

**PECC Statement**  
**APEC Ministerial Meeting**  
**Beijing, 7-8 November 2014**  
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**Co-Chairs of the Pacific Economic Cooperation Council (PECC)**

On the occasion of APEC's 25<sup>th</sup> anniversary, we congratulate you for past achievements and look forward to working with you in the same spirit of partnership and support to achieve our common mission.

**PECC and APEC Relationship**

Over the past quarter of a century, as one of your official observers and as a forerunner to APEC, we have contributed to your work by bringing together experts from the academia, business, and government to address issues to further promote the vision of an Asia-Pacific community. This has included groundbreaking work on issues such as Non-Binding Investment Principles; Competition Policy; Guidelines for RTA/FTAs; and a new growth strategy to mention just a few.

This statement is based on our discussions that resulted from our 22<sup>nd</sup> General Meeting held here in Beijing just two months ago as well as our ongoing work program.

**APEC in Context**

Since APEC was founded, the regional and global economies have undergone profound changes – the very changes that APEC was created to help foster and shepherd. Today, we are confronted by an extraordinary set of circumstances that will challenge whether the vision of an open Asia-Pacific driving the global economy will endure or fall by the wayside. Our annual survey of the regional policy community highlighted three key challenges: slowing growth; an international trading system badly in need of updating to modern business practice; and rising income inequality.

**Promoting Growth**

Amongst the priorities selected by opinion-leaders in our annual survey, two of the top five were related to growth: innovative development, economic reform and growth; and the APEC Growth Strategy. When the Global Financial Crisis unfurled six years ago, governments responded with unprecedented stimulus packages. At the same time, it was recognized that these were only temporary measures to prevent collapse of our economies. In time, reforms would be needed to address the systemic problems that allowed such a crisis to occur in the first place and to foster the emergence of new growth engines.

By and large, the first set of reforms have taken place, mostly in the financial sector. We note with some concern, however, that some of these regulations are inappropriate for emerging economies that need to boost the role of the financial sector in their development. Secondly, we fear that the structural reforms have been lacking. The failure to implement structural reforms was cited as the third highest risk to growth in our annual survey. While there is no one set of prescriptions appropriate for this diverse region, the potential of the services sector to drive growth is immense.

Our region has made enormous strides in liberalizing trade in goods, though outstanding protectionism evident in tariff peaks continues to severely restrict trade in certain primary products, non-tariff barriers and regulatory differences remain difficult challenges more widely, and barriers to services trade remain significant. The latter are all the more egregious as the barriers that prevent the international

trade of services also hamper the development of a domestic services sector. Services are the critical foundation for competitiveness as well as connectivity and development. We have worked closely with your Senior Officials and ABAC to define a work program on services that will contribute to the growth of the services sector in the region.

### **Innovative Growth**

In developing the APEC Growth Strategy, the emphasis was on the need to promote new engines to replace those that had been driving growth in the recent past. While this challenge remains a fundamental one, another challenge today is that many of the region's economies have now reached middle income status. With that status they can no longer rely on their low-cost labor advantage to grow. Deeper and more far-reaching structural reform is therefore necessary, which includes addressing the remaining trade barriers cited above. As noted in our State of the Region report productivity has plateaued and as part of economy-wide structural reforms we need to implement policies that focus on innovation rather than just adding more labor or capital to drive growth.

We therefore welcome the focus on innovative growth and policy reform. A coherent set of structural reforms that enhance productivity over the medium to long term are necessary to ensure the continued growth of the region – especially emerging economies.

### **The Regional and International Trade System**

The Free Trade Area of the Asia-Pacific has been the top priority for APEC Leaders' discussion in our annual survey for many years. Even though the idea has been discussed in detail, it remains only an idea without any form. The rationale for the FTAAP was simple – the WTO Doha Round was failing, APEC's own concerted unilateralism was seen to be insufficient, and in their place the regional trade system was becoming a spaghetti bowl of bilateral and regional trade agreements. Today there are two major attempts to consolidate the regional trading system: the RCEP and the TPP.

