

## Agriculture Liberalization in Preferential Trading Agreements: The Case of ASEAN Free Trade Area

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The breakdown of the Doha negotiations, due in large part to difficulties in reducing agriculture trade barriers in developed economies, while not a surprise to many observers, delivered a blow to the multilateral trading system. The setback prompted countries' dilemma on how much negotiating capital to continue investing in the multilateral negotiations at the World Trade Organization (WTO), even though most of them still submit that open multilateral trade remains the best way to achieve the greatest benefits from trade.

Yet, even before the collapse of the Doha Round, the slow pace of multilateral negotiations, had already led many countries to enter into preferential trade agreements (PTAs), both at the bilateral and regional levels. Several positive arguments for PTAs exist. First, a smaller set of presumably like-minded countries can come to an agreement relatively quickly in contrast to unwieldy multilateral negotiations. Fast-track agreements are also more likely to result from negotiations between similar economies, especially when trade agreements include mutual recognition and harmonization of standards. Arguably, PTAs can also be building blocks to a multilateral trading system if exposure to competition in the regional market prepares firms for global competition through "learning by doing"; and if it does not cause major trade diversion at the expense of non-parties to the PTAs but rather expands the regional/bilateral trade.

Taking these benefits into account, the proliferation of PTAs in the past decade is not surprising. According to the WTO, there are currently more than 200 agreements in force – 75 of which are in the Asia-Pacific region (APTIAD, 2006). A majority were forged in the past ten years, while others are still under negotiation. Among the best known preferential trade agreements are the North American Free Trade Agreement (NAFTA), ASEAN Free Trade Area (AFTA), MERCOSUR (the Southern Cone Common Market), and Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). The European Union (EU), of course, is the most developed economic integration agreement to date, but it also started as a PTA. Besides these, a host of other bilateral and regional trade agreements cut across continents, making the hodgepodge of trade agreements the very likeness of a "spaghetti bowl".

The question, however, remains whether PTAs deliver on their presumed benefits, a question that has become more significant with the suspension of the Doha Round. Are PTAs – the so-called alternative to the multilateral trading negotiations – viable in terms of actually delivering trade liberalization outcomes? There are, for sure, tangible results from the EU, the NAFTA, and, to a limited extent, from MERCOSUR. But for the majority of PTAs, especially the more recent ones, the results remain to be seen. Do the positives outweigh the negatives? Beyond manufacturing, do all sectors benefit? In particular, does agriculture?

### TREATMENT OF AGRICULTURE IN PTAs

Whether at the multilateral, regional, or bilateral level, agricultural liberalization is a sensitive topic for a number of reasons. Foremost are the sector's significant share in employment, issues of food security, safety and quality, the difficult political economy affecting agriculture talks, as well as other non-trade concerns like 'rurality' as a societal preference and the aging farmers' population, especially in the developed world. Still, for comprehensive trade liberalization, agriculture could not be left untouched in any PTA, albeit with some significant differences especially when compared to the multilateral negotiation's treatment of the sector.

In the first place, whereas WTO negotiations consider three major pillars of agriculture liberalization namely, market access, domestic support, and domestic subsidies, various PTAs only deal with market access issues, rarely with export subsidies, and almost never with domestic support. Moreover, negotiations usually skirt the ticklish issue of agriculture market access through exclusions of whole or parts of the sector, typically the highly sensitive products which ironically also happen to be the major export interest of the other parties in the PTA. They also treat agriculture with condescension through extended timeframes for liberalization relative to other sectors.

As regards health and sanitary measures, while a few have provisions for mutual recognition of standards, they do not substantially go beyond the WTO provisions. Safeguards are also present in many PTAs but in a seemingly more lenient way

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than in the WTO. In addition, whereas WTO negotiations begin from bound tariff rates, PTAs, at least, start from applied rates.

The special treatment of agriculture has both positive and negative facets. On one hand, the bracketing of especially sensitive agriculture products allows trade negotiations to move forward and to focus on other sectors where mutual benefits could be found. It prevents lengthy stalling of trade talks due to agriculture – a likely possibility in light of the suspended WTO negotiations. Scollay (2003) even argues that, for trading partners that are not competitive in agriculture, such exclusion reduces the trade diversion associated with preferential trading arrangements, making the PTA more welfare enhancing and mutually beneficial. Moreover, with an extended timeframe for liberalization, PTAs manage to include sensitive products for eventual liberalization.

