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The Strategic Importance of APEC

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The strategic significance

The story of APEC is the story of the rise of Asia. And today that is the story of the rise of China. There is an important sub-plot. That is the relationship of the United States with Asia and China. The strategic significance of APEC lies in the interplay of these developments and relationships.

It is conventional in international relations to measure strategic significance by military capacity and intent. The strategic significance of APEC arises from the new strategic significance of economic capacity. This is very much a late century twentieth century development. We appreciate today the implications of the globalized world and the integrated global economy that created it. We think less about the strategic significance of economic power and how it might be wielded.

How this plays out in the Pacific Rim will have a major impact on the welfare of people living in it. If we get it right, it will deliver rising standards of living, peace and an end of poverty. APEC can play a critical role in getting it right. That is its strategic significance.

The economic rise of Asia

In 1948, Asia's share of world trade in goods was 15 percent. In 1996, it was 27 percent and in 2006, it was 34 percent; China was the third largest exporter, following Germany and the United States.

The Asian growth miracle is now almost regarded as ordinary. But the consequences should not be overlooked. Between 1990 and 2001, the share of population in East Asia and the Pacific living on less than one US dollar a day fell from 29.6 percent to 14.9 percent. In China the share fell from 33 percent to 16.6 percent.

Since 1950, Japan, Singapore, South Korea, Taiwan and Hong Kong have grown to the economic standard of industrialized economies, there has been record growth in the ASEAN economies, followed by even more spectacular growth in China, and signs Vietnam might follow suit.

The East Asian region has shown that elimination of poverty is an achievable goal.

Building economies to trade into global markets has been an essential factor in this growth. In the case of China and Vietnam, there has been the additional impetus of restructuring command and control economies as market economies.

Since 1950, trade has consistently expanded twice as fast as GDP, generating the highest consistent rate of growth in the global economy since we started considering ourselves in a global economy.

A key feature of the expansion of trade by the Asian economies was access to the US market. Historically trade with the US by Asian economies typically doubled the level of trade with the EU. A second feature was the emergence of a Japan as a market and source of investment, often industries which supplied the US market

This was the basis for the emergence of an interesting regional economy. East Asia became the manufacturing base for the Information Technology products the demand for which was created by the advent of the Information Age economy in the United States.

The formation of APEC

Concern that the market of the global economy might be denied to Asian economies was the spur in the late eighties that led to the formation of APEC. Although the negotiations in the Uruguay Round of the GATT were in full swing, and were to deliver a fundamental reform of the multilateral trading system, the decision by the European Communities to create the Single Market and the announcement of the negotiation of the North American Free Trade Area led to fears trading blocs were being constructed in Europe and North America.

This led Australia and South Korea, with support from Japan to propose the formation of an Asian Pacific economic group. There were early proposals to create a Free Trade Area, particularly by Fred Bergsten from whom you will hear at this conference, but there was no taste for that.

The initial concept to express the form of economic cooperation APEC would pursue was "open regionalism". It is more likely that it was the impracticality of creating a free trade area among the United States, the ASEAN economies, South Korea, Japan and China - only a bare decade into the Deng Xiaoping era of gradual market reform – than the intellectual power of the concept that turned the focus of work in APEC to economic cooperation rather than economic integration through a free trade area.

The group expressed itself in full support of trade liberalization, gave active support to the Uruguay Round negotiations and, four years after formation, even adopted a political declaration, the Bogor Declaration, to remove all barriers to trade and investment by 2020.

The group turned heads. The European Union became anxious that it might be excluded from arrangements between the world's two biggest economies, the US and Japan, and the world's fastest growing economies. Their concern was as misplaced as the fear in East Asia that trade blocs were forming in Europe and North America.

APEC worked, however, and for several reasons.

The group was unique in several respects. It included Hong Kong and Taiwan as full members in their own right. They did not participate in UN organizations which meant that the economic importance of East Asia was not reflected in discussions in the UN system of economic affairs.

APEC included a business arm as formal part of its structure. And it had a miniscule secretariat, with members providing secretarial services for working groups, and it then had grafted on it a Summit forum.

Finally, it was the first international body in which East Asians were in a majority.

In the mid nineties, APEC was the showpiece forum of East Asian success.

The nineties was a spectacular decade, until the Asian Currency Crisis in 1998. Record rates of growth were recorded in East Asia and the US grew at a consistently higher rate than the rest of the OECD, achieving record increases in total factor productivity.

The group flirted with trade liberalization, unsuccessfully. It made a clumsy effort to promote a model of voluntary, collective trade liberalization. It was strongly supported by the US and finally blocked by Japan at the APEC Summit in Malaysia in 1998.

But by then, APEC had created a forum for Finance Ministers, as well as regular meetings of Transport, Tourism, Energy and Human Resource Development Ministers. So as the debate

over trade became increasingly focused on technical issues, activities in these other areas increased.

The annual Summit had become a regular event where leaders could collectively address contemporary issues of concern, such as the Asian Currency Crisis, the SARS pandemic, human security and terrorism, and the threat of bird flu.

Competitive tensions

Until it was clear Japan had entered what became a prolonged recession, the competitive tension inside APEC was jockeying for leadership between Japan and the United States. President Clinton used APEC to demonstrate US interest in East Asia.

