

“New Asia-Pacific Trade Initiatives”

(English)

Summary

WELCOMING REMARKS

Fred Bergsten: Welcome to the New Asia-Pacific Trade Initiatives. I'm delighted not only to be hosting the conference but to be co-hosting it with our very good friends from the Japan Economic Foundation led by Noboru Hatakeyama, whom many of you know as the architect of Japan's modern trade policy.

We thought it would be a good idea to take stock of the current state of transpacific trade relations and trade initiatives, to look at some of the possibilities for the future evolution of those relationships, and to discuss some of the proposals that have been made, most notably for a free trade agreement or economic partnership agreement between Japan and the United States, as well as a free trade area of the Asia-Pacific.

Noboru Hatakeyama: I would like to express my heartfelt gratitude to all speakers, discussants and participants for attending the conference, and especially thank Dr. Bergsten for making the conference possible as a co-host.

Today we will discuss a possible U.S.-Japan FTA and the creation of a Free Trade Area of Asia Pacific. However, the environment surrounding us is not necessarily favorable. In Japan, the past election was won by an opposition party that pledged to give all farmers direct subsidies, thereby undermining government policies to limit the recipients of direct subsidies. In the U.S., the wind might be blowing toward more protection. Last month I visited China, where there seemed to be a unanimous chorus to the effect that farmers are important, which I had never heard before. It is vitally important to realize a U.S.-Japan FTA, as well as a Free Trade Area of Asia Pacific, but the hurdles are getting higher.

SESSION I

Bilateral and regional FTAs and EPAs that the United States and Japan have concluded and other trade initiatives in the region

Moderator: Fred Bergsten

Presenters

Jeffrey Schott: The major economies of the Asia-Pacific Region have embarked on a series of negotiations of free trade agreements with key trading partners, which I broadly classify into two camps: East Asian 'incrementalism' and U.S.-style FTAs. The East Asian approach of building consensus takes time. Compared to the comprehensive scope and juridical detail of provisions contained in U.S. FTAs, most Asian pacts have much more limited coverage and many more exceptions for sensitive products and services.

What has brought this wave of new initiatives? Clearly, countries were prompted by Chinese trade overtures to ASEAN. Basically, they want to emulate China and protect their own national trade and investment interests in the region.

These trends have also been reinforced by new U.S., Japanese and Korean initiatives in the region. U.S. objectives have been broad, covering both economic and political objectives. Japan has emulated U.S. policy in the western hemisphere and negotiated pacts with Mexico and Chile, but unlike the United States, it has not concluded EPAs with any of its major trading partners. Korea has negotiated or is negotiating with many of its trading partners, and this is a key factor in restructuring its domestic economic policy to increase productivity and growth.

In the Asia-Pacific region, the United States and Japan, and Korea and Japan, have the highest export similarity indexes. In a simple way, this explains the competitive liberalization pressures generated by recent Asia-Pacific trade pacts.

What will drive integration forward? Korea is acting as a catalyst as the only country that has FTA initiatives with all the major Asia-Pacific countries. And ratification of the Korea-U.S. and EU-Korea FTA would change the calculus of moving forward with both a U.S.-Japan FTA and probably Korea-Japan talks.

Yukiko Fukagawa: Three key issues are shaping a complicated interplay within East Asia: centrifugal forces acting on the ASEAN+3 framework, the dilemma between sovereignty and FTA institutionalization, and geopolitics, especially between Japan and China.

Japan has approached Australia and India before negotiations with China. Korea, feeling like it's in a nutcracker between Japan and China, wants FTAs with outsiders. China is pressured by energy security, so it seems to be more serious about energy-rich countries,

rather than energy-poor East Asia.

The basic structures of East Asian economies are FDI-driven trade, so even though they're committed to FTAs, many countries are still trying to maintain their industrial policies for infant industries. Very comprehensive pacts are unrealistic. Japan is concerned about sovereignty versus regionalism, so it is set to pursue bilateral investment treaties and less comprehensive FTA packages, especially in services.

