

APEC IDEAS AND REALITY: HISTORY AND PROSPECTS

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INTRODUCTION

The need for Asia Pacific Economic Co-operation (APEC) emerged from the reality of deepening economic integration of the East Asian, North American and Southwest Pacific economies during the period of sustained, rapid internationally-oriented economic growth in East Asia. The increasing scale of Asia Pacific economic transactions and their expanding relative importance to all economies in the region generated awareness that national policy decisions taken in ignorance of their regional implications could damage a beneficent process of market integration. The success of economic integration in the Asia Pacific also generated awareness of the opportunity for further gains through the provision of a more certain and open environment for market exchange.

More particularly, as the scale of the Japanese and later other East Asian economies and external transactions expanded, there was recognition of a need for an international framework to contain the inevitable trans-Pacific tensions from rapid structural change. A need was recognised for providing a secure regional trade environment within which large, new entrants to the international economy, particularly Indonesia and China, could confidently commit themselves to internationally-oriented development strategies. There was also a need to provide a more open alternative to inward-looking sub-regional arrangements, which were given greater legitimacy through the 1980s. Within the Southwest Pacific, the interest in Asia Pacific Economic Co-operation derived partly from recognition that the alternatives to an open international economic framework in the Asia Pacific included the danger of exclusion from or invidious choice between inward-looking blocs in North America and East Asia.

Thus the motive for Asia Pacific Economic Co-operation was essentially conservative: to preserve and extend a process of market integration amongst

rapidly growing economies and their major regional partners. Asia Pacific Economic Co-operation in its first decade has had some success from this perspective. Along the way to realisation of these conservative aims, APEC became more ambitious, even radical, with the Leaders' commitment at Bogor in 1994 to free and open trade in the Asia Pacific region by 2010 and 2020. The elevation of ambitions increased interest in and the energy levels of APEC activities. It has contributed significantly to trade liberalisation in a number of APEC member economies over the past half decade. It has also introduced tensions into Asia Pacific Economic Co-operation, and a risk of disillusionment and reaction against APEC and trade liberalisation. Doubts about whether APEC has the right membership, constitution and institutional structure to realise the radical ambitions have contributed to a sense of crisis in APEC over the past two years. The manner of resolution of the tensions in the radical APEC agenda will determine whether APEC continues to play a major role in regional affairs.

The APEC story is about the evolution of ideas to fit an Asia Pacific reality that was different from that which shaped regional economic co-operation in Western Europe and later North America. It is the story of building institutions to fit the ideas that have emerged in response to the different reality. The evolution of APEC has faced a special challenge from the strength in North America of ideas and political perceptions formed in a North Atlantic reality. The contemporary tensions in APEC have their origins partly in this challenge. The resolution of the tensions and therefore the future of APEC depends significantly on the ideas which have shaped APEC expanding their influence in the North American intellectual and political heartland.

The influence of the APEC ideas in North America is closely dependent on Western Pacific economies demonstrating that the unusual Asia Pacific approach to regional economic co-operation can deliver substantial trade and investment

liberalisation. This has become more difficult in the aftermath of financial crisis in some East Asian economies, and in the current circumstances of economic stagnation and policy incoherence in Japan.

This paper introduces the realities and the ideas that have shaped Asia Pacific Economic Co-operation, and evaluates their influence on economic policy and contribution to regional economic integration. Have the results justified the intellectual and political investment in APEC? Is it possible to build on APEC successes, and to correct APEC approaches productively in response to some undoubted failures? Or will the weaknesses in APEC lead to disillusionment, and eventually to failure in APEC's most fundamental purposes? The paper argues that much is at stake, because the successes of APEC have been considerable, and failure would signal the emergence of sub-regional economic co-operation in forms that would impose large costs on APEC members and the global economic system.

APEC BOUNDARIES AND MEMBERSHIP

APEC's origin in regional integration through market processes defined membership naturally, according to the extent of countries' integration into the Asia Pacific economy. The initial natural selection was embodied in the participation in first Pacific Economic Community meeting (later Pacific Economic Co-operation Council (PECC)) in Canberra in 1980, and also in the first APEC meeting in Canberra in 1989. It included the then market economies of East Asia (Korea, Japan, the member states of ASEAN) which had sovereign political status, Australia and New Zealand in the Southwest Pacific, and the United States and Canada in North America. These were economies that were committed to internationally-oriented growth and conducted a high proportion of their trade with other Asia Pacific economies.

On these criteria, in the years of central planning China (until the new strategy of 1978 took hold and began to transform the economy and its international relations through the 1980s), Vietnam (until the collapse of COMECON in 1991), and the DPRK (still today) were excluded by the weakness of commitment to integration into the international economy.

While Hong Kong and Taiwan both qualified from the beginning on the economic criteria, there was an obvious difficulty until China was a member, given the international recognition of Chinese sovereignty. These issues were resolved with Chinese membership in 1991, importantly in a way that allowed full participation of China, Taiwan and Hong Kong.

