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KIEL WORKING PAPER NO. 869

Regional Integration APEC Style:
Are there Lessons to Learn from Regional Integration EU Style?

by

Rolf J. Langhammer

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Regional Integration APEC Style: Are there Lessons to Learn from Regional Integration EU Style?

Abstract

The paper discusses similarities and differences between past EU binding internal liberalization „across the board“ in the industrial sector and present so-called voluntary sectoral liberalization of member states of the Asia-Pacific Economic Cooperation (APEC). While both approaches are second-best compared to unconcerted unilateral liberalization, the major disadvantage of liberalization APEC style in the industrial sector consists in introducing distortions between sectors as well as between member states due to rising disparities in timing liberalization within Asia Pacific. Such disparities raise problems of time consistency of liberalization under the so-called Bogor target of achieving free trade within APEC in 2010 (2020 for less advanced member states). Reliance on „peer pressure“ as the only mechanism to commit member states to liberalization is seen as a weak driving force to make APEC's concerted unilateralism a stepping stone for the successor round of the Uruguay Round. The paper proposes a number of measures successfully applied in the EU to give APEC's liberalization more „teeth“ to the benefit of multilateral liberalization.

JEL Classification: F14, F15
Keywords: Regional integration, trade liberalization, open regionalism, multilateral trade negotiations

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REGIONAL INTEGRATION APEC STYLE:
ARE THERE LESSONS TO LEARN FROM REGIONAL INTEGRATION EU STYLE?

I. Who Plays the Music Determines the Tone: APEC's Medley versus EU's March

APEC and the EU have often been described as two very different approaches to regional integration. To specify the familiar label attached to APEC, that is „open regionalism", Garnaut [1996] defines APEC as 'concerted unilateral MFN liberalization of trade by a number of states'. The EU way of forming a free trade area, customs union, common market and economic union in a stepwise approach can then be labeled 'concerted plurilateral non-MFN-(discriminatory) liberalization by a specified number of club members'.

These descriptions do not necessarily preclude that APEC's regionalism is effective and that EU's regionalism is closed. APEC's approach could become redundant if a critical mass of countries prepared to liberalize concertedly does not exist or if countries from the very beginning prefer to transfer the APEC approach to the WTO multilateral trade negotiations. Furthermore, nobody prevents a country whether or not it is located in the APEC area from liberalizing unilaterally without waiting for neighbors to join. On the other hand, the EU way to regional integration must not be „closed" *per se* and in fact was not closed except for the agricultural sector. There is unanimous evidence from a number of empirical studies, showing that since 1957 the EU preference margin declined substantially especially in recent years since parallel to the removal of trade barriers within the Community trade barriers with the rest of the world in the industrial sector were dismantled as well [Sapir, 1992; WTO, 1995]. It was the WTO Secretariat itself which attributed part of the success of the post-war worldwide liberalization to the process of regional integration in Europe moving on a parallel track of internal and external dismantling of trade barriers. Yet, two

important qualifications are necessary. Between EU internal and external liberalization there was no fixed link which would have committed the Union to automatically lower external trade barriers when lowering internal barriers. Second, external liberalization on a club basis may have proceeded more slowly for individual member states than if the member states had the sovereignty to liberalize unilaterally. For some other member states, it might have been the other way round: regional discipline forced them to liberalize more rapidly vis-à-vis non-member states than if they had the chance to decide on their own. The net result of the two conflicting positions within the European Union is not easy to specify because of the counterfactual and because of the special situation of the agricultural sector. Hence, at least for the manufacturing sector one can argue that the group of „liberal“ traders within the Union had sufficient weight (and financial means) to induce the „less liberal“ members to liberalize more than under the national scenario. This advantage seems higher than the uncertain loss of options for the more liberal countries to liberalize more under the national scenario. For instance, it is unlikely that Germany would have liberalized more had it stood alone compared to what the country was prepared to liberalize concertedly with the other members.

Ultimately, both approaches are concerted in the sense that member states of the two schemes share common targets such as trade liberalization, both within the region and outside. Each member state in the respective region is prepared to liberalize provided that others join him. Hence, the reciprocity element in concerted liberalization is also common to both the EU and APEC. But it is here where the common elements seem to end.

The major difference between the EU and APEC is the way they play the theme called liberalization. For musicians, APEC is like playing a simple medley in an orchestra of talented musicians who find together because everybody enjoys music on his own. Beyond music, they do not share other

common interests. Admission to the orchestra is largely free (except from the prerequisite that musicians in the early stage should come from a specific geographic quarter). At a later stage, everybody is invited to join the orchestra. Given its open nature, admission to APEC basically requires the ability and the will to play an instrument and it is up to the choice of the individual member of the orchestra which instrument he wants to play. The way the orchestra finds its harmony is simply by playing the medley and by playing to improve quality through benchmarking, that is taking the best player as a reference. APEC calls this benchmarking peer pressure.

In contrast, the EU needs a much tougher approach. What they play is a march with an exact rhythm and time because it is only this type of music which is believed to guarantee discipline and to prevent the members of the orchestra from falling back to old times of dissent and dispute. The march is a means to prepare for the ultimate stages of discipline and convergence, that is playing „a capella“ in a family. To beat time, a conductor is needed who, on the one hand, has its own vested interests and, on the other hand, can be controlled by the orchestra through exerting group discipline.

In economic terms, a conductor of the EU orchestra means implicit economic leadership. Post-war trade policy history has shown Germany in the industrial sector to exert economic leadership by urging for internal and external liberalization and by persuading other member states to follow suit. Such persuasion was by no means costless. It comprised payments for the various structural and regional funds, decoupling of the agricultural sector from external liberalization, shouldering a major part of financial burden of subsidizing agriculture (with some selfish interests to continue subsidizing its agricultural sector), assuming the role of the anchor currency and surrendering sovereignty over trade policies (and other policies) to Brussels. Instead of peer pressure APEC style, „do et des“ bargaining EU style had to be pursued until discipline

in the orchestra was such that the march could be played. Such bargaining has become legalized in contractual form from the very beginning, but with ascending order of commitments. Today, the type of music the EU plays is still the march but increasingly sophisticated pieces are played. New members are therefore coached outside the orchestra in a preparatory room before they are allowed to join. Leaving the orchestra is not taken into consideration as the revenues of the orchestra are sizable especially for newcomers who can benefit from its long-standing reputation. In a music contest, bringing the two orchestras together, precision and loudness of the EU march audibly dominates the elegance and innovativeness of the APEC medley which is still looking for making itself perceptible. Whatever we know about APEC, is that the medley will not offend the ears of the audience while the EU march is sometimes said to do so. Yet, there is also a big drummer in the APEC orchestra who outside the orchestra can easily play a similar sound if the EU march should be found unduly loud and aggressive.

