

Preliminary Assessment of the Proposal for a Free Trade Area of the Asia-Pacific (FTAAP)

An Issues Paper for the APEC Business Advisory Council (ABAC)

(This paper has been prepared by Robert Scollay from the PECC Trade Forum, taking account of comments from other members of the Trade Forum, which are gratefully acknowledged at relevant points in the paper. While the paper attempts to strike a balance across the views expressed, it has not been possible to reach a consensus on the paper within the PECC Trade Forum. The paper is therefore submitted on the author's sole responsibility.)

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The stated purpose of the proposed Free Trade Area of the Asia Pacific (FTAAP) is to consolidate and accelerate progress toward achievement of APEC's Bogor goals. This is the correct perspective from which to view the proposal, and it is therefore the basis on which it is assessed in this report.

1. FTAAP in the Asia-Pacific and Global Trade “Landscapes”

1.1. FTAAP and Existing Liberalisation Processes

1.1.1. APEC

In the Bogor Declaration of 1994 the APEC economies committed themselves to the achievement of free trade and investment in the Asia-Pacific region through a three-pronged programme of trade and investment liberalisation, trade and investment facilitation (these two elements being commonly combined under the acronym TILF), and economic and technical cooperation (Ecotech). The target dates set for achievement of these goals were 2010 for APEC developed economies and 2020 for APEC developing economies.

These “Bogor goals” were to be pursued in accordance with the principle of “open regionalism”. Although never formally defined by APEC itself, the commitment to “open regionalism” was widely understood to signify that APEC would not seek to establish itself as a preferential trading bloc, but rather that APEC economies would progressively remove their trade and investment barriers on a non-discriminatory basis. The commitment to “open regionalism” reflected the determination of APEC economies at that time to give firm support to the primacy of the multilateral trading system and the newly-created WTO as the custodian and administrator of that system.

Consensus around the Bogor Declaration and its underlying principles was facilitated by a degree of imprecision in defining both objectives and principles. In the absence of a formally agreed definition of “open regionalism”, policy makers and analysts with quite different views of its meaning were nevertheless able to subscribe to the principle. On the one hand there was widespread acceptance of the view that “open regionalism” implied a commitment to non-discriminatory liberalisation on an “unconditional” basis, meaning that it does not depend on reciprocation by other economies. On the other hand those to whom this interpretation was unacceptable could also support the principle, based on an alternative interpretation that non-discrimination was to be “conditional”, meaning that it was to proceed only if other economies reciprocate.

Other important concepts were also left without precise definition. No precise definition was given of “free trade in goods”, “free trade in services”, or full liberalisation of investment. APEC economies were left free to choose whether to classify themselves as “developed” or “developing” economies for the purpose of deciding which of the two target dates applied.

The “road-map” to achievement of APEC’s liberalisation and facilitation objectives was set out in 1995 in the Osaka Action Agenda (OAA). The OAA set out agendas for action in 15 trade policy areas, each to be the subject of a chapter in the individual action plans (IAPs) of each APEC economy and of a collective action plan (CAP). The OAA also established nine key APEC principles to guide the implementation of APEC’s liberalisation and facilitation agendas. The modality for implementation of the Bogor goals adopted in the OAA, and to which APEC members are still formally committed, is “concerted unilateralism”. This involves voluntary liberalisation by each APEC economy, with “peer pressure” being employed as the main enforcement mechanism, facilitated by the IAPs. “Concerted unilateralism” aims to strengthen the resolve of individual economies through a sharing of experiences and expertise, building on the recognition that liberalisation will deliver greater benefits to the APEC economies if it is undertaken together. Gary Hawke comments that “concerted unilateralism” has also been alternatively described by different observers as “soft reciprocity” or “constrained voluntarism”, and that both interpretations are useful.

Gary Hawke also notes that the design of the APEC process can usefully be viewed as an attempt to reconcile an Asian consensus-based approach with a North American or Anglo-Saxon approach that insists on reciprocity. This may be an important insight to bear in mind when considering possible changes to the APEC process or pursuit of an FTAAP.

It was never envisaged that progress toward achievement of the Bogor goals would occur solely or even primarily through initiatives generated and agreed within the APEC process itself. Both multilateral and unilateral liberalisation were expected to make substantial and indispensable contributions. At the time of the Bogor Declaration and OAA, considerable momentum had developed behind both the multilateral liberalisation process, as evidenced by the successful conclusion of the Uruguay Round, and unilateral liberalisation processes as exemplified by the many APEC economies that had undertaken important unilateral liberalisation initiatives.

Nevertheless, although APEC’s work on trade facilitation is relatively well-regarded in many quarters, the contribution of the APEC process itself to progress on liberalisation has been widely viewed as disappointing. For many observers, the failure of the Early Voluntary Sector Liberalisation (EVSL) initiative highlighted two limitations of the APEC process as a vehicle for liberalisation. First, EVSL showed that the APEC process as then constituted was clearly not – and is still not - suited to formal negotiation on liberalisation commitments. Second, it showed that the major APEC developed economies are wedded to the “conditional” version of non-discriminatory liberalisation, in which reciprocity is essential. APEC’s voluntary, non-binding approach cannot readily deliver reciprocal commitments.¹ This implies that the APEC process itself may have limited potential as a vehicle for trade liberalisation as long as its members are unwilling to admit reciprocity-based negotiations or binding commitments. Furthermore,

¹ Some argue that the Information Technology Agreement (ITA) provides a counter-example of a successful reciprocal negotiation within APEC. Others argue that the ITA was a special case that does not have general implications for possible future negotiations in APEC.

to the extent that the major economies in particular are concerned with reciprocity from non-APEC as well as APEC economies, this points inescapably to the WTO as the appropriate forum for negotiation of non-discriminatory trade liberalisation.² Reciprocity, properly considered, involves not only achieving an acceptable exchange of benefits, but also a sharing of the adjustment burdens arising from major changes in the world economy.

At the present time APEC continues to undertake important work on trade facilitation but there is little enthusiasm for parallel work programmes on liberalisation. Within the APEC process, the emphasis now appears to be placed almost exclusively on WTO negotiations as the vehicle for achieving APEC's liberalisation objectives. Outside the APEC process, APEC economies have turned decisively and increasingly towards preferential (bilateral and plurilateral) agreements as the vehicle for pursuing their liberalisation goals.

Faced with these developments a number of observers, including within ABAC, have asked whether the time may have come for APEC to move from its current voluntary, non-binding approach to pursue binding negotiated agreements across its membership.

1.1.2 Unilateral Liberalisation

A number of smaller APEC economies in particular undertook significant unilateral liberalisation in the early years of APEC. Further significant liberalisation took place in some APEC economies as part of adjustment programmes following the East Asian crisis of 1997-98, and some other economies such as Chile have continued to liberalise unilaterally.

Nevertheless the impetus behind unilateral liberalisation by APEC economies has clearly weakened in recent years. Ironically the sudden surge of interest in preferential (bilateral and plurilateral) negotiations may have to some degree created an incentive for economies to hold back on unilateral liberalisation, preferring to retain their trade and investment barriers to use as "bargaining chips" in these negotiations. In this situation economies that have gone furthest in removing their trade and investment barriers can find themselves at a disadvantage, because there are fewer "concessions" that they can offer prospective partners.

1.1.3. WTO: The Doha Development Agenda (DDA)

The WTO-based multilateral trading system continues to have a vital role as the cornerstone of the global trading order and of efforts to liberalise international trade, for several reasons:

² These comments are not intended to imply that the APEC process has no potential to contribute to liberalisation. APEC clearly has a role in maintaining and where possible enhancing support for liberalisation via the WTO process, and it may also be argued that APEC has been important in sustaining support for trade liberalisation among its members, in the face of major challenges such as the East Asian crisis of 1997-98.

- As is well understood, multilateral liberalisation offers the greatest benefits to participants while avoiding the damaging effects that can result from preferential liberalisation, especially for excluded economies
- Multilateral liberalisation plays an important role in mitigating any damaging effects of preferential liberalisation, by reducing the degree of discrimination that it involves and hence reducing the potential for trade diversion.
- A rules-based system based on the principle of non-discrimination is essential, both to protect smaller economies against discrimination by their larger partners, and to guard against the kind of behaviour that proved so destructive for the international trading system prior to World War II

For APEC economies, as unilateral liberalisation has faltered and the weakness of the APEC process as a vehicle for liberalisation initiatives has become increasingly apparent, multilateral liberalisation has increasingly been seen, at least until very recently, as the principal vehicle for achieving APEC's liberalisation objectives.

A key consideration therefore in assessing any initiative such as the FTAAP is its likely implications for the WTO and the multilateral trading system. Members of the PECC Trade Forum would not support any initiative that they considered would undermine the WTO and the multilateral system.

Nevertheless there is a legitimate question as to whether WTO negotiations by themselves can be expected to deliver sufficient progress to enable APEC's liberalisation objectives to be met. Serious doubts over the outlook for the DDA following the Cancún debacle appear to have been dispelled, at least for the time being, by the successful "July outcome" of the Geneva deliberations announced on 1 August last, which reached sufficient agreement on the negotiating agenda to allow negotiations to proceed. The agreement on the ending of agricultural export subsidies was rightly hailed as a significant step forward, even if details remain to be worked out in negotiations. Significant differences remain to be bridged however on the two other main elements of the agriculture agenda, as well as on modalities for negotiation on industrial tariffs, while the content of the eventual negotiations on services remains unclear. Investment, competition and transparency in government procurement had to be dropped from the negotiating agenda in order to secure agreement to proceed, although they may remain part of the WTO's work programme, along with trade and environment. Trade facilitation was retained as an item on the negotiating agenda only with great difficulty.

There is also now no suggestion that the DDA will result in the complete removal of trade barriers, even by developed countries. The concept of "sensitive products" that will be exempted, at least temporarily, from the main liberalisation commitments, both for agricultural and industrial products, now appears to be gaining ground, with debate becoming focused on the relative latitude to be allowed to developed and developing members in this respect. WTO members have also abandoned the January 2005 deadline for completion of the DDA. The next ministerial meeting is scheduled for December 2005, and completion of the round is expected in 2006 or 2007.

It is clear therefore that the DDA by itself cannot be relied upon to deliver achievement of the APEC Bogor goals, even on trade; investment is no longer even on the DDA agenda. There is also no realistic prospect that a further round of WTO negotiations could be launched and concluded by 2010, the deadline for achievement of the Bogor goals by APEC developed economies.

1.1.4. Preferential (Bilateral and Plurilateral) Agreements

The advantages and disadvantages of preferential trade agreements (PTAs) have been extensively and repeatedly discussed elsewhere, and this discussion will not be repeated here.³

At the time of the Bogor Declaration there were already three PTAs in existence among APEC economies: NAFTA, AFTA and ANZCERTA. The relationship between these preferential developments and APEC's commitment to "open regionalism" was the subject of considerable discussion at that time, especially by the APEC Eminent Persons Group (EPG), which had its life extended by an extra year specifically to consider this and other issues. The possibility of establishing an APEC-wide PTA was considered in the course of these discussions, but this approach was discarded in favour of the "open regionalism" approach, principally because this was viewed as more consistent with the determination of the APEC members to support the multilateral over the preferential approach as the preferred modality for liberalisation.

