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## **Beyond Trade Liberalisation**

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# **“APEC’s Future – Reaching Beyond Trade Liberalization”**

## **Economic Development in the Region, not Economic Regionalism**

### **Summary**

Australia is the chair of APEC in 2007. This comes at a strategic time. The economic architecture in the APEC region is in a state of flux. New proposals for region –wide trade arrangements continue to emerge and bilateral FTAs continue to proliferate. In contrast, the WTO seems incapable of making multilateral progress in the Doha Round.

Some ask if APEC should assume the mantle of global leadership in trade liberalization if the WTO continues to falter. APEC needs new settings, but not that one.

In many senses the WTO has done its job. Overall, global trade barriers are low. The world’s economies have never been more open. Trade liberalization is necessary to keep markets locked open, but building long term prosperity in the APEC region now requires wider and deeper foundations – measures that ensure domestic structures foster and do not hinder efficient markets.

Freedom to invest, from foreign and domestic investor alike, is now as, if not more important, than freedom to trade. Closely related is removal of regulations that impede business, protection of intellectual property and effective competition policy.

The WTO remains important – its system of multilateral trade rules and dispute settlement must remain authoritative and effective. China and Vietnam accepted WTO rules as external disciplines for strategies to adopt market models. New trade tensions are emerging between Washington, Brussels and Beijing and the WTO system is the only one able to keep them honest.

Economic strategies among APEC economies now have to look beyond trade liberalization to how to adjust domestic measures and structures that restrain the operation of domestic markets.

Can APEC do that? Would the emerging East Asian Summit process, which brings in India and excludes Pacific economies in the Americas, be more relevant than APEC for supporting economic growth in East Asia in the future?

The quick answer is no. APEC includes the United States and no other economy has its wealth of experience at adjusting to changing circumstances and wringing consistently high rates of growth out of market economies for nearly two centuries.

There is also a longer answer. The pressure for new regional organizations like the East Asia Summit process is not from desire to get economies working better, but a desire to lead. China’s ambition for regional political leadership was behind its promotion of the “ASEAN Plus Three (China, Japan and South Korea)” grouping and the East Asian Summit process. Japan was driven by the same motive in proposing the East Asian Summit group negotiate a regional trade agreement.

A study commissioned by ASEAN envisages a European Union – style community among ASEAN and even the members of the ASEAN plus three model. That was also driven by a political vision. Leading economists in ASEAN do not consider its practicable.

The drive behind most bilateral FTAs in East Asia is risk management - to ensure trade competitors do not get an edge from preferential access trade in a bilateral FTA with a trading common trading partner.

This trade politicking has been counterproductive because it has diverted attention from tackling economic challenges across the APEC region which are critical to achieving sustainable growth in the long term. The list is long – from managing imbalances in savings and reserves, to securing investment, reducing debt, de-regulating services industries, promoting effective competition and removing structural rigidities.

If China's economy misses a beat, the structural weaknesses in many APEC economies will be laid bare and the consequences of failing to address them will be palpable.

APEC was not established to create a formally integrated economic community nor to foster political regionalism and its future should not be assessed by its capacity to do so. Its purpose was to promote economic growth among its members. There is a clear mission to focus APEC economies on structural constraints to growth. The OECD has played this role effectively for industrialized economies. APEC can do the same for economies in Asia-Pacific. Getting APEC focused beyond trade liberalization is Australia's challenge in its APEC year.

### **Beyond trade liberalization**

Most trade in the world faces few barriers. The task of reducing trade barriers and the economic value gained from doing so is evidently much smaller than it used to be. When the General Agreement on Tariffs and Trade was negotiated in 1948, average tariffs worldwide were between 30 and 40 percent and use of non-tariff measures was extensive. Today the average trade weighted tariff barrier worldwide would be five or six percent and few non-tariff barriers are used.

