

# SUBREGIONAL TRADING ARRANGEMENTS AMONG APEC ECONOMIES: MANAGING DIVERSITY IN THE ASIA PACIFIC

Since 1999, there has been a sharp rise of interest in new subregional trading arrangements (SRTAs) involving APEC economies. Many, if not most, of the emerging new economic partnerships are expected to be based on a preferential free trade area (FTA). These arrangements are likely to divert attention from the wider objectives of the APEC process and its commitment to open regionalism, and strain its cohesion. It cannot be taken for granted that the liberalisation agreed within subregional FTAs will be smoothly extended to others.

As well as liberalising border barriers to trade and investment, new SRTAs are expected to deal with the many other significant impediments to international commerce. Even with the best of intentions, it will not be easy to address these relatively new issues without creating new discrimination and diversion of economic activity. If these relatively new issues are addressed in association with a preferential FTA, these arrangements could be discriminatory by default. The practical challenge is to avoid preferential treatment from becoming either entrenched or permanent.

This paper sets out a range of policy issues that will be created by any proliferation of SRTAs, especially if they are constructed around FTAs. To manage these issues, it is essential that future SRTAs meet standards that are substantially higher, and less ambiguous, than minimum WTO requirements. A set of guiding principles, which build on already-agreed APEC principles, are presented for consideration, with emphasis on transparency, avoiding new obstacles to trade or investment and creating objective, non-discriminatory opportunities for accession.

## **Introduction<sup>1</sup>**

Since its inception in 1989, the Asia Pacific Economic Cooperation (APEC) forum has established itself as a significant international organisation. The diversity of its participants, from both shores of the Pacific, has led to the emergence of a new model of voluntary international economic cooperation, quite distinct from the treaty-driven options adopted in Western Europe and the Americas.

Diversity has many positive aspects. It creates strong complementarities and enormous potential for mutually beneficial economic integration – that is the logic behind APEC's efforts to promote trade and investment liberalisation and facilitation (TILF). Diversity also creates

a rich pool of information, experience, expertise and technology. The region can share and use these resources to enhance the capacity of all Asia Pacific economies for sustainable growth – that is the logic behind APEC's efforts to promote economic and technical cooperation (ECOTECH).

Managing its diversity will also be a permanent challenge for APEC as its 21 members are not likely to all have the same goals at the same time. Close neighbours and significant trading partners are likely to cooperate relatively more closely, while those that are more economically or geographically distant are likely to have less in common. Most APEC economies are involved in various other forms of cooperation, either with other APEC participants, or with the rest of the world, especially Europe.

It was never expected that a large number of very diverse economies would move at the same pace toward closer economic integration. APEC's 1995 Osaka Action Agenda made explicit provision for economies that wanted to pursue particular cooperative arrangements within the APEC grouping to do so, with other members able to join later.<sup>2</sup>

At the time this (21-x) principle was adopted, it may have been taken for granted that initiatives among subgroups would not seek to divert trade or investment away from other economies, especially other APEC economies. It is now becoming obvious that many, if not most, subregional trading arrangements are likely to cause some diversion of economic activity.

In the past two years, interest in new subregional trading arrangements has risen sharply. Many, if not most, of the new economic partnerships are likely to be built on the base of a preferential free trade area (FTA). The prospect of such discriminatory arrangements poses critical challenges for the APEC process.

Preferential trading arrangements depart from the principle of open regionalism adopted by APEC economies (that is, to reduce impediments to economic transactions among participants without seeking divert economic activity away from other economies). This raises concern about whether open regionalism can continue to be the basis for APEC-wide cooperation. The attention given to subregional trading arrangements is also likely to divert attention from the wider objectives of APEC. Another, perhaps even more urgent, concern is that new arrangements that discriminate against some APEC economies in favour of others are likely to strain the cohesion of APEC itself.

As explained in this paper, it cannot be automatically assumed that the liberalisation agreed within subregional FTAs will be smoothly extended to other APEC members. Nor is

it easy to envisage potential FTAs among several subgroups of APEC economies coalescing smoothly in order to realise the goal of an APEC-wide zone of free and open trade and investment adopted at the 1994 APEC meeting at Bogor, Indonesia.

The FTAs under discussion tend to be among groups where prospective partners do not compete in sensitive sectors such as agriculture or are likely to exclude such sectors. Subregional trading arrangements currently under consideration include a potential arrangement between Japan and Korea, an economic partnership between Japan and Singapore, close links between Australia, New Zealand and ASEAN, and a possible arrangement for free trade in services between Australia and Japan.

Prospective subregional trading arrangements are expected to cover far more than traditional border barriers to economic activity. All of them are expected to deal with the many other significant impediments to closer and mutually beneficial economic integration, such as technical and regulatory obstacles – concentrating as much on trade facilitation as trade liberalisation.

If these relatively new issues are addressed through a preferential FTA, there is a risk of unintended side effects. New sources of discrimination can be created simply by default, as new arrangements can all too readily be drafted using a ‘members only’ style of language.

Many of the problems discussed in this paper could be avoided if all future subregional trading arrangements were based on APEC’s principle of open regionalism, rather than being constructed around FTAs. But this outcome does not appear likely in the short term. Nor would all the concerns about the diversion of economic activity disappear simply by avoiding the discriminatory reduction of border barriers. Given the rapidly growing relative importance of other impediments to international economic transactions, it is becoming essential to spell out more carefully the meaning of open regionalism as applied to trade and investment facilitation.

Even where cooperative arrangements to reduce non-border impediments to trade or investment seek to take account of the interests of others, it will be quite difficult to avoid some discrimination and diversion of economic activity. The challenge is to avoid preferential treatment from becoming either entrenched or permanent, and this usually requires the inclusion of other countries.

This paper illustrates the many practical issues that arise from the creation of subregional trading arrangements, or any other ‘clubs within clubs’. These issues suggest that some concise guidelines could help encourage new cooperative arrangements in the APEC

region to be consistent with the already-agreed objectives and guiding principles of the APEC process and to take full account of the interests of others.

A set of guiding principles are presented for consideration, under the headings of:

- objectives;
- instruments – individual and collective action;
- consistency with existing obligations;
- transparency;
- avoiding new obstacles;
- accession; and
- provision for review.

These principles, which build on APEC's existing principles, could help maximise the potential benefits of new initiatives for closer economic partnerships, while minimising any unintended and undesirable side effects on non-members.

## **Managing diversity**

APEC was launched by Foreign and Trade Ministers of 12 Asia Pacific economies: the then six members of ASEAN (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) together with Australia, Canada, South Korea, Japan, New Zealand and the United States. Several years ahead of the North American Free Trade Agreement (NAFTA), APEC was the first attempt to forge a new type of voluntary international economic cooperation among developing as well as developed economies.

The number of member economies has since expanded to twenty-one. China, Taiwan and Hong Kong joined in 1991, with the non-formal nature of APEC permitting their simultaneous inclusion as economies, finessing issues of sovereignty. Mexico and Papua New Guinea were admitted in 1993, Chile joined in 1994 and Peru, Russia and Vietnam became members in 1997.

One response to APEC's growing diversity was the 1997 decision to impose a 10-year moratorium on expanding participation. Another was to adopt a flexible approach to cooperation. The guiding principles for TILF, set out in the Osaka Action Agenda, allow each APEC government to set the pace and sequence of their reforms to meet the agreed deadlines for free and open trade and investment in the region (2010 for developed economies and 2020

for developing countries). It is expected that many cooperative arrangements to deal with non-border impediments to trade or investment, such as the APEC Business Travel Card, will be pioneered by some members, with others joining when they perceive the benefits and/or develop the institutional capacity to do so. APEC leaders also need to respond to another inevitable consequence of diversity: the many new initiatives for closer partnerships among some APEC economies as well as new partnerships with non-APEC economies.

