Northeast Asia:
The Role of International and Regional Economic Institutions and Regimes

Hugh Patrick

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Hugh Patrick is the R.D. Calkins Professor of International Business and Director of the Center on Japanese Economy and Business, Graduate School of Business, Columbia University.


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By Hugh Patrick
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Abstract

This paper considers the international and regional economic institutional environment within which the economies of Northeast Asia interact. One conclusion is that there are sufficient mutual economic relationships to think of Northeast Asia as a distinctive economic region. This is true both in terms of a narrow geographic definition—Japan, China, Mongolia, Russia, South Korea, North Korea—and a broader definition including Hong Kong and Taiwan. A second conclusion is that the World Trade Organization (WTO) is the single most important institution globally for these economies. The major regional WTO issue is China's accession to membership. It is clearly in everyone’s interest that China become a member and thereby increasingly integrated into the world economy, but membership should be on terms that will bring its trade policies into conformity with WTO standards and procedures within a stipulated acceptable time period.

Most of the paper is about the Asia-Pacific Economic Cooperation forum (APEC), and its potential regional institutional role. There are a number of issues which must be resolved if APEC is to successfully implement its future policy agenda of trade and investment liberalization, facilitation, and economic development. Various approaches are assessed in light of the free rider problem and timing concerns. Trade liberalization is the most contentious issue, given the lack of consensus on MFN treatment for non-APEC members, and the unwillingness of some members to engage in formal, comprehensive, and substantive trade negotiations. A new approach to trade liberalization, based on voluntary liberalization and peer group pressure has been proposed, termed “concerted unilateral liberalization.” Whether it will succeed depends on how willing APEC members are to reach substantive, concrete agreements to implement the vision enunciated at Bogor in 1994 of free trade and investment in the Asia-Pacific region by 2010 for developed economy members and by 2020 for the developing members.

* This paper has benefitted from comments by Alexander Rogojine, Zhan Shiliang, Chyuan-jeng Shiau and other participants in the Conference on Prospects for International Cooperation in Northeast Asia, and especially from Charles Morrison as well as Patricia Thayer.
The Northeast Asian economies engage in a wide range of economic transactions with each other, centering on trade but increasingly including foreign direct investment, technology transfer, bilateral and multilateral official development assistance, and private portfolio capital flows. This is true in terms both of a narrow geographic definition -- Japan, China, Mongolia, Russia, South Korea, North Korea -- and a broader definition which includes Hong Kong and Taiwan. If the United States is included, it changes the picture dramatically since it is such a large trading partner for all the Northeast Asian economies.

Tables 1 and 2 provide some basic facts on economic size and on bilateral trade flows among these economies. They report what is well known: Japan, China, South Korea, Hong Kong, and Taiwan are major exporters and importers. However, with the exception of Mongolia most of their trade is not with each other as a group, but with the United States, the European Union, Southeast Asia, and the rest of the world. Moreover, unlike the ASEAN economies, foreign direct investment flows into and among Northeast Asian economies have been severely limited by host country policies and economic conditions, though China is becoming an increasingly important exception. Nonetheless, there are not sufficient mutual economic relationships to think of Northeast Asia as a distinctive economic region. Perhaps for political reasons even more than economic, no one has seriously proposed any form of a comprehensive

\[ 1 \] Trade data for Russia are not included since very little of its total trade is with the other Northeast Asian economies and it is not possible for me to estimate its Siberian and Maritime Provinces trade separately. North Korea data are not readily available. Neither materially affect the discussion.
Northeast Asian economic regional institution. Economic forces are simply allowed to work, and they have been effective.

This does not mean that Northeast Asia is unimportant economically, politically, or in terms of institution-building and rules making. After all, it is the locus of two of the four dominant players in the Asia-Pacific, Japan and China; the United States and the ASEAN group of nations are the other two. Economic transactions and activities do not occur in a vacuum. They are carried out under rules, procedures, and business arrangements determined by national governments, international and regional governmental institutions, and regimes shaped by international agreements or customary practices. These set the "rules of the game" for the markets in which business enterprises engage in foreign (and domestic) transactions with each other. Moreover, international institutions provide a litmus test of the policies and commitments of members and potential members toward the institution and toward each other. My purpose here is to consider the international and regional economic institutions and regimes in which the Northeast Asian economies currently or potentially participate. Following a brief survey of the full panoply, I focus particularly on issues involving two trade-related institutions, the World Trade Organization (WTO, the successor to GATT) and the Asia-Pacific Economic Cooperation forum (APEC), and one potential institution, the East Asian Economic Caucus (EAEC).

The WTO is the single most important global economic institution. It was created January 1, 1995 under the Uruguay Round to absorb and strengthen GATT, the institutional foundation of the world trading system which embodies the long postwar history of setting the rules for trade
among market-oriented economies, and trade liberalization on an unconditional Most-Favored-Nation (MFN) basis. Among its many provisions the WTO expands coverage to services, strengthens the possible actions against domestic subsidies which distort trade, and provides enhanced dispute settlements procedures.  

