

***The mid-term review of the Bogor Goals***  
***Strategic issues and options***

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## **Abstract**

The 2005 mid-term review of progress towards the 1994 Bogor goals will demonstrate the substantial achievements of the APEC process. There have been many beneficial moves towards free and open trade and investment. Work by officials and independent observers of APEC will set out this worthwhile progress in full detail. This paper focuses on the many challenges which have yet to be tackled before achieving free and open trade and investment.

Consensus-building and capacity-building by APEC working group has promoted many arrangements to facilitate trade and investment, including more efficient and more harmonised customs procedures and the accelerated use of information and communications technology (ICT) for paperless trading. But APEC is barely scratching the surface of the challenge of creating an integrated market in the Asia Pacific.

Many border barriers to trade and investment have been reduced, often to negligible levels. But there is not yet sufficient political will to get rid of the border barriers to trade in some sensitive products, either in APEC or in the WTO. That problem cannot be resolved by attempts at radical reform of APEC and it is proving even harder to tackle these barriers in preferential trading arrangement arrangements.

The liberalisation of sensitive products is most likely to happen in the WTO, where comparable reforms by other economies can magnify the gains from, and reduce the short-term adjustment costs of, liberalisation. Collective leadership in the WTO is an essential intermediate target on the way to free and open trade and investment.

Given the problems faced in getting rid of some sensitive border barriers, APEC's credibility will depend on accelerating efforts on other fronts. In addition to assessing progress in terms of facilitation, the mid-term review offers the opportunity to set ambitious targets for specific aspects of trade and investment facilitation, to be reached by 2010 and 2020, along with targets for reducing border barriers. This paper proposes a set of specific objectives; for convenience, the list of targets is repeated in Annex 7.

Adopting clear targets for facilitation alongside those for liberalisation would invigorate APEC's existing trade facilitation initiatives, bringing them together under a single banner, and setting new and more ambitious goals. That will create much greater momentum for reform. It would also provide an imaginative way of achieving a steady succession of results during the next 10 to 15 years, alongside efforts to reduce border barriers.

A clear commitment to significant medium-term goals for trade and investment facilitation is an essential part of the effort needed to mobilise the resources needed to strengthen human and institutional capacity in the region. Once APEC-wide targets for facilitation are set for 2010 and 2020, APEC leaders will need to engage the private sector and international financial institutions (IFIs) at the highest levels and to assign responsibility within APEC to monitor and report on the necessary capacity-building effort.

# ***The mid-term review of the Bogor Goals***

## ***1. Strategic issues and options***

The 2005 mid-term review of progress towards the Bogor goals will demonstrate the substantial achievements of the APEC process.

Since 1994, APEC governments have made valuable progress towards free and open trade and investment. Concerted liberalisation in APEC has reduced the protection of many products to negligible levels. Average tariffs are considerably lower and there are fewer quantitative restrictions on trade. People and capital are moving more freely around the region.

The APEC-led move to ensure that information technology products will not be restricted by trade policy has set a valuable, WTO-wide, precedent to help ensure that today's new inventions do not turn into tomorrow's sensitive, heavily protected, products.

Consensus-building and capacity-building has promoted, amongst many other things:

- more efficient and more harmonised customs procedures;
- greater mutual recognition of product and process standards;
- accelerated use of information and communications technology (ICT) for paperless trading.

Billions of dollars per year are already being saved by such practical co-operative arrangements to facilitate trade and investment. Recent research indicates that APEC governments may have already achieved the 5 per cent reduction in transactions targeted by APEC leaders in 2001.

The broad commitment to reducing obstacles to international commerce has also helped to avoid new restrictions. None of the economies hit by severe financial crises in the late 1990s contemplated a retreat from an outward-looking development strategy. And the rush to reduce the risk of terrorist attacks after September 2001 led to region-wide consultations about effective cooperative responses, rather than unilateral resort to potentially highly discriminatory measures.

Officials and independent observers of APEC will set out this worthwhile progress in full detail, showing how these gains provide a basis for further progress. This paper focuses on the many challenges which have yet to be tackled before achieving free and open trade and investment.

One important challenge is to reduce the protection of several sensitive products, especially in agriculture. That is proving difficult, as expected at the outset. APEC governments will have to do more than restate a shared hope of doing better in the next few years.

Whatever progress is made on lowering border barriers, other opportunities to facilitate trade and investment are steadily becoming a more important part of the effort to achieve free and open trade and investment. While welcome, the incremental gains in reducing transactions costs are only a beginning of a comprehensive effort to deal with non-border barriers.

APEC economies have much more to do, so the mid-term review of progress needs to be more than a celebration of past achievements and a general commitment to meet the Bogor goals, if not by 2010/2020, then as soon as possible.

This paper recommends that APEC leaders seize the opportunity of the review:

- to clarify the meaning of free and open trade and investment;
- to set ambitious, but not unrealistic, targets for trade liberalisation and other aspects of free and open trade and investment, to be achieved by 2010, or no later than 2020; and
- to identify where consensus-building and capacity-building will need to be backed by negotiations to achieve these medium-term targets, either among APEC governments, or in other forums.

APEC's mid-term review of progress also provides the opportunity to assess prospects for radical changes in approach. In particular, the review can consider whether it is feasible, or desirable, to convert APEC into a formal organisation that can impose binding obligations on member economies. The review can also assess whether APEC governments can rely on the growing number of regional trading arrangements (RTAs) to be the main instruments for trade and investment liberalisation and facilitation.

APEC is not likely to be converted into a formal organisation during the next few years. Several APEC governments, including Japan and the United States, cannot be expected to make a binding commitment to comprehensive free trade with all Asia Pacific economies in the foreseeable future. An attempt to formalise APEC as a means of accelerating progress towards the Bogor vision would probably be at the expense of abandoning the objective of achieving free and open trade and investment by any particular date.

There are other ways to assure the business sector that reforms to implement liberalisation and facilitation will be sustained. APEC governments should be expected to entrench agreed reforms in domestic legislation. Any problems with implementation of legislated commitments can be dealt with by using already available options for resolving international disputes.

Many more RTAs can be expected to be formed in the next decade. These arrangements are lowering border barriers to trade and investment among pairs, or groups, of economies without raising them against others. In that limited sense, they are taking the region closer to free and open trade and investment. But they are not dealing adequately with the sensitive issues that are proving difficult to resolve elsewhere, either in APEC or in the WTO. Moreover, the emerging pattern of RTAs, in terms of the choice of partners and the exclusion of sensitive products, does not provide any assurance that they will lead to region-wide arrangements.

In 2004, APEC governments endorsed a set of "*APEC Best Practices for RTAs/FTAs*". These encourage RTAs which are more likely than others to contribute to region-wide free and open trade and investment. However, these guidelines fall well short of an agreement to make either liberalisation or facilitation in RTAs comprehensive, or of an agreement to extend improvements in access provided to RTA partners to other Asia Pacific

economies. Reaching and implementing an agreement to on either of these matters would be no less difficult than converting APEC to a formal organisation.

There is scope to reform some aspects of the APEC process. But these will not eliminate the strong political resistance to some sensitive aspects of free and open trade and investment. APEC leaders cannot simply rely on hopes for radical reform to guarantee adequate progress towards free and open trade and investment in the coming years.<sup>1</sup>

While constantly looking for practical ways to enhance the APEC process, APEC governments will need to rely on voluntary co-operation in the foreseeable future. APEC governments should seek to maximise the potential contribution of voluntary co-operation to trade and investment liberalisation and facilitation. That, in turn, requires a clear assessment of the comparative advantage, as well as the limitations, of voluntary co-operation.

The track record since 1994 shows that voluntary co-operation can accelerate moves towards free and open trade and investment, as long as these are perceived to lead to net gains to participants. At the same time, it is well understood that some governments consider that the short-term political costs of certain reforms outweigh their the long-term benefits. Such reforms will need to be negotiated.

APEC leaders need to accept that a voluntary process of cooperation has no comparative advantage as a forum for negotiations. Rather than repeating the early voluntary sectoral liberalisation (EVSL) experience, APEC governments should strive to develop their collective capacity negotiate difficult aspects of liberalisation in the WTO. On sensitive issues, like agriculture, APEC governments could make a collective offer to eliminate obstacles to trade and investment, provided that other significant economies, particularly the European Union, are willing to undertake comparable reform.

There may not sufficient political courage to make collective offers to liberalise sensitive products in the WTO. If that proves too hard, even when the rest of the world is expected to reciprocate, then it is even less likely that APEC economies will be able to negotiate the same reforms among themselves. The short-term costs of adjustment would be considerably greater, since they would need to be absorbed in the Asia Pacific, rather than spread globally.

If APEC governments expect to achieve the liberalisation of sensitive products by 2020, let alone 2010, they need to launch a concerted effort to build the capacity needed to make collective offers on these products in the WTO. That would also lead to an efficient division of effort between APEC and the WTO.

Given the problems faced in getting rid of sensitive border barriers, APEC's credibility will depend on accelerating efforts on other fronts. APEC can do more to encourage Asia Pacific governments to design and implement the policy decisions and institutional reforms necessary to address the many available opportunities to facilitate trade and investment. For most of these options, the real constraint on reducing transactions costs is not political

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<sup>1</sup> Options for radical reform are evaluated in more detail in Annexes 2 and 3.

difficulty, but the need to develop the capacity needed to implement the necessary decisions and arrangements.

For example, the perceived benefits of faster clearance of products through ports and airports have come to outweigh the interests of potential rent-seeking from delaying or obstructing clearance. Therefore, almost all governments are keen to seize opportunities for harmonisation and more efficient exchange of information needed for customs clearance. Voluntary cooperation is an appropriate and efficient means of promoting this, and many other, practical opportunities to facilitate trade and investment. Voluntary cooperation can also help dismantle those border barriers to goods and services that are already, or still, quite low.

In the many cases where potential co-operative action is perceived to be a positive-sum game, in political as well as economic terms, formal negotiations are not necessary. These issues can be addressed on their own merits, so there is not need to design complex package deals to balance costs and benefits.

For example, there is no need to delay progress on widening the scope for mutual recognition of standards, by insisting that it should await progress on other collective arrangements, such as the introduction of paperless trading. Nor should progress on such options to facilitate trade and investment wait until all border barriers have been dealt with. Progress on important aspects of facilitation should not be held hostage to solving the most difficult issues of trade liberalisation.

This paper recommends that APEC leaders adopt a set of medium-term targets, not only to deal with border barriers, but also with the many other opportunities to reduce impediments to trade and investment. The next section sets out some ambitious targets which:

- clarify the meaning of free and open trade and investment;<sup>2</sup>
- are well understood by business;
- have political resonance; and
- can be achieved by 2020 at the latest and;
- when achieved, would significantly reduce the costs of international trade and investment.

The targets for facilitation are based on a set of targets proposed by members of the APEC Business Advisory Council for a Trans Pacific Business Agenda.<sup>3</sup> That agenda concentrates on non-border obstacles to trade and investment, especially those caused by:

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<sup>2</sup> Annex 1 discusses the nature of free and open trade and investment.

<sup>3</sup> ABAC's 2004 report recommended that APEC leaders should commission a scoping study to determine the detailed content of a Trans Pacific Business Agenda (TPBA), to be adopted by APEC in 2005. The ABAC report did not recommend specific targets; however, ABAC (2004), the paper circulated by Australian members to ABAC's final meeting in 2004, set out some targets which indicate the scope of reforms needed to achieve genuine free and open trade and investment. In November 2004, APEC leaders noted ABAC's recommendation for a TPBA, clearing the way for endorsing medium-term targets as part of the mid-term review of progress towards free and open trade and investment.

- out-dated approaches to regulating and processing the international movement of goods, services, capital and skills;
- lack of transparency of administrative or legal procedures; or
- needless differences in approach to commercial regulation.

