

## Chapter 1: An APEC Trade Agenda

*Charles E. Morrison*

### **Introduction**

The papers in this report are the results of a study undertaken through the PECC with sponsorship from the APEC Business Advisory Committee (ABAC). As the result of agreement between the ABAC and the PECC, it was agreed that the study should look at the political feasibility of a proposal to establish a Free Trade Agreement of Asia-Pacific (FTAAP) as well as alternatives that APEC could take to promote greater regional trade and investment. The authors were selected by the two parties, and since proponents and opponents of the FTAAP were included there was no unanimous consensus within the study group regarding the FTAAP issue. This overview reviews the current economic context, reviews the arguments both for and against an FTAAP, makes an evaluation regarding its political feasibility, and sketches out an outline for an APEC 2010 Trade Agenda that the author regards as a more realistic and still ambitious approach to trade liberalization.

### **The Economic Context**

By standards of any other region of the world, the Asia Pacific region is doing very well. A number of its economies, especially China and Vietnam, are achieving extraordinary growth. The United States economy has continued to confound pessimists in maintaining strong growth, and Japan, for long the weak performer of the region, now is experiencing solidly based growth. Moreover, inflation remains low, despite commodity and fuel price spikes. Trade and investment continues to boom around the region. Since the 1994 Bogor Goals were set, trade barriers have continued to go down, with average tariffs lower in all of the sub-regions of the Asia Pacific. Moreover, despite some protectionist sentiments in some parts of the region, the APEC economies adhere to their World Trade Organization (WTO) obligations. The WTO system enjoys high favor and continues to attract additional membership by Asia Pacific Economic Cooperation process (APEC) economies. China became a WTO member in 2001, Vietnam will become a member this year, and Russia is also seeking WTO membership.

Despite these successes, the APEC economies face numerous challenges to continued strong performances. Virtually all the member-economies are experiencing a backlash against globalization and trade liberalization from weak or non-competitive sectors. The backlash, which is not just in the APEC region but global, has increased the difficulties of negotiating a mutually beneficial Doha Development Agenda liberalization package, forcing suspension of active DDA negotiations in July. Many observers believe that this suspension will result in an even more frenetic pace of negotiating bilateral and mini-lateral PTA (preferential trade agreements, frequently mislabeled “free trade agreements” by their supporters).

Projections of the world economy suggest a global slowing of growth, and some pessimists are extremely worried about a possible “train wreck” as the result of the huge macro-economic imbalances between the United States and other countries, particularly East Asia. Two of the most important drivers of contemporary global growth are the American consumers and investors in China. There are concerns about both. U.S. interest rates have

been creeping up, cooling the bubble-like American housing market. This in turn affects the perceived wealth of households and curtails consumer spending. On the other side of the Pacific, Chinese economic growth is highly leveraged on exports (especially to the United States). A U.S. slowdown will be felt through the global economy, but especially in China. In the meantime, China's high investment rate continues to build export capacity that may become idle if there is a serious recession in the United States. Unfortunately, with growth rates in Europe also declining, that continent will not be in a position to pick up the slack if there is a significant medium-term decline in U.S. consumer spending.

APEC should be a vehicle through which the major economies in the region review economic analysis and policy options and potentially undertake reinforcing policies that could help ensure a "soft landing" and a restored, healthier growth. Such policies could include measured currency realignments and further trade liberalization. However, it was the sense of many members of the study team that APEC is not fulfilling this role, in part because a decline in government and public interest in the APEC process and in part because governmental attention has been diverted to other issues, especially terrorism. While never carefully defined, APEC's 1994 Bogor Goal of "free trade and investment in the region" by 2010 for developed economies and 2020 for all economies, seems very unlikely to be met, and APEC trade liberalization and facilitation initiatives seem more designed to take advantage of trends already occurring through market activity rather than proactively stepping up the pace.

In sum, while not necessarily accepting the most pessimistic prognoses of the regional and global economies, there are reasons for serious concern. The ABAC-PECC study team sees as among the most urgent challenges a need to restart the DDA, a need to prevent the further proliferation of PTAs while developing compatibilities among existing PTAs, the need to manage transpacific macroeconomic imbalances in both their economic and political dimensions, and a need to revitalize and give new meaning to the APEC.

The combination of concerns about APEC, the DDA, and the health of the region economy led the ABAC in 2004 to ask the governments to study the FTAAP proposal. When the governments failed to act on a study, the ABAC moved forward on its own to make the study, asking PECC to join in this effort.

