
Towards a single market:

a 21st century vision for Asia Pacific economic integration

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Contents:

Abstract	3
Executive Summary	4
1..A new vision for Asia Pacific integration.....	7
1.1 APEC's track record.....	7
1.2 Economic integration in the 21 st century	10
1.3 Towards a single market	11
2. Towards a single market in the Asia Pacific	13
2.1 The changing nature if international commerce	13
2.2 Impediments to international economic transactions	14
2.3 Policy objectives and policy instruments	15
2.3 Finding mutual benefit.....	18
3. Setting a practical agenda	18
3.1 Trade in goods	18
3.2 Trade in services.....	20
3.3 Contingent protectionism	20
3.4 Factors of production	21
4..Implementing the agenda	22
4.1 Mobilising resources for capacity-building.....	22
4.2 Setting priorities	23
4.3 Setting an example	23
4.4 Building on success	24
5 Conclusion	25
6. References	27

Abstract

APEC leaders can take pride in progress towards free and open trade. There will always be more to do to integrate Asia Pacific economies. 2010 is the time to look beyond border barriers to trade and adopt a new post-Bogor vision of a single market.

Traditional border barriers to trade in some sensitive products remain costly, but affect only a rapidly shrinking part of international commerce. Today, it is more efficient to concentrate on problems of communications and logistics, combined with the lack of efficiency, transparency and sometimes arbitrary implementation, of economic policies in different economies.

The effective constraint on collective action to deal with these problems is not political will. It is limited capacity to design and implement the necessary policy reform. Creating the necessary capacity needs a unifying vision to deal all obstacles to genuine economic integration, that is, to build a single market.

In doing so, Asia Pacific governments can learn from the European Union **experience. But they need to promote ever-deeper economic integration without relying on a supra-national authority.**

Like free and open trade, a single market is a vision which can only be approached, rather than reached by any deadline – it is a point of reference for the many things that need to be done to integrate Asia Pacific economies in a meaningful way.

Asia Pacific governments should be encouraged to set their own medium-term targets for progress towards well-defined ingredients of a single market. Strict selection criteria should be used to identify options for cooperation which build on what APEC is already doing and which are in line with the priorities of most member economies. An ambitious program to enhance the efficiency of supply chains could set a successful **example and generate the confidence to do more.**

Executive Summary

APEC leaders can take pride in progress towards free and open trade. Average tariffs have fallen from 17 per cent in 1989 to less than 6 per cent in 2010. Efficient customs procedures and other practical arrangements to facilitate trade are saving billions of dollars per year.

There will always be more to do to integrate Asia Pacific economies, so there is no need to worry about not meeting APEC's Bogor 2010 goal in full. This is a time to look ahead and adopt a new **vision, based on experience and** the remarkable change in the nature of international commerce since 1989.

The time has come to set a vision of a single market and commit to a strategy for ever-deeper economic integration to move towards this vision.

The European Union created a trading bloc by 1970. It took them another 20 years to realise that was nowhere near enough for genuine economic integration. It was not until the late 1980s, that the EU committed itself to moving beyond a trading bloc. Asia Pacific cannot afford to waste so much time.

APEC's core objective remains promoting **mutually beneficial** integration, but the relative importance of obstacles has shifted. It is essential to end preoccupation with border barriers, which are issues of the last century, and respond to new realities.

Traditional border barriers to trade in some sensitive products remain costly, but affect only a rapidly shrinking part of international commerce. Today, it is more efficient to concentrate on problems of communications and logistics, combined with the lack of efficiency, transparency and sometimes arbitrary implementation, of economic policies in different economies.

The effective constraint on collective action to deal with these problems is not political will. It is limited capacity to design and implement the necessary policy reform. And capacity cannot be created by negotiation.

Creating the capacity to design and implement cooperative arrangements for cooperation is largely a matter of sharing **information, experience, expertise and technology. That will take time and resources.**

High-level political attention will be needed to catalyse the resources which will be needed. That, in turn, needs a unifying vision to deal with the across-the-border and behind-the-border obstacles to genuine economic integration.

A commitment to work towards a single market in the Asia Pacific can provide the vision for practical cooperation among the region's economies.

In moving towards this vision, Asia Pacific governments can learn from the European Union's progress towards a single market since 1990. **But they need to promote economic integration in a very different way which is consistent with the nature of the**

Asia Pacific region. There is no prospect of an European Union style supra-national authority.

The Asia Pacific experience of recent decades shows that successful cooperation needs to be based on a flexible, voluntary and evolutionary approach that delivers mutual benefits. There is no need to rely on negotiations or treaties. Voluntary cooperation can be effective as long as priorities are carefully selected, looking for practical ways to accelerate the ongoing, market-driven economic integration of the region.

Pursuing ever-deeper economic integration will require a lot of policy convergence. With voluntary cooperation, policy convergence can be expected only after patient work to demonstrate that it is consistent with national interests as well as market forces.

There are many dimensions of economic integration which meet these conditions. For example, making economic regulations more transparent, efficient and mutually consistent can improve the efficiency of markets and deliver benefits to the economies able to implement such reform.

It will also be essential to recognise the limits of voluntary cooperation. There are some matters where the short-term costs of cooperation are seen to exceed potential long-term benefits. In those cases negotiations will be required.

Issues which need negotiations should be left to institutions such as the World Trade Organisation, which are designed to conduct them. That will allow the APEC process to concentrate on issues consistent with the comparative advantage of a voluntary process of cooperation.

Achieving genuine economic integration will need patience. There will always be more to be done as new technologies create more opportunities to reduce the costs or risks on international commerce.

