

REVISED DRAFT

FEASIBILITY STUDY ON BOLD REFORMS TO REINVIGORATE THE APEC LIBERALIZATION AND FACILITATION AGENDA

1, Introduction

APEC's mid-term review is intended to assess progress toward the Bogor goals and to lay out a "road map" toward the eventual achievement of the Bogor goal of 'free and open trade and investment' by the target dates of 2010 for developed economies and 2020 for developing economies. It is clear that by the use of the words 'free and open' the APEC leaders intended not only that barriers to trade and investment would be removed, but that this would be done on a basis that would not involve discrimination among APEC member economies. Full support for the WTO-based multilateral trading system is also a key principle underlying the Bogor goals. Increasingly, APEC leaders have also been focusing attention on the objective of encouraging the development of an Asia-Pacific "community".

The Bogor goals are to be achieved through a combination of trade and investment liberalization ('reducing barriers to trade and investment and by promoting the free flow of goods, services and capital among (APEC) economies') and facilitation ('eliminating administrative and other impediments to trade and investment'), supported by capacity building through programmes of economic and technical cooperation.

APEC economies have been using a mixture of modalities to move toward achievement of the Bogor goals

- Multilateral liberalization through the WTO: Conclusion of the WTO's Doha Development Agenda (DDA) negotiations is currently anticipated in 2006 or 2007. A successful DDA outcome will make a substantial contribution towards the achievement of Bogor goals by APEC economies. Nevertheless it is clear that even a successful DDA will stop well short of 'free trade and investment'. Tariffs may be reduced to zero on some but certainly not on all goods, and it remains to be seen how far the negotiations will move toward removing the quota restrictions and other non-tariff barriers that continue to affect world trade. It is clear that full liberalization will not be achieved in all service sectors, and investment has been dropped from the negotiating agenda.
- Preferential Trade Agreements (PTAs): APEC economies are actively pursuing bilateral and in some cases plurilateral PTAs with each other. Many of these provide for extensive liberalisation between the partners in these agreements, but

in general even the most ambitious agreements do not provide for liberalisation of trade in all goods and services, and lengthy implementation periods in some cases stretch well beyond the Bogor target dates. The liberalization that occurs within these agreements discriminates against APEC economies that are not party to them and the proliferation of agreements without provision for consistency in key areas such as rules of origin threatens to fragment more than integrate the markets of the region, causing the transaction costs associated with doing business in the region to rise rather than fall.

- The APEC Process operates on the basis of “concerted unilateralism”, encouraging APEC members to move forward together with voluntary commitments to liberalization and facilitation initiatives, motivated by a combination of self-interest and peer pressure. In practice the emphasis has increasingly been on facilitation rather than liberalization commitments.
- Unilateral liberalization: In the early and mid-1990s a number of APEC economies undertook unilateral liberalization and facilitation initiatives, independent of their involvement in multilateral, regional or APEC processes. Unilateral initiatives have been much less in evidence in recent years although they have not disappeared entirely.

The Individual Action Plans (IAPs) of APEC economies are intended to document the progress of each economy toward achievement of the APEC goals, and to provide a basis for the exertion of “peer pressure”, reinforced by the peer review exercise that has just been completed. In principle each economy’s IAPs should record the progress made through all four of the processes listed above, and not only through the APEC process. The IAPs and the peer review exercise have been useful, but they have some shortcomings as mechanisms to guide APEC economies through the remaining steps needed to achieve the Bogor goals. These shortcomings and possible ways to overcome them are discussed later in the report.

There is no doubt that APEC economies have benefited greatly from the liberalization and facilitation of trade and investment that has been achieved as the combined outcome of the four processes listed above. Further progress can be expected over the next five years but on present trends this will fall far short of the achievement by APEC developed economies of any reasonable definition of the Bogor goals. ABAC is therefore rightly concerned to identify and recommend ways to reinvigorate APEC’s liberalization and facilitation agendas, and this report is intended to contribute to its deliberations on this issue.

The report begins by discussing the constraints applying to each of the modalities open to APEC economies in their liberalization and facilitation efforts. Understanding these constraints will be helpful in identifying the steps that APEC economies could realistically take to reinvigorate momentum toward the Bogor goals. In the light of these constraints it then considers the options open to APEC for reinvigoration of its liberalisation and facilitation agenda.

2. Constraints in Voluntary Liberalization and Facilitation

APEC economies face important legal and political constraints in pursuing liberalization and facilitation on a voluntary basis through concerted liberalization.

2.1. Legal Constraints

- The non-discrimination principle enshrined in GATT Article I prevents them from preferentially reducing barriers or providing each other with preferential treatment in relation to rules and formalities involved in export and import of goods, unless this is done through the establishment of a free trade area or customs union complying with the provisions of GATT Article XXIV (or with the provisions of the “Enabling Clause” of 1979 in the case of agreements between developing countries).
- Similarly, GATS Article II requires non-discrimination in the liberalization of services trade, except where expressly provided in each members’ GATS schedule, unless this is done through an economic integration agreement complying with the provisions of GATS Article V.
- The TRIPs Agreement also has a non-discrimination provision

These constraints effectively limit the range of liberalization and facilitation that APEC members can undertake on a voluntary basis to those that (a) they are willing to undertake on a non-discriminatory basis, or (b) that are not covered by the non-discrimination requirements of the GATT, GATS and TRIPs Agreements, or at least are not likely to be challenged under those provisions.