China has the political will for FTAs, but their institutional capacity remains weak. Japan is the opposite. The Japanese political situation is getting more negative about open trade, so political commitment remains weak.

As a result of diverse economic and political structures in East Asia, intra-regional FTAs are synchronized with inter-regional FTAs, an outstanding feature of East Asia.

Japan will pursue a dual track approach, including both FTAs and functional cooperation, to boost market-driven integration. The institutional conversions of +1 FTAs are a strategic issue because ASEAN+1 is already completed. If Japan tries to push for highly institutionalized FTAs, Korea would be a strategic partner, which is why there is interest in reviving Japan-Korea negotiations.

Chulsu Kim: Korea is emerging today as a key player in the FTA initiatives in the region. The Korea-U.S. (KORUS) FTA is a comprehensive FTA containing many WTO+ elements. It covers nearly all trade in goods, including agriculture, and 80% of its tariff lines will be duty-free immediately. Nearly all agricultural products are subject to tariff removal. The agreement goes well beyond Doha in trade and services. It calls for strong investment rules and strengthens IPR protection in Korea.

KORUS could create a wave of FTAs involving Japan, China and the ASEAN countries, and accelerate bilateral and trilateral FTA initiatives among Japan, China and Korea. It might also be an impetus for FTA negotiations between China and Korea, and help revive Japan-Korea FTA negotiations. If these negotiations are concluded, they may serve as the basis for a trilateral FTA among Japan, China and Korea. KORUS may set off a chain reaction to the process of regional integration in East Asia at first within the framework of ASEAN+3, perhaps leading to ASEAN+6 eventually. It may also trigger an APEC Free Trade Area.

KORUS' ratification in Korea will be contentious, but approval is likely. An FTA with the

European Union may be signed and possibly implemented in 2008. An FTA with China now under study could have substantial implications for trade relations in Northeast Asia, and for regional integration in East Asia. The new governments in Japan and Korea might create opportunities for resuming suspended FTA talks. Agriculture will continue to be the key. In 2008 an FTA negotiation will start with the GCC countries, from which Korea imports nearly 60% of its oil.

Q&A

Q: What if the Korea-U.S. FTA were held up in the U.S. Congress?

Kim: The Korea-EU FTA could be concluded in advance, which will bring discrimination against U.S. suppliers in the Korean market. If ratification were delayed to the first part of 2009, the impact would be felt in FTA movements in East Asia and throughout Asia-Pacific.

Schott: It would delay increased access of U.S. exporters to the Korean market. Meanwhile, domestic legislation is helping Korean firms and workers adjust to the new competition. So it's a lose-lose situation for the United States if we do not proceed with the KORUS FTA in 2008.

Q: Are we likely to see this hodge-podge of free trade agreements as far as the eye can see?

Bergsten: A motivation for the Free Trade Area of the Asia-Pacific is to bring under a single umbrella the proliferating frenzy of agreements. Most studies show that the biggest economic benefits would occur under a Free Trade Area. For countries in the region, the ultimate goal is probably consolidation, initially at the Asia-Pacific level.

Q: What would be the impact if unexpected progress were achieved in negotiations between Japan and China toward greater cooperation?

Fukagawa: Japan's political situation is very complicated now, but there [are opportunities for] political recognition of market realities, which the prime minister will take seriously.

Bergsten: This whole frenzy is generating lots of competitive liberalization pressures on outsiders. One does hypothesize that this will eventually lead to something pan-regional.

Q: Would it help to deal with questions like currency and sovereign wealth funds in trade agreements?

Bergsten: Everyone is concerned about exchange rate issues and their relationship to trade, but it would be too complicated to add exchange rates and sovereign wealth funds to trade agreements.

Q: Should the U.S. pursue more seriously free trade with Taiwan?