Like free and open trade, a single market is a vision which can only be approached, rather than reached— it is a point of reference for the many things that need to be done to integrate Asia Pacific economies in a meaningful way.

The Bogor experience, has shown that an ambitious point of reference can be very helpful, but unrealistic deadlines create needless disappointment. Although much has been achieved, APEC is widely regarded as a failure, due to creating excessive expectations for 2010 and 2020.

Learning from their own experience, APEC leaders should avoid commitment to another set of deadlines for achieving an ideal of a single market. Instead, economies should be expected to set ambitious, but realistic milestones which they can expect to meet along the long hard road towards a single market.

As discussed in this paper, an agenda for progress towards a single market has many ingredients. In each case, some economies will be able to move faster than others. The challenge for economic cooperation in the Asia Pacific is to share the information,

experience, expertise and technology needed to help all economies to gain the benefits of deeper economic integration as soon as possible.

Strict selection criteria should be used to identify options for cooperation which build on what APEC is already doing and which are in line with the priorities of most member economies. An ambitious program to enhance the efficiency of supply chains could set a successful **example and generate the confidence to do more.**

Such an Asia Pacific strategy to promote progress towards a single market will allow APEC leaders to point to measurable gains from their economic cooperation, year after year.

1..A new vision for Asia Pacific integration¹

1.1 APEC's track record

1.1.1 Achievements

Concerted decisions of APEC governments to reduce obstacles to trade and investment have sustained the region's 'opening to the outside world':

- average tariffs in the region have fallen from 16.9% in 1989, to 5.5% in 2004; border barriers to trade in many goods are already at zero or negligible levels and there are very few quantitative restrictions on trade.
- people and capital are moving more freely around the region.
- an APEC initiative in the WTO ensured that information technology (IT) products have remained freely traded.

APEC work on trade facilitation **has led to:**

- more efficient and more harmonised customs procedures;
- greater mutual recognition of product and process standards;
- accelerated the use of information and communications technology (ICT);
- allowed new measures to guard against terrorism and pandemics to be implemented with least possible disruption to trade;
- easier for business travel using the APEC Business Travel Card.

These, and many other initiatives have already reduced transactions costs by billions of dollars per year. Nine of the APEC economies are among the top 20 in the World Bank's *Ease of Doing Business* rankings in 2010.

APEC-wide commitment to outward-looking economic growth proved important in limiting the damage of the East Asian financial crisis of the 1990s and the global crisis of 2008. The Asia Pacific continues to be the fastest-growing part of the world economy. Market-led integration has led to a five-fold increase in intra-APEC merchandise trade which has grown from US\$1.7 trillion in 1989 to US\$8.4 trillion in 2007.²

1.1.2 Expectations

Despite these achievements, APEC is widely seen to be ineffective and likely to be sidelined by initiatives for East Asian cooperation and the new G20 process. This

¹ A draft of this paper was presented at the December 2009, international conference; *APEC: The Next Decade*. I am grateful to the Taiwan Institute for Economic Research for inviting me to the conference and the constructive comments from **participants**.

² A more detailed account of APEC's performance is in Yamazawa (2009a and 2009b).

apparent contradiction is due to the excessive expectations raised in 1994 to eliminate obstacles to all **trade and investment** by 2010 and 2020.³

The Bogor goal of was remarkably ambitious (Patrick, 2005). Neither the GATT, nor the WTO, have ever set such a target, let alone a deadline for its achievement. The European Union has gone a long way in the direction of free (but not open) **trade and investment**, but does not have free trade in services.

Some sensitive products are likely to remain protected by some APEC governments long after 2010 or even 2020. But the APEC process should not be judged by the narrow criterion of liberalising the few remaining high border barriers where even the WTO cannot make much progress. APEC should never have been expected to outperform the WTO in terms of **trade liberalisation**.

It is more important to appreciate the many decisions of APEC governments have taken to liberalise both trade and investment. These essentially unilateral decisions have created an environment where most goods and services face very low border barriers and all Asia Pacific economies welcome international investment. That has helped the Asia Pacific to be the fastest growing region in the world in recent decades.

Singapore Prime Minister Lee Hsien Loong, the host of APEC 2009, was therefore not too concerned that APEC's Bogor goals will not be met in full. However, he reminded us that there is much left to be done:

While tariffs may look low, the real problems which businessmen face may be far from negligible. So much work remains: to harmonize trade rules, to remove non-tariff barriers, to simplify customs regulations, [and] to help companies realize more fully the benefits of free trade.

In order to tackle these challenges with confidence, it will be useful to transform the perception of APEC from a process seen to be falling short of expectations to a successful process which can point to measurable gains, year after year.

The Bogor goals have been a useful point of reference for the APEC process since 1984, but the time has come for a vision which allows a clear break from past emphasis on trade liberalisation. It is time to commit to an ongoing effort to promote ever-deeper economic integration towards a single market in the Asia Pacific.

This vision needs to be approached in a way which draws on past experience in this region and on APEC's comparative advantage relative to other regional and global cooperation efforts. It is also essential to respect the diversity of the region. In future, APEC should not set uniform deadlines for either developing or developed economies.⁴

³ The deadlines for meeting the Bogor goals are 2101 for **developed** and 2020 for **developing** economies.

⁴ Uniform deadlines for diverse groups of economies will either be a very modest lowest common denominator goal, or create expectations which some will not meet.

All APEC governments want to reduce the cost and risks of investment in, and trade with, their economies. But there are speed limits imposed by limited capacity to design and implement the many policy improvements which will be needed. Rather than imposing deadlines, governments can be encouraged to set ambitious, but realistic, **milestones** which they want to achieve as part of their **development strategies**.

