APEC-FRIENDLY ECONOMIC PARTNERSHIPS[1]

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SOME GENERAL CONSIDERATIONS

Closer economic partnerships among pairs, or groups, of economies are designed to reduce and, where possible, to eliminate impediments to international economic transactions.

These international economic transactions include trade in goods and services as well as international movement of factors of production; capital, labour and information. Impediments to these transactions include border barriers such as tariffs and quantitative restrictions, uncertainty about the policies of trading partners (including the threat of contingent protection against successful exporters) combined with divergent approaches to the regulation of economic activity which can add to the costs of risks of international commerce.

Policy options to reduce these impediments to international economic transactions include policies to reduce tariffs and other border barriers. Such trade or investment liberalisation can be implemented unilaterally, or collectively. The reductions in border barriers can be either non-discriminatory or, in circumstances permitted by the GATT/WTO, they can be preferential.

Successive GATT/WTO rounds of negotiations have led to low average tariffs and the abolition of quantitative restrictions on a growing proportion of world trade. Protection has also remained very low for the vast range of new goods and services, such as information technology related products, which have entered international trade since the founding of the GATT. At the same time, most economies retain substantial protection of their 'sensitive sectors'. This distinction raises the possibility that different policy instruments may be appropriate for dealing with border barriers to 'sensitive sectors' as against the growing majority of lightly protected sectors.

Other, non-border, obstacles to international transactions can be reduced by changes in policies which make the economic policies of trading partners more transparent, more predictable and more compatible.

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[1] This paper was not presented at the TPF but represented part of a summary that the author was asked to prepare as the result of the meeting.
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Arrangements to facilitate trade or investment among groups of economies typically consist of co-operative arrangements to reduce particular costs and risks; for example by adopting more transparent and harmonised approaches to customs documentation and clearance, by the mutual recognition of standards, or by setting up speedy and impartial means of dealing with disputes about international trade and investment between groups of economies. In some cases, economies may co-operate to enhance their individual or collective capacity to adopt policies needed to participate in particular arrangements to facilitate trade or investment: for example, the Inter-American Development Bank (IADB) is financing capacity-building for more efficient and harmonised customs procedures.

Collective arrangements which reduce the costs or risks of trading among particular groups of economies will generally have some preferential effects. For example, the many mutual recognition arrangements (MRAs) for standards among various groups of economies will tend to encourage trade and investment among participants, relative to other economies. But any preferential effects of such co-operative arrangements for facilitation can be overcome if any other economy, which is willing and able to adopt the relevant policies is allowed to become party to these arrangements.

In view of these considerations, initiatives for CEPs can be classified in terms of whether and, if so, how they seek to deal with three kinds of impediments to international economic transactions; namely:

1. high border barriers to 'sensitive sectors'
2. low or negligible border barriers to other goods and services;
3. new issues, such as movements of factors of production, harmonisation, mutual recognition etc.

For example, the WTO is designed to deal with all border barriers, but only indirectly and very partially with new issues. APEC seeks to deal with all three sets of issues but has found it hard to make progress on border barriers to 'sensitive sectors'. These limitations are part of the reason why many Asia Pacific economies are seeking to deal with some of these issues in smaller groups.

THE AMERICAS

Perhaps the best-known example of regional co-operation in the Asia Pacific is the North American Free Trade Agreement (NAFTA). That agreement has set new precedents in dealing with new issues such as investment, competition and environment. NAFTA has also set a binding schedule for eliminating border barriers to trade in most goods and services. However there is a 'negative list' of services not yet covered by the agreement. There are also some special side-agreements which allow the United States to maintain high protection of some sensitive agricultural products. NAFTA opens the United States' motor vehicle, textile and clothing industries to competition from Mexico as well as Canada. At the same time, NAFTA contains elaborate product-specific rules of origin which are designed to prevent other economies, including East Asian economies, from having easier access to US markets in these 'sensitive sectors'. These special rules of origin aggravate the diversion of trade and investment by the preferential NAFTA. However, most econometric models suggest that NAFTA will not have significant net effects on other economies.