Our studies have shown significant benefits in both pathways. It is imperative and urgent to complete these negotiations. The larger the trade arrangement, the greater the benefits and less the diversionary effects. The APEC Leaders' vision of an FTAAP, although not necessarily limited to the APEC economies, remains valid, and work should be done to explore best next steps to make further progress toward the realization of this vision.

Value chains have powered much of the economic integration of this region. These value chains typically cut across both the current TPP and RCEP memberships, suggesting the importance of broader liberalization or sector liberalization where possible. Neither of these negotiations includes both China and the United States, and both currently do not include a number of APEC economies.

We welcome the work undertaken by APEC this year. While the RCEP and the TPP provide way-stations for experimenting with and adjusting to deeper integration, they will not achieve an FTAAP on their own. The FTAAP needs to be ambitious enough to incorporate the merits of both TPP and RCEP. Much effort and ingenuity will be needed to achieve this balance.

### **Principles for Free Trade in the Asia-Pacific**

To this end we have established a taskforce to try to address this. We believe that an approach that looks at the operation of value-chains has much to offer, though it should not become the only prism through which trade policy is viewed. An initial discussion that brought together analysis of both global

value chains as well as the existing trade agreements offered the following principles for furthering free trade in the Asia-Pacific:

1. Align with the Bogor Goals
2. Pursue relevant coverage
3. Link with the WTO
4. Add onto existing regional FTAs and RTAs
5. Recognize the continuing key role of APEC
6. Be transparent and commit to significant progress
7. Support development

The next step is to undertake further work to make these principles operational. A report from our taskforce's discussions is attached to this statement, and we commend to you the chapter from our State of the Region report which outlines the benefits, challenges and possible modalities of moving from the existing pathways to a broader inclusive FTAAP.

### **Financial Cooperation**

Our recent discussions have highlighted financial cooperation as an integral part of future regional economic integration. The areas for financial cooperation include financial services liberalization, capital account liberalization, capital market development, and the establishment of integrated, safe and efficient settlement systems.

We note that although APEC's roots have been in support for the trade system, the broader idea of the Asia-Pacific supporting the global system should also be applied in the financial policy realm. Thus far, financial cooperation in Asia has been to provide safety nets in the event of liquidity shortages- the Chiang Mai Initiative, but there is a vast agenda ahead that needs to be addressed – including how to finance the various initiatives to promote connectivity in the region.

### **Connectivity and Inclusive Growth**

We welcome the progress made to turn the framework for connectivity into an actionable blueprint. The region - both emerging and advanced economies - badly needs investment in infrastructure – to overcome bottlenecks to growth and to provide extra stimulus to growth. We emphasize that connectivity should be seen through the prism of inclusivity. We need to address the supply side constraints through improved infrastructure, improving our institutions both domestic and regional, and providing the skills and knowledge to people so they can participate in the global economy.

### **Restoring Confidence in the International System**

One of the central principles that underlie APEC is that it would not be an inward-looking process but would foster an integrated but open regional economy. While trade and financial flows understandably top the regional and international agenda, we cannot ignore the need for cooperation on sectoral issues.

To this end, we welcome the discussions of APEC Energy Ministers and emphasize the need to find mechanisms to ensure that markets are competitive and remain open to all. Confidence in the international markets for energy and food, which are so fundamental to growth and stability, is a prerequisite to a stable regional system.

### **A Regional Partnership for the Future**

As we celebrate APEC's 25<sup>th</sup> anniversary, we think it would be useful to look back and try to define contemporary relevance. One of the founders of PECC and APEC, Dr. Saburo Okita wrote 25 years ago that, "*with this vigorous economic activity in and by the Asia-Pacific region, it is expected this region will be able to provide the locomotive force for the world economy in the 21<sup>st</sup> century.*" While we have highlighted some of the challenges facing our region, we emphasize the enormous potential of the Asia- Pacific to continue to drive global growth.

During our General Meeting it was suggested that a Pacific economic partnership that encapsulates existing regional initiatives could be the starting point for ensuring that the region continues in this role. Such a partnership could include ensuring that the TPP and RCEP are concluded, addresses the need for infrastructure and connectivity, and innovative growth amongst others.