## **Evaluating The FTAAP**

### ***Arguments for and against***

The proposal for a regional free trade agreement is the oldest idea for promoting mutual beneficial Asia-Pacific regional cooperation. Japanese economist Kiyoshi Kojima is usually credited with first Pacific Free Trade Agreement proposal in 1966, and, while that proposal was clearly premature and unrealistic, it enhanced awareness of regional interdependencies and potentials for increased benefit through cooperation, and eventually led to the establishment of both the Pacific Economic Cooperation Council (PECC) and to the APEC process.

In more recent times, American economist C. Fred Bergsten has been the foremost advocate of a Free Trade Agreement of Asia-Pacific. His paper, prepared as part of this study, provides a most comprehensive and forceful statement in favor of an FTAAP. In Dr. Bergsten's view, if the FTAAP could be realized, it would provide the largest single liberalization in history. Moreover, its benefits would extend beyond the APEC economies

because it would effectively force the Europeans to sit up and take notice, probably restarting the WTO's multilateral trade negotiations. Even if it did not, it is the best "Plan B" available, since its own benefits would be so great. It would also sweep up the extending smaller PTAs with their proliferation of unwieldy rules of origins into a larger framework, thus dampening the "noodle bowl" effect. It would also prevent competitive liberalizations in the Americas and Asia, which Dr. Bergsten believes threaten to "draw a line down the Pacific." The FTAAP would provide a framework for the United States and China to head off trade tensions and revitalize APEC. Dr. Bergsten believes that because the economic logic of the FTAAP is so compelling, it is also politically feasible, although he acknowledges the difficulty of getting governments to recognize their longer-term interests and overcome protectionist pressures.

Some of the other papers in this volume critique Bergsten's FTAAP proposal. Most of the study team are skeptical of the political feasibility of the FTAAP concept. The most direct and comprehensive rebuttal to the proposal comes from American political scientist, Vinod Aggarwal. Based on an analysis of the American political economy, Dr. Aggarwal argues that the FTAAP is neither politically feasible nor desirable. In his view, selective liberalization through sector and bilateral trade agreements has rewarded freer trade interests, but left trade policy dominated by protectionist interests. Thus the free trade coalition needed to push an FTAAP through Congress is not there. Moreover, the politically charged massive trade deficit with China makes any FTA effectively "dead on arrival" in Congress. Dr. Aggarwal also argues that APEC does not have the institutional basis to negotiate an accord and dismisses the FTAAP as a good "Plan B," noting that it would not accomplish the agricultural and industrial market objectives the U.S. is seeking through the Doha Round.

### ***Evaluation Factors***

How do we evaluate the political viability of the FTAAP proposal in light of these differing assessments? In my mind, a logical way to proceed was to make as the working hypothesis the proposition that the FTAAP is a political feasible option, and see if this could stand up during a review of various important factors that would affect its viability. These factors were: (1) the magnitude of the undertaking, (2) the requirements for political leadership and will to successfully negotiate an FTAAP, (3) the scope of changes required in APEC and the likely political support for those changes, (4) the potentially positive and negative impacts of an FTAAP on the WTO and the current DDA round, (5) the risks of trying to secure an FTAAP but failing, and (6) the risks of failing to attempt an FTAAP.

**Magnitude:** Dr. Bergsten notes that an FTAAP would be a historically significant liberalization, especially when set against the objectives of the current DDA. This is no doubt correct since, in fact, an FTAAP would be a much more ambitious undertaking. The APEC ministers themselves insist that free trade agreements must be of "high quality," and WTO rules (GATT Article 24) require that they cover substantially all trade. This combination means that an FTAAP must cover between 80-95 percent of trade among member economies and address behind-the-border issues such as finance, telecommunications, national treatment for foreign direct investment, and intellectual property protection. Even mild forms of proposed liberalization in some of these areas were enough to sink the 2002 Cancun WTO ministerial meeting. Based on the experience of the Free Trade Agreement of the Americas (FTAA) proposal, which had much less internal variation in levels of economic development, legal development, current and financial regimes, and political and international relations issues, an FTAAP would require at least five and probably more years of negotiation. As suggested by Dr. Stephenson in her paper on the lessons of the FTAA experience, a successful FTAAP negotiation would also require the participating partners to make it their central trade

negotiating activity. Dr. Stephenson, in fact, suggests that there be a standstill agreement at the outset for negotiating other regional trade agreements.

**Political Will and Leadership:** Obviously, an undertaking of the magnitude just outlined will require a huge investment in leadership time and bargaining chips in the major APEC economies. Lukewarm support will not be enough. Dr. Stephenson makes this point very clearly, again based on the FTAA experience. Without the required support, sustained over the entire period of the negotiations, the FTAAP is unlikely to succeed. She suggests that a “unity of vision” is needed among China, Japan, and the United States. We believe that to be politically viable, the FTAAP would need at least one of the major APEC economies to become its very committed champion.

