

# Causes of Regionalism. How ASEAN-China FTA Fits the (New) Wave of Regionalism?

Ivana Miková<sup>1</sup>

## Abstract

The main aim of this paper is to discuss standard explanations of the causes respective to each wave of economic regionalism and to introduce an alternative approach suggesting the existence of a common mechanism driving all three periods of intensified economic integration. This study argues for the general logic to economic regionalism based on the balance mechanism. Proposed mechanism embraces standard theoretical explanations and places them into a broader context of general encompassing logic common to all three occurrences of economic regionalism. For acquiring empirical evidence of this mechanism, all three waves of regionalism and their causes are analysed as well as on one particular case of the third wave of regionalism - ASEAN-China FTA. Central motivation is the existence of plethora of factors leading to the preference of the regional trade strategies in particular time periods without offering explanation common to all three main occurrences of regionalism. However, this study argues that every instance of economic turmoil leads to protectionist tendencies in the form of economic regionalism followed by the multilateral trade liberalisation mitigating negative effects of protectionist tendencies.

**Key words:** Regionalism, China, East Asia, Multilateral Trade Liberalisation, WTO, ASEAN-China FTA, Balance mechanism

## INTRODUCTION

Topics of multilateral trade liberalisation and economic regionalism are subjects of an endless debates not only among academics. However, even after the detailed analysis they still do not lose their importance. Apparently this is due to the fact that these phenomena represents constantly ongoing transformation process of the old Westphalian system. Direct result of this transition process is intensification of economic relations which takes the form of regionalism and multilateral trade liberalisation. Both processes are two sides of the same coin of the increasingly interdependent global economy. Problem of their separation is well reflected in wide academic discourse where debates are still unsettled on

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<sup>1</sup> Miková Ivana, U Kříže 8, Jinonice Praha 5, Faculty of the Social Sciences, Institute for Political Science at the Charles University in Prague. Author is doctoral student at FSS CU, e-mail: ivana.mikova@fsv.cuni.cz.

their causes and on effects they have on each other and on the world trade and economic prosperity. In an academic literature, multilateral trade liberalization is perceived as a process leading to the desirable objective of removing all barriers to the trade and regionalism is seen as a deviation from this ultimate goal. Therefore we ask questions on the causes of the regionalism. What makes countries to pursue regional trade strategies instead of multilateral trade liberalisation? Moreover, regionalism is not one time event, it comes and retreats periodically. We recognise time periods characterised by a sudden intensification of economic ties among countries concluding regional trade agreements (RTAs), referred to as the *waves of (economic) regionalism*. Thanks to the rigorous research multiple sources have been identified as a root causes of single waves of regionalism.

Generally accepted categorization divides regionalism into three waves. Its first manifestation is usually framed by the decade between 1950s and 1960s. European regionalism and import-substituting integration among developing countries are used as standard explanations of the *first wave of regionalism*, slowly fading out at the beginning of 1970s. This period was replaced by multilateral trade liberalisation, gaining momentum once again, until it has been replaced by the *second wave of regionalism* with the time span of approximately a decade, beginning in the 1980s and peaking in the first half of 1990s. This wave is attributed to the slow pace of Uruguay round of negotiations, announcement of Single European Market and a new position of United States towards regionalism followed by renewed activities in Latin America, Africa as well as in Asia. Since the establishment of World Trade Organisation (WTO) in 1995 a number of RTAs rose rapidly with high proportion of trade agreements among developing countries. This increment in preferential trade agreements is often described as the *third (new) wave of regionalism*, attributed mainly to the changes of international order after the end of the Cold War era and it is often explained by the new perspectives on globalisation, ongoing European integration and by obsolescence of international financial institutions. Bretton Woods institutions were said to be unable to solve the financial downturn and many believe that push for liberalisation of financial services in early 1990s helped to escalate the financial crisis and consequent regionalism in East Asia.

Each wave is characterised by the various causes. However, I propose different explanation of the causes of regionalism and why it waxes and wanes over the time. This paper suggests mechanism under which all three waves have been operating. Regionalism and multilateral trade liberalisation represent an aftermath of the “shock-situation” such as an economic crisis. This “shock-situation” is followed by the wave of protectionism in the form of economic regionalism which is then followed by the wave of trade liberalisation alleviating

negative consequences of the first wave. We can say that they are constantly following each other. Same mechanism applies to every wave of regionalism of which the East Asian regionalism is part as well.

This paper is structured around two central questions. First, why has regionalism waxed and waned over the time? Second, does ASEAN-China FTA fits the “shock-situation” mechanism managing the waves of regionalism? This study is intended to achieve two goals. First, to offer an alternative explanation of the waves of regionalism by inductive identification of the causal process of all three waves of regionalism which are similar on the dependent variable in order to discern common causal factors. Second, by using the case of ASEAN-China FTA, the goal is to demonstrate operation of the “shock-situation” mechanism in this particular case of the third wave of regionalism. Therefore, it serves as supporting evidence to the argument that all three waves of regionalism were driven by the same logic.

Since the qualitative case study methodology provides tools for researchers to study complex phenomena within their contexts, this instrumental case study aims at the general understanding of the economic regionalism. By using the method of process tracing, the mechanism behind the occurrence and behaviour of the observed phenomenon would be better understood. Documentation and archival records data are used as a sources for the detailed narration of the process in the chronological order, a technique used to shed the light on the how the all three waves of regionalism took place, what caused them and what followed them. Moreover, aggregate trade data and trade statistics data are used to support argument of “shock-situation” mechanism operating also in the case of ASEAN-China FTA.