Unfortunately, a downside also exists. With different countries excluding different sensitive agriculture products from liberalization, future harmonization or multilateralization of different PTAs becomes more difficult. More specifically, if countries are looking at PTAs as a stop gap measure while the multilateral trade talk is stalled, hoping that the complex “spaghetti bowl” would eventually turn into a simpler “lasagna”, then they are bound to be disappointed.

## THE CASE OF AFTA

Notwithstanding the ‘special treatment’ of agriculture, was there actual liberalization of the sector from PTAs? Global analysis of liberalization effects of PTAs exist elsewhere (see, for instance, Adams, et al., 2003), but the remainder of this brief will only consider the case of the ASEAN Free Trade Area (AFTA).

AFTA was signed in 1992 by Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand to foster greater economic cooperation within the region. Later on, four other Asian countries joined the agreement: Viet Nam in 1995, Lao PDR and Myanmar in 1997, and Cambodia in 1999. AFTA was notified to the WTO under the Enabling Clause, instead of the GATT Article XXIV, allowing it to bypass the Article’s requirement to liberalize ‘substantially all’ sectors. Under the Common Effective Preferential Tariff (CEPT) Scheme, products are categorized under the Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL), and General Exception List (GEL), with respective timelines for achieving 0-5 per cent tariff and/or eventual insertion in the Inclusion List.

AFTA dealt with the issue of agriculture by initially excluding all unprocessed agricultural products (UAPs) from tariff liberalization. Subsequently, however, all UAPs were incorporated into the liberalization process. Recognizing the difficulties involved in the transition process, ASEAN allowed flexibilities such as creating new Sensitive and Highly Sensitive List categories. Certain timelines were agreed upon with regard to inserting sensitive products into either TEL or IL. The liberalization clock only starts to tick once products are

included in the Inclusion List. Currently, only a few tariff lines remain in the Sensitive List – 25 and 19 tariff lines for Indonesia and the Philippines, respectively, out of more than 11,000 in each of these countries. Unsurprisingly, almost all the remaining products in the SL belong to agriculture.

In sum, AFTA proves how step-by-step tariff reductions, phased transitions and other flexibilities achieve agricultural liberalization – an accomplishment thought impossible decades ago.

## AFTA AND TRADE LIBERALIZATION

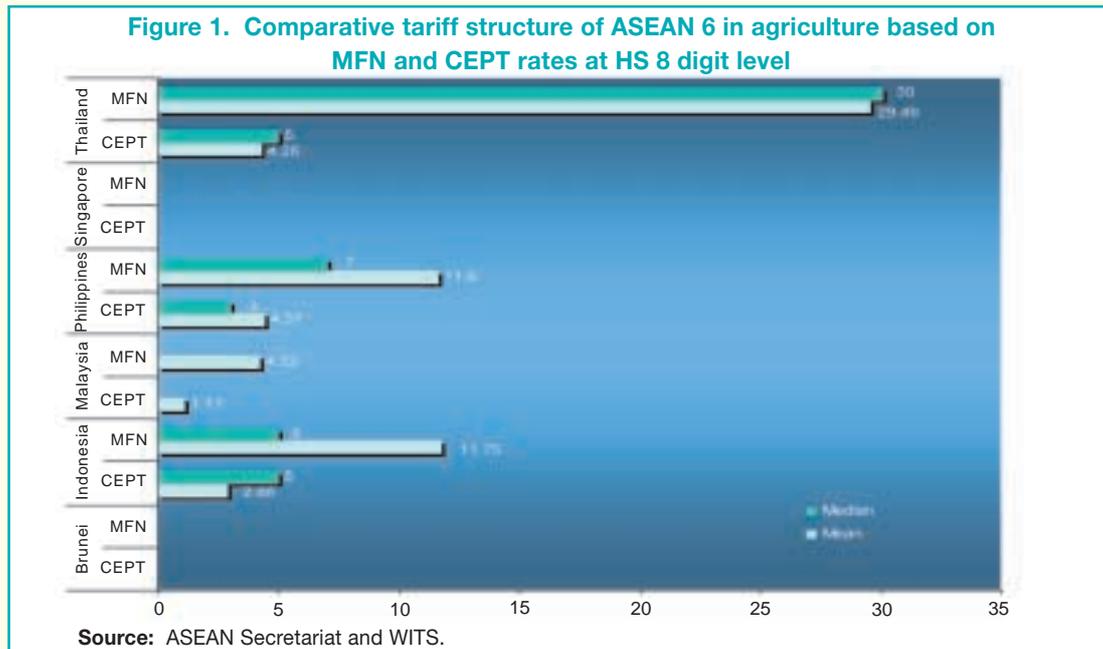
The feasibility and desirability of a particular trade agreement is often measured by the trade creation or diversion effects it produces. Economic theory posits that an PTA that is trade creating is good, while one that is trade diverting reduces economic welfare. On this note, past studies on AFTA using gravity equations show net positive trade creation which implies that AFTA does not discriminate against non-ASEAN importers, arguably making it a building bloc towards freer multilateral trade.