Investment and competition policies are important examples of areas that are not currently the subject of a separate WTO agreement, although some elements of them are present in other agreements, for example the provisions of the GATS relating to Mode 3 (commercial presence) and the TRIMs Agreement in the case of investment. Modern PTAs often contain provisions on investment, and investment is also the subject of many Bilateral Investment Treaties (BITs). Investment and competition policy have been addressed by respectively in the APEC Non-Binding Investment Principles and the APEC Principles on Competition Policy and Regulatory Reform

2.2. Political Constraints

Experience has also highlighted a number of political constraints on voluntary liberalization and facilitation:

- Requirements for reciprocity: it is clear that there are some liberalization and facilitation measures that at least some and possibly many APEC members will not be prepared to undertake unless they are reciprocated by trading partners. Liberalisation of trade in goods and services falls into this category for a number

of APEC economies, and agreements to phase out or reduce the use of contingent protection measures (anti-dumping, safeguards and countervailing duties) are in this category also for at least some APEC economies. Under WTO rules reciprocity between APEC members in these areas is only possible in the context of free trade areas and customs unions. If reciprocity from non-APEC members is required, this is most efficiently achieved through the WTO.

- Requirements for enforceability are typically related to the requirement for reciprocity, since economies are unlikely to be willing to rely on reciprocal commitments from partners unless they know that they can be enforced. In many cases enforceability will require agreement on some form of dispute settlement mechanism. On the other hand, one of the reasons that economies are likely to prefer voluntary commitments is precisely the absence of enforceability, leaving them free to modify their policies in the light of experience or changing priorities.
- Sensitive sectors: most economies have sensitive sectors that are politically difficult to liberalize. While the degree of political difficulty may vary greatly between economies and across sectors, it seems clear that the existence of “sensitive sectors” is an important constraint for a number of APEC economies. It is most unlikely that any economy will voluntarily liberalize a highly sensitive sector in the absence of external pressure. Peer pressure may not be enough, and the pressure that can be applied in reciprocity-based negotiations may be the only way to make progress.
- Sensitive bilateral trading relationships: economies may have inhibitions about liberalizing trade in their bilateral trade flows with particular partner economies, and may not be willing to make voluntary commitments that would result in the liberalization of bilateral trade with those economies. This consideration seems to be important in some bilateral relationships among APEC economies at the present time.
- Need to preserve “negotiating coin”: Since the nature of WTO and PTA negotiations is that they involve reciprocal exchange of “concessions”, economies will typically feel a need to “hold back” sufficient potential concessions to use as “negotiating coin” in future negotiations. This helps to explain why in the WTO economies often bind their tariffs at levels higher than their “applied” rates, and why services commitments under the GATS typically fall well short of economies’ actual practice. As PTAs become an increasingly important part of the international trading environment, economies may become even more reluctant to “give away” potential concessions on a voluntary basis.
- Lack of capacity: Successful liberalization requires economies to have the capacity to undertake necessary accompanying policies and measures, and to manage the adjustments that inevitably results from liberalization. Economies will be rightly reluctant to undertake liberalization before they have developed the necessary capacity.

The ‘Pathfinder’ concept allows progress to be made in situations where the political constraints are holding some APEC members back while others are prepared to move forward. It does not however change the legal constraints.

2.3. Implications for APEC’s Progress

This review of the constraints helps to clarify the limitations of the voluntary approach to liberalization and facilitation. These limitations are due not so much to the unsuitability of APEC as a forum for negotiations but more to the fact that the range of areas where significant progress can be expected on a voluntary basis is relatively narrow, essentially comprising measures

- for which APEC members do not require reciprocity, particularly from non-APEC members
- that do not compromise potential negotiating positions in WTO negotiations or subsequent PTA negotiations
- that do not create unacceptable difficulties for APEC members in “sensitive” sectors or through requiring liberalizing trade in “sensitive” bilateral trade flows
- where perceived benefits exceed perceived costs at the current stage of APEC members’ development
- that APEC developing economy members consider they have sufficient capacity to successfully implement
- that can either be implemented on a non-discriminatory basis or that deal with matters that are not covered by the non-discrimination provisions of the GATT, GATS and other relevant WTO agreements.

The areas where APEC is acknowledged to have made substantial progress are all areas where the constraints identified above tend to be absent or weak, and where the conditions outlined above are accordingly satisfied to a considerable degree:

- Customs procedures
- Standards and conformance: expanding the adoption of international standards
- Mobility of business persons (on a general basis, unconnected to the liberalization of specific sectors, e.g. the APEC Travel Card)

These are all areas that fall under the general heading of facilitation rather than liberalization. Economies that do not face the constraints highlighted above (or are able to overcome these constraints) in liberalizing trade in goods and services may well be content to liberalize unilaterally, without requiring “concertation” with other APEC members through the APEC process. However it is clear that the constraints will inhibit voluntary liberalization by a number of APEC economies, including some key economies.

Investment and competition are two areas where the ‘legal constraints’ to voluntary commitments do not currently apply, but where some of the ‘political constraints’ may nevertheless still present obstacles. In both cases APEC has adopted non-binding

principles: the APEC Non-Binding Investment Principles and the APEC Principles on Competition Policy and Regulatory Reform.

3. The Potential Contribution of Binding Commitments within APEC

Binding commitments involve the acceptance by economies of legal obligations. Acceptance of legal obligations is of course unavoidable in the context of the WTO and PTAs. Before considering these options however, this section of the report addresses the potential contribution of binding commitments within APEC that do not involve the creation of PTAs or the need for agreements to be concluded within the WTO.

The potential contribution of binding commitments within APEC to the achievement of APEC's trade and investment goals depends on how far they enable the legal and political constraints on voluntary commitments to be overcome.

3.1. Binding Commitments in APEC and the Political Constraints

Among the political constraints, the main one that may be overcome by binding commitments is the requirement for reciprocity. The value of binding commitments in allowing for reciprocity depends in turn on the degree to which the commitments are enforceable, and the extent to which the commitments are rendered irreversible.

On the other hand, greater enforceability and irreversibility may result in other constraints being felt more acutely; economies are likely to be more cautious about the degree to which they commit themselves if there is effective provision for those commitments to be enforced and if they know that the commitments will be difficult to reverse. This incidentally is another factor that helps to explain the reluctance of WTO members to reduce their "bound" tariffs to the level of their "applied" rates, or to undertake GATS commitments that fully reflect their actual practice.