The South Asian economies and the Soviet Union and its successors were not committed to deep integration into the international economy until the early 1990s, and have never yet conducted the major part of their external trade with Asia Pacific economies.

The small island economies of the Southwest Pacific were strongly internationally oriented in economic structure and conducted the large majority of their foreign economic relations with other Asia Pacific economies. But in their case, size and its implications for political and administrative capacity was an issue. At the first PECC meeting in 1980 the island economies were represented by the South Pacific Forum and subsequently Papua New Guinea (by far the most populous, with 5 million people) alone was admitted to APEC membership.

The boundaries were difficult to draw in Pacific Latin America, where international orientation was sometimes equivocal and where Asia Pacific orientation was overwhelming with a single APEC member, the United States.

The formation of NAFTA settled the issue for Mexico. Chile was straightforward on the original criteria, Peru less so.

The recent admission of Russia adds new complexity. APEC has now placed a moratorium on membership.

The original membership of APEC, while gaining coherence from commitment to internationally oriented growth and Asia Pacific concentration of foreign economic relations, was highly diverse in scale, levels of development, political culture and institutions, domestic economic structure, and open-ness to the international economy. This diversity carried large implications for regional economic co-operation. Amongst other things, it required a framework of international pluralism that allowed differences in domestic political and economic structure to sit comfortably alongside far-reaching economic integration.

The expansion of membership to China was necessary for APEC to achieve its fundamental objectives. One inevitable consequence was to reinforce the original conception of APEC as a vehicle for economic and not for strategic regional co-operation. The inclusion of Russia raises special complications because of the embryonic nature of market reforms and the fact that Russian external economic relations remain strongly weighted towards Europe.

THE ASIA PACIFIC REALITY

The phenomenon of sustained, rapid internationally-oriented growth in East Asia created the beginnings of an Asia Pacific community, and prompted the early discussion of Asia Pacific economic co-operation.

The phenomenon emerged first in Japan, Hong Kong and Taiwan in the early 1950s. Open-ness to foreign trade and payments, at first partial and halting except

in Hong Kong, allowed large and rapid gains from specialisation in production of labour-intensive goods for export. This was facilitated by the open-ness of the United States economy, reinforced then by the United States' strategic commitment to the success of non-communist Northeast Asia. Maintenance of reasonably stable macro-economic conditions encouraged high rates of savings and investment once growth momentum was established. Strong societal commitment to the primacy of the growth objective overcame the inevitable resistance to the structural effects of sustained, internationally-oriented growth. High levels of public investment in education, health and infrastructure — more effectively in Northeast Asia than later in Southeast Asia — removed bottlenecks to growth, and helped to maintain political support for growth by dispersing its benefits widely.

Economic success in Japan, Hong Kong and Taiwan provided models and opportunities for others. By the early 1960s, coinciding with reforms in Taiwan and Korea to increase international orientation and growth, labour scarcity and rising costs in Japan were corroding competitiveness in simple labour-intensive exports and strengthening comparative advantage in more capital-intensive industry. Hong Kong, Taiwan and Korea took over part of Japan's share in labour-intensive imports into North America and Europe. Japanese direct investment began to strengthen growth in labour-intensive manufacturing industries in developing Northeast Asia.

Singapore's separation from Malaysia in 1965 marked the first unequivocal commitment of a Southeast Asian economy to export-oriented growth. Singapore was joined by Malaysia and Thailand from the early 1970s, with exports and direct foreign investment then being enhanced by rising costs and structural change in Taiwan and Korea as well as Japan. Continued structural change in Japan towards more technologically sophisticated production created new opportunities for

investment in and exports from standard-technology capital-intensive manufacturing industries in Taiwan and Korea.

The Philippines made its first attempts at trade and payments liberalisation to support an internationally-oriented growth strategy in the early 1970s, but political economy constraints prevented clear success until the 1990s.

Indonesia had abolished exchange controls as part of its macro-economic stabilisation program in the late 1960s, but unlike any of the Northeast Asian economies, and more strongly than Malaysia, its comparative advantage in the early years of opening to the international economy was in natural resourced based products, especially oil. In the oil boom from late 1973 to the early 1980s, it responded to “Dutch Disease” effects on the competitiveness of manufacturing industry by increasing protection. It was not until the large falls in the oil price in the mid-1980s, supported by trade liberalisation and regulatory reform, that Indonesia joined the East Asian pattern of growth supported initially by rapid expansion of labour-intensive manufactured exports.