In its third and final report the EPG concluded that 'further liberalization within the existing subregional trading arrangements (SRTAs), and any link-ups between them, would be constructive and supportive of the overall APEC process *only* if they were pursued within the principles of "open subregionalism"', which the EPG claimed to be identical to the principles of "open regionalism". Among these principles the EPG emphasised 'the maximum possible extent of unilateral liberalization', 'a firm commitment to reduce barriers to APEC economies that are non-members of the SRTA as well as within the SRTA itself', and 'an offer by each SRTA to extend the benefits of its SRTA liberalisation to all other APEC economies on a reciprocal basis'. The EPG also said that it 'would support, even more strongly, an extension of current SRTA liberalization to other APEC members along these lines. This would represent one technique for implementing the Bogor commitments and should be considered *if the alternatives now being considered were to falter*' (italics added). The EPG also stated firmly however that it would 'oppose any further SRTA initiatives that ignored these principles'. (EPG 1995).

In the event the APEC economies showed little appetite for fresh preferential initiatives in the years immediately following the Bogor Declaration, with the exception of FTAs between Canada and Chile and between Mexico and Chile, which could be seen as substitutes for the failed attempt to bring Chile into NAFTA. A proposal for an East Asian preferential trade bloc, the East Asian Economic Grouping (EAEG), that was put

³ For a summary see for example PECC (2003a)

forward as an alternative to APEC in the early 1990s, also failed to gain traction. A key reason for this was the lack of support from Japan and Korea, who remained committed at that time to a policy of avoiding involvement in PTAs.

1.1.4.1 Recent PTA Developments in the APEC Region

Since 1998 however there has been a rapid proliferation of PTA initiatives in the APEC region. At least 12 new PTAs have been concluded between APEC economies since 1999, there are at least a further 15 PTAs under active negotiation, and many more are at various stages of discussion or study. Economies not so far involved in these developments are gearing up to become involved in future. If all the PTAs currently under negotiation or active study are concluded, there could soon be over 40 PTAs between APEC members.

Some smaller APEC economies such as Singapore, Chile and Mexico have played a leading role in these developments, and are within reach of a situation where most or even all of their main trading relationships will be covered by PTAs. The entry into the field of the major APEC economies – the US, China and Japan – has raised the prospect of a series of “hub and spoke” configurations, with each major economy acting as the “hub” at the centre of a web of PTAs (perhaps all closely following the major economy’s preferred “template”) with smaller “spoke” economies in the APEC region (and beyond, in the case of the US). Smaller economies like Singapore, Chile and Mexico may be viewed as endeavouring to establish themselves as secondary “hubs”, leading to a more complex pattern of relationships.

A powerful “domino effect” is now in operation. Smaller economies find themselves impelled to react to the success of their competitors and neighbours in securing PTAs with major partners by seeking their own PTA with the same major partner, to defend themselves against the discrimination they would otherwise suffer in that market. Major economies see themselves as obliged to match the activity of their major competitors. The strength of this “domino effect” is such that the trend to proliferation of PTAs in the Asia-Pacific region is likely to be unstoppable, at least in short- and medium-term. ASEAN’s ambitions to establish itself as an alternative “hub” are being frustrated as individual ASEAN economies find themselves unable to resist the pressure to establish their own bilateral agreements with major partners.

The “domino” effect reinforces a tendency that was already apparent among some APEC economies to favour bilateral agreements as vehicles for negotiation of economic integration across a wider range of issues, including services, investment and behind-the-border issues.

While governments of economies entering into these PTAs have obviously made the assessment that these arrangements are in their best interests, a number of concerns about these developments have been expressed by independent observers, including the following:

- They may lead to the fragmentation rather than integration of trading relationships in the Asia-Pacific region
- They can create new patterns of discrimination in the region, leading to fresh inefficiencies in trade and damaging excluded economies.
- A “spaghetti bowl” of overlapping PTAs with inconsistent provisions such as rules of origin may impose significant additional transactions costs on business
- The rules of origin in new PTAs may undermine the integration already achieved under existing arrangements
- Preoccupation with the negotiation of PTAs has been draining resources and energy from multilateral negotiations and from APEC
- The imbalance of bargaining strength inherent in “hub and spoke” relationships may lead to unbalanced agreements that disproportionately reflect the interests and sensitivities of the “hubs”.

New PTAs are routinely described as “WTO-consistent” and as “contributions to the achievement of the Bogor goals”, although precisely what is meant by this is rarely if ever spelt out. WTO rules on PTAs are notoriously imprecise.

It has nevertheless been widely accepted that PTAs can contribute to the achievement of APEC’s Bogor goals provided that certain conditions are met. PECC has proposed a “Common Understanding” on the features that should be found in PTAs that can be regarded as contributions to achievement of the Bogor goals (PECC 2003b). These essentially involve the application to PTAs of APEC principles from the OAA.

However bilateral PTAs are unlikely by themselves to lead to the achievement of the Bogor goals. Lloyd has calculated that 210 PTAs would be needed to cover all the bilateral trading relationships between the 21 APEC economies. Even the 40 or so PTAs currently in prospect fall far short of this. Admittedly the bilateral trade flows between some APEC economies are quite minor. It is also true however that there has been a conspicuous lack of moves towards establishing PTAs covering some of the largest bilateral trade flows among APEC economies. Bilateral PTAs will have to be complemented by multilateral and unilateral liberalisation if the Bogor goals are to be achieved. Multilateral and unilateral liberalisation also has the essential property of mitigating any negative effects caused by trade diversion associated with PTAs.

1.1.4.2. The FTAA and a Possible East Asian Trade Bloc

Two potential preferential developments with especially important implications for the Asia-Pacific region are the proposed Free Trade Area of the Americas (FTAA) and a possible East Asian trade bloc.

The FTAA is intended to be a preferential trading agreement covering every economy in the Americas except Cuba. The target date set for the completion of negotiations is January 2005. At the moment however the negotiations are stalled and it is clear that this deadline will not be met. The FTAA could in many respects be regarded as a precedent for the FTAAP, since it involves the creation of a single large preferential trade

arrangement out of a multiplicity of bilateral and plurilateral arrangements among smaller groups of its potential members. The FTAA experience may therefore contain valuable lessons for proponents of an FTAAP.

In East Asia it is clear that a major shift in emphasis has taken place in thinking about economic integration. There is an increased focus on economic integration within East Asia, and a corresponding loss of focus on integration across the full Asia-Pacific region. It is unclear at this stage what the end result will be of the ferment of intellectual and policymaking activity that currently surrounds the subject of "East Asian regionalism". One possibility that has received considerable attention, though it is not perhaps the "front-runner" at this stage, is an East Asian trade bloc based on the "ASEAN Plus Three" grouping, comprising China, Japan, Korea and the ten ASEAN economies.

Parallel establishment of an East Asian trade bloc and the FTAA, if it came about, would herald the creation of a "bipolar Pacific", with separate trade blocs on opposite sides of the ocean. This directly contrasts with the APEC vision of an integrated Asia-Pacific region, embracing both sides of the Pacific. Even if the FTAA does not proceed, NAFTA of course already constitutes a very large preferential trade bloc, and it really only requires the East Asian trade bloc to proceed in order to bring about the "bipolar Pacific".

1.1.4.3. EU Developments

The EU already exists as the third bloc in a potential "tripolar world trading system". This year the EU has already increased its membership from 15 to 25 by taking in ten new members, although the resulting increase in the EU's GNP is relatively modest at less than 10 percent of the combined GNP of the EU-15. Two further new members are scheduled to join in 2007, and accession by Turkey at some unspecified future date has also been mooted.

The EU is also extending its own network of FTAs. It has already established the European Economic Area with the four remaining EFTA countries. The Barcelona Declaration envisages the eventual creation of a free trade area embracing the EU, the EFTA countries, and all of the North African and Middle Eastern countries of the Mediterranean Basin, building on the network of bilateral FTAs that the EU has been establishing with those countries. The EU has already established FTAs with South Africa, Mexico and Chile, and is in the process of negotiating free trade agreements with Mercosur, and with the various regional groupings making up the African Caribbean and Pacific group of 77 countries.

1.1.5. The Potential Role of the FTAAP

The FTAAP would involve abandoning APEC's present voluntary non-binding approach in favour of a binding set of commitments. It would be a preferential agreement, and would therefore also involve a decisive turning away from the non-discriminatory approach to liberalisation which has been widely held to be a key element of APEC's

“open regionalism”. This however is inevitable if APEC wishes to adopt a binding approach to trade liberalisation on a regional basis. It needs to be emphasised that if the APEC economies wish to establish binding commitments between each other without making those same commitments available to non-APEC economies, the only way to do this that is legal in WTO terms is to create an APEC-wide free trade area or customs union. The FTAAP would also address the concerns of some APEC economies over reciprocity, since all liberalisation in a WTO-consistent PTA must be reciprocal as well as binding. In principle, if all APEC members participate, if investment is covered as well as trade, and if there are no permanent exclusions, an FTAAP could deliver a binding commitment to establish free trade and investment in the Asia-Pacific region by date or dates certain. Whether these dates would be consistent with the Bogor target dates, and whether the conditions mentioned in the previous sentence are likely to be met in practice, are important issues that will be considered further below.

An FTAAP in which all APEC members participate could eliminate the “spaghetti bowl” from the Asia-Pacific region, if it resulted in a single agreement covering all APEC economies. It is also perhaps the only initiative that could stop the “domino effect” that is driving the spread of bilateral agreements, since if all APEC economies are included it would no longer be necessary for individual economies to pursue bilateral deals in order to protect their position. It would thus satisfy the condition set out in the PECC Trade Forum’s “Common Understanding”, that full participation in the preferential trading arrangements being established in the Asia-Pacific region must ultimately be open to all APEC economies. The proposed FTAAP would also affirm the concept of economic integration embracing the entire Asia-Pacific region, as against the alternative prospect of a “bipolar Pacific”.

As pointed out in the PECC Trade Forum’s “Common Understanding”, an FTAAP that is to fully meet APEC objectives would also have to meet the criteria that APEC has established for implementation of the OAA, including adherence to the relevant OAA principles and other relevant sets of non-binding principles to which APEC members have subscribed, including those on investment, competition policy, government procurement, trade facilitation and transparency. In other words, the FTAAP would need to be a high-quality agreement. There are of course serious questions as to the feasibility of an agreement covering all APEC members that would meet these conditions. These questions are considered further below.

If all APEC members participate in the FTAAP the resulting preferential trade bloc will also be very large relative to the world economy, since its members will account for over 60% of world GNP. It follows that its impact, whether positive or negative, would have enormous global significance. It is therefore vital that, in addition to its potential benefits for APEC economies, careful consideration should also be given to the implications of an FTAAP for the WTO and the multilateral trading system, and for its implications also for non-APEC economies that may be excluded from membership in the FTAAP, at least initially.

2. APEC Economies and their Trade in Regional and Global Perspectives

2.1. North America and Northeast Asia as the “Economic Core” of the APEC Region

The statistic that APEC economies account for 60% of the world economy is often quoted. In fact, in 2002, APEC economies accounted for 61% of world GNP measured at official exchange rates, or 55% of world GNP measured at purchasing power parity (PPP) exchange rates.⁴ Less often highlighted are the facts that the US alone accounts for 32% of world GNP, and 52% of APEC GNP, or that the six largest APEC economies (the three North American economies of the US, Canada and Mexico plus the three largest Northeast Asian economies of China, Japan and Korea) together account for 55% of world GNP and 90% of APEC GNP.⁵

In other words, APEC’s “weight” in the world economy is due principally to the inclusion of the US, and more broadly is due almost entirely to the presence as members of the six large economies in North America and Northeast Asia. North America and Northeast Asia together clearly constitute the “economic core” of APEC. If an FTAAP is to truly bring about economic integration of the APEC region, these “core” economies must be at the centre of the enterprise.

