



**THE POLITICAL ECONOMY OF  
REGIONAL DEVELOPMENT AND COOPERATION  
IN THE PACIFIC BASIN, WITH SPECIAL REFERENCE TO APEC  
A Rapporteurs' Report**

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## The Political Economy of Regional Development and Cooperation in the Pacific Basin, with Special Reference to APEC

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**Paper:** "APEC: Beyond Economics"  
*Brian L. Job*, University of British Columbia  
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**Moderator:** *Robert Riemer*, SVD, Nanzan University

## **Introduction**

The papers and discussion summarized here were presented at the workshop “The Political Economy of Regional Development and Cooperation in the Pacific Basin, with Special Reference to APEC,” which was held at the Kellogg Institute, 12–14 October 1995. Some of the papers presented, including those by Yoji Akashi, Brian Job, and Clark Reynolds, will also be published in their entirety as part of the Kellogg Institute Working Paper Series.

The United States, Canada, Japan, Korea, Indonesia, the Philippines, and many other East Asian countries all belong to the Asia-Pacific Economic Cooperation (APEC), and a distinctive feature of the workshop was that it consisted of experts from both sides of the Pacific. The result is a comprehensive look at the issues of trade and development in this region. Yoriyumi Watanabe pointed out some tensions between regional and multilateral trade agreements. Satoshi Hanai’s paper analyzed the current Japanese recession; the papers by Akashi, Tsutomu Kikuchi, and Job focused on APEC, the former two from an Asian perspective, the latter from a North American—which provided a provocative contrast between different explanations and interpretations of the exact same events. Shozo Inouye analyzed Japan’s contribution to human resource development throughout the Asia-Pacific, while Michael Plummer and Reynolds analyzed the economic impact of economic integration in this region.

### **I. THE POLITICAL ECONOMY OF PACIFIC BASIN INTEGRATION**

#### **APEC beyond Economics: The Politics of APEC**

Brian Job (in a paper cowritten with Frank Langdon) argued that it is misleading to regard APEC as an apolitical institution. According to Job, there are two important political dimensions of APEC membership. First, each country is constantly engaged in the political task of defending its economic independence, advantage, and freedom of action; therefore, political conflicts of interest can arise. Second, although members may recognize the importance of regional and subregional stability for national and economic growth, individual states simultaneously seek to advance their specific political and security agendas. Given the reality of these political dimensions, Job analyzed whether or not the current APEC framework can resolve political tensions over clashes of economic interests. He also evaluated whether or not APEC can become an effective institutional mechanism that can take up security issues in the region.

### **Political Conflicts of Interest**

Job highlighted two potential causes of political conflict among APEC members: the clash of interests between large and small states and the clash of interests between developed and developing states. Small states lack the economic and political clout to stand up to bigger states; therefore, the former seek to amplify their interests by banding together. This is what members of the Association of South East Asian Nations (ASEAN) have done during the past thirty years. In an organization like APEC, which includes both very small and very large states, the natural tension between the two is unavoidable. Perhaps an even more significant tension is that which arises between developed and developing countries. Less developed states insist that APEC remain a loose and cooperative body which will not set strict dates and goals for economic liberalization, while developed states such as the US and Australia wish APEC to take on a more organized form with firm rules and agreed-upon deadlines for liberalization. In this context, the agreement in 1994 on target dates for complete liberalization of both advanced countries (by 2010) and developing countries (by 2020) was viewed as a significant accomplishment.

### **Political and Security Interests**

With the economic dynamism of the Asian states in the last two decades has come a renewed political self-confidence. At the same time, Job continued, the self-adopted role for the US as regional ideological policeman and regional 'manager' has begun to diminish. Within this context three paradoxical results have emerged. First, just at the time that the principles of economic liberalism and state economic decentralization are achieving acceptance, the parameters of the framework of regional security stability that these forces require must undergo fundamental adjustment to accommodate new political realities. Second, with economic growth has come dramatically increased interaction among Asia Pacific states, the opening of trade and investment relations, and increased economic interdependence. This increased interdependence may mitigate tension among states as some have predicted, but it does not rule out behavior that poses a threat to both short- and long-term stability. Third, there remains a distinction in the Asia Pacific between the character of regionalism found in the economic sphere and the more amorphous regionalism found in the political/security sphere. There is a natural tendency towards institutionalization in the economic sphere, but in the security domain efforts towards institutionalization have been resisted, particularly in Northeast Asia.

As the primary agent of economic regionalism in the Asia Pacific, APEC finds itself within each of the above three paradoxes. According to Job, it cannot, therefore, escape implication in the political/security climate of the region.

However, Job did not argue that APEC will eventually assume a political or specifically security-oriented role within the Asia Pacific; this goes against the intentions of its key members. Up until now members have avoided impinging on one another's professed political or security interests. Key members such as the US and especially China have stuck very close to a narrow economic agendas in their APEC dealings. China is extremely sensitive to issues of sovereignty, both practical and symbolic, and now regards its acquiescence to inclusion of Hong Kong as a major mistake. Also, APEC simply lacks the requisite institutional infrastructure for dealing with political/security matters. This lack of institutionalization is commonly seen to be more in accordance with Asian political and security 'cultures.'

Reluctance to deal more explicitly with political issues may be risky. Liberal and economic political theories generally assume that economic growth and increased economic interdependence will promote more stable and cooperative bilateral and multilateral relations. Job argued that this view may be too sanguine. Defense expenditures in the region have increased over 40% in the last decade. This is in the context of a region that has over twenty ongoing territorial disputes. Increased defense expenditure does not necessarily lead to conflict but it does have substantial implications for the power projection capabilities of high-spending states. Additionally, increased trade and investment may not necessarily lead to greater equanimity in interstate relations. As Asian states industrialize their economies may become more directly competitive rather than complementary. As diplomatic historians have noted, the presence of increased economic interrelationships has not always proved a sufficient deterrent to the outbreak of serious international conflict.

Job concluded by noting that the states of the Asia Pacific do realize that economic progress and secure and stable regional relations cannot advance independently or in opposite directions; these states are struggling to move forward on both fronts to achieve a stable regional order. However, it appears that progress in the economic dimension is ahead of the progress in the security dimension, and this situation, if perpetuated, is fraught with uncertainties. It is therefore misleading to portray APEC as an apolitical institution; the members of APEC and the institution itself are inextricably bound in interrelationships that have political and security aspects—as well as economic ones.

## **Discussion**

Discussant Raimo Väyrynen agreed with Job that APEC must be thought of as a political organization. However, he distinguished himself from Job by stating that he is "maybe more pessimistic" about whether APEC can be used as an instrument with which to enhance economic and political cooperation.

He first asked if the goals of free trade by 2010 and 2020 are realistic. Many economists have concluded that APEC's goals are short of details. One possibility is that APEC will remain a loose framework, with subregional groups gaining momentum and strength because their particular goals are clearer.

Väyrynen then stressed the issues of democracy and human rights, asking if it would remain possible to keep them out of the agenda. These issues have up until now been handled in a bilateral framework, with the US and China being in most visible disagreement. China, he emphasized, will continue to resist bringing up human rights in a multilateral format. In fact, he argued, China's mercantilism, its military buildup, and its human rights policies may require even more emphasis on bilateralism (with the US seeking to contain China), and multilateralism may suffer as a result.

Finally, Väyrynen asked about leadership in Asia. With Japan seemingly absorbed with internal affairs, the most likely scenario may be a hybrid of US-Japanese leadership coupled with weak multilateral arrangements.

