



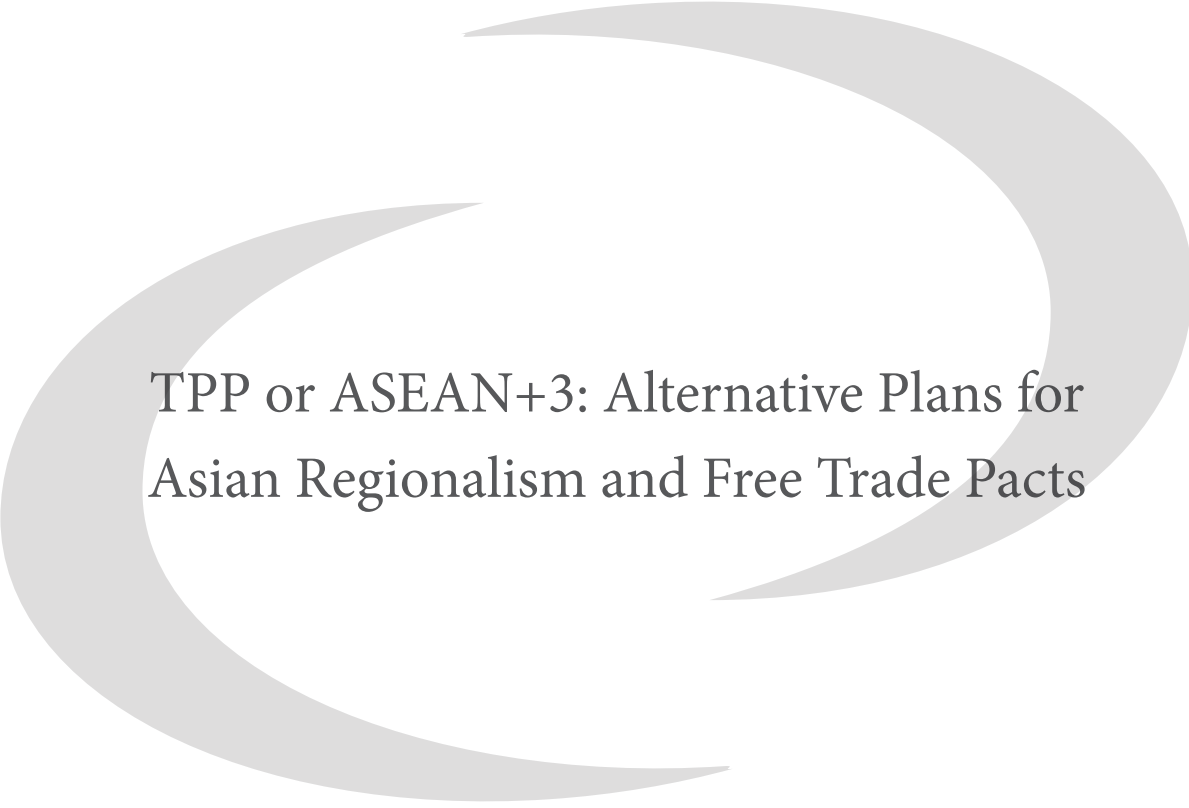
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TPP or ASEAN+3: Alternative Plans for Asian Regionalism and Free Trade Pacts

Competing Templates in Asia Pacific Economic Integration

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Nearly two decades have passed since the last major multilateral trade agreements were concluded in 1993—a gap already longer than any since the GATT/WTO system emerged in 1948. Action on trade rules has instead shifted to bilateral and regional agreements; for example, at the time of the Uruguay accords there were three trade agreements in force among APEC economies while today there are forty-one (and more are in the works). This shift is due to multiple forces and it is likely to persist.¹ In the Asia Pacific, the shift to regional agreements has generated two major, controversial initiatives: an Asian track of negotiations centered on ASEAN, and a trans-Pacific track centered on the proposed Trans-Pacific Partnership (TPP) agreement, including the United States. The Asian track aims to deepen economic relationships among Asian economies, but it has also been viewed as an effort to reduce America’s historically important role in Asia. The TPP would strengthen ties between Asia and the Americas and create a new template for the conduct of international trade, but it has also been described as an American effort to encircle China. To make matters more complicated, each track could lead to a Free Trade Area of the Asia Pacific (FTAAP) comprising countries on both tracks.

Where will these tracks lead? The Asia Pacific is easily the world’s most important region from the viewpoint of long-term economic growth. It is also the site of a potentially critical rivalry or partnership—or both—between China and the United States. International flows of goods, services, capital, technology and people in the Asia Pacific account for two-thirds or more of all such global flows, excluding intra-European flows. Effective region-wide integration could yield benefits larger than those that expected from the Doha Round. Conflict in the Asia Pacific would severely damage the world’s economic and political prospects.

This paper examines the structure of the tracks, their possible trajectories, and their economic implications for the region and the world. It estimates how the benefits are likely to evolve on each track and shape countries’ decisions to join one or another. This analysis draws on an ongoing quantitative study of the Asian and TPP negotiating tracks by Michael Plummer, Fan Zhai and me.² The results suggest that both tracks will generate substantial benefits for participants and potential new members. Over time, most Asia Pacific countries would likely join both tracks. China and the United States would thus be left among the very few countries *without* preferences in both of their huge markets. That should generate increasing incentives for them to develop a wider agreement, perhaps based on one of the tracks, or on new global negotiations that also include Europe. This view may be “Polyannaish,” in the sense that politics could easily overwhelm its economic arguments. What we can demonstrate is that competition in the Asia Pacific takes place in a highly positive-sum context. Thus, competition need not be viewed in apocalyptic terms—it could as easily pave the road to regional integration.

WHY ASIA PACIFIC INTEGRATION MATTERS

Asia Pacific trade matters because it is huge, innovative and dynamic. A liberal global trading environment has helped to drive Asian development, generating tremendous flows of goods and services within Asia and with advanced economies elsewhere. The region's production networks, in turn, have set new standards for manufacturing efficiency. And these linkages will become even more important in the future, as the Asia Pacific's share of the global economy rises. Given the region's role in the world economy, it is hardly surprising that the venue of trade negotiations is shifting from global forums to agreements within the Asia Pacific.

