

Asia-Pacific Economic Integration: Projecting the Path Forward¹

Jeffrey J. Schott, Senior Fellow, Peterson Institute for International Economics

INTRODUCTION

Almost two decades ago, the leaders attending the Asia-Pacific Economic Cooperation (APEC) Summit in Bogor, Indonesia, agreed to achieve free trade and investment in the region by 2010 for developed economies and 2020 for developing economies. The deadlines for those ambitious ventures might have seemed distant to the APEC leaders in November 1994, but the first marker has already long past and the second is fast approaching.

APEC gets a grade of “A” for its vision of regional economic integration and an “incomplete” for its execution. Nonetheless, progress toward an Asia-Pacific free trade region over this period has been notable, even though much of it has taken place outside the scope of APEC deliberations. The network of bilateral and regional free trade agreements (FTAs) in the Asia-Pacific region has expanded dramatically over the past decade, interconnecting almost every major trading nation in the region, with one notable exception: neither the United States nor China has pursued a FTA initiative involving the other. Most APEC economies now participate in a variety of integration arrangements, and all are committed to the long-run APEC goal of creating a Free Trade Area of the Asia-Pacific, or FTAAP.

That said, the pathway toward economic integration in the Asia-Pacific region is still uncertain. Several options for crafting the FTAAP are under review. As a practical matter, the two mega-regional integration arrangements in the APEC region—the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP)—will substantially inform the APEC debate.² This short chapter assesses the prospects for achieving a FTAAP via the mega-regional pathways.

THE MEGA-REGIONAL PATHWAYS: MERGING OR CONVERGING?

The TPP and RCEP initiatives cover a large number of economies that cumulatively account for a substantial share of world output and exports (see Table 1). Both involve more than half of the APEC membership, and a growing number of economies are participating in both the TPP and RCEP negotiations. Both have ambitious agendas to dismantle barriers to trade and investment in goods and services.

Table 1. TPP and RCEP: Overlapping membership

	TPP	RCEP	In both TPP-12 + RCEP	In both TPP-16 + RCEP	In both TPP-17 + RCEP
Number of economies	12	16	7	11	12
Aggregate share of world GDP (%)	38	29	12	15	27
Aggregate share of world exports (%)	24	30	10	16	28

TPP = Trans-Pacific Partnership; RCEP = Regional Comprehensive Economic Partnership

Notes:

A TPP-16 scenario would include Korea, Indonesia, the Philippines, and Thailand.

A TPP-17 scenario would include China.

Sources: IMF WEO database and IMF Direction of Trade Statistics, 2013.

To date, APEC discussions about potential pathways toward a FTAAP have looked at each mega-regional. At first blush, similar negotiating agendas and overlapping membership of the TPP and the RCEP seem to suggest that a FTAAP could be crafted from the convergence of the two. However, merging these arrangements into a common FTAAP would be difficult, for two reasons.

First, the mega-regionals have different time horizons for completion of the negotiations. The TPP talks are likely to conclude in 2014, while the RCEP talks still are in the early stages of a multi-year negotiation. Accommodating the least-developed economies in the Association of Southeast Asian Nations (ASEAN), and avoiding delays provoked by current foot-draggers, like India, to trade liberalization will be stiff tests for the RCEP negotiations, and will likely result in the talks extending well beyond the targeted completion date of late 2015.

Second, and more problematic, is that the TPP deal is likely to be much more substantial in terms of the depth of prospective trade liberalization and the scope of rule-making obligations than the RCEP. The TPP aims to develop a twenty-first century rulebook for trade that goes beyond current WTO obligations in important areas, such as labor and environment, intellectual property, investment and competition policy, and disciplines on state-owned enterprises, with enforcement of most obligations covered by binding dispute settlement procedures similar to those in the Korea-US (KORUS) FTA.³ Though the RCEP also aims to expand the liberalization commitments contained in existing FTAs between ASEAN and its six bilateral partners, it has less lofty ambitions regarding the depth and scope of reforms, far more exemptions for sensitive products and

for broad development considerations, and more consultative rather than binding dispute resolution procedures.

Harmonization of the two mega-regionals would inevitably require a dilution of the reform commitments mandated by the TPP. Most TPP economies would regard the return on such an investment to be inadequate.