1.1.3 Learning from experience

APEC is not a negotiating forum. It is a voluntary process of cooperation because Asia Pacific governments are not willing to consider ceding significant sovereignty to a regional supra-national authority.⁵

APEC's successes have been in areas where governments have perceived the benefit of cooperating, voluntarily, to achieve agreed practical objectives. **Problems, together with perceptions of failure, have arisen when participants sought to engage in negotiations.**

Looking ahead, **APEC should play to its strengths; using the comparative advantage of voluntary cooperation to build consensus on ways to promote shared interests, including in economic integration. At the same time, it is essential to accept the limits of a voluntary process of cooperation.**

APEC leaders should be concerned with all important international issues. They should use their meetings to identify shared interests. But they should not expect to solve them all within the APEC process.

Some issues will continue to need the negotiation of binding commitments, for example to set trade rules or to deal with global warming. Since APEC is not designed for negotiations, these should take place in institutions which have comparative advantage in conducting negotiations.

The APEC process could then concentrate on the many opportunities for cooperation which are seen to lead to all-round benefits and can be addressed by capacity-building to design and implement the policies needed to seize these opportunities. That is the strategy which is consistent with the comparative advantage, and the limits, of voluntary cooperation.

As a voluntary process, APEC should not seek to negotiate agreements which divert economic activity away from any economy – it should set positive examples for the rest of the world to follow when they become aware of the advantage of doing so. That is the essence of open regionalism.

⁵ The reasons for adopting an voluntary and non-discriminatory approach to Asia Pacific cooperation are set out in Drysdale et al (2008).

1.2 Economic integration in the 21st century

Reducing obstacles to mutually beneficial integration remains APEC's core objective, but the relative nature of international commerce has changed remarkably in recent years. Consequently, the relative importance of impediments to trade and investment have also changed, pointing to the need for a new vision for APEC.

1.2.1 The new environment for regional economic integration

Trade in goods dominated international commerce when the GATT was established and much of that trade faced very high border barriers. Since then, and particularly since 1989, the share of trade in goods has fallen sharply. Moreover, most traditional border barriers to trade are low, or gone. What remains is costly, but affects only some sensitive products which account for a rapidly shrinking share of international commerce.

The nature of trade in goods has also changed. The share of easily defined finished goods or commodities has declined in relative importance: intra-industry and intra-firm trade are growing much faster than trade in final products. Supply chains involving several economies are becoming ever more important compared to bilateral trade.

These days, most of those involved in international commerce do not need to worry about high tariffs. They are more interested in much less transparent cost and risks such as logistic and security problems and in solving problems posed by economic regulations which are not efficient and needlessly different among economies. These policy weaknesses are often compounded by uncertainty about how policies and regulations will work in practice. These issues were highlighted at the 2009 **Singapore meetings of APEC**.⁶

Therefore, the time has come to complement a world of already low border barriers to trade in most products with an environment of transparent, consistent and efficient economic policies and regulations, along with best practice information networks and logistics. As explained in Section 2.3.1 Facilitation, these are now the areas with the highest potential for significant reductions in transaction costs.

1.2.2 New priorities for integration

Meaningful economic integration needs more than low border barriers to trade in all goods and services. The much wider challenge for the region is to back this with an environment with features including:

- strict, transparent rules for subsidies and anti-dumping measures;

⁶ These new realities are highlighted in a recent speech by, Lim Hng Kiang, Singapore's Minister for Trade and Industry and the speech to APEC CEOs by the host of APEC, Prime Minister Lee Hsien Loong.

- full rights of establishment and the national treatment of all firms, in all significant sectors.
- region-wide minimum standards for competition policy, which are sufficiently rigorous to avoid the need for anti-dumping actions among APEC economies;
- a comprehensive program of mutual recognition of product standards and professional qualifications;
- transparency and harmonisation of a wide range of administrative procedures, including agreed minimum standards for auditing and disclosure.⁷

Approaching such aims will need to deal with many of the issues the EU has addressed as part of its single market agenda **that tackled a much wider range of costs and risks of intra-European trade.**

But in the Asia Pacific region, where there is no interest in ceding sovereignty to any new regional authority, a very different approach can, and will, be needed. A flexible approach has been already been able to achieve such a high degree of integration between Australia and New Zealand (Nottage, 2009) and Southeast Asian economies are committed to deep integration without a Brussels-like bureaucracy to create an ASEAN Economic Community (Hew, 2007).

1.3 Towards a single market

Like free and open trade, a single market is a vision which can only be approached, rather than reached by any deadline. But striving towards a single market is a useful new point of reference for the many things that need to be done to integrate Asia Pacific economies.

Australian Prime Minister Rudd's speech to Asia Pacific business leaders in Singapore emphasised that ASEAN, rather than the EU, provides the realistic model for cooperation in the Asia Pacific (Rudd, 2009). Cooperation among diverse Southeast Asian nations has shown the effectiveness of 40 years of patient consensus-building; forging a sense of community through a habit of cooperation to deal with issues through voluntary cooperation leading to mutual respect and mutual benefit.

At the same time, there is much to learn from European economic integration since the 1960s. **Western Europe had free trade in goods by 1970.⁸ Subsequently, it became obvious that getting rid of border barriers was nowhere near enough to integrate any groups of economies, leading to their single market initiative. It is also essential to deal**

⁷ This is not an exhaustive list. It is based on Elek (2004) and Romulo (2005). As the nature or international commerce continues to change, new issues will arise. Nottage (2009) has proposed a different, but overlapping set of objectives for deep economic integration.