In response Job acknowledged that China does want regional power and pointed to a dilemma: He asked whether or not the value of keeping China in APEC was worth abrogating issues such as human rights. "Asian, consensus decision-making," he said, "cannot ignore sensitive issues in the long run."

Michael Plummer argued against directly putting sensitive political and security issues on the table, especially while APEC is in its infancy.

Clark Reynolds pointed out that increased regional economic integration may lead to more economic and political conflicts and problems but the resolution of these problems is less likely to be through aggressive unilateral measures. There will be greater negotiation among members to solve problems.

## **II. REGIONALISM vs. MULTILATERALISM**

### **II.1. Multilateralism and Regionalism: Conflicts and Cooperation**

In Yorizumi Watanabe's "Multilateralism and Regionalism" is a concise and comprehensive reference text of the General Agreement on Tariffs and Trade (GATT) articles pertaining to regional trade arrangements. In particular, he examined the GATT articles delineating the conditions that must be satisfied in order for a free trade agreement (FTA) to be permitted by the GATT/World Trade Organization (WTO). As Watanabe pointed out, the most important—and surprising—thing to realize about FTAs is that they are a violation of the GATT rules and, thus, they are allowed under GATT only as exceptions. Finally, Watanabe made

useful comments on these articles, pointing out ambiguities and problems in their interpretation as well as citing actual examples of how they have been applied in practice.

GATT effectively forbids FTAs. As Watanabe put it:

Trade preferences such as any special tariff reductions applying exclusively to specific countries are prohibited, in principle, under GATT Article I, which requires most-favored nation (MFN) treatment as a basic rule (Watanabe ms., p. 2).

That is, “all [the] contracting parties of the General Agreement have been bound to grant each other treatment as favorable as they give to any other country” with respect to tariffs and trade regulations: “the MFN principle thus allows no country to give special trading advantages to another” (p. 3).

Under GATT—according to Article I—free trade agreements would not be allowed because a country cannot extend trade privileges or tariff reductions to one country unless it also extends them to *all* GATT members. But, as stated, there are various other articles in GATT that allow countries to get around Article I. Article XXIV: 5(b) states that if a group of countries form a free trade area, then the tariffs and trade regulations pertaining to nonparticipating countries cannot be more restrictive *ex post* (articles XXIV: 8(a) and XXIV: 5(a) state the same thing with regards to customs unions); then there is the so-called Enabling Clause which provides developing countries with an additional way to get around Article I:

Regional or global arrangements entered into amongst less developed contracting parties for the mutual reduction or elimination of tariffs...must be designed to facilitate and promote the trade of developing countries and not to raise barriers or create undue difficulties for the trade of any other contracting [i.e., contracting to GATT] parties. Neither should such arrangements constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on an MFN basis (p. 6).

Although the Enabling Clause seems similar to Article XXIV: 5(b), having a separate clause available only to developing countries has created a problem:

The Enabling Clause has been conceived as permitting regional arrangements among developing countries under less stringent conditions than those applied to developed countries under Article XXIV. It is, however, *not so clear as to what extent these conditions have been relaxed* (p. 6, emphasis ours).

This ambiguity caused trouble, for example, in 1992 when Paraguay, Uruguay, Argentina, and Brazil wanted to form their own common market (Mercosur): they argued that the Enabling Clause meant that their agreement did not have to hold to the standards of Article XXIV: 5(b), while nonparticipants argued that “given the size and importance of the agreement, Mercosur could not escape the obligations provided in Article XXIV” (p. 7).

Finally another fact that Watanabe's paper made clear is that the impressive sounding wording of Article XXIV: 5(b) and the Enabling Clause has not prevented countries from violating them, to at least some extent, in practice. For example, when Sweden, Finland, and Austria recently joined the European Union (EU), their tariffs on some high-tech items actually went up, although "in permitting its member states to use different criteria to establish origin, the EU violates the GATT requirement that the parties to a CU [customs union] apply substantially the same trade regulations to nonmember countries" (p. 13).

## **Discussion**

Discussant Denis Goulet asked whether regionalism impedes multilateralism/globalism and, conversely, whether multilateralism ultimately eliminates or displaces regional arrangements? Or does regionalism facilitate the development of multilateralism? That is, is regionalism a stepping-stone to global multilateralism or a millstone around its neck?

Watanabe replied that overall, global multilateralism still plays a more important role than trade regionalism because trade regionalism inherently creates outsiders and the outsiders are often the weaker and smaller countries. In the case of the North American Free Trade Agreement (NAFTA), for instance, the smaller countries in Central America are the victims, and this kind of victimization is an inherent part of any regional trade grouping. So he believes that the proliferation of regional trade agreements should be under the auspices of the multilateral trading system.

Due to the overriding importance of the North American and EU markets, it does not make much economic sense to those of us in the Asia-Pacific scene, he said, to form a regional economic bloc. However, regional cooperation is generally felt to be a desirable goal, and this is the role that APEC can play because it is a very important forum for the promotion of regional cooperation.

These remarks seemed to point to the conclusion that APEC is important for facilitating economic cooperation in the region but, due to conflicting interests, it would be difficult for it to grow into a formal customs union/regional free trade area.

Reynolds called into question the argument that regionalism—the 'new regionalism'—victimizes smaller countries. He thought this might reflect a misunderstanding of at least the goals if not the realities of the 'new regionalism.' In his view the object of working with contiguous regional partners where there are profound asymmetries among them is to try and mitigate to some extent the backwardness of the less developed regions that are linked with the more developed and faster developing regions, while recognizing that this cannot be done globally or instantly.

He used as an example the asymmetry in development that exists between Hong Kong and China. “You can’t expect globalism to deal with that kind of problem: it’s too big and it’s too localized. You’ve got, for example, immigration questions on your border.”

Another example he cited is Mexican interest in Central America and vice versa and the existence of agreements between the two. Central Americans are not afraid of being swamped by Mexico; rather, Central Americans have been fleeing up to Mexico not only for political but also for economic reasons and Mexico believes that the only way to have a stable relationship is to try to develop Central America.

This said Reynolds, is the new regionalism. The old regionalism of the '50s and '60s argued that small countries are victimized by the big ones—“the big countries are going to eat us, we have to protect ourselves”—hence the old regionalism’s closed policies of import protection as opposed to the new regionalism’s open policies of export promotion and multilateralism. The new regionalism is more of a functional process, and in that respect we have much to learn from Asia.

Watanabe agreed that regionalism, as long as it is open regionalism, does not necessarily impede the effective functioning of multilateralism. He expressed concern, however, about systems such as the American concept of the hub-and-spoke system: Country A has preferential agreements with country B and country C, but between countries B and C there is no such preferential agreement so investment will flow into country A but not into countries B and C. Watanabe claimed that this will certainly harm the global functioning of multilateralism because the very virtue of multilateralism is that the less powerful developing countries can take advantage of all the results multilaterally negotiated.

Reynolds concurred that the hub-and-spoke approach is not consistent with open regionalism, but he did not find this a fair characterization of NAFTA or of American trade policy in general.

Kwan Kim opined that the essential element of regionalism is discriminatory, otherwise it should not properly be called regionalism. He said he had not seen any hard proof that even open regionalism is beneficial to everybody.

## **II.2. Emerging Multilateralism in Asia and the Pacific**

Tsutomu Kikuchi argued that regionalism has now become a major factor shaping the structure of the world economy and is thus one of the most important factors in international politics. A ‘new’ regionalism in the form of APEC has emerged in the Pacific region. Kikuchi discussed reasons for this development, the characteristics of this regionalism in the Asia Pacific,

and the tasks that lie ahead as members of APEC seek to maintain and build on their current relationships.

