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Regional Trade and Investment Architecture in Asia-Pacific: Emerging Trends and Imperatives

Tiziana Bonapace

RIS-DP # 92/2005



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Regional Trade and Investment Architecture in Asia-Pacific: Emerging Trends and Imperatives

Tiziana Bonapace*

Abstract: Regionalism has become a key component of the new international order. It offers to the governments of developed and developing countries a new and attractive complementary strategy to multilateralism. Most countries of the world today belong to one or more regional trading arrangements of some kind covering more than two-thirds of the trade conducted. The Asia Pacific region is no exception to this trend. This paper examines the evolving regional trading panorama in the Asia Pacific region with its recent surge in bilateralism and its implications for evolving a regional trade and investment architecture. It argues that by facilitating the development of a seamless, region-wide zone of trade and investment, the region will enhance its prospects for becoming world's center of economic growth and prosperity by 2020.

Introduction

As developed and developing countries seek to more effectively manage their increasingly interdependent economic relationships, the Asia-Pacific region provides outstanding evidence of the benefits of open trade and investment policies spurred on by the birth of the World Trade Organization in 1995 which brought about far-reaching policy changes. The region continues to generate the highest rates of economic growth in the world, which has seen an average reduction in poverty of about 12.5 per cent in this region.¹ No Country of the region has made sustained inroads into poverty reduction without trade and investment liberalization.

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However, as countries accelerated their liberalization processes and integration into the world economy, imbalances and instabilities increased : it was unrealistic to assume that these changes would continue to bring about enhanced cooperation among countries, greater stability and prosperity. Within countries as well rapid growth generated deep socioeconomic and political changes which, when not addressed by the right domestic and international policies, engendered instability and selfperpetuating marginalization. Escalating violence at major global conferences was but one symptom of these imbalances.

Against this complex multilateral background, regionalism has become a key component of the new international order. It offers Governments – of developed and developing countries alike –an attractive complementary strategy. Currently, with the exception of Mongolia, trading countries of the world belong to one, or more typically, two or three regional trading arrangements (RTAs) or regional integration arrangements of some kind, covering about two thirds of the trade conducted. The Asia-Pacific region is no exception.

If multilateralism is complex, regionalism has proven to be even more so. It is a process that is inextricably linked to political objectives, cultural affinities and historical perspectives. Regionalism should therefore be studied from different angles. This paper, in accordance with the secretariat’s mandate, does not discuss geopolitical issues or regional security issues, notwithstanding their importance, whether as motivators or as consequences of enhanced trade relations.² The focus is on trade and development. Movement of labour, financial cooperation or monetary union are also not discussed at any length.

The purpose of this paper is to consider the evolving regional trading panorama with its recent surge in bilateralism and what it could imply for the evolving regional trade and investment architecture in Asia-Pacific.

A. Situational Analysis

Where do we come from?

Asia-Pacific regionalism or aspirations to create a pan-continental integration scheme have never really taken root. A few starts have surfaced from time to time, notably, the Bandung Conference in 1950, which was to become the precursor of the non-aligned movement. Consequently, until recently, the Asia-Pacific or ESCAP region was the least regionalized in terms of RTAs notified to

WTO. The highest concentration of RTAs was in the European Union’s various RTAs with Central and Eastern Europe, as well as northern and southern African countries and further afield.

Notwithstanding the above, broadly speaking three waves of regional integration can be distinguished in post-War history. The first wave occurred in the 1960s, following the establishment of the European Economic Community in 1957. South-South cooperation, particularly in Africa and Latin America, intensified, driven by the desire of developing countries to consolidate import substitution industries within larger economic spaces. These agreements sought through high external tariffs and administrative policy to determine which industries should be developed, how and where. This came to be known later as closed regionalism.

By the late 1970s, the ineffectiveness of these agreements became evident, as they had not achieved the intended objective of large scale industrialization and some countries had reached untenable BoP situations. A second wave of regionalism appeared in the 1980s as countries realigned development strategies towards exports. The emphasis shifted to open regionalism so that trade and investments from the outside would be boosted rather than deflected, thus enhancing export competitiveness. Adherence to the principles of nondiscriminatory treatment gained ground with membership in the GATT/ WTO system increasing quickly, while at the same time developing countries pursued a second even-faster track to trade liberalization via the regional route. Multilateralism and regionalism thus entered a golden age of mutually reinforcing liberalization. The Golden age peaked with the formation of APEC and its embodiment of open regionalism and non-discriminatory liberalization in the strictest sense of the word. In other words, the best tariff preference that one member would accord to other APEC members would also be extended to non-APEC members. The design of APEC was thus intended to offer the strongest possible support to the non-discriminatory principles of the multilateral trading system.

As the end of the century approached, regionalism took a new turn, which in effect ushered in a third wave of regionalism. The trigger was the 1997 financial crisis. Shortly thereafter, the APEC process of liberalization stumbled and came to a virtual halt. APEC’s largest trading nations, led by the United States and Japan, when pushed to make liberalization commitments in sensitive sectors, decided that they would be willing to liberalize only within the context

of the negotiated reciprocity of the WTO, and traditional preferential RTAs. Sensitive sectors notably, forestry and fisheries were transferred to the WTO. At the same time, erstwhile stalwarts of multilateral liberalization, such as Japan and the Republic of Korea abandoned their earlier reticence with preferential trade agreements and a new age of bilateral Economic Partnership Agreements (EPAs) took root.

Where do we stand now?

At last count, there were more than 70 RTAs involving ESCAP members and associate members, of which 65 had been notified to WTO (Table 1).

Between January 2002 and 2005, 135 agreements were notified to WTO. Among these, 59 were BTAs, of which 37 involved members or associate members of ESCAP. The region has thus seen an explosion of BTAs. They vary considerably in membership, style, design and effectiveness, in line with the diverse and heterogeneous nature of the political affinities and economic landscape of the ESCAP region. Many agreements are grounded in clear regional political alliances. Some appear to have common cultural affinities as a driving force, but most do not. Some have well-developed institutionalized rules of interaction, while others have a more informal structure based on voluntary cooperation. Some are open to new members, while others have placed a moratorium on new members. The breadth of coverage varies as well, with services covered in a few agreements while most do not cover services in any meaningful way. Agriculture may be wholly or partially excluded, while movement of factors of production, depth of tariff cuts, coverage of non-tariff measures and decision-making processes also vary widely. Likewise, the results achieved vary tremendously.