China’s engagement in internationally-oriented growth was initiated in December 1978, when the Communist Party’s Central Committee adopted Deng Xiaoping’s approach to reform and opening to the international economy. The reflection of strategy in detailed policy, institutional development and regulatory reform was slow, with important landmarks in 1984 (industrial economy and trade reform), 1987 (the commitment to a “planned socialist market economy”), 1988 (the “coastal economic strategy”) and 1997 (radical reform of the public sector and state-owned enterprises). China’s economy responded quickly to reform, with export specialisation in line with comparative advantage being reflected in rapid expansion of labour-intensive manufactured exports from the mid-1980s. At first, international orientation and rapid growth was concentrated in the coastal

provinces, but regulatory reform and investment in transport and communications infrastructure supported the gradual extension inland in the second half of the 1990s.

Vietnam's entry into the Asia Pacific economy was held back by central planning and membership of COMECON until the collapse of the Soviet Union. Since then, there has been rapid growth in output and foreign trade, but market reforms have been tentative and state-owned enterprises continue to dominate external transactions. Vietnam's foreign trade and investment is overwhelmingly with APEC members, but equivocation on reform, reinforced by the East Asian financial crisis since mid-1997, limits its scale.

For the past quarter century, the preponderance of the increase in East Asian external trade and investment transactions was with other East Asian economies and North America. From the mid-1980s until the eve of the financial crisis, the majority of export growth was to other East Asian economies. Access to the United States market had underwritten the beginnings of export-oriented growth, and the absolute size of the North American market remained substantial. From 1997, the United States temporarily resumed its role as the prime destination for export growth.

The United States was always closely linked to East Asian growth, as a market, and as a source of financial services, direct foreign investment and ideas and institutional models for economic and business management. As East Asian production and trade expanded through the 1980s and 1990s, the United States became linked to the region's fortunes in other ways, with trans-Pacific exceeding trans-Atlantic trade in the mid-1980s and continuing to grow more rapidly.

The Southwest Pacific was closely integrated into East Asian trade expansion from the beginning, as a result of proximity and exceptional complementarity in resource endowments. The East Asian trade and investment opportunity was an encouragement to trade liberalisation in Australia, which became more East Asian-oriented in its export patterns than any economy in East Asia itself.

The deepening integration of Asia Pacific economies required as a starting point reasonably open trade and payments, and liberalisation was important to the initiation of internationally-oriented growth in each new entrant. In China, the hangover of political constraints and uncertainties from the civil war and Cold War limited trade and investment with Hong Kong prior to the Sino-British Agreement in 1984, and with Taiwan and Korea until the late 1980s.

Deepening economic integration, the demonstration effect of successful trade liberalisation, and competition for direct foreign investment encouraged unilateral trade and investment liberalisation. This was important throughout the Western Pacific region in the decade from the mid-1980s, when there were major unilateral reductions in trade barriers in Japan, Korea and Taiwan (each mainly in relation to manufacturing), China, Indonesia, the Philippines, Thailand, Vietnam, Australia and New Zealand. Trade liberalisation in the major higher income East Asian economies, Japan, Taiwan and Korea, encouraged the transfer of manufacturing capacity in labour-intensive activities into China and Southeast Asia.

Unilateral trade and payments liberalisation for reasons of development strategy provided the opportunity, and market forces delivered the deepening integration. Market processes generated progressively lower transaction costs, expanding trade as surely as reductions in protection. This was especially important to the explosion of trade and investment ties between mainland China and its neighbours, and across the Chinese business communities of East Asia.

There has been debate through the 1990s about the extent to which liberalisation in the Western Pacific was unilateral, as an instrument of development strategy, rather than in response to conditions from aid donors, pressures from trading partners or negotiated outcomes of multilateral negotiations. Multiple causes, reinforced each other. Generally the East Asian macro-economies were strong, allowing governments to implement development strategy independently of conditions from bilateral donors and the international agencies. But the aid-linked external pressures were important in the early 1960s in Taiwan and Korea, in the Indonesian stabilisation period of the late 1960s, in Papua New Guinea through the 1990s, and in Indonesia, Thailand and Korea after the onset of financial crisis. United States political pressures connected to the bilateral trade imbalances played some role in the liberalisation of the mid- and late-1980s in Japan, Taiwan and Korea. While most APEC countries were GATT members, participation in multilateral negotiations was important to liberalisation decisions only for Japan before the Uruguay Round. Amongst Western Pacific economies, Uruguay Round commitments went beyond the momentum of unilateral liberalisation only in Japan and Korea, and in each of these mainly in hard corners of agriculture and services. As we will see, APEC participation added to the momentum of unilateral liberalisation in the 1990s. The main influence from the wider international community, particularly the multilateral institutions, was through encouragement and provision of technical assistance in support of internationally oriented economic strategy.

Thus for several decades, and most powerfully from 1985 until the financial crisis, there was a virtuous circle linking rapid economic growth, trade and payments liberalisation, increased direct foreign investment, trade expansion and reduction of private transaction costs through East Asia. Growth was supported by the rapid

expansion of intra-regional trade, which accounted for a majority of the export growth in East Asia in the decade from 1985.

