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Evolution of trade bilateralism in Asia and Pacific region. **An overview**

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1. Introduction

Countries of the Asia and Pacific region are increasingly hesitant towards the efficiency of multilateral trade forums, such as WTO and APEC, in their effort to implement the rules of global trade liberalization. In 1999, members of WTO failed to initiate the next round of trade negotiations in Seattle. Within the first decade of the 21st century, multilateral trade negotiations have formed a sinusoidal pattern. The success of WTO meeting of November 2001 in Doha, resulting in preliminary outline of future negotiations, was followed by a spectacular failure in negotiations of September 2003 in Cancun. Geneva summit of WTO of July 2004 restored the hope in effective implementation of multilateral approach to trade. However, the failure of Doha round of talks to bring a tangible breakthrough in the matter at hand does raise certain questions and doubts. Doha obstacles, such as the pushback of Development Round deadline, as well as the range of issues discussed, increases the scale of uncertainty in regard to the very nature of global approach to trade negotiations. Faced with the perspective of indefinite protraction of global talks, many countries choose to seek alternative solutions to trade liberalization.

In the Asia and Pacific region, this tendency to pursue substitute solutions to the WTO and APEC has been reflected in multitude of bilateral trade agreements. The first post-war bilateral trade agreement was initiated between Japan and Singapore (EPA)¹. The remaining countries of Asia and Pacific region were quick to follow the example, by setting up a dense network of formal bilateral relations with partners on regional and supra-regional level, in an effort to secure access to pro-import markets. The aftereffects of the Asian financial crisis of 1997 – 1998, the need to re-orient existing trade relations, liberalization of trade and capital markets on global scale, and the lack of effective multilateral alternatives have contributed to the fact that bilateral agreements remain a key solution among the multitude of alternative approaches to trade negotiations.

¹ Ironically enough, the agreement was finalized during the APEC summit in Shanghai, in October 2001.

In the light of the above considerations, this paper tries to analyze the phenomenon of bilateralism in the Asia and Pacific region, fully aware of the fact that the problem at hand requires deepened and multidisciplinary studies.

2. Forms of trade liberalization

Studies of trade liberalization phenomenon in modern global economy requires knowledge of different political instruments employed on national level to ensure control over trade flow.

Development of international trade policy in Asia and Pacific region at the turn of the centuries is a good example of dilemmas faced in promotion of global free trade idea. Three major approaches to global trade liberalization can be distinguished: *unilateralism*, *regionalism* and *multilateralism*². The practice of implementation of regional agreements in trade allows to supplement the list with one other significant variant, namely *bilateralism*.

The unilateral approach, involving one-sided decision to eliminate trade barriers, has recently been supplanted by the concepts based on the mutual concessions principles. A good example of such approach is the trade liberalization system promoted by World Trade Organization (WTO). The *WTO's multilateral trading system (MTS)* postulates that changes in trade policy be negotiated on international level. The main advantage of this approach lies in its potential to circumvent the destructive trade wars between individual countries or groups of countries³. Although regionalism may lead to trade discrimination towards partners outside the regional group, WTO adopts the policy of tolerating *regional trade agreements (RTAs)*, as long as any such agreement does not violate the existing relations with other trade partners, and thus presents no threat to multilateral approach. Since the majority of RTAs take the form of bilateral *free trade agreements (FTAs)*⁴, bilateralism may be regarded as a dominant method of regulating international trade policy in the modern world.

The intertwine of the above trends in development of international trade policy is particularly evident in the Asia and Pacific region. Without doubt, the unparalleled development of this region's economies over the last few decades can be attributed mainly to liberalization of foreign trade and capital flow (mostly in the form of foreign investment)

² M. Bijak-Kaszuba, *Regionalism as Option of International Trade Policy, The Influence of the Globalization Processes on Central and Eastern European Region*, Working Papers No. 22, Institute of International Business, University of Gdańsk, Sopot 2006.

³ P. Krugman, M. Obstfeld, *Ekonomia międzynarodowa. Teoria i praktyka*, vol. 1., PWN, Warszawa 2007, pp. 328-329.

