



RTA TRENDS IN THE APEC REGION

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A number of new proposals have proliferated at a rapid pace in the APEC region over the last two and a half years. Many were proposed prior to the failure of the WTO Ministerial Meetings in Seattle to achieve results. Therefore, there are fundamental trends that need to be understood and analyzed. This paper aims to review the new proposals for preferential trade arrangements in the region. It is then followed by an assessment of the main patterns that can be discerned from these developments.

NEW PROPOSALS FOR PREFERENTIAL TRADE ARRANGEMENTS (PTA) IN THE REGION

At the time of writing, the number of new proposals is approaching thirty, and new initiatives continue to be brought forward. The following is a brief summary of how proposals for new preferential trade arrangements have developed in the region since late 1998.

A dramatic early step was the decision by Japan and Korea to study the implications of a free trade area (FTA) between the two countries as part of a wider program of deepening economic ties. This initiative resulted from meetings during the October 1998 visit to Japan of Korean President Kim Dae Jung, and received further impetus from the proposal for a 'Japan-Korea Economic Agenda 21' put forward during the March 1999 visit to Korea by then Prime Minister Keizo Obuchi of Japan. The Institute for Developing Economies and the Korean Institute for International Economic Policy published the results of the study in May 2000. Korea has suggested that it might be preferable to include China in any such arrangement, and there have been unconfirmed reports that less formal studies are also under way on this possibility.

At the time of the APEC Economic Leaders' Meeting in Auckland in September 1999, announcements were made regarding proposals for negotiations or studies on FTAs between the following APEC members:

- *Singapore and Japan*: initial study and discussion followed by formal negotiations aimed at concluding a free trade agreement by December 2001, to come into effect

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during 2002. The second of three planned rounds of negotiations has just been completed.

- *Singapore and Chile*: announcement of exploratory talks on a possible FTA.
- *Singapore and New Zealand*: agreement concluded in November 2000.
- *Korea and Chile*: first round of negotiations held as early as April 1999. Negotiations recently reported to be on the verge of breakdown over sensitivities in relation to agricultural trade.
- *Japan and Mexico*: study released in April 2000 called for establishment of a FTA. Japan declined a Mexican request to begin negotiations during 2000, citing concerns over Mexican agricultural exports, and indicating an initial preference for a bilateral investment agreement.

Proposals were also circulating informally for a so-called “P5” (Pacific Five) FTA between the United States, Australia, Singapore, Chile and New Zealand around the time of the Auckland APEC Leaders Meeting. While this proposal never reached the stage of formal discussions, it is known that some prospective participants remain interested in taking it further.

Other developments in 1999 include an attempt to revive an earlier proposal for a FTA between Chile and New Zealand, and the announcement by the Korean and New Zealand governments of a joint study into a FTA between the two countries. In the early part of 2000, the governments of Korea and Australia made a similar announcement. Discussion on a Korea-Singapore FTA has also been reported.

Furthermore, subsequent to the APEC Economic Leaders’ Meeting in Auckland, a number of proposals has emerged for FTAs between:

- *Japan and Canada*: after the idea was originally raised during 1999, studies were commissioned by Japan’s MITI and by Canada-Japan business groups.
- *Japan and Chile*: reports during 2001 indicated that analysis of a possible FTA is continuing.
- *Korea and Mexico*: possible FTA discussed in March 2000 and again at the November 2000 APEC leaders’ meeting in Brunei, where an investment guarantee treaty was signed.
- *Singapore and Mexico*: negotiations began in June 2000 and the two countries issued a joint declaration at the November 2000 APEC leaders’ meeting.
- *Singapore and Canada*: agreement to begin talks reached in June 2000.

Discussions have also been proceeding on further development of the linkage between the ASEAN Free Trade Area (AFTA) and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA, usually shortened to CER). The AFTA-CER linkage has hitherto focused on facilitation measures and information exchanges but some participants on both sides of these discussions have expressed clear interest in elevating this linkage to the status of a full FTA arrangement. A high-level task force produced a report entitled the “Angkor Agenda” in October 2000 outlining recommendations for proceeding with AFTA-CER arrangements. Under pressure



from Malaysia, ASEAN ministers at that time declined to consider the possible elimination of tariffs between the two groups.

The APEC Economic Leaders' meeting in November 2000 was the focus of still further announcements. Perhaps the most dramatic was the announcement that study would begin on a free trade area between the United States and Singapore, marking the first time the United States has officially engaged in the new trend towards bilateral arrangements in the region. The Prime Minister of Singapore, Goh Chok Tong, forcefully put forward the view that new trans-Pacific bilateral developments represent a fresh concept in regional integration, which he dubbed "Cross Regional Free Trade Areas" (CRFTAs). He argued that in present circumstances, CRFTAs offer the best defense against the evolution of a "three-bloc world".

