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### **American and European Competing Strategies in Free Trade Agreements in the Asia Pacific**

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# **American and European competing strategies in Free Trade Agreements in the Asia Pacific**

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## **Abstract**

*The 2000s have witnessed an unprecedented rise in free trade agreements in Asia. Wishing to retain their relevance in this thriving economic region, the USA and European Union are also striving to acquire agreements with partners in Asia. This paper charts their respective economic and political motivations for their trade agreement strategies in the region, and reveals the importance of regulatory expansion and completion amongst them as crucial motivating factors.*

## **1. Introduction**

This paper charts the motivations behind the free trade agreements (FTAs) policies of the EU and USA in the Asia Pacific region. Economists have cast doubts as to the benefits of individual FTAs between large and smaller economies (Krugman 1993; Bhagwati 2008). Whilst the benefits of FTAs are asymmetrical, offering advantages to particular economic sectors, notably exporters and in the new generation agreements of the EU and USA also to service providers, the overall net welfare gains for the larger economy tend to be minimal (Ahearn 2010). Within this context, political economists have found FTAs carry significant political motivations as well, ranging from altering domestic coalitions against liberalization, to locking in domestic reforms, or emulating others (Aggarwal & Urata 2006; Ravenhill 2003). This paper

further focuses on the political motivations behind these powers' policies. It refines an analytical framework of competitive diffusion (Solis & Katada 2009) by offering evidence of economic balancing taking place, as these powers prepare for an uncertain future. The paper is organized as follows: the second section briefly outlines the background to FTAs, the third and fourth section look at the USA's and EU's FTA policy respectively. The fifth section discusses some implications of the agreements. A final section offers some concluding remarks on the divergences and convergence points between strategies.

## **2. Background to Free Trade Agreements**

Preferential and regional trade agreements are not new, but their numbers have multiplied exponentially since the 1990s, alongside the international organization-led preference for liberal economic reforms. The 2000s have witnessed further explosion of these arrangements, under the official label of free trade agreements. Detractors claim this is a misnomer as agreements vary in the degree of liberalization, trade facilitation and sector coverage that the signatory parties commit to. Nonetheless, for simplicity this paper uses the term FTA as shorthand for free and preferential trade agreements. The dramatic increase in FTAs in the 2000s has been characterized by the geographic extension of this phenomenon to the Asia-Pacific region, especially to Asian states, and the USA, which until that moment had remained on the sidelines of FTA developments. This era has also witnessed agreements amongst developing economies and between developed and developing states (Fiorentino et al. 2007). The growth of cross-regional FTAs in the 2000s has also defied explanations of economic integration placing an emphasis, amongst other variables, on geographic proximity (Krugman 1991a, 1991b; Jacquenin & Sapir 1991) through gravity models (Deardorff 1998).

This proliferation of FTAs also challenges strictly economic logics. 'Trade diversion' and 'trade creation' are key elements in economic explanations of FTAs (Viner 1950). Richard Baldwin (1993) maintains that fears of trade diversion from FTAs negotiated by other states will

encourage a ‘domino effect’ where outsiders to FTAs will want to become insiders, thus expanding free trade. Pressures to join FTAs are said to derive from export-oriented producers lobbying the governments (Dür 2007). However, the welfare outcomes of many FTAs are scant (Ravenhill 2003). Models of projected outcomes for agreements, typically, predict scarce increases in welfare. From the EU-South Korea FTA, for example, a mere 0.02 percent increase in EU GDP is expected, and between 0.5 and 0.8 percent GDP increase for South Korea (Decreux et al. 2010). Moreover, often exporting lobbies’ pressure is either absent, mild, or only activated once the political momentum for FTA negotiations has begun (Ravenhill 2010; García 2008).