The agenda also includes some aspects of liberalisation not yet dealt with adequately in the WTO, notably international investment and transport.

## **2. Setting medium-term targets**

Medium-term targets for consideration as part of the mid-term review of progress towards the Bogor goals, are proposed below. Additional comments on the targets can be found in Annexes 4 and 5.<sup>4</sup>

### **2.1 Border barriers**

#### *Trade in products*

Trade in very many products, especially trade in recently invented goods and services, already faces negligible border barriers. For these products, it is realistic to expect further progress by means of concerted unilateral liberalisation. It should be possible to overcome residual resistance to eliminating already negligible protection. Already low barriers should be reduced to zero. These zero rates can then be bound in the WTO.

In addition, APEC governments could also adopt, by 2010/2020, policies that would prevent products of the future from becoming sensitive products. This could be done by agreeing that newly invented products can be protected by intellectual property rights, but will not receive protection from future border barriers.

In these ways, APEC governments can avoid the emergence of additional sensitive products.

For products that are already sensitive, APEC leaders should commit themselves to make a collective offer, in the WTO, to dismantle protection of these products, provided other economies are prepared to respond with comparable reforms. Such an offer should be made before 2010 and would greatly improve the prospects of significant WTO-wide gains by 2020. To generate sufficient political will to make a collective offer, APEC governments would need to launch an intensive effort to rebuild community support and consensus for genuine free trade. That effort would need to be endorsed as part of the 2005 review of APEC's goals.

APEC governments should also make a collective offer to accept considerably greater disciplines on subsidies and on contingent protectionism, such as anti-dumping. Agreement on a collective stance will be difficult, but should be possible by 2010. Unless tighter disciplines are agreed, zero border barriers, by themselves, will not be adequate to create the conditions for free and open trade and investment.

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<sup>4</sup> For convenience, the list of 2010/2020 targets for liberalisation and facilitation are repeated in Annex 7.

Free and open trade and investment will also require substantial reform and deregulation of international transport. To achieve that, APEC governments should agree to support a policy of open seas and open skies, subject to an agreed set of safety and security procedures for ports and airports. Given the current state of play and sensitivities regarding regulation of international transport, this objective is likely to need negotiations in the WTO. If such negotiations are to succeed by 2020, they would need to begin well before then. APEC governments need to start work now, first to agree on the need for comprehensive reform, then to bring these sectors under WTO disciplines by 2010.

#### Factors of production

APEC governments adopted a non-binding investment code in 1994. Many aspects of that code have been incorporated into domestic legislation of APEC governments. To reach free and open trade and investment, the guidelines will need to be strengthened. APEC governments could agree to enact all the legislation needed to implement the currently agreed non-binding code by 2010, then to offer full rights of establishment and national treatment of international direct foreign investment by 2020.

The East Asian financial crisis in the late 1990s showed that full mobility of all forms of international capital is desirable only after the management and supervision of domestic financial systems have been sufficiently strengthened. Most developed Asia Pacific economies have already achieved this. If APEC governments commit themselves, in 2005, to an ambitious program to build the necessary human and institutional capacity, then all APEC economies should be able to reap the benefits, while managing the risks, of free capital movement by 2020.

Free and open trade and investment also needs adequate labour mobility. In the Asia Pacific region, characterised by wide differences in population and incomes, full labour mobility is not a realistic objective for the foreseeable future. However, APEC governments should be able to agree, in principle, to full freedom of business-related short-term travel, subject to general security screening. Appropriate targets for ease of movement, to be achieved by 2010 and 2020, can be set after consultations with the business sector.

#### Medium-term targets for liberalising border barriers

The medium-term targets for liberalisation discussed above can be summarised as:

1. *Border barriers to be set and bound at zero by 2010/2020, for goods and services which are already lightly protected, or not yet invented.*
2. *APEC governments to make a collective offer in the WTO to eliminate the protection of sensitive products, in return for comparable liberalisation by non-APEC economies: the offer should be made by 2010 to allow the negotiation of free and open trade and investment by 2020.*

3. *APEC governments to make a collective offer, by 2010, to impose tight WTO disciplines on subsidies, anti-dumping and other forms of contingent protectionism.*
4. *APEC governments to propose bringing international transport under WTO disciplines by 2010 and offer to create open seas and skies by 2020.*
5. *Enact the domestic legislation needed to implement the currently agreed non-binding investment code by 2010; then offer full rights of establishment and national treatment of international direct foreign investment by 2020.*
6. *Launch a capacity-building program from 2005, to develop the expertise and institutional capacity needed for free flow of capital to and from all APEC economies by 2020.*

In consultation with the private sector, it should also be possible to set realistic medium-term targets for production-related labour mobility.

## **2.2 Other obstacles to free and open trade and investment**

Reducing border barriers in line with the medium-term objectives listed above will not be easy. But even they would not be sufficient to bring APEC close to genuine free and open trade and investment. That will also need a wide range of cooperative arrangements to reduce transactions costs by adopting new technology and reducing divergences in approaches to economic regulations.

Some of the opportunities for reducing impediments to free and open trade and investment, by no later than 2020, include:

7. *An intensified program of mutual recognition of product standards and professional qualifications, comparable in scope to that achieved by the EU.*
8. *Full compatibility and fully electronic data interchange of customs documentation and clearance procedures.*
9. *Transparency and harmonisation of a wide range of administrative procedures, including agreed minimum standards for auditing and disclosure.*
10. *Harmonised fiscal incentives for investment and production.*
11. *An APEC code for the consistent taxation of international income.*
12. *Region-wide minimum standards for competition policy, which are sufficiently rigorous to avoid the need for anti-dumping actions among APEC economies.*<sup>5</sup>

These objectives, based on those proposed by the Australian members of ABAC in 2004, share some important characteristics.<sup>6</sup>

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<sup>5</sup> The set of targets proposed above is not exhaustive. As discussed in Annex 1, there will always be additional opportunities to facilitate trade and investment. Some of these will become more evident as the targets listed in this paper are approached; just as the elimination of most border barriers has demonstrated the need to attend to non-border issues. In that sense, the suggested medium-term objectives are a necessary, rather than a sufficient condition for free and open trade and investment.

All of these medium-term targets pose difficult challenges for APEC governments and the APEC process. All of them will need a combination of political will and extensive, region-wide, capacity-building. But all of them are necessary to create a unified, region-wide zone of production and an integrated region-wide market for consumption.

Most of the issues listed above are not yet on the WTO agenda. Pursuing these objectives among APEC economies would thus complement, rather than duplicate, efforts to achieve other objectives within the WTO.

Some of targets (particularly 7 to 9) can be reached by intensifying and accelerating trade and investment facilitation efforts already under way, such as APEC's work on standards and conformance and on customs clearance. The mid-term review of progress towards the Bogor goals will demonstrate that useful progress has already been made. But incremental gains, such as 5 or even 10 per cent cuts in transactions costs, will not come sufficiently close to free and open trade and investment by 2010/2020. Well-understood and ambitious targets are needed to attract adequate political support for accelerating the capacity-building needed for these aspects of facilitation.

Other objectives (such as 10 to 12) may not appear to be directly related to reducing obstacles to trade and investment. However, they are important means for approaching that goal. The frequent use of contingent protectionism, such as anti-dumping and countervailing subsidies, is currently justified by claims that firms in certain economies enjoy unfair advantages provided by divergent approaches to competition policy or fiscal policy. Agreement on tight disciplines over contingent protectionism (see objective 3) can only be expected after an adequate degree of harmonisation of such 'domestic' policies.

A set of targets, like those above, constitutes a package of initiatives for market integration in the broadest sense, which can be pursued in parallel with ongoing multilateral, regional and bilateral trade liberalisation efforts. Such a multi-faceted new agenda for facilitation would also represent an imaginative means of achieving a steady succession of results during the next 10 to 15 years, alongside efforts to reduce border barriers. Adopting such an agenda would invigorate APEC's existing trade facilitation initiatives, bringing them together under a single banner with new and more ambitious goals, creating much greater momentum for reform.

#### *Learning from experience*

Implementing such a market integration agenda can draw on the experience of the European Union (EU), which has demonstrated that the absence of border barriers to trade was nowhere near sufficient to create a single market, either for consumption or production.<sup>7</sup>

To achieve anything like free and open trade and investment, APEC governments will also need to reduce the cost of needless divergence in economic regulations, such as standards and competition policy. But that does

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<sup>6</sup> The following paragraphs draw on AUSPECC (2004), ABAC Australia (2004) and Drysdale (2004).

<sup>7</sup> The European Union experience is discussed in more detail in Annex 5.

not mean adopting all of the European agenda. Harmonisation of regulations can go too far and some hallmarks of European integration, such as the free movement of all labour and a single currency, need not be embraced.

But many significant elements of the EU Single Market agenda, including the mutual recognition of standards and professional qualifications, are appropriate for any group of economies seeking closer integration. Action on these issues will need to be consistent with the APEC process, where there is no supra-national authority or bureaucracy with enforcement powers. APEC will need to rely heavily on consensus-building and capacity-building which has already led to significant facilitation of trade and investment.

Progress towards the targets listed above will require careful policy development and institutional development. All these targets need to be approached, but they do not need to be tackled at the same pace. Cooperative measures to capture the potential mutual benefits in any of these areas need not wait for progress on others. Nor do all APEC economies need to tackle all of them at the same time.

### Setting positive examples

Given the diversity of the region, APEC-wide targets for facilitation will be reached by some economies ahead of others. The flexible nature of the APEC process allows several sets of issues to be tackled at the same time by a self-selecting group of Asia Pacific economies. Therefore, APEC leaders should continue to encourage some member economies to set examples for others, rather than accept the lowest common denominator acceptable by all.<sup>8</sup>

If some economies are to set examples for others, the arrangements they devise will need to be genuinely open to others. This requires transparency and genuine openness to accession.

Transparency of cooperative arrangements, such as mutual recognition of standards, together with the certainty needed for international commerce, can be provided by APEC governments enacting necessary domestic legislation and/or agreeing to appropriate disciplines which can be enforced by existing multilateral organisations. As discussed in Annex 5, adequate transparency and certainty can be provided without having to convert the APEC process to a formal organisation.

To be successful catalysts for APEC-wide arrangements, initiatives to facilitate trade and investment pioneered by some APEC economies will need more than formal clauses which allow, in principle, for accession by others. Additional economies should not only be permitted to join new arrangements; they should be encouraged to do so. Pathfinders who implement initiatives will need to share relevant information, experience, expertise and technology so that others can join as soon as they perceive the benefits of doing so.<sup>9</sup>

### Capacity-building

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<sup>8</sup> APEC leaders endorsed the principle of pathfinder initiatives in 2001 to encourage such positive examples.

<sup>9</sup> As discussed in Annex 3, innovative ways will need to be found to promote region-wide application of practical initiatives for facilitation, some of which may be pioneered in the context of RTAs.

APEC governments will need to intensify region-wide capacity-building at the same time as they muster the courage for genuine free trade. Substantial financial and institutional resources will be needed to enable all APEC economies to participate in the cooperative arrangements for facilitation already being pioneered among the relatively more developed member economies. This capacity-building cannot all be financed by aid programs, but will need greater, and more creative, efforts to forge public/private partnerships.

APEC should not become a development agency, or duplicate the work of existing institutions. APEC will need to learn to catalyse the resources needed for mutually beneficial economic integration in the region from the private sector and international financial institutions (IFIs). These institutions are already financing substantial investment in capacity-building for trade and investment facilitation. But the scale of this investment will need to be greatly increased.