Paper is divided into four main sections. First section aims at the identification of the concept of economic regionalism and its place within the rules managing trade relations among states. Second section focuses on the standard explanations of all three waves of regionalism and an alternative explanation suggesting the “shock-situation” mechanism. Third section narrates in details and chronological order how the all three waves of regionalism took place and offers historical evidences for the alternative explanation of the causes of regionalism and its consequences, consistent with the “shock-situation” mechanism. Fourth section uses the ASEAN-China FTA as an example of the “shock-situation” mechanism at work. This part provides the evidence that even China, usually portrayed as a rescuer of the economies in the region and as a country relatively unharmed by the economic downturn, was in fact saving itself from the disastrous consequences of the Asian financial crisis in 1997 and one way to achieve this goal was the new regional trade strategy started by the FTA with ASEAN countries. Therefore, also in this case is “shock-situation” mechanism at work.

## COMPLEX CONCEPT OF REGIONALISM

Although regionalism is not an entirely new phenomenon it is one of the most prominent characteristic of the present international system. Density of states' interactions is steadily increasing and establishing new platforms for cooperation whether it is within the geographically determined area or outside. Therefore, there is not only one concept of regionalism and it is indeed very elusive.

Regionalism, broadly speaking, refers to the reinforcement of cohesiveness among countries in the specific region and this cohesiveness is expressed through the establishment of common institutional frameworks. In the narrow sense, regionalism can be defined as a policy and intentional political project for cooperation in a specific area of interest among actors in the region, resulting into the establishment of formal institutional framework which can be again classified by its looser or tighter form, depending on the legally binding agreements on cooperation.

As well as the concept of the region is subject to change, so the concept of regionalism acquire different values according to the academic discipline studying this phenomenon. For example, political regionalism is defined as a shared policy interests which are coordinated via common institutions (Hurrell, 1995; Hurrell and Fawcett, 1995). Security regionalism manifests itself in the sense of cooperative activities varying from "simple balance of power system or concerns to more comprehensive communities and integrated policies" (Hettne, 2008, p. 404; Rosecrance, 1991; Hurrell and Fawcett, 1995; Morgan, 1997). In this regard, concept of security regionalism can be defined as based on the commonly shared identity (Scott, 1999; Väyrynen, 2003; Hemmer and Katzenstein, 2002). Economic regionalism is perceived as a purposeful attempt of a group of countries to collectively reduce trade barriers among themselves (Mansfield and Milner, 1999; Baldwin, 1997; Bhagwati, 1996, 2008; Krugman, 1993).

Since much of the existing research on regionalism focuses on the international trade, economic regionalism is also at the centre of this study. Research focusing on the economic regionalism can be divided according to the question it aims to answer. First, what is regionalism, how can it be defined? Second, why there is regionalism, what causes it? Third, what are the effects of regionalism?

First question focuses on the concept of economic regionalism and its place within the broader framework of the rules and processes managing international trade relations. Economic regionalism can be defined as a "preferential trade agreements among a subset of nations" (Bhagwati, 1993, p. 1) or as an arrangement to facilitate trade flow among countries. RTAs in form of the

custom unions (CUs) and free trade areas (FTAs) has been officially permitted under the provisions of GATT and its Article XXIV and they have been central topic of research for many scholars, for a long time. However, this does not mean that closer trade cooperation did not occur prior to the 20th century. It did but on much smaller and negligible scale and in an environment where mutual trade interdependence among states was not perceived as particularly deep. This perspective undertook radical change at the beginning of the 20th century after two destructive world wars. Interconnection and trade linkages among states proved to be essential for the economic prosperity. However, longtime practice of closer trade cooperation among subset of countries has not been out ruled from the trade relations. Moreover, it has been framed by the new perspective on international trade - multilateral trade liberalisation, which had to embrace regionalism. Therefore, concept of regionalism is linked with the multilateral trade liberalisation and with the WTO, as a formal institution in charge of the global removing of barriers to trade.

Multilateralism is seen as a desirable process guiding trade relations among states since the end of the Second World War and formation of RTAs is seen as a undesirable departure distorting trade linkages and cooperation among states. Nevertheless, RTAs are part of the trade reality and rules managing this reality. Even though, they are defined as a as trade discrimination measures having negative effects on trade, GATT/WTO rules recognise states' right to conclude them which is in itself contradictory to non-discrimination principles of GATT and WTO's Article I and II. However, by incorporation of the Article XXIV of GATT/WTO allowing formation of RTAs, certain degree of trade discrimination is acceptable and these RTAs should not rise trade barriers to the third countries. Therefore, regionalism can be defined as preferential trade barriers reduction among group of countries which shall not be more restrictive than general trade duties prior to the formation of such interim agreement.

We can say that there is no regionalism without discrimination albeit moderate. If multilateralism is an antithesis of regionalism than its main feature is non-discrimination. For example, under the MFN rule all countries should be treated equally in the sense of trade duties. Non-discrimination and free trade are also general goals of GATT/WTO managing world trade and removal of trade barriers. However, it is often disputed whether WTO follows these objectives by treating all countries equally. Even it is contradictory, GATT/WTO has been an umbrella organisation setting framework for regionalism and multilateralism at the same time.

From the nature of economic regionalism inherently follows question of its effects on the international trade and welfare. If the ultimate goal is to remove all

trade barriers among states, is regionalism helping or harming? Or in other words is it building or stumbling block towards free trade? Since the Jacob Viner (1950) published his work *The Customs Union Issue*, plethora of economists (Tinbergen, 1962; Bhagwati, 1968, 1991, 1993, 1996; Panagariya, 1996; Krugman, 1979, 1991, 1993) studied the welfare effects of regionalism and its desirability. However, question of effects of regionalism is out of the scope of this study aiming to answer question of causes of regionalism. Standard explanations of the causes of regionalism differ with every wave of regionalism. Moreover, causes of regionalism were explained differently in every region where regionalism took place. Generally speaking, academic debates on regionalism and its causes are divided into two basic groups, referred to as *old* and *new theories of regionalism*. Old theories of regionalism correspond with the first wave of regionalism and new theories reflect new realities after the end of the bipolarity and correspond with second and third wave of regionalism.