Other proposals for bilateral arrangements also surfaced at this time, including Australia-Singapore and New Zealand-Hong Kong, with some suggestions also of a possible New Zealand-Chinese Taipei link. Informal discussions apparently also took place on possible reduced-form variations on the P5 formula, involving some combination of Australia, Chile, New Zealand and Singapore. Just before the APEC leaders' meeting, the New Zealand-Singapore Closer Economic Partnership Agreement was signed by their Prime Ministers, marking the first of the new initiatives to reach the stage of formal agreement.

A significant trend is that there have also been further developments in East Asia. In November 2000, Premier Zhu Rongji is known to have suggested a FTA between China and ASEAN. An ASEAN-China Expert Group on Economic Co-operation is now undertaking a study on this possibility. At the "ASEAN plus three" summit, also in November 2000, a study on a possible East Asia-wide free trade area was commissioned. More recently still, there were unconfirmed reports of a new expert group being created to consider prospects of a Japan-ASEAN FTA.

More recently, an independent study was recently published on a possible US-Korea FTA, and rumors have begun to circulate about proposals for an US-Japan FTA. In December 2000 came an announcement that discussions would reopen on a possible free trade area between Chile and the United States. Australia is reported to have called for negotiations on a bilateral free trade agreement with the United States and there have been reports of discussions of a possible Australia-Thailand free trade arrangement.

These developments appear to mark the end of the brief period following the Bogor Declaration in November 1994, in which the APEC region sharply differentiated itself from the rest of the world in its approach to regional economic integration.

In the rest of the world preferential liberalization arrangements actually proliferated since the early and throughout the 1990s. The WTO (1998) records that the number of notified regional trading agreements (RTAs) increased from 77 in 1990 to 162 in mid-1998, with an average of 11 new agreements notified annually since 1992. The rate of



notification of new RTAs increased rather than decreased in the mid-1990s, after the creation of the WTO. If the figures are adjusted for RTAs that have since gone out of existence, the number of notified agreements remaining in force grew from 42 in 1991 to 87 in 1998. Parallel to the increase in notified RTAs there was also an acceleration in the rate of establishment of non-notified agreements. WTO figures indicate 18 non-notified RTAs in 1990, rising to 58 by 1998. Once again the pace of establishment of new non-notified agreements appeared to accelerate in the mid-1990s. A newer survey in 2000 by WTO (2000) counted a total of 172 RTAs currently in force with a further 68 under negotiation.

The APEC region stood apart from these trends in the mid-1990s. Three preferential trading agreements already existed in the APEC region at the time of the Bogor Declaration, namely the North American Free Trade Agreement or NAFTA (entered into force in January 1994), the ASEAN Free Trade Agreement or AFTA (entered into force in 1993), and the Australia New Zealand Preferential Trade Agreement or ANZCERTA (entered into force in 1983). These were subsequently followed by free trade agreements between Chile and Mexico and Chile and Canada, both of which could reasonably be interpreted as by-products of NAFTA, serving as partial substitutes for the aborted earlier effort to bring Chile into NAFTA. After some initial anxieties (reflected in the 1995 APEC Eminent Persons Group report), APEC settled down into comfortable acceptance of the coexistence of these preferential agreements with its own “concerted unilateral” process. From 1994 to 1997 there was little apparent interest in the creation of new preferential trade arrangements in the APEC region, in contrast to the continued proliferation of such arrangements elsewhere in the world. APEC’s approach of “open regionalism”, reflected in its adoption of the “concerted unilateral” modality, for a brief period took center stage as the principal focus for the efforts to further advance the cause of trade and investment liberalization in the region.

Therefore, the sudden resurgence of interest in PTAs marks a dramatic change of direction for the region. While many commentators have linked this change of course to disillusion with prospects for further multilateral liberalization following the Seattle debacle, the new trend appears in fact to have become established well before the Seattle meeting. The chronology of the new developments already discussed, suggests that the failure of the Early Voluntary Sector Liberalization (EVSL) initiative at APEC’s Kuala Lumpur summit in 1998, might more plausibly be regarded as the initial “trigger” for the renewed interest in PTAs. This is not to deny that the collapse of the Seattle meeting and subsequent deadlock in Geneva may not have imparted added momentum to the new trend. Seattle was certainly a major setback for APEC as well as the WTO, since in the aftermath of the EVSL fiasco, APEC had placed increased reliance on a successful WTO round as the principal hope for continued progress in non-discriminatory liberalization within the region.

