



## Pacific Asia and the Asia Pacific: The Choices for APEC

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The Asia Pacific Economic Cooperation (APEC) forum comprises 21 developed and developing economies that surround the Pacific Rim.<sup>1</sup> The organization was created in 1989 and holds annual Leaders' Meetings that bring together its heads of government. In this policy brief, I assess the record of the APEC over the 20 years of its existence and discuss the world environment in which APEC is likely to be operating in

1. The 21 member economies are Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, United States, and Vietnam.

the next 20 years, with a particular focus on the major change in global institutional arrangements implied by the replacement of the Group of Seven/Eight (G-7/8) by the Group of Twenty (G-20) as the chief steering committee for the world economy and, within that group and other international economic organizations, the increasingly central role of an informal and de facto Group of Two (G-2) between China and the United States.

### APEC AT 20

APEC has gone through three distinct periods during its two decades of existence:

- the *formative years* of 1989–92, initiated by Australia and Japan,<sup>2</sup> with annual ministerial meetings to chart the forum's early course;
- the *dynamic leadership* years of 1993–97, sponsored primarily by Indonesia and the United States, when the newly instituted annual summits set out the ambitious Bogor Goals to achieve “free and open trade and investment in the region,” took the lead in negotiating the highly significant Information Technology Agreement (ITA), and accelerated the momentum of global trade liberalization by agreeing to launch a program of Early Voluntary Sectoral Liberalization (EVSL); and
- the *marginalization* of 1998–2008, during which the earlier initiatives faltered and the institution, despite its useful creation of extensive networks across a wide range of issues and its summits' continued utility as a venue for important bilateral meetings, failed to adopt leadership positions on any of the key issues facing the region and the world economy.

The important issue for the future is why the early dynamism gave way to prolonged stagnation. The main cause was clearly the decision of the key Asian countries to prioritize economic cooperation within East Asia itself rather than across

2. Yoichi Funabashi, *Asia Pacific Fusion: Japan's Role in APEC* (Washington: Institute for International Economics, 1995).

the broader APEC construct: a focus on Pacific Asia rather than the Asia Pacific. This advent of a “new Asian architecture” was driven and reinforced by four major factors:

- the Asian financial crisis of 1997–98, which generated strong and lasting distaste in Asia for the Washington Consensus and its institutions, especially the International Monetary Fund (IMF), propelling in particular the Chiang Mai Initiative and related steps toward creating an alternative Asian Monetary Fund;
- *the absence of multilateral trade liberalization in the World Trade Organization (WTO) after the completion of the Uruguay Round and its “built-in agenda” follow-ups, pointedly underlined by the failures to first launch (Seattle 1999) and then negotiate the Doha Round;*
- *the addition of the North American Free Trade Agreement (NAFTA) to the European Union so that the world’s two other economic poles had created their own blocs, stimulating the proliferation of ASEAN + 1 and other preferential agreements throughout Pacific Asia that are creating a de facto East Asian Free Trade Area<sup>3</sup>; and*
- *the two economic bubbles that burst in the United States during the present decade, emanating from the dot.com sector in its early years and the financial sector at present, dragging down the world economy and discrediting the credibility and competence of the United States as both a model and global leader. Doubts about the United States increasingly extended to its performance on trade policy with Congress’ near rejection of liberalization initiatives in 2002 and 2005, abrogation of trade promotion (“fast track”) authority in 2007, and current failure to approve negotiated free trade agreements (FTAs) with Colombia, Korea, and Panama.<sup>4</sup>*

The United States sought to counter the emerging Asia-only focus in the region by launching FTA negotiations of its own with several East Asian countries (Singapore, Australia, Thailand, Korea, and Malaysia) and especially by proposing in 2006 a Free Trade Area of the Asia Pacific (FTAAP)—an operational version of the original Bogor Goals. The idea attracted modest support from a few smaller APEC members, several of which tried to commence the process by setting up a P-4 (Brunei, Chile, Singapore, and New Zealand), which has now evolved into the Trans-Pacific Partnership (with some participation from Australia, Peru, the United States itself, and Vietnam).

