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

INTRODUCTION

Korea is on the front line between two contrasting proposals for regionalism based on economic integration. On the one side is the Chinese effort to establish an exclusive economic bloc in East Asia, starting with ASEAN+3 and the trilateral Sino-Japanese-South Korean summit. Given the growing dependence of the South Korean economy on China and the launching of FTA talks between South Korea and China in 2012, resistance to China's persistent overtures may prove difficult. On the opposite side are the TPP talks aiming for an agreement at the end of 2012, which Japan has considered joining since November 2011. This agreement would build on the ratification of the Korean-U.S. FTA by both Washington and Seoul in the fall of 2011 if South Korea decided to join. With its emphasis on setting a high standard for economic exchange and corporate governance, this would establish a united front to encourage China to separate politics from economics if it did not want to be excluded from the next wave of institutionalization of economic ties. In a year of elections, South Korea straddles the two possibilities, as the opposition calls for renegotiating the KORUS FTA and the public remains wary of negotiating an FTA with China, deepening dependency.

Ed Lincoln explains U.S. interest in TPP. He traces the timing to a drawdown in the Iraq and Afghanistan wars, and a recovery from a preoccupation with security and the 2008 world financial crisis. Noting the increasingly assertive nature of Chinese policies, he observes that U.S. entry into TPP negotiations came at a time when it was convenient to express displeasure toward China. The core of his argument deals with the prospects for finding another way forward after the dismal record of the Doha Round of negotiations on a global level that permits agreement on services, which are a U.S. advantage, and for reviving trade talks with Japan after a hiatus of fifteen years in efforts to deal with its trade barriers. Lincoln argues that the TPP fits logically into the evolution of U.S. foreign policy after opposition to bilateral and regional agreements dissipated, as a way to obstruct a purely East Asian form of regionalism that would interfere with both economic and strategic goals, and as a means to gain greater U.S. access for internationally competitive service industries.

Hyung-Gon Jeong lays out the calculations of South Korea's relative gains in choosing one option or the other. He explains U.S. motives, which include stymieing China's inward looking strategies, acquiring leadership, and transforming the Chinese economic system in its favor. Jeong proceeds to consider Japan's motives for joining the TPP, including opening Japan as a new engine to connect it to global economic trends, changing its agricultural structure, and consolidating its alliance with the United States in the face of concerns about China and competition with South Korea. Finally, he notes China's new flexibility in support of an ASEAN+6 FTA and its renewed push for an FTA with Japan and South Korea, as it shows antipathy toward the TPP while keeping its options open. In these circumstances, Jeong estimates that South Korea would gain more from an ASEAN+6 FTA than from the TPP. Yet, he suggests that if Japan were to join the TPP, however unlikely, this would likely trigger South Korea's decision to join. He concludes that it should not rush, as the pros and cons of joining are still uncertain, while watching the movements of China and Japan as the new organization is taking shape.

Peter Petri explains that the competition in the Asia-Pacific takes places in a highly positive-sum context. Warning that the early contest between the TPP track advocated by the United States and an exclusively Asian track pressed by China may lead to hardened positions that preclude later convergence, Petri optimistically envisions a multi-stage process with benefits to China and the United States from consolidating the two tracks as liberalization progresses along each of them. In the first stage he finds that the benefits will depend in large part on preferential access to the markets of the United States and China, yielding important gains for smaller countries. In the second stage, integration would extend to several large economies on each track, and countries that join both tracks would benefit the most. Finally, in the third stage China and the United States would be left among the few economies without preferential access to both of their large markets. A consolidated agreement would enable them to realize most of the gains, providing incentives for these states to move to this stage of deep economic integration. Without taking account how the impact of the factors raised in Parts 1, 2, and 3 of this book will play out, this upbeat analysis of the momentum economics can generate offers a hopeful prognosis.

The three chapters of Part 4 are the sort of accessible economic analysis that should caution critics of political leadership struggles, natural security dilemmas, or national identity gaps from dwelling on negative tendencies. Yet, as economists are optimistically showing the way toward mutual prosperity based on still significant complementarities, there are undercurrents that should not be overlooked. East Asian states not only have vested great prestige in economists who have shown the way toward successive "economic miracles," an unprecedented rate of regional economic integration, and widespread public support for not falling behind their neighbors' enthusiasm for more FTAs, they have also kept control in the hands of politicians who were well known for fiercely protecting particular sectors of the economy and delaying reforms to open them in the face of U.S. pressure. Despite the rosy scenarios of a positive-sum race to openness in the chapters that follow, the path forward is complicated by these politicians, who are under the influence of ideologies anathema to most economists, and by public faith in national identities, which are inconsistent with bold reforms.

Two undercurrents keep resurfacing when economists look closely at the U.S. drive to conclude a platinum-standard TPP with wide membership in 2012 and the Chinese drive to jump-start negotiations for a China-Japan-South Korea FTA from May 2012. First, many understand this competition to be driven by hegemonic ambitions, which block not only the ultimate economic prize of one overarching Asia-Pacific FTA, but also a truly successful outcome in each of the two separate negotiations. For instance, Japanese fear of U.S. hegemony has not disappeared after the "trade wars" of the 1980s-90s, and South Korean fear that China's large bilateral trade deficit amid worrisome levels of dependence leave Chinese feeling entitled to a one-sided, low-level FTA that does little to open China's markets. In light of fierce political in-fights, Japan and South Korea may stall.

The other worrisome undercurrent is distrust of China's shift toward greater state intervention as a fundamental barrier to a high-level FTA. This raises concern that protectionist measures will take unexpected forms, economic dependency will enable monopolistic and political ends, and even that there remains a socialist core to China's market economy. Distrust of China casts a shadow over the Asian track even prior to the challenge of reconciling the two tracks.

Together the four parts of this book point to conflicting currents that leave the Asia-Pacific future uncertain. Leadership is in the midst of its most far-reaching transition in decades with little indication of more cooperative attitudes. Security relations are growing tenser. National identity gaps are widening without networks likely to reverse the trend. Only economic negotiations suggest a more optimistic outcome, but they too must overcome polarizing trends. The three chapters that point the way to new agreements capitalizing on complementary economies show why nations should overcome bilateral problems, but they do not contradict views in earlier chapters that indicate how politics, security, and culture stand in the way.

The U.S. Approach to Regional Trade Agreements Involving East Asia

EDWARD J. LINCOLN

The U.S. government has had a long and convoluted approach to the issue of bilateral or regional trade agreements involving East Asian countries. This paper focuses on three key aspects of this history: the intellectual battle between global and bilateral or regional approaches to trade agreements, the relationship of trade policy to U.S. security policy, and the rising importance of trade in services. Fundamentally, American economic policy toward East Asia is rooted in the strategic involvement of the United States in the region, which leads to a preference for trans-Pacific trade agreements rather than the intra-Asian alternative. But the U.S. approach to regional trade issues was complicated over the years due to the strong belief among economists and government officials that the global approach to trade and investment issues is more efficient than a bilateral or regional approach. Nonetheless, the rising importance of international trade and investment in service industries has helped push the U.S. government away from its commitment to the global approach since the World Trade Organization has made relatively little progress yet on covering these issues. This chapter explores the evolution of American policy in the context of these factors.

THE INTELLECTUAL DEBATE OVER TRADE POLICY

For at least the past century, American undergraduate students have been taught about the virtues of free trade. The theory is rooted in the work of Adam Smith's concept of absolute advantage (1775) and David Ricardo's (1820s) concept of comparative advantage. In the 1930s, Heckscher and Ohlin extended the theory to explain why nations have a comparative advantage in particular products (based on varying economic resource endowments across countries), and shortly after World War II, Paul Samuelson added mathematical rigor to the theory. As taught today, comparative advantage theory is often called the Heckscher-Ohlin-Samuelson theory. The basic conclusion of all versions since the late 18th century is that nations benefit from being open to international trade. There are few, if any, concepts in theoretical economics on which virtually all economists (at least in the United States) agree.[1]

Newer theories of trade, such as differentiated products and intra-industry trade, the product-cycle theory, or external economies of scale and clustering, emerged in the 1960s and 1970s, but none of them counter the belief that open international trade is the best policy. For a time, the concept of internal economies of scale led economists to suggest that protectionism to permit a domestic industry to grow to a sufficient size to achieve lower production costs might justify temporary protectionism. Dubbed strategic trade policy, the basic idea was that developing countries could grow industries in which they did not currently have a comparative advantage, but in which they could become competitive in the future once the scale of production grew behind protectionist barriers and as wages rose to a level giving them a comparative advantage in the protected industry. Japan's export success in the first three decades after World War II was often used as the example of how such a policy might succeed, as it protected industries such as automobiles in which it had no comparative advantage in the 1950s. However, the weak economic performance and inefficient industries of most countries that followed such policies (such as India) caused this concept to be largely abandoned by economists. Today, most economists support the notion that even developing countries will perform better (that is, grow faster) with greater openness to international trade and investment. That conclusion has characterized American trade policy for the past two decades—developing countries should lower their barriers for their own good.

The point of this discussion is that any American taking an introductory economics course in the past century has been taught the value of free trade. Economic welfare of the society rises when consumers can purchase products from the most efficient producers in the world. Nonetheless, the concept of free trade remained unpopular politically through the 19th and early 20th centuries. Only the economic disaster of the 1930s (during which politicians in many advanced countries raised tariffs) and the subsequent devastating war led toward political acceptance of reducing or eliminating trade barriers. For the Americans, the concept gained additional desirability due to the strong position of many manufacturing industries in the immediate aftermath of the war (industries that would benefit if barriers in other countries were lowered). The result was the General Agreement on Tariffs and Trade (or GATT, now the World Trade Organization, WTO), created in 1947. One of the hallmarks of the GATT agreement was a principle of "most favored nation," which states that any member nation that permits a lower tariff on a product coming from another member must extend that lower tariff to every other member of the GATT. The goal was to end the discrimination that had been rampant in the 1930s in which nations had high tariffs in general, but applied lower tariffs to products from some "favored" trade partners.