In principle, the NAFTA is open to additional members and negotiations are in progress to create the Free Trade Area of the Americas (FTAA) to include all 34 Latin American and Caribbean economies with democratic governments. This broader agreement, due to be completed by 2005, is designed to deal with the same broad set of issues as NAFTA. Once again, special arrangements are likely to be made for the 'sensitive sectors' of the United States and possibly other potential members of the FTAA.

The FTAA will also have to resolve the insistence of the US Congress that any new trading arrangements with the US will need to address labour and environmental issues. Other Latin America economies are expected to resist any agreement which would allow the US to impose trade sanctions on trading partners whose labour or environment standards are judged to be inadequate by the US. However they may accept provisions which ensure that the domestic labour and environment standards of FTAA participants are enforced. If a compromise can be reached, it may set a precedent for a similar understanding in the WTO, removing a presently serious obstacle to progress in WTO negotiations.

THE WESTERN PACIFIC

A growing number of CEPs are also emerging on the western side of the Pacific. Some of these, such as the Australia-New Zealand Closer Economic Relations Arrangement (CER) are quite comprehensive in coverage, dealing with many new non-border issues, including competition policy[3] as well as border barriers to all trade in goods and services as well as to movement of factors of production.[4] The CER is was perhaps the first PTA which covers all trade in goods, including 'sensitive sectors'.[5]
Preferential trade liberalisation under the CER was accompanied by substantial non-discriminatory unilateral liberalisation by both Australia and New Zealand, with both economies reducing protection of most products to negligible levels. Similarly, ASEAN governments have implemented almost all of their commitments to intra-ASEAN free trade under the ASEAN Free Trade Area (AFTA) agreement by means of

[3] The mutual recognition of competition policies under the CER had led to an agreement to rule out anti-dumping actions between Australia and New Zealand

[4] The CER provides for free flow of labour. However, it does not include an agreement on the free flow of investment between Australia and New Zealand, due to the most-favoured-nation clause in a pre-existing Australia-Japan treaty on the treatment of investment between those two economies.

[5] The EU abolished all border barriers to all trade in goods in the 1960s, but both internal and external trade in agriculture are systematically distorted by the EU's Common Agricultural Policy (CAP).

most-favoured-nation tariff reductions. Therefore, AFTA and the CER will not have any significant trade diverting effects.

New Zealand and Singapore have recently entered into a comprehensive CEP, dealing with new issues as well as border barriers. Singapore is also negotiating CEPs with Japan, Australia and the US. Singapore has very few trade barriers (with the exception of some services), so the main benefit of these agreements is expected to flow from their trade and investment facilitation, or TIFA, components, rather than from the accompanying PTAs.

Singapore has suggested that this network of CEPs with several Asia Pacific economies could become a building block for APEC-wide free and open trade and investment. However, it may not prove easy to link these arrangements. The United States can be expected to seek to exempt agricultural products, or to draw up very tight rules of origin to protect its sensitive agricultural sectors (and possibly its motor vehicle and textile sectors) against competition from indirect imports from other East Asian economies. Japan and Australia are also likely to seek tight rules of origin for products which currently receive significant protection against imports from Singapore's neighbours.[6] That makes it unlikely that bilateral PTAs with Singapore can be smoothly expanded to merge with AFTA.[7]

SENSITIVE SECTORS

Recent and current experience with bilateral and sub-regional negotiations for PTAs suggest that sensitive sectors are no more likely to be dealt with in bilateral or sub-regional trading arrangements than in the WTO. Most PTAs exclude 'sensitive sectors'.

Modelling work confirms that such selective PTAs will not lead to significant benefits to participants. Nor do they cause serious problems of trade diversion. Trade diversion or creation are likely to be significant only for PTAs which are comprehensive and include large trading economies.

