

EXECUTIVE MEMO

**Regional Trade Negotiations in the Asia-Pacific Region:
Assessment of Current Trends and Implications for the
FTAA and WTO**

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1. Background: APEC in the late 1990

In the mid-1990s the Asia-Pacific region appeared to have achieved an exceptional degree of congruence between the regional and multilateral approaches to trade liberalisation. The successful conclusion of the Uruguay Round and the establishment of the WTO marked an apparently decisive reassertion of the primacy of the multilateral trading system. This coincided with the adoption by APEC of a unique approach to regional economic integration, designed to eliminate the contradiction between multilateralism and regionalism. In the Bogor Declaration of 1994 APEC's members committed themselves to the establishment of free trade and investment in the Asia-Pacific region through a voluntary process based on "open regionalism". The emphasis on voluntarism and the non-binding nature of commitments envisaged within APEC was adopted in deference to the strong preferences of East Asian members of APEC, particularly the ASEAN economies.

"Open regionalism" came to be understood within APEC to mean the gradual reduction of trade barriers by APEC members on a non-discriminatory basis. APEC was thus explicitly designed not to be a preferential trading arrangement. A voluntary liberalisation process of the kind envisaged by APEC can be regarded as equivalent to unilateral liberalisation by each participating economy, and so the term "concerted unilateralism" was coined to describe the APEC approach to regional liberalisation. While it is always open to individual economies acting in isolation to secure for themselves the benefits of unilateral liberalisation, the "concerted" aspect of APEC's approach recognised that if the group liberalises together each member will benefit more than if it liberalises in isolation, and that concerns over the political sustainability of liberalisation will also be reduced since the benefits will be spread more widely within each member economy.

Three preferential trading agreements already existed in the APEC region at the time of the Bogor Declaration, namely the North American Free Trade Agreement or NAFTA (entered into force in January 1994), the ASEAN Free Trade Agreement or AFTA (entered into force in 1993), and the Australia New Zealand Preferential Trade Agreement or ANZCERTA (entered into force in 1983). These were subsequently followed by free trade agreements between Chile and Mexico and Chile and Canada, both of which could reasonably be interpreted as by-products of NAFTA, serving as partial substitutes for the aborted earlier effort to bring Chile into NAFTA. After some initial

anxieties APEC settled down into comfortable acceptance of the coexistence of these preferential agreements with its own “concerted unilateral” process. From 1994 to 1997 however there was little apparent interest in the creation of new preferential trade arrangements in the APEC region, in contrast to the continued proliferation of such arrangements elsewhere in the world.

Disappointment with the initial results from APEC’s “concerted unilateralism” combined with impatience for more rapid progress towards APEC’s goals led APEC in 1997 and 1998 into the experiment of the Early Voluntary Sector Liberalisation (EVSL) initiative. Fifteen sectors, selected in 1997 by consensus among APEC members were targeted for early liberalisation, and through 1998 negotiations were undertaken to establish commitments on the part of APEC members that would give effect to the APEC free trade goal in nine of these sectors, selected by agreement of members. EVSL was welcomed by some trade officials as a way of introducing more rigorous liberalisation commitments into the APEC process, but regarded by others as an unfortunate intrusion of the reciprocity-based WTO style of negotiation into a process that the members had earlier agreed would be based on voluntarism.

In the event it was not possible to reach consensus on an agreed set of liberalisation commitments in the initial nine sectors. The attractiveness of the overall “package” was greatly diminished when it became apparent that some members would not agree to the inclusion of some of the nominated sectors in their EVSL commitments (particularly the forestry and fishery sectors in the case of Japan and Korea), and that the United States would not undertake non-discriminatory sectoral liberalisation outside the WTO context. It was agreed that trade facilitation and economic and technical cooperation in relation to the nine sectors would continue to be pursued within APEC, but that efforts to achieve liberalisation in these sectors would be transferred to the WTO, where the APEC members would endeavour to secure participation in these sectoral initiatives by the full WTO membership. This latter endeavour has not so far been successful.