This was the reality from which ideas emerged about more formal processes of Asia Pacific economic co-operation.

APEC IDEAS

It is common for new entrants to discussion of Asia Pacific economic co-operation to think in terms of conventional free trade areas, and to judge progress by the conventional criteria of such institutions. This was true of Japanese and Australian contributions to the first Pacific Trade and Development Conference in Tokyo three decades ago. It was true of participants from mainstream American policy discussion when they focussed seriously for the first time in the 1990s on Asia Pacific regional economic arrangements.

Mature consideration has always taken discussion down a different path, focussing on private transaction costs as well as official barriers, emphasising the positive sum nature of trade liberalisation rather than adversarial negotiation, and stressing the role of information, trust in international partners and their policies, and arrangements that are voluntary rather than enforced by supra-national authority.

This different path reflects strengths as well as weaknesses in the Asia Pacific environment for deeper economic integration. The Asia Pacific reality has limited the scope for progress through formal, negotiated, enforceable agreements. But the powerful momentum of unilateral liberalisation and deepening integration through market processes provided exceptional scope for gains through consultation, peer encouragement and voluntary co-operation.

The distinctive features of Asia Pacific economic co-operation emerged from academic discussion from the late-1960s in the Pacific Trade and Development conference series, business discussion from the mid-1960s in the Pacific Basin Economic Council, and from 1980 tripartite (business, academic and official) exchange within the Pacific Economic Co-operation Council.

Closer co-operative association and communication amongst government officials, business and a wider intellectual community can cause all parties to recognise their shared interests in open trade and investment more closely. They can reduce perceived and real risks of commitment to international orientation. They can lead directly to reductions in transaction costs in intra-regional exchange. A paper to the U.S. Congress in 1979 by two experienced participants in the Asia Pacific discussion recommended the formation of an OECD type institution, an Organisation for Pacific Trade, Aid and Development. Australian Prime Minister Bob Hawke reached for an OECD analogy in his call for the establishment of APEC in Seoul in early 1989.

If deeper Asia Pacific economic integration has been emerging from unilateral liberalisation and the actions of market forces, why is any inter-governmental process like APEC required? The conceptual answer, emphasised before the formation of APEC, is that some of the communication and co-operation services that reduce transaction costs and deepen integration have characteristics of public goods, and are under-supplied without leadership and explicit effort to internalise external costs and benefits. Now, ten years after the formation of APEC, we can apply an empirical test: has APEC raised the gains from regional economic integration? We will come back to this question later in the paper.

The task of APEC was to expand gains from deeper regional economic co-operation. Four aspects of this co-operation came to be identified in the APEC

discussion. All four emerged from the general objective, and were closely related to each other: an information-sharing role (the “OECD function”); trade and investment facilitation; trade and investment liberalisation; and economic and technical co-operation.

In the early years of APEC, there was considerable focus on the “OECD function” and trade facilitation. These tended to be seen by outsiders to the process and some insiders as soft areas of co-operation. Trade and investment liberalisation tended to be seen as the hard areas, by which APEC would be judged.

President Clinton’s elevation of APEC annual meetings from Ministerial to Leaders level was partly a reflection of growing recognition of the importance of the regional organisation. For some, it was a reflection of disappointment that APEC had not achieved more — of a desire to raise APEC’s aspirations. The elevation certainly raised aspirations, notably with the 1994 commitment under President Soeharto’s leadership to a radical program of deepening regional integration, including through free and open trade and investment in the Asia Pacific region by 2010 (developed economies) and 2020 (developing).

Early APEC discussion of trade and investment liberalisation concentrated on the role that APEC could play within the multilateral system. This built on and extended the Western Pacific senior trade official, meetings of the mid-1980s, which had encouraged Western Pacific support for what became the Uruguay Round, including a comprehensive agenda covering agriculture and textiles, and for full participation by East Asian developing economies. It also assigned an important role to convergence of perspectives on the advantages of internationally-oriented economic strategies, supporting more confident expectation that such strategies would not suddenly be undermined by protectionism in important Asia Pacific trading partners.

Support for the GATT/WTO, and for unilateral trade liberalisation, and for unilateral liberalisation within internationally-oriented strategies, sat easily alongside established APEC approaches to regional co-operation. In principle, the Bogor commitment to free and open trade in the Asia Pacific was also fully consistent with APEC-style co-operation. But the mention of regional free trade brought traditional North Atlantic perceptions of discriminatory free trade areas into play, especially but not only in North America, despite the fact that formal trading blocs had been explicitly rejected whenever the possibility had arisen in informed Asia Pacific discussion.

