



EAST-WEST CENTER

A New Agenda for APEC: Setting up the 'Building Blocks' of Free Trade

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I S S U E S

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The U.S. Congress established the East-West Center in 1960 to foster mutual understanding and cooperation among the governments and peoples of the Asia-Pacific region, including the United States. Principal funding for the Center comes from the U.S. government, with additional support provided by private agencies, individuals and corporations and more than 20 Asian and Pacific governments.

The Center promotes responsible development, long-term stability and human dignity for all people in the region and helps prepare the United States for constructive involvement in Asia and the Pacific.

SUMMARY The recent spectacular economic growth in the Asia-Pacific region has been fueled by the increasing trade and investment activities among nations of the region. For this to continue, barriers to trade and investment must fall more than they already have, but members of the new Asia-Pacific Economic Cooperation (APEC) forum are divided on how to accomplish this goal. U.S. policymakers and their allies want to concentrate on legalistic agreements and timetables for the rapid reduction of trade barriers. Some Asian policymakers fear this approach will result in establishment of a free trade area, which they oppose; they favor a more evolutionary course. APEC can help bring these two approaches together by trying to foster agreement on a number of policies that will reduce trade and investment barriers. Whatever the outcome of the broader debate, setting up these "building blocks" of free trade can help move the countries of the region steadily toward closer economic cooperation.

**Asian and American
leaders differ in
their approach to
an Asia-Pacific
community**

Introduction

U.S. and Asian leaders seeking to strengthen economic ties between their nations are increasingly looking to leadership from APEC, which has grown in importance and potential since a November 1993 meeting in Seattle. That meeting added substance to the vision of an Asia-Pacific economic "community" and facilitated the successful completion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) paving the way for a more structured global trading system to be called the World Trade Organization. Yet the future direction of APEC remained undecided due to differing visions of what this future should be, and this uncertainty persists in the discussions leading up to the second meeting of leaders, to be held in Jakarta in November 1994. While all members of APEC want to see progress toward global free trade, they disagree on what steps should be taken—and how quickly.

**American and Asian Views of Economic
Cooperation**

APEC's short history has generally been marked by a split between the American and Asian views of an Asia-Pacific "community." Clearly, distinguishing an "Asian" and an "American" approach overstates the differences between American and Asian viewpoints as well as the similarities among different Asian approaches. In general, however, the United States has pushed for a more legalistic approach and an adherence to timetables while a number of Asian countries prefer leaving APEC as a forum for consultation and discussion.

The American "institutional" approach to Asia-Pacific economic cooperation is evident in both reports of the APEC Eminent Persons Group, an advisory panel charged with creating a vision for the organization's future. The first EPG report in 1993¹ called for a clear endorsement of free trade and the setting of a target date for reaching that goal, something APEC leaders declined to do. The panel's chairman, Fred Bergsten, is a key proponent of another American idea: having Asian-Pacific coun-

tries accord each other trade benefits beyond those authorized to all GATT members. Such an approach aims to utilize APEC's negotiating leverage vis-à-vis other countries and regions to obtain maximum liberalization around the world.

The contrasting "evolutionary" Asian view of economic cooperation calls for gradual development of regional ties and firmly rejects anything resembling a trade bloc with preferential treatment for members. This approach is most clearly illustrated by the Association of Southeast Asian Nations or ASEAN (Thailand, Malaysia, Indonesia, Singapore, Brunei, and the Philippines). ASEAN's style can be characterized as "cautious, consensus-driven, low-key, and proceeding at the pace dictated by the slowest member."² The association was formed in 1967; its first summit was not until 1976; and the agreement to establish the ASEAN Free Trade Area (AFTA) emerged only in 1992. This leisurely pace of cooperation in Southeast Asia has led to a strong regional identity and a grouping of unprecedented longevity in the developing world. ASEAN, however, has its limits as a model for APEC, having proven less successful in promoting economic integration than in building regional confidence. Even ASEAN's new free trade area, although a revolutionary step focusing on tariff liberalization, has yet to address more sensitive issues such as investment and competition policies, infrastructure development, and environmental protection—issues for which APEC-wide negotiations appear more promising.

'Free Trade in the Area'

The American perspective is again represented in the EPG's second report, which will be considered at the November 1994 meeting in Indonesia. The report recommends a program for "free and open trade and investment in the area" by 2020.³ Starting in the year 2000, developed APEC members would have 10 years to dismantle all trade barriers to other member countries. The Newly Industrialized Economies or NIEs (Hong Kong, Singapore, South Korea, and Taiwan) would have 15 years to remove trade barriers to other members, while other developing

Trade and Investment Spurring Asia-Pacific Growth

The driving force behind the region's economic boom has been Asian countries trading more with each other and investing more in each other. Trade is expanding rapidly among the Newly Industrialized Economies or NIEs (Hong Kong, Singapore, South Korea, and Taiwan), between the NIEs and China, and between the NIEs and Association of Southeast Asian Nations or ASEAN (Thailand, Malaysia, Indonesia, Singapore, Brunei, and the Philippines). Inter-ASEAN trade has not increased significantly in recent years but may begin to do so with the recent formation of an ASEAN Free Trade Area (AFTA). APEC members' trade with each other grew from 57 percent of their total trade in 1980 to 69 percent in 1992, while trade among Asian countries as a whole rose from 34 percent to 43 percent of total Asian exports. As Asian trade shifted from the United States to markets in Asia, exports to the United States dropped from a peak of 34 percent in 1986 to only 24 percent, close to the 1980 level (although U.S. exports to Asia are increasing and are currently around 24 percent of the total).