Schott: With regard to Taiwan, it would get hurt by many of these agreements because its export composition is similar to that of many of its East Asian neighbors. Studies that we did a few years ago on a U.S.-Taiwan agreement concluded that it wasn't a good idea, and that a broader regional initiative was more appropriate.

Bergsten: Under the 3 China Formula, mainland, Hong Kong and Taiwan were accepted as members to APEC on a fully equal basis, except that Taiwan cannot participate at the political level. Any APEC arrangement to liberalize trade would include Taiwan. And I think that's one of the major arguments for a Free Trade Area of the Asia-Pacific, using APEC as a tool where, at least in principle, the China issue has been largely resolved.

Q: How do you reach consolidation of rules of origin across all these FTAs?

Schott: Rules of origin only matter where there's high MFN barriers in many of the products. The easiest way to deal with it is just to reduce the level of MFN tariffs, and therefore reduce the margins of preference that are accorded.

Fukagawa: Rules of origin complications are a big cost for small SMEs and traders, but technologies such as electronic data interchange can help them overcome this burden.

Claude Barfield: This is not just a question of economic integration or bilateral versus regional versus WTO, because out in East Asia there are many more equally important factors, such as security, that will influence what happens in the future.

Schott: Economic and security interests bind the U.S. participation in these initiatives. There are explicit economic and foreign policy components that work together. That has been at the heart of APEC from its origin. Ensuring continued U.S. engagement is an objective of many of the countries in East Asia.

SESSION II

Issues towards the conclusion of a high-quality US-Japan EPA/FTA

Moderator: Noboru Hatakeyama

Presenters

Scott Bradford: Using an Applied General Equilibrium Model, a standard tool most economists use to analyze welfare effects of trade agreements, if goods were completely opened and 10% services opened, Japan would gain about a 130 billion dollar permanent boost every year. That's 2.7% of GDP. And the U.S. would gain a similar amount in dollar terms, or about 1.1% of GDP.

If we exclude rice, Japan still gains 110 billion dollars, or 2.3%. The impact on the U.S. would be minimal. If you exclude services, Japan's gain drops hugely to just a half a percent of GDP, 22 billion dollars; the U.S. gain also drops. A 20% reduction in services barriers would give Japan 240 billion dollars and the U.S. a similar number. With 30%, the gains are still greater.

If Japan totally opens agriculture, the contractions would be 19 billion dollars in grains output and 22 billion dollars in meat. On the other hand, manufacturing would expand because Japan is competitive in these sectors.

General expansion of services would result in reduced construction services for Japan, but other sectors would tend to expand. In general, opening up services makes sectors more efficient and allows them to expand.

On the U.S. side, agriculture pretty much uniformly expands, but manufacturing contracts, particularly transport equipment, electronics, machinery and other equipment. But if you

exclude services, the output gains for the U.S. subside, and you mute the changes in the rest of the economy.

You can also translate this into jobs. If rice were opened up in Japan all the way, almost all related workers lose their jobs. Other agricultural jobs also encounter large shrinkages. But there are more jobs gained elsewhere, and manufacturing jobs increase significantly. In services, construction suffers job losses, but there are other job increases in the rest of services.

On the U.S. side, agricultural jobs gain, but 300,000 jobs in manufacturing could be lost.

Shujiro Urata: I measured total factor productivity, which is a more pure productivity indicator. In 1960, Japan's TFP amounted to about 52.4% of the U.S. level. By 2004, the gap narrowed to almost 80%, but still, Japan's TFP productivity level is substantially lower than that of the United States.

I assumed that the FTA would reduce the gap between these two countries, because Japan has better systems for accounting, medical services, educational services and so on. With a free FTA, we can expect Japan's GDP to increase by 0.43%, whereas the U.S. GDP would decline by 0.02%. A possible explanation is that imports entering the U.S. could increase quite a bit.

But if we factor in a narrowing of the productivity gap, the TFP productivity level for those industries that have lower productivity than in the other country would increase. With a 25% reduction in productivity gap, Japan is likely to gain in terms of GDP by 3.27%, whereas the U.S. gains 0.71%.

