

February 2009

Asia Research Report 2008

The Huge Asia-Pacific Market Comes of Age: Japanese and US Strategies and APEC's Twentieth Anniversary

Shujiro Urata

Senior Economist, Japan Center for Economic Research

Professor, Waseda University

[Main Points]

- The APEC member economies achieved smooth economic growth with the help of exports and foreign direct investment, and they have come to occupy a very prominent position in the world. APEC's economies are at present moving sluggishly because of the ongoing global financial crisis, but if they can manage to rebound and return to the growth track, the smooth growth they enjoyed before the crisis should resume. For that to occur, however, trade and investment must expand, assisted by liberalization and facilitation.
- An agreement on the proposed Free Trade Area of the Asia-Pacific (FTAAP) would have many merits for APEC's economies, Japan included. For this reason, Japan should actively promote the agreement's conclusion. There is, however, an impediment standing in the way: domestic opposition to liberalization of the agricultural sector. Even so, by properly timing the introduction of liberalization and providing technical support and temporary income compensation to the people harmed by liberalization, the damage can be limited and human resources can be effectively utilized. If the competitiveness of agriculture were enhanced at the same time through the promotion of reform, resistance to liberalization would weaken and the Japanese economy would gain vitality.
- With Japan to host the annual APEC summit in 2010, one of the years targeted by the 1994 Bogor declaration for realizing free and open trade and investment in the Asia-Pacific, we wish to propose that the establishment of the FTAAP be set as the next goal. If Japan becomes actively involved in the negotiations, an agreement that is beneficial for it can be realized. Specifically, Japan should endorse a comprehensive agreement, one providing not just for free trade and investment but also for facilitation and economic and technical cooperation. Because Japan and its partners in the ASEAN Plus Six group are already working on a similar agreement called the Comprehensive Economic Partnership in East Asia (CEPEA), thought

must be given to coordinating the FTAAP and the CEPEA. In pursuing discussion of the FTAAP, Japan must closely coordinate strategy with other APEC members, particularly with Singapore, the host for 2009, and the United States, the host for 2011. Toward the realization of the FTAAP, Japan should quickly conclude the FTA it is negotiating with Australia and begin FTA negotiations with the United States.

Introduction

Established in 1989, Asia-Pacific Economic Cooperation (APEC) greets its twentieth anniversary in 2009. It began with 12 members and has grown into a regional cooperation organization with 21 members belonging to it. Even as APEC was drawing in new members, its member economies were achieving dazzling economic growth, with the result that APEC's importance in the world economy has greatly increased. APEC's share of the world's population rose from 14.9% in 1989 to 40.7% in 2006; its share of world gross domestic product rose from 50.2% to 55.5%; and its share of trade (exports and imports) rose from 33.0% to 46.3%.

APEC's aim is to promote regional cooperation for the realization of economic growth in the region and the world. Because among its members are some with great influence in the world economy, including the United States, Japan, China, and Russia, APEC also has come to play an important role in making and revising international rules in various economic sectors, notably trade and finance. The member countries and regions hold differing views, however, on how to promote liberalization of trade and investment, which is a key means of regional cooperation for the sake of economic growth. Some observers say that the progress in this area has been insubstantial compared with what was originally anticipated. It cannot be denied that the discussions in APEC have sometimes shifted from economic affairs to security matters. While the cause of this is the worsening problems of terrorism, disappointment with the lack of progress in trade liberalization has also been involved.

In recent years, because of such factors as the growing interest in regionalism in East Asia and the rise of the Chinese economy, APEC discussions have again come to center on regional cooperation in the economic arena. Meanwhile, the future of the world economy is becoming harder to discern because of a number of developments, such as the breakdown in the Doha round of multilateral trade negotiations under the World Trade Organization (WTO) and the intensification of the global financial crisis originating from the United States. In this setting, eyes are once again being turned to APEC and its talks on regional economic cooperation.

Japan has played an important role in APEC. On the occasion of the organization's birth, it joined with Australia in performing the role of midwife, and subsequently it has made major contributions in many areas, including organization building and cooperative activities. It was in Bogor, Indonesia, that APEC in 1994 agreed on what is considered to be its primary goal: the achievement of free and open trade and investment no later than 2010 in the case of developed economies and no later than 2020 in the case of developing economies. But it was in Osaka, Japan, that APEC in 1995 adopted an action plan for achieving this goal, the Osaka Action Agenda. For Japan, 2010 is a year in which it must, as a developed economy, attain the Bogor goal, and it is also a year in which it will host the annual APEC summit.

APEC today is a regional cooperation organization dealing with the broad Asia-Pacific region, which has become an enormous market in the world. With the organization's twentieth anniversary soon to arrive, though, the significance and role of APEC are being called into question. In this context, the present report makes policy recommendations to the Japanese government based on the results of analyses. These analyses focused on recent trends in the APEC region in key economic fields, including trade, investment, finance, and energy, as well as on the results achieved by cooperation within APEC. Over a three-year period the Japan Center for Economic Research (JCER) conducted studies on the theme of regional integration and regionalism in East Asia (in 2005 covering the ASEAN Plus Three group [the Association of Southeast Asian Nations plus Japan, China, and South Korea], in 2006 covering the East Asian economic community, and in 2007 covering the ASEAN Plus Six group [ASEAN plus Japan, China, South Korea, India, Australia, and New Zealand]). In 2008, with the objective of drawing comparisons with this research on regional cooperation centered on East Asia, the JCER research relating to APEC was directed at the United States, APEC's most important non-Asian member, soon to have a new administration. As a specific policy, moreover, the research looked into the proposal advanced by the United States in 2006 for the creation of a Free Trade Area of the Asia-Pacific (FTAAP).

In this chapter, section 1 looks at APEC, explaining the process of its birth, its features, and issues for it to address. Section 2 introduces the analyses of each chapter of the full report, and section 3 presents the proposals.