Within Northeast Asia, however, China, Taiwan, Russia, Mongolia, and North Korea are not members of the WTO, as is discussed below.

There are Asian-Pacific and Asian regional and subregional governmental trade-oriented organizations, but none has great economic impact yet on the Northeast Asian economies. The U.N.’s Economic and Social Council for Asia and the Pacific (ESCAP), located in Bangkok, includes all Asian economies; it has not played a major economic role. ASEAN, the Association of Southeast Asian States, has been economically successful primarily by agglomerating and coordinating the bargaining power of its members in dealing with Japan, China, the United States, and the European Union. That power has been reflected in ASEAN’s negotiations with Japan on economic aid and in the formation and development of APEC. The ASEAN Free Trade Area (AFTA), established in 1993, aims to eliminate tariff barriers among the participant Southeast Asian members over the next 10-15 years. The potentially important issues are whether trade liberalization policies will be extended more broadly (APEC or the entire world), which seems likely; and the extent to which the prospects of participating in intra-regional trade -- the making

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3 A useful reader, encompassing selections on a range of topics and institutions, is Ross Garnaut and Peter Drysdale, editors, Asia Pacific Regionalism - Readings in International Economic Relations (Pymble, Australia: Harper Educational Publishers, 1994).
of components and parts in one ASEAN country and assembly in another -- will attract foreign direct investment from Japanese, South Korean, and other firms, which in fact is already happening in automobiles, consumer electronics, and office equipment.

Capital flows to and from the Northeast Asian economies are of increasing importance, and Japan plays a central role. Capital flows are of four types: bilateral official development assistance (ODA), mainly from Japan; multilateral government institutional loans from the World Bank and the Asian Development Bank (ADB); private investment portfolio capital through loans and purchases of equities and bonds; and foreign direct investment by transnational enterprises (TNEs). The World Bank, with U.S. leadership, plays a significant development financing role globally. The ADB, with Japanese leadership, plays a similar regional role. Both lend substantially to China, and are also important for Mongolia. North Korea, living in self-imposed isolation, is not a member of either institution. Taiwan, excluded from the World Bank, is a member of the ADB under the nomenclature Taipei China, and is a donor rather than a loan recipient.

Two private, market-based global regimes are very important for Northeast Asia and for the world: the foreign exchange market system and the private world capital markets system. The roles of governments are limited primarily to determining the nature and degree of access of their financial institutions and business enterprises to these markets.

With the breakdown of the Bretton Woods fixed exchange rate system, in the early 1970s,
supply and demand in currency markets have determined the exchange rates among the world's
major currencies, notably the U.S. dollar, Japanese yen, and German Deutsche mark. The
Deutsche mark is the anchor for a fixed exchange rate system among most continental Western
European nations. Most other smaller economies, including all those in Northeast Asia except
Japan, have pegged their respective currencies either to the dollar or to a weighted average in
which the dollar is predominant. The sustained appreciation of the yen relative to the dollar over
the past several years, and particularly in spring 1995, has caused great concern in Japan,
threatening to halt the recovery from long recession so slowly underway during the past year. It
is a mixed blessing for other Northeast (and Southeast) Asian economies, providing their
industries a competitive boost vis-a-vis Japanese rivals but also increasing their costs of servicing
yen-denominated debt as their currencies have declined with the dollar. Japanese policymakers
want international exchange rate system reform to be given high priority, but it is not clear what
can actually be achieved. Basically, establishment of a stable yen/dollar rate in a competitive
equilibrium in the near run requires expansionary macroeconomic policies in Japan and budget
deficit reduction (resulting in higher national savings) in the United States. In the longer run it
requires a commitment to better coordinated macroeconomic policies by the two nations. This
has been a serious problem for several years; policy makers (executive and legislative) in neither
country have been willing to pay the attendant political prices. In the longer run, should the
perception persist that the yen will remain strong, it will make creation of and membership in a
yen bloc more attractive to some Northeast Asian, and other Asian, economies.

Moreover, U.S. and Japanese perceptions differ substantially both as to the sources of the
unexpected yen appreciation in March-April 1995 to close to 80 yen/dollar, and as to what should be done. The realities are that the weak dollar is not yet hurting the U.S. economy, so there is little incentive for the U.S. government to take action; that Japan is being hurt by the yen appreciation; and that the Japanese government has not yet taken effective action to reverse the trend. These perceptions were clear at the APEC Finance Ministers meeting April 14-16, 1995. Incidentally, that consultative forum is not likely to be the locus for exchange rate system reform, which more likely would be considered under G-7 or IMF auspices.

The world capital market is founded on free, unrestricted short-term and long-term capital flows among the major national capital markets of Western Europe, the United States and Japan. It is a wholesale market of large-scale financial transactions among financial institutions and large industrial corporations. Its core is the Euro-currency market for bonds and loans, located mainly in London. This market developed independently of governments, although governments supervise and regulate participating institutions domiciled in their respective countries; its market-determined interests rates establish the world's basic interest rate structure. The world capital market has become an increasingly important source of borrowing by creditworthy Northeast Asian governments and large industrial enterprises.