⁴ *Regional Trade Agreements notified to the GATT/WTO and in Force*, <http://www.wto.org>.

resulting from multilateral arrangements under GATT/WTO and APEC⁵. In the 1990s, postulates to strengthen and integrate the regional organism were voiced, resulting in the 1992 decision to constitute a regional free trade zone AFTA (*ASEAN Free Trade Agreement*), with its ultimate aim of total elimination of tariffs (or most of them) in the trade flow between ASEAN member states. The growing concerns over the tempo of AFTA liberalization, the limits of its geographic scale, as well as difficulties in the actual negotiation process have forced the countries of the region to seek alternative solutions to regional cooperation: bilateral trade agreements and agreements of cooperation in areas other than trade.⁶ Although the first bilateral FTA was entered into as early as 1983 between Australia and New Zealand (ANZCERTA), only after the year 2000 one may observe increased interest in this form of trade liberalization in the region under study (see: Table 1).

Table 1. Free trade agreements in Asia and Pacific region

| <i>Present</i> | <i>Negotiated</i> | <i>Analyzed</i> |
|--|---|----------------------------------|
| ASEAN Free Trade Agreement | ASEAN – CER (ASEAN – Australia – New Zealand) | ASEAN – EU (FTA) |
| ASEAN – Japan (EPA) | ASEAN – China ¹ (FTA) | ASEAN – India (FTA) ² |
| ASEAN – South Korea (FTA) | | |
| China – Hong Kong (CEPA) | | ASEAN – USA (FTA) ² |
| China – Thailand (FTA) | China – New Zealand (FTA) | China – Australia |
| Japan – Brunei (EPA) | China – Singapore (FTA) | China – New Zealand |
| Japan – Chile (EPA) | Japan – Australia (EPA) | South Korea – China (FTA) |
| Japan – Philippines (EPA) | Japan – India (EPA) | South Korea – New Zealand (FTA) |
| Japan – Indonesia (EPA) | Japan – South Korea (EPA) | South Korea – Mexico |
| Japan – Malaysia (EPA) | Japan – Vietnam (EPA) | Malaysia – Australia |
| Japan – Mexico (EPA) | Hong Kong – New Zealand (CEPA) | Malaysia – New Zealand |
| Japan – Singapore (EPA) | Singapore – Bahrain | |
| Japan – Thailand (EPA) | Singapore – Egypt | |
| South Korea – Chile (FTA) | Singapore – India (CECA) | |
| South Korea – Singapore (FTA) | Singapore – Canada (FTA) | |
| South Korea – USA (FTA) | Singapore – Mexico (FTA) | |
| Singapore – Australia (FTA) | Singapore – Pakistan (FTA) | |
| Singapore – EFTA (FTA) | Singapore – Peru (FTA) | |
| Singapore – Jordan | Singapore – Panama | |
| Singapore – New Zealand (EPA) | Singapore – Sri Lanka | |
| Singapore – USA (FTA) | Thailand – USA (FTA) | |
| Singapore – Chile – Brunei – New Zealand (Trans-Pacific Strategic EPA) | Thailand – India (FTA) ² | |
| Taiwan – Panama | | |
| Thailand – Australia (FTA) | | |
| Thailand – New Zealand (CEPA) | | |

⁵ M. Kawai, *Regional Economic Integration and Cooperation in East Asia*, Impact and Coherence of OECD Country Policies on Asian Developing Economies, Policy Research Institute of the Japanese Ministry of Finance / OECD, Tokio 2004.

⁶ K. Tsunekawa, *Why So Many Maps There? Japan and Regional Cooperation*, Remapping East Asia. The Construction of a Region, (ed.) T.J. Pempel, Cornell University Press, Ithaca 2005, pp. 127-128.

¹ - the agreement (negotiations started in November 2001) is implemented in stages. Trade agreements were entered into in three phases, with the last phase concluded in June 2007. Agreements on investment policies are still under negotiation.

² - framework agreement.

