preferential trade liberalization with RTAs.<sup>8</sup>

In recent years, the world has seen a rapid growth in the number of RTAs around the globe<sup>9</sup>. Since the beginning of the 1990's, the number of regional trade agreements has increased tremendously. It is an economic phenomenon which is happening not only in the Asia-Pacific region but also in other parts of the world. The most common type of typologies of RTA is Free Trade Agreements (FTAs), which accounts for about 84 % of RTA. Customs Union accounts for 8%. Whereas the remaining percentage accounts for Partial scope agreements.

A significant feature of modern RTAs is that it does not just provides for the traditional tariff-cutting exercises, but they go beyond to cover services, labour mobility, investment, competition policy, trade facilitation, government procurement, intellectual property rights, contingency protection, environment and rules of origin. so on. In one important development, a number of these agreements even provides for the use of competition policy instruments in place of anti-dumping procedures on trade among parties.<sup>10</sup>

The wider scope of the new agreements is meant to allow for greater efficiency gains than is possible from the elimination of frontier alone. The elimination or harmonisation of technical barriers is the key to achieving economies of scale as well as helping regional industries to become more competitive internationally.

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<sup>8</sup> [www.wto.org/English/tratop\\_e/region\\_e/scope\\_rta\\_e.htm](http://www.wto.org/English/tratop_e/region_e/scope_rta_e.htm)

<sup>9</sup> As of January 2005, 312 RTAs had been notified to the GATT/WTO.

<sup>10</sup> The EU, the EEA, the Australia-New Zealand Agreement on Closer Economic Relations, and Canada-Chile FTA.

Another feature of the new RTA is that traditionally, RTA formation occurred between so-called “natural” trading partners, geographically contiguous countries with already well-established trading partners<sup>11</sup>. Nowadays, RTAs are expanding and consolidating across regions and within continents<sup>12</sup>.

## 6. RTA AND ASEAN

Looking at ASEAN’s commitment for economic integration and trade liberalisation, it is evident that this region has been actively engaging in regional and bilateral FTAs in the recent years.

Initially, there was the conclusion of the ASEAN Free Trade Area or more commonly known as AFTA in January 1992. The basic feature of AFTA is liberalisation of trade in the region via the elimination of intra-regional tariffs and non-tariff barriers through the Common Effective Preferential Tariff (CEPT)<sup>13</sup> Scheme for AFTA. It has been stressed that AFTA is considered to be an outstanding example of ASEAN’s commitment to regional economic integration. It has been stated that tangible benefits have since been derived with high GDPs maintained, with the exception of the regional financial crisis in 1997.

In 2002, the ASEAN-China FTA<sup>14</sup> was signed. The FTA, a zero-tariff market of 1.7 billion people, has been targeted to come into force in 2010 for the six original<sup>15</sup> ASEAN

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<sup>11</sup> Examples: Australia and New Zealand, the NAFTA Countries, the EC, EFTA and CEFTA.

<sup>12</sup> Most countries today belong to at least one RTA. All but one WTO Member, Mongolia, are engaged in RTAs of one sort or another.

<sup>13</sup> CEPT is a common arrangement between Member Countries whereby intra-regional tariffs will be brought down to within the 0-5% tariff band over a period time, i.e. 2002 – ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand); 2006-Viet Nam, 2008-lao PDR and Myanmar; 2010-Cambodia. Non-tariff barriers will also have to be eliminated under the CEPT Scheme.

<sup>14</sup> Framework Agreement on Comprehensive Economic Cooperation between ASEAN and the People’s Republic of China (2002)

members and in 2015 for the other four<sup>16</sup>. Implementation of the framework agreement would occur in stages. An early harvest programme covering trade in goods came into force in July 2005 where tariff on most of the products traded are to be removed or reduced.

Japan entered to FTA<sup>17</sup> with ASEAN in 2003. The six founding ASEAN members and Japan made a schedule to establish a free trade area by 2012, and the newer members by 2017. At the Second ASEAN-India Summit in 2003, the ASEAN-India Framework Agreement on Comprehensive Economic Cooperation was signed by the Leaders of ASEAN and India. The Framework Agreement laid a sound basis for the eventual establishment of an ASEAN-India Regional Trade and Investment Area (RTIA), which includes FTA in goods<sup>18</sup>, services, and investment.

ASEAN entered into an FTA with Korea in 2005<sup>19</sup> which entered into force this year. The FTA aims to strengthen and enhance economic cooperation through progressive elimination of tariffs and non-tariff barriers in trade in goods and progressive liberalisation of trade in services.

ASEAN is currently engaging in negotiations with Australia and New Zealand for an ASEAN-Australia-New Zealand FTA (AANZFTA). Negotiations on Rules of Origin, Services, investment and legal institutional issues are targeting for completion in March 2007.

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<sup>15</sup> Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand

<sup>16</sup> Cambodia, Laos PDR, Myanmar and VietNam.

<sup>17</sup> ASEAN-Japan comprehensive economic partnership (CEP)

<sup>18</sup> The FTA in goods was scheduled to be established by 31 December 2011 for Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand, and India, while the deadline for the Philippines and CLMV countries is set for 31 December 2016.

