

# Chapter **II.6**

## **ERIA Perspectives on the WTO Ministerial and Asian Integration**

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## **II.6 ERIA Perspectives on the WTO Ministerial and Asian Integration**

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### **1. Multilateralizing regional organizations**

Little can be expected from the WTO Ministerial in Bali in December 2013. However, global economic governance will be no less important in the future than it was in the past. The WTO should retain its position as the central coordinating institution. It should also retain important functions, including dispute resolution. Some minor agreements in Bali would be useful for maintaining the WTO as an institution. But 'business as usual' cannot be sustained, and at Bali, the WTO should begin the process of converting itself into an institution that ensures the compatibility of a number of regional network institutions. It should also begin to adapt to the contemporary world by seeing its field of responsibility as 'economic integration' rather than 'trade'.

The world has changed. Politicians everywhere still think of 'trade' as putting things in boxes and sending them to customers who live in other countries, thereby gaining domestic jobs from wider market access. But the world is now one in which international production networks combine the resources of producers in several economies to serve customers who may be widely dispersed. Production networks depend on just-in-time manufacturing to common standards and consumer welfare depends on competition, mobilization of resources in relatively undeveloped economies, and innovation, which is spread among producers along a chain from initial innovator to final consumer. The issue is not 'trade liberalization' but integration. The task is not to cope with add-ons to the core business of market access for trade in goods, but to deal with an integrated package of goods, services, investment, and the whole range of regulatory issues which affect the ease of doing business across international boundaries.

We expect the WTO to manage the multilateral system directly in a way which deals with integration so-defined. The needs of economic integration as enunciated above require collaborative efforts by governments. Such efforts taking place simultaneously among 200 or so economies are hard to conceive, even with skilled negotiators rather than simplistic commentators. The participation of more parties makes any negotiation more difficult and this is sometimes offered as a reason why the WTO is unable to move beyond what was agreed in the Uruguay Round. There is undoubtedly some weight in this argument, but it is not complete. First, CGE modeling generates an equally persuasive argument that in general the more parties there are to a trade agreement, the greater the aggregate gains available. Secondly, GATT and WTO bargaining was never a debate among an increasing number of equals. The fundamental dynamic of GATT was bargaining among the 'Quad', Canada, the EU, Japan and the US, modified by adjustment to cater for undeniably important impacts on other economies. At the very least, we should amend the starting argument, that the WTO is paralyzed simply by increased membership, to the assertion that changes in the relative significance of specific economies have prevented the emergence in the WTO of a modified Quad. But more important is how economic integration has focused attention on the fact that what was previously seen as a matter of domestic regulation is now central to the management of international business. Economic diplomacy deals above all with knowledge and trust shared by participating governments. This is more likely to exist among smaller groups than among the whole membership of the WTO. The WTO will remain important as the guardian of the multilateral system, and in particular of the dispute resolution system, but it is likely to be a coordinator of a set of networks rather than a centralized hierarchy.

Collaborative efforts among governments will probably be known as 'negotiations' – the word is used in the 'Guiding Principles and Objectives' agreed among ASEAN and its trading partners and endorsed by ASEAN leaders when RCEP was launched,

and it is standard terminology in the context of the TPP, TTIP and other proposed agreements. Because 'trade' will continue to be used as shorthand for economic integration diplomacy – the misplaced concreteness with which 'trade' has been used in much political and media commentary has become absurdly misleading but the word is too common to be displaced – we can be sure that 'trade negotiations' will be part of the vocabulary used to discuss those collaborative efforts. However, they need not resemble what became standard practices in WTO Rounds or in PTA 'studies' and 'negotiations'. ('Studies' have become the early stages of 'negotiations' in which governments retain the option of withdrawing without investing political capital in the achievement of a successful outcome.) In particular, conventional language with a known relationship to legal precedents need not be used, and as there does not need to be a single document recording everything that is agreed, there may be no 'single undertaking'. This change should not be made lightly. Agreement that nothing is agreed until all is agreed was central to the institution of 'GATT rounds. The single undertaking was formalized in the Uruguay Round in response to dissatisfaction with the decision of many members of GATT to remain aloof from various codes which had been negotiated in previous rounds, to prevent opting out from agreements on new agenda items, and to dignify the transition from GATT to the WTO. However, its essentials go back to the origins of GATT and the idea that a comprehensive package allowed trade-offs among components and facilitated consensus. It has also been important in maintaining a genuine multilateral system which accords equal treatment to all participating economies. However, the MFN system was always qualified – by the Article 24 provision for PTAs, by the political adjustments for the 'agricultural waiver' to suit US interests, acceptance of the EEC to serve the geo-strategic interests of the US and its allies, acceptance of 'special and differential treatment' for developing countries, and through the use of variable transitional periods in PTAs. Modern PTA developments, and now the move to economic integration clubs, are merely the latest modifications, and the crucial issue is preserving what remains relevant in a conventional understanding of