FTA – Free Trade Agreement, EPA – Economic Partnership Agreement, CEPA - Closer Economic Partnership Arrangement, CECA – Comprehensive Economic Cooperation Agreement

Source: Kawai M., *Regional Economic Integration and Cooperation in East Asia, Impact and Coherence of OECD Country Policies on Asian Developing Economies*, Policy Research Institute of the Japanese Ministry of Finance / OECD, Tokyo 2004; *Japan's Current Status and Future Prospect of Economic Partnership Agreement*, The Ministry of Foreign Affairs of Japan, October 2007; www.bilaterals.org; www.fta.gov.sg

Nesadurai⁷ emphasizes elasticity as the main reason for popularity of bilateral approach in Asia. The negotiating parties may choose whether to preserve as much of the autonomy of respective national economies as possible, or to extend cooperation even beyond the framework postulated by WTO. Feng Lu⁸ distinguishes two distinct stages of the process: the present stage involves formation of a dense network of bilateral free trade agreements (FTA), to be followed by a most probable stage of incorporating the individual agreements into a wider, regional construct (large, regional free trade zone). This trend distinctly contradicts the integration processes observed in North America and Europe, as integration of those regions was predominantly initiated by strong centers of economic (France and Germany in EU) or political power (US dominance in NAFTA).

3. Evolution of the bilateral process in Asia and Pacific region

Evolution of the bilateral process observed in contemporary global economy can be presented in a phasic form. *Phase I applies to the roots of bilateralism*. In this phase, the external shock – problems with international institutions or financial crises – generates the pressure for change, while various factors of political and economic character shape the individual response of a nation to this shock. More often than not, the chosen form of reaction is to enter into a trade agreement. In such cases, several considerations should be observed, falling into distinct areas and dimensions. The first of these is the effect of resulting cooperation between partners: does it lead to regional dispersion or concentration? Furthermore, trade agreements may be classified according to the strength of international links between parties, the nature of mutual relations (liberal vs. protectionist), and the scale of influence (wide vs. narrow scope of areas covered by the trade agreement)⁹.

⁷ *Asian Regional Governance. Crisis and Change*, (ed.) Jayasuriya K., Taylor & Francis, 2004.

⁸ F. Lu, *Free Trade Area: Awakening regionalism in East Asia*, China Center for Economic Research Working Paper Series No. E2003010, Beijing 2003.

⁹ Vinod K. Aggarwal, *Bilateral trade agreements in the Asia-Pacific*, in: *Bilateral Trade Agreements in the Asia-Pacific. Origins, evolution, and implications*, Vinod K. Aggarwal, Shujiro Urata, Routledge, New York and London 2006, p. 7.

Analysis of international security issues in Asia and Pacific region shows that the first such external shock was the end of the Cold War era. The resulting conflict resolution facilitated negotiations over free trade agreements between the countries of the region. It marked the conclusion of bipolar order of international power play, effectively wiping the barriers to trade cooperation between countries of the former opposing blocks. Moreover, with the end of Cold War, the United States toned down their strict attitude towards preferential agreements¹⁰.

The Asian financial crisis of 1997 - 1998 was another phenomenon that affected small and medium economies of the region. The crisis experience made them more inclined to enter into close economic cooperation not only through the network of regional production, but also through active pursuance of bilateral trade agreements.

The third such shock occurred during the WTO meeting in Seattle, after the voiced concerns over the perspectives of multilateral trade system. The WTO summit in Doha reinstated the chance of opening a new round of negotiations, but the subsequent Cancun meeting fiasco in September 2003 and the July 2004 decision to re-visit the agenda show that the future of multilateral process is still uncertain. Moreover, the strongly voiced interest of Bush administration to support the idea of Free Trade Area of the Americas has fueled the anxiety in the Asia and Pacific region in respect to future US priorities¹¹.