Of the world's \$14.3 trillion in trade in 2010, all but \$4.7 trillion involved APEC countries—a useful working definition of the Asia Pacific region—as either an exporter or importer (Table 1) or both. Of the region's trade, intraregional trade amounted to about half, or \$4.9 trillion. This trade further divides into trade within the Americas (\$1 trillion), within Asia and Oceania (\$2.3 trillion), and across the Pacific Ocean (\$1.6 trillion). These magnitudes indicate the huge scale of Asia Pacific integration and its importance to the global economy.

	Americas	Asia	Oceania	Russia	ROW	World
Americas	999	397	28	8	635	2,067
Asia	740	2,291	109	51	1,340	4,532
Oceania	14	154	14	1	55	238
Russia	14	53	0	0	332	400
ROW	894	1,198	62	177	4,720	7,050
World	2,661	4,094	214	237	7,082	14,287

Source: APEC Bilateral Database, accessed 25 February 2012.

Asia Pacific trade is also dynamic. The region is characterized by great variations in resource endowments and levels of development, and enabling countries to exploit the major growth opportunities implicit in these gaps. Trade has permitted labor-rich and resource-poor countries to exchange manufactured goods for primary materials; advanced and emerging economies to exchange high-technology and labor-intensive products and services; and rapidly growing countries to move into new industries and, in turn, pass older ones to new “flying geese.” Vietnam and China were the two most recent Asian economies to join the WTO; they were required to make major concessions and have benefited greatly from doing so. These flows are likely to remain dynamic in the future; in the next fifteen years, the APEC region is expected to further increase its share of world GDP from 53% to 56% (Table 2). Table 2 also points to change in the composition of the Asia Pacific economy; the Americas, which now account for 54% of the region's GDP, will by 2030 account for only 45%. Meanwhile, the rules that

govern these vital linkages are becoming frayed. After a decade of work, the Doha Development Agenda is collapsing. An agreement would have been required by 2007 to come under U.S. fast-track negotiating authority, and by mid-2011 to avoid the politics of election cycles in the United States and elsewhere. These and many other

Table 2. Projected Growth in the Asia Pacific, 2010-25

	GDP US\$2007bill.		2010-25	Share of World GDP	
	2010	2025	Growth	2010	2025
Americas	16,784	24,918	2.7	28.8	24.4
Asia	11,856	27,999	5.9	20.4	27.5
Oceania	1,056	1,632	2.9	1.8	1.6
Russia	1,323	2,790	5.1	2.3	2.7
ROW	27,182	44,627	3.4	46.7	43.8
World	58,201	101,967	3.8	100.0	100.0

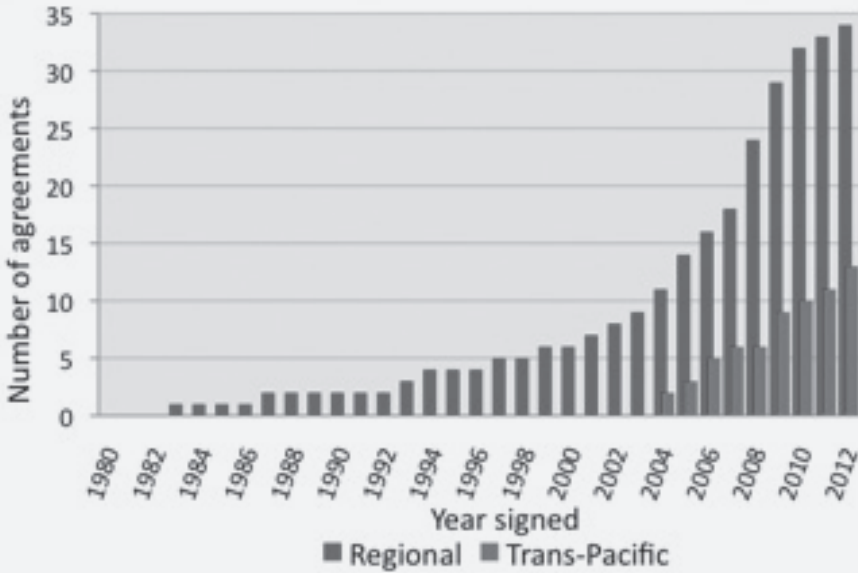
Source: Petri et al, (2011).

deadlines were missed. In 2011, even modest efforts to find “alternative deliverables”—agreements on market access for Least Developed Economies, environmental goods and services, and trade facilitation—appear to be failing. Instead of global rules, a wave of bilateral and regional free trade agreements has swept across the world and the Asia Pacific (Figure 1). Among APEC economies, there were only four major agreements before 2000—the ASEAN Free Trade Area, the Canada-U.S. Free Trade area, the North American Free Trade Area, and the Australia-New Zealand Closer Economic Relations accord. Today there are thirty-nine, with others in negotiation.

Until 2004, all of the new regional agreements among APEC countries involved regional groupings or pairs of countries, including agreements involving ASEAN. As Table 1 suggests, about two-thirds of Asia Pacific trade indeed takes place within sub-regions, such as the Americas and Asia. It is not surprising that the region’s first wave of trade agreements targeted these relationships. But the remaining one-third of Asia Pacific trade that crosses the Pacific involves especially important types of trade—linkages that permit exchanges across countries that differ substantially in development, resource endowments, technology, and capital-labor ratios. As Figure 1 also shows, the most recent wave of Asia Pacific trade agreements that began to appear in the mid 2000s has focused precisely on flows across the Pacific, between the Asia Pacific’s major eastern and western sub-regions.

As regional trade agreements have begun to fill the vacuum left by stalled global negotiations, they have created new opportunities and sources of uncertainty for Asia Pacific trade. A more coherent, comprehensive regional or global system could offer significant gains, and either track could, in principle, lead to such deeper integration. The great challenge to policy makers and analysis is to explore whether, and how, the Asian and the newly emerging Trans-Pacific tracks could provide the basis for a truly integrated regional trading system.

Figure 1. Trends in Asia Pacific Trade Agreements



Note: among APEC members.

