

## Market-driven economic integration in the 21st century: potential roles for APEC, WTO and the G20

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### Abstract

*Economic integration in the 21st century is driven largely by market signals, rather than by inter-governmental trading arrangements. It also means much more than "free trade." Integration needs to consider all of the ways 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.*

*Except for a small number of sensitive products, especially in agriculture, most goods and services face no, or very low, formal trade barriers. Reducing border protection of the remaining sensitive products will certainly require negotiations, but they are no longer the most strategic obstacles to economic integration.*

*These days, the problems of most concern of those engaged in international commerce are logistics, communications, coping with security concerns and with different regulations in other economies. The effective constraint to designing and implementing cooperative arrangements to reduce such costs or risks of international commerce is the capacity to do so, rather than political resistance. Inter-governmental negotiations are not always necessary to deal with these practical issues.*

*Therefore, it should be possible to have a logical division of effort between APEC and the WTO in the Asia Pacific with the WTO dealing with those issues that do need to be negotiated; and APEC dealing with the many other issues where negotiations are not needed. In the longer term, an efficient division of labour could also emerge between the G20 and the WTO.*

**Keywords:** *market-driven economic integration, potential roles, APEC, WTO, G20.*

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## 1. Economic integration

A hundred years ago, international commerce was dominated by trade in commodities and manufactured products. These manufactures were either simple things like knives and forks, or more complex products like sewing machines or locomotives, made in a single factory. In those days it was possible to interpret economic integration as the removal of border barriers to trade in goods, such as tariffs or quotas.

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.

In other words, international commerce is an intertwined flow of goods and services accompanied by international movement of capital (including direct foreign investment), people and information.

Among these, trade in services is growing more rapidly than trade in goods. International investment is growing faster than trade in goods or services, while international exchanges of information are essential to all international commerce (Hummels, 2008).

Trade in goods, which are a shrinking proportion of international commerce, has itself been transformed quite thoroughly. The most rapid growth is in intra-industry and intra-firm trade. Components, whose value is increasingly made up of intellectual property and information technology are being moved along supply chains involving several economies.

It is becoming less and less possible to ascertain where a product is made or who owns the firms which add value in different locations. Against this background, it is ironic that rules of origin are becoming a major tool of trade policy as preferential trading arrangements (PTAs) proliferate.<sup>1</sup>

## 2. Market-driven economic integration

The Asia Pacific is already becoming integrated, day by day, essentially by the private sector responding to market signals.

The very diverse resource endowments of Asia Pacific economies create the potential for integration. This potential is being realised by market forces, facilitated by:

- spectacular improvements in information technology;

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<sup>1</sup> Trading arrangements which depart from the fundamental principle of non-discrimination are permitted under various provisions of the GATT/WTO (for example Article XXIV of the GATT). Such agreements are sometimes described as free trade areas (FTAs) or regional trading arrangements (RTAs). This paper describes them as preferential trading arrangements (PTAs), since they involve discrimination among trading partners.

- falling costs of transport;
- and the extensive, largely unilateral, 'opening to the outside world' by APEC economies.

Border barriers to trade are already very low, for all except a few sensitive products. These sensitive products account for an already small, and rapidly shrinking, share of trade. The remaining border barriers are no longer the most strategic obstacles to regional economic integration.

For most people actually engaged in international trade and investment and in operating supply chains, the real issues are no longer old-style border barriers. For them, the significant impediments to international commerce are:

- logistics;
- communications especially the electronic exchange of data;
- coping with security concerns; and
- coping with different, and not always transparent, regulations in other economies.

The EU experience has shown that the absence of border barriers to trade is nowhere near enough. The EU had 'free trade' 40 years ago, but it took them 20 more years to realise that genuine integration needs attention to a huge array of non-border barriers, such as incompatible regulations and standards.