1 APEC: History, Goals, Results, and Issues

1.1 History of Regional Cooperation in the Asia-Pacific

The first meeting of Asia-Pacific Economic Cooperation took place in Canberra, Australia, in November 1989.¹ In attendance were the foreign and economic

¹ For information on APEC's origins and early developments, see the websites of APEC and the Japanese Foreign

ministers of 12 nations (Australia, Canada, Japan, New Zealand, South Korea, the United States, and the six members of ASEAN: Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand). Discussions were held on various subjects, notably economic development in the world and the Asia-Pacific region, global liberalization of trade and the role of the Asia-Pacific, the possibilities of regional cooperation in specific areas, and directions to move in for future cooperation in the region.

The history of efforts to promote regional cooperation in the Asia-Pacific dates back to the 1960s. In that decade a proposal was floated to establish a Pacific Free Trade Area (PAFTA). This was to be a governmental organization for creating an area akin to the common market of the European Community (EC), with Japan, the United States, Canada, Australia, and New Zealand taking the lead. In the 1970s, as a Pacific version of the Organization for Economic Cooperation and Development (OECD), the idea of an Organization for Pacific Trade and Development (OPTAD) was unveiled. In the end, neither of these proposals became a reality. With governmental-level efforts to construct a setup for cooperation making slow progress, two private-level organizations came into being in the 1960s for promoting regional cooperation. These are the Pacific Basin Economic Council (PBEC), a gathering of business leaders, and the Pacific Trade and Development Conference (PAFTAD), a gathering of economists and other academics. But it was another organization—the Pacific Economic Cooperation Council (PECC), established in 1980—that became the direct impetus for the construction of a government-level framework for regional cooperation. PECC began as a conference of business leaders, senior government officials, and academics, who participated in the capacity of private individuals.

The second half of the 1980s saw a breakdown in the Uruguay round of the General Agreement on Tariffs and Trade (GATT), the final multilateral trade negotiations conducted under the GATT framework, while maneuvers to advance regional cooperation were picking up steam in Europe, North America, and other areas. People in the Asia-Pacific came to keenly feel the need for the promotion of trade liberalization in order to suppress protectionism, a barrier standing in the way of economic growth. To be more specific, countries in East Asia saw the retention of access to the American market, their largest export market, as a vital concern, while the United States wished to maintain access to the Asian market, which was expected to grow dynamically, and to remain politically involved in Asia. Against this backdrop, the first meeting of APEC was held in 1989.

The APEC ministerial-level meeting has continued once each year since then.

Ministry, as well as *APEC nyumon: Hirakareta chiiki kyoryoku o mezashite* (An APEC Primer: Aiming for Open Regional Cooperation), Ippei Yamazawa et al., eds., 1995.

At the 1993 meeting in Seattle, the United States, an informal summit of heads of government was arranged, and this informal summit has also continued to take place annually. APEC's membership also increased. China, Russia, and other participants joined the organization, giving it 21 member economies today. The themes addressed have expanded beyond trade and investment and now encompass such matters as energy, the environment, finance, training of human resources, and security.

Brisk direct investment and trade played key roles in both the high-tempo growth before the crisis and the swift recovery from it. An inward flow of direct investment promotes capital investment, production, and employment in the recipient country, and working through technology transfer, it lifts the country's technological level, which also plays a key role in economic development. Direct investment works in such ways to accelerate growth in recipient countries. The inflow of such investment into East Asia caused a major expansion of trade, which made high-tempo growth possible.

APEC is a governmental organization, but it recognizes the importance of reflecting private-sector opinions in its activities. It therefore promotes cooperation with the aforementioned PECC. In addition, to enhance exchange with the business world, it set up the APEC Business Advisory Council (ABAC) in 1995, and to enhance exchange with the academic world, it created the APEC Study Center in 1993.

1.2 Framework for Trade and Investment Liberalization

With its declaration at the 1994 summit in Bogor, APEC adopted the important goal of achieving free and open trade and investment in the Asia-Pacific by 2010 for developed economies and by 2020 for developing economies. At the 1995 summit in Osaka, APEC adopted guidelines for accomplishing this goal in the Osaka Action Agenda. This agenda specifies principles, frameworks, and actions in the three areas of trade and investment liberalization, trade and investment facilitation, and economic and technical cooperation. Among the general principles for liberalization and facilitation are comprehensiveness, WTO consistency, comparability, and nondiscrimination. The economic and technical cooperation is to be implemented by the APEC members as soon as each is ready, making use of action, forums, and other means. The agenda provides for liberalization and facilitation action in 14 specific areas, including tariffs, nontariff measures, investment, and trade in services, and it provides for economic and technical cooperation in 13 specific areas, including human resources development, industrial science and technology, and small and medium-sized enterprises.

To implement the Osaka Action Agenda, APEC's members plan and execute independent action individually, and they also participate in plans for collective action. Each member independently prepares and implements an individual action plan for activities including liberalization, facilitation, and cooperation, and in order to assure that objectives are fully attained, there is a peer review for mutual evaluation of progress in plan implementation. The evaluation work in these reviews is undertaken not just by concerned persons of the respective members but also by specialists.

At the 2005 APEC meeting in Busan, South Korea, an evaluation was carried out just for the developed economies of progress made toward the Bogor goal. This review confirmed that satisfactory results had been realized in lowering or eliminating tariffs and removing nontariff barriers and that trade had significantly expanded, but it spotlighted the need for a response to behind-the-border barriers, a subject that had been gaining attention, in addition to border measures. In greater detail, the review stressed the need for more work in a number of areas, including support for the multilateral trading system, economic and technical cooperation, promotion of high-quality free trade agreements (FTAs), liberalization and facilitation of investment, and facilitation of trade.