3. ASEAN stands for the Association of Southeast Asian Nations.

4. The foreign policy of President George W. Bush, which was reviled in many parts of the world, may have contributed to the declining image of the United States but does not appear to have had major negative repercussions in most of Asia.

None of the major Asian countries have joined this program, however, and suspicions remain that the United States is trying to derail Asian economic integration rather than promote a parallel transpacific counterpart to it.

Hence *APEC enters its third decade with strong unresolved tensions between its original main purpose, to “avoid drawing a line down the middle of the Pacific,” and the Asia-centric cooperation priorities of most of its key members.* Reconciliation of these goals is an essential prerequisite for any resumption of meaningful institutional development of APEC.

## THE NEXT 20 YEARS

The world and the region have undergone sweeping changes over the past 20 years and are likely to experience even more far-reaching evolution over the next two decades. These shifts in the global and regional settings will provide the context in which APEC will be operating. Four stand out as likely to be most relevant:

- *the sharply increasing weight of Asia* in the global economy as the developing countries, led by China, and Asia more broadly, already account for half of world output<sup>5</sup> and are increasing their share by 2 to 3 percentage points per year;
- *the “new mercantilism,”* as more and more countries seek to self-insure against future crises by running large external surpluses in order to build even larger war chests of foreign exchange reserves (as well as export their way out of the current crisis)<sup>6</sup>;
- *a slowing, if not a reversal, in financial globalization* due to the responsibility of the financial sector for bringing on the current crisis and continuing doubts over the benefits of that process; and
- *further deepening of area-wide monetary and trading arrangements in Asia,* which will not yet be as integrated as Europe but will coalesce sufficiently to effectively form a third bloc in the world economy.

A major and highly uncertain variable will be the response of the global economic institutions, especially the IMF and the WTO, to these challenges. The Bretton Woods system is undergoing its first real stress test, as a result of the crisis, to see if it can fulfill its fundamental purpose of preventing a return to the world of the 1930s. Its effectiveness in promoting recovery, and avoiding competitive devaluations and protectionism, is yet

5. With exchange rates calculated at purchasing power parity. The number is about 40 percent using market exchange rates but will also exceed 50 percent on that basis in less than a decade.

6. C. Fred Bergsten and Arvind Subramanian, “New Mercantilism,” *Washington Times*, June 9, 2009, A4, Nation section.

to be determined. The outcome will have far-reaching implications for all regional institutions, including APEC and the new Asia-only bodies, because failures at the global level would spur much greater reliance on regional regimes.

### THE ASCENT OF THE G-20

One momentous institutional change is already clear: the replacement of the G-7/8 by the G-20 as the chief steering committee for the world economy.<sup>7</sup> This evolution was inevitable, in light of the global growth trends cited above, but has been sharply accelerated by the current crisis.

This development has three major implications for APEC. First, it greatly enhances the role of Asia in the global leadership structure because the G-20 includes five Asian countries, seven if Australia and Russia are counted, while the G-7 has only one. Second, the role of the United States (and, even more so, Europe) is diluted. No protracted negotiation over “chairs and shares,” as in the IMF, was required when it became essential to forge a global response to the first global economic crisis since the 1930s by including the countries that constitute the bulk of worldwide economic activity.

Third, APEC countries account for half the membership of the entire G-20. Hence the group could dominate the new process if it chose to act together. There could in fact be considerable merit in forming an “APEC caucus” within the G-20 to address at least some issues—e.g., Europe’s reluctance to reform the governance structure of the multilateral institutions and India’s blockage of the Doha Round. Such a group would amount to the new Asia Pacific Summit, or “G-10 of the Asia Pacific,” that has been proposed by such Asian leaders as Prime Minister Kevin Rudd of Australia and Hadi Soesastro from Indonesia.<sup>8</sup>

### THE DE FACTO G-2

Whatever happens with the current multilateral institutions and the larger steering committees, global leadership will increasingly devolve onto the two most important countries in the world: China and the United States. They will shortly be the

two largest economies and the two largest traders. They are the largest polluters and will determine much of the outcome on climate change. They lead the two groups of countries, developed and developing, that each now account for about half of world output. They are on opposite sides of the global imbalances as the world’s largest creditor/surplus and debtor/deficit countries, respectively.