The question to be tackled in the following is whether the young APEC orchestra can take some lessons from the old and experienced EU orchestra and whether this would yield a good harvest for APEC. Before taking lessons, however, it is essential not to suppress what the two regions have shared in contributing to expanding world trade and to commit themselves in their discipline vis-à-vis the world trading order and what they share in terms of challenges (Chapter II). Departing from common strengths and challenges, Chapter III highlights the essential differences in orchestrating trade liberalization and their underlying economic and political underpinnings. Chapter IV stylizes major elements of the framework under APEC which APEC operates (since the Bogor targets) and their possible implications and constraints as seen from a European perspective. Chapter V departs from the findings derived from Chapter IV and proposes elements of the EU liberalization which

could accelerate the APEC process without changing its nature. Chapter VI concludes on the results.

II. APEC and EU: Common Strengths and Challenges

1. Strengths

a. Contributing to world trade expansion without trade diversion

APEC and the EU comprise the leading trading partners in the world. Member states of the two groupings have absorbed about 82 per cent of world imports and 85 per cent of world exports along a rising trend in the mid-nineties. Distinguishing between intra-area and extra-area trade provides hints for the potential of further trade expansion either replacing domestic production (trade creation) or substituting for trade from non-area trading partners (trade diversion).

If for reasons of simplicity APEC is confined to the three sub-groups developing Asia (including China), Japan and the US thus disregarding Australia/New Zealand, Canada and the Latin American member states, it becomes evident that the rising share of APEC in world trade (from 37 per cent in world imports 1990 to 44 per cent in 1995) was mainly carried through by higher growth of intra-area trade than extra-area trade (Table 1). As a result, the share of intra-area exports in total exports of the three core sub-groups rose from 64 to 69 per cent within the first half of the nineties with overproportionate growth in Japan and lower growth in the US. For both developing Asia and Japan, APEC trading partners absorbed three quarters of their total exports in 1995. In contrast, the EU intra-area trade share (comprising EU 15) slightly declined by 4 percentage points for two reasons. First, acceding new members had lower intra-EU trade shares than the old members and secondly, rapidly growing economies expanding their import demand were outside the EU. The latter reason seems more important.

Table 1 – Share of Intra-Area[a] Exports in Total Exports

	Sub-group	1990	1995
APEC	Developing Asia (incl. China)	73	75
	Japan	68	75
	US	51	54
	Total APEC Sub-groups	64	69
EU 15		66	62

[a]Areas are defined as APEC and EU respectively.

Source: UN, Monthly Bulletin of Statistics, current issues.

This rough breakdown bears two interesting implications. First, trade expansion between rapidly growing economies can be achieved without discriminatory trade policies and thus without impeding market access to non-members. Under such circumstances, trade will not be diverted from the low-cost source to the high-cost source because of unequal treatment. This is the message from the APEC figures as APEC did not pursue such policies during the first half of the nineties. APEC's *regionalization* was market-driven and not policy-driven [Langhammer, 1995]. Secondly, deepening and widening *regionalism* (note the different wording) will not promote further trade diversion if two conditions are met. Internal dismantling of trade barriers is simultaneously accompanied by commitments and implementation toward trade liberalization vis-à-vis non-member countries. Furthermore, GDP growth differentials between the rest of the world and the integration scheme become larger. This is what happened in the EU in the early nineties. The EU has been acknowledged to have liberalized external trade further [WTO, TPRM, 1997] while driving forces for economic growth were weak. The latter point is supported by the observation that there was zero growth of real gross fixed capital formation in EU 1990-1995 contrasting to the US and developing Asia

with annual growth rates of about 4 and 8 per cent, respectively [European Economy, No. 64, Table 20].

To summarize the first common element between the EU and APEC, both groupings were the major stimulants of world trade in the early nineties. Somewhat counterintuitively, the EU did not expand intra-area trade as in the decade before while APEC did so. Therefore, as APEC did not pursue discriminatory trade policies, neither APEC nor the EU can be blamed to have expanded industrial trade to the detriment of third countries during this period.

b. Participation in reforming and strengthening the multilateral trading system

Both the EU and the APEC economies have been the engines in concluding the Uruguay Round (UR). While the EU acted as a single entity, APEC economies practiced concerted unilateralism also in Geneva, however, with the major contribution from some APEC economies in the Cairns Group representing the interests of net exporters of agricultural products and with the most important single country effort of the US in negotiating the Blair House Agreement with the EU.

In terms of quantifiable commitments, both the EU and the APEC economies (excluding the not yet-WTO member China) reveal liberalization performances which stand up to a comparison with the rest of the world (Table 2). The import-weighted APEC average of industrial tariff reduction amounted to 32 per cent which is the same rate achieved by a representative group of rest of world (ROW) countries. The EU-12 and EU-15 reduction is only slightly higher. This is remarkable as the APEC is not only influenced by the industrial countries' strong compliance with GATT/WTO prescriptions but also by developing countries with traditional claims for special and differential treatment. The same assessment holds for the weight of imports subject to bound tariffs. Again, it is noteworthy that after the UR more than 80 per cent of imports of the APEC economies is subject to bound tariffs which brings a high degree to

accountability and stability into internal liberalization endeavors of APEC. In this respect, the Bogor targets benefit from the Geneva commitments. For the EU, tariff binding is complete while the ROW is located between APEC and the EU. The most important superior achievement of both APEC and the EU compared to the ROW is in the importance of imports subject to zero tariffs. Here, the ROW (18 per cent) scores far below the two groupings' rates of 52 per cent (APEC) and 38 per cent (EU). Yet, the merits of high shares of imports subject to zero tariffs are not unambiguous. Should zero tariffs be concentrated in input sectors while high tariffs are kept in downstream industries, tariff escalation within APEC could be high thus indicating high effective rates of protection and thus high discrimination between different stages of processing. Sectoral liberalization efforts (compared to across-the-board liberalization) could cement such discrepancies. This aspect is given further attention below.