An example is the emerging caucus among East Asian economies. The informal meetings of the leaders of the ASEAN-10 with those of China, Korea and Japan (the ASEAN-plus-three grouping) provide opportunities to exchange views on the many economic issues where East Asians have justifiable, shared concerns. Another is the tendency to seek new economic links, either bilaterally or with existing subregional arrangements, such as ASEAN. This reflects a desire for closer economic relations with particular neighbours as well as the wish to move more rapidly than the pace set by APEC.

Finding ways to ensure that these subregional initiatives help achieve APEC's region-wide objectives is a similar challenge to reconciling APEC's global and regional aims. In that context, APEC can be seen as a 'club' of economies, within a broader international economic system. Correspondingly, initiatives for closer economic partnerships among some APEC economies can be seen as 'clubs' within a broader, region-wide club. Within APEC it is expected that these clubs should pay attention to others, especially other APEC members. It is also reasonable for members to expect that new arrangements with economies outside APEC will not seek to divert economic activity from the rest of APEC. These expectations can be met if new cooperative arrangements are designed to be 'open clubs' – groupings that avoid adverse effects on other countries and eventually widen their membership.

## **New initiatives and APEC**

Understanding and coping with the challenges raised by new types of economic cooperation will be a continuous learning process. New issues will continue to arise as different groups of governments look for innovative ways to facilitate different aspects of international economic transactions.

The decisions taken by APEC governments involved in these partnerships are the same kinds of decisions that are needed to implement their commitments to the vision of free and open trade and investment laid out in the Bogor Declaration. In that sense, the new

partnerships are encouraging reforms that are consistent with the APEC process. The challenge is to maximise the likelihood that these steps are consistent with, and promote, the region-wide reduction of impediments to international economic transactions.

Different issues will be raised by the different cooperative arrangements being considered. In each case, it is important to consider whether the arrangements are consistent with the 2010/2020 deadlines adopted by APEC leaders. There should also be a realistic strategy for encouraging all APEC governments to take similar steps, possibly by joining cooperative arrangements pioneered by others.

### ***The nature and scope of closer economic partnerships***

Each of the initiatives for forging closer economic partnerships currently under consideration is likely to have unique features, but most are expected to contain a framework agreement that sets out the expected scope and depth of cooperation, and some general principles for reducing specific impediments to economic transactions. Typical framework agreements to promote closer economic partnership among a group (or pair) of economies contain agreements on both trade liberalisation and trade facilitation.<sup>3</sup>

The range of arrangements within a framework agreement usually include decisions to liberalise border barriers to trade in goods or services; for example, agreed schedules to eliminate tariff barriers to trade in goods and/or some border barriers to trade in services. But these days, trade liberalisation is seldom the sole, or even the principal, objective of economic cooperation. Initiatives for closer economic partnerships are also likely to include arrangements to facilitate trade and investment; such as:

- facilitating the movement of factors of production: for example, by reducing the costs and delays of business-related travel;
- building mutual confidence to trade or invest by introducing measures such as improved transparency of economic regulations, mutual investment promotion/protection agreements or dispute mediation/settlement arrangements; and
- enhancing the compatibility of regulations and procedures for managing economic activities within the economies involved: for example, by mutually recognising standards or harmonising administrative procedures.

Western Europe's experience has confirmed that effective economic integration requires far more than the elimination of border barriers. Members of the European Economic Community formed a customs union with no internal border barriers in the 1960s, but a very comprehensive range of additional cooperative arrangements was needed to complete the Single European Market by 1993.<sup>4</sup> In view of that experience, most initiatives for closer economic relations are more than just free trade areas. Indeed, the Transatlantic Economic Partnership (TEP) being implemented between the EU and the United States leaves all traditional border barriers to be dealt with in the WTO and focuses on what its proponents perceive to be the more important goal of facilitating trade and investment.<sup>5</sup>

Nevertheless, framework agreements for proposed closer economic partnerships are often built around a preferential trading arrangement or FTA agreement, with additional provisions for dispute settlement procedures, mutual recognition of standards and other agreed collective actions to facilitate trade or investment among the participants. Consequently, there has been a tendency to refer to all initiatives for closer economic partnerships as proposals to set up an FTA. However, it is important to be aware that forming a discriminatory FTA is only one option for promoting closer economic relations.

Almost all of the countries involved in proposals for new FTAs or other options for closer economic partnerships have emphasised that others would be able to join such arrangements. Despite such statements of principle, it may not prove easy for other countries to join. First, the agreements are often specifically designed to take account of the concerns of the original participants.<sup>6</sup> Second, as in the case of the EU, the framework of existing agreements may be very broad, requiring massive policy adjustment by those seeking accession. As discussed below, much will depend on whether prospective members are required to join all the cooperative arrangements that come under a framework agreement, or are permitted to join specific arrangements within that framework.

## **Trade liberalisation and FTAs**

In principle, any pair (or group) of economies can achieve free trade among themselves by independent decisions to dismantle trade barriers, consistent with the fundamental principle of non-discrimination at the heart of the GATT/WTO system. Unilateral decisions to reduce border barriers to trade are the most efficient in economic terms and require no negotiations.

While many APEC governments have made significant unilateral progress toward liberalisation, this option does not seem to be politically attractive as a means of forging closer economic partnerships with particular economies.

In practice, most groups continue to favour the preferential FTA model to achieve free trade among members. Except for the Northeast Asian economies of China, Hong Kong, Japan, Korea and Taiwan, many APEC members already belong to preferential FTAs. Since these arrangements discriminate against other economies, they are difficult to reconcile with APEC's principle of open regionalism.

The negotiation of any new preferential trading arrangement involving some APEC would raise some difficult issues, but problems could be avoided if subregional trading arrangements were non-discriminatory. By far the most desirable option would be for APEC economies to adopt the principle of open regionalism for all future links with all other economies. That would certainly be consistent with progress toward the Bogor vision and there would be no need for concern about side effects on any other economy.

At the same time, it would be unwise to expect ready acceptance of rules that would prevent preferential trading arrangements from being established. While arguing against preferential trading arrangements, it is also essential to understand their potential implications and the strains they may put on the APEC process. As explained below, adverse effects can be minimised if all new preferential trading arrangements meet standards higher than those required by existing WTO provisions, which allow discriminatory trading arrangements in some circumstances.<sup>7</sup>

Existing preferential trading arrangements are not inconsistent with the achievement of the Bogor vision. For example, under the Australia–New Zealand Closer Economic Relations and Trade Agreement (CER), all border barriers between the two countries have already been eliminated. In other cases, such as the ASEAN Free Trade Area (AFTA) and NAFTA, the schedules for reducing trade barriers are to be completed well before the 2010/2020 deadlines agreed at Bogor.

Future FTAs can also be consistent with the Bogor deadlines, as long as:

- they are comprehensive, covering all trade in goods and services; and
- the schedule for eliminating border barriers to trade among members is to be completed by 2010 for any developed economies or by 2020 for any developing economies involved in such arrangements.



These criteria are stricter than the minimum requirements of Article XXIV of the General Agreement on Tariffs and Trade (GATT), or the corresponding Article V of the General Agreement on Trade in Services (GATS). In contrast to the comprehensive coverage of the Bogor commitment, the WTO does allow some trade to be exempted from the scope of FTAs.<sup>8</sup> Moreover, the WTO articles are usually interpreted as allowing developed economies to implement schedules of up to 10 years, which could stretch beyond the agreed 2010 deadline for these economies.