## **The Rise of Regionalism**

In spite of falling trade barriers and increasing globalism, regionalism in the form of organizations such as NAFTA, the EU, and APEC has emerged in various parts of the world. Kichuchi offered several explanations for this. The decline of US hegemony has allowed the international economic system to become multipolar in nature. Regionalism is seen as a way to enhance international competitiveness of member economies by expanding markets. Additionally, many developing countries have abandoned import substitution and actively seek market access to developed countries; developed countries, in turn, are investing heavily in these countries. This interdependence is encouraging forms of regionalism that include nations in widely different stages of development. APEC is a prime example of this: it includes countries that are large and small, developed and developing.

Kikuchi characterized two processes by which countries come together to form a regional grouping: community building and institution building. Community building is a natural, gradual process that occurs over decades and even centuries. A similar history and geography becomes the foundation on which people and firms build a 'community.' On the other hand, institution building is a process by which political actors (often states) deliberately establish frameworks or systems to achieve some end. Common objectives, rather than common histories, are the prime reason for building institutions.

## **APEC**

Where does APEC fit into this framework? APEC is not as institutionalized as organizations like NAFTA and the EU; it is neither a customs union nor a free trade agreement and it does not have any policy instruments that discriminate against nonmembers. The diversity and the history of the region mitigate against tight institutionalization. Most countries place a high priority on maintaining national autonomy and independence.

Although APEC is also an organization that has refrained from using the term 'community,' Kikuchi argued that the actions of most APEC members reveal a distinct preference for community building. Reasons for this include a process-oriented rather than a results-oriented approach to regional cooperation, the desire for a loose, informally structured APEC, and an emphasis on consensus decision making and confidence building.

## **Building a Viable APEC**

There are, however, important differences among APEC members. Asian members of APEC are much more inclined to argue against institutionalization and the adoption of binding agreements. Asian members are quite critical of trade agreements like NAFTA, pointing out their

exclusionary character and unsuitability for such a diverse region as Asia. Instead they stress that APEC should continue to adhere to a principle of 'open' regionalism in which non-APEC members are not subject to institutionalized trade discrimination. On the other hand, the US and other countries such as Australia and Canada have been much more eager to formalize and institutionalize APEC procedures.

Kikuchi argued that the lack of binding agreements in APEC presents a problem: it allows domestic opposition in individual countries to hinder the development of a free trade area. He also warned that the US may resort to bilateralism if it perceives the unilateral liberalization efforts of other countries as being too slow. According to Kikuchi, the solution is to continue to strive for open regionalism while also striving for concrete negotiations seeking agreement on such areas as the liberalization of trade, the adoption of an investment code, and a mediation mechanism to manage intraregional dispute. This will create a de facto free trade area in the Asia Pacific Region.

Kikuchi also stressed that Asia still needs the involvement of the US to sustain regional stability and that APEC will help maintain the interest of the US in Asian affairs. The Japan/US alliance remains crucial for the peace and prosperity of the region, and APEC provides a regional framework for the two countries to share a leadership role.

The great task now facing APEC members is how to integrate China into a regional and a global framework. The potential for Chinese expansionism worries many of the countries in the region. However, it is impossible to develop an open and liberal trade and investment regime in the region unless China takes part. According to Kikuchi, the integration rather than containment of China is critical for the establishment of a secure and stable Asia.

### **History Matters**

Lastly, Kikuchi argued, the history of the Asian region needs to be carefully considered as regional cooperation is sought. The Korean peninsula still destabilizes the region. The history of disagreement and confusion among Allied powers regarding Indochina and the wars that followed now affects Vietnam as it tries to find its appropriate place in a changing regional setting. The Cold War had a tremendous impact in the region and there are still unresolved rivalries stemming from it. Many Asian states are now anxious to express their cultural and national identities which were subsumed during the Cold War. Many remain suspicious of Japan becoming a military power again, and thus Japan is largely unable to take a leadership role in the region. All of these legacies point to the importance of a historically informed approach as Asia-Pacific regionalism is promoted.

In conclusion, Kikuchi argued for caution as members of APEC seek greater mutual cooperation. More ambitious members of the organization must not adopt sweeping initiatives

that may alienate other partners. However, APEC's existence is pointless if it fails to carry out meaningful objectives; thus, setting appropriate objectives and determining the proper speed at which to achieve them is very important. The diversity of the region and the overall lack of a strong community consciousness makes this task all the more difficult. Patient diplomacy and the will to cooperate is especially required of China, Japan, and the US. APEC members should concentrate on the practical and the achievable and should cultivate a gradual, confidence-building approach.

## **Discussion**

Discussant James Rakowski began his discussion by asking several questions. Just what is regionalism anyway? Is it always the same thing? What place does it have in a global economy? Is it a good idea or a bad idea? Reviewing several of the terms and ideas Kikuchi employed in his paper to describe regionalism, including 'outward,' 'open,' 'mega,' 'institutional,' 'noninstitutional,' and 'nondiscriminatory' regionalism, Rakowski commented that regionalism seems to be a "widely varied thing." He also noted how cautiously Kikuchi seemed to approach the idea of regionalism and asked him to explain in more detail why Asian countries seem so ambivalent about regional arrangements like NAFTA.

Väyrynen noted that Kikuchi's characterization of Asia's 'new' regionalism reflects economic competition: regional agreements help to mobilize all available factors of production. He asked whether regionalism is a stepping stone to new global multilateralism or whether it is the beginning of a new fierce competition among trading blocks.

Reynolds called into question the argument that regionalism victimizes smaller countries. According to Reynolds, this argument misunderstands the goals if not the reality of the new regionalism: the object of working with regional partners is to try to mitigate the backwardness of the Less Developed Countries (LDCs).

There were several comments regarding regionalism and multilateralism. Plummer observed that Asia's 'open' regionalism is beneficial for world trade if it also pushes multilateralism. Kim argued that the term 'open' regionalism is misleading: the essential element of regionalism is discriminatory, especially in the short term. He also argued that multilateral liberalization may harm certain countries, citing the case of countries in Sub-Saharan Africa. Watanabe stressed the importance of global multilateralism for weaker countries: a multilateral system allows those countries to exercise substantial voice in negotiations.

### III. REGIONAL DEVELOPMENT AND INTEGRATION FROM ASIAN PERSPECTIVES

#### III.1. An ASEAN Perspective on APEC

“An ASEAN Perspective on APEC” by Yoji Akashi gave a detailed history of APEC. Akashi related the historical events in terms of the different fears and goals of the participating countries, explaining *why* the various players acted as they did and thus providing a basis for predicting what will happen in the future.

The Asia-Pacific Economic Cooperation (then consisting of just the twelve founding countries) met for the first time in November 1989 in Canberra. What was remarkable about this meeting was who was at it: APEC consisted not only of the six ASEAN countries of Thailand, Malaysia, Indonesia, Brunei, the Philippines, and Singapore but also of Japan, New Zealand, Australia, South Korea and, from across the ocean, Canada and the United States. As Akashi stated, “the participant nations welcomed the meeting, though every nation had its own ulterior motive...” With reference to supporting documentation he went on to analyze these ulterior motives.