It is still necessary to be vigilant about protectionism. Notorious pockets of high trade barriers remain, notably in agricultural trade, and should be removed, and new, emerging forms of protection, like misuse of anti-dumping and countervailing duties as well as imposition of new technical barriers to trade, must be resisted.

The rhetoric on trade liberalization from APEC Leaders at their annual Summits leaves an impression this remains APEC's most important international economic goal. In the extremely unlikely event that the Doha Round secured an agreement to remove all remaining trade barriers, the benefits for economic growth in APEC would be slight compared to solving the challenges to secure sustained growth which face economic policy makers in APEC economies.

Consider some of these challenges. Chinese officials have to decide how to direct savings to build domestic social infrastructure (and address the directly related questions of regulation of exchange rates and reserves) and to liberalize China's financial and telecommunications markets. South Korean officials still need to complete the dismemberment of the Chaebol system. Japanese officials need to introduce competition in key services industries and tackle enormous Government debt. Thai officials have yet to remove the debt accumulated since the Asian currency crisis and make domestic competition law effective. Officials in ASEAN economies need to build competitive services sectors.

In almost all of those economies, there is also a challenge to attract private capital to finance the infrastructure needed to support growth because there is not enough finance in the public sector.

Another way to illustrate the point is to compare the importance today of reducing barriers to investment to reducing barriers to trade.

The steady global reduction of trade barriers over the last 50 years now means a business decision on whether or not to supply a foreign market from a domestic production base or by exports is now largely determined by the receptiveness of the market to foreign investors. With removal of the need to take trade barriers into account, businesses now look more closely at controls on investment, the efficiency of the economy, the impact of domestic regulations, the cost of logistics and transport, and protection under law and from the administration of justice of economic and intellectual property rights.

Most members of APEC have commitments to reduce the remaining trade barriers. It is clear however that there are larger and more important issues for them to address to build or maintain competitive economies and to promote economic growth. The guiding principle is to build flexible economies that can adjust as circumstances change.

To continue as Leaders do to focus on trade liberalization as the leading economic goal means that they have put APEC out of step with the leading economic needs of APEC economies.

Others in APEC recognize that other factors are more important for securing economic growth in APEC economies.

### **APEC's work program has been changing**

APEC's work program already reflects interests in this wider policy agenda. Action agendas focus on trade facilitation, investment and the various regulations and policies which have come to be termed in APEC as affecting the business environment "beyond the border". These are the rules and regulations that govern and regulate business in domestic markets. This has also been a focus of the the APEC business community.

The work covers wide range of areas and has tended to handled by technical specialists. Trade officials work on reductions of trade barriers, Finance ministries set tariffs, Treasuries and regulate taxes and foreign investment, Customs Departments administer border controls, Agriculture Ministries manage farm support programs, Justice Departments or specialist agencies regulate competition, Customs and Transport agencies manage trade facilitation, technical standards are handled by regulators, intellectual property is handled by IP specialists. and specialist line agencies regulate services industries.

From an economic standpoint this work has not been coherent or focused. This results in some discordance. Trade and Foreign Ministries are the strategic managers of APEC but are not equipped to bring order to this situation because the bulk of the technical work "Beyond the Border"<sup>1</sup> is not their responsibility.

The organizing principle behind improving policy in all these areas is to change domestic policy to enable markets to function better. The aim of changing these policies is to achieve structural change. For this to be handled coherently in APEC and for broad policy goals to be set, this requires the attention of officials from economic affairs agencies. To date there has been no such function under either Trade and Foreign Ministers or in the processes under the Finance Ministers.

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<sup>1</sup> This terminology is revealing. It reflects the perspective of Trade Ministers which is shaped by their responsibility to set policy which governs measures which restrict trade "at the border". These measures are beyond their ken because they are "beyond the border" or "not what Trade Ministers do".