Table 2. Phases of the bilateral process

| No. | Phase | Phenomena characteristic of the phase |
|------|---------------------------|--|
| I. | Roots of bilateralism | <ul style="list-style-type: none"> • External shock • Political and economic factors conditioning the reaction to shock • Negotiation • Agreement (parties, strength of ties, character, aim) |
| II. | Evolution of bilateralism | <ul style="list-style-type: none"> • Expectations towards change of agreement • Factors influencing the change or replacement of the existing agreement • New or modified agreement (parties, strength of ties, character, aim) |
| III. | Impact of bilateralism | <ul style="list-style-type: none"> • Adjustment to existing agreements |

Source: Vinod K. Aggarwal, *Bilateral trade agreements in the Asia-Pacific, w: Bilateral Trade Agreements in the Asia-Pacific. Origins, evolution, and implications*, Vinod K. Aggarwal, Shujiro Urata, Routledge, New York and London 2006, p. 7.

¹⁰ B. Skulska, P. Skulski (ed.), *Bezpieczeństwo międzynarodowe w regionie Azji i Pacyfiku. Wybrane zagadnienia*, Wydawnictwo Uniwersytetu Ekonomicznego we Wrocławiu, Wrocław 2010

¹¹ V.K. Aggarwal, Min Gyo Koo, *The evolution and implications of bilateral trade agreements in the Asia-Pacific*, in: *Bilateral Trade Agreements in the Asia-Pacific. Origins, evolution, and implications*, Vinod K. Aggarwal, Shujiro Urata, Routledge, New York and London 2006, pp. 282 - 284.

In phase II, various internal circles of interest may demand changes to the existing agreement, from redefinition of the product structure up to incorporation of third parties (countries) to the agreement. Similarly to the preliminary phase, the decision making process is influenced by factors of both political and economic nature. In phase II, directions for development of bilateral process can be distinguished, especially in the context of the number of parties involved, strength, character and aims of the agreement.

In the Asia and Pacific region, a multitude of phenomena can be identified, having varied impact on the evolution of the bilateralism process. Of economic factors, the most notable are the expected economic benefits resulting from free trade agreements. Those include generation of trade, investment expansion and financial stability. New trade streams are generated between both parties through reduction of tariff and elimination of other non-tariff barriers. Moreover, re-allocation of trade from signatories of other bilateral trade agreements may generate incentive to form own trade agreements.

The level of expected benefits resulting from the trade generation effect between parties is conditioned by complementarity of their respective production structures. For example, Japan and South Korea may expect to draw tangible benefit from bilateral trade agreement, since Korean trade market structure is based on Japanese components, half-finished products and industrial equipment. At the same time, South Korean tariffs on Japanese products remain significantly higher than the tariffs imposed by Japan on Korean products. In this context, bilateral free trade agreement offers Japan a chance to pursue export opportunities suppressed, to date, by steep tariff and non-tariff barriers imposed by South Korea. Meanwhile, South Korea may expect to gain considerable profit due to reduction of Japanese non-tariff barriers, as the profit from further reduction of already low tariffs is marginal¹².

Another internal economic factor explaining the popularity of bilateral trade agreements is the level of expected economic benefits. In the developing countries of Asia and Pacific region, foreign investments are subject to high risk and a wide spectrum of restrictive local regulations¹³. Bilateral free trade agreements, through institutional facilitation of trade and investment, offer reduction of economic and political risk involved, together with limitation of transaction costs, resulting in promotion of foreign investment. Based on

¹² Vinod K. Aggarwal, *Bilateral trade agreements in the Asia-Pacific, ..., op. cit.*, pp.11-12

¹³ For more on the subject, see: B. Skulska (ed.), *Biznes międzynarodowy w regionie Azji i Pacyfiku*, Wydawnictwo Adam Marszałek, Toruń 2009

bilateral agreements between countries, companies may direct their investment to partner countries, drawing additional benefit from attractive terms of product and capital flow.

Analysis of political factors influencing the evolution of bilateral process should concentrate on examination of relations between government and interest groups, as well as motivation of all parties involved towards better understanding of potential results of changes for both parties of the agreement. In this case, the type of political system and its resistance to external pressure will determine the form of reaction. Economic and political power of the country on international market will shape its reaction to pressure from other countries. In other words, potential changes to original content of the bilateral agreement and directions of its evolution will depend on the situation on international arena as well as the will to defend the existing position on the part of both parties involved.