For example, Japan has avoided pursuing a leadership role in APEC because—consistent with the Asian concern for what others think of them—the Japanese “were afraid other Asian nations would suspect that Japan and the United States were attempting to dominate the region with their military and economic power.” In contrast—in what is perhaps consistent with Western thinking—US Americans seem only reluctantly concerned with how their actions are perceived by their fellow APEC members: this was especially evident at the 1993 APEC meeting in Seattle where, as Akashi documented, the United States was pushing its own desire for a formal trade agreement and the institutionalization of APEC in a way that the Asian members found much too heavy-handed.

Why do the Asian countries prefer agreements on trade matters to be nonbinding and informal? Why do they resist APEC becoming a more formal organization with greater power? Part of it is because, as Akashi stated, APEC’s Asian members were wary of moves to institutionalize APEC:

The United States, after all, had a pool of trained lawyers who could codify laws and regulations to its own advantage, and Asian countries were particularly alert against any codification that might infringe upon their sovereignty. They preferred APEC to be a loosely organized, informal and merely consultative body.

Or, as Akashi stated with respect to the East Asian Economic Caucus (EAEC):

EAEC is as much a group of East Asian nations to discuss issues informally...and arrive at conclusions by consensus. This is what is meant by caucus. *This is an Asian way* [of doing things]. America and Australia, Mahathir [President of Malaysia] insists, do not have such a culture; they solve problems through a rigid legal approach and tend to impose their opinions on others [as opposed to seeking a decision by consensus].

Unless one realizes the above, the resistance of the Asian countries to sitting down and writing a formal agreement that is legally binding becomes difficult to understand. In the Western press, such resistance is interpreted as due to stubbornness or selfishness or backwardness, but when one reads Akashi's paper (and Kikuchi's as well), one sees that this is a misinterpretation: they simply have a completely different way of looking at things. With regard to this, an enlightening exercise is to read Brian Job's "APEC: Beyond Economics" (which, like Akashi's paper, will also be published in its entirety as a Kellogg Institute Working Paper) to see how a Westerner interprets the very same events: the differences in interpretation and evaluation are striking.

Akashi's paper provided not only a history but also a 'guide' to the conflicting interests that are currently at work within APEC and what we should and should not expect regarding the breadth, specificity, and enforcement mechanisms of any regionwide agreements in the Pacific Rim. For example, given our new understanding of how the Asian members of APEC look at things, it should not be surprising that when APEC members finally resolved to move towards free trade (in 1994 at Bogor, Indonesia), the agreement they reached was nonbinding on its members.

Akashi listed the so-called Golden Rules adopted by the organizers of the Canberra meeting at which APEC was founded: APEC decisions are to be made by consensus; the role of APEC is to be consultation *not* negotiation; APEC should not establish a permanent secretariat; APEC should not be invested with authority, or as little authority as possible. On looking at these rules, one can see that they would be anathema to the European/American way of doing things. What is the use of forming a body if it has no power? If decisions have to be by consensus, how can anything ever get done? Proceeding by consensus without formal mechanisms of enforcement is not congenial to the European mind but, from reading Akashi's paper (also Kikuchi's), it is clear that, to the Asian way of looking at things, these rules make perfect sense. Why join an organization if you can have decisions *imposed* on you? Why spend decades fighting for your independence from colonial powers and then turn around and sacrifice part of your sovereignty unless decisions are made by consensus?

Given how consistent these rules are with the Asian way of looking at things, it should not be surprising that—except for the founding of a permanent secretariat—APEC has stayed true to them. For example, at the Bogor conference, the APEC members unanimously agreed to move

towards free trade—even setting target dates—but neither the movement towards free trade nor the target dates are binding on any of the members.

### **Discussion (Akashi)**

Kim wondered why Malaysia had targeted the US, rather than Japan, as the enemy. He pointed out that the small Asian countries, such as Korea, the Philippines, and Thailand, were more afraid of the potential economic dominance of Japan and inclined to see the US as a counterforce to Japanese influence.

ASEAN, Kim emphasized, is composed of six countries, heterogeneous in size, level of development, endowment, and even trade strategies. Increasingly they are moving from labor-intensive to capital-intensive industrialization, which means more dependence on Japan, South Korea, and the US for help with capital and technology. Under these circumstances it makes no sense economically to narrow integration to a smaller area; he does not see the ASEAN countries forming an EAEC (East Asian Economic Caucus) type of bloc. Whereas Akashi concentrated on the Malaysian point of view, Kim would hazard that Singapore, for example, is more interested in a global Pacific framework, and Indonesia and Thailand would prefer to work in a larger group than ASEAN, at least including Japan and the Asian NICs and possibly Australia and the US. Politically other ASEAN members might sympathize with Mahathir, but in practice they will lean towards the economically more important countries in the region, such as South Korea and Taiwan.

Akashi replied that Mahathir's objections were not so much directed at the US in particular as at the West in general. Mahathir was characterized as an intense nationalist who still harbors bitterness about the British colonial past and is fearful of what he sees as the tendency of the US to impose its will on other countries.

Kikuchi reminded participants to distinguish between rhetoric and actual policy implementation where Mahathir is concerned. Mahathir may strongly criticize the US's Western-oriented actions but at the same time he has, albeit cautiously, approached closer economic relations with the US. For example, the last time he attended the UN general meetings, he met with leaders of General Motors to invite them to invest in Malaysia. Job agreed that much of Mahathir's rhetoric was probably designed for domestic purposes within Malaysia.

### **III.2. APEC and the Japanese Economy**

Satoshi Hanai detailed two distinct phases that the Japanese economy went through in the last decade: the emergence of the 'bubble economy' from 1986 to 1991 and the serious recession that followed the bursting of that bubble in the first half of the 1990s. Next, he evaluated Japan's role in APEC. In his conclusion Hanai raised a question: How will Japan's current economic troubles affect APEC and the other East Asian nations as they continue to seek high growth? Hanai suggested that the past adaptability of Japan and other East Asian countries will allow the region to continue to prosper despite any short-term hardships brought on by Japan's current recession.

#### **The Bubble Economy**

Japan's 'bubble years' were characterized by 1) a rapid expansion of the economy, 2) relatively stable prices for goods and services, and 3) an extremely steep rise in land and stock prices. What differentiates the bubble years from past phases in Japanese economic expansion was the astonishing rise in asset (land and stock) prices. In his paper Hanai detailed the long-term trends in different price indexes to reveal the degree to which asset prices separated from the prices of commodity prices during this period.

From 1986 to the end of 1989 the Nikkei stock market index went from 13,000 points to 39,000 points. Similarly, the prices of land in Japan's six largest cities tripled. The rate of increase of asset prices far exceeded the rate of increase of Japan's commodity prices and of GDP during the period. These price increases are a classic example of 'bubble' inflation.

Why did the explosion of asset prices happen? Hanai points to the appreciation of the yen after the 1985 Plaza Accord and the actions of the government to cushion the economy from this shock. The doubling of the yen within two years after 1985 caused businesses to radically cut production costs and to shift resources into higher value added products. Exporting industries did much better than expected. At the same time the government adopted a series of expansionary measures, lowering the discount rate five times from 1985 to the beginning of 1987. The money supply increased significantly at a time when Japanese industry was still performing well and when commodity prices were relatively stable.

Using an aggregate demand and supply framework, Hanai argued that expansionary monetary policy combined with an exporting sector that was not significantly hurt by the appreciation of the yen caused aggregate demand to increase. At the same time imports became cheaper, which meant lower production costs; thus, aggregate supply also increased. Combining equal increases in aggregate demand and supply curves (a rightward shift in these curves) reveals that the aggregate price level of ordinary goods and services remained unchanged while

the aggregate output level expanded. Instead of going into commodity markets, the extra money that was injected into the economy ended up going into asset markets. This excessive money in asset markets created significant bubbles in stock and land prices.