Apart from quantifiable commitments, both the EU and APEC economies have supported the WTO in qualitative reforms, for instance, by complying with the dispute settlement mechanism and by contributing to transparency in new areas such as trade in services, TRIPs and TRIMS. They have also repeatedly expressed their interest in submitting further liberalization efforts to the WTO rules instead of negotiating bilaterally. This also holds for the Transatlantic Market Place Initiative between the US and the EU which would be embedded in the multilateral trading framework. In general, it is fair to say that it is the group of Asia-Pacific APEC members which has the lowest stake in preferential trading and highest stake in MFN-based trade among all major trading partners. Thus, supporters of the multilateral trading order can be expected to come primarily from this quarter.

Table 2 – APEC and EU Commitments in the Uruguay Round

	(1)	(2)	(3)
APEC			
Australia	39	96	16
Canada	47	100	39
Japan	56	96	71
New Zealand	50	100	43
US	35	100	40
Hong Kong	0	23	100
Indonesia	0	92	2
Korea, Rep.	54	89	26
Malaysia	9	78	23
Mexico	27	100	1
Chile	29	100	0
Philippines	6	67	0
Singapore	0	73	46
Thailand	22	70	1
Import-weighted APEC average	32	83	52
EU			
EU 12	37	100	38
Austria	32	100	38
Finland	31	100	35
Sweden	33	100	34
Import-weighted EU 15 average	37	100	38
Rest of the World (ROW)			
Norway	44	100	65
Switzerland	32	100	35
South Africa	30	99	21
Argentina	19	100	0
Brazil	34	100	5
Columbia	20	100	0
India	55	68	16
Tunisia	0	32	1
Turkey	11	39	3
Venezuela	38	100	0
Import-weighted ROW average	32	88	18

(1) = Percentage reduction of industrial tariffs.
(2) = Share of bound imports in industrial imports (post UR conditions)
(3) = Share of imports duty-free in industrial imports (post UR conditions)

Source: Hoda [1994]. Own calculations.

2. Challenges

a. Increasing heterogeneity through enlargement

Both the EU and APEC are bicycles in motion. The EU faces the challenge of parallel deepening and widening of the integration process while APEC tries to sustain the momentum by encouraging member states to subscribe to ambitious targets (Bogor) and actions (Manila) adopted at the annual summit meetings. Ongoing motion, however, implies costs in terms of increasing heterogeneity and costs of compromising. In the EU, under constant membership, one might expect increasing heterogeneity to be kept under control. However, different speeds of implementation, for instance, in implementing Single Market commitments, can lead to higher heterogeneity even among the old member states. In APEC, economic and political heterogeneity (some would call it diversity) is the most important challenge and from the very beginning was accepted as such by stressing the principle of concerted unilateralism.

But beyond heterogeneity under constant membership, there is heterogeneity due to enlargement. While the EU has decided to enlarge the Union in eastern direction, APEC has decided to go both northwest (Russia) and southeast (Latin America). In both cases, poorer countries with higher levels of external protection and substantially different perceptions of a market economy join more advanced countries. For APEC being widely informal, it does not make much difference to have Russia and Colombia/Peru/Central American countries at the table provided that peer pressure can still continue to work. Yet, this is open to debate as countries accede which have not yet acted in a competitive spatial environment where partner countries see themselves as units competing for mobile resources. While east and southeast Asian countries clearly have developed this environment internally and with respect to the US also externally, this perception is probably weaker in Russia and Latin America. Hence, should peer pressure as a major force which drives the APEC bicycle

become weaker, an enlarged APEC could be confronted to eventually establish stricter rules of checks and balances among a core group while allowing peripheral countries to go their own way. Hence, at the end, an explicit rule of „integration at different speeds“ could replace peer pressure and would make APEC even more „fluid“ than today.

The EU case is clearer. The gate to the EU will be opened fully only after the accession countries comply with the entire set of common legislation, rules and regulations which the EU calls the *acquis communautaire*. Hence, a long transition period is taken as a means to reduce heterogeneity somewhat. In spite of the smoothening role of transition periods (which APEC does not have), heterogeneity in terms of income disparities, differences in economic structures and world market orientation will rise in a similar way in which, for instance, the enlargement of ASEAN toward Indochina increases heterogeneity [Langhammer, 1997]. This gives rise to the question whether the EU with more than twenty members will still be capable to play music in a march style or whether it will gradually move to a medley style. Without prescribing conclusions, there is a case for arguing that a blend of elements of the APEC approach on the one hand, i.e. allowing new members to join quickly and thus stimulating reforms both in old and new member states, and of the EU approach on the other hand, i.e. giving candidates some pre-accession tasks, could be the optimal way to reduce some heterogeneities, at least those dealing with differences in commitments toward policy reforms.

b. More members, more plans, more policies

Apart from heterogeneity, it is the sheer size of both groupings which will establish challenges. Both the EU and APEC are heading for exceeding the number of twenty and both seem to have difficulties to implement strong reforms unless the summit meetings initiate and endorse them. The result is that summit meetings become overloaded with both setting new targets and

reviewing the state of implementation of the former ones. The price to be paid is less time of checks of coherence especially if at the same time heterogeneity increases. To an outsider looking at APEC, it appears that the rapidly rising number of acronyms standing for sets of measures and plans like OAA, MAPA, IAPs, CAPs, TILF, EVLS, ECOTECH mirrors the rising tendency of overloading the summit meetings not to speak of overloading the various Committees which are responsible for stock-taking and implementation. To an outsider looking at the EU, however, it appears that beyond targets toward the Economic Union, ambitious objectives spread beyond into the political field. Such political objectives must accept that it is still the old-fashioned trade policy which acts as a substitute for a common foreign policy which is still missing [Messerlin, 1997] and that it is this role which explains why the EU trade policy is so diverse and special toward individual countries.