<sup>19</sup> Framework Agreement on Comprehensive Economic Cooperation among the Governments of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea Kuala Lumpur, 13 December 2005

At the same time, individual ASEAN member countries are also pursuing bilateral arrangements with a number of countries within and outside this region, such as, Singapore-Japan, Singapore-US, Singapore-India, Malaysia-Japan, Philippines-Japan, etc.

As can be seen, ASEAN are parties to, or in the process of negotiating, one or more free trade arrangements not only with countries within the region but outside the region as well. For this reason there have been talks to form an East Asian Free Trade Area (EAFTA) which is envisaged to facilitate the integration of the East Asian economies, ultimately leading to an East Asia Economic Community. Furthermore, EAFTA, which can take the form of encompassing bilateral and sub-regional free trade areas in the region, seeks to boost not only intra-regional trade and investments, but also cooperation among East Asian countries including human resource development, tourism, security, environment, and financial services. EAFTA is seen as a prelude to the ASEAN Common Market by 2020 where there is free movement of goods, services, investments and people.

## **7. WHY ARE RTAS FAVOURED?**

The main purpose of FTAs is to secure trade liberalisation. While the traditional debate about FTAs is the danger that they can divert rather than create trade, the record to date suggests there has been little diversion and that FTAs and regional agreements have been effective in encouraging wider trade liberalisation.

A more practical advantage of RTAs is that they are quicker and easier to negotiate than multilateral agreements because fewer parties are at the table. Parties can secure advantages that are harder to win in bigger forums. Hence, more countries are taking this route because such RTAs are often a more practical and feasible way to liberalize trade. RTAs can bring faster results than the multilateral process. It enables the Parties to make commitments that are more meaningful and more trade liberalizing than a multilateral undertaking. And often RTAs can address issues that are not on the multilateral agenda. It can also deal with tough issues which often cause deadlocks in multilateral negotiations. In

cases of bilateral agreement, it may be used as leverage to facilitate domestic reforms, particularly in areas that are not dealt with multilaterally, such as investment, competition, and environmental and labor standards

Supporters for FTAs view regionalism as a building block for multilateralism. The number of existing RTAs can produce a multilateral trade agreements which otherwise would have been held up under the WTO level. Bilaterals can also become building blocks for regionalism. Take for instance, under the ASEAN-Japan FTA, in order to realise the ASEAN-Japan comprehensive economic partnership (CEP), Japan has signed economic partnership agreements (EPAs)<sup>20</sup> with Singapore, Malaysia and the Philippines. The EPAs are different from a free trade area (FTA) since they would go beyond trade and will encompass services, investments, tourism, standardization of regulation and intellectual property rights and others. The EPAs are supposedly similar to the CEP and therefore will serve as building blocks for the realization of the ASEAN-Japan CEP, including the most lucrative ASEAN-Japan FTA by 2012.

Other argument for RTAs is that countries may hope to maximize their benefits through so-called first-mover advantages. That is, they focus on the gains they could obtain from signing an agreement with a large trading partner before competing countries do so. Or they may seek to pre-empt other countries, by denying them first-mover advantages. In RTAs, countries may also seek to guarantee permanent access to particular markets. Signing an agreement bilaterally or regionally may be the quickest and easiest way of achieving that goal.

In cases of FTAs, they are also comprehensive in scope and the most recent agreements often go beyond the WTO regulatory framework to include, *inter alia*, provisions on investment, competition, intellectual property, environment and labour. This probably depends where countries place its interest in such issues.

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<sup>20</sup> Brunei Darussalam is currently under negotiation with Japan on an EPA.

## 8. COSTS AND CONSEQUENCES OF RTAS

Naturally, RTAs has its drawbacks and one of the most well-known problems of an RTA is the “spaghetti bowl” effect<sup>21</sup> or “noodle-bowl” effect of multiple or overlapping RTAs. The more dimensions there are to an agreement, the more scope there is to apply discrimination in a variety of ways and the more difficult it is to bolt together the agreements that emerge. The range of the issues now being considered, such as services, standards and investment, add to the dimensions of the agreements. The outcome could be a bowl of noodles made up of criss-crossing of agreements, of different content, applying different principles in resolving new issues.

This in turn could also contribute to the increase of cost of doing business due to the inconsistencies between the various elements of the agreements, such as different schedules for phasing out of tariffs, different rules of origin, exclusions, conflicting standards and differences in rules dealing with anti-dumping and other regulations and policies. The more dimensions there are to the new agreements and the more agreements there are, the wider the scope for inconsistencies. For example, complicated rules of origin are required to prevent third country product entering via the other party. With different rules negotiated under different agreements, enforcement of these rules and compliance with them by business can be a complicated task. Business also has to take into account the different dispute settlement mechanisms as well as different standards regimes and other harmonisation arrangements.