3.2. Different Degrees of Binding Commitments

Binding commitments can be undertaken at different levels, reflected in different degrees of enforceability and irreversibility. The greater degree of enforceability and irreversibility, the more effective the binding commitments are likely to be in overcoming the "reciprocity constraints", but the greater also may be the degree of acuteness with which other political constraints are felt.

At the most basic level, as Bergsten has pointed out, all commitments must be incorporated in domestic legislation or regulatory systems in order to become effective. This applies to voluntary as well as binding commitments. In the absence of reciprocation by other economies, commitments are unilateral and can be made without

the need for involvement in APEC or any international negotiating process. Unilateral commitments cannot be enforced by other economies, and are fully reversible, since economies retain the sovereign right to withdraw or amend these commitments at any time.

Binding reciprocal commitments require treaty-level international agreements between economies. In the absence of dispute settlement provisions, enforceability and irreversibility depends on the costs that parties to the agreement will incur if they fail to honour their commitments. These costs could include the risks of undermining a mutually beneficial agreement, and adverse effects on the offending economy's international reputation, possibly causing other economies to be more reluctant to enter into agreements with it in future.

The inclusion of dispute settlement provisions underpins reciprocity by enhancing the enforceability and irreversibility of commitments. Not all treaty-level trade and investment agreements include formal dispute settlement mechanisms. There is no formal dispute settlement mechanism in the ANZCERTA agreement between Australia and New Zealand, for example. In other cases, such as AFTA, formal dispute settlement provisions may exist, but there may be an understanding that they will be rarely if ever invoked. Other agreements, such as NAFTA, include formal dispute settlement procedures that are regularly used.

The effectiveness of dispute settlement procedures depends in turn on the availability and impact of sanctions for non-compliance. For example in the WTO, non-compliance can result in a requirement for compensation or the authorisation of retaliation. In cases where effective economic sanctions are not available, non-compliance may still be costly, for example if it risks undermining a mutually beneficial agreement or if it has an adverse effect on the offending economy's international reputation.

3.3. Binding Commitments and the Legal Constraints

A move to binding commitments within APEC may thus be helpful in overcoming political constraints associated with the need for reciprocity and enforceability, though possibly at the cost of rendering other political constraints more acute. It does not however change the legal constraints faced by voluntary commitments.

In other words, binding commitments within APEC, outside of PTAs and the WTO, must either (a) relate to measures that are not covered by the non-discrimination provisions of relevant WTO Agreements such as the GATT, GATS and the TRIPs Agreement, or (b) be non-discriminatory in relation to all WTO members.

Binding commitments that are non-discriminatory in relation to all WTO members, and that are made outside the context of either PTAs or the WTO, could theoretically be made within APEC. The proposed EVSL commitments were viewed in this way by some of their advocates. If reciprocity from non-APEC WTO members is required however, it is difficult to think of an effective process for achieving this other than the WTO.

Realistically therefore, unless APEC members are prepared to forego reciprocity from other WTO members, the scope for effective binding commitments within APEC, outside the context of either PTAs or the WTO, would appear to be limited to commitments to measures that are not covered by the non-discrimination provisions of relevant WTO Agreements, and where the political constraints noted earlier do not apply.

4. Issues for APEC's Future

A number of the issues where commitments can appropriately be pursued within the APEC process are obvious, and some have already been mentioned. They include:

- Efforts to further streamline and where appropriate harmonise customs procedures (the recent mid-term assessment of the APEC Trade Facilitation Action Plan noted areas for possible further action, for example more “complete electronic integration and automation of all governmental responsibilities at the border”)
- Measures to enhance the security of trade in the most efficient way possible
- Promotion of increased use of information and communications technology (ICT) in trade between APEC members.
- Measures to further enhance the general mobility of business people (both the recent mid-term assessment of the APEC Trade Facilitation Action Plan and other assessments have noted for example that more effective implementation of the APEC Travel Card scheme by some APEC economies would considerably enhance the usefulness of the scheme for business)
- Further efforts to expand the use of international standards.

Expansion of mutual recognition agreements (MRAs) is often mentioned as possibly a useful objective for APEC in the standards and conformance area. It needs to be noted however that the number of MRAs that have been agreed within APEC to date is disappointingly small and the number of APEC members that have agreed to participate in these MRAs is also disappointing. If negotiation of MRAs is to form an important element in APEC's future agenda, it would be advisable to assess the factors that lie behind this disappointing experience to date, and to identify ways of overcoming any problems that may be identified in the process.

Mutual recognition of professional qualifications and standards is also often mentioned as a likely area for progress. It may be salutary to note however that it has proved difficult to make rapid progress on this issue in the WTO, where significant progress has so far been limited to accountancy qualifications. A sober assessment of the difficulties involved and ways of overcoming them once again suggests itself as a desirable prerequisite to any decision to pursue this issue within APEC. Subject to such an assessment, APEC members might consider moving to build on the progress made in the WTO by adopting the Disciplines on Accountancy and applying them as soon as possible without waiting for the conclusion of the DDA. APEC might further consider acting as a “pathfinder” in the WTO context by seeking to gradually extend these disciplines to other professions.

Given the importance of investment, and given that investment is an area where APEC members are not formally constrained from entering into additional commitments with each other, consideration should also be given to whether further commitments on investment could be developed within APEC. ABAC could have a role in identifying the further steps on investment that would be of greatest interest and potential benefit to business.

The wide-ranging sets of transparency standards that have been adopted within APEC also represent a potentially important development. As APEC members move to implement these standards, business should work with APEC governments to identify measures dealing with transparency-related issues that will be of greatest benefit to business.

Agreement on a common approach to preferential rules of origin would be another valuable contribution that APEC could make, and is discussed further below.