The failure of EVSL was a defining event in the evolution of APEC’s approach to trade liberalisation. It showed the difficulty, and perhaps undesirability, of moving beyond voluntarism to binding commitments within the APEC process, and this in turn may have devalued the APEC process itself as an instrument of regional liberalisation in many eyes, particularly those of hardened trade negotiators. Japan and Korea are likely to have felt uncomfortable over the position in which they found themselves during the EVSL debates, and this may have spurred interest in exploring alternative regional configurations in which they might be less likely to face pressures for the liberalisation of sensitive sectors. Less obviously, but equally significantly, the EVSL experience signalled indirectly to the rest of the APEC membership that the two of the three leading economic powers of the region, the United States and Japan, are unlikely to be willing or active participants in APEC’s “concerted unilateral” approach to liberalisation, and are likely instead to be willing to liberalise only within the context of the negotiated reciprocity of the WTO and perhaps also of traditional preferential regional trading arrangements. This realisation is likely to have removed a major incentive for continued commitment to the APEC process, to the extent that increased access to the United States

and Japanese markets was viewed by many other APEC members as a major component of the economic benefit potentially obtainable from their participation in APEC.

These developments did not mean that APEC's trade and liberalisation objectives had become unattainable. A review by the independent Pacific Economic Cooperation Council in 1999 in fact concluded that APEC members were making reasonable though uneven progress towards the achievement of those objectives. It was clear however that at least for the time being relatively little progress could be expected from decisions taken within the APEC process itself. Momentum towards APEC's objectives would have to be maintained through other processes: unilateral liberalisation by individual members and multilateral liberalisation in the WTO. APEC members also began to turn their attention to the possibilities of preferential liberalisation within a new array of subregional trade agreements.

A successful WTO round thus assumed crucial importance to the maintenance of forward momentum of trade liberalisation in the APEC region. APEC's efforts during 1999 were accordingly heavily focused on developing a common position in support of the launch of a new round at the WTO's Seattle ministerial in December 1999. The failure of the Seattle ministerial was a major setback not only for the WTO but also for APEC, since it left the APEC region for the time being bereft of any significant initiatives for pressing forward with non-discriminatory liberalisation. APEC's credibility also suffered a blow from its failure to make any significant impact as a collective entity at Seattle, despite the adoption by APEC leaders at their meeting in September 1999 of an agreed common position on a new WTO round. Some APEC governments were even reported to have taken positions on certain issues at Seattle that contradicted the common APEC position agreed three months earlier by their leaders.

A new WTO round continues to be of critical importance to the APEC region, both to provide a continuing focus for ongoing non-discriminatory liberalisation in the region, and because studies clearly show that APEC members are likely to be among the biggest beneficiaries of further multilateral liberalisation through the WTO. APEC members continue to look for ways of providing impetus for the launch of a new round. Consensus has tended to break down however whenever the discussion has moved beyond statements of general support for a new round to consideration of the round's possible agenda. The potential agenda issues that have been so divisive within the WTO at Seattle and afterwards have proved equally divisive among the APEC membership.

2. A "New Wave" of Preferential Trade Agreements in the APEC region

Meantime, in the last two years there has been something of an explosion of new proposals for bilateral or plurilateral subregional preferential trade agreements (PTAs) in the APEC region. The new trend appears to have first clearly emerged following the failure of the EVSL initiative at the end of 1998. By the end of 1999 several new preferential arrangements had been proposed. The failure of the WTO ministerial meeting at Seattle may have given further impetus to the emerging trend, and proposals for new agreements continue to proliferate, to the point where there are now well over

twenty such proposals for new preferential agreements at various stages of study, discussion or negotiation.

These developments have coincided with the emergence of renewed interest in the establishment of some form of East Asian economic bloc. In part this interest arose from the perception that a lack of economic independence had resulted in East Asia being forced to accept externally-imposed policy responses to the East Asian economic crisis of 1997-98, and a related sense that the achievement of a greater degree of economic independence would be beneficial. Reflecting these concerns, the possibilities of greater monetary and financial cooperation or coordination featured high on the initial agenda of discussions on achieving greater economic cohesion in East Asia. The newly-formed ASEAN-plus-three group, comprising the ten ASEAN members plus China, Japan and Korea, quickly emerged as a natural potential forum for these discussions. More recently the ASEAN-plus-three group has begun to show interest in the possibility of forming themselves into some kind of trade bloc.

The following is a brief summary of how proposals for new preferential trade arrangements have developed in the region since late 1998.