A clear commitment to significant medium-term goals for trade and investment facilitation is essential to mobilise the substantial resources which will be needed. Once APEC-wide targets for facilitation are set for 2010 and 2020, APEC leaders should engage private sector and IFIs at the highest levels and to assign responsibility within APEC to monitor and report on the necessary, region-wide capacity-building effort.<sup>10</sup>

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<sup>10</sup> Strategic options for capacity-building are discussed in Annex 6

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## **Annex 1: The Bogor goals**

### **The Bogor declaration**

At their 1994 meeting in Bogor, APEC leaders described their vision of free and open trade and investment in the following terms:

*With respect to our objective of enhancing trade and investment in the Asia-Pacific, we agree to adopt the long-term goal of free and open trade and investment in the Asia-Pacific. This goal will be pursued promptly by further reducing barriers to trade and investment and by promoting the free flow of goods, services and capital among our economies. We will achieve this goal in a GATT-consistent manner and believe our actions will be a powerful impetus for further liberalization at the multilateral level to which we remain fully committed.*

*We further agree to announce our commitment to complete the achievement of our goal of free and open trade and investment in the Asia-Pacific no later than the year 2020. The pace of implementation will take into account differing levels of economic development among APEC economies, with the industrialized economies achieving the goal of free and open trade and investment no later than the year 2010 and developing economies no later than the year 2020. (paragraph 6)*

APEC leaders made it clear that the vision of free and open trade and investment meant more than eliminating border barriers to trade, such as tariffs and quantitative restrictions. The Bogor Declaration stated that:

*To complement and support this substantial process of liberalization, we decide to expand and accelerate APEC'S trade and investment facilitation programs. This will promote further the flow of goods, services, and capital among APEC economies by eliminating administrative and other impediments to trade and investment.*

*We emphasize the importance of trade facilitation because trade liberalization efforts alone are insufficient to generate trade expansion. Efforts at facilitating trade are important if the benefits of trade are to be truly enjoyed by both business and consumers. Trade facilitation has also a pertinent role in furthering our goal of achieving the fullest liberalization within the global context. (paragraph 7)*

As an example, they drew attention to the need for:

*APEC arrangements on customs, standards, investment principles and administrative barriers to market access. (paragraph 7 )*

The Bogor Declaration did not attempt to set out, in any detail, how these objectives were to be achieved. However, it:

- stipulated that any cooperative arrangements among APEC governments were to be fully consistent with the GATT (paragraph 6);
- emphasised that APEC economies should reduce obstacles to trade and investment with non-APEC economies as well as among themselves (paragraph 6);

- encouraged some APEC economies that were ready to implement cooperative arrangements to reduce impediments to trade or investment to do so, setting positive examples which others could follow (paragraph 9).

Leaders directed ministers and officials to prepare detailed proposals to implement their vision. The guiding principles and strategies for cooperative action towards this vision were set out in the 1995 Osaka Action Agenda (OAA). That agenda has continued to evolve in the light of developments, including continuing rapid changes in technology, especially information and communications technology.

The OAA set out 15 areas for action, most of which dealt with issues beyond border barriers to trade. This was followed by adopting, and commencing implementation of, Individual Action Plans (IAPs) and Collective Action Plans (CAPs) by APEC governments, in line with the broad agenda agreed for each of these areas.

### **Constructive ambiguity**

The ultimate nature of free and open trade and investment, or how it was to be achieved, were not fully defined either in the Bogor Declaration or the Osaka Action Agenda.

For example, it remains unclear whether obstacles to trade are to be eliminated for the full range of goods and services; whether eliminating tariffs means setting or binding them at zero; whether free and open investment implies unrestricted capital flows; or whether free trade in services implies unrestricted labour flows. The option of implementing free and open trade and investment by means of an APEC-wide preferential trading arrangement (PTA) has not been ruled in or out. Immediately after Bogor, it was more efficient to begin implementing policies which were clearly in line with the intent of the declaration, leaving some specifics to be sorted out later.

In other cases, the ultimate goals are inherently hard to define. For example, the Osaka Action Agenda calls for greater mutual recognition of standards. But it is not possible to agree on standards for all products and processes. New products will continue to appear in international markets beyond 2010/2020 and it will always take time to agree on appropriate standards and to develop the capacity to ensure adequate conformance to these. Similar considerations arise for most aspects of facilitating trade and investment. As technology evolves, there will always be scope for more efficient processing of commerce across borders. Once again, at the outset, it was more efficient to start to implement practical cooperative arrangements, rather than to define a set of potentially elusive ideals.

These decisions, which were often implicit, rather than explicit, allowed for early progress. The call for free and open trade and investment came at a time when APEC economies were already heading in that direction. The ambitious Bogor vision has helped to sustain and accelerate this trend.

### **Clarifying the Bogor vision**

As we approach the 2010 deadlines, the time has come to clear up some ambiguities. Without losing sight of the broad APEC vision, APEC leaders

need to decide which aspects of the potentially infinite task of reducing impediments to trade and investment they expect their governments to achieve by 2010 and 2020. They will also need to clarify their strategy for accelerating progress in areas which have proved difficult.

### Border barriers

In principle, free and open trade and investment ultimately means the complete elimination of all tariffs, quantitative restrictions and other policies which are designed to protect domestic producers against international competition.

This ideal will not be achieved by 2020. For the foreseeable future, some border measures, such as those imposed for security or health reasons, will continue to be imposed. Experience shows that it is very hard to distinguish which of these measures discriminate intentionally against international trade and investment.

Like a perfectly competitive market, perfect free trade can only be approached, rather than attained. That does not mean that the Bogor vision needs to be artificially limited. However, to remain credible, APEC leaders will need to define what aspects of it are expected to be achieved by 2010 or 2020, particularly in relation to the substantial protection of some sensitive products such as many agricultural products.

Many border barriers to trade in goods and services have been reduced, and many have been eliminated. But, on current trends, there is no prospect that the developed APEC economies will eliminate the protection of some sensitive goods and services by 2010. A simple deferment of the target would be unsatisfactory, unless APEC governments can explain why a few additional years would make it possible to resolve the problems which are making hard to reach the current deadline. It would be preferable to set out a strategy for achieving measurable progress by 2010 and 2020.

One aspect of such a strategy will be ensure that APEC economies avoid the emergence of additional sensitive sectors in future. For products which are already sensitive, APEC governments should set how they intend to reduce the strong political opposition to further liberalisation and what gains they can expect by 2010 and 2020. A potential strategy, which includes collective efforts in the WTO is described in Annex 4.

APEC leaders will also need to set targets for the extent of mobility they expect to achieve for factors of production, such as direct foreign investment and the international movement of capital, labour and information movement.

Free movement of capital is probably desirable and feasible in the Asia Pacific, after adequate preparations. It is less likely that full freedom of labour movements will be seen as either desirable or feasible. This principle is already proving difficult in Europe and may not be acceptable in a region of much greater diversity in population size and income levels. Movement of information should not pose any problems. Further advances in information and communications technology will almost certainly make it impossible to impose significant impediments to trade and investment related information among market-oriented economies.

### Other impediments to trade and investment

Given the problems involved in getting rid of some sensitive border barriers, APEC's credibility will depend on accelerating efforts on other fronts. As summarised in the main paper, consensus-building and capacity-building efforts by APEC governments have already led to worthwhile reductions in the costs and risks of international trade and investment. This work is also setting useful examples as the WTO begins to deal with opportunities to facilitate trade.

However, the gains from facilitation are not receiving much attention, either from APEC leaders or commentators, since no clear objectives have been set.

In order to generate sustained, high-level government and business support for programs for cooperation in these areas, objectives for 2010 and 2020 need to be clearly defined. That will not always be easy. As discussed above, there is no end-points to many of the parallel efforts needed to reduce non-border barriers to trade and investment. The practical option is to set specific targets for some important aspects of this effort; targets:

- which are well understood by business;
- whose achievement will reduce, significantly, the costs of international trade and investment;
- which have political resonance; and
- which can be achieved by 2020 at the latest.

Timetables for approaching these targets can set up ambitious milestones to be achieved by APEC economies by agreed dates, such as 2010, 2015 and 2020. The main paper suggest some targets, based on recent proposals from the APEC Business Advisory Council. Strategies for progress towards such target is discussed in Annex 5.

To a considerable extent, progress will be constrained by limits of human and institutional capacity in many Asia Pacific economies, so a successful strategy to deal with non-border barriers will need to be backed by capacity-building. As outlined in Annex 6, APEC governments will need to learn how to catalyse the funds and skills needed for accelerated capacity-building, by means of new partnerships with the private sector and international financial institutions.

The strategies described in Annexes 4 to 6 rely on continued voluntary co-operation among APEC economies. Annexes 2 and 3 explain why APEC cannot expect to rely on radical reforms in order to accelerate progress during the next few years.

## **Annex 2: Transform APEC into a formal organisation**

The mid-term review of progress towards the Bogor goals provides the opportunity to assess prospects for major changes in approach. One option would be to convert APEC into a formal organisation which could impose binding obligations on member economies.

### **Lessons of experience**

At its inception, in 1989, APEC was set up as a voluntary association of Asia Pacific economies. Due to the diversity of the original twelve participants, and ASEAN's concern about the effect of APEC on its own processes, there was considerable resistance to a formal Asia Pacific wide organisation which might impose new binding obligations on members economies or any supra-national authority which might have the power to enforce such obligations.

ASEAN's conditions for participation in APEC was set out in the Kuching Consensus, which included:

*APEC should provide a consultative forum on economic issues and should not lead to the adoption of mandatory directives for any participant to undertake or implement.*

A formal inter-governmental process was also ruled out by the need to include the economies of both People's Republic of China and Taiwan. The Chinese Government would not accept any organisation which might imply that Taiwan was a separate sovereign entity.

Tackling these reservations against a formal organisation, then waiting for the potentially difficult process of ratifying participation in a new, formal international organisation through the legislative processes of member economies, would have delayed, and possibly prevented the launching of the APEC process.

Therefore, in the Seoul APEC Declaration (1991) it was agreed that, in the APEC process:

4. *Cooperation will be based on:*
  - (a) *the principle of mutual benefit, taking into account the differences in the stages of economic development and in the socio-political systems, and giving due consideration to the needs of developing economies; and*
  - (b) *a commitment to open dialogue and consensus-building, with equal respect for the views of all participants.*
5. *APEC will operate through a process of consultation and exchange of views among high-level representatives of APEC economies, drawing upon research, analysis and policy ideas contributed by participating economies and other relevant organisations including the ASEAN and the South Pacific Forum (SPF) Secretariats and the PECC.*
6. *Recognising the important contribution of the private sector to the dynamism of APEC economies, APEC welcomes and encourages active private sector participation in appropriate APEC activities.*

Within a voluntary process of cooperation APEC, as such, does not make decisions. The challenge is to encourage APEC governments to make decisions, either unilaterally or in coordination, in line with voluntarily agreed commitments, such as the Bogor goals of free and open trade and investment.

In practice the APEC process has encouraged trade and investment liberalisation and facilitation by means of building consensus on the necessary policy decisions and by helping to develop the capacity to make and implement these decisions.

The mid-term review of progress will show that such voluntary co-operation has been sufficient, sometimes in combination with other factors, to lead to substantial liberalisation of border barriers as well as to reduce other obstacles to trade and investment. The review will also show where voluntary co-operation has not led to progress which is likely to meet the Bogor deadlines of 2010/2020, particularly in terms of reducing border barriers to trade in some sensitive sectors like agriculture.<sup>11</sup>

### **Comparative advantage of voluntary co-operation**

Encouraging reforms which reduce obstacles to trade and investment are multi-level games involving Asia Pacific governments, producers and consumers. APEC's experience has demonstrated the comparative advantage, as well as some limitations of voluntary co-operation, which are in line with basic game theory.

Voluntary cooperation accelerated reforms where Asia Pacific governments have perceived that the gains from reform can outweigh the costs of adjustment. Coordinated voluntary actions can be especially effective when the gains to participants are magnified if others act in similar ways.