multilateralism.

A 'single undertaking' remains attractive, not least to participants who give high importance to a component which other participants find especially difficult, notably agriculture. However, it cannot be accommodated in a rolling agenda of collaboration in which new issues arise and are incorporated. In a continuous process, there is no place for a 'single' conclusion. Negotiators have to find new ways to ensure that their particular concerns do not slip off the international agenda. This is one of several ways in which 'trade negotiators' will have to adapt to major changes in their task. And we have to expect that the continuation of 'trade negotiations' will disguise from many commentators how much the agenda of economic diplomacy has changed. (And overcome the nostalgia for the familiar, which leads to comments such as 'you cannot negotiate trade facilitation' or 'I don't know how to negotiate for supply chain operation.' To which the appropriate reply is, 'the modern international economy requires lifetime learning everywhere'.) While we might well criticize the content of many 'trade negotiations' it is unwise to overlook the continued potential contribution to desirable economic integration of such interactions.

Some kind of club management will emerge. In the Asia and Asia Pacific regions, the leading candidates are TPP and RCEP. An ideal TPP would lead to a Free Trade Area of the Asia-Pacific. Another proposed mega-agreement is the Trans-Atlantic Trade and Investment Partnership or TTIP, and so two major players in future world economic governance could have the US at their center. The US initiative to seek closer engagement with ASEAN, announced in late 2012, may be an alternative path to the same end. The 'Expanded Economic Engagement with ASEAN' places emphasis on facilitation and collaboration on appropriate regulatory regimes, but it also suggests a focus on investment and standards that could easily distract ASEAN as a whole to the kind of wrangling already happening in the TPP discussions. The

balance of positive and negative effects is far from obvious.<sup>35</sup> Alternatively, RCEP could make Asia one central player, along with NAFTA, the EU, and whatever evolves in Latin America and Africa. A central role of the WTO would be to ensure that the rules agreed by these mega-agreements are not incompatible, and continually simplifying them where possible into a single set of rules. The objective remains a multilateral trading system but its meaning should be updated to reflect the modern world.

## **2. Facilitation, liberalization and integration**

The WTO would certainly benefit from some more immediate gains, but they are not easy to determine. It may be possible to extend the agreement on market access for information technology goods proposed under the ITA2 negotiating process. This is worth doing, perhaps more for the symbolism of success than for any major gains in consumer welfare. Entrenching a boundary between 'information technology' and goods and services in general creates an arbitrary definition which will later have to be removed. Furthermore, the usual theory of the second best warns us that liberalizing market access for a subset of commodities is not necessarily welfare enhancing. Nevertheless, the demonstration effect of enhanced cooperation across boundaries makes the dangers worth risking.