Lastly, *phase III represents potential influence of particular forms of agreement upon any existing agreements*. Does the new trade agreement correspond with wider scope of regional or multilateral agreements or is it a threat to the existing trade market order? Institutional transparency, compatibility with broader agreements – those are the most important dimensions of any further analyses.

According to Aggarwal, the majority of preferential agreements made in the years 2000-2004 in Asia and Pacific region were bilateral in nature and characterized by geographical openness. To a large extent, the majority of bilateral agreements in Asia and Pacific region were aimed at stimulating the market through a wide assortment of products covered. At the same time, however, many of these agreements excluded a range of highly sensitive products or sectors, in contradiction with multilateral norms and principles adopted by GATT/WTO. The observed phenomena pose a number of questions: why do parties choose to enter such agreements, what is the specificity of such agreements in relation to particular partners, what is the direction of their evolution and, lastly, what implications can be expected of such agreements?¹⁴

4. The effects of bilateralism development in Asia and Pacific region

Trade agreements involving countries of Asia and Pacific region form an intricate network of resolutions, regulations and criteria. N. Munakata, a famous Japanese economist, describes

¹⁴ V.K. Aggarwal, Min Gyo Koo, The evolution and implications of bilateral trade agreements in the Asia-Pacific, in: *Bilateral Trade Agreements in the Asia-Pacific. Origins, evolution, and implications*, Vinod K. Aggarwal, Shujiro Urata, Routledge, New York and London 2006, pp. 280-281.

this ever-growing tangle of ties using the term *spaghetti bowl effect*¹⁵. This phenomenon is typically associated with:

- Condensing network of regulations applying to rules of origin, technical standards and other adjustment criteria,
- Increased transaction and administration cost,
- Obstacles to regional convergence¹⁶.

A question arising in the context of growing significance of regional trade agreements (region – region, region - country, and country – country) may be formed as follows: does the spaghetti bowl effect remain a sort of unavoidable side effect or can it be considered a necessary stage in the path to regional integration?

In this respect, it may be useful to emphasize that the spaghetti bowl effect is not a trait specific for the region of Asia and Pacific – the last decade of the 20th century shows similar effects taking place in the course of European¹⁷ and North American integration processes¹⁸. It can safely be assumed that the spaghetti bowl effect manifested itself in the region of Asia and Pacific in the years 2000 – 2006, mainly as a result of mixed policies of China, the United States and European Union, in their effort to identify instruments for development of bilateral and multilateral economic cooperation with countries of the region under study. On the one hand, reluctance or even inability to propagate advanced institutionalization for regional cooperation contributed to formation of subsequent ‘noodles’ of this spaghetti; on the other hand, the condensing network of regulations effectively torpedoes any attempts towards closer, formal integration at regional level.

It may be useful here to ask the question: does formation of the dense network of regional trade agreements offer more benefits than losses in the foreseeable future? On the one hand, we deal with a particularly significant, detrimental effects in the sector of companies of the Asia and Pacific region, forced to operate under several (dozens) bilateral agreements that regulate trade conditions in relation to such factors as rules of origin. In addition, differentiation of principles and rules of individual agreements may lead to discrimination of partners into dominant and underprivileged, which can be particularly detrimental in respect to less-developed countries. On the other hand, it seems undeniable that entering into further

¹⁵ *Spaghetti bowl effect* (N. Munakata, *Evolution of Japan's policy toward economic integration*, 2001 CNAPS Working Paper, Brookings Institution, December 2001).

¹⁶ C.S. Yue, *Regional and bilateral FTAs in Southeast Asia*, Singapore Institute of International Affairs, www.pecc.org, 15.12.2009

¹⁷ Dotyczą one w szczególności następstw upadku ZSRR, pogłębiania unii monetarnej i politycznej w ramach UE.

¹⁸ W kontekście relacji handlowych na linii USA – Meksyk, kraje NAFTA – MERCOSUR.

bilateral agreements does induce cooperation, warrant fast effects and elastic solutions, improve accessibility, transparency and investment appeal of regional markets, tighten geopolitical relations and contribute to formation of strategic alliances.