c. From adoption to implementation

Both groupings have learned the lesson that adopting plans and programs is far from implementation. This seems self-evident for APEC which leaves it to member states to announce liberalization programs unilaterally and implement them in accordance with their domestic rules [Yamazawa, 1998: 12]. Whether peer pressure will be sufficient to induce member states to submit liberalization programs at least as consistent as those of the neighbors and to compete with neighbors in terms of early implementation, is an open question. But it is also open whether a fully legalistic approach with national law subject to revision if this is required by European law (a quasi anti-APEC approach) can guarantee implementation on schedule. It is known that countries like Germany and Italy are far behind schedule to implement the Single Market measures which are to be implemented since 1992. Even if stock-taking (either done officially by the EU Commission or unofficially by PECC or Asian economic scholars) provides

transparency on the state of implementation, both groupings seem to be bound to wait in patience for results to be delivered.

d. Susceptibility to asymmetric shocks

Heterogeneity is a constitutional element of large integration schemes and thus can be anticipated and accounted for. When enlarging a scheme it is certain that heterogeneity increases since founding core members as a matter of fact share more common interests and mostly more similar economic structures than latecoming peripheral members. What is uncertain and therefore costly in terms of precautionary action is the likelihood of asymmetric shocks shaking a grouping. While heterogeneity in principle raises the likelihood of asymmetric shocks to be deeper than in a homogeneous scheme, it is not evident that the outbreak of such a shock is a result of increasing heterogeneity. Instead, the causes may often arise from outside the grouping, such as changes in commodity prices.

For different reasons, in the past asymmetric shocks have challenged both APEC and the EU in a similar way, that is undermining the credibility of continuing the integration plans as if nothing has happened. In the EU, the major recent asymmetric shock, the German reunification, produced a boom, real appreciation, massive inflows, a current account deficit and the fall 1992 crisis of the ERM. The shock was the strongest in Germany and its neighboring countries pegging to the DM and the weakest in the UK and the Mediterranean countries. As the pound crisis also triggered contagion effects in the Mediterranean candidates of the EMU, it casted doubts on the credibility of the EMU project. Now, with the third stage of the EMU project scheduled to start in 1999, the risk of asymmetric shocks in the real economy has not become smaller since the speed of real convergence outside the core group is still slow. Nominal exchange rate changes as a buffer are no longer available and the burden to cope

with asymmetric shocks rests on labor markets which are not (yet) flexible neither concerning migration nor with respect to prices.

In East Asia, the currency crises have swept over a number of APEC (and ASEAN) member states as if the groupings had never existed. At hindsight, it is no surprise that financial markets heavily discounted membership in APEC. The scheme has competence (better: builds up competence) only in current account transactions which were not at the roots of the crises. For capital account transactions, it does not make a difference whether a country belongs to APEC or not. But the risk cannot be excluded that the burden of current account stabilization within APEC primarily rests upon import squeeze of affected countries, at least in the short run. Such squeeze is not only a result of a massive decline of domestic absorption or a credit crunch but perhaps also a result of some policy action, for instance, to postpone trade liberalization in general or to insist on exempting sensitive sectors longer from liberalization schedules than initially announced. It is this risk of second-round effects of the crises which APEC in the aftermath of the crises has to face.

e. Pathfinder for WTO universality

Both the EU and APEC members bear crucial responsibility for the stability and improvement of the multilateral trading system. One of the most stabilizing elements is universality, i.e. bringing all trading partners under the WTO discipline. Apart from few small countries, two large countries are still left out, Russia and China. While Russia may geographically or strategically adhere to APEC, it is economically linked much more strongly to Europe than to Asia. If the intensity of bilateral trade links can be accepted as a proxy for the degree of trade policy frictions, then it is the EU which bears special capabilities to act as a pathfinder in bringing Russia into the WTO. Such capabilities also exist under the current status of Russia as an accession candidate. A positive stance of the

EU can strongly help to shorten the time which is needed for Russia to accede to the WTO.

With respect to China, being even a member of APEC and economically most strongly integrated into the APEC region, it is clearly within the competence of APEC member states to accelerate the accession process which runs since 1986. To the non-APEC world, APEC would strongly gain in reputation if a summit meeting would signal green light for China's WTO membership. Such signal would certainly pave the way for China into the WTO.

III. Differences in the Trade Liberalization Targeting and Implementing Between APEC and the EU

Possible lessons from EU trade facilitation and liberalization have to accept a number of crucial differences in targets, constraints and means between the EU and APEC. Such differences can be briefly stylized as follows:

1. Synchronised Regional Versus Concerted Unilateral Trade Facilitation and Liberalization

The EU operates a common trade policy toward non-members and further facilitates trade among member states following uniform rules. This happens, for instance, by gradually lifting *ad personam* quotas in border trade of specific consumption goods (tobacco, spirits) which are still subject to different excise taxes in EU member states and the control of which requires checks at inner borders. For APEC member states, there is no difference between internal and external trade policies since trade facilitation and liberalization are not restricted to APEC members. Thus, the only umbrella is the commitment to focus liberalization on commonly selected sectors in order to meet the Bogor deadlines on the years 2010 and 2020.

Given the non-existence of common actions (or even policies) against non-APEC members, APEC members operate purely MFN-based. The EU,

however, as mentioned above, operate trade policies in the broader context of external relations being a substitute for a future common foreign and security policy. As such policies are *per se* discriminatory, it is the EU which can be made responsible for what is called the hub and spoke system which liberalizes trade between the hub and the spoke without necessarily liberalizing trade between the spokes and with other hubs (such as the US).

2. Across the Board Liberalization Versus Sectorally Differentiated Liberalization

With the general exception of agriculture and few manufactures (cars, textiles), EU internal liberalization has been based and is still based on the „across the board“ principle, i.e. liberalizing all sectors along a common formula. This principle also seems to be the departure point of an EU proposal to proceed in a next multilateral trade negotiations round. The advantage is well-known; nominal rates of protection decrease jointly with effective rates and no rent-seeking of sectors for special treatment is encouraged.

APEC (and also AFTA) proceeds differently. Their members agree on sectoral liberalization by selecting a number of priority sectors. Dee, Hardin and Schuele [1998] partly find the expected outcome of sectoral liberalization in the APEC Early Voluntary Sectoral Liberalization (EVSLs) proposals following the Subic Bay Summit in November 1996: some initiatives concentrate on upstream input sectors with low or moderate protection while the highly protected downstream industries are left out. As a result, the authors find significant second-best welfare losses. However, they also acknowledge that some initiatives have a broader coverage. Yet, in general, the early experience with EVSL initiatives tends to support the concerns that too much flexibility allowing individual APEC member states to opt for the least sensitive sectors as early liberalization candidates brings much less allocative gains than could be otherwise collected.