Source: ESCAP database (<http://www.unescap.org/stat/data/>).

STRUCTURE OF THE ASIAN AND TRANS-PACIFIC TRACKS

Since 2007, APEC leaders have repeatedly noted the benefits of an Asia Pacific wide trading system, recognizing both the Asian and Trans-Pacific negotiating efforts as possible pathways toward it. Yet there is still much debate about the objectives of each track, and about the likely speed and rigor of their progress. Indeed, some observers have even argued that the tracks are more likely to divide the region than to integrate it. These issues are explored in some detail below, beginning with the historical evolution and current structure of the negotiating tracks. We will show that the two tracks originated in different policy contexts and have adopted different approaches to integration. Nevertheless, we will also show that they are fundamentally interdependent. Each has already begun to influence the other. The parallel progress of the tracks and their interactions are likely to be salient features of the region’s trading system for some time.

The Asian Track

The region’s modern trading institutions are, somewhat surprisingly, based on the initiatives of the Association of Southeast Asian Nations (ASEAN) rather than the linkages of Northeast Asia’s giant economies. This has left a distinctive mark on the Asian track, yet much is now in flux as China assumes a central role in the region’s economy. Launched in 1967 as a political institution, ASEAN turned its attention to economics starting in 1977 with a preferential trade agreement and joint industrial projects. Economics has since become its dominant interest. ASEAN has concluded an impressive network of free trade agreements within

the region and beyond and established a prominent venue for regular regional summits. This central role was dramatically advanced by a free trade agreement that China initiated in 2002, leading to a full ASEAN-China FTA in 2010. The Chinese initiative was quickly followed by Japanese and Korean agreements, and eventually by “ASEAN Plus One” agreements with India, Australia and New Zealand. Negotiations are now also underway with the European Union.

With the number of regional FTAs rising sharply, interest has grown in wider regional agreements to exploit the advantages of larger economic zones and to simplify the “noodle bowl” of existing arrangements, including 180 bilateral arrangements among various Asian economies. In 2004 the ASEAN+3 economic ministers commissioned a feasibility study to establish a trade agreement, the East Asia FTA (EAFTA). A group of experts recommended an agreement that was comprehensive in scope, achieved high standards, and was implemented as a single undertaking. But no action followed. A follow-up study in 2009 suggested a slower approach, focused on a unified RoO regime for existing FTAs.

In the meantime, ASEAN established an East Asian Summit (EAS) in 2005, adding Australia, New Zealand and India and addressing concerns that the dialogue was becoming too heavily dominated by China. At the EAS in 2007, Japan proposed a free trade agreement based on this wider group, the Comprehensive Economic Partnership of East Asia (CEPEA). A study of the framework was presented to the 2009 summit, which agreed to examine it in parallel with the EAFTA proposal. The study argued that that this wide arrangement would create larger gains than other regional FTAs, and proposed economic cooperation, trade and investment facilitation, and trade and investment liberalization as the principal pillars of the new agreement.

FTAs now connect ASEAN with all six partners in EAFTA and CEPEA, but an FTA among China, Japan and Korea (CJK) remains elusive. The three are critical for any regional institution, but cooperation has proven difficult. Serious attempts are underway to bridge these gaps, perhaps due to the competitive pressure of the TPP agreement. In 2008 the leaders of the three countries began to meet annually outside of the ASEAN+3 summit, and in 2011 completed an accelerated study of a trilateral FTA, expecting to begin negotiations in May 2012. At that time, they are also expected to sign a trilateral investment agreement. In parallel with these initiatives, China and Korea have conducted bilateral negotiations. China and Japan have reached a truce on their alternative visions for the regional arrangement, now proposing to move ahead with both the ASEAN+3 or ASEAN+6 frameworks in parallel. At ASEAN’s Bali Summit in 2011, they also jointly proposed several working groups to shape the dialogue, some of which ASEAN accepted. But ASEAN, in turn, has added a template for regional integration based on an “ASEAN++” model that would harmonize existing ASEAN agreements and permit other countries to join. Perhaps a response to the TPP’s objective of serving as the template for regional arrangements; it aims to make sure that future integration remains “ASEAN-centric.”

A comprehensive regional agreement remains to be concluded. Existing Asian trade agreements, though wide ranging, have been relatively shallow and do not include trade among the region’s largest economies. Economic studies—including by us—show

that an agreement that is more rigorous and includes the Northeast Asian economies would produce results that are substantially better than more modest ones.³ However, the progress has been facilitated by exceptions, modest concessions on “behind the border” regulatory issues, and relatively weak labor and environmental provisions.

The Trans-Pacific Track

The modern vision for Asia Pacific (or trans-Pacific) economic integration also dates back to the 1960s. In 1968, economists from around the Asia Pacific region founded the Pacific Trade and Development Forum (PAFTAD), which then convened conferences on trade liberalization across the Pacific region. PAFTAD eventually became the midwife of the quasi-governmental Pacific Economic Cooperation Council (PECC) in 1980. PECC’s efforts, in turn, helped to set the stage for the official Asia Pacific Economic Cooperation (APEC) forum. Since the collapse of the “Early Voluntary Sectoral Liberalization” effort in 1998, APEC has settled into an operating model based on non-binding approaches focused on trade and investment facilitation. But APEC has encouraged “pathfinder” initiatives among APEC sub-groups that lead to agreements without full consensus. One such initiative (although not officially labeled an APEC pathfinder) was a high-quality trade agreement, the Trans-Pacific Strategic Economic Partnership (typically referred to as the P4 agreement), signed by Brunei, Chile, New Zealand and Singapore in 2005. This became the seed of the current TPP negotiations.