In welcome development, APEC Ministers at the end of Vietnam's year agreed to give a new mandate to address structural economic issues in the Economic Committee which reports to the Committee on Trade and Investment. This is a welcome beginning to develop a coherent economic perspective in APEC, 'beyond trade liberalization.

This is important. New East Asian regional economic architecture is being developed and questions are being raised about the relevance and effectiveness of APEC.

### **Competition for regional leadership**

The regional architecture in East Asia is becoming complicated. The East Asian Summit process which includes most of APEC's members in the Western Pacific hemisphere has been established. Various proposals for regional economic integration are on the table.

ASEAN has the idea of an EU-style "economic community" under study. The concept of expanding it to an ASEAN plus three (China, Korea and Japan) idea has been adopted, as has the idea of an ASEAN plus 3 Free Trade Agreement. Japan has proposed negotiation of an FTA among the East Asian Summit process countries. And the idea of an APEC FTA is being considered.

Little strategic reflection has been given to discussion about the political purpose or economic benefit of such arrangements. Most of these initiatives have come from top level forums as announcements by Leaders. The mores of international diplomacy are to treat any proposal from a leader with gravity and respect, regardless of its merit. Accordingly all these ideas are in play.

Clearly one driver is the desire to exercise political leadership. This is to be expected among APEC economies. They account for more than half of global economic activity, include the three of the largest economies in the world as well as ASEAN and include the rising China, keen to exercise influence commensurate with its rapidly expanding economic role.

Political interests will determine which arrangements Governments will finally settle on. Economists have had their say and are by and large unimpressed by the grand economic projects. Leading ASEAN economists have described the goal of an ASEAN Economic Community as unrealistic. An analysis by regional scholars and commissioned by APEC's business group, ABAC, considers an APEC FTA economically and politically impractical. The response to Japan's proposal for an Asian Summit Process FTA is lukewarm. Finally, there is no common or even strong view among economists that these grand regional trade agreements will deliver an improved economic result, but there is general apprehension their economic impact might be negative.

As well as reflecting strategic interests, these proposals are also a consequence of the "politicization" of the purpose of regional free trade agreements. The upsurge globally of bilateral and regional FTAs has been much discussed. Most are being negotiated to demonstrate political amity, albeit couched in trade language; or have been negotiated as an economic defense strategy: 'can we afford not to have an agreement with a major trading partner if it is negotiating agreements with our trading partners?'

Members of APEC do not need to enter a regional FTA to demonstrate political friendliness. They have APEC for that purpose already.

The concepts of new regional trade agreements only challenge the legitimacy of APEC if the primary purpose of APEC were to forge a regional trade arrangement. It wasn't, it was to foster growth.

According to this analysis, that requires a much wider ambit than measures to regulate trade. While the scope of trade agreements has expanded, with the inclusion of services, intellectual property and investment, they cannot be effective instruments to foster frameworks to create efficient market economies outside the traded sector. That requires a focus on the domestic policies that make economies efficient and flexible.

There is a natural focus for APEC here which no other regional agreement can satisfy.

### **Beyond Liberalization - APEC'S natural economic mission**

There is a natural economic mission for APEC. It is a region of economic success. It has hosted the greatest economic change in modern history. Since the watershed created by the Second World War, Japan has become the first Asian nation to qualify as a developed economy: South Korea, Taiwan and Singapore followed suit; high growth and rapid transformation has occurred in ASEAN and we are now witnessing an even more dramatic process of economic modernization in China with Vietnam following in its wake. The function of the US economy as an open market for the external trade strategies and as a source of capital and technology was and remains critical to that process.

The East Asian region has been more successful than any other with the breadth and speed with which it has reduced poverty and raised living standards, although that task is far from complete.

APEC also includes Latin American Pacific Rim economies which have been more successful economic modernizers than the norm in Latin America; and Russia, which is facing a major task of modernization.