The WTO and China's Membership

The major WTO issue for Northeast Asia is China's accession, with its attendant rights and responsibilities. China's effort to obtain membership is both a political issue and an economic
issue; I focus here on the latter. The WTO, like its predecessor GATT, is based upon market mechanisms and free trade principles on an unconditional Most-Favored-Nation (MFN) basis. Planned economies were excluded from GATT. While China's economic reform policies have emphasized privatization and markets, and have made considerable progress, the rules and institutional arrangements for foreign trade still constitute major barriers and problems. It is clearly in the long-run interest not only of China but of all economies that China become a WTO member and be increasingly integrated into the world economy. The key issue for China's membership is how far it must bring its trade practices into conformity with international standards and procedures, and how rapidly.

Negotiations over China's membership are politically sensitive and at times tense. They involve a wide range of complex issues. The United States has taken the lead in insisting that China substantially increase market access (tariffs and quotas are high); make rules, regulations, procedures, and policies transparent (currently opaque); and take related measures to conform more with international practices. In mid-April the European Union joined in informing China that it must make major concessions along these lines before it can be accepted into the WTO. Both American and European government concerns are influenced by increasingly large bilateral trade deficits with China. Chinese negotiators have argued that China is making rapid progress in privatization and trade liberalization, and it cannot be expected to accomplish everything at once.

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4 For articulation of a relatively tough position, see Gregory J. Mostel, "China and the WTO" (Washington: Economic Strategy Institute, November 1994); for an argument that the United States should work for China's early entry, see Nicholas Lardy, China in the World Economy (Washington: Institute of International Economics, April 1994).
It demands developing country status, which would exempt or substantially delay its required liberalization. American and European policymakers apparently oppose granting China blanket developing country status without countervailing commitments to ensure that China will not become an enormous free rider on the world trading system.

Like other developing economies, China pursues an industrial policy to support future growth industries; this is particularly important given the actual and potential size of its domestic market. The policy encompasses a wide range of industries, and is epitomized by the automobile industry. An important industrial policy instrument is protection of the domestic producers from import competition, counter to the intent and thrust of WTO trade liberalization objectives. On the other hand, unlike Japan and South Korea China has encouraged selected foreign direct investment in its automobile industry on its own terms. How the contradictions between industrial policy and trade liberalization policy are reconciled, or balanced compromises struck, is an important issue.

A related issue is accession of Taiwan to WTO membership, which it eagerly seeks as a developed economy. Taiwan is applying as a “customs territory,” a concept earlier used for colonies and under which Hong Kong long ago became a GATT/WTO member. Taiwan has proposed a substantial liberalization package in order to be accepted.5 Having met the economic obligations, the decision on Taiwan's membership is essentially political, tied to the decision on

5 "What Price Glory?", Far Eastern Economic Review (April 6, 1995, pp. 66-67), briefly reviews Taiwan's proposed concessions, and their anticipated effects on the Taiwanese economy.
China. China does not want Taiwan to be accepted into membership before China becomes a member. This may become a political problem if China decides to postpone its application for admission in light of what it determines to be unacceptable conditions, but it may also be a source of leverage on China by its major WTO interlocutors -- the E.U. and the U.S. -- which may threaten to move forward on Taiwan’s application in order to put pressure on China. Whereas China has apparently regarded WTO membership as a political issue involving its “acceptance” into the international economic community, its negotiating partners, especially the U.S., have argued that it is a matter of China’s having accepted the legal obligations required to bring its trade regime to WTO standards. They know that once membership is granted, the ability of outsiders to push further reforms in China’s trade regime will markedly decrease.

A related potential WTO issue is utilization of its new dispute settlement mechanism, substantially strengthened over the weak GATT provisions. It is desirable, politically and for economic institution-building, that economies settle bilateral disputes through the WTO mechanism rather than relying on unilateral retaliation. However, it is not clear whether and under what circumstances members will decide to avail themselves of the WTO dispute settlement mechanism. This may be tested shortly as the United States-Japan automotive and auto parts trade negotiations are played out, since both sides are threatening to take aspects of the dispute to the WTO.

APEC: A New Approach to Trade Liberalization?
The basic objectives of the Asia-Pacific Economic Cooperation forum (APEC), created in 1989, are to promote and facilitate, through liberalization of the rules for trade and investment flows, the development and growth of its members; and to do so in ways which not only conform to WTO rules but are supportive of the multilateral, global WTO system. In a very real sense APEC is a governmental institutional reaction to the economic realities of the substantial and increasing regional economic integration, led by private businesses operating through markets. Businesses and governments alike seek to increase market access and to reduce transactions costs by improvements in the rules of the game engineered by APEC. An APEC core concept is "open regionalism," which in its pure form means that any trade liberalizations arranged among APEC members will be extended on a non-discriminatory, unconditional MFN basis to all WTO members. Since this creates free rider problems, especially vis-a-vis the European Union, the United States and Canada (among others) have not been willing to accept this concept fully, as discussed below.

