



Economic Freedom Network Asia

"Preferential Trade Agreements: Local Solutions for Global Free Trade" 8th Annual Conference

In recent years, there has been a sharp increase of interest in bilateral and regional Preferential Trade Agreements (PTAs), especially in East and South-East Asia, where many countries are in negotiations or have already signed preferential trade agreements with important economies such as China, Japan and the USA.

While this appears to be a rational, local response to the lack of progress in multilateral trade agreements, following stalls in the Doha round of negotiations at the World Trade Organisation (WTO), there is widespread disagreement of how beneficial or not such agreements may be. Indeed, big differences of opinion can be found even among advocates of freer trade, as could be seen among the participants and speakers of the 8th Annual Conference of the Economic Freedom Network Asia, which was held in Kuala Lumpur, Malaysia, from September 12th to 13th, 2006.

In his opening speech, **Mohamed Ariff**, Executive Director of the Malaysian Institute of Economic Research (MIER), one of the host organisations noted that "some have postulated that BFTAs (Bilateral Free Trade Agreements) are 'building blocks' of global free trade, while others view them as 'stumbling blocks'", that undermine the attempt to establish a global consensus through a multilateral agreement on trade.

One particular concern raised throughout the conference, concerns multiple "Rules of Origin", that determine the eligibility of products to receive preferential treatment. In a modernized world, the inputs for most products usually originate from more than just one country, making it very problematic to determine if a given product, or rather how much of it, was in fact produced in the country party to the BFTA. At present, there is no universal standard for determining rules of origin, which raises transaction cost, as companies have to employ lawyers and other specialists to work out how to comply with multiple rules. This is a "nightmare for business", and not just for the large corporations, who can afford to do so, but also small companies which are unable to take advantage of the agreements.

Yet these negative considerations are outweighed by the perceived costs of being left behind. According to Ariff, "BFTAs ... are all by design discriminatory, trade-distorting, messy and cumbersome. Even so they are temptingly attractive. Arguably it is unwise to reject the BFTA option simply because it is no more than second best, especially when one's competitors are already at it".

His views were echoed by those of his colleague, **Tan Sri Dato' Mohd Sheriff Kasim**, Chairman of the Board of Trustees of MIER, according to whom Malaysia cannot sit back and watch as neighbours Thailand and Indonesia sign trade agreements with the USA and other important economies. As an externally-oriented economy, Malaysia has

much to lose if it does not retain its position as an attractive destination for investment and a competitive location for export industries. Thus, while Malaysia would ideally prefer to further trade liberalisation multilaterally under the auspices of the WTO, and regional trade under ASEAN, it has to consider reality, and weigh this preference against the opportunity-cost of not engaging in its own bilateral agreements. Consequently, Malaysia has recently signed an FTA with Japan, and is presently in negotiations with the USA, New Zealand, Australia, Pakistan and Chile.

This point was reinforced by **Christopher Dent** of the University of Leeds, who cites the fear of exclusion after the US-Singapore FTA as the main reason for the rush into preferential trade agreements in the ASEAN region. While the opportunity-cost of not engaging in a PTA are high, the costs of engaging in PTA negotiations are also tremendous, and will usually exceed *several* Million US dollars. This cost factor is the major reason why small economies do not engage in PTAs with each other. Detailed impact assessments have to be undertaken on the various affected sectors, and the failure to do this thoroughly usually results in failure of the PTA. As Dent pointed out, a considerable number of PTA negotiations have stalled, chiefly due to the lack of preparation that has gone into them, as was the case in the stalled BFTA between Korea and Thailand.

Dent also pointed out that while each PTA is different, the world's most powerful economies each have their own models with some striking differences from one another. Japan and China both emphasise economic cooperation, with Japan preferring to package its PTAs as Economic Partnerships Agreements, which include capacity building measures for the partner country, while China's emphasis on economic cooperation signifies a willingness to negotiate over contentious issues such as international property rights.

For the European Union and the United States, PTAs are not just about trade but a whole series of other objectives, mainly relating to investment conditions in the partner economy. As stated by **Colin Helmer**, Economic Counselor of the US Embassy in Malaysia, the USA takes a comprehensive approach to bilateral and regional PTAs including trade related labour and environmental issues. While this is far more challenging to negotiate, the benefits to be gained are much greater, than simply "cherry picking", the liberalisation of less contentious sectors. This point was taken up by Christopher Dent, who argued that the choice of recent PTA partners for the US has in fact been a "cherry picking" of sorts. The countries it has made agreements with, such as Chile, Australia and Singapore, with their open economies pose no threat to the protected US agricultural sector. In the case of the Australia-US FTA, important farm products, notably sugar and beef, were deliberately excluded.

Thierry Rommel, the Head of the European Commission Delegation to Malaysia, was even more critical, calling for the US to change its attitude, and match the EU's recent offer to fully eliminate all export subsidies in the agricultural sector. The EU's position on bilateral and regional trade agreements is that they are a supplement, but not an alternative to multilateral trade. According to Rommel, the EU has not been very active in pursuing PTAs as it is concerned that these will undermine attempts to revive the Doha round of WTO negotiations.