Given the ambiguous definition of 'substantially all trade', selective PTAs may not be declared to be inconsistent with the WTO. However, it will not be possible to link PTAs which exempt different sectors, depending on their membership, into a consolidated WTO-consistent PTA which covers substantially all trade among these economies. At the same time, a proliferation of PTAs which exempt sectors like agriculture, textiles and clothing is likely to undermine efforts to reduce world-wide distortions to trade in these products in the WTO.

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[6] In addition, Japan may insist on the exclusion of goldfish, or any other agriculture or fisheries products which may still be exported from Singapore.

[7] AFTA may provide for free trade in most products with Singapore. However, the substantial re-exports of some products from ASEAN via Singapore may effectively block a significant part of existing trade between Singapore and the rest of ASEAN.

Due to the problem of 'sensitive sectors', it is not realistic to expect an APEC-wide PTA which would be WTO-consistent. In that case, if new initiatives to facilitate trade and investment by reducing non-border impediments come to be closely, or tightly, linked to participation in bilateral or sub-regional PTAs, it could also prove difficult to promote region-wide or global arrangements for facilitation.

Accordingly, it may be useful to think about parallel, but differentiated, policy instruments to deal with border barriers to sensitive, or other, products and with the many options to deal with new, non-border issues.

PTAs or TIFAs?

At present co-operative arrangements to facilitate trade and investment by dealing with non-border issues are often associated with PTAs as part of broad efforts to promote CEPs. However, as discussed extensively at the Trade Policy Forum, it is not always easy to negotiate a PTA. The number of FTAs or custom unions which are implemented as expected are far fewer than the number which are announced. As discussed above, most PTAs exempt sensitive sectors. Very few pairs or groups of economies can expect to agree on a comprehensive elimination of border barriers to all trade.

These realities mean that, in many cases, APEC economies cannot expect to agree on PTAs with some of their significant trading partners in ways which would not undermine the WTO or be practical stepping stones towards comprehensive APEC-wide free and open trade and investment.

On the other hand, most Asia Pacific governments are eager to find practical ways to promote mutually beneficial doser economic integration to promote efficiency and to reduce avoidable costs and risks of international commerce among them.

Several pairs, or groups, of Asia Pacific economies are, therefore, choosing to promote CEPs which are not built on the foundation of a PTA. For example, due to various sensitivities, Australia cannot expect to agree on a WTO-consistent PTA with most of it trading partners in the near future. As already noted, Australia is now exploring the prospects of CEPs with Japan, Korea. Together with New Zealand, it is also discussing a CEP with AFTA.

Each of these CEPs is expected to deal with all of the issues of trade and investment liberalisation and facilitation which are included in the Osaka Action Agenda, together with even newer issues like e-commerce and financial sector integration which have gained prominence since 1995. Each set of discussions or negotiations can be expected to lead to a Trade and Investment Facilitation Agreement (TIFA) which will be based on a shared commitment to address all non-border impediments to economic transactions between the participants.

Each TIFA is expected to contain a set of practical co-operative arrangements on issues, such as mutual recognition of standards, harmonisation of regulations (including for e-commerce) and possibly for speedy procedures to mediate or arbitrate policy disputes about trade or investment. The scope of various TIFAs is likely to vary, reflecting the different priorities of various participants, but all are likely to be open-ended, so that they can deal with a progressively wider set of matters as new issues arise and/or to incorporate constructive ways of facilitating trade or investment pioneered in by other economies.

TIFAs may prove to be a practical option for engaging China in CEPs. For the next few years, China will need to cope with the very significant structural adjustments needed to cope with its expected entry to the WTO. It is unlikely to be able to contemplate entering into comprehensive, or even WTO-consistent, PTAs with other economies. However, closer economic integration among East Asian economies, including China, could be pursued by devising a gradually broader range of co-operative arrangements to facilitate trade and investment. Arrangements for individual issues like mutual recognition of standards or financial co-operation could be pursued in their own right. They could also be pursued under the framework of an open-ended TIFA which could reflect the intent of East Asian economies to promote progressively deeper economic integration.