This highly varied state of trade cooperation is taking place against a highly dynamic trading panorama. Consider some of its features: intra-ESCAP trade in the ESCAP is expanding at almost twice the rate of world trade, with manufacture exports playing a leading role in intra-developing country trade.³ Developing countries in the ESCAP region now account for more than two thirds of South-South Trade. On average, developing countries have undergone much greater reductions in trade barriers (by two-thirds, to about 12 per cent) than developed countries, which has contributed to higher productivity in developing countries, by reducing the tax on imported intermediate inputs for manufacturing and kept factor prices rising in line with productivity growth. China and India serve as locomotives, but a range of other low income countries

Table 1. RTAs notified to GATT/WTO and in force in the ESCAP region, by date of entry into force

(As of 4 January 2005)

Agreement	Date of entry into force	Date	GATT/WTO notification		Document series	Examination process	
			Related provisions	Type of agreement		Status	Ref.
Bangkok Agreement	17-Jun-76	2-Nov-76	Enabling Clause	Preferential arrangement	L/4418 L/4418/Corr.1	Report adopted	25S/109 14.03.78
PATCRA	1-Feb-77	20-Dec-76	GATT Art. XXIV	Free trade agreement	L/4451 L/4451/Add.1	Report adopted	24S/63 11.11.77
SPARTECA	1-Jan-81	20-Feb-81	Enabling Clause	Preferential arrangement	L/5100	Examination not requested	...
CER	1-Jan-83	14-Apr-83	GATT Art. XXIV	Free trade agreement	WT/REG111	Report adopted	31S/170 02.10.84
CER	1-Jan-89	22-Nov-95	GATS Art. V	Services agreement	WT/REG40 S/C/N/7	Consultations on draft report	...
GSTP	19-Apr-89	25-Sep-89	Enabling Clause	Preferential arrangement	L/6564/Add.1	Examination not requested	...
Laos — Thailand	20-Jun-91	29-Nov-91	Enabling Clause	Preferential arrangement	L/6947	Examination not requested	...
AFTA	28-Jan-92	30-Oct-92	Enabling Clause	Preferential arrangement	L/4581	Examination not requested	...
ECO	not available	22-Jul-92	Enabling Clause	Preferential arrangement	L/7047	Examination not requested	...

Table 1 continued

Table 1 continued

Agreement	GATT/WTO notification			Examination process			
	Date of entry into force	Date	Related provisions	Type of agreement	Document series	Status	Ref.
<u>EFTA — Turkey</u>	1-Apr-92	6-Mar-92	GATT Art. XXIV	Free trade agreement	WT/REG86	Report adopted	40S/48 17.12.93
Armenia - Russian Federation	25-Mar-93	27-Jul-04	GATT Art. XXIV	Free trade agreement	WT/REG174	Factual examination not started	...
Kyrgyz Republic — Russian Federation	24-Apr-93	15-Jun-99	GATT Art. XXIV	Free trade agreement	WT/REG73	Under factual examination	...
MSG	22-Jul-93	7-Oct-99	Enabling Clause	Preferential arrangement	WT/COMTD/N/9WT/COMTD/21	Examination not requested	...
Georgia — Russian Federation	10-May-94	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG118	Under factual examination	...
CIS	30-Dec-94	1-Oct-99	GATT Art. XXIV	Free trade agreement	WT/REG82	Under factual examination	...
Kyrgyz Republic — Armenia	27-Oct-95	4-Jan-01	GATT Art. XXIV	Free trade agreement	WT/REG114	Under factual examination	...
Kyrgyz Republic — Kazakhstan	11-Nov-95	29-Sep-99	GATT Art. XXIV	Free trade agreement	WT/REG81	Under factual examination	...
SAPTA	7-Dec-95	22-Sep-93	Enabling Clause	Preferential arrangement	WT/COMTD/10	Examination not requested	...

Table 1 continued

Table 1 continued

Agreement	GATT/WTO notification			Examination process			
	Date of entry into force	Date	Related provisions	Type of agreement	Document series	Status	Ref.
Armenia — Moldova	21-Dec-95	27-Jul-04	GATT Art. XXIV	Free trade agreement	WT/REG173	Factual examination not started	...
EC — Turkey	1-Jan-96	22-Dec-95	GATT Art. XXIV	Customs union	WT/REG22	Under factual examination	...
Georgia — Ukraine	4-Jun-96	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG121	Under factual examination	...
Armenia - Turkmenistan	7-Jul-96	27-Jul-04	GATT Art. XXIV	Free trade agreement	WT/REG175	Factual examination not started	...
Georgia — Azerbaijan	10-Jul-96	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG120	Under factual examination	...
Kyrgyz Republic — Moldova	21-Nov-96	15-Jun-99	GATT Art. XXIV	Free trade agreement	WT/REG76	Factual examination concluded	...
Armenia - Ukraine	18-Dec-96	27-Jul-04	GATT Art. XXIV	Free trade agreement	WT/REG171	Factual examination not started	...
Israel — Turkey	1-May-97	18-May-98	GATT Art. XXIV	Free trade agreement	WT/REG60	Factual examination concluded	...

Table 1 continued

Table 1 continued

Agreement	Date of entry into force	GATT/WTO notification			Document series	Examination process	Ref.
		Date	Related provisions	Type of agreement			
EAEC	8-Oct-97	6-Apr-99	GATT Art. XXIV	Customs union	WT/REG71	Under factual examination	...
Kyrgyz Republic — Ukraine	19-Jan-98	15-Jun-99	GATT Art. XXIV	Free trade agreement	WT/REG74	Under factual examination	...
Romania — Turkey	1-Feb-98	18-May-98	GATT Art. XXIV	Free trade agreement	WT/REG59	Factual examination concluded	...
Kyrgyz Republic — Uzbekistan	20-Mar-98	15-Jun-99	GATT Art. XXIV	Free trade agreement	WT/REG75	Under factual examination	...
Georgia — Armenia	11-Nov-98	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG119	Under factual examination	...
Bulgaria — Turkey	1-Jan-99	4-May-99	GATT Art. XXIV	Free trade agreement	WT/REG72	Factual examination concluded	...
Georgia — Kazakhstan	16-Jul-99	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG123	Under factual examination	...
Georgia — Turkmenistan	1-Jan-00	21-Feb-01	GATT Art. XXIV	Free trade agreement	WT/REG122	Under factual examination	...
Turkey — Former Yugoslav Republic of Macedonia	1-Sep-00	22-Jan-01	GATT Art. XXIV	Free trade agreement	WT/REG115	Factual examination concluded	...