Unlike the WTO, of the Northeast Asian economies only Mongolia, North Korea and Russia are not among the eighteen members of APEC. China, Hong Kong, and Taiwan (termed Chinese Taipei) joined at the Seoul meeting in 1991 as a result of successful negotiations handled

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6 Together, the APEC economies comprise about one-half of world gross domestic product measured at exchange rates, though two-thirds consists of the United States and Japan. APEC exports are close to one-half the world total; about two-thirds of APEC member trade is with each other.

7 A broader definition of open regionalism, involving a bundle of policy changes which reduce barriers to trade in goods and services and to investment flows on a non-discriminatory basis through consensus, is given in Pacific Economic Cooperation Council, Pacific Economic Development Report 1995 (Singapore: PECC Secretariat, 1994), p 27.
by South Korea. Currently a two-year moratorium on new members is in effect until 1996. The Indochinese states are front-runners in any expansion of membership, followed by Russia, Peru and Colombia; India has also expressed interest in membership. Inevitably Japan and China play major roles in APEC together with the United States and ASEAN, as already noted. In addition, by virtue of their substantive policy proposals as well as economic size both South Korea and Australia are significant players.

APEC is a governmental institution at the Ministerial level. It is a young organization which has made considerable progress since its inception in 1989. To date it has been a consultative arrangement, based on annual ministerial meetings, and more frequent meetings of senior officials. So far it is administratively lean and simple. A small APEC Secretariat was set up in Singapore following the fourth meeting in 1992. Working Groups and two policy committees develop policy proposals and suggest modes of cooperation in a range of specific areas, sometimes in cooperation with PECC (Pacific Economic Cooperation Council), an active organization of business and academic leaders and government officials "in their private capacity."

APEC established the Eminent Persons Group (EPG) in 1992, consisting of one private citizen from most members to develop a vision of APEC's long-run objectives and modes of operation. Its reports for the 1993 meeting in Seattle and the 1994 meeting in Indonesia provided an intellectual framework for approaching many of the concrete issues that APEC must ultimately
The EPG, under its energetic American chairman C. Fred Bergsten, also became the setting where differences in concepts and approaches have been most forcefully articulated. Their deliberations have reflected substantial differences in substance and style among the APEC members, as well as diverse levels of development, economic systems, and size. The United States government is eager to achieve results quickly. It, Canada, Mexico, Singapore, Hong Kong and perhaps some others prefer to achieve trade liberalization through formal negotiations in the traditional way. Many Asian countries, including Japan, China, and many ASEAN members, prefer a more informal style, less contractual and less binding approaches, and reliance on peer pressure and moral force rather than treaty sanctions. The latter approach emphasizes confidence-building as a prior step in institution-building, and tends to shy away from issues that may be confrontational.

The two most recent meetings have moved APEC dramatically forward. At Blake Island, Washington in November 1993, President Clinton in effect raised APEC to the highest governmental level by convening an informal leaders meeting of the heads of government following the APEC Ministerial meeting. That summit also exposed political difficulties facing APEC. China successfully insisted that Taiwan's President and Hong Kong's Governor not be invited; and Prime Minister Mahathir of Malaysia refused to attend. At Bogor in November 1994, with the strong leadership of President Soeharto, the leaders committed themselves to achieving free and open trade and investment no later than 2010 for the industrialized economies and no

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8 See, in particular, the Second Report of the Eminent Persons Group, Achieving the APEC Vision - Free and Open Trade in the Asia Pacific (Singapore: APEC Secretariat, August 1994).
later than 2020 for the developing economies. This was a political rather than binding legal commitment, but with strong moral intent and peer pressure; and the leaders also agreed to work on a blueprint or agenda for implementation, a task their senior officials are now struggling to carry out. The biggest challenge facing the November 1995 APEC meeting at Osaka and probably several subsequent meetings as well is that of developing a long-term framework for implementing the Bogor vision.

The APEC policy agenda has three main interrelated components: trade and foreign direct investment liberalization; facilitation of trade and other economic transactions; and economic "cooperation" or promotion of the economic development of the developing APEC members. The economic development component includes human resource development through education and training, science and technology transfer, tourism, and infrastructure projects in transport, telecommunications, and energy. Japan is the major foreign aid provider in APEC. Facilitation includes the simplification, standardization, and (where possible) harmonization of product standards and testing procedures, customs procedures, reduction of administrative barriers, greater transparency, and similar more or less technical matters which are not of high visibility and politically less controversial, but in practice significant in reducing transactions costs.

The most difficult policy issues are how actually to implement trade and investment liberalization. This is the thorny agenda item placed in the hands of the Japanese government as host of the 1995 APEC meeting. What should the basic approach be; what about unconditional versus conditional MFN; how can APEC be not only WTO-consistent but WTO-supportive; how
should the differences in levels of development be dealt with?

