

Singapore and the New Regionalism: Motivation and Drawbacks

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The East Asian financial crisis of 1997-98 and its lingering effects appears to have slowed the pace, if not the commitment, by some ASEAN countries towards trade liberalization, and appears to have depleted the organization's collective economic strength. Meanwhile, APEC has become large and unwieldy, and appears ill equipped to handle substantive trade and investment liberalization issues effectively. Consequently, Singapore policy makers have underscored the need to explore alternative (i.e. third and fourth track) liberalization paths. Free Trade Agreements (FTAs) have, therefore, become an integral part of Singapore trade policy.

Motivation

FTAs appear to be increasingly regarded by policymakers around the world as effective and expeditious instruments for achieving trade liberalization among 'like minded' trading partners. Formation of bilateral FTAs among such partners is also seen as a way to overcome the so-called 'convoy problem', whereby the pace and depth of trade integration is held back by the 'least willing member'. FTAs are viewed as a means of maintaining forward momentum towards trade and investment liberalization, failing which there might be a lapse into protectionism. To the extent that contracting parties to an FTA agree to move beyond their respective WTO commitments, there may be a demonstration effect that motivates future rounds of broader multilateral negotiations, under the auspices of the WTO. Since trade agreements nowadays go well beyond trade in goods, to encompass an increasing number of areas and issues, FTAs could also act as a 'testing ground or pilot project for exploring complex trade issues', and establish some sort of precedent or benchmark for trade negotiations involving a larger number of countries, including one at the multilateral level.

Being among the first few countries to establish a number of FTAs ensures that Singapore is not discriminated *ex-post* in the event that its 'competitors' form

FTAs with third countries. A further first-mover advantage in forming FTAs with a large number of different countries takes the shape of a 'hub' of overlapping arrangements. Producers in the hub have cost advantages vis-à-vis producers in the 'spokes', being able to obtain more of their intermediate goods at lower prices. Further, since exports originating from Singapore are given preferential access to a number of other markets (with which Singapore has trade pacts), this may encourage the trans-shipment of goods through Singapore ports, hence fortifying its dominant role as an entrepot. Of course, it is for this very reason that FTAs have special provisions or rules of origin (ROOs), that are meant to prevent goods being re-exported from the lower tariff country to the higher tariff country one. However, this in turn may lead to a shift of export platforms from other regional developing economies to Singapore in order to enjoy duty-free market access.

Singapore has already established a bilateral FTA with New Zealand, and is in the process of negotiating others with Japan and the US, while trade pacts with Australia, Chile, the European Free Trade Area, and Mexico are also being seriously considered.

Singapore's Trade Pacts with Japan and the US

While the US has signed a series of bilateral FTAs with Canada, Israel, Mexico and Jordan, most recently, the announcement of the Singapore-US FTA is considered especially significant, as it will be the first one that the US intends to sign with an Asian economy. It has also been suggested that Singapore's bilateral trade pacts with the US and New Zealand, along with anticipated ones with Australia and Chile, may lead to a 'Pacific-5' FTA, which itself could be a precursor to an APEC-wide FTA. The announcement of a Singapore-Japan FTA is also of significance, as Japan and Hong Kong have been the only two economies that have hitherto not participated in any FTAs. Rightly or wrongly, the Singapore-Japan FTA has been viewed as a precursor to the formation of an East Asia-wide FTA between countries in Southeast Asia plus Japan, Korea and China ('ASEAN plus Three' or APT).

Entering into broad-ranging trade pacts with these two economic superpowers is not only seen as a means of gaining greater market access (with Japan in particular), but also as a way of avoiding the imposition of possible protectionist measures in the

future (with regard to the US in particular) and managing future trade tensions, including establishing orderly dispute settlement mechanisms. Singapore's total merchandise trade with the US and Japan, over the period 1980-99, constituted one third of Singapore's total merchandise trade. Conversely, trade with Singapore constituted a mere 2 percent of the US' global trade in 1999, and 3 percent in the case of Japan. Nevertheless, despite the city-state's microscopic physical size, it was the US' tenth largest export market and the twelfth largest source of imports in 1998. Singapore was the sixth largest export market for Japanese goods and Japan's thirteenth largest import source in 1999. Significant linkages also exist in trade in services, as well as foreign direct investment.

