

# East Asian Economic Integration: critical policy choices<sup>1</sup>

Andrew Elek

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## *The setting*

The financial crises of the late 1990s sparked off a strong political drive towards East Asian economic co-operation.<sup>2</sup> This has already led to the ASEAN+3 process, which has promoted closer economic co-operation in the region.

Many additional options have been mooted, including an ASEAN Common Market to follow up the completion of AFTA with co-operation on non-border issues, such as trade and investment facilitation. Options for co-operation among China, Korea and Japan are being explored, as well as a potential East Asian Economic Community, which would draw together both Northeast and Southeast Asian economies. Such a community could then take its place along the European Union and a potential Free Trade Area of the Americas (FTAA).

Some East Asia-wide arrangements are emerging, for example the beginnings of financial integration (de Brouwer, 2002). However, efforts towards integration are being pursued mainly by means of closer economic partnerships (CEPs), based on preferential trading arrangements (PTAs), some sub-regional, but mostly bilateral. It is hoped that these economic partnerships will evolve into broader East Asian economic co-operation which, in its turn, would be a building bloc towards Asia Pacific, and ultimately global, free trade and investment.<sup>3</sup>

Such a benign evolution, with each new partnership acting as a stepping stone towards wider objectives, cannot be taken for granted. It is far from clear that bilateral and broader trade policy objectives are being promoted in a coherent way, using all of policy options available, ranging from unilateral to multilateral action, in order to tackle a diverse range of impediments to economic integration.

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<sup>1</sup> The material in this paper has drawn on the proceedings of several seminars on trade policy options for East Asia which have been held at the Australian National University and the Centre for Strategic and International Studies, Jakarta. The reports of those meetings, including Australia-Japan Research Centre, 2003) can be obtained from the Australia-Japan Research Centre of the Australian National University.

<sup>2</sup> In this paper, East Asia is defined as the members of ASEAN plus China, Hong Kong, Japan, Republic of Korea and Taiwan.

<sup>3</sup> Closer economic partnerships (CEPs) usually consist of a preferential arrangement to liberalise border barriers to trade, complemented by a number of arrangements to address new issues in order to facilitate trade and investment among the participants of the CEP. The term 'regional trading arrangement' (RTA) is often used as an alternative to CEP. However, this paper uses the CEP description, in order to emphasise that these partnerships are more than trading arrangements.

Regional co-operation is no substitute for global efforts. Whatever is achieved in terms of economic integration within East Asia, these economies will continue to need confident trading links with the rest of the world. Therefore, East Asian economies have a vital interest in the successful conclusion of the Doha Development Round of WTO negotiations. If East Asian economies make strategic use of the Doha Round, it can provide the opportunity to reduce border barriers to trade, not only within the region, but globally. That would allow intra-regional co-operation in East Asia free to focus the many non-border impediments to trade and investment.

While East Asian economies are considering partnerships with each other, others are also active. The European Union has developed an extensive network of PTAs which reach into the Americas and may soon extend to parts of East Asia.<sup>4</sup> The North American Free Trade Agreement (NAFTA) already links the United States to Canada and Mexico, with negotiations under way for a possible FTAA which is expected to include most Latin American economies. The United States has signed a new economic partnership with Singapore, has offered to begin negotiations with other individual members of ASEAN and is negotiating an FTA with Australia.

At the same time as Southeast Asian and Northeast Asian economies are initiating options for closer integration, they are continuing to seek preferential deals with these two 'hubs' as well as with other economies. Japan and Korea are seeking indirect links with the US hub by negotiating FTAs with Chile and/or Mexico. Singapore has already signed PTAs with Australia, New Zealand and is seeking to form a new one with India. It is possible that all these initiatives will contribute to some kind of economic community in East Asia, but much will depend on the design of these many overlapping discriminatory agreements.

East Asian economies are taking care to ensure that their new agreements are consistent with the relevant provisions of the WTO. However, they are also tending to take advantage of the ambiguities in existing WTO disciplines on PTAs. These loopholes allow them to avoid liberalising the same sensitive products which they are reluctant to liberalise, either unilaterally, or in APEC or in WTO negotiations.

This tendency to avoid difficult issues limits the choice of partners. For example, Japan can only deal with economies which have no agricultural land or are willing to exempt much of agriculture. If PTAs are tailor-made to exempt the most sensitive sectors of current participant, then it will be difficult to include other economies with different characteristics.

At the same time, the preferential treatment of some economies is already setting off defensive reactions by others. Once Singapore and Thailand have embarked on negotiating PTAs, others may decide they cannot be left on the sidelines as their neighbours negotiate deals which can lead to discrimination against them. However, new discriminatory deals, which are driven by defensive reactions

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<sup>4</sup> See Bridges Weekly Trade News, April 16, 2003 at <bridges\_weekly@isttd.ch>

against other agreements, will not coalesce smoothly into wider zones of free trade.<sup>5</sup>

Although most new agreements declare themselves to be open to accession, the region needs to confront the reality that preferential deals, especially those which dodge the most difficult pockets of protectionism, create new vested interests against wider co-operation.

If the network of new and proposed discriminatory trading arrangements are to evolve into a wider agreement covering the very diverse East Asian group of economies, these economies will need to devise a strategy for bringing them together. That will need more than lip-service to WTO-consistency which have nothing to say about accession: it will also require the design and adoption of WTO-plus principles for new closer economic partnerships.

