



Fighting Irrelevance: The Role of Regional Trade Agreements in International Production Networks in Asia – A Study of Asia-Pacific Research and Training Network on Trade, United Nations ESCAP 2011, 244 pp. ISBN: 978-92-1-120620-3

Regional trade agreements (RTAs) became the chosen approach to trade liberalization during the last fifteen years. Asian countries quickly made up for the slow start and now contribute about half of all trade agreements in force globally. In Asia, the trade agreements complement market driven integration of so-called international production networks (IPNs) that have a much longer history.

The book *Fighting Irrelevance: The Role of Regional Trade Agreements in International Production Networks in Asia*¹ talks about the link between two processes of integration in Asia: one driven by the formal trade agreements and the other, the market-driven regional production networks. Case studies in this book are based on a collection of primary data gathered through surveys and in-depth interviews with business people of selected manufacturing sectors from five Asian countries: Bangladesh, China, India, Indonesia, and Thailand. The use of primary data in analysis of the two different but related types of regional integration makes studies in the book quite distinct from other studies on a similar topic.

The analytical potential of the primary data however has not been fully used. While rich anecdotal evidence and many examples of business practices have been brought into the discussion, they could have been more systematically analyzed. For instance, better organized and more harmonized surveys across countries in the study would have enabled cross country

¹ The book is a joint product of a team of authors: Archanun Kohpaiboon, Bala Ramasamy, Biswajit Nag, Dionious Narjoko, Ira Setiati, Khondaker Golam Moazzem, Mochamed Pasha and Md Tariqur Rahman.

comparisons of the link between trade agreements and production networks in the region. Nevertheless, this book contributes significantly to the literature by providing a thorough survey on the regulatory environment and trade policies relevant for the selected industrial sectors in the region.

RTAs and IPNs: What does the book tell us?

The book mostly focuses on how production networks have been affected by the implementation of RTAs in Asia. The first part of the book presents literature reviews and a conceptual basis of this link, and a synthesis of findings of the study. The analysis focuses on the effect of the trade liberalization aspect of RTAs in promoting the development of production networks in Asia. The main message of the book regarding the link between those two phenomena is that IPNs in Asia were mainly driven by market initiatives and while formal trade agreements have potential to foster their development, no clear evidence is found about this causation.

The emergence of international production networks is closely related to the advancement of a new production model that has swiped manufacturing production for the last three decades. In a traditional production model originated from the industrial revolution era, goods are produced mostly at the same location under single management and organization. The involvement of outside vendors and suppliers is very limited as producers manufacture mostly all parts and components inside the organization due to the high costs of communication, coordination and transportation.

As a consequence, having all production under the same roof make producers unable to exploit advantages arising from particular characteristics of locations. While it might have been cheaper to produce certain labor-intensive parts and components in locations where labour is available abundantly, firms would discard the idea since it is costly to coordinate and to handle numerous problems arising during production. High costs of transportation also mean that cost savings resulted from having production in labor abundant locations would be drawn up for bringing the components to other locations of production.

However, with the advance of communication and information technology along with the decline of transportation costs, placing different production stages in different locations to take advantage of location characteristics is no longer difficult. Jones and Kierzkowski (1990) are

among the first scholars to notice the impact of reduction in what they call a service link² in facilitating fragmentation of production into smaller units of production blocks and placing them in several different locations. Countries no longer produce finished products for their consumption and exports, but tend to specialize in specific stages of the production process and involve in a massive international chain of production to come up with a single product used by consumers. With this new production model, foreign direct investment, offshoring or simply international services trade has been intensified rapidly.

Locating different production stages at various different places require intensive international trade particularly in intermediate products. Therefore lower costs of trade become a crucial aspect in developing the network. Trade liberalizations, that is, tariff and non-tariff cuts as well as simplifying trade procedures, helped a great deal to make cross-border activities cheaper, simpler and timely contributing to a spread of this new production model.