2.2. Regional Trade Flows: The Pre-eminence of North America and Northeast Asia

North America and Northeast Asia also dominate the trade of the APEC region. The region’s trade flows can be summarised in various ways. Figures 1 and 2 compare trade flows of APEC economies in terms of absolute size.

Figure 1 compares the size of each subregion’s trade flows with the APEC region as a whole, and shows that, unsurprisingly, North America and Northeast Asia account for by far the largest shares of the intra-APEC trade flows.

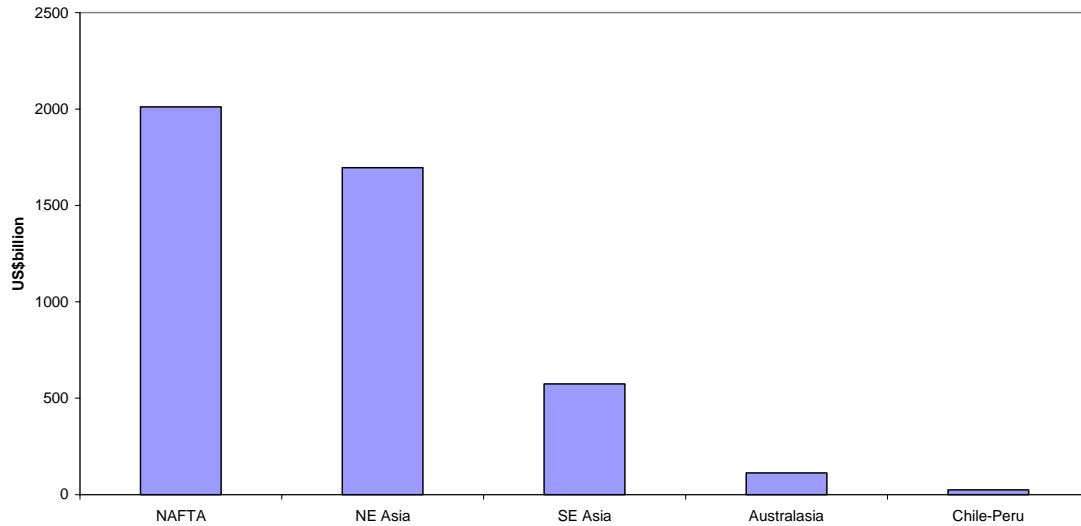
Figure 2 illustrates the relative size of the main intra-subregional and inter-subregional export flows within the APEC region. All of the largest flows in the region occur among the economies of North America and Northeast Asia. While the largest flows are intra-NAFTA and intra-Northeast Asia, the flows between Northeast Asia and the NAFTA economies exceed all other flows in absolute size. The export flows within North America, within Northeast Asia, and between North America and Northeast Asia together account for over 70% of all exports of the APEC economies.

⁴ These figures and others provided in this section of the paper are calculated from the World Bank’s World Development Indicators, supplemented from other sources for economies not included in the World Bank’s database.

⁵ 2002 figures, measured at official exchange rates. At PPP exchange rates the US accounts for 21% of world GNP and 39% of APEC GNP, while the six largest APEC economies account for 46% of world GNP and 83% of APEC GNP.

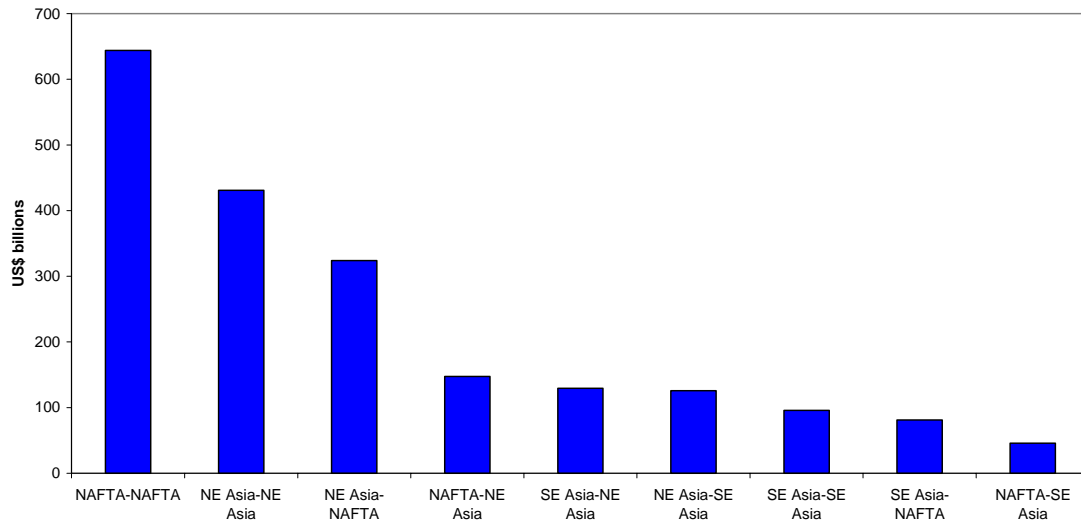
**Figure 1: Average Annual Trade Flows of Major Asia-Pacific Regions with APEC Economies
2000-2002**

(Source: IMF Direction of Trade Statistics)



**Figure 2: APEC Economies: Main Intra-Regional and Inter-Regional Export Flows in the Asia-Pacific
Region
2000-2002 (annual averages)**

(Source: IMF Direction of Trade Statistics)



Yet important elements of these key trade flows have been largely left out of the development of preferential trading arrangements in the Asia-Pacific region. Intra-North American trade is of course covered by NAFTA. There are however no PTAs covering bilateral trade flows among the three largest Northeast Asian economies, and only one,

the proposed FTA between Japan and Korea is even under active negotiation. There is only one PTA, the recently concluded Japan-Mexico FTA, covering trade flows between North America and the major Northeast Asian economies, and no other PTA linking these economies appears to be under serious consideration at present.

The absence of PTAs covering several bilateral trading relationships among the North American and Northeast Asian economies thus constitutes a major gap in the developing pattern of PTAs in the Asia-Pacific. Yet these economies are demonstrably the economic “core” of the APEC region, and the trade flows among them are easily the largest trade flows in the region. The “gap” – the bilateral trading relationships among North American and Northeast Asian economies not currently covered by a PTA – accounts for over 40% of all APEC economies’ exports. Even if the Japan-Korea FTA is successfully concluded the “gap” will still account for almost 40% of total APEC exports.

It is fair to say that if an FTAAP is intended to foster economic integration across the entire APEC region, one of the most important criteria for judging its success in this regard would be whether it is successful in filling this “gap”.

2.1.3. The Importance of Trans-Pacific Trade

The trade data also clearly indicates the importance of trans-Pacific trade as the third major strand that binds the Asia-Pacific region together through trade, along with trade within North America and within the western Pacific. Table 1 classifies the exports of APEC economies according to whether they involve trade that is intra-western Pacific, intra-American, or trans-Pacific.⁶ It shows a neat 40/30/30 split – 40% of APEC trade is conducted within the western Pacific, 30% is conducted within the Americas, and 30% is trans-Pacific trade.

Table 1: Exports of APEC Economies 2000-2002
Classified by Direction of Trade Flows

	%
Intra-western Pacific	40
Intra-American	30
Trans-Pacific	30

Source: calculated from IMF Direction of Trade Statistics

⁶ For this purpose intra-American trade is defined as trade among the US, Canada, Mexico, Chile and Peru. The western Pacific is defined as Northeast Asia, Southeast Asia, Australasia, and Russia.

Table 2 provides further information on how each subregion's trade is distributed across the APEC region. It shows that intra-East Asian trade accounts for easily the largest share of the trade of the economies of both Northeast Asia and South East Asia, but also shows that trans-Pacific trade remains of major importance for Northeast Asia in particular, especially for Japan. It also shows that the United States conducts as much of its trade with its APEC partners in the western Pacific as with its NAFTA partners, and eight times as much trade with those western Pacific APEC partners as with its prospective FTAA partners in South America.

Table 2: Trade Among APEC Economies 2000-2002

Region	Percentage of Total Trade Conducted with:					
	East Asia	Western Pacific	USA	NAFTA	APEC	South America
Northeast Asia	49	52	20	22	74	1
<i>among which Japan</i>	41	44	25	27	73	2
Southeast Asia	55	58	16	17	73	1
Australasia	45	52	15	16	70	1
NAFTA	24	25		46	72	4
<i>among which USA</i>	31	32		32	65	4
Chile and Peru	23	24	20	26	49	23

Source: IMF Direction of Trade Statistics

Notes

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

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

Australasia: Australia, New Zealand

Western Pacific: Northeast Asia, Southeast Asia, Australasia

NAFTA: Canada, Mexico, USA

3. Issues in the Design of an FTAAP

An FTAAP will necessarily have to comply with the WTO rules on regional trading arrangements, contained in GATT Article XXIV⁷ and GATS Article V. This means that it must involve the removal of barriers to trade on “substantially all” trade in goods between its members, and that its provisions for the liberalisation of services trade must have “substantial sectoral coverage”. An FTAAP that is intended to give effect to APEC's Bogor goals will however have to go much further than this in order to meet the higher standards embodied in APEC principles, as underlined in the PECC Trade Forum's “Common Understanding”. Crucially, it will have to provide for the liberalisation of investment among APEC economies. It will also need provisions on

⁷ An alternative rule, embodied in the so-called “Enabling Clause”, with much less stringent conditions than Article XXIV, is available for PTAs between developing economies. However Article XXIV applies to any PTA in which a developed country is a member, and would therefore apply to an FTAAP, except in the bizarre circumstance that all APEC developed economies choose not to join. There is no “Enabling Clause” for services trade.

competition policy, standards and conformance (including SPS issues), customs procedures, intellectual property, government procurement, mobility of business persons, and dispute settlement. APEC members will almost certainly want to include provisions on e-commerce and secure trade. There will inevitably be discussions on whether to include safeguards and possibly also provisions on anti-dumping and subsidies. Like all preferential trade agreements it will need a comprehensive set of rules of origin (and corresponding provisions relating to denial of benefits in relation to services trade) and these will be crucially important. A proposal for an FTAAP in other words is likely to feature extensive coverage similar to many modern “closer economic partnerships” (CEPs).

3.1 Trade in Goods

3.1.1. Product Coverage

An FTAAP that is intended as the vehicle for achievement of APEC’s goals should follow the principles that APEC has already established to guide the pursuit of those goals. Two APEC principles in particular are designed to cater for competing concerns related to product coverage: comprehensive and flexibility. The principle of comprehensiveness indicates that ultimately all products are to be covered, without exception. The principle of flexibility requires due consideration to the sensitivities surrounding certain products for individual APEC members. If comprehensiveness means that all products are ultimately to be covered, the main avenue for extending flexibility is through elongated timetables for the liberalisation of “sensitive” products. This is the standard endorsed in the PECC Trade Forum’s “Common Understanding”.