Tokyo worked furiously to exercise influence, guaranteeing a large fund to finance technical activity in APEC. Leadership of an Asian Pacific grouping had been a Japanese ambition for many years. Many APEC economies had economic research centres funded by the Japanese Government.

It was the steady growth in China's economy and the reform of that economy, underlined by its membership of the WTO in 2001, which altered the balance in APEC.

Beijing will have observed one of the modern phenomena of international relations – the capacity of states with powerful economies to exert influence without significant military power. Germany ultimately succeeded in becoming the leading nation in Europe by dint of economic success and strength. Also defeated in the Second World War, Japan also achieved global prominence from economic success.

As China's wealth grew, so clearly did its influence. It has garnered massive foreign reserves for reasons that are not clear and have led some economists to accuse it of Asian mercantilism.

It has become a major trading partner of most countries, has contributed significantly to sustained growth in the global economy and has created such demand that it is supporting growth in most economies in East Asia when initially many feared China's competitiveness would crush their industries.

Its cheap manufactures have provided a strong counter inflationary pressure in other countries, in particular the United States. Wal Mart is its eighth largest trading partner.

Its currency is strong and when China finally allows it to float, it will be major global currency.

China has newly won influence and is starting to exert it. China has altered the economic equations in East Asia. It fostered a new Summit process, the East Asian Summit - a forum that nearly rivals the APEC Summit. It promoted the idea of Free Trade Agreement between it, Japan, South Korea and ASEAN.

It is negotiating Free Trade Agreements (FTAs), but not doing much liberalizing. These are tools for political amity. That is nothing new in that. Most FTAs serve that purpose, even when they are good instruments for liberalization.

This activity has unbalanced officials in Tokyo and Washington. There have been suggestions from both those quarters for new regional free trade agreements. It is hard to see why they would work.

It is still difficult to conceive of a successful FTA which included Japan, China and the US. The latent political tensions which would be exposed by the commitments necessary in a proper FTA are still too great. They may dissipate in time. But it is likely an effort now to pull this off would end in grief.

Securing prosperity

That is not anyway what the region needs. While economic success has been extraordinary, major challenges remain.

China is still a long way from locking into place the foundations of a modern market economy. If it is to take its place alongside the world's large, modern economies, it needs to cease believing it can direct the structure of sectors and industries and pick and choose who should invest. It needs to separate fully the State from the market, by constituting a fully independent legal system and guaranteeing property rights.

Some of this is happening in some parts of the Chinese economy. Parts of it are fully controlled by markets, to the chagrin of officials. New property rights are being created and courts are functioning better.

But today it has to be said that nationalism and mercantilism are re-asserting themselves in industry policy which seeks to promote national champions and in part models itself on the sort of industrial conglomerates which Tokyo and Seoul are trying to dismantle.

China has a long way to go before businesses among its trading partners will believe the political risk is sufficiently low that very large investments will be safe and the intellectual property in technology will be protected.

Japan faces a major reform task, now being the most indebted industrialized economy in the world. Services sectors in East Asia are lagging. Most Governments understand fully that as their economies grow, services industries become more important, yet there is clear reluctance throughout the region to de-regulate the sectors.

Before China's growth cranked up and increased demand for products from the region, there were distinct signs among the ASEAN economies that they were losing global competitiveness. A slowdown in China would probably expose that.

An aging population will produce particular challenges to several APEC economies, including Japan, China, South Korea, the US, Australian, Canada and New Zealand.

In a nutshell, the region needs an institution which can provide policy advice on how to deal with those problems and in which competitive economic interests can be addressed from an economic standpoint, not a political standpoint.

The competitive tensions will grow as China's expanding economy seeks the room to express its legitimate interests as a global economy. The means to manage the competitive tensions is to address them from the standpoint of the mutual benefits to be won from ensuring economies are open and economic actors can move freely among them.

Such institutions were established among industrialized economies. The OECD has been immensely useful in assisting those economies to share experience and analyze development problems. The US, Canada, the EU and Japan formed the "Quad" group where competing trade and economic interests could be discussed in a way which prevented economic rivalries from becoming political problems.

The Asian Pacific Rim needs an institution that will serve those functions. They cannot be delivered through a legal Free Trade Agreement. It has no macroeconomic policy function. They cannot be delivered through regional groupings which have been constructed to build political communities.

A forum with no political purpose and in which the aim is to address economic problems from the perspective of structuring them to deliver mutual economic benefit is required. If we were to start from scratch today, we would probably create APEC.

APEC's strategic significance

I believe this is APEC's strategic significance. It has been built on the foundation that growth and prosperity are most effectively achieved with market economies. It has all the key economies in East Asia as members. It has the most efficient of the industrialized economies, the most advanced of the East Asian and Latin American economies and it has the United States, the global benchmark economy of the Information Age.

APEC has created a habit of cooperation among members. All it needs is a new vision to provide support to members to develop their economies to continue to generate prosperity and the resources to do so.

Two middle sized economies had the vision to propose APEC back in 1989. One of them is in the chair today. Let us hope it has the vision to work with other members of APEC to craft a fresh direction.

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