

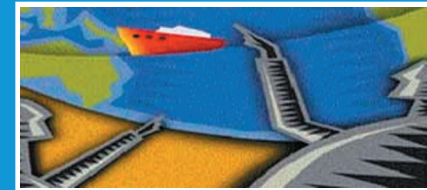
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## Asia Pacific RTAs as Avenues for Achieving APEC's Bogor Goals

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## APEC Commitments and the Regional Approach to Liberalization

APEC's Bogor Declaration sets out a commitment by APEC members to realisation of the vision of free trade and investment in the Asia-Pacific region, and to implementation of the liberalization and facilitation measures required to achieve this vision by 2010 in the case of developed APEC economies and by 2020 in the case of developing APEC economies.

There were a number of important features underlying the commitments of APEC members in the Bogor Declaration:

- Achievement of the Bogor goals is to be achieved by a process of "open regionalism", the key feature of which is non-discrimination.<sup>1</sup> "Open regionalism" was explicitly intended to contrast with the discrimination inherent in conventional regional trading arrangements (RTAs). It was thus made clear that APEC was not intended to be a conventional regional trading bloc.
- The Bogor goals are to be pursued in such a way as to strengthen the multilateral trading system and contribute to its increasing openness
- APEC was explicitly conceived as a trans-Pacific regional grouping, embracing both sides of the Pacific
- In elaborating on the modalities for implementing the Bogor Declaration, the 1995 Osaka Action Agenda (OAA) committed APEC members to adherence to nine basic APEC principles.

### *The Logic and Benefits of the APEC Approach to Regional Liberalization*

The commitment of APEC members to the Bogor goals was underpinned by the recognition that their successful growth and development has been based on openness and stability of global and regional markets. The APEC commitments were also firmly based on a foundation of strong business linkages and intense trade and investment relations already established throughout the APEC region, including across the Pacific (the trans-Pacific dimension), within the western Pacific economies (intra-western Pacific dimension) and among APEC members in the Americas (intra-American dimension).

Commitment to the APEC goals also reflected an understanding that the economic benefits of trade and investment liberalization accrue primarily to the liberalizing economies themselves. This is especially true of small economies, and provides the economic rationale for unilateral liberalisation. APEC members also understood that the economic gains from liberalisation are greater if trading partners liberalise at the same time, and indeed this simultaneous liberalisation may be essential in the case of larger economies to ensure that the potential gains from liberalisation are fully realised. One of APEC's original contributions was to provide for this through a process envisaged as simultaneous unilateral liberalisation by APEC members. The term "concerted unilateralism" was coined to describe this process.

At the same time it was also clearly recognised that realisation of the gains from liberalisation by developing economies requires building human and institutional capacity, to ensure that liberalisation truly contributes to development goals. For this reason developing APEC members have always insisted that economic and technical cooperation should be given equal status with liberalization and facilitation in APEC's agenda. It was recognised too that realisation of the potential gains from liberalisation and facilitation requires as well that economies undertake key economic reforms in the areas of market structure and public and corporate governance. The importance of these issues received recognition through the inclusion of competition policy and deregulation/regulatory reform and review as items on the OAA, and they have received much greater emphasis and prominence following the experiences of the East Asian economic crisis of 1997-98.

### **The Evolution of Preferential Trading Arrangements in the Asia-Pacific Region**

At the time of APEC's Bogor Declaration in 1994 there were already in existence three regional trading arrangements (RTAs) between groups of APEC members: the North American Free Trade Agreement (NAFTA), the ASEAN Free Trade Agreement (AFTA), and the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). Proposals to extend NAFTA to include Chile did not bear fruit at

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<sup>1</sup> In this context there was an ambiguity in the interpretation of non-discrimination, as to whether non-discrimination was to be unconditional or conditional, the latter version meaning that the principle would apply only to trade with economies that were prepared to reciprocate. This ambiguity was left conveniently unresolved, allowing APEC members supporting either interpretation to support APEC's "open regionalism".

that time but two NAFTA members, Canada and Mexico, did subsequently conclude free trade agreements (FTAs) with Chile in 1996 and 1998 respectively.

Proposals for new regional trading agreements (RTAs) among APEC members began proliferating from 1998 onward. Six of these initiatives have now resulted in completed agreements (Singapore-Japan, Singapore-U.S., Chile-U.S., Chile-Korea, Singapore-New Zealand, and Singapore-Australia), but many more proposals are at various stages of negotiation, study or discussion.

Early initiatives in this new “wave” of Asia-Pacific RTAs were generally of a bilateral nature, and new bilateral initiatives have continued to emerge at frequent intervals. These have generally involved at least one small or medium-sized Asia-Pacific economy, in a proposed partnership with one of the three economic giants of the region (Singapore-Japan, Singapore-U.S., Australia-U.S., Chile-U.S., Korea-Japan, Chile-Korea, Mexico-Japan, Thailand-Japan, Hong Kong China-China) or with another small or medium-sized economy (for example Singapore-New Zealand, Singapore-Australia, Singapore-Canada, Singapore-Mexico, Singapore-Korea, Mexico-Korea, Thailand-Australia, Hong Kong-New Zealand). There have also been occasional proposals for plurilateral RTAs, such as the “P5” proposal informally floated some years ago for an FTA involving the U.S., Australia, Singapore, Chile and New Zealand, and the current proposal for a trilateral FTA between Singapore, New Zealand and Chile.

A notable feature of these bilateral and plurilateral initiatives is that they include a large number of trans-

Pacific initiatives as well as initiatives confined to partners on one side of the Pacific only. On the western side of the Pacific bilateral RTA initiatives have developed both within East Asia and between East Asian economies and partners in the Oceania sub-region. In the Americas, bilateral or plurilateral RTA initiatives now cover almost all bilateral trade flows among APEC members. APEC members in the Americas are also engaged in numerous bilateral and plurilateral initiatives with other partners in their hemisphere, as well as in the effort to create a Free Trade Area of the Americas (FTAA).

Interest in the creation of a large-scale trading bloc emerged in East Asia also, with the proposal that the “ASEAN Plus Three” group – originally established to consider monetary cooperation in the wake of the East Asian economic crisis, and comprising China, Japan, Korean and the ten ASEAN economies – should form itself into an FTA. The formation of an East Asian trade bloc in parallel with establishment of the proposed Free Trade Area of the Americas would herald the emergence of a “bipolar Pacific”, divided between large scale trade blocs on opposing sides of the ocean. At the global level it would entail the formalisation of a “tripolar” world trading system, based on three “mega-blocs” – the EU, the FTAA, and the East Asian bloc – together accounting for approximately 90% of world GDP.

More recently the proposal for an “ASEAN Plus Three” FTA appears to have been overshadowed by a number of “ASEAN Plus One” initiatives. These began with China’s proposal for a China – ASEAN FTA, to which Japan responded with its own proposal for

an economic partnership agreement with ASEAN, which could potentially include an FTA. The U.S. followed with its “Enterprise for ASEAN” initiative which is also envisaged as including an overall framework agreement with ASEAN as a group as well as bilateral FTAs with individual ASEAN countries.

These developments, considered together with other bilateral initiatives of the U.S. and Japan in particular, suggest the potential for a “hub-and-spoke” pattern of RTAs to emerge in the Asia-Pacific region as an alternative to the “bipolar Pacific”. This would involve the establishment by the three major economies of the region – the U.S., Japan, and China - of networks of bilateral PTAs centred on themselves.