1.3 Issues

By promoting the liberalization and facilitation of trade and investment and engaging in economic and technical cooperation, APEC aims to realize free and open regional trade and investment and contribute to economic growth in the Asia-Pacific and the world. The means employed to attain this end are left to the discretion of each member, and they do not include legally binding negotiations, treaties, and conventions, like those of the WTO. In addition, APEC liberalization measures are also applied to nonmembers, thereby adopting most-favored-nation treatment without discrimination.

Trade liberalization works to stimulate economic growth by improving the efficiency of resource allocation. Over the short term, however, it has a high probability of causing injury to producers and workers if increased imports depress domestic production. People who may suffer damage therefore apply political pressure to block liberalization. Because of the operation of these political and economic mechanisms, liberalization is hard to accomplish on a voluntary basis. Particularly when business is in a slump, little can be expected of voluntary liberalization.

Because reliance on voluntary liberalization does not hold high promise, APEC members deeply interested in promoting liberalization proposed to work on it jointly with other members, but this idea did not gain favor. The proposal was put forward at the 1997 ministerial meeting as an initiative for "early voluntary sectoral

liberalization” (EVSL), or collective liberalization in designated sectors. Opposition was encountered, however, from those who argued that collective liberalization was not in line with the APEC principle of voluntary action. As a result, the attempt to pursue liberalization collectively by means of EVSL ended in failure.

Since collective liberalization also proved to be hard to accomplish, some of APEC’s members moved instead to conclude free trade agreements for the purpose of realizing free trade with other like-minded members. All of APEC’s members have entered into FTAs of one form or another. Bilateral agreements are by far the most common, but agreements among three or more countries are not unusual. Representative examples of multiparty agreements are the North American Free Trade Agreement (NAFTA) among the United States, Canada, and Mexico, the ASEAN Free Trade Area (AFTA) among the association’s 10 Southeast Asian members, and separate FTAs concluded by ASEAN with China, South Korea, and Japan. In addition, an FTA between AFTA and the Australia–New Zealand Closer Economic Relations Agreement (CER) was concluded on 28th August 2008.

In this context of spreading FTAs among APEC members, ABAC in 2004 put forward the idea of an FTA embracing all of APEC’s members. This is the FTAAP, the Free Trade Area of the Asia-Pacific. One of the arguments behind this proposal is that when a multitude of separate FTAs are concluded, you are apt to find that trade is repressed by a spaghetti-bowl effect of complex and confusing trading systems. To circumvent this problem, a single FTA subsuming all the separate FTAs is needed. The United States presented this proposal at the 2006 APEC meeting. The organization has since been studying the concept, but many researchers are of the opinion that it will not be possible to create such an area in the near future because of not just differences in the development stages and political systems of the APEC members but also domestic political obstacles.²

Among the FTAs concluded among APEC’s members, of note is the Trans-Pacific Strategic Economic Partnership Agreement. This is a high-level FTA appealing for complete removal of all tariffs within 10 years. Ratified by four founding members—Brunei, Chile, New Zealand, and Singapore—it was originally known as P4. At APEC’s 2008 meeting in Peru, it was announced that the United States, Australia, and Peru would take part starting in 2009, and the P4 designation was changed to the Trans-Pacific Partnership (TPP). This is an agreement among those countries interested in achieving free trade but believing that it will be hard to conclude the FTAAP for APEC overall. Their aim is to get FTA arrangements in place at an early date among like-minded countries. At the same time, they hope that their actions with regard to the

² See *An APEC Trade Agenda?* Charles E. Morrison and Eduardo Pedrosa, eds., 2007.

TPP will lead the way to the FTAAP's conclusion.

FTAs are exclusionary agreements with binding powers, and in this sense they are not in conformity with APEC's norms of behavior, which espouse nondiscriminatory, nonbinding, and voluntary action, but there is nothing to prevent the organization's members from entering into FTAs. Even so, there is a possibility of a split in opinion within APEC among members that join the TPP and those that are unable to do so right away. As this presents an argument affecting the most important APEC principle, that of taking voluntary action to liberalize trade and investment, the organization's respective members need to strive for a common understanding.

APEC has drawn up basic principles covering a number of areas including investment and competition policy. As in the case of the voluntarism applied to trade liberalization, however, these are nonbinding principles intended for use as a reference, and they do not appear to be making much of a contribution to improving the environment for investment and competition. The handling of the principles needs to be given further thought, and the possibility of providing them with binding power should be kept in mind.

APEC has made a major contribution by enhancing economic and technical cooperation in a variety of fields. But while the liberalization of trade and investment can work effectively to expand trade and investment during economic development, it will have few merits if taking advantage of the new trade and investment opportunities that open up is not easy. Economic and technical cooperation paves the way to the utilization of these new opportunities. This cooperation within APEC has significant content in such areas as developing human resources, fostering small and medium-sized enterprises, and installing economic infrastructure. It must be noted, though, that the World Bank and other international organizations as well extend cooperation of this sort, and it also takes place in bilateral assistance programs. What distinguishes APEC's economic and technical cooperation is its close relationship to trade and investment liberalization and facilitation. A task to be addressed in the promotion of APEC's cooperation is placing high value on this distinguishing characteristic while pursuing coordination with cooperation from other frameworks.

These are some of the topics to be addressed in trade and investment liberalization and economic and technical cooperation. There are also various other questions, such as how to enhance facilitation by, for instance, evaluating the extent of its advancement, or how to handle APEC's organization by, for instance, strengthening its functioning as a secretariat and setting goals to follow the Bogor goal. For lack of space, however, these issues will not be treated here.

The foregoing has been a discussion of APEC issues, but before moving on, let us briefly note some tasks for Japan. There are two major ones at present: (1) making a contribution to the resolution of APEC issues and (2) fulfilling Japan's duty as APEC's host country in 2010.