These developments have coincided with the emergence of renewed interest in the establishment of some form of East Asian economic bloc. In part this interest arose from the perception that a lack of economic independence had resulted in East Asia



being forced to accept externally-imposed policy responses to the East Asian economic crisis of 1997-98, and a related sense that the achievement of a greater degree of economic independence would be beneficial. Reflecting these concerns, the possibilities of greater monetary and financial cooperation or coordination featured high on the initial agenda of discussions on achieving greater economic cohesion in East Asia. The newly-formed ASEAN-plus-three group, comprising the ten ASEAN members plus China, Japan and Korea, quickly emerged as a natural potential forum for these discussions. More recently the ASEAN-plus-three group has begun to show interest in the possibility of forming themselves into some kind of trade bloc.

While the first hesitant moves towards possible establishment of a trading bloc are surfacing in East Asia, the Western Hemisphere has already firmly set its course towards establishing a trading bloc of its own. The decision to conclude negotiations for a Free Trade Area of the Americas (FTAA) by 2005 has already been taken in principle. While the Western Hemisphere is committed to their own version of “open regionalism”, the FTAA is clearly intended to be a preferential trading bloc. The parallel emergence of an East Asian or western-Pacific trade bloc, and the FTAA on opposite sides of the Pacific would tend to polarize trade relationships within the Asia-Pacific region. It would also herald the emergence of a “tripolar” international trading system, in which the three “poles” would be the European Union, the FTAA, and the East Asian bloc. In the early 1990s commentators such as Krugman (1991) argued that this might be the worst possible outcome for the world as a whole.

Table 1: Shares of Selected Regions in World GDP
(based on official 1998 data)

Region	Share of World GDP (%)
Northeast Asia	20.2
Southeast Asia	2.0
Australasia	1.5
USA	27.5
NAFTA	30.9
FTAA	36.3
EU-15	28.7
EU-28	30.6

Note: EU-28: Existing EU membership (EU-15) plus thirteen current candidates for accession

Source: World Bank: World Development Report, 1999-2000

Table 2 shows that on the basis of official 1998 figures an East Asian bloc corresponding to “East Asia” would comprise just over 20 percent of world GDP, rising to over 22 percent of GDP for a bloc formed on the basis of the “Western Pacific” grouping. The Japanese economy would by itself account for over half of this figure, at 14 percent of world GDP. By way of comparison, a Western Hemisphere bloc



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corresponding to the FTAA would comprise just over 36 percent of world GDP, with the United States alone accounting for over 27 percent of world GDP. The fifteen current members of the European Union account for almost 29 percent of GDP, rising to nearly 32 percent if the thirteen additional potential members earmarked for accession are also included. The three blocs between them could thus account for approximately 90 percent of world GDP, despite the fact that over half the nations of the world, embracing a substantial proportion of the earth's land surface and population would not be included in any of the three blocs.

The specter of a bipolar Pacific adds a new element to the challenge posed to the "APEC paradigm" by the new PTA proposals. In addition to the obvious challenge to APEC's "open regionalism" posed by the preferential character of the new arrangements, a bipolar Pacific runs to directly counter to another key rationale of APEC, namely the preservation of a trans-Pacific dimension to Asia-Pacific economic integration, by encompassing within its boundaries both the growing and increasingly crucial trade interdependence within East Asia and the western Pacific and the still significant and vital trade interdependence between East Asia and the Americas (see Table 2)

Table 2: Trade Among APEC Economies 1998-98

Region	Percentage of Total Trade Conducted with:					
	East Asia	Western Pacific	USA	NAFTA	APEC	South America
Northeast Asia	47	50	21	23	74	2
among which Japan	38	41	26	29	72	2
Southeast Asia	54	57	17	18	75	1
Australasia	43	52	15	17	70	1
NAFTA	26	27	22	44	72	4
among which USA	32	34		30	65	5
Chile	23	24	20	25	50	20
Peru	14	16	29	34	54	17

Notes:

Northeast Asia: China, Hong Kong China, Japan, Korea, and Taiwan

Southeast Asia: Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam

Australasia: Australia, New Zealand

Western Pacific: Northeast Asia, Southeast Asia, Australasia

NAFTA: Canada, Mexico, USA

Source: IMF Direction of Trade Statistics

It is of course interesting to speculate on the reasons for the explosion of interest in PTAs in the APEC region. This paper however will not discuss this, but instead endeavors to assess the significant patterns within the new "crop" of PTA proposals, and to explore their potential economic implications.