The Eminent Persons Group's two reports (1994, 1995) contained two contradictory models of regional trade liberalisation. The dominant one was the discriminatory free trade area — never explicitly defined, but implicit in much of the detailed discussion of the way forward. At the same time, there was more than genuflection to the established APEC commitment to open or non-discriminatory liberalisation. The contradiction was neither addressed nor resolved, and the irresolution introduced elements of uncertainty into the development of APEC for several years.

Given APEC's strong support for the unilateral trade institutions, a free trade area was feasible only under Article XXIV of the GATT, which requires formal agreement on comprehensive liberalisation over a defined period (by the early 1990s said to be 10 years). On any reasonable assessment, this was simply infeasible.

So was the Bogor Declaration mere puff, whose only possible consequence was disillusionment with APEC as an effective regional organisation?

A paper delivered to a CSIS Conference in Jakarta on the eve of the Bogor meeting, argued that there were ways in which the trade liberalisation component of the emerging Bogor Declaration could be given substantial content without trade discrimination. The key was to use an agreed goal of free and open trade by 2010 and 2020 to reinforce the on-going momentum of unilateral liberalisation in the Western Pacific. If all liberalisation were to be on a most favoured nation basis, the established momentum could be reinforced by sectoral agreements on free trade on a most favoured nation basis amongst sub-sets of APEC members. APEC including Leaders' meetings could review progress towards the Bogor free trade objective, building confidence in each country that it was not acting alone. Ultimately the sanctions were peer disapproval and recognition that some economies' slow progress could reduce the chances of success in a process that was valuable to each participant.

It was unlikely that the United States would initially be an enthusiastic participant, given its longstanding political commitment to reciprocity in trade agreements. It was important that Western Pacific members realised that it was not important for the United States to be a leading participant from the beginning. The United States was already a reasonably open market. The ultimate realisation of the Bogor objectives would depend on the United States polity noticing through the APEC discussions and especially the Leaders' meetings that internationalisation of historic importance was occurring in the Western Pacific, and accepting that this diffuse reciprocity was a basis for substantive American response. At this point, APEC could take the Bogor objectives into a new round of multilateral trade negotiations, with the goal of global free trade by 2020. The most difficult elements of protectionism in the Asia Pacific region ultimately would be unravelled in global negotiations within the WTO.

The APEC process gradually developed an approach to the Bogor objective. The Osaka meeting in 1995 made it clear that APEC liberalisation would be comprehensive, non-discriminatory and voluntary. Manila saw the tabling of individual country plans on liberalisation towards the Bogor objective, and approaches to measurement and peer review. Manila was the venue for agreement in sectoral liberalisation in information technology, which was taken up by the WTO at and beyond the 1996 Singapore ministerial meeting. Continuing frustration at apparent slow progress on liberalisation, especially in the United States, saw the initiation of more formal negotiations for Early Voluntary Sectoral Liberalisation in 15 sectors in Vancouver in 1997. The realisation of failure of that initiative at Kuala Lumpur in 1998, marked by Japanese unwillingness to participate in liberalisation of forestry and fisheries and realisation of United States incapacity to enter commitments except in the WTO, triggered disillusionment.

Economic and technical co-operation (“Ecotech”) has always been important to ASEAN participation in APEC, but has not been favoured by developed members. Increasingly “ecotech” within APEC has been defined in terms of technical assistance and human resource development in support of internationally-oriented development strategies. This is more acceptable than conventional development assistance in developed and developing members alike. Its success in this form is important to the future effectiveness of APEC as a regional organisation.

While I have defined “OECD-type”, “trade facilitation”, “trade liberalisation” and “economic and technical co-operation” components of Asia Pacific Economic Co-operation, the sophisticated APEC discussion has not drawn tight boundaries between them. The sharing of perspectives on economic trends, strategies and policies is an important element in trade facilitation, trade liberalisation and technical co-operation. Economic and technical co-operation in its APEC context

strengthens the base for trade facilitation and co-operation. Trade expansion and accelerated economic growth deriving from trade facilitation and liberalisation underpins commitments to all aspect of the APEC process.

Largely as a result of Southeast Asian influence, there has been little development of executive capacity within APEC. APEC has neither supra-national authority, nor the means for executive action if it had that authority. APEC members can agree on objectives and desirable courses of action. For their implementation, it must rely on decisions by member governments, either unilaterally, or through agreement between member government.

EVALUATION OF APEC

What difference has APEC made?

This is a complex evaluation, since Asia Pacific economic integration had been proceeding prior to the formation of APEC and would have delivered gains in any event.

There has been a significant APEC contribution on the *OECD FUNCTIONS* of sharing information and perspectives on economic performance, strategy and policy. There is increased awareness amongst business, official and intellectual communities in every APEC member of developments in other APEC economies.

One would presume without having hard evidence that the reduction in transaction costs associated considerable increase in interpersonal contact and information exchange has contributed to the acceleration of expansion of intra-regional trade and investment flows through the 1990s.