The remainder of this paper considers the kind of principles which would make it more likely that CEPs do become stepping stones towards wider co-operation. It also looks at how CEPs could be complemented by other policy options available to East Asian economies, in order to pursue their full range of regional and multilateral trade policy objectives.

## ***Trade strategy options for East Asia***

### **Objectives and instruments**

Promoting economic integration requires the reduction, or elimination, of impediments which add to the costs and risks of international commerce among any group of economies, such as East Asia.

These impediments can be grouped into:

- ?? border barriers to trade in products and factors of production; uncertainty
  - for example, contingent protection, such as anti-dumping measures;
- ?? divergences in standards or administrative procedures;
- ?? physical impediments;
  - for example, transport and communications networks.

Dealing with the first set of impediments is usually termed liberalisation, while arrangements to deal with the third and fourth group is termed facilitation. The second group is linked to both of these, since uncertainties can prevent

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<sup>5</sup> ASEAN economies are being courted for new partnerships from all sides – from China, Japan, the United States, Australia/New Zealand, India and even the EU. At first sight, this would appear to give ASEAN the opportunity to be a hub amidst many important economies. However, actual agreements are likely to be signed by individual members, rather than ASEAN as a whole. Individual ASEAN economies could thus become spokes to several other hubs. The potential problem of splitting, rather than linking existing partnerships is demonstrated by a new side-effect of the recently signed PTA between Singapore and the United States. Trade between Malaysia and Singapore, as well as trade between Batam Island and the rest of Indonesia is now subject to rules of origin imposed by the new discriminatory agreement.

specialisation in line with international comparative advantage, even in the absence of other impediments.

The sets of policy options which can address these issues can be divided into:

- ?? unilateral policy reforms by individual governments;
- ?? voluntary co-operation among groups of economies;
- ?? formal agreements or treaties among groups of economies, which may involve PTAs; and
- ?? multilateral agreements on disciplines to limit policies which create impediments to international commerce, for example, through the WTO.

Groups of economies which are involved in either voluntary, or formal economic co-operation can range from bilateral partnerships among pairs of economies to large regions, such as East Asia or the APEC group of economies.

The challenge is to match available policy options to objectives, taking care to identify each of these with some precision, then assigning instruments according to their expected effectiveness in dealing with different impediments to international economic integration.

### **Border barriers**

Border barriers, such as tariffs, bans or quotas can be classified into:

- ?? barriers to trade in products;  
    goods or  
    services; and
- ?? barriers to the international movement of factors of production:  
    capital or  
    people.

Many barriers to the international movement of goods, services, capital and people have been reduced substantially, or even eliminated by most economies. This is certainly the case in East Asia, where governments are aware that 'opening to the outside world' is the only viable strategy for sustainable growth. For example, the great majority of goods, especially goods that have been recently invented, is now subject to only very light, or no border barriers. Technology is rapidly making controls on capital movements obsolete and there are fewer and fewer restrictions on the short-term movement of people across borders to provide or receive services.

At the same time, there are some products and factors of production which remain heavily protected; sometimes for cultural reasons, more often in response to vested interests of producers or trade unions who feel threatened by international competition. For example, most governments protect farmers producing staple foods, economies with relatively high labour costs usually protect their textile and clothing sectors and many economies restrict investment in mass media. Very few, if any, economies allow long-term migration of unskilled labour.

For now let us focus on trade in goods and services.

### Border barriers to trade in products

Many economies, including in East Asia, have proven that they are willing to act individually to reduce many border barriers. They have also proved willing to implement such reforms as part the program of concerted unilateral liberalisation which has been adopted by APEC. Individual Action Plans (IAPs) of APEC economies provide evidence that voluntary liberalisation is making reasonably consistent progress. However, it is becoming increasingly evident that voluntary cooperation will not be able to deal with the really sensitive sectors.

For these sectors, the political cost of reform outweighs the potential economy-wide gains, so concerted liberalisation of sensitive sectors is not perceived as a positive-sum game. In these cases, where reform is perceived as a 'concession' to others, negotiations are needed to reduce border barriers.

Progress on such hard issues is most likely to be made in forums, like the WTO, which are designed to create the possibility of negotiating simultaneous action by the many economies involved. The WTO has, indeed, been able to make progress, even on difficult issues like agriculture and clothing. Some more progress can be expected, in due course, from the Doha Round, especially if East Asian economies are willing to offer significant liberalisation of their sensitive sectors, in return for reforms by others.

Lowering border barriers can also be negotiated as part of PTAs between pairs, or among small groups of economies. However, for reasons set out in Findlay et al (2003), it is harder to deal with 'sensitive sectors' in small groups. Compared to multilateral negotiations, it is more difficult to overcome vested interests against reform. In a growing number of examples, PTAs deal only with the relatively easy issues, while dodging around the hardest ones. In these circumstances, they are not really adding much to liberalisation, compared with what could have been achieved elsewhere, with lower costs in terms of trade diversion.

These considerations suggest that different policy instruments can be assigned to deal with negligible protection, as against the entrenched protection of a shrinking number of 'sunset industries' and other sensitive matters.

### Zero or negligible border barriers

These barriers are low for several reasons:

- ?? the vested interests against international competition have already been overcome, possibly in the course of past multilateral trade negotiations;  
or
- ?? in the case of new products, or factors of production, vested interest against international competition has not yet become effective.