MAIN PATTERNS OF THE NEW PTAs

The number and variety of new proposals for sub-regional trade arrangements (SRTAs) in the Asia-Pacific region may initially seem a little bewildering. In most cases relatively little is known about the motivations or strategies underlying the proposals, and there is relatively little information available on the details of the arrangement that contemplated.

It is noteworthy that much of the impetus to the formation of new SRTAs in the APEC region comes from just six APEC members, each involved in three or more of the possible agreements. The members are, Japan (involved in six initiatives or potential initiatives), Korea (seven), Singapore (nine), Chile (five), New Zealand (six), and Mexico (three). This suggests that one approach would be to analyze and assess the strategies of these governments. Here an alternative approach of relating the new developments to patterns of trade integration in the region is adopted. For the purposes of this discussion a provisional classification of the new initiatives might be as is described in Box 1.

Box 1 Classification of New Initiatives

Trans-Pacific CRFTAs

NAFTA-related:

- Singapore-United States
- Japan-Mexico
- Korea-Mexico
- Singapore-Mexico
- Japan-Canada
- Singapore-Canada
- P5 (USA, Australia, Singapore, Chile, New Zealand)

Chile-focused:

- Korea-Chile
- Singapore- Chile
- Japan-Chile
- New Zealand-Chile

Western Pacific Integration

Western Pacific bilateral SRTAs

- Singapore-Japan
- Singapore-New Zealand
- Singapore-Australia
- Singapore-Korea
- Korea-Australia
- Korea-New Zealand
- Hong Kong-New Zealand



Amalgamation of Existing SRTAs

AFTA-CER

Potential Steps to the Formation of an East Asian Bloc

Japan-Korea

Japan-Korea-China

ASEAN-plus-three

China-ASEAN

Source: Author's compilation

There are numerous proposals for both trans-Pacific CRFTAs and Western Pacific bilateral SRTAs, reflecting the dual focus of trade and economic integration in the Asia-Pacific region. Trade links across the Pacific are vitally important for most countries of the region, but at the same time, trade and investment linkages have been rapidly integrating the economies of the Western Pacific, particularly those in East Asia.

However, while the large number of trans-Pacific proposals must in some sense reflect recognition of the continuing importance of trans-Pacific trade ties, it is significant that the United States initially remained unengaged with the new trend. There are now signs that the decision at the end of 2000 to open discussions on a FTA with Singapore may mark the beginning of a more proactive stance by the United States. The most important trans-Pacific trade ties are those involving the United States, so that unless the United States becomes engaged with the new trend, the largest bilateral trans-Pacific trade flows will remain almost entirely outside the scope of the proposed new trans-Pacific arrangements. Similarly, Japan occupies a central position in trade integration within the Western Pacific, but after its opening initiative with Singapore, has been slow to develop proposals for SRTAs with other Western Pacific trading partners.

The positions of the United States and Japan are central to the evolution of Asia-Pacific trading relationships, not only because of their dominant share of the region's output but also because they are both major trading partners of virtually every economy in the region. By contrast, the region's other economic giant, China, is at this stage less fully integrated into the region's trade. Although it is a formidable competitor in regional trade in a number of sectors, it accounts for a significantly smaller share than either the United States or Japan in the trade of most economies in the region, even when its share is aggregated with that of Hong Kong. Its potential future importance is however enormous. The lack of a clearly defined strategy from these three regional economic giants, particularly from the United States, remains a source of uncertainty over the future development of the region's trading relationships.

Prospective FTAs between Japan and Korea, and between Japan, Korea and China could be classified along with other Western Pacific SRTAs, but are here placed in a separate category because of their potential importance as steps towards the formation of an East Asian trade bloc. The key to the development of any East Asian trade bloc lies in Northeast Asia, which accounts for 23 percent of world GDP and almost 90



percent of the combined GDP of the Western Pacific economies. ASEAN and Australasia, by contrast, respectively account for only 2 percent and 1.5 percent of world GDP. Northeast Asia has hitherto been an “empty box” in the worldwide map of SRTAs, and any credible move towards establishing an East Asian (or Western Pacific) trade bloc would have to be based around the filling of this “empty box”. Until very recently Japan and Korea had steadfastly rejected involvement in preferential trading arrangements in favor of consistent adherence to the MFN principle, and as such had formerly been counted among the last remaining “friends of GATT Article 1”. In addition their trade policies towards each other had in the past more often seemed directed towards discouraging rather than encouraging bilateral trade, despite their close geographic proximity to each other.