The principle of most favored nation became the bedrock for American trade negotiators for the next several decades, and energized an international bargaining process that lowered trade barriers around the world in a series of multilateral "rounds" of negotiations among GATT member countries. However, Article 24 of the GATT (and the follow-on WTO) allowed one exception to the most favored nation principle. If two or more members were willing to remove "substantially all" trade barriers among themselves, then the agreement would be permitted.[2] Presumably, this exception had been included in 1947 to accommodate the Imperial Preference System of the British Empire (a large free trade area among all the members of the empire). Little used by other GATT members, this exception finally became popular around the mid-1980s, and the number of such agreements (free trade agreements, or preferential trade agreements) has exploded since that time. As of 2011, the WTO reports 319 bilateral and regional preferential agreements in active use.[3]

As these agreements began to proliferate, economists were deeply divided on their impact. Economists have had three principal objections to free trade agreements. First, any agreement between two countries that eliminates tariff and other barriers implies that some imports will be switched from the globally efficient manufacturer to one located in the partner country. In that case, the government of the importing country no longer receives the revenue from collecting the import tariff. This loss of revenue is called the trade diversion effect, and is a net economic loss for the importing country. Trade diversion also implies an inefficient allocation of productive resources as less efficient firms benefit from exporting to a partner country at the expense of more efficient firms not located in the trade bloc. Second, every bilateral agreement is negotiated separately, so that the coverage and rules will be different, creating what leading trade theorist Jagdish Bhagwati dubbed the "spaghetti bowl" effect, creating confusion and extra costs for firms as they attempt to keep track of the mass of differing rules.[4] Third, every preferential agreement must include rules on what is legitimately a product manufactured within the partner country by specifying the share of local value added in a product necessary to qualify as being manufactured within the exporting member country. These "rules of origin" open the way for challenges and the necessity for adjudication of disputes, adding another layer of cost that does not exist when a tariff applies to all imports.

Free trade agreements do, however, have some advantages, not all of which are strictly economic. First, in an era when membership in the WTO exceeds 150 countries, global agreements have become very difficult to negotiate. The current Doha Round began in 2001 and remains uncompleted eleven years later. A bilateral or small group agreement can typically be completed within a year or two. The long wait for progress at the global level means that achieving pockets of progress around the world might be better than no progress at all.

Second, these agreements involve trade creation. Consumers now have access to imported products at a lower price (since the imports from the partner country enter paying no import tariff), even if the product is not coming from the globally efficient producer. Lower prices (and expanded consumption of the imported product) increase economic welfare (even if not all the way to the maximum level possible with global free trade). Economists argue that if a nation had relatively low import barriers to begin with, the trade expansion benefit will likely outweigh the trade diversion loss discussed earlier.

Third, if the number of members in the trade group is greater than two, the possibility of a globally efficient producer being a member of the group increases, lessening the global inefficiency from switching to products from less efficient producers. Therefore, economists generally prefer groupings with several members.

Fourth, even if an agreement introduces distortions, the envy of countries not part of the agreement might lead them to participate. Optimists concerning this possibility see free trade agreements as building blocks toward the eventual goal of global free trade.[5] Or the countries left out might move to re-energize WTO negotiations (and the creation of such a movement at the WTO level was a specific goal of the U.S. government in negotiating the North America Free Trade Agreement at a time when the Uruguay Round of GATT negotiations were stalled at the beginning of the 1990s).

Finally, as the process has evolved, FTAs often include agreements on both trade in services and direct investment, two areas in which the WTO has made relatively little progress. The Uruguay Round agreement of 1994 did include a General Agreement on Trade in Services (GATS), but it is relatively weak. This chapter argues that barriers to trade and investment in the service sector have gained increased attention and importance over time.

Where does the debate stand today? It is fair to say that economics textbooks generally present a far more favorable view of FTAs than was the case twenty-five years ago when such agreements began to proliferate. The concerns raised by Jagdish Bhagwati remain, but may not be as serious as once thought. The overall level of tariffs is relatively low, even for many developing countries; so that it is more likely that trade creation will outweigh trade diversion in bilateral or regional blocs. Firms are not complaining loudly about the legal burden due to litigation over rules of origin, or about the administrative cost of tracking the relevant agreements and rules when making trade or investment decisions. Finally, firms have discovered that if they are disadvantaged by the creation of a free trade area to which their home government does not belong, they always have the option of locating a factory within the area, thereby benefiting from the lack of barriers within the region. This option may still mean a distortion in the global location of production facilities relative to a world of no barriers, but it is likely that this efficiency loss is relatively modest.

Why does this discussion of the theoretical argument about free trade and global versus bilateral or regional agreements matter? American officials were initially skeptical of free trade areas, but attitudes have shifted over time, especially with the disappointment in making progress with the current Doha Round of WTO negotiations. Ideas and theories do matter, and in this case the theoretical ground about how to proceed with lowering or eliminating trade and investment barriers around the world has shifted over the past several decades.

THE STRATEGIC CONTEXT AND THE EVOLUTION OF APEC

Since the end of World War II, the United States has regarded itself as having strong strategic interests in East Asia. The Communist victory in the Chinese civil war in 1949, plus the Korean War, helped to create the belief that East Asia was a crucial battleground in the Cold War, especially as Southeast Asian nations were emerging from colonial rule. The story of failure to establish a regional counterpart to the North Atlantic Treaty Organization in Asia is well known. With the failure of the Southeast Asia Treaty Organization (SEATO), the U.S. government opted for a hub- and-spoke strategy of bilateral security agreements. This strategic posture matters for trade and other economic policy as well.

Since the late 1960s, various Asian governments (and particularly Japan and Australia) were interested in building a trans-Pacific regional economic organization to discuss trade and other business and economic issues.[6] The U.S. government initially resisted this idea. The original proposal for an organization resembling the eventual Asia Pacific Economic Cooperation (APEC) group was presented as a report to the U.S. Congress in 1978, but elicited no interest in Washington. As a partial step toward an official organization, the Pacific Economic Cooperation Council (PECC) was established in 1980, a group in which some government officials, including from the U.S. government participated unofficially in their private capacity.[7]

Why was the U.S. government reluctant to participate in a trans-Pacific organization? One factor was the strategic context. The U.S. government was used to dealing with East Asia on all issues in the bilateral framework that had come to dominate strategic policy toward the region. Why should the U.S. government endorse a regional body, even if it was to be ostensibly for economic discussions, which might interfere in the carefully crafted hub-and-spoke strategic approach to the region? In addition, the U.S. government at that time had deep misgivings about any regional organization that might end up including participants from the other side of the cold war divide (i.e. China, Vietnam, or Laos). Finally, economic officials in American administrations remained firmly committed to a global approach on major trade and investment policies.

When APEC finally emerged, it was the initiative of Australia, with quiet prodding by the Japanese government. With two regional allies making the request for participation, the U.S. government reluctantly agreed to participate. But soon the U.S. position on regionalism and APEC changed, for four important reasons.

First, Prime Minister Mahathir of Malaysia began to speak of forming an East Asian Economic Caucus (EAEC), a grouping that would include the ASEAN countries plus Japan, China, and Korea (but not Australia or New Zealand). His rhetoric was explicitly anti-Western and racist (hence the Australia and New Zealand exclusion), which worried the U.S. government. The U.S. Secretary of State when this idea was first proposed, James Baker, responded by declaring that it would be imprudent for Asian nations to draw a line down the middle of the Pacific to exclude the United States. A regional economic organization in Asia excluding the United States would cause American firms to suffer from trade diversion (especially losing out to their Japanese rivals) and potentially jeopardize American strategic involvement in the region. Therefore, for strategic reasons it now behooved the U.S. government to promote APEC as the appropriate regional organization in order to stymie the creation of the EAEC. If the region was to form new institutions anyway, the trans-Pacific format was better from the U.S. strategic standpoint than the East Asian alternative.

Second, in the late 1980s and early 1990s, the U.S. government remained wary of the regional aims of Japan. Mahathir's EAEC would, in this view, provide an organization in which Japan could wield power to the detriment of American firms, especially if the outcome were a regional free trade bloc. To be sure, Japan was an ally of the United States, but it was also viewed as economic rival. The Japanese government had been somewhat more active at that period of time in indicating dissatisfaction with American trade policy and in expressing interest in a stronger relationship with Asia as an alternative to close economic ties with the United States. This tilt to Asia was somewhat contradictory to the Japanese efforts to bring about the creation of APEC in the 1970s and 1980s, but reflected the growing disenchantment with American trade policy (either attempting to limit Japanese exports to the United States, or to open Japanese markets to imports) by the early 1990s. Since Japan was a key American strategic ally, it served American strategic interests to keep Japan engaged with APEC rather than drifting toward a new EAEC, a drift that could undermine the alliance.

Third, the overarching strategic preference for a hub-and-spoke approach to the region in a Cold War context was turned on its head in the economic sphere. That is, APEC presented the opportunity to get China and Taiwan into the same regional organization (accomplished in 1992). This accomplishment enabled the beginnings of a more productive relationship between the two governments, at least in the realm of trade and economics, and thereby potentially reducing the possibility of armed conflict.

Fourth, several years after APEC was formed as a ministerial-level meeting, a new president, Bill Clinton, with little foreign policy experience saw an opportunity shortly after coming into office to show his positive personal engagement with the world by adding a leaders' meeting to APEC (enabled by the fact that the United States was hosting the meeting in 1993). Making APEC more visible also created an imperative to show that APEC was actually a useful organization.

The effort to make APEC a vehicle for significant reduction in trade and investment barriers, though, soon bogged down. A 1996 APEC agreement eliminated tariffs on information technology products (the Information Technology Agreement, ITA), which was then adopted by many WTO members. But an attempt to do something similar the following year in nine different product areas, the Early Voluntary Sectoral Liberalization (EVSL) failed, largely because of Japanese opposition to inclusion of some agricultural fishery products. That failure signaled the end of American enthusiasm for APEC as an organization to create a more open region. To be sure, APEC has continued a modest agenda aimed at greater openness, but "modest" is the operative term.

The EVSL failure might have led to renewed concern that the Asian members of APEC would proceed to construct a regional trade bloc, as had been feared by the U.S. government in the late 1980s. In fact, at the same time that the EVSL went down to defeat, the EAEC came into existence in the form of the ASEAN+3 group. But the disappointment with APEC appears to have led to a conclusion by U.S. government officials that the Asian governments would be no more successful in an ASEAN+3 setting to achieve a robust open trade and investment area than had APEC. The lack of American official concern was borne out by subsequent developments, since ASEAN+3 has accomplished little more than APEC. From the late 1990s, therefore, the U.S. government ceased its trans-Pacific versus East Asia strategic concern for institutional settings.

For much of the first decade of the 2000s, the U.S. government nudged APEC toward a more strategic focus, using it as a venue to urge East Asian governments to pursue various anti-terrorism initiatives. The region-wide trade agenda with East Asia languished with APEC. Bilaterally, the activism in dealing with Japan faded by the late 1990s, and few substantive negotiations to further open Japanese markets occurred. At the global level, the U.S. government pushed for the start of the Doha Round of WTO negotiations, but then failed to bring those negotiations to a conclusion. Instead, the U.S. government continued to pursue bilateral and regional free trade agreements. Table 1 provides a complete list of the twenty agreements successfully negotiated as of the end of 2011.

Table 1. U.S. Free Trade Agreements

Country	Year Implemented
Australia	2005
Bahrain	2006
Canada**	1994
Chile	2004
Colombia*	2011
Costa Rica***	2004
Dominican Republic***	2004
El Salvador***	2004
Guatemala***	2005
Honduras***	2005
Israel	1985
Jordon	1996
Korea*	2011
Mexico**	1994
Morocco	2004
Nicaragua	2005
Panama*	2011
Peru	2006
Singapore	2004

Notes: *Ratified by Congress but not implemented.
**Originally a bilateral agreement with Canada in 1987, incorporated into NAFTA (with Mexico) in 1994.
***These countries are members of the regional Central American Free Trade Agreement (CAFTA).
Source: Office of the United States Trade Representative, "Free Trade Agreements," http://www.ustr.gov/trade-agreements/free-trade-agreements (January 15, 2012).