The WTO rule contained in GATT Article XXIV is much less demanding than this. It requires coverage of “substantially all trade between the parties”. However WTO members have never been able to agree on a definition of “substantially all trade” (SAT). As a result the rule is largely unenforceable. While WTO members clearly do feel constrained from entering arrangements that blatantly contravene the SAT rule, within quite a wide degree of freedom they are in practice free to choose the definition of SAT to which they choose to conform. Among the more popular definitions are 90% or 80% of all trade between the parties, or 95% of all tariff lines defined at the HS 6-digit level. The possibility has also been recognised that in PTAs involving both developed and developing countries SAT could be implemented asymmetrically. This means that the developed country partner’s liberalisation commitments would have more complete product coverage than those of the developing country, with the average of the two being taken for the purpose of establishing compliance with the SAT requirement. This is one way in which “special and differential treatment” can be provided to developing economies within a PTA. Another question often debated in the context of SAT is whether it is legitimate to exclude whole sectors, regardless of the percentage of trade or percentage of tariff lines covered. The preamble to the 1994 “Understanding” on the interpretation of Article XXIV contains an admonition against the exclusion of complete

sectors, but it is unlikely to be legally binding, especially as it appears only in the preamble.

The usual reason for excluding products is to maintain protection for domestic producers in politically sensitive industries⁸. The concept of “sensitive products” that can be excluded from liberalisation commitments because their inclusion would be politically too difficult, now appears to be gaining a degree of acceptance also in the WTO’s DDA negotiations. PTAs recently concluded between APEC economies also contain many examples of products being permanently excluded, even from agreements involving only developed economies. There are also some cases where the exclusion of whole sectors is almost complete. In some cases the excluded products include products of major export interest to one of the parties.

In light of these precedents the argument may be made that full comprehensiveness, in the sense that every product is to be covered, may not be realistically achievable in an FTAAP. If that argument prevailed, APEC members designing an FTAAP would have to decide whether to relax the APEC principle of “comprehensiveness” by accepting that some, but preferably very few “sensitive products” can be permanently excluded, on the grounds that the costs of doing so would be relatively small compared to the benefit of making feasible an agreement that would otherwise be impossible to reach. Difficult political as well as economic judgements would be involved in this decision.

3.1.2. Transitional Periods

Liberalisation commitments in PTAs are rarely implemented instantaneously, but are usually phased in over a transitional period in order to facilitate adjustment processes in the member economies. APEC’s Bogor Declaration sets 2010 as the target date for full implementation of liberalisation commitments by APEC developed economies, and 2020 as the target date for APEC developing economies. The PECC Trade Forum’s “Common Understanding” emphasises that the transitional periods in PTAs among APEC economies should be consistent with these Bogor target dates. GATT Article XXIV contains a stipulation on the length of the transitional period, requiring implementation of liberalisation commitments made under the PTA within a “reasonable period of time”. This is another GATT term whose precise meaning has often been debated. Guidance is however provided in the 1994 “Understanding”, which states that a “reasonable period” should mean no more than ten years unless there are “exceptional circumstances”.

Recent PTAs involving APEC economies already include examples of transitional periods extending well beyond the WTO’s ten year guideline and beyond the Bogor target dates. There is even an agreement between two APEC developed economies in which full implementation takes 18 years (and which also provides for some products to be permanently excluded after that date). The 18 year transitional period in this case extends the implementation period beyond not only the 2010 Bogor target date for

⁸ Some developing economies rely heavily on tariffs as a source of government revenue. This problem can usually be overcome by developing alternative sources of revenue.

developed economies but also beyond the 2020 target date for developing economies. There are also examples of “reverse special and differential treatment”, where the developed partner is allowed a lengthier timetable than the developing partner for liberalisation of some sensitive products.

This is another issue that APEC members would need to consider carefully when designing an FTAAP. In the case of bilateral agreements members can presumably argue that there is still time for them to accelerate their liberalisation commitments when the circumstances are right. In the case of the FTAAP however it would be difficult to reconcile commitment to the Bogor targets with transitional periods extending beyond those target dates. On the other hand APEC members are likely to find it politically difficult to impose transitional periods much shorter than those they have become accustomed to adopting in their bilateral agreements.

3.1.3. External Barriers and Trade Diversion

Another respect in which WTO rules are inadequate concerns the external barriers that remain in place against non-members of a PTA. Article XXIV simply requires that these barriers should not be increased. This is quite insufficient to prevent trade diversion, with its resulting inefficiencies and damaging impacts on non-members, which can be potentially serious, especially when the external barriers are high. If damage to non-members is to be minimised, the FTAAP will have to include a rule that external (MFN) barriers be reduced in parallel with implementation of the FTAA. This requirement has been recognised in the PECC Trade Forum’s “Common Understanding” and in numerous other analyses of the effects of PTAs. One way for this requirement to be met is through further rounds of WTO negotiations. The potential impact of an FTAAP may be helpful in encouraging other countries outside APEC to participate constructively in such negotiations. Within the PECC Trade Forum Professor Ernesto Tironi has also proposed a rule that could be adopted by APEC economies themselves to ensure that preferential liberalisation will be accompanied by agreed degrees of MFN liberalisation, and this proposal could profitably be given further consideration.

3.1.4. Agriculture

Agriculture is likely to feature prominently among the “sensitive products” in an FTAAP negotiation, as it does in the WTO negotiations and in many bilateral negotiations, and also in the FTAA negotiations. In addition to its sensitivity and the formidable trade barriers widely applied to agricultural products, agriculture presents a particular problem for PTAs in that trade is distorted not only by trade barriers but also by export subsidies and domestic support measures.

While the removal of conventional trade barriers on agricultural products in a PTA does not present any special technical (as distinct from political) difficulty, export subsidies and domestic support measures are more difficult to address in a PTA context, since it is often not easy to isolate the effect of these measures on particular bilateral trade flows. Yet the removal of trade barriers without addressing export subsidies and domestic

support can give rise to very inequitable situations. Mexican farmers have experienced this as the removal of trade barriers under NAFTA has left them facing competition from US farmers who may not only be highly efficient but are also subsidised by their government. The same or similar issues have created major difficulties in the FTAA negotiations, and this may be a pointer to problems that may also be faced in an FTAAP.

Issues of this kind have led some observers to conclude that decisive action in the WTO to deal with export subsidies and domestic support is an essential precondition for successfully addressing agriculture within a preferential initiative such as the FTAA. The same argument would apply to the FTAAP. The very recent agreement in Geneva on action to eliminate export subsidies offers the hope that this issue will finally be resolved. It will however take longer to resolve the issue of domestic support. In the meantime the possibility must be faced that the dismantling of existing distortions will be offset by the intensification of the use as trade barriers of SPS and food safety measures, labelling requirements, regulations on the use of genetically modified organisms and requirements for traceability in production chains from finished product to originating crops and animals.

3.1.5. Rules of Origin

All preferential trade agreements require rules of origin that determine which products are eligible to receive preferential treatment. There are however no international disciplines on preferential rules of origin and PTA members are therefore free to adopt whichever rules they choose. The main types of rules of origin involve area content rules, change of customs heading or subheading, or requirements for a product to undergo a specific manufacturing process in an exporting partner. PTAs often employ a mixture of these different rules under the heading of “substantial transformation”.

Rules of origin can have complex effects on production efficiency and trade, and the economic analysis of these effects is still in its infancy. At the practical level however it is clear that rules of origin are often used to shelter domestic producers in sensitive industries. For these producers restrictive rules of origin can partly or wholly offset the loss of protection resulting from the removal of tariffs. Rules of origin customised to the interests of particular industries can lead to great complexity, and the rules of origin in many modern PTAs take up hundreds of pages. The usefulness of rules of origin as a means of protection is greatly enhanced by their non-transparency, since their complexity means that their effects are generally understood only by those engaged in the industry to which they relate. It has been observed that domestic producers will often fight much more fiercely to retain their preferred rules of origin than they fight against the reduction or removal of tariff protection.

The cost of compliance with rules of origin, especially complex rules of origin, can undermine the liberalising intention of trade agreements. It has been observed that the cost of compliance not infrequently deters exporters from using the preferences available to them, and they simply pay the MFN tariff instead. Compliance costs may be of particular concern in a “spaghetti bowl” situation, where an economy belongs

simultaneously to several PTAs each with different rules of origin. The manufacturing process may then have to be varied to suit the rules of origin applicable in each export market.

Rules of origin can also undermine production efficiency and frustrate trade by forcing producers to use inputs from uncompetitive sources within the PTA. In a PTA with multiple members, provision for cumulation can overcome this problem as far as it relates to inputs sourced within the PTA, but does not overcome situations where the use of competitive inputs from outside the PTA is being penalised. Provision in the rules of origin for cumulation would be a very desirable and crucially important feature to include in an FTAAP.

The PECC Trade Forum's "Common Understanding" sets out useful guidelines for rules of origin in PTAs aimed towards achievement of the Bogor goals:

"Rules of origin are not an appropriate mechanism for protecting "sensitive sectors" or for facilitating adjustment to liberalisation. Complex rules with protectionist purposes should be avoided. Ideally rules of origin should as far as possible be neutral in their impacts on trade flows. Rules of origin should be as straightforward as possible, and should be transparent, clear and consistent, and should not impose unnecessary compliance costs. It is important to allow full cumulation in PTAs with multiple members." (PECC 2003b)

3.1.6. Trade Remedies

So-called "trade remedies", particularly safeguards and anti-dumping measures, are likely to feature in any negotiations for an FTAAP.

Some existing PTAs among APEC economies feature extensive safeguard provisions, and it is possible that some APEC members would seek similarly extensive provisions in an FTAAP. While it is important that safeguard measures are adequate to deal with sudden and unexpected market disturbances, it is also important that safeguard provisions are not sufficiently loose as to provide opportunities for governments to respond to what are in effect simply demands for increased protection. APEC WTO members already have rights and obligation under the WTO Agreement on Safeguards. Any additional measures included in the FTAAP should be minimal and must be transparent.

Anti-dumping is emerging as one of the major threats to the liberalisation of global trade, as more and more economies establish anti-dumping procedures. To the extent that the issues of "fairness" often raised in anti-dumping actions have any validity they are essentially competition policy issues. In some PTAs among APEC members anti-dumping actions have been abolished in favour of the use of harmonised provisions of the relevant competition laws. Adoption of a similar provision in the FTAAP would be a major step forward for the APEC region, but a proposal along these lines is sure to be very controversial. It would also require a much closer convergence in competition policies among the APEC economies than exists at present.

3.2. Services Trade

Achievement of the Bogor goals requires free trade in services as well as goods. The principle of comprehensiveness once again suggests that all services should be covered, which is a more demanding requirement than the stipulation in GATS Article V that agreements for free trade in services should have “substantial sectoral coverage”, and that the agreement should provide for the “absence or elimination of substantially all discrimination” in the sectors covered. As already noted, APEC balances the principle of comprehensiveness with the principle of flexibility, and GATS Article V specifically refers to the need for flexibility to be shown to developing countries.

Achievement of “free trade in services” is not an easy task. For one thing, the meaning of the “elimination of all discrimination” in services trade is not as clear as the meaning of the “removal of all barriers” in goods trade. In the GATS furthermore, WTO members have often simply bound their status quo, and there has been relatively little fresh liberalisation, except in the case of accessions, where even least developed countries have often been asked to make much deeper commitments than many existing WTO members, developing or developed. The GATS also takes a “positive list” approach to the identification of sectors or subsectors in which commitments are to be made.

Stephenson points out furthermore that the requirements of GATS Article V on PTAs covering services trade stop far short of free trade. She notes that in practice all that is required is “the binding of existing measures across the board (all sectors) so as to prohibit the introduction of new or more discriminatory measures in the future”. She stresses that this requirement is in fact very useful, but notes that it does not explicitly require further liberalisation.

While a number of modern PTAs, especially those based on the NAFTA model, have adopted a “negative list” approach to sectoral coverage, nevertheless the services provisions of these PTAs are often to a large extent “standstill agreements”, involving binding of existing practice and commitments not to raise new barriers, rather than specific commitments leading to the removal of existing barriers.