First wave is framed by the decade between 1950s and 1960s when six western European countries underwent closer economic integration (EC), followed by the counter project of other seven European countries (EFTA), which eventually jointed original integration. Dynamic progress of European integration led to the attempts, albeit unsuccessful, by developing countries to emulate European project in Africa, Latin America and Caribbean. Most of these early trade agreements among developing countries collapsed and proved the import-substituting regionalism to be unsuitable for their economic development. However, regionalism became prominent feature of international relations and found its way into theoretical reflections of the new international environment.

These so called old theories of regionalism (i.e. federalism, functionalism, neo-functionalism, inter-governmentalism) were Euro-centric due to the fact that European project has been most developed and evolved and also served as a blueprint for evaluation of other regionalism projects. Early theoretical reflections of the regionalism were more of the normative methods (i.e. functionalism of David Mitrany 1943) and political programmes (i.e. federalism) describing ideal and definite order of relations among states. Functionalism was in 1960s challenged by Ernst Haas and many others like Joseph Nye, Leon Lindberg and Philippe Schmitter. Neofunctionalism emphasized role of the states in the process of deliberate institutions formation, however latter shift of loyalties would lead to the decline in importance of nationalism and the nation-state. Neofunctionalism can be assigned to first theoretical reflections of regionalism describing and explaining the process of integration.

Nevertheless, neofunctionalism had been challenged by the new theoretical approach of intergovernmentalism contesting the role of institutions and

emphasizing the role of states. Neofunctionalism was no more able to successfully reflect empirical realities. Stanley Hoffman (1966), key figure of the new approach, argued that regionalism is possible only if it is part of the states' interests, thus factors advocated by neofunctionalism as a causal factors of regionalism were denied.

Theoretical debate in the developing countries also attempted to make sense of the causes of regionalism. Although, influenced by the European theoretical debate, developing countries accepted logic in the contrast to European functionalism. Causes of regionalism were determined by the need for economic development and nation-building leading to the structural transformation not to functionalism cooperation.

Second wave of regionalism marks the development of the new theoretical approaches explaining causes of regionalism. This wave of regionalism is framed by the decade between 1980s and 1990s and is characterised by the formation of regionalism in North America (NAFTA), Asia Pacific (Australia, New Zeland) and renewal of the process in Europe (i.e. EU internal market 1992, new members), Latin America (MERCOSUR) and Africa.

Theoretical reflections of the causes of regionalism had to cope with the new international environment and with changes it brought, like the new role of non-state actors (Baldwin, 1993, 1997; de Melo and Panagaryia, 1995; Fawcett and Hurrell, 1995; Hettne et al, 1999; Mansfield and Milner, 1997) and new role of the international institutions managing international trade (Bhagwati, 1991, 1993, 1996; Panagariya, 1996; Krugman, 1991, 1993).

Paul Krugman (1993) offers summary of standard answers to the question why countries incline more to regionalism. First, with large number of participants in WTO multilateral trade negotiation the risk of non-cooperation is higher and achieving the decision is more cumbersome. Second, current system of tariffs and trade barriers among economies is a complex system further reducing the possibility of agreement on their reduction. In other words it should be easier to strike a deal among small number of countries via RTA than via WTO negotiations on trade liberalisation. But today trade represents not only goods, but also services, capital, workforce and know-how. Thus trade policy became broader in sense of regulations and measurements and it is indeed more difficult to find common ground among large number of countries with diverting view on the role of the state and its competences. Finally, considering social, political and economic changes and differences among regions brought about more difficulties in running the multilateral trade system. One such change is new position of the U.S. towards regionalism.

Last wave of regionalism came at the beginning of the new millenia. Although, this third wave has manifested itself mainly in the East Asian region, it has not limited itself only to this region. RTAs between the U.S. and other countries followed (e.g. Jordan, Morocco or Australia) as well as deepening of already existing regionalism projects including U.S. like APEC (i.e. TPP). European regionalism undergone widening with admission of new members. Moreover, WTO noticed difficulties in the process of trade liberalisation caused by the collapse of talks in Seattle in 1999 and consequent deadlock of Doha round.

More or less, theoretical reflection of the third wave of regionalism is based on the same assumptions as in the second wave of regionalism. However, they are supplemented by the argumentation that regionalism is caused also by the countries' fear of exclusion from the international trade and loss of competitiveness. According to Mansfield and Reinhardt (2003) fear of undermined competitiveness leads countries to seek membership in the rival RTAs. In other words, with undermined WTO trade talks and multilateral liberalisation, states seeks other forms of trade cooperation in form of regional trade strategies.

Here, I would like to address different explanation of the regionalism which interconnects all three waves following the logic of the balance mechanism. Regionalism in the sense of protectionist measures is always triggered by some event threatening trade and economic development of countries. Even though, trade discrimination against non-members hampers economic development and it is refused as a trade tool in globalised world, countries often approach to some kind of protectionism every time their economies and trade are threatened. Consequently, every wave of regionalism or protectionism is followed by the counter wave of multilateral trade liberalisation balancing trade discrimination and mitigating its negative effects. It serves as a break to uncontrollable protectionism.

Every multilateral trade liberalisation wave reacts to different discriminatory tools used at specific time, be it trade and non-trade tariffs or regulation of services. Even then countries try to keep at least some ways to protect their economies, they often enforce some kind of "escape clause" (e.g. GATT Article XIX) into multilateral trade liberalisation rules. According to widely accepted premise - protectionism has negative effects on world trade and multilateralism or a free trade has positive effect - countries do cooperate via WTO on lowering trade barriers, but on the other hand, in each country's interest is to protect its trade, exporters, producers etc. Why, if countries always tend to incline to the protectionism, would they realise regionalism in the first place? First, economic regionalism is type of discrimination against non-members, hence it protects its own trade by setting up favourable trade conditions. Second, countries with close

ties (e.g. economic, political, strategic, historical etc.) depends on each other and it is more favourable to promote diminishing trade boundaries and new trade opportunities among themselves where they have already existing ties.<sup>2</sup> Third, other countries recognise this tendency in one region as a threat of discrimination against their trade causing spread of regionalism in other regions. Fourth, with every economic downturn or protectionism, discrimination intensifies and it is the main objective of WTO to mitigate protectionist tendencies in the world trade and promote free trade. Therefore multilateral trade liberalisation serves as balancing mechanism trying to reach a bottom line on trade barriers reduction in the world trade. It serves as a brake preventing uncontrolled spread of protectionism.