One of the major reasons for the positive assessment of AFTA rests in the region’s production structure. ASEAN countries, as a whole, have been the production base of multinational companies, with vertically integrated operations within the region, for products that are ultimately destined for extra-regional destinations such as the United States and Japan. Hence, trade volumes with non-ASEAN countries were little affected after AFTA. If at all, it even facilitated trade outside the region by lowering transaction costs of intra-ASEAN trade in industrial inputs and by making the vertical integration of Multinational Corporations more seamless.

More detailed analysis of tariff protection, likewise, shows remarkable progress especially when compared with Most Favored Nation (MFN) treatment of agriculture in the World Trade Organization. Average agriculture MFN tariff, for instance, is higher than the CEPT mean (see Figure 1) even as tariff dispersion in the CEPT (2 per cent) is lower than that in the MFN (12 per cent). Further, ninety-nine per cent of CEPT tariff lines are now below five per cent, of which half are already traded tariff-free. In contrast, a majority of MFN tariff rates continue to range from 5-20 per cent, with a few tariff lines greater than 30 per cent.

Yet, despite AFTA’s unambiguous gains in tariff liberalization, the figures hide the unevenness of liberalization between sectors. Between industry and agriculture, more industrial goods are traded within ASEAN tariff free, with less than 1 per cent of industrial tariff lines having tariffs greater than 5 per cent. In contrast, the percentage distribution of tariffs higher than 5 per cent in agriculture is larger than 1 per cent.

Further, ASEAN’s record of intra-regional trade flows is relatively less straightforward, especially in the agricultural



sector (see Table 1). While the share of intra-regional trade to total trade increased by more than ten percentage points, most of the increase came from industry trade, not from greater intra-regional agriculture trade.

While the share of intra-ASEAN agriculture trade to total increased from 1.44 per cent in 1995 to 1.9 per cent in 2003, it was a mere 0.5 percentage point increase – incomparably slight when one notes that total ASEAN 10 trade share in total trade of ASEAN 6 grew by ten percentage points from 21.41 per cent in 1995 to 31.74 per cent in 2003. Moreover, the table shows that, while total imports of ASEAN dropped and exports increased in 2003, both intra-ASEAN 10 imports and exports increased. The reduction in total ASEAN imports is largely due to the drop in the region’s imports from the rest of the world (ROW), while the increase in regional exports was large enough to offset the reduced export to ROW. Though partial, this observation points to the existence of net trade creation which many other studies on ASEAN have also found.

Deconstructing ASEAN into its member economies would show that some countries appear to have improved their

agriculture trade within the region. For example, Philippines and Thailand’s ratio of intra-/extra-ASEAN agriculture trade in 1995 were 0.11 and 0.12, respectively. These ratios expanded to 0.22 and 0.19 in 2003. Moreover, the index of intra-ASEAN agriculture trade shows that Philippines, Thailand, Malaysia and Indonesia increased trade in the region since 1992, and that Singapore’s trade decreased.