But it is not just a matter of setting sufficiently rapid timetables for comprehensive liberalisation. To meet their Bogor commitments, those involved in FTAs would also need to be prepared to extend their liberalisation to others sometime between now and 2010/2020. Any diversion of economic activity from other economies caused by new FTAs would then be temporary if those involved achieved the Bogor deadlines.<sup>9</sup>

There should be no concerns about 'free riding' by any other APEC economy, since all members are separately committed to eliminating border barriers to trade by the same deadlines. There could, however, be a concern with free riding by other economies – that is the long-standing challenge to open regionalism.

### ***Subregional trading arrangements and open regionalism***

There are WTO-consistent options for extending the benefits of liberalisation within an FTA, at least to other APEC economies, in order to achieve free and open trade and investment in the region by 2010/2020. The main options would be:

- for the economies involved in FTAs to extend the scope of their liberalisation; or
- to form a single FTA that includes at least all APEC economies.

Both these options would involve some problems – some of which have been widely recognised since the establishment of APEC, while others have arisen as a result of the increase in the number of separate or overlapping FTAs.<sup>10</sup>

The simplest option would be for those involved in FTAs to make unilateral decisions, sometime before the Bogor deadlines, to extend the liberalisation agreed within FTAs to other APEC economies. Under WTO rules the benefits would also need to be made available to at least all members of the WTO. That raises the prospect of free riding by non-APEC economies.

APEC governments have maintained their support for the principle of open regionalism. At the same time it is becoming obvious that major APEC economies such as the United States and Japan will not agree to stop protecting sensitive sectors, such as agriculture, unless the EU also eliminates border barriers to trade in these sectors. If such negotiations did not prove possible within future WTO rounds, then the United States and Japan might consider extending the full liberalisation of such sectors to the rest of APEC as long as the European Union was not able to benefit as a free rider.

To achieve that, without contravening WTO articles, would require the formation of an FTA that includes all APEC economies. But this is also hard to envisage – Asia Pacific leaders have consistently rejected the idea of negotiating an APEC-wide FTA for several reasons.

An APEC-wide preferential trading arrangement intended to discriminate against the rest of the world would be difficult to reconcile with the agreed principle of open regionalism. The resurgence of interest in discriminatory FTAs might suggest that at least some APEC participants could be willing to drop the concept of open regionalism. Their fear of free riding by the rest of the world could then reunite interest in a region-wide FTA.

Even if a consensus to drop open regionalism could be achieved, there is very little likelihood that a WTO-consistent FTA agreement could be negotiated among 21 diverse economies. Furthermore, attempts to negotiate such an agreement would be likely to delay actual liberalisation.<sup>11</sup>

An alternative approach, which could avoid the need for simultaneous negotiations among many economies, would be the gradual coalescence of smaller FTAs to form a region-wide FTA. In theory, all APEC economies could join an existing or new FTA during the coming years. These could then be amalgamated in some way, possibly gradually, into a unified FTA that includes at least all APEC economies. If such a coalescence could be achieved, it would provide a WTO-consistent option for achieving free (although not open) trade among APEC economies.

But, once again, it is very hard to imagine such a large group coming together in a way that would discriminate against the rest of the world, particularly against the European Union, Latin America or the least-developed economies. The United States is seeking to promote free trade with all of Latin America, while several Latin American economies have entered, or wish to enter, into free trade arrangements with the EU. The United States has also committed itself to a comprehensive economic partnership with the EU. Russia is an

unlikely member of any economic grouping designed to discriminate against either the former Soviet republics or its European trading partners.<sup>12</sup>

In practice, any APEC-wide FTA would have to cover even more than the existing APEC economies. Any wish to discriminate against the EU or other countries would be hard to negotiate with some prospective partners and would also require remarkably expensive efforts to obstruct globalisation through complex rules of origin.

For all these reasons, it is not easy to envisage potential FTAs among several subgroups of APEC economies coalescing smoothly in order to realise an APEC-wide zone of free and open trade and investment. The prospects for a WTO-consistent FTA that embraces at least all APEC economies, but discriminates against the rest of the world, remain as weak as ever. And, as more and more links are formed with non-APEC economies, especially the EU, even these weak prospects are diminishing year by year.

A coalescence of smaller FTAs does not offer an answer to those concerned about free riding by non-APEC economies. There is, instead, considerable risk that concerns about free riding could prevent the extension of subregional liberalisation to other APEC economies, especially liberalisation of sensitive sectors. That would result in entrenched discrimination among APEC economies and prevent the realisation of the Bogor vision.<sup>13</sup>

### ***APEC-consistent FTAs***

It may be seen that neither the growth in the number of FTAs among APEC economies nor even their potential coalescence would be likely to create a reliable set of stepping stones toward APEC's goal of free and open trade and investment in the region.

A realisation of these limitations, together with their inherent inconsistency with open regionalism, may serve to dampen the recent enthusiasm for new or enlarged FTAs. Moreover, it is not certain that the current crop of feasibility studies or in-principle agreements will lead to actual FTA agreements. Resistance to the full liberalisation of sensitive sectors, even among potential FTA partners, may make it impossible to conclude WTO-consistent agreements.<sup>14</sup>

At the same time, these concerns will not eliminate interest in forming FTAs. Therefore, as well as pointing to their serious limitations as potential stepping stones to wider free trade, it is important to help ensure that any subregional trading arrangements that are created do not become obstacles to the Bogor vision.

To do so, it would be desirable to seek assurances that new FTAs involving APEC economies would take adequate account of existing APEC commitments, as set out in the Bogor Declaration and the Osaka Action Agenda. Accordingly, APEC leaders should be encouraged to confirm that the schedules for eliminating border barriers to trade would be at least as rapid as required to meet APEC's agreed 2010/2020 deadlines, and that the FTAs would provide for comprehensive liberalisation of all sectors.

In line with the standstill principle adopted as part of the Osaka Action Agenda, new arrangements should not create any additional barriers to trade or investment. That would be also be a stronger commitment than strict consistency with the letter of the relevant WTO provisions, which can be interpreted as allowing some barriers to rise as long as some measure of 'average barriers' is not increased.

Any FTAs involving APEC economies should have clear and simple rules for accession. The main requirement should be that prospective entrants agree to reduce barriers to trade or investment according to a schedule that is at least as comprehensive and rapid as the schedules agreed to by one or more existing members.<sup>15</sup> There should be no additional political or social conditions for accession: such additional criteria would make the commitment to the Bogor vision conditional on non-economic issues, which is contrary to the current understanding among APEC members.

It would also be useful to make a distinction between accession to an FTA and accession to the full range of arrangements under framework agreements built around, or in addition to, the FTA arrangement.

The decision to join an FTA always requires the decision to eliminate barriers to substantially all trade in goods and/or services according to binding schedules. Some economies may be willing to make the required policy changes and accommodate the consequent structural changes, but may not be willing or able to deal with all the additional matters covered by the FTA's framework agreement.<sup>16</sup>

The EU allows FTA arrangements with non-member economies without requiring (or allowing) them to enter into the rest of their complex '*acquis communautaire*' (club rules). APEC economies should be at least as flexible.

## **Beyond border barriers**

As already noted, current proposals for closer economic partnerships are expected to deal with far more than border barriers to trade. Many additional questions will be raised by the way new economic partnerships seek to facilitate trade.

Once we move beyond simple border barriers, it is very hard, and often impossible, to avoid some diversion of economic activity. When any group of economies finds a way to reduce the costs or risks of economic transactions among themselves, it becomes relatively easier to do business within the group than with other countries. It is important to avoid such discrimination from becoming entrenched. In practice, the extent and duration of any diversion of economic activity depends, crucially, on the details of the arrangement.