Political economists have argued in favour of a host of political rationales behind the proliferation of FTAs such as learning processes, locking in domestic liberalization reforms, sending signals to other potential FTA partners and strengthening their position in other negotiations (Aggarwal & Urata 2006; Ravenhill 2003). John Ravenhill (2009: 199) offers compelling evidence from East Asia for a ‘political’ rather than economic ‘domino effect’. This is characterized by ‘shallow’ intergovernmental agreements that do not extend economic liberalization reforms beyond what these states already apply through the WTO. Instead, they reflect ‘governments’ primary concern’ as ‘potential exclusion from a new dimension of regional economic diplomacy’. Mireya Solis and Saori Katada’s (2009) ‘competitive diffusion’ concept also places the motivation for FTAs in the governments’ hands, and argues that emulation of others’ policies plays an important role.

The rest of this paper focuses specifically on the USA’s and EU’s FTA policies, particularly in East Asia. These, too, possess a strong political motivation, although expressed in a different way. Unlike the economically ‘shallow’ agreements amongst Asian economies, EU and USA FTAs aim to incorporate ‘deep’ trade issues (elimination of behind the border obstacles to trade in the form of regulations, harmonizing competition policy, liberalizing trade in services, opening national government contracts and public procurement to foreigners, and tightening the

protection of intellectual property rights). The Doha round of WTO negotiations initially aimed to incorporate these matters. This proved, however, impossible. Subsequent sections reveal that the USA made a conscious decision to extend these via bilateral ‘deep’ agreements. The approach combines political and long-term economic objectives. Political motivations include maintaining and extending its preferred regulatory system and gradually defeating opposition to its preferred system; creating a ‘domino effect’ amongst third parties. A long-term economic objective is securing advantages for certain economic sectors from more open markets and the acceptance of their standards and regulations.

A similar set of incentives and objectives is evident in the EU’s FTA strategy. However, as a late comer into FTAs in East Asia, a further motivation of competition with the USA is apparent. Furthermore, all EU FTAs are accompanied by a political Framework Agreement, which institutionalizes cooperation on a host of political, environmental, security and social issues, as well as incorporating the EU’s international ‘normative power’ agenda of extension of human rights and democratic values (Manners 2002), again revealing an intricate connection between political and economic motivations.

### **3. USA FTA Strategy in East Asia**

As Nicola Phillips (2007) has highlighted, USA foreign policies are by nature a combination of security, economic and other goals. The USA’s trade policy in East Asia has followed two key logics. On the one hand the pursuit of bilateral FTAs since the early 2000s is a response to the difficulties concluding the Doha WTO Round. On the other hand, deals have been signed with key USA security allies in the region rather than focusing on more significant economic partners. This reflects the USA’s interest in remaining involved in the region as China gains influence, whilst attempting to maintain control over waterways in the confluence of the Indian and Pacific oceans (Twining 2007).

The aim of the USA's FTA policy is to achieve 'competition in liberalisation' via a 'three-dimensional trade strategy' (Schott 2006: 98): multilateral, regional and bilateral, so as to exert latent pressure on recalcitrant liberalisers by concluding FTAs with other states. The USA Trade Representative (USTR) in the early 2000s, Robert Zoellick, put forward a series of 'tests' to choose FTA partners. Potential FTAs had to help broaden political support in Congress for USA trade initiatives (partially through including countries that in the past Congress has sought to help for economic or political reasons). They also had to promote USA economic interests (improve access to growing markets, build alliances for WTO). Potential partners had to be willing and able to undertake pertinent domestic reforms to implement the FTA, thus extending the USA's preferred trade, economic and regulatory model. FTAs also had to promote broader USA foreign policy objectives (rewarding friends for international support, economic incentives to promote economic and political reform) again tying the economics and the politics together (Schott 2007: 103). Apart from this, partners needed to accept the USA's 'gold standard' of WTO plus FTAs which incorporate comprehensive coverage of goods, services, and investments with only limited exceptions, and rule-making obligations in competition policy, labour and the environment and e-commerce. The expectation among USA trade policy makers is that a competition among countries will consequently emerge to provide the most attractive set of incentives for the initiation of negotiations, as states seek not to be left out once their neighbours have established FTAs with the USA (Phillips 2007: 163).