**Changes in APEC.** APEC was designed as a community-building institution for general socio-economic cooperation, not an institution for trade negotiations. However, strengthening trade flows has always been an important part of its agenda. In 1994, the APEC economies adopted the Bogor Vision, to be achieved through a voluntary and concerted process of liberalization rather than on the basis of binding commitments. To this day, this continues to be the accepted basis of APEC cooperation. At Busan last year, the APEC ministers committed themselves again to the principle that “APEC must not be an inward-looking trade bloc that diverts from the pursuit of global free trade.”

An FTAAP would obviously require a different kind of APEC process, one involving formal negotiations and binding rather than voluntary commitments. An FTAAP would also require rules of origin, discriminating against those outside the FTAAP. Thus, the political feasibility of the FTAAP requires an assessment of how likely such changes can be achieved.

Finally, a different kind of secretariat and base of funding support would be needed to sustain the negotiating process over a several year period of time.

**Impact on the WTO/Doha Development Agenda.** Another criteria would be the likely impact of the FTAAP on the WTO and its Doha Development Agenda, given the commitment of all the APEC economies to the WTO and a successful DDA. The Bergsten argument is that if the FTAAP is launched – or even just seriously studied by the government – it would have a powerful impact on outsiders, possibly reviving the DDA. The Aggarwal argument is that even if an attempt is made to use the FTAAP only as a tactic to advance the WTO agenda, it is likely to backfire.

**The Risk of Failure.** Given the tremendous time and political commitments that the APEC economies would have to make to conclude a successful FTAAP, and considering the implications of success or failure of the FTAAP proposal to perceptions of APEC’s importance and success, a central question has to be whether the FTAAP would be a good investment, either for the individual governments or for the institution. It could be argued that an effort that is doomed to failure from the start would only add to the woes of the world and regional trade system and further discredit APEC. It could also result in “community-destroying” rather than community-building activities if the result were a blame game by the economies involved.

**Doing Nothing.** Despite the continuing positive performance of the Asia-Pacific economies, is there an unacceptable risk of not undertaking the FTAAP? Dr. Bergsten argues that there would be a continued proliferation of PTAs that are likely to take an East Asian v.

American character, creating two competing blocs and drawing a line down the Pacific. This arguments needs to be carefully considered.

***The Net Political Assessment: An FTAAP Is Not Politically Viable***

Taking these factors into consideration, and consulting with many others on this issue, the net assessment is that the FTAAP is not politically feasible at the present time or in the near term. Most of the study team shares this basic assessment.

The main reason for this assessment is that the political challenges of negotiating an FTAAP are so massive when placed against any likely political will. Even before any negotiations could begin, they would require major and controversial changes in APEC's "social contract," which our studies indicate is likely to be resisted by a number of important member-economies. Even if this high entry barrier could be surmounted, an FTA compatible with the WTO and with APEC's own enunciated standards for "high quality," must cover highly controversial sectors, such as agriculture and complicated behind-the-border issues. There are powerful political interest groups in the APEC economies that will oppose concessions in these areas. Even if there were "a unity of vision" among China, Japan, and the United States, the negotiations will take a likely minimum of 5 years. The FTAAP, requiring almost exclusive attention from trade ministries during this period, would cause postponement of other negotiations that are of high priority to some of the key APEC economies. Regional trade negotiators are unenthusiastic because they see little likelihood of success given that less ambitious projects – such as the FTAA and the DDA – have floundered.

An implicit assumption underlying the FTAAP proposal – and particularly the notion that of the FTAAP as a "Plan B" in the event of an unsuccessful DDA – is that the constellation of political and economic interests in the Asia-Pacific venue makes trade liberalization politically more attractive. While some of the economies that have complicated the WTO negotiations (e.g., EU, India, Brazil) are left out, the FTAAP is so large and diverse, it still encompasses many protectionist interests. And the goal of the FTAAP – free trade – is much more politically demanding than the much less ambitious DDA goals. This would be true even if the standards were somewhat relaxed and a true FTA is not fully achieved. Therefore, as the gains from smaller size are cancelled out by a much more politically demanding agenda, there is no particular political advantage to the FTAAP venue.

For these reasons, sufficient political champions and political will for an FTAAP are not now visible. Could this change? It might if governments or publics become convinced that there is compelling urgency to negotiating such a regional agreement. But in fact, regional trade and economic growth is continuing without an FTAAP. A crisis (or perceived opportunities) of the scale needed to change political calculations so much that an FTAAP would be politically attractive to government leaders and their publics, would also undoubtedly also make politically possible the DDA. The DDA remains the region's "Plan A."