This table indicates that the U.S. government did maintain an agenda of pursuing bilateral and regional agreements even as the global Doha Round negotiation in the WTO remained uncompleted and APEC proved disappointing as a vehicle for negotiating open trade. Note that the United States had created trade agreements with a number of individual APEC members by 2011 (Australia, Canada, Chile, Korea, Mexico, and Singapore).

Efforts to push forward on bilateral and regional agreements might have been more vigorous over the past decade without the 9/11 attack and the subsequent preoccupation of American foreign policy with the war on terrorism, and specifically the invasions of Afghanistan and Iraq. The head of USTR in 2001, Robert Zoellick, pushed for the start of the Doha Round in the fall of 2001 by casting it into the framework of the war on terror. That is, terrorism may be fostered by poverty and envy. Economists (like Zoellick) believe that open trade and investment fosters economic growth, providing the mechanism to reduce poverty and disparities between rich and poor countries. However, this line of argument did not become a major element in the administration's rhetoric or policy during the war on terrorism. President Bush, for example, did not press other leaders for a successful conclusion to the Doha Round negotiations nor did he include references to Doha very often in public statements.

The Obama administration did not develop any clear trade agenda in its first two years in office—even getting the already negotiated bilateral agreements with Korea, Colombia, and Panama submitted to Congress was delayed until 2011. The global recession and the negative political image of losing jobs (by lowering trade barriers at home as the price for getting other nations to lower their barriers), combined with the importance of union support for the Democratic Party makes the reluctance to pursue an activist trade policy understandable. Nor did the administration have an overarching policy toward East Asia. Like the Bush administration before it, much of the foreign policy energy was absorbed by Iraq and Afghanistan. Relations with Japan, Korea, and China were governed more by reactions to specific events without an overall agenda.

By 2011 the Obama administration was ready to focus on Asia. With troops withdrawn from Iraq and the beginning of the endgame in Afghanistan, the administration could refocus on East Asia, a shift in the fall of 2011 dubbed the "pivot."[8] Concerns about China provided a major motivation for the strategic policy pivot. China continued to grow rapidly (making it increasingly important to the United States economically). But a series of incidents, such as the ramming of a Japanese coast guard ship by a Chinese fishing vessel in the fall of 2010 (and subsequent angry pressure on Japan when the captain was detained in a Japanese jail), the embargo that same fall on exports of rare earth metals for which China is the major world supplier, and China's unhelpful stance at the United Nations Security Council on developments in the Middle East during 2011 all indicated that policy toward China and East Asia needed more attention.

The Obama administration's embrace of TPP, therefore, should be seen in light of this strategic policy history. The reinvigorated strategic approach to East Asia in 2011 provided a renewed opportunity to include economic policy as part of overall policy, much as earlier economic policy toward the region was influenced by strategic concerns. Unlike the 1980s, the economic concerns had shifted largely from Japan to China. How and why TPP specifically fit the new strategic focus on East Asia in 2011 is considered later in this chapter.

SERVICES TRADE

One of the most significant developments in international trade over the past half-century has been the rise of international trade in services. Furthermore, trade in services is generally more closely linked to foreign direct investment than is the case for merchandise trade, since the provision of many services requires a physical presence in the market where the service is offered. The original GATT agreement concerned only merchandise trade. Creation of the WTO in 1994 brought with it a first step toward inclusion of services, in the form of the Agreement on Trade in Services. That agreement remains limited in scope and applicability to many specific service sector issues. Nor does the WTO address issues related to foreign direct investment. As services trade has expanded, therefore, bilateral and regional free trade negotiations have provided a vehicle for pursuing these increasingly significant issues that have been largely unanswered in the WTO.

Service sector trade is of particular interest for the United States, for three important reasons. First, like all advanced countries the structure of the economy has shifted away from manufacturing toward services. Second, like the world in general, services trade has become relatively more important for the United States over time. Third, unlike merchandise trade, the United States maintains a surplus in trade in services. Assuming that surplus to represent an American comparative advantage in services (relative to manufactures), it is understandable that the U.S. government would have a particular enthusiasm for reducing barriers to services imports in other countries (much like the enthusiasm the U.S. government had in the earlier post-World War II era when the United States had a surplus in merchandise trade and pressed for global reductions in tariffs).

Using World Bank data, manufacturing was 23% of GDP in the United States in 1981, falling to only 13% by 2010. Services, on the other hand, were already 63% of GDP in 1981, rising to 78% by 2010.[9] The shift in employment over a longer time period is even more dramatic. In 1950, the share of total employment in manufacturing was 32% while services were 42%; by 2010 manufacturing was down to 11% while services were up to 68%.[10] With the rise of services as a share of both output and employment over time, and with an overwhelming share of jobs and output in the service sector, it should be no surprise that issues related to that sector would draw more attention from government.

Decades ago, economists thought of international trade predominantly in terms of merchandise trade. Most services, the thinking went, must be consumed where they are created, limiting possibilities for international trade (as in the case of the ever popular introductory economics course example of haircuts). However, an increasing array of services has been traded over the years, ranging from architectural, legal, and accounting services to showings of Hollywood films (which generate royalty payments that are counted in the balance of payments data as part of services trade). But it is true that some services must be delivered where they are created. The increasingly international nature of activity in those industries shows up more in increased foreign direct investment.

Figure 1 shows U.S. services trade relative to the size of U.S. trade in merchandise. Services exports were just over 30% of the size of U.S. merchandise exports in 1960, expanding to over 40% by 2010 (after a decline in the ratio during the 1970s). Although this increased relative size of services exports is not a dramatic change, it is certainly sufficient to explain why services have claimed more attention on the part of trade negotiators. Figure 1 also indicates that the rising relative importance of services trade applies only to American exports; measured as a percentage of the size of merchandise imports, services have declined over the past half-century. From a large 50% in 1960, services imports were only 20% the size of merchandise imports by 2010.

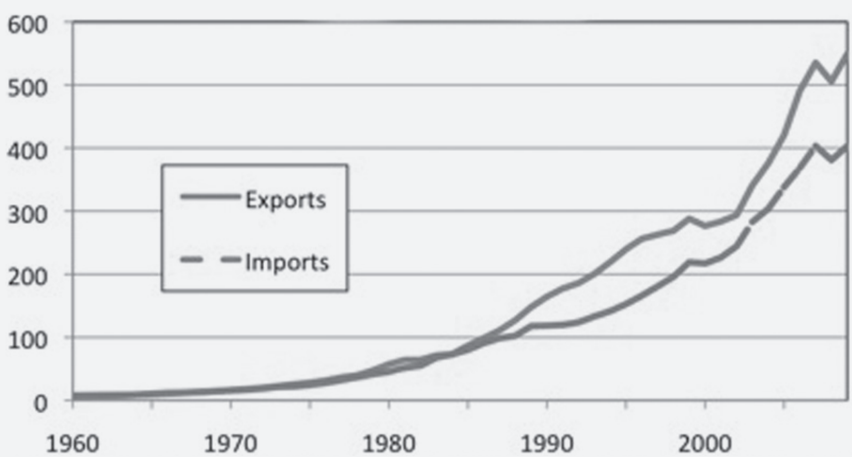
Figure 1. U.S. Services Trade Relative to the Size of Trade in Manufactured Goods (as a %)

Source: Bureau of Economic Analysis, United States Department of Commerce, "U.S. International Transactions, 1960-present," http://www.bea.gov/international/index.htm (January 22, 2012).

Figure 2 shows the trend in the dollar value of services exports and imports. As might be expected given the opposite movements for exports and imports in figure one, figure 2 shows a rising trade surplus of the United States on trade in services. Beginning in the 1980s, the U.S. surplus on trade and services reached $146 billion by 2010. Although this surplus was far smaller than the U.S. deficit in merchandise trade ($646 billion), the surplus is large enough to attract attention as a partial offset to the deficit on merchandise.

Similar trends are evident in American direct investment abroad. Direct investments (FDI) are those in which the investor has managerial control of the asset. That is,

Figure 2. U.S. Trade in Services (in US$ billions)

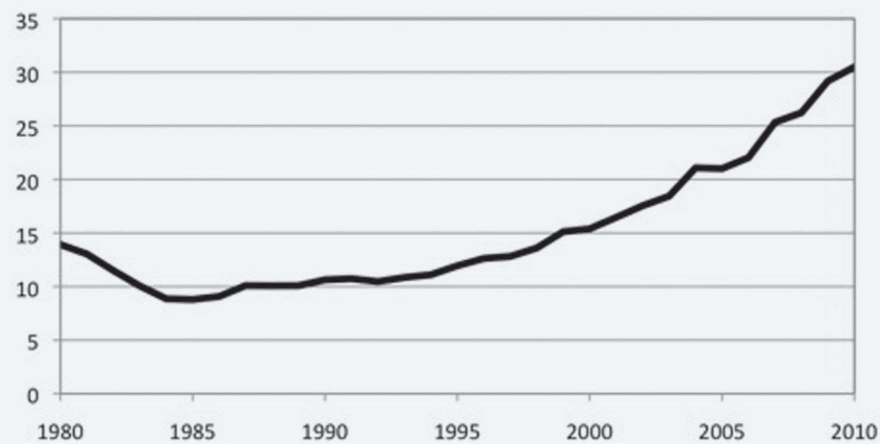


Source: Bureau of Economic Analysis, United States Department of Commerce, "U.S. International Transactions, 1960-present," http://www.bea.gov/international/index.htm (January 22, 2012).

FDI represents partial or complete ownership and effective control of corporations in other countries. They can include partial or complete purchases of existing firms, or creation of new joint ventures or wholly owned firms. Figure 3 shows what has happened to the stock of FDI owned by Americans, expressed as a share of GDP.

From the mid 1980s, the stock of FDI owned by Americans has risen sharply as a share of GDP, from only 9% in 1985 to 30% by 2010. Some of that investment is in manufacturing, but the majority of American direct investment abroad is in services. In 2000, 22% of the stock of American direct investment abroad was in manufacturing and 66% in various service industries (with the remainder in mining, construction, and agriculture). Just ten years later, only 14% was in manufacturing and 80% in services. Some of the international "trade," in services, therefore,

Figure 3. Stock of Foreign Direct Investments Held Abroad by Americans as a Share of GDP (as a %)



Source: Bureau of Economic Analysis, U.S. Department of Commerce, "International Investment Position, Yearend position, 1976-2010," http://www.bea.gov/international/index.htm#iip (January 22, 2012).

shows up as repatriated earnings from service-sector direct investments abroad rather than through actual cross-border trade. These data on trade and investment provide a clear picture of the rising importance of international engagement of American firms in exporting services or selling them locally abroad.