The broad coverage of RTAs today also makes it a complex one. They contain provisions applicable to subjects that go beyond those negotiated at the WTO level, *inter alia*, investment, competition, environment, and labor. Other arguments against RTAs also

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<sup>21</sup> In describing the spaghetti bowl effect, Bhagwati, a famous modern-day economist from the Columbia University, warned that bilateral FTAs could create regulatory complexity and confusion in trade policy, particularly in the administration of overlapping, contradictory, and mind-bogglingly complicated rules of origin requirements.

includes the believe that a proliferation of intra-regional or bilateral FTAs risks distorting trade flows, complicating trading rules and undermining multilateral free-trade initiatives, particularly the WTO's Doha Development Agenda.

Adding to the disadvantages, the negotiation of RTAs is resource intensive and there can be an 'opportunity cost' in devoting resources to bilateral or regional, as opposed to multilateral<sup>22</sup>. Take for example, under the ASEAN trade negotiations; the Trade Negotiating Committee (TNC) has been tasked to deal with the details of RTAs which ASEAN has been committed. In efforts to meet deadlines, the committee meets quite frequently, and taking into account the several RTAs that exist in this region, such meetings can put a strain on the resource of one country especially when several FTAs are negotiated simultaneously or consecutively one after the other.

Another issue is the procedures of the dispute settlement regime. Most RTAs also have provisions on dispute settlement although often they do not set out the procedures in detail. In many cases, RTAs rely on arbitral tribunal for the resolution of disputes, instead of a panel as in the WTO, and the rules and procedures of the arbitral tribunal are not predetermined in detail. The arbitral tribunals are conducted, for instance, in accordance with the UNCITRAL Arbitration Rules or any other agreed rules and procedures between the contracting parties. In some of the recent agreements such as the Japan-Singapore Economic Partnership Agreement, the rules and procedures for arbitration are set out in detail. Usually, all provisions of the agreement are subject to arbitral tribunal.

Some RTAs such as Japan-Korea Investment Treaty or NAFTA have introduced an investor-to-state dispute settlement mechanism. This is a mechanism that allows investors of a Party to submit a claim to an arbitral tribunal that another Party has breached an obligation and caused losses to them. It is a major departure from the intergovernmental mechanism

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<sup>22</sup> The NAFTA agreement, for example, was over one thousand pages long and required the establishment of more than two dozen committees and working groups.

under the WTO where only Members are qualified to resort to the dispute settlement mechanism.

## **9. RTA AND BRUNEI DARUSSALAM**

Regional and bilateral free trade agreements have become an important part of Brunei Darussalam's international trade policy. Brunei Darussalam has used free trade agreements / closer economic partnerships to liberalise trade within ASEAN and other countries.

Brunei is one of the originating six members of AFTA. To implement the CEPT/AFTA commitments, Customs (ASEAN Common Effective Preferential Tariffs Order has been adopted in 2005 which enables all imports from ASEAN under the CEPT/AFTA to receive tariffs of 0-5 per cent.

As part of ASEAN, Brunei is engaged in FTAs with China, Korea, Japan and India. Brunei is party to the Free Trade Agreement with Chile, New Zealand and Singapore known as the Trans Pacific Strategic Economic Partnership or more commonly referred to as the P4 Agreement which was concluded in 2005.

In terms of implementation, Brunei has laws which enforce its FTA commitments domestically. The Customs (Goods under the Early Harvest Programme) (Framework Agreement on Comprehensive Economic Co-operation between ASEAN and China) Order which came into force in 2005, implements the Early Harvest Programme in Brunei under ASEAN-China FTA.

## **10. CONCLUSION**

Despite the failure of the Doha round, the WTO still holds an important role as the world's multilateral trading system providing an international forum for trade between

countries. The positive relationship between WTO and RTAs can be seen still be seen in a number of arguments.

*First*, it is argued that RTAs, by moving at a faster pace than WTO rules, while sharing its goals, represent a way of strengthening the latter. *Second*, smaller regional groupings may be more effective in tackling new areas such as services, investment, intellectual property protection, cooperation in competition policy, technical standards and government procurement compared to multilateral rule-making. By acting as laboratories to try out alternative rules and strategies to encompass these issues, it is argued that they can ease the reaching of agreements on these issues at the multilateral levels.

*Third*, despite the fears of trade diversion, the empirical evidence suggests that trade-creating effects dominate in major RTAs thus enhancing world welfare. A study conducted by the WTO Secretariat showed that there had been a definite trend toward broader as well as faster market access liberalization on non-tariff measures in RTAs, in parallel to developments in the WTO<sup>23</sup>. Also, although on a simple static analysis third parties may be disadvantaged by trade diversion, this is less obvious in a dynamic context if overall growth, and hence the demand for imports, is increased as a result of the integration process<sup>24</sup>. *Fourth*, it is argued that RTAs have had a positive effect by facilitating the integration of developing countries into the world economy.

ASEAN should not be frustrated with the recent suspension of the Doha round. In fact, ASEAN should still continue to place highest priority on the role of the WTO. Regional trade liberalisation can still be pursued by meeting the conditions and guiding principles of the WTO rules on RTAs.

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<sup>23</sup> WTO (1995)

<sup>24</sup> Crawford and Laird, 2000

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