The second day of the conference consisted of panel discussions on trade agreements within and among specific regions, namely South Asia, with its South Asia Free Trade Agreement (SAFTA), and East Asia with the Asian Free Trade Agreement (AFTA), as well as a panel on the Free Trade Agreements of Europe (EFTA), North America (NAFTA) and South America (Mercosur).

Despite the fact that it has a regional trade agreement (SAFTA), the South Asian region has made little progress in fostering regional trade and economic integration. This has resulted in a number of other attempts to deepen trade, both bilaterally and regionally, through BIMSTEC, another regional grouping which excludes Pakistan. According to **Rajesh Mehta**, Senior Fellow at RIS, India, the SAFTA, like many so-called free trade agreements, falls short of achieving its aims as it contains many exceptions. As his fellow panellist, **Dushni Weerakoon** of the Institute of Policy Studies in Sri Lanka explained, more than 50% of all intra-SAARC trade imports are heavily restricted, and the agreement includes an extensive "Sensitive List" of over 800 items that are excluded. This is in stark contrast to the India-Sri Lanka FTA, of which Dushni Weerakoon gave a positive assessment, as less than 14% of Sri Lankan exports are restricted under the Indian sensitive list.

Most panellists concurred that the chief culprit for this lack of depth to the SAFTA has been the conflict between its largest states, India and Pakistan, and lamented the lack of political will to solve this. However, according to **Ravi Karunanayake**, MP, the former Minister of Trade, Commerce & Consumer Affairs of Sri Lanka, this lack of political will is also matched by a lack of enough initiative from the private sector. The private sector is not asserting its rights as much as it could and should.

Unlike the South Asian region, the driving force behind East Asian trade agreements is the private sector. East Asia has a much higher level of economic integration, comparable to that of the EU and NAFTA, which **Kriengsak Charoenwongsak**, MP, Democrat Party of Thailand, believes will continue and increase as countries deepen their trade relations. This success has been achieved despite a number of obstacles, including; vast differences in the sizes and level of development of the different economies, diversity of religion and cultural values, the lack of a clear legalistic tradition, poor institutional frameworks, strong interest groups and ingrained protectionist tendencies. Moreover, the legacy of past conflicts and strong nationalism act against the need to give up some sovereignty. There is also a lack of political will, as politicians fear making mistakes. As a politician himself, he believes it is very difficult to overcome these obstacles without addressing the issue of compensation. This is a controversial point as it is difficult to justify why those who benefited from unfair advantages prior to a PTA, should be entitled to any compensation. However, the removal of privileges has a wider impact. When companies lose their privileges, jobs may be lost, producing social costs that cannot be ignored by a politician seeking election.

On the issue of compensation, there was strong disagreement from **Arianto Patunru**, the Deputy Director of the Institute for Economic and Social Research at the University of Jakarta. The experience of Indonesia, which proceeded with a compensation programme after the removal of oil subsidies, is that such programmes don't work, as the funds do not reach the intended persons. In his view, the notion that multilateral

trade is the ideal, with regional and bilateral agreements as second best solutions, is incorrect, as the ultimate solution according to the ideas of economic freedom is a world without borders. Hence, countries should not stoop to mercantilist approaches, but open their markets unilaterally and admit that imports are good just as exports are.

This point was echoed later by **Ricardo Lopez-Murphy**, the chairman of the Civico-Republicana Foundation of Argentina, who lamented that his own country did not follow the enlightened example of its neighbour, Chile, which has unilaterally opted for free trade. For Lopez-Murphy, Chile and Hong Kong present excellent examples of the benefits that unilateral removal of protectionism brings, but he conceded that such a policy is politically difficult to introduce, because there are many vested interests in protectionism. This is why he accepts Kriengsak's points about the need to address the issue of compensation up to a degree, on the condition that "the compensation should not go to those who benefited from protectionism but to the poor". While the issue of compensation doesn't agree with the principles of economic freedom, it raises the important question of how to find a balance between idealistic aspirations and political reality.

Unfortunately the concept of economic freedom is not well understood. Economic freedom is about personal choice, limited government, competition, the rule of law and the security of property rights. As **Wolf-Dieter Zumpfort**, the Deputy Chairman of the Friedrich Naumann Foundation pointed out, economic freedom is highly beneficial to ordinary people, and not just for the benefit of big business, as some critics like to claim. It has proven to generate wealth economic growth, lower unemployment and human development. The Fraser Institute's *Economic Freedom of the World* report, the latest edition of which was launched at the conference, clearly shows that economic freedom has a greater impact than foreign aid in helping poor nations escape poverty, evidence corroborated by data from the World Bank.

It is a positive sign that governments all over the world are beginning to realise that protectionism and other forms of state intervention have not produced the desired results. Whether they can assert themselves against vested interests and enact policies that aim at liberalising their economies and promoting free trade, remains to be seen.

The 8th Annual Conference of the Economic Freedom Network Asia on "Preferential Trade Agreements: Local Solutions for Global Free Trade" was organised by the Friedrich Naumann Foundation and the Malaysian Institute for Economic Research, in cooperation with the Atlas Foundation, and held at the Corus Hotel, Kuala Lumpur, Malaysia from September 12-13, 2006.