The international issue for these industries is not tariffs, as in the case of manufactures, but regulations governing entry and competitive behavior in each service industry. As noted earlier, the WTO has still made relatively little progress in working out robust agreements covering service industries. Therefore, the rising importance of services to the U.S. economy and the increasing export of those services push the U.S. government in the direction of negotiating bilateral and regional free trade agreements in which service industry issues can be included.

TPP

After more than a decade of minimal focus on APEC, drift with the Doha Round, and a preference for bilateral trade agreements, the U.S. government has now embraced the TPP negotiations. TPP fits well with the evolving U.S. global and regional strategy in the second decade of the century in several ways, reflecting the three issues discussed in this paper.

First, consider the strategic reengagement on Asia in 2011. Economic policy has always been intertwined with strategic policy. Therefore, TPP represented one possible way to bring economic relations with the region into the newly reenergized strategic approach to East Asia.

Second, and related to the first point, the decade-long single-minded absorption with military engagement in foreign policy faded, opening the way for trade and investment issues to gain a greater standing in the hierarchy of foreign policy issues to be pursued with East Asia. To be sure, the huge global macroeconomic/financial problems accompanying the global recession of 2008-2009 absorbed considerable government attention, but trade and investment issues did not, and the international policy dialogue related to the global recession implied little involvement for East Asia (other than the dispute over the exchange rate with China). Therefore, as the wars wound down, it was easier for the U.S. government to reengage on regional trade and investment issues. Perhaps the first evidence of that reengagement was the effort by the Obama administration to submit to Congress (successfully) bilateral trade agreements with Korea, Peru, and Panama. Those agreements were actually left over from the Bush administration (with some additional tweaking by the Obama administration). In terms of new engagement at the regional level, though, joining the TPP negotiations was a convenient vehicle for reengagement.

One probable reason for the embrace of TPP specifically was the fact that the concept of a Free Trade Area of the Asia-Pacific (FTAAP) had been discussed in Washington for several years. C. Fred Bergsten, the respected founder and head of the Peterson Institute for International Economics (a major think tank in Washington), was vigorously pushing the concept of the FTAAP.[11] Bergsten had been a voice for using APEC for this purpose in the mid-1990s when that organization had been the focus of American trade policy toward the region. Bergsten did not take a position in the Obama administration, but his presence in the city, contacts, and convocation of meetings on trade issues gave him a considerable role in shaping discussion of trade policy ideas. TPP is not the FTAAP, since it includes only a subset of the governments that belong to PAEC. Nonetheless, it represented a start in that direction if one believes in the notion of building blocks. The chapter by Peter Petri specifically considers the possibility of a movement toward an FTAAP driven by TPP and other sub-regional agreements. To the extent, therefore, that the concept of FTAAP was in play in Washington policy discussions, joining the group of countries already engaged in the TPP process was a rather logical step to take.

Third, TPP fit well into the increased importance of dealing with China as part of the strategic engagement with East Asia. The Obama administration is adamant that the TPP negotiations are not an attempt to isolate or surround China, and they may be correct. Perhaps it is better to see TPP as a response to Chinese interest in either an ASEAN+3 or China-Japan-Korea free trade area. Either of those combinations involves both the straightforward trade diversion losses that would negatively affect American firms, and a strategic gain for China in the region (pulling other East Asian nations closer to itself). Neither outcome is in American economic or strategic interests. Therefore, TPP can be viewed as a defensive move to counter rising Chinese influence in the region. In the world of proliferating FTAs, the U.S. government cannot stop East Asian governments from forming agreements among themselves (and China already has an FTA with the ASEAN nations as a whole), but creating an additional trade group that includes the United States sends a signal of U.S. engagement in the region to counter the rising influence of China.

Furthermore, despite administration protestations, there can be no doubt that TPP provides a convenient pressure point on China. U.S. entry into the TPP negotiations came at a time when it was convenient for the U.S. government to show some displeasure toward China, due to the increasingly nationalistic and aggressive nature of Chinese policies at home and abroad noted earlier.

Fourth, in the context of reengagement on trade and investment issues, the U.S. government was confronted with the continuing stalemate on the Doha Round. Begun in late 2001, those negotiations are now in their second decade. The dismal record of inability to bring these negotiations to a close increased the attractiveness of regional and bilateral approaches to trade and investment from the perspective of the U.S. government. The alternative analysis would be that governments have become so enamored of regional and bilateral agreements that the energy was sucked out of the Doha Round negotiations. Given the generally tepid approach of the U.S. government to all trade negotiations in the past decade, this alternative interpretation of global versus regional approaches does not seem correct.

Fifth, TPP includes the advantage of multiple participants in the Asia-Pacific region. As noted earlier, economists believe that regional free trade areas are more likely to produce benefits that outweigh the trade diversion liability of this approach. More important, TPP allows a regional approach that avoids the problems upon which APEC stumbled in the late 1990s. APEC provided the Obama administration with a venue at which to push the idea of TPP, but the negotiation itself is not an APEC initiative.[12] That is, TPP is simply a coalition of the willing (or supposedly willing). Those APEC member countries that are either disinterested in participating, or are not encouraged to participate (like China) can remain outside the negotiation. If those governments that are participating are serious about their commitment, the conclusion is that an agreement will be easier to reach.

Sixth, TPP fits the effort of the U.S. government to push lowering barriers to trade in services. All U.S.-negotiated bilateral and regional free trade agreements have included extensive agreements on trade and investment issues related to services. TPP will be no exception.

Seventh and finally, TPP has somewhat accidently become a vehicle for the Obama administration to engage Japan. Possible inclusion of Japan in the TPP negotiations arose when the prime minister of Japan expressed interest in participating (originally suggested by Prime Minister Kan Naoto, but then pushed formally by Prime Minister Noda Yoshihiko). Even though the Obama administration has officially welcomed Japan's decision to seek admission to the negotiations, the reality is that Japan's involvement remains somewhat problematical. Japan expressed interest in a bilateral free trade agreement with the United States in the late 1980s, but ever since that time, the U.S. government has been reluctant to pursue such a negotiation with Japan out of concern that the Japanese government is not ready to open up as much as would be necessary to create a successful agreement. Those concerns arose out of the years of difficult negotiations on a myriad of different trade issues related to opening Japanese markets from the 1960s to the mid-1990s. TPP, therefore, represents the first time in fifteen years that the United States would have to confront the problem of Japanese trade barriers and the reluctance of the Japanese government to take major steps to reduce them. Parts of agriculture (principally rice) are the most obvious examples of remaining barriers, but a variety of service industries (ranging from finance to provision of healthcare) and manufactured products also retain significant import barriers. Much depends, therefore, on the attitude of the U.S. government on the question of trade negotiations. If the decision is that after a virtual hiatus of fifteen years the time has come to once again deal with Japan's trade barriers, TPP offers a useful format to do so. The presence of other governments in the negotiation to mount pressure on Japan to make substantial offers in the negotiations helps to take some of the burden off the U.S. government. Furthermore, should negotiations with Japan in the context of TPP be successful, the economic importance of TPP would be greatly enhanced by the inclusion of two rather than just one large country. Japan's presence would also enhance the strategic importance of TPP, since Japan would be the big participant other than China in either an ASEAN+3 or China-Japan-Korea trade group.

CONCLUSION

Three decades ago, American trade policy was firmly rooted in a global approach centered on the GATT. Somewhat reluctantly, American policy shifted, as did that of most other countries around the world. While the Doha Round continues to be stalemated, the U.S. government has negotiated a number of bilateral and regional agreements. TPP now provides an opportunity to continue in that direction. This chapter has argued that TPP fits logically into the evolution of American foreign policy way in several ways.

First, the initial opposition to bilateral and regional agreements due to the dominance of theoretical support for the most-favored-nation principle of the GATT faded over time. For more than two decades, the U.S. government has pursued bilateral and regional free trade agreements. TPP is simply the latest initiative in this approach, especially given the continued stalemate on the WTO's Doha Round of global negotiations.

Second, TPP fits in the evolution of American strategic policy toward East Asia. Since the late 1980s, the U.S. government has embraced economic policy engagement with East Asia as a means of fending off narrower East Asian-only groupings that would be detrimental to American strategic and economic interests in the region. Initially the concern was a grouping that would include Japan, since Japanese firms were major global competitors to American firms. Japan pulling away from the United States economically to join an East Asia group would have been detrimental to American interests. Concern over Japan has faded, only to be replaced by concerns over China. Given both Chinese moves to pull the region toward itself economically through possible new regional or sub-regional trade blocs, plus China's more aggressive foreign policy stance in the region, TPP provides an opportunity to strengthen American involvement in East Asia.

Third, pursuit of trade negotiations (bilateral or regional) with East Asian partners fits with the strengthening resolve to address access issues affecting internationally competitive American service-sector industries. Given the global competitiveness of these firms, TPP would provide an opportunity for them to become more deeply embedded in East Asian markets, mainly through direct investment. That deepening has both economic benefits—for American firms and the economies of the host countries—and the strategic impact of increasing the visible presence of linkages to the United States.

For all these reasons, the U.S. government is likely to pursue the TPP negotiations with considerable effort. Whether TPP will serve as a stepping-stone toward an FTAAP, or simply a counter to either ASEAN+3 or China-Korea-Japan, a successful conclusion to the TPP negotiations would bring economic and strategic benefits.

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South Korea: Which Way Will it Go on Asian Integration?

HYUNG-GON JEONG

Since 1990, Regional Trade Agreements (RTAs), including Free Trade Agreements (FTAs) and Customs Unions, have spread rapidly on the basis of the WTO system that was launched in 1995; 224 FTAs were reported to GATT/WTO by late 2011, many of them in Asia.[1] Korea, China and Japan have already signed FTAs with ASEAN and individual ASEAN countries. The positive attitude of East Asian countries toward FTAs has contributed to trade liberalization in the East Asia region, and discussions surrounding ASEAN are becoming more active. Integration, however, is difficult to achieve due to the clash between China and Japan, the former hoping to pursue an East Asian FTA (EAFTA) within the ASEAN+3 (China, Japan, South Korea) framework; while the latter prefers a Comprehensive Economic Partnership in East Asia (CEPEA) within the ASEAN+6 (India, Australia, New Zealand) framework. Discussions entered a new phase as Japan, which has favored ASEAN+6, expressed its willingness to participate in TPP (Trans-Pacific Strategic Economic Partnership Agreement) at the APEC Summit in November 2011.

TPP was first launched by Chile, New Zealand, Singapore, and Brunei (Pacific 4 or P4) and has become one of the leading economic integration systems in the Asia-Pacific; the United States, Australia, Malaysia, Peru, and Vietnam are participating in the negotiations, while Japan, Canada, and Mexico have declared their interest. After President Obama's suggestion that South Korea and Malaysia join TPP, their responses are awaited. These recent trends may have a great impact on the future of East Asian economic integration. China, which has been supportive of ASEAN+3, is already shifting toward integration through ASEAN+6, as suggested by Japan. These changes in the trade environment will have significant influence on the future of the South Korean economy. Under the assumption that CEPEA of ASEAN+6 and TPP centered on the United States will clash, this chapter analyzes the effects the two systems would have on the Korean economy, and assesses which would be more desirable.