Hence China and the United States bear primary responsibility for the success and stability of the world economy. Only they have the heft and policy flexibility to exercise such responsibility.<sup>9</sup> They must of course do so informally and diplomatically, operating as a de facto “G-2” without ever announcing or even acknowledging its existence, and China has publicly enunciated its opposition to the concept (while obviously being attracted by it). Their chief goal should in fact be to make the other “Gs” and broader institutions work much more effectively, by reaching agreement between themselves before engaging the larger fora, thus supplementing rather than supplanting these other bodies. This should assuage the other major countries that might otherwise feel slighted by such a new leadership construct.<sup>10</sup>

The G-2 could and should provide leadership for APEC as well. Indeed, it is perhaps clearer in the regional context than in any other that nothing of consequence will happen without the concurrence, and probably the leadership, of these two economic superpowers. Thus any serious planning for the future of APEC must focus on the views of China and the United States and the potential for finding agreement between them.

### OPTIONS FOR APEC: PACIFIC ASIA AND/OR ASIA PACIFIC?

These dramatic changes in the world economy and global governance patterns will influence the policy choices of countries in the region but they do not alter the basic issue described at the outset: Do the Asian members of APEC want a primarily Pacific Asia future (whether constructed via a 10+3, 10+6, or something else) or do they want an Asia Pacific dimension as well? The answer to that question will go far to determine the architecture of the region.

7. The G-7/8 has itself already come very close to replicating the G-20. Its latest summit in July 2009 included the “plus five” countries (Brazil, China, India, Mexico, and South Africa) that have become regular invitees to parts of its meetings and, for the climate change discussion, the Major Economies Forum that adds all but two of the G-20. The G-20 of course treats all these countries on an equal footing, which the G7/8 does not, and will thus become the dominant venue but the membership question is clearly being resolved in an inclusive direction in all forums.

8. See Hadi Soesastro, “Architectural Momentum in Asia and the Pacific,” East Asia Forum, June 14, 2009, available at [www.eastasiaforum.org](http://www.eastasiaforum.org).

9. The European Union is the third economic superpower in today’s world but operates as a unit on very few issues. Hence it cannot play the central steering role envisaged here.

10. I first proposed a China-United States G-2 in *The United States and the World Economy: Foreign Economic Policy for the Next Decade* (Washington: Institute for International Economics) in late 2004 and developed the idea more fully in 2008 in *China’s Rise: Challenges and Opportunities* (Washington: Peterson Institute for International Economics) and “A Partnership of Equals: How Washington Should Respond to China’s Economic Challenge” in the July/August issue of *Foreign Affairs*. Such influential experts as Zbigniew Brzezinski and Niall Ferguson have more recently proposed extending the G-2 concept to security and overall foreign policy issues.

**Option One: Terminate APEC.** If the Asians decide that their futures lie in Asia-only arrangements, that their sizable presence in the new G-20 steering committee assures them of an adequately powerful seat at the global table, and that their ever-growing economic and political weight guarantees respectful attention by the United States without any direct institutional linkages, there is a case for ending APEC. All of its original and continuing rationales would largely disappear in that context (though the Asians would obviously still have to find a way to manage their economic and broader relations with the United States).

**Option Two: Business as Usual.** This “path of least resistance” would acknowledge and accept APEC’s marginalization over the past decade but nevertheless keep it in place as an insurance policy against a failure of Asia’s integration efforts and the risk of US withdrawal from the region. Important decisions would be left to another day.

**Option Three: Support Major Reform of the Global Economic Architecture.** APEC has paid lip service to the WTO and the Doha Round over the past decade but has never made a serious effort to actually support them. Indeed, sharp divisions among major APEC countries contributed mightily to the failure of the Seattle Ministerial in 1999, the near-death of Doha at Cancún in 2003, and its latest setback in July 2008. Moreover, Asia’s distaste (or worse) for the IMF is a basic datum of the current milieu.