Thank you.

## Free Trade in the Asia-Pacific:<sup>1</sup> Principles and Processes

### Background

In 2010, after 3 years of internal study and debate by officials and ministers, APEC leaders committed to taking ‘concrete steps toward realization of a Free Trade Area of the Asia-Pacific (FTAAP)’. Furthermore, they stated that ‘An FTAAP should be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership, among others.’<sup>2</sup>

This year, one of APEC’s goals is advancing regional economic integration. At APEC SOM 1 held in Ningbo, China proposed a work program with four possible objectives for 2014:

1. To enhance transparency among RTAs/FTAs in this region.
2. To strengthen capacity building activities in pursuit of an FTAAP.
3. To formulate a Work Plan towards the realization of an FTAAP.
4. To launch a feasibility study of an FTAAP

To date, the TPP has completed, by some measures 19 rounds of negotiations, and in East Asia, the Regional Comprehensive Economic Partnership (RCEP) between ASEAN and those economies with whom it has an existing trade agreement has also begun negotiations with a deadline of 2015 for completion.

At a speech at a PECC Conference in February 2014, Singapore’s Trade Minister Lim Hng Kiang proposed that there was now a need for principles that would guide the development of the FTAAP.

This paper responds to these developments in the regional trade discussions and builds on the work that a number of PECC task forces and member committee projects have undertaken in recent years to suggest areas which a set of principles might cover. It is based on a high level roundtable discussion the plenary session discussions on regional economic integration during the 22<sup>nd</sup> PECC General Meeting as well as the 2014-2015 State of the Region report. It concludes with a preliminary draft of principles, which can be refined and extended in further work which PECC would offer to lead.

### Views on Regional Economic Integration

PECC’s annual survey of the policy community on the state of the region ranked ‘Further liberalization of trade and investment in the Asia-Pacific as a whole’ as the second most important factor for further Asia-Pacific growth, just behind the success of structural reforms in China.

The survey also highlighted the importance of regulatory transparency issues which was selected as the most important issue to be dealt with in regional trade agreements followed by investment and services.

However, the survey also revealed a high amount of skepticism about whether any of the pathways would be completed within the next 3 years. Only 35 percent of respondents thought the TPP would be completed within the next 3 years with 27 percent thinking it would be unlikely. The results were

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<sup>1</sup> Prepared by Christopher Findlay on behalf of the PECC Task Force on Free Trade in the Asia-Pacific

<sup>2</sup> The push for an FTAAP has a long history, in recent times primarily from the APEC Business Advisory Council (ABAC) – see <http://www.pecc.org/research/ftaap>

similar for the RCEP, with 27 percent of respondents thinking it would be completed within the next 3 years and 24 percent unlikely.

These results encourage efforts by policy makers to raise confidence in the achievement of regional integration, including through the FTAAP, and also provide some guidance on the coverage of those efforts that would contribute to that outcome.

## Context

Important elements of the context for this discussion of the design of the next steps in work on regional integration and the FTAAP are experience to date in bilateral agreements, results on estimated economic impact of larger regional arrangements, the case for taking a value or supply chain perspective on its design and the constraints of domestic political responses to proposals for new trade agreements.

### a) Contribution of bilateral preferential agreements

A number of firm-level studies point to low rates of utilization of FTAs by business. Recent studies<sup>3</sup> find that about a quarter of firms for whom an FTA may be relevant actually make use of its provisions. This rate varies significantly between economies and some studies (although not all) find smaller firms less likely to make use of an agreement. Contributing factors are lack of awareness of the provisions of the agreements and their complexity, particularly the specification of the rules of origin, which adds to the costs of their use. A recent study reports that its respondents are asking for more comprehensive agreements which include larger economies.<sup>4</sup> It will also be important that ways be found to encourage businesses in the region to actually utilize any new agreements and their provisions, which will include consideration of their coverage, as noted above, and their complexity.