Table 1 continued

Table 1 continued

Agreement	Date of entry into force	GATT/WTO notification			Document series	Examination process	Ref.
		Date	Related provisions	Type of agreement			
New Zealand - Singapore	1-Jan-01	4-Sep-01	GATT Art. XXIV	Free trade agreement	WT/REG127	Factual examination concluded	...
New Zealand - Singapore	1-Jan-01	4-Sep-01	GATS Art. V	Services agreement	WT/REG127 S/C/N/169	Factual examination concluded	...
India — Sri Lanka	15-Dec-01	26-Jun-02	Enabling Clause	Free trade agreement	WT/COMTD/N/16	Examination not requested	...
United States — Jordan	17-Dec-01	18-Oct-02	GATS Art. V	Services agreement	WT/REG134 S/C/N/193	Under factual examination	...
United States — Jordan	17-Dec-01	5-Mar-02	GATT Art. XXIV	Free trade agreement	WT/REG134	Under factual examination	...
Armenia - Kazakhstan	25-Dec-01	27-Jul-04	GATT Art. XXIV	Free trade agreement	WT/REG172	Factual examination not started	...
Bangkok Agreement - Accession of China	1-Jan-02	29-Jul-04	Enabling Clause	Accession to Preferential arrangement	WT/COMTD/N/19	Examination not requested	...
Japan - Singapore	30-Nov-02	14-Nov-02	GATS Art. V	Services agreement	WT/REG140 S/C/N/206	Factual examination concluded	...

Table 1 continued

Table 1 continued

Agreement	GATT/WTO notification			Document series	Examination process Status	Ref.
	Date of entry into force	Date	Related provisions			
<u>Japan - Singapore</u>	30-Nov-02	14-Nov-02	GATT Art. XXIV	WT/REG140	Under factual examination	...
<u>EFTA - Singapore</u>	1-Jan-03	24-Jan-03	GATS Art. V	WT/REG148 S/C/N/226	Under factual examination	...
<u>EFTA - Singapore</u>	1-Jan-03	24-Jan-03	GATT Art. XXIV	WT/REG148	Under factual examination	...
<u>ASEAN - China</u>	1-Jul-03	21-Dec-04	Enabling Clause	WT/COMTD/N/20WT/COMTD/51	Examination not requested	...
<u>Turkey - Bosnia and Herzegovina</u>	1-Jul-03	8-Sep-03	GATT Art. XXIV	WT/REG157	Factual examination not started	...
<u>Turkey - Croatia</u>	1-Jul-03	8-Sep-03	GATT Art. XXIV	WT/REG156	Under factual examination	...
<u>Singapore - Australia</u>	28-Jul-03	1-Oct-03	GATS Art. V	WT/REG158 S/C/N/233	Under factual examination	...
<u>Singapore - Australia</u>	28-Jul-03	1-Oct-03	GATT Art. XXIV	WT/REG158	Under factual examination	...
<u>China - Macao, China</u>	1-Jan-04	12-Jan-04	GATT Art. XXIV	WT/REG163	Factual examination not started	...

Table 1 continued

Table 1 continued

Agreement	GATT/WTO notification			Document series	Examination process Status	Ref.
	Date of entry into force	Date	Related provisions			
<u>China - Macao, China</u>	1-Jan-04	12-Jan-04	GATS Art. V	WT/REG163 S/C/N/265	Factual examination not started	...
<u>China - Hong Kong, China</u>	1-Jan-04	12-Jan-04	GATT Art. XXIV	WT/REG162	Factual examination not started	...
<u>China - Hong Kong, China</u>	1-Jan-04	12-Jan-04	GATS Art. V	WT/REG162 S/C/N/264	Factual examination not started	...
<u>United States - Singapore</u>	1-Jan-04	19-Dec-03	GATT Art. XXIV	WT/REG161	Factual examination not started	...
<u>United States - Singapore</u>	1-Jan-04	19-Dec-03	GATS Art. V	WT/REG161 S/C/N/263	Factual examination not started	...
<u>United States - Chile</u>	1-Jan-04	19-Dec-03	GATT Art. XXIV	WT/REG160	Factual examination not started	...
<u>United States - Chile</u>	1-Jan-04	19-Dec-03	GATS Art. V	WT/REG160 S/C/N/262	Factual examination not started	...

Table 1 continued

Table 1 continued

Agreement	GATT/WTO notification				Examination process		
	Date of entry into force	Date	Related provisions	Type of agreement	Document series	Status	Ref.
United States — Israel	19-Aug-85	13-Sep-85	GATT Art. XXIV	Free trade agreement	L/5862 L/5862/Add.1	Report adopted	34S/58 14.05.87
Republic of Korea - Chile	1-Apr-04	19-Apr-04	GATT Art. XXIV	Free trade agreement	WT/REG169	Factual examination not started	..
Republic of Korea - Chile	1-Apr-04	19-Apr-04	GATS Art. V	Services agreement	WT/REG169 S/C/N/302	Factual examination not started	..
Thailand - Australia	1-Jan-05	5-Jan-05	GATT Art. XXIV	Free trade agreement	WT/REG185	Examination not requested	..
Thailand - Australia	1-Jan-05	5-Jan-05	GATS Art. V	Services agreement	WT/REG185 S/C/N/311	Examination not requested	..
US - Australia	1-Jan-05	23-Dec-04	GATT Art. XXIV	Free trade agreement	WT/REG184	Examination not requested	..
US - Australia	1-Jan-05	23-Dec-04	GATS Art. V	Services agreement	WT/REG184 S/C/N/310	Examination not requested	..

Source: WTO web site.

such as Cambodia, Lao PDR although still at low levels of trade per capita, also count among the most dynamic exporting countries of the region. What emerges therefore is that countries at varying levels of development are showing trade dynamism. This enhances the opportunities for complementary industrial production chains and trade links across developing countries, while also increasing the attractiveness of the region as a global trading partner in its own right.