3. The Rule of Law Versus Peer Pressure

EU-internal liberalization of goods and service trade and factor movements is the overriding principle underlying the EU Treaty. Interventions into free trade within the EU are subject to painstaking inquiries and are accepted only in exceptional cases of negative consumer externalities, i.e. in the BSE („mad cow disease“) case and the subsequent import ban on British beef or in containing the trade consequences of national differences in the legal handling of consumption of soft drugs. But even in these cases, interventions are very porous as personal belongings of individuals moving across the borders within the EU are usually not checked, neither within „Schengenland“ nor outside. The principle of free trade now spreads into the remnants of national sovereignty, such as public health services. Access to the cheapest source of medical treatment including hardware (like spectacles and artificial teeth) has been opened thus bringing domestic providers of such services under European-wide competition. The European Court of Justice oversees the principle of free internal trade and by decision-taking binds national legislation irreversibly. The conditions for external trade liberalization are not as legally settled as for internal trade except for the sole competence of the EU Commission in external trade negotiations concerning border transactions (such as tariffs and tariff-equivalent NTBs) and the joint competence of the Commission and national authorities in some „behind the border“ domestic measures such as TRIPs. But as concerns the external negotiations, again it is solely the Commission representing the Union even when there is joint competence. However, while the Commission negotiates, it remains with the Ministerial Council to endorse and adopt the results of negotiations.

Given the legalistic nature of orchestrating trade liberalization within the EU negotiations, there are sanctions against non-compliance which „bite“ in terms of penalties. There is nothing comparable in APEC. Instead of formal

sanctions, there is peer pressure or moral persuasion to participate in liberalization offers or plans adopted during the summit meetings. There is no difference between internal and external trade liberalization. Nor is there a common negotiation platform vis-à-vis non-APEC states. What is common to the EU and APEC is asymmetric external liberalization between manufactures and agriculture. Those APEC members regarding their agricultural sector as non-competitive are not urged by other member states to liberalize this sector first. Likewise in the EU, EU member states with stakes in a domestic agricultural sector which seems less competitive under world market prices have always succeeded in urging upon the Commission that these sectors should be given more time before they open up to international competition. EU member states with an internationally competitive agricultural sector failed to convince other member states in arguing that continuing to protect the agricultural sector impeded structural change and growth in the Community.

4. Beyond Tariffs: Trade Facilitation APEC Style versus Removal of Barriers EU Style

Trade facilitation within APEC rests on two plans, the country-specific so-called Individual Plan of Actions (IAPs) adopted in 1996 and the Collective Action Plans designed in the 1995 Osaka Action Agenda as common guidelines to orchestrate individual procedures. As these plans go beyond tariffs and include NTMs, services, investment, standards, customs procedures, intellectual property rights, competition policy, government procurement, deregulation, rules of origin, dispute mediation and mobility of business people, one could argue that the issue coverage comes close that of the EU which had all these issues in its Single Market Program. Yet, there is a crucial difference concerning intra-area trade. The IAPs are intended to provide transparency on trade barriers which are to be removed (positive list) but fail to bridge the gap in information between this list and the remaining barriers. A panel type of qualitative

assessment of individual country commitments such as that of Yamazawa [1998] is necessarily conditioned by some degree of value judgment as concerns the deviation of commitments from the Bogor targets. However, it arrives at the acceptable conclusion that differences between APEC member states are large and systematically show the advanced member states (following the UR commitments) ahead of the less advanced member states. But again, one must stress that these are commitments only. As concern internal trade, the EU is far ahead. Many of the issues mentioned above are already under Brussels rule (for instance, competition policy) and in many cases barriers against maintaining trade restrictions were removed. For instance, in liberalizing internal air transport, the so-called „double disapproval principle“ states that tariffs fixed on a specific route become effective unless disapproved by both governments. Under this principle, a single government is no longer capable to protect its flag carrier against EU-internal competition. When the freedom of establishment was achieved thus abandoning the exclusive rights of state-owned flag carriers , this was the stepping stone to free movement of services with full cabotage introduced in 1997. One could easily extend this example to other areas and they all yield the same result: EU directives specified what was generally laid out in the Treaty as the four freedoms (goods and services, establishment, capital and movement of persons) and developed principles and rules to open up formerly segmented markets and to set deadlines for meeting the commitments.

As concerns external trade liberalization, however, many EU offers in the WTO, for instance, in services, still come close to the transparency and „positive list“ procedure. It is for this reason why the EU way of liberalizing new areas such as services has been seen as a helpful pathfinder for multilateral negotiations.

5. Free Movements of Persons: APEC's Limited Scope Versus EU's Full Scope

Mobility of people is an essential element of market integration. People are carriers of goods, business and consumer services and knowledge and can effectively tear down policy-induced barriers to trade by carrying these assets with them. APEC's approach is strictly limited to enhancing the short term mobility of the business community traveling within APEC for trade and investment. It goes without saying that this objective excludes migration of construction workers, for instance. Given the enormous differences in unskilled labor endowment within APEC, one could argue that labor mobility will be the last area to be liberalized and that micro- and macroeconomic costs of mobility are much lower if capital moves to labor than if labor moves to capital. But even within more homogenous regional sub-groupings such as ASEAN and NAFTA, free movement of non-business people is the last point on the integration agenda knowing that the degree of migration inertia has been traditionally lower for unskilled people in Asia than outside Asia (though probably still higher than for skilled people). That means that any policy measure toward freer movement of people is feared to trigger large migration flows which are seen unacceptable for political reasons.