Particular care will be needed if cooperative arrangements to facilitate trade or investment are part of a framework agreement that sets up a preferential trading arrangement. In that case, there is a risk that any cooperative arrangements, such as the harmonisation of certain economic regulations, could be for 'members only', even where there is no political pressure for exclusive, discriminatory arrangements. On the other hand, as the following examples will show, it is possible for APEC to establish successful cooperative arrangements that can be opened to others.<sup>17</sup>

### ***Business mobility and the APEC Business Travel Card***

In most cases a visa is required if a non-resident wishes to conduct business in another country. Any government can choose to ease the conditions under which they issue such visas or to facilitate the path through immigration. They can do so either unilaterally or collectively with other governments.

Governments can choose to apply these new policies to all other countries, or to selected countries. Usually policies are applied selectively, for example to countries that offer comparable conditions for business-related travel (that is, reciprocal treatment) and/or to those countries that are party to a framework agreement for closer economic partnership. The side effect of such an arrangement is that business travellers from some countries are treated less favourably than others. There is seldom any objection to this type of discrimination, so long as entry is not made more difficult than in the past.

The APEC Business Travel Card scheme is an example of a practical and very visible initiative to improve business mobility among the economies that have adopted the arrangement.<sup>18</sup> Some APEC economies are not yet involved, which means that their businesspeople are treated less favourably. But that is not seen as a problem, since they do not face obstacles that were not there before. Moreover, all APEC governments are being encouraged to join the arrangement.

Given the non-formal nature of the APEC process, the Business Travel Card arrangements are not part of any overarching APEC framework agreement. It is indeed interesting that some of the early members of the scheme belong to separate partnership arrangements such as the CER or AFTA.<sup>19</sup>

The all-round benefits of the scheme would be increased by an expansion of membership. Therefore consideration could be given to including any non-APEC country willing and able to offer comparable treatment to business travellers from members of the scheme.

### ***Joining new cooperative arrangements***

Many arrangements similar to the APEC Business Travel Card are likely to be pioneered by some subgroup of APEC economies with the goal of reducing the costs or risks of economic transactions in the region.

One such arrangement might be to accept, under certain circumstances, commercial audit reports from certified auditors in other member economies. Such a mutual recognition arrangement would be preferential to some extent, but that would not be a problem if it encourages others to consider adopting similar policies to facilitate international commerce. As already noted, the important issue is whether discriminatory effects of such arrangements become entrenched or permanent.

Other economies are likely to perceive the potential advantages of joining cooperative arrangements and to express interest in doing so. In this example, prospective entrants would be expected to demonstrate that their auditing policies and regulations are at least as rigorous as those of existing members. That would be feasible as long as the conditions set by the arrangement are transparent.

The spirit of open regionalism adopted for Asia Pacific economic cooperation suggests that the current members should give serious consideration to new entrants that can

demonstrate they are willing and able to comply with the conditions of such a mutual recognition arrangement. There should not be any additional, unrelated criteria.

In the case of the APEC Business Travel Card, it is expected that additional participants will be welcomed into the arrangement. The same would be likely to apply to any other ad hoc cooperative arrangements among a subgroup of APEC economies. However, some arrangements, such as the mutual recognition of auditors, may be one of several (perhaps many) cooperative arrangements to facilitate trade or investment among parties to an existing framework agreement. Would new entrants be welcomed into specific arrangements that are part of a wider economic partnership covered by a framework agreement, such as AFTA or CER?

Parties to such a framework agreement could choose to admit any economy to the arrangement, as long as the conditions applying to that particular arrangement are met. Alternatively, they could decide that accession would only be permitted to those who join a 'critical mass' of the cooperative arrangements among the existing 'club'. New members could also be required to join all of the cooperative arrangements involved, which may require accession to a formal WTO-consistent FTA. It may be decided to include only other APEC economies in specific arrangements.

### ***Dispute settlement procedures***

A quite common feature of framework agreements for closer economic partnerships is an arrangement for the settlement of any disputes among parties to the agreement. Such dispute settlement procedures may be more rapid than currently available under the WTO, they may also cover issues not dealt with by the WTO, and the parties to the framework agreement may be legally bound to act on any policy recommendations made to settle the dispute.<sup>20</sup>

A framework agreement between (say) Korea and Japan could include a procedure for the rapid and impartial resolution of any disputes over commercial policy. Other countries may perceive the advantage of setting up such a procedure to cover their dealings with Korea and Japan. Whether they can do so would depend on the provisions made for accession to this arrangement, which (in this example) would be part of the broader framework agreement between Korea and Japan.

Depending on the nature of the framework agreement, China (for example) may be welcome to set up a cooperative arrangement with the two countries, as long as it agrees to

use the same type of procedure to settle any commercial policy disputes between it and either Korea or Japan. Alternatively, China may not be eligible to join the dispute settlement arrangement unless it joins all of the cooperative arrangements covered by a broader Korea–Japan framework agreement. If the agreement included a preferential FTA, China may be required to impose preferential rules of origin that discriminate against other trading partners such as Hong Kong. Whichever of these conditions were applied to China, different conditions might apply to Mongolia, for example, which is not an APEC economy.

### ***The Transatlantic Economic Partnership***

In late 1998 the United States and the EU launched a major initiative to promote a much closer integration of their economies – the Transatlantic Economic Partnership (TEP). This important and innovative arrangement between an APEC member and a group of non-APEC economies raises some interesting issues for other APEC members.

Unlike most previous proposals for closer economic relations, the TEP does not assume that serious cooperation has to begin with an FTA. Traditional border barriers are to be tackled in the WTO, rather than bilaterally. The TEP focuses on bilateral problems caused by technical and/or regulatory obstacles, which, in the words of its proponents, are now the main impediments to economic transactions between the European Union and the United States.<sup>21</sup>

TEP's November 1998 Action Plan sets the stage for a large number of cooperative arrangements to be implemented by a series of collective decisions over several years. Prospective collective actions include:

- lowering technical border barriers to trade in goods in the context of shared commitments to high health, safety and environmental standards;
- widening mutual recognition of testing and approval procedures by progressively aligning standards, wherever possible to existing internationally agreed standards;
- reducing impediments to trade in agriculture through closer scientific cooperation to set appropriate mutually recognised regulations; and
- facilitating access to public procurement markets, including by enhancing the compatibility of electronic procurement information and government contracting systems.



The framework agreement emphasises that all of the TEP's cooperative arrangements will conform fully to the members' international obligations and that the new partnership will not put up new barriers to third countries. These undertakings will protect the interests of other countries to some extent. Nevertheless, many of the arrangements will result in the relatively favourable treatment of products and producers from member states. Others, including other APEC economies, will have an incentive to seek similar treatment. The challenge is to create a synergy between America's efforts to promote closer economic integration with its trading partners across the Atlantic and across the Pacific.

The EU is continuing to deepen its economic integration by setting up new cooperative arrangements that build on the Single Market Program, while the Osaka Action Agenda commits APEC economies to achieve a comparable degree of economic integration by 2020. In each case, closer links will be promoted by a series of successive cooperative arrangements to facilitate trade or investment. The series of arrangements to reduce regulatory barriers to trade envisaged under the TEP will overlap with progress within the EU and APEC.

It should be possible to build on these concurrent efforts by APEC, the United States and the EU to promote wider, possibly global, cooperative arrangements for reducing the various costs and risks of international economic transactions currently caused by divergent approaches to technical and commercial regulations.