For example, the experience since 1989 has shown that voluntary coordination can help to reduce the costs and risks of international commerce by mutual recognition and/or harmonisation of standards and administrative procedures. All economies can gain by adopting standards and regulations which are more in line with international best practice. But the gains from such reforms can be enhanced substantially if significant trade and investment partners reforms are as compatible as possible.

Similarly, the gains from lower border barriers can be enhanced if neighbouring economies are also lowering theirs. That can widen the range of products where the economy-wide gains are seen to outweigh the political costs of reform. In several APEC economies, the region-wide commitment for sustained trade liberalisation has made it possible to adopt significant initiatives to reduce many border barriers (see Garnaut, 2000)

On the other hand, when cooperation is not perceived as a positive-sum game by all participants, then voluntary co-operation cannot be expected to work.

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<sup>11</sup> Some trade and investment liberalisation and facilitation reforms were made by APEC governments in the context of WTO negotiations and in structural adjustment programs agreed with international financial institutions. Such progress should not be discounted in the mid-term review of progress.

The role of APEC consultations is to encourage member governments to use whatever means are available to liberalise trade in order to approach the agreed targets. Therefore, it does not matter how much credit APEC, as such, can claim for actual decisions.

Negotiations will be required and participants need to be bound to outcomes which are perceived as short-term concessions to others.

But that does not necessarily mean that APEC would become more effective by converting it to a formal organisation which can impose binding commitments on member economies.

Before considering such a radical reform, it is important to assess:

- whether it would be feasible to convert APEC into a formal organisation;
- whether such a body would be able to negotiate the difficult aspects of reaching the Bogor goals; and
- whether such a body would have comparative advantage over other options for conducting such negotiations.

### **Has a formal organisation become feasible?**

Some of the resistance to the prospect of a formal organisation has dissipated since the early days. Asia Pacific economies have become less resistant to accepting binding obligations to each other. Members of ASEAN have accepted obligations with respect to trade and investment policies and have set up a dispute settlement process which may be needed to monitor adherence to these commitments. They are also negotiating regional trading arrangements (RTAs), collectively as well as individually.

These trends suggest that APEC participants may be willing to accept disciplines which are agreed, or negotiated, among member economies, backed by some dispute settlement procedure. But other problems remain.

The People's Republic of China has accepted Taiwan's participation in the APEC process as the economy of Chinese Taipei. But there is little likelihood that China would accept Taiwan's membership of a formal organisation of APEC economies in the near future.<sup>12</sup>

The problem of ratification also remains. Any treaty which sought to establish APEC as a formal organisation with powers to impose binding obligations would need to be ratified through the legislative processes of all participants.

In the foreseeable future, several APEC governments, including Japan and the United States, cannot be expected to make a binding commitment to comprehensive free trade with all APEC economies. If APEC is defined as an organisation whose members accept a formal commitment to eliminate all obstacles to trade and investment by 2010/2020, then only some legislatures could be expected to ratify membership. Success in formalising the nature of APEC would almost certainly require the abandonment of any commitment to the goal of free and open trade and investment by any particular date.

For these reasons, it would not be pragmatic to use the occasion of the mid-term review of the Bogor goals to recommend a radical move away from voluntary cooperation. Lengthy and possibly unsuccessful consensus-building

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<sup>12</sup> At present there are no formal inter-governmental discussions, let alone negotiations, between the two economies. Matters of mutual interest, such as direct transport links are discussed among commercial entities.

would be needed to transform APEC into a formal organisation which was able to begin negotiations on the sensitive issues which are proving to be beyond the reach of voluntary cooperation.

As discussed in the paper and other annexes, it would be desirable for APEC governments to be bound to sustain agreed reforms to liberalise or facilitate trade and investment. But that does not require an attempt to convert the APEC process as a whole to a binding, treaty-based organisation. It will be far more efficient to rely on entrenching reforms to implement liberalisation and facilitation in domestic legislation, combined with access to already available options for resolving international disputes which may arise.<sup>13</sup>

### **Prospects for APEC negotiations**

Even if APEC could be transformed into formal organisation, at some time, it does not follow that member economies could negotiate solutions to the most difficult aspects of trade liberalisation.

The WTO has been designed to facilitate such negotiations. Reforms, which are seen by individual economies as concessions to others, need to be matched reforms of others whose net benefits exceed the perceived net costs of reforms by particular economies. Both theory and experience indicate that such a balance is more likely to be achieved when a large number of economies negotiate reforms of a wide range of policies. Successive GATT/WTO have relied on the design of such package deals.

The APEC process involves a large number of economies. In 1997 and 1998, APEC governments attempted to negotiate a 'package deal' to liberalise up to 15 sectors. This Early Voluntary Sectoral Liberalisation (EVSL) failed, partly due to domestic resistance to liberalising sensitive products, partly because the sectors chosen were not seen to provide an acceptable balance of benefits and costs, and partly because some governments, including the United States, did not have a mandate to negotiate trade liberalisation among this group (see Damond, 2003).

Some of these problems could be reduced, or overcome, if APEC was a formal organisation. APEC economies could then attempt to replicate a WTO-like round of negotiations. That could lead to a carefully designed package of trade and investment liberalisation and facilitation whose balance of costs and benefits was acceptable to all of them. Within a new formal organisation, APEC governments may be willing to change their perceptions of the costs and benefits; that could make it possible to agree on some reforms which could not be achieved through voluntary coordination (for example, concerted unilateral liberalisation).

APEC economies could restrict the benefits of reforms to member economies if they negotiated a WTO-consistent preferential trading arrangement which reduced border barriers to zero, for a sufficiently high share of products traded

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<sup>13</sup> In some cases, it may be possible to use the WTO's dispute settlement. Other options are also available to resolve international disputes involving governments and/or investors.

among them and did not create barriers to trade with the rest of the world. Such an arrangement might then be called an APEC-wide free trade area.<sup>14</sup>

Since WTO disciplines on preferential trading arrangement are weak, a discriminatory arrangement negotiated by APEC governments could be declared to be WTO-consistent, even if some sensitive products, such as foodgrains and clothing were exempted. But unless border barriers were eliminated for a perceptible share of sensitive products which are proving to be beyond the reach of voluntary co-operation, the arrangement would not justify the time and effort needed to attempt to convert APEC into a negotiating body.

The obstacle to liberalising sensitive products is the political costs of the short-term adjustment to the structural changes needed to cope with new competition. This problem would be harder to overcome in negotiations among APEC economies alone, than in the WTO.

If APEC economies were to negotiate a PTA, eliminating border barriers to sensitive products, then non-APEC economies, such as the EU, would not be given additional access. However, if APEC governments acted by themselves, all of the burden of adjustment to competition from the Asia Pacific would need to be made within the region. Since APEC already includes some of the most competitive producers of sensitive agricultural and labour-intensive manufactured products, substantial adjustments would be required.

If APEC economies acted by themselves, the EU would not be required to respond with their own liberalisation. Therefore, it would be far more efficient to negotiate the liberalisation of sensitive products in the WTO, where the EU would need to undertake comparable liberalisation. They would need to absorb some of the adjustment costs, rather than get a free ride.

In the Doha Round of WTO negotiations, APEC governments offers on several significant sensitive products fall well short of full liberalisation. APEC governments are not yet prepared to contemplate full liberalisation of these products even if others, like the EU, would be expected to respond. In that case, there is even less prospect for negotiating free and open trade in these products among APEC economies acting alone.

Even as a formal organisation, APEC would not have comparative advantage over the WTO to negotiate free and open trade<sup>15</sup> If APEC leaders wish to make a convincing commitment to liberalising the currently most sensitive products, they should seek to build the capacity to make a collective offer to do so in the WTO.

Annex 3 considers the option of negotiating RTAs in order to resolve aspects of trade and investment liberalisation and facilitation which are proving difficult in APEC.

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<sup>14</sup> An Asia Pacific free trade area has been proposed many times since the 1960s, most recently in 2004.

<sup>15</sup> In WTO negotiations, it is possible to negotiate reductions in border barriers. By contrast, negotiating a PTA requires the full elimination, not just the reduction of border barriers to trade. This is a further source of the WTO's comparative advantage in negotiating the liberalisation of trade in sensitive products.

### **Annex 3: Regional trading arrangements**

Partly due to disappointment with the pace of trade liberalisation in either the WTO or APEC, almost all APEC economies have entered into regional trading arrangements (RTAs) with other economies. Many additional arrangements are being negotiated, or under consideration, including RTAs with non-APEC economies.

These RTAs are typically based on a preferential trading arrangement (PTA) for trade in goods and, in many recent cases, a PTA for trade in services. All recent RTAs include, or at least propose, some cooperative arrangements to facilitate trade and investment by dealing with some non-border issues.

These arrangements are lowering barriers to trade and investment among pairs, or groups, of economies without raising them against others. Therefore, many observers consider them to be potential building-blocks towards region-wide free and open trade and investment. Unfortunately, there is little prospect of that happening in time to meet the Bogor deadlines of 2010/2020.

#### **Hard to link preferential trading arrangements**

If PTAs among small groups of economies were comprehensive, they could be linked to form wider regional arrangements, creating free trade in all products by abolishing all border barriers to trade among member economies. In that case, any other economy could join, as long as it was prepared to abolish all border barriers to trade with existing members. It would also be possible to link several comprehensive PTAs into larger ones.

But there are very few comprehensive PTAs. The same products which are proving hard to liberalise in the WTO or APEC, are proving just as hard to tackle among smaller groups of economies. As Findlay *et al* (2003) explain, it is harder to deal with sensitive sectors in PTAs among pairs, or small groups, of economies. Compared to multilateral negotiations, it is more difficult to overcome vested interests against reform.

If governments are not willing to agree to end their protection of some sensitive products in the course of WTO negotiations, they are even less likely to do so for selected competitors. That was made explicit in the attempt to negotiate an Free Trade Area of the Americas (FTAA) between 1994 and 2005: The United States has insisted that liberalisation of sensitive aspects of agriculture must be taken up in the WTO.

The recent pattern of PTAs has highlighted this problem of 'sensitive sectors'. In a growing number of examples, PTAs deal with relatively easy aspects of trade liberalisation, while dodging around the hardest ones. Recent agreements, including those between Japan and Singapore, Korea and Chile demonstrate that PTAs tend to exempt the products which are deemed to be the most sensitive. Even the agreement between two of the most vehement advocates of the Bogor goals, the United States and Australia, excludes some aspects of agriculture, or sets deadlines well beyond 2010 for even modest liberalisation.

Recent experience indicates that any economy, which is not yet ready to open some sectors to significant international competition can form PTAs only with those economies:

- which are willing to exclude these sectors from the agreement; or
- which do not offer serious competition in these sectors.

The Australia-United States PTA is an example of the first. The Australian Government was so eager to reach an agreement, that it was willing to conclude a deal which exempted some agricultural products, or offered very limited increases in quotas, without any changes in the heavy domestic subsidies to US producers.

A potential PTA between Japan and Korea could exclude rice and other sensitive primary industries. Such an agreement could still claim to be WTO-consistent, since it covered a high proportion of bilateral trade, but would dodge the same problems which are causing problems in the WTO.

Another way of avoiding hard issues is to include sensitive products in agreements which do not lead to significant new competition. For example, an agreement between Japan and Singapore may include the full liberalisation of rice imports from either partner, since neither is concerned about rice imports from the other. But such PTAs contain product-specific discriminatory rules of origin which prevent the re-export of rice from economies which would threaten existing producers. Even if such agreements contain a clause which provides for wider accession in principle, efficient rice producers would not be able to join, without renegotiating the rules of origin, or exempting the sensitive product.

It is proving possible to dodge sensitive products by careful selection of partners and selective rules of origin. This is creating a large number of overlapping PTAs; the so called "spaghetti-bowl" of arrangements which cannot be linked readily to form an APEC-wide zone of free and open trade and investment.