Efforts have been made to develop an ASEAN strategy involving a variation on this theme, whereby ASEAN itself would serve as the “hub”. In addition to the proposed arrangements with China, Japan and the U.S., a proposal was recently floated for an ASEAN-India FTA, and there is also a longstanding proposal to link the AFTA and CER arrangements, although the two groups have not yet been able to agree that the linkage should include the removal of tariffs in a combined AFTA-CER FTA. ASEAN’s prospects of establishing itself as an alternative “hub” depend crucially on its ability to maintain a unified stance and to negotiate cohesively as a group with its intended partners. There are already signs that this is likely to prove difficult. The U.S. and Japan have already indicated the intention of establishing FTAs with individual ASEAN countries on a bilateral basis, and some of the latter have signaled a willingness to follow Singapore down the bilateral route.

Thailand is already in negotiations with both Japan and Australia. There have been suggestions also that the proposed China-ASEAN FTA may prove in practice to take the form of a series of bilateral arrangements.

It thus appears possible that the “gravitational” pull of the larger economies on individual ASEAN economies may prove too strong for ASEAN’s ambitions to act as an alternative “hub”, and that the traditional “hub and spoke” architecture will prevail, with the larger economies in their traditional role as the major “hubs”, and the individual ASEAN economies, along with other small and medium-sized economies of the region, in the role of “spokes”.

However it develops, a “hub and spoke” architecture in the region is likely to become increasingly complex. In addition to the potential major “hubs” – the U.S., China, and Japan – and the ambitions of ASEAN to serve as an alternative “hub”, several of the small and medium-sized economies in the region could be viewed as setting themselves up as “secondary hubs” in the evolving regional patterns of RTAs. Chile, Mexico and Singapore, and perhaps in the future Australia and Korea, are obvious examples of “secondary hubs”.

The common characteristic of all of these RTAs, and the one that sets them apart from APEC itself is that they embody a preferential approach to trade liberalisation, and thus more accurately described as preferential trading agreements (PTAs). PTAs discriminate in favour of their members and therefore against non-members. By contrast, APEC adopted the concept of “open regionalism”, embodied in the Bogor

vision of non-discriminatory free trade and investment in the Asia-Pacific region. The central importance within APEC of the trans-Pacific dimension also sets it apart from initiatives leading in the direction of a “bipolar Pacific” or of establishment of a series of “hub-and-spoke” configurations.

### **Issues Raised by Preferential Liberalization**

The potential inconsistency between PTAs and APEC’s “open regionalism” was recognised by APEC leaders at the time of the Bogor Declaration, and the APEC Eminent Persons Group (EPG) was asked to report on how this issue could be resolved. In the years immediately following Bogor however the issue began to appear less pressing, as little interest was shown within APEC in the pursuit of new preferential agreements at that time. It has returned to centre-stage as a result of the proliferation over the last five years of proposals for new preferential agreements among APEC members.

From the perspective of economic analysis PTAs represent a “second-best” approach to liberalisation. From the perspective of policymakers they represent a “pragmatic” approach, to be pursued when unilateral or multilateral liberalisation cannot make progress to the extent desired, due to factors such as market imperfections and political and strategic considerations. The “pragmatic” approach tends to proceed on the assumption that some liberalisation is better than none at all. Economic analysis has long shown that this is not always or necessarily true, so that the key issue becomes to identify the conditions under which PTAs can

indeed be relied upon to contribute to national and global welfare, and towards a more open multilateral trading system.

### *Trade Creation and Diversion*

The basic issue raised by PTAs stems from the fact that by granting preferences to each other the members of PTAs necessarily discriminate against non-members. Some of the increase in trade generated by a PTA will genuinely be new trade, created in response to the new opportunities for efficient exchange resulting from the removal of barriers between the members of the PTA. This “trade creation” yields gains from trade in the usual way. Some of the increase however will reflect the diversion of existing trade, as the margins of preference established under the PTA cause trade that formerly took place between members of the PTA and economies outside the PTA to be replaced by trade between the members. This “trade diversion” is unambiguously harmful to the non-members whose exports are displaced by intra-PTA trade. Potentially offsetting this negative effect is the possibility that additional economic growth stimulated by the PTA may eventually lead the members of the PTA to increase their imports from the non-members beyond the level that would have occurred in the absence of the PTA. Less obviously, trade diversion also has a negative effect on the economic welfare of the members, to the extent that more expensive or lower quality imports from members are able to displace imports from non-members solely because of the margins of preference created by the PTA.

The balance between these two



effects may go either way: trade creation effects may exceed trade diversion effects or vice versa, and the overall effect on the economic welfare of members may correspondingly be either positive or negative. Even if the overall effect on members is positive it is possible for the effect on global economic welfare to be negative if the harm to the economic interests of non-members exceeds the economic gains to the members of the PTA.

While these issues are typically analysed in the context of trade in goods, analogous arguments apply with perhaps even greater force to trade in services. While market access may be important for service-exporting economies, from the perspective of the liberalizing economy a prime purpose of liberalization is to enhance competition and enhance efficiency in the service sector by encouraging the entry of internationally competitive providers. Preferential liberalization runs counter to this objective if it encourages instead the entry of less competitive providers from the partner economy.

#### *Investment Creation and Diversion*

It has been increasingly recognised that the negotiation of new PTAs may be motivated as much or perhaps even more by the desire to encourage investment as by the desire to encourage trade. A PTA gives rise to effects on investment that are analogous to the effects on trade. As well as investment creation there will also be investment diversion, as the preferential market access available within the PTA attracts investment to the members that might otherwise have taken place in non-member

economies. Some of this diverted investment is likely to represent the response of exporters in the non-member economies, to counter the displacement of their exports by competitors within the PTA.

#### *“Hub and Spoke” Patterns of PTAs*

The disadvantages for the “spoke” economies in “hub and spoke” patterns of PTA development are well-known. These patterns tend to reinforce the unequal bargaining strength of the parties, since the “hub” can exploit competition among the “spoke” economies, and use precedents established in PTAs with one “spoke” to strengthen the case for inclusion of similar provisions in agreement with other “spokes”. There are further inequalities in that the “hub” gains access to all the “spoke” markets whereas the “spokes” gain access to the “hub” alone unless they negotiate separate PTAs with each other. The greater size of market to which access is available from the “hub” also gives the “hub” an advantage over the “spokes” in attracting investment.

On the other hand successful “spoke” economies may derive almost all available gains from trade by securing PTAs with every major “hub”, perhaps supplemented by PTAs with other “spokes” with whom they have a significant trading relationship. However those economies that are unable for whatever reason to secure PTAs with “hubs” face significant economic damage.

One of the strategies for the “spoke” economies to compensate for their disadvantaged position in the “hub and spoke” configuration is to seek PTAs with each other. This strategy may account for the pattern recently

observed in the Asia-Pacific region whereby leading “spoke” economies seek to establish themselves as “secondary hubs” by negotiating PTAs with a number of their minor trading partners. In this way they may be able to not only offset the disadvantage of being a “spoke” attached to a major “hub” but also to capture the benefits of being the hub within their own secondary “hub and spoke” configuration.