Within this logic the USA has negotiated FTAs with Singapore and the Republic of Korea (ROK). The FTA with ROK is particularly relevant as this country represents the USA's sixth trade partner accounting for 2.6 percent of USA total trade. Singapore, for its part accounts for 1.5 percent of USA trade and is its tenth partner (USA Census, 2012). Both these states are becoming 'hub' states in their region (see Tay 2010), and have actively sought FTAs with the USA and other partners. They are, at least in theory, easier negotiation partners. Notwithstanding

this, it did take four years for South Korea and the USA to conclude a mutually acceptable document.

There are also no current plans for a FTA with ASEAN, given the diversity within its members (Schott 2007). The USA only has a Trade and Investment Framework Agreement (TIFA) with ASEAN, and less comprehensive bilateral trade and TIFAs with Thailand, Malaysia, Indonesia, Philippines and Vietnam. TIFAs provide a forum for discussion and facilitation of trade and investment and consultation and possible further cooperation include market access issues, labour, the environment, protection and enforcement of intellectual property rights, and, in appropriate cases, capacity building rather than the binding commitments of detailed FTAs. These economic relations are, of course, just one aspect of the USA's overall agenda in East Asia, where it is seeking to bolster relations with democratic states and emerging economies to counter the regional influence of China. To further this aim the USA is also engaging through multilateral fora (APEC, ASEAN Regional Forum) in curtailing Asian only initiatives. What is significant about its FTA policy thus far, is that like the EU, and unlike China, the USA is not willing to extend FTAs for purely political reasons, but these must be accompanied by an acceptance of its WTO-plus economic agenda.

#### **4. EU's FTA Strategy in East Asia**

Over the last decades the trade and investment relationship between the EU and East Asia has experienced spectacular growth, leaving EU-level policies trailing behind. Concerned with voices calling for an APEC FTA in the 1990s that never materialized, the European Commission launched a 'New Asia Policy' in 1994. These institutionalized contacts, discussions, cooperation in trade and investment facilitation, in different settings, including the Asia Europe Meeting (ASEM) have yielded little in terms of binding regulations.

Throughout the early 2000s, Asia experienced a proliferation of FTAs (see Ravenhill 2009), as talks collapsed at the WTO in 2003, and the USA undertook an aggressive policy of



FTA negotiations. Meanwhile, a moratorium was placed in the EU on new FTAs by Trade Commissioner Pascal Lamy, so as to focus efforts on the WTO. With the appointment of Peter Mandelson as Trade Commissioner in 2004, the EU, too, changed its policy to simultaneous multilateral and bilateral liberalization in the 2006 ‘Global Europe’ trade strategy. The strategy highlighted the need to ensure agreements are ‘deep’ and extensive in coverage of all economic sectors.

‘Global Europe’ exudes a sense of urgency and prioritises Asia, acknowledging the EU’s late response in this area (DG Trade 2006a). It reveals concern about potential losses given third party FTAs and proposes FTAs with ASEAN and South Korea. It is no coincidence that the proposed partners had already negotiated or were expecting to negotiate FTAs with the USA (USA–Singapore, USA–Thailand and USA–Malaysia, and USA–South Korea) (see Table 1) and were also negotiating with China.

Table 1: **United States of America and European Union Free Trade Agreements in Asia**

	USA			European Union		
	Start	Conclude	Implementation	Start	Conclude	Implementation
ASEAN				2007	Suspended in 2010	
THAILAND	2004	Suspended in 2006 after regime change		Launched negotiations March 2013		
SINGAPORE		2003	2004	2010	2012	
S KOREA	2006	2007 2010 (final)	2012 (Mar)	2007	2009	2011 (Jul)
MALAYSIA	2006	2010		2010		
VIETNAM				2010		
INDIA				2007		
AUSTRALIA		2004	2005	Negotiating only Framework Agreement		
Trans-Pacific Partnership (TPP) negotiations with New Zealand, Australia, Vietnam, Singapore, Brunei, Canada, Mexico, Chile, Peru						