For acquiring empirical evidence of this mechanism, we should take closer look at all three waves of regionalism and their causes as well as on one particular case which may offer more details supporting information. Therefore, next section will offer alternative explanation of all three waves of regionalism by applying detailed narration, a technique of process tracing method used in case studies. This technique should serve for doing causal investigation by using documentations (i.e. memoranda, agendas, study reports) and archival records (i.e. video records) as a sources of historical evidences supporting alternative explanation of the causes of the regionalism. Due to the selectiveness of the case studies, last section examines case of ASEAN-China FTA as an example of regionalism often explained by other causes than those offered in this study. For this purposes official documents of WTO and ASEAN complemented by the World Trade Centre aggregate trade data and trade statistics data on of China and ASEAN countries to find evidence supporting alternative explanation of the causes of (new) regionalism.

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<sup>2</sup> Such clustering of countries in the region is explained by the domino theory of regionalism. In the very simplified way, the logic of the domino theory goes as following: an idiosyncratic event like establishment of the new FTA or deepening of the existing one triggers trade distortion and thus forces exporters from non-member countries to pressure for membership. Consequently, we can say that complicated negotiations within the WTO or U.S. attitude towards regionalism has nothing to do with spread of regionalism and it is more the case of securing of the economic gains. But as Baldwin himself says the first idiosyncratic event can be characterised by the wide variety of causes from political, geopolitical to economic. "The domino theory cannot explain all incidents of regionalism, since some agreements have little to do with economics. For instance, the theory never tells us why the triggering incidents of regionalism occurred. The theory's merits are that it fits the facts, and that it rests on the analysis of systemic political economy forces rather than on the opinions of a handful of policy makers in a single country" (Baldwin, 23:1993).

### **THREE WAVES OF REGIONALISM**

Trade barriers as a tool for protection of domestic trade had been well established tradition for a very long time. But it was not until the beginning of the twentieth century when they became seen as an obstacle for the states' economic welfare. Establishment of the General Agreement on Tariffs and Trade (GATT) in 1947 is usually described as a stepping-stone towards the elimination of trade barriers among the states and towards so called multilateral trade liberalisation. But ideas upon which GATT stands reach far more into the past. World Economic Conference which took place in 1927 in Geneva embraced the same ideas of trade barriers diminishment or MFN principle as later on reappeared in GATT agreement. Negative effects of protectionism on which Geneva Conference in 1927 pointed were soon after perceived. Three years later, after the end of the First World War, American president Herbert Clark Hoover signed controversial Smoot-Hawley Act, in 1930. Many factors contributed to the spread of economic downturn worldwide, among which Smoot-Hawley Act did its part. European countries devastated by war were struggling with war debt repayment and they retaliate with their own trade barriers towards the American export. This Act had been very much opposed by U.S. economists and its rejection also found its way into the Franklin Delano Roosevelt presidential campaign. Soon after presidential elections, Roosevelt signed Reciprocal Trade Agreements Act (RTAA) in 1934 which represented significant shift in U.S. foreign trade policy. Till that time Congress right to establish tariffs rate and regulate foreign trade was passed (temporarily) on the U.S. president. He could increase or decrease tariffs up to fifty percent of the levels set by Smoot-Hawley Act. But this tariff shift was conditional on concessions by other countries. These concessions were executed through agreements not requiring Senate approval and were extended to third countries to which U.S. had accorded MFN status. This principle became the main pillar of GATT and the future multilateral trade liberalisation.

Negative effects of trade discrimination and protectionism which manifested itself at the beginning of the twentieth century led to the desired cooperation in the world trade. It was the role of the International Conference on Trade and Employment held in 1946 in Havana to find a tool for maintaining world trade, employment and post-war recovery. This objective should be fulfilled by International Trade Organisation (ITO) but its charter never came into the force, however, despite the absence of fully fledged international organisation multilateral agreement GATT has taken over the role of regulatory mechanism for international trade from 1947 to 1994 when it was replaced by World Trade Organisation. The main goal of reducing trade barriers of international trade

by diminishing tariffs, quotas and subsidies begun immediately after the end of war. In 1945 fifteen countries negotiated over the reduction of custom tariffs and their binding which is considered as the first round of negotiations resulting into the signing of GATT agreement, a package of trade rules and 45,000 tariff concessions affecting \$10 billion of trade. Correction of protectionists legacy from 1930s was furthered by the second and third round of negotiations following immediately after the first round resulting into further tariff reduction and more countries signing General Agreement.

However, even after the GATT came into the effect formation of discriminatory trade blocks has not been ruled out, on the contrary Article XXIV of GATT admits the possibility of creating custom unions, free trade areas or other interim agreements with the condition that such a closer economic integration should not rise trade barriers higher against non-members than previous to the agreement. It can only lower or remove barriers among the members. Then these economic agreements should serve as a fast track for removing the trade barriers and multilateral trade liberalisation executed via single round of trade negotiations (GATT or WTO) should serve as a balancing mechanism ensuring that the difference between trade barriers would be minimized.