It seems that in order to profit from the observed spaghetti bowl effect, countries of Asia and Pacific region should undertake all attempts to implement the negotiated agreements and refine them in this manner. Only then, in the words of R.E. Baldwin, it may be useful to *clear the short distance between the fuzzy, fragmented matrix of bilateral, pseudo-free trade agreements and the truly free market of the multilateral trade system*¹⁹. For it seems undeniable that many of the countries of the region under study have made enormous advances towards liberalization of trade exchange, while the spaghetti bowl effect was only a by-product of the particular stage of their economic development.

Interestingly enough, some authors observe that the spaghetti bowl effect observed in Asia and Pacific region may actually prove a catalyst in the process of revisiting Doha negotiation table. Experts demonstrate that Asian-style regionalism may prove more detrimental than other forms of regional agreements. Large number of reciprocal arrangements, each covering a different range of products and expressing different rules of cooperation, will significantly affect the logistics of this particular region that embodies the modern trends of global decentralization of production. Since such agreements lead to reduction of reciprocal tariffs, Asia may soon become a playground of trade discrimination. This, in turn, may push Asian nations back to the Doha table of multilateral negotiations²⁰.

Abstract

In their drive to find an alternative solution to WTO and APEC, countries of Asia and Pacific region reach for bilateral trade agreements. Bilateral relations in trade patterns of the region under study are actively sought not only within the region, but also in trade agreements with distant countries that represent the pro-import markets. With impact of the Asian financial crisis of 1997 – 1998, with resulting need to re-orient trade relations, with liberalization of trade and capital flow and with scarce potential to enter into multilateral agreements, countries of Asia and Pacific region chose bilateral approach as the key alternative to a wide spectrum of trade patterns.

¹⁹ R. E. Baldwin, *The path to global free trade: spaghetti bowls as building blocs*, World Economy Annual Lecture, Nottingham, 22.06.2006.

²⁰ *In the twilight of Doha*, "The Economist", June 29, 2006

The evolution of bilateralism in Asia and Pacific region may be perceived as a series of phases. The first phase of this process concentrates on the roots of bilateralism, namely the effects of external shocks such as the end of Cold War and financial crisis of the late 1990s, as well as the resulting wariness in regard to perspectives of multilateral agreements in trade. The above phenomena seem to motivate the countries of the region in their preference for bilateral agreements, characterized by a varied degree of cooperation, varied nature of the ties (liberal vs. protectionist) and varied scope (i.e. the number of areas subject to trade agreement). In phase II, original bilateral agreements evolve in response to a number of factors of economic and political nature. Those changes may take the form of modifications to the original content and scope of bilateral agreements, broadening of product and/or sector structure within the existing agreements and incorporation of new countries. The last, third phase of the evolution process is concerned with the effects of new forms and specificities of the agreements upon the existing trade contracts. Do the new trade agreements incorporate well within the wide spectrum of regional and multilateral agreements or do they pose a threat to the trade relations at hand? Negotiation of bilateral agreements and their potential expansion towards multilateral trade contracts, together with effects of the shift in trade and investment flow, may significantly affect broader trade agreements, such as AFTA, APEC, NAFTA and WTO.

The large number of bilateral agreements initiated in Asia and Pacific region in the first decade of the 21st century, though widely acclaimed by supporters of trade liberalization, bears the risk of the so-called *spaghetti bowl effect*. It is therefore necessary to devise efficient instruments and methods that warrant cohesion across the multitude of bilateral agreements, so that regional cooperation does not stray towards a chaotic knot of decidedly conflicting regulation. It is not a question of institutional superstructure, as such solutions may be perceived as contradictory to the values of bilateralism. It is a question of precise rules for construction of individual agreements; rules that offer transparency and clarity of procedures, as well as secure economic and political interests of both parties, regardless of their status of an economic power (Japan, China and the USA) or a petty actor of the region (Vietnam and Cambodia).

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