### b) Modelling results

The negotiations underway are regarded by many as pathways that will all lead to wider regional integration, the benefits of which are significant. Available research suggests that the benefits of the TPP would be nearly US \$290 billion for its members, of RCEP to be much greater at over US\$620 billion for its members and of comprehensive free trade in the whole region closer to be US\$2.5 trillion or more for APEC members.<sup>5</sup> There is other work modelling variants of FTAAP structures, but they also confirm the benefits of larger membership when compared to TPP and RCEP. The estimated economic gains are also much larger when the contribution of integration to capital accumulation and productivity growth rates are included.<sup>6</sup> The economic gains also vary according to the coverage of the agreements with NTM reduction (associated with domestic reforms) adding significantly to the benefits of tariff reform. The further inclusion of trade facilitation measures add to the benefits by a factor of 4 on top of tariff and NTM reductions. The results show that economies do benefit from the joint actions of others although the extent of this contribution relative to the benefits of their own actions varies

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<sup>3</sup> See for example, Masahiro Kawai and Ganeshan Wignaraja (2010), *Asia's Free Trade Agreements: How is Business Responding?*, Edward Elgar, and The Economist Intelligence Unit (2014), *FTAs: fantastic, fine or futile?: Business Views on Trade Agreements in Asia*, EIU, London

<sup>4</sup> See the EIU report in note 3.

<sup>5</sup> PECC, *State of the Region 2014-2015*, PECC, Singapore, forthcoming.

<sup>6</sup> Sangkyom Kim, Innwon Park and Soonchan Park (2013), 'A Free Trade Area of the Asia Pacific (FTAAP): Is it desirable?' *Journal of East Asian Economic Integration*, 17(1), March, 3-25 and Kenichi Kawasaki (2014), 'The relative significance of EPAs in Asia-Pacific', RIETI Discussion Paper Series 14-E-009.

among the group. The studies also show significant trade diversion effects of any agreements on non-members, building the case for an agreement with wide membership and in the case of the FTAAP drawing attention to the value of consideration of its global impacts and the likely response of the rest of the world.

c) The supply chain perspective

The framework for most thinking about the design of trade policy in the region is now the value chain setting. Following the OECD, '*A value chain identifies the full range of activities that firms undertake to bring a product or a service from its conception to its end use by final consumers.*'<sup>7</sup> The chains appear to be organized around hubs (China and Japan in Asia, the US in North America and Germany in Europe). Chains are regional because contact between people is important in their management and proximity makes that easier. However, in the case of Asian value chains there is a significant reliance on markets outside the region for final demand.

The value chain literature also suggests several imperatives for policy reform for economies to be competitive as links in the value chain. Some of these can be undertaken unilaterally, and there is advantage in doing so. But in other areas such as standards there is value in coordination. Trade agreements can play such a role. Such agreements are more valuable if they include a group of economies that are aligned to the value chain maps. Discussion is turning to how these pathways of RCEP and the TPP as well as the Pacific Alliance might contribute to that outcome. This focus is also valuable for work on the FTAAP.

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#### d) Domestic politics

Comprehensive large member agreements may generate more benefits than smaller and/or narrower agreements, but just because the estimate of benefits is greater, success may not follow. Comprehensive large member agreements may generate a more significant domestic political response in each member economy. The intensity of this response, for example, is striking in the case of TPP (see Figure 1). The opposition is prompted by a number of issues, including the impact on employment of reform of traditional market access measures, the implications for particular sectors such as agriculture and the consequences of new provisions such as intellectual property regimes. As has always been the case, measures to support the confidence within each economy of the local capacity to adapt to and capture the benefits from integration will be important.

Figure 1: Opposition to TPP<sup>8</sup>



### Principles for Free Trade in the Asia-Pacific

Working from these four main elements of the context of the proposal for an FTAAP, from a recent PECC high level roundtable discussion hosted by the University of International Business and Economics and from the PECC General Meeting in September 2014, we are able to identify elements of principles which participants thought would be important for success in the development of free trade and investment in the region. These principles can also be aligned with the list of the headings under discussion in APEC of principles for progress on this goal of regional economic integration. The next step is to undertake further work to make these principles operational.