International negotiations are no longer, or not yet, needed to remove such negligible border barriers. Unilateral reforms are possible and desirable, since the benefits of reform accrue largely to the economies undertaking the reform. At the same time, concerted unilateral liberalisation, through voluntary international

economic co-operation (for example, through APEC) can help accelerate the process, since the benefits can be magnified if trading partners are undertaking similar reforms.

There is some resistance to voluntary reform by those who believe that such reforms can prove more useful in the context of bilateral or multilateral negotiations. However, negligible reductions of already low barriers do not provide negotiating leverage on other, more difficult, issues. Therefore, there is no need to wait for formal rounds of negotiations – the WTO provides means for obtaining credit from past reforms.

In many cases, the prevailing zero, or negligible, border barriers are far below the ceilings notified to (or 'bound' in) the WTO. East Asian economies which have implemented significant trade policy reforms in recent years can use the WTO, not just for further reductions, but to undertake to bind border barriers at their already low rates. Such WTO 'bindings' can generate negotiating leverage from past reforms, since they reduce the uncertainty faced by trading partners.

#### High border barriers

The Doha Development Round of the WTO can also be used to help reduce remaining high border barriers. East Asian economies can choose to take a passive role, reducing barriers only to the extent which is needed to avoid a failure of the Round. On the other hand, they could take a collective leadership role, by offering to make large reductions if others were willing to match them.

If East Asian governments remained committed to the APEC objective of free and open trade and investment, as agreed in Bogor in 1994, they could offer to dismantle all border barriers in sectors covered by WTO disciplines by 2010 or 2020, as long as other economies were also willing to do so.

If other economies, including the United States and the European Union, were willing to respond by dismantling all their remaining border barriers, then bilateral and sub-regional PTAs would no longer be needed to reduce barriers covered by WTO disciplines. Closer economic partnerships could deal with other matters.

Unfortunately, it is not likely that all significant economies are ready to dismantle all such border barriers in the Doha Development Round. In this case PTAs could make a difference, but only if they are able to deal with issues which cannot be solved in the WTO: this is the 'competitive liberalisation' argument for PTAs.

Let us consider the options for dealing with politically sensitive, high border barriers in PTAs. Under what circumstances could such agreements lead to a WTO-consistent reduction of border barriers throughout East Asia? It may be useful to look at some examples.

Singapore has been reaping the benefits of free trade in goods for some time. Recently, Singapore has signed a sequence of PTAs, with New Zealand, Japan, Australia and the United States, which reduce most remaining barriers to trade in services, for example in financial services. Each of these agreements will force Singapore's service providers to become more competitive. Once these agreements have been in place for some time, Singapore is likely to be ready to

remove any remaining border barriers to trade in these services with all other economies, including East Asian economies. Such PTAs, where benefits granted initially to some economies are progressively extended to other economies, can be regarded as stepping stones to wider liberalisation.

Other examples may not be as constructive. If an economy is not yet ready to open some sectors to significant international competition, it can enter into PTAs only with economies which do not offer serious competition in these sectors, or with economies which are willing to exclude these sectors from the agreement. Since the WTO does allow some exemptions it would be possible to envisage a WTO-consistent agreement between economies which wish to protect the same set of products. For example, Japan and Korea could create a PTA which excluded rice.

However, such an agreement could not be widened to an East Asia-wide agreement unless those economies which were efficient rice producers were also willing to exclude that product. In that case, they would seek to exclude some other products in which they were not prepared to face competition from Korea and Japan. In a very diverse region like East Asia, economies have different sets of 'sensitive sectors'. If they all wanted to exclude their 'sensitive sectors', then PTAs among pairs, or small groups, of East Asian economies cannot be linked up to form a WTO-consistent PTA to cover all of East Asia.

This dilemma is illustrated by Table 1. As shown there, PTAs are not needed to deal with 'easy' sectors, where border barriers are already eliminated or set at negligibly low levels. At the same time, the PTAs which are currently agreed, or expected to be agreed, exempt the most 'sensitive sectors'. In that case, they cannot be expected to link up to cover all of East Asia.

*[insert Table 1 around here]*

This problem could be avoided by PTAs which anticipated future changes which would expose sensitive products to progressively greater competition. This could be achieved:

- ?? by agreeing that products initially excluded from the coverage of agreements would be included subsequently, so that PTAs would become comprehensive over time;
- ?? by agreeing that lowered border barriers initially offered to PTA partners would be offered to other economies over time.

In each case the transition period could be, say, 10 years.

PTAs which accepted either of these principles would be genuine stepping stones towards global free trade and investment. But only PTAs which accepted both of these principles would make it possible to achieve free and open trade and investment either in East Asia, APEC-wide, or more broadly.

It would be important to write such principles into PTAs at the outset, since any preferential deal generates subsequent vested interests against extending similar preferences to others.

Such principles would set considerably higher standards than current WTO disciplines. The difficulties experienced in seeking to tighten WTO disciplines on PTAs suggests that such principles are not likely to be accepted by all members of the WTO.

Could such higher standards for PTAs be accepted by APEC economies? The NAFTA, and more recently, the PTA between the US and Singapore contain detailed rules of origin designed to prevent competition in sensitive sectors against other economies, including other APEC economies. They, or others, may not be willing to face APEC-wide competition in their sensitive sectors. On the other hand, if some APEC economies are not willing to face such competition, even after a reasonable transition period, then they will not meet their commitment to free and open trade and investment by in the foreseeable future. A refusal to accepting such principles for PTAs would amount to an admission that the Bogor targets are not expected to be met.