While eschewing negotiations, APEC has also encouraged work on a region-wide free trade area, in part to speed the achievement of its 1994 Bogor Goals of free trade and investment in the region. In 2006, the APEC Business Advisory Council formally proposed efforts to establish a Free Trade Area of the Asia Pacific (FTAAP). The concept has since appeared in several Leaders’ Declarations, starting in 2007. The 2010 Leaders’ Declaration formally recognized the EAFTA, CEPEA and the TPP as pathways to the FTAAP.⁴

The TPP negotiations were energized by the Bush administration decision of the United States to enter into negotiations with P4 members in February 2008. Australia, Peru and Vietnam announced their intention to negotiate later in 2008. The pace of activities then accelerated in late 2009, when Obama made the TPP a centerpiece of his new trade policy. Malaysia joined the negotiations in October 2010 and at the APEC Summit in 2011 the negotiators issued an outline of the agreement. Canada, Japan and Mexico then also expressed their intentions to join. Thus at least nine, but perhaps as many as thirteen economies (since some expect Korea to join at some point) are now likely to be involved in the agreement.

Domestic politics in the United States might appear to pose a serious obstacle to the TPP since the U.S. president no longer has “fast track” authority to facilitate the approval of trade agreements in Congress. Still, an agreement reached among like-minded, open economies is likely to have reasonable chances for success. Despite its deep political divisions, Congress has approved the Colombia, Korea and Panama FTAs, and there is considerable business and bipartisan support for the TPP. Most importantly, the agreement would reinforce the strategic objective of deepening the U.S. “pivot” with Asia. Speaking before the Australian parliament,

Obama argued that as “the world’s fastest-growing region—and home to more than half the global economy—the Asia Pacific is critical to achieving my highest priority: creating jobs and opportunity for the American people.”⁵

This ambition, complicated by expanding membership, poses huge challenges. Each round of negotiations involves 400 or more negotiators, and nine rounds were already held between March 2010 and the November 2011 APEC Summit in Honolulu. Three more are scheduled for 2012. Prime Minister Razak of Malaysia has said that the goal is an agreement by July 2012,⁶ but in light of the challenges this timeline seems optimistic.

The TPP could also represent a breakthrough in consolidating existing trade agreements (there are fourteen bilateral or regional agreements spanning the countries now negotiating the TPP).⁷ In the absence of strong regional or global initiatives, a complex “noodle bowl” of rules and regulations has emerged to cover trade in Asia and elsewhere. It would be important if the TPP could unify rules of origin across the region, permitting the cumulation of value originating across member countries. Inconsistent rules of origin are particularly problematic in current trade agreements because they impose costs of compliance and generate incentives to diminish rather than increase productivity.

Most importantly, the TPP would help to sustain the vigor of trans-Pacific linkages. Most new Asian FTAs exclude the United States and could divert trade and investment from it, eventually eroding support for trans-Pacific trade in the United States. For example, of the eight countries now involved in the TPP negotiations, seven already have a free trade agreement with China, and six already have a free trade agreement with Japan. Helping to entrench integration across the Pacific, it could prevent “drawing a line in the middle of the Pacific.”

A Contest of Templates

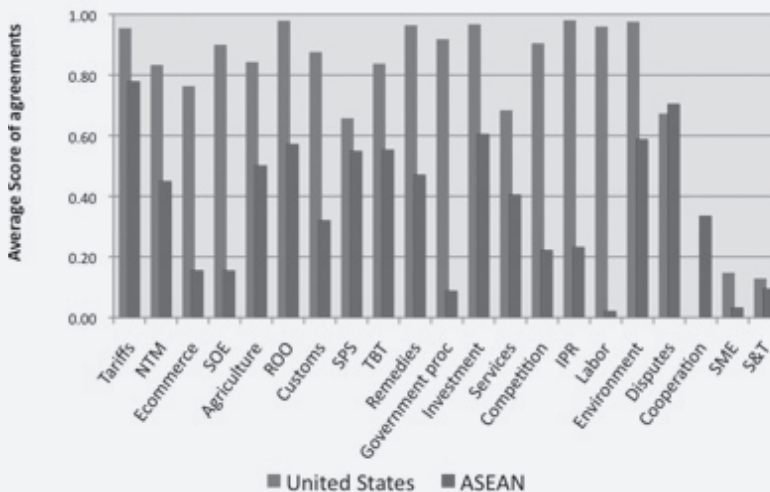
The tracks differ in membership and coverage of issues. The Asian track excludes the United States and other countries in the Americas, while the TPP track excludes China and some other Asian economies, at least for now. Some Chinese observers have complained that China has not been asked to participate in the TPP,⁸ and the United States responded that any country willing to sign an ambitious TPP is welcome to join. Both governments understand that the TPP is likely to contain provisions that China would find unacceptable for now. Reconciliation of the tracks will have to be left to the future. Asian agreements typically seek gradual liberalization, while the TPP aims to create a comprehensive, forward-looking template for economic integration. Asian agreements are intended as less intrusive; the “ASEAN way” has emphasized consultation and consensus, complementing the region’s political commitment to non-interference. In practice this has meant that Asian agreements contain more exceptions and tend to accommodate the reluctance of countries—especially large ones like China or Indonesia—to accept intrusive restrictions on domestic policies. The TPP track, by contrast, will require commitments in many areas of economic activity, including “behind the border” regulations that constrain international commerce (albeit long transition periods may be allowed in some countries).

These qualitative observations are borne out by quantitative comparisons of trade agreements concluded by ASEAN and the United States in the past. Petri et al. develop a database of trade agreements that includes scores that attempt to assess the rigor of provisions in twenty-one issue areas commonly contained in trade agreements (Figure 2).⁹ Agreements concluded by the United States tend to have much higher scores than Asian agreements on issues such as government procurement, intellectual property rights, investment, and competition. ASEAN agreements tend to have more limited provisions on average, but have stronger provisions on cooperation and collaborative dispute resolution. On average, intra-Asian accords have also applied smaller average tariff cuts to higher initial tariffs, leaving larger barriers behind.

The templates are likely to take contrasting positions on three clusters of issues. One such cluster, involving market access for goods, is likely to be addressed in similar ways (albeit with different tolerances for exceptions). A second cluster, addressing investment, services and related rules, will present sharper contrasts. The third cluster, comprising provisions that respond to political concerns, may appear to differ substantially, but often has more limited effects in practice than would appear on paper.