- A dramatic early step was the decision by Japan and Korea to study the implications of a free trade area (FTA) between the two countries as part of a wider programme of deepening economic ties. This initiative resulted from meetings during the October 1998 visit to Japan of Korean President Kim Dae Jung, and received further impetus from the proposal for a 'Japan-Korea Economic Agenda 21' put forward during the March 1999 visit to Korea by then Prime Minister Keizo Obuchi of Japan. The results of the study were published in May 2000 by the Institute for Developing Economies and the Korean Institute for International Economic Policy. Korea has suggested that it might be preferable to include China in any such arrangement, and there have been unconfirmed reports that less formal studies are also under way on this possibility.
- At the time of the APEC Economic Leaders' Meeting in Auckland in September 1999, announcements were made regarding proposals for negotiations or studies on FTAs between the following APEC members:
 - Singapore and Japan
 - Initial study and discussion followed by formal negotiations aimed at concluding a free trade agreement by December 2001, to come into effect during 2002. The second of three planned rounds of negotiations has just been completed.
 - Singapore and Chile
 - Announcement of exploratory talks on a possible FTA
 - Singapore and New Zealand
 - Agreement concluded in November 2000

Korea and Chile

- First round of negotiations held as early as April 1999. Negotiations recently reported to be on the verge of breakdown over sensitivities in relation to agricultural trade.

Japan and Mexico

- Study released in April 2000 called for establishment of an FTA. Japan declined a Mexican request to begin negotiations during 2000, citing concerns over Mexican agricultural exports, and indicating an initial preference for a bilateral investment agreement.

- Subsequent to the Auckland leaders' meeting it emerged that proposals have also been made for FTAs between:

Japan and Canada

- After the idea was originally raised during 1999, studies were commissioned by Japan's MITI and by Canada-Japan business groups

Japan and Chile

- Reports during 2001 indicated that analysis of a possible FTA is continuing

Korea and Mexico

- Possible FTA discussed in March 2000 and again at the November 2000 APEC leaders' meeting in Brunei, where an investment guarantee treaty was signed.

Singapore and Mexico

- Negotiations began in June 2000 and the two countries issued a joint declaration at the November 2000 APEC leaders' meeting

Singapore and Canada

Agreement to begin talks reached in June 2000

- Also at the time of the APEC Economic Leaders' Meeting, proposals were circulating informally for a so-called "P5" (Pacific Five) FTA between the United States, Australia, Singapore, Chile and New Zealand. While this proposal never reached the stage of formal discussions, it is known that some prospective participants remain interested in taking it further.
- Other developments in 1999 were an attempt to revive an earlier proposal for an FTA between Chile and New Zealand, and the announcement by the Korean and New Zealand governments of a joint study into an FTA between the two countries. In the early part of 2000, a similar announcement was made by the governments of Korea and Australia. Discussion on a Korea-Singapore FTA has also been reported.
- Discussions have been proceeding on further development of the linkage between the ASEAN Free Trade Area (AFTA) and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA, usually shortened to CER). The AFTA-CER linkage has hitherto focused on facilitation measures and information exchanges but some participants on both sides of these discussions have expressed clear interest in elevating this linkage to the status of a full FTA arrangement. A high-level task force produced a report entitled the "Angkor Agenda" in October 2000 outlining

recommendations for proceeding with an AFTA-CER arrangements. Under pressure from Malaysia ASEAN ministers at that time declined to consider the possible elimination of tariffs between the two groups.

- The APEC Economic Leaders' meeting in November 2000 was the focus of still further announcements. Perhaps the most dramatic was the announcement that study would begin on a free trade area between the United States and Singapore, marking the first time the United States has officially engaged in the new trend towards bilateral arrangements in the region. The Prime Minister of Singapore, Goh Chok Tong, forcefully put forward the view that new trans-Pacific bilateral developments represent a fresh concept in regional integration, which he dubbed "Cross Regional Free Trade Areas" (CRFTAs). He argued that in present circumstances CRFTAs offer the best defense against the evolution of a "three-bloc world". Other proposals for bilateral arrangements to surface at this time included Australia-Singapore and New Zealand-Hong Kong, with some suggestions also of a possible New Zealand-Chinese Taipei link. Informal discussions apparently also took place on possible reduced-form variations on the P5 formula, involving some combination of Australia, Chile, New Zealand and Singapore. Just prior to the APEC Leaders' meeting the agreement between Singapore and New Zealand was signed by the Prime Ministers of the two countries, the first of the new initiatives to reach the stage of formal agreement.
- Further new initiatives continue to be announced in the APEC region. Reports that China has indicated willingness to consider a free trade area with the ASEAN countries were followed at the November 2000 summit of the "ASEAN-Plus-Three" group by the commissioning of a study on a possible East Asia-wide free trade area. In December 2000 came an announcement that discussions would re-open on a possible free trade area between the United States and Chile. The Peruvian government is reportedly moving to explore possible trans-Pacific FTA linkages. Australia is reported to have called for negotiations on a bilateral free trade agreement with the United States and there have been reports of discussions of a possible Australia-Thailand free trade arrangement.