Drawbacks

It is commonly noted that since Singapore has one of the most liberal trade and investment regimes in the world, and the near zero tariff rates on most goods (and limited non-tariff barriers) implies that the scope for trade diversion from Singapore's vantage point is quite small.¹ Proponents of Singapore's push towards FTAs note that the proposed bilateral trade pacts with these two economies is a formalization of the *de facto* extensive and deep linkages that already exist. While this may all be true, it would certainly be a leap of faith to conclude that there are no ill effects whatsoever. So what are some potential concerns of Singapore's recent drive to form FTAs?

The proliferation of a number of overlapping FTAs raises many technical problems with respect to the implementation of ROOs. Even with a single FTA, a concern is that ROOs with a particular country, say the US, may be sufficiently prohibitive to induce Singapore exporters to source their inputs from the US rather than some other country in Asia (such as Korea). In other words, the US exports its external tariffs to Singapore. This appears to have been the case with NAFTA, where the US negotiated a ROO on Mexican assemblers of automobiles. ROOs can also give rise to significant costs, due to the need for administrative surveillance and implementation. In practice, ROOs are particularly complex -- almost two hundred pages long in the case of NAFTA, and eighty pages of small print in the case of the EU's agreement with Poland -- as they have to take into account tariffs on imported

intermediate goods used in products produced within the FTA. The book-keeping and related costs rise sharply as production gets more integrated internationally.

Apart from the issue of ROOs, a large number of FTAs may leave investors confused as to which rules, obligations and incentives correspond to which partner. Worse still, there is the possibility that membership in multiple trade pacts may create ‘obligations made in one that contradict those made by others’. Bergsten highlights this point in the context of APEC’s goals of region-wide trade liberalization. As he notes of the blueprint on the Singapore-Japan proposed FTA:

“... it states that Japan is unwilling to liberalize agricultural trade, even in a deal with Singapore where there is no agricultural trade. In other words, they do not accept the principle. They can argue, as this blueprint does, that it is perfectly compatible with the WTO. The WTO says you must substantially cover all trade. If there is no agricultural trade, you do not have to include it to meet the WTO test. But the APEC test, which was hammered out after much debate in both Bogor and Osaka, states that trade liberalization must be comprehensive - no sectors can be excluded. APEC was consciously being WTO+ and the Japan-Singapore agreement, if that study result becomes the actual outcome, would violate its precepts ... Japan and Singapore should be asked how their new agreement is compatible with APEC”.²

Time and efforts spent on negotiating and implementing a series of bilateral and trilateral FTAs may divert scarce resources from the multilateral rounds. Potentially more important is the fact that, by being involved in a number of FTAs, Singapore must accept at least partial responsibility for diverting attention of trade partners away from multilateral negotiations.

Singapore appears to be willing and able to negotiate FTAs fairly quickly. However, this rapid pace apparently hinges on Singapore’s readiness to accept a

¹ Ninety nine percent of Singapore’s imports are not dutiable. Tariffs are only imposed on alcoholic beverage imports while excise duties are imposed on tobacco products, automobiles and gasoline.

number of conditions in the context of the bilateral pacts set forth by the larger partners, such as labour and environmental standards, in the case of the FTA with the US, or exclusion of agriculture in the case of the FTA proposals with Japan. While acceptance of these conditions may not be problematic in the case of Singapore, given its high environmental standards and negligible agricultural sector, if they are eventually included in the agreements, Singapore may be doing a disservice to developing economy interests in multilateral negotiations at large. More narrowly, such supplemental agreements may not be as readily acceptable to other ASEAN members. Accordingly, Singapore-based FTAs may not be an appropriate model for future agreements by other Asian nations. Further, Singapore unilaterally signing on to such terms and conditions (such as linking trade with labor standards), might preclude ASEAN from taking a common and credible stand on these and other issues.

An oft-noted question is whether bilateralism and regionalism are a ‘stepping stone’ or a ‘stumbling block’ towards multilateral liberalisation. Insofar as a key component of Singapore’s growth strategy has been its outward orientation, particularly its openness to trade and investment flows, and the city state has been a leading advocate of global trade liberalization, it is fairly clear that Singapore’s drive towards regionalism is not an instrument of covert protectionism. That said, there is the important question of how Singapore’s decision to embark on a separate series of trade initiatives to bolster its trading, investment and strategic position, without the consent of ASEAN, are perceived by other Southeast Asian economies, and what it means for initiatives towards the implementation of an ASEAN Free Trade Area.

² F. Bergsten, “Back to the Future: APEC Looks at Subregional Trade Agreements to Achieve Free Trade Goals”. Speech given at the Pacific Basin Economic Council luncheon, Washington, DC (31 October 2000).