The task of maintaining growth in industrialized economies is also a challenge for APEC economies. The experience of Australia and New Zealand in the eighties and Japan in the nineties as well as those affected by the Asian currency crisis demonstrates that growth cannot to be taken for granted. The lesson for all is that economies must be flexible and continuously adapt to changing circumstances. Japan is now grappling with a program of major structural reform to provide that flexibility.

The preeminent of APEC's economies is of course that in the United States. It is the world leader at adjusting as circumstances change, as evidenced by its consistently higher growth than the average of OECD economies over the last decade and a half.

The diversity and the range of experiences with economic growth and development among APEC economies are vast. These economies are united by the coincidence of geography, historical patterns of trade and investment, natural endowment and a common interest in growth and economic development. The anchor economies in this odd concoction are the United States, Japan and now China.

The APEC economies have been the motor of growth in the global economy over the last quarter century. They are the inventors, investors, manufacturers, consumers and traders adopters of information technology and IT products.

The natural economic purpose of APEC is to foster collaboration to ensure that member economies continue to grow, to adopt strategies to ensure their economies reform and adapt to change and to ensure that policies on short term matters such as imbalances in savings and investment allow the most efficient allocation of resources among members.

There is strategic importance in this. Political rivalry among the members of APEC can generate friction over economic relations. Bilateral imbalances in trade and payments and exchange rate policy are favorite points of criticism when political relations are tense.

Ensuring that politics does not intrude into economic management to the point where the results have adverse economic impacts is a major challenge to APEC economies. Using APEC as a forum where the basic economic issues which shape economies are jointly examined and technical analysis is undertaken of policies to optimize growth would be an important contribution to strengthening political relations among Pacific Rim economies

APEC has a larger natural economic purpose to serve than trade liberalization.

### **What should happen in APEC?**

APEC needs to reaffirm that its primary goal is economic growth and needs to declare that a new program of collaboration on macroeconomic policy is required achieve it.

The case is simple. The world economy is changing rapidly. Only governments that set their economies up to adjust with changing economic forces will achieve or maintain growth. APEC economies need to ensure existing economic structures serve that purpose.

This is the core mission for APEC.

APEC's structure needs changing to serve it. Economic Ministers need to be brought into the process as primary advisers on these matters to leaders. Action has already been taken to energize the APEC Economic Committee of officials. APEC needs additional resources to support this new economic work. At the initial stage, the costs of that can be met by those members of APEC who consider this work important.

This process would not replace the existing strategies to improve trade liberalization or to change system to improve the "beyond the border" environment for business. Those programs would continue. But it would erect an overarching framework to guide and give coherence to those activities.

These are realistic and achievable goals for APEC in 2007.

## **“APEC’s Future – Reaching Beyond Trade Liberalization”**

### **Economic Development in the Region, not Economic Regionalism**

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## **APEC’s Future – Reaching Beyond Trade Liberalization**

- **Beyond trade liberalization**
- **APEC’s changing work program**
- **Competition for regional leadership**
- **APEC’S natural economic mission**
- **What should happen in APEC?**

## **Beyond trade liberalization**

- **WTO has largely done its job**
- **Other challenges face economic policy makers**
- **Other impediments to business**

## **APEC's changing work program**

- **Trade facilitation**
- **Beyond the Border**
- **Secure Trade**
- **Investment**
- **Technical issues**
- **Microeconomic reform/structural change**
- **Needs coherent policy focus – structural change/microeconomic reform**

## **Competition for regional leadership**

- **New regional entities proposed**
- **Motivation political rather than trade liberalization**
- **APEC's purpose – promote growth, not create a regional trade arrangement**

## **APEC'S natural economic mission**

- **Promotion of economic growth based on open markets**
- **Common interest of members**
- **Prevent political rivalry interfering with growth**

## **What should happen in APEC?**

- **Reaffirm that APEC's primary goal is economic growth**
- **Create a new program of collaboration on microeconomic policy**
- **Strengthen structural change program**
- **Mainstream Economic Affairs Ministers in APEC**