For a long time, Europe had been in a more comfortable position. People-specific impediments to cross-border movement for commercial reasons were relatively large since labor endowment and employment opportunities were similar in Western European countries. The reservoir of unskilled people ready to migrate at any cost was small and „push" motives (motives which are exclusively rooted in conditions of the sending country such as distress migration) were irrelevant. Policy regulations such as mutual recognition of school grades and diplomas were strict and thus, in spite of the early enough adopted principle of free mobility of people, weakened the „pull" motives (the attractiveness of the receiving country). Today, migration within western Europe

outside border regions is still small though „pull“ motives become more important. Yet, similarities to APEC have increased with the pre-accession agreements of the EU with the much more unskilled labor-abundant Central and Eastern European countries. However, mobility of people from these countries has not been confined to business people but has early enough allowed migrant unskilled labor (subject to country quotas) to work temporarily in EU member states. In this respect, the EU has responded more offensively to the labor endowment differentials between the EU and the accession candidates than APEC in which this differential was huge from the very beginning.

6. APEC's Tacid Understanding of Non-Intervention into Domestic Policies Versus EU Move to a Common Foreign and Security Policy via Commercial Policies

It seems trivial to point to the entirely economic nature of APEC cooperation. The principle of non-intervention into domestic policies is vital to APEC's sustainability and is strictly maintained in order to keep disagreement, for instance, on boundary issues or human rights, within politically manageable dimensions. The EU approach has been different from the very first decade onward. Political cooperation was always conceived as a prime target to be approached via economic integration and, as mentioned above, trade policies toward non-member countries still act as a substitute to a common foreign policy. This long-term objective of intensified political cooperation between nations has always influenced trade policies in the way that compromises between more and less world market-oriented partner countries became easier. In other words, for the sake of not endangering the long-term objectives, agreements on common positions and policies have always been facilitated. This was most clearly shown in the final stage of the UR when French opposition against some elements of liberalizing trade in agriculture in the aftermath of the Blair House Agreement was removed by the other member states by endorsing French claims in other issues (anti-dumping). In general, the overriding principle

not to violate political cooperation has sometimes weakened the liberal position of the EU toward non-members and has tied the hands of those member states which would have been prepared to accelerate EU market opening.

An observer's view on APEC is that collective action in economic cooperation would be facilitated if there were broad common visions of principles of political cooperation. As they do not exist, the power for the APEC bicycle must be entirely generated from the economic benefits which individual APEC countries derive from their membership and from the spillovers which a critical mass of bundled individual countries' advantages creates for the „laggers" within APEC. Such power can easily evaporate if asymmetric shocks such as the current currency crises in Asia Pacific drive a wedge into APEC and reduce the critical mass of liberalization „leaders".

IV. Framework Conditions Determining Trade Liberalization APEC Style and their Implications

1. Open Regionalism: The Flip Coin Problem

The principles of openness and non-discrimination are APEC's brandmark. So is the regional label „Asia-Pacific" which in order to remain meaningful implies clarification on who is seen as (actual or potential) member of the region and who belongs to other regions. APEC has always sought to maintain the liberalization momentum by keeping the principles flexible and defining Asia-Pacific widely in terms of the entire Pacific Rim which would include Russia and those Latin American countries bordering the Pacific. In addition, the scope of issues has been opened from traditional trade liberalization to trade facilitation including alleviation of factor movements related to trade in goods and services.

This flexibility and openness brings APEC close to quasi-multilateralism and a semi-WTO from which the EU (as the major non-APEC grouping left) is

excluded because of the tyranny of geography. With both widening country coverage and scope of issues, APEC is called to define its genuine role vis-à-vis the multilateral trading system which shares the same principles (non-discrimination and wide scope of issues) but is stronger in implementation because it enjoys the advantages of contractional arrangements and commitments. Openness in its extreme form can go hand in hand with uncontained heterogeneity, sub-optimal informality and loss of track keeping. Should this development proceed, APEC members can be tempted to see the grouping only as a long-winded way to a Millennium Round in Geneva and to ask how large the value added is not to go this way directly but to pass via APEC. Increasing overlap and substitutability with the more powerful contractual multilateralism under the WTO is APEC's flip coin of utmost flexibility and openness. Being successful in this respect could make APEC ultimately redundant while it could be applauded for having protected the multilateral system against closed regionalism and aggressive bilateralism.

2. APEC in the Era of Sky-Rocketing Capital Account Transactions

APEC has been founded as a vehicle for trade facilitation within the Asian-Pacific Rim. As a result, APEC instruments, measures and procedures concentrate on reducing transaction costs in the current account. Though rising current account transactions find their counterpart in rising capital account transactions as concerns financing of trade flows repatriating investment income, this is not the major root of sky-rocketing capital account transactions in recent years. Instead, the latter transactions are autonomous in the sense that they are widely delinked from the current account and are geared to finance investment. Due to lacking monetary integration in APEC, the fruits of trade facilitation can easily become overshadowed by turbulences in financial markets and perhaps be made ineffective. This holds as market imperfections and negative spillovers have proven to impact more strongly on capital account

transactions than on current account transactions. In the course of the currency crises, APEC had to learn the lesson that its focus on the current account did not induce financial markets to believe that it would be risky to launch speculative attacks against the currencies of individual APEC member states. It is not likely that either a wider issue coverage and/or a wider country coverage in current account liberalization will help APEC to impress financial markets more strongly than in the past.

3. APEC and the Asian Economic Recession

Since its foundation, APEC has never been more seriously challenged by a spread of recessionary trends than in 1998. It seems that the burden of balance of payments stabilization in debt-ridden Asian economies in the short run will have to be shouldered mainly by declining import demand thus affecting other APEC member states which badly need foreign exchange revenues from exports. Past intensification of intra-area trade thus takes a heavy toll and puts strains upon the „business as usual“ continuation of accomplishing the Bogor targets. So do competing supply structures of East Asian economies in third markets after competitive devaluations. In addition to strains among East Asian developing economies, a growing trade surplus of Japan vis-à-vis the North American APEC members could give rise to the re-emergence of trade policy conflicts across the Pacific. Hence, there are at least three possible sources of stress among APEC member states.

In this situation, APEC is handicapped in arresting trade-restrictive measures by the informality of trade facilitation offers which can easily be postponed or withdrawn.

4. APEC Facing Asymmetric Shocks

Experiences with currency crises suggest adjustment periods to take more than two years if new institutional arrangements, for instance, in financial markets are

needed. However, even if the recession will be managed, the likelihood of asymmetric shocks departing from the capital account and no longer solely from the current account (such as the 'Dutch disease' phenomenon) can plague APEC for a longer period. This likelihood might call either for intra-APEC bail-out arrangements which might be rated non-credible by financial markets. Alternatively, APEC could signal its understanding of fighting asymmetric shocks by accelerating trade facilitation in sectors which are close to financial transactions, for instance, liberalization of trade in financial services. Again, as mentioned above more generally, APEC must then define its genuine role vis-à-vis the WTO arrangement for financial services coming into force in 1999.