2 Chapter Summaries

2.1 Economic and Trade Interdependence among APEC's Members

There are 21 economies that have joined APEC, which has become a huge organization whose member economies account for more than 40% of the world's population, more than 50% of its GDP, and close to 50% of its exports and imports. There are, however, major differences among the members in such respects as population size, economic scale, and development stage. At the same time, many of the economies share the characteristic of being heavily reliant on trade in economic activities. Another common characteristic is that many of the developing members, including China, Russia, and Vietnam, have been growing at a blinding pace.

In the field of trade, APEC's economies are highly interdependent and involved in complementary relationships. To be specific, some economies like Australia and Russia have an abundance of natural resources, while many East Asian economies, Japan included, are dependent on natural resource imports. In the area of manufactured products as well, even as competitive relations exist among these economies over, for instance, electronic products, a closer inspection reveals that complementary relations also exist in many cases. Economies have come to specialize in certain areas, such as parts or finished products, and even within this division between parts and finished products, trade is going on among items with differing levels of quality. Within this area of manufactured products, particularly in the sectors of electronic products and transport equipment, there are numerous transactions among APEC's economies involving parts and finished products mediated by the production networks of multinational corporations. These networks have been created by means of foreign direct investment.

The global financial crisis has temporarily slowed the pace of globalization, but it should pick up speed again when business gets back on its feet. Under the circumstances, economic growth can still be effectively realized by using an expansion of direct investment and trade as a lever. APEC's economies have ample room for mutually expanding trade. Recognizing that the realization of such opportunities will lead to economic growth, they need to undertake activities centered on trade and investment liberalization, as stated in the Bogor declaration.

2.2 Trade and Trade Policy in the Asia-Pacific: Status in Fulfilling the Bogor Declaration economy

Free trade is a key APEC goal. Exactly what trade liberalization consists of has not been rigorously defined, but going by the individual action plans that the Bogor declaration asks each member to prepare for goal attainment, the content includes tariff cuts, nontariff barrier removal, and trade facilitation. Under the WTO and its predecessor GATT, liberalization has been perceived to center on lowering tariffs, but APEC targets a broader range of measures and fields. It seeks to create an environment in which trade that is truly free can take place.

The ambitious content of the Bogor declaration was decided on at a time when the member economies of APEC were recording solid economic growth. Subsequent events created conditions that made trade liberalization more difficult. These included the 1997 Asian currency crisis, which caused economies to stagnate in the late 1990s, and the collapse of the information-technology (IT) bubble and the terrorist attacks on the United States of September 11, 2001, which caused the whole world economy to falter early in the twenty-first century. Even in these circumstances, however, APEC's members made significant progress in terms of cutting tariffs. It is not easy to evaluate how much credit APEC deserves for this progress, since other factors were also involved. China, for instance, was strongly motivated to reduce its own tariffs for the sake of its negotiations for admission into the WTO. It may nonetheless be observed that the individual action plans led to a sharing of information on tariffs and nontariff barriers among APEC's members, and this presumably contributed to the lowering and removal of tariffs through increased awareness of the need for it.

This action on the tariff front made progress in many sectors, but high tariffs continue to exist in agriculture and other sensitive sectors. In addition, there has been an increase in so-called technical measures and other nontariff barriers. Even as tariffs were reduced or eliminated, systems were put in place for inspection, certification, and other procedures, creating new hurdles in the area of importation and customs clearance and, as a result, limiting or shutting out some imports. Concern about the safety of foods has been on the rise, and this can be seen as a justification for applying technical measures to food imports. What is problematic, though, is the possibility for the provision of unnecessary protection in the guise of assuring food safety. In the area of quality inspections, moreover, imported products and domestic products need to be handled without discrimination.

In this way, much progress has been achieved on the tariff front for trade liberalization within APEC, but there remains considerable scope for liberalization in the area of nontariff barriers. Liberalizing trade in some cases causes unemployment

and compels industrial adjustment because of increased imports, but seen from the vantage point of the economy overall, it energizes business and enhances growth. In actuality, many APEC economies have realized high growth by taking the path of free trade. Japan will be serving as APEC's host in the critical year of 2010. It will be called on to steer arrangements so as to maximize the interests of all the member economies, including itself, while keeping a close eye on trends in the United States, China, and other members.

2.3 Service Trade and Movement of People in APEC: Liberalization Measures for Their Further Promotion

Trade in services, which include transport, communications, finance, education, and tourism, has been expanding over recent years. In the background, the service sector is accounting for a growing share of economic activity, and the costs of engaging in service trade are falling. With respect to these falling costs, it may be observed that two of the primary causes are technological progress and deregulation in the fields of transport and communications, which provide the main means of conducting service trade. The scale of the service trade within APEC is large, accounting for close to 40% of the world total, and the United States occupies a prominent position, accounting for more than one-third of APEC's service trade. Japan and China come next after the United States, but each has a service trade total not quite reaching one-third of the American figure. The United States is highly competitive in service trade, which can be understood from the fact that it records a huge surplus in this trade, whereas other countries and regions are running deficits. The United States over the past few years has demonstrated keen interest in liberalizing service trade by means of the WTO's multilateral trade negotiations and its own FTA negotiations. Behind this policy lies the competitive power it commands in this field.

An expansion of service trade will work to enhance economic growth by drawing the economic relations of APEC's economies more closely together, but because in many cases this trade involves movement of people or has an impact on cultural customs and traditions, it can easily become a cause of friction. Numerous restraints on service trade have been put in place to prevent friction. Among these restraints, however, are quite a few that use the preservation of customs as camouflage for protecting industry. APEC has sought to assist the movement of people through new systems, which facilitate arrangements for multiple-entry visas and enable the acquisition of an APEC Business Travel Card, but the spread of these systems has not gone far. One task for APEC to address is encouraging wider use of existing systems through the spread of information and the enhancement of their convenience, while another is promoting mutual recognition of credentials for specialist occupations. In

order for the necessary policies to be implemented for realizing such objectives, it will be important that people share an understanding of the merits of liberalizing service trade. Toward this end, detailed analyses of the effects of this liberalization need to be conducted.