Similarly, if such WTO-plus principles for PTAs were not acceptable to East Asian economies, then there is no real prospect of East Asia-wide free and open trade and investment as part of a drive towards economic integration in the region. But such principles may be accepted by East Asian economies for two possible reasons. Firstly, they may give adequate priority to East Asia-wide economic co-operation, rather than a large number of PTAs which prove impossible to link. Secondly, East Asian economies may also be serious about using PTAs with a gradually wider set of economies as preparation for global competitiveness.

There are some positive precedents. In implementing the preferential tariff arrangements under ASEAN Free Trade Area (AFTA), ASEAN economies have often lowered their general non-discriminatory (MFN) tariffs. They may be willing to make a general commitment to do so, possibly after some well-defined transition period. Others may be willing to follow such an example. If so, the dilemma illustrated in Table 1 could be resolved for trade in goods and services.

*[insert Table 2 around here]*

Table 2 illustrates the case where East Asian economies agree that any PTAs involving their economies will adopt the WTO-plus principles discussed above. In that case, sensitive products would be included in these agreements after an agreed transition period. Moreover, any benefits granted to some economies would be extended, at least to other East Asian economies, over time.

With such WTO-plus principles, sensitive issues would be dodged only for a limited time. PTAs involving East Asian economies could be linked, after that time, to form an East Asia-wide PTA. In that case, PTAs would make a genuine contribution to economic integration in East Asia.

Such PTAs could act as a stepping stone towards APEC-wide free and open trade and investment. If East Asian economies succeeded in forming a WTO-consistent PTA, then it would be up to the rest of APEC to decide whether to revise their trade policies, including the design of the PTAs in which they are involved, in order to widen free and open trade and investment from East Asia to APEC.

### Border barriers to factors of production

The Osaka Action Agenda confirmed that free and open trade and investment does mean the dismantling of border barriers to all products. It is less certain whether it is also intended to dismantle all restrictions to cross-border movement of all factors of production, which are not covered by WTO disciplines, in the same way as goods or services.

It is reasonable to expect that, for the foreseeable future, very few East Asian economies are willing to remove all such barriers, especially restrictions on long term movement of unskilled labour. In that case, the concept of 'comprehensiveness' in the above principles could be restricted to those border barriers which are covered by WTO disciplines.

On the other hand, East Asian economies may want to set a WTO-plus standards for comprehensiveness to include a wide range of factor movements, possibly with limited exceptions.

### **Beyond border barriers**

The Osaka Action Agenda makes it clear that free and open trade and investment requires far more than the dismantling of border barriers. As demonstrated by the evolution of the EU, a wide-ranging set of co-operative arrangements on matters such as the mutual recognition of standards and the harmonisation of approaches to regulating economic activity are also needed to create a unified market.

The EU took up these non-border issues long after the removal of border barriers among members. But it is not necessary to proceed in that order. APEC economies are implementing an extensive agenda to facilitate trade and investment at the same time as they tackle border barriers. The two largest economies, the EU and the US, have decided to leave negotiations on remaining border barriers to the WTO while embarking on the Transatlantic Economic Partnership (TEP). This is a framework for implementing a growing number of co-operative arrangements to facilitate trade in goods, services and some factors of production between the two economies.<sup>6</sup>

East Asian economies can choose to proceed with the liberalisation of border barriers alongside a program of facilitation to address non-border barriers to trade and investment. Moreover, it would be possible to implement East Asia-wide co-operative arrangements to reduce some costs and risks of international commerce in the region, even if it proves difficult to implement East Asia-wide liberalisation of some border barriers.

As for liberalisation, a range of trade policy instruments can be used for facilitation, from unilateral action to WTO-wide agreements. This can be illustrated using an example.

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<sup>6</sup> See Elek (1998).

### Alternative approaches to facilitation

One practical example of facilitating trade in services would be to speed up transit through immigration checkpoints. Many economies already have machine-readable passports for this purpose.

As a (hypothetical, but feasible) further step, one or more economies could introduce 'smart-card' versions of passports, resembling the entry cards already used by several organisations. These cards would be designed to be read electronically, while flashing a photo for matching with the holder and checking that the person is eligible to enter or to leave.

One economy could act unilaterally to introduce such a card to speed the processing of its own citizens on arrival and departure. That would lead to some cost savings.

The benefits of such innovation could be magnified by a co-operative arrangement among several economies to introduce compatible smart-card versions of their passports. If such an arrangement was implemented by some economies, then others may wish to join, by adopting similar technology. As in the case of the APEC Business Travel Card, a smart-card passport arrangement could be pioneered by a group of APEC economies, with a view to gradually extending the arrangement to the rest of APEC.

East Asian economies could promote closer regional integration, by adopting such practical arrangements to facilitate trade or investment among themselves. They may be able to move more rapidly than the wider APEC group.

A practical arrangement for facilitation, such as mutually compatible smart-card passports, could also be adopted as part of a CEP agreement between two East Asian economies. Can that arrangement be widened to include other East Asian economies, or perhaps all APEC economies?

It would be desirable to include others, since the benefits of the arrangement become greater as more participants join the network of economies with more easily processed migration documents. Whether other economies are allowed to join a specific co-operative arrangement, which is part of a wider CEP arrangement depends, once again, on the design of such partnerships.