I don't put 100% confidence in these numbers and details, but the order of magnitude is very interesting. If the FTA covered many items, including harmonized systems, we can expect a quite substantial increase.

Why do we have high protection of agriculture? In a nutshell, I have to say it is a political factor. Because of agriculture protection, vested interest groups gain a lot.

If we can be innovative in dealing with this pressure, like introduce safeguard measures, introduce phased-in trade liberalization, or even if the U.S. can accept the exclusion of rice as they did to Korea, that will really remove a lot of hurdles in Japan.

In terms of FDI, the U.S. is very open compared to Japan. But the differences are rather

small, so I think there will not be many FDI problems.

When it comes to services, these are gaps in commitment. And you can see those with shaded area are the areas where the U.S. and Japan did not commit to opening. If you count the number of these items, the U.S. has slightly higher numbers. I know there are hurdles to overcome, but compared to the hurdles we observe in agriculture, these hurdles are low.

What we need is a strong political leadership in both Japan and the U.S.—mostly in Japan.

Discussants

Ed Lincoln: The Urata paper comes up with considerably smaller gains as percentage points of GDP from a free trade area than what we have in the Bradford paper. Nevertheless, the underlying premise here is, number one, if we can go at this in a thorough way, particularly if you have a version of the Urata model that includes a fairly major improvement of TFP in Japan, then an FTA appears to be a good idea for these both countries. And, number two, at least in the Bradford model, the FTA may be a more realistic proposition politically today than it was, say, 10 or 20 years ago.

However, in some cases, these models may overestimate some of the opportunities and outcomes. And there may actually be legitimate reasons why the trade impact is not that big. I have some doubts about the presumed advantages of certain industries.

Clyde Prestowitz: To talk about trade without talking about exchange rates, I'm not sure it's meaningful. Moreover, we're talking about countries that have very different strategies. If we don't deal with those differences, I think an agreement would be very difficult. And so, what I would like to suggest here this morning is using this proposal as a starting point. I propose an economic union between the U.S. and Japan, with Canada, Mexico and Korea included for starters. I know it sounds utopian, maybe unrealistic, but there are reasons to take it seriously. It would be an economic entity that has a balance of savings and investment that doesn't exist today. The yen's situation is only going to get worse over the next several years. The energy picture would become much different, given the energy reserves of Canada and Mexico. Japan and Korea would have a much stronger position in their negotiations and relationships with China. Finally, in terms of the total factor productivity gains that Urata-san was talking about, I doubt that a free trade agreement would do that, but a union might.

Junichiro Kuroda: If we could integrate the two markets, not just by eliminating tariffs, but also harmonizing regulations and standards, a U.S.-Japan FTA should be an ideal incubator for innovation, especially for cutting-edge industries.

Hatakeyama: How can we measure this high quality? My idea is to measure based upon the domestic consumption. Tariff lines are very artificial, and import amounts lead to misunderstanding if importation is prohibited.

I agree on the importance of the service sector. So why don't we exclude those commodities or goods from our FTA? Even if we do that, 70% of our economy is, roughly speaking, covered.

Regarding an economic union, my terminology is 'real integration.' Why don't we think of our market in Japan as an integral part of the United States market, and the U.S. market as an integral part of the Japanese market; a system where Japan could rely upon the supply of rice, for example, from the United States under any circumstance?

Q&A

Q: How would the FTA affect the Japanese account surplus and the U.S. deficit, and would we have the employees to handle the expanded production through legal immigration?

Bradford: The model does not track the current account surplus, nor the effect on immigration. But the point of the model is to try to ferret out connections that you might not see otherwise.

Q: What about the problem of Japan's Iron Triangle of collusion between farmers, the Ministry of Agriculture and Forestry, and the LDP?

Urata: The so-called Iron Triangle actually involves four or five factors: construction is one. A large part of investment in agriculture comes in the form of public works and construction, which is exempted from internal monetary policy. This has to be changed.