An FTAAP that aims to fulfil the Bogor goals in relation to services trade will have to break new ground, and this will be a significant challenge.

3.3. Investment

APEC’s Bogor goals require the full liberalisation of investment flows as well as trade. The lack of precedents on which to build is once again a difficulty. The OECD’s attempt to promote a multilateral agreement on investment (MAI) ended in failure, and investment has also now been dropped from the agenda of the WTO’s DDA negotiations. There are many bilateral investment treaties (BITs) in operation, and a number of PTAs also contain provisions on investment, but in many cases these agreements often seem to focus heavily on investor protection and dispute settlement. While these elements are

important, APEC's Bogor goals imply that they need to be accompanied by stronger specific provisions designed to liberalise investment flows. After a promising start in the mid-1990s APECs own work on investment liberalisation has largely lost momentum. Significant unilateral liberalisation of investment flows has been undertaken by some APEC economies, such as Korea.

The difficulty in reaching international agreements to liberalise investment flows reflects in part deep-seated differences between developed and some developing economies⁹ over what should be the content of such agreements, even though there is now widespread understanding and acceptance of the contribution that foreign direct investment (FDI) can make to the development process.

NAFTA's Chapter 11 is sometimes suggested as a possible model, but it is not clear that this model would be acceptable to all APEC members. Robert points out furthermore that thinking in the Americas on "best practice" in the investment provisions of a PTA has now moved beyond NAFTA Chapter 11, as economies in the Americas have learned from the NAFTA experience. Current thinking is reflected in agreements such as the US-Chile and US-Singapore FTAs, and incorporates new language on investor protection and dispute settlement. She notes also that PTAs in the Americas do generally contain a market access component in their investment provisions, and that there is also a trend toward this in new PTAs in the Asia-Pacific region.

It is clear is that developing the investment provisions of an FTAAP would be another significant challenge.

3.4 Trade Facilitation

If an FTAAP is to proceed it would be desirable that it build on the progress that APEC has already made on trade facilitation, in areas such as standards and conformance, customs procedures, government procurement, mobility of business persons, e-commerce and secure trade. Many PTAs among APEC economies already contain provisions on these issues. With the FTAAP the opportunity would exist to seek convergence around "best practice" in these measures. This would be in line with the PECC's "Common Understanding", which strongly supports moves to greater harmonisation of trade and investment facilitation measures across the APEC region.

It should be recognised however that trade facilitation measures among regional groups of economies can give rise to trade diversion to the extent that they facilitate trade among the group at the expense of trade with economies outside the group. A focus on trade facilitation therefore does not necessarily eliminate concerns over the discriminatory characteristics of PTAs.

⁹ As Robert has pointed out, not all APEC developing economies adopt views on investment opposed to the views of developed economies. The views of some APEC developing economies, for example Chile, Korea, Mexico, Thailand and Peru, have much in common with the views of developed economies.

3.5. Intellectual Property

A number of PTAs among APEC economies already include substantial provisions on intellectual property. It is likely that some APEC members would insist that an FTAAP also contain intellectual property provisions. It needs to be recognised that there can be a conflict of interest between economies that are essentially exporters of intellectual property and those that are essentially importers of intellectual property. The former group, mainly advanced industrialised economies, may seek intellectual property provisions in PTAs that are “TRIPs-plus”. Developing economies on the other hand are often in the latter category, and some consider that the TRIPs agreement is already unbalanced in favour of developed economies. Intellectual property issues have been a significant source of friction in the FTAA negotiations, and it is likely that they would also be controversial in the FTAAP. Developed economies that have already secured “TRIP-plus” provisions in PTAs with individual economies may be reluctant to agree to any intellectual property provisions less favourable to them in an FTAAP.

3.6. Setting the Agenda: Insights from the FTAA Process

Stephenson and Robert note that five APEC members are also participants in the FTAA process: USA, Canada, Mexico, Chile and Peru. This group includes the APEC economies that have been most insistent on a reciprocity-based approach to trade liberalisation

The FTAA agenda is “WTO-Plus” in several areas, in particular including negotiating groups and draft chapters on investment, government procurement and competition policy (the three “Singapore Issues” that have now been dropped from the DDA negotiating agenda). The third version of the draft text for the FTAA may be viewed on the official FTAA website at www.ftaa-alca.org.

Stephenson and Robert note also that setting the negotiating agenda for an FTAAP will itself be a challenging task, raising the issues both of how wide the agenda needs to be to encompass the Bogor goals and the extent of the agenda on which agreement is feasible. While most modern PTAs do cover a comprehensive agenda, there is no universally accepted “template” setting out the issues to be covered. Defining the scope of the negotiating agenda is thus another matter that must be resolved at an early stage.

4. Membership Issues

4.1. Membership Issues for APEC Economies

The proposal by Canadian ABAC members envisages that membership of the FTAAP will be voluntary. This is seen as being in the spirit of APEC, and also avoids the possibility that the proposal could be torpedoed by the unwillingness of some APEC economies to join the initiative. It is presumably also envisaged that members who do not join initially may join at a later date. This raises the difficulty that economies may be

reluctant to join agreements with important implications for themselves when they have had no part in negotiating its terms.

The APEC “Pathfinder” concept offers one possible answer to this difficulty. Pathfinder initiatives are conceived as initiatives that may be agreed by all members but which only some members join initially. The expectation would appear to be that all APEC members will be involved in negotiating the terms of the initiative, and that those that do not join initially will do so at a later date. Whether this model might be realistic in the case of the FTAAP would depend importantly on whether the unwillingness of some economies to join initially was based on factors such as a perceived need for more time to prepare for participation, or whether it was based rather on fundamental disagreement with some proposed terms of the agreement. In the latter case they would presumably be very unlikely to join the agreement at a later date, or alternatively might adopt a “spoiling” role in the negotiations to prevent the agreement from going ahead. The temptation to adopt the latter course would be especially tempting for economies who anticipated that the agreement would have politically unpalatable effects on their economies.

A less stringent interpretation of the “Pathfinder” concept would be that it merely requires that all members are “comfortable” that the initiative should proceed, but not that all should actually participate in the negotiations. This view still raises questions over the degree of influence, if any, that non-participating economies could reasonably expect to have on the negotiations. Lloyd is sceptical of the value of the “Pathfinder approach” in the FTAAP context. He argues that the agreement should be negotiated by those members who choose to participate from the beginning, with others free to join the agreement at a later date provided they accept its terms and conditions.

Stephenson and Robert note that experience with the FTAA process has shown that these can indeed be difficult issues. Another issue that arises is how to handle a request by an economy to join the negotiations mid-way. If this is allowed, it raises the question of whether the “late joiner” should have the opportunity to unravel important decisions already made in the negotiations. On the basis of the FTAA experience Stephenson and Robert suggest that criteria should be established at the outset both for joining the negotiations at a later date and for joining the completed agreement.

A separate question is whether any APEC member would attempt to insist on the exclusion of another APEC member or members from the FTAAP. This could be very divisive, and could risk the unravelling of carefully crafted conventions that have served APEC well for many years. It is to be hoped that no such proposal will be made. If the issue does arise however it should be addressed and resolved at a very early stage.

Other arguments regarding membership could be advanced. There is a strong argument that the FTAAP could not be considered feasible if the major economies of North America and Northeast Asia do not join. As noted above these economies are the “economic core” of APEC, and the bilateral trade flows among them are easily the largest trade flows within the APEC region, accounting for over 70% of the exports of all APEC economies, as already noted earlier. Participation by these major economies is essential

if the FTAAP is to be capable of bringing about economic integration of the Asia-Pacific region through achievement of the Bogor goals. Partnership with major APEC economies is the greatest prize sought by the smaller APEC economies in their pursuit of PTAs, and conversely exclusion from partnership with the major economies is the greatest risk that they face from the proliferation of PTAs. Thus participation by all the major economies of the region would inevitably draw the region's smaller economies into the FTAAP as well.

Arguably it is also important that all of the major economies join the initiative together from the start. If only one or two participated initially, it would be likely in the nature of such negotiations that the terms of the agreement would begin to strongly reflect the preferences of those major economies. Other major economies might then see the agreement as not being in their interests and might refuse to join. Similar difficulties are less likely with smaller APEC economies. As noted above, if all the major economies participate it is likely that few if any of the smaller economies would opt out.

Stephenson and Robert note that the FTAA process also highlights another aspect of the key role of the major economies in any group negotiating such an agreement. It is important not only that the major economies participate but that there should be a workable consensus among them on the process to be followed. If one major economy disagrees with the process the negotiations can be "held hostage".

An alternative scenario that might be advanced is that in the event that the major APEC economies are initially uninterested in an FTAAP, smaller APEC economies might proceed to develop a "high quality" FTAAP of their own, effectively seeking convergence of the various PTAs already existing between them and extending the coverage to other bilateral relationships not presently covered by PTAs. This would be an interesting test of the feasibility of replacing bilateral PTAs with a PTA among a larger group of economies. The proposed AFTA-CER free trade arrangement could perhaps serve as the foundation for such an endeavour, with other smaller APEC economies being encouraged to associate themselves with this effort. If the smaller economies are successful in forging a "high quality" PTA along the lines suggested, they might then encourage the larger economies to join. This could be viewed as an application of the "pathfinder" concept. Against this it might be argued that bilateral trade flows among the smaller APEC economies are too small to make worthwhile the considerable effort that would be involved, and that major APEC economies would be very unlikely to enter a PTA on terms and conditions that had been negotiated exclusively among the smaller APEC economies.

4.2. The Position of Non-APEC Asia-Pacific Economies

One group of economies whose position in relation to an FTAAP requires careful consideration are the small Asia-Pacific economies that are not members of APEC. This group includes thirteen independent Pacific Island states, the three non-APEC members of ASEAN (Cambodia, Laos and Myanmar), Timor Leste and Mongolia. It might also include the non-APEC economies of the Pacific seaboard of Latin America, although

they are in a somewhat different position in that they are entitled to membership of the FTAA and have already been offered FTAs with the US.

The smaller states are already being marginalised by the spread of PTAs among APEC trading partners with whom they have no special preferential trading relationship. Exclusion from the FTAAP would seriously increase their marginalisation. Consideration needs to be given to ways of allowing them to associate themselves to the FTAAP without at the same time imposing unsupportable adjustment burdens on them.

4.3. Non-APEC non-Asia-Pacific Economies

An APEC-wide FTAAP would have a major global impact. Many economies outside the Asia-Pacific region would be concerned about its impact on them and about their future economic relationship with the APEC economies. One group among which particular concern might be expected is India and the other South Asian economies.

A strong case might be made that APEC economies should make membership of the FTAAP open to any economy that is willing to accept its terms and conditions. Once the APEC economies have adjusted to free trade among themselves, the further adjustments needed to accommodate additional members are likely to be minimal. Membership in an APEC-wide FTAAP might be sufficiently attractive that new members could be willing to join on the basis of full acceptance of its established terms and conditions, as is currently occurring in the case of EU enlargement.

The same argument, that most of the adjustment requirements associated with a move to multilateral free trade will already have been faced within the FTAAP, could also be invoked to argue that there should be nothing to prevent APEC economies from making an offer in the WTO to multilateralise the commitments they make to each other in the FTAAP. Several members of the PECC Trade Forum have argued that they should be strongly encouraged to do so, in some cases with the proviso that this should be done if a sufficient number of other WTO members reciprocate.