Another option for region-wide free trade would be to exempt some sensitive sectors from a PTA, but agree to extend the liberalisation of other products which are offered to existing partners to a wider group of economies, over time. If the liberalisation offered to some economies were to be offered to all other APEC economies by 2010/2020, then such PTAs would lead to an APEC-wide arrangement. That arrangement, in turn, would be WTO-consistent if the liberalisation were extended to all members of the WTO, perhaps after some further delay. An alternative way to be WTO-consistent would be to limit liberalisation to APEC economies, but to ensure that excluded products did not account for a substantial share of trade.

A third option for forming an APEC-wide trading arrangements would be to form a PTA including all APEC economies, which would replace all the existing PTAs among them.

An region-wide PTA has been advocated many times over the past 30 years. It was proposed in 2004 by the Canadian members of ABAC. The suggestion was not taken up.<sup>16</sup> That is not surprising at a time when the Free Trade Area of the Americas (FTAA) initiative has proved to be beyond reach after 10 years of negotiations.

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<sup>16</sup> ABAC, as a whole only recommended further study of the option, while APEC leaders merely noted their suggestion.

An APEC-wide PTA is not feasible. An arrangement, which only eliminated border barriers to products which are no longer sensitive, would fall well short of the Bogor vision of eliminating all obstacles to trade and investment. A PTA with a long list of exemptions would hardly even meet the ambiguous WTO criterion of covering substantial trade among members.

Any arrangement which did seek to eliminate border barriers to sensitive products would confront the problems which are being carefully avoided in recent PTAs by exempting sensitive products and/or ruling out partners who would threaten serious new competition to protected producers of these products.

It would not be easy to commence, let alone complete negotiations, for a region-wide PTA for substantial liberalisation. The failure of the early voluntary sectoral liberalisation (EVSL) experiment in 1997-98 suggests that a new structure would be needed, in which governments had the intent and authority to negotiate reforms. As noted in Annex 2, there is little prospect of converting APEC into a negotiating body in the foreseeable future.

In view of these considerations, it would not be credible to announce an attempt to negotiate a region-wide PTA as a means of reaching the 2010/2020 targets for free trade.

### **Growing concerns<sup>17</sup>**

The proliferation of overlapping RTAs, based on PTAs, is causing increasing concern.

Business leaders are becoming concerned that the proliferating PTAs are not making much headway on the most important aspects of liberalisation. They are not dealing with the most serious border barriers to trade and, in most cases, they are yet to deal effectively with non-border barriers.<sup>18</sup>

At the same time, firms involved in trade, especially intra-industry or intra-firm trade, are facing rapidly increasing administrative costs by the need to impose rules of origin. These rules are becoming a central element of international trade policy, at a time when falling costs of transport and other communications it is becoming harder, and less meaningful, to calculate the value which is added to elaborately transformed products in the economies involved in international supply chains.

In its 2004 annual report to APEC leaders, the APEC Business Advisory Council (ABAC) pointed out:

*The trend amongst APEC economies to forge regional trading arrangements (RTAs)/free trade agreements (FTAs) is .. a cause for concern.*

*Many of these RTAs/FTAs fall short of the Bogor Goal commitments of APEC member economies in terms of timelines and comprehensiveness.*

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<sup>17</sup> Garnaut (2004) provides a comprehensive overview of the problems stemming from the proliferation of PTAs.

<sup>18</sup> Recent RTAs catalogue a range of options for facilitation and set up working groups to study these. These can be expected to lead to practical future arrangements to reduce the costs or risks of trade and investment among participants.

*These agreements, while enhancing trade relations and opening economies, may also have the potential to impose additional transaction costs on business, due to the challenges of navigating this multiplicity of RTAs/FTAs.*

These concerns are also reflected in the 2004 statement to APEC Ministers by the Pacific Economic Cooperation Council (PECC) as follows:

*Bland statements of resolve to abide by Article XXIV, or that PTAs are designed to promote the achievement of the Bogor goals, are not convincing. This is especially the case when commitments in some regional trading arrangements are less than those made in Bogor, or have transition periods which go beyond 2020. In a negotiating environment, either at the bilateral level or in Geneva, tensions occur between a commitment to the principles of the trading system and the delivery of special domestic benefit.*

In 2003, the Trade Forum of PECC proposed a common understanding of RTAs, see (PECC, 2003). That work set out the criteria which RTAs based on preferential arrangements would need to meet if they were to be consistent with achieving the Bogor goals.

These criteria deal with (amongst other matters):

- Coverage: PTAs should cover trade in both goods and services, and should also cover all sectors, possibly allowing relatively slower reforms of sensitive sectors.
- Non-discrimination: credible assurances should be given that the concessions provided within the PTAs between APEC members will be made available to all APEC members as soon as circumstances allow, and no later than the Bogor target dates. The benefits of liberalisation, offered initially to PTA members can be extended to others by 'multilateralisation' (making them available to all other economies), or by ensuring that all other APEC economies can accede to PTAs initiated by others.
- Timetables would need to be consistent with the 2010/2020 deadlines.
- Rules of origin are not an appropriate mechanism for protecting "sensitive sectors" or for facilitating adjustment to liberalisation: therefore complex rules with protectionist purposes should be avoided.

These criteria are hard to meet. As 2010 approaches, there is little scope for phased elimination of border barriers to trade in sensitive products. While PTAs may be declared to be open to further accession in principle, that would need radical revision of complex rules of origin.

Very few (if any) existing or proposed are either comprehensive or provide timetables for extending liberalisation offered initially to PTA partners to all APEC economies. In other words, the agreements being formed may be WTO-consistent, but not necessarily building blocks for APEC-wide free and open trade and investment.

APEC leaders have declared, repeatedly, that RTAs should be consistent, not only with WTO disciplines but with the principles and 'architecture' of APEC. They are aware that some of them are not consistent with Bogor deadlines and that they will not be easy to link to form a region-wide arrangement.

In 2004, based partly on the criteria proposed by PECC, APEC leaders have endorsed a paper which describes 'best practice' RTAs involving APEC economies. These are RTAs which, among other things:

- go beyond minimum WTO requirements;
- being comprehensive in scope, providing for liberalisation in all sectors;
- phase-out periods for liberalising of sensitive products to be kept to a minimum;
- are seen as first steps towards multilateral liberalisation at a later stage;
- have simple rules of origin;
- allow wider accession on negotiated terms and conditions.

RTAs which have these characteristics would, indeed, be relatively more likely to be building blocks towards APEC-wide free and open trade and investment.

But that is not sufficient for meeting the 2010/2020 deadlines for achieving this objective. In order to do that, APEC economies would have to agree to find ways of ensuring that the RTAs in which they are involved meet well-defined standards in terms of these aspects of 'best practice'. Moreover, these standards would need to be at least as high as the more tightly defined criteria listed by PECC.

The mid-term review of progress towards the Bogor goals needs to assess the prospects for agreement on clearly defined minimum criteria for PTAs which are consistent with the 2010/2020 deadlines for free and open trade and investment. Moreover, the review would need to assess whether APEC governments would be prepared to accept such criteria in the near future, together with Bogor-consistent timetables for meeting them.

Prospects for concerted adoption of such tough criteria are no better than the prospects of meeting the Bogor goals by means of concerted unilateral liberalisation. Similarly, negotiating a binding commitment to such criteria would not be just as difficult as converting APEC into a formal organisation.

Therefore, a credible mid-term review of progress could not simply assert that 'best practice' RTAs will be sufficient to achieve free and open trade and investment by 2010/2020.

To sum up, once the options for using PTAs as the route to APEC-wide free trade are carefully examined, it becomes evident that there is no way to reach the Bogor goals for trade liberalisation without significantly greater political will to tackle the vested interests of producers of heavily protected goods or services.

## Beyond border barriers

Once APEC leaders adopt a set of ambitious targets for facilitation, they can look for ways to learn from and build on the ways non-border barriers are being addressed in RTAs, so they can act as pathfinders for potentially region-wide arrangements.

Cooperation among pairs, or small groups, of economies can be a useful way to deal with some options to facilitate trade or investment. For example, developed economies with adequate skills and communications infrastructure can set examples for harmonising information technology intensive approaches to economic regulation, which could be followed later by others. Similarly, it will be easier to agree to mutual recognition of standards and conformance procedures among a few economies at similar stages of development than among over 20 diverse economies.

Some aspects of facilitation, such as competition policy, are technically complex. Some harmonisation and/or mutual recognition of competition policies is essential if APEC governments are to accept tight disciplines on anti-dumping procedures. However, it will be hard to achieve that among economies with different legal traditions. Therefore, it is practical for some to move ahead of others.<sup>19</sup>

Most recent RTAs include provisions for reducing impediments to trade and investment by means of regulatory reform aimed to achieve mutual recognition and/or greater compatibility. In most cases, the arrangements provide for cooperative work to identify practical options. In due course, such work should lead to innovative arrangements to deal with new aspects of facilitation.

Cooperative arrangements agreed among parties to RTAs could become building blocks for region-wide, or even multilateral, arrangements. That could happen if other economies are not only permitted, but encouraged, to join such arrangements. However, it may prove difficult to use these new arrangements as precedents for region-wide facilitation, especially if these new arrangements are part of many-faceted agreements including a PTA for trade liberalisation.

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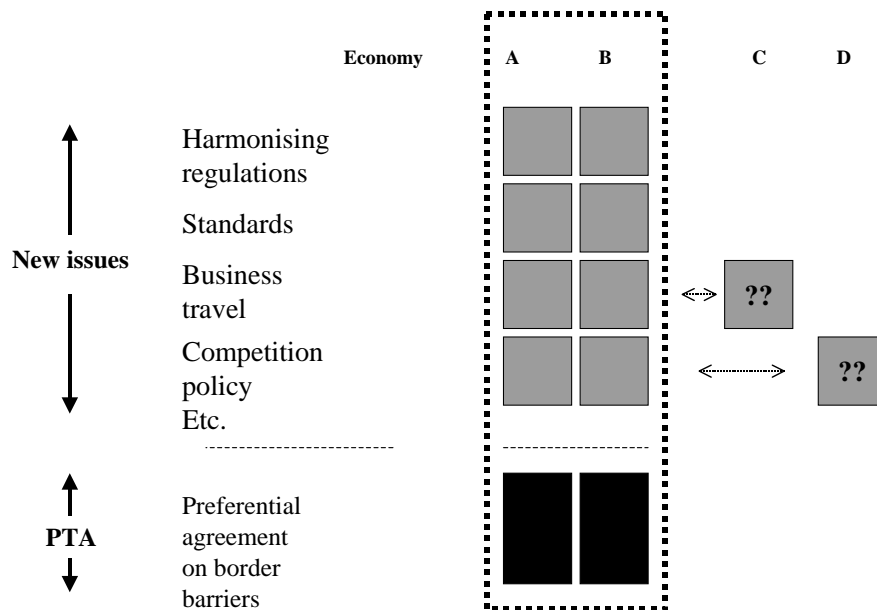
It is certainly not sufficient to rely on a general principle of open accession, without careful attention to the design of RTAs.

Figure 1 illustrates an RTA agreement between two economies (A and B) which contains a PTA, together with numerous arrangements for facilitation. Other economies (C and D) may wish to join one of these arrangements and be able to demonstrate that they can implement the policies and make the institutional changes necessary to join that particular initiative.

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<sup>19</sup> Australia and New Zealand have been able to harmonise their approaches to competition policy to an extent that they could agree on eliminating anti-dumping actions against firms from the other partner. In principle, it would be desirable to extend such arrangements to more economies.

## Diagram 1



If those particular arrangements are to act as pathfinders for wider cooperation, then it would seem desirable to admit them to those arrangements. But several kinds of problems may arise, even if the RTAs are stated to be open to wider accession in principle.

One of these problems, which is certainly relevant to the diverse Asia Pacific region, is that many economies find it difficult to implement a large number of arrangements for facilitation simultaneously, so all all-or-nothing approach is not a practical options.