⁸ EU members have a customs union, which is a stronger form of integration, since it covers all trade, set uniform trade policies for trade with the rest of the world and does not require rules of origin.

with across-the-border and behind-the-border obstacles to genuine economic integration.

This experience shows that a region-wide preferential ‘free-trade’ trade bloc is not an adequate new vision for APEC, even if such an arrangement was remotely feasible.

1.3.1 A practical agenda with realistic ambitions

To avoid excessive expectations, APEC leaders should not aim for perfection. It is better to concentrate on some well-understood requirements for a genuinely integrated region, reflecting what the business sector needs to be able to operate throughout the Asia Pacific.

Significant ingredients of a single market, such as those listed above will take a long time to be achieved in a diverse **groups of economies**. **However**, the objectives listed above are not dreams, but realistic ambitions,. Some APEC economies are well on the way. Their **experience** indicates that progress towards such important dimensions of economic integration requires attention to the regulation of domestic **as well as** international markets, together with the ability to manage structural adjustment.

The economies which have moved fastest to integrate with others have been the most successful. Other governments are interested in drawing on their **experience, while adapting it to their own situations**: APEC leaders can encourage those governments to set medium-term **milestones** which reflect their current capacity.

The APEC process can help enhance the capacity of all member economies by sharing relevant **information, experience, expertise and technology**. This is in line with the intention of APEC ministers to:

... leverage APEC’s traditional strengths of voluntary cooperation, capacity building, sharing of best practices, and working with the private sector, to implement necessary reforms in infrastructure development, agriculture/food management, social security, education and workforce training, and regulatory frameworks. (APEC Ministerial Statement, 2009)

Cooperative capacity-building to promote economic integration will not only need time, but will also need substantial financial resources. APEC is not a **development** agency, so its role is to catalyse the necessary resources from international capital markets, including through the intermediation of multilateral **development** banks (MDBs).

High-level political attention will be needed to mobilise adequate resources. That is why APEC needs to adopt a unifying vision for the long-term challenge of economic integration.

1.3.2 Setting priorities

It should be possible to agree on criteria for selecting dimensions of economic integration where Asia Pacific governments are likely to set and meet medium-term objectives.

This paper outlines means to identify options for cooperation which build on what APEC is already doing and which are in line with the priorities of most member economies. To generate momentum, it will be desirable to focus on investments in capacity-building where measurable progress will yield sound economic returns. In such areas, there are usually examples of successful private investment and/or lending by international financial institutions.

There are programs which meet all of these criteria. This paper explains how one of these, enhancing the efficiency and security of ports, airports and supply chains could be adopted as an early priority for cooperation.

That is only one of several opportunities for cooperation to generate significant, measurable mutual benefits for Asia Pacific economies. Success in one dimension of regional economic integration can generate confidence to implement others.

Rather than seeking to force governments to change policies, the APEC process should support those governments who are keen to take practical steps towards deeper regional integration. For example, **APEC's policy development work can help create the ASEAN Economic Community.**

2. Towards a single market in the Asia Pacific

2.1 The changing nature of international commerce

In the 1940s, international commerce was dominated by trade in commodities and manufactured products which were usually made in a single factory. Trade was obstructed by high border barriers to trade in goods, such as tariffs or quotas (Feketekuty, 1992).

By 1989, trade in services had increased relative to trade in goods while international movements of capital and people were becoming increasingly important. Successive rounds of GATT negotiations had achieved welcome reductions in border barriers.

These negotiations were accompanied by extensive unilateral reforms as more and more governments recognised that 'opening to the outside world' was essential for sustained development.

However, **border barriers were still** formidable when APEC was established.

Therefore, it was still appropriate to be quite concerned about border barriers. The need to reduce other cost and risks of **trade and investment**, for example, by facilitating the movement of products and people across customs and immigration barriers was acknowledged, but received somewhat lower priority and attention.

Since 1989, spectacular changes in information technology and the dramatic decline in communications costs have transformed the pattern of production and exchange. The marginal cost of electronic communication has fallen very close to zero. Along with steadily declining border barriers and lower real costs of transport, this has allowed ever-finer specialisation in line with evolving comparative advantage.

International commerce has become an intertwined flow of goods and services accompanied by international movement of capital (including direct foreign investment) and people. Information and communications technology has been transformed and international exchanges of information have become essential to all international commerce.

These days, economic integration encompasses all of the ways national economies are connected in international markets, including trade in goods, services ideas and information, along with essential and complementary international movements of people and capital and the coordination of public policies(Hummels, 2008).

Trade in services continues to grow more rapidly than trade in goods, while international investment is growing faster than trade in either goods or in services. Reflecting rapid growth in intra-industry and intra-firm trade, supply chains are becoming the main means of integrating economies (Fung, 2005 and World Bank, 2007).⁹

As border policy barriers have come down and the nature of international commerce has evolved, it is essential to focus on the full range of impediments to economic integration, including the many regulatory, institutional and policy measures that reduce the potential for trade and investment (Elek, 1992 and Drysdale, 2004).

2.2 Impediments to international economic transactions

Progress towards a long-term vision of a single market needs to pay attention to the full range on impediments to all types of international transactions. These can be classified as follows:

⁹ The capacity of logistics infrastructure and the quality of economic regulations which are needed to join international production networks are becoming a new source of comparative advantage, along with the availability of natural resources and factors of production.