In this new global trade geography as UNCTAD stressed at its eleventh session, the time is ripe for higher quality and closer economic partnerships that will further strengthen the region's integration into the global economy. As the then Secretary-General of UNCTAD aptly put it, a new international economic configuration is emerging in which developing countries, particularly those with high rates of economic growth – are becoming dynamos of economic activity. The world as whole stands to gain from this major structural evolution. (Rubens Ricupero, UNCTAD Secretary General, *Financial Times*, 15 June 2004.) The question that arises is whether the region has found in bilateralism a more promising avenue for capturing the gains from trade, than that promised by multilateralism and regionalism. The following section attempts to answer this question.

B. New Age Regionalism: Where Are We Going?

A related question is why bilateralism? Furthermore, is this surge in bilateralism a short-term phenomenon or not?

Based on the sheer number of agreements under negotiation, their disparate membership and varying coverage it is difficult to draw conclusive answers. It is also difficult to discern the final configuration at which bilateral trade agreements will come to rest, and how it will shape the process of regional integration.

Notwithstanding this, broadly, two major trends can be distinguished, they are discussed in turn below.

1. Linking subregions and continents: globalizing regionalism

One is a trend directed at coalescing existing regional groupings into outward-oriented FTAs that bridge subregions and continents. It holds the potential to lay the foundation for the eventual integration of all countries of the region into a forward-looking ESCAP-wide zone of efficient production

with enhanced opportunities for world trade. It is the more promising of the two trends.

The locus of this integration is centred around East and South-East Asia. Progress in bringing about the China-ASEAN FTA has been faster than initially expected, notwithstanding a recently missed deadline of 30 June 2004. With a market of nearly 1.8 billion people, a regional gross domestic product of about US\$ 2 trillion, international trade worth US\$ 1.2 trillion and average annual economic growth of 6 per cent, by current trends, this will become the productionbase and trade and investment centre of the region. The addition of Japan, which has long worked at strengthening its economic ties with the members of ASEAN, is further boosting the integration process. Although Japan has proposed a somewhat different approach, focusing on a deeper and slower approach that goes beyond traditional tariff liberalization to encompass wider economic and technical cooperation, the size and advanced nature of Japan's economy make its role central to the integration process of this region. The Republic of Korea is also pursuing its own initiative and studying the implications of an FTA with ASEAN, thus bringing the vision of an ASEAN+3 free trade area one step closer. Likewise, India has signed an agreement with ASEAN for freer trade, with early harvest on selected products. This could have a significant impact on the westward expansion of the ASEAN+3 process of integration.

Another initiative with potential for strengthening intersubregional trading ties within Asia and the Pacific is the Bangkok Agreement. As the oldest RTA in the region, it is a well-established agreement. It has a region-wide membership and is open to all developing countries irrespective of geographic location. It is the only agreement that currently includes countries from South Asia (Bangladesh, India and Sri Lanka), South-East Asia (Lao People's Democratic Republic) and East Asia (China and Republic of Korea). With two of the fastestgrowing economies of the region, and a consumer base of nearly 2.5 billion persons, the Agreement has the potential to become the world's largest RTA. Although to date, the Agreement has been beset by problems of limited product coverage and shallow tariff concessions, the third round of negotiations completed in July 2004 is expected to bring much wider and deeper benefits to members. The information contained in table 2, although of a preliminary nature, shows the number of items that will come under Bangkok Agreement concessions after the third round.

Table 2. Number of items under Bangkok Agreement concessions

Country	Current	After third round
Bangladesh	129	210
China	902 (18)	1671 (156)
India	188 (33)	577 (57)
Republic of Korea	214 (29)	1298 (316)
Sri Lanka	288 (32)	523 (80)
Total	1 721 (112)	4 279 (609)

Source: Calculations by the ESCAP secretariat.

Note: () = special concessions to LDCs.

Furthermore, the modalities and guidelines for these negotiations stipulate that they take place in conformity with WTO provisions governing RTAs, which discourage raising trade barriers against non-members.

Recent developments in BIMST-EC (renamed as the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation) could also play a linking role between AFTA and the South Asian Free Trade Area (SAFTA), particularly following the adoption of a framework agreement in January 2004 to form an FTA by 2017, the addition of Bhutan and Nepal as new members and the clear political will that emerged at the first summit for broader economic cooperation, held in July 2004. Of particular note is the plan to launch a BIMST-EC business card/visa scheme that could go a long way in promoting cross-border trade and investments.

Bridging initiatives are taking place not only between subregions of the ESCAP region. They also stretch across continents. Calls have been made for stronger links between AFTA and the North American Free Trade Agreement to promote and strengthen trade and investment links between the two regions, while at the same time the United States, in November 2002, announced an "Enterprise for ASEAN" initiative, which envisages an overall framework agreement with ASEAN. Talks are also under way to create stronger links between AFTA and the Andean Community, and AFTA and Mercosur. Another initiative that reaches across continents is the linkage between AFTA and ANZCERTA, although no consensus has emerged on forming an FTA and activities have mostly focused on information-sharing. The Asia-Europe Meeting is yet another initiative that seeks to bridge trade, investment and a social development agenda between the EU and Asia, although once again the results

emerging from this process are modest, confined mostly to exchanges of information and personnel in education, information and communication technology and environmental projects. Another example of the EU's region-to-region approach are the recently launched negotiations for an EPA between the EU and seven southern African countries. Of particular interest, although not strictly a region-to-region configuration, is the India-Mercosur initiative, as the large and more inclusive linkage it proposes with the Latin American common market indicates the huge potential for cross-continental South-South trade. Current levels of trade are low (US\$ 1.3-1.8 billion) but this figure could rise 16-fold both ways if current inhibiting factors are addressed.⁴ It could also be designed to be a building bloc of the ongoing ASEAN+3 initiatives and of the multilateral trading system.

Finally, important pan-continental bridging initiatives such as the negotiations under the Free Trade Area of the Americas and the addition of 10 new members to EU are further developments pointing to the consolidation of RTAs into wider continental agreements within geographically congruent spaces.

2. Fragmenting regionalism: bilateral FTAs

A second, and potentially more sinister, trend can be distinguished. An increasing number of trading nations are showing, through the number of new initiatives, that bilateralism is the more effective route for the promotion of trade and economic cooperation. This is a movement in the opposite direction: instead of amalgamating RTAs into wider bridging initiatives, there is a splintering of RTAs into bilateral FTAs. Figure I is an attempt – by no means comprehensive – to show these two opposing trends.