2.4 APEC's Future and Japan's Role: Possibilities for Further Developing the Asia-Pacific's Investment Environment and Production Networks

In the region of East Asia and North America, multinational corporations working primarily in machinery industries have assembled regional production networks. Fast economic growth has been realized in this region with the help of these networks, which enable growth of efficient production and trade. These multinationals have conducted a site-selection strategy in East Asia, where countries differ greatly in development stage, tailored to fit each country's wage level, infrastructure availability, and trade and direct investment policies. Japanese corporations and their overseas affiliates initially built networks in which production was handled within each corporate group, but later they expanded the networks by developing business ties with other companies, especially local firms in each country. With the construction and expansion of this sort of production mechanism, the region's countries achieved growth led by foreign direct investment and exports.

In order to promote growth by attracting investment, many APEC countries and regions adopted a variety of preferential policies, such as tax breaks, for inward direct investment. At the same time, however, policies were also implemented to protect and foster domestic industries, and inward direct investment was sometimes restricted in designated sectors, making it hard for multinational corporations to operate efficiently. There are also cases in which the employment of foreign workers has been restricted in order to promote the hiring of local workers. In developing countries and regions, legal measures like foreign investment laws have placed limits on the operation of multinationals, and in the enforcement of these legal measures, a lack of transparency and inefficiency in application have created major impediments to inward direct investment. In addition, there are often serious inadequacies in infrastructure and shortages in human resources, problems that hinder efficient operations not just of foreign companies but also of domestic firms.

The members of APEC have acted to liberalize investment and rectify shortcomings in the application of investment policies. Seen from the standpoint of multinationals, though, there is still much room for improving the investment environment. The problems are especially critical in developing countries and regions. In order for growth of foreign direct investment and trade to promote economic

development, a country needs to cultivate human resources for the improvement of its infrastructure. An effective way to improve the investment environment through the liberalization and facilitation of investment is to conclude FTAs and bilateral investment agreements. Investment liberalization would be a likely component of any FTAAP scheme, but regardless of what happens with the FTAAP, progress is required in liberalizing and facilitating investment.

2.5 Currency and Financial Cooperation in the Asia-Pacific: Status and Tasks

Flows of money within the APEC region have been picking up speed in recent years. Particularly notable has been the expansion of securities investment within the Asian region excluding Japan. Whereas US outward securities investment has been directed both at Japan and at the rest of Asia, Japanese outward securities investment has primarily gone to the United States, with only a small flow to other parts of Asia. Obtaining information on bank financing is not easy, but it can be said that in the case of the international financial centers of Hong Kong and Singapore, financing has flowed into both Asian countries and Western countries on a large scale. There is great unevenness in the state of development of the money and capital markets of APEC's developing economies, with mature markets in places like Hong Kong and Singapore and very undeveloped markets in places like Russia and China. Under the circumstances, APEC's members have come to appreciate the importance of strengthening money and capital markets for economic development, and they are moving forward on cooperation in the financial sector, especially for human resources development. By contrast, currency cooperation has not been going on. This is because the interests of regional currency cooperation are not necessarily in agreement with an international currency order centered on the US dollar.

In the part of the APEC region consisting of the ASEAN Plus Three (ASEAN plus Japan, China, and South Korea), active moves to cooperate in currency and financial affairs have started up. The original motive behind this cooperation was to prevent a recurrence of the 1997 Asian currency and financial crisis, which had a large impact on the ASEAN Plus Three group. In concrete terms, the cooperation includes the Chiang Mai Initiative for currency swaps in the event of foreign currency shortages, monitoring of economic and financial trends, economic surveillance through exchanges of views, and the creation of Asian bond markets so that the funds of Asia can be invested in Asia. Stable exchange rates play a key role in the achievement of East Asian economic development. Recognition of this point has prompted discussion of the need for currency cooperation, but various constraints are blocking progress. Among these constraints are insufficient feelings of regional unity as soon as a sense of crisis recedes, disparities in economic levels and policy goals, the wall of national sovereignty, and a

lack of political will. In order to loosen these constraints and make progress on currency cooperation with a beneficial influence on the ASEAN Plus Three, a blueprint of what this cooperation would consist of needs to be drawn up. After that, the important thing will be to come up with the political will to turn the blueprint into reality.

2.6 Possibilities for Cooperating on Energy in APEC

The primary energy consumption of APEC's members has grown fairly consistently since the 1980s, except during the 1997 Asian crisis and the slump following the terrorist attacks on the United States in 2001. APEC's economies saw their share of world primary energy consumption increase from 57.2% in 1985 to 61.3% in 2007. The United States is the region's largest energy consumer, followed by China, Russia, and Japan, in that order. APEC's members have generally become increasingly dependent on imports of primary energy. To be sure, because Canada and Russia are exporters of oil and natural gas while Mexico is exporting oil, APEC's overall dependence is relatively low compared with that of the ASEAN Plus Six group. Still, reliance on energy imports has been tending to grow and is expected to continue to do so in the future. A characteristic of oil supplies is a pattern of heavy reliance on imports from the Middle East. Looking at the supplies of oil and natural gas within the region, we find that Russia can make a contribution as a full-fledged exporter of natural resources to the Asia-Pacific but that if these exports are to grow, Russia's supply infrastructure will have to be enlarged and upgraded.

The members of APEC are becoming increasingly concerned about global environmental problems and measures for dealing with them. The APEC members recognize that they have a fragile supply-and-demand structure for energy, and they are becoming increasingly concerned about global warming. In this context, each of the region's major energy consumers is stepping up efforts to implement its energy policy. But because something of a zero-sum game results when each member formulates energy strategy separately, an optimum situation cannot be realized in the absence of cooperation and collaboration with other members.