More is to be gained by exploring whether there are not better ways to deal with services than by trying to extend the traditional approach of trading concessions that has been used for trade in goods. While international trade in services can be done directly through cross-border supply, as with some business services; through movement across borders to engage in consumption, as with education and health services; or through movement of natural persons across borders to perform a service, as with some engineering operations, a commercial presence in the destination market is often necessary, and commercial presence usually requires

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<sup>35</sup> Cf. Andrew Elek 'US commits to ASEAN integration' *East Asia Forum* (25 November 2012).

supporting investment. There is a direct link between trade in services and an increasing flow of international investment. It is well known that conventional statistical measurement of trade in services is underestimated because of conventions that record some transactions as investments rather than trade flows. Statistical mis-measurement is an inconvenience; international trade in services is a potential source of enhanced productivity in both source and destination economies. We know that gains are possible – since marginal equivalences across borders have not been realized. We also know that the traditional practice of ‘requests and offers’ in WTO negotiations have not been fruitful and that no alternative procedures have yet been adopted. For example, it might be worth changing the burden of proof and require parties to reduce barriers to international service flows identified by possible trading partners unless a convincing rationale for the barrier can be generated. Obviously that would require a great deal of experience in developing the idea of ‘convincing’ but it is no more than a development of the accepted idea of transparency, and the idea of a ‘bound’ tariff rate was just as experimental in the 1950s.

The close connection between services and investment highlights the need for the WTO to begin more intimate dialogue with global financial institutions. For international production networks, services trade is not a minor supplement to trade in goods but is essential to business operations, and because services trade cannot be separated from international investment flows, trade and investment have to be considered together. The conventional separation of real and financial integration is deeply entrenched in international economic governance through the WTO on the one hand and the World Bank and IMF on the other, but it is incompatible with how the global economy has changed. Quick or easy fix are not readily available but the WTO should begin familiarizing all its Members with what is at stake. Asian members could usefully discuss the learning processes associated with AMRO, and ASEAN members could usefully discuss their individual experiences of how financial

regulators learn to consider regional interests rather than only the application of entirely domestic rules. These may seem to be small steps, but they will help the WTO to begin what will necessarily be a lengthy process. It will exemplify the process of 'learning together' which is needed for progress in global economic governance, something very different from conventional discussion of capital controls and exchange rate regimes divorced from the needs of international business.

A similar refocusing is required if the WTO is to make a real contribution to reducing development gaps. There may be some gains available through market access for the exports of the least-developed countries or other aspects of 'special and differential' treatment but the effects of what can be agreed are unlikely to be large. More is likely to be gained by facilitating the spread of production networks to utilize the relatively low-cost labor which is available in those economies.

This will require unilateral attention to the conditions under which foreign and multinational business can operate, but it also requires appropriate management of intellectual property and standards. These are the frameworks for innovation, not just introducing processes and products which are new to the global economy as a whole, but also introducing ways of doing business which are new in least-developed economies and which are the means by which incomes grow. However, participation in production networks requires access to standards and intellectual property.

Standards have long been part of the agenda of technical barriers to trade since standards purportedly adopted for consumer safety or to provide for interconnectivity among products (between for example fire hydrants and fire-hoses) could be used to preclude competition between imports and domestic products. But standards have become much more important because of the need for interoperability among members of international production networks. In turn, standards can be private property and thus an important part of intellectual property (IP) rules. Public policy

conceives IP as finding the optimal balance between encouraging invention and disseminating knowledge so as to promote the efficient use of resources. But there can well be conflicts between economies where patents are held and economies which seek to innovate.

The demands for adjustment are enormous. One of the three competing 3-G standards is protected by more than 2000 patent families comprising more than 6000 patents from 50 companies and consortia. A smart phone involves hundreds of standards coming from dozens of standard-setting organizations – camera, video, web browser, PDA, Wi-Fi etc. Eight thousand patents for smart phones are held by 41 companies.<sup>36</sup> Patents are merely part of the issue; they are much used in some industries such as pharmaceuticals whereas other industries rely on continual innovation for firms to remain ahead of the competition.<sup>37</sup> For some industries, not only the print media, but also films, software developers and internet service providers, it is copyright which is crucial and whereas economists tend to think of ‘intellectual property regimes’, IPR lawyers have a long tradition of separate rules for copyright and patents.

The economic issue is the same, balancing incentives offered to creators of new knowledge with the public interest in disseminating knowledge of how to make the most effective use of resources in generating consumer welfare. The ideal or even a ‘high-quality’ IPR provision is not the one which provides the longest period of protection to the existing property holder, but the one which strikes the best balance between incentives to innovators and facilitation for knowledge-users.