However, country studies in this book do not find that regional trade agreements (a popular form of trade liberalization) advance considerably the development of IPNs in Asia. The studies note that RTAs signed by China, Indonesia and India, for instance, exclude selected industries, in particular automotive, from the agreements or do not provide enough liberalization content. The costs of complying with procedures to obtain preferential tariff rates also often outweigh its benefits. Instead of creating more a supportive environment for exports, numerous RTAs with various different rules of origin impede the flow of goods when it comes to goods containing intermediate inputs from the third country outside the RTAs, which is very common in the case of current international production practice. Relatively low tariff rates in manufacturing goods – as a result of unilateral and multilateral liberalization - along with higher cost of administration make the negotiated concessions no longer attractive to business community in the region.

More positive stories come from the trade agreement between Thailand and India. This agreement has resulted in reducing trade barriers for specific automotive components, such as gearboxes and parts for spark ignition in engines. This in turn increases trade in automotive parts and components between the two countries. Other agreements involving India, however, do not present similar outcome. The Asia-Pacific Trade Agreement, the only trade agreement having

² Service link refers to services such as coordination, communication and transportation in production.

China and India as members, is partial in its scope and does fail to foster IPNs between the two countries due to exclusions of parts and components in schedule of concessions currently offered by this agreement. In summary, mixed effects of RTAs to the development of IPNs indicate that the agreements have not yet reached their potential.

..... and what it overlooks

While trade liberalization, as the most important part of any RTA, might be the most obvious aspect of trade agreement affecting IPN, there are other aspects, though less noticeable, that might have an influence on the development of the networks. These other aspects of RTAs may be able to provide necessary disciplines needed to address some problems which arise from cross border activities of new production practices.

Business deals involving two or more parties originated from different countries create new kind of problems. Industrial contracts are no longer specified under a specific legal and business environment but rather being formulated under multinational setting. Business deals known as original equipment manufacturing and other types of outward manufacturing require different set of rules as the transactions are determined through bilateral bargaining, rather than through market clearing (Antras and Staiger 2008). This increases business risks and uncertainty, particularly from political and legal environment perspectives. It also encourages hold-up problems between the parties involved. Business and investment disputes can be very costly and require more efforts due to different a legal environment and practice. A Japanese multinational, for example, willing to open up a subsidiary in a South-East Asian country might find out that its investments are exposed to many unfavourable business and legal practices. It would be more constructive for all parties involved to conduct their business under more harmonized set of rules and regulations. The new arrangement of production and trade, in short, requires new and deeper disciplines and governance.

Here is where RTAs can play active role in shaping up IPNs. The 21st century regionalism, a term coined by Richard Baldwin (2011), offers the effort to provide deeper disciplines of international trade and production by covering more than just simply trade liberalization. The agreements talk about simplifying domestic regulations and providing tools to create more business supportive environments. Many also offer protection for investments and intellectual

property rights. It is apparent that the deepening of commitment becomes a major feature of recent RTAs as described in the recent World Trade Report (WTO 2011).

Development towards more harmonized trade and production disciplines through RTAs has potential to foster the advance of international production network. It reduces costs related to business operation and coordination, and increases certainty in carrying out cross-border production activities. Deepening of commitments has also taken place in trade agreements between countries in Asia. According to the WTO database on trade agreements, from 20 agreements in the region, around 70% of them cover deeper commitments in protecting investments, competition policy, IPRs, and other aspects of domestic regulations. It is obvious that this 21st century trade agreements has become a common pattern and might bring significant impact to IPNs in the region.

Unfortunately, the book does not talk much about this recent development. While it gives detailed description on domestic regulatory environment related to manufacturing production and industrial network in each country of the sample, it does not provide connection with the recent development of RTAs that goes beyond trade liberalization. While the connection might be more subtle and more difficult to examine, the issue of deeper commitments in RTAs and its link to the development of IPNs in Asia is worth investigating further. A future study on these linkages may help bridge the gap between our understanding of the role of trade agreements in IPNs and the current practice.

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