THE FREE TRADE DOCTRINE, REGIONALISM, THE ASEAN FREE TRADE AREA AND THEIR EFFECTS ON TRADE AND TRADE POLICY

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The Free Trade Doctrine, Regionalism, the ASEAN Free Trade Area and Their Effects on Trade and Trade Policy

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DECLARATION

I, Anuar Ariffin, hereby declare that this thesis, submitted to fulfil a requirement for the award of Doctor of Philosophy from Murdoch University, is my own piece of work. This thesis does not contain any pieces of work of other persons, except those that are duly acknowledged and referenced in the text. Also, this thesis has not been submitted for any qualifications at any other academic institutions.

Anuar Ariffin
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ABSTRACT

This thesis examines a number of issues concerning the free trade doctrine, regionalism and Regional Free Trade Areas (FTAs), with a special focus on the ASEAN Free Trade Area (AFTA). This study is broadly divided into three parts. The first part examines the doctrine of free trade from the perspectives of ideological belief as well as theoretical expositions, and how these influence trade policies of many countries throughout the history of trade. The second part of the study analyses the forces that influence the formation of regionalism and regional FTAs all over the world. In the first and second parts, an extensive survey of the existing literature is undertaken to unearth relevant ideas and events, which are important to policy makers and the general public.

The third part of the study deals primarily with empirical investigation of the economic effects brought about by the formation of regional FTAs. Two main issues are examined in this part. The first issue is the assessment of the effects that regional FTAs have on trade of members against other countries that do not become members of any economic groupings. The second issue is the examination of the effect of AFTA on trade of member vis-à-vis non-member countries. In addition, this part also examines the question of whether AFTA “creates” or “diverts” trade. For the purpose of addressing issues grouped in this part of the study, a gravity model is employed to answer the questions of interest. This part of the study covers a period of 24 years (1980-2003). Cross sectional data involving 990 pairs of countries, which trade with each other, are used in regression analysis based on the Ordinary Least Square technique.

Findings from the first and second parts of the study indicate that trade between countries during the era of mercantilism (1500s-1750s) was carried out under enormous restrictions in consonance with the thinking of that time. However, by the end of eighteenth century the economic arguments in favour of free trade began to be accepted, resulting in the adoption of the free trade idea into the commercial policies of many countries, particularly in Europe in the middle of nineteenth century. The period characterized by unilateral free trade regimes lasted only about three decades, as protectionist elements made a return into trade policy formulation in the 1870s. The period of liberal trade policy regimes came to a complete end at the breakout of the First World War in 1914, and the protectionist trade policies of many countries continued to strengthen their grip until the Second World War.
After WW2 ended in 1945, many countries realised that security and the orderly conduct of international trade were important to ensure continuous prosperity of the world. This led to a series of negotiations involving major trading countries that resulted in the establishment of the GATT in 1947. The main thrust behind this initiative was that all trading nations must cooperate to liberalize their trade policies, reflecting the idea that countries should move towards adopting “freer” trade policy than the regime they adopted in the 1930s and the early 1940s.

At the end of 1990s the world once again observed agreement amongst prominent trade economists for the case of pursuing free trade policy. This is due to the renewed recognition by economists of two important propositions: (1) if market failures remain unfixed, then pursuing free trade policy can harm rather than help, and (2) if market failures are fixed through suitable policy interventions, then free trade can be used to exploit the potential gains from trade. Within the second proposition, economists emphasis that if market failures arise in domestic markets, then the most appropriate policy interventions would be to devise policies targeting at correcting those domestic market failures, while free trade is maintained externally.