After the end of the Second World War, efforts for the reconstruction of world order and trade started in two camps. On one hand, international community had been busy with building the new world institutional framework ensuring future peace and prosperity and avoiding harmful trade protectionism. On the other hand, process of regionalism acquired new characteristics which ever since shaped development of international trade relations. Treaty of Rome (1957) does not only represent foundations of the European Economic Community, but from international perspective, it also meant potential threat of trade discrimination. This situation led to the series of GATT negotiations rounds leading to trade concession avoiding protectionism, even though the price had to be paid in the form of compromise over EEC Common Agricultural Policy (CAP). Trade negotiations under Dillon round (1960-1962) (AP Archive and British Movietone. President Kennedy - Press - Sound. 12 March 1962. <http://goo.gl/XYLA6T>) as well as Kennedy round (1963-1967) represented vital interests of the U.S. as the main trading partner of Europe. At this time, series of negotiations were conducted among developed economies with principal supplying interests which put developing countries at the edge of discussions, since they did not represent major source of export or target of import in the world trade dominated by transatlantic relations. Moreover, developing economies were dependent mainly on the export of primary commodities to the developed countries, but since GATT rounds were not able to address their tariffs reduction, General

Agreement became irrelevant to them and they followed inward oriented strategy of import-substitution industrialisation (ISI) as a method to achieve economic growth and modernisation. This inward orientation resulted into the attempts to form RTAs supporting trade barriers reduction and economic development among members with not very satisfying results, despite promising economic development after the Kennedy round. First major economic crisis in the 20th century led to political and economic disturbances which resulted into the first wave of regionalism and consequential protectionism mitigated by efforts for multilateral trade liberalisation.

Rapid economic growth and further elimination of tariffs on industrial goods had been replaced by the economic downturn in 1970s for number of reasons. Oil crisis in 1973 and 1979 led to deflation, stagnation, high rates of unemployment and problems with balance of payment. Protectionist lobby, on both sides of Atlantic, led to implementation of quotas and other trade discrimination tools which were outside the jurisdiction of GATT, such as subsidies or voluntary export restraints (VERs). It was the new type of protectionism, different from the one in 1930s which could be characterised as direct protectionism with strict controls of foreign trade. On the other hand, states used other ways to protect their producers and markets by deploying non-tariff barriers like subsidies or standards of production. Trade discrimination by using high tariffs has been outlawed by the Dillon and Kennedy round, but non-tariff barriers (NTBs) were not covered by previous trade negotiations, this became a goal of next Tokyo round (1973-1979). The principal objective of the trade negotiations was to avoid setting in retaliation and disruption of carefully built multilateral trade system. However, as indicated in the World Bank report (1980), Tokyo round of negotiation did not meet all initial expectations, mainly of developing countries, and results should be regarded as best that was politically feasible at that time. On the other hand, this situation of trade protectionism and need for restructuring of energy policies led to rapprochement among developing countries (e.g. Argentina, Brazil, Paraguay) and to the increase of their common interest and tripartite agreement between Argentina, Brazil and Paraguay in 1979 came by no surprise. In the same year Ronald Reagan introduced the idea of North America Union in his announcement to seek the Republican nomination for President of the United States.

This second wave of economic downturn has been followed by increased tendency for protectionism which culminated in the 1990s by signing new FTAs or upgrading of those already existing. This time period is also described as a second wave of regionalism. Although, it is disputable to what extent was multilateral trade liberalisation successful, Tokyo round contributed to

the alleviation of the new type of protectionism. Multilateral talks on trade liberalisation continued in the following years after Tokyo round in 1986 by launching Uruguay round which in 1994 resulted into the establishment of WTO, further reduction of trade barriers in industrial as well as agricultural production, rules protecting producers in services, investments, intellectual property rights and rules governing the ability to take action against the imports of a product sold at an unfairly discounted export price.

1990s were marked not only by success in multilateral trade liberalisation, but also by another economic shock, this time on financial markets. Few disturbances preceded and followed the major shock wave coming from Asia in 1997. As in previous two waves of economic downturn, protectionism became good safeguard tool at hand because financial crisis led to the collapse of economic growth rates in several South East Asian countries. Economies of Indonesia, South Korea, Malaysia and Thailand suffered decreasing production, increasing unemployment as many businesses went bankrupt. As in previous cases, also this crisis had potential to negatively affect the rest of the region and overseas due to connection of financial markets, foreign investments in the region and mutual imports and exports. Moreover, this crisis had potential to impede trade and investment liberalisation under the WTO and APEC. Reaction to this economic downturn led to largest business and banks bailouts in the history, necessary financial and government reforms and protectionist measures not only in Asian countries but also in other countries to ensure stability of their own currencies and trade. Over the decade previous to the crisis, both U.S. and European trade shifted towards Asia-Pacific whilst their mutual trade declined. It became important issue on both sides of Atlantic that economic and political stability is maintained in Asian-Pacific region. But protectionist tendencies prevailed also in this part of the world, mainly due to the fact that multilateral liberalisation of financial services (often referred to as deregulation) was blamed to be the main cause of the crisis. However, that would be very short sighted view if we take into consideration Asian economies relying heavily on export and the fact that GATS had in the time of crisis minimal influence, close to zero.

Nevertheless, Asian countries directed their attention towards closer regional cooperation not only in the matter of financial regulation but also trade and politics. They came up with the plan to create an alternative to IMF by establishing Asian Monetary Fund (AMF), later replaced by Chiang Main Initiative, and ASEAN Plus Three. The original idea of AMF proposed by Japan was stiffly opposed by the U.S. which caused a conflict with Japan favouring AMF. However, Asian countries realised that closer cooperation and need for some kind of surveillance mechanism in East Asia became vital for future stability of the region. After

all, not only Asian countries (e.g. Brazil) realised that certain regulation and surveillance of capital flow and financial services is tool for protection against uncontrolled inflow of foreign (speculative, short-term) capital (e.g. market based capital control; taxes for certain types of capital). As in previous cases when crisis created wave of protectionist measures we can see similar consequences after 1997/1998. Also in this case WTO reaction was to prevent further development of trade discrimination, this time on the financial markets. Even though, GATS went into the force after Uruguay round in 1995, it was only “interim agreement” and pressure for further liberalisation was exercised mainly by the U.S. via MFN exemptions. Further liberalisation became integral part of the new Seattle ministerial conference, which collapsed in 1999 and was followed by the new Doha round of negotiations launched in 2000. However, this round of negotiations seems to be the most complicated mainly due to the increasing sensitiveness of negotiated issues and we have no reassurance of its early conclusion.