Sources: European Commission DG Trade website, USA Trade Representative website (2012)

Strengthening strategic links with important emerging markets also appears to be a key motivating factor behind EU FTAs with South East Asia and India. The latter was not a top priority in the 2006 document, as it was not in negotiations with the USA, however it was highlighted as a potential FTA partner. Here the aim is to strengthen trade and investment links with markets that will be important in the future (Woolcock 2007: 4), and secure future business opportunities. Given the EU's 'deep' agreements it is also a mechanism for extending its regulatory preferences to other significant economic actors. As a general rule the EU FTA policy requires that there be a clear economic case for any FTA. This can generally be interpreted as meaning some real increase in market access in addition to that achieved at the WTO (Woolcock 2007: 4). Given asymmetric outcomes of FTAs, any FTA will produce gains for some sectors, especially those facing greatest restrictions. This means that despite the limited overall welfare gains derived from FTAs, it is normally possible to make some economic case. The sectors the EU seeks to benefit through FTAs are service provision and the strengthening of international rules such as intellectual property or safety standards.

Making an economic case, however, is, in itself a political act. In 2004 the EU refused to commence FTA negotiations with Singapore based on the absence of an economic case (DG Trade interview 2006). Once Singapore had signed FTAs with the USA and China, and after the EU had come to accept FTAs under 'Global Europe', the EU proceeded to enter negotiations and suddenly found its limited markets much more appealing. It appears that the economic case for the EU and USA is less about the actual gains and more about competitors potentially gaining an advantage, as well as competitors spreading their regulatory regime. It could, thus, be viewed as a race to maintain the status quo amongst the major players, at a time when agreeing multilateral rules appears more complicated.

Targeting first those states involved in negotiations with the USA, between 2007 and 2009 the EU negotiated an Association Agreement with ROK. The FTA was signed in October 2010 and entered into force in July 2011. Given ratification delays in the USA, the

implementation of the EU's agreement predated that of the USA by nine months. EU companies faced significant problems accessing and operating in ROK due to stringent standards and testing requirements for products and services often creating barriers to trade, despite being the largest investor in Korea since 1962 (DG Trade 2012). Some of the expected gains from the FTA derive from negotiated improvements in this respect, despite overall effects being extremely modest.

Fearing that its manufacturers will be disadvantaged once the EU reduces tariffs on Korean manufactures, Japan asked the EU to initiate FTA negotiations. This is in line with economic 'domino effect' predictions (Faletti 2010). The EU, despite its focus on Asia, initially refused. This was due to its targeting of markets with the greatest growth potential. The EU also wanted to facilitate the passage of the ROK FTA in the European Parliament without deputies expressing concerns of whether the same type of advantages in automobiles granted to ROK would be extended to Japan under a projected FTA (*Japan Today* 1/5/2010). However, in July 2012 the European Commission requested a mandate for negotiations from the Council of the EU. So as to exert pressure on Japan to further liberalise internally, the mandate is likely to include the possibility of withdrawing from negotiations if no significant progress has been achieved after one year. This would a situation like the current ongoing negotiations with India.

ASEAN was the other initial priority of the EU's FTA strategy. As a bloc ASEAN represents 5.1 percent of the EU's total trade, however, individually these states' economic significance to the EU is much smaller. Negotiations began in May 2007 and progressed slowly, due to the differences amongst ASEAN members and the EU's requirements that its FTAs be comprehensive and encompass a host of political clauses. The Philippines, for example, signaled from the start that the political cooperation agreement would be problematic as it requires signatories to become members of the International Criminal Court (*Thailand Business News* 2011).