#### *Issues with Large Blocs*

When PTAs take the form of large trade blocs other considerations come into play. On the one hand there may be increased scope for efficiencies arising from enhanced competition and the ability to exploit economies of scale. On the other hand disparities between member economies may increase if some are better placed than others to take advantage of the new opportunities. By increasing trade with each other at the expense of other trading partners, the members of large trade blocs may be able to improve their terms of trade, and correspondingly worsen the terms of trade of the non-members, who may in turn be provoked to retaliate. The possible emergence of a world trading system dominated by three major trading blocs was viewed with apprehension by those who feared precisely this prospect of destructive trade wars, especially if two blocs were tempted to combine against the third.

#### *Source of Trade Conflicts*

The possibility of trade wars between large trade blocs is an example of the more general risk of increased trade conflicts generated by PTAs. Even bilateral PTAs may upset excluded economies who find themselves newly discriminated

against in the markets of neighbours or close trading partners. “Hub and spoke” patterns of PTAs may give rise to tensions between “hubs” vying for hegemonic influence and between “spokes” jockeying for favoured positions in the markets of the “spokes”. Unequal distribution of gains between “hubs” and “spokes” may also be a source of tension or conflict.

### *Trade Facilitation*

The coverage of PTAs in the Asia-Pacific region typically extends well beyond the liberalization of trade in goods and services. These modern PTAs often contain a range of trade facilitation provisions addressing issues such as customs procedures, standards and conformance, quarantine, government procurement and, increasingly, e-commerce. Some include provisions on anti-dumping, safeguards and countervailing measures. Many PTAs also contain provisions for liberalization of investment as well as provisions on “behind-the-border” issues such as competition policy, intellectual property, and harmonisation of business and tax laws. Some PTAs contain provisions on labour and environmental standards, and some also contain a range of sector-specific provisions. The term “closer economic partnership” (CEP) has become increasingly popular to describe agreements with such wide-ranging coverage. CEPs are often promoted on the grounds that they are “WTO-plus”, although even some very progressive CEPs may be “WTO-minus” in certain respects, most notably in the treatment of agriculture.

It has become well understood that in cases where formal trade barriers are relatively low improvements in trade facilitation can produce economic benefits at least as great as those from trade liberalization. Gains from trade facilitation in PTAs may thus partly or wholly offset any negative balance in the net effects from trade creation and trade diversion on the member economies, and trade facilitation is accordingly heavily emphasized in some modern Asia-Pacific CEPs. It is likely that the resulting benefits for members are indeed substantial. This does not however necessarily improve the position of non-members. By encouraging trade to flow among members trade facilitation measures in PTAs may in fact effectively discriminate against non-members, although the effect in this case is produced by genuine reductions in transactions costs rather than artificial creation of cost advantages through the granting of tariff preferences.

### *Rules of Origin*

Rules of origin are required in PTAs to prevent unwanted trade deflection and thereby ensure that preferences are available only to those for whom they are intended and to the extent intended. They are one of the most important parts of any PTA, but also one of the most under-emphasised. Rules of origin in PTAs among APEC economies range from the highly complex to the apparently very simple. Rules of origin serve a range of purposes besides assuring the integrity of the preferences under the RTA. At one end of the spectrum they can be designed to facilitate trade. At the other end of the spectrum they can have an explicitly

protectionist purpose, being designed to offset the reduction of protection for sensitive products that would otherwise occur as a result of the tariff reduction provisions of the PTA.

Compliance with rules of origin requirements involves costs for businesses that may well be significant. Although research on this point is sparse, one estimate puts the costs of complying with rules of origin at between three and five percent of the f.o.b. value of the exported goods.<sup>2</sup> Very complex rules of origin are especially likely to add to the compliance costs of business and increase the likelihood of costly disputes. The burden of compliance costs is likely to fall disproportionately heavily on small and medium-sized exporters. Rules of origin may also impose efficiency costs on the members of a PTA, though these effects are as yet poorly understood.

As PTAs proliferate, rules of origin in new PTAs may have the unintended effect of unravelling some of the integration achieved in existing PTAs. A manufacturer who previously freely used inputs from partner economies in an existing PTA may have to curtail the use of such inputs in order to comply with the rules of origin imposed in the PTA with the new partner. This may be of particular concern in the development of “hub and spoke” configurations where the “spokes” are already integrated through an existing PTA.

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<sup>2</sup> For a discussion of these and other research findings see Estevadeordal, A. and Suominen K., “Rules of Origin: A World Map”, paper presented at PECC/LAEBIA symposium on Regional Trade Arrangements in Comparative Perspective: Latin America and the Caribbean and the Asia-Pacific, Inter-American Development Bank, Washington DC, 23 April 2003 (available at PECC website: [http://www.pecc.org/trade/trade\\_washington.htm](http://www.pecc.org/trade/trade_washington.htm))

## A “Spaghetti Bowl” Problem?

The proliferation of PTAs raises a further separate set of concerns. As economies become involved in multiple RTAs the likelihood increases that there will be inconsistencies between the provisions of the different RTAs. Rules of origin are the most obvious and perhaps the most important potential source of these inconsistencies. The costs of complying with rules of origin, possibly already significant in a single PTA, are likely to escalate for exporters from economies that are involved in multiple PTAs, each with their own separate and mutually inconsistent rules of origin. Inconsistencies can also arise in other areas as well, such as standards and conformance, customs procedures and quarantine procedures.

Jagdish Bhagwati has suggested<sup>3</sup> that as individual economies become involved in a growing number of PTAs, a “spaghetti bowl” of inconsistent provisions will develop, imposing increased transactions costs on businesses involved in exporting and importing. The extent of these increased transaction costs is an empirical matter and no reliable estimates are yet available. In the APEC region economies that are already involved in multiple PTAs, such as Chile, Mexico and Singapore may prove to be useful “laboratories” for the investigation of this issue. Increasing transactions costs due to a “spaghetti bowl” effect would of course run directly counter to APEC’s trade facilitation objectives, as expressed originally

in the Bogor Declaration and more recently in the Shanghai Accord.

## Attractions of PTAs

The popularity of PTAs is clear evidence that governments perceive substantial advantages in them. The attractions of PTAs to governments may include some or all of the following:

- It is likely to be possible to proceed further and faster with a small group of trading partners than in the multilateral negotiations
- Political economy factors: the more readily identifiable increases in export opportunities arising from PTAs make them easier to “sell” politically.
- Agreements may be tailored to suit specific circumstances of the members.
- In contrast to APEC, PTAs allow the establishment of binding commitments through the negotiation of reciprocal concessions.
- PTAs may provide a context for discussing and resolving difficult bilateral trade and investment issues.
- PTAs can serve as “training grounds” for unilateral and multilateral liberalisation, where governments and business learn how to adapt to increased competition resulting from liberalisation.
- PTAs can contribute to economic development by providing vehicles for the production and delivery of regional public goods
- Negotiations and implementation of PTAs may be helpful in “locking in” economic reforms.
- Negotiation of PTAs can be linked to foreign policy and security objectives.

Less positively, governments may be attracted to PTAs by the opportunity to pursue liberalization with selected partners while excluding “sensitive” items that might have to be included in a multilateral negotiation.

Motivations for PTAs may also vary depending on whether the agreement is North-North, North-South, or South-South. An important motivation for North-North agreements may be to capture the dynamic gains potentially available from economies of scale and increased competition through intra-industry trade in technologically dynamic markets. Similar motivations may apply in North-South agreements, but North-South agreements are also much more likely to offer potential for the conventional gains from inter-industry trade based on differences in comparative advantage. Developing countries are also likely to pursue agreements with developed partners to safeguard vital export markets that they perceive to be vulnerable. South-South agreements may be pursued by developing countries as a way of developing potential export markets for value-added products in situations where they face difficulty in penetrating developed country markets for these products due to the well-known phenomena of peak tariffs and tariff escalation.