### Facilitating trade and investment in APEC

The above, hypothetical, example is just one of many options for facilitating trade and investment. Each of these options can be dealt with individually, on their own merits. Alternatively, groups of economies may want to deal simultaneously with several options for facilitation.

APEC has been designed so that options for facilitation can be considered one at a time. For example APEC economies could adopt a sequence of arrangements, each of which leads to cost savings by progressive harmonisation of customs procedures. APEC economies can also choose to deal with several related arrangements simultaneously, for example mutual recognition of standards for a number of closely related products.

In addition, in their 2001 Shanghai Accord, APEC leaders endorsed the concept of 'pathfinder initiatives'. In that statement, they reaffirmed the principle (first stated in the Bogor Declaration) that APEC economies that are ready to implement a co-operative arrangement may do so, while those that are not yet ready to participate may join such the arrangement at a later date.

This flexibility offers two important advantages. It recognises that implementing co-operative arrangements for facilitation often requires extensive capacity-building. For example, few economies oppose the concept of harmonising customs procedures, but not all of them are able to install and operate the systems which are needed to do so. The concept of pathfinder initiatives allows some APEC economies to implement practical arrangements to reduce the cost or risks of some economic transactions, setting examples for others and then encouraging and/or helping them to develop the capacity to join such arrangements.

The ability to deal with some issues ahead of others also makes it possible to deal with easier matters first. That can generate perceptible mutual benefits, generating the confidence needed to tackle more complex or sensitive matters later. Such flexibility has served to generate momentum in, and measurable benefits from, APEC's ongoing facilitation program.

#### Facilitating trade and investment in closer economic partnerships

The CEPs which have been agreed recently, as well as those under consideration among East Asian economies, deal with many issues at the same time. In most cases, the CEP contains a PTA for liberalising border barriers, together with a set of co-operative arrangements for reducing various costs or risks of trade and investment among the partners.

With many CEPs in prospect in East Asia, it is quite likely that several of them will pioneer innovative arrangements to deal with new aspects of facilitation. In principle, it would be desirable to use these new opportunities for facilitation as precedents for APEC-wide facilitation.

*[insert Diagram 1 around here]*

For example, as illustrated in Diagram 1, an agreement between two East Asian economies (A and B) may contain a PTA together with numerous arrangements for facilitation. Other East Asian economies (C and D) may wish to join one of these arrangements and demonstrate that they are willing and able to implement the policies and make the investments necessary to join that particular arrangement.

If CEPs are seen as precedents for wider cooperation, then they should be allowed to join those particular arrangements. However, problems might arise if they are not permitted to join any aspect of a CEP unless they participate in every part of a wide-ranging agreement.

For example, Economy C may want to join a specific mutual recognition agreement (say for safety standards for toys), adopted by A and B. However, it may be blocked from joining that arrangement unless C also joined a PTA between A and B. That may be impossible in practice. Economy C may have

strong comparative advantage in products which A and B wish to protect and had excluded from their PTA. In that case A and B are unlikely to admit C to their PTA and C may, therefore, be prevented from joining any of the facilitation arrangements linked to that PTA.

This problem could be avoided if liberalisation and facilitation were pursued on parallel tracks. While it may prove difficult to link bilateral or sub-regional PTAs into an East Asia-wide trading arrangement, it may still be possible to use particular co-operative arrangements for facilitation, which were pioneered in CEPs to promote region-wide facilitation.

Another kind of problem could be caused by limited capacity to implement a large number of arrangements for facilitation simultaneously. The EU has adopted such an all-or-nothing approach. There is an '*acquis communautaire*' of several hundred arrangements, which potential participants are required to adopt at the same time. This has made the EU very difficult to join.

Such an '*acquis communautaire*' approach would be highly undesirable for the Asia Pacific, which is seeking to promote the integration of a very diverse groups of economies. Economies like Japan and Singapore have the capacity to implement many co-operative arrangements to facilitate trade and investment. However, others like Brunei or Vietnam, may find it impossible to join all the facilitation arrangements which have been agreed by Japan and Singapore.

#### Closer economic partnerships as pathfinders for region-wide facilitation

Asia Pacific economies should seek to encourage others to accede to any practical arrangements to facilitate trade or investment which might be pioneered within a new CEP. That could be ensured by a careful specification of the conditions for accession. At present, most new partnership contain a general clause that states that third parties who accept the provisions of the existing agreement can accede to it, subject to the consent of existing partners.

Such an accession clause could be interpreted to mean that a potential new participant would need to enter all of the arrangements of the existing CEP simultaneously. In that case, if some economy wanted to join a particular co-operative arrangement for facilitation (for example, mutual recognition of a specific product standard), it may be required to join a PTA among existing partners as well as a large number of other arrangements for facilitation.

As discussed above, it can often be impossible for new economies to join a PTA which is tailor-made to the sensitivities of existing partners. Moreover, some economies do not have the capacity to accede to many arrangements for facilitation at the same time. For these reasons, a general accession clause may make it very difficult to use arrangements for facilitation, which were pioneered in a CEP, as catalysts for East Asia or APEC-wide facilitation.

This potential problem is illustrated in Table 3. If new participants are required to implement every part of a CEP at the same time, it will also be hard to use bilateral or sub-regional CEPs as stepping stones for region-wide facilitation.