Cooperation on the energy front in APEC has a longer history than cooperation within the ASEAN Plus Three and ASEAN Plus Six groups. At the first APEC ministerial meeting in 1989, the importance of regional cooperation on energy issues was acknowledged, and agreement was reached on creating a place for experts to discuss the matter. A work project for dealing with energy was set up in 1990, and cooperation got off to a start. In the ASEAN Plus Three, energy ministers got together for an informal meeting in 2004, and they recognized the need for efforts to achieve energy security. An important part of the cooperation content is the creation of forums

for discussions among experts on each of several energy topics. In addition, concrete projects including feasibility studies are going gradually forward for the construction of state stockpiles. The ASEAN Plus Six framework was only created in 2004 and thus has had little time to act, but in addition to engaging in discussions, the group has made a start on concrete cooperation. For the sake of energy cooperation within APEC in the future, it will be important both to share information on international markets and to construct and operate a setup for collaborating with other frameworks, including the ASEAN Plus Three and ASEAN Plus Six.

2.7 Trade Liberalization and Agriculture in APEC: The Agricultural Issue in FTAs

APEC's overall trade in agricultural products ran a surplus in the 1980s but has shifted to an excess of imports over exports since the 1990s. The trend in recent years has been for APEC's share of world agricultural exports to decline and its share of imports to steadily increase. There is great variation from one APEC economy to the next with respect to agricultural trade. The United States is the largest exporter, and it accounts for more than 30% of APEC exports. Australia, Canada, and China are also large exporters. On the import side, again the United States is in first place, with Japan coming second and China third. The growing volume of imports by Japan, China, and the United States lies behind the shift in the overall APEC region from net exports to net imports.

The main factor behind the differences among APEC's members in agricultural trade competitiveness is disparities in the endowment of farmland, the primary factor of production in the case of farming. The United States, Australia, and Canada enjoy competitive power as developed nations located on new continents and with large tracts of farmland per agricultural worker. The situation is somewhat different, however, in the case of fruits, vegetables, and other horticultural products, which are not heavily dependent on abundant farmland. The position occupied by the agricultural sector in the economy varies among APEC countries as a reflection mainly of the development stage. In such latecomers as Papua New Guinea and Vietnam, agriculture has a large economic share in the 20%–40% range, but in the advanced economies, it accounts for only a small percentage.

Most economies protect agriculture from imports with the aim of sustaining and increasing domestic production, reasoning that a stable supply of agricultural products is imperative for human life. In the APEC region, not just agricultural importers but also the exporting economies have adopted protective measures in such forms as tariffs and tariff quota systems. The degree of protection varies widely by economy and agricultural product, but in general there is a tendency for protection to be

light in developing economies and heavy in developed economies. Japan and South Korea in particular have raised very high protective barriers. Because many APEC economies have applied protective policies over a long period of time, strong resistance to liberalizing agricultural trade has developed. The latest round of WTO multilateral negotiations is stalled at present precisely because of differences of opinion in agricultural talks. In many of the free trade agreements APEC economies have concluded over recent years, moreover, agricultural products have either been excluded from liberalization or accorded special treatment, by, for example, setting long periods for liberalization to take effect. In the FTAs Japan has entered into, many agricultural products have been exempted from liberalization.

Discussion has begun in APEC on the possibility of constructing very free and open FTAs, such as the FTAAP and the TPP. It is said that Japan would have a hard time taking part in the FTAAP or the TPP on account of stiff domestic resistance to liberalizing agriculture. But this would mean that Japan would be unable to take the lead within APEC in proposing policies and constructing systems, and it might even be given the cold shoulder by other APEC members. Opening up the Japanese agricultural market would be of great service in enabling Japan to assume a trusted position in APEC, and it would also revitalize and strengthen the Japanese economy. Measures to open up the market would stimulate exports of agricultural products that enjoy a competitive edge, but they would be likely to depress production and cause unemployment in the case of products that are not competitive. To minimize the costs of this sort of adjustment, it will be important to exercise ingenuity, such as by slowing the speed of liberalization, and to promote domestic reform, including revision of land-use systems.

2.8 Economic Impact of the FTAAP: Analysis Using a Computable General Equilibrium Model

The Free Trade Area of the Asia-Pacific is a scheme that would eliminate the trade barriers in APEC's economies. According to trade theory, trade among APEC's members would expand as a result of the removal of these barriers, while trade between them and countries not belonging to APEC would contract. The FTAAP would thus have one effect of stimulating economic growth among the members through its influence on trade and another effect of reducing growth among the nonmembers. In a theoretical analysis using a purely economic model, these are the results that the FTAAP could be expected to produce, but in the complex situation of actual economies, the anticipated effects of the FTAAP are much harder to predict. This chapter of the report analyses the impact of the FTAAP on each of APEC's economies in a conceptualized framework of actual economic arrangements (a computable general equilibrium model),

making use of the market mechanism, which plays the central role in economic activities, in an explicit manner.

The analysis was performed using the most recent GTAP (Global Trade Analysis Project) database, which is for 2004. It consists of 19 countries and regions including 18 APEC members and the rest of the world, and it covered 21 industries. To assess the effect of the FTAAP, it simulated the results of liberalizing trade of goods and services for APEC overall, and to make comparisons, it also simulated the results of free trade agreements covering Japan, China, and South Korea; the ASEAN Plus Three; and the developed APEC members (the OECD members in APEC). Several scenarios were postulated for rice liberalization, which presents a stumbling block to Japan's conclusion of FTAs, and the influence of each was calculated.