5. APEC and the Millennium Round

One of the external framework conditions facing APEC is the endeavor of major trading partners to keep the WTO bicycle in motion beyond the mere implementation of UR commitments. The appropriate way of maintaining the momentum of world-wide trade liberalization is launching a new multilateral round, the Millennium Round. Signals in this direction have been sent by the EU Commission which, however, apart from few sensitive sectors like agriculture and audio-visual services, seems to prefer an „across the board" liberalization approach. This contrasts with the sectoral approach which is preferred by APEC and which since 1994 has also been pursued in the WTO (see information technology agreement). As APEC follows open regionalism, its stance toward the „across the board" approach and toward the requirement of reciprocity is important both for the progress in intra-APEC trade facilitation and for introducing this progress into the multilateral negotiations.

A compromise between the two approaches could be a flat rate of liberalization across the board followed by sectoral liberalization mark ups provided that a critical mass of non-APEC countries are prepared to liberalize specific sectors more than the flat rate.

V. Trade Liberalization EU-Style: What is Worth to be Taken into Consideration by APEC?

EU is certainly a widely different arrangement compared to APEC. Hence, any operational details of liberalization aiming at the customs union, the Single Market or even the economic union cannot be considered by APEC as it does not envisage these stages of economic integration before the Bogor targets are met. Possible lessons from forty years of EU integration can therefore be only taken from the institutional toolbox of rule-making and the operational level of the free trade area which unlike in the fifties today includes elements of free capital movements.

1. Anchoring Principles and Procedures in Liberalization Timetables

Internal trade liberalization focusing on the removal of border barriers can easily be made obsolete if domestic „behind the border“ measures remain untackled. As a result of substantial unilateral and multilateral cuts of border barriers in the past, domestic measures such as subsidies and regulations discriminating against foreign suppliers have become the true barriers to trade. This holds for APEC and for the EU. Instead of dealing with each issue separately, the EU has anchored principles and procedures in various layers of legislation. In the area of trade, the most important principle is that of mutual recognition based on the country of origin. Translated into the APEC context, this would mean that products (including services) which have been orderly marketed (without violating consumers' welfare) in a member state, could be supplied under the home country regulation in other APEC member states. This is a powerful defence against bureaucratic preferences for *ex ante* harmonization. In the second banking directive of 1989, the EU has applied this principle to cross-border supply of banking services. It is this sector which is of particular relevance to APEC in the current crisis since applying the home country

principle to the financial sector would initiate a healthy competition between different prudential standards of APEC countries.

However, given the MFN nature of all APEC liberalization measures, one may ask why this principle should be limited to APEC member states and not be extended to the EU provided that the EU applies the same principle to APEC.

Another more operational procedure in the EU which has been instrumental to stimulate competition is the so-called 'double disapproval rule' mentioned above in the context of liberalizing internal air traffic. If the majority of APEC member states wanted to augment peer pressure upon member states lagging in liberalization and if in the past freer trade was impeded by bilateral regulations (for instance, landing rights, fares), it can confirm this rule at a summit meeting. An individual member state would then no longer be capable to postpone liberalization against the requests of other member states to facilitate market access.

2. Monitoring and Transparency

The EU regularly publishes reports on the state of liberalization for various issues (interestingly enough, however, not for trade where it is the WTO Trade Policy Review Mechanism (TPRM) which pursues this task. The motive is to provide transparency and to enhance peer pressure where the Commission has no legal means to file cases. Such monitoring could take a similar two-step procedure as in the TPRM: the Secretariat reports on the state and the member state responds. Both, response and the minutes of the discussion, are integrated into a final report which is released for publication.

Monitoring and transparency is facilitated if targets are articulated for shorter periods and for precise sub-issues. In this respect, the Bogor targets seem fairly broad and vision-like rather than operational. The EU Single Market target

(1985-92) was agreed upon for half the timespan needed to arrive at free trade among the advanced APEC member states.

Finally, the maximum of activities is often not the optimum especially if the capacities of implementation are weak. APEC obviously seems to need a new program, action plan or target for each summit meeting to keep the bicycle in motion. Apart from confusing overlaps and duplications, this can create credibility deficits and problems of time inconsistency since observers are aware of the weak implementation and enforcement capacities in the APEC medley orchestra. As in the EU where implementing the Single Market program formed the core issue of each summit during 1985 and 1992, the Bogor targets should be monitored as each year in order to enable the summit participants to take stock and keep track. Individual exporters could be invited to contribute to a databank on trade barriers in APEC economies. This databank could be installed and up-dated by the APEC Secretariat in a way the EU Commission operates a „market access“ databank (available in Internet) reporting on trade policy measures in trading partner countries.

3. Trade Liberalization and Development Level

In liberalizing internal trade, the EU has never differentiated between member states at different levels of development. Instead, such differences were tackled by payments from structural fonds. Hence, allocation targets were separated from distributional targets in order to prevent the infant industry argument from influencing integration policies. APEC, however, has followed the GATT (Art. 18 and Part IV, 1979, Enabling Clause) and has given developing partner countries more time to dismantle trade barriers than developed partner countries. This distinction creates vested interests and path dependency as the status of „being in the state of development“ is fixed according to questionable criteria and is unlikely to be changed. It can lead to liberalization inertia and rent-seeking for maintaining the development status.

What holds for countries, holds for sectors, too. Apart from the agricultural sector which is far from being a liberal showcase in APEC as well as in the EU, APEC prefers sectorally differentiated liberalization tracks in the industry sector which, as argued above, can provoke a number of allocative distortions plus rent-seeking. The EU „across the board“ liberalization approach might be less effective in the beginning but seems more effective at the end when rent-seekers want to test the steadiness of governments against pressures for delaying the deadline for opening the market.