By the way, economic union is a very good idea. Maybe we would like to see economic integration taking place in goods and services before talking about macroeconomic

policies, such as fiscal management and exchange rates. Japan must realize that we have to change the system to improve our living standards. We have so much waste in agriculture protection and non-tariff barriers.

Lincoln: Japanese leaders in favor of economic reform and increased efficiency would like to use a free trade area with a major trading partner like the United States to help to force the issue in Japan.

LUNCHEON SPEECH

Wendy Cutler: This conference is quite timely, given all the activity in the Asia-Pacific region to tie economies together through a variety of means, including FTAs, EPAs, and regional groupings. Today I wish to discuss APEC and the Free Trade Area of the Asia-Pacific (FTAAP), the KORUS FTA and prospects for a U.S.-Japan FTA.

Our long-term vision for Asia is an FTAAP negotiated under APEC. The U.S. saw a number of other regional initiatives being considered, including ASEAN+3 and ASEAN+6, and concluded that we need an inclusive Asia-Pacific Economic Integration Scheme achieved through APEC.

As a first step, APEC should undertake a detailed analysis of the similarities and differences between FTAs in the region. But here are three key challenges: negotiating with 21 economies; the economies' different barriers and levels of development; and APEC commitments are non-binding.

The U.S. has demonstrated its commitment to economic engagement in Asia through the U.S.-Korea FTA. About 3 1/2 years ago, at a conference hosted by Fred Bergsten, we had no confidence that Korea would be prepared to make the hard decisions necessary to conclude an FTA with us. It's so impressive to think how fast Korea turned around. A number of people around the world, including the Japanese, didn't think we could do it. But the KORUS FTA did work at the end, and it showed that our high-quality FTAs do work with big countries, and that we can address non-tariff measures across a wide range of sectors.

Now we have congressional approval before us. Given the widespread benefits of the Korea FTA to the U.S. national interest, and the implication for the U.S. position in Asia if the KORUS FTA were not be approved, I remain confident that we will be able to get this landmark deal through Congress.

The U.S. and Korea brought home a strong, balanced agreement for several key reasons. First, each side decided that it wanted this FTA. Second, both sides had political commitment, so negotiators could take risks. Third, Korea was prepared to address non-tariff barriers. And finally, we approached the negotiations as partners concluding a win-win agreement.

I sense from my Japanese colleagues in the ministries that more work needs to be done in Japan to create the conditions necessary for an FTA. Clearly, it would be the most ambitious undertaking in the history of our long economic relationship. We would need to go beyond the 90% trade coverage in Japan's current FTAs. We would need to be on the cutting-edge of non-tariff measures, including regulatory barriers. And we would need a fundamental commitment to the reform of Japan's agriculture sector.

There are a number of things that we do to lay the groundwork. In the joint statement issued recently by the U.S. and Japan Business Council, I was impressed by their support of an FTA. I believe this is the first time the Japanese private sector has signed a document pointing out that the most important task now is structural reform of the agriculture sector. So our respective private sectors need to build support in each country, supported by academic studies. And the two governments must continue exchanging information about our respective FTAs to see how they would contribute to an FTA discussion.

Prospects for both an FTAAP and a U.S.-Japan FTA would be significantly enhanced with enactment of the KORUS FTA. The United States must leave no doubt in the minds of its trading partners regarding its continued commitment to free trade in the region.

SESSION III

Creation of a Free Trade Area of Asia-Pacific (FTAAP)

Moderator: Chulsu Kim

Presenters

Gary Hufbauer: In the paper that Jeff Schott and I have written, we show the percentage of trade covered by agreements in force, under negotiation and under contemplation. For the United States, per capita about 33% is covered by agreements in force, but it would leap to 62% if we got all the way to an FTAAP, and that's quite common throughout the countries.

Foreign direct investment, as a driver of agreements, is getting to be of equal weight as trade.