*[insert Table 3 around here]*

To promote region-wide facilitation, it would be desirable for all arrangements to facilitate trade and investment, including arrangements agreed as part of CEPs, to be potential catalysts for wider arrangements. That could be achieved by agreeing that all arrangements for facilitation should be open to accession by economies which were willing and able to conform to the requirements of that particular arrangement.

*[insert Table 4 around here]*

APEC economies have already adopted a set of principles for facilitation which seek to ensure that cooperative arrangements to facilitate trade and investment are transparent and non-discriminatory. Adding a principle on accession would form a logical link between APEC's already agreed principles for facilitation and the concept of 'pathfinder initiatives' within APEC, as endorsed in the Shanghai Accord of 2001. Therefore, such a principle should be acceptable to East Asian governments and, hopefully, to all APEC governments.

New arrangements to facilitate trade or investment, which were created as part of a CEP involving East Asian economies (or preferably all APEC economies) would then be treated as potential pioneers for APEC-wide arrangements. Other East Asian, or APEC, economies could decide whether to join arrangements pioneered in the context of CEPs.

### **Next steps**

Several policy instruments, ranging from unilateral to multilateral, are available to promote closer economic integration in East Asia alongside progress in APEC and the WTO. Bilateral or sub-regional CEPs can play a constructive part in this effort,. But that will only happen if these CEPs are based on principles which make it possible to link them in order to form wider partnerships.

As discussed, it is not sufficient to implement CEPs based on discriminatory PTAs with selected product coverage and a general clause on accession. If East Asian economies really intend to link these CEPs in future, then the PTAs within these arrangements will need to meet higher standards. Such WTO-plus principles would set firm timetables for:

- ?? extending product coverage so that the PTAs become comprehensive;  
and
- ?? to extend the benefits of preferential trade liberalisation to other economies over time.

In addition, East Asia economies should also agree that each of the new arrangements to facilitate trade and investment, which are part of CEPs involving their economies, should be open to accession, so that they can be 'pathfinder initiatives' in the context of APEC.

### WTO-plus PTAs

If East Asian economies agreed to adopt such WTO-principles for any CEPs which contained PTAs among them, then sensitive sectors could be avoided at the outset, but exposed to wider competition within a well-defined time period.

In that case, it would be possible to link these PTAs at the end of such a transition period. It would also be possible to merge the co-operative arrangements for facilitating trade and investment which were linked to these PTAs. These arrangements, originally pioneered within bilateral or sub-regional CEPs, could also serve as the core of East Asia-wide, or even APEC-wide arrangements for facilitation, as long as each of them were open to other economies willing to conform to such arrangements.

If PTAs involving East Asian economies were to become comprehensive after some time, with benefits extended to other economies over time, then East Asian economies would be able to meet the Bogor commitment to free and open trade and investment at the end of these transition periods. Moreover, East Asian economies would be in a position to make a substantial offer in the Doha Development Round. They could offer to:

- ?? bind those levels of protection which were already at low rates; and
- ?? to dismantle border barriers to sensitive sectors by the end of the transition periods specified in their PTAs.

That would be a very substantial offer which could alter the dynamics of the WTO negotiations. In return, East Asia could demand very significant liberalisation from others, together with the adoption of tighter rules for anti-dumping and other forms of contingent protection. That would be an important gain. The recent proliferation of such contingent protectionism means that an absence of border barriers is no longer sufficient to provide the basis for a confident international trading environment (see Flowers and Bosworth, 2003).

#### Business as usual?

Negotiating PTAs has become very fashionable in recent years. If they are seen as a way of preparing economies for subsequent wider competition, then WTO-plus principles should be acceptable. On the other hand, part of their attraction may be that it is all too easy to meet WTO-only standards. Economies can select favoured trading partners and build closer links with them, without any commitment to expose their sensitive sectors to real competition. If avoiding sensitive sectors is a significant part of the motive for PTAs in East Asia, then the region's governments will not agree to adopt these higher standards.

In that case, PTAs which avoid sensitive issues can be expected to proliferate. Lip-service will continue to be given to WTO-consistency, while taking advantage of the loopholes available to exclude sensitive sectors, and/or to exclude trading partners which can offer effective competition in these sectors.

The recent Japan-Singapore agreement is a warning. Although Singapore has negligible agriculture, Japan insisted on excluding those few segments of agriculture in which Singapore is a potential exporter to Japan. An efficient rice producer like Thailand could never expect to join such an agreement. Moreover, a PTA between Thailand and Japan would only be feasible if Thailand agreed to exclude most agricultural products.

Such agreements will not be stepping stones towards region-wide free and open trade and investment. On the contrary, they would indicate that the economies involved do not intend to meet their APEC commitment to free and open trade and investment in the foreseeable future.

Moreover, as more such selective PTAs are signed, more and more economies are likely to resist consideration of the WTO-plus standards for PTAs, which will be needed for PTAs to contribute to region-wide economic integration. That is why it is urgent to press for such principles to be adopted as soon as possible.

Agreements with economies outside the region may also cut across the objective of East Asian economic integration. Unless care is taken, agreements with North American or Latin American economies could rule out subsequent moves to extend the benefits of trade liberalisation to other East Asian economies.

An additional risk is that work to develop co-operative arrangements to facilitate trade and investment could shift away from APEC-wide efforts to CEPs, in ways which make it difficult to use the arrangements embedded in wide ranging CEPs as bases for region-wide facilitation.