The financial crisis of 1997-99 provided a shock to regional trade expansion that might have led to major fractures in the regional trading system, and therefore might have contributed to cumulative decline into protection and trade contraction. It provided in an extreme form the type of shock against which the conservative original conception of APEC was meant to provide protection. Again, we cannot be certain of causation, but we do know that unlike the developed world in the Great Depression and most economies in postwar recessions, there was no significant retreat into protection in the crisis of the late 1990s — neither in the countries in deep recession, nor in their trading partners (notably the United States, China and Australia) where continued strong economic growth and East Asian currency depreciation and output contraction generated historically large deficits (or in China's case, declines in the surplus) in current payments. The story is not yet over in the United States, where the intensification of anti-dumping actions may yet accumulate into a problem of macro-economic significance. But Asia Pacific governments' policy responses generally did not gratuitously magnify the trade-contracting effects of the crisis. APEC's contribution came through increased awareness of the regional effects of individual economies' responses.

APEC in 1997 was not geared to respond to financial crisis, and its initial actions were clumsy. The Leaders' response at Vancouver in 1997, when crisis was evident only in parts of Southeast Asia, was banal. The Asia Pacific lost an opportunity to mitigate the contagion when APEC failed to sculpt a constructive regional response to the Japanese Ministry of Finance's proposal for an Asia Fund for this purpose, pushing a major part of the Japanese financial response into bilateral channels. Subsequently, APEC showed that it could play a useful role in response to financial crisis through the establishment of the Manila Framework, within which a number of senior Finance and Central Bank officials came together formally to discuss policy responses and institutional reform within the financial sector. The Kuala Lumpur Leaders' meeting provided an effective setting for

some regionalisation of Japanese bilateral financial support, through United States participation in activities complementary to the Miyazawa Plan.

At the same time, there were some obvious failures in co-operative policy development within APEC. Chinese membership of the WTO is an essential element in an effective regional and global trading system. In addition to being important in itself, it is a condition of Taiwan membership. In 1994 and 1999, China made major reform efforts designed to attract support for WTO membership, and each time the United States failed to respond creatively. Contact within APEC was not unhelpful, but in the end was ineffective. The failure in 1994 greatly complicated Chinese integration into the global food economy, and the failure in the first half of 1999 is potentially a setback for the Millennium Round of global trade negotiations.

In *TRADE FACILITATION*, APEC was unambiguously if modestly successful in contributing to reduction in transaction costs. For this success to be bought fully to account, a major research effort is required to quantify benefits.

In *TRADE LIBERALISATION*, current perceptions are unreasonably dominated by the failure of EVSL in 1998. On the credit side, APEC's continued and unequivocal support for the multilateral trading system helped to bring the Uruguay Round to a successful conclusion, and in 1996 played a major role in the WTO's first major liberalisation success, the information technology agreement.

The first eight years of APEC's life saw a considerable acceleration of unilateral liberalisation in many economies of the Western Pacific, and especially in economies which had once applied high protection to manufacturing (Australia and New Zealand) or all industries producing tradeables (China, Indonesia, the Philippines and Vietnam).

In Australia, the final and largest step in a process of dismantling high protection was taken in March 1991, and was strongly influenced by the discussion of Australia's expanding relations with the Asia Pacific region. New Zealand followed Australia, and its decision to take the final step to complete free trade by a date early in the next century became part of its APEC Individual Action Plan. While Australian liberalisation preceded the 1994 Bogor Declaration, Australia's participation in the Bogor understandings was of large and direct importance in preventing backsliding in the recession of the early 1990s.

Like Australia and New Zealand, developing economies of East Asia were on a path of unilateral liberalisation prior to the formation of APEC, and the new regional association provided a context for the acceleration of reductions in protection in the 1990s. China announced two major packages of trade liberalisation measures in APEC ministerial meetings in 1995 (Osaka) and 1996 (Manila), preferring voluntary action in APEC to the appearance of responding to bilateral pressures, in the absence of participation in WTO multilateral negotiations.

In Indonesia and the Philippines, major steps in trade liberalisation were directly related to the hosting of APEC Leaders' meetings and to the Bogor commitment to free and open trade and investment by 2020. There was some shift in the direction of liberalisation in the complex political economy of trade policy in Indonesia following President Soeharto's close association with the Bogor declaration, and this was influential in the liberalisation packages announced in 1995 and 1996. In the Philippines, the linkage was immediate. After several decades of Presidents failing to implement much-discussed liberalisation strategies, in 1996 the Philippines Congress supported the Ramos program of radical liberalisation in the lead-up, to and to provide the President with a platform of leadership for, the

Manila Leaders' meeting. In the Philippines, too, the APEC framework of voluntary commitments was more acceptable politically than response to pressure in bilateral or multilateral negotiations.

Elsewhere in East Asia, the links with APEC were more distant. Malaysia's downbeat pronouncements on APEC suggest that that country's large reductions in tariffs, announced annually with the budget, had other origins.