<sup>3</sup> See Bhagwati, J., Greenaway, D., and Panagariya, A., “Trading Preferentially: Theory and Policy” (*Economic Journal*, Vol 108, 1998, pp 1128-1148)



## Economic Effects of Alternative Approaches to Regional Trade Liberalization

The comparative analysis in this section of the various regional trade liberalization strategies being pursued by APEC economies draws on both economic logic and the weight of evidence of some forty empirical investigations based in computable general equilibrium (CGE) analysis.<sup>4</sup>

At the same time that they move toward increasing involvement in PTAs, APEC economies have consistently reiterated their commitment to APEC and the Bogor objectives. The wisdom of this stance is strongly supported by both economic logic and by the results of empirical investigations showing that APEC-wide liberalisation can in general deliver greater benefits to APEC members, both collectively and individually, than any of the other possible regional trading configurations open to APEC members. This conclusion holds whether APEC-wide liberalisation is pursued on a non-discriminatory basis in line with the concept of “open regionalism” or on a preferential basis, although these two modalities tend to have different implications for the impact on the rest of the world.

There is a convincing logic behind this result. Trade diversion will generally be less, the larger the proportion of the members’ trade flows covered by the free trade

arrangement. The APEC region typically accounts for 70% or more of APEC members’ trade flows, and includes within its borders the majority of their significant bilateral trade flows. This, together with the fact that APEC members comprise a cross-section of economies at different stages of development, makes it likely that the majority of APEC member economies’ imports affected by APEC-wide liberalisation will come from internationally-competitive suppliers. Trade facilitation undertaken at the APEC-wide level is also likely to yield greater benefits than facilitation initiatives among smaller groups of economies. Compared to preferential liberalisation among smaller groups of APEC economies, APEC-wide liberalization will both provide a greater stimulus to economic growth across the Asia-Pacific region and also ensure that all APEC economies have access on the best possible terms to the markets where the most dynamic growth is occurring.

Among the different configurations of preferential liberalization being pursued by APEC economies, bilateral PTAs between small and medium-sized economies generally cover relatively small trade flows, and not surprisingly tend to generate relatively small economic benefits to their members. At the same time the negative effects on non-members are also relatively small, although still sufficient in some cases to cause irritation among neighbours and other close trading partners.

Bilateral PTAs between small or medium-sized economies and large economies typically cover a relatively large share of the trade of the smaller partner, and a much smaller share of the trade of the larger partner. It again comes as no surprise therefore to find that empirical studies often indicate that the gains in economic welfare from the PTA, measured as a percentage of GDP, are relatively large for the smaller member while those for the larger member are relatively small. There can sometimes be significant negative effects on excluded economies that are neighbours or competitor of the smaller economy in the PTA. These negative effects can give rise to a form of “domino” effect, whereby the excluded economies are driven to seek their own PTA with the larger economy in order to neutralise the negative effects and secure economic gains for themselves. This “domino” effect can provide a powerful impetus to the formation of “hub and spoke” patterns of PTAs.

It is instructive however to compare the effects of a single PTA between a “hub” and “spoke” pair of economies with the effects when several “spokes” simultaneously secure PTAs with the same “hub”. A recent study<sup>5</sup> indicates that while the single PTA yields the expected result of relatively large gains for the “spoke” and small gains for the “hub”, the situation is reversed in the case of simultaneous “hub and spoke” PTAs. In this case the gains for the “hub” tend to be more significant while the gains for the

<sup>4</sup> “Summary of Results of CGE Analyses of Asia-Pacific RTAs”, appendix to “Asia-Pacific RTAs as Avenues to Achieving the Bogor Goals: Analysis and Ways Forward”, presented by PECC at APEC SOM Policy Dialogue on RTAs/FTAs, Khon Kaen, Thailand, 27 May 2003 (APEC Document: 2003/SOM II/RTAs/FTAs/012)

<sup>5</sup> Gilbert, J., “CGE Simulation of US Bilateral Free Trade Agreements”, background paper prepared for conference on Free Trade Agreements and US Trade Policy, Institute for International Economics, Washington DC, 7-8 May 2003.

“spokes” are much smaller than in the single PTA case. The addition of new “spokes” in a “hub and spoke” configuration thus tends to erode the economic advantages of the existing “spokes”. Analogously, studies tend to show that expansion of existing PTAs to include new members may in some cases erode the benefits that the existing members, particularly the smaller members, derived from the PTA.

Some analyses of the proposed “ASEAN Plus One” FTAs (ASEAN-China and ASEAN-Japan), nevertheless indicate substantial welfare gains for the ASEAN economies from these arrangements. These gains are generally less however than those that accrue to the ASEAN economies in an “ASEAN Plus Three” FTA. The “ASEAN Plus Three” FTA also has the advantage of yielding economic benefits to the two Northeast Asian economies that would suffer from being excluded from each “ASEAN Plus One” arrangement. Perhaps more surprisingly, some studies indicate that even the Northeast Asian partner in an “ASEAN Plus One” PTA would derive greater economic benefits from the “ASEAN Plus Three” configuration.

At the same time the economic losses of excluded economies are generally much higher in the case of these “ASEAN-plus” PTAs than in more limited PTA configurations. These losses are heavily concentrated on the economies that trade intensively with the members of the PTA, primarily other APEC economies. As the size of the PTA rises the size of the losses also rises while at the same time being concentrated on a progressively

smaller group of Asia-Pacific economies. The “ASEAN Plus Three” PTA, which of all the “ASEAN-Plus” combinations produces the largest economic gains for members, also produces the largest economic losses for the remaining western Pacific non-members, Australia, New Zealand and Chinese Taipei. Expansion of the “ASEAN Plus Three” PTA to include these economies would convert their economic losses into significant economic gains, while continuing to provide the same or larger benefits for the majority of the “ASEAN Plus Three” economies.

The main conclusions of this analysis are worth emphasising. PTAs among APEC members are likely to yield economic gains for their members, but are also likely to impose economic losses on non-members. A move to PTAs among larger groups of economies can increase the economic gains of members, but at the same time can impose larger economic losses on non-members. This tension can be resolved by the inclusive APEC-wide approach to liberalization, which delivers greater overall gains to APEC members while eliminating the losses imposed on excluded APEC economies by PTAs among smaller groups of their fellow APEC members.

By highlighting APEC-wide liberalization as the most beneficial approach to regional trade liberalization by APEC members, these results reaffirm the validity of the APEC objectives. They also indicate that bilateral and plurilateral PTAs among APEC members can benefit their members and that an initial proliferation of PTAs among APEC members can potentially

constitute a step towards realizing the benefits obtainable by achieving the APEC goals. Because they tend to impose economic losses on non-members however, these PTAs also however contain the seeds of trade tensions and conflicts. The potential for such tension and conflict may be increased by some of the possible intermediate steps towards APEC-wide liberalization, that involve the creation of PTAs among larger groups of APEC members.