BOX 1: Impediments to international economic transactions

- | | |
|---|--|
| 1 | Natural impediments; |
| A | physical (e.g. distance or infrastructure shortages); |
| B | intangible (differences in language or culture); |
| 2 | Policy-based impediments; |
| A | policy barriers to crossing borders, applied to:
products (intermediate and final goods and services); or
factors of production (labour, capital and information); |
| B | divergences of domestic policy, including:
standards;
administrative procedures;
commercial legislation and regulation; |
| C | policy uncertainties caused by problems including:
lack of transparency of regulations;
arbitrary application of regulations;
inadequate dispute settlement procedures. |

Reducing natural obstacles to international commerce (Group 1 above) is largely a matter of capacity-building, for example by investing in economic infrastructure or by learning new languages. Tackling the impediments in Group 2 A (shaded more darkly) is usually termed liberalisation, while policies to deal with Subgroups 2.B and 2.C are called facilitation.

Liberalisation and facilitation can both lead to significant economic benefits, so there is no need to choose between them. The challenge is to find where a voluntary process of cooperation can contribute to reforms at, or behind, the border.

2.3 Policy objectives and policy instruments

APEC's **experience** demonstrates that a voluntary process of cooperation can deal with those dimensions of both liberalisation and facilitation which are positive-sum games – opportunities for integration which promise mutual benefits to all the governments involved.

Some opportunities for economic integration are not (or sometimes not yet) perceived to be positive-sum games. Where long-term gains are seen to be outweighed by short-term costs, voluntary cooperation cannot be expected to work. **Negotiations will**

be needed for short-term results; those should take place in institutions with comparative advantage as a negotiating forum – not in APEC.¹⁰

2.3.1 Facilitation

APEC's contribution to facilitation relies on consensus-building to design cooperative arrangements which can be adapted to the circumstances of different economies. For example, the progressive adoption of the **APEC Business Travel Card** by all APEC governments was made possible by sharing compatible software to handle the electronic exchange of information about business travelers.

This example shows that **negotiations** are not always needed for practical cooperation; it also makes it clear that **negotiations** are neither relevant, not sufficient to achieve practical outcomes. Easier movement of business people cannot be achieved by negotiating statements of good intentions. Real progress needs patient work to set up compatible information technology to allow movement of people consistent with security requirements. Similarly, a negotiated undertaking, for example to enact legislation and regulations to promote competition in particular services is meaningless in the absence of the skills and institutions need to implement and enforce relevant legislation.

Dealing with Subgroups 2.B and 2.C in Box 1 is a matter of encouraging gradually better policy-making, including policies for many areas which are well inside the borders of economies.

The potential gains from reducing transactions costs other than traditional border barriers are enormous. For example:

- the ADB has cited potential to save up to 1 per cent of the value of traded products by reducing port clearance times by one day.
- the World Bank (2007b) has estimated that bringing below average APEC members half way to the APEC average in terms of the efficiency of their trade logistics would result in a 10 per cent increase in intra APEC trade, worth about 280 billion.
- APEC's new 2009 target to make it 25 percent cheaper, faster and easier to do business within APEC economies by 2015 is expected to reduce the average the cost of importing and exporting a container of goods by up to US\$450 (APEC, 2009).
- Wilson et al (2003) estimated that a 0.55per cent improvement in port efficiency or a 5.5 per cent improvement in customs efficiency would increase intra-APEC trade by US\$27 billion per year.¹¹

¹⁰ The so-called early voluntary sectoral liberalisation (EVSL) experiment in 1997 and 1998 was a costly failure, demonstrating that the APEC process is not designed to be a forum for negotiations (Damond, 2003).

The effective constraint on collective action to seize these significant gains is not political will. Progress depends on capacity for **policy development as well as** the capacity of information and communications technology and economic infrastructure. The APEC process can ease capacity constraints by sharing the vast resources of **information, experience, expertise and technology** available in this diverse region.

2.3.2 Liberalisation

Voluntary cooperation has also proved useful on liberalisation. As noted at the outset, Asia Pacific governments have cut most of their tariffs to zero or negligible rates, without the need for APEC negotiations. **Policies to attract investment are being updated constantly, with no need for compulsion, as governments compete for attention.**

Getting rid of the residual border protection of a few sensitive products will need negotiations, but there is no need to try to convert APEC into a negotiating forum. Trying to do so, then attempting to negotiate an APEC-wide trading bloc would be a costly and wasteful diversion from the comparative advantage of the APEC¹².

A sober assessment of prospects for negotiating a region-wide preferential trade agreement suggests that they would take many years. And after much effort and tension, such negotiations would then result in:

- to failure, like the unsuccessful attempt to create a free trade area of all of the Americas, or
- to a lowest common denominator outcome that left many of the significant residual border protection of sensitive products in place, resulting negligible economic gains and still falling well short of free trade.¹³

It will be far more efficient for APEC to deal with border barriers in more imaginative ways as set out in Sections 3 and 4.

¹¹ Additional evidence of the economic gains from trade facilitation can be found in OECD (2005) and CIE (2009).

¹² An Asia Pacific trading bloc is not a new idea. It has been advocated and repeatedly rejected for good reasons since the 1960s. These days the idea has been called a potential FTAAP. The many problems which would be faced in negotiating and ratifying such a trade deal are set out in Elek (2005) and (2007).

¹³ Several APEC governments have committed themselves to an attempt to negotiate a Trans-Pacific Partnership building on an earlier preferential trade agreement among Brunei, Chile, New Zealand and Singapore. As discussed in Elek (2009), **this negotiation will take time: even if a lowest common denominator agreement is negotiated, it may not prove possible to persuade the United States Congress to ratify it. In the meantime, there is little point in considering and even more ambitious set of negotiations.**

2.3 Finding mutual benefit

There are many opportunities for cooperation which are already perceived to be positive-sum games. For example, identifying and implementing ways to enhance the efficiency of ports and airports by means of harmonising customs and information exchange systems is already known to be beneficial to all Asia Pacific economies and APEC has been able to contribute to improved efficiency. APEC should concentrate its efforts in such areas.