The basis of a wider arrangement could be a framework agreement between the EU and any APEC governments interested in closer links with the EU. But it may not be necessary to negotiate such an elaborate agreement. A series of cooperative arrangements that include APEC and EU economies could be achieved by appropriately designing the arrangements formed under TEP and other agreements that involve APEC economies.

TEP's framework agreement and APEC's Osaka Action Agenda already commit those involved in either grouping to avoid raising new barriers to other economies. Closer economic links across the Atlantic and the Pacific could be facilitated, quite simply, by a provision that any new cooperative arrangement that involves APEC economies should be open to accession to any economy prepared to accept its policy norms.<sup>22</sup>

## **Defining the issues**

The wide range of issues raised by just these few examples of cooperation among economies suggests it may be helpful to consider some guiding principles for the design of cooperative arrangements.

As illustrated by the preceding examples, new cooperative arrangements are likely to result in the favourable treatment of products or producers from the economies involved. Current WTO disciplines on new economic partnerships focus on border barriers and are ambiguous about the possibility of new types of barriers or new sources of discrimination.

For any cooperative arrangement among a group of economies, the most effective way to avoid any diversion of economic activity from becoming either entrenched or permanent is to encourage others to accede to these arrangements. Neither the WTO nor APEC's Osaka Action Agenda deals directly with the important issue of accession, either to FTAs or to the many other new cooperative arrangements to facilitate trade and investment.

Accordingly, there is scope for cooperative arrangements to be more clearly defined. It would also be useful to distinguish between the framework agreements that may emerge and the range of cooperative arrangements that may be created by parties to those agreements.

### ***Individual and collective action***

Governments, including APEC governments, can make decisions to raise or reduce the costs or risks of economic transactions between their economies and others. Some decisions may be taken unilaterally, for example to make domestic economic regulations more transparent, to implement a voluntary tariff cut or to relax customs or immigration procedures. A group of governments may also decide to act collectively; for example to set up a cooperative arrangement to reduce impediments to international transactions. Examples include reciprocal visa-free entry for tourists, the mutual recognition of some standards or the creation of an FTA.<sup>23</sup>

While both the liberalisation and facilitation of trade or investment can be achieved either by individual or collective action, in most cases liberalisation can be implemented more simply and efficiently through unilateral action. However, political imperatives or a desire for reciprocity can lead to a collective action to liberalise.

Many important aspects of trade and investment facilitation do require collective action. The effects that either individual or collective actions have will depend on their coverage, as well as their impact on economies not included in these decisions.

### *Individual action*

Unilateral decisions of governments that affect the ability of products or producers who compete in their markets can apply globally or selectively. In some cases, existing international commitments limit the scope for selective coverage. For example, the same tariff rates must be applied to all other WTO members, except under special circumstances defined in WTO articles. But most individual decisions to liberalise or facilitate international commerce can be, and are, applied selectively. Selective policies that make entry easier for some need not make it more difficult for others. Even so, such decisions will lead to the preferential treatment of products or producers from certain economies. The extent and duration of any discrimination can be reduced by:

- having objective and transparent criteria for limiting coverage;
- not creating any new difficulties for products or producers from economies not covered; and
- being willing to include any economies that meet the criteria for coverage.

Governments can also determine the extent to which they will share information about the potential benefits of coverage and the expertise and technology that may be needed to meet the criteria for inclusion.

### *Collective action*

Collective actions or decisions to reduce impediments to international commerce are implemented by cooperative arrangements among a group of economies. Most economies are involved in cooperative arrangements with other economies. Most enter into different types of cooperative arrangements and/or framework agreements with different groups of economies, and these agreements may overlap in various ways.<sup>24</sup>

In very many cases, several cooperative arrangements to facilitate international commerce exist among any particular group of economies. In some cases, a combination of existing or prospective cooperative arrangements may be set up under a framework agreement for closer economic partnership.

The framework agreement can require that all parties also sign up to the full set of cooperative arrangements under the agreement. In most cases, however, there is some flexibility. Typically, not all parties need to be involved in each arrangement, although they are often encouraged to be.

As for individual actions, most arrangements set up by the collective decision of certain economies will tend to provide some favourable treatment of producers or products from those economies. Once again, this need not create new difficulties. However, the overlapping membership of a very large number of cooperative arrangements, which may or may not be part of a formal framework for closer cooperation, can still result in confusion and increased administrative costs.

Whether the growing number of framework agreements and the much larger number of cooperative arrangements currently being created can coexist, and perhaps coalesce, will depend on the detail of their provisions. As for individual actions, it would be desirable for all agreements and cooperative arrangements to be objective and transparent and to avoid creating any difficulties for those not covered. It would also be desirable to allow others to join these arrangements, since that is often the only way to avoid discrimination.

### ***Accession to cooperative arrangements***

If a pair or group of economies wishes to facilitate trade or investment among them, without any intent to divert activity from other trading partners, then they can try to make the arrangements for facilitation (for example, to promote business mobility or to mutually recognise standards) easy to join.

Returning to the example of the APEC Business Travel Card, the scheme has set a precedent for the way additional economies can join cooperative arrangements. The group that pioneered the facility succeeded in encouraging others to join. This evolution seems to fit well with the intent of the (21-x) provision in the Osaka Action Agenda, with some APEC economies setting positive examples for others, without seeking to entrench preferential treatment of some economies over others.

In the context of open regionalism, it would seem appropriate to build on the precedent set by the APEC Business Travel Card scheme for any other cooperative arrangement pioneered by APEC economies. Based on this precedent, accession to any particular coopera-

tive arrangement would be open to any economy that adopted and implemented policies that met the technical requirements of the arrangement.

Such a principle may be readily acceptable for an ad hoc cooperative arrangement, such as the APEC Business Travel Card, which was launched by a group that did not act under a comprehensive framework agreement. But complications can arise when several specific arrangements are components of a framework agreement such as AFTA or NAFTA.

### ***Accession to framework agreements***

The parties to framework agreements for closer economic cooperation often state that the agreements are open to wider participation. But prospects for accession to an existing subregional trading arrangement, or to some of the specific cooperative arrangements it creates, can vary greatly.

One approach would be to allow economies that are not party to a framework agreement, such as the CER, to participate in one or more of the specific cooperative arrangements covered by that framework.<sup>25</sup> That would facilitate progressively closer cooperation between members and others, possibly paving the way for subsequent full participation in the overall framework. Such an approach could help to widen the participation in, and the potential coalescence of, existing subregional trading arrangements. Gradually, closer association would allow prospective new members to become comfortable with the nature of existing groupings. It would also allow existing members to gain confidence that prospective entrants are likely to make a constructive contribution.

An all-or-nothing approach could also be considered. Any economy that wished to become part of any specific cooperative arrangement set up under a framework agreement (such as NAFTA's dispute settlement arrangement) may have to become party to the full framework agreement. That may require meeting the policy requirements of all of the cooperative arrangements covered by the framework agreement.

The EU comes close to setting such a strict requirement. Non-members cannot simply choose which of the EU's many cooperative arrangements are of interest to them. Most of the arrangements to facilitate deeper integration in Western Europe are available only to members. Prospective members are required to undertake a very substantial set of reforms. New members are not only required to enter into a customs union with existing members but have to adopt all of the policy measures that existing members implemented to achieve the

single market and meet several non-economic conditions. This has certainly made the EU hard to join.

EU leaders are realising that some members are not willing to work toward all aspects of European integration at the same pace, and that the desire for flexibility will increase further if membership is eventually expanded. As existing members are no longer required to enter all EU arrangements, such as European Monetary Union, it is becoming more difficult to define the EU's *acquis communautaire*.<sup>26</sup> The EU is currently addressing these issues. A possible outcome is that prospective members will be required, at least, to meet the policy requirements of cooperative arrangements that apply to all existing members.