On the other hand, we have yet another evidence that this economic downturn led to the third wave of protectionism. Moreover, we have evidence that malfunction of the multilateral liberalisation as a balancing mechanism to protectionism led to the rampant spread of RTAs after 1999.

## **ASEAN-CHINA FTA IN THE CONTEXT OF THE EAST ASIA REGIONALISM**

In 1978 China adopted new path of economic reforms. This meant a change of track departing from enclosed economy towards integration into global markets and introduction of market principles. This so called new *Open Door* policy brought People’s Republic of China (PRC) closer to the trades of developed economies and had significant impact on Chinese economy by easing state control and encouraging foreign investment. Gradual opening of Chinese economy led to the fast-paced development and made China important engine for economic growth in world trade. Progressive opening of its trade and alternation in its foreign policy led to strengthening of relations with its neighbours as well as with the rest of the world. However, it was not until the new millenia when China was for the first time in the history committed to FTA with other countries or WTO member.

In the same year when economic reforms in China started, Deng Xiaoping visited Thailand, Malaysia and Singapore and expressed willingness for closer cooperation with ASEAN countries. In 1991 China became consultation partner to ASEAN and attended ASEAN Post-ministerial conference (PMC)

and in 1996 China became full dialogue partner with ASEAN.

In the following year, Asian financial crisis brought about new challenges as well as need for new mechanism of consultations between China and ASEAN countries. Other countries in the region soon joined efforts for closer cooperation. In December 1997 leaders of ASEAN countries, China, Japan and Republic of Korea (ROK) issued joint statement on East Asia cooperation at their third ASEAN Plus Three (APT) summit in Manila. This initiative should ensure “strengthening and deepening East Asia cooperation at various levels and in various areas, including energy, transport, and information and communications technology (ICT) (ARIC, 2015).” (Asia Regional Integration Centre, 2015) Other initiatives for cooperation were signed in the following years widening scope of (economic) collaboration. Moreover, individual members further proceeded with common frameworks for cooperation mainly in economic realms.<sup>3</sup> Since 1997 APT cooperation encompassed also such areas as security, transnational crime, poverty alleviation, promotion development of vulnerable groups, culture and people-to-people contact, education, science and technology, public health or disaster management (ASEAN Plus Three Cooperation, 2015).

East Asian countries hit by the turmoil were disappointed by the inappropriateness of assistance offered by international financial institution. This led to the proposal for an alternative Asian version of monetary institution which would serve the needs of Asian countries. “In order to strengthen our self-help and support mechanism in East Asia through the ASEAN+3 framework, we recognize a need to establish a regional financing arrangement to supplement the

<sup>3</sup> *China*: The Third ASEAN-PRC Transport Ministers Meeting on 24 November 2004 in Phnom Penh, Cambodia adopted the ASEAN-PRC Memorandum of Understanding (MOU) on Transport Cooperation. ASEAN and the PRC signed a Memorandum of Understanding (MOU) on Cooperation in ICT on 8 October 2003 in Bali, Indonesia. ASEAN and the PRC reiterated their commitment on ICT cooperation in the Beijing Declaration on ASEAN-PRC ICT Cooperative Partnership for Common Development on 12 May 2005 in Beijing.

*Japan*: The Framework for Comprehensive Economic Partnership between ASEAN and Japan, signed in Bali in October 2003, called for ASEAN-Japan cooperation in the area of transportation and logistics. The ASEAN-Japan Plan of Action to implement the Tokyo Declaration for the Dynamic and Enduring ASEAN-Japan Partnership in the New Millennium includes activities to facilitate cooperation in the transport sector. The First Meeting of ASEAN and Japan Transport Ministers, held on 25 October 2003, endorsed the Terms of Reference for ASEAN-Japan Transport Partnership, as well as the 16 joint projects for implementation for 2003-2004. ASEAN-Japan Commemorative Summit in December 2003 called for enhancing cooperation in energy security under the overall theme of "Consolidating the Foundation for Economic Development and Prosperity".

*Korea*: Korea extends technical assistance in the preparation of the ASEAN Highway Fact Book and the Technical Manual for Highway Feasibility Studies under the ASEAN-ROK Preparation Studies for the ASEAN Highway Network Project. Korea has committed to fund five Initiative for ASEAN Integration (IAI) projects in infrastructure and ICT.

existing international facilities” (People’s Daily, 2000). The proposal to establish Asia Monetary Fund was soon opposed by United States but representatives of APT countries together with governors of Asian Development Bank met in 2000 in Chiang Mai, Thailand to discuss bilateral currency swap to strengthen regional capacity to counter economic downturns. Financial crisis in 1997/98 bound East Asian economies even closer and renewed emphasis on political as well as economic collaboration.

Besides the joint commitment of East Asia countries for (economic) stability in the region, China and ASEAN continued to follow their own track of regional cooperation. Two years after crisis broke out, ideas for establishment of FTA between ASEAN countries and China preoccupied academic debate. This intention was expressed by ASEAN on ASEAN Plus One (APO) Manila summit in 1999 and confirmed by Chinese proposal to establish FTA with ASEAN in 2000. The leaders signed the Framework Agreement on China-ASEAN Comprehensive Economic Cooperation at the sixth China-ASEAN Summit in November 2002 committing themselves to form FTA until 2010. In the following years agreements on trade in goods (2004), services (2007) and investments (2009) were signed.

Meanwhile, China successfully completed its accession to WTO and it became fully fledged member at the end of the year 2001. Membership accelerated Chinese economic growth and speeded up economic reforms in the country and help to attract more foreign investments. Although heavily dependent on the export to the world markets and mainly to the developed countries, percentage of trade with other countries in the region has always been very significant to China before the financial crisis and its importance has been rising steadily ever since.