We read American complaints about stolen intellectual property but the biggest

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<sup>36</sup> Dieter Ernst *Indigenous Innovation and Globalization: The Challenge for China's Standardization Strategy* (UC Institute on Global Conflict and Cooperation and East-West Center, June 2011), p. 44.

<sup>37</sup> Bronwyn H. Hall, Christian Helmers, and Thomas Juster ‘The Importance (or Not) of Patents to UK Firms’ *NBER Working Paper* No. w19089 (May 2013).

engine of change in the Chinese intellectual property regime is the challenge to legitimate Chinese businesses as they respond to attacks from illegal producers.<sup>38</sup> The process is one which has occurred many times before,<sup>39</sup> but it can also be facilitated by international agreements. They must deal with the desired balance and not merely with the enforcement of unduly lengthy protection for property holders. International agreements include commitments by firms and the governments of advanced economies to ensure 'Fair, Reasonable and Non Discriminatory' access to standards and patents and the elucidation and application of such clauses is important. There have been legal cases in the US about corresponding provisions in US law in which judges have assessed their own valuation of royalties which may induce companies to be more accommodating<sup>40</sup> and the US has also experienced the problems of writing rules which are operational but do not encourage opportunistic behavior.<sup>41</sup>

The above problems are inherently more difficult to solve in an international setting. What we should look for in Bali is for the WTO to initiate a process by which it joins with the World Intellectual Property Organization (WIPO), in the search for optimal international IPR rules.

'Technology transfer' is still widely understood as it was in the 1960s, to refer to vehicles for official aid. It now relates to the terms of participation in international supply chains. In any case, the term is antiquated: the better conception is 'technology sourcing: strategies of technology-using companies and countries that involve search, absorption, learning, diffusion, as well as innovations – especially incremental innovations – that convert ideas, inventions, and discoveries into new

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<sup>38</sup> Ernst, p.82.

<sup>39</sup> David Clayton 'Trade-offs and rip-offs: Imitation-led industrialization and the evolution of trademark law in Hong Kong', *Australian Economic History Review* 51(2) (July 2011), pp. 178–98. The same story can be told in terms of US economic history.

<sup>40</sup> 'Free exchange: Standard procedure', *Economist* 407 (8835) (11 May 2013).

<sup>41</sup> Edward Wyatt 'Obama Orders Regulators to Root Out "Patent Trolls"', *New York Times* (4 June 2013); editorial 'Fighting "Patent Trolls"', *New York Times* (5 June 2013).

products, services, processes, and business models.<sup>42</sup>

We cannot avoid the tension between standards and innovation. Standards can freeze technology. That can be an incidental by-product of the search for ‘fitness for purpose’ and interoperability. Or it can be the deliberate result of firms seeking competitive advantage by manipulating access to intellectual property. An international regime for managing Intellectual Property and Standards is an essential component for economic integration. But it is no easy task. Any idea of a uniform international intellectual property regime has to be complex. For most economies, economic development is a matter of catching up with the frontier. In poor countries, a weak IPR regime is optimal to encourage dissemination, utilization of knowledge from abroad should be preferred to incentives for innovation. Advanced economies will naturally prefer stronger IPR regimes. That can be derived as an abstract argument, or it could be deduced from the economic history of many countries, including the US, which was not known for its ready adoption of European copyright agreements in the nineteenth century. American practice then – and well into the twentieth century – is a useful antidote to USTR advocacy now. It is not surprising that patents and intellectual property issues are among the issues proving to be contentious in the TPP negotiations,<sup>43</sup> but they will be even more problematic when considered in conjunction with China’s participation in moving from TPP to FTAAP.<sup>44</sup>

As well as genuinely addressing development gaps in this way, the WTO at Bali could seek progress on trade facilitation. The aim should be simply to supplant the current narrow WTO conception of ‘facilitation’ in terms of customs procedures with the wider concept of extending ‘ease of doing business’ which is explicit in APEC and

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<sup>42</sup> Dieter Ernst and Barry Naughton ‘Global Technology Sourcing in China’s Integrated Circuit Design Industry: A Conceptual Frame-work and Preliminary Findings’, *East-West Center Working Papers Economics Series No. 131* (August 2012).