TIFAs can also be envisaged between APEC and non-APEC economies. As noted earlier, the US and the EU are implementing such an agreement under the Transatlantic Economic Partnership (TEP) framework adopted in 1998. The Asia-Europe Meeting (ASEM) process, which has encouraged East Asian governments to identify their shared interests, is not likely to lead towards any formal PTA between East Asia and Europe. On the other hand, ASEM has the potential to promote a growing set of practical arrangements to facilitate trade and investment between the two regions.

TOWARDS APEC-WIDE ARRANGEMENTS FOR FACILITATION

As the number and scope of TIFAs grows, either independently or in combination with PTAs, it is useful to consider their implications on other CEPs and on other economies in general.
Asia Pacific governments seldom enter trade and investment facilitation arrangements in order to disadvantage other economies. However, as noted earlier, any arrangement to facilitate trade or investment among some group of economies will have some preferential effect. Lowering the costs or risks of economic transactions among one group of economies will tend to divert some economic activity away from others. But any such negative side-effects can be overcome if other economies are able to participate in these facilitation arrangements.

Given the shared commitment to region-wide facilitation of trade and investment, as part of the drive towards free and open trade and investment, APEC governments should be seeking ways to widen practical arrangements, which may be pioneered by some, to region-wide arrangements as rapidly as possible.

Accession to particular arrangements for facilitating trade and investment (such as the mutual recognition of some standards) would be simplest if any economy can join each such arrangements as soon as it is willing and able to implement the policies relevant to that particular arrangement.

By contrast, accession could be made difficult by additional conditions. In some cases, pairs (or groups) of governments may decide that only countries which met some unrelated social or political conditions could join any of their agreed arrangements for facilitation.

Alternatively, if a pair of group of economies which had negotiated a PTA could require economies to join their PTA before they could participate in any of the several arrangements for facilitation which are part of their broader agreement for a CEP. In that case, it would be difficult to merge parallel initiatives to facilitate trade and investment. For example, the arrangements expected to be implemented under a TIFA between Australia and Japan are likely to be similar to the set of facilitation arrangements which are implemented between Japan and Singapore, and between Singapore and Australia, alongside PTAs between those economies. Since Australia and Japan cannot expect to agree on a PTA, it could prove difficult to merge similar facilitation arrangements agreed between the three pairs of economies into an arrangement covering all three economies.

A different problem could arise if the set of arrangements for facilitating trade and investment among a pair of group of economies was treated as a 'package deal', so that any other economy would need to join all of them at the same time.[8] Such an arbitrary constraint would delay, perhaps substantially, the all-round benefits of region-wide facilitation of trade and investment.

Adopting an 'all or nothing' approach to linking facilitation arrangements would have relatively serious effects on the developing economies of the Asia Pacific. They may have adequate human and institutional resources to join some options for facilitation, but not for joining a large number at the same time. For example, Papua New Guinea may be interested in joining a co-operative arrangement for (say) electronic exchange of information about customs and other administrative procedures with Australia and Singapore, but may not have the capacity to join all of the co-operative arrangements involved in the potential agreement between Singapore and Australia.

Therefore, TIFAs are most likely to contribute to APEC-wide facilitation of trade and investment is each particular arrangement within each TIFA was open to accession. That would also be fully consistent with APEC's (21-x) principle; namely that

[8] Such an all-or-nothing approach has been adopted by the EU. The EU's trading partners in the rest of Europe cannot join any of the many co-operative arrangements among EU members unless they accept all of the complex *'acquis communitaire"*. This is one of the factors which is delaying a widening of the EU.

economies which are ready to implement co-operative arrangements should be encouraged to do so, with others to join later, once they perceive the benefits of doing so.[9]

NEXT STEPS

Assessing alternative options for closer economic partnerships

The Trade Policy Forum's review of the nature and implications of a wide variety of options to promote CEPs can help to distinguish those arrangements which are relatively more likely to contribute to achieving the Bogor vision of APEC-wide free and open trade and investment.