APEC has rejected the establishment of a Pacific free trade association (FTA) since, by reducing trade barriers only among members, an FTA discriminates against non-members, is trade diverting and, though allowed, often is not ultimately supportive of WTO objectives and principles. AFTA runs counter to the principle of open regionalism, embodying unconditional MFN. Many APEC economies, including Japan, appear willing to extend any APEC-based trade liberalizations on an unconditional MFN basis. However, as already noted, the United States, Canada and some others are unwilling to extend on an unconditional non-reciprocal basis any reductions in trade barriers to the European Union, not only on free rider grounds but because that would sharply reduce EU incentives to participate in a new global round of trade negotiations and thus, in their minds, not be conducive to future WTO liberalization. The U.S. position is not surprising, since it has a very large market and great bargaining power, unlike smaller economies with far less bargaining power.

How, then, to proceed? The Second EPG report proposes a four-pronged approach by member countries: engaging in unilateral liberalization; making an APEC commitment to reduce barriers to non-members on a MFN basis while achieving region-wide free trade; extending benefits of APEC liberalization to non-members on a mutual reciprocal basis (conditional MFN); and allowing any individual APEC member unilaterally to extend its APEC liberalization to non-members on either an unconditional or conditional basis. This package papers over the lack of consensus on MFN by allowing members to behave differently.
Although Americans often perceive the trade liberalization process to involve negotiated mutual concession among economies, in practice a large majority of the APEC economies have engaged in substantial unilateral deregulation and liberalization policy packages in recent years, including in Northeast Asia Japan, China, South Korea, Mongolia, and Taiwan. This is textbook economics: an economy on net balance benefits from its own trade liberalization even if its partner does not liberalize. Of course it benefits more if its partners also liberalize; those are the benefits of the WTO and APEC. However, when its bargaining power is small it makes sense to liberalize unilaterally. It is textbook politics, however, that liberalization is economically costly to previously-protected, entrenched, organized interests -- mainly domestic producers of import-competing goods -- who will attempt to impose political costs upon those making the decision to liberalize. The practical question, accordingly, is how much further will countries liberalize unilaterally without external pressures and benefits?

China, Malaysia and Thailand prefer a purely unilateral approach, since they want flexibility and the ability to protect domestic industries until they become internationally competitive. That position is unlikely to be acceptable. In contrast, the United States, Canada, Mexico, Singapore and Hong Kong want GATT-like negotiations, with firm timetables and enforceable commitments. Others do not want to go that far. Indonesia has proposed a middle way, "concerted unilateral liberalization."

Three of the four approaches are based on the assumption that there will be APEC-wide liberalization. They allow for divergence among members in application of the open regionalism
principle. While the EPG pragmatic compromise approach was not specifically endorsed in the Bogor Declaration, it may well serve as the basis for proposals put on the agenda at Osaka.

A different approach to the free rider problem, which minimizes it, has been proposed independently by Ross Garnaut of Australia and Paul Wonnacott of the United States: to negotiate trade liberalization initially on those products for which the APEC economies as a group are predominant suppliers to the world market (including each other); and to extend the liberalization on an unconditional MFN basis to all countries, since in practice other countries are small suppliers. Products for which APEC has a world market share of 80 percent or more comprise 19 percent of APEC's exports and 16 percent of its imports. An alternative would be to negotiate liberalization of major product categories where trade is primarily among APEC members; electronics equipment is a good candidate.

It is particularly difficult for APEC to define a concrete action plan to implement trade liberalization. The traditional procedure -- to enter formal trade negotiations among members, to trade concessions, to set timetables, and to sign and ratify a legally binding treaty -- does not seem to be acceptable. That has been the American approach in past trade negotiations and earlier certainly was the preferred procedure in its approach to APEC. However, the Republican Congressional victory in the November 1994 elections certainly means that is not now possible for the President to obtain fast-track trade negotiation enabling legislation under which Congress can

only accept or reject ratification of any ensuing treaty without the power to amend it. Indeed, even earlier in the fall it appeared that support for further fast-track legislation was waning among some influential Democratic members of Congress as well as Republicans. More important, most of the Asian countries (including, I understand, Japan and China) oppose entering formal negotiations resulting in a legally binding agreement; they prefer instead a more informal, consultative progress to achieve consensus on the degree and pace of liberalization.