The papers prepared for this study underscore some specific problems for APEC economies that reinforce the main points above.

In the case of China, Sheng Bin's study suggests that the priority interest for China's leaders is an East Asia Free Trade Agreement. Moreover, China is strongly committed to

APEC as an institution based on open and voluntary regional cooperation. The membership of Chinese Taipei in APEC may also introduce political complications.

In the case of Japan, Shujiro Urata's study shows that agriculture liberalization remains a very difficult domestic political issue. Moreover, Japan's government also may have a stronger interest in East Asian regionalism, as highlighted by the recent proposal of METI minister Nikai for an East Asia free trade agreement based on the membership of the 16-member East Asia Summit group. Agricultural interests have also strongly opposed even bilateral free trade agreements in the case of Korea.

In the case of ASEAN, the paper by Chia Siow Yue and Hadi Soesastro indicates that some ASEAN economies are not at all prepared politically or otherwise to enter an undertaking of the magnitude of the FTAAP. Dr. Stephenson points out that this was also the case of the FTAA, which resulted in a deliberate decision to stretch negotiations over a ten-year time frame while capacity was being built. As it turned out, the time frame was too long for sustained political commitment.

Very importantly, the Trade Promotion Authority of the United States expires in mid-2007. No viable negotiations involving the United States can take place without an extension of the TPA. This looks increasingly doubtful because of growing protectionist tendencies, which could be further reinforced by the outcome of the November 2006 Congressional elections. Moreover, as pointed out above, because of the already highly controversial American trade deficit with China, it seems very unlikely that a TPA extension could be achieved for a project involving free trade with China.

Yet other problems should be mentioned.

\* The underlying purpose of APEC is to bring the economies together to recognize and act on common interests. Trade negotiations, however, are an inherently adversarial process. There may be a basic incompatibility between the APEC's community-building mission and an effort to transform it into a trade negotiating body.

\* APEC economies have different approaches to FTAs. As pointed out by Sheng Bin, China (and some other Asian economies) prefer a "piece meal" approach. However, a comprehensive template is preferred in North America. Because of these differences in approach, and the preference of some Asian economies to move forward on an East Asian agreement based on Asian approaches, it has been suggested that an effort to push forward an FTAAP in a serious way by some governments would be more likely to "draw a line down the Pacific" than the current PTA noodle bowl (which includes quite a few trans-Pacific noodles).

\* Finally, with respect to the impact on the WTO and APEC's own credibility, the FTAAP carries high side risks of diverting rather than galvanizing the DDA and of further jeopardizing APEC's credibility. Given the political unreality of the FTAAP proposal, a formal study of an FTAAP is unlikely to be taken so seriously by outsiders to result in changes in bargaining positions on the DDA. However, it could help reinforce a further sense of erosion of the world trading system into competing blocs. In hoping to erase a potential line down the Pacific, the FTAAP proposal could create other lines, ones down the Atlantic or across the Eurasian landmass.

In sum, FTAAP is not currently politically viable, and its desirability is also questionable. However, the proposal has attractive elements, particularly if it could be an avenue toward global freer trade. For this reason, it will continue to have advocates and should continue to be studied. We believe, however, these studies should continue to be with the nongovernmental sector, rather than official and governmental.

There are certainly risks to doing nothing or completely ignoring trade liberalization in favor of trade facilitation. The specter of a continued unruly proliferation of free trade agreements and an erosion of the global trade order remains a real one, particularly as protectionist pressures continue to grow with globalization. The APEC economies need and can take more immediate and politically realistic steps toward achieving the Bogor vision. These steps do not preclude a future FTAAP. If crafted properly, they can create the conditions in which an FTAAP could become more politically realistic as well as more economically desirable.

### **A Credible APEC 2010 Trade Agenda**

APEC needs a credible trade agenda. The suspension of the WTO negotiations and the proliferation of PTAs are regarded by the entire study team as undesirable. The Bogor vision of free trade and investment in the region, although not clearly defined, remains highly relevant. Trade liberalization and facilitation are an essential part of the APEC community-building process. The dilemma, however, is that APEC itself does not have a mechanism for achieving the Bogor vision. The APEC mechanism of concerted, voluntary liberalization may have helped economies who understand the value of liberalizing to do so, but even the most dedicated advocates of the voluntary process understand that at the end of the day some kind of negotiations based on binding commitments and reciprocity will be needed to achieve the objectives set out at Bogor. For this reason, achievement of the Bogor vision is dependent on successful WTO negotiations.