The EU has adopted such an all-or-nothing approach. There is an '*acquis communautaire*' of several hundred arrangements, which potential participants are required to adopt at the same time. This has made the EU very difficult to join.

Such an *acquis communautaire* approach would be highly undesirable for the Asia Pacific. Economies like Japan and Singapore have the capacity to implement many cooperative arrangements to facilitate trade and investment. However, others, like Brunei, Papua New Guinea or Vietnam, might find it impossible to join all the facilitation arrangements which have been agreed by Japan and Singapore.

A second kind of problem could arise from 'bundling' options for cooperation. Entering arrangements for cooperation which are perceived to be of mutual benefit to potential participants could be conditional on agreement on some other options which are seen as net costs.

For example, Australia and Japan may want to agree on mutual recognition of standards for auditing and disclosure for firms which could be listed on their

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stock exchanges, with shares traded electronically on either exchange. But that option would be ruled out if it could only be considered alongside a PTA. In that case, Australia and Japan would need to forego the potential mutual benefits of this option for wider facilitation, since they cannot expect to enter into a WTO-consistent PTA due to their various sectoral sensitivities.

In principle, it should be possible to link another economy, say Singapore, to a practical arrangement to facilitate trade or investment between Australia and Japan. But a problem may arise, since Australia and Japan have already concluded a wide ranging RTA with Singapore and either or both of these may have already included a similar option for facilitation. It might seem natural to create a triangular arrangement covering all three (and potentially more) economies. The scope to do so will depend on the nature of any provisions for accession to all or part of the already signed RTAs.

Accession will be difficult if RTAs contain PTAs, as well as co-operative arrangements to deal with non-border barriers. PTAs embedded in the RTAs are typically agreed after lengthy negotiations of comparable reductions in border barriers which were seen as 'concessions'. In that case, there will be a tendency to regard that RTA as a 'single undertaking'. Insistence on a 'package deal' could make it impossible to use practical options for facilitation, pioneered among RTA partners, as building blocks for region-wide arrangements for facilitation.

There may be an alternative way to create region-wide agreements which can lead to mutual benefits to all Asia Pacific economies.

APEC working groups could be encouraged to devise potential region-wide cooperative arrangements which are based on (though not necessarily identical to) the most attractive initiatives for facilitation which are pioneered within the growing number of RTAs. In line with the agreed provisions for pathfinder initiatives, any APEC economy which wished to be party to such an APEC-initiated arrangement for facilitation, and had the capacity to join, should be encouraged to join.

In many cases, these cooperative arrangements lead to mutual benefits which, through positive network effects, can be magnified if additional economies join. Therefore APEC pathfinder initiatives for facilitation should be backed by capacity-building to encourage and enable others to join.

The prospect for using ideas pioneered in RTAs as pathfinders for potential region-wide cooperative arrangements will depend on the attitude of the pioneers. Economies which have negotiated an RTA which contained an arrangement for facilitation, such as streamlined processes for listing on each others' stock exchanges, will also need to decide whether to join an APEC initiative, possibly modelled on their ideas.

Hopefully, the pioneers would perceive gains, including positive network effects, from a wider agreement and would be the first to join, then encourage others to do so.

In other cases, the pioneers may refuse to join the new arrangement. A potential reason might be that they would regard that as eroding the value of the wider preferential RTA. They could also object to others 'cherry-picking' among aspects of what they regard as a package deal.

Such objections would not prevent arrangements based on particular aspects of particular RTAs.<sup>20</sup> However, if the pioneers refused to be part of such initiatives, there is a high risk of new 'spaghetti bowl' of similar, potentially overlapping cooperative arrangements among different groups of APEC economies for the many potential means of facilitating trade and investment.

An effective way to deal with this potential problem would be for all for APEC governments to agree that all of their arrangements for co-operative arrangements for facilitation be treated as pathfinder initiatives in the context of the APEC process.<sup>21</sup>

However, for the reasons discussed above, it may not be possible to reach agreement on such an additional principle for facilitation. In that case, RTAs could not make much contribution to dealing with either border or non-border barriers.

<sup>20</sup> The pioneers should not object to initiatives modelled on their arrangements: the principle of transparency has been accepted as a general principle of trade and investment liberalisation and facilitation and as a desirable feature of best practice RTAs.

<sup>21</sup> APEC's current principles for facilitation do not offer guidance on accession to cooperative arrangements which involve some, but not all APEC economies. It is certainly not clear if the facilitation principles apply at all to arrangements contained in RTAs. PECC's proposals for a common understanding do not yet address this issue explicitly.

As explained in Elek (2003) a synthesis between APEC's principles for facilitation and its Pathfinder Principle could be achieved by adopting additional principle along the following lines:

*"Co-operative arrangements to facilitate trade and investment may be pioneered among pairs or groups of economies, including in the context of closer economic partnerships (or regional trading arrangements) involving APEC economies.*

*In line with the principles of the 1995 Osaka Action Agenda and the concept of pathfinder initiatives endorsed in the 2001 Shanghai Accord, **APEC economies***

*should be encouraged to **pioneer new arrangements for facilitation.***

*In the interest of promoting wider free and open trade and investment, any economy whose government adopts policies compatible with any existing or proposed co-operative arrangement **nt involving APEC economies**, should be able to, and be encouraged to, become party to any of **those** arrangements."*

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## **Annex 4: Border barriers**

The main paper proposes medium-term targets for liberalising trade in products and factors of production. This Annex provides further detail about these targets and strategies to approach them.

### **Goods and services**

#### Lightly protected products

International trade in a growing majority of goods and services face zero, or negligible border barriers. Some of these are products where the vested interests of producers in protection from international competition has been overcome, sometimes by means of multilateral trade negotiations. Others are new products which tend to face no border barriers, since vested interests seeking protection have not had the time to entrench themselves.

In these circumstances, APEC governments should be able to make the modest reforms needed to set and bind already low border barriers to zero in the WTO. They should be able to do that by continuing the process of voluntary concerted unilateral liberalisation.<sup>22</sup>

That would be more than a symbolic gesture. Binding border barriers on most products at zero would ensure that they do not become increasingly heavily protected products in future, as comparative advantage shifts towards new competitors. Zero border barriers for most products would lead to huge savings in administrative costs; there would be much less need to document rules of origin in order to qualify for preferences under the proliferating number of discriminatory RTAs.

#### Sensitive products

For products which are already sensitive, significant voluntary liberalisation cannot be expected to lead to free trade in the foreseeable. Reducing, let alone eliminating, these high and politically sensitive barriers will need to be negotiated.

As discussed in Annex 2, the voluntary nature of APEC means it is not an efficient forum for negotiations. It may prove possible, eventually, to convert APEC into a formal process which could impose binding obligations on member economies. However, APEC would still not have any comparative advantage over the WTO as a forum for negotiating cuts in border barriers to trade in sensitive products.

In the course of WTO negotiations for cutting protection of sensitive products, non-APEC economies would be expected to offer cuts in response to any offered by APEC governments. That would help to overcome the vested interests of those who are opposed to such cuts in protection: the benefits to potential exporters increases with the number of economies involved in the

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<sup>22</sup> It would be possible for APEC economies to apply zero tariffs without binding them in the WTO. That would allow a subsequent binding to be used as 'negotiating coin' in WTO negotiations. But that could not be expected to have a significant effect. Many APEC economies are already binding some zero rates with respect to a growing number of non-APEC economies as part of PTAs. APEC economies would, in theory, still be able to raise some zero rates for some economies, but that would not create significant leverage relatively to other issues at stake in a WTO round.

negotiations, while the costs of short-term adjustment to reforms would be spread globally, rather than concentrated within a smaller group of economies.

It will not be easy to persuade APEC governments to make a collective offer in the WTO offer to get rid of border barriers to trade in sensitive agriculture and labour-intensive manufactured products. But, if they are not willing to do so, they are even less likely to solve these problems among themselves.

In the current Doha round of WTO negotiations, APEC governments have offered to reduce, but not to eliminate, border barriers to sensitive products. That means they do not yet have the political will to eliminate these barriers, even if other economies, especially the EU were willing to respond with comparable reforms, which would enhance the benefits and reduce the costs of reforms by APEC economies. APEC governments would be even less likely to offer to eliminate these barriers among APEC economies alone, since non-APEC economies would not share in the short-term costs of adjustment. All of the adjustment to competition from efficient Asia Pacific producers of agricultural and labour-intensive manufactured products would need to be made by APEC economies.

The pragmatic option is to acknowledge that most APEC economies do not have the political will, right now, to eliminate border barriers to sensitive products, even in the WTO. Changing that current reality will need a patient effort to build the community support and consensus for genuine free and open trade and investment.

That will take time. If WTO negotiations on these difficult issues are to be completed by 2020, they would need to begin well before then. A realistic medium-term objective for APEC economies would be to agree on making a collective offer in the WTO, by 2010, to dismantle protection of these products, provided other economies are prepared to respond with comparable reforms.

As discussed in the paper, reaching free and open trade and investment will depend on getting trade restrictions on some sensitive products which have not yet been brought under WTO disciplines, especially international transport. Once again APEC governments would need to agree to do bring them under WTO disciplines by 2010, if they expect to make significant progress in WTO negotiations by 2020.

An offer for free trade in all products, including sensitive products, would need to include an offer to accept tight disciplines on the use of subsidies and contingent protectionism, including anti-dumping actions. Unless such disciplines are agreed, zero border barriers, by themselves, will not be adequate to create the conditions for free and open trade and investment.

At present, there is considerable resistance to tighter disciplines on contingent protectionism, including by the United States. This resistance can only be overcome if APEC governments are willing to agree to greater harmonisation of aspects of fiscal policy, such as subsidies to investors and producers, and demonstrate the capacity to apply competition policies which would prevent anti-competitive behaviour in international as well as domestic markets.

Unless these underlying problems are tackled, APEC governments cannot be expected to restrict their options to use trade restrictions to deal with their symptoms. Annex 5 discusses some of the medium-term challenges APEC

governments will need to meet to tackle the policy problems which are currently used to justify protectionism.

Reaching consensus on dealing with these issues will take time and (especially for competition policy reform) the necessary reforms will need substantial capacity-building. If APEC governments expect to make progress by 2020, they will also need to set a timetable to address these issues well before then.

#### *Avoiding the emergence of new sensitive products*

Given the difficult and complex problems posed by products which have become heavily protected and political sensitive, it would be desirable to avoid the emergence of additional sensitive products in the future.

It may be possible to prevent new sensitive pockets of protection by finding a way to 'immunise' newly invented products against trade policy distortions.

In 1996, APEC leaders agreed, voluntarily, not to impose barriers to trade information technology (IT) products. Much discussion and persuasion was needed to convince all APEC governments that such a decision was in their mutual interest. But there was no need for adversarial negotiations about reciprocal 'concessions'.

Once APEC leaders reached their agreement, it led, with support from others, to a WTO-wide agreement on IT products. These are a rapidly growing share of all products, so this agreement will contribute to sustained progress towards global free and open trade and investment. If a similar agreement could be reached for all newly invented products, that would ensure that the problems of protection affected only a continuously dwindling share of all trade.

In 1997 and 1998, APEC governments tried, and failed, to build on the IT precedent. The early voluntary sectoral liberalisation (EVSL) effort failed, because it tried to accelerate liberalisation of some products which were already sensitive. The experience confirmed that APEC does not have the structure, or comparative advantage, for WTO-style trade negotiations.

However, it may be possible for APEC governments to build on their success in IT, by generalising the concept to apply to all newly invented products, where there is no short-term pressure for protection from international competition.

In near term, the comparative advantage of producers or marketers of new goods and services is created by the intellectual property embedded in these products. Therefore, they generally seek to protect their intellectual property rights (IPRs), but they do not have an urgent interest in protection by means of traditional policy instruments such as border barriers or anti-dumping.