The recent proliferation of PTAs among APEC members, and the attractions that PTAs are likely to hold for individual APEC members, thus do not invalidate the APEC Bogor goals as the desirable and appropriate objective for APEC members. There are however clearly serious questions to be addressed as to how APEC members can be expected to make the transition from an initial proliferation of PTAs to the eventual achievement of the APEC Bogor goals. This question is analogous to the much-discussed question of how preferential liberalization affects the prospects for multilateral liberalization, which has spawned a large literature on the issue of whether PTAs are “stumbling blocks” or “building blocks” to the achievement of global free trade. To anticipate the conclusion of the following sections, the answer to the question in relation to APEC goals is the same as the answer in relation to global free trade, that PTAs can be “building blocks” provided appropriate conditions are met. The crucial task is to identify and then to fulfil those conditions.

## “Building Blocks” or “Stumbling Blocks” for the Achievement of APEC Objectives?

### *From Proliferating PTAs to APEC-wide Free Trade: Possible Routes*

There are four main routes that could lead from a proliferation of PTAs to eventual APEC-wide or global free trade, none of them mutually exclusive:

- Creation of a comprehensive “web” of bilateral PTAs covering all pairwise relationships. While some APEC economies, such as Chile, Mexico and Singapore appear to have a strategy of concluding PTAs with all their significant trading partners, it is to be doubted whether this is a realistic or efficient route towards free trade at the region-wide or global level. Peter Lloyd points out that to achieve the equivalent of multilateral free trade via bilateral PTAs in a world of  $n$  countries would require  $[n(n-1)/2]$  bilateral PTAs.<sup>6</sup> Thus to achieve free trade among the 21 APEC members would require 210 bilateral PTAs. To achieve free trade in a world of 200 economies would require 19,900 bilaterals. It is hard to believe that this would be a feasible way to proceed, nor is it likely to be efficient, especially if there are many inconsistencies among the provisions of the multiple PTAs.

- Gradual expansion of existing PTAs offers in some ways a more practical and efficient way to proceed, since as Lloyd points out adding a new member to an existing PTA is equivalent to establishing separate bilateral PTAs between the new member and each member of

the existing PTA. This allows for much greater economy in the number of PTAs required and also reduces though it does not eliminate the likely incidence of inconsistent provisions among the various PTAs.

- Amalgamation or convergence of existing PTAs will have to occur in a world of multiple PTAs, if the transition is to be eventually made from these multiple PTAs to APEC-wide or global free trade.

- MFN liberalisation on either a multilateral or unilateral basis, proceeding in parallel with PTA liberalisation but at a slower pace will eventually see all existing PTAs converge on APEC-wide or global free trade, even if the PTAs themselves do not converge.

It is therefore important to establish how far each of these routes can be relied upon. It will be apparent that each of the first three routes faces significant difficulties. This of course only serves to highlight the importance of parallel MFN liberalisation as the guarantee that the ultimate objective will eventually be reached, regardless of what happens within the PTA processes, and the crucial importance also of the question as to whether the PTA process can be expected to have positive or negative effects on MFN liberalisation at the multilateral and unilateral levels, as well on the achievement of the Bogor goals.

### *Incentives for Proliferation, Expansion or Amalgamation of PTAs: Competitive Liberalisation*

A concept that has recently become popular is that of “competitive

liberalisation”.<sup>7</sup> According to this concept the establishment of new PTAs, particularly by a major economic power, creates incentives for other countries to seek PTAs of their own, including with the major economic power, either by establishing new PTAs or obtaining membership of existing PTAs. One possible explanation is the “domino effect” identified by Baldwin, whereby the establishment of a new trading bloc, or a significant advance in integration within an existing bloc, creates incentives for non-members to seek membership of the bloc, in order to capture the benefits of bloc membership and to avoid the costs of being excluded from the bloc. A similar motivation could lead members of separate PTAs to seek their amalgamation into a single PTA. In another possible variant of the “domino effect”, economies react to the success of their competitors in securing a PTA with one of the major economies by seeking a PTA of their own with the same major partner. The motivation for doing so is to defend their markets in the major trading partner from discrimination arising from PTAs with that partner secured by their competitors.

“Competitive liberalisation” thus explicitly seeks to exploit the negative effects of PTAs, by using them to place pressure on other economies to enter into the preferential liberalisation arena, and in the process to create additional pressure for multilateral liberalisation.

If this effect is important it would be expected that more and more

<sup>6</sup> Lloyd, P., “New Regionalism and New Bilateralism in the Asia Pacific”, presented at PECC Trade Forum meeting, Lima, May 2002, available at PECC website: [http://www.pecc.org/trade\\_lima.htm](http://www.pecc.org/trade_lima.htm)

<sup>7</sup> See for example Bergsten, C. Fred, “A Renaissance for U.S. Trade Policy?” (*Foreign Affairs*, Vol 81, No. 6, November/December 2002, pp 86-98)

economies would be seeking PTAs with a large trading partner such as the United States that has shown itself open to the establishment of new PTAs, and this does indeed appear to be occurring in the Asia-Pacific region. The results of empirical analyses noted earlier suggest that the “domino” effect is likely to be quite strong in such cases. Proposed amalgamations of existing PTAs could also begin to emerge, such as the proposal to merge AFTA and CER into a single PTA. There has been little sign to date of APEC economies seeking to join existing PTAs, perhaps with the exception of Chile’s unsuccessful attempt to join NAFTA in the mid-1990s, but there is little doubt that if an East Asian FTA were to be formed by the “ASEAN Plus Three” group, other western Pacific economies such as Chinese Taipei, Australia and New Zealand would be very anxious to join this FTA if possible.

Competitive liberalisation does therefore put pressure on economies excluded from particular PTA developments to seek PTA arrangements of their own. It is less clear that the same incentive exists for the incumbents to admit new members. Andriamananjara has pointed out that for the existing members of a PTA there are two opposing factors affecting their incentive to admit new members.<sup>8</sup> On the one hand they benefit from the expansion of the size of the market when new members are admitted. On the other hand the entry of new members also affects them negatively by diluting their preferences in the PTA market, a point also highlighted in empirical analyses. Andriamananjara’s

analysis shows that the market expansion effect tends to dominate in the early stages of the expansion of the PTA, but that eventually the preference dilution effect will take over, so that the incentive to expand the PTA peters out well before global free trade (or perhaps even APEC-wide free trade) is achieved. This is especially likely to be the case if the economies remaining to join in the latter stages of the process are small and thus offer little benefit to the existing members by way of market expansion.

In the western Pacific one notes the opposition of some ASEAN members to the amalgamation of AFTA and CER into a single PTA, and to possible Australian and New Zealand membership of an East Asian PTA, although this opposition may be based more on political than economic grounds. This latter example illustrates the point that in addition to economic incentive effects there may also be significant political obstacles to the expansion, amalgamation or convergence of PTAs, and these obstacles may be difficult to overcome. Furthermore the process of PTA proliferation itself may create divisions and conflicts that add to these obstacles.

In the case where “competitive liberalisation” operates by way of a major economic “hub” such as the United States negotiating separate bilateral PTAs with individual partners, the structure of incentives is somewhat different. On the basis of an overall economic welfare calculus the “hub” ought to have an incentive to conclude PTAs with all its significant trading partners. On the other hand special interest groups in sensitive sectors will

oppose each new PTA, especially in cases where several prospective partners are potentially competitive exporters within the PTA of the same sensitive products. For the incumbents who initially secure PTAs with the major partner however the conclusion by that partner of new PTAs with additional partners is likely to have unambiguously negative effects, since the new PTAs do not provide them with any additional market access but do dilute their preferences in the market of the major partner. These incumbents will thus have an incentive at the very least not to encourage the negotiation by the “hub” of new PTAs with their competitors, and may well have an incentive to actively obstruct such developments. There are again apparent examples of this behaviour in the Asia-Pacific region.