5. Assessment of the FTAAP Concept

5.1. Economic Effects

It is not easy to accurately gauge in advance the economic effects of a proposed trade agreement such as the FTAAP. The standard methodology for this purpose is computable general equilibrium (CGE) simulations. It is however well-known that the results of these simulations can vary widely depending on the assumptions used and adjustments that may be made to the underlying database. CGE simulations also tend to lack in varying degrees the ability to capture all dynamic effects within the members of a PTA or the full impact of services trade liberalisation. The effects of a trade agreement cannot be confidently predicted from a single simulation, but sensible assessments can often be made by comparative analysis of a number of different simulations of the same

agreement. CGE simulations are also useful for comparing the effects of different agreements. While the absolute size of the effects of an individual agreement predicted by simulations should be treated with caution, a useful indication of the relative effects of different agreements can be gained by simulating each agreement under the same assumptions and using the same database.

The results of one set of simulations of this kind, are shown in Table 3. In addition to the FTAAP, the other agreements or arrangements for which results are shown are APEC MFN (non-discriminatory liberalisation), full multilateral liberalisation (global MFN), an East Asian trade bloc (based on the “ASEAN Plus Three” group), and the proposed ASEAN-China and ASEAN-Japan FTAs. The table shows projected changes in overall economic welfare for APEC economies and for some other economies or groups of economies.

The results indicate, first, that the FTAAP yields a more favourable overall economic outcome than any of the other preferential agreements shown. Compared to an “ASEAN Plus Three” FTA (the “East Asian trade bloc”), the FTAAP yields higher economic welfare for all East Asian economies except Malaysia, Singapore and Thailand. Although the welfare gain for Southeast Asia as a whole is slightly lower under the FTAAP than under the “ASEAN Plus Three” FTA, the gain for Northeast Asia and East Asia as a whole is much greater. This suggests ample scope for a negotiated outcome under which all East Asian economies would be better off under the FTAAP than under the “ASEAN Plus Three” FTA. The APEC economies excluded from the “ASEAN Plus Three” FTA are understandably much better off under the FTAAP, which yields gains for all of them except Mexico, whereas they all register losses of economic welfare under the “ASEAN Plus Three” FTA scenario, again with the exception of Mexico. The net gain in combined economic welfare under the FTAAP for the eighteen APEC economies shown is more than three times the net gain registered under the “ASEAN Plus Three” FTA.

The “ASEAN Plus Three” FTA in turn yields more favourable economic welfare outcomes than the other two preferential arrangements shown, an ASEAN-China FTA and an ASEAN-Japan FTA. A notable result is that under the “ASEAN Plus Three” FTA the outcome is more favourable for all three Northeast Asian members than under the ASEAN-China FTA and the ASEAN-Japan FTA. Compared to the ASEAN Plus Three” FTA, China does worse not only under the ASEAN-Japan FTA, as one would expect, but also under the ASEAN-China FTA, and similarly Japan does worse under the ASEAN-Japan FTA as well as the ASEAN-China FTA. Not surprisingly Korea does much worse under the two arrangements from which it is excluded. The Southeast Asian economies as a group also enjoy significantly lower welfare gains from the ASEAN-China and ASEAN-Japan FTAs than from the ASEAN Plus Three” FTA, although some individual ASEAN economies do better under the more limited arrangements (the Philippines in both cases, Malaysia and Singapore in the case of the ASEAN-China FTA, and Thailand in the case of the ASEAN-Japan FTA). An offsetting favourable effect of the ASEAN-

Table 3:
Selected Trade Agreements/Arrangements: Projected Changes in Economic Welfare
US\$ (1997) millions

	ASEAN- China	ASEAN- Japan	ASEAN Plus 3 FTA	FTAAP	APEC MFN	Global MFN
Australia	-118.7	-234.9	-690.0	1744.8	939.9	1742.2
New Zealand	-22.0	-49.9	-134.8	682.4	296.8	2240.7
China	209.5	-861.5	514.1	3275.1	1846.6	5180.0
Hong Kong	-267.1	-218.6	-1221.6	3038.7	2428.6	3272.7
Japan	-1628.5	528.1	6612.4	14931.7	12437.4	14578.4
Korea	-491.3	-706.9	5028.2	5658.1	4885.2	7764.8
Chinese Taipei	-429.3	-477.9	-2011.8	3100.0	2961.8	3091.3
Indonesia	461.0	842.2	2403.0	2658.5	2123.1	2750.4
Malaysia	1128.0	504.9	805.9	771.6	515.5	1305.9
Philippines	205.1	154.7	61.3	86.8	-218.2	-36.2
Singapore	2688.6	1947.1	2438.6	1933.0	1569.4	2585.5
Thailand	691.7	2983.2	2933.8	2497.1	1908.9	2963.3
Vietnam	429.8	877.8	1092.5	1278.8	489.9	1646.1
Canada	0.1	-25.0	-62.4	1111.4	570.5	1771.0
United States of America	-1166.3	-2035.9	-4266.3	1189.4	-6390.8	-569.2
Mexico	3.8	29.3	59.4	-317.9	-593.1	-484.8
Rest of South America	17.7	-62.0	-354.0	-1766.1	2652.9	2815.3
Columbia	8.4	-2.2	-50.8	-247.0	349.5	341.2
Peru	-61.0	-15.8	-88.2	66.1	-83.1	1602.9
Venezuela	17.4	6.8	-0.8	-73.4	122.2	646.7
Argentina	-75.3	-32.7	-195.6	-527.9	221.2	3145.3
Brazil	-219.3	-145.6	-591.3	-1908.0	2075.2	6067.7
Chile	4.0	-52.8	-118.9	310.0	74.3	621.0
Uruguay	-3.7	-1.8	-17.7	-37.9	29.0	770.9
Europe	-1255.3	-2055.9	-3282.5	-9178.3	4505.7	-1450.6
ROW	-155.0	-758.0	-2356.6	-6483.1	2855.7	23384.5
<i>Aggregations</i>						
18 APEC Economies	1637.1	3188.2	13355.0	44015.7	25762.7	52025.8
Northeast Asia-5	-2606.8	-1736.9	8921.2	30003.6	24559.6	33887.1
Southeast Asia-6	5604.0	7310.0	9735.1	9225.8	6388.7	11214.9
Australasia	-140.7	-284.7	-824.8	2427.2	1236.7	3982.9
North America-3	-1162.5	-2031.6	-4269.3	1983.0	-6413.4	717.0
Non-APEC	-1682.7	-2989.5	-6495.2	-18455.6	10158.5	32905.7

Source: Model Simulations by John Gilbert

China and ASEAN-Japan FTAs is that they generate smaller welfare losses for the excluded economies, especially those in the western Pacific.¹⁰

¹⁰ Yamazawa argues that an “ASEAN Plus Three” FTA is supported by a deeper economic logic that is not adequately captured in this kind of analysis. This comment in turn may be related to comments from other observers that could be symptomatic of a widespread sense among East Asian policymakers and expert

Thus if preferential agreements are being considered, the FTAAP offers considerable advantages in terms of economic welfare effects over more limited preferential agreements.

Perhaps surprisingly, more favourable welfare effects are indicated under the FTAAP than under APEC non-discriminatory liberalisation (APEC MFN) for every APEC economy shown. In looking at these results it is important to bear in mind the limitations of CGE modelling highlighted above. Nevertheless it is striking that the overall welfare gain for the eighteen APEC economies shown is more than 50% higher under the FTAAP than under APEC MFN liberalisation. Conversely non-APEC economies register a gain in welfare under APEC MFN liberalisation, but a loss under the FTAAP, which discriminates against them. In other words, the larger gain for APEC economies under the FTAAP is achieved at the expense of the rest of the world. The results shown here do not account of possible retaliation by the rest of the world.

The remaining key result is the comparison between the FTAAP and full multilateral liberalisation. More favourable welfare outcomes are indicated under full multilateral liberalisation than under the FTAAP for all APEC economies except Australia, Japan, Chinese Taipei, the Philippines, the US and Mexico, and in three of the latter cases – Australia, Japan and Chinese Taipei – the differences are very small in relative terms. Each of the APEC subgroups shown registers larger welfare gains under full multilateral liberalisation, with the exception of North America, the latter result being caused by the substantially less favourable result for the US.¹¹ For the eighteen APEC economies shown the welfare gain under full multilateral liberalisation is almost 20% higher than under the FTAAP. For non-APEC economies the difference is much greater, between a sizeable welfare loss under the FTAAP and a still larger gain under full multilateral liberalisation, which also therefore produces by far the largest gain in overall global welfare, as one would expect.

One interpretation of these results is that full multilateral liberalisation should always be the ultimate goal. An FTAAP should not even be considered unless it can be shown to be helpful in facilitating eventual full multilateral liberalisation. Another possible interpretation is that establishment of an FTAAP would create a very considerable incentive for non-APEC economies to work constructively in the WTO toward full multilateral liberalisation.

commentators that development of a stronger East Asian regional economic bloc is now a priority, leading to a corresponding reluctance to consider alternative initiatives that might distract attention from this agenda.

¹¹ A negative impact on the US is not uncommon in simulations of this nature. Part of the explanation is likely to be the limited treatment of services trade in such models. Modelling which includes a fuller specification of the services sector tends to indicate significant positive impact on the US. The effect shown for the US in the results quoted here is shown to be extremely small when expressed as a percentage of US GNP.

5.2. Feasibility

Some PECC Trade Forum members flatly assert that an FTAAP is not feasible. Others do not go that far but nevertheless agree that there are serious questions over the FTAAP's feasibility. The political obstacles alone in the way of engaging the 21 APEC economies in an FTAAP are formidable.

One point often made is that it will be difficult to achieve comprehensive product and sector coverage in an FTAAP. According to this argument issues and products that have been difficult to negotiate in the WTO will be just as, if not more difficult to negotiate in an FTAAP. It is indeed very likely that some exclusions would have to be accepted in order to reach agreement on an FTAAP. This however is not so much an issue of feasibility as whether to it is worthwhile pursuing an FTAAP under these conditions. It should not be impossible to limit exclusions sufficiently to allow compliance with the SAT requirement to be claimed. Acceptance of permanent exclusions would however contravene the APEC principle of comprehensiveness, which is also a fundamental element in the PECC Trade Forum's "Common Understanding". On the other hand it might be argued that this could be an acceptable trade-off for securing binding commitments to full liberalisation of most products and sectors, which otherwise is beginning to look increasingly unattainable. Commitments to reduce all tariffs to zero in the WTO, for example, do not at present appear very likely in the near or even medium term.

Similar arguments could surround the question of transition periods in an FTAAP. In their bilateral agreements many APEC economies have become used to very lengthy transition periods, often extending well beyond the WTO's ten year guideline. The transition periods allowed in the FTAAP will have to be considerably shorter if it is to be fully implemented within the deadlines established in the Bogor Declaration. At least some APEC economies are likely to find this difficult to accept.

There are other questions concerning the degree of ambition that might feasibly be entertained. An FTAAP designed as a vehicle for achievement of APEC's Bogor goals should be a far-reaching and comprehensive agreement, not only providing for liberalisation of most, or preferably all products and sectors, but also containing provisions relating to the full range of areas covered in the OAA, as outlined in the proposal from ABAC Canada. It may be difficult to reach binding agreement on such a wide range of provisions. The greater the number of participating economies, the more likely it is that different economies will find different proposed provisions unacceptable. The upshot may be that the scope of the negotiations and eventual agreement might have to be limited to a narrow range of "core" provisions, as now appears to be happening in both the WTO and FTAA negotiations.