The North American Free Trade Agreement (NAFTA) experience has reinforced this awareness: 10 years after signing NAFTA it was still taking 2 to 3 days to move a container across land border crossings, due to problems with security, safety standards and union restrictions.<sup>2 3</sup>

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

- OECD (2005) research indicates that the largest potential gains from cooperation among Asia Pacific governments are no longer from reducing border barriers, but from looking behind the border;
- The Asian Development Bank has recently drawn attention to the potential to save up to 1 per cent of the value of traded products by reducing port clearance times by just one day;
- Research by the World Bank (2006) 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.

The shortfall in investment to realise these gains are an international market failure,

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<sup>2</sup> A recent pilot scheme to allow some Mexican trucks to cross the border was cancelled by the United States Congress in early 2009, leading to trade retaliation by Mexico see *The Economist*, March 21, 2009, page 40.

<sup>3</sup> In a recent assessment of the changing nature of international commerce, Fung(2005) has drawn attention to the increasing need for concern about efficient communications and logistics.

which institutions like APEC should be able to help correct. It should be possible to realise the huge potential gains listed above, if existing institutions were up to the challenge.

### 3. Institutional options

The GATT/WTO system has been a huge success. It has created a rules-based global trading order where most products do not face significant traditional border barriers such as tariffs and quantitative restrictions; allowing a steadily growing number of economies to trade their way out of poverty.

But it is no longer efficient to rely solely on an institution which was created to deal with international trade as it was 60-70 years ago, when it was still dominated by commodities and finished manufactures.

An international trading environment where most products face low formal border barriers to trade needs to be complemented by:

- reducing uncertainty about future market access: for example anti-dumping actions or other arbitrary or discriminatory measures to deal with trade tensions;
- reducing physical and administrative bottlenecks, such as shortfalls in infrastructure, ranging from harbours to telecommunications;
- harmonising domestic legislation and rules, such as those relating to competition policy or product and process standards.

The need to deal with these issues is, at last, becoming well understood. But it is still assumed that we have to deal with the remaining traditional border barriers to trade before we move onto these other dimensions of integration. WTO and PTAs are all trying to tackle both sets of issues at the same time, but none of them can do so efficiently. It is time to look for a sensible division of effort among institutions.

In the WTO, progress is held up by the difficulty of dealing with sensitive products like agriculture and labour-intensive manufactures. The Doha Round will, nevertheless, be concluded in due course. But that will leave many more issues to resolve. It is no longer possible to expect all dimensions of economic integration be dealt with by WTO Rounds.

On one hand, the WTO negotiating agenda is already too wide; so achieving a single undertaking takes far too long. On the other hand, agenda is also too narrow; it is no longer able to cope with all the new dimensions of international economic transactions and the impediments to them.

These shortcomings of the WTO are accelerating the growing reliance on preferential trading arrangements (PTAs). Their proliferation will not end with the end of the Doha Round. With careful choice of partners and a cavalier interpretation of WTO disciplines on discriminatory trading arrangements, PTAs can be negotiated while largely avoiding

politically difficult decisions to liberalise trade in sensitive products.

By avoiding the most sensitive issues, PTAs can be completed much more rapidly than WTO negotiating rounds. These bilateral or regional deals can lock in low rates of protection for almost all goods and they are making some progress on trade in services. They are also beginning to address new issues such as regulatory impediments to international commerce. However, PTAs are promoting integration only with trading partners which do not threaten deeply entrenched producer interests.

PTAs rely on discriminatory, product-specific rules of origin to avoid indirect competition to sensitive products. Such rules of origin run counter to market-driven globalisation and impede opportunities for fine specialisation along lines of comparative advantage to take advantage of falling costs of transport and communications.