The emergence of a willingness on the part of these two countries to consider participation in preferential trading arrangements, and to consider moving towards free trade with each other, thus represent essential historic shifts which had to occur before an East Asian trade bloc could become a realistic possibility. A decision by China to consider participation in preferential trading arrangements, and a willingness by Japan and Korea to contemplate inclusion of China in such an arrangement involving the Northeast Asian economies, are further essential prerequisites. Once these conditions are in place it in turn becomes realistic to consider the ASEAN-plus-three grouping as the possible vehicle for an East Asian trade bloc.

The proposed linking together of AFTA and ANZCERTA would join together two well established and relatively “high standard” preferential trading arrangements. The twelve economies covered by such an arrangement comprise a large part of the region in geographic terms. However their economic significance, as noted above, is much less. In the wider East Asian context the significance of a joining together of AFTA and ANZCERTA is that it could provide a natural basis for considering an extension of the concept of an East Asian trade bloc to embrace the entire Western Pacific.

ECONOMIC IMPLICATIONS OF THE NEW PTAs

Scollay and Gilbert (2001) and Gilbert Scollay and Bora (2001) report the results of CGE simulations of a large number of the new PTA proposals, as well as the various possible “steps towards an East Asian bloc”, APEC liberalization, and global liberalization. The first set of simulations draws on the GTAP4 database, whereas the second set utilizes a pre-release version of the GTAP5 database. The following discussion of the economic implications of the various possible configurations draws heavily on the results of these simulations.

Bilateral SRTAs

Many of the new initiatives involve smaller and medium-sized economies of the region, such as Australia, Singapore, Chile and New Zealand. In addition the majority of proposed new SRTAs in the region, both intra-Western Pacific and trans-Pacific,



cover trade flows that are relatively small both from the regional perspective and from the perspective of the prospective participants. It is accordingly no surprise that the results reported in Scollay and Gilbert (2001a) suggest that the welfare impact of preferential trade agreements among the smaller and medium-sized economies of the region is typically negligible. These welfare effects of course relate only to the traditional role of PTA in eliminating formal barriers to trade in goods among the partners. Many of the proposals also incorporate forward-looking approaches to a number of the “newer” trade issues, such as services trade, investment, competition policy, and trade facilitation. In a number of areas they are likely to move significantly further than has proved possible within the framework of the WTO or even APEC.

These latter considerations are unlikely to change the judgment that the majority of the proposed new initiatives will have relatively small economic impacts. However the smaller and medium sized economies promoting these countries have tended to emphasize the potential role of preferential agreements in promoting APEC's objectives. Singapore's Prime Minister for example has spoken of an “intention to spin a web of interlocking free trade agreements between APEC members, which could help move the organization towards achieving free trade in the Asia Pacific.” Initiatives such as the Singapore New Zealand CEP have been consciously put forward as models of progressive sub-regional trade agreements.

On the other hand, in cases where proposed arrangements do have more significant effects on the welfare and trade of the potential partners, these are typically accompanied by quite widely diffused negative impacts on other trading partners, suggesting the existence of trade diversion effects and the possibility that these arrangements may be a source of increased trade tensions in the region. For example Singapore's proposed PTAs often seem to have negative, though admittedly minor, welfare implications for Singapore's ASEAN neighbors. Negative effects of this kind may themselves add further momentum to the proliferation of preferential agreements. A form of “domino” effect may operate whereby countries that otherwise might not be inclined to pursue such arrangements may feel themselves compelled to do so as a defensive maneuver. For example, negotiation of a FTA between Australia and the USA will almost inevitably prompt New Zealand to seek a comparable arrangement for itself. Whether these “domino effects” lead to consolidation of a small number of regional arrangements gradually converging around the APEC objective, or whether they lead to a fragmentation of the regional trading environment, seems likely to be an open question.

Fragmentation of the Asia-Pacific trading environment is likely to have further negative consequences in addition to the possible increased incidence of trade conflict. The proliferation of sometimes overlapping trade agreements containing divergent and perhaps even mutually inconsistent provisions has been dubbed the “spaghetti bowl” phenomenon by Bhagwati, Greenaway and Panagariya (1998). Each agreement, for example, is likely to have different rules of origin. This will tend to reduce the efficiency of regional trade and impose additional costs on business. It also remains to be seen how far negotiation of multiple agreements of this kind will absorb scarce



negotiating resources and consume political capital that might otherwise be employed in support of broader-based multilateral and regional initiatives.