Although APEC officials formally respond to instructions from leaders and ministers, observation would suggest that in practice the way in which their agenda is developed in response to those instructions is largely determined by what is acceptable to bureaucracies in APEC capitals. ABAC's first step in having additional issues added to APEC's agenda will be to clearly identify the additional problems it wishes to see addressed. Following last years Expanded Dialogue on Trade Facilitation ABAC was invited to work together with officials to identify trade facilitation problems being encountered by the private sector. ABAC will then need to use its influence to ensure that this identification of needs will be followed by the development of appropriate action programmes that are supported in APEC capitals.

There are a number of further "behind-the-border" measures that could in principle also be addressed within the APEC process. Agreements on the harmonised tax treatment of international income and harmonisation of the regulation of key sectors such as banking are possible examples. These however are complex issues that entail costs and pose difficulties as well as potential benefits, as can be clearly illustrated by the recent experience of Australia and New Zealand. The costs and difficulties will be higher, the greater is the divergence between existing systems. In the case of the regional agreements that have gone furthest with "behind the border" measures, such as the EU and ANZCERTA, serious attention began to be paid to these types of measures for the most part only after trade had already been fully liberalised. It is likely that this sequencing is based on sound economic reasons rather than historical accident. Only after trade and possibly also investment has been liberalised do the likely benefits of addressing such measures begin to appear to outweigh the costs and difficulties. Even mutual recognition of professional qualifications may make little sense unless agreement has already been reached to liberalise trade in the relevant services.

There are further possible issues in which business is likely to have a strong interest. These include:

- Liberalisation of passenger air transport and maritime transport, currently covered inadequately or not at all in WTO agreements and negotiating agendas
- Agreements designed to limit the abuse of contingent protection measures (anti-dumping, safeguards and countervailing duties)
- Liberalisation of government procurement.

These are all issues where reciprocity is likely to be essential if progress is to be made, and may not therefore be suitable candidates for commitments within APEC. APEC may however be able to contribute to introducing these issues into the negotiating agenda of the WTO when a suitable opportunity arises.

5. The Contribution of Preferential Trading Agreements

As is well-known, PTAs have become in practice one of the principle avenues through which APEC economies are pursuing trade and investment liberalization. Many APEC economies appear to be allocating at least as much priority and effort to the negotiation of PTAs as to the WTO negotiations.

5.1. PTAs and the Legal Constraints

The legal constraints on voluntary and binding commitments within APEC do not apply in the case of PTAs. PTAs are legal in the WTO provided that they comply with the requirements of GATT Article XXIV (or the “Enabling Clause” of 1979 in the case of PTAs involving only developing countries), GATS Article V, and other relevant provisions in the WTO Agreements. To comply with GATT Article XXIV they must involve establishment of a free trade area or customs union within the meaning of the Article, but they can and do include provisions covering many other matters, such as investment, competition policy, standards and conformance, customs procedures, intellectual property, and so on.

5.2. PTAs and the Political Constraints

PTAs are also effective in avoiding many of the political constraints that face voluntary commitments and binding commitments within APEC. Specifically:

- Since they are both reciprocal and enforceable, they can satisfy the requirements of their members in these two regards.
- The WTO rules allow some “sensitive products” to be excluded, provided they satisfy the Article XXIV requirement for elimination of barriers on “substantially all trade” within a “reasonable period of time”. As is well-known, the interpretation of the terms “substantially all trade” and “reasonable period of time” has never been precisely clarified, and in practice has proved somewhat elastic. PTAs involving only developing economies have even greater latitude under the “Enabling Clause” to provide special treatment for “sensitive products”.
- Economies are able to select the economies with whom they are prepared to negotiate PTAs, and thus can avoid agreements covering bilateral trade flows that are particularly “sensitive”, for whatever reason.

- Since PTAs require removal of barriers only trade with the members of the agreement, barriers to imports from other economies remain available as “negotiating coin” in WTO negotiations or in subsequent PTA negotiations with additional partners.
- Sequencing of commitments: The FTAs or customs unions that form the “core” of a PTA represent natural first steps towards economic integration with the selected partner economies. Additional measures that enhance the degree of integration can readily be added, either at the time the PTA is first negotiated, or at some later date when the partners deem this to be in their interests.

There are also some other factors that enhance the attractiveness of PTAs to governments:

- PTAs, particularly bilateral PTAs can be “customised” to address economy-specific concerns of the participating economies, or specific issues that affect the bilateral trading relationship between the partner economies.
- PTAs, particularly bilateral PTAs, may allow some economies to secure agreement from their partners that go significantly further in satisfying their national interests than agreements that might be possible either at a region-wide level or in the WTO.

5.3. PTAs and APEC’s Bogor Goals

It is when PTAs are considered in relation to APEC’s goals, including the principles of non-discrimination among APEC members and full support for the WTO-based multilateral system together with the desire to build an Asia-Pacific community, that they begin to appear more problematic.

The essential problem is that PTAs are discriminatory. Each PTA discriminates against economies that are not members of the agreement, to the potential detriment of both the excluded economies and the partner economies themselves.

From a business perspective, the most immediate concern is the potential for increased transaction costs associated with the development across the region of a “spaghetti bowl” of PTAs containing inconsistent provisions on matters such as rules of origin. The exact extent of possible increased transaction costs imposed by such a “spaghetti bowl” remains to be quantified. Preliminary analysis and comment, and some anecdotal evidence, suggests that the costs will be substantial but further research is needed for this to be verified.

Also significant for business is the extent to which a “spaghetti bowl” of PTAs will fragment the markets of the region, thereby denying APEC economies and their businesses the full efficiencies and other benefits that could be attainable through the greater integration of the markets of the region.