<sup>43</sup> Claude Barfield ‘The TPP: A model for 21st century trade agreements?’ *East Asia Forum* 25 July 2011.

<sup>44</sup> A similar argument can be developed relating intellectual property rules and attractiveness to FDI. Cf. Hodaka Morita ‘FDI and Technology Spillovers Under Vertical Product Differentiation’, *APEC Economies Newsletter* Vol.15 No. 08 (September 2011).

at least implicit in both the TPP and RCEP. Streamlining customs procedures is only part of the wider 'logistics improvements' which has been extensively documented in ERIA research and which connects readily with ASEAN ideas of 'connectivity' and hence the pursuit of inclusive growth through narrowing development gaps. The WTO could well benefit from all this Asian experience, perhaps beginning by seeking a dialogue with the World Customs Organization in parallel with that with WIPO.

### **3. Undertakings, single and otherwise**

The ideal institution for facilitating economic integration in the modern global economy would have a wide mandate. Its central focus would be promoting positive interactions that reconcile important social and cultural customs with the removal of barriers to international commerce. It would seek to promote competition wherever this could be expected to enhance consumer welfare. It would look especially towards reducing impediments to the operation of international production networks. It would seek to resolve disputes and issues that arise in managing intellectual property rights, including accessibility and dissemination of standards. It would deal with impediments to flows of services and therefore of investment which facilitate cross-border business. And its mandate would extend to the movement of people, especially those with skills which are needed by international production networks in specific places, but also as skill-acquisition in employment grows in significance relative to basic education, to movement of people able to acquire new skills. The institution would understand that its task is not simply to implement well-understood rules but to evolve new rules as issues not foreseen are encountered. It would be an institution suited to a world of networks rather than of established organizations and hierarchies, and a world of relational contracting rather than black-letter law. The ideal is some distance away.

My emphasis has been on persuading WTO Members in Bali to establish paths towards securing the long-term future of the multilateral trading system. That means

embracing the concept of economic integration rather than being satisfied with trade negotiations aiming at market access. It means embracing plurilateral agreements while ensuring that regions remain active participants in world economic governance.

A particular challenge is preserving the possibility of new adherents joining the major plurilateral agreements. This amounts to no more than maintaining the most elementary component of the widely accepted ideal of 'open regionalism'.

Especially worrying is the likely provision in TPP for widening its membership. US leadership really matters here. While several parties to the TPP negotiation support it only as a step towards a Free Trade Area of the Asia Pacific and so look forward to membership by the North Asian economies of China, Japan and South Korea, some observers of US political processes see Chinese and even Japanese membership as unlikely or problematic. (This is distinct from the point that several noneconomic commentators, in the US and elsewhere, see TPP as an instrument for the containment of China. While there are certainly proponents of such a position, it is not supported by the Administration.) But US processes require Congressional endorsement of economic agreements, and if the TPP ends up being a set of related bilateral agreements (a bowl of noodles *within* a bowl of noodles), for which the US has thus far revealed a preference, China will have to negotiate bilaterally with the US in order to join a broader TPP – no matter what the wishes of other members; and any agreement would require separate approval by the United States Congress. That is rightly viewed by China as a set - up.<sup>45</sup>

It is somewhat ironic given the political situation in Washington, that to get the TPP to

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<sup>45</sup> Shiro Armstrong 'China's Participation in TPP' *APEC Economies Newsletter* Vol.16 No. 05 (July 2012). Sourabh Gupta has also commented, 'Once/if TPP is signed and implemented, inviting new members (China) will require a change in existing law ... which means a vote in Congress to change the law ... which will not happen because in White House–Congress consultations, the former will not be given formal or informal authority to negotiate in the first place.) And to suggest that it could, or should, will be seen as unrealistic, and ultimately therefore, unserious.' (I am grateful for permission to quote this extract from private correspondence.)

the starting line as a potential positive step towards economic integration in the modern world, a major change in US legal procedures (and probably in US law) is required.