With APEC’s newly central role in the now-dominant G-20, however, and the systemic stress test that the crisis has forced onto the Bretton Woods institutions, the members (led informally by the G-2) might reasonably choose to explicitly forget about the Bogor Goals and other regional objectives in favor of trying to break the deadlocks over the governance structure in the IMF and the Doha Round in the WTO. They could use their strong position in the new G-20, via an “APEC caucus” within that grouping, to do so. The trouble of course, even if APEC could really get its act together for these purposes, is that non-APEC countries can and might well also wield veto power: the Europeans in the Fund, India and Brazil in the WTO. Hence a sole reliance on the multilateral system, even if sincerely and ardently pursued, is likely to be as unproductive over the next decade as it has been over the past 10 years.

**Option Four: Renew Aggressive Leadership of the Asia Pacific.** This option would reconcile the “Pacific Asia versus Asia Pacific” debate by embracing both as parallel initiatives. The United States would agree to support Asian regional integration (as it has always supported European regional integration) as long as its components were compatible with the (perhaps amended) global rules. The Asians would agree to simultaneously liberalize across the Pacific (as the Europeans always supported transatlantic liberalization via the GATT/WTO to

reduce the discriminatory impact of their increasingly preferential arrangements). The Bogor Goals/FTAAP would be updated, to embrace “behind the border” and “across the border” as well as “at the border” issues, and realistic new timetables would be set for concluding them.<sup>11</sup>

There are several possible techniques for achieving parallel progress in economic cooperation within Pacific Asia and across the Asia Pacific. The United States could negotiate a series of bilateral FTAs with major Asian countries, building on the Singapore and Korea pacts that have already been agreed and the Thailand and Malaysia talks that have begun (but are now in suspense). It could pursue its own “ASEAN + 1” arrangement as China, Japan, and Korea have already done.<sup>12</sup> These alternatives are distinctly inferior to an APEC-wide initiative, however, as they would inevitably include numerous inconsistent and even conflicting provisions that would limit their practical utility, especially with respect to rules of origin, and leave important gaps in country linkages.

The goals of the North Atlantic Treaty Organization (NATO), one of the most successful regional institutions of all time, whose 60th anniversary is also being celebrated this year, were stated very succinctly by a prescient observer at the time of its creation: to keep the Soviet Union out, to keep the United States in, and to keep Germany down.

APEC has no external enemy like the Soviet Union, except perhaps for terrorism and the specter of trade and investment protectionism, so the case for transpacific cohesion is less compelling than it was for transatlantic cohesion six decades ago. But virtually all Asians want to keep the United States in. There is no other institutional economic link between Pacific Asia and the United States and a number of Asian countries clearly want to retain US engagement, including to provide a counterweight to the growing preponderance of China. The hedging strategies of many Asian governments, designed to provide insurance against any adverse effects from China’s rising power, would be significantly promoted by a combination of Asia-only economic linkages and an ongoing Asia Pacific economic compact with the United States. US allies in the region, including Japan and Korea, would benefit greatly from a strategy that avoided their ever having to “choose between China and the United States.”<sup>13</sup>

11. Any FTAAP would of course have to be implemented on a preferential basis among its members, resolving another long-standing tension within APEC, as indeed the Trans-Pacific Partnership and all the East Asian regional agreements already are.

12. The Obama administration has already announced that it will sign the Treaty of Amity and Cooperation, a prerequisite for possible participation in the East Asian Summit and thus closer relations with ASEAN. US participation in the East Asian Summit could of course also be part of any new Asia Pacific strategy.

13. I initially presented the case for “Embedding Pacific Asia in the Asia Pacific: The Global Impact of an East Asian Community” in a speech to the

China too should welcome such an outcome. Its symbiotic economic relationship with the United States, to which it exports a substantial share of its GDP and where it holds enormous investments, is of crucial importance to its continued economic success and thus its political stability. As the regional hegemon, it should certainly prefer having the United States “inside the tent” rather than prowling outside it. Its systemic interests, ranging from the global role of the dollar through policy coordination toward North Korea, could be seriously damaged by excluding the United States from the Asian region. Trade and currency disagreements between China and the United States continue to smolder and launching a transpacific cooperation project should help contain them. Option four would appear to be a winning proposition for all concerned.