Shifting from its previous strategy prioritizing multilateral and interregional negotiations (with ASEAN, Mercosur, Central America), which had even been characterized as 'a doctrine of

global policy-based on interregionalism' (Soderbaum et al. 2005: 366, 371), EU Trade Commissioner De Gucht (since 2009) in March 2010 announced the launch of negotiations for a FTA with Singapore and with Vietnam. It is no coincidence that these two states are amongst the group of six ASEAN states who have already begun to implement their FTA with China, and that Singapore also has a FTA with the USA.

The move to bilateral deals reflects a more pragmatic approach to FTAs, as a bilateral deal will be easier to negotiate than a FTA with another regional grouping that often lacks the level of institutional unity the European Union has developed. Notwithstanding this, the EU remains intent on a bloc-to-bloc FTA with ASEAN as highlighted by De Gucht (2010): 'Although Singapore is the 'first one in', our door remains open for other ASEAN countries[...] We are not available to do shallow FTAs, but we will be mindful of differences in levels of development.'

In November 2010, the EU also launched negotiations with Malaysia. At the end of 2012, negotiations with Singapore are nearing completion. Despite Singapore's open economy, and its extensive network of FTAs and eagerness to negotiate with the EU (see Tay 2010), negotiations have been challenging, given reluctance on the Singaporean side to acquiesce to EU environmental and sustainability clauses and regulation preferences. Negotiations with the other states are only just reaching a state of agreement on which issues to include, and are likely to be lengthy. For these states, as for India, with whom the EU has been negotiating since 2007, public procurement is part of the governments' efforts to promote regional development. Opening this market to foreign companies is, therefore, a very delicate matter, yet it is one of the core elements in the EU's agenda. Differences in their priorities in services and patent life lengths for medicines have also spurred conflicting positions in the EU-India negotiations (Khorana & Perdakis 2010).

## 5. Implications of the agreements

Thus far, ROK is the only state in the region with whom the EU and USA have both implemented FTAs, making these the only ones available for comparison. They are significant as they represent each party's most comprehensive FTA to date, and models for subsequent agreements. To the extent that Korean negotiators viewed KOREU as a "balancing act" against USA reliance through KORUS (Nicolas 2009: 38), it is unsurprising that the coverage of the agreements is similar. Where differences occur it is due mainly to divergent interests in the negotiating positions of the USA and EU, as determined by their domestic contexts.<sup>1</sup>

Both agreements achieve USA and EU aims of incorporating all the controversial non-resolved issues at the WTO. Both cover intellectual property rights. The key difference is that the EU approach also includes the extension of its protection for Geographic Indicators (GIs) for wines, spirits and other agricultural and traditional products. In this FTA, the EU only achieved the inclusion of 100 GIs. The EU hopes that ROK will eventually adopt more of its GIs. The major difference in terms of the liberalization of services is the EU's positive list approach, which lists sectors to be liberalized, in contrast to the USA's negative list approach, which liberalises all service sectors (including possible new ones developed in the future) except any explicitly listed as not liberalized. This places the USA at an advantage in the future as new types of services appear.

Negotiations over access to ROK's car market were complicated in both cases, especially given ROK's complex safety standards. The different this was resolved by the EU and USA are revealing in terms of their future stance on FTAs. The USA negotiated a *de facto* mutual recognition of standards. It convinced ROK to raise the quota for USA cars exported to Korea using only USA standards to a level well beyond current export levels. Instead, the EU convinced ROK to adopt a process for joint-standard making, and adapt to international

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<sup>1</sup> USA objectives were to obtain better access for its agricultural products, pharmaceutical and medical equipment, high-technology goods, and services (especially financial and professional). EU aims, in keeping with 'Global Europe' were to tackle non-tariff-barriers (especially in chemicals), and the Singapore issues.

standards of the United Nations Committee for Economic Cooperation in Europe. In the political Framework Agreement the EU also persuaded ROK to sign up to the core International Labour Organisation (ILO) conventions. This shows a reflex on the part of the EU towards the joint-creation of norms and regulations, and the use of already existing international ones. Given the diversity of interests and views amongst EU member states (see Meunier & Nicolaidis 2007; Baldwin 2006), sometimes international standards they have already accepted are all that they can agree to.