There is growing concern about the convoluted network of overlapping PTAs, relying on trade-diverting rules of origin, but no government can risk being left out of PTAs.<sup>4</sup>

The concerns about proliferation of bilateral PTAs are leading to attempts to link and rationalize them. However, it is not easy to expand the membership of preferential arrangements, many of which have been tailor-made to avoid hard political decisions of existing members.<sup>5</sup>

There is certainly no realistic prospect of negotiating a Free Trade Area of the Asia Pacific which would lead to genuine free trade among all APEC economies. An attempt to negotiate an APEC-wide agreement would need to deal with those same difficult issues which have slowed WTO negotiations and could not be completed in any meaningful time frame. Moreover, any eventual outcome could only lead to a lowest common denominator result on border barriers, while delaying any alternative means of addressing all the many other dimensions of economic integration.<sup>6</sup>

If APEC tries to deal with all issues at once to negotiate a single FTAAP undertaking then we risk the same fate as the Doha Round. There would be protracted negotiations, with progress held hostage to the vested interest of ageing Japanese rice farmers and billionaire Florida sugar barons.

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<sup>4</sup> It is beyond the scope of this presentation to set out more of the arguments for refocusing attention to multilateral negotiations, rather than on hundreds of more PTAs. Bhagwati (2008) and Fung (2005) have done so from an analytical and a practitioners point of view, respectively.

<sup>5</sup> For example, the new PTA linking the 10 ASEAN economies with Australia and New Zealand contains a clause that the new agreement does not override any of the provisions of existing agreements involving the participants. Negotiations continue to conclude further bilateral PTAs among the economies involved, so the new 12-member agreement has had a limited effect in terms of rationalising the proliferation of agreements.

<sup>6</sup> As an example of one of the many difficult issues which would need to be confronted: a meaningful agreement involving the United States and major East Asian economies would require a significant renegotiation of the North American Free Trade Agreement (NAFTA) rules of origin designed to avoid new competition from East Asian imports.

#### 4. Looking beyond trade negotiations

Fortunately, there is no need to negotiate a comprehensive APEC-wide agreement before making worthwhile, progress in terms of ever-deeper economic integration among all the Asia Pacific economies that want to do so.

There certainly no need to assume that promoting integration among pairs, or groups, of economies needs to begin with dealing with the remaining border barriers to trade in the few sensitive products which remain protected by traditional border barriers.

Impediments to trade, investment and other international economic transactions can be grouped into:

- problems where short-term costs are perceived to exceed long-term benefits, so that inter-governmental negotiations are needed for progress; and
- other matters where at least some governments perceive the potential of mutual benefit from cooperation: In these cases, cooperative arrangements to reap the shared benefits do not need to be negotiated.

Once we divide the potential dimensions of cooperation into those which do, or do not require negotiations, we can see that they can be viewed as international games. On closer examination, cooperative arrangements to reduce many of the costs and risks of international economic transactions are positive-sum games with potential gains to all of the economies involved. Therefore, there is no need for negotiations among these governments to persuade them to cooperate.

While negotiations may not be needed, governments will usually need to consult closely in order to design and implement, and in some cases enforce, cooperative arrangements, for several reasons.

Firstly, cooperative arrangements may require substantial work to devise suitable legislation and administrative arrangements. These days, many policies rely extensively on information technology and governments may need to consult and coordinate the adoption of compatible software and training in its use. Accordingly, implementing new cooperative arrangements will need substantial capacity-building. That, in turn, requires human and financial resources. As discussed below, while many dimensions of economic integration need not be negotiated among governments, they will need to be backed by adequate resources.

Secondly, most options for cooperation are multi-level games. Governments may be aware that cooperation on a particular matter can be of mutual benefit, due to the potential economy wide gains to all those involved. However, some economic agents may perceive themselves to be losers. In some cases, such as some harmonisation of customs procedures, inefficient or corrupt customs officials can lose from harmonisation based on better information technology. However, the potential gains to the economies involved are usually

perceived to exceed, by a very large margin, the potential losses to some officials. Indeed, all APEC governments are participating constructively in APEC's work to improve and harmonise customs procedures. Each of them needs to devise domestic regulations to ensure internationally agreed procedures are followed. But there is no need for a supra-national authority to enforce these domestic regulations, since each government has an interest in their application.