We say the United States has 500 billion dollars more imports plus exports as a result of its agreements in force. That's principally NAFTA. ASEAN has an additional 250 billion dollars in trade. If we got all the way to a Free Trade Agreement of Asia and Pacific, Japan might get as much as 900 billion dollars more in imports and exports.

Total trade would increase by roughly 50% if we had an FTAAP. It's even a little more for agriculture, and about 60% for manufacturers.

A trade agreement between two countries can increase trade with non-members. How does that happen? Well, there are the familiar income effects, and also network effects. Trade production arrangements cross many boundaries, so if you get an increase between two partners, it's going to pull in trade from others.

You can have diversion of exports as well as imports. Exports can be diverted from non-members because countries trade more with their partners and don't have the capacity to supply non-members, at least not at the same price. So, that's why we can have non-member diversion. Agricultural trade goes down. Manufacturers realize predominantly positive figures, with very few exceptions.

One of our big messages of this paper is that the diversion story has been vastly overused. It may have a useful political effect: 'if you don't get on the stick and ratify Korea-U.S., you'll lose a lot.' But actually you'll lose relative to what you would have lost with a free trade agreement.

Trade boosts investment, which is no surprise, but the amount of the boost is pretty substantial. When countries trade more thanks to a free trade agreement, they get a secondary boost to their investment. There is investment diversion with respect to non-members. That is, for non-members an FTA probably diverts more investment than it does trade.

What are the implications for the WTO? In terms of the sharp differentiation between American and Asian regionalism, WTO norms are pretty fuzzy. This preference was revealed in the Doha round. I would again emphasize that compared to trade diversion, investment diversion may be more important. Agricultural trade diversion is the most important trade diversion. So far, WTO efforts have been timid. In the Asia-Pacific area there's some effort to self-enforce WTO norms that could go a lot further than it has gone.

Hatakeyama: It is imperative for a study on an FTAAP to be undertaken immediately, for two reasons. The first is for the sake of APEC itself. Ironically, FTAs played a role in making it obvious that the Bogor Declaration was not going to be complied with. For example, two influential APEC countries betrayed their commitments with a bilateral FTA that scheduled trade liberalization of certain products in 2023, beyond the target year for both industrialized and developing economies. Thus, the APEC method of liberalizing trade voluntarily has come to a deadlock. In this regard, an FTAAP would be an appropriate tool to bail out APEC.

The second reason for an FTAAP study is related to the United States. The U.S. is not located in East Asia, therefore it is difficult for the U.S. to join an East Asian FTA. Many Americans say the U.S. should qualify to join because it offers the biggest market to this region and ensures the region's security. This is true. But the U.S. did not join the former EEC, nor the current EU, so in view of this history, why is the U.S. trying to join an FTA in East Asia? However, if we can come up with a legitimate scheme for the U.S. to join an FTA, we would welcome the U.S. wholeheartedly. Such a scheme is the FTAAP.

For the ASEAN+3 FTA, or EAFTA, a general track-two study finished last year and a track-two study for specific areas has started. For the ASEAN+6 FTA, or CEPEA, a general track-two study has started. I think an FTAAP track-two study should start soon and should proceed in parallel with EAFTA and CEPEA studies. Why not let them compete on a first-come, first-served basis?

If some APEC countries are opposed, like-minded countries supporting an early FTAAP study should be called upon. This may serve as leverage to have all APEC members participate.

Docking current FTAs should be avoided, because to harmonize them would take more time than to start from zero.

Taiwan is a member of APEC not as a country, but as a separate custom territory, so it could become a member of an FTAAP under this status.

The FTAAP should not be too ambitious. Consensus among as many as 21 economies is not an easy job. We should not try to achieve a high-quality FTAAP, but rather we should seek an early conclusion.

Bergsten: I basically agree with the five or six most important conclusions in

Hatakeyama-san's statement. First is his statement that APEC must shift its method from voluntary to compulsory. Unless APEC is willing to get serious in terms of compulsory, binding negotiations among its members, it'll never amount to anything.