These examples suggest that, to be genuinely open to accession, subregional trading arrangements (or other types of framework agreements) involving APEC economies should be flexible. Given the diversity of regional economies, accession to comprehensive subregional initiatives could be extremely difficult if prospective members have to meet the criteria for participation in every single existing cooperative arrangement from the outset.

On the other hand, parties to a framework agreement might consider it desirable for prospective members to join a 'critical mass' of cooperative arrangements in which all existing members participate. Such a requirement would not appear to be unreasonable: an economy that wants to become a full member of an arrangement, with the right to help shape its future agenda and rules of cooperation, can be expected to meet the policy requirements for participating in most, if not all, of the cooperative arrangements among existing members.

In practice, it could prove difficult for prospective members to join subregional trading arrangements among APEC economies. Relatively more comprehensive agreements will set up relatively more preferential arrangements, creating correspondingly greater incentives to join. At the same time, they will become harder to join. That raises the prospect of substantial and potentially entrenched discrimination among APEC economies.

To avoid such problems, it would be useful to allow opportunities for other economies to be included in particular cooperative arrangements without requiring them to join the framework agreement that created the arrangements.

### ***Cooperative arrangements within framework agreements***

Returning again to an earlier example, let us assume that Korea and Japan enter into a framework agreement to create a range of cooperative arrangements to promote a closer

economic partnership. These could include an FTA for goods and/or services as well as arrangements to facilitate trade and investment, such as a dispute settlement procedure.

As discussed in that example, China might wish to set up a cooperative arrangement with both Korea and Japan to use similar procedures to settle the same kind of disputes about trade or investment policy. However, given the significant structural adjustment entailed in complying with its WTO requirements, China may not wish to take on too many other policy challenges. Should the existing parties allow China to enter into selected cooperative arrangements created by their framework agreement?

Making this possible would be consistent with open regionalism. Trade and investment among China, Korea and Japan would be facilitated without any attempt to introduce new barriers to trade or investment with any other economy. China may also be encouraged to consider the early adoption of the kind of arrangements it has committed itself to set up with all APEC economies, not just Korea and Japan, by 2020.

More generally, to enhance their contribution to realising the Bogor vision, new initiatives for closer economic cooperation should not only permit but also should encourage and assist others to join any of their cooperative arrangements. Parties to existing framework agreements may, nevertheless, express some reservations.

One of these might be the potential for 'cherry picking'. New members could choose to take part in only those arrangements where they perceive the benefits to be greater than the short-term costs or difficulties of applying new policies, and not enter others if the adjustment costs are seen to exceed the benefits. In some cases, the latter arrangements may be exactly those that the existing parties would like that particular economy to enter, when they assess the balance of expected gains from their point of view. Therefore, parties to an existing framework for closer economic partnership may require new members to enter a package of cooperative arrangements that is expected to lead to net welfare gains for them as well for the new member.

But such problems are unlikely to arise very often. The arguments for requiring 'package deals' do not apply where including new participants in a particular cooperative arrangement is perceived to be a positive-sum game. For example, if a group of economies have adopted a speedy and effective dispute settlement procedure, it is difficult to see what they would stand to lose from another economy agreeing to settle its disputes through a similar procedure.

The experience of APEC's first 10 years indicates that most cooperative arrangements to facilitate trade and investment are perceived to be positive-sum games. In such cases, any particular arrangement can be implemented on its own merits and its coverage can also be expanded without detriment to existing participants. In reality, like telephone networks, most of these arrangements become increasingly beneficial to existing participants as coverage is expanded. It will often be in the interests of existing participants to help others acquire the capacity needed to participate in as many of such arrangements as possible.

Perceptions of negative-sum, zero-sum, or prisoners' dilemma games are most likely to arise with cooperative arrangements that require liberalisation of trade in sensitive sectors. Existing parties to an agreement on free trade in (say) some agricultural products are not likely to welcome new members who would compete with them in that sector, unless prospective entrants were prepared to liberalise sectors of interest to existing participants. That is the logic of FTAs. Indeed, WTO rules prevent parties to an FTA to agree to free trade only in the products they choose – they are required to eliminate barriers to substantially all trade in goods and/or services.

Another reason for requiring package deals may be a variant of the free-rider problem. Allowing an economy to enter one (or a selected set) of cooperative arrangements could take away the incentive for them to join others. Extending the coverage of any cooperative arrangement will involve administrative (or other) costs, so there may be no net benefit to existing parties from encouraging others to join unless such costs can be spread and offset against the benefits of new participants to a set of several (possibly related) cooperative arrangements.

For example, existing parties to a framework agreement are unlikely to want to expend resources to extend a mutual recognition arrangement for (say) safety standards to a narrowly defined product. But prospective entrants are also fairly unlikely to want to deal with only one product standard, as against a wider arrangement for mutual recognition. Therefore a rule requiring simultaneous entry into a minimum set of cooperative arrangements may not be required.

In practice, the most effective way to achieve entry to a wide-ranging set of cooperative arrangements may be to encourage 'pilot tests'. In this example, these could confirm the practicality and usefulness of a more comprehensive mutual recognition arrangement. More generally, such experiments can build the confidence needed to enter into a gradually more comprehensive range of cooperative arrangements.



There may be yet another reason why existing parties to framework agreements may require simultaneous entry to at least a 'critical mass' of their cooperative arrangements. They may not want to encourage closer links with countries that are not prepared to share the responsibilities associated with maintaining or enhancing the framework. On the other hand, those countries that only enter a few arrangements are not likely to have any say in setting the criteria for any other arrangements they may subsequently wish to enter.

Even more importantly, many of the cooperative arrangements needed to realise APEC's vision of free and open trade and investment are likely to evolve from cooperative arrangements initiated as part of broader framework agreements decided by subregional arrangements. Accordingly, there are strong incentives for all APEC economies to become associated with existing partnerships as closely as possible. Otherwise, they cannot expect to have any influence on setting the agenda and criteria for these cooperative arrangements.

These examples suggest that there are few instances where existing parties to framework agreements should require others to join more cooperative arrangements than they can, or wish, to do so. The exceptions are likely to be for arrangements to liberalise trade in sensitive sectors. In those cases, the WTO already requires simultaneous full liberalisation of significantly all trade. It follows that new framework agreements, including subregional trading arrangements, are most likely to help promote regional cohesion and progress toward the Bogor vision if they allow others to participate in any of the cooperative arrangements set up under these frameworks, except where that opportunity is ruled out by existing international obligations.

### ***APEC and its neighbours***

APEC itself, as well as its subregional trading arrangements, needs to consider the effects of its cooperative arrangements on others. APEC does have reason to be concerned about its excessively rapid expansion. At the same time, consistent with the principle of open regionalism, APEC should seek to avoid sharp distinctions between the treatment of member economies and that of non-members.

From the outset, APEC has emphasised its intent to promote closer economic cooperation in the region without seeking to divert economic activity away from other economies. It has also sought to pioneer arrangements for liberalising and facilitating trade and investment

in ways that can subsequently be adopted more widely. This suggests that future cooperative arrangements among APEC economies should be as open as possible.

For example, if Mongolia was willing to join the APEC Business Travel Card arrangement, it should not only be permitted, but also encouraged, to do so. Opportunities to accede to arrangements to reduce impediments to trade or investment are of particular interest to the island economies of the South Pacific Forum, as well as to prospective participants such as Colombia and others. Such opportunities can be provided if other economies could participate in any cooperative arrangement involving some (or all) APEC economies, except in the few circumstances where that may be ruled out by existing obligations.