Perhaps the issue on feasibility is not so much whether an FTAAP is feasible, but what sort of FTAAP is feasible, and would that FTAAP be worthwhile?

In considering this question it may be useful to consider the degree of adjustment required from APEC economies, as this may in turn be an indicator of the degree of difficulty they may have in accepting a worthwhile agreement. A number of smaller APEC economies have reached or are approaching the situation in their bilateral agreements where there are internationally competitive suppliers among their FTA partners for a wide range of products and services. For these economies many of the adjustments required by an FTAAP will already have been made. Some of the major APEC economies on the other hand have yet to conclude FTAs with partners that can provide a serious competitive threat to many important domestic industries. For these major economies the perceived adjustment required by an FTAAP may be much greater. An implication is that political will in the major APEC economies may be a major factor determining whether agreement on a worthwhile FTAAP is feasible.¹²

5.3. Implementation

The potential to eliminate the “spaghetti bowl” and the discriminatory effects associated with the current “kaleidoscope” of bilateral PTAs is one of the strongest attractions of the FTAAP proposal. Even if this can be achieved however it will not be a clean or instantaneous process. As the FTAA experience demonstrates economies are not likely to abandon their pursuit of bilateral and plurilateral PTAs immediately the FTAAP negotiations are launched. There will inevitably be a period in which the FTAAP and the bilateral and plurilateral negotiations will proceed in parallel. Bilateral and plurilateral PTAs will continue to be pursued for some time, partly as insurance against failure of the FTAAP negotiations, and partly out of a belief, especially on the part of major economies, that conclusion of new PTAs in accordance with their preferred “template” for PTAs will increase their leverage in the FTAAP negotiations.

Nor is it certain that the existing PTAs will disappear entirely if and when an FTAAP is concluded. In the FTAA case it is apparently envisaged that the existing arrangements will continue in some form, although how this will be done has yet to be worked out. APEC economies may also be reluctant to completely abandon their existing PTAs, especially if they contain provisions that are not included in the FTAAP.

Some PECC members have expressed strong doubts as to whether it is realistic to expect the FTAAP to supersede the existing “spaghetti bowl” of multiple PTAs, even in the long term. If these doubts were to prove well founded it would remove one of the major potential advantages of the FTAAP.

Doubts along the lines outlined in the preceding paragraphs lead Yamazawa to suggest that an FTAAP may be “beyond the capacity of APEC at the moment.” He argues that APEC economies should instead make greater efforts to ensure that their bilateral and subregional PTAs meet the standards set out in PECC’s proposed “APEC Common Understanding on RTAs”.

¹² Andrew Elek also argues that major APEC economies would be unwilling to make such adjustments unless other major economies outside APEC, such as the EU, agree to make comparable adjustments. Sharing of adjustment across all major economies of the world can only be achieved in the WTO.

The FTAA negotiations may provide a useful “test case” of the feasibility of forging a single region-wide PTA to eliminate the discrimination inherent in a patchwork of multiple bilateral and plurilateral PTAs.

5.4. Design

The design of any FTAAP will be a crucial factor in determining whether it can be a worthwhile contribution to achievement of APEC’s Bogor goals. Under an optimistic scenario an FTAAP would be a high quality agreement. As Peter Lloyd has emphasised, this means that it would have few (or preferably no) exclusions in product or sector coverage, simple and transparent rules of origin designed to restrict trade as little as possible, clear and minimal safeguard provisions, prohibition on anti-dumping measures on products sources from members and agreement to deal with the relevant issues via competition policy, extensive trade facilitation provisions, full coverage of government procurement, full liberalisation of investment flows, and a transparent and effective dispute settlement process.

Much more pessimistic scenarios are also possible however. Undesirable features can be found in many PTAs among APEC members, such as complex and restrictive rules of origin, extensive exclusions of agricultural and/or industrial products, minimal provisions for liberalisation of services trade, exemption of government procurement, and extensive and non-transparent safeguard provisions. Where these features exist, they are usually responses to strong political imperatives in the relevant member economies. The economies concerned may well perceive severe political obstacles to abandoning these provisions in an FTAAP, unless the FTAAP can be shown to offer sufficient additional benefits to convince domestic constituencies that these concessions are worthwhile. A “lowest common denominator” FTAAP that incorporated many of the least desirable features from existing PTAs is therefore not an impossible outcome, and could not be considered a useful contribution to the achievement of APEC’s goals.

APEC senior officials have included identification of “best practices” in PTAs as an element in their forward work programme. This work should be encouraged, and its results should be used as input to any proposal for an FTAAP.

5.5. Implications for the WTO and Multilateral Trading System

Support for the WTO and the rules-based multilateral trading system has rightly been a key tenet of APEC, and should remain so despite, or rather perhaps especially because of the current difficulties being experienced in the WTO. The implications of an FTAAP for the WTO and the multilateral trading system are therefore very important considerations. A number of competing arguments can be advanced in this connection.

On the one hand it might be argued that launching of negotiations for an FTAAP could create a powerful incentive for non-APEC economies to devote greater energy and

commitment to the pursuit of liberalisation through the WTO process. It might also be argued that a world trading system containing fewer and larger trading blocs might be easier to manage and administer than the current “kaleidoscope” of bilateral and plurilateral PTAs. Larger blocs would be likely to be acutely aware of their interest in maintaining a viable and effective rules-based system, in order to minimise the risk of trade wars and other destructive developments.

Discussions with officials and other trade experts since the first draft of this paper was prepared have revealed substantial support for the view that credible pursuit of an FTAAP by APEC members could have a strong positive impact on the WTO negotiations. On this view, consideration of the potential consequences of a preferential agreement covering such a large part of the global economy would inevitably drive other WTO members to move decisively in the direction of global liberalisation through the multilateral process, as their best available option under these circumstances. Thus an FTAAP could not only offer the prospect of delivering the Bogor objective of free trade and investment in the Asia-Pacific region, but could also serve as a powerful catalyst for global free trade. Furthermore, as Bergsten has pointed out, the catalytic role of the FTAAP might depend only on the “credible threat” of an FTAAP. If other WTO members respond as suggested above, the FTAAP might never have to be implemented.

It does need to be emphasised that the credibility of moves toward an FTAAP would be crucial to any possible catalytic effect. Yamazawa rightly notes that APEC has already lost some credibility in Geneva as a result of the inability to date of its members to take concerted action in the WTO. APEC members would need to give careful consideration as to how to ensure the credibility of any move to develop the FTAAP proposal. An approach lacking in credibility could well prove counter-productive in the WTO context.

By way of balance it must be stated also that some PECC Trade Forum members take a view that is diametrically opposed to the one just outlined. In their view the launching of FTAAP negotiations by APEC economies would be perceived as a sign that they have lost confidence in the WTO, thereby undermining the WTO’s credibility and conceivably even precipitating its collapse. The behaviour of APEC economies in the WTO in this situation might well have an important bearing on the outcome. Even if an FTAAP is deemed acceptable and desirable, it might still be argued that it would be inappropriate for it to be launched at the current stage of the DDA process. Another point to consider is the potential of FTAAP to add to the drain of resources away from the DDA negotiations that is already occurring as a result of the greatly increased emphasis on PTAs.

APEC members will have to make careful judgements on these issues in deciding whether to pursue an FTAAP.

5.6. Implications for APEC

There has also been considerable disquiet among PECC Trade Forum members over the possible effect that pursuit of an FTAAP might have on APEC itself. Concern has been expressed that FTAAP negotiations could be divisive within the APEC process. This might especially be a risk if a number of APEC economies choose not to participate in the FTAAP. Even with full participation, the negotiation of binding reciprocal trade agreements can in itself be a divisive process, as experience in the WTO makes clear. It appears to be common ground that the APEC process as it currently stands is not suited to such negotiations. This is widely believed to be one of the lessons from the failure of the EVSL initiative.

There are a number of possible responses to these concerns. One response is to argue that the APEC process must be restructured to become an effective vehicle for negotiation of agreements like the FTAAP. Proponents of this view are inclined to argue that APEC's voluntary, non-binding approach has outlived its usefulness, and the time has come to switch to a binding approach, and to accept the associated need to restructure the APEC process accordingly. This view implies that the FTAAP could serve as an important step toward achievement of the Bogor goals.

The contrary view is that the voluntary, non-binding approach constitutes APEC's unique strength, and that the fact that the APEC process is not suited to the negotiation of binding agreements is in itself a reason not to pursue the FTAAP. According to this view APEC should continue to work in areas where a voluntary non-binding approach is effective, and leave the negotiation of binding agreements to other forums like the WTO. An attempt to negotiate an FTAAP could destroy much that is valuable in the APEC process.

A third approach in effect seeks to reconcile these conflicting views. It is suggested that negotiation of the FTAAP should be a separate process, distinct from the main APEC process. This is similar to the approach followed in the Americas, where the summit process is kept separate from the FTAA negotiations. This means that the summit process, and the cooperative activities associated with it, need not be compromised by difficulties or even failure in the FTAA negotiations. This approach should be considered by APEC economies if they decide to proceed with the FTAAP.

6. Alternatives to the FTAAP: An Asia-Pacific Single Market?

Within the PECC Trade Forum Andrew Elek has proposed that APEC's members should commit themselves to the establishment of an Asia-Pacific single market¹³ through a Single Market Agenda for the Asia-Pacific (SMAAP).¹⁴ The aim of SMAAP would be to

¹³ It may be worthwhile to consider alternative terminology rather than "single market", given the aversion displayed by APEC politicians and officials in the past to concepts borrowed from the European Union.

¹⁴ Andrew Elek's views are supported by a number of his AUSPECC colleagues, although they are not presented as an official AUSPECC view.

achieve a degree of integration comparable to that in the European Union's "single market", but using different processes and institutional arrangements.

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. The EU's single market developed from the foundation of the successful liberalisation of most trade among its members, including the establishment of a customs union with a common external tariff and common commercial policy. 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. Common policies have been adopted in a number of policy areas including not only agriculture but also transport, energy, telecommunications, fisheries, regional policy and elements of competition policy and social and labour market policy. Extensive powers of enforcement have been entrusted to a supranational agency in the form of the European Commission, supported by a body of European law that generally takes precedence over national law. The most recent advance in economic integration has of course been the adoption of a common currency, the Euro, although debate continues over whether this move was driven more by the imperatives of economic integration or by the political agendas of some EU members and their politicians.

Some elements of the EU's "single market" would be readily consistent with APEC's Bogor goals, for example free trade in goods and services and free movement of capital, harmonisation or mutual recognition of technical standards, and liberalisation of government procurement. Other elements are not being contemplated by APEC economies in the foreseeable future, for example the customs union and common commercial policy, free movement of labour, removal of border controls, harmonisation of indirect tax rates, the adoption of common policies and bodies of law, and of course the adoption of the common currency. It will be a challenge for APEC members to pursue an Asia-Pacific single market with a much more limited range of policy measures and without the support of an enforcement agency with supranational powers.