To be sure, the overlapping membership of the TPP and the RCEP will promote the convergence of the two agreements. To date, seven of the sixteen RCEP economies also are negotiating the TPP. In addition, four RCEP economies—namely Indonesia, the Philippines, South Korea, and Thailand—are already performing “due diligence” on the TPP to assess the potential benefits and domestic policy adjustments that would be required if they join in the coming years. It is thus quite possible that eleven of the sixteen RCEP economies could be engaged in the TPP before the end of this decade.

Since the TPP is expected to conclude well before the RCEP, the TPP outcome could well affect RCEP negotiations. For those economies involved in the two talks, it will be easier to implement RCEP standards if they already have committed to more comprehensive TPP obligations. From this perspective, there already seems to be a convergence of the two mega-regionals. But it is not the merging or harmonization of the TPP and the RCEP that poses the biggest challenge; rather, it is a convergence toward the TPP template!

However, not all APEC economies participate in the two mega-regionals, and some non-APEC members are involved. Russia, Chinese Taipei, and Hong Kong don't participate in either initiative, and the RCEP involves four economies that are not in APEC.⁴ Restrictions on participation in each mega-regional pose problems for the

broader application of the pact to the entire APEC membership. The TPP is limited to APEC economies, while the RCEP is limited to ASEAN FTA partners. In practice, membership restrictions etched into these pacts will need to be overcome if the FTAAP, as broadly envisioned, is to build on these initiatives.⁵

In sum, APEC economies seem to be “voting with their feet” for the TPP pathway. Yet, as in any infrastructure project, the site preparation may need some modification to deal with specific challenges. The following sections suggest two scenarios for going forward with the construction of the FTAAP.

TPP: THE PATHWAY TO ASIA-PACIFIC ECONOMIC INTEGRATION?

From the outset, the TPP has been a dynamic initiative, evolving from an agreement of the P4 economies (Brunei, Chile, Singapore, New Zealand) to an agreement of 12 economies, with new members added throughout the course of the talks and prospects for additional members after the deal enters into force. TPP architects envision building an eventual FTAAP on the comprehensive foundations of the TPP accord, with other APEC economies joining the pact in coming years through an accession process similar to that provided in the World Trade Organization (WTO) for new members—even though there are few precedents for such docking. TPP economies have said that the pact will be open to the accession of other APEC members; however, the procedures have still to be clarified.

As noted earlier, there already are prospective candidates for TPP expansion in a “second tranche” of negotiations once the TPP enters into force. Indonesia, the Philippines, South Korea, and Thailand are primary contenders for boosting the TPP-12 to a TPP-16. These economies have been motivated to consider joining the TPP primarily

for two reasons: the perceived larger payoff from TPP reforms, and the cost of nonparticipation in terms of trade and investment diversion.

Another major trading nation carefully weighing the advantages (and disadvantages) of the TPP is, of course, China. If China asks to join the TPP, it would boost the TPP's prospective additional members to 5, potentially creating a TPP-17—one step closer to a TPP covering all 21 APEC economies.⁶ While China is currently considering how the TPP could complement and reinforce domestic reforms approved by the Third Plenum in November 2013, the broad consensus is that China is not ready to accept TPP obligations, particularly those on transparency and disciplines on government intervention in the market. Participation in the TPP would require significant narrowing of the gaps in China's current record of liberalization commitments. However, China is making incremental strides toward this end as it deepens pacts with its Northeast Asian trading partners, including its current FTA negotiations with South Korea. China's willingness to make meaningful commitments within key plurilateral WTO initiatives—the Trade in Services Agreement (TISA) and Information Technology Agreement (ITA), among others—would also provide important signals of progress.⁷

If China is willing and able to join the TPP in the coming years, then it seems clear that the TPP will be the standard not only for the FTAAP, but also for the global trading system. A TPP-17 would be an irresistible attraction to other trading partners; in that context, it would be relatively easy to accept special TPP arrangements to encourage the participation of nonmember least-developed economies (Cambodia, Laos, and Myanmar). Participation by Chinese Taipei and Hong Kong, both with existing bilateral pacts with China, could follow a similar path to their accession to APEC. However, if the

high standards and reforms required by the TPP prove to be significant barriers to crafting an APEC-wide regime, consideration should be given to an umbrella agreement that overlays the hard and soft integration approaches of the TPP and the RCEP without requiring revision of either arrangement.