For example, the United States Framework Agreement under the “Enterprise for ASEAN” initiative in effect consists of a series of bilateral PTAs with individual ASEAN countries, the United States-Singapore FTA being the first one concluded, followed by Australia, with the Philippines, Thailand, and Indonesia among others, in the pipeline. Similarly, Japan has indicated that it has concerns about the varying levels of industrial development between the founding and newer members of ASEAN and prefers to enter into a series of bilateral trade agreements with individual member countries of ASEAN, also having started with Singapore and Mexico, with the Philippines, Thailand, Indonesia, and others in the pipeline. China is also negotiating separate bilateral agreements with a number of ASEAN countries as well as India, Pakistan, among others.

Likewise, the three-way linkage between China, Japan and the Republic of Korea, and the prospects for it to link up with the 10 economies forming AFTA in an ASEAN+3 configuration appears to have lost momentum. Instead, attention has been diverted to FTAs between individual North-East Asian economies and ASEAN, starting with ASEAN+China, followed by ASEAN+Japan, ASEAN+India and ASEAN+Republic of Korea. ASEAN+1+1+1 therefore appears at least for the time being to have gained attraction over the ASEAN+3 configuration.

3. The net effect?

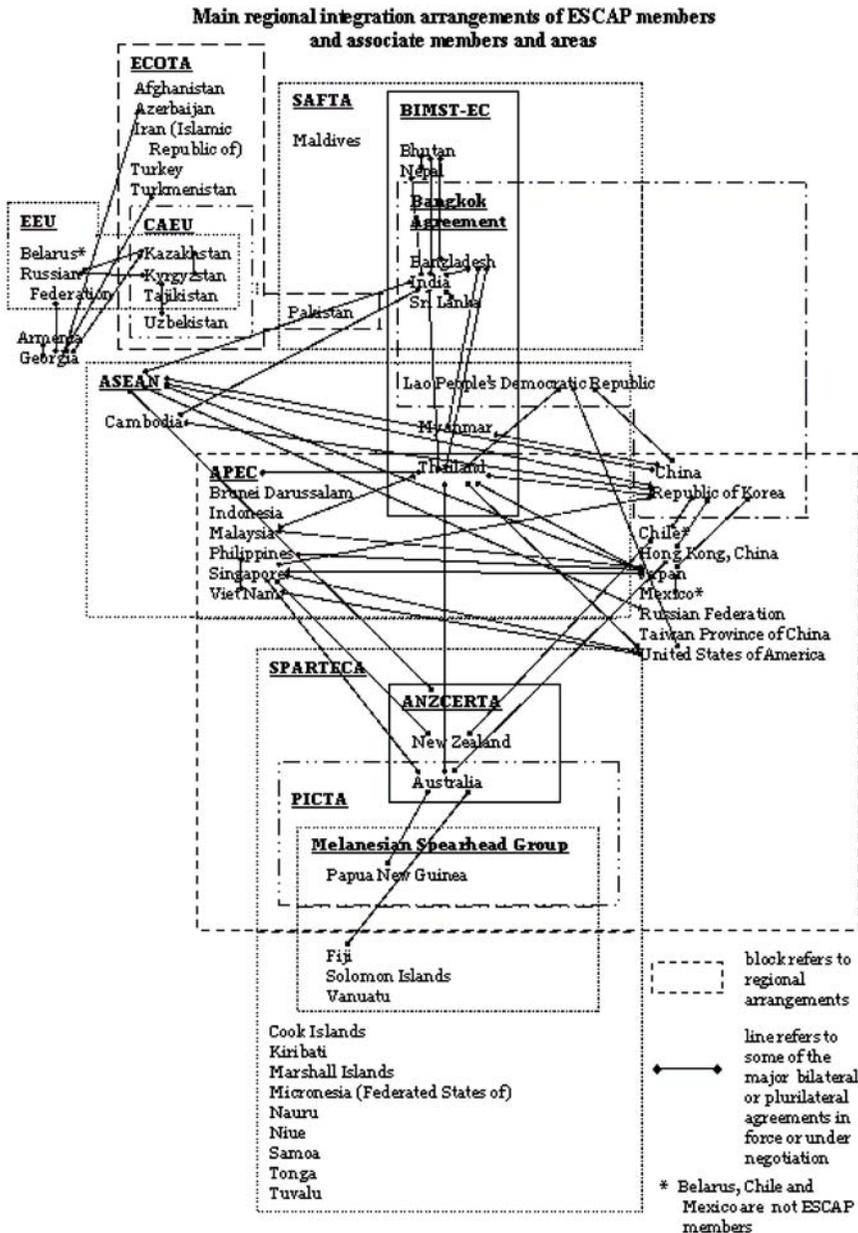
Benefits

These bilateral agreements have some clear advantages. They offer speed as agreement has to be reached between two countries only, as well as deeper and wider liberalization. Second, they are also useful conduits for linking trade and development goals, as they often encompass provisions for investments, technology transfer and other forms of economic cooperation and can be tailored to specific development goals. Those that are based on North-South partnerships also have an added pillar, namely, aid or financial packages, thus linking trade, capacity-building and development goals in an integrated win-win-win manner. Third, they are useful vehicles for deepening integration through regulatory reform and wider areas of economic and technical cooperation. By current indications, it would appear that the region has found through these new initiatives a more effective route for the promotion of trade and economic cooperation that promises greater economic benefits than a region-wide or a WTO approach to liberalization.

Concerns

Notwithstanding the above, contrary to conventional wisdom, the recent surge in FTAs is not benign. A key concern is whether these initiatives are reinvigorating or detracting from WTO negotiations? Judging from the current momentum (or lack thereof) in the Doha Round, particularly with regard to the services negotiations, one is tempted to conclude that these initiatives have not reinvigorated the WTO negotiations. Furthermore they have eroded the non-discriminatory principle on which the GATT/WTO was founded. By definition, they are preferential and therefore discriminate against third parties and given their sheer numbers, MFN trade is now more the exception than the norm. Of particular concern is the trade diversionary impact of preferential tariffs when high external MFN tariffs persist. Beside these systemic issues, on a more practical level, cross-country memberships in multiple FTAs leave

Figure I



investors confused as to which rules and incentives correspond to which FTA. Worse still, rules in one FTA contradict rules in another FTA. Of immediate concern is the implementation of rules of origin (ROO). ROO are sine qua non for FTAs because they prevent imports from entering the lowest tariff country and circulating freely within the FTA. Substantial value added, or substantial transformation should take place within the FTA, in an origin conferring manner, for the product to be eligible for the preferential rate. ROO have however evolved in a particularly complex manner. Furthermore, as tariffs reach their zero mark, ROO tend to increase in complexity. The rules of origin contained in recent BTAs signed with Singapore, for example, contain more than 240 pages. Methods of calculating ROO vary, as do definitions and coverage, and specialized knowledge is required in implementing the rules. Furthermore, ROO under preferential FTAs, escape WTO rules, and have therefore evolved in a manner that is agreement specific, thus further increasing the likelihood of contradictory provisions across agreements.