### **The Bursting of the Bubble and the Recession**

The 'popping' of these bubbles was dramatic. The Nikkei index went from close to 40,000 yen in 1989 to as low as 14,000 yen by mid-1992. Soon thereafter land prices began falling. By 1991 the whole Japanese economy began to decelerate. The growth rate of real GDP fell, consumer spending fell, capital investment became increasingly sluggish, the growth rate of consumer prices fell, and wholesale prices continued to drop. Unemployment began to increase.

Hanai again used an aggregate demand and supply framework to show that decreased consumer spending and capital investment caused aggregate demand to decrease, while the continuing appreciation of the yen has resulted in an increase in aggregate supply. The combination of these two shifts in the curves reveals that output has remained the same (or is slightly negative) while prices are declining.

### **Japan's Role in APEC**

Hanai argued that in the past Japan has been particularly well positioned to help other East Asian countries. Japan can 1) help improve insufficient industry infrastructure, 2) help increase efficiency in the use of energy, and 3) help to educate and train human resources in the region. However, the recent recession in Japan raises a question. Will Japan's economic woes adversely affect neighboring East Asian countries, or will East Asian dynamism spur Japan's economy to a 'more mature growth stage'? Although Hanai did not attempt to answer this question in any detail, his basic tone is optimistic. Hanai concluded that by expanding free trade relationships and further securing economic ties to its East Asian neighbors (and other members of APEC such as the US, Canada, and Australia), Japan will be helped by the dynamism of the Asia Pacific region. This will in turn allow Japan to continue to contribute substantial resources to the region.

## **III.3. Human Resource Development in Asia**

In "Human Resource Development in Japan and Asia" Shozo Inouye first documented the importance of human resources in economic growth and development in Asia. He then described forms of technical cooperation between Japan and its Asian neighbors that are particularly useful for developing human resources and mentioned some of the difficulties that are encountered in implementing these technical cooperation programs.

## **The Importance of Human Resources**

Growth accounting provides evidence that one-third to one-half of output growth in Asian countries is attributable to labor inputs and total factor productivity. This highlights the importance of developing the quality of management and labor as Asia continues to develop. Many countries in Asia have a wide pool of labor available for work, but finding skilled workers can be a problem. Job matching is not always easy, and different countries deal with this in different ways.

Human resource development can help alleviate job mismatching problems and make the labor force more productive. New entrants to labor markets may need training and education that facilitate their transition from formal schooling to their first job. Workers already on the job may need skills development training to further increase their adaptability to rapidly changing jobs in a rapidly growing region. As a country that has quickly developed and is known for the quality of its human resources, Japan is well positioned to cooperate with other Asian countries in human resource development.

## **Japan's Contribution to Human Resource Development**

There are numerous ways in which Japan contributes to human resource development. Inouye discussed several recent trends. The number of vocational trainees accepted from developing countries has steadily increased since the early 1980s, rising from a little under 10,000 individuals in 1981 to well over 20,000 in 1992. Foreign students studying in Japanese universities have increased significantly, especially since 1989 (rising from around 8,000 students to close to 30,000).

Japan also sends experts, study teams, and youth corps members abroad. In 1992 over 15,000 individuals were dispatched to developing countries to assist in development projects and to do feasibility studies. Additionally, close to 2,000 youth corp members were sent to assist developing countries; of those, 549 were sent to Asian countries.

To improve workers' skills in specific sectors such as the machine, metal, automotive, and electronics industries, Japan has built training institutions in many ASEAN countries. Inouye pointed out that these training institutions were first established in the 1970s to improve the basic skills needed for employment; more recently, skill development for job holders and for local instructors has been emphasized.

Inouye also stressed that management development training is critical for improving productivity at the firm level. NGOs are important in management development, and the Japanese government provides financial resources for many of these NGOs. Representative organizations are the Japan Productivity Center, the Japan Federation of Employers Association, the ILO association, and the Asian Productivity Organization. To encourage managerial and

labor awareness of the importance of increasing productivity these organizations put on workshops and training courses and publish manuals and research findings. To be effective, however, these organizations also have to be willing to adapt to the local needs within individual countries.

Finally, Inouye noted that developing human resources is not easy. Many technical cooperation programs fail: some do not find enough trainees, others may not provide workers with the right skills. To increase the effectiveness of cooperation with other countries in the human resources arena Japan needs to strengthen country specialists and build on the personal networks that inevitably develop with training and education programs. Inouye concluded by stating that Japan's commitment to improving human resources will continue and that these efforts will have positive implications for the Asian region.

### **Discussion (Hanai and Inouye)**

Yusaku Furuhashi first extended Hanai's empirical analysis of Japan's recession by asking what Japan should do at this stage. Although policymakers have tried all of the textbook methods of stimulating the economy, it has remained stagnant. Tax cuts, government spending, and a record low interest rate have accomplished little. According to Furuhashi, economic deregulation and liberalization and corporate restructuring would help the economy, but politics mitigate against this. Furthermore, he argued, the worst may finally be over for Japanese companies, and because of this they may avoid or delay fundamental restructuring. This may lead to lower growth rates than would be possible with deregulation and restructuring.

Furuhashi also argued that Japan's ties to Western nations will continue to shape Eastern Asian affairs. Japan may face trade deficits with Asia in the long run, and this and other factors may reinforce Japan's ties to the West. As Furuhashi put it, "Japan may be tilting towards Asia, but its center of gravity is remaining put." Japan's stake in Asia is likely to make it an effective ally of the US and European countries as all three seek to contain future economic conflict. He concluded by noting that although the Asian region has not turned inward, it is possible, especially if NAFTA or the EU begins to take on an exclusionary character. US policy and US/Japan policy cooperation should work to preserve the open character of the region.

Juan Rivera first noted the complexity of the human resource development field. The government, multinational corporations, domestic companies, and international agencies all have a role to play in development of human resources. There is also the issues of how to train workers and who will pay for training. Rivera specifically mentioned several problems with training workers. How do you effectively develop human resources when technology is changing so quickly? Downsizing in developed countries and uneven development in big countries like China exacerbate the problem. Rivera also noted that Inouye's numbers on Japan's role in

human resource development indicate that Japan may have much more to do in the area. He criticized the fact that much of the human resource aid has strings attached and called for aid that focuses on workers who are not employed by Japanese companies.

Reynolds addressed Hanai's and Inouye's papers by asking: If Japan does not have any money, where is the money for East Asian development and human resource training programs going to come from? Hanai replied that in the short run there may be a slight decrease in assistance, but in the long run Japan still has the resources to provide substantial overseas development assistance.

Plummer noted that Hanai's presentation of Japan's economy reveals the price deflation that is going on in Japan, a situation that could result in financial crisis. Thus APEC needs to share and discuss basic information in order to collectively prevent problems like price deflation in the future.

#### **IV. COOPERATION AND INTEGRATION FROM US AND LATIN AMERICAN PERSPECTIVES**

##### **IV.1. Open Regionalism: Lessons from Latin America for East Asia**

Clark Reynolds first defined 'open regionalism' and then went on to demonstrate why it is that this type of regionalism—which APEC embodies—should result in pure trade creation as opposed to trade diversion. He showed that the presence of net trade creation does not imply that real wages will rise: If the economies involved are sufficiently asymmetric it is highly likely that real wages will fall and, where this is a possibility, he advocated an active government fiscal policy combined with skills enhancement and job training. Finally, he argued that all the countries in the region will benefit if open regionalism not only involves the lowering of tariffs and other barriers but also active economic cooperation among the countries involved.