#### Region-wide facilitation of trade and investment

If a significant number of East Asian economies are not willing to make even long-term commitments to liberalise their sensitive sectors, then the WTO-plus principles proposed above, will not be accepted, at least for now.

In that case, the PTAs which are being negotiated will prove hard to link to create an East Asia-wide zone of free and open trade and investment. However, this need not prevent progress towards region-wide arrangements to facilitate trade and investment. Such facilitation could begin to generate East Asia-wide benefits, providing the motive, as well as the mutual confidence, needed to face up to the politically difficult decisions on sensitive sectors.

Economic integration of East Asia can be promoted by arrangements to facilitate trade and investment, even if region-wide trade liberalisation proves difficult. Progress can be made on at least two fronts.

One of these is to accelerate the ongoing work towards APEC-wide facilitation to implement the wide-ranging Osaka Action Agenda for facilitating trade and investment. APEC's work on facilitation is already leading to appreciable region-wide gains. East Asian economies are participating in this collective effort and reaping some of the benefits. They could also choose to move ahead of APEC, with East Asian economies implementing ideas which can become pathfinder initiatives in the APEC process.

Secondly, the co-operative arrangements to facilitate trade and investment, which are being developed as part of CEPs involving East Asian economies, could also act as catalysts for wider facilitation arrangements among East Asian as well as other Asia Pacific economies.

CEPs could play such a positive, catalytic role if the arrangements for facilitation are readily accessible to other trading partners. As discussed above, this will need

more than a rather general clause about accession to CEPs as a whole. It would be desirable to agree that arrangements to facilitate trade and investment which are adopted as part of CEPs should also serve as pathfinder initiatives for potentially APEC-wide arrangements.

As discussed above, this could be achieved by adding a new principle to APEC's already agreed principles for facilitation, which do not yet include a principle on accession. That principle would be consistent with the concept of pathfinder initiatives, allowing CEPs to act as pioneering catalysts for APEC-wide facilitation. Such an additional principle for facilitating trade and investment could be stated as follows:

*“Co-operative arrangements to facilitate trade and investment may be pioneered among pairs or groups of economies, including in the context of closer economic partnerships (or regional trading arrangements) involving APEC economies.*

*In line with the principles of the 1995 Osaka Action Agenda and the concept of pathfinder initiatives endorsed in the 2001 Shanghai Accord, they should be encouraged to do so.*

*In the interest of promoting wider free and open trade and investment, any economy whose government adopts policies compatible with any existing or proposed co-operative arrangement should be able to, and be encouraged to, become party to any of these arrangements.”*

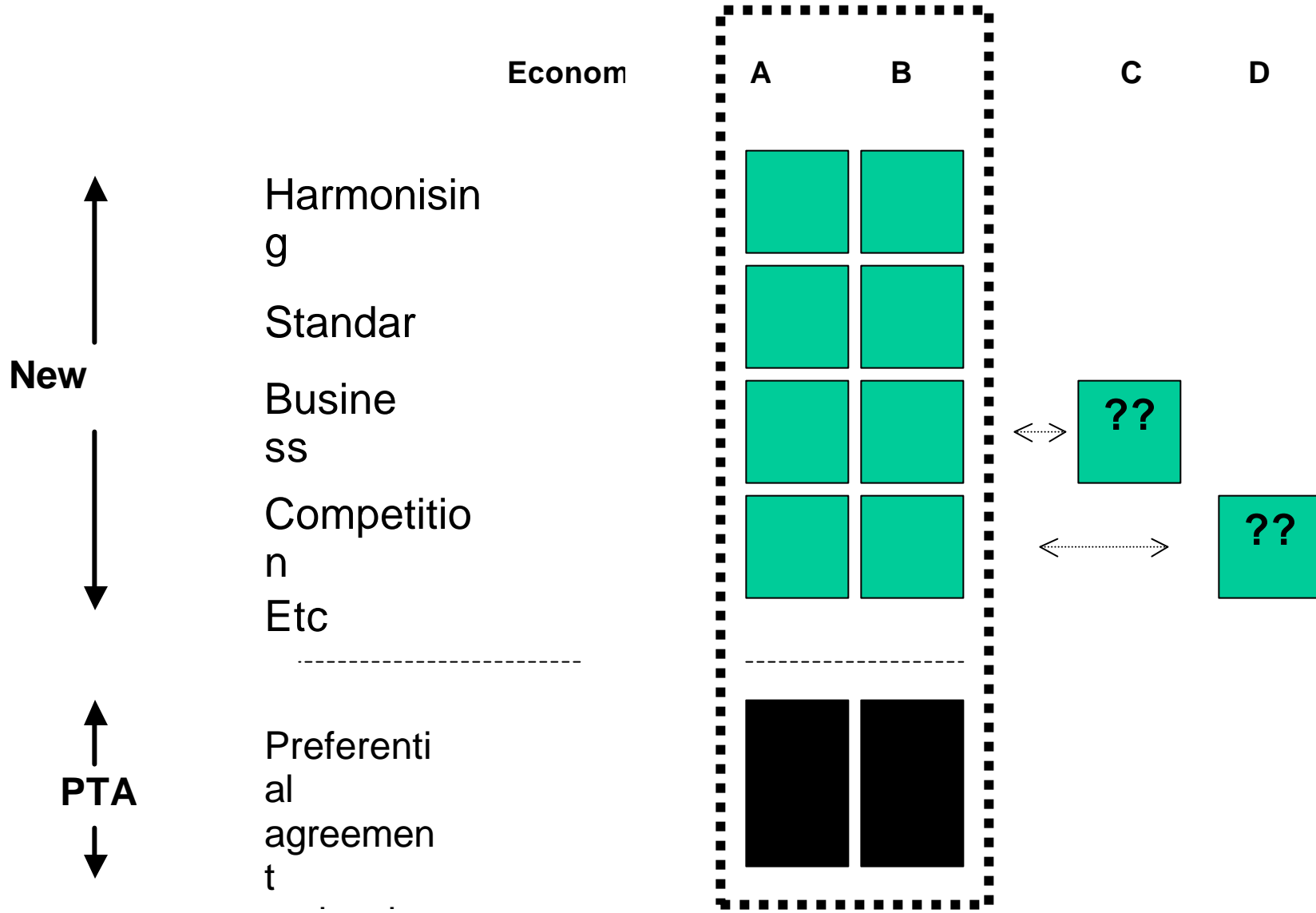
Joining co-operative arrangements for facilitation pioneered by others will often require capacity-building. APEC could promote the sharing of information, experience, expertise and technology by means of ECOTECH projects designed to help more economies to become involved in new opportunities to facilitate trade and investment.