Another issue of major concern, is the configuration at which fragmentation will come to rest. What happens to developing economies, particularly those with small market access offers that are left on the sidelines?

It would appear that the current criss-crossing of bilateral FTAs portrayed in figure I could evolve into, and organize itself into a more systematic hub-and-spoke configuration. Both proactive and defensive trade strategies seem to be driving this process. On the one hand, major trading powers appear to be competing to establish trade hegemony in the region. At the same time, there are a number of smaller middle-income trading countries that are equally active in forging bilateral trade deals and also appear to be competing to establish dominance as a hub. This, however, may be more symptomatic of a defensive trade strategy, designed to avoid finding themselves at the spoke end of another major hub. A multilayered constellation is thus emerging, made up of a dominant hub-and-spoke arrangement with substrata of other hub-and-spoke arrangements in which smaller economies may be trying to establish alternative hubs. The option of developing countries collectively establishing themselves through ASEAN, as the alternative hub, stands out in particular.⁵ At the same time, more sceptical analysts question whether given the slow progress ASEAN has made in deepening integration and evolving into an integrated and seamless production base, it will ever evolve into this role.

Taking this emerging scenario, further, is the question as to whether under the current network of criss-crossing hub-and-spoke arrangements, the gravitational force of one large trading country will eventually prove to be too strong so that it emerges as the dominant hub. Under this scenario alternative minor hubs dissolve and become tied to the hub by a separate agreement, each tailored to the particular and separate interests involved between the hub and the spoke. Preferential treatment between the hub and spoke is not necessarily extended to other spokes in a most-favoured-nation manner. This is the least liberalizing of the configurations, as each spoke is likely to have comparative advantages in a different set of sectors, with the result that liberalization is tailored to fit the particular needs of each individual spoke. This bilateralism based on exclusivity rather than the inclusiveness of MFN is a major departure from WTO rules and principles. It is also driven much more by the political relationship between the hub and the spoke, rather than a multilaterally agreed body of norms, rules and principles that apply equally to all. Furthermore, import-competing industries in the hub country will insist on including wide-ranging safeguard clauses and stringent rules of origin. Vested interests may become firmly entrenched and more difficult to dislodge in future liberalization attempts⁶, while more spokes are added to the hub, the more diluted the benefits for each of the spokes. Finally, if a hub country conducts freer trade with spokes that in turn are not involved in reducing trade barriers among each other, outer-rim trade, which typically consists of South-South trade, is displaced and spokes turn into “spikes” as the hub continues to suck trade and investments towards itself.

4. Re-establishing the primacy of the multilateral trading system

Ultimately, from a trade perspective, the future configuration at which bilateral trade agreements will come to rest will be influenced by the pace, depth and scope of WTO negotiations. At the end of the day, the more WTO negotiations achieve significant reductions in trade barriers on an MFN basis, the weaker the rationale for pursuing alternative discriminatory, more preferential FTAs, be they regional or bilateral, and the less problematic they will be to third party non-members.

At the WTO level, a conclusion to the Doha Round by 2006, with sufficient depth and scope that neutralizes perceived benefits in bilateral trade agreements would be essential. Tighter disciplines governing RTAs/BTAs would also help. However, given the complexities of the tasks at the multilateral level, this will be no easy task. The question thus returns to the regional level, and how can regional initiatives be designed so that they play a more supportive role?

The central question therefore is how to make the myriad bilateral, regional and cross-continental initiatives coalesce and provide a fast track to global free trade under the multilateral trading system? Future initiatives will need to focus on the development of a set of common and cohesive principles, practices and operational procedures for regional economic integration consistent with WTO principles. The next Section considers this in more detail.

C. The Trade Architecture for a Future Asian Economic Community?

In the absence of a supranational structure of governance in the region, or of region-wide institutions, an intergovernmental organization with region-wide outreach like ESCAP, working in close collaboration with its regional partners such as RIS, and international partners, are all well positioned to forge linkages and promote the coalescing of these groupings while ensuring that they evolve in a manner supportive of WTO principles. The Commission at its 60th session endorsed the Comprehensive Trade and Investment Cooperation Framework (CTCIF) of ESCAP (figure 1) and requested the secretariat to undertake further work on this Framework.

The overall objective underlying this framework is to broaden the economic space for cooperation and deepen integration as a building block of multilateralism. ESCAP in partnership with interested regional organizations would seek to promote a consensus and develop cooperation among various regional groupings, in particular ASEAN+3, SAFTA, BIMST-EC and Bangkok Agreement members. The framework⁷ is built on the central premise that the long-term trade competitiveness of the ESCAP region is dependent on the primacy of the multilateral trading system. While WTO has its own weaknesses and will need to undergo certain reforms to ensure that it can perform its role more effectively, multilateral liberalization in accordance with multilaterally negotiated norms and rules is the first best policy option. Any other configuration is second best, and in a global economy of unbalanced trading powers, preferential trade agreements could result in some developing countries and LDCs risking further marginalization. At the same time, preferential RTAs are a reality and are growing. The framework therefore incorporates a second and parallel track, at the regional level. Track 3 of the framework aims to assist countries, particularly the less developed, in negotiating and implementing BTAs that are anchored and eventually consolidated into a more rational regional process.

How might regionalism evolve in a more streamlined and consolidated process? Two possibilities are considered.