There are other reasons as well for thinking that the “spaghetti bowl” of PTAs is unlikely by itself to lead to the APEC goal of region-wide free trade. Some bilateral trade flows

among APEC economies may be considered by one or both of their participants to be too “sensitive” to be the subject of a PTA. It is noticeable at the present time that some very large bilateral trade flows in the APEC region are not the subject of any formal PTA proposals.

As an APEC “spaghetti bowl” develops it will also become quite straightforward for APEC members to choose to exclude certain other APEC members from consideration as possible PTA partners, for reasons which may include

- Desire to exert political pressure on the excluded economy
- Lack of attractiveness of the excluded economy as a PTA partner, due to small economic size or other factors
- Perception that the excluded economy lacks the policy and institutional framework necessary for successful implementation of a PTA, due to its development status.

In some cases a combination of these factors may apply. Less developed APEC economies and smaller economies that have significant political differences with larger APEC members may be especially at risk of being marginalised for reasons such as these, in a region where liberalization and facilitation becomes heavily concentrated on PTAs.

Marginalisation of some APEC economies in this way, and the exclusion from liberalizing initiatives of some important bilateral trade flows among APEC members, would both cut directly across the objective of building an Asia-Pacific community, and risk undoing years of patient effort in bringing APEC economies together.

The proliferation of PTAs also risks undermining the basic APEC principle of providing full support to the WTO-based multilateral system. The rush towards negotiation of PTAs is already diverting scarce resources and energy away from the multilateral process. APEC members may be further tempted to emphasise preferential as against multilateral liberalisation to the extent that they find that PTAs allow them to

- Sidestep politically difficult commitments, in terms of either sectors or bilateral trade flows to be liberalised
- Achieve greater progress in pursuing deeper agreements on issues to which they give special priority
- “Customise” arrangements to take account of economy-specific concerns or issues specific to the bilateral relationships with particular partners.

Nevertheless it is clear that the APEC governments will continue to pursue PTAs in the short term at least. Some will pursue PTAs as a chosen element in their preferred trade strategy, while others will pursue them out of necessity, to defend themselves as far as possible from erosion of their position in the markets of their trading partners. This issue therefore is to find ways of maximising the favourable effects and minimising the negative impacts of the spread of PTAs in the APEC region.

5.4. PTAs as Avenues to the Bogor Goals

Creating a region of free trade and investment out of a “spaghetti bowl” of bilateral PTAs is a challenging task. It requires that the discrimination and fragmentation inherent in the “spaghetti bowl” will eventually be overtaken by the integrative effect of falling barriers to trade and investment across the region as a whole.

One way in which this could happen is if global barriers can be eventually be eliminated or reduced to negligible levels through the WTO process. It is very important that APEC members continue to give a high priority to pursuing this objective. Reducing barriers on an MFN basis is the most reliable way of limiting the discriminatory impact of PTAs.

Another avenue would be to encourage the formation of progressively larger preferential groupings, including through the expansion and amalgamation of existing PTAs, so that they eventually converge towards regional free trade and investment. The record to date suggests that this kind of convergence is going to be difficult to achieve. It has been difficult to make progress even where the formation of a larger grouping might seem to be a relatively natural development. Establishing a trilateral “P3” FTA between Chile, New Zealand and Singapore has not proved easy, and there has been no serious effort to consider, for example, whether Australia and New Zealand might amalgamate their respective PTAs with Singapore and Thailand. Proposals to form plurilateral “ASEAN Plus One” groupings have encountered countervailing tendencies toward the negotiation of bilateral FTAs instead. The concept of an “ASEAN Plus Three” FTA remains alive, but it remains to be seen whether it can be out into practice. The obstacles would appear to be political, based in some cases on an apparently strong preference of economies for bilateral PTAs with a high degree of “customisation”, in other cases around the sensitivity of one or more of the bilateral relationships within the proposed larger group, or simply different degrees of readiness. Further study is needed to explore the feasibility of this kind of approach and to identify feasible steps that APEC members might take in this direction.

Nevertheless there are important steps that APEC economies can take to ensure that bilateral PTAs do not become an unnecessary obstacle to subsequent region-wide integration. One contribution would be to avoid unnecessary divergence in the terms of bilateral PTAs within the region. A possible approach is to establish “best practice” guidelines for the design of PTAs and to encourage individual pairs of economies to adhere to these guidelines as closely as possible. APEC has already made a useful start in this direction with its “Best Practice Guidelines for RTAs/FTAs”. There is scope to further amplify these guidelines. For example APEC economies might consider whether they could design “model provisions” for the various elements in an FTA, and to reach an agreement to follow these models as closely as possible in their individual bilateral PTAs. If groups of APEC economies, or better still the APEC economies as a whole find that they can reach consensus on adopting these “model provisions”, they might then consider whether they could come together in an agreement that would have a common set of rules, but separates sets of concessions for the elimination of trade barriers in each bilateral relationship. This approach could make an important contribution to minimising “spaghetti bowl” effects. The US-CAFTA Agreement may be an instructive example to consider in this regard.

Preferential rules of origin are especially crucial in this connection, since they have the greatest potential to undermine wider regional integration, both immediately and in the future. If APEC economies could agree on a common “best practice” approach to preferential rules of origin in their bilateral PTAs, this would be a most valuable contribution to both limiting “spaghetti bowl” effects in the short term, and holding the door open for wider integration among larger groups – and eventually region-wide integration – in the longer term.

Two important conclusions from the recent APEC workshop on rules of origin were that “best practice” rules of origin are likely to differ between sectors or industries, and that sector or industry representatives who are committed to promoting efficient trade are generally in the best position to recommend appropriate rules of origin for their sector or industry. A business group such as ABAC could play an important role in the development of “best practice” rules of origin. It should not be imagined however that agreement on a common approach to preferential rules of origin will be easy to reach, as can perhaps be illustrated by noting that even the agreement on non-preferential rules of origin, the establishment of which was a commitment that WTO members made during the Uruguay Round, has not yet been concluded.