To strengthen its own credibility as a mechanism for trade liberalization and facilitation, APEC needs to set realistic objectives and achieve these. I believe that this entails reviewing and being willing to discard old and increasingly unrealistic goals that it cannot achieve through APEC's own processes. This means dropping or revising the Bogor 2010, 2020 goals even while maintaining the Bogor vision.

Positive steps include developing a more coherent, focused and strategic approach based on mid-term, multi-year building blocks and a strong effort to steer PTAs in a positive direction making use of the energy behind the proliferation of PTAs. APEC also needs to broaden its stakeholder base beyond the relative narrow bureaucratic, business, and academic groups currently involved in the APEC processes.

This year's Hanoi meeting in November provides an excellent time for launching a 3-year APEC trade agenda to wind up in 2010, Japan's year to chair APEC. An APEC 2010 Trade Agenda project, led by all the host economies from Vietnam through Japan, and with specific goals to be achieved over this period, would provide an ambitious but doable trade agenda for APEC. The Busan Road Map, while quite general, provides some important principles, and the ideas and principles need to be linked to specific tasks.

An APEC 2010 Trade Agenda might consist of four broad elements: deepening the WTO, aligning regional PTAs, enhancing outreach, and undertaking APEC reform.

**Deepening the WTO.** APEC has already been successful in deepening knowledge of and strengthening adherence to WTO disciplines among the APEC economies. Even without entailing new obligations, more effective implementation of existing obligations constitutes a major contribution to the international trading system. This contribution can be more consciously pursued and publicized.

It would be a significant achievement if the APEC process could help restart the stalemated DDA. This would require dialogue with non-APEC negotiators, especially with the EU and among the emerging developing economies, as well as greater initiative among some APEC economies, who have held back making offers in the DDA while awaiting the outcome of American-European negotiations.

**Aligning PTAs.** Even while contributing to the so-called “noodle bowl,” the PTAs in the region reflect a desire to deepen economic cooperation and integration and lock-in domestic reforms. They also can provide economies with the opportunity to test the waters in breaking through protectionist barriers that are too difficult to address at the global or broad regional scale. We believe that as part of its APEC 2010 Trade Agenda, APEC can encourage the outward orientation of PTAs through the focus, sophisticated efforts to develop model measures, which it has begun, and a credible review process of existing PTAs and those under negotiation. It is particularly important that larger PTAs, such as those being negotiated around the ASEAN group and the proposed U.S.-Korea PTA, achieve the highest possible standards. The study by Robert Scollay provides some practical and realistic means for APEC to move ahead on PTAs, fully recognizing the many difficulties.

APEC can also place priority on behind the border measures, rules of origins, capacity building, and trade related aspects of Ecotech characteristic of high quality PTAs, thus complementing rather than competing with areas of WTO competence and traditional leadership.

**Extending Outreach.** As indicated, APEC should systematically develop stakeholders beyond the current involved communities. We believe emphasis should be placed on parliamentary and media leaders. Moreover, APEC should make an effort to market the APEC “brand name” more effectively. Too many of APEC initiatives have been named for cities, such as the Busan Road Map, which does not necessarily connect to APEC itself in the minds of even the more interested publics in APEC societies.

**Undertaking Organizational Reforms.** The program outlined here does not require fundamental change in APEC’s modalities or its commitment to open regionalism, but it does require more effective and focused collective leadership, a stronger secretariat, and a more secure and generous funding base.

To carry out an effective APEC 2010 Trade Agenda, there should be a small, but solid core professional staff in the APEC Secretariat. This staff needs to be committed to APEC as an institution (rather than loyalty to a government from which seconded), professionally knowledgeable about trade issues, and capable of commissioning and utilizing needed research.

## **Conclusion**

APEC cooperation and community-building processes, of course, go far beyond trade. The leaders have extended the APEC agenda into new areas, such as diseases, disasters, and terrorism, which are of mutual concern and where APEC cooperation can make a difference. However, trade in both its liberalization and facilitation dimensions remains a key and core area of economic cooperation because it is a major contributor to regional economic growth.

While our studies include an advocate of as well as critics of the Free Trade Agreement of the Asia Pacific proposal, the overall weight of our study is that the FTAAP is not politically feasible. However, we strongly urge continued efforts to promote regional and global freer trade through more focused support for WTO processes, strengthened efforts to align PTAs, and enhanced outreach both to increase involved sectors of society in APEC process and to build stronger public awareness of the individual economies' and the region's stakes in liberalized trade.

#####