An increase in direct foreign investment has also accelerated the growth of trade and helped to integrate the region's economies. Investment encourages trade directly, through the trade of multinational affiliates, and indirectly, through the spread of information, the transfer of technology and management skills, and spurring of improvements in transportation, communications, and other basic development

and services. The NIEs and Southeast Asia benefited from investment first from the United States, then from Japan; more recently, the NIEs themselves have invested heavily in Southeast Asia and China. From 1986 to 1991, the NIEs accounted for one-third of investment in China and the ASEAN nations of Thailand, Malaysia, Indonesia, and the Philippines, exceeding even Japanese investment in the region.

The linkage between investment and trade has also led to a triangular pattern of trade in the region. Countries getting direct foreign investment from the NIEs and Japan import materials and equipment from those economies, usually running significant bilateral trade deficits. The countries then export the finished products to third countries, particularly the United States, with which they often run bilateral trade surpluses. Similar patterns have led to formation of "growth triangles"—also called "transnational processing zones" or "natural economic territories"—such as the dynamic Hong Kong–Southern PRC–Taiwan axis or the Southeast Asian triangle formed by Singapore, the Riau Islands of Indonesia, and Johore State in Malaysia. Development of other such economic groupings continues; examples include the Tumen River project (involving North and South Korea, Russia, China, Japan, and Mongolia) and the Mekong Valley arrangement (between Thailand, Laos, Vietnam, Cambodia, and China).

countries including China would have 20 years. Although the report specifically rules out creation of a free trade area (calling it instead "free trade *in* the area") critics charge that it sets out a blueprint to do just that. Proponents argue that even if a trade area is created, it would be less closed than other agreements because the tariff reductions of APEC members could be extended to non-members who reduce their own tariffs.

The issue is controversial because many Asian countries are afraid a formal trade agreement in APEC would mean additional pressure from the United States to reduce trade barriers too quickly, as well as pressure about national policies dealing with such sensitive areas as human rights, intellectual property rights, and the environment. Asia's current

economic boom has come about without the formation of a trade bloc or any other arrangement granting special economic benefits to members and therefore discriminating against non-members. It has simply been based on market forces. Tariffs and non-tariff restrictions in the region have been applied equally to all nations that are GATT members and follow the Most Favored Nation (MFN) principles of the GATT. Asian countries have traded more with each other and invested more in each other as production and national incomes have gone up, and as trade barriers have been reduced—which has occurred only as the individual countries feel they are ready to reduce them.

Since creation of anything resembling a free trade area is opposed by some Asian leaders, it is debatable

Asia's current economic boom has come from market forces, not a trade bloc

whether a preferential free trade area along the lines of NAFTA will emerge in 2020. On the other hand, the second EPG report has attracted some support, and the strong push by Indonesia's President Suharto, the host of the next APEC summit, for APEC to make a bold move toward trade liberalization makes some agreement likely. Other policymakers who disagree with portions of the report may accept it in principle but try to change it in the negotiations over the details of implementation.

Convergence of American and Asian Views

Despite these disagreements, the American and Asian approaches to regional cooperation may be part of an evolution of regional consensus rather than merely a clash of wills. The two sides are wrangling over timetables and free trade areas but at the same time have moved steadily closer together on other issues. U.S. trade policy toward Asian countries such as China and Japan seems to be softening, and Asia-Pacific countries have in turn agreed to many important liberalization measures under the GATT Uruguay round. ASEAN, once reluctant even to join APEC, is now active in shaping its future, and will host the organization's meetings every other year.

Both the content and the response to the second EPG report demonstrate a gradual convergence of the Asian and American views. The report proposes a gradual time frame—starting in five years and taking 20 years to complete—and sidesteps the question of whether or not a preferential free trade bloc will be created in 2020. The “agree first and negotiate later” approach seen in the response to the report has been a major characteristic of the ASEAN Free Trade Area as well.

APEC leaders, both Asian and American, appear to agree on creating an Asia-Pacific community that benefits its members without discriminating against nations outside the region. Whatever results from the larger debate, APEC can help bring the Asian and American approaches closer together by working on specific policies that will reduce barriers to trade and investment.