Issues related to market access in goods—principally tariffs and non-tariff barriers—are usually of greatest interest to emerging economies and to those that specialize in “sensitive” commodities, especially agriculture. The Trans-Pacific track is likely to attempt comprehensive market access, including in sensitive sectors such as labor-intensive manufactures and agriculture. Whether this ambition can be realized remains to be seen; both Japan (rice) and Canada (dairy) have highly-politicized barriers that may require special treatment. The Asian track, by contrast, will permit more exceptions—indeed, one of the selling points of the Asian track for Japan and Korea has been that it will not require the political sacrifices expected in the TPP. However, labor-intensive manufactures in Southeast Asia will create strong concerns as Asian agreements deepen over time.

Figure 2. Average Scores of Provisions on Major Issues



Source: Petri, Plummer and Zhai (2011).

The second cluster of issues involves the competitive sectors of advanced economies—services, technology, and investment, and related rules on competition, government procurement and intellectual property. These topics should yield larger differences between the tracks, because they will be strongly promoted by the United States on the TPP track. Many of the resulting provisions will be contentious, since other economies—even some at high levels of development—are often importers of the relevant products and services. Non-government groups will also play a large role, since they are eager to avoid any international rules that might constrain their ability to influence domestic regulation.

Finally, a third cluster of issues covers political objectives, which appear in agreements in order to accommodate domestic politics. Some economists strongly oppose these “non-economic” issues, but in practice they don’t seem to generate significant economic distortions. The issues of interest to advanced countries are labor rights and environmental protection, which are typically addressed in agreements by requiring countries to accede to international conventions and to develop appropriate enforcement mechanisms. There is currently discussion in the TPP to step up the international standards required. The issues of interest to emerging economies are cooperation in culture and science, technology transfers, and labor mobility. These are often addressed by various collaborative projects and exchanges. Thus, while the Asian and TPP tracks are likely to have somewhat different policy provisions, contrary to common expectations these issues are unlikely to define the greatest contrasts between them.

These differences between the tracks reflect policy approaches and structural challenges in their respective member economies. Asian agreements seek to preserve “policy space,” while Trans-Pacific agreements, influenced by the United States and other advanced economies, focus on market access for advanced sectors, and on provisions designed to satisfy their contentious domestic politics. But it would be a mistake to read too much into the “selfishness” of such positions. International economics argue that the growth of trade, including in sectors of interest to less advanced countries, requires the growth of opportunities for the exports of all countries. Market access for advanced economies enables them to build support for trade, and to shift to industries that favor their areas of comparative advantage. The resulting imports generate market access for other economies. Thus, the liberalization of manufactures in the GATT era, largely undertaken because U.S. manufacturers sought improved access to global markets, built a strong coalition in support of trade and made room for dramatic increases in manufacturing activity across the world.

Interaction of the Tracks

The Asian and Trans-Pacific tracks, as the economic linkages they represent, are interdependent. Each can influence the other by demonstrating faster progress, attracting more members, or adopting “better” provisions. They are also likely to compete for acceptance and legitimacy in the international policy community. Competition among regional trade negotiations has been long recognized as potentially beneficial, but the theoretical conclusions are ambivalent; while

greater liberalization is one ultimate outcome, another is a world of warring protectionist blocs. In practice, the current proliferation of regional and bilateral negotiations is generating many, often overlapping, agreements—it does not appear to be leading to a bifurcated outcome. This may mean inefficiencies due to confusing rules, but does not seem to foreshadow an antagonistically partitioned trading system. Asia Pacific agreements exemplify these trends; a majority of the region's economies are likely to participate on both tracks.

Even in these early stages, the two tracks are stimulating mutual progress. The TPP appears to have been motivated by Asian track agreements that have excluded the United States. The TPP, in turn, has led to more vigorous Chinese efforts to accelerate the negotiations toward the China, Japan and Korea (CJK) FTA. The Honolulu announcement that Canada, Japan and Mexico had entered consultations to join the TPP was quickly followed by announcements on the completion of the CJK study and the impending CJK investment treaty. The "ASEAN++" initiative is, in turn, an ASEAN-centric response to the TPP template. The United States may be seeking to attract additional partners to the TPP track, including other Southeast Asian countries, even if this greatly complicates the process.

Agreements on the two tracks also seem to be converging in content. More recent trade agreements on the Asian and Trans-Pacific track appear to have more similar provisions than those concluded in the past, and both groups of agreements have expanded to cover more areas with similar language. If only to save negotiating effort, agreements routinely borrow provisions from each other. Indeed, one of the most important benefits of a high quality trade agreement is that its template may become a model for subsequent initiatives. Nevertheless, some observers see the tracks as fundamentally divisive, designed by China and the United States primarily to harm each other. The competition between the tracks seems to encourage hyperbole; Cold War terminology such as "encirclement" and "containment," and some even call the TPP "economic warfare within the Asia Pacific region."¹⁰ Critics of Asia-only agreements in the United States have warned of attempts to squeeze it out of Asian markets and to establish Chinese hegemony in Asia.¹¹ Shril references to a trade war are common on both sides. Such apocalyptic pronouncements naturally attract more than their share of media attention, and are amplified in mostly unrelated political debates within the countries involved in, or affected by, the negotiations.

The strains have been intensified by the sluggish recovery from the global financial crisis, as governments blame others abroad for domestic setbacks (whether unemployment in the United States or inflation in China) and argue for policy changes abroad as solutions (whether appreciation in China, or increasing savings in the United States). In the United States, the TPP has thus become a strategy for increasing U.S. exports and for combating trade practices that are thought to be unfair to U.S. producers. Such rhetoric is typical in campaigns; in 2008, Hillary Clinton and Barack Obama sent messages to trade partners to explain that their public attacks on NAFTA should not be taken too seriously.¹² Political pressures of this type are not exclusive to democratic systems; they appear to be affecting policy discussion in China during its leadership transition.