The results of the analysis show that, as expected, the conclusion of FTAs could be expected to promote growth of GDP and trade in FTA members. For nonmembers, meanwhile, there would be a small negative impact or virtually no impact on GDP and trade. The FTAAP's positive impact on GDP would be largest in such economies as Vietnam, South Korea, Taiwan, and China. Of all the FTA arrangements, the one that would have the greatest beneficial influence on the economies taking part would be the FTAAP. In Japan's case, the FTAAP would boost GDP by 0.83%, compared with 0.51% for an advanced APEC countries' FTA, 0.49% for an ASEAN Plus Three FTA, and 0.42% for a Japan–China–Korea FTA. As for Japan's liberalization of rice in the FTAAP, we used a systematic sensitivity analysis to determine the confidence interval, since there are uncertainties regarding tariff rates on rice and scenarios of liberalization under FTAs. The finding was that the influence of the FTAAP on Japan's GDP would be in the 0.36%–0.92% range at the 90% confidence interval. That is, the impact would be positive.

2.9 The US Strategy toward Asia-Pacific: Focusing on APEC-Wide Integration

The United States has employed free trade agreements as a tool of its trade policy ever since the 1980s. Its first FTA was a 1985 agreement with Israel. In its relations with APEC members, it has put into effect NAFTA and FTAs with Chile, Australia, and Singapore, and it is negotiating other FTAs, notably with ASEAN and Malaysia. Furthermore, it has completed an FTA with South Korea, a major US trading partner, and the agreement at present is awaiting ratification by the US Congress. The United States is pursuing these agreements with other APEC members partly because APEC has been unable to deliver the kind of free trade it wants. At the same time, in 2006 it proposed the FTAAP concept, hoping that this would provide it with a means of maintaining and strengthening relations with East Asian countries, which have been

energetically concluding their own FTAs. The bogging down of the Doha round of the WTO has also stimulated American interest in the FTAAP concept. However, many people appear to question the FTAAP's feasibility for a variety of reasons. For instance, there is apprehension about the participation of China, which is classified as a nonmarket economy, and there is also concern about US trade with the Asian region, which is responsible for a large portion of the American current account deficit.

In working with East Asia's developing countries, the United States prefers to conclude trade and investment framework agreements (TIFAs) prior to starting negotiations on FTAs. TIFAs promote the improvement of systems by, for example, simplifying customs procedures, establishing agreements on sanitation and quarantine, and standardizing registration and certification for pharmaceuticals. Many TIFAs have contents comparable to those of FTAs, but the United States treats them as an intermediate step after which FTAs, which put the finishing touches to the economic reform process in the target country, are concluded. Since the United States in this way has positioned the FTA as an important trade policy, the agreements it signs have the reputation of being "gold standard FTAs" with qualitatively superior contents for realizing free trade and economic reform. Among the key components of the FTAs the United States has entered into are environmental protection, observance of labor standards, liberalization of services in which the United States is strong, and removal of behind-the-border barriers.

In the background of the US proposal of the FTAAP is the desire to reduce or escape injury from the rise of regionalism in East Asia and respond to the region's growing influence, particularly that of China. But while the FTAAP can be seen as the ultimate goal of the free trade frameworks in APEC, its formation cannot be accomplished quickly in an organization with as many as 21 member economies. Under the circumstances, the United States has expressed interest in participating in the aforementioned TPP, thereby moving ahead toward free trade with like-minded countries. Meanwhile, the foremost US concern in the Asian region is relations with China, a country with which the United States is running a large trade deficit and wrestling with problems in the political and security fields as well as the economic arena. It is possible that the United States will call on Japan to cooperate with it in dealing with Chinese issues. Japan will need to proceed carefully when extending such cooperation, keeping its own relations with China in mind. After all, China is a country with which Japan must maintain and strengthen a good relationship.

2.10 APEC as a Regional Institution: American Influence and Changes in Functions and Norms

The twentieth anniversary of APEC's creation arrives in 2009. The organization's history can be divided into four periods, each with a theme of its own: period 1 (1989–95), setting the liberalization agenda; period 2 (1996–2001), implementing liberalization; period 3 (2001–06), addressing security concerns; and period 4 (2006–), building a free trade area. The United States took the lead in establishing these themes, but on account of opposition from some members, it was unable to get all the results it wanted.

What the United States desires in the area of free trade is comprehensive, high-level liberalization, including rules for labor and environmental protection, as can be seen in the content of the so-called “gold standard FTAs” it seeks to conclude. It has been unable to realize its desires in the APEC framework, however, because the organization's decisions require unanimous consent. In actuality, even though liberalization of trade and investment is a key APEC goal, the organization adheres to nondiscriminatory, voluntary, and nonbinding action as behavioral norms, with the result that those policies that have encountered domestic resistance have made only slow progress. Because of this, the US interest in APEC as a vehicle for liberalization receded for a while.

In 2001, the year of the synchronized terrorist attacks on the United States, the threat of terrorism was on the rise around the world, and security issues became a pivotal concern of APEC. Even as the United States sought to stimulate interest in security measures, however, a growing number of economies centered on East Asian members countered with the assertion that APEC ought to stick to its original mission of serving as a forum for discussing economic issues. APEC positioned the adoption of antiterrorist measures as representing a desirable approach on the grounds that they were needed for achieving the organization's goals, since terrorist activities pose a threat to economic activities, but the Asian members uncomfortable with this tilt toward security began groping their way toward regional integration without the United States.

Early in the twenty-first century Asian member economies began to conclude FTAs including, ironically, discriminatory liberalization and binding content, principles they had refused to accept when advocated by the United States in APEC. Fearing that Asian members might damage American interests out of disregard for them, the United States proposed the establishment of a free trade area covering all of APEC's member economies. To some extent this US interest in the FTAAP was motivated merely by a desire to promote the negotiations in the WTO, or to prepare a fallback measure in the event these talks broke down. Resistance to the FTAAP concept was weakening in other

APEC members, as they themselves had gained interest in concluding FTAs with a discriminatory and binding nature. Nonetheless, there is no way this free trade area can be created in a short period of time with the participation of 21 members at different development levels and with differing economic systems. Under the circumstances, moves have picked up speed to conclude FTAs limited to like-minded members. At the present time, such a scheme is the Trans Pacific Partnership, which began as an agreement among Brunei, Chile, New Zealand, and Singapore and has drawn the interest of the United States, Australia, and Peru.