Liberalisation in Western Pacific economies — unilaterally as a matter of domestic strategy and through participation in APEC, and in multilateral negotiations — proceeded after 1994 at a rate that, if maintained, would achieve the Bogor objectives (APEC, 1996; Yamazawa, 1998). This was revealed in the Individual Action Plans defined in Osaka, presented in Manila, and subsequently updated annually. Did the Manila Action Plan and the IAP process assist this outcome? At least, it was part of the wider process of assuring individual APEC members that their own liberalisation was supported by continued expansion of opportunities in major regional trading partners.

In moving towards free trade by 2010 (Australia, New Zealand, Korea and Taiwan) or 2020 (developing East Asia and Papua New Guinea), the protection that remains may be harder to eliminate than that which has so far been removed or promised away. The voluntary processes and peer influence that have been influential so far will need to be supplemented by formal negotiations within the WTO in getting to the end of the road.

APEC influence on trade liberalisation is not so clear in the Eastern Pacific, especially in the United States. The test there will be whether the United States polity eventually recognises the importance of helping to sustain the historic

opening of the Western Pacific economies through its own commitment to free trade by 2010, ultimately implemented through multilateral negotiations.

APEC seems to have been important in influencing the shape of trade liberalisation within the region's three discriminatory trade blocks: the ASEAN Free Trade (AFTA); Australia-New Zealand Closer Economic Relations (CER); and NAFTA. Reductions in protection on a most favoured nation basis are in the process of removing most (Australian) or virtually all (New Zealand) discrimination against third country imports. In New Zealand the choice of end points was influenced by Bogor commitments. Similarly, AFTA members have mostly been implementing their commitments to intra-regional free trade by 2003 through most favoured nation liberalisation — in the Philippines explicitly in recognition of Bogor commitments, and in Indonesia and Thailand with APEC considerations being influential. APEC has been less important to NAFTA, but at least at the margins, the APEC commitments and process have heightened official awareness of the external costs of trade diversion.

The APEC process constrained proliferation of discriminatory sub-regional trading agreements. It made United States overtures on free trade agreements to some individual Western Pacific economies less compelling than they otherwise would have been. The presence of APEC inhibited enthusiasm for the emergence of an East Asian trading bloc, once briefly favoured by Malaysia. APEC was used explicitly by the Indonesian and Japanese governments in opposition to discriminatory free trade in East Asia. The ground may be slipping with perception of diminished success in APEC following failure in the EVSL in 1998, most importantly with MITI's promotion of discussion of a Northeast Asian or Korea-Japan free trade area.

ECONOMIC AND TECHNICAL CO-OPERATION attracted the least enthusiastic response from the developed members. Yet its success is crucial to ASEAN participation, and important to APEC realising its full value for all members. Amongst modest achievements, technical assistance in the financial sector delivered through APEC Finance Ministers and the Manila Framework has had value in the recovery from financial crisis, and has contributed to the strengthening of financial institutions and therefore to the view that open capital accounts can be consistent with domestic economic stability. The most important development in relation to ECOTECH has been the clarification of its role within APEC over the past several years. Gains will follow as these intellectual clarifications are absorbed into policy.

THE FUTURE

The growth in interdependence among East Asian economies and between East Asia and the Southwest Pacific and North America placed more formal co-operative arrangements on the regional agenda. If APEC did not exist, there would be efforts to build something like it. If the something like it were an East Asian bloc, it would be much less helpful to realisation of gains from co-operation, and damaging for the global trading system.

The unusual *modus operandi* of APEC, the distinctive commitment to support of the multilateral system and to non-discrimination, and the emphasis on voluntary association, are all inevitable consequences of APEC's history and membership. Three decades of regional discussions culminating in the APEC process have achieved a great deal in defining a new approach to regional economic co-operation, fully supportive of and complementary to the multilateral system, within the special constraints of a politically and economically diverse region.

APEC does not have the membership that everyone would choose. Papua New Guinea's political and administrative weakness raises questions that are best answered by a concerted effort through economic and technical co-operation within APEC. Papua New Guinea has been committed to the Bogor objectives, and has taken major policy steps to achieve them. In the Christian idiom favoured in that country, the spirit is willing but the flesh is weak. International technical assistance can strengthen the flesh. Russia's weak economic connections to the Asia Pacific raise many questions, most of which must be answered within Russia. It is as important for Russia as it is for APEC that its initial Individual Action Plans reveal commitment to progress towards free and open trade and investment. If they do, it is important that APEC members respond with encouragement, including through economic and technical co-operation. If they do not, it will be time for Russia and its APEC partners seriously to consider whether Russian membership can work.

APEC has important achievements to its credit, but the contemporary mood is one of disillusionment. The causes of this disappointment must be addressed urgently, or the process and commitments that have delivered positive results will disintegrate.