## **MOTIVATIONS FOR THE ASEAN-CHINA FTA**

Regarding question of motivation for ASEAN-China FTA, we can classify discussion among scholars into two categories, although both offering arguments based on the logic of Chinese regional strategy. In the first group are arguments favouring security or political reasons and in the second group are arguments supporting economic reasons. However, many scholars argue that even if economic causes are identified behind the Chinese regional integration strategy, it can be in fact result of using economic tools for political or security goals. Thus, to cope with these kind of evidences, realists uses the term “peaceful ascendancy” which means that China is using economic statecraft as a tool to secure resources (e.g. raw materials) for its economy and cementing its position within the region to counterbalance Japan and the U.S. influence. Scholars

supporting security reasons argue that China turned towards regionalism with ASEAN countries to counterbalance U.S. and its allies in the region. ASEAN countries proved not to be tightly bounded with the U.S. and this attitude was highly appreciated in Beijing. In other words, according to this approach “balance of power” is at the heart of the China-ASEAN regionalism. Security and political motivations arguments are supported mainly by proponents of core realist premises stating that main Chinese motivation is to ensure survival and to expand power in changing security environment (Leong and Ku, 2005).

On the other hand we cannot say that no economic reasons were present. Standard economic explanations of the ASEAN-China FTA point out that previously to the PRC’s shift towards regional trade strategies, its integration into the global trade via WTO membership had been at the centre of its interest. But after China entered WTO and gained better access to the developed markets, it has started to compete with ASEAN countries on the same markets, therefore new Chinese regional strategy should neutralise this competition by diversion of ASEAN trade towards China (Nakagawa and Liang, 2011). On the contrary Drysdale (2002) argues that it were ASEAN countries who feared of the Chinese competition on common markets. Therefore, ASEAN-China FTA represents Chinese guarantee for further trade cooperation and eventual compensation for the losses.

Either way, ASEAN-China FTA is presented as a shift from the multilateral strategy towards regional. However, China never ceased to follow integration into the global economy via WTO, neither China perceived multilateral trade liberalisation to be ineffective or cumbersome. On the contrary, WTO membership was meant to bring changes to Chinese institutional environment necessary for economic reforms, even though, this membership did not brought immediate economic gains. In fact, Chinese economy showed high proportion on FDI and it became its second largest recipient in 1990s. PRC not only received much of the investments but it itself massively invested abroad, even before the WTO accession (Lardy, 2001).

WTO membership represents long-term interest (since 1986) of Chinese government in economic recovery and growth. WTO membership was long-run political agenda following the strategic commitment to economic development which has to keep up with growing population as well as with external factors influencing internal political and economic situation. Need for structural reform was enhanced by membership in WTO which served as factor triggering positive changes in economy by exposing state companies to the competition which would bring more effectiveness in their functioning.

On the other hand, it also meant extensive economic concessions and

legislative changes caused by translation of WTO legal code into Chinese law resulted into “abolition, revision and promulgation of more than 3,000 laws and regulations at central government level and 190,000 at local government level” (Jiang, 49, 2014), it also contributed to the institutional changes and more transparent business environment. This so called new *Open Door* policy brought PRC closer to developed economies’ trades and had significant impact on Chinese economy by easing price controls, decreasing tariffs and non-tariff barriers.

China committed itself to deeper concessions (compared to other developing countries) because Beijing believed that WTO membership would help to reform the domestic sectors as it would be exposed to competition and foreign investments in form of FDI flowing mainly into capital-intensive and technology-intensive sectors with huge potential, like telecommunication, electronics industry or IT. It was expected that industries such as light manufacturing and electronics would be the biggest beneficiary. Even before the WTO accession China “implemented a new import tariff-exemption plan for some goods under revised investment guidelines on 1 January 1998. The plan was designed to increase investment in high-tech manufacturing by domestic and foreign firms” (Kong, 29, 2000).

This policy is consistent with long-term plan to change China status from world assembly line into economy taking advantage from technology transfer. Another benefit for China was permanent most favoured nation (MFN) status granted by the U.S.. This status was re-evaluated on yearly bases by the U.S. Congress. Moreover, China became more comfortable with WTO mechanisms and also became more active by greater involvement into the dispute settlement system.

Not even China has learned the ropes, but at the same time it was able to take an advantage of the membership by following the strategy of “techno-nationalism” (The Economists, 2011). WTO membership brought about positive as well as negative effects, but overall consequences for China were positive, because it helped accelerate economic development making China economic engine of the world trade.

Therefore the argument of standard explanation of the causes of regionalism does not explain the case of ASEAN-China FTA. China did not abandon multilateral liberalisation due to its ineffectiveness. In fact, it is supporter of WTO’s multilateral trading system. In 2013 at the WTO Bali conference “Chinese delegation said it would aim to strengthen WTO as a multinational trading system and work towards the conclusion of the Doha Round of multilateral negotiations. The outlook for the Doha Round is uncertain at best, however, so for the time being China looks set to continue its trade strategy of pursuing trade integration

through FTAs while stressing the importance of the WTO” (Xiaoming Pan, 2014). Moreover, ASEAN-China FTA followed immediately after China WTO accession. Therefore, no positive or negative economic consequences could be experienced.

ASEAN-China FTA does not represent a shift in China trade strategy due to its WTO membership. On the contrary, ASEAN-China FTA reflect regional need for closer cooperation emanating from negative consequences of Asian financial crisis and following the logic of protectionism.