#### *Effects of RTAs on the Incentives for Multilateral Liberalisation*

Economic analysis has not come to definite conclusions on whether RTAs increase or decrease the incentives for multilateral liberalisation. In part the answer depends on whether the incentives are viewed from the perspective of the community as a whole, or from the perspective of the profits of domestic firms. If PTAs produce a lower level of overall economic welfare than multilateral liberalisation, then the community in at least one potential PTA member is likely to have an incentive to prefer multilateral liberalisation and thus reject the PTA option. On other hand trade diversionary PTAs may yield very sizeable economic rents to some domestic firms, even if their

<sup>8</sup> Andriamananjara, S., “On the Relationship Between Preferential Trading Arrangements and the Multilateral Trading System”, presented at PECC Trade Forum meeting, Washington DC, April 2003, available at PECC website; [http://www.pecc.org/trade/trade\\_washington.htm](http://www.pecc.org/trade/trade_washington.htm).



overall economic welfare effect is negative, and these rents may be larger, the greater is the trade diversionary effect of the PTA. Once the PTA is in place these firms are likely to have an incentive to resist any multilateral liberalisation that would dilute their preferences and thus reduce their economic rents. PTAs may also provide an additional rallying point for opponents of trade liberalisation and globalisation, thus indirectly boosting the forces ranged against multilateral liberalisation.

On the other hand there have been clear cases in the APEC region, for example the CER example of Australia and New Zealand, where a PTA has helped to attune the business community to the requirement of adjusting to a liberalising trade environment, and in so doing has helped to pave the way for extensive subsequent MFN liberalisation, in the case of Australia and New Zealand on a unilateral basis.

It has also been argued by advocates of “competitive liberalisation” that the emergence or threatened emergence of significant PTAs may increase the pressure on economies elsewhere to participate effectively in the multilateral negotiations. For example it was argued by Fred Bergsten<sup>9</sup> - and denied by Jagdish Bhagwati<sup>10</sup> - that the potential emergence of APEC as a serious liberalising force was instrumental in persuading the EU that it needed to move constructively towards the successful conclusion of the Uruguay Round. This argument has been inconclusive.

One little-discussed potential way that proliferation of PTAs may inhibit multilateral liberalisation is by encouraging economies to retain trade barriers as “bargaining chips”. Economies that have eliminated all barriers on goods and services trade may hold little attraction as potential RTA partners, since they are unable to offer any significant preferences. If PTAs come to be perceived as the principal liberalisation modality, economies that might otherwise have considered unilateral liberalisation may feel impelled to retain some trade barriers in order to preserve scope for bargaining with prospective RTA partners.

One concern that is frequently expressed is that PTA negotiations absorb large quantities of scarce negotiating resources in trade bureaucracies, as well as using up scarce political capital in many cases. The focusing of substantial negotiating resources and deployment of political capital in the pursuit of PTAs may leave some economies in a weak position to play their full part in the multilateral process, which may suffer accordingly.

Another possible issue relates to the apparent intention of some APEC economies, notably Chile, Mexico and Singapore to negotiate PTAs with all their significant trading partners. There could be some concern that once an economy has been successful in this objective it may have little remaining incentive to participate actively in WTO negotiations. On the other hand, it is likely that there will remain trade issues of vital interest to these economies that can best be

pursued, or in some cases can only be pursued through the WTO, and this may ensure their continuing commitment to engagement with the multilateral process.

#### *Treatment of “Sensitive” Sectors*

There has been extensive debate over whether it is legitimate to exclude “sensitive” sectors from RTAs. The debate is typically conducted in terms of whether such exclusion is compatible with the relevant provisions of GATT Article XXIV. Economic analysis shows that exclusion of “sensitive” sectors may have negative or positive effects on economic welfare, depending on whether the sector is uncompetitive in only one partner, in which case the exclusion limits trade creation gains, or in both partners, in which case the exclusion reduces the losses from trade diversion.

From the perspective of the “building block versus stumbling block” debate the underlying question is whether exclusion of “sensitive” sectors is or is not helpful to the cause of multilateral, or in the present case APEC-wide liberalization. The danger is that the ability to exclude “sensitive” sectors from PTAs may lead economies with significant “sensitive” sectors to increasingly prefer preferential liberalization over multilateral liberalization.

#### *Inconsistencies Between RTA “Models”*

The evolution of multiple “hub and spoke” configurations is likely to

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<sup>9</sup> Bergsten, C. Fred., “Sunrise in Seattle” (*International Economic Insights*, Vol 5, No. 1, January/February 1994)

<sup>10</sup> Bhagwati, J., “Dissent at APEC Meeting Cannot be Ignored” (Letters to the Editor, *Financial Times*, 6 December 1996)

result in competition between different PTA “models” favoured by the respective “hubs”. Distinctive E.U. and U.S. “models” can already be observed, and distinctive Japanese, Chinese and Korean “models” may also emerge. Differences between the U.S. and E.U. models can be found on issues where the U.S. and E.U. are competing to have their approaches accepted within the multilateral trading system, and inclusion of these approaches in their respective RTAs is bound to reflect this “competition”. The most obvious differences relate to rules of origin, but differences can also be observed on many other issues as well, including contentious areas such as environmental and labour standards.

The possibility of convergence of the “models” is likely to depend on whether convergence on the issues in question is achieved within the multilateral process. Development of clusters of PTAs based on inconsistent and perhaps irreconcilable “models” may inhibit convergence.

The propagation of “models” containing features that may not be acceptable at the multilateral level is not likely to be a positive development for the multilateral trading system. It also becomes important to identify whether there are any undesirable features in these “models”, viewed in the light of the intention that these PTAs should be “building blocks” for eventual APEC-wide and global free trade. Restrictive and highly complex rules of origin, such as the “NAFTA type rules” appearing in PTAs negotiated by the U.S. clearly fall into the category of undesirable features. Other potentially controversial features, including the treatment of sensitive sectors and provisions on labour and

environment need to be reviewed from the same perspective.

#### *WTO-Consistency*

Economies announcing new PTAs routinely emphasise that the new agreement will be WTO-consistent. It is of course important that PTAs should be WTO-consistent, but it is also important to recognise that WTO disciplines on PTAs, while not wholly lacking in effect, are relatively weak, due to the well-known imprecision and ambiguity of GATT Article XXIV in particular and GATS Article V, and the inability of WTO members to reach agreement on the interpretation of these articles. As a result there is no universally accepted definition of a number of important provisions in the Articles, including but by no means limited to the interpretation of the requirement that PTAs should cover “substantially all trade” between the parties. As a result the WTO’s Committee on Regional Trade Agreements (CRTA) has failed to reach consensus on the WTO-compatibility of all but one of the over 100 PTAs that have been referred to it for examination, and is unlikely to reach consensus on any further PTAs in the near future. The effect is that members are in practice left free within quite a large range to unilaterally adopt their own interpretations of the disputed provisions.