##### **What is Open Regionalism?**

What is the difference between 'open' and 'closed' regionalism? Closed regional integration involves "the geographic extension of protection, market reserves, and other barriers of exchange from the national to the regional level, whereas "open regionalism is understood as a strategy of international economic opening which stresses regional cooperation with an emphasis on the reduction of intraregional transactions costs, broadly defined."

##### **Why Open Regionalism Should Result in Trade Creation and Not Trade Diversion**

Why can regional integration result in trade diversion under traditional economic analysis? When regional barriers are dropped—while maintaining barriers against

nonmembers—it will likely be the case that items that were formerly purchased from the lower cost extraregional suppliers will now be purchased from regional suppliers: not because the regional supplier is truly lower cost in terms of the value of the resources consumed to produce that commodity, but because the price the consumers of the region face is equal to the world price plus a tariff.

Reynolds' analysis was more optimistic in that he took account of several factors that the preceding, traditional analysis, ignores: the effects of regional integration on transactions costs, the effect of market widening on production costs and the impact, if present, of increasing returns to scale. Reynolds included transactions costs in his analysis because of the empirical fact that the effective costs of tariffs and other barriers are not just the tariffs themselves but also the added administration, paper work, communications and transport costs resulting either from complying with the tariff and nontariff barriers or dealing with all their associated red tape: "Our work on the Andean region indicates that they amount to ten or more percentage points in total value added." Since integration would lead to the reduction or elimination of these, regional costs would be lowered by *more* than the amount predicted by standard analysis.

Another of Reynolds' critical departures from traditional analysis was his incorporation of increasing returns to scale. If, as there is every reason to believe, there are economies of scale at the industry and national level, then the market widening accompanying the decline in trade barriers will allow these economies to be exploited. Result: Average costs of production could easily fall enough to cause regional production of many goods to become internationally competitive.

Thus, by taking account of the reduction in transactions costs and assuming that increasing returns are present—a not unrealistic assumption in the long run—one should expect that trade diversion is much less and trade creation much more than is predicted by traditional analysis.

### **Why the Integration of Asymmetric Economies Could Result in a Fall in Real Wages**

Although Reynolds' analysis was optimistic with respect to the results of liberalization on efficiency and GNP, he pointed out that there is no guarantee that real wages will benefit from all of this. Although liberalization will shift the marginal revenue product (MRP) of labor (i.e., labor demand) curve to the right, if there is a large increase in the supply of labor due to the elimination of jobs in the more labor-intensive, less efficient agricultural sector (as in Mexico), the net result could be a fall in real wages. Such an outcome is much more devastating to the economy than just a fall in the income of the workers involved: Since market widening (critical in allowing the exploitation of economies of scale) comes about not just from the access to a larger population

but also from their purchasing power, it is vital to prevent this purchasing power from being eroded by a fall in real wages.

### **The Policy Action that Reynolds Recommends**

Given that a fall in real wages is a real possibility, Reynolds advocates an activist government policy to ensure that displaced workers are provided with skills training and, if that is insufficient to prevent a fall in real wages, that job opportunities be created, for example, by building infrastructure via public works projects. Finally, it is important that all the countries involved coordinate their efforts in this area. The reason for this is that, because capital will tend to flow to the countries with the lowest wage rates, those countries that allow a huge surplus of unemployed labor to build up will attract a lot of capital that might otherwise have gone to the other countries of the region. Thus, it is in every country's best interest to assist the smooth development of its regional partners.

Following the above strategy should not only prevent a real wage collapse but also allow the gains from trade to be diffused throughout the population—via increased job opportunities and better wages—so that the market size will increase still further, allowing still greater exploitation of any increasing returns and permitting regional output to become still more competitive.

### **Conclusion**

Professor Reynolds' paper provided a theoretical justification for believing that regional trade agreements can result in pure trade creation rather than trade diversion. In addition, he examined the effects of such integration on real wages and, in cases where a fall in real wages is likely, made a case for both an active domestic policy and regional cooperation to deal with this problem.

### **Discussion**

Jaime Ros commented that he found Reynolds' paper to be very thoughtful and provocative. However, the definition of 'open regionalism,' the term that appears repeatedly in the paper, was not exactly clear to him. At times—and especially at the beginning of the paper—Reynolds seemed to suggest that 'open regionalism' is the new wave of regionalism as opposed to and in contrast to the closed regionalism that was attempted in Latin America through the Central American Common Market, the Andean Pact, and the Latin American Free Trade Agreement (LAFTA). And that was really an extension of import substitution to a larger economic space.

But, especially at the end of the paper when the author defined open regionalism as “one that maximizes the benefits of trade creation and distributes these benefits fairly among countries and social groups,” Ros opined that Reynolds was using “a more romantic definition of ‘open regionalism’—‘as it should be.’” Ros raised the question, in what ways is regionalism as currently practiced really ‘open regionalism,’ i.e., regionalism ‘as it should be’?

There is, he continued, an interesting discussion of how the traditional analysis of trade creation and trade diversion is modified when we bring in nontariff transaction costs and increasing returns to scale. In summary, if regional integration brings about a fall in the regional price net of transactions costs, which may, as a result, fall below the world price, then trade creation would indeed be larger and trade diversion smaller than what traditional analysis would lead us to expect.

Similarly, if economies of scale, as a result of market expansion, lead to a fall in regional costs, which may, as a result, become lower than extraregional costs, then, again, trade creation is enhanced and trade diversion is reduced. Incidentally, in this case the region will have created a comparative advantage in some increasing returns industries. Ros agreed with all this but asked: Does it follow from this that the case for preferential regional trade agreements is stronger because of the presence of transactions costs and economies of scale? He suggested that the same argument would apply to multilateral as opposed to regional integration.

Ros argued that, if there are transactions costs and they fall as a result of multilateral trade liberalization, then world prices net of transactions costs will also fall, and if there are increasing returns activities, then world costs should also fall as a result of the market expansion following a multilateral trade liberalization. If transaction costs and increasing returns to scale enhance the benefits of regional integration, then they should also enhance the benefits of multilateral integration. If this is not so, then the case for regional integration is based on infant industry grounds because the region has a long-term comparative advantage in some increasing returns industries that would not be realized in the event of a premature multilateral integration. Ros noted that this sounds close to the closed regionalism of the old Latin American variety.

His second set of comments referred to the issue of the distribution of the gains from regional north-south integration. He shared Reynolds’ concern about the danger that the benefits from integration between developed and developing countries may be heavily biased against labor as a whole. He derived the following example from the paper by way of illustration: Suppose that capital—as a result of regional integration between two asymmetric economies—flows from the developed country, which has an inelastic supply of labor, to the developing country, which has a very elastic labor supply. Real wages will then fall in the developed country along a very steep supply function and they will increase in the developing country along a very flat supply function. The result is that although overall employment

increases, the overall level of real wages falls, i.e., there is a downward convergence of real wages.

In the context of NAFTA, Ros maintained that the paper correctly called attention to the fact that the structural adjustment that Mexican agriculture will have to go through may shift the labor supply function of the urban centers in the developing countries. He feared that these problems will be with us for years to come, with or without formal regional integration agreements, and shared Reynolds' viewpoint that these formal regional agreements are in a sense a response—an attempt to regulate—a process that is much older, a process of silent integration that has been going on for a long time. He also shared the perspective of the paper that the only long-term solution for this problem is the progressive tightening of labor markets in developing countries.