4. Improving Accountability

The EU operates a system of presidency which semi-annually rotates from country to country. In addition, a Troika consisting of the country holding the presidency „on duty“ plus the successor and predecessor country of presidency represents the Community in all international affairs. It is less clear what the role of the APEC summit host is as concerns the medium-term perspective of APEC. While the APEC procedure of an annual summit meeting seems to place more workload upon the interim-work of Committees and the APEC Secretariat, the accountability of the operational level is weaker than it would be under a Troika system. Peer pressure and continuity could be enhanced if a rotating APEC Troika would be officially charged to oversee the work of the Secretariat and convey stock-taking results on „how far are APEC economies from the Bogor targets“ to the public. Accountability could be further improved if the Troika were allowed to address legislative bodies of member countries.

Such proposals are necessarily EU-biased and probably beyond the informal nature of APEC. Yet, in order to give peer pressure „teeth“ in bad-weather times such as a recession, an institutional strengthening of the Heads of State level (including their ministries) could be fruitful in terms of giving the Bogor targets true identity and ownership in APEC member states.

5. Representing APEC in the WTO

Unlike the EU which commands full control over all policies related to trade and is therefore a legitimate representative of the individual member states as Contracting Parties, APEC is not in this position. However, given the proximity of the APEC „open regionalism“ concept to the MFN principle, it could be advisable to find common guidelines for negotiations with the EU (and other non-APEC Contracting Parties) under the auspices of a new multilateral round. The Cairns Group of the UR as an *ad hoc* group could be taken as the model for an APEC Group which as a precondition, however, has to build up commonly accepted positions to be represented outside APEC. The question who should present APEC in Geneva again points to the important prerequisite of strengthening the accountability of APEC. Inviting the EU to an APEC summit for presenting the EU view toward a Millennium Round could also be helpful to gain a maximum of transparency on each others position before negotiations officially start.

6. Learning from the EU Way of Handling Currency Crises?

EU’s second major project (following the Single Market), the Monetary Union, suggests lessons to be drawn from the pre-stage, the European Exchange Rate Mechanism (ERM) for supporting APEC members against attacks on their currencies. This issue has been dealt with in more detail in Langhammer [1998]. To summarize the findings, it is argued that neither the examples of the old 1950 European Payments Union nor the experiences with the anchor currency role of the Deutschmark are transferable to APEC. The reasons are first the stronger likelihood of asymmetric shocks resulting from the current account (‘Dutch disease’ problems) and the capital account. The emergence of asymmetric shocks, however, are open invitations to financial markets to test the credibility of exchange rate binding. Heterogeneity in EU 15 is much smaller than in APEC 18. This is witnessed, for instance, by the lack of commodity exporters inside

the EU. Second, no Asian currency is prepared to take the anchor currency role so that even a sub-APEC monetary arrangement is not credible. In the APEC-wide context, the long-standing use of the dollar as a nominal external anchor became unsustainable given the mismatch between dollar borrowing and credit allocation in the domestic economy under conditions of asset bubbles and collapsing exchange rate pegging. Third, binding APEC currencies together would put more strain upon APEC labor markets as an adjustment buffer to asymmetric shocks. While APEC labor markets are relatively flexible internally, they are not flexible among APEC member states for economic and political reasons.

Hence, a stress-free implementation of the EMU project requires a long pre-stage of goods and factor market integration which comes close to the level of integration in a domestic market. Even in the EU, there are good reasons to assume that such integration has not yet been achieved and that the so-called coronation theory (the monetary union being the coronation of goods and factor market integration) is well-founded. APEC and sub-groups of APEC are far from meeting this requirement.

VI. Concluding Remarks

The preceding sections have shown that APEC and the EU have started regionalism from very different historical, economic and political legacies. Against these legacies, „open regionalism“ and the step-by-step approach of deepening institutionalized regionalism have been logical follow-ups. The essential difference between the two approaches is the degree to which national policies and policy maneuvering are bound. The APEC principle of peer pressure stands for non-binding in the legal sense whereas the EU principles of supranational contracts and surrendering national sovereignty stands for strong binding. In the words of music, the medley with its variability of themes meets the march with its clear beat.

An outlook for the future has to answer the question whether the two approaches will converge or diverge. My presumption is that they will converge for three major reasons.

First, EU integration widening brings lower-income countries with very different economic structures into the Community which eventually will lead to integration at different speeds (the so-called concentric circles assumption). Thus, playing a march with more than twenty members many of them pure amateurs now joining an orchestra of professionals sounds differently compared to the small orchestra of the seventies and eighties. At the same time, APEC will have to streamline the peer pressure approach somewhat in order to remain credible and to maintain the liberalization momentum. The first streamlining was targeting regional free trade for 2010/2020. Further streamlining could include a focusing of liberalization ranges (in terms of more specified tariff rate reduction corridors) as was done by AFTA. Thus, even a medley can be nailed down to a clear theme.

Secondly, the two schemes will have to further reconcile their approaches with the multilateral system. For APEC, this is an easy task since open regionalism like multilateralism is non-discriminatory. There is not a large gap between the two principles. As concerns the EU, recent WTO decisions against the EU such as the banana case as well as the general issue of compatibility of EU-third country trade agreements with Art. 24 GATT show that the EU will have to submit **all** measures (including agriculture, textiles, cars and the special external relations like the Lomé Convention) under WTO discipline. That means that the all-embracing WTO umbrella will induce a convergence between APEC and EU principles

Thirdly, the role of the nation state has to be revised in the era of globalization. Formerly non-tradables become tradable. People and taxe bases become more mobile and country border become increasingly porous. There are

two likely developments arising from these trends. Issues with cross-border spillovers will be increasingly dealt with on a multilateral level (environment, labor standards). On the other hand, investment in spatially limited services like education and physical infrastructure are likely to be financed increasingly on a lower level than countries, i.e. sub-regions, municipalities, states within a country [Tanzi, 1998]. In future, citizens will be more prepared to pay local authorities taxes for public services where they are produced instead of paying national authorities taxes simply for receiving a passport and for being protected against external threats. In short, the beauty contest for mobile resources will be decided more between sub-national entities than between nations. Such entities can also comprise border areas of different countries such as the well-known growth triangles in Southeast Asia. Under this process, the EU internal allocation of resources will no longer be decided alone between countries but between sub-regions and their immobile factors. It is this diffusion of borders which at the end might shift the EU toward a degree of diversity and heterogeneity which APEC had from the very beginning.

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