A HYBRID APPROACH

If China does not participate in the TPP later this decade, then another option for a pathway to a FTAAP would be a hybrid approach that links the “hard” elements of the TPP and the “soft” elements of the intra-Asian approaches to trade integration. Under such a scenario, the hybrid pact—the FTAAP—would be an umbrella providing reciprocal obligations applying to TPP and RCEP economies, while the more comprehensive and legally binding TPP provisions would remain in force among the TPP signatories. Importantly, under this scenario, the United States and China could continue to deepen their commercial relationship without the strain of trying to directly incorporate China into the TPP, or the cost of diluting the vitality of the TPP on trade and investment among its signatories to accommodate China. Indeed, China and the United States, each for its own political reasons and economic objectives, might find it attractive to pursue such a hybrid approach to a FTAAP.

What should a hybrid Asia-Pacific integration pact cover? As a first approximation, it is worth looking at China’s most recent trade and investment initiatives in the region. A prospective middle ground between the TPP and RCEP approaches seems to be evolving within those concurrent Northeast Asia initiatives. South Korea and China launched FTA talks in May 2012, and in 2013, a parallel negotiation between China, South Korea, and Japan was launched. Although a bilateral or trilateral trade pact

among these economies would comprise obligations less comprehensive than those negotiated in the Korea-US FTA—which served in many respects as the foundation for the TPP—these initiatives could produce a deal in the large middle zone between the two sharply distinctive integration paths of the Asia-Pacific region. Precedents for the deal could also be drawn from economic cooperation provisions under construction in the RCEP and from the environment chapter of the TPP, among others.

CONCLUSIONS

The TPP and RCEP countries are pursuing parallel tracks toward the APEC vision of economic integration that could be mutually reinforcing and prepare Asia-Pacific economies for accession to a broader FTAAP. That said, the TPP seems to have a first-mover advantage in terms of setting important precedents for economic integration in the region that could critically shape the pathway toward the FTAAP. Increasingly, more and more economies are looking into the benefits and adjustment demands of gradually adopting TPP norms. The rationale is straightforward: adopting the TPP's "high standards" would complement prospective domestic economic reforms and help boost productivity growth across the economy. In so doing, it would create new opportunities for trade and investment, while improving the quality of economic institutions and governance.

To be sure, participation in the TPP entails adherence to high standards and binding obligations that would constrain the use of politically popular policies, a fact that has already slowed the integration of China and other economies. If that presents intractable economic or political problems, APEC members should consider a hybrid

approach to constructing a FTAAP in the form of an umbrella agreement that serves as an overlay to the RCEP and the TPP.

First-mover effects could prove to be important and encourage convergence toward the TPP as the primary platform for regional economic integration. This will largely depend on TPP's success in attracting and incorporating new members after the talks conclude. If China decides to participate in the TPP in the coming years, it will cement the TPP as the template for both a FTAAP and an upgrading of the world trade rules. Of course, in this regard, the political and economic climate within the United States and China will play key constraining (or enabling) factors.

NOTES

1. © Peterson Institute for International Economics, 2014. Used with permission. Forthcoming in Tang, Guoqiang and Peter A. Petri, eds, 2014, *New Directions in Asia Pacific Economic Integration*, Honolulu: East-West Center.
2. For an economic analysis of the prospective gains, see Peter A. Petri, Michael G. Plummer, and Fan Zhai, *The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment*, Policy Analyses in International Economics 98 (November 2012), Peterson Institute for International Economics, Washington, DC.
3. In so doing, the TPP will achieve a substantial upgrading of existing trade pacts among participating economies.
4. All 12 TPP economies are APEC members; 4 of the 16 RCEP economies (India, Cambodia, Laos, and Myanmar) are not in APEC.
5. For details, see Jeffrey Schott, "Revisiting APEC's Membership Freeze," *Boao Review*, November 21, 2013.

6. At present, Russia's participation is problematic. Hopefully, current frictions will abate, allowing trade relations to normalize in the coming years and FTAAP participation by all APEC members.

7. See "Froman Says China ITA Stance Does Not Bode Well for TISA, Cites Other Factors," *Inside US Trade*, October 29, 2013, www.insidetrade.com (accessed on March 21, 2014).