Secondly, I agree that the United States should have no complaint about being excluded from the East Asian Summits. We don't invite the Asians to summits of the Americas. However, we do not want to draw a line down the middle of the Pacific. We want to find ways in which the two sides can interrelate effectively, and that is one of the cardinal arguments for the FTAAP.

Next, Hatakeyama-san is right that there should be a parallel study of the FTAAP within APEC at the same time that the Asians are studying the 10+3 or 10+6 initiatives. Some Japanese say, 'Well, we'll get our 10+6 in place, and then we'll talk about an FTAAP.' It would be a long time in coming if that were to occur.

Then Hatakeyama-san said, if some APEC members won't go ahead, you should proceed with the like-minded group short of the full membership. The key is to avoid veto power. The rest of the membership should start down the road without China, if necessary, because the dynamics would almost surely force China to participate.

Hatakeyama-san said that we should not try to achieve a high-quality FTA at APEC, but rather permit something to occur on a lower standard. But I think that the U.S. and a number of other members would want to maintain relatively high standards, certainly compared with the Chinese agreements, and not give up on that at the outset.

Let me review the basic case for the FTAAP. First, every study shows that a transpacific agreement would bring much greater benefits to the Asian countries than any conceivable Asia-only agreement. Second, it would support global, multilateral negotiations. Third, an FTAAP would sweep under one roof the explosion of FTAs in the region and forge a more consistent whole.

Finally, if one worries about the risk of disintegration between North America and East Asia, then one wants to form transpacific networks somewhat akin to the transatlantic networks. When the European Union was creating its discriminatory economic union, it was nested in transatlantic institutions, which eliminated the risk of drawing a line down the middle of the Atlantic. But we don't have a similar institutional framework within which to nest a 10+3 or a 10+6 in East Asia. That's why it's so important to strengthen APEC, not just for economic reasons. The only big-picture initiative that is conceivably available to put APEC back on the map, as it was when it got started 10 to 15 years ago, is this free trade agreement. The

FTAAP would bear dividends going well beyond economics.

Discussants

Barfield: As Hatakeyama-san said, you really need these studies quickly. Sure, you could have institutes in Japan, Korea or wherever do independent studies, but that's not part of the formal process.

There's no way that in the next six months to a year that anybody's going to pay attention to an FTAAP in terms of [promoting] the Doha Round. While I agree with the virtues, it is a long-term proposal.

When the Australians were planning their turn at APEC leadership, we kept telling them, 'If you're really serious about making APEC front and center again, come forward with a bold proposal to do something beyond talk, talk, talk.' But they didn't do it, so here we are.

We should not worry about harmonizing all the existing FTAs. Start with a coalition of the willing.

The United States' closest allies—Japan and Korea, and I would add Australia and Singapore—are going to have to take the lead. The United States should not push, given what happened with the early APEC sectoral agreements. There are two visions on the table: Asia-Pacific regionalism and intra-Asian. In the end, you'll go one way or the other. From my perspective, it has to be done to a great degree by the U.S.'s closest allies.

Urata: Drs. Hufbauer and Schott have found that an FTA creates benefits not only for members, but also outsiders, so now we can say that they are win-win-win.

I suspect that compared to some FTAs involving developing countries, the average tariff rates for EU FTAs will be much lower for outside members, so I'd like to see more information.

My second question is on the impacts of FTAs on investment. The EU used investment stocks, which is cumulative FDI flows, so the results are affected by previous flows. I wonder if you'd like to use flows instead of stocks.

Regarding the very interesting presentations by Hatakeyama-san and Dr. Bergsten, I agree that APEC should launch a study as quickly as possible on the possible impacts of an

FTAAP.

I agree with Dr. Barfield that you cannot have APEC as a negotiating institution. The EVSL told us that you cannot have a negotiation with 21 members. If a negotiation on trade liberalization is put on the table, I am quite positive there are several APEC member countries that would oppose this idea.