5.5. The FTAAP

A further approach to reconciling PTAs with the Bogor goals is the proposal for a Free Trade Area of the Asia-Pacific (FTAAP). The FTAAP potentially covers all APEC economies, and would involve commitments to reduce trade barriers to zero on “substantially all trade” within a reasonable period of time. It thus offers the prospect of a reasonable approximation of achievement of the Bogor goals. While there might be some exceptions to full product coverage, and the implementation period might well extend beyond the first Bogor target date of 2010, a firm commitment to phase out barriers to trade in most if not all products could be in place by that date. The possibility of allowing some exceptions to full product coverage might actually be helpful in overcoming political constraints among the APEC members. The other key advantage of the FTAAP is that provides the means for APEC economies to avoid the problems associated with a “spaghetti bowl” of PTAs.

In general the constraints facing the FTAAP proposal are all political, and are similar in nature to those facing the formation of PTAs among large groups of APEC members. In particular, if it is to be an effective vehicle for achievement of the Bogor goals, the FTAAP requires the participation of all APEC members, and a willingness to include all bilateral trade flows between APEC members within the scope of its provisions, including bilateral trade flows that are regarded by at least one of the parties as highly sensitive.

In order to secure the participation of all APEC members it is likely that the provisions of the FTAAP in at least some areas would have to be less ambitious than at some members

would prefer. It might not be impossible to consider a “two-tier” approach, whereby the FTAAP would comprise the basic agreement between all APEC members, but some pairs or groups of APEC economies would maintain their own bilateral or plurilateral agreements as “side agreements” containing those provisions where the members wish to make commitments to each other that go further than those that can be agreed within the FTAAP. Something of this kind appears to be contemplated in the Americas in the case of the FTAA (Free Trade Area of the Americas), where it is envisaged that existing PTAs among members will continue to exist in some form after the FTAA is implemented.

The participants in the FTAA process have agreed to develop an agreement based on a two-tiered approach, where the common set of disciplines would be agreed to by all countries, while the upper or more far-reaching set of disciplines would be agreed by a sub-set of like-minded countries. This approach of “variable geometry” would provide a flexible way to proceed with trade liberalization in light of political and economic constraints, and enormous differences in size and levels of economic development. This approach might also have merit in the APEC context, where the same constraints and factors are present. The concept of “variable geometry” stands in sharp contrast to the “single undertaking” approach adopted in the WTO, and it is not surprising that it is proving difficult to operationalise.

If APEC members wish to explore the FTAAP concept further, it would be useful to study the FTAA process in greater depth, to identify the issues that will need to be faced and ways to overcome the difficulties that will inevitably arise, including both the advantages and the problems of the “variable geometry” approach as a way of handling the enormous economic disparities among APEC members.

5. Possible Contribution of the WTO Process

As noted above, it is clear that even a successful DDA will not go close to achieving free trade. Thus the DDA process by itself cannot be regarded as an adequate instrument for APEC developed economies to achieve the Bogor goals by 2010. Nor is it likely that another round could be launched and completed before 2010. This does not alter the fact that it is vitally important that APEC economies remain committed to a successful DDA outcome, as already emphasised above.

Nevertheless there is one further multilateral liberalisation initiative that is worth APEC’s, and ABAC’s, consideration. This is the trade liberalisation recommendations of the U.N.’s Millennium Project, which was tasked to produce recommendations for achieving the elimination of poverty as set out in the Millennium Development Goals. These recommendations are to be considered at the Millennium Summit in September 2005.

The draft report of the Trade Group of the Millennium project includes the following recommendations:

- By 2015 developed countries are to bind their tariffs on non-agricultural goods at zero and OECD members are to bind their agricultural tariffs at 5% or less.

Domestic support in agriculture is to be limited to 5% of the value of agricultural production by this date. All export subsidies, tariff rate quotas and any other non-tariff barriers in agriculture are to be removed by 2010.

- Developing countries are to aim for zero tariffs by 2025, and should have reduced their agricultural tariffs to 10% by 2015 (15% for the poorest countries).
- A new approach to special and differential treatment for developing countries.

Unlike the Bogor goals, the targets in these recommendations are precisely defined. While the targets do not provide for complete achievement of the Bogor goals, if the latter are understood to include zero tariffs, and the target dates are 2015/2025 rather than the Bogor dates of 2010/2020, nevertheless they are targets which involve a close approximation to free trade, and which take account of the peculiarities of agricultural trade. Furthermore they are targets that are to be achieved through the WTO, meaning that they are to be achieved by all WTO members, not just APEC members. This satisfies the requirement of some APEC members for reciprocity from non-APEC countries as well as APEC members, and thus potentially overcomes this constraint on APEC's efforts to achieve the Bogor goals.

The Millennium Project recommendations are underpinned by the moral imperative of eliminating poverty on a global basis. It is just possible that sufficient momentum could be developed behind these recommendations to give them a realistic prospect of being adopted. APEC economies should consider committing themselves to the Millennium Project's trade recommendations, conditional on a like commitment from other WTO members. This could increase the momentum towards the prospective adoption of these recommendations, which in turn could create a realistic possibility that APEC economies might actually manage an "approximate" achievement of the Bogor goals.

Adoption of the Millennium Project trade recommendations would imply a five year delay in the achievement of the Bogor goals, and this would need to be carefully presented in order to preserve APEC's credibility. It could however be presented as a step which not only greatly enhances the prospect that the Bogor goals will actually be met, but that also greatly enhances the value of the commitment by APEC members, by linking it to a corresponding commitment by other APEC members and to the moral imperative of eliminating global poverty.

6. Monitoring and Review

Monitoring of APEC members' progress towards the Bogor goals is currently based around the Individual Action Plans and the peer review process.