The question of whether regional integration will help or not with respect to increases in real wages, he argued, depends to a large extent on the size of its benefits in terms of market expansion and productivity gains: If these benefits are large, formal regional integration is likely to mitigate the trend towards downward convergence of real wages as it accelerates the transition towards tighter labor markets in developing countries; but if the gains are small, then we should perhaps stop worrying so much about the formal regional arrangements and focus our attention towards other mechanisms that would accelerate the pace of development in the developing regions.

On the question of the definition of open regionalism Reynolds replied that we have not really seen full open regionalism, though he thinks that NAFTA is closer to it than other efforts at integration. Among other things, it has domestic content requirements because there is asymmetric external protection: This raises, rather than lowers, transactions costs and tends to divert.

Reynolds pointed to a distinction between the original rhetoric lying behind closed regionalism and the actual practice. The Andean Pact did not in practice set the stage for a gradual move towards liberalization but rather for directly unproductive rent seeking. Small markets with import substituting industries became a little bit larger under the pact but there was still so much protection that the suppliers were able to make directly unproductive rents while having no incentive to open to the rest of the world. "You don't open the rest of the world when life is comfortable, unless somebody hits you on the head or some external threat comes and forces you to get competitive."

Reynolds went on to speculate about what happens when you attempt to integrate very unbalanced economies: How does this affect the partners as they begin to integrate and how are these asymmetries affected by the opening process? What happened that we did not expect as a result of NAFTA? The 1994 peso meltdown reflected something that had already happened to

some extent in 1982: Namely, that the process of asymmetrical integration of markets tends to begin with the liberalization of the financial system. He was not referring to active government decisions to liberalize the financial system but rather claiming that technology and the development of financial markets around the world are opening the system up whether we like it or not and the financial flows are incredibly rapid as a result.

If there are large asymmetries between economies that are opening up to integration and thus becoming more volatile to capital real investment flows, then it is hardly surprising, said Reynolds, that the management of this interdependence becomes more problematic. Not too much has been done in NAFTA about the management of major financial disequilibria or about major short-term capital flows between the United States and Mexico.

A major macroeconomic shock in one of two asymmetrical partners, such as the peso collapse, will affect the real wage—Mexico's real wages are going to go way down in dollar terms when the peso collapses just as they went up over time when the peso was being overvalued.

Reynolds acknowledged that the analysis in his paper goes back into the old trade creation/trade diversion literature and claimed that it shows what is different about the new integration. The new integration is basically lower transaction costs through regional cooperation taking advantage of the benefits of proximity, which are enhanced by the new technologies, and taking advantage of the joint approaches to infrastructure, education, and so forth in order to make the region as a whole more competitive in international markets. The effect is to create trade, not to divert trade.

Next he addressed the issue of social access. How do you diffuse productivity growth and how does this diffusion of productivity growth translate into higher wages? If you have a very elastic supply of labor, then you may delay a long time the improvement in real wages that would come with a rise in average productivity and, if that happens, you can have a Chiapas and the slums of Mexico City for decades, even with significant growth.

In other words, structure matters; for example, if a copper exporter like Chile opens up its economy, there will likely be a fast impact on copper exports but a slow impact on wages throughout the economy because not many people are employed in copper. Whereas if a country like Costa Rica increases exports, the result will be a big demand because the production of exports is diversified.

Our evidence from the Andean region, Reynolds concluded, is that there are enormous possible gains in the reduction of transactions costs from regional cooperation.

## **IV.2. APEC from a US Perspective**

Michael G. Plummer in “US Interests and Asia-Pacific Cooperation” pointed out that, given the enormous amount of trade and investment flowing between the East Asian countries and the US—“the Asia-Pacific region is now the most important overseas market for the United States” (p. 2)—it would be in the interest of both to develop APEC into an organization that facilitates trade, where ‘facilitation’ of trade could mean anything from APEC serving as a forum within which trade disputes are peaceably resolved to the development of APEC into a full-fledged free trade area. With respect to the latter possibility, Plummer dealt with the fact that traditional economic analysis is not very enthusiastic about free trade areas because—unlike the multilateral dropping of trade barriers—they can be trade diverting since they cause purchases to be rerouted from lower cost nonmembers to higher cost member sources. He pointed out that this criticism suffers from a huge deficiency: it simply does not take into account the many positive effects that the much larger market will have on innovation and on production costs. That is, if one takes into account the ability to exploit economies of scale, the external economies (e.g., pools of trained, specialized workers and knowledge), the greater return available to R & D, and the increased attractiveness to foreign investment that a larger market provides, then there is every reason to believe that the trade diversion effects will not be very important.

Against the standard economic analysis that “preferential treatment of partner countries causes a partial reallocation of purchases from more efficient nonpartner sources to less efficient partner sources (trade diversion), resulting in a lowering of global economic efficiency” (p. 3), Plummer raised two objections. First, while acknowledging the argument’s persuasiveness in theory, he pointed out that, realistically speaking, the world is not going to move to multilateral free trade any time soon, so moving regionally towards free trade may be the next best thing:

PTAs [Preferential Trading Areas] are by their very nature ‘second-best’ solutions and, hence, are inferior to the ‘first-best’ solution, i.e., free trade. But because the first-best solution is unattainable at present, the proper comparison is between the *status quo* and a preferential grouping (p. 13).

Second, he argued that the rejection of such agreements on the grounds of trade diversion omits the most important consequence of a PTA: the creation of a larger market. This increase in market size carries with it numerous benefits that traditional analysis simply does not take account of:

- 1) If there are external economies (e.g., increased availability of specialized inputs or services or “know-how and/or proprietary technical information” dispersed among firms with the intrafirm movement of employees), then the larger the market, the more beneficial will be the effects on average costs of production;
- 2) the larger the market, the greater the number of efficient competitors that each industry can support (which has a positive effect on efficiency);

- 3) the larger the market, the greater the probability that producers in the region will have a large enough market to fully exploit economies of scale and thus support a world-scale plant;
- 4) the larger the market, the greater the incentive for the undertaking of R & D because the larger market allows for greater revenue per dollar of R & D expenditure; and, finally,
- 5) the enlarged market will make these countries more attractive to foreign direct investment since the profit potential, everything else being equal, will be much greater.

He also pointed out that “while DFI [Direct Foreign Investment] flows usually constitute a small percentage of total domestic capital formation in Asian developing countries, they have played a key role in manufacturing sectors beyond what the numbers indicate, as joint ventures, licensing agreements, and other enterprise relationships have resulted in transfer of technology that has contributed to the advancement and modernization of the economies concerned” (p 9).

If we take account of all these effects, then the negative impact of any trade diversion that results could easily be *more* than offset by the positive impact arising from all these other forces. Yet traditional analysis ignores them.

He emphasized that, whether APEC develops into a free trade area or not, other countries have been busily developing their own preferential trading areas (the EC and NAFTA being the two most famous) and the result of this has inevitably been the diversion of trade and investment from the nonparticipating countries of Asia.

Overall, Plummer’s paper demonstrated that both the East Asian countries and the United States have a huge interest in the development of APEC, both parties not only representing important markets for each other’s output but also important sources of and opportunities for investment: “East Asia is...the fastest-growing region in the world and is forecasted to grow at an impressive rate in the future, suggesting continuing opportunities for lucrative trade and investment” (p. 21).

## **Discussion**

Discussant Jeffrey Bergstrand presented two models analyzing some technical aspects of the relation between economic size and per capita incomes and the share of intraregional trade among Pacific Rim countries.