The concept of "concerted unilateral liberalization" develops a new approach to trade negotiations. Each country will unilaterally develop its own liberalization program, and bring it to the APEC table for discussion and consultation. No doubt each country will be criticized for being laggard, and will be asked to do more, particularly in its sensitive or difficult areas. This mode of "negotiation" (perhaps better termed consultation) relies primarily on peer pressure, though no doubt understandings would be reached as to what in effect will be mutual concessions. Each country would then revise its program, and announce it. As I understand it, these consensual decisions for each country to liberalize unilaterally are consistent with WTO provisions so long as the country does so on an unconditional MFN basis. Discriminatory treatment of non-members is acceptable under GATT Article 24 only where a free trade area is established which involves liberalization of substantially all trade. It is not clear how, in such an arrangement, under WTO rules the United States or other countries could "unilaterally" extend concessions only to other APEC members while requiring reciprocity (conditional MFN) from non-members.
On first appearance, this seems to be a recipe for inaction because there are no legal commitments and no enforcement mechanisms. Since the procedure depends critically upon peer pressure, it remains to be seen how vigorously economies would liberalize under "concerted unilateral liberalization." Nonetheless, unilateral liberalization by one member has competitive effects on the policies of others. It was not mere coincidence that Indonesia announced a liberalization of its foreign direct investment regime in early June 1994 following U.S. delinking of its human rights policies and its application of MFN status toward China. And Indonesia's May 1995 announcement of a specified schedule of tariff reductions is a signal, perhaps a goad, to other APEC members. The viability of APEC in the longer run requires all members to liberalize trade and investment, and no one wants to be seen as undermining APEC.

A further issue is the timing for reaching the commitment to free trade and investment flows in the Pacific. The Bogor Declaration stated that advanced industrialized economies should achieve this goal by 2010, while the less developed ones have until 2020. This represents a continuation of the "special and differential" treatment embedded in GATT, though under attack in recent years as no longer required for any but the poorest nations. Certainly the U.S., Japan, Canada, Australia, and New Zealand are in the 2010 group. It appears that China, Thailand, the Philippines, Malaysia and Papua New Guinea expect to be in the 2020 group. It is reasonable that Singapore, Hong Kong, South Korea, Taiwan, and Chile will be in the 2010 group; and Soeharto has expressed his hope that Indonesia will be as well. The 2010 group comprised four-fifths of APEC exports to each other in 1993; on the other hand, present trade barriers are much higher in the 2020 group, so the potential for trade growth through liberalization is greater.
The time sequence of the liberalization process is a concrete issue that has to be addressed. There will surely be a grace period of several years before any APEC-wide liberalization process begins. Will liberalization proceed in equal annual amounts, will it be greater in earlier years, or greater in later years?

Considerable progress will be made at the Osaka APEC meeting, though less than the United States is seeking. (By definition it will be a success, since no one -- except perhaps Malaysia -- wants APEC to fail.) It is unlikely that the Japanese Prime Minister will exercise personal and political leadership like Soeharto or Clinton; that should not be expected in light of usual Japanese low-key approaches to diplomacy and leadership opportunities. However, Soeharto evidently continues to play a central role; he wants to see the Bogor Declaration implemented.

At the February 1995 APEC senior officials preparatory meeting in Fukuoka, Japanese officials proposed a Partners for Progress program which placed primary emphasis on the developmental component of the APEC agenda, including allocation of some of its ODA funds to the APEC Secretariat. This was responsive to ASEAN pressures to expand and transform Japan’s foreign aid program, but was criticized in that it intruded North-South, donor-recipient issues into the APEC process. However, to the extent that the developmental component of the APEC policy agenda is addressed, to some degree that is inevitable. Following the February meeting the Japanese senior officials set in place a process to elicit by June inputs from the other APEC members, on the basic themes of liberalization, facilitation and cooperation, and established
two frameworks -- senior officials meetings (SOMs) and special SOMs -- leading to a blueprint for the Osaka meeting. It is too early to know the substance of the action plan blueprint, how much progress will be made, and how the lack of consensus on certain key issues will be dealt with.

My expectations are that concrete progress will be made at the Osaka conference on training and other developmental agenda items and in a number of facilitation areas. There will probably be agreement on the general principles of an overall trade liberalization action plan, with specifics to be decided at subsequent meetings. Since it was agreed upon in principle at Bogor, there will probably be a decision on a timetable for accelerating the Uruguay Round commitments (even though China and Taiwan are not signatories). That alone would be a significant step.

My overall evaluation of APEC is positive. It is beneficial to all its members. Perhaps its most important substantive contribution in the near future will be in the facilitation of trade and related economic transactions, where opportunities for simplifying procedures and reducing transactions costs abound. Its developmental activities are certainly useful, though perhaps they would occur anyway. Trade liberalization is the most contentious and difficult issue, especially given the lack of APEC consensus on unconditional versus conditional MFN treatment of non-members. Moreover, some countries -- certainly Malaysia and perhaps China -- are reluctant to engage in concrete, substantive, comprehensive APEC trade discussions. For China, its APEC negotiations must be significantly dependent upon the outcome of its negotiations to enter the WTO. Japanese officials have expressed reservations about agriculture. Much depends on how
willing APEC members are to put peer pressure on each other, and to respond to the pressure they receive.

At this stage the APEC process is just as important as the results. The APEC Ministerial and leader summit meetings, and the preparations for them, are important in themselves. They build knowledge, trust, and confidence; raise consciousness of each other's circumstances; and develop networks. Moreover, movement is in the right direction; the goals are highly desirable. And it should not be forgotten that APEC is young, and its processes and institutional arrangements are still fragile.