We have to begin with the so-called plus finder approach, or a coalition of the willing. In that case, I think a Japan-U.S. FTA should be pursued first.

Regarding economic technical cooperation, the East Asia FTA has this kind of component and it is demanded strongly by developing members, especially CLMV countries. The FTAAP may have to have this component too, but I wonder how.

Finally, I'd like the U.S. to put more effort into starting an FTAAP study group. The U.S. increased its budget for APEC. We need sponsors for an FTAAP study.

Q&A

Bergsten: I am pessimistic about U.S. trade policy in the short run, but quite optimistic in the long run. As Jeff Schott said this morning, the foreign policy imperative will commend itself, even to an administration that comes into office with anti-globalization leanings. They will see that you can't run foreign policy in the 21st century without having an active trade policy.

Q: U.S. agreements apply to U.S. multinationals wherever they're based. In Vietnam, the bilateral trade agreement had almost no increase in U.S. foreign investment as regularly measured by IMF statistics. But a study found that U.S.-related foreign investment boomed because multinationals tend to invest in Vietnam not from the United States but from Singapore and Hong Kong. It's hard to track that side of FDI. Also to note, ecotech work in APEC is purely tangential.

Urata: One of the most important technical supports that developed countries can give to developing countries is to develop their capacity to formulate and implement policies, like trade policies. Unless that can be done, this is not really technical assistance.

Bergsten: Not only has APEC ecotech been of minimum impact, it's actually been a deliberate diversion by some APEC members who didn't want to see APEC's main agenda go forward. There is merit in what Urata-san just said. But putting it as a third co-equal layer, along with trade liberalization and trade facilitation, has always been something of a sham.

Q: The reality of trade agreements is, much of the work done by the negotiators is negotiating tariff reductions and market access on investment, but much of the work done by actual countries is changing their laws and building their institutions to be able to run market economies and abide by the agreements. It requires huge changes that go far beyond the mandate of what a trade group looks at. I would say ecotech is not diversionary at all. It's fundamental to making sure that the developing countries in the agreement can really take advantage of the benefits.

Bergsten: I totally agree it needs to be done. The issue is whether it's in the comparative value of APEC.

Hatakeyama: The paper by Drs. Schott and Hufbauer says that 'relevant statistics on foreign direct investment are required only for services. Odd! Since many developing countries complain that the major problem caused by RTA is investment diversion in manufacturing.' I don't think this is odd. What is odd is the decision on the part of the WTO to exclude the investment rule for manufacturing. We proposed to have the investment rule incorporated in the Doha round, but unfortunately we did not succeed. This is a very important point.

Q: If China is successfully using this situation politically, and if this kind of diplomacy has a great strategic dimension to it, as Claude Barfield says, then why not make some kind of broad initiative, less than a gold standard, as something that the United States could pull everyone together with?

Hufbauer: We can shoot for the stars, but I would accept a lot less than that in 2011.

Turning to Claude Barfield, he was quite right to say the economic models have evolved from input-output to macro models and CGE models, which are descendents of input-output models, and also gravity models. So there's been quite an evolution over the last 20 years in terms of models that are used. The results are obviously different from one to another. But then he urged that we use political economy models.

I would agree with that. The problem is to actually measure the political economy forces, such as lobbying, and see where they're coming from.

Urata-san added some very insightful remarks on how you'd extend the gravity model. He suggested we extend it to looking at tariffs and at foreign direct investment flows. Both of those are well taken, but the problem is that it's expensive.

Kim: Unless there are further comments, I think we can close the session.

Bergsten: Once again, I thank Hatakeyama-san, his colleagues, the Japan Economic Foundation, for co-hosting this with us. We thank our friends from Japan & Korea, in particular, who came so far to participate in this. We're delighted to have worked with you again. We look forward to many more collaborations. Even if we disagree on some of the marginal aspects of the issues, we have full coherence when it comes to the fundamentals.