THE CURRENT STATUS OF ECONOMIC INTEGRATION IN THE EAST ASIAN AND ASIA-PACIFIC REGIONS

This chapter first compares the main economic indicators of CEPEA and TPP. In the analysis, TPP includes the P4, the five countries in negotiations (Australia, Malaysia, Peru, U.S., and Vietnam), those who expressed an interest in participating at the APEC summit in Hawaii (Canada, Mexico, and Japan), and lastly, South Korea. As shown in Table 1, ASEAN+6 accounts for 49% of the world population, which is considerably larger than the 12.1% in TPP. Yet, it only accounts for 27.4% of the world economy, which is much lower than the 41.2% of TPP. In world trade, it comprises 27.8%, while TPP has 29.3%.

Figure 1 shows intraregional trade shares of ASEAN+3, ASEAN+6 and TPP. The intraregional trade of ASEAN+3 and ASEAN+6 are steadily increasing. The figure for ASEAN+6 was 33% in 1990, but increased to 45.1% in 2010. The percentage of intraregional trade between TPP countries, however, dropped sharply from 54.7% in 1990 to 44.4% in 2010, yielding a lower trade share for those countries.

Figure 2 examines South Korea's export share to each bloc. It continues to rise to ASEAN+3 and +6. In the early 1990s, its export share was 56.2% to TPP countries and 28.4% to ASEAN+6; however, in 2003 its exports to ASEAN+6 exceeded exports to TPP. In 2010, exports to ASEAN+6 reached 48.8%, while exports to TPP decreased dramatically to 28.4%.

Imports from ASEAN+6 were 36.3% of its total in 1990, which rose steadily to 52.4% in 2010, while imports from TPP dropped from 58.4% in 1990 to 37.6% in 2010. In comprehensive terms, trade between South Korea and ASEAN+6 increased from 32.5% in 1990 to 50.5% in 2010; on the other hand, trade between South Korea and TPP showed a sharp decrease from 57.4% in 1990 to 32.7% in 2010.

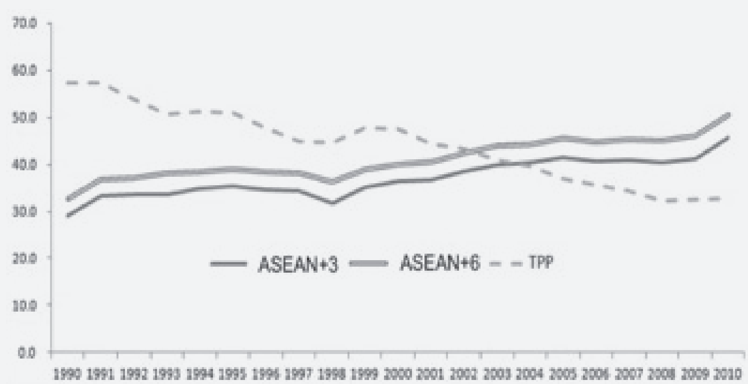
Table 1. Economic Indicators of Major Economic Blocs in the Asia-Pacific Region (2010)

Economic Blocs	States		Population (Million)	Economic Scale (GDP) (Billion)	GDP per capita	Total Trade (Billion)
ASEAN+3	CJK	S. Korea	49	1,014	20,756	857
		Japan	1,341	5,878	4,382	2,974
		China	128	5,459	42,783	1,466
		Sub Total	1,518	12,351	8,136	5,297
			(22.3%)	(19.6%)		(17.5%)
	ASEAN	Brunei	0	12	29675	11
		Cambodia	14	12	814	14
		Indonesia	238	707	2,974	293
		Lao DPR	6	6	1,004	6
		Malaysia	28	238	8,423	416
		Myanmar	61	45	742	16
		Philippines	94	200	2,123	131
		Singapore	5	223	43,117	665
		Thailand	64	319	4,992	380
		Vietnam	88	104	1,174	164
		Sub Total	598	1,866	3,120	2,096
			(8.79%)	(2.97%)		(6.91%)
	Total		2,117	14,217	6,714	7,394
			(31.1%)	(22.6%)		(24.4%)
ASEAN+6	India		1,191	1,632	1,371	550
	Australia		22	1,237	55,672	426
	New Zealand		4	141	32,163	62
	ASEAN+3		2,117	14,217	6,714	7,394
	Total		3,335	17,227	5,166	8,432
			(49.0%)	(27.4%)		(27.8%)

TPP	Brunei	0	12	29,675	11
	Chile	17	203	11,827	127
	New Zealand	4	141	32,163	62
	Singapore	5	223	43,117	665
	Australia	22	1,237	55,672	426
	Malaysia	28	238	8,423	364
	Peru	30	154	5,205	61
	USA	310	14,527	46,860	3,246
	Vietnam	88	104	1,174	153
	Canada*	34	1,577	46,303	817
	Japan*	128	5,459	42,783	1,466
	Mexico*	109	1,034	9,522	630
	S. Korea*	49	1,014	20,756	857
	Vietnam	88	104	1,174	153
	Canada*	34	1,577	46,303	817
	Japan*	128	5,459	42,783	1,466
	Mexico*	109	1,034	9,522	630
	S. Korea*	49	1,014	20,756	857

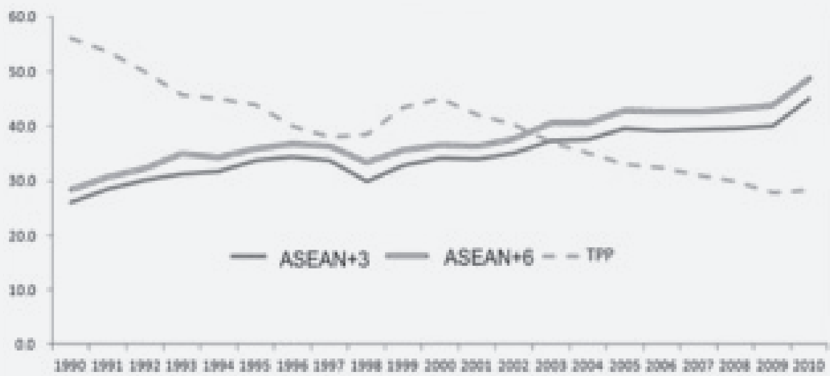
Note: 1) Numbers in parentheses indicate the percentage of the world total 2) Countries with an asterisk are prospective ones that are in negotiations for or considering TPP membership participation.
Source: IMF, World Economic Outlook [Online]; *IMF, Direction of Trade Statistics*.

Figure 1. Trends of Intraregional Trade on a Regional Level



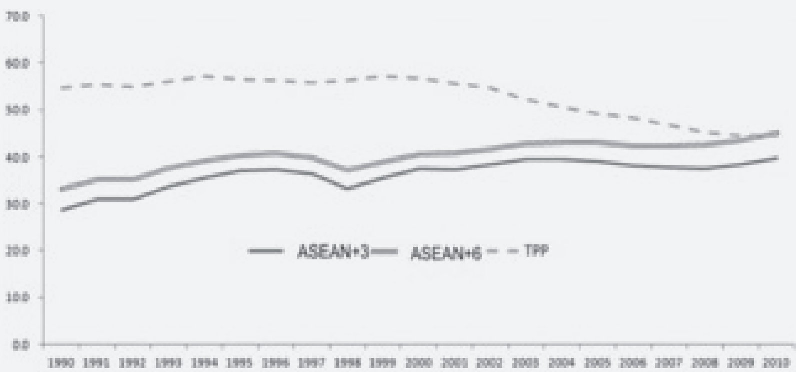
Source: IMF Direction of Trade Statistics. TPP member countries P4, five countries in negotiations (Australia, Malaysia, Peru, U.S., Vietnam), those who have expressed their willingness to participate at the APEC summit in Hawaii (Canada, Mexico, Japan), and South Korea.

Figure 2. Trends of Korea's Intraregional Export Share



Source: IMF Direction of Trade Statistics.

Figure 3. Trends of Korea's Intraregional Import Share



Source: IMF Direction of Trade Statistics.

SOUTH KOREA'S DECISION: ASEAN+6 VS. TPP

Comparing Macroeconomic Effects of CEPEA and TPP[2]

To determine which would be more beneficial for Korea, I compare TPP and ASEAN+6, estimating macroeconomic effects (real GDP growth and changes of welfare level) with the CGE model. This model incorporates interdependent individual sectors within the economy (such as production, consumption, and investment) and foreign sectors (imports and exports) and is used to estimate the ripple effects following changes in the global economic environment, such as the trade environment related to FTAs and DDAs, as well as climate change. This study uses the standard GTAP model, most commonly used of all CGE models, and the GTAP V 7.1 data. GTAP V 7.1 is based on data covering 2004; re-released in June 2010 with modified, complemented V7 content.

Table 2. Classification of States	
	Country
1	S. Korea
2	China
3	Japan
4	United States
5	EU (27 Countries)
6	ASEAN
7	India
8	Rest of the World (ROW)

Basic Assumptions of the CGE

For this analysis, countries will be classified into Korea, TPP participants or those considering participation (twelve countries), and remaining ASEAN countries, the United States, China, Japan, India, the EU, and others. Analysis proceeds under the assumption that the KORUS and Korea-EU FTAs have taken effect.

For convenience and reliable results, industries are classified into 1) rice, 2) grains, 3) other agricultural products, 4) manufacturing and 5) services. Due to its sensitivity, rice has been exempt from concessions in all signed FTAs; therefore it is classified separately from grains. In grain imports, Korea applies quota tariffs and, when necessary, adjusts the volume of market access, so the actual tariff rate may be lower than what is indicated on the GTAP data. Everything considered, the range of tariff reductions is assumed to be around half the product. Because this analysis shows macroeconomic effects and analyzes various forms of FTA, simplified industrial classification is applied. KORUS and Korea-EU FTAs are assumed to be in effect, while FTAs signed with countries directly involved in TPP and ASEAN+6 are assumed to be newly upgraded as agreements come into effect. Commodity markets are assumed to be open-ended; however, the rice market of Korea and Japan is assumed to be closed. Service Tariff Equivalent has not been considered. Production input has been divided into five categories: land, low-skilled labor, skilled labor, capital, and natural resources. Classification of inputs complies with default configuration given by the data. While land is not transferable and natural resources also have transfer limitations, low-skilled and skilled labor, and capital have been set to move freely between industries. Factors of production can move between industries, so changes in domestic production in accordance with tariff reductions are possible. However, the GTAP model does not assume that factors of production are transferable between countries; therefore, movement of labor and resources between countries cannot be considered.