APEC has been particularly important for the United States, and for those desiring active American involvement in Asia. APEC has provided a coherent, region-wide focus to U.S. Asian economic policy. It provides another mechanism for liberalizing trade and expanding market access. It potentially mitigates the heavy U.S. reliance on bilateral economic negotiations. And it has been an important education in Asia for U.S. government officials from the President on down. There are now APEC offices in every relevant U.S. government department, and a very competent U.S. Ambassador-designate to APEC, a new position.

Of course APEC is far from a panacea; it cannot resolve all regional economic issues. Some have gone so far as to say that APEC is irrelevant, others that it is potentially dangerous. One strand arguing irrelevance says that Asian-Pacific economic integration is market-led (which is correct) and that governments have no significant role (incorrect). Establishing rules and
harmonizing them is a key role governments can play in the building of market institutions.

Another strand of argument is that the really key economic issues are not region-wide but bilateral and triangular, among China, Japan, and the United States. These are certainly very important relationships that probably will continue to be managed directly; however, it is possible that the larger audience of other APEC members will have a mediating influence.

The potential danger of APEC is that it might become an inward-looking, discriminatory trading bloc which thereby undermines the global role of the WTO. That is not going to happen. All APEC members well understand that they benefit most of all from a liberal, open global trading system, and they will do nothing to undermine the WTO. Rather, they correctly see APEC's role to be complementary to and supportive of the WTO. This underlies the emphasis on open regionalism, and the rejection of a free trade area. In trade facilitation and in other areas it serves as a negotiating (or consultative) laboratory for new issues not yet dealt with by the WTO. Most importantly, APEC is very likely to be the source of efforts to enter, in due course, the next round of global trade liberalization negotiations -- maybe even termed the APEC Round.

**Challenges to APEC**

APEC faces challenges from two potential alternative institutions: the East Asian Economic Caucus (EAEC), and the Western hemisphere "Free Trade Area of the Americas."

Both contradict the goals of APEC.
The EAEC was initially proposed by Prime Minister Mahathir of Malaysia to encompass the Southeast Asian ASEAN nations, and in Northeast Asia China, Japan, and South Korea. This proposed organization is explicitly Asian; it excludes Australia and New Zealand as well as the United States, Canada, and Mexico. Mahathir's stated purpose is to have a consultative forum to discuss economic problems and free trade issues. The way Mahathir has presented the EAEC concept, for instance at his UN speech in 1991, has been clearly racist: anti-white, anti-Western. However, that certainly does not mean that other supporters of the EAEC concept see it in such racist terms.

U.S. policy makers have reacted in a strongly negative way to the EAEC proposal, only in part for emotional or anti-racist reasons. They see it as divisive, at the least diverting attention and effort from APEC and at worst undermining APEC and its objectives. There is concern that a negative Congressional reaction would make it more difficult to fight protectionism targeted toward Asia. Moreover, Japanese participation in EAEC would weaken the U.S.-Japan relationship, and raise the spectre of a new-style Japanese Asian co-prosperity sphere.

Indeed, EAEC's purposes remain unclear. Its most credible potential role is as a threat: that if the U.S. moves away from APEC, East and Southeast Asian nations are prepared to move ahead on their own. More benignly, since APEC has in fact become the authoritative dialogue mechanism, if an Asian (or Western Pacific) caucus were to form which was not only APEC compatible but APEC supportive, it might not be so bad. The difficulty remains, nonetheless, that Mahathir has used the EAEC concept to reduce rather than enhance trust and confidence.
Credibility requires economic power, namely the participation of both China and Japan in EAEC. China had expressed willingness to participate, which is not surprising. Japan has been caught in an in-between position. On the one hand it wants to improve and deepen its relations with other Asian nations; on the other hand it wants to maintain its fundamentally close relationship with the United States. Japan would like to do both, serving (in its own perspective) as a bridge. However, EAEC is an either/or, not both/and choice. American policymakers and analysts view Japan's participation in EAEC as a turning away from the United States. In April 1995 Japan decided not to attend a proposed meeting in Thailand only of Asian economic and trade Ministers after Malaysia vetoed its proposal that Ministers from Australia and New Zealand be invited as well. Fearful that the meeting will be interpreted as the formation of an Asian-only caucus (EAEC), Japan decided to defer its participation. This suggests, however, that Japan might be willing to participate in a Western Pacific Economic Caucus in which Australia and New Zealand were also members.