3. Some Key Patterns in the New PTA Developments

The number and variety of new proposals for subregional trade arrangements (SRTAs) in the Asia-Pacific region may initially seem a little bewildering. In most cases relatively little is known about the motivations or strategies underlying the proposals, and there is relatively little information available on the details of the arrangement that is contemplated. For the purposes of this discussion at least a provisional classification of the new initiatives is however desirable.

It is noticeable that much of the impetus to the formation of new SRTAs in the APEC region seems to come from just six APEC members, each involved in three or more of the possible agreements: Japan (involved in six initiatives or potential initiatives), Korea (seven), Singapore (nine), Chile (five), New Zealand (six), and Mexico (three). This

suggests that one approach would be to analyse and assess the strategies of these governments. Here however an alternative approach is followed of relating the new developments to patterns of trade integration in the region. On this basis a useful provisional classification might be as follows:

(1) Trans-Pacific CRFTAs

(a) NAFTA-related

Singapore-United States
Japan-Mexico
Korea-Mexico
Singapore-Mexico
Japan-Canada
Singapore-Canada
P5 (USA, Australia, Singapore, Chile, New Zealand)

(b) Chile-focused

Korea-Chile
Singapore- Chile
Japan-Chile
New Zealand-Chile

(2) Western Pacific Integration

(a) Western Pacific bilateral SRTAs

Singapore-Japan
Singapore-New Zealand
Singapore-Australia
Suingapore-Korea
Korea-Australia
Korea-New Zealand
Hong Kong-New Zealand

(b) Amalgamation of Existing SRTAs

AFTA-CER

(c) Potential Steps to the Formation of an East Asian Bloc

Japan-Korea
Japan-Korea-China
ASEAN-plus-three
China-ASEAN

There are numerous proposals for both trans-Pacific CRFTAs and Western Pacific bilateral SRTAs, reflecting the dual focus of trade and economic integration in the Asia-Pacific region. Trade links across the Pacific are vitally important for most countries of

the region, but at the same time trade and investment linkages have been rapidly integrating the economies of the Western Pacific, particularly those in East Asia.

However, while the large number of trans-Pacific proposals must in some sense reflect recognition of the continuing importance of trans-Pacific trade ties, it is significant that the United States initially remained largely unengaged with the new trend, although there are signs that the decision at the end of 2000 to open discussions on an FTA with Singapore may mark the beginning of a more proactive stance by the United States. Yet easily the most important trans-Pacific trade ties are those involving the United States, so that unless the United States becomes engaged with the new trend, the largest bilateral trans-Pacific trade flows will remain almost entirely outside the scope of the proposed new trans-Pacific arrangements. Similarly, Japan occupies a central position in trade integration within the Western Pacific, but after its opening initiative with Singapore has been slow to develop proposals for SRTAs with other Western Pacific trading partners.

The positions of the United States and Japan are central to the evolution of Asia-Pacific trading relationships, not only because of their dominant share of the region's output but also because they are both major trading partners of virtually every economy in the region. By contrast, the region's other economic giant, China, is at this stage less fully integrated into the region's trade. Although it is a formidable competitor in regional trade in a number of sectors, it accounts for a significantly smaller share than either the United States or Japan in the trade of most economies in the region, even when its share is aggregated with that of Hong Kong. Its potential future importance is however enormous. The lack of a clearly defined strategy from these three regional economic giants, particularly from the United States, remains a source of uncertainty over the future development of the region's trading relationships.