RCEP is less advanced than the TPP. The modalities which will be used are not yet apparent. The agreed objectives, which were negotiated by all ASEAN members with the existing ASEAN FTA partners, include provisions for delayed entry by an ASEAN PTA partner that did not participate at the outset. 'The RCEP agreement will also have an open accession clause to enable the participation of any ASEAN PTA partner that did not participate in the RCEP negotiations and any other external economic partners after the completion of the RCEP negotiations'. The term 'any other economic partners' is ambiguous, but the emphasis on ASEAN centrality elsewhere in the document probably means that accession will require a PTA with ASEAN. The experience of Hong Kong's proposed accession to the China-ASEAN FTA points in the same direction.

In practice, accession of any but a very small economy to an existing agreement requires some consultation on how the terms of the agreement apply in the particular circumstances of the acceding economy. (The US did not even consider using the open accession clause of P4 before initiating negotiations to join P4 and make it into the TPP.) There is therefore the possibility of political gamesmanship in any accession, and RCEP too needs some further consideration of its accession provision. There is, however, a useful precedent in the evolution of the ASEAN Economic Community.

The ASEAN Economic Community is scheduled to be complete in 2015. In this context, 'complete' is not a precise term, but we need appropriate monitoring to know what tasks remain to be done and which of these are most important. Governments and their officials do not readily acknowledge that targets will not be met. Officials like

to count what is simple and can be presented in a good light.

To their credit, the governments and officials of ASEAN sought honest assessment rather than comfort in distorted data. ERIA was commissioned to conduct a Mid-Term Review of the ASEAN Economic Community. It constructed a Scorecard which is not a checklist of declared objectives but a genuine scrutiny of what was intended, a careful review of whether declared intentions have been implemented, and an assessment of whether the expected economic outcomes are being realized.

The resulting review provides a generally positive assessment of how the ASEAN Economic Community will be in place in 2015. There will be gaps, and governments have been given guidance on what they should set as their priorities.

This exercise has several interesting implications. It shows that reaching a desired end does not depend on an external agency able to impose sanctions. Learning from European experience requires effort, and notions that ASEAN is copying the EU are simplistic. Nobody can look at European experience in recent years and think that making obligations subject to supranational monitoring guarantees implementation. What is important is not declarations and signed agreements, but commitment to shared objectives and frequent discussion of how barriers to implementation can be overcome, including through cooperation. The 'ASEAN Way' has a great future.

Secondly, engagement of an independent but 'inside' agent like ERIA can help to reconcile technocratic expertise with democratic control. ASEAN governments retain control and answer directly to their electorates. 'Track 1.5' ERIA benefits from official information and respects confidentiality, but informs governments, officials and the public about where expectations are not being realized and what can best be done about it.

There are many areas of economic diplomacy where a similar mechanism could be useful. An especially important one relates to accession clauses in plurilateral agreements. Make the process of entry as technocratic as possible by engaging a track 1.5 institution like ERIA to assess whether an applicant is indeed reforming its own institutions and processes in a sensible way so as to satisfy the collective's ambitions. There will still be plenty of room for political debate, but it will be constrained.

One of the tasks for the WTO as it seeks to ensure that plurilateral agreements are open to new members is to endorse a process such as the one ASEAN used for the mid-Term Review and to compile a list of institutions which could be entrusted with a technocratic assessment (the OECD might well serve a similar purpose for European and trans-Atlantic agreements, ERIA for Asian ones, etc.)

#### **4. Conclusion**

At Bali, WTO members should take whatever gains in liberalization are available, but they are likely to be small.<sup>46</sup> It is more important to establish a positive start on longer-run strategies for preserving the multilateral trading system by positioning the WTO as its guardian at the center of a network of plurilateral clubs which can experiment with the regulatory changes needed for economic integration in a world of production networks, with special emphasis on services and investment, shared global governance with financial institutions and organizations like WIPO and WCO, standards and IP regimes, and open accession clauses.

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<sup>46</sup> Claude Barfield 'A Realist's View of the Global Trading System', *Real Clear Markets* (1 May 2013).