Furthermore, the majority of such cases where Scollay and Gilbert's simulations indicated more significant impact are possible arrangements involving either the United States or Japan as one of the partners, for example possible free trade agreements between Japan and Singapore, Japan and Mexico, Japan and Canada, or the United States and Singapore. Again this is not entirely unexpected, given that these two countries are the major trading partners of so many other countries in the region. This in turn suggests that if the United States and Japan do decide to become more actively involved in the trend towards preferential trading agreements they are likely to quickly become the most sought-after preferential trading partners for other countries in the region.

A further implication is that competition to secure these two economic giants as preferential trading partners could become a divisive factor in trade relations in the region. Any economic gains to countries that are successful in securing a preferential arrangement with one of the two major economic powers may come at least partly at the expense of economic losses for many of the countries who are unable or unwilling to do so. A "domino" effect may drive even reluctant participants to defend their interests by pursuing their own preferential arrangements. The addition of "latecomers" to the ranks of the United States' or Japan's preferential partners may not be welcomed by the earlier "incumbents", who may perceive this – probably correctly – as diluting their own earlier economic welfare gains. A preference among other countries of the region for the United States or Japan as preferential trading partners seems likely to lead to a regional PTA configuration of the "hub-and-spoke" variety, with all the associated negative implications of the likely unequal balance of negotiating strength between the "hubs" and "spokes", and of the tendency of such arrangements to accentuate further the undermining of the WTO's non-discrimination principle.

Indications to date of possible strategies towards PTA development by the United States and Japan provide some grounds for concern. Japanese officials have openly stated that the choice of Singapore as an initial partner was based importantly on the consideration that the potential for agricultural exports to Japan from Singapore is minimal. Even so, Japan has reportedly insisted on excluding from any proposed agreement even the small number of agricultural and fisheries products in which some minor potential for increased exports exists, such as goldfish and cut flowers. In announcing the opening of its own discussions with Singapore, the United States indicated that an understanding had been reached that any resulting agreement would contain labor and environmental provisions modeled on those included in an earlier agreement with Jordan, including the possibility of trade sanctions. At time of writing it remained to be seen how far this approach would be maintained by the new US Administration of President Bush.



It would be difficult to view as anything other than a setback for the goal of a more economically-integrated Asia Pacific region a scenario in which the United States and Japan began establishing networks of preferential trading links in the region with partners selected on the basis of willingness to accept their respective positions on labor and environmental standards on the one hand, and the exclusion of agriculture from trade liberalization programs on the other, particularly if these networks also became vehicles for renewed trade rivalry between these two major economic powers of the region. To the extent that it causes already divisive negotiating positions on such contentious issues to become still further entrenched, a development of this kind might also have disturbing implications for the prospect of meaningful progress within the WTO.

Opposing arguments have been put forward in relation to suggestions that agriculture may be systematically excluded from PTAs involving the Northeast Asian economies. On the one hand it is argued that in cases where the agricultural sectors are seriously uncompetitive, their exclusion helps to minimize the risk of trade diversion. The simulation results reported in Scollay and Gilbert (2001a), for example, indicate that exclusion of agriculture from a Japan-Korea FTA unambiguously improves the welfare outcome both for those two countries and for their trading partners.² On the other side, there is concern that the opportunity to exclude “sensitive sectors” from PTAs might encourage some important trading nations to increasingly give priority to preferential alternatives to the multilateral approach to trade liberalization.

Steps Towards an East Asian Bloc

It was argued earlier that any credible proposal for an East Asian trade bloc would have to be based around Northeast Asia. Any proposed free trade area involving Japan, Korea and China of course faces formidable political obstacles. The results reported in Scollay and Gilbert (2001) and Gilbert Scollay and Bora 2001) indicate however the possibility that in purely economic terms a powerful “domino” effect could operate in favor of the emergence of an East Asian or western Pacific trade bloc. The results suggest that the welfare effects of a Japan-Korea free trade area are rather weak. The inclusion of China would face even greater political obstacles, but the simulation results show that it strengthens the economic logic supporting a preferential trade arrangement in Northeast Asia, yielding a much improved welfare outcome for the Northeast Asian economies. However the improved economic outcome from the inclusion of China occurs at the expense of significant damage to the trade and economic welfare of the ASEAN economies, which are direct competitors of China in a number of fields. Likewise, China’s trade interests are shown to be threatened by any move by Japan and Korea to link with ASEAN to the exclusion of China. On the other hand, a free trade area joining all three Northeast Asian economies together with ASEAN – the “ASEAN-Plus-Three” group – yields enhanced economic welfare both for the individual members of the arrangement and for the group as a whole. The simulations further indicate that countries that are closely integrated into western Pacific trade, notably Australia, New Zealand and Taiwan would suffer economically

² This result is in line with the analytical argument earlier advanced in Laird (1999).



from being excluded from an “ASEAN-Plus-Three” free trade area, whereas their inclusion in a wider western Pacific free trade arrangement has a strong positive effect on their economic welfare and further enhances the overall welfare of other countries in the region.