Such tensions are inevitable in trade politics and have to be taken in stride. China and the United States may not negotiate a free trade agreement now for many reasons, but they have much to gain from cooperation. Each may pursue regional agreements initially to strengthen its future bargaining position. But given projections of Asia's rapid economic growth, U.S. interests in broad, region-wide integration should grow in the future, and Chinese reforms should help to make Chinese policymakers more interested in, and comfortable with, rigorous market access provisions.¹³ In the meantime, U.S. business (and presumably also Chinese business) strongly support continued engagement. For example, the *Wall Street Journal's* CEO Council recently recommended a specific, new "economic cooperation agreement" with China that, short of a trade agreement, would promote cooperation and build confidence in the bilateral relationship.¹⁴

THE EMPIRICS OF THE TRACKS

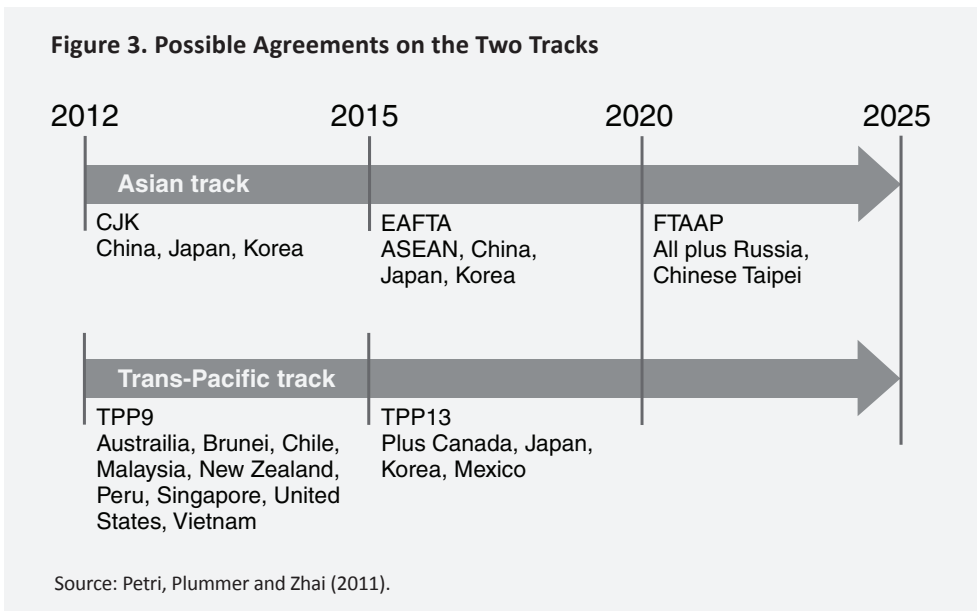
Empirical estimates of the effects of the tracks offer a surprisingly simple and positive story. The results below indicate that each track will generate significant benefits for existing members and potential new members, and competition is likely to lead to enlargement and progress on each track. And they suggest that as the tracks gain momentum, they will generate incentives for consolidation. As expected, we also see evidence of trade diversion (or losses for excluded economies), but find that the vast majority of benefits on both tracks result from trade creation and not diversion from third parties.

Modeling Framework

The results reported in this study are calculated using a twenty-four-region, eighteen-sector computable general equilibrium (CGE) model developed by Zhai.¹⁵ Such models have long been used to assess the implications of trade liberalization and have become increasingly sophisticated over time. Their results have been also widely debated. Three major concerns have arisen. CGE models appear to have: 1) underestimated economic changes that resulted from large and ambitious agreements, such as NAFTA;¹⁶ 2) have missed important effects of such agreements, including increases in productivity and international investment; and 3) often underestimated the effects of trade agreements, because they are based on the assumption of complete regional liberalization rather than the more limited progress that is usually achieved.¹⁷

We address all of these concerns with modeling innovations that, hopefully, provide more accurate results. First, we use a new type of trade model based on the finding that productivity differences among firms explain a substantial part of trade flows. This specification implies substantial changes in productivity due to liberalization; reductions in barriers accelerate the growth of productive firms and the exit of unproductive ones. Second, we do not assume that an agreement will eliminate all barriers in a bilateral relationship, but rather model only partial reductions, calculated with reference to the relevant agreement provisions. Third, we account for existing agreements and calculate benefits (say, from the TPP) as the incremental effects of the agreement over previous agreements that may already cover a trade relationship (say, the Australia-U.S. FTA).

We model the Asian and Trans-Pacific tracks described in the previous sections with the paths illustrated in Figure 1, assuming rapid progress on each track, in part to generate simulations that show contrasting results for different strategies. An accelerated timeline makes it possible to take account of the full results of the agreements in a reasonably short (2025) timeframe. As is the case with most simulation studies, the goal is not to project the future, but rather to answer “what if” questions about the consequences of policy. In line with this modeling strategy, we assume quick early results on each track, a CJK agreement on the Asian track and a TPP9 agreement on the TPP track reached by 2012 and implemented by 2015.¹⁸ The two tracks are assumed to move forward to ASEAN+3 and TPP13 agreements, respectively, by concluding these in 2015 and implementing them by 2020, and, finally, to consolidate these in a region-wide FTAAP agreement in 2020 (the target date actually envisioned by APEC leaders), implemented by 2025.



Results

The empirical results confirm the value of Asia Pacific integration and the promise of both negotiation tracks (see Table 1). Four major results stand out. First, Asia Pacific integration promises large benefits. The income gains associated with liberalization are likely to exceed \$1 trillion, or around 1.5% of world GDP in 2025. Asia Pacific agreements represent a Doha-scale project. These large benefits reflect the fact that even though the region accounts for only part of world trade, the scenarios envisioned in this study offer so much liberalization that they could generate value beyond that possible under global agreements such as Doha, even reenergizing global negotiations.

Second, the benefits increase with the scale and ambition of the integration project. As the TPP expands from nine members to thirteen (through the incorporation of Canada, Japan, Korea and Mexico), total benefits would grow from \$16 billion in 2015 to \$104 billion in 2025. On the Asian track, we find similar economic incentives for moving from the trilateral agreement among China, Japan and Korea to the thirteen-member EAFTA.

This path would generate gains rising from \$44 billion in 2015 to \$215 billion in 2025, producing larger benefits than the TPP track because initial trade barriers (especially among the region's three largest economies) are relatively high; by contrast, much trade among TPP countries is already covered by high quality agreements.