This is not quite to say that “anything goes” in relation to WTO-consistency of PTAs. Some common understandings on the meaning of parts of GATT Article XXIV and GATS Article V do exist, and have the effect of ruling out some modes of dealing with PTA issues. For example non-reciprocal PTAs involving developed economies are ruled out. This counts against the suggestion of the APEC

EPG that APEC members of PTAs should consider extending to other APEC members on a voluntary basis the same preferences that they provide to their partners within the PTA. Arrangements involving developed economies for the granting of partial preferences are also ruled out, except for schemes like GSP that are available to all developing economies, and consequently fit criteria set out in the Enabling Clause.

Clarification and improvement of the WTO rules on trade would certainly be desirable and this question is on the negotiating agenda for the Doha Development Agenda. Prospects for significant change are not however encouraging.

In the present context the basic drawback of the WTO rules on RTAs is that they do not require economies participating in PTAs to take actions that would assist in ensuring that PTAs among APEC members contribute to the achievement of the Bogor goals. For example they do not require adoption of an inclusive approach that would ensure that all APEC economies eventually enjoy the benefit of the concessions negotiated under the PTAs, nor do they require that PTA members take steps to limit trade and investment diversion, for example by continuing to lower their MFN trade barriers in parallel to the preferential removal of barrier within a PTA. Nor do they require that steps be taken to minimise potential “spaghetti bowl” problems or to avoid the use of unnecessarily restrictive rules of origin.

#### *Political Considerations*

Some of the larger prospective PTAs face well-known political obstacles to their achievement. It may not be an exaggeration to say that some of

the most economically beneficial PTAs may be the most difficult to achieve in political terms. Less beneficial PTAs may be pursued because they are politically easier to achieve, and this could contribute to the emergence of divisions among economies that may be difficult to bridge.

#### *Conclusion: The Route to Bogor via PTAs is not Automatic*

The foregoing discussion does not provide a conclusive answer to the question of whether PTAs are “building blocks” or “stumbling blocks” to the achievement of APEC’s Bogor goals. It shows however that there are many ways in which the uncoordinated spread of PTAs by APEC economies may result in their falling short of the APEC objectives. Deliberate coordinated action is likely to be needed to ensure that proliferation of RTAs contributes to a liberalization process that will ultimately embrace the entire Asia-Pacific region. This has led to the suggestion that APEC member economies should adopt and implement a “common understanding” on RTAs in the APEC region. The purpose of the “common understanding” would be to ensure that RTAs among APEC members serve as “building blocks” rather than “stumbling blocks” for the achievement of APEC’s Bogor goals.

### **Guidelines for PTAs as “Building Blocks” for Achievement of the Bogor Goals**

Suggestions have been made that PTAs should be accommodated within the APEC framework by

treating them as “Pathfinder” initiatives. The common understanding of “Pathfinders” is that they are initiatives to which all APEC economies have agreed, but which will initially be implemented by only a subset of APEC members, with other members joining the initiatives at a later date. Clearly individual PTAs do not fit these criteria, unless they include an effective “open accession” clause. Nevertheless it is useful to think of PTAs in the spirit of the “Pathfinder” concept, as if the array of PTAs entered into by APEC economies constitute a form of collective “Pathfinder” initiative. Since “Pathfinder” initiatives must by definition be consistent with APEC objectives and principles, this provides a straightforward starting point for establishing and applying guidelines based on the requirement that PTAs between APEC members should also be consistent with these same objectives and principles. The guidelines might constitute an APEC “common understanding” on RTAs.

In the following section, the suggested guidelines are highlighted in italics, with explanations in plain text.

### **Relation to the “Pathfinder” Concept**

*While preferential trading arrangements (PTAs) may not meet the formal criteria for “Pathfinder” initiatives, the array of PTAs in which APEC economies have engaged may usefully be viewed in the spirit of the “Pathfinder” concept. This implies that they should be fully consistent with APEC objectives and principles. It also implies that participation in the network of PTAs being developed within the APEC region should, over time, become open to all APEC economies.*

### **Conformity with APEC Liberalization Objectives**

#### *Commitment to the Bogor Goals*

*It is important that APEC members engaging in PTAs re-affirm that they remain committed to the Bogor goals and that pursuit of PTAs does not detract from that commitment. It should be acknowledged that this means that the liberalisation and facilitation provisions of PTAs between APEC members must be extended to all APEC economies by the Bogor target dates.*

#### *Timetable*

*The timetable for liberalisation within PTAs between APEC members should be consistent with the Bogor dates i.e. it should not extend beyond 2010 in PTAs involving developed APEC economies and beyond 2020 in other PTAs.*

#### *MFN Liberalisation*

Progressive MFN liberalisation in parallel with liberalisation within PTAs provides the ultimate assurance that the negative effects of preferential liberalisation will be minimised and that the ultimate goal of APEC-wide or even global free trade will be attained.

*It is important that MFN liberalization should proceed in parallel with PTAs being implemented by APEC members. This will assist in minimising negative effects of PTAs and will provide assurance that the Bogor goals will ultimately be reached. In order to minimise negative effects of PTAs it is important that all MFN barriers be reduced to moderate levels as soon as possible, thereby limiting margins of preference in*



*PTAs and so reducing the scope for trade diversion. Elimination of peak tariffs and tariff escalation must be a priority.*

## **Conformity with APEC Principles in the Osaka Action Agenda**

### *Non-Discrimination*

PTAs are by nature discriminatory. Nevertheless if the array of PTAs entered into by APEC members is treated as a form of “collective Pathfinder”, as suggested above, a basis for applying the non-discrimination principle becomes evident. This would take the form of a credible commitment that the concessions provided within the PTAs will eventually be available to all APEC members. There are three ways in which this may be done:

- Multilateralisation, on an MFN basis, of the preferential concessions provided within each PTA. This provides a direct link between PTAs and the Bogor goals, since achievement of the Bogor goals effectively implies multilateralisation of the liberalisation commitments undertaken by APEC members within PTAs. Multilateralisation is thus the “first best” approach to applying the non-discrimination principle to PTAs between APEC members. Confidence that APEC members are serious in their intention to use PTAs as “building blocks” towards the achievement of Bogor goals will be strengthened by a credible up-front commitment on the part of APEC members to eventually multilateralise the concessions that they make to PTA partners. It is suggested that APEC members give consideration to the

form that such a commitment might take. The experience of PTAs where partial or full multilateralisation has already taken place, such as AFTA and CER, may provide useful guidance.

- Inclusion in each PTA of an “open accession” clause, providing for the automatic acceptance of a membership application from any economy willing to join the PTA on the same terms and conditions. While this is an attractive notion in principle it is clear that it will be a difficult one to operationalise. The terms and conditions of bilateral PTAs tend to contain at least some provisions that are specific to relations between the two partners, and that would not be easy to apply to the relationship with the new partner. Certain conditions that are acceptable in an agreement with one partner may not be acceptable in an agreement with a different partner, with whom there may be a different balance of strengths and weaknesses, and advantages and disadvantages.

More pessimistically the PTA option may in some cases be chosen precisely because the benefits of the PTA do not have to be extended to other parties, particularly those with strengths in sectors considered sensitive by the original members.

- A credible commitment that no APEC member will be permanently excluded from the pattern of PTAs being developed in the region.