Given the comprehensive nature of APEC leaders' commitment, CEPs which are to act as building blocks for region-wide free and open trade and investment should tackle both border barriers and other impediments to international economic transactions. Therefore, they should combine efforts to facilitate as well as liberalise trade and investment.

In this context, all pairs or groups of economies should be encouraged to implement co-operative arrangements to facilitate trade and investment; many options, including several discussed above, are already being pursued in the context of new CEPs.

As discussed above, the contribution of any arrangement to facilitate trade or investment to the agreed goal of APEC-wide free and open trade and investment will be greatest if it is open to accession by any other economy which is able and willing to meet the policy requirements of that arrangements. Such a simple principle for accession will also serve to minimise any unintended negative side-effects on of facilitation arrangements on other economies.

In some cases, pairs (or groups) of economies may agree on a TIFA to deal with options for trade and investment facilitation. Such TIFAs may, in turn, form part of a broader CEP agreement for both liberalisation and facilitation. Once again, the contribution of specific practical arrangements for facilitation included in such economic partnership to APEC-wide facilitation will be greatest if economies can accede to each specific arrangements. They should not be required to join all aspects of a TIFA or CEP at the same time.

Turning to trade liberalisation, its potential contribution to APEC-wide free and open trade and investment will depend on the policy instruments chosen. Non-discriminatory (or mfn) liberalisation will make an unambiguous contribution,

[9] This principle of flexibility was included in the Bogor Declaration of APEC leaders, then in the 1995 Osaka Action Agenda.

whether such liberalisation measures are taken unilaterally or through concerted action by any pairs or groups of economies.

Preferential liberalisation can also make a contribution. One of these is that they set up binding commitments to progress towards goal of free and open trade and investment, at least with some other economies. Such commitments can give greater assurance than the existing, in principle support for voluntary liberalisation. And binding agreements for free trade with some economies can prepare the ground for widening such agreements to other economies. However, to make a real contribution to the Bogor goal, binding PTAs will need to meet standards higher than the minimum requirements of the WTO.

For example, PTAs involving developed APEC economies could be WTO-consistent if the schedule for eliminating border barriers was 10 years. But that would signal that the participants are not willing to meet the Bogor deadline of 2010.

Similarly, a PTA could merely meet the minimum WTO condition that trade barriers to non-participants should not rise ‘on average’, raising some new barriers while lowering others. That would not demonstrate a commitment to APEC-wide liberalisation in line with the standstill principle of the Osaka Action Agenda.

If PTAs are to merge to include at least all other APEC economies, then they will need to be open to accession in practice, not just in principle. For example, the product-specific rules of origin of NAFTA were designed discriminate against East Asian economies, in favour of North American ones. It is difficult to see how NAFTA could expand, or be transformed, to include those APEC participants. PTAs are only likely to be genuinely open to accession if they do not contain tailor-made measures to protect the interests of particular producers in the participating economies. It follows that APEC-friendly PTAs should have rules of origin which are liberal and simple, rather than elaborate and/or product-specific.

The WTO requires PTAs to cover ‘substantially all trade’ rather than all trade. As discussed above, many PTAs exempt trade in selected sensitive areas. These are usually the same ones, such as agriculture, that are proving hard to liberalise either through APEC’s concerted unilateral liberalisation process, or in the WTO. Such selective PTAs do not deal with the serious obstacles to achieving the Bogor goal. Moreover, since different groups of APEC economies have different ‘sensitive sectors’, selective PTAs cannot be merged into anything like a region-wide WTO-consistent trading arrangement.