The central causes of disillusionment are the apparent irrelevance of APEC to the financial crisis, and the apparent ineffectiveness of APEC in contributing to expansion of trade and investment within the Asia Pacific.

APEC was not geared to play a major role in the financial crisis. Its traditions were oriented towards support of the multilateral organisations — in the case of financial crisis, the International Monetary Fund and the World Bank. In the end, APEC played this role, but with false starts, and with too little adding of value. It could have played a larger role in providing advice to the international

organisations on recovery policy and strategy. The meetings of APEC Finance Ministers and the Manila Framework provides a suitable mechanism for APEC members now to do more that is of value through technical assistance in the financial sector

While the urgent requirements when the crisis struck were outside APEC's comparative advantage, the established agenda of APEC is highly relevant to recovery from crisis. APEC has an important role to play, especially in Leaders' meetings, in building support for the maintenance of open trade policies in the economies now experiencing exceptional deficits in current payments, notably the United States and Australia, and in China, where large surpluses were been corroded by the crisis. APEC is the right forum for encouraging understanding of the value to the United States and to its Asia Pacific partners of accepting the large imbalances in external current payments that emerge naturally from open trade and investment policies. A large Japanese current surplus allows Japan to play its natural role in the recapitalisation of economies that have been damaged by crisis. A large United States (or Australian) deficit is consistent with large gains from trade and with profitable United States business leadership in the emergence of open financial sectors throughout the Asia Pacific.

The disillusionment with APEC's contribution to trade and investment expansion is premature. The contribution that is made by APEC trade facilitation is probably greatly undervalued, and will continue to be undervalued until the region has access to the results of authoritative research on these matters. On trade liberalisation, the disappointment stems mainly from failure to recognise contributions that came mainly through influence on the domestic policy-making process, rather than through formal negotiations. Failure to recognise the APEC role in influencing domestic policy decisions led to the attempt at more formal,

reciprocal negotiation of the EVSL, the failure of which is itself a major source of disappointment.

Three lessons need to be drawn from the failure of EVSL.

The first is that APEC has no comparative advantage in formal, reciprocal negotiations, and should not seek a role that it cannot perform well.

The second is a lesson for Japan. Japan placed at risk major national interests by granting excessive influence to sectors now of minor importance to its national performance. APEC will fail without effective leadership from Japan. Effective leadership requires the Japanese polity to assert national over minor sectoral interests.

The third is a lesson for the Asia Pacific as a whole about the United States. United States trade policy is for the time being at least deeply committed to reciprocity, delivered through formal negotiations. This is inconsistent with the APEC *modus operandi*. The United States will not quickly change, and it is neither possible nor desirable for APEC to change. The way forward is for Western Pacific APEC members, hopefully with support from some American participants, to recognise the importance of maintaining momentum in their own liberalisation, and to communicate the reality of those developments into the United States polity. APEC so far has failed in this communication.

United States Presidential participation in Leaders' meetings, with all of the political and media attention in the United States that accompanies it, is a principal vehicle for the necessary communication. Once the United States' polity's attention has been engaged, an opportunity can be created to complete the

implementation of the Bogor commitments through multilateral negotiations within the WTO.

One large risk of the current disillusionment is that it will encourage exclusive regional arrangements within East Asia. The East Asian Economic Caucus has enhanced credibility and new importance as a consequence of perceptions that APEC has failed. The annual meeting of leaders of ASEAN countries, Japan, China and Korea is the East Asian Economic Caucus at work. Within Japan, reaction to the regional response to the Asia Fund and to failure of EVSL has given new legitimacy to discussion of East Asian regional arrangements. There is no necessary harm in regular consultation at a high level amongst East Asian governments, and possibly some good. Harm would be done, however, if discussion drifted towards a discriminatory trading bloc in East Asia. The established APEC framework is Japan's, East Asia's and APEC's best protection against East Asian economic co-operation moving fatefully towards an exclusive bloc. A Japan-Korea or Northeast Asian regional agreement need not contain any element of discrimination. It would not be discriminatory if it were premised on the APEC objective of free and open trade and investment in the Asia Pacific by 2010. But without that anchor, it would be difficult to resist the introduction of elements of discrimination against outsiders. The inevitable international reaction would damage East Asian economic co-operation with the Southwest Pacific and the Americas.

Finally, APEC as an organisation that has at its centre commitment to the success of the multilateral trading system, and many of whose actions relate closely to the work of the WTO, cannot be expected to operate successfully if such important member economies as China and Taiwan continue to be outside the WTO. The continued exclusion of China now has much to do with wider political tensions between the Asia Pacific region's two most populous countries. This is a deep

problem at the heart of APEC. However clever the managers of the APEC process may be in managing the affairs for which they have responsibility, APEC will not make progress if problems in the Sino-American relationship fester, and China remains outside the WTO.