Prospective FTAs between Japan and Korea, and between Japan, Korea and China could be classified along with other Western Pacific SRTAs, but are here placed in a separate category because of their potential importance as steps towards the formation of an East Asian trade bloc. The key to the development of any East Asian trade bloc lies in Northeast Asia, which accounts for 23% of world GDP and almost 90% of the combined GDP of the Western Pacific economies. ASEAN and Australasia, by contrast, respectively account for only 2% and 1.5% of world GDP. Northeast Asia has hitherto been an "empty box" in the worldwide map of SRTAs, and any credible move towards establishing an East Asian (or Western Pacific) trade bloc would have to be based around the filling of this "empty box". Until very recently Japan and Korea had steadfastly rejected involvement in preferential trading arrangements in favour of consistent adherence to the MFN principle, and as such had formerly been counted among the last remaining "friends of GATT Article 1". In addition their trade policies towards each other had in the past more often seemed directed towards discouraging rather than encouraging bilateral trade, despite their close geographic proximity to each other.

The emergence of a willingness on the part of these two countries to consider participation in preferential trading arrangements, and to consider moving towards free trade with each other, thus represent essential historic shifts which had to occur before an

East Asian trade bloc could become a realistic possibility. A decision by China to consider participation in preferential trading arrangements, and a willingness by Japan and Korea to contemplate inclusion of China in such an arrangement involving the Northeast Asian economies, are further essential prerequisites. Once these conditions are in place it in turn becomes realistic to consider the ASEAN-plus-three grouping as the possible vehicle for an East Asian trade bloc.

The proposed linking together of AFTA and ANZCERTA would join together two well-established and relatively “high standard” preferential trading arrangements. The twelve economies covered by such an arrangement comprise a large part of the region in geographic terms. However their economic significance, as noted above, is much less. In the wider East Asian context the significance of a joining together of AFTA and ANZCERTA is that it could provide a natural basis for considering an extension of the concept of an East Asian trade bloc to embrace the entire Western Pacific.

4. Assessment of the New Trend in Regional Trade Arrangements in the APEC Region¹

Proliferating Subregional Trade Arrangements (SRTAs)

The majority of proposed new SRTAs in the region, both intra-Western Pacific and trans-Pacific, cover trade flows representing a relatively small proportion of their prospective members’ total trade. The first of these agreements to come into effect, the Singapore-New Zealand agreement, provides an extreme illustration of this point. Over the period 1996-98 trade with New Zealand accounted for just 0.17% and 0.30% respectively of Singapore’s imports and exports, with the corresponding figures for New Zealand’s trade with Singapore being 1.70% and 1.55%. In general the significance of most of the proposed new agreements for their members’ trade is relatively small and their effects on economic welfare are likely to be correspondingly minor.

It is true that many of the new agreements go well beyond the traditional focus on trade in goods, and contain provisions for liberalisation of services trade and investment, and a wide range of trade facilitation measures. In all cases however there is a risk of the fragmentation of the Asia-Pacific trading environment due to the proliferation of sometimes overlapping trade agreements containing divergent and sometimes mutually inconsistent provisions. This “spaghetti bowl” phenomenon, as it has been called by Jagdish Bhagwati, will tend to reduce the efficiency of regional trade. A further possible negative consequence is that the negotiation of these agreements will require the commitment of scarce negotiating resources and political capital, and divert attention away from potentially more beneficial initiatives. It is questionable whether the very

¹ Discussion of trade flows and economic effects of RTAs in this memo is based on data and the results of computable general equilibrium (CGE) simulations contained in Scollay, R. and J. Gilbert, New Pathways for Regional Trade Arrangements in the Asia-Pacific?, Institute for International Economics, Washington DC, 2001 (*forthcoming*)

small potential welfare gains offered by most of the proposed agreements are sufficient to offset these negative factors.

Those proposed agreements which do offer the prospect of more substantial welfare gains to their members are likely to do so to some extent by diverting trade away from other trading partners, who will consequently suffer a loss of economic welfare. This may in turn add further momentum to the proliferation of preferential agreements. A form of “domino” effect may operate whereby countries that otherwise might not be inclined to pursue preferential trade arrangements may feel themselves compelled to do so as a defensive manoeuvre.