Such openness need not dilute the effectiveness of APEC. To take advantage of such opportunities, new entrants would need to adopt the policy norms of such arrangements in order to benefit from the resulting reduction in the costs and risks of economic transactions with the APEC economies involved. Taking advantage of opportunities to join cooperative arrangements involving APEC economies need not give a non-APEC economy any automatic claim to future membership of the APEC process as a whole.

Even with no assurance of future membership, non-APEC economies would still have incentives to join a growing number of practical cooperative arrangements with APEC economies. Any economy would benefit from joining arrangements to facilitate trade or investment. In addition, APEC's neighbours who are potential participants could demonstrate their credentials for subsequent full membership, while existing members would have an objective way to assess which economies are likely to be constructive new members.

## **Guiding principles**

All of the APEC economies that are considering new framework agreements, including subregional trading arrangements, want and expect these agreements to be consistent with the Bogor targets. Such new arrangements can set positive examples for the many cooperative arrangements that will be needed to link all members in order to achieve free and open trade and investment in the region.

The examples used above suggest that, depending on their design, some initiatives are more likely than others to contribute to wider cooperation. They also indicate the kind of guidelines that would help these initiatives make a maximum contribution to APEC-wide

objectives. Such guidelines, which build on APEC's already agreed principles, could be set out under the following headings:

- objectives;
- instruments – individual and collective action;
- consistency with existing obligations;
- transparency;
- avoiding new obstacles;
- accession; and
- provision for review.

### ***Objectives***

A preamble along the following lines could be used to summarise the aim of the guidelines for initiatives to promote closer economic partnerships.

*APEC economies that are ready to initiate and implement cooperative arrangements to reduce impediments to economic transactions are encouraged to do so. They are also encouraged to design them in ways that:*

- *enhance their contribution to realising the agreed objective of free and open trade and investment by 2010 for developed economies and 2020 for developing economies; and*
- *take adequate account of the interests of other economies.*

### ***Instruments***

*APEC governments can promote closer economic partnerships with other economies by means of unilateral or collective decisions or actions, including decisions to liberalise or otherwise facilitate trade and investment.*

*Collective decisions can be implemented by setting up cooperative arrangements designed to reduce costs or risks of international economic transactions with the economies involved.*

Such cooperative arrangements may form part of a wider framework agreement. In those cases, the following principles should apply to each cooperative arrangement within that framework.

### ***Consistency with existing obligations***

*Individual and collective actions by APEC governments should be consistent with existing international obligations, including those under the WTO.*

*Without prejudice to such formal obligations, these actions by APEC governments should also be consistent with the agreed commitment to achieve free and open trade and investment by 2010/2020 and other agreed principles, including the Osaka Action Agenda and the APEC Principles for Competition and Deregulation.*

Recognising that individual and collective decisions of APEC governments to reduce various impediments to economic transactions will not often apply simultaneously to all economies, the following guidelines would help them take adequate account of the interests of other economies.<sup>27</sup>

### ***Transparency/avoiding new obstacles***

#### *Unilateral action*

*Unilateral actions by APEC governments to reduce impediments to international economic transactions should be transparent and should not create any new or additional impediments to products or producers from any economy.*

*Where such actions affect economies selectively, the criteria for coverage should be transparent, objective and non-discriminatory.*

#### *Collective action*

*Any cooperative arrangements set up by the collective actions involving APEC economies should be transparent and should not contain any provisions that create any new or additional impediments to products or producers from any economy.*

*Any economy whose government adopts policies compatible with any existing or proposed cooperative arrangements among groups of APEC economies should be able to, and be encouraged to, become party to these arrangements; except where existing international obligations require that several cooperative arrangements be entered into simultaneously.*

In such exceptional cases, for example where economies have set up an FTA for substantially all goods and/or services, new entrants would need to provide for free trade in substantially all goods and/or services with the economies already involved in the FTA.

### ***Provision for review***

These principles could prove helpful in the design of initiatives for closer economic partnerships. If the many cooperative arrangements to reduce impediments to trade and investment are designed with reference to such guidelines, they are more likely to set positive examples for other region-wide or even multilateral arrangements. Cooperative arrangements are less likely to have unintended side effects on other economies if they are designed with a view to wider participation and do not create new obstacles to international transactions.

At the same time, as demonstrated by the examples given above, new framework agreements and their cooperative arrangements can raise a wide range of issues. While APEC governments may design them to be constructive, it will be difficult to anticipate all potential side effects. It will certainly be difficult for other economies to anticipate these unless they are consulted about their design.

The wider the participation in cooperative arrangements, the more readily they will contribute to region-wide objectives. As well as providing for new entrants to existing arrangements, it would be desirable to encourage the widest possible participation from the outset. Therefore, some prior notice of proposed arrangements would be consistent with promoting wider participation. Providing for a well-defined period for informed consultations would increase the likelihood that new arrangements will take account of the interests of others. The consultations could also encourage wider involvement from the outset, without unduly delaying the implementation of such arrangements.

Even if the utmost care is taken in the design of new arrangements, unexpected issues are likely to arise after implementation. It would therefore be useful to provide the opportunity for those affected to comment on the impact of new arrangements and to make constructive suggestions for how they could be adjusted. Those involved in the arrangements should be prepared to review its details to see if they can be made more consistent with the guiding principles.

These aims could be promoted by the following guidelines for giving prior notice of potential new cooperative arrangements, as well as for reviewing their operation.

*Prospective participants should provide reasonable prior notice of new cooperative arrangements to reduce impediments to economic transactions among them; setting out:*

- *the nature and objectives of proposed cooperative arrangements;*
- *the policies by which these are to be implemented; and*

- *the criteria that would need to be met by others wishing to accede to these cooperative arrangements.*

*Participants in cooperative arrangements to liberalise or facilitate trade and investment should endeavour to respond positively to constructive suggestions from other economies for improving the consistency of existing or proposed cooperative arrangements with the preceding principles.*

APEC is a voluntary process of cooperation, so reviews of particular cooperative arrangements would not oblige existing participants to make changes that they would consider to be contrary to the original intent of their arrangements. On the other hand, the reviews could help avoid unintended problems for other economies and, perhaps even more importantly, avoid missing opportunities for wider cooperation. In keeping with the evolutionary nature of the APEC process, such reviews are also likely to lead to the further refinement of APEC's guiding principles.

If conducted in a cooperative spirit, reviews of cooperative arrangements would be likely to reveal that the obstacles to wider participation in cooperative arrangements to facilitate trade or investment are mostly due to a lack of capacity. Such problems can then be addressed by encouraging the exchange of relevant information, experience, expertise and technology – in other words by economic and technical cooperation among Asia Pacific economies.<sup>28</sup>

## **Conclusion**

The renewed interest in subregional trading arrangements involving APEC economies creates opportunities as well as challenges. As APEC enters its second decade, its leaders are becoming increasingly aware of the need to manage these developments, which reflect the diversity of the region.

As indicated by the discussions of APEC Ministers in June 2000, there is growing awareness of the potential strains that may be caused if subregional trading arrangements lead to new sources of trade discrimination among APEC economies. There is a growing willingness to seek a clearer understanding of the nature of emerging proposals and their implications.

Many of the potential problems, such as those outlined in this paper, could be avoided if all subregional trading arrangements involving APEC economies were based on the principle of open regionalism. But that does not appear to be a likely outcome in the short

term. Therefore, to minimise the strain on the APEC process and to help APEC leaders to focus productively on the options for and implications of new economic partnerships, it would be desirable to set out some guiding principles for the kind of subregional trading arrangements that would be compatible with the achievement of the agreed Bogor vision of free and open trade and investment.