The IAPs contain much useful information. Nevertheless they are cumbersome, and to conscientiously maintain them is a resource-intensive process. Perhaps as a result, they tend to be of uneven quality. They do not always provide full coverage of all issues on the Osaka Action Agenda. Furthermore they tend not to be target-oriented. The emphasis is on recording past actions rather than outlining commitments for future

actions or identifying the further steps needed to achieve the Bogor objective. While the distance still to be travelled in the case of tariffs can often be readily deduced by inspection of the summary information presented on tariffs, in other areas, for example services, it is often not at all clear. Furthermore, IAPs do not always include all actions that economies have taken that contribute to progress toward the Bogor goals. One of the reasons for this appears to be a desire not to undermine negotiating positions in the WTO or elsewhere. One consequence of these characteristics of the IAPs is that, despite the quantity of information presented and the efforts that have been made to make them more user-friendly, they tend to be of limited usefulness to business and other audiences.

The peer review process has been a useful exercise. The independent expert reports often provide a useful snapshot of where economies stand in relation to the Bogor goals. The lack of agreed methodology however limits the comparability of the assessments. For this reason, and because the reports are generally based on the information on the IAPs, they do not generally highlight the steps that still need to be taken to reach the Bogor target. Another reason for this is of course that many of the targets themselves have not yet been precisely defined. As the target dates draw nearer the need for precise definition of the targets, as well as identification of the steps still required to reach them, becomes more acute.

Monitoring and review is essential to the APEC process if the process is to retain credibility. Consideration should be given however to modifying the format of both the IAPs and the peer review. Before that APEC should endeavour to clarify the definition of the Bogor targets in areas where the current definition remains unclear, such as services and investment, so that both the IAPs and the peer reviews can more directly focus on these targets. The IAPs should then be focused more on the remaining steps needed to achieve the targets. Actions recorded in the IAPs should be presented in terms of the extent to which they reduce the distance still to be travelled to achieve the targets.

The impact of the IAPs might be increased if the frequency with which they are revised is reduced. One possibility would be to require economies to revise their IAPs in the year immediately before the year in which a peer review is undertaken, assuming that agreement can also be reached to conduct peer reviews on a regular basis. Reducing the frequency of IAP revisions would also reduce the burdensomeness of IAP revisions on APEC governments, and the hope would be that governments would respond by making more conscientious efforts to ensure that each IAP revision represents a comprehensive and easily digestible update on progress made toward the Bogor targets since the last revision, along with steps that the government in each case intends to take before the next revision and review.

Reviews should be undertaken on a regular timetable synchronised with IAP revisions. The independent expert's report should play a central role, and steps should be taken to develop a common methodology for the expert report. The expert(s) should be required to assess the steps that have been taken since the last report, measured against the steps proposed in the previous IAP revision, and also to assess the status of liberalisation and facilitation in each area of the APEC agenda against the targets that have been agreed in

that area. Economies should be encouraged to record commitments to future actions as well as actions already taken. Given the current importance of PTAs, an assessment should also be required of the extent to which PTAs that have been entered into by the member being reviewed confirm to the latest version of the “Best Practice Guidelines for RTAs/FTAs” or any similar guidelines that have been agreed by APEC members. The experts should be instructed that they are expected to produce a frank and objective assessment, and government should acknowledge that they are not entitled to expect “soft” assessments. The reports should be publicly released and the aim should be to ensure that the status of the reports are such that favourable comments become a matter for congratulation for governments within their own economy, while unfavourable comments are correspondingly a matter of some embarrassment. The OECD reviews of member economies could serve as a model in this respect, although their policy focus is of course different.

7. Modifications or Restructurings of the APEC Process

The APEC process as presently constituted has been designed to achieve progress in those policy areas that have been identified as being suited to seeking liberalisation or facilitation through voluntary commitments, and to engage in agenda-setting on those policy issues where it is acknowledged that progress requires reciprocal negotiations in other fora, principally the WTO and PTA negotiations. It also is an appropriate forum for seeking agreement on standards of trade policy conduct expected from APEC economies, for example the “Best Practice Guidelines for RTAs/FTAs”. There is no reason to think that the APEC process could not also handle negotiations for binding commitments in the policy areas for which it is suited, should APEC members agree that a shift to binding commitments in these areas are desirable. The point that needs to be recognised is that the range of policy areas that are suitable subjects for commitments within the APEC process is likely to be relatively narrow.

Nevertheless APEC members should be encouraged to streamline the APEC process, to improve the productivity of the process by avoiding unnecessary meetings and duplication of effort, and by ensuring that the APEC subforum responsible for each policy area is clearly identified. This will assist ABAC in targeting their approaches to APEC when pursuing specific policy objectives.

The appropriate structure for the peer review process does need further consideration. If a common methodology is to be adopted for the expert review and the rigour of the review process is to be increased, provision needs to be made for ensuring continuity of access to a core of expertise that can ensure that the necessary standards of review are maintained over time. One way to do this would be to locate that core of expertise in the APEC Secretariat. This would require agreement by APEC economies to the necessary increase in the resources of the Secretariat, including at least some degree of professionalisation, and the expansion of its functions. Another approach would be to sub-contract the expert review to another organisation with the necessary expertise, most likely the OECD. Before doing so it would be necessary to ascertain that the OECD has

available to it adequate expertise in the specific policy areas that are to be the subject of the APEC peer reviews.

APEC of course has no direct role in the WTO negotiations or in the negotiation of PTAs between subgroups of APEC members, although it can endeavour to influence these negotiations through agenda-setting and through promoting desired standards of policy design and conduct. A decision to attempt to establish an FTAAP would be a different matter, requiring careful consideration by APEC members as to how the negotiations would be constituted and managed. The process for negotiating an FTAAP would be fundamentally different from the present APEC process. There would be a significant risk of deadlock or even failure that could undermine the cooperative spirit that currently characterises the APEC process, and the requirements of reciprocal bargaining might well also have this effect. The spirit of cooperation is a valuable aspect of the APEC process, and in order to ensure that this is preserved as far as possible it would be sensible to consider creating a process for negotiating an FTAAP that is separate from the existing APEC process, just as in the Americas the Summit of the Americas process is separate from the FTAA negotiation process.’