For most countries in the region the United States and Japan are major trading partners, and the likelihood of significant welfare gains is accordingly likely to be greater in preferential agreements with those two economic giants. Competition to secure the United States and Japan as SRTA partners could be a divisive factor in trade relations in the region. The outcome could be a regional configuration of preferential trade agreements of the “hub-and-spoke” variety, with all the associated negative implications of the likely unequal balance of negotiating strength between the “hubs” and “spokes”, and of the tendency of such arrangements to accentuate further the undermining of the WTO’s non-discrimination principle.

As noted above, the strategies of the United States and Japan towards preferential trading arrangements have yet to be fully articulated. Initial indications have not, however, been particularly encouraging. Both countries have been carefully selective in their initial choice of partners. Japanese officials have openly stated that the choice of Singapore as an initial partner was based importantly on the consideration that the potential for agricultural exports from Singapore to Japan is minimal. Even so, Japan has reportedly insisted on excluding from any proposed agreement even the small number of agricultural and fisheries products in which some minor potential for increased exports exists, such as goldfish and cut flowers. In announcing the opening of its own discussions with Singapore, the United States indicated that an understanding had been reached that any resulting agreement would contain labour provisions modelled on those included in an earlier agreement with Jordan, which the Clinton administration at least apparently regarded as a template for future FTAs, at any rate in the areas of labour and environmental provisions. It would be difficult to contemplate with equanimity a scenario in which the United States and Japan began establishing networks of preferential trading links in the region with countries selected on the basis of willingness to accept their respective positions on labour standards and the exclusion of agriculture from trade liberalisation programmes, particularly if these networks also became vehicles for renewed trade rivalry between these two major economic powers of the region.

Opposing arguments have been put forward in relation to suggestions that agriculture may be systematically excluded from SRTAs involving the Northeast Asian economies. On the one hand it is argued that in cases where the agricultural sectors are seriously uncompetitive, their exclusion helps to minimise the risk of trade diversion. On the other side, there is concern that the opportunity to exclude “sensitive sectors” from RTAs and

SRTAs might encourage some important trading nations to increasingly give priority to preferential alternatives rather than the multilateral approach to trade liberalisation.

Prospects of an East Asian Trade Bloc

Progress towards an East Asia-wide trade bloc depends on mechanisms being found to link the Northeast Asian economies together in such an arrangement, as noted above. A free trade area between Japan and Korea could be an important step in this direction, but faces formidable political obstacles. The inclusion of China would strengthen the economic logic supporting a preferential trade arrangement in Northeast Asia, but would face even greater political obstacles. Furthermore, increased economic benefits from the inclusion of China would be likely to be achieved at the expense of significant damage to the trade and economic welfare of the ASEAN economies, which are direct competitors of China in a number of fields. Likewise, China's trade interests would be threatened by any move by Japan and Korea to link with ASEAN to the exclusion of China. On the other hand, a free trade area joining all three Northeast Asian economies together with ASEAN – the “ASEAN-plus-three” group – could be expected to enhance the welfare both of the individual members of the arrangement and of the group as a whole. Other countries that are closely integrated into Western Pacific trade, notably Australia, New Zealand and Taiwan would suffer economically from being excluded from an “ASEAN-Plus-Three trade area, whereas both they and the region as a whole would benefit from their inclusion in a wider Western Pacific free trade arrangement.

The degree of inclusiveness towards participation by economies within the region will thus have an important bearing on the impact of a possible East Asian trade bloc, and of the steps towards its creation. An inclusive trade agreement covering all of the economies of East Asia or the Western Pacific will offer substantial economic benefits to its members. A bloc with more limited membership on the other hand, while offering benefits to the members of the arrangement, will damage the trade interests of excluded non-members in the Western Pacific as well as elsewhere.

The existence of a cogent economic logic in favour of the formation of an inclusive East Asia-wide or Western Pacific-wide trade bloc does not necessarily mean that such a bloc is likely to eventuate. The politics and related security issues associated with relations between the potential members of the bloc, particularly between the Northeast Asian economies, present a complex of array of problems and difficulties that would have to be overcome. The politics of trade issues could also be potentially divisive in a larger East Asian trade grouping. There are likely to be sharp differences of view as to whether, and to what extent, agriculture should be included in any East Asia free trade arrangement. Malaysia recently insisted on excluding autos from its AFTA commitments, and this stance also is likely to be controversial if repeated in negotiations for an East Asia-wide FTA.