Findings from empirical assessment of the effects of regional FTAs on trade indicate that economic theory might be able to approximate reality. One important result of this part of the study suggests that three regional FTAs, AFTA, CER and MERCUSOR have had an intra-bloc trade intensifying effect in recent years, particularly since the early 2000s. This implies that trade among members of these economic groupings is higher than their trade with other countries. Meanwhile, the EU and NAFTA do not show an intra-bloc trade intensifying effect for any part of the study period. The other important result obtained by this study suggests that although AFTA member countries trade with each other, comparatively, more than their trade with the rest of the world, the intensity of trade between them is less pronounced for the period after the formation of AFTA. This implies that AFTA has the characteristic of an “open trading bloc”. Lastly, the finding of this part of the study also suggests that AFTA essentially creates rather than diverts trade. This means that AFTA’s establishment does not only increase trade among member countries but it also boosts trade with the rest of the world.
ABBREVIATIONS

AAC – Association of African Countries
AFTA – ASEAN Free Trade Area
AIC – ASEAN Industrial Complementation/Alkaike Information Criteria
AIJV – ASEAN Industrial Joint Venture
AIP – ASEAN Industrial Project
ANCOVA – Analysis of Covariance
ANDEAN – Andean Pact
APEC – Asia Pacific Economic Cooperation
ASEAN – Association of South East Asian Countries
BA – Bangkok Agreement
BFT – Bilateral Free Trade
BFTA – Bilateral Free Trade Area
CACM – Central American Common Market
CAP – Common Agriculture Policy
CEAO – Communauté Economique de l’ Afrique Occidentale
CEPT – Common Effective Preferential Tariff
CER – Closer Economic Relations
CES – Constant Elasticity of Substitution
CGE – Computable General Equilibrium
COMESA – Common Market of Eastern and Southern Africa
CRS – Constant Return to Scale
CU – Customs Union
CUSFTA – Canada-US Free Trade Agreement
DC – Developing Countries
EC – European Community
ECOWAS – Economic Community of Western Africa States
EEC – European Economic Community
EFTA – European Free Trade Area
EMU – Economic and Monetary Union
EOI – Export Oriented Industrialisation
EU – European Union
FBM – Federation of British Manufacturers
FDI – Foreign Direct Investment
FTA – Free Trade Area
FTAA – Free Trade Area of the Americas
GATT – General Agreement on Tariffs and Trade
GCC – Gulf Cooperation Council
GDP – Gross Domestic Product
GECA – General Equilibrium Counterfactual Analysis
GNP – Gross National Product
GSP – Generalised System of Preferences
GTC – Gross Trade Creation
HAC – Heterocedasticity and Autocorrelation Consistent
IMF – International Monetary Fund
IRS – Increasing Return to Scale
ISI – Import Substitution Industrialisation
ITO – International Trade Organisation
LAFTA – Latin America Free Trade Area
LAIA – Latin American Integration Association
LDC – Least Developed Countries
MERCUSOR – Common Market of the South
MFN – Most Favoured Nation
MFT – Multilateral Free Trade
MTN – Multilateral Trade Negotiations
NAFTA – North America Free Trade Area
NEDA – National Economic Development Authority
NESDB – National Economic and Social Development Board
NFIS – National Federation of Iron and Steel
NIC – Newly Industrialised Countries
NUM – National Union of Manufacturers
OECD – Organization for Economic Cooperation and Development
OLS – Ordinary Least Square
PECA – Partial Equilibrium Counterfactual Analysis
PTA – Preferential Trading Arrangement
RFTA – Regional Free Trade Area
ROW – Rest of the World
RPTA – Regional Preferential Trading Arrangement
RTA – Regional Trading Arrangement
SBC – Schwarz Bayesian Criterion
SFT – Sectoral Free Trade
SMP – Single Market Program
SPSS – Statistical Package for Social Sciences
TD – Trade Diversion
UDEAC – Union Douaniere et Economique de l’ African Centrale
UEMOA – Union Economique et Monetaire Ouest Africaine
UFT – Unilateral Free Trade
UNCOMTRADE – United Nation Commodity Trade Statistic Database
UNICOM – United Coconut Oil Mills
WTO – World Trade Organisation
WW1 – First World War
WW2 – Second World War