

## THE PROLIFERATION OF FREE TRADE AGREEMENTS IN THE ASIA-PACIFIC REGION: A BUSINESS PERSPECTIVE

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### EXECUTIVE SUMMARY

The USC Marshall MBA research team studied the current proliferation of bilateral and regional free trade agreements (FTAs) among APEC members and its effect on business operations and investment decisions. The key deliverables included:

1. A report with findings based on 106 interviews and 40 survey responses with business executives, trade officials, and industry representatives across 15 APEC economies regarding:
  - The preferred direction of FTA developments;
  - How FTAs have impacted their global business decisions, and will likely influence future strategic investment decisions;
  - What aspects of FTAs, such as specific provisions, have been most beneficial or most difficult for their business activities;
  - Improvements business executives would like to see implemented in existing and future FTAs.
2. A comparative RTA/FTA catalog in digital format consisting of a matrix of 23 existing RTA/FTAs among APEC economies. Within each RTA/FTA, 37 provisions were evaluated to determine consistency with WTO. The RTA/FTA catalog was developed for two intended uses:
  - Assist businesses in navigating differing trade requirements;
  - Assist trade negotiators and researchers engaged in developing new free trade agreements.

### Broad Findings and Conclusions

**Preference for Multilateral Trade Agreements.** Business executives expressed a strong preference for multilateral free trade agreements over a series of bilateral preferential trade agreements. Executives, however, are supportive of the continuing trend of negotiating and signing bilateral preferential agreements between economies because they remain skeptical that a comprehensive multilateral agreement is feasible in the near future. Business executives expressed a sense of urgency, and a certain degree of frustration, with efforts to further liberalize and facilitate free trade. APEC economies appear to have essentially made a tradeoff between their preference for a multilateral agreement and the feasibility of successful bilateral negotiations. Bilateral trade agreements are viewed as short-term solutions that allow businesses to reap the benefits of free trade now, rather than waiting an indeterminate length of time for a WTO or APEC-wide trade agreement to eventuate.

In the absence of a viable multilateral solution and the breakdown of the Doha Round of WTO negotiations, business executives support bilateral agreements as a temporary compromise for the following reasons:

- **Insurance:** Business executives do not want to be left behind other global competitors. In the increasing race to sign free trade agreements, they do not want to be disadvantaged compared to rivals in other economies that have signed more preferential trade agreements. Executives across economies and industries expressed genuine uncertainty about the outcome of the Doha Round and future WTO negotiations, and therefore were in favor of the continued negotiation of bilateral agreements as insurance against the failure of WTO.
- **Comparative Advantage:** Executives seek the comparative and competitive advantages over foreign rivals that preferential market access brings to first-movers in the absence of multilateral trade solutions.

- **Experience:** An unintended benefit of the proliferation of bilateral trade agreements is that trade officials and the business communities are building experience in negotiating more sophisticated free trade agreements. This experience may be invaluable as the efforts to negotiate a comprehensive multilateral solution continue.
- **Short-term Solution:** Business executives expressed the hope that existing and newly negotiated bilateral trade agreements might become foundational building blocks for future multilateral regional agreements. However, they also reported concerns that too many preferential bilateral agreements may create an intractable problem for future multilateral negotiations.

**Unintended Negative Consequences for Business.** Business executives are beginning to recognize important new problems with the proliferation of FTAs in the Asia-Pacific region. While liberalizing tariff levels and reducing some business costs, businesses are also experiencing increased transaction costs due to the complexity of dealing with multiple trade agreements with varying language and provisions. Additionally, businesses are encountering

difficulties in implementation and enforcement across economies. As economies seek new bilateral trade agreements that improve on the basic requirements of WTO (WTO plus), increasing divergence and complexity among current FTAs is imposing substantial transaction costs on businesses.

Business executives were asked about the most beneficial and most difficult areas and specific provisions within FTAs. Conclusions from this analysis are summarized below:

- **Rules of Origin (ROO):** Divergent rules of origin increase transaction costs for businesses in terms of additional monetary and human resources needed to interpret and utilize them. It is becoming increasingly difficult for businesses to qualify for and take advantage of tariff reductions as more expertise is required to untangle the different terms of Rules of Origin applied to each FTA and economy. Overall, there seems to be a trend moving from Ad Valorem/mixed ROO before year 2000 to Tariff Change/mixed ROO in the years thereafter. Although complexity increases with each new FTA, there is a trend in how APEC economies are defining ROO. Business executives would like to see standardization of Rules of Origin, preferably at the WTO level.
- **Customs:** Substantial improvements were reported in customs procedures and clearance times but executives informed us that in some economies customs procedures being used as an effective non-tariff barrier. Businesses have raised issues concerning inconsistent interpretation and lack of transparency of customs procedures. The consensus is that customs procedures are still very complex and bureaucratic. Business executives would like to see a template for customs provisions that is well defined and standardized along with specific procedures for implementation that can be used consistently across all agreements.
- **Non-Tariff Barriers:** Business executives are cognizant of the fact that APEC economies use certain provisions within an FTA as non-tariff barriers. Examples of this type of protectionism include excessive paperwork, complicated equipment testing and certification rules, and phyto-sanitary standards. Business executives would like to see some flexibility within standards requirement provisions and they believe that mutual recognition agreements can help mitigate protectionist behavior to further liberalize trade.
- **Intellectual Property Rights (IPR) Protection:** Business executives diverged significantly in their opinions on IPR Protection by economies and industries.
  - Executives in developing economies reported that developed economies use IPR protection provisions as a trade barrier to maintain an unfair advantage in trade and commerce. Businesses in developing economies would like to see shorter duration of IPR protection so as to gain access to new technologies and methodologies in order to be able to better compete in the global arena.
  - In contrast, executives in developed economies argued for longer duration of IPR protection as well as legitimate enforcement of IPR policy so that they may be able recoup costs of research and development as well as profit from their efforts. They believe that the lack of proper enforcement of IPR protection is a barrier to free trade.
- **Dispute Resolution:** While opinions differed, business executives were in general agreement that trade disputes should be resolved using the WTO trade dispute mechanism. They seek a clear policy across FTAs that can be easily implemented and which makes the process of trade dispute resolution swift, easy, and effective. They also want individual economies to be consistent and assertive in resolving open disputes.
- **Effect of FTAs on Small and Mid-Sized Enterprises (SME):** Business executives agreed that FTAs are theoretically equally beneficial for large corporations and SMEs, but realistically, SMEs lack the resources, both

human and monetary, to take advantage of the benefits that FTAs provide. SME executives want to see less complexity in FTAs both internally (within an FTA) as well as collectively (compatible provisions across FTAs) so their businesses can incur less transaction costs.

- **Transparency:** Business executives want to see simple and consistent language, and streamlined bureaucracy and stronger enforcement. More specifically, they would like standardized tariff and customs procedures, simple and consistent rules of origin, and aggressive FTA promotion and information dissemination through business forums and trade conferences.

## Research Approach

The USC Marshall MBA research team gathered opinions from 146 business executives, trade officials, and industry representatives across 15 APEC economies (Australia, Canada, Chile, China, Chinese Taipei, Hong Kong, Indonesia, Japan, Mexico, New Zealand, Peru, Singapore, South Korea, Thailand, United States) to draw broad conclusions of what business executives would like to see in the future to enhance free trade among APEC economies. The research team traveled to ten economies to conduct in-person interviews, and interviewed executives in four additional economies by phone. A survey was also used to supplement the qualitative interviews. Efforts were made to gather opinions from executives in a broad range of industries and in companies of different size.

## Key Takeaways and Action Agenda

- In large part, the message business executives shared with us is not unknown to ABAC members, APEC and government trade officials. What is, however, important in their message is a sense of urgency to tackle these problems sooner rather than later. They want action now, and real progress toward improved trade opportunities. This finding gives ABAC a stronger mandate to push its agenda even more aggressively.
- Concern was expressed that without strong collective leadership, multilateral solutions to trade agreements will not eventuate. If the current trend toward the proliferation of divergent bilateral FTAs continues, these once beneficial bilateral FTAs which executives thought might become building blocks towards a comprehensive multilateral agreement may actually become stumbling blocks.
- Business executives are also very concerned that the proliferation of bilateral preferential trade agreements with their divergent provisions will continue to add new costs to businesses, in spite of the goal of liberalizing and facilitating trade. This is particularly important to small and mid-sized businesses, and entrepreneurial companies in developing economies.
- In the absence of multilateral trade solutions, business executives want simpler language, standardization, and consistency across the provisions of FTAs, and they want equitable enforcement, consistency, and transparency in the implementation of the agreements in all economies.
- The newly created APEC RTA/FTA Catalog may prove to be a solid platform for advancing the agenda of standardizing provisions within trade agreements. The comparative RTA/FTA catalog provides trade officials and business executives a simple tool for comparing and evaluating different trade agreements. If expanded to include all provisions of FTAs and updated with new provisions as they are negotiated, it may facilitate a move toward more harmonized trade agreements.
- A road map for moving toward increased standardization across FTAs would be to start by putting efforts into areas where standardization would be easier to achieve, such as in the case of customs procedures, and then proceed through to the more intractable and divergent provisions, such as intellectual property rights protection.
- If standardization can occur, and FTAs can be easily implemented and enforced, they can be used to build towards an APEC-wide regional trade agreement. Furthermore, if an APEC-wide RTA can be negotiated, APEC can use the consensus built there to strongly influence the WTO negotiations.