A distinct possibility is that economic logic and political feasibility may point in opposite directions. Whereas economic logic may favour a more inclusive trade bloc covering the

entire Western Pacific, political constraints may lead in the direction of more limited groupings. This may be a recipe for sharply increased levels of trade conflict, possibly provoking responses that lead to further reductions in economic welfare in the region. The potential for increased trade conflict, and also political conflict, is likely to be especially acute if the Northeast Asian powers – Japan, Korea, possibly later China and perhaps even Chinese Taipei – pursue separate strategies of building their own SRTA linkages in the Western Pacific (and further afield).

Of all the possible trade developments in East Asia, an East Asia-wide or Western Pacific-wide trade bloc would be most likely to damage the economic interests of the United States and provoke an outbreak of trans-Pacific trade conflict. Given the importance to them of their trade with the United States, East Asian economies are likely to be wary of this possibility. On the other hand potential negative impacts on major economies outside the region may add to the incentives for major players such as the United States and the European Union to return to the WTO negotiating table.

5. Alternative Future Roles for APEC

In comparison with other regional trade groupings, APEC, by virtue of its trans-Pacific dimension, continues to offer most countries of the Asia-Pacific region the potential advantage of including a larger number of their most important trading relationships. Accordingly the achievement of APEC's liberalisation promises larger economic welfare gains than a free trade area covering either East Asia or the Western Pacific. APEC also offers the further advantage of having already settled some thorny political issues that might have to be revisited in the context of the construction of an East Asian or Western Pacific bloc, most notably the simultaneous inclusion of China, Hong Kong China and Chinese Taipei. The position of Australia and New Zealand is another example of an issue which may be problematic in the latter context but which does not cause difficulty in the APEC context.

APEC however faces a serious challenge in maintaining – or perhaps restoring – the confidence of its members in its effectiveness as a vehicle of regional trade liberalisation, and it remains to be seen whether in its present form it will be able to meet this challenge. Widespread doubts clearly exist as to whether a process based on voluntary, non-binding commitments is capable of successfully realising APEC's objectives. The recent proliferation of SRTAs in the region appears to be widely interpreted as an implicit judgement by the economies of the region that progress towards APEC's objectives under the existing process is likely to be unsatisfactory.

APEC is likely however to remain an important regional institution, regardless of whether it remains a principal vehicle for regional trade liberalisation efforts. The high degree of trans-Pacific trade interdependence means that maintenance and enhancement of an open trading environment in the Asia-Pacific region will remain a worthwhile objective for the countries of the region, even if the focus of trade liberalisation efforts

shifts to the negotiation of bilateral trade agreements or the development of preferential trade blocs. If the Asia-Pacific region as a whole is to successfully navigate its way through these developments without serious outbreaks of divisive trade conflict, an extraordinary degree of understanding if not consensus will need to be built about how any such new arrangements will proceed and how they should be related to each other. APEC is the ideal forum for the necessary dialogue to take place.

6. Parallel Developments in East Asia and the Western Hemisphere

Depending on the outcome of the new developments in East Asia, profound changes in the architecture of trade linkages across the Pacific may be in prospect. APEC and the FTAA initiative have in recent years co-existed as two quite distinct approaches to the management of the integration of regional trade and investment flows. The FTAA has by definition focused on integration within the Western Hemisphere, and represents the ultimate expression of the preferential approach to regional trade liberalisation that has long been entrenched there. APEC in contrast was explicitly designed to preserve the benefits of trans-Pacific interdependence and ensure that separate blocs would not be formed on each side of the Pacific Ocean, and to emphasise the non-discriminatory as against the preferential approach to trade liberalisation.

The new preferential trading developments involving East Asian economies provide a clear signal that both sets of premises underlying the APEC approach are being re-assessed. It seems already clear that for the time being East Asia is increasingly inclined to place greater faith in preferential rather than non-discriminatory liberalisation, at least at the regional level. What is less clear is where the balance will be struck between the pursuit of preferential liberalisation entirely within East Asia or the Western Pacific on the one hand, and the effort to maintain a trans-Pacific dimension to regional trading linkages on the other. The proposed subregional arrangements within East Asia and the embryonic proposals for an East Asian trading bloc represent the former tendency, while the array of proposals for trans-Pacific or “cross-regional” free trade areas represent the latter.