Third, while nearly all economies benefit under each scenario, the countries that systematically gain the most (in relative terms) are those that are small, initially protected, and participate early on both tracks. By participating in both, Vietnam will be in an especially favorable position to capture industries that China leaves behind as it moves into higher-technology activities. But economies such as Malaysia and Peru also capture substantial gains. In absolute terms, of course, the region's largest economies are nevertheless the biggest gainers, with China, the United States, and Japan capturing the largest benefits.

Fourth, the gains associated with the two tracks are mainly derived from trade creation—deeper integration made possible by reduced barriers—rather than trade diversion, that is, gains achieved at the expense of countries that do not receive preferential treatment. For example, Europe will also gain from the FTAAP, mainly because the production efficiencies generated by deeper Asia Pacific integration will improve Europe's terms of trade with the region.

More detailed results in Petri et al. provide information on microeconomic issues such as sectoral effects and adjustment.¹⁹ The effects of comprehensive regional integration affect substantially all aspects of economic structure.

Strategic Implications

The results suggest that the tracks are a complex “game”—they represent several stages and types of strategic interactions among Asia Pacific economies. In the early stages—the TPP9 and CJK agreements—the benefits will depend in large part on preferential access to the markets of the United States and China, respectively, yielding important gains for smaller countries—Vietnam, Malaysia and Peru in the case of the TPP, and Korea in the case of CJK. China and the United States would benefit only modestly in this early stage; their support would have to be motivated by the longer term gains that they expect to achieve in the “contest of templates.”

In a middle stage of the game, the agreements would widen—to the EAFTA and TPP13 on the two tracks—and integration would extend to several large economies on each track. Benefits would expand accordingly, including for China and the United States. The dynamism of the two trading systems could well accelerate their integration efforts. Countries that join both tracks would benefit the most. In our scenarios, Brunei, Japan, Korea, Malaysia, Singapore and Vietnam would be included in both tracks from an early stage, while Indonesia, the Philippines, and Thailand might join somewhat later. Competition between the tracks could help to ensure their participation. By the end of this middle stage—2020 under our assumptions—many Asia Pacific economies would have preferential access to most Asia Pacific markets. In that privileged position, for example, Japan and Korea would have gains equal to 91% and 90% of their total potential gains from comprehensive region-wide free trade, respectively.

Table 3. Economic Gains under Alternative Scenarios									
	GDP	Income gain (US\$2007 bill)				% Baseline GDP			
	2025	TPP track	Asian track	Both tracks	FTAAP	TPP track	Asian track	Both tracks	FTAAP
TPP track economies	26,550	77.9	6.7	83.7	228.5	0.29	0.03	0.32	0.86
United States	20,337	39.2	3.2	41.8	143.1	0.19	0.02	0.21	0.70
Australia	1,426	5.5	0.1	5.6	13.1	0.38	0.01	0.39	0.92
Canada	1,982	7.0	0.4	7.3	12.0	0.35	0.02	0.37	0.61
Chile	289	4.4	0.1	4.5	6.7	1.53	0.04	1.57	2.32
Mexico	1,999	12.0	2.8	14.4	41.6	0.60	0.14	0.72	2.08
New Zealand	206	2.0	0.0	2.0	3.0	0.95	0.02	0.99	1.44
Peru	311	7.8	0.1	8.0	8.9	2.52	0.02	2.57	2.87
Asian track economies	19,540	-19.2	139.2	122.8	510.0	-0.10	0.71	0.63	2.61
China	16,834	-15.7	103.8	90.2	387.5	-0.09	0.62	0.54	2.30
Hong Kong	405	-0.1	15.1	15.0	66.4	-0.02	3.72	3.69	16.38
Indonesia	1,473	-1.5	8.1	7.0	26.4	-0.10	0.55	0.48	1.79
Philippines	308	-0.4	3.8	3.5	11.2	-0.12	1.25	1.15	3.66
Thailand	520	-1.4	8.3	7.1	18.4	-0.28	1.60	1.37	3.54
Two-track economies	8,460	122.2	122.6	222.9	283.4	1.44	1.45	2.64	3.35
Brunei	22	0.2	0.3	0.4	0.4	0.86	1.31	1.88	1.80
Japan	5,332	52.9	54.2	99.1	115.0	0.99	1.02	1.86	2.16
Korea	2,063	18.9	46.4	58.3	70.8	0.92	2.25	2.83	3.43
Malaysia	422	11.6	6.5	17.3	25.3	2.74	1.53	4.09	6.00
Singapore	386	2.2	0.0	1.7	6.2	0.58	-0.01	0.43	1.60
Vietnam	235	36.4	15.2	46.2	65.8	15.50	6.49	19.67	27.99
Others	47,418	-7.7	-9.9	-17.1	176.7	-0.02	-0.02	-0.04	0.37
Russia	2,790	-1.0	-1.3	-2.3	175.3	-0.03	-0.05	-0.08	6.28
Taiwan	800	-1.6	-7.6	-8.4	50.0	-0.20	-0.95	-1.05	6.25
Europe	22,237	1.6	6.2	6.5	-2.3	0.01	0.03	0.03	-0.01
India	5,229	-0.6	-6.3	-6.8	-10.9	-0.01	-0.12	-0.13	-0.21
Other ASEAN	82	-0.2	0.5	0.3	2.9	-0.30	0.64	0.40	3.60
ROW	16,280	-5.9	-1.4	-6.6	-38.3	-0.04	-0.01	-0.04	-0.24
WORLD	101,967	173.3	258.6	412.3	1,198.5	0.17	0.25	0.40	1.18
Memorandum									
TPP13	35,010	200.2	129.3	306.6	511.8	0.57	0.37	0.88	1.46
ASEAN+3	28,081	102.8	262.3	346.1	796.3	0.37	0.93	1.23	2.84
APEC	58,140	178.4	259.6	418.8	1,247.1	0.31	0.45	0.72	2.14

Note: The results include both trade effects reported in the Petri et al. and investment effects that have been subsequently estimated. The latter will be incorporated in upcoming revisions of the earlier study. The groups reported in the table reflect assumptions used in the simulations. TPP-track economies are those that were assumed to participate only in Trans-Pacific-track agreements. Asia-track economies are assumed to participate only in Asia-track agreements, and Two-Track economies are assumed to participate in both sets of agreements. The FTAAP was assumed to include all APEC economies.