In summary, the tariff and trade analysis confirms results from gravity trade equations that AFTA is not trade diverting. More specifically, there is no clear evidence that intra-regional trade had dislodged trade with the rest of the world, particularly so for agriculture where the increase in intra-regional trade had been lackluster. If there was any growth in agriculture trade, most of it is due to trade outside ASEAN.

That most of the growth of intra-ASEAN trade came from trade in industry is, to a certain extent, not surprising. First, ASEAN countries produce agriculture products that are broadly similar, i.e., mostly tropical products, and, hence, provide relatively little room for trade with one another. Second, the AFTA itself was originally conceived to facilitate the already burgeoning

**Table 1. Direction of ASEAN 6 Trade: 1995, 2003 (in million US\$ and in per cent)**

	Imports (1)		Exports (2)		Per cent Share in Total ASEAN Trade	
	1995	2003	1995	2003	1995	2003
<b>ASEAN 6 Trade</b>						
ASEAN 6	53 244	75 393	69 518	88 476	20.23	29.61
ASEAN 10	54 900	79 140	74 994	96 504	21.41	31.74
Non-ASEAN	258 058	164 086	218 810	213 718	78.59	68.26
<b>Total ASEAN</b>	<b>312 958</b>	<b>243 226</b>	<b>293 804</b>	<b>310 222</b>	<b>100.00</b>	<b>100.00</b>
<b>ASEAN 6 Agricultural Trade</b>						
ASEAN 6	2 997	4 097	4 021	5 101	1.16	1.66
ASEAN 10	3 536	4 523	5 224	6 003	1.44	1.90
Non-ASEAN	11 237	7 242	18 147	10 334	4.84	3.18
<b>Total ASEAN</b>	<b>14 773</b>	<b>11 765</b>	<b>23 371</b>	<b>16 337</b>	<b>6.28</b>	<b>5.08</b>

Source: UNCTAD PC-TAS

intra-industry trade in manufacturing that arose from the vertically-linked operations of transnational corporations in the region. It was only later that agriculture liberalization, especially of unprocessed agriculture products, was appended in the agreement. Consequently, agriculture tariff reduction was only carried out in more recent years, unlike some industrial goods which were liberalized almost from day one of AFTA.

## CONCLUSION

The suspension of the Doha negotiations may signal nations to seriously consider options other than multilateralism; PTAs appear to be the second-best choice. The effect of PTAs, in the case of AFTA, showed that it had, indeed, helped lower tariff barriers against other ASEAN countries. The average and median CEPT tariffs have gone down significantly, especially when compared to the MFN levels. The tariff distribution analysis shows that tariffs of a large number of agriculture products, and indeed of all commodities, have been capped within zero to five per cent, while in the MFN case, a large portion of tariffs still lie between five and 20 per cent. Major ASEAN export interests are also not prevented entry into each other's domestic markets by high tariffs, except for products like rice, sugar or coffee.

While agriculture products remain sensitive and are given special treatments such as a prolonged timetable for liberalization, the fact that PTAs manage to include many sensitive products in the schedule of liberalization is already a significant improvement over multilateral negotiations. It is understandable that, for political reasons, some countries would have greater difficulty opening up certain agricultural sectors. But the flexibility afforded them in preferential trading agreements make for a less painful transition process. At the same time, the fact that these countries even commit to the liberalization of difficult sectors is already a major improvement over multilateral negotiations.

Despite these successes, hurdles remain and both time and patience are necessary to ensure that commitments are observed and withdrawal through policy reversals is avoided. Considering that least developed economies (LDCs) tend to be excluded from liberalization through PTAs, it is also vital to continue working towards multilateral trade liberalization in parallel, since this best serves the interest of every country, but especially the LDCs.

In the final analysis, the assistance or obstruction of PTAs to multilateral liberalization greatly depends on the design of the trade agreements, the sector inclusiveness, the timetable, and the flexibilities agreed upon. The AFTA, in particular, has proven itself to be a building block as far as total trade is concerned. Whether the same holds true for agriculture trade, an affirmative answer, in the case of AFTA, can likewise be given albeit less enthusiastically.

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