The outcome is likely to depend heavily on the stance adopted by the United States. The benefits of a satisfactory economic and political relationship with the United States remain a powerful incentive for East Asian economies, particularly the Northeast Asian economies, to find ways of avoiding irreversible ruptures in trans-Pacific trade relations. On the other hand, signals from the United States that constructive economic and political engagement with East Asia will receive a lower priority in future could conceivably tip the balance towards a move by the East Asian economies to form their own economic bloc. Commitment by the United States to the FTAA does not by itself necessarily constitute such a signal, but is likely to add to the preoccupation by policymakers in the East Asian economies with finding signs of the future direction of United States policy toward East Asia.

7. Trade Implications of Parallel Trade Blocs

Separate trade blocs in East Asia and the Western Hemisphere will by definition discriminate against each other to some degree. Trade creation within each bloc, and the stimulus to trade from increased economic dynamism, will therefore be offset to some extent by tendencies towards trade diversion.

Trade creation within the Western Hemisphere may be partly offset by the negative effects on economic welfare arising from competitive East Asian exports being displaced from Western Hemisphere markets as well as some Western Hemisphere exports being displaced from East Asian markets. These negative effects will tend to be heavily concentrated on the United States, which trades far more intensively with East Asia than any other Western Hemisphere economy with the possible exception of Chile. The displacement of East Asian exports from Western Hemisphere markets and the displacement of competitive Western Hemisphere exports from East Asia will likewise tend to partly offset the benefits of trade creation within East Asia.

It is interesting to contrast the impact of an East Asian bloc with that of an APEC-style approach to the situation that would be created by implementation of the FTAA. Under a parallel APEC-wide liberalisation Western Hemisphere products are not displaced from East Asian markets and East Asian exports are not displaced from the markets of APEC's Western Hemisphere members. Both East Asia and the Western Hemisphere, particularly its APEC members are better off if a trans-Pacific rather than exclusively East Asian approach to liberalisation develops as the counterpart to the FTAA. The proliferation of proposals for trans-Pacific preferential trade arrangements can be interpreted as an effort to replicate some of these advantages of the APEC approach, but the advantages will clearly be much diminished to the extent that the United States does not participate in the new arrangements, and also because of the patterns of discrimination and exclusion to which a proliferation of preferential regional trade arrangements inevitably gives rise.

On a purely economic assessment, the United States as well as East Asia has an interest in the retention of a trans-Pacific dimension to regional trade liberalisation. While the United States may stand to benefit from the FTAA, its economic gains may be nullified if an East Asian trade bloc becomes established at the same time. Simultaneous engagement with APEC, or some alternative trans-Pacific arrangement, provides a way out of this dilemma. However while economic logic may support the retention of the trans-Pacific dimension offered by APEC, political pressures may point in different directions.

8. Trade Blocs and the World Trading System

The development of an East Asian or Western Pacific trade bloc parallel to the formation of the Free Trade of the Americas (FTAA) in the Western Hemisphere would also herald

the emergence of a “tripolar world trading system”, organised around blocs in Europe, the Western Hemisphere and East Asia. Such a development was viewed with considerable apprehension in the early 1990s, on the grounds that such large blocs may face particularly strong incentives to aggressively pursue the enhancement of their own welfare at the expense of the other two blocs, potentially leading to destructive trade wars – or even that incentives may exist for any two of the blocs to form a coalition against the third.

Two considerations may be cited to possibly alleviate such concerns. First, a strong WTO potentially has the ability to restrain such behaviour by large trading blocs. Second, studies continue to show that global liberalisation offers substantially greater benefits to most economies than those available from alternative preferential arrangements, even the formation of “mega-blocs, suggesting that the three blocs will have a strong incentive to cooperate to ensure the continuing effectiveness of the WTO. It is even possible that the emergence of trading blocs in East Asia and the Western Hemisphere may place additional pressure on the European Union to seek a successful outcome from multilateral negotiations.

It is also conceivable that a tripolar trading system may have favourable implications for the problematic relationship between regionalism and the multilateral trading system. A situation where three large trading blocs, each with an interest in maintaining the effectiveness of the WTO, dominate both regional and multilateral trade, may be less subversive of the multilateral trading system than the present worldwide proliferation of SRTAs over which the WTO appears relatively powerless to exert effective discipline in a number of important respects.