In the longer term, such initial advantage can be eroded; for example if close substitutes are invented, using genuinely different ideas or technology. In that case, comparative advantage would depend increasingly on relative prices in different economies. As products mature, there may be growing pressure for protection against international competition, risking the emergence of more sensitive sectors.

In order to avoid this, governments could decide to offer to safeguard IPRs for new products using policy instruments which do not differentiate among

domestic or international suppliers, but to rule out subsequent protection by any means which do discriminate against international suppliers.

It should be feasible to require a choice between either protection of IPRs, or protection aimed specifically at international competition, if the decision was to be taken before new products need old-style protection. The short-term political costs should be small since no existing jobs or profits would be threatened, while the long-term gains will become significant as the share of new products continues to expand.

APEC economies could set a target of 2010 to agree on a strategy along these lines, as part of their long-term commitment to free and open trade and investment. As in the case of information technology products, it may be possible to reach WTO-wide agreement on such a policy, giving APEC governments a further opportunity to demonstrate collective leadership in that forum.

### **Factors of production**

As discussed in Annex 1, the Bogor Declaration does not define what is to be achieved, by 2010/2020, in terms of reducing obstacles to international trade in factors of production.

#### *Direct foreign investment*

Free and open trade and investment has been widely assumed to mean dismantling obstacles to direct foreign investment. To make this commitment meaningful, the time has come to clarify what this means.

APEC's non-binding investment code, agreed in 1994, sets out the principles which APEC governments are expected to apply to their legislation concerning direct foreign investment. As set out in Davidson (2003), the policies of APEC economies on direct foreign investment are converging towards consistency with these principles.

A reasonable target for 2010 would be for all APEC economies to adjust their legislation to be fully consistent with the current form of APEC's non-binding investment code.<sup>23</sup>

Such progress towards free and open investment would identify at least two additional challenges:

- firstly, the need to assure potential investors that such policies would not be changed in future, in ways which would impose new costs or risks;
- secondly, the extent to which the principles themselves needed to be strengthened in order to approach genuine free and open investment.

Most Asia Pacific economies are sources as well as destinations for direct foreign investment. There is intense competition among them to attract additional direct foreign investment. Therefore, once legislation has been

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<sup>23</sup> Developing economies could, if they wished, delay their commitment to such legislation to 2020. However, there would be an incentive to accelerate the necessary reforms in order to become more attractive to potential investors.

adapted to conform to APEC-wide principles, governments will have a strong incentive to sustain those reforms, even if the principles themselves were not formally binding.

Such incentive for adherence may not be considered to be sufficient by potential investors. They may want to be assured that governments are willing to enforce their legislation, which may impose restrictions on some economic agents. They may also want to be assured that future policies will not, possibly unintentionally, be inconsistent with agreed principles. Such assurance can be provided without needing to convert the APEC process as a whole into a formal organisation.

As discussed in Annex 5, it is possible to provide adequate assurance of adherence to arrangements which are initially agreed voluntarily among APEC economies, then entrenched in domestic legislation. There are already existing means to resolve international disputes involving governments and investors which may arise if governments do not adhere to their legislative obligations.

Turning to the second challenge, APEC governments will also need to consider strengthening the principles underlying their legislation on direct foreign investment.

Fully free and open investment would require, amongst other things, principles which provide for full rights of establishment in APEC economies and full national treatment of all firms in these economies.

As in the case of restrictions to trade in sensitive products, some there will be sensitivities about the right to invest in some sectors, such as entertainment, news media or air transport. Once again, it may not be possible for APEC governments to accept such principles for all direct foreign investment.

By 2010, APEC governments could agree to negative lists for sectors where general principles would not necessarily apply and to agree not to add to these negative lists. APEC governments should also set a 2020 deadline for eliminating such negative lists. As in the case of trade restrictions on sensitive products, it may not be possible to reach comprehensive free and open investment through concerted unilateral liberalisation. If negotiations are needed for some highly sensitive sectors, then the 2020 deadline for comprehensive free and open investment would need to be added to other matters which would need to be negotiated in the WTO by that time.

#### Other capital flows

The experience of the late 1990s showed that free movement of all capital, especially short-term portfolio capital, needs an adequately developed financial system. On the other hand, changes in technology will continue to erode the relevance and feasibility of capital controls.

APEC working groups are already designing ways to strengthen and deepen the capital markets in the region, including the development of bond markets in a growing range of currencies and currency swap arrangements.

As part of the mid-term review, APEC governments could commit themselves to an ambitious capacity-building program to develop the skills and institutions which will be needed to enable all APEC economies to manage the risks of,

and reap the benefits of, essentially free international movement of capital, to and from APEC economies, by 2020.

Labour movement

A broad interpretation of free and open trade and investment and economic integration could also include free movement of people employed in relation to international investment and trade in services.

Given the diversity in population, population density and incomes per head, unrestricted labour mobility is not a realistic ambition in the Asia Pacific for the foreseeable future. However, in consultation with the private sector, it should be possible to set realistic targets for reducing restrictions to production-related movement of people, to be achieved by 2010 and 2020.

## **Annex 5: Other obstacles to trade and investment**

Section 2.2 of the paper lists several medium-term targets for reducing non-border barriers. These targets need to be met if genuine free and open trade and investment in the Asia Pacific region is to be achieved by 2020. They draw on the set of targets suggested by the Australian members of the APEC Business Advisory Council (ABAC) in 2004. ABAC has recommended that a Trans Pacific Business Agenda (TPBA), with goals to be finalised, be implemented from 2005.

The business sector considers that achieving well-defined targets for reducing non-border barriers to be an essential part of progress towards an integrated market environment in the Asia Pacific, in which businesses can operate freely anywhere in the region, as if they were in their own domestic markets.

The targets are not intended to exhaust the options for trade and investment liberalisation and facilitation. As discussed in the paper, there will always be opportunities to reduce obstacle to international commerce. Changes in technology, as well as progress towards targets already adopted will reveal new opportunities to facilitate trade and investment. The 1995 Osaka Action Agenda has already had to be updated to cater for changing circumstances.

Ultimately, like a perfectly competitive market, free and open trade and investment is an ideal, which can be approached but never fully realised. The practical way to deal with this dilemma is to set well defined medium-term goals. The mid-term review of progress towards the Bogor provides an opportunity for APEC leaders to select an initial set of targets for 2010 and 2020, such as those suggested in this paper.

This Annex comments on how such targets can be approached, learning from the experience of others, while taking advantage of the flexible nature of the APEC process.

### **Learning from experience**

Trade and investment facilitation has become a high priority in APEC for at least two reasons:

- Firstly, there is an urgent need to deal with the increased security costs of international transactions due to rising international terrorism. These costs are already estimated at US\$35 billion for East Asia alone. The SARS outbreak in 2003 also focused policy attention on improving systems to reduce the cost and risks associated with the movement of goods and people.
- Secondly, regulatory barriers to trade or investment are becoming an increasingly significant part of the transactions costs of international commerce. As border policy barriers (tariffs and border restrictions on trade and investment) come down, business is more and more focused on other regulatory, institutional and policy measures that reduce the potential for trade and investment.<sup>24</sup>

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<sup>24</sup> See Drysdale (2004)

The European Union (EU) has gone furthest in terms of dealing with non-border barriers to trade and investment. APEC can draw on this experience, but can also improve on it, dealing with the most urgent aspects of facilitation in a creative way which suits the Asia Pacific region.

EU economies took some time to recognise the importance of facilitation. The founding members of the EU had eliminated border barriers by end of the 1960s. By the late 1980s, it was evident that the absence of border barriers to trade was nowhere near sufficient to create a single market, either for consumption or production. EU leaders then committed themselves to, and implemented, a wide ranging set of reform of domestic economic regulations to reduce the cost of needless divergence in matters such as standards and competition policy. Through hundreds of cooperative arrangements, ultimately adopted in domestic legislation, members of the EU implemented an ambitious agenda of trade and investment liberalisation and facilitation: namely, the European Single Market agenda.

Scollay (2004) explains that:

*The single market is based around “four freedoms”: free trade in goods, free trade in services, free movement of capital and free movement of labour. A further ingredient was an extensive programme of trade facilitation and other “behind the border” measures, including harmonisation or mutual recognition of technical standards, removal of border controls on movements of goods and in many cases also of people, liberalisation of government procurement, and harmonisation of indirect tax rates. Implementation of this programme involved obligations on members to enact a large number of legislative changes.*

Eleven members of the EU have also adopted a common currency. Scollay notes that:

*A key lesson from the EU’s “single market” is that trade facilitation and other measures aimed at removing “behind the border” barriers can deliver economic benefits substantially greater than those available from agreements to remove conventional border barriers such as tariffs and quantitative restrictions.*

Compared to what was achieved by the EU’s Single Market Agenda, Asia Pacific economies are barely scratching the surface of the many opportunities to facilitate trade and investment. But that does not mean that APEC should imitate the EU.

For example, there can be too much harmonisation of economic regulation. Some harmonisation can preclude subsequent deregulation and it may be more efficient to experiment with different forms of regulation, rather than entrench current practice. Some aspects of European integration, such as the free movement of all labour and a single currency need not be embraced.

Other aspects of the EU Single Market agenda, such as the mutual recognition of standards and professional qualifications are appropriate to any group of economies seeking closer integration. To approach genuine free and open trade and investment, APEC governments will need to address a substantial part of the same issues as European economies have done

APEC will have to address these issues in a manner suitable to the APEC process, where there is no supra-national authority or bureaucracy with enforcement powers. APEC will need to rely on the consensus-building and capacity-building which has already achieved significant gains in terms of facilitation.

Unlike the EU, Asia Pacific economies need not wait to complete trade liberalisation before dealing with non-border barriers. . Designing and implementing cooperative arrangements to seize the benefits of dealing with non-border issues should not be held hostage to impasses in agricultural trade or other sensitive areas. The need to work on border and non-border barriers at the same time is emphasised in the Osaka Action Agenda.

### **Staying flexible**

Progress towards the recommended medium-term targets is, essentially an acceleration of action plans for trade and investment facilitation.

Meeting the targets listed above will require careful policy and institutional development. Medium-term objectives can be tackled at the same time, but not necessarily at the same pace. In the many cases where Asia Pacific economies perceive potential net gains, the design and implementation of appropriate cooperative arrangements can proceed at the same time, as already envisaged in the Osaka Action Agenda. Progress on some positive-sum games need not be conditional on progress on other fronts. There is certainly no need to insist that all members tackle all aspects of market integration at the same time to create an EU-like '*acquis communautaire*'.

These are some of the advantages of flexibility offered by the voluntary nature of the APEC process. On the other hand, a potential problem with voluntary cooperation is the need to assure other governments and the private sector that voluntary agreements will be adhered to.

An important part of the answer is provided by game theory. If voluntary cooperative arrangements to facilitate trade or investment are perceived to be positive-sum games, then participants will have an incentive to abide by these arrangements. Policies which are adopted voluntarily by APEC governments by means of consensus on reforms, will be policies where those governments perceive a net benefit from those voluntary reforms. Once these reforms are adopted, Asia Pacific governments will not have any incentive to reverse them, since they would damage their interests by doing so. They would forego the advantages of the cooperative arrangements they may abandon and they would also damage their reputation as a reliable destination for investment.

For these reasons, reforms which are made voluntarily should not require much effort to make them binding. Binding inter-governmental agreements and sanctions for non-compliance are not likely to be needed.

But some governments and potential investors may not be satisfied with this assurance. That does not mean that APEC needs to become a treaty-based organisation with powers of enforcement over member economies.

If considered essential, additional assurance about the durability of agreed reforms could be provided by specific agreements on a specific aspects of

facilitation, such as adopting certain harmonised approaches to customs documentation and clearance.