#### 1. Align with the Bogor Goals

The purpose of the arrangement and the vision of what is to be achieved must be clear. The Bogor goals for all APEC economies to achieve free and open trade and investment are an important reference point, but the Leaders Statement of 1994 also says their goal was to ‘enhance the prospects of an

<sup>8</sup> <http://www.dailykos.com/story/2014/01/30/1273714/-Reid-s-opposition-to-fast-tracking-Trans-Pacific-Partnership-gives-foes-time-to-fight-trade-deal>, <http://japandailynews.com/japanese-farmers-protest-imminent-entry-into-tpp-trade-talks-132503>, <http://www.freemalaysiatoday.com/category/opinion/2013/08/27/tppa-shrouded-with-uncertainty/>, <http://livenews.co.nz/2014/04/06/gpja-497-2-of-3-news-on-aotearoa-nz/>



accelerated, balanced and equitable economic growth not only in the Asia-Pacific region, but throughout the world as well'. This remains the ultimate goal.

## 2. Pursue relevant coverage

A value chain view of international business helps identify items which are important to cover in any approach to free trade in the region. These include the value of: taking a packaged approach to include all dimensions of business models now in operation as well as the relevant policy measures affecting them; taking care to ensure coverage of services, investment, trade facilitation, intellectual property, and competition policy and working on regulatory coherence; of achieving predictability; adopting a common set of commitments; using a rule of open accession; and adopting a simple and liberal rule of origin. According to the modelling results, coverage should extend to NTMs and trade facilitation measures, going beyond the familiar other border barriers. In a world of value chains, simplifying border procedures such as customs have a more powerful effect than reducing tariffs. This perspective has the potential to be more inclusive than the traditional sector-based approach to liberalization. It will also encourage business participation.

## 3. Link with the WTO

There must be an understanding of how together these approaches lead to free trade in the region and how they can be taken into and connected with higher level structures and agreements, the WTO in particular. Application of these principles may lead to consideration of sectoral approaches to the design of commitments and policy reform or work by like-minded groups on specific issues. The translation of results to the WTO setting helps to ameliorate the risks associated with the discriminatory effects of large-member preferential agreements. It also offers the best regime for the construction of efficient value chains.

## 4. Add on to existing regional FTAs and RTAs

Any commitments or policy reforms made in this process should add to what has already been committed to in existing agreements, either bilateral or multi-member agreements. The manner in which RCEP and TPP contribute to the goal separately or jointly should also be examined: the question arises of whether whatever they achieve there will be 'unfinished business' for reaching regional free trade and if so how that should be managed.

## 5. Support development

By whatever pathway, successful implementation will benefit from efforts to support the active participation of all members, in the processes of reaching agreement on how to proceed, in managing any formal negotiations that follow, in implementing commitments and in adjusting to their consequences. Capacity building programs in all these areas are valuable.

## 6. Recognize the continuing key role of APEC

There are various pathways to free trade and investment in the region which can be envisaged, some working from existing agreements and others involving new agreements. There is also scope to conceive and develop new forms of partnership. Whatever the formal pathways, they lie 'outside' APEC. There is no expectation that APEC would be involved in processes leading to binding agreements. But APEC retains a critical role, which includes refining and sharing a common vision, discussing principles for achieving that vision and taking actions including capacity building to build the confidence among members to reach that outcome. As Leaders said in 2010, 'APEC will make an

important and meaningful contribution as an incubator of an FTAAP by providing leadership and intellectual input into the process of its development, and by playing a critical role in defining, shaping, and addressing the "next generation" trade and investment issues.... APEC should contribute to the pursuit of an FTAAP by continuing and further developing its work on sectoral initiatives’.

#### 7. Be transparent and commit to significant progress

Transparency on the reporting of commitments and the progress delivered in each member economy will be useful to identify opportunities for participation in regional and world markets. It will also build confidence about the capacity to manage change and provide a response to the domestic resistance to change in each economy. All participants would also be expected to liberalize progressively and to achieve significant results. It will then be valuable to share experience of the consequences of reform and of the application of domestic measures to support the goals of balanced and equitable growth.