The general pattern is one of positive welfare impacts on economies participating in the proposed arrangements, accompanied by widespread negative impacts on non-participants. The presence of negative allocative efficiency as well as terms of trade effects suggests that trade diversion is a significant factor in these negative welfare effects. The size of the positive welfare effects on members tends to rise as number of economies covered by the proposed arrangements expands, but the size of the negative effects on non-members also increases. However as progressively more economies of the region are included within the proposed arrangements, these negative welfare effects are increasingly concentrated on economies outside the region. These increasing losses for non-participants occur despite the fact that global welfare also tends to increase with the larger arrangements.

The degree of inclusiveness towards participation by economies within the region will thus have an important bearing on the impact of a possible East Asian or western Pacific trade bloc, and of the steps towards its creation. An inclusive trade agreement covering all of the economies of East Asia or the western Pacific will offer substantial economic benefits to its members. A bloc with more limited membership on the other hand, while offering benefits to the members of the arrangement, will damage the trade interests of excluded non-members in the western Pacific as well as elsewhere, and is accordingly likely to be divisive.

The existence of a cogent economic logic in favor of the formation of an inclusive East Asia-wide or Western Pacific-wide trade bloc does not necessarily mean that such a bloc is likely to eventuate. The politics and related security issues associated with relations between the potential members of the bloc, particularly between the Northeast Asian economies, present a complex of array of problems and difficulties that would have to be overcome. The politics of trade issues could also be potentially divisive in a larger East Asian trade grouping. There are likely to be sharp differences of view as to whether, and to what extent, agriculture should be included in any East Asia free trade arrangement. Malaysia recently insisted on excluding autos from its AFTA commitments, and this stance also is likely to be controversial if repeated in negotiations for an East Asia-wide FTA.

Of all the possible trade developments in East Asia, an East Asia-wide or Western Pacific-wide trade bloc would be most likely to damage the economic interests of the United States and provoke an outbreak of trans-Pacific trade conflict. Given the importance to them of their trade with the United States, East Asian economies are likely to be wary of this possibility. On the other hand potential negative impacts on major economies outside the region may add to the incentives for major players such as the United States and the European Union to return to the WTO negotiating table.



A distinct possibility is that economic logic and political feasibility may point in opposite directions. Whereas economic logic may favor a more inclusive trade bloc covering the entire Western Pacific, political constraints may lead in the direction of more limited groupings. This may be a recipe for sharply increased levels of trade conflict, possibly provoking responses that lead to further reductions in economic welfare in the region. This is perhaps the most important point to emerge from the simulations of the various “steps to an East Asian bloc” (whereas the finding that larger blocs lead to larger welfare gains for their members is of course not at all surprising). The potential for increased trade conflict, and also political conflict, is likely to be especially acute if the Northeast Asian powers – Japan, Korea, possibly later China and perhaps even Chinese Taipei – pursue separate strategies of building their own SRTA linkages in the Western Pacific (and further a field).

Welfare Implications of a Bipolar Pacific

In order to explore the welfare implications of a “bipolar Pacific” Scollay and Gilbert (2001) and Gilbert, Scollay and Bora (2001) include simulations of the FTAA, both in isolation and in parallel with the development of trade blocs on the opposite side of the Pacific. The results for the “ASEAN Plus Three” FTA and the FTAA in Gilbert Scollay and Bora (2001) are particularly interesting.

The effects of the FTAA are in a sense the mirror image of those for an East Asian trade bloc. A range of positive welfare effects is generated in the Western Hemisphere, with corresponding negative on all economies of the western Pacific. These negative effects are however small when expressed as a percentage of GDP, in no case exceeding 0.1 percent of GDP. The negative effects of the “ASEAN Plus Three” FTA on the Western Hemisphere countries are also relatively small. Given that trade blocs on either side of the Pacific produce only relatively small negative welfare effects on economies on the opposite of the ocean, it is no surprise that the simulation of the FTAA in combination with an “ASEAN plus three” FTA produces welfare gains for the members of each group which fall only marginally short of the gains which they register when their respective blocs are analyzed in isolation. These results provide little support for the view that emergence of the FTAA provides a powerful justification for the formation of an East Asian trade bloc.