Elek is confident that an Asia-Pacific single market can be achieved without the need for an FTAAP. He argues that the elements of the programme should be pursued within the forums best suited to each element. Negotiation of binding reciprocal trade liberalisation should be left to the WTO, which has a comparative advantage in this area, and perhaps also to unilateral liberalisation initiatives; the role of bilateral PTAs in his vision of the SMAAP is not entirely clear. APEC has demonstrated comparative advantage in trade facilitation, an area where it has some impressive achievements. It should continue to focus on trade facilitation and should retain its voluntary, non-binding approach. Elek

proposes the following illustrative list of goals that the APEC economies should set for themselves to achieve through this approach by 2020:

- Full rights of establishment and the national treatment of all firms in all significant sectors, regardless of ownership, together with the removal of restrictions on short-term business-related travel.
- Facilitate international investment by harmonising fiscal incentives, adopting an APEC code for the taxation of international income (based in existing bilateral double-taxation treaties) and acceding to existing international conventions for settling international disputes.
- An agreed set of traffic control and other safety procedures for ports and airports, then eliminating all other restrictions on air and sea transport.
- Region-wide minimum standards for competition policy, based on APEC's agreed Competition Principles. These standards should be sufficiently rigorous to rule out anti-dumping actions among APEC economies.
- Transparency and harmonisation of a wide range of administrative procedures, including agreed minimum standards for auditing and disclosure as well as full compatibility and fully electronic data interchange of customs documentation and clearance procedures.
- A program of mutual recognition of product and process standards as well as professional and vocational qualifications, comparable in scope to that achieved by the EU.

Since APEC is a voluntary process of international cooperation, the arrangements needed to achieve particular aspects of the SMAAP would not be "APEC agreements", as such. Elek envisages that they would be set out in enabling domestic legislation and, where possible, commitments made in appropriate multilateral organisations, such as the WTO. He is confident that these goals can be achieved by means of the voluntary, non-binding approach, and believes that the need for adversarial negotiation can be avoided by adopting the "pathfinder" approach, whereby those economies not ready to participate are not obliged to do so.

The agenda outlined by Elek is ambitious. Its achievement would certainly be a significant step in the direction of achieving an Asia-Pacific single market. Questions may remain as to whether multilateral liberalisation and unilateral liberalisation can realistically be expected to proceed quickly enough to match the level of ambition proposed for the elements of the programme to be pursued within APEC. The FTAAP proposal surfaced partly as a result of concerns over the outlook for multilateral and unilateral liberalisation, as well as disquiet over the effects of the proliferation of PTAs. It also remains to be seen how far a result comparable to the EU's single market can be achieved through the voluntary, non-binding approach. It is possible that achievement of the single market will require a switch to a binding approach at some point.

Lloyd argues that it is unrealistic to expect a "single market" to be realised in the absence of full liberalisation of trade among the participants. Indeed it is difficult to understand how a single market could be considered to exist if all border barriers have not been removed. Lloyd points out that all historical examples of "single market" initiatives have built on the foundation of a pre-existing PTA. This is the true of the EU and it is also true of ASEAN and CER. He likens the relationship between the FTAAP and a "single

market” to the relation between “learning to walk” (FTAAP) and “learning to run” (single market). He considers it quite unworkable to leave the modalities up to different fora, as “they would work at different paces and have varying degrees of success, both of which are contrary to the notion of a single market. However elements of this could be a supplement to border trade liberalisation”. His view is supported by comments from other Trade Forum members emphasising that removal of border barriers is a fundamental building block of any “single market”.

Another Trade Forum member, Yuen Pau Woo has suggested an agenda for APEC along similar lines to that proposed by Elek, with a heavy emphasis on facilitation. He suggests however that consideration be given to implementing this agenda through a negotiated agreement, covering issues such as trade facilitation, regulatory coordination, government procurement, investment rules, and movement of people. As another option, it would of course be possible to pursue the SMAAP agenda in conjunction with an FTAAP, either within the FTAAP framework itself or, if advantages are seen in retaining the voluntary non-binding approach for some elements of the SMAAP, within the existing APEC process, parallel to but separate from the FTAAP.

7. Conclusions

The conclusions to be drawn from the foregoing analysis include the following:

- The proposal for an FTAAP should be assessed on the basis of its potential to contribute to APEC’s Bogor goals.
- An FTAAP will be a preferential free trade arrangement based on binding reciprocal commitments. It would thus represent a fundamental and decisive departure from the concept of “open regionalism” that has hitherto enjoyed widespread support within APEC, based on non-discriminatory liberalisation and voluntary non-binding commitments. In order to support the FTAAP concept APEC members would need to be satisfied that this change of direction is justified and desirable.
- If APEC members wish to move forward on the basis of binding commitments to each other, without making the same commitments to other WTO members, the only way to do this that is legal in WTO terms is an APEC-wide FTA (i.e. the FTAAP) or customs union.
- One of the principle attractions of an FTAAP is its potential to replace the “spaghetti bowl” of bilateral and plurilateral PTAs in the APEC region. If APEC members decide to pursue an FTAAP, it should be on the clear understanding that its provisions will replace the corresponding provisions in existing bilateral and plurilateral PTAs among the FTAAP members, recognising that in practice confidence in the viability of the FTAAP will have to be established before this can occur.
- An FTAAP can also reinforce the concept of economic integration across the full Asia-Pacific region, embracing both sides of the Pacific.
- An FTAAP should not be considered unless it is supported by, at a minimum, the US, China and Japan, and preferably by all six major North American and Northeast Asian economies. These six economies account for 90% of APEC GNP, and the

trade flows among them are by far the largest trade flows in the APEC region. It would be useful to have an assessment from the ABAC members from those economies as to whether this support is likely to be forthcoming.

- Preliminary analysis indicates that an FTAAP will deliver more favourable economic outcomes for APEC members than PTAs among smaller groups of APEC members. It may also deliver greater benefits to APEC members than APEC MFN liberalisation, but the additional benefits will be secured at the expense of the rest of the world. Full global liberalisation delivers greater benefits to the APEC membership and to the world as a whole.
- An FTAAP should therefore be considered only if members are satisfied that it will act as a “stepping stone” to full global liberalisation. Establishment of an FTAAP may create an incentive for non-APEC economies to accelerate progress toward full global liberalisation in the WTO.
- Since APEC members account for over 60% of world GNP, an APEC-wide FTAAP would be of enormous global significance. It follows that very careful consideration should be given to the impact on non-APEC economies, and to the implications for the WTO and the multilateral trading system.
- An FTAAP must be a “high quality” agreement, designed to meet the objectives of the Bogor Declaration. This is a much higher standard than conformity with the WTO rules contained in GATT Article XXIV and GATS Article V. The PECC Trade Forum’s proposed “APEC Common Understanding on RTAs” should be used as guidelines for an FTAAP that would be consistent with the Bogor goals.
- The following are key elements to consider in designing a “high quality” FTAAP:
 - The FTAAP should provide for adherence to relevant principles from the Osaka Action Agenda, and to the principles that APEC has established on investment, competition policy, government procurement, trade facilitation and transparency.
 - Product coverage: If possible, there should be no permanent exclusions. Realistically, however, APEC members may have to decide whether some exclusions may have to be allowed in order to conclude an agreement. If exclusions are to be allowed they should be minimal.
 - Implementation timetable: The timetable should allow for full implementation within the timeframes agreed for implementation of the Bogor goals by developed and developing APEC economies. If this proves too difficult, APEC members may have to decide whether some relaxation of the timetable is an acceptable price to pay for achieving a binding agreement.
 - Rules of origin should be transparent and as straightforward as possible, based on the principle of facilitating rather than restricting trade.
 - In order to limit economic damage caused to non-members, there must be progressive reductions of MFN tariffs by APEC economies in parallel with the gradual elimination of trade barriers between them. This could be achieved via successive rounds of WTO negotiations or through application of a rule agreed among APEC economies themselves. APEC members should be encouraged to offer to multilateralise their FTAAP commitments within the WTO.
 - Designing the services and investment elements of an FTAAP to meet the Bogor goals in those two areas will be a major challenge.
 - Any safeguard provisions should be transparent and minimal.

- It would be very desirable that FTAAP members agree to abolish anti-dumping procedures on trade between them, and agree instead that the relevant issues should be handled under the umbrella of competition policy.
 - Government procurement should be liberalised under the FTAAP.
 - Provisions may also be included on facilitation measures such as mutual recognition of technical and occupational standards, streamlining of customs procedures, mobility of persons, e-commerce, and secure trade.
 - Provisions on intellectual property should reflect a balance of interests between the members.
 - Effective dispute settlement provisions are essential.
- Special difficulties will be presented by the liberalisation of agricultural trade because of the importance of export subsidies and domestic support as well as market access barriers. While market access can readily be addressed within a PTA such as the FTAAP, it may be difficult to address export subsidies and domestic support outside the WTO. The ability to successfully handle agriculture within an FTAAP may therefore be dependent on successful negotiations in the WTO on export subsidies and domestic support.
 - If APEC members proceed with an FTAAP they must give special consideration to the situation of small non-APEC Asia Pacific economies, particularly the independent Pacific Island states, the non-APEC members of ASEAN, Timor Leste and Mongolia. Ways should be sought to allow these economies to associate themselves with the FTAAP without having unsupportable burdens imposed on them.
 - The FTAAP will have important implications for some economies outside the Asia-Pacific region, especially those in South Asia. Consideration should be given to offering membership in the FTAAP to any economy that is prepared to accept its terms and conditions.
 - Support for the WTO and the multilateral trading system must remain a central tenet of APEC. An FTAAP should be considered only if APEC members are satisfied that it can be implemented without damaging the WTO and the multilateral trading system. This will require careful consideration.
 - Successful negotiation and implementation of an FTAAP meeting the conditions outlined above will be an enormous challenge, requiring strong political commitment from the leadership of APEC economies, especially the major economies. An attempt to negotiate an FTAAP in the absence of such commitment would be futile and should not be attempted.
 - The APEC officials' work programme on "best practices" in PTAs can make a valuable contribution. The results of the programme should be utilised as an input into the design of an FTAAP.
 - A "lowest-common-denominator FTAAP", incorporating undesirable elements from the various existing PTAs among APEC members should be avoided at all costs.
 - The value of the APEC process to its members now appears to be well-accepted, and care should be taken to ensure that it is not compromised by pursuit of an FTAAP. If an FTAAP is to be pursued, APEC members should consider separating the FTAAP negotiations from the main APEC process.

- APEC members should consider committing themselves to a Single Market Agenda for the Asia-Pacific (SMAAP). It would be possible to pursue the SMAAP without an FTAAP. Elements of the SMAAP suited to reciprocally binding agreements could be left to the WTO, while APEC could continue to deal with those elements in which its voluntary non-binding approach has established a comparative advantage. Alternatively those elements of the SMAAP not covered by the WTO could become the subject of a negotiated agreement among APEC members. It would also be possible to pursue the SMAAP in conjunction with an FTAAP, either within the FTAAP framework itself or, if advantages are seen in retaining the voluntary non-binding approach for some elements of the SMAAP, within the existing APEC process, parallel to but separate from the FTAAP.

ABAC members will need to consider whether they

- agree with the foregoing assessment of the conditions required for an FTAAP aimed at achievement of the Bogor goals.
- consider that there would be sufficient support from their own economies for an FTAAP under these conditions to make an FTAAP feasible in practice.
- consider that the potential advantages of an FTAAP, if feasible, are sufficient to warrant a recommendation to APEC to take up the proposal.
- should make an alternative recommendation, for example along the lines proposed by Andrew Elek, in the event that they conclude that an FTAAP is not feasible or desirable.

It would be fair to say that all PECC Trade Forum members who have expressed views on the matter consider that it will be at least difficult to meet the conditions outlined above. Political will in the major APEC economies is identified as a crucial issue. Some Trade Forum members go further than this. In particular, Andrew Elek and his colleagues have forcefully and unequivocally stated the view that an FTAAP is neither feasible nor desirable.

It is hoped that this paper will be useful to ABAC members in reaching their own conclusions on these issues.

8. References

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