Japan, for its part, faces the stumbling block of opening its agricultural sector, and it appears to be watching from the sidelines as other members debate the FTAAP proposal and move forward on the TPP. But if Japan is to secure a leadership position in APEC and restore the vitality of the Japanese economy, it ought to take action by proposing and striving for the realization of an FTAAP with the kind of content it sees as important, such as trade and investment facilitation and economic and technical cooperation.

3 Proposals

APEC's member economies have achieved smooth economic growth with the help of exports and foreign direct investment. At the present time the region's economies are in a slump because of the global financial crisis, which was touched off by the subprime loan meltdown in the United States. If they can manage to rebound and return to the growth track, however, the smooth growth they enjoyed before the crisis should resume. As they recover and start growing again, trade and investment expansion will play a key role. To enable this expansion, liberalization and facilitation of trade and investment will be indispensable.

APEC's most important goal is the creation of an environment for free and open trade and investment. APEC's member economies adopted the Bogor declaration in order to realize this goal and prepared the Osaka Action Agenda to follow through on the declaration, and they have pursued liberalization on a voluntary basis since that time. It is hard to estimate, however, how much credit should go to APEC for the cuts in tariff rates by its members. They have made progress in lowering and removing barriers to trade and investment, but numerous barriers still remain in many of the members. According to a simulation performed with a computable general equilibrium model, the establishment of the Free Trade Area of the Asia-Pacific, a free trade agreement covering all APEC members, would boost the GDP of every member. The simulation did not include investment liberalization, but if that also occurs, the FTAAP's impact would be even greater.

The establishment of the FTAAP would have merits for APEC's members, Japan included. For this reason, Japan should actively promote the agreement's conclusion. There is, however, an impediment standing in the way: domestic opposition to liberalization of the agricultural sector, which is considered to lack competitiveness. In order to overcome the resistance to the sector's liberalization and make progress in concluding FTAs, the following can be considered. First, Japan can seek approval of exceptional measures so that liberalization takes effect over time in the case of the agricultural sector's uncompetitive products. Even in that case, though, these products would not be exempted from liberalization, which needs to apply to all products eventually. Second, Japan can seek approval of the application of safeguard measures when a sudden surge in imports causes injuries. Third, for workers who lose their jobs as a result of import expansion, Japan can provide technical assistance in such forms as training and education for skill upgrading, and it can provide income compensation over a limited time period. Fourth, Japan should also promote structural reform in the agricultural sector so as to increase efficiency in land utilization and distribution.

The general view is that it would be difficult to realize the FTAAP in the near future. In this context, some APEC members have begun work on high-level FTAs, notably the Trans Pacific Partnership (TPP). The TPP at present consists of the four members of Brunei, Chile, New Zealand, and Singapore (leading to the original nickname P4), but in 2009 the United States, Australia, and Peru also plan to take part, and some observers expect South Korea to join too if its FTA with the United States goes into effect. FTAs of this type centered on advanced countries are growing more numerous. If Japan is forever unable to conclude FTAs with these countries because of resistance to liberalizing imports of agricultural products, it will become subject to discriminatory treatment and suffer damage in the form of fewer export opportunities. To avert such a situation, firm resolve is required to move forward on opening the agricultural market.

Before Japan can decide on joining the TPP, it must conclude the ongoing negotiations for an FTA with Australia. Next, it would be best if Japan also entered into an FTA with the United States, which is becoming more interested in these arrangements. When FTAs with these important APEC members are in place, Japan should find it easier to conclude agreements with other members.

When preparing FTAs with APEC's members, Japan should preferably aim for agreements including all three of APEC's primary concerns: trade and investment liberalization, trade and investment facilitation, and economic and technical cooperation. A stronger effect on economic expansion can be anticipated when FTAs are framed as comprehensive agreements. In addition, the implementation of economic and technical cooperation can reduce the costs of the employment adjustment necessitated by

liberalization. Japan and its East Asian partners in the ASEAN Plus Six are now working actively to construct the Comprehensive Economic Partnership of East Asia, and like APEC, this arrangement also has three pillars of trade and investment liberalization, facilitation, and economic cooperation. Accordingly, Japan should give thought to coordinating the FTAAP and the CEPEA. While the success of this strategy will be crucial for realizing a bright future for our nation, it needs to be stressed once again that liberalizing the agricultural sector will be indispensable.

Finally, all of APEC's developed members, including Japan, should conduct an assessment of the progress toward achieving the Bogor goal by 2010, a year when Japan will host the annual meeting. Our first proposal is that Japan take the initiative in promoting this assessment. If the examination turns up areas where the goal has not been reached, the remaining obstacles must be verified, and the presentation of a plan for their removal should be required. In keeping with the APEC spirit, it will be best to allow each member to undertake this work on its own, but thought may be given to securing assistance from other members and experts. Our second proposal concerns the setting of a goal to follow the Bogor goal. While this will depend on the progress made in studies of the FTAAP concept, we recommend that Japan urge APEC in 2010 to make the creation of the FTAAP its next goal. By taking an active hand in the FTAAP process, Japan will be able to realize the creation of a free trade area beneficial to it. For these two proposals to be turned into reality, Japan must closely coordinate strategy with other APEC members, particularly with Singapore, the host for 2009, and the United States, the host for 2011.

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Japan Center for Economic Research (JCER)

Nikkei Kayabacho Bldg. 2-6-1 Nihombashi Kayabacho, Chuo-ku, Tokyo 103-0025, Japan
Phone:81-3-3639-2801 / FAX:81-3-3639-2839