8. Summary of Implications for Issues Raised in the Terms of Reference

8.1. Voluntary or Binding Commitments

The legal and political constraints on voluntary commitments within APEC are such that the realistic scope for such commitments may be limited to those

- for which APEC members do not require reciprocity, particularly from non-APEC members
- that do not compromise potential negotiating positions in WTO negotiations or subsequent PTA negotiations
- that do not create unacceptable difficulties for APEC members in “sensitive” sectors or through requiring liberalizing trade in “sensitive” bilateral trade flows
- where perceived benefits exceed perceived costs at the current stage of APEC members’ development
- that APEC developing economy members consider they have sufficient capacity to successfully implement
- that can either be implemented on a non-discriminatory basis or that deal with matters that are not covered by the non-discrimination provisions of the GATT, GATS and other relevant WTO agreements.

In practice this means that the scope for further voluntary commitments will largely lie in the area of trade facilitation. Further progress is possible in customs procedures, standards and conformance and business mobility. APEC should consider whether further progress can be made on investment issues on the basis of voluntary commitments. APEC could also very usefully work on further developing the “best practice” guidelines for RTAs/FTAs, including establishment of a common approach to preferential rules of origin.

A move to binding commitments among APEC members could be useful in satisfying the need for reciprocity, in cases where reciprocity from APEC members alone is sufficient, but in most other respects binding commitments within APEC would face the same constraints as voluntary commitments. Investment would be one area where the possibility of binding commitments should be considered.

Elements of the TPBA programme that satisfy the political and legal constraints on APEC commitments could be pursued through the APEC process on the basis of either voluntary or binding commitments. ABAC would need to clearly identify the problems it wishes the TPBA to address, and to work with officials to develop effective action programmes to address the problems. The APEC CTI has already indicated that it will be receptive to such an approach from ABAC. ABAC would also need to work to mobilise support for the resulting programmes in APEC capitals.

Issues and programmes that do not fit within the political and legal constraints on APEC commitments are unlikely to be successfully addressed by commitments within the APEC process, unless the constraints can be lifted, for example through the creation of greater political will.

The FTAAP would be based on a conventional free trade agreement that satisfies the legal requirements of WTO rules on free trade agreements and customs unions. APEC members can make binding legal liberalisation commitments to each other within the FTAAP, just as they currently do in their bilateral FTAs. Trade facilitation commitments and other commitments that have been made within the APEC process could for the most part be readily incorporated into the FTAAP, just as similar commitments are typically already included in bilateral FTAs.

8.2. Structural Reforms

A move toward binding commitments within APEC would not of itself necessitate structural reforms within APEC. Structural reforms are necessary, regardless of whether commitments within the APEC process are to be voluntary or binding. Structural reform is needed to:

- streamline the APEC process and make it more efficient
- ensure that a credible and effective peer review and monitoring process is kept in place without placing unnecessary burdens on APEC members.

The review process should have a standard methodology and should be target-focused rather than simply a record of progress. Rigour and continuity in the review process could be enhanced if a core of the required expertise could be maintained within the APEC Secretariat. This would require a degree of professionalisation of the Secretariat.

APEC's unique characteristic is that it is focused on economic cooperation and integration across the entire Asia-Pacific region, embracing both sides of the Pacific, as

distinct from other processes that focus on integration only in East Asia or the Americas. As such it is crucial that any structural reform in APEC is supported by members on both sides of the Pacific. This principle applies to possible expansion of the functions of the Secretariat. While there are a number of additional functions that the Secretariat could usefully perform (identified for example in the APIAN reports), it would be necessary for members across the entire region to agree that any new functions are appropriate to the nature of the cooperation they envisage among each other. Likewise the FTAAP is only feasible if supported by APEC economies, especially major economies on both sides of the Pacific.

8.3. On RTAs/FTAs

APEC should work on amplifying its “Best Practice Guidelines for RTAs/FTAs”. There is scope to further amplify these guidelines. APEC members could seek agreement on “model provisions” for the various elements in an FTA, and to reach an agreement to follow these models as closely as possible in their individual bilateral PTAs. If groups of APEC economies, or better still the APEC economies as a whole find that they can reach consensus on adopting these “model provisions”, they might then consider whether they could come together in an agreement that would have a common set of rules, but separates sets of concessions for the elimination of trade barriers in each bilateral relationship. This approach could make an important contribution to minimising “spaghetti bowl” effects.

If APEC economies could agree on a common “best practice” approach to preferential rules of origin in their bilateral PTAs, this would be a most valuable contribution to both limiting “spaghetti bowl” effects in the short term, and holding the door open for wider integration among larger groups – and eventually region-wide integration – in the longer term.

Binding commitments within the existing APEC process are unlikely to deter APEC members from pursuing bilateral FTAs with each other, since bilateral FTAs allow them to make binding commitments to each other that are not legally possible within APEC, unless APEC itself becomes an FTA. The FTAAP concept on the other hand does involve the creation of a WTO-consistent FTA, and is thus a legally feasible alternative to the proliferation of bilateral FTAs. Its political feasibility on the other hand is more problematic.

It is unlikely that any binding commitments could be made within APEC that would affect the DDA outcome. On the other hand there have been differences of opinion over the likely effect of the FTAAP on the WTO. On one side are those who argue that the FTAAP would undermine the WTO, while on the other side it is argued that a credible FTAAP proposal would create a greater sense of urgency in the DDA among other WTO members, since an ambitious DDA outcome would be their best defense against the trade discrimination that they would suffer as a result of the FTAAP. It is difficult to see how the FTAAP and other developments that it might provoke would be more damaging for the WTO than the current situation of proliferating FTAs.