An Agenda for APEC

Although most countries of East Asia and ASEAN have reduced their trade barriers, they remain protected by tariffs and other barriers that are far greater than those in the United States. Average tariff rates will remain 30 to 40 percent in Thailand and around 20 percent in Indonesia and the Philippines even after implementation of agreements forged during the GATT Uruguay round. Non-tariff barriers also exist in many forms such as government procurement practices, customs procedures, health and safety standards, testing requirements, administrative guidance, antimonopoly legislation, and distribution systems. Most of the countries also maintain significant restrictions on foreign investment.

The converging North American and Asian views suggest that the APEC Ministers and working groups should focus on “building blocks” of economic cooperation—that is, the specific policy components that work toward liberalization or removal of trade and investment barriers. They should focus on policy measures that facilitate trade rather than on prolonged negotiations for multilateral tariff reductions. The following building blocks should be emphasized:

- Reduce the disparity between the tariff levels of nations
- Bind tariffs at current levels as a step toward reducing or eliminating them
- Establish a database to keep track of the current tariff rates on the thousands of commodities involved in Asia-Pacific trade
- Share information on rules of origin used by trade areas such as NAFTA and the ASEAN Free Trade Area to determine what goods come from their area and so qualify for favored treatment
- Standardize the processes of trade such as customs procedures and foreign investment rules and regulations
- Identify non-tariff barriers and agree to cooperate on reducing and eliminating them
- Replace quantitative restrictions, which limit the

‘Building blocks’ are specific policies that work toward removing trade barriers

amount of a commodity that can enter a country, with tariffs, which impose costs but do not limit amounts

- Standardize assessments of the value of trade
- Ensure that countries treat direct foreign investment more like investment that comes from domestic sources
- Standardize labeling and packaging requirements
- Make governmental policies on matters such as procurement clear to all potential foreign suppliers so they have the same chance as domestic suppliers to meet the requirements.

Many of these items are among the measures that the second EPG report recommends that APEC adopt in order to encourage trade. These “building blocks” should not be pushed to the side in the quest for the more ambitious “free trade in the area” agreement. Clearly, agreement upon a timetable for tariff reductions would only mark the beginning of negotiations on how to bring about trade liberalization. Thus, whether or not a timetable is adopted or something like a free trade area formed, the “building blocks” can serve as an important approach to expand trade and investment in the region. They are also the measures likely to gain acceptance by the forum no matter what the fate of the broader agenda.

There are other steps APEC can take to help increase trade and investment. Some natural candidates for the APEC agenda are the recommendations for an Asia-Pacific investment code, dispute settlement process, macroeconomic policy coordination, competition policy, technical cooperation, and building of institutions within APEC. Background research will be needed for each of these complex topics or for any combination of them. Creating APEC institutions is an important but sensitive issue; APEC already has a committee on trade and investment, and two others—dealing with economic trends and development cooperation—have been suggested. APEC should establish a variety of committees to prepare and implement the “building block” agenda.

Another step long supported by the authors and included in the EPG report would be for APEC to

work to change the GATT’s posture on free trade areas. GATT currently has little control over such regional groupings, as illustrated by the fact that it has never vetoed any significant bilateral accord. A GATT provision merely states that free trade areas should not increase trade barriers; it should be revised to require that barriers be reduced. Another clause that free trade areas be general rather than concentrated on specific sectors has often been ignored; changes are required to put teeth into the regulations.

In short, the converging American and Asian approaches to regional integration can help APEC to methodically tackle complex issues surrounding trade, investment, and development of the Asia-Pacific region. APEC might in this way be able to help move forward the unfinished business of the GATT Uruguay Round in such areas as the treatment of services, intellectual property rights, and the environment. For such issues, the GATT agreement represents the beginning of the process to establish a set of coherent, reasonable international rules. Preparation for a new trade round should begin soon, and meanwhile concerted liberalization efforts at the regional level can help pave the way toward a World Trade Organization of free, strong, and interdependent economies.

Notes

1. APEC Secretariat. 1993. *A Vision for APEC: Towards an Asia Pacific Economic Community*. Report of the Eminent Persons Group to APEC Ministers. Singapore: Asia Pacific Economic Cooperation.
2. Hill, Hal. 1994. *ASEAN and AFTA: A Stocktake and Issues for the Future*. Paper prepared for the ESCAP/TDRI Queen’s University Conference on AFTA and Beyond: An ASEAN Perspective, Bangkok, 27–28 April, pg. 25.
3. APEC Secretariat. 1994. *Achieving the APEC Vision: Free and Open Trade in the Asia Pacific*. Second Report of the Eminent Persons Group. Singapore: Asia Pacific Economic Cooperation.

These ‘building blocks’ should not be ignored in the quest for the broader agenda

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Also available in conjunction with this paper are two tables in poster format, "Trade Policies of Selected Asia-Pacific Countries," and "Between GATT and a Free Trade Area: 'Building Blocks' of Economic Cooperation." For copies, please contact the Office of Public Programs, East-West Center, 1777 East-West Road, Honolulu, HI 96848.

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