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# Diagram 1





## Table 1

<b>Policy options</b>	<b>Voluntary Cooperation</b>			<b>Formal Agreements</b>		
	<b>Unilateral</b>	<b>East Asia</b>	<b>APEC</b>	<b>Closer Economic Partnerships</b>	<b>East Asia</b>	<b>WTO (Doha Round)</b>
<b>Issues</b>						
Border barriers						
Zero or negligible protection	Feasible	Feasible, with magnified mutual benefit	Feasible, through concerted unilateral liberalisation	Feasible, but do not need CEPs for this purpose	Feasible, but do not need CEPs for this purpose	Feasible, though not essential. Can obtain credit for past voluntary liberalisation
Highly protected sensitive sectors	Not possible	Very difficult	Has proven to be too hard	Feasible, but usually dodge sensitive issues	CEPs which dodge hard issues cannot be merged to form an East Asia-wide agreement	Feasible, but difficult
<b>Principles for design of PTAs</b>				<b>No better than merely WTO-consistent</b>		

## Table 2

<b>Policy options</b>	<b>Voluntary Cooperation</b>			<b>Formal Agreements</b>		
	<b>Unilateral</b>	<b>East Asia</b>	<b>APEC</b>	<b>Closer Economic Partnerships</b>	<b>East Asia</b>	<b>WTO (Doha Round)</b>
<b>Issues</b>						
Border barriers Zero or negligible protection	Feasible	Feasible, with magnified mutual benefit	Feasible, through concerted unilateral liberalisation	Feasible, but do not need CEPs for this purpose	Feasible, but do not need CEPs for this purpose	Feasible, though not essential. Can obtain credit for past voluntary liberalisation
Highly protected sensitive sectors	Not possible	Very difficult	Has proven to be too hard	Feasible, and include all products following a transition period	WTO-plus CEPs can be merged later to form an East Asia-wide agreement	Feasible, but difficult
<b>Principles for design of PTAs</b>		<b>Agree to adopt WTO-plus principles</b>		<b>WTO-plus CEPs involving East Asian economies</b>		

### Table 3

Policy options	Voluntary Cooperation			Formal Agreements		
	Unilateral	East Asia	APEC	Closer Economic Partnerships	East Asia	WTO (Doha Round)
<b>Issues</b>						
Options for facilitation						
Potential co-operative arrangements include mutual recognition agreements and harmonising administrative procedures	Limited progress possible  Can deal with issues one at a time	Potential for East Asia wide arrangements  Could move ahead of APEC-  Can deal with issues one at a time	Considerable progress being made  Pathfinder initiatives can set examples  Can deal with issues one at a time	Usually include arrangements for facilitation  Often alongside PTAs  Usually deal with many issues at the same time	Hard to implement any East Asia wide CEP  Very hard to link to existing CEPs	Too many members for simultaneous progress
<b>Principles for facilitation</b>				<b>Accession possible only to CEP as a whole</b>		

## Table 4

<b>Policy options</b>	<b>Voluntary Cooperation</b>			<b>Formal Agreements</b>		
	<b>Unilateral</b>	<b>East Asia</b>	<b>APEC</b>	<b>Closer Economic Partnerships</b>	<b>East Asia</b>	<b>WTO (Doha Round)</b>
<b>Issues</b>						
Options for facilitation						
Potential co-operative arrangements include mutual recognition agreements and harmonising administrative procedures	Limited progress possible          Can deal with issues one at a time	Potential for East Asia wide arrangements   Could move ahead of APEC-  Can deal with issues one at a time	Considerable progress being made   Pathfinder initiatives can set examples  Can deal with issues one at a time	Usually include arrangements for facilitation   Often alongside PTAs  Usually deal with many issues at the same time	Hard to implement any East Asia wide CEP   But easy to promote region-wide facilitation	Too many members for simultaneous progress
<b>Principles for facilitation</b>		<b>Agree on new principle for facilitation</b>	<b>Could also agree on new principle for accession</b>	<b>Individual arrangements for facilitation open to accession</b>		



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