Some Asian countries, including Japan, avowedly support both Pacific Asia and Asia Pacific integration but want the former to proceed to completion *before* tackling the latter. Such sequencing would be very dangerous because it would inevitably defer the transpacific dimension for a very long time and risk the adverse consequences of the Asia-only approach in the meanwhile—sizable trade and investment discrimination and diversion, transpacific disintegration rather than integration, and the inevitable security implications thereof.

### THE 2009–11 WINDOW

Option three or, preferably, option four could be adopted and implemented over the coming three years with Singapore, Japan, and the United States successively in the chair of APEC. Singapore has been a cardinal architect of both the 10+1 agreements that are forging an East Asia Free Trade Area and continued transpacific ties. Japan, an original founder of APEC, is a close US ally with particular anxieties over the growing clout of China. The United States wants to stay engaged in the region, in security as well as economic terms, and can do so successfully if Asia agrees to avoid excessive discrimination against outsiders as it pursues its internal integration.

A three-step process can be envisaged if it proves impossible to move directly toward an FTAAP. First, the United States and one or more major Asian countries—probably Korea

and Japan—should join the Trans-Pacific Partnership, which would then comprise about half of APEC.<sup>14</sup> This would be fully consistent with the “pioneer” and “21-x” strategies that APEC has pursued on other issues. Second, the Trans-Pacific Partnership should be transformed into an FTAAP—perhaps with less comprehensive terms than the “gold standard” agreements championed by previous US administrations<sup>15</sup>—as soon as a critical mass (70 to 80 percent of the trade-weighted membership, on the model of the Information Technology Agreement) could be engaged. Third, in a combination of options three and four, the new Asia Pacific grouping could then respond positively and forcefully to support revival of the Doha Round as will surely be demanded by non-APEC countries to counter such a new burst of Asia Pacific trade assimilation.<sup>16</sup>

The Obama administration is formulating a new trade policy for the United States.<sup>17</sup> It has already signaled a focus on Asia and will be looking to implement major initiatives when it hosts APEC’s 2011 summit (in Honolulu?), for which planning could begin at the Singapore summit later this year and continue through 2010. However, it faces strong domestic opposition (mainly within its own party in the Congress) to any new trade liberalization and needs support from its trading partners to get back on track. The timing offers a golden opportunity for Pacific Asia to simultaneously achieve its regional objectives and solidify its relationship with the United States. APEC could thereby restore the dynamic leadership role of its initial decade and immeasurably strengthen both the region and the world economy as it addresses the likely global evolution of the next 20 years.

Japan National Press Club in Tokyo on September 2, 2005. I spelled out the arguments for an FTAAP most comprehensively in “Toward a Free Trade Area of the Asia Pacific,” Policy Briefs in International Economics 07-2 (Washington: Peterson Institute for International Economics, February 2007): the large welfare gains for all members from achieving free trade in the region, the strong push to revival of the Doha Round and multilateral liberalization that would inevitably result as in 1993, the consolidation of the “noodle bowl” of overlapping FTAs, the reinvigoration of APEC itself, the institutionalization of parts of the China-United States economic tension, and the overriding benefit of promoting transpacific integration rather than disintegration.

14. The outgoing Bush administration announced its intention to join part of the Trans-Pacific Partnership negotiations. The Obama administration has not yet made a decision on the issue but is clearly leaning in a favorable direction.

15. As proposed by Noboru Hatakeyama in “The Creation of a Free Trade Area of the Asia Pacific,” a presentation to a conference sponsored by the Japan Economic Foundation and the Peterson Institute for International Economics, Washington, November 27, 2007.

16. The issue of expanding APEC membership, most importantly to India, will presumably arise during this period. It would be a huge mistake to add India at this time for at least three reasons: It is impossible to characterize India as a *Pacific* nation, its inclusion would virtually require the addition as well of Pakistan and Bangladesh and perhaps others (e.g., Sri Lanka and Nepal), and—like the European Union at every important stage of its development—APEC should deepen its cooperation before it makes that process even more complicated by broadening its membership. It should be noted, however, that the Asia Pacific Summit and Asia Pacific G-10 ideas referenced favorably above would include India.

17. C. Fred Bergsten, “Obama Needs to Be Bold on Trade,” *Financial Times*, June 24, 2009.