In the final stage, China and the United States would be left among the few economies without preferential access to both of their large markets. For them, the grand prize would be a consolidated agreement. The FTAAP would offer China 3.8 times the benefits of the Asian track alone, and the United States 4.5 the benefits of the TPP track alone. Reaching a consolidated agreement, say a decade from now, would yield greater gains at lower cost for both countries than it would today. By then, Chinese per capita incomes will be twice as high as now, and China should have interest in several rigorous provisions of the TPP template. Both will have “rebalanced” their economies. Much will still depend on the chemistry of their political and economic relationship, but both should find the economics of region-wide integration compelling.

If China and the United States agree on a region-wide agreement embracing all APEC economies,²⁰ the annual benefits would rise into the \$681-\$969 billion range, depending on the template used, around one percent of world GDP in 2025. Much of these gains would accrue to China and the United States, providing them with strong incentives to move to this final stage of integration. And the vast majority of the gains would reflect trade-creation rather than the diversion of benefits from the rest of the world. Deep integration in the Asia Pacific would help to make the region and arguably the world more collaborative, prosperous, and peaceful.

While the value of region-wide agreement is relatively easy to demonstrate, the path leading to it is unclear. Regional free trade could be approached from either of the two tracks, leading to an FTAAP agreement with a template characteristic of the track used. But in fact it is not likely to be the simple end result of either track—after all, China would find it difficult to join the TPP through a standard accession mechanism, just as the United States would find it difficult to join an ASEAN++ agreement. A more likely outcome is a new regional agreement that spans both groups, or perhaps a new global negotiation that also includes Europe. These various pathways could affect outcomes in two ways: by making it more or less likely that broad integration is achieved, and by influencing the template used in the final agreement.

The TPP track has explicitly targeted the FTAAP as a goal, while Asian integration efforts have so far focused only on Asian economies. But this does not mean that the TPP path is more likely to lead to a region-wide outcome. Progress toward that goal might be slowed by an unusually rigorous TPP template; competition between the tracks could result in a hardening of positions that makes an eventual compromise impossible. This suggests an important reason for China and the United States to find and cooperate on areas of potential mutual interest early on, even while they support different tracks to Asian and Trans-Pacific integration. Extra benefits that would result from using a Trans-Pacific rather than an Asian template for a region-wide agreement favor the TPP approach. The TPP template is likely to require deeper tariff reductions, stricter behind-the-border disciplines, more extensive protection of intellectual property rights, and greater market access for services than the Asian template. It would directly boost the exports of advanced countries such as the United States, but, in the process, it would also increase their demand for imports and generate productivity gains for all participants.

We estimate benefits under the FTAAP to be \$969 billion per year if a Trans-Pacific template is used and \$681 billion per year if the Asian template is used. (A more likely compromise would be a template in between—that yields our estimate of \$862 billion in Table 1.) The United States would get a larger share of benefits if the TPP template rather than the Asian template were used, and the reverse would be true for China. But these share differences appear small compared to productivity effects that benefit the region as a whole. The depth of liberalization, rather than its details, appears to dominate. Consequently, even China would gain more from an FTAAP reached through the TPP track than through the Asian track, although the pattern of liberalization would give it a slightly smaller share of total benefits.

The implications associated with the two tracks are optimistic. In the early stages, the tracks appear to provide benefits for small countries to join, and for the track leaders, China and the United States, to compete for their attention. In the middle stages, the benefits for all members would rise, reinforcing the momentum of regional integration. In the end, China and the United States would have strong incentives to consolidate the two tracks, or perhaps shift the venue of discussions to an even more beneficial global negotiation. By demonstrating the feasibility and profitability of high-level integration, the TPP template will make it more likely that a rigorous approach is adopted in the region-wide or global integration process. Its benefits would be widely shared, as the majority of the incremental gains accrue to Asian economies.

CONCLUSION

This analysis reaches three broad conclusions. First, liberalization along the Asian and Trans-Pacific tracks generates substantial benefits over time, and especially large benefits from region-wide integration in the end. Second, the structure of the tracks is likely to accelerate progress, first by generating benefits on each track and competition between them, and later by simulating their consolidation. Third, benefits from region-wide integration, and on the paths leading there, will depend on the ambition and effectiveness of the templates used, with a rigorous TPP template leading to the largest gains.

The key tension in these scenarios involves choices between the rigor of provisions and the scope of regional coverage. The rigorous templates on the Trans-Pacific track should yield greater gains, but they could make it harder to consolidate the tracks by setting standards that are too difficult for some economies to reach. With this tradeoff in mind, leaders and negotiators will need to seek a careful balance between the rigor and scope of their agreements. Good negotiators often know how to pursue delicately balanced outcomes, but their constituents may be not so motivated, or as skilled. It does not help that negotiations today are conducted under the scrutiny of many special interest groups and a huge “blogosphere” publicizing extreme positions.

The greatest concern is that the early contest of templates between the tracks will lead to hardened positions and/or acrimony that preclude later convergence. That outcome would be especially harmful to China and the United States, since these countries will depend on region-wide integration to realize most of their gains. The challenge to policy

makers is to proceed on limited, politically feasible, tracks now, keeping open the option of shifting to region-wide initiatives. Various factors could improve the prospects for Asia Pacific integration over time. As we have seen, the benefits to China and the United States from consolidating the two tracks will rise as liberalization progresses along each of them. The prospects for accommodation could be further improved as the U.S. economy achieves a new equilibrium following the debt cycle of the last decade, and as the Chinese economy continues to grow and reform.

Several policy initiatives might help to keep the long-term objective of region-wide liberalization consistent with short-term progress. An important signal that negotiators could give is to reaffirm the goal of region-wide free trade on both negotiating tracks. Each track could assure the region that its templates are based on this perspective by incorporating common provisions when possible, and by framing more ambitious standards in a way that could make them accessible to all potential partners in a reasonable timeframe. A possible target might be an agreement that “leads by a decade,” adopting provisions, including by ample adjustment periods, that could become acceptable to all reform-minded economies by 2020, the date APEC leaders have targeted for FTAAP.

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