The East Asia FTA and TPP in this CGE analysis assume the model of capital accumulation. The capital accumulation model supposes that the short-term economic gain from an FTA draws investment and savings, leading to additional accumulation of capital that works as one of the main production factors, and is mostly used to analyze economic expansion effects from the FTA. It is highly possible that an East Asian FTA will be pursued not simultaneously, but in a step-by-step process based on a long-term perspective, so it is advisable to use the capital accumulation model, rather than the static model, for analyzing mid to long-term effects. Furthermore, considering that the static model only takes the increase of domestic production from tariff reduction into account, it is likely that the possibility of varying ripple effects depending on various industries will be overlooked. In some industries, the effects of tariff reductions are quick, making capital accumulation possible as soon as the FTA enters into force; on the other hand, other industries may not even register any effects of tariff reductions. Therefore, short-term effects will only reveal limited significance. Also, because the economic effects of an FTA reinforce the fact that reinvestment leads to activation of industries, the capital accumulation model is deemed more reasonable compared to the static model.

Table 3. Economic Integration Perspectives

Scenarios	Details	
East Asian FTA ASEAN+CJK+India, Australia, New Zealand	Refer to KORUS (Korea-USA) FTA	100% import tariff elimination
TPP (13 States)	Refer to KORUS (Korea-USA) FTA	100% import tariff elimination

Note: The rice market has been exempt from tariff cuts. Korea's grain tariffs for China and Australia, the agricultural tariffs of the Korea-India CEPA, etc. have been considered.

Table 4 compares the expected economic effects depending on whether Korea signs an FTA with ASEAN+6 or TPP countries. It can expect 2.69% in actual GDP growth when an FTA is signed with ASEAN+6, while expecting 1.44% in actual GDP growth when signing with TPP countries. Moreover, in welfare changes, Korea can expect a profit of $16.571 billion, while in the case of TPP, Korea can expect $7.787 billion. In conclusion, the economic effects of ASEAN+6 are larger than that of TPP from Korea's perspective because trade liberalization with China, one of Korea's largest trade partners, has been considered. It is necessary to compare the relative size of expected FTA effects, rather than the effects driven by FTA, and to observe the direction of economic effects. Furthermore, the absolute value of figures resulting from this analysis may be prone to change, due to the gap between model assumptions and actual negotiations.

The CGE model may not reflect qualitative changes due to shifts in the trade environment and the effects of non-tariff barriers because it is centered on changes in tariffs, domestic production, exports and imports, and other quantitative changes. Because this CGE model utilizes the GTAP DB Version 7.1, it is unable to reflect the changes in East Asian and global trade environments after

Table 4. Economic Impact of ASEAN+6 & TPP: With Reference to KORUS & Korea-EU FTA		
Reference to KORUS & Korea-EU FTA	100% import tariff elimination	
	Impacts (%) on Real GDP	Changes in Welfare (100 Million US$)
ASEAN + 6	2.69	165.71
TPP	1.44	77.87
Note: The effects of FTA signed by Korea, China, and Japan with ASEAN individually have not been taken into account.		

2004. Although GTAP DB 7.1 has been released with partial modifications made on GTAP DB Version 7, it still relies on data from 2004; therefore countries like China that have continuously registered high economic growth exceeding 10% annually have not been taken into account, nor does it show the effects of the 2008 financial crisis.

CAN TPP BECOME A HIGH STANDARD FTA THAT LEADS THE GLOBAL ECONOMY?

Although the GDP size of TPP member countries is greater than that of ASEAN+6, TPP's reliance on regional trade shows a downward trend, while ASEAN+3 and +6 show a stable increase. ASEAN+6's reliance on regional trade is higher than that between TPP members. Mutual trade between East Asian countries is higher than trade with countries outside the region. Even in the case of Korea, exports and imports to and from ASEAN+3 and ASEAN+6 continue to increase; however, trade with TPP member countries is in continuous decline. Furthermore, the expected economic effects from ASEAN+6 are larger in the CGE model analysis. Pursuing cooperation with ASEAN+6 seems to be more desirable. However, if TPP is signed on a higher level than the present KORUS FTA, and is concluded as a high standard FTA that will lead the global economy, than Korea must consider TPP participation. Thus, the following sections examine if TPP can pursue the trade liberalization process left unfinished at APEC, conclude a high standard FTA, and lead to new global economic norms.

Countries are adopting a quantitative approach in measuring the level of trade liberalization, deeming that more than 90% of the total trade share between countries sharing an FTA needs to be open, in order for it to be considered trade liberalization. If so, have the P4—who are the founding members of TPP—opened more than 90%; has their agreement reached a higher level of trade liberalization than bilateral FTAs signed with other countries regarding tariff and non-tariff barriers and the service sector; and does their agreement show higher standards compared to the U.S.-led negotiations with P4+?

P4 countries have been more positive towards opening their markets than they were when they each signed bilateral FTAs as individual countries. Some scholars argue that because Singapore, Brunei, and New Zealand took an active open-door policy even before P4 negotiations, in reality, economic gains acquired through participation in P4 were not great. This argument makes sense, considering that Singapore had already abolished tariffs on most of its imports; that Brunei, as a small country, imports little and depends on Singapore for most of its imports; and that New Zealand had already achieved a high level of trade liberalization even before joining P4. However, Chile was able to achieve market opening. For example, in its FTA with Canada and Australia, Chile excluded dairy products from target items; however, in the agreement with New Zealand it abolished 100% of its import tariff, regardless of the fact that New Zealand is an agriculturally advanced country. Chile has also adopted very open policies toward P4 countries with respect to reducing import tariffs. Furthermore, in the FTA with Canada (CCFTA) signed before P4, Chile only selected around 75% of total imports from Canada as customs-free items, but it liberalized imports for 89.3% of items from New Zealand and Singapore.[3] In addition, at the TPP P+ negotiations with Australia, Chile agreed to import 96.9% of import items customs-free.[4] With Canada, Chile also set fifteen years as a grace period regarding the phased tariff reduction after the FTA entered into force, while it set ten years as a transition period for New Zealand (six years for Australia).

If P4 countries are contributing more to mutual trade liberalization by lowering tariffs compared to other FTAs, are they also pursuing trade facilitation policies by eliminating non-tariff barriers? GATT Art. XXIV (b) clearly states that in order to truly liberalize trade, ORRC (Other Restrictive Regulations of Commerce) must be abolished. The P4 Agreement, Article 3.8, contains the following phrases, “in accordance with its rights and obligations under the WTO Agreement” and “in accordance with other provisions of this Agreement,” a reminder that other measures can be taken between member countries apart from trade remedy measures fixed by the WTO. Singapore, Brunei, and New Zealand have not applied any strong trade remedy measures to any trade partners, which shows that the level of openness is relatively high even in the aspect of non-tariffs. Recalling that Chile has overused these measures toward countries except for the P4, it can be said that Chile is not doing so because trade between countries is small, and has determined that even if such a system were abolished, the negative impact on the economy would not be great.[5] In any case, the fact that trade remedy measures are applicable between member countries when FTA goes into force means that restrictive measures can be taken in future intra-P4 trade; but they may be ambivalent, knowing it might inhibit trade liberalization.

As mentioned earlier, GATS Article V implies trade liberalization regulations in service trade; however, the statement is also vague as to what is stated in the commodities sector. Only Singapore, Chile, and New Zealand out of P4 agreed to liberalize trade in services when the P4 Agreement was concluded, while Brunei agreed to submit a schedule for liberalizing the services trade to its trade partners within two years after the Agreement goes into effect. But Brunei has still not turned in the corresponding agreement, which means that P4’s FTA agreement has not achieved the rules of substantial sectoral coverage explicitly stated in GATS. It is noteworthy that the three countries, excluding Brunei, put conditions of trade in services on the “negative list,” which shows that even if they seem completely open on the surface, they are actually adopting rather strict conditions, as seen in Article 12.8. They ruled out opening up various services provided by the government, such as air transportation and financial services. In the case of Singapore, the article on services contains relatively relaxed conditions compared to those of FTAs concluded with other nations; but it adopted rather strict regulations compared to the case of the U.S.-Singapore FTA. In its FTA negotiations with the United States, Singapore fully agreed to open financial, recreational, cultural and sports, transportation services, etc. Likewise, even in the service sector, P4 countries are showing ambivalent attitudes. It is still subject to debate whether they have achieved substantial sectoral coverage pursued by GATS.

In general, P4 takes more liberal policies compared to other FTAs, but also betrays strong protectionism in some parts due to the interests of each P4 country. However, in order to establish a new world economic order, the TPP Agreement should be a model for future FTAs, by further strengthening current trends in liberalization. TPP has expanded into an economic integration system, which contains nine countries total including the main countries of the Asia-Pacific region; the United States, Australia, Peru, Vietnam, and Malaysia; newly joining the early member states of P4. The concern is now whether the five additional countries will be able to conclude a high standard FTA that is more open than the P4 Agreement and includes the aforementioned contents. Let us look at the feasibility of TPP, by examining the main issues discussed in the TPP negotiations involving the United States, and the position of each participating country on each issue.

The Position of the United States

The United States is promoting TPP participation policies in earnest, as an alternative to the stalled discussions on the FTAAP through APEC and as a platform for the transition to FTAAP. Negotiating through twenty-four working groups, the United States aims to introduce the Platinum Standard that covers all the items above.[6] Many of the regulations that were not able to be included in existing FTAs, such as indiscriminate elimination of tariffs on agricultural products, intellectual property rights, labor, environment, rules of origin, settlement for investor-state dispute, and articles related to competition (linked to SOEs) have been included in the TPP negotiations. One of the reasons why the United States started to take an interest in TPP is because the P4 Agreement included many of the conditions it supported during the process of negotiating FTAs. Furthermore, Chile and Australia—who have recently concluded bilateral FTAs with the United States—were participating in the TPP negotiations; so the United States wants to promote additional negotiations on issues that are sensitive, within a multilateral framework.