In other words, unless PTAs are comprehensive, covering all trade in goods and services, they will not make a worthwhile contribution to overcoming the serious barriers to APEC-wide free and open trade and investment.

APEC-FRIENDLY ECONOMIC PARTNERSHIP

Drawing on the above, it is possible to identify those CEPs that can be regarded as APEC-friendly – these are initiatives which will make it easier to achieve the Bogor vision of free and open trade and investment. Accordingly, the following types of partnerships should be encouraged.

Facilitation

All pairs and groups of APEC economies should be encouraged to implement co-operative arrangements to facilitate trade and investment. Such arrangements, (which could be components of TIFAs, or broader CEPs among these economies) should be open to accession by other economies which are willing and able to meet the policy requirements of any particular co-operative arrangement for facilitation pioneered by some APEC economies.

Liberalisation

All APEC economies should be encouraged to continue to reduce border barriers to trade and investment, either unilaterally or collectively.

If pairs or groups of APEC economies are involved in a PTA, then such PTAs should meet standards higher than the minimum requirements of the WTO. In particular, PTAs involving APEC economies should:

- set timetable for liberalisation which are consistent with the 2010/2020 Bogor deadlines;
- guarantee the right of accession to any other economy which is willing to commit itself to a similar schedule of liberalisation;
- raise no new barriers against other economies;
- have rules of origin which are simple, rather than product-specific; and
- cover all trade in goods and services.

TOWARDS GUIDELINES FOR CLOSER ECONOMIC PARTNERSHIPS

Few existing CEPs meet all of the criteria listed above. And not all of those under consideration will meet them either. For example, it is unlikely that many new PTAs will set binding schedules to liberalise trade in either all goods and all services. They are more likely to dodge the same issues which make it difficult to reduce such entrenched forms of protection in other forums.

Therefore, it is not likely that APEC governments will agree to adopt all of these criteria in the near future; not even as voluntary, non-binding guidelines for closer economic partnerships. However, it should be possible to move beyond a rather unproductive lip-service about pursuing WTO-consistent options for closer economic partnerships.

It may be possible to achieve a growing degree of consensus on which approaches to facilitating and/or liberalising trade and investment are more likely to be genuine building blocks for free and open trade and investment. Over time, experience with alternative approaches and peer pressure may encourage gradually more constructive ways of encouraging economic integration; encouraging options which do take serious account of their effects on other economies as well as their systemic effects on both APEC and the WTO.

FURTHER WORK FOR THE TRADE POLICY FORUM

Understanding and coping with the practical issues raised by new types of closer economic partnerships will be a continuous learning process. New issues will continue to arise as different groups of governments look for innovative ways to facilitate different aspects of international economic transactions. All participants at the Trade Policy Forum agreed that it was important to continue to follow the evolution of the many diverse approaches to promote CEPs among pairs or groups of economies.

Both quantitative and qualitative assessment of various proposals and options can continue to improve understanding of their cost, benefits and risks for participating economies, other economies as well as systemic effects on the WTO and on the APEC process.

Such assessments are already demonstrating that some types of partnership are likely to have different effects in terms of either diversion or creation of economic activity. Different approaches to the choice of partners and the design of CEPs will have different effects in terms of promoting efficiency and the potential coalescence of partnerships to include wider sets of economies.

There are many opportunities to learn about, and disseminate, innovative options for dealing with the wide range of non-border issues which influence international trade and investment, for example competition policy and the harmonisation of ‘domestic’ economic regulations. Some of these partnership could also find acceptable means to confirm commitment to improving labour conditions and the environment, without creating opportunities for protectionism.

The lessons learned could help to promote consensus on the favourable or less favourable features of CEPs and to the acceptance of guidelines for identifying those partnership which are likely to be most constructive in furthering the shared objectives of Asia Pacific economies in APEC as well as in the WTO.