1. Geography-based consolidation

Here, consolidation could take place on a geographical basis. The idea is to build on and rationalize current initiatives on a region-wide basis, while avoiding the creation of a new grouping of countries. A new grouping would add to the current proliferation, including proliferation of secretariats and costs that accompany such initiatives, with no guarantee that this new subset of countries would not run into the well-known problems that other RTA groupings have encountered, both when politically non-aligned countries seek to join, and when competition in the production of similar products prevent further liberalization. An example of the type of geographic consolidation envisaged is given in figure III. In this case, the Bangkok Agreement, as the only trade agreement that currently links South and East Asia, with three of its members sharing common membership with BIMST-EC (figure I), might eventually coalesce into an initiative that promotes a wider East, South-East and South Asian FTA. A third circle encompassing SAFTA could also be added, particularly since Bangladesh, India and Sri Lanka belong to all three RTAs (figure II). An agreement open to all countries of Asia-Pacific, for example, the Asia-Pacific Trade Agreement (APTA), as the Bangkok Agreement will eventually come to be known, might be a useful vehicle for laying some of the groundwork of this framework. The Bangkok Agreement has the advantage of being a relatively evolved text, which is the product of a long history of negotiations. Furthermore, the Bangkok Agreement's members represent a widely diverse development spectrum (with Republic of Korea at one end and Bangladesh and Lao PDR at the other end) and thus represents true and tried rules across a representative group of the development cross-section of the region. The potential for this text to evolve further as a modal South-South Agreement should thus be further explored.

In the long run, the success or failure of the Bangkok Agreement will depend on the extent to which members of the Agreement are able to move away from the positive list approach to a more comprehensive negative list of liberalization, expand coverage to include services and investment liberalization, and widen membership so that the Agreement is truly open to all developing countries of the ESCAP region.

2. Issue based consolidation

The bilateral trading arrangements (BTAs) criss-crossing the RTAs and cutting through established boundaries of the circles (figure III) could provide the fast track towards consolidation, in the sense that they are wider and deeper agreements that go beyond RTAs. They may thus result in RTAs becoming “obsolete”. However, the opposite might also happen. BTAs might fragment and splice up RTAs as they continue to evolve into highly stylized agreements that entrench vested interests, proliferate conflicting and irreconcilable rules and hamper the rationalization process. Conflicting ROO are of particular concern.

That may make rationalization of overlapping FTAs all but impossible. Adopting the less restrictive ROO could result in significant trade deflection and redundancy of a trade agreement, while adopting the most restrictive ROO may result in no trade taking place under the agreement. This is an area that needs further analysis and the ESCAP secretariat plans to give it much more critical attention than has been the case up to now.

Figure II. Comprehensive Trade and Investment Cooperation Framework for Asia-Pacific

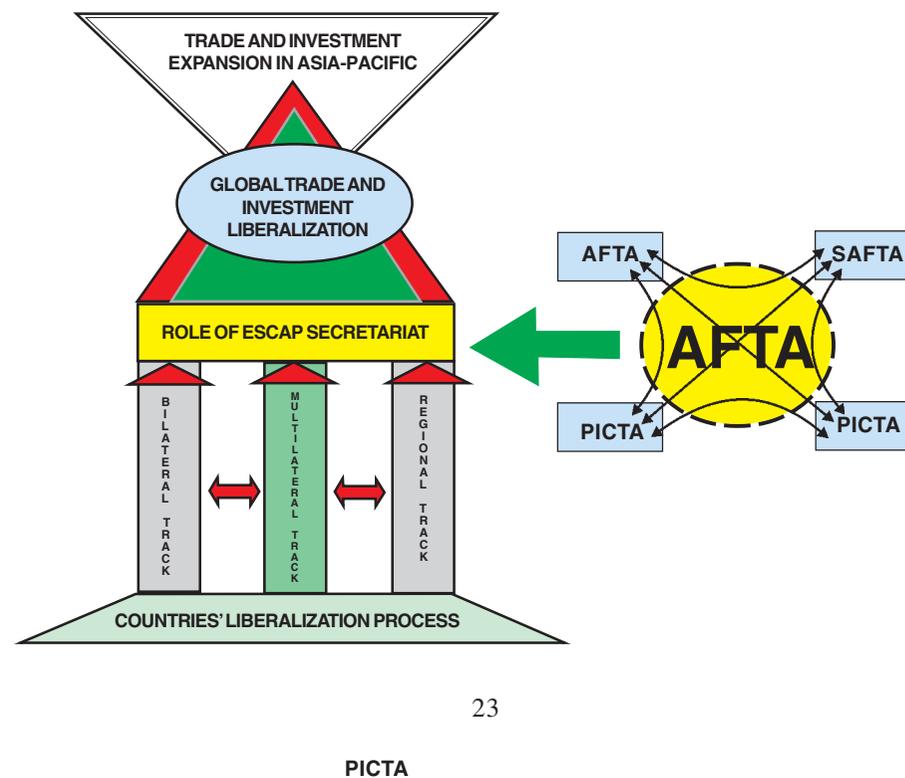
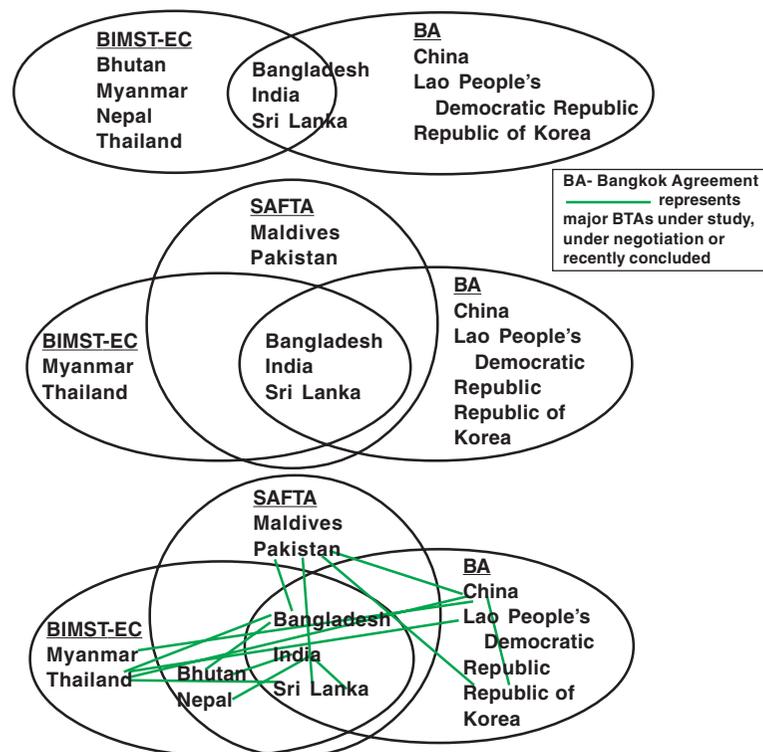


Figure III. Consolidating RTAs: an example of a geography-based consolidation



This all increases the urgency for an overarching region-wide common framework of principles, guidelines and procedures to which BTAs and RTAs would be anchored.