Out of the twenty-four items under negotiation shown in Table 5, items that are controversial include: dispute resolution, competition-related provisions, rules of origin, indiscriminate tariff abolition including agricultural products, and strengthening of intellectual property rights.[7] Settlement of investor-state disputes refers to a system in which disputes between foreign investing companies in markets and local governments are filed at the International Court of Justice. Australia and New Zealand are reluctant to accept due to concerns about U.S. superiority in legal know-how, while the United States is opposed to an internal bilateral dispute between a company and local government settled by a third party. The competition provision is an article aiming to regulate unfair actions of state-owned companies to ensure fair competition between the public

Table 5. Twenty-Four Negotiation Items on the TPP	
Main Agendas	
Chief negotiators' meeting	
Market access (goods)	Services (Free trans-border mobility of service industries)
Market access (Fabrics/clothes)	Services (Finance)
Market access (Agricultural products)	Services (Communications)
ROOs (Rules of Origin)	Services (Free trans-border mobility of supply chains & management skills)
Additional measures for Trade Facilitation	E-commerce
Sanitary and Phytosanitary Measures	Investment
TBT (Technical Barriers to Trade)	Environment
Trade Protectionism (Safeguard, etc)	Labor issues
Government Procurement	Issues on various organizations
IPR (Intellectual Property Rights)	Dispute settlement
Fair competition-related clauses	Cooperation
Crosscutting issues	
Source: "Japan Looks to Trans-Pacific Partnership to Transform its Economy," JETRO, Feb. 2011, cited from the ministries of foreign affairs, trade, economy and industries of states participating in the TPP.	

and private sector. This is a provision that countries with a relatively large public sector, such as Malaysia, Vietnam, and Brunei, are against. It specifically targets China's future participation in TPP, and is expected to be a huge burden on China, which has many large public companies. Rules of origin is a provision causing the sharpest controversy between those that suggest consistent across-the-board rules of origin, and those that argue that the rules of origin in existing FTAs should not be invalidated. There are also concerns that goods linked to multiple countries cannot receive protection from TPP if across-the-board rules of origin were to be introduced. Indiscriminate abolition of tariffs including agricultural products is also intertwined with the interests of each country. The United States is insisting on complete abolition of tariffs on commodities by the end of 2014. Yet, the U.S. logic is unjustified because it has so far been persistent in claiming the permanence of the U.S.-AUS FTA and the U.S.-New Zealand FTA, which have helped to achieve a status quo of tariffs on American sugar and dairy products. The participation of Japan in TPP negotiations is expected to make settlement even more difficult. Due to stiff opposition from its own farmers, Japan will try its best to protect its agricultural sector, complicating U.S.-led negotiations. On intellectual property rights, the United States is expected to seek application of the IPR article that was concluded in the KORUS FTA. The IPR provision in the KORUS FTA is an enhancement of the May 10th Agreement between former President Bush and the Democratic Party, aimed at strengthening property rights, particularly in the pharmaceutical industry.[8] If the May 10th Agreement allows the production of generic drugs in developing countries, the new provisions prohibit it. Insertion of this provision is controversial, even in the United States, between generic drug manufacturers and pharmaceutical companies.[9]

Following are the reasons why the United States is trying to include such a wide range of items all at once. First, it wants to send a message that through an across-the-board conclusion that the TPP may have export inducement effects compared to existing FTAs, leading to a positive impact on domestic employment and income enhancement. Ron Kirk, the U.S. Trade Representative (USTR), argues that TPP "should function as a new trade system in the 21st century" that embodies high standards of providing new market approach opportunities to American workers, farmers, service providers, and small business owners. Through this the U.S. administration expects to draw out political support from small to mid-sized businesses and labor unions that have been relatively disadvantaged by existing FTAs.[10] Second, the United States wishes to become the new center of the Asia-Pacific economic community through the achievement of the Platinum Standard, containing China, which is trying to achieve East Asian economic integration by excluding it through ASEAN+3 and +6, and using the expansion of TPP as a basis for negotiations with countries outside the region.[11] It aims to provide a reference point that is capable of inducing transformation in China's trade and industrial structure and drawing China's large state-owned companies into a competitive market system.[12]

American media perceptions about the U.S. government participating in TPP are not wholeheartedly positive. The U.S. auto industry is opposed to Japan's participation in the TPP, while its meat and dairy industries show deep concern over meat and dairy products imported from agriculturally strong New Zealand. Furthermore, the media warn that fully opening the sugar industry during individual negotiations with Australia will invite strong opposition from the American sugar industry and distrust of the government. The United States tried to proceed with TPP formation through bilateral negotiations with countries that have not yet concluded FTAs at the second TPP negotiations amongst eight countries held on June 14-18, 2010 in San Francisco. However, such plans hit a wall when Australia, New Zealand, and Singapore sought unified regulations through multilateral negotiations. The United States has expressed this position because it has already signed individual FTAs with five out of the eight countries; so concluding FTAs with New Zealand, Brunei, and Vietnam, would create more favorable circumstances to enter the TPP economic bloc. Other countries strongly opposed this.[13] When the United States proposed to adopt the same contents as in the KORUS FTA, opposition from the P4 members indicated that negotiations would not be easy.[14]

The Position of Japan

Kan Naoto concluded the "Basic Policies on Comprehensive EPA" on November 9, 2010, and soon after, officially declared active participation in TPP negotiations at the APEC General Meeting held in Yokohama.[15] Japan's strategy is completely different from its existing FTA strategies. Full elimination of tariffs on all commodities and services is a basic premise in TPP, and signifies a full opening of the agricultural market it has sought to protect so far.[16] Voices in support or opposition, including those in the DPJ, stand in stark contrast. Surveys predicted that if Japan does not participate in TPP and the Korea-China FTA is concluded, its GDP is expected to decrease by 10.5 trillion yen. Other results suggested that total GDP will decrease by 7.9 trillion yen, due to reduced production in agriculture and fisheries, if Japan participates in TPP.[17] The ruling party, however, wants to promote TPP participation in earnest, even if it means enduring extreme internal resistance and political pressure.[18] There are three main reasons behind this persistence: to accelerate opening of the Japanese economy, to create momentum for reform of Japan's industrial structure (especially in the agricultural sector), and to acquire a leading position in future discussions on East Asian economic integration vis-à-vis Korea and China.

First, Japan is planning to use participation in TPP as a platform towards an "Open Japan." Kan argued that a new growth engine is necessary to overcome the domestic market-oriented economic system that is becoming permanent, and the situation in which Japan is far removed global economic trends.[19] Moreover, as it can be understood from Table 6, Japan regards participation in TPP as a strategic means to revitalize the economy and also go beyond a simple FTA.[20] In the meanwhile, considerable damage to Japanese exports to the EU and the United States is expected due to the recently concluded Korea-EU and KORUS FTAs.[21]

Table 6. Comparing Tariffs of EU and the U.S. on Imports from Korea and Japan

	Japanese goods (Tariff rate %)	Korean goods (Tariff rate %)
US Market	Passenger cars (2.5%)	Tariff abolition within ten years of activation of KORUS FTA
	Polystyrene·Polyester (6.5%)	
	LCD screens·Color TV (5%)	
	Electrical amplifiers·speakers (4.9%)	
EU Market	Passenger cars (10%)	Tariff abolition within five years of activation of Korea-EU FTA
	CLBS TV (14%)	
	Liquid crystal display screens (14%)	
	Microwaves (5%)	

Source: Sun-Taek Hwang, "Japanese FTA Policies and Possibility of TPP Participation," (Seoul: 2011, in Korean).

Second, Japan sees an opportunity to change its industrial structure, drastically reforming the agricultural sector that has relied on government subsidies for a long time. The government has been adhering to basic policies of FTA promotion enacted in 2004, which excluded the sensitive agricultural sector and focused on industrial products.[22] However, Japan determined that full opening is inevitable once it starts participating in TPP, and focuses on "enhancing competitiveness and expanding foreign demand" and boosting the potential of Japanese agriculture as key challenges.[23] It referred to an "agricultural structure reform headquarters" in the "EPA Basic Policy" issued in November 2010, and plans to engage in proactive countermeasures, including basic policies for agricultural reform, finances, and mid to long-term action plans by November 2011.[24] Noda Yoshihiko cannot escape internal resistance, stating that he will "try his best to achieve what is in the best interest of the nation." Yet, a passive attitude due to conscious awareness of domestic opposition directly contradicts indiscriminate market opening that the United States is demanding, making it unlikely that Japan will be able to fully and immediately participate in TPP. If there is a shift in U.S. intentions in order to expand its influence in Asia, this could make it possible for Japanese attitudes to soften and lead to unexpected progress.[25]

Third, Japan recognizes TPP as a strategic opportunity to check future expansion strategies of Korea and China, and to occupy a leading position in East Asian economic cooperation. It intends to make these views known by participating in the establishment of FTAAP standards, which is the ultimate goal of APEC and TPP. In other words, because TPP is already in the actual negotiating stage, unlike ASEAN+3 and ASEAN+6, which are still being conceptualized, there is a chance to prepare for launching other moves at economic integration. Japan also determined that TPP participation would re-consolidate its alliance with the United States. This line of reasoning is one of the factors that enhances the chances for TPP conclusion, coupled with the intentions of the United States to expand its influence in East Asia.

The Position of China

The discussion of East Asian economic integration is at a standstill with no significant progress, with Japan and China locked in leadership competition. From logic stemming from deep-seated Sinocentrism, China prefers autonomous interaction (ASEAN+3) in East Asia without interference from the United States. It expresses antipathy toward the U.S. push for TPP.Even though China already concluded FTAs with New Zealand and Singapore, bilateral FTAs between these countries led to no great increase in openness. The possibility of it joining the TPP cannot be ruled out, because the TPP members, including the United States, believe that any country should be able to participate freely if it simply accepts the level of market opening and trade/investment liberalization required.[26] In addition, the Chinese government is well aware that it needs to find a new road before China falls into a stagnation trap when its high growth winds down. But considering that it took a long time for China to open up to the WTO and that it has been severely criticizing the shortcomings of the American market economy, there is little likelihood that this will happen for a long time.[27]

The form of economic integration that China prefers is the EAFTA. It may continue its overtures towards the region: strengthening cooperation via ASEAN+3 and accelerating regional economic integration that would not be different from a Korea-China FTA or China-Japan-Korea (CJK) FTA. China expects the CJK FTA to contribute to forming ASEAN+3 as a building bloc, because these three states have already concluded FTAs with ASEAN countries individually. As TPP discussions centering on the United States gather momentum, China is taking a rather flexible stance toward ASEAN+6, expecting to achieve integration that focuses on ASEAN. China is encouraging the start of negotiations for CJK FTA in earnest, and now displays a more positive stance toward the formation of ASEAN+6 that Japan has suggested.

CONCLUSION: PROSPECTS FOR TPP CONCLUSION AND KOREA'S DECISION

From Korea's standpoint, economic benefits are larger in ASEAN+6, which focuses on ASEAN, compared to TPP, which centers on Asia-Pacific countries. In addition, considering that the drive for future economic growth is bigger in the East Asia region, an ASEAN-oriented regional integration seems more desirable for Korea. Korea has signed FTAs with major TPP members (the United States, Chile, Peru, and Singapore), and is conducting FTA negotiations with Australia and New Zealand, so incentives for joining the TPP do not seem great. Of course, some argue that Korea should first join TPP, because ASEAN+6 has only just been conceptualized, while TPP is already at the negotiating stage. Moreover, TPP negotiations are expected to follow the standards of KORUS FTA, which includes all of Korea's sensitive issues, so there are arguments that Korea will not experience major difficulties after joining TPP.[28] However, the results of ongoing negotiations for the five latecomer countries in joining TPP, and whether or not Japan and China will join TPP, are more important factors.