APEC governments could enter into a treaty that would make arrangements agreed for a certain aspect of facilitation binding. It would be necessary to agree on some procedures to resolve potential disputes, just as ASEAN has set up dispute settlement procedures for some economic matters. The United Nations Commission on International Trade Law (UNCITRAL) has also developed several procedures for settling international commercial disputes.<sup>25</sup> Such procedures could be drawn on, or adapted by APEC governments.

A potentially more efficient approach would be for APEC governments to take a collective initiative in the WTO; in this case to agree, voluntarily, to a WTO protocol which sets out their obligation to adhere to agreed customs arrangements.

There are precedents for a group of WTO members agreeing to abide by specific-purpose protocols which may not be acceptable to all members. Additional protocols on opportunities to facilitate trade or investment, accepted initially by APEC economies, could subsequently be extended to WTO-wide disciplines.

Either of these approaches can provide adequate assurance that APEC governments would adhere to policies which they had already decided to be in their own interests. Neither approach relies on an attempt to convert the APEC process, as a whole, into a formal organisation for economic cooperation.

### Setting positive examples

The flexible approach set out above would allow several sets of issues to be tackled at the same time, by a self-selecting group of Asia Pacific economies. There is no need to wait until Papua New Guinea is ready for paperless trading, or to await the liberalisation of the Japanese rice market. On the contrary, APEC will need to encourage some member economies to set examples for others, rather than sticking to the lowest common denominator acceptable by all.

Given the diversity of the region, APEC-wide targets for facilitation will be reached by some ahead of others. It is therefore important that practical, cooperative arrangements for trade facilitation are genuinely open to others. Pathfinders who implement initiatives will need to share the information, experience, expertise and technology needed for others to join as soon as they perceive the benefits of doing so.

There will be some incentive to broaden arrangements pioneered by some APEC economies. The gains from many cooperative arrangements to facilitate trade or investment can be magnified by capturing positive network effects. For example, the benefits of mutual recognition arrangements to existing participants can be enhanced by widening the number of participants.

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<sup>25</sup> Adopted in 1976, the UNCITRAL Arbitration Rules provide a comprehensive set of procedural rules upon which parties may agree for the conduct of arbitral proceedings arising out of their commercial relationship. The Rules are widely used in ad hoc arbitrations as well as administered arbitrations (see <http://www.uncitral.org/en-index.htm>)

If some economies are to set examples for others, the arrangements they devise will need to be genuinely open to others. That will need transparency and openness to accession.

APEC's agreed principles for facilitation already call for transparency. In practical terms, transparency of cooperative arrangements, for example for mutual recognition of standards, can be provided by means of appropriate domestic legislation by APEC governments and/or agreeing to appropriate disciplines which can be enforced by existing multilateral organisations.

APEC leaders have also endorsed the concept of pathfinder initiatives. Economies which are ready to implement cooperative arrangements are encouraged to do so, while others can join as soon as they perceive the benefits of doing so (see APEC 2001).

To be catalysts for APEC-wide arrangements initiatives to facilitate trade and investment pioneered by some APEC economies will need more than formal accession clauses. Other economies should be permitted to join specific practical arrangements for facilitation, without conditions which are not related to that arrangement. For example, economies should be allowed to join a pathfinder initiative (such as for some aspect of paperless trading) without having to be members of particular sub-groups of Asia Pacific economies.<sup>26</sup>

To promote region-wide arrangements, additional economies should not only be permitted to join cooperative arrangements pioneered by others. They should be encouraged to do so. Pathfinders who implement new initiatives will need to share the information, experience, expertise and technology needed for others who wish to join these arrangements.

### **Capacity-building**

Some APEC economies already have the capacity to implement cooperative arrangements in line with the medium-term targets listed in this paper. However, corresponding region-wide facilitation will take time. It will require extensive ongoing capacity-building to enhance human resources, technology and institutions throughout the region. APEC governments need to do much more on this front, starting now, even while they muster the courage for genuine free trade.

The capacity-building program of APEC will need to grow rapidly, giving priority to capacity needed for region-wide economic integration. Substantial financial and institutional resources will be needed if all APEC economies are to be able to participate in the cooperative arrangements for facilitation which are already being pioneered among the relatively more developed member economies. This effort can not all be financed by aid programs, but will need much greater and more creative efforts to forge public/private partnerships.

Once APEC-wide targets for facilitation are set for 2010 and 2020, APEC leaders will need to engage private sector and international financial

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<sup>26</sup> Nor should accession to specific, practical co-operative arrangements require membership of an RTA. The prospects for using facilitation arrangements, which are being pioneered in the context of RTAs, as building blocks for region-wide facilitation is discussed in Annex 3.

institutions, at the highest levels, and to assign responsibility within APEC to monitor and report on the necessary region-wide capacity-building effort.<sup>27</sup>

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<sup>27</sup> Strategic options for capacity-building are discussed in Annex 6.

## ***Annex 6: Capacity-building<sup>28</sup>***

In the foreseeable future, APEC governments will find it hard to get rid of some sensitive border barriers. APEC's credibility will, therefore, depend on accelerating efforts on other fronts, such as progress towards the medium-term targets for reducing non-border barriers trade and investment suggested in this paper.

In most cases, the real constraint on implementing cooperative arrangements to reduce transactions costs is not political difficulty, but the need to develop the capacity needed to implement them.

Substantial financial and institutional resources will be needed if all APEC economies are to be able to participate in the cooperative arrangements for facilitation which are already being pioneered among the relatively more developed member economies.

That does not mean that APEC should become a development agency. It is not designed to implement large, region-wide capacity-building programs. Moreover, the resources needed are well in excess of what APEC governments would be able to grant to an APEC bureaucracy.

Just as APEC needs to learn to use, rather than imitate the WTO. APEC will need to learn to catalyse the resources needed for mutually beneficial economic integration in the region from the private sector and international financial institutions (IFIs), such as the World Bank and the Asian Development Bank.

APEC governments have created a wide-ranging economic and technical co-operation (ECOTECH) agenda. The private sector and IFIs are already supporting this work program. For example, the World Bank is already supporting investment in capacity-building for trade and investment facilitation. There are increasingly regular contacts between APEC and IFI officials. But the scale of their involvement will need to be greatly increased.

Neither the IFIs, nor the business sector, can be expected to participate in hundreds of projects. A clear sense of priorities is essential for creating the substantial public-private partnerships which will be needed. APEC governments have already agreed that the current ECOTECH program will need to be streamlined. But that will not be easy.

APEC working groups have identified many opportunities for mutually beneficial sharing of information, experience and expertise in the diverse Asia Pacific region. That has led to an emergence of hundreds of small co-operative actions, such as data collection and dissemination, seminars, workshops and training courses.

Almost all of these are very small-scale activities, often funded by one APEC economy. While almost all of these are useful, APEC's consensus-based decision-making process has made it hard to set priorities. That has prevented any of these efforts to reach a scale sufficient to make a significant

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<sup>28</sup> This Annex draws on Foundation for Development Cooperation (1999), which is one of a series of publications on capacity-building and ECOTECH in APEC, available at <[www.fdc.org.au](http://www.fdc.org.au)>.

contribution relative to the region's human resources, institutional capacity or economic infrastructure.

A high-level commitment to a small number of significant medium-term goals for trade and investment facilitation is an essential part of the effort needed to mobilise substantial resources capacity-building.

Once APEC leaders commit themselves to a few well-defined objectives for 2010 and 2020, they can draw on the expertise of the IFIs to design multi-economy and multi-year programs for the investment in the kind of capacity-building which is needed for these aspects of trade and investment facilitation.

APEC leaders, through their Finance Ministers, have considerable influence on IFIs, so they could be expected to help to define programs which are not only feasible, but efficient and expected to generate a sound economic return on these investments.

These programs will be able to draw on APEC's ECOTECH efforts, for example training materials for various aspects of facilitation. Relevant training materials and courses have been designed and tested in recent years; some of them now need to be scaled up sufficiently to make a real difference to implementation capacity throughout the region.

Once multi-year programs for capacity-building are designed, APEC governments and the private sector will need to provide the resources needed to implement them. The private sector could provide funds, facilities and expertise. That would reflect the potential gains to business from lower costs and risks of international trade and investment. The private sector has already funded several APEC-related training efforts. However, the private sector cannot be expected to finance all of the public goods (including international public goods) which will be needed to achieve significant facilitation.

Therefore, APEC governments which will all benefit from these programs will need to agree to repay the cost of the capital raised by IFIs to implement the programs.

All these programs can be expected to yield sound economic rates of return. Moreover, all APEC economies would share in these benefits. Therefore, they should be prepared to service the necessary borrowing from the IFIs. Ambitious medium-term targets for APEC-wide TILF cannot be achieved without substantial investment and the willingness to use some of the returns from investment in capacity-building to repay the costs of those investments.<sup>29</sup>

Ensuring progress towards goals such as broad mutual recognition of standards requires managing the process of mobilising resources for capacity-building. Once APEC-wide targets for facilitation are set for 2010 and 2020, APEC leaders will need to assign clear responsibility within APEC to monitor and report on the necessary region-wide capacity-building effort involving the IFIs as well as the private sector.

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<sup>29</sup> IFIs do provide grants to some projects or program (for example, through the World Bank's IDA window). But these need to be financed indirectly by grants from member governments. The volume of grants will not be sufficient to finance more than a small share of the capacity-building needed to reach ambitious region-wide targets for facilitation.

Managing progress is likely to require a streamlining of the Individual Action Plans (IAPs). At present, they contain a massive amount of information about the policy intentions of APEC governments. That is extremely valuable information and can be presented on the Biz-APEC website. That would allow the IAPs to become more digestible and more focused management tools which would be of practical use to business as well as government leaders.

These management tools would measure progress in terms of success or failure to reach the benchmarks which need to met by Asia Pacific governments (and their private sector partners) in order to reach a small number of agreed medium-term targets for trade and investment liberalisation and facilitation.

## **Annex 7: 2010/2020 targets for liberalisation and facilitation**

For convenience, this Annex repeats the targets for both liberalisation and facilitation which are proposed in the main paper.

### Medium-term targets for liberalising border barriers

The medium-term targets for liberalisation discussed above can be summarised as:

1. *Border barriers to be set and bound at zero by 2010/2020 for goods and services which are already lightly protected, or not yet invented..*
2. *APEC governments to make a collective offer in the WTO to eliminate the protection of sensitive products, in return for comparable liberalisation by non-APEC economies: the offer should be made by 2010 to allow the negotiation of free and open trade and investment by 2020.*
3. *APEC governments to make a collective offer, by 2010, to impose tight WTO disciplines on subsidies, anti-dumping and other forms of contingent protectionism.*
4. *APEC governments to propose bringing international transport under WTO disciplines by 2010 and offer to create open seas and skies by 2020.*
5. *Enact the domestic legislation needed to implement the currently agreed non-binding investment code by 2010; then offer full rights of establishment and national treatment of international direct foreign investment by 2020.*
6. *Launch a capacity-building program from 2005, to develop the expertise and institutional capacity needed for free flow of capital to and from all APEC economies by 2020.*

In consultation with the private sector, it should also be possible to set realistic medium-term targets for production-related labour mobility.

### Other obstacles to free and open trade and investment

Some of the opportunities for reducing other, non-border, impediments to free and open trade and investment, by no later than 2020, include:

7. *An intensified program of mutual recognition of product standards and professional qualifications, comparable in scope to that achieved by the EU.*
8. *Full compatibility and fully electronic data interchange of customs documentation and clearance procedures.*
9. *Transparency and harmonisation of a wide range of administrative procedures, including agreed minimum standards for auditing and disclosure.*
10. *Harmonised fiscal incentives for investment and production.*
11. *An APEC code for the consistent taxation of international income.*
12. *Region-wide minimum standards for competition policy, which are sufficiently rigorous to avoid the need for anti-dumping actions among APEC economies.*