This does not mean that APEC should ignore issues where negotiations are needed.

In the short-term, consultations and consensus-building among APEC governments can help advance negotiations in existing forums, especially the WTO **as well as** by helping to create new, or improved institutions. In the longer-term, APEC's work can help change some of the perceptions which create the need for **negotiations**.

APEC researchers and policy-makers can continue to gather evidence that the economy-wide benefits of reforms to promote economic integration greatly outweigh the short-term costs. They can help each economy to develop policy-making institutions which can boost the political influence of winners from proposed reforms, rather than allow decision-making to be dominated by losers. Member economies can also assist each other to implement policies which use some of the net gains from reform to compensate the losers from structural adjustment.

Such long-term efforts can be expected to change perceptions, creating more positive-sum games which can be dealt with by voluntary cooperation. However, it is not possible to set timetables for changing perceptions, so the short-term agenda needs to concentrate on the many dimensions of cooperation where governments already perceive potential mutual benefits.

3. Setting a practical agenda

The potential agenda set out in this Section is fully **consistent** with the Busan Roadmap endorsed by APEC leaders in 2005 and builds on the steps being taken to implement it, as outlined in the 2009 declarations in Singapore.

3.1 Trade in goods

As already noted, many Asia Pacific governments have already liberalised their trading regimes to an extent where only the relatively most sensitive products receive substantial border protection. In these cases, short-term politics dominates economics. Therefore, the pace of unilateral liberalisation has slowed substantially in recent years (Patrick 2005).

For the foreseeable future, further liberalisation of trade in sensitive products, will require negotiations elsewhere. However, voluntary cooperation in APEC can increase, immediately, the already large proportion of goods which are freely traded.

3.1.1 Eliminate nuisance tariffs

Where border barriers are already quite low (for example, tariffs below 5 per cent) APEC governments should be able to agree to set these at zero.¹⁴

This move would make only a modest direct contribution to economic integration, but the indirect effects may be even more important. The efficiency of ports and airports would be improved if clearance procedures could concentrate on just a few products which are dangerous or remain significantly protected.¹⁵

3.1.2 Sensitive products

Economic theory, including game theory, predicts that border barriers which are hard to reduce in WTO-wide **negotiations** are even harder to reduce in **negotiations** among pairs or groups of economies. **Therefore, it is not surprising that neither APEC, nor recent PTAs, have not made significant progress on these sensitive problems (Findlay et al, 2003).**

APEC should not expect to outperform the WTO as a negotiating forum. But APEC could take an innovative policy initiative to prevent the emergence of more sensitive products which could pose new problems in coming years.

3.2.3 Avoiding more sensitive products

In 1996, APEC leaders agreed, voluntarily, not to impose barriers to trade in information technology products, leading to the WTO-wide agreement on information technology products. That ITA agreement has already helped a rapidly growing share of trade to remain duty free. It should be possible to build on this precedent to cover more, or even all, newly invented products whose intellectual property rights (IPRs) are acknowledged.¹⁶

Such 'immunisation' of newly invented should be politically feasible. The comparative advantage of inventors of new products is created by the intellectual property embedded in new products. Therefore inventors are anxious to protect their IPRs.

Such initial advantage can be eroded. As products mature, former hi-technology products like silicon chips can become mass-produced commodities. Once

¹⁴ Many Asia Pacific governments are already willing to take this step in bilateral trade **negotiations**. **An APEC-wide decision to eliminate nuisance tariffs would be far more efficient than waiting for up to 200 PTAs to be ratified.**

¹⁵ Reducing border barriers to zero unilaterally could be seen to reduce leverage in negotiating PTAs. However, WTO rounds deal with the rates at which protection is bound, rather than applied. Moreover, the negotiating leverage provided by already negligible barriers is also negligible.

¹⁶ Immunising new products would need to involve more than agreeing to set zero tariffs. It would also be essential to prevent future recourse to other less visible means of protection which discriminate between domestic and international sources of competition. These issues are discussed in detail in Elek (2008).

production become less skill intensive, there will be growing pressure for protection against international competition, risking the emergence of more sensitive sectors.

This potential problem for the future could be avoided if inventors were required to make a choice between protection of IPRs, or the possibility of future protection by trade-distorting measures.

Technological pioneers can be expected to choose the current benefits embedded in IPRs . Before long, a large and growing share of trade could be immunised against protectionists.

3.2 Trade in services

The effective constraints on trade in services often well behind the border. For example, professionals may be able to cross borders fairly easily, but may not be allowed to practice their skills. It is almost impossible to stop capital crossing borders, but direct foreign investment can be blocked by many sector-specific regulations.

In many cases, the constraints on supplying services in other economies cannot be resolved by trade **negotiations**. Policy reforms to create competitive domestic markets will be more effective than seeking special provisions for international suppliers of services. APEC's potential contribution will be to facilitate these changes by sharing **experience of policy development** and institution-building.

APEC leaders could also use their influence in the G20 to put international transport on the WTO agenda and, over time, brought under normal WTO disciplines. That would be a very significant contribution to economic integration.

3.3 Contingent protectionism

Protection of domestic producers against international competition has shifted from transparent border barriers towards other less transparent policies, such as anti-dumping measures and countervailing subsidies. Such measures to prevent what is 'unfair' competition are often applied an arbitrary manner. They are becoming the new front line of **protectionism**.