It is unlikely that Japan will participate in TPP, but if the level of openness in TPP is high and Japan decides to join, then Korea's competitiveness, in comparison to that of Japan, may decline in the TPP member market. This means that Japan's participation would likely trigger Korea's participation in TPP. The level of openness in the agricultural market will play a prominent role in determining whether or not Korea will decide to join. Japan's level of openness in the agricultural sector, which is more closed than that of Korea, may also affect Korea's conditions and willingness to participate.[29]

Whether or not China will join TPP will also become an important factor in Korea's decision. As seen in the CGE model, the biggest reason ASEAN+6 would bring more economic benefits for Korea is China. It is expected that China's position as a consumer market and producer will become stronger in the future, under the current global and European financial crisis. However, if TPP expands and Korea and ASEAN decide to join, a new market and production network will be formed within TPP, in which case China's position will be weakened in the mid to long-term. So China is expected to decide whether it will accept the expansion of U.S. influence toward East Asia in the short term and participate in TPP in the mid and long term; or continue with efforts toward regional economic cooperation independently.[30] Such intentions are also expressed in China's official stance, stating that "it is somewhat unpleasant not having been invited to TPP discussions, but if the economic integration process is carried out in a transparent and fair manner, we will accept it." Furthermore, although it is hard for China to accept the across-the-board conclusion of multilateral negotiations according to the Platinum Standard, given concerns that it will fall into the middle-income trap, the possibility of China's participation in the mid and long term cannot be ruled out.[31] If China's participation in TPP progressed rapidly, it is possible that Korea would fall behind and be left out of the bloc. However, it is much more likely that China will be active in organizing a China-led regional economic integration and discussing the CJK FTA, while engaging in efforts to bolster its relations with ASEAN. Korea is expected to respond positively to such efforts from China.[32]

Another important factor in Korea's decision to participate in TPP is whether or not the TPP Agreement will be concluded under more favorable conditions than the KORUS or Korea-EU FTA in future negotiations between P+ member countries. This has to do with whether the sensitive parts of twenty-four detailed provisions, such as rules of origin and intellectual property rights, are more advantageous for Korea compared to the KORUS FTA. In particular, TPP is more favorable because it is more diverse in terms of developmental stages than the KORUS FTA, regarding the rule of origin. There is a debate in the KORUS FTA on whether the Kaesong Industrial Complex will be recognized as a processing zone outside of the region. In the case of rules of origin applied to outward processing zones, the concluding standards of each FTA are different and do not have clear criteria. Moreover, in the KORUS FTA, goods and parts produced in North Korea, including Kaesong, must receive approval from OFAC (Department of Office of Foreign Assets Control) in order for them to be applied to the KORUS FTA.[33] For the automotive industry that is expected to benefit the most from this FTA, it is necessary to keep an eye on the direction toward which the TPP rule of origin progresses, given the tens of thousands of parts needed in automobile manufacturing. KORUS FTA stipulates "to encourage producers that utilize parts, labor, and other production factors produced in Korea or the US, this FTA limits its applicable range to Korea and United States, excluding markets in North Korea, China, and other countries." Also, looking at the division of labor within East Asia, exporting Korea's manufactured goods may be a burden in the future.[34] Furthermore, if the rule of origin in TPP is concluded over-reciprocal to countries within the region, there is a possibility of Korea becoming a target of reverse discrimination from the countries within the TPP region, regardless of the KORUS FTA. However, such coordination of detailed terms only favorable towards countries within the TPP region must be preceded by concessions from the United States, which it will find difficult to accept.

The United States is taking the standards of KORUS FTA as a basic template, instead of existing standards of P4.[35] In fact, when the TPP is compared to the P4, it reveals that the divisions in negotiations for commodity trade have been divided into more specific areas such as agriculture, industrial products, textiles and clothing. Things such as Yarn Forward regulation for textiles and clothing, as in the KORUS FTA, will be added to rules of origin; "service" was divided into finance, telecommunications, and e-commerce; and provisions on labor and environment have been added. This seems to be the intention of the United States to apply the same standard of intellectual property rights (IPR) in TPP, as they have demanded in the KORUS FTA.[36] The IPR in KORUS FTA focuses on pharmaceuticals; the KORUS FTA prohibits the manufacture and distribution of generic drugs within developing countries, that have been allowed to do so according to the May 10th Agreement established during the Bush Administration, upon agreement between the U.S. administration and Congress (the Democratic Party) at the time. In other words, the United States clearly specified a higher protection level of IPR than they did in the KORUS FTA.[37] Considering the position of the United States to apply such standards to TPP, mutual concession regarding the rule of origin seems difficult. Assuming this situation, the conclusion of TPP is expected to be more complex, in which case the goal of conclusion by 2012 will be difficult to achieve. Also, the aforementioned internal resistance within Japan and the government's reserved negotiating attitude, will make conclusion of negotiations very difficult Since there are big differences among TPP members in economic and institutional development, it will be difficult to conclude high quality FTAs. Within East Asia attitudes are polarized: South Korea, Japan, and Singapore are pursuing relatively advanced FTAs, while ASEAN and China are pursuing a low quality FTA.

It is expected that East Asian economic integration will grow more complex, as the positions of East Asian countries and the United States regarding TPP are not congruent. Korea has already effectuated FTAs with two giant economies, the United States and EU, so for the time being, the situation is not urgent with respect to TPP participation. Furthermore, it is unlikely that TPP will be actualized in a short period, and Korea has already concluded bilateral FTAs or is in the process of negotiation with the majority of the TPP participants, so it is all the more unnecessary to rush into joining the TPP. However, there is a subtle difference between bilateral and multilateral FTAs. In a world where the products and services of each country are made or are available only in a particular country, there will probably be no differences. But the global production network is expanding, and input from various nations is added between the start of manufacturing and the sale of the final product. This impacts production. In such a situation, multilateral FTAs, especially economic integration systems like TPP, between countries with various special advantages such as resources, labor, technology, and markets, are much more beneficial in satisfying the rules of origin, compared to bilateral FTAs. Korea should not rush in determining the pros and cons regarding TPP. It would be wiser to take some time in deciding, while examining the future agenda of TPP and the ongoing movements of China and Japan.

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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.

Table 1. Trade Flows in the Asia Pacific, 2010 (in US$ billions)

	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

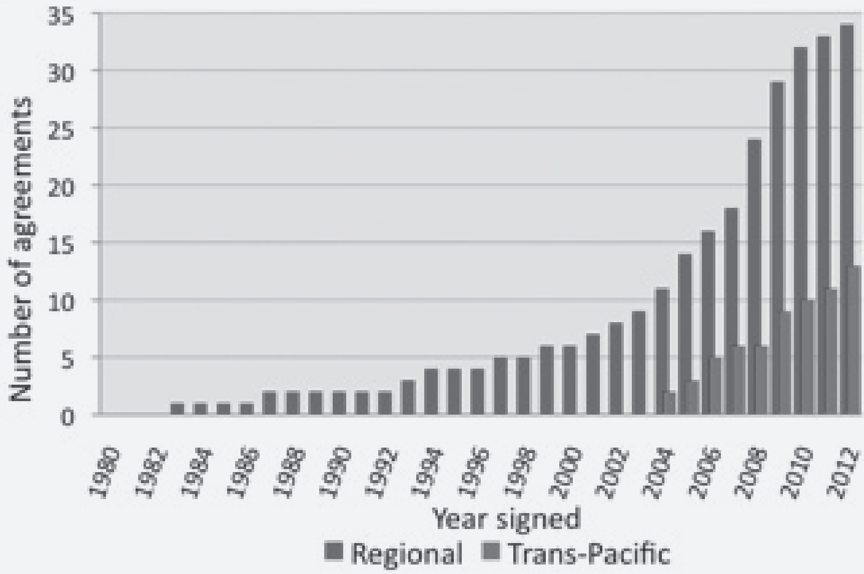
Source: Petri et al, (2011).

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

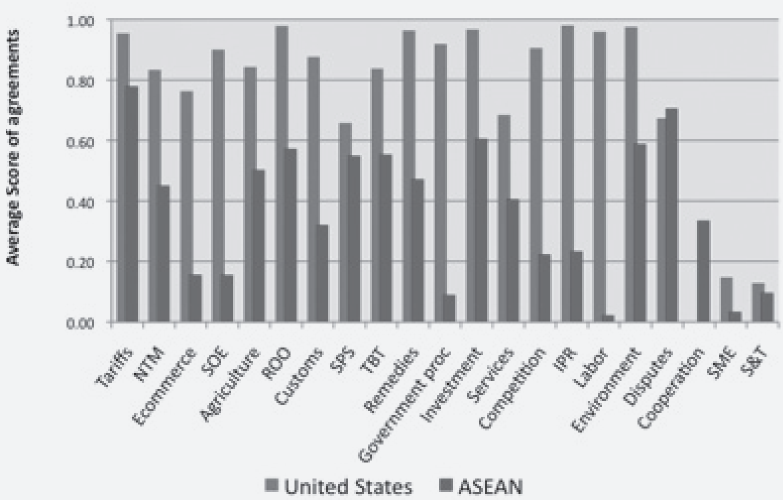
The tracks differ in membership and coverage of issues. The Asian track excludes the United States and other countries in the Americas, while the TPP track excludes China and some other Asian economies, at least for now. Some Chinese observers have complained that China has not been asked to participate 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 lead 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] Shrill 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 simply 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.

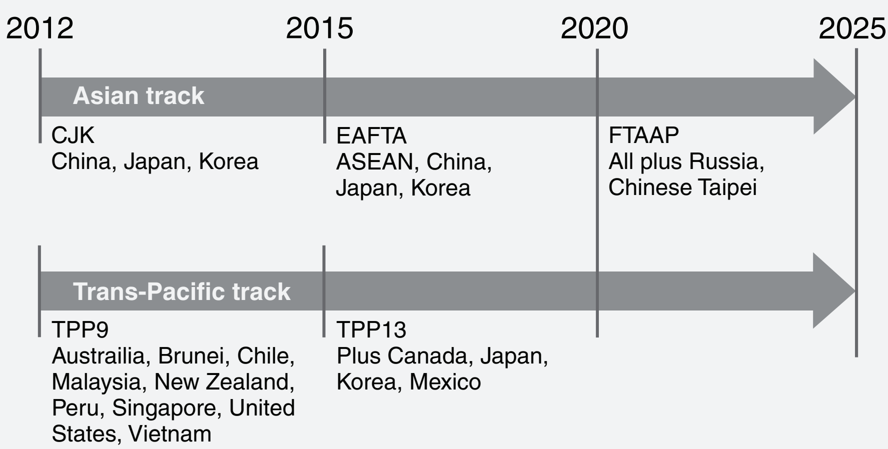
Modeling Framework

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.

Figure 3. Possible Agreements on the Two Tracks



Source: Petri, Plummer and Zhai (2011).

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 than 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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ASIA AT A TIPPING POINT: KOREA, THE RISE OF CHINA, AND THE IMPACT OF LEADERSHIP TRANSITIONS

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