The other challenge to APEC is the commitment of 34 Western Hemisphere democracies to negotiate a comprehensive "Free Trade Area of the Americas" made at the Miami summit


11 At the Conference on Prospects for Cooperation in Northeast Asia, a Japanese former senior official suggested that Japanese participation in EAEC would be possible only if it were correctly perceived as being within and supportive of APEC, and not regionally divisive. Specifically, Australia and New Zealand should be included; Hong Kong and Taiwan, as members of APEC, should be included; and the EAEC have very clear rules of transparency and could be correctly perceived as not undermining Japan's relations with the United States.
meeting in December 1994, three weeks after the Bogor APEC meeting. This was a result of the earlier United States Initiative of the Americas. A Western hemisphere free trade area is in seeming conflict with the U.S. commitment to APEC. The Western Pacific economies are far more important economic partners for the United States than Latin America, (aside from Mexico which is already in the NAFTA free trade area), and their growth rate is likely to make this even more true. This is a contradiction the United States must resolve. While immediate negotiation of a Western hemisphere FTA is unlikely, a gradual, pragmatic, ad hoc approach in which subregional economic integration occurs first seems in the works. Indeed, it is probable that trade liberalization will move ahead more rapidly than within APEC. There apparently is a greater commitment to move ahead in Latin America; there are fewer cultural problems and probably a lesser sense of threat; and NAFTA may be easier to access.

Outward-looking free trade areas such as NAFTA, AFTA, and the CER, as well as the APEC approach, can be complementary to global, multilateral liberalization. Countries may want to test themselves against smaller, neighboring economies before opening themselves to global competition (though in practice this has often been a dangerously inward-looking approach). They may initially be able to generate deeper or broader liberalization than global negotiations. They can serve as negotiating laboratories for new issues not yet addressed in the WTO or other global fora. Much depends on intent and political will. Indeed, with the proliferation of presumably outward-looking regional approaches to trade liberalization -- APEC, the Free Trade

Area of the Americas, the very recent suggestion of an Atlantic free trade area encompassing the U.S. and the European Union -- perhaps the world is in fact moving to a new global WTO round by the process of universal coverage of outward-looking regional free trade areas.
Table 1. Northeast Asia Basic Economic Indicators, 1992

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (millions)</th>
<th>Area (1000 sq.km.)</th>
<th>GNP/capita¹ (dollars)</th>
<th>GNP¹ (billion)</th>
<th>GNP/capita² (dollars)</th>
<th>GNP² (billion)</th>
<th>Merchandise Exports³</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>124.5</td>
<td>378</td>
<td>28,190</td>
<td>3,509.7</td>
<td>20,160</td>
<td>2,509.9</td>
<td>9.7</td>
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<td>1.162.2</td>
<td>9,561</td>
<td>470</td>
<td>546.2</td>
<td>1,910</td>
<td>2,219.8</td>
<td>15.6</td>
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<tr>
<td>South Korea</td>
<td>43.7</td>
<td>99</td>
<td>6,790</td>
<td>296.7</td>
<td>8,950</td>
<td>391.1</td>
<td>25.7</td>
</tr>
<tr>
<td>North Korea</td>
<td>22.6</td>
<td>121</td>
<td></td>
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<tr>
<td>Mongolia</td>
<td>2.3</td>
<td>1,567</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Russia</td>
<td>149.0</td>
<td>17,075</td>
<td>2,510</td>
<td>374.0</td>
<td>6,220</td>
<td>926.8</td>
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<td>9,373</td>
<td>23,240</td>
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<td>10,202</td>
<td>211.7</td>
<td></td>
<td></td>
<td>38.5</td>
</tr>
</tbody>
</table>

**SOURCES:**
World Bank, *World Development Report 1994*, Table 1 (pp 162-3), Table 30 (pp 220-1), Table 1a (p228), Table 13 (pp186-7); Far Eastern Economic Review *Asia 1995 Yearbook*, pp 14, 16 (Taiwan)

¹ U.S. dollars at exchange rates.

² Purchasing power parity, in U.S. dollars.

³ Merchandise exports are calculated as a percent of GNP at official exchange rates. Hong Kong excludes re-exports.
TABLE 2. Northeast Asia: Bilateral Merchandise Trade Shares (1993, percent)

<table>
<thead>
<tr>
<th>PARTNER</th>
<th>CHINA</th>
<th>JAPAN</th>
<th>KOREA, REP</th>
<th>MONGOLIA</th>
<th>SUB-TOTAL</th>
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</thead>
<tbody>
<tr>
<td>CHINA</td>
<td>12.28</td>
<td>17.28</td>
<td>3.13</td>
<td>0.09</td>
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<tr>
<td>HONG KONG</td>
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<tr>
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<td>28.40</td>
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<tr>
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<td>1.21</td>
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<td></td>
</tr>
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</tr>
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<table>
<thead>
<tr>
<th>PARTNER</th>
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<th>SUB-TOTAL B</th>
<th>UNITED STATES</th>
<th>WORLD</th>
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<td>19.90</td>
<td>13.01</td>
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</tbody>
</table>

Horizontal: share in country's total exports, imports.
Vertical, World: share of country in world export to, and imports from, it.

Note: China's trade with Hong Kong excludes re-exports to the United States and elsewhere

Source: International Monetary Fund trade statistics tapes, February, prepared by PAFTAD Secretariat, Australian National University.

¹Subtotal B equals Subtotal A + Hong Kong + Taiwan