The WTO can sometimes rule out some protectionist actions. But it takes a long time to resolve disputes, so the threat of arbitrary contingent protectionism is deterring investment to promote economic integration in line with evolving comparative advantage.

Many governments are reluctant to accept tighter disciplines on contingent protectionism and the problems cannot be resolved by negotiations alone. A negotiated agreement to tighten some restrictions on some forms of contingent protectionism tends to lead to new, potentially even less transparent, protectionism.

Progress depends on addressing with the underlying causes of contingent protectionism, such as anti-dumping measures. That, in turn, requires mutual

understanding of each others' regulatory systems, especially competition policy and fiscal policies.

In time, it should be possible to move towards some harmonisation of policies on subsidies to investors and producers and of competition policies to prevent anti-competitive behaviour in international as well as domestic markets.

3.4 Factors of production

3.4.1 Direct foreign investment

APEC's non-binding investment principles, agreed in 1994, have encouraged reforms of investment policy towards increasing **consistency with these principles (Davidson, 2003).**¹⁷

Looking ahead, these guidelines can be strengthened to deal with new issues as they are raised by the changing nature of both **trade and investment**. Governments can also be encouraged to set timetables for full national treatment of all investment, except in a short negative list of sectors.

2.4.2 Other capital flows

The experience of the late 1990s showed that free movement of all capital, especially short-term portfolio capital, needs an adequately developed financial system. APEC working groups are already designing ways to strengthen and deepen the capital markets in the region.

APEC leaders could commit themselves to an ambitious capacity-building program to develop the skills and institutions needed to enable more APEC economies to manage the risks of, and reap the benefits of, essentially free international movement of capital. Each economy can be encouraged to set out a strategy and its own timetable for meeting this broad objective.

2.4.3 Movement of people

Free movement of labour is a politically sensitive issue. The EU is finding it hard to sustain its commitment to free movement of labour. Therefore, it is not advisable to consider any deadline for full mobility of labour in the Asia Pacific. It will be more productive to continue to look for ways of facilitating what is permitted, following the precedent of the APEC Business Travel Card.

¹⁷ Indonesia has recently adopted new investment legislation in line with APEC's non-binding investment principles. See Jakarta Post, March 30, 2007, <http://www.thejakartapost.com/yesterdaydetail.asp?fileid=20070330.C06>

4..Implementing the agenda

The wide-ranging agenda set out above is only part of the larger, never-ending task of deepening **mutually beneficial** economic integration. It will be essential to set clear priorities, backed by a high-level effort to mobilise resources.

4.1 Mobilising resources for capacity-building

As discussed in Section 2, significant **economic gains can be made by reducing many costs or risks of international commerce with no need for adversarial trade negotiations. But that does not mean that cooperative arrangements are easy to implement.**

A wide-ranging capacity-building effort to support opportunities to facilitate trade and investment will need substantial human resource **development**. Investment in economic infrastructure will also require significant financial investment. The funds needed for rapid progress towards a single market are much greater than the capacity-building resources currently available to APEC, including from bilateral or multilateral development agencies.

The challenge is to mobilize substantial resources for capacity-building, without turning APEC into an aid organization. Just as APEC needs to learn to use the WTO, rather than to imitate it, APEC will need to learn to catalyse the resources needed for mutually beneficial economic integration in the region from the private sector and from MDBs, such as the World Bank and the Asian Development Bank.

This is not a revolutionary idea. Development banks have been lending to individual economies for decades, to enhance the capacity to promote growth. The APEC process can identify opportunities for them to work with groups of Asia Pacific economies, not just with individual economies. Thinking regionally can take advantage of economies of scale and scope. There are already many examples of public–private partnerships for capacity building, for example for training in ICT skills. APEC economies can share their experience to set up more of these partnerships.¹⁸

The 2009 statement of APEC Finance Ministers indicates they expect to involve MDBs to help upgrade necessary infrastructure, helping Asia Pacific governments to adopt:

sustainable and viable financing policies, and supporting technical assistance, capacity-building and knowledge-sharing initiatives to make infrastructure markets operate more effectively.

MDBs are also to:

conduct studies and provide recommendations to help facilitate, catalyse and channel private sector financing into these sectors.

¹⁸ The central role of capacity-building and the need for mobilising adequate resources is set out in detail in Elek and Soesastro (2000).

By focusing attention on dimensions of trade facilitation with high economic returns, it should be possible to attract substantial private investment, including through public-private partnerships.

4.2 Setting priorities

It is not realistic to expect to accelerate the pace of all the very many activities in the current TILF agenda. APEC leaders are most likely to mobilise resources by adopting a selective strategy, backing programs of cooperation which meet strict selection criteria. These will be programs:

- which most APEC economies perceive to be of high priority.
- where the constraints on reducing transactions costs are limits of capacity, rather than political sensitivities;
- which accelerate successful components APEC's existing work program;
- where **APEC-wide sharing of information, experience, expertise and technology** can add value;
- whose progress can be measured against well-defined performance criteria;
- where a significant economic rate of return can be expected; and
- where there are examples of successful private investment and/or lending by MDBs.

It will not be easy to find programs to meet all these desirable attributes, but there are some which do so. For example, APEC leaders could initiate, immediately, a substantial program to enhance the efficiency and security of trade logistics and supply chains.

4.3 Setting an example

The Joint Ministerial Statement of the 5th meeting of APEC Transport Ministers in March 2007 noted that:

“Substantial economic benefit can be gained through further work such as addressing the practical side of trade facilitation and reducing ‘behind-the-border’ barriers which add cost and time to the movement of goods and people and constrain efficient trade flows.”