## **ASIAN FINANCIAL CRISIS: DRIVING FORCE OF THE ASEAN-CHINA FTA**

East Asian region is marked by turbulent history. Current stage of development was moulded by both political as well as economic factors such as gradual changes in political leadership in particular countries leading to wider trade liberalisation and market integration or financial collapse in 1997/8. Today, this region is described as a hub for Asian regionalism with enormous potential for investments. Regionalism in a broader sense has been present in East Asia long before the new wave of regionalism. At the beginning leaders of five countries (Philippines, Singapore, Thailand, Indonesia, Malaysia) had in mind mainly political and security reasons for cooperation when they met in 1967 in the main hall of the Department of Foreign Affairs building in Bangkok, Thailand and signed the document by which ASEAN was born. Later other countries in the region joined organisation (Brunei Darussalam 1984, Viet Nam 1995, Lao PDR and Myanmar 1997, Cambodia 1999).

Gradually, under the influence of globalisation forces, region exhibited economic growth and mutual cooperation in 1990s, similar to that in Europe and Latin America. Following economic decline contributed to further changes in mutual relations between countries, in political as well as economic sense. Previous trade liberalisation, deregulation, heavy export orientation supplemented by high saving and consequent investments into export production and low public spending led to the growth but at the same time left most of the Asian economies vulnerable economically as well as politically. Although, China came out of the crisis relatively unharmed compared to ASEAN countries, it does not mean that it had no influence on its future foreign trade policy direction.

PRC as export oriented country with heavy reliance on export to the U.S. and slowing growth of GDP faced difficulties at the time of crisis and currencies in ASEAN countries were devaluated which made their export cheaper and thus creating much stronger competition to Chinese products, since they were

all exporting to the same trades. Moreover, depreciation of currencies led to increasing price of Chinese export, while 40% of its total export went to Asian countries. With China heavy reliance on export, this was potentially very dangerous situation. Also currency devaluation and recession caused decreasing GDP in export trades and this led to decreasing consumption demand and production demand. Consequently, Chinese political representatives faced two important challenges. First, participation in global economy may not be only beneficial but can bring decline in growth and economic stability. Second, China was not isolated from the economic situation in East Asia region. Thus the need for regional cooperation became part of the national interest. To secure future stable economic development, closer trade cooperation within the region became necessary measure.

In 2001 China's export to ASEAN countries was only 6,9% share on total export to the world and 11% in 2013 and from 2001 to 2008 volume of ASEAN-China bilateral trade increased by almost 28%, that was faster than growth of China's total trade with the rest of the world. China's growing share of export to ASEAN countries was the most significant within Asian region. In 2001 export to ASEAN countries was around 13% on total Asian export and in 2013 their trade jumped to 21% share on total Asian region. On the import side, in 2002 China's import from ASEAN grew much faster than China's export to ASEAN; China's trade deficit with ASEAN increased from US\$4.8 billion in 2001 to more than US\$20 billion in 2004. Result of FTA is that China has been ASEAN's largest trading partner since 2009, while ASEAN has been the third-largest trading partner of China since 2011.

Another aspect of ASEAN trade diversion towards China is mutual competitiveness in same export trades. During financial crisis export oriented industries suffered from outflow of investments. This situation was partially beneficial for China because it lowered competition on foreign trades. On the other hand, recovery meant increasing competition with Chinese goods, thus it was more advantageous to divert their export towards China. Not only China but ASEAN countries as well were fully aware of economic potential of huge unsaturated trade able to absorb investments and export, also both sides saw opportunities and available resources for growth within the common trade with more than 1.7 billion people, potential consumers. ASEAN countries were attracted by new economic opportunities and trade liberalisation especially in the Chinese services. Moreover, China would ensure the input import from ASEAN countries, which is in consistency with its strategy of "techno-nationalism" supporting technology development and production of capital-intensive goods.

China came out of the financial collapse as the economy pulling other

countries from crisis, by maintaining the exchange rate of Renminbi at the steady level and by channelling financial aid via International Monetary Fund (IMF). Although, since financial crisis in 1997, China has been labelled as responsible regional actor saving others, it was in fact saving itself. Add to this the fact, Asian countries were disappointed by insufficient approach of IMF, they felt to be left behind. Consequently, setting up of Chiang Mai Initiative (CMI) came by no surprise. East Asian region was floating on the waves of growth and crisis that resulted into efforts to bring stability, by strengthening closer relations within the region and by supporting economic development. Subsequently, regionalism represented by free trade agreements seemed as a natural way for coping with economic instabilities. Since 2000 Southeast Asia region has been marked by rapid spread of FTAs with 47 FTAs in effect as of June 2010 and about another 90 in various stages of preparation (Fortin, 2011).

## CONCLUSION

Variety of approaches to the new wave of regionalism offer different arguments explaining the causes of this process. Commonly accepted premises are referring to the power position of the U.S. or its changed attitude towards multilateral trade liberalism. WTO and problem of its effectiveness is also very often seen as the cause of the deviation from multilateralism and inclination to regionalism. Although, some authors offer different explanation of the causes of regionalism their approaches cannot explain every case. Moreover, they can explain only one part of this complex process when other countries decides it would be better to joint already existing preferential trade agreement for securing their interests. Is not to say that we should not pay the attention to this part of the problem too. On the contrary we should. On the other hand, we should look for common denominator of all events when countries decide to create preferential trade area that in fact discriminates non-members. Even though, level of abstraction is high, all three waves of regionalism are interconnected by turbulences in globalised world trade leading to protectionist measures by creating new preferential areas or strengthening those already in existence. ASEAN-China FTA is no exception. Simultaneous occurrence of two important events, accession of China to WTO and its proposal to create FTA with ASEAN, can lead to misunderstanding of motivations for the latter by giving more importance to the former. By closer inspection of historical events and development of relations among countries, both form global and regional point of view, more evidences support claim that also ASEAN-China FTA is result of stabilising tendencies after economic turmoil in 1997. China membership in WTO served its long-term strategy and

goals for economic reforms. WTO membership itself help to accelerate economic growth in China and its positive effects outweighed negative effects in terms of legislative and institutional reforms. Inconveniences connected to the WTO membership were marginal and they did not have to be offset by formation of FTA. On the other hand, future economic destabilisation in the region could lead to similar or even more severe effects causing hampering of economic growth and development.

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