With care, new cooperative arrangements among APEC participants can set useful precedents for the subsequent region-wide arrangements that will be needed to realise the Bogor vision. With care, it will also be possible to limit the risks of a proliferation of arrangements that could fragment, rather than integrate, regional markets.

APEC is a group of economies that is committed to reducing impediments to commerce without seeking to damage the interests of any other economy. In designing framework agreements and specific arrangements for closer economic cooperation, APEC members can include guidelines that maximise the contribution of these arrangements to agreed regional objectives.

APEC's guiding principles have evolved continuously since 1989, as the objectives and potential instruments of cooperation have become more clearly defined and understood. The agreed principles for TILF, as set out in the 1995 Osaka Action Agenda, are a significant example of this evolution as they allow member economies who are ready to enter into cooperative arrangements to do so, with others joining later. The renewed interest in subregional trading arrangements indicates that it is time to spell out their implications in more detail.

## Notes

- 1 This paper is based on a presentation to the joint meeting of the Pacific Economic Cooperation Council's Trade Policy Forum and the Consortium of APEC Study Centres in Brunei Darussalam, May 2000. Its preparation also benefited from discussions on the future of APEC in Shanghai and Beijing in May and June 2000, respectively. I would like to thank all those who made it possible for me to participate in each of these meetings. I am also grateful to Professor Peter Drysdale for comments on an earlier version of this paper.
- 2 This provision for flexibility, which allows some of APEC's 21 member economies to take initiatives ahead of others, was first stated in the Bogor Declaration of APEC leaders. It is frequently referred to as the (21-x) principle.

- 3 As well as initiating new cooperative arrangements from the outset, such framework agreements may also contain collective decisions on future cooperation, possibly with schedules for taking the necessary individual or collective actions.
- 4 Many of the EU's neighbours have entered into either FTA or customs union agreements with the EU, but these are certainly not seen as alternatives to full membership.
- 5 The nature and some implications of TEP, launched in 1998, are discussed below.
- 6 For example, the North American Free Trade Agreement (NAFTA) contains detailed rules of origin designed to divert trade and investment in textiles and automobiles to its participants. It would, therefore, be hard to extend this agreement to other Asia Pacific economies that are more efficient manufacturers of such products.
- 7 It is beyond the scope of this paper to discuss the possibility of strengthening the GATT/WTO articles that permit preferential trading arrangements under some circumstances. Following the difficulties incurred in recent attempts to strengthen these articles, substantial progress cannot be expected in the near future. For further discussion of these issues, see Scollay (2000).
- 8 Considerable ambiguity remains about the definition of the scope of trade that can be exempted from FTAs while meeting the stipulation of covering substantially all trade.
- 9 As the 2010/2020 deadlines approach, the rationale for separate schedules for preferential liberalisation lessens. While such schedules might make the initial preferential liberalisation binding, they would require that rules of origin be negotiated, with inherent complexities and administrative costs.
- 10 See Snape et al. (1996) for a discussion of some of these issues.
- 11 These issues are set out in Elek (1995) and in Drysdale et al. (1998).
- 12 It may be quite legal for economy A to enter into an FTA with B that is designed to discriminate against C. It may also be legal for A to enter into an FTA with C that is designed to discriminate against B. This is likely to take place when A is a dominant economy that is willing and able to discriminate against both B and C by limiting competition from either B or C in particular sectors. That is possible using the loophole that exists in WTO articles of specifying 'substantially' all trade. This scenario is not relevant to any attempt to include all APEC economies in an FTA that seeks to discriminate against the EU. The EU would not be likely to sustain FTAs with relatively small economies (say Peru or Chile) if these economies then sought to enter into APEC-wide arrangements to discriminate against the EU. Even if the EU did not abrogate earlier agreements, it would seek to include rules of origin aimed at avoiding unwanted competition from other APEC economies.
- 13 Members of potential FTAs could take advantage of the ambiguity of WTO articles to exclude sensitive sectors such as agriculture. That may make them more willing to extend their FTA liberalisation to other economies. However, that would not achieve the Bogor vision of free and open trade and investment in all sectors.
- 14 The prospective FTA between Korea and Japan is already raising concerns from the agricultural lobbies of both countries, but it is unlikely that an attempt to exclude



agriculture would be considered to be consistent with WTO rules. Difficulties are also being encountered in finalising an ASEAN FTA as the deadlines for liberalising difficult sectors are approaching.

- 15 Some groups may not require matching schedules in order to extend liberalisation to some others. For example, Vietnam has been allowed to join AFTA with a longer timetable for liberalisation than existing members.
- 16 For example, the CER arrangement between Australia and New Zealand rules out anti-dumping actions between the two: the need for these has been obviated by the adequate development and compatibility of their respective competition policies. It should be possible, in principle, to link the FTA component of the CER to the FTA component of AFTA (which also deals with issues other than border barriers to trade) without necessarily agreeing to rule out anti-dumping actions. Such arrangements to facilitate trade or investment can be dealt with separately, in their own right.
- 17 These examples are not necessarily the most important of the trade and investment facilitation arrangements that could be included in closer economic partnerships. They are chosen to illustrate specific policy issues that are raised by the actual or potential design of such cooperative arrangements.
- 18 The APEC Business Travel Card scheme, which offers accredited business travellers visa-free travel and expedited airport processing when visiting participating economies, was pioneered by Australia, Korea and the Philippines, followed by Chile and Hong Kong. Malaysia and New Zealand joined the scheme in 1999 and Thailand joined in 2000.
- 19 It is interesting to note that the APEC Business Travel Card initiative has been called an 'APEC arrangement' from the outset. This paper does not deal with the question of defining an APEC arrangement, which may not ever be necessary in a non-formal voluntary process. The intention of the definitions and principles proposed is to distinguish those arrangements involving APEC economies that can be deemed to be 'APEC-consistent'.
- 20 The desire for more effective ways of dealing with trade policy disputes with the United States was an important motive for the preferential trading arrangement between Canada and the United States, which was the forerunner of NAFTA.
- 21 See European Commission (2000) for more details of the TEP. Elek (1998) discusses some of the implications of the TEP for APEC.
- 22 The TEP is just one new initiative between an APEC economy and non-APEC trading partners. Similar types of issues will emerge if further progress is made by APEC's North American participants to implement their commitment, in principle, to a Free Trade of the Americas agreement. The more general issue of whether non-APEC economies can become involved in cooperative arrangements pioneered by current APEC participants is taken up below.
- 23 Individual and collective decisions of APEC governments are set out in their Individual Action Plans and Collective Action Plans, respectively.
- 24 In theory, collective action to reduce impediments to international economic transactions can be universal, but it is hard to think of any examples – even the United Nations does not have universal coverage.

- 25 An example, mentioned in footnote 15, might be for (say) Singapore to harmonise its competition policies with those of Australia and New Zealand, leading to a CER–Singapore agreement to desist from any future anti-dumping actions.
- 26 Until recently, all members were required to enter all of the many cooperative arrangements created by collective decisions of EU governments. The number of examples of cooperative arrangements in which not all members need to participate is still quite limited, but is likely to grow.
- 27 An important aspect of this, consistent with the agreed APEC Principles for Competition and Deregulation, is to help avoid new forms of discrimination among alternative sources of supply.
- 28 While it is beyond the scope of this paper, it is likely that principles along these lines could also be designed for the individual and collective actions of APEC governments to promote capacity building through economic and technical cooperation (ECOTECH).

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