On the investment side there are currently about 1,800 bilateral investment treaties in place⁸ and, as evidenced by new-generation EPAs, trade and investment issues are often being treated increasingly in an integrated manner. The prospects for consolidation could go thus further to encompass closely related issues such as trade in services, competition policy and wider forms of economic cooperation like financial and monetary cooperation. Eventually on the long term, these initiatives could serve as the building blocks for a common understanding on the international architecture that is needed to support and anchor these regional efforts.

Another interesting issue worthy of further study in the specific context of the ESCAP region is that of financial packages. Contrary to examples from other agreements around the world (e.g. Euro-Mediterranean partnership, AGOA, CAFTA etc) trade liberalization and financial/aid packages, in all their varieties and forms, in the ESCAP region have remained separate entities. New age regionalism however is bringing with it a convergence between financial compensation packages and trade liberalization programmes. Newer agreements are devoting much greater attention to so called flanking issues that encompass trade liberalization. Furthermore, SAFTA under special and differential provisions to LDCs foresees the establishment of a revenue compensation mechanism to assist in recovering revenue lost from SAFTA trade liberalization. The modalities on how this mechanism will work have not been agreed to, and by current indications, there are doubts on whether this mechanism will ever come to fruition.

Nevertheless the principle of compensating revenue loss from tariff reduction can be a facilitating factor in determining the success of an eventual free trade area, if designed properly. A problem when setting up such a facility among a restricted group of developing countries is that many are grappling with poverty reducing challenges and fiscal constraints as LDCs, and can ill afford extensive compensatory packages.

This raises the question as to whether a regional financing facility that encompasses a wider set of countries should be set up, and whether linking such a facility to trade liberalization could be made to work at the regional level. A region-wide facility involving a much larger set of countries, both developed countries and developing countries would have clear advantages. The region now has US\$ 2.2 trillion in unutilized foreign reserves. Regionwide mechanisms offer benefits such as scale economies in pooling resources, spread of risk, enhanced credibility and access to supplementary sources of financing, including private sources. Furthermore a regional facility is linked by geographical, cultural and historical factors that can provide a further stimulus for a cohesive approach to these issues.

How such compensatory mechanisms would work as indicated in the SAFTA case, remains an open question? For example, should a common fund be set up? Who should fund it? Should only the more advanced countries provide financing? Should a portion of export income be used, and if yes, what

percentage? On the import side, how should “losers” be compensated? Should a proportion be calculated according to import volumes? What would trigger its use? Revenue compensation as under SAFTA, BoP shortfalls as under IMF/TIM, or should it provide only technical assistance to facilitate structural adjustment arising from trade liberalization? How should it be monitored? Least developed countries face particular vulnerabilities. They do not have the resources to set up social safety nets, and worse, they do not have the resources to endure longterm structural unemployment. Should only LDCs have access to such compensatory financial resources? What about other developing countries? India and China despite their remarkable export and economic growth, after all, account for almost three quarters of the world’s poorest people. Should sector-specific special credit schemes on a region-wide evolve that would allow some enterprises to invest in upgraded production for competing in an increasingly competitive global trading environment, the abolition of the MFA being a case in point?

3. Political leadership as a necessary condition

Beyond this, a vision for a more coordinated process of regionalism will require political leadership from one country or from a group of influential like-minded countries or perhaps even from only one visionary leader. Is the region ready for a stronger South-South solidarity to evolve? Can a region-wide solidarity evolve with the major developed countries? Can resource-rich rapidly growing countries lead the way? Does the political will exist to take regional integration forward? ESCAP and its regional partners stand ready to provide technical support and will rise to the occasion if members give a clear mandate and the necessary resources to pursue this goal.

Thrashing out and agreeing on such a mechanism is no easy task, but it is all worthy of further analytical scrutiny. Without this, the risks are high that proliferation will continue and that suboptimal choices will continue to be made.

Conclusion

Trade and investments will play a central role in the further integration of the region into the global economy, but the confluence of economics and politics will bring to the fore new challenges. The continued formation of trade and investment agreements with mutually inconsistent provisions puts a premium on convergence and consolidation.

ESCAP, as the regional arm of the UN, together with its regional partners can lay the foundations for the coalescing of fragmented agreements into a region-wide common framework of principles and procedures that would at the same time promote WTO principles and objectives. By facilitating the development of a seamless, region-wide zone of trade and investments, the region will enhance its prospects for becoming the world’s centre of economic growth and prosperity by 2020.

Endnotes

- ¹ Based on data in “Investing in Development”, UN, 2005, Table 2, p. 9.
- ² Political scientists suggest that negotiations between political leaders on trade issues gradually build trust among countries. Some would even suggest that regions that are highly integrated may have less conflict because interlocking the supply of raw materials and creating interdependence among strategic industries makes it materially impossible to sustain conflicts. The Association of South-East Asian Nations (ASEAN) is a case in point: intraregional conflicts were experienced among the founding members before ASEAN was established in 1967, but not afterwards. However, the opposite may also happen: if integration brings adjustment costs, redistribution of benefits and costs among members new tensions will arise, thereby worsening regional security.
- ³ Theme topic for the 61st session of Commission on “Implementing the Monterrey Consensus in the Asia-Pacific region: achieving coherence and consistency”.
- ⁴ UNCTAD, “Forum on Regionalism and South-South Cooperation: the Case of India and Mercosur” (TD/L.370).
- ⁵ R. Scollay, “Economic impact of RTAs in Asia and the Pacific”, paper presented at the Expert Group Meeting on Regional Trade Agreements in Asia and the Pacific, Bangkok, 30-31 January 2003.
- ⁶ M. Kostecki and B. Hoekman, *The Political Economy of the World Trading System* (New York, Oxford University Press, 2001).
- ⁷ ESCAP, *Meeting the Challenges in an Era of Globalization by Strengthening Regional Development Cooperation* (United Nations publication, Sales No.E.04.II.F.24).
- ⁸ <www.unctad.org>

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