The Enduring Economic Logic of APEC

Viewed in the light of the foregoing discussion it is not surprising that the simulation results in Scollay and Gilbert (2001) and Gilbert Scollay and Bora (2001) show that APEC liberalization yields superior economic welfare outcomes to the “bipolar Pacific” scenario both for APEC economies as a group and for the majority of individual APEC economies on both sides of the Pacific. This is illustrated in Table 3.

If APEC non-discriminatory liberalization in accordance with the tenets of APEC’s “open regionalism” no longer commands sufficient support from the APEC membership, the results also show that conversion of APEC into a preferential arrangement would be equally effective in capturing the benefits of a trans-Pacific



dimension to regional economic integration.³ A preferential APEC would however represent a major transformation of the “culture” which has grown up around APEC, and would have to overcome many of the political considerations, which led APEC to adopt the non-discriminatory approach to regional liberalization in the first place.

Thus while economic logic may support the retention of the trans-Pacific dimension to regional liberalization offered by APEC, political pressures may point in different directions. The proliferation of proposals for trans-Pacific preferential trade arrangements can be interpreted as an effort to replicate some of the advantages of the APEC approach, but the advantages will clearly be much diminished to the extent that the United States does not participate in the new arrangements, and also because of the patterns of discrimination and exclusion to which a proliferation of preferential regional trade arrangements inevitably gives rise.

Table 3: Impact on Economic Welfare (equivalent variation basis) of alternative liberalization scenarios (percent of initial GDP) Selected APEC members and full APEC membership

	APEC MFN Liberalization	APEC Preferential Liberalization	East Asian FTA (ASEAN plus three)	Western Pacific FTA	FTAA
Japan	0.68	0.74	0.34	0.57	0.00
Korea	1.08	1.63	1.18	1.20	-0.10
China	3.35	2.56	1.96	1.94	-0.08
Indonesia	0.58	0.70	0.69	0.71	-0.04
Malaysia	1.35	1.59	1.24	1.74	-0.02
Philippines	3.94	4.16	-0.19	1.01	-0.34
Thailand	1.93	1.81	1.00	1.19	-0.06
Singapore	0.37	0.72	4.12	0.92	-0.01
Australia	0.81	0.81	-0.11	1.05	-0.01
New Zealand	2.53	3.60	-0.36	4.32	-0.06
USA	0.01	-0.01	-0.03	-0.06	0.06
Canada	-0.07	0.02	0.06	0.06	0.04
Mexico	0.07	0.12	0.03	0.03	0.27
Chile	0.24	0.18	0.02	0.01	-0.04
Total APEC	0.56	0.58	0.25	0.35	0.02

Source: Scollay and Gilbert (2001)

³ The results reported in Scollay and Gilbert (2001) are broadly consistent with the main body of results from other CGE assessments of APEC liberalisation reported in Scollay and Gilbert (2000). While the welfare gains for the APEC membership as a whole from APEC preferential APEC liberalisation are comparable to those from APEC MFN liberalisation, the distribution of those welfare gains among APEC members will be different.



Moreover, the results indicate that the negative consequences for economic welfare of APEC members from choosing the “bipolar Pacific” over APEC liberalization are not especially large. For most economies on both sides of the Pacific the negative impact of the FTAA and an East Asian or western Pacific trade bloc on each other’s economic welfare are small relative to the gains from membership of the relevant “bloc”. On the other hand, one striking result in Scollay and Gilbert (2001) is that the negative impact on US economic welfare of the establishment of a western Pacific trade bloc would almost completely negate the welfare gains it might expect from the FTAA, suggesting that the United States at least may have an economic incentive to press for the retention of an APEC-wide approach. The welfare effects on the USA are however small relative to the size of US GDP, and in any event there may once again be a clash between economic and political logic.

CONCLUSIONS

The proliferation of PTAs in the region in the last two years are of great concern because they reflect a shift in direction in the Asia Pacific and East Asian region from open regionalism to preferential liberalization. The motivations and objectives remain unclear, and the economic implications show that APEC wide liberalization is still superior to a bipolar Pacific. Much more analysis and thought needs to be undertaken to fully understand the motivations underlying this trend and its potential adverse economic implications so that a well informed dialogue can take place to minimize any adverse impact on the region and global trading system.



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