As noted in Section 2.3.1, a 10 per cent increase in intra APEC trade could be gained by raising the efficiency of the trade logistics of all APEC economies to half way to the current APEC average. That translates to a high, fully commercial rate of return.

Adapting current best practice to the conditions in different Asia Pacific economies can be expected to foster growing commitment to inter-operability, including by harmonising communications and other standards **along with** security and customs clearance procedures.

An ambitious program to improve the efficiency and security of supply chains would also meet the other selection criteria listed above. The nature of the investments needed in both hardware and software is well understood and progress can be measured. The private sector and MDBs are already investing in this area in partnership with Asia Pacific governments. And the APEC process can add value by designing compatible initiatives which focus on linkages among economies, rather just within individual economies.

Work to improve the efficiency of supply chains is already a high priority for many Asia Pacific economies. Singapore's Prime Minister noted recently that ASEAN has:

decided to pursue a Connectivity Initiative, to enhance the land, sea communications, internet, the physical, as well as people and system links between the ASEAN countries, so as to make ASEAN a more integrated entity, which is able to be a significant partner to China, India, America, and other regions of the world. (Lee Hsien Loong, 2009b)

That suggests that ASEAN economies can act as pathfinders. APEC-wide sharing of relevant information, experience, expertise and technology to enhance the capacity of ports and airports can accelerate the upgrading of ASEAN capacity. Moreover, the benefits of improved procedures in Southeast Asian ports can be multiplied by making them as compatible as possible with those of other trading partners.

Initiating an ambitious APEC program to enhance the capacity of the region's ports and airports would demonstrate how Asia Pacific governments intend to move towards a single market in a practical way, suited to the nature of the APEC process.

APEC leaders could also ask MDBs already active in the Asia Pacific region to prepare projects to promote a coordinated effort in several economies, rather than lending to just one at a time. Once the potential gains of well-defined investments are identified, such projects could be financed by the private sector capital, means of public-private partnerships or MDBs loans.

4.4 Building on success

There are excellent prospects for an APEC-initiated program to enhance trade logistics in the region, perhaps beginning with one group of pathfinder economies.

Once there is a working precedent for ambitious voluntary cooperation resulting in significant progress towards a single market, it will be easier to agree on further cooperative initiatives:

- Deepening: best practice continues to evolve rapidly especially in sectors which make intensive use of information technology. By the time some Asia Pacific ports reach half the efficiency possible with 2009 best practice, there will be scope to do more.
- Broadening beyond transport and communications: there will be a strong incentive for those with expertise in other areas of economic integration (for

example on standards and conformance) to define programs which also meet strict selection criteria.

- Widening based on APEC's pathfinder principle: once some economies gain from successful integration initiatives, others are very likely to want to join such cooperative arrangements as soon as they are able to do so. APEC can help them to create the necessary capacity.

ASEAN could be the pathfinder in many cases. Learning from their own as well as the European Union's **experience, Southeast Asian leaders know that a free trade area just scratches the surface of genuine economic integration; hence their determination to create an ASEAN Economic Community.**

APEC's policy development work help ASEAN to move towards their 21st century ambition. ASEAN economies can draw on APEC's work as well as the experience of other economies to pioneer practical initiatives. Hopefully, their cooperative arrangements will be designed so that that other governments can join when they are able to do so.¹⁹

5 Conclusion

Voluntary cooperation can promote ever-deeper economic integration. But there will always be more to do.

The EU **experience** has shown that a creating a trading bloc with no border barriers is nowhere near enough for genuine economic integration. So an **APEC-wide** bloc is not an adequate vision for APEC, even if it were remotely feasible.

The EU adopted a much more modern vision of a single market thirty years ago. Asia Pacific economies cannot afford to waste a decade or more before they think beyond creating yet another trading bloc.

The European **experience** also shows that creating a single market is a major challenge, which is never complete. While much has been done, European Union economies still do not have a single market for many services.

If APEC leaders adopt a vision of a single market, they will need to pursue it patiently, avoiding unrealistic expectations and deadlines which cannot be met. In the Asia Pacific region, a single market needs to be seen as distant, but useful vision which will need to be approached in an way which accepts diversity.

Deep economic integration requires extensive policy convergence. In a voluntary process of cooperation among diverse economies, such convergence can be

¹⁹ Ideally cooperative arrangements among Asia Pacific economies should be designed as 'open clubs'. As explained in Elek and Soesastro (2008) it would be desirable to adopt principles which do allow accession in practice, not just in theory. In particularly initiatives for integration should not seek to divert economic activity away from other economies.

expected where it is consistent with the interests of **participants as well as** with market forces.

In a region where governments are not willing to cede much sovereignty to a supra-national authority, ever-deeper economic integration integration will need patient consensus-building to identify opportunities for mutual benefit. That will need to be followed by more patient cooperation to create the capacity to seize these opportunities.

Tangible process will depend on mobilising substantial resources and drawing on a wide range of skills. **That will take time. To sustain attention and commitment to this new vision it will be essential to start with no more than a few programs to generate momentum and confidence.**

Policy development can proceed on all the many useful part of APEC's work program. But high-level endorsement should be reserved for initiatives which meet strict selection criteria such as those proposed above. **These are the programs with a high probability of success in terms of reaching measurable medium-term milestones. They are the initiatives which can attract the necessary investment in capacity-building based on the expectation of high economic rates of return.**

If APEC leaders adopt this approach, APEC can look forward to recording tangible achievements, year after year. At the same time, it can set an example for global, not just regional economic integration, using an approach which accepts diversity and does not need enforcement by a supra-national authority.

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