In the subsequent discussion Plummer further laid stress on the fact that free trade areas are very complicated. The old textbook way of describing a free trade area was simply that there be no internal tariff barriers. This may be true, but this is only a very small part of the whole thing. As John Whalley once noted, “if NAFTA really was a free trade area it could be just a paragraph long instead of being 2,000 pages long.” For an EAEC free trade area or an APEC free trade

area we should think in terms of 15–20,000 pages because there are such divergent regimes and legal practices, which is what really inflated the NAFTA agreement. Plummer argued that an Asian FTA is neither feasible nor desirable, mainly because this is not an Asian approach to things and the presence of divergent legal structures is not going to make it any easier. He referred to Akashi's previous observation with respect to APEC that everything was left to be decided later—nothing was expressed concretely. The experience with ASEAN is a good illustration of the Asian way of doing things: there is no ASEAN treaty, there is no enforcement mechanism, there are no monitoring devices—and ASEAN constitutes the core of APEC!

Plummer argued that we can no longer focus on the standard Vinerian argument of trade diversion/trade creation because of the complications of free trade areas and the dynamic effects that go with them. The economic rationale of free trade areas can be questioned if they are dominated by unilateral trade liberalization. For example, if a country like Indonesia drops all of its tariff barriers it can have trade creation but no trade diversion, because it is on a most favored nation (MFN) basis, which will be superior to having a discriminating trading arrangement. But Canadian economists Wonnacott and Wonnacott came up with the idea that perhaps one of the motivations for liberalizing your markets in a free trade area is that other countries will also open their markets to your exports and, if you include the liberalization of other markets, the dominance of unilateral trade liberalization over the creation on an FTA disappears. We come back to the argument of "Well, it depends"; a second-best solution approach.

Plummer commented approvingly that finally economists have started to think more about the dynamic effects of integration. Even in a net trade diverting free trade area there may still be other effects that could more than compensate. The new literature on natural economic blocks, introduces the idea that regionalism, if consistent with the natural trading patterns, can actually be beneficial.

The dynamic effects of FTAs can be characterized in a number of ways: external economies, greater intrafirm rivalry. Plummer argued that direct foreign investment flows are extremely important in stimulating intraregional trade flows, although this has not been considered very much in the literature, mainly because it is very difficult to model.

Policy dynamics, whether good or bad, should also be taken into consideration. An inward-looking policy would be a negative dynamic. On the other hand, an open regionalism solution whereby you lower external tariffs and nontariff barriers for all countries while you liberalize would obviously be a positive policy dynamic internationally. For example, the Asian Free Trade Agreement (AFTA) is liberalizing tariffs within the free trade area and at the same time multilateralizing, i.e., these tariff reductions apply to all countries outside of the free trade areas as well. A net trade creating FTA will tend to knock out a lot of inefficient firms within that

area, leaving more efficient firms, at least at the margin more internationally competitive, and these are precisely the firms that tend to want to have openness rather than closedness.

Plummer cited studies on the effects of FTAs by the World Bank and others, using general equilibrium models. These conclude that on the whole an APEC free trade area would be welfare-enhancing for member states but inferior to the most favored nation treaty because you have a much larger customs union or free trade area and global [free] trade is always going to be best.

In practical terms the question becomes to compare the status quo to what might be in the future and, even though the Eminent Persons Group seemed to want to go very quickly, Plummer's reading is that the focus within APEC is going to continue to be trade facilitation, rather than discriminatory agreements, particularly with tariffs since tariff rates are already so low. The focus should be on issues like harmonization of standards, rules of origin, investment codes, opening of dialogue, and confidence building.

Denis Goulet commented that almost everyone who talked about APEC at least mentioned incidentally that there have been no instrumental results—either in trade promotion or economic advantages—in the few years that it has existed. Plummer remarked several times that the transformation of APEC into a free trade agreement is most unlikely. Several speakers noted that there are no enforcement mechanisms or penalties, no commitments in the form of binding obligations to do something in trade. So Goulet's question was, what is APEC? The rather malicious answer would be that it is a club. And to Goulet it does seem that its first function is information exchange: members keep each other informed. It also functions as a P.R. agency, trying to sell the beauties of free trade. If this is APEC or a reasonable facsimile thereof, Goulet failed to see that the US has any particularly significant stake.

Plummer agreed that Goulet's characterization of APEC was a fair one, but demurred that current circumstances would not allow it to move any faster. In stressing the important stake that the US has, Plummer said he was talking about a longer-term vision of closer relations with APEC with eventual binding investment codes. He foresaw that there would be greater standardization of products and other means to reduce transactions costs in the longer term. He predicted that at first codes would be nonbinding and the focus would be mainly on mutual confidence-building measures.

He argued that there should be some sort of framework agreement under which these progresses can be charted and directed. If there are disputes in areas where the WTO does not have jurisdiction, it may make sense, for example, for Thailand and the US to sit down under the auspices of an APEC—rather than a purely US-Thai relationship in which Thailand would know it is always going to get the short end. Thus some sort of dispute panel, even if nonbinding, would be a good idea. He claimed that one of the main reasons Canada wanted a free trade area with

the United States was as a means of getting a dispute settlement panel going. Though he would call this trade facilitation rather than trade liberalization he would see it as positive. Goulet's point was well taken, he said; there has not been much progress. But, while more definite progress might have been desirable, Plummer doubted that it would have been feasible at this point.

## Conference Wrap-up

Fr. Robert Riemer chaired the conference wrap-up and began by emphasizing the importance of communication and mutual understanding between Americans and Asians. Americans, he said, tend to go into Asia with a stress on institutions rather than community. Intentions may be good but a lot of damage may be caused in the process—rather like the effect of “a bull in a China store.” One of the reasons for this is a lack of cultural communication. Riemer stressed the importance of cultural sensitivity as we seek to develop the human community of the APEC region and noted that sociologists and anthropologists may have much to contribute.

Several people then gave brief comments and observations. Job commented that there remains much work to be done as we try to understand the process of international integration. The often discussed idea of silent, ‘natural’ integration is intriguing for political scientists, who tend to think in terms of clear goals and objectives. What are the impacts of this type of integration? We must also consider the converse: ‘nonspontaneous’ integration. The question of how APEC fits into these processes remains unanswered. Job pointed out that politicians do not make decisions based on economics alone, and that there will be times when domestic affairs may cause decisions that look highly irrational from a regional or an international viewpoint.

Reynolds argued that the disintegration of traditional culture and values as growth occurs is something we should not forget. He also mentioned the importance of learning from the experiences of Asian countries, focusing specifically on Japan: even though Japan’s old institutional model may be in deep trouble as capital markets open up, there may be things we can learn from Japan’s institutions and values.

Plummer commented that it will remain important for us to think about what Japan’s relationship will be to Asian countries and to the US as the APEC region develops.

Watanabe cautioned that regionalism needs to be put into historical context so that we can work to avoid the negative outcomes of some of the regional arrangements in the past. The fragmentation of markets in the 1930s was characterized by regionalism, bilateralism, discrimination, and uncertainty. Watanabe argued that these four phenomena can be seen be seen again today, and thus the importance of globalizing economic growth continues.

Kikuchi ended on a positive note, stressing that APEC has an important role to play in liberalization and in pioneering a form of regional cooperation less dominated by the US. Like Father Riemer and many others at the conference, he emphasized that the way to go about developing an effective APEC is to be open to the insights of social scientists from a wide range of disciplines.