Whilst the FTAs with ROK are very similar and broadly compatible, these subtle differences in approach reinforce findings that USA FTAs are more binding in their content and in exporting USA regulatory preferences through mutual recognition of standards. Meanwhile EU FTAs cover more issues, but in less legally binding and more flexible ways with an emphasis on international regimes (see Horn et al. 2010). This is exemplified by the use of international car safety standards, and the inclusion of ILO core conventions. Other areas are covered in non-binding terms in the Framework Agreement. Here the parties agree to ‘work towards’ and ‘encourage mutual cooperation and information exchange’ in education, environmental protection, migration issues, fisheries, development policies, combating terrorism and arms trafficking amongst others (EU 2010). However, in the longer-term this can create cooperation reflexes amongst the parties, and an environment more conducive to co-creation of policies and policy transfers.

## **6. Concluding remarks**

Future work will focus on empirically comparing the content of FTA agreements negotiated by the USA, EU, and also China, in East Asia and on gathering relevant materials to more clearly establish the mechanisms by which perceived competition and ‘competitive diffusion’ of FTAs operate. For now, it appears that USA FTA policy in East Asia, follows a greater logic of USA ‘multitrack’ trade policy geared at exporting its liberalization preferences,

even where economic gains are likely to be scarce. The goal is to enforce liberalization reform elsewhere. The same applies to the EU, although for now, it seems to be following the USA lead. Indeed, EU documents often refer to competition with the USA and potentially losing out. The 2006 ‘Global Europe’ trade policy, which determines criteria for FTA negotiations, emphasizes ‘tak[ing] account of our potential partners’ negotiations with EU competitors, [and] the likely impact of this on EU markets and economies [...]’. It also states that ‘Where our partners have signed FTAs with other countries that are competitors to the EU, we should seek full parity at least’ (DG Trade 2006: 11). The 2010 strategy ‘Trade, Growth and World Affairs’ follows a similar line, and stresses that ‘completing our current agenda of competitiveness-driven FTAs remains a priority’ and that ‘our trade policy needs to pay particular attention to the USA, China, Russia, Japan, Brazil and India’ (DG Trade 2010: 10). FTAs, are, thus, a hedge against potential benefits accrued by competitors. This explains why so far the ‘FTA process...more closely resembles fingers reaching idiosyncratically around the globe than the formation of politico-economic blocs centred respectively on Beijing, Brussels and Washington’ (Hufbauer & Wong 2005: 12).

It appears the USA and EU will end up with a similar network of FTAs. The difficulty may lie in the very few elements that differ in their FTAs (e.g. GIs), and the additional costs on third parties of operating under various regulatory systems. Overlapping standards and regulations may impact on firms’ internationalization decisions. More crucially, it may also affect the feasibility of multilateralising FTAs, something both the USA and EU would hope for.

On 13 February 2013, USA President Obama and European Commission President Barosso jointly announced the start of internal procedures to commence negotiations for a Transatlantic Trade and Investment Partnership, following the recommendations of a scoping exercise established in October 2012. A Transatlantic FTA has been proposed in the past, and has always been abandoned. The USA and EU have a thriving economic relationship, some famous WTO disputes notwithstanding, and engage extensively in cooperation on trade and

investment facilitation, mutual standard recognition and regulatory cooperation. Their remaining few differences (over approaches to environmental, labour standards and geographic indicators) have proven too difficult to resolve. A Transatlantic FTA would be very challenging to negotiate, and given the past record it seems unlikely that they will successfully resolve their differences. Both are facing increasing resistance to their FTA regulatory agendas from other partners, and their individual leverage is weakening as a result of the financial crisis. In this context, a Transatlantic FTA in which both agree on a common regulatory framework might bolster their combined position in the international economic governance system. Time will tell how this latest twist in the FTA saga evolves.



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