*In line with the APEC principle of non-discrimination, credible assurances should be given that the concessions provided within the PTAs between APEC members will be made available to all APEC members as soon as circumstances allow, and no later than the Bogor target dates, by one of the three*

*following means:*

- *a credible up-front commitment on the part of APEC members to eventually multilateralise the concessions that they make to PTA partners.*

- *inclusion in each PTA of an “open accession” clause, providing for the automatic acceptance of a membership application from any economy willing to join the PTA on the same terms and conditions.*

- *a credible form of commitment to inclusiveness, whereby each member demonstrates preparedness to entertain the possibility of a PTA relationship with every other member, whether through negotiation of a bilateral PTA or through membership of a larger PTA grouping, and that no APEC member will be permanently excluded from larger PTA groupings that may develop among APEC economies.*

The requirement that no APEC member should be permanently excluded is also consistent with the logic of “competitive liberalisation”, which requires that “hubs” should be prepared to negotiate PTAs with all prospective partners that display a desire and readiness to do so and are prepared to conclude agreements on acceptable terms and conditions. Permanent exclusion of some potential partners would also contradict one of the fundamental purposes of the WTO’s non-discrimination principle and one of the most basic arguments for WTO membership, namely that it ensures that small economies cannot be discriminated against by large economies for reasons that have nothing to do with trade.



## WTO-Consistency

*In line with the APEC principle of WTO-consistency, PTAs between APEC members should be fully consistent with GATT Article XXIV and GATS Article V. It must be recognised that this is a necessary but not a sufficient condition for ensuring that these PTAs contribute to the achievement of APEC objectives.*

## Comprehensiveness and Flexibility

*In line with the APEC principles of comprehensiveness and flexibility, PTAs among APEC members should cover trade in both goods and services, and should also cover all sectors, with sensitive sectors being liberalised on a slower timetable with due regard to the sensitivities of member economies.*

Provision of a slower timetable for liberalisation of sensitive sectors is to be preferred to the alternative of excluding them.

## Transparency

Transparency in PTAs among APEC members is essential if confidence is to be maintained that they will serve as “building blocks” towards achievement of the Bogor goals. There is merit in the suggestion that a review process similar to the TPRM should be introduced in the WTO for PTAs, and APEC members should consider promoting this suggestion.

In the meantime, in the interests of transparency, APEC members should institute their own process of peer review of PTAs involving APEC members. To be fully effective, peer review should occur before the PTAs are finally

concluded. It is also important that provision be made for the inclusion of PTAs in the IAPs of APEC members. This would formally bring PTAs within the scope of the IAP peer review process.

Also in the interests of transparency, the texts of PTAs should be made publicly available as soon as possible after agreements are concluded. APEC members might also consider following the example of Canada, in releasing the negotiating texts of PTAs into the public domain, thereby facilitating meaningful input by business and civil society into the negotiating process.

*In line with the APEC principle of transparency, APEC members should institute their own process of peer review of PTAs involving APEC members. To be fully effective, peer review should occur before the PTAs are finally concluded. It is also important that provision be made for the inclusion of PTAs in the IAPs of APEC members. Also in the interests of transparency, the texts of PTAs should be made publicly available as soon as possible after agreements are concluded.*

## Cooperation

*In line with the APEC principle of cooperation, peer reviews of PTAs involving APEC members should provide an opportunity for discussion of any problems that the PTAs being reviewed may be causing for other APEC members, and of ways of resolving those problems.*

## Consistency with other APEC Principles

*Where relevant, provisions in PTAs among APEC members should be linked to the specific sets of*

*Principles that APEC members have adopted such as the Principles on Competition and Regulatory Reform, the Non-Binding Investment Principles, the Principles on Government Procurement, and the Principles on Trade Facilitation.*

## Promoting Convergence and Minimising “Spaghetti Bowl” Problems

### Rules of Origin

Rules of origin are a crucial factor in determining the overall liberalising effect of a PTA. They also give rise to significant transactions costs and are a prime source of potential “spaghetti bowl” problems for economies with membership in multiple PTAs.

*Rules of origin are not an appropriate mechanism for protecting “sensitive sectors” or for facilitating adjustment to liberalisation. Complex rules with protectionist purposes should be avoided. Ideally rules of origin should as far as possible be neutral in their impacts on trade flows. Rules of origin should be as straightforward as possible, and should be transparent, clear and consistent, and should not impose unnecessary compliance costs. It is important to allow full cumulation in PTAs with multiple members. The development by APEC members of “best practice guidelines” for preferential rules of origin would be a very useful contribution.*

### Facilitation Measures

The adoption of common provisions across APEC RTAs is one way of potentially minimising “spaghetti bowl” problems and facilitating the eventual convergence or

amalgamation of PTAs. Some provisions are likely to be much easier to harmonise than others. Facilitation measures should be among those that are easier to harmonise, and harmonisation of facilitation measures should have a substantial pay-off in terms of reduced transaction costs.

Harmonisation of certain facilitation provisions across PTAs in the APEC region would create the potential for these provisions to become in effect a single arrangement across all economies involved in the PTAs. This could assist in promoting eventual convergence of PTAs. It could also open the possibility that such arrangements might become APEC-wide in scope, by encouraging the participation of all APEC member economies.<sup>11</sup> This is a promising avenue that warrants further exploration.

Harmonisation may be assisted by the development of “best practice” guidelines for each type of provision typically found in PTAs. APEC-wide trade and investment facilitation can also be encouraged by the adoption wherever possible of international standards and APEC-wide agreements and processes, including mutual recognition agreements.

*Adoption of harmonised provisions across PTAs in the APEC region should be encouraged, especially for provisions on trade and investment facilitation. Use should be made wherever possible of international standards and APEC-wide agreements and processes, including mutual recognition agreements.*

*Exploration should be undertaken of the potential for harmonisation of facilitation provisions across PTAs to contribute to APEC objectives by opening the way for APEC-wide application of the provisions in question and by assisting eventual convergence of PTAs.*

*Consideration should be given to the development of “best practice” guidelines for each type of provision typically found in PTAs.*

### **“Best Practice” Guidelines for PTA Liberalisation**

*APEC members should endeavour to ensure that the liberalisation of both goods and services within PTAs is progressive and automatic.*

*In the case of services trade, binding of the status quo should be regarded as acceptable. Where liberalisation is undertaken, MFN liberalisation should be regarded as the norm, especially in key infrastructure sectors. APEC members should not insist on preferential liberalisation by their PTA partners in these key sectors. To facilitate liberalisation of trade in services, relevant domestic regulations should be subject to a necessity test, and should be applied in the least trade restrictive manner possible.*

*In cases where liberalisation cannot commence immediately “negative lists” should be employed, with provision for regular reviews aimed at removing all remaining trade restrictions. This should apply to both goods and services trade, including “sensitive sectors”. The “negative lists” should be subject to “sunset clauses” and there should be no permanent exclusions.*

## **Development Dimension**

APEC members should carry over into their PTAs and CEPs their recognition that trade and investment liberalisation and facilitation must be accompanied by capacity building for developing economies in order for the full benefits to be realised.

*PTAs and Closer Economic Partnerships (CEPs) between APEC economies should allow for assistance in capacity building to be provided to developing economy members by their developed economy partners. The potential for CEPs to serve as vehicles for the provision of regional public goods should be recognised and exploited.*

<sup>11</sup> see for example Elek, A., “Pathfinder Initiatives and APEC Guiding Principles for Facilitation”, presented at PECC Trade Forum meeting, Phuket, Thailand, May 2003, available at [www.pecc.net](http://www.pecc.net)