In other cases, the vested interests of some economic agents can outweigh potential economy wide gains. Perhaps the best known example is the political economy of liberalising trade in some sensitive products, such as some basic crops. In these cases, the political power of domestic producers seeking continued shelter from international competition may be large enough to resist reforms, since the short-term political cost to governments outweighs the long-term political gains from faster economic development. Inter-governmental negotiations are then needed, so that governments can point to short-term gains of market access in return for granting access to others. Moreover, an international institution with powers of enforcement (in this case the WTO) is needed to make sure governments cannot make short-term political gains by renegeing on agreements.<sup>7</sup>

The example of efforts to liberalise the remaining border barriers to sensitive products can be used to explain a grouping of opportunities to promote economic integration into those which do, or do not, require inter-governmental negotiation is not the same distinction as the one between liberalisation and facilitation of trade or investment.

For example, inter-governmental negotiations have not been needed for all dimensions of trade liberalisation. Much of the actual liberalisation of applied rates of protection of most products and extensive liberalisation of restrictions on direct foreign investment have been made unilaterally, not in the context of negotiations. That has certainly been the case in Australia and China. In another example, the APEC-wide, then WTO agreement to prevent restriction of trade in information technology products did not require difficult negotiations.

The many challenges of trade facilitation can also be grouped into those which do, or do not require negotiations.

On one hand, governments may need to negotiate mutual recognition of some products standards or professional qualifications in return for mutual recognition of others.

On the other hand, seizing many opportunities to reduce costs or risks of international commerce do not require negotiations, since governments already perceive them to be positive-sum games, leading to cooperative arrangements which are in the interest of all participants in these arrangements. Practical examples include the many opportunities (including customs harmonisation) to enhance the efficiency and security of supply chains with, as already noted, potentially huge economic returns to all the economies involved.

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<sup>7</sup> Actual and potential international economic cooperation can be classified into many types of multi-level games. Some of these and their implications for negotiations or for enforcement are discussed in the Appendix.

On issues such as improving business mobility or better trade logistics, inter-governmental negotiations are not only unnecessary, but they are not sufficient. Any tangible, practical progress needs more than statements of intent: The effective constraint on action is not political will, but the capacity to design and implement compatible institutions and procedures.<sup>8</sup>

A distinction of opportunities to promote economic integration into positive-sum games which do not require negotiations and other games where negotiations are needed should also lead to an efficient division of effort between institutions.

Institutions like APEC, where cooperation is voluntary, can expect to make progress on matters where cooperation is already perceived to be positive-sum game.

The successes of the APEC process have, indeed, been in areas where progress was seen to be of mutual benefit or in perceived self-interest of member economies.

As set out in the 2005 mid-term stocktake of progress, APEC governments have made substantial progress. There has been significant unilateral reduction of traditional border barriers to trade, encouraged by means of peer pressures and a broad commitment to move towards free and open trade and investment. Voluntary collective action among Asia Pacific economies is already saving billions of dollars per year by practical cooperation to reduce administrative and logistic delays and costs, for example by harmonising customs procedures.

Conversely, the APEC process has not made appreciable progress in areas where short-term political considerations outweigh potential long-term benefits. In these areas, such as reducing remaining border barriers to trade in sensitive goods or services, negotiations are needed.

Such inter-governmental negotiations cannot be conducted in a voluntary process of cooperation like APEC; they need to be left to the WTO or negotiations among smaller groups, or pairs of governments.

## 5. A new division of effort

Based on the above discussion, it should be possible to agree on a logical division of effort in terms of promoting market-driven economic integration.

Policy-makers could agree that promoting economic integration (liberalisation or facilitation) does not always need to be negotiated. They should then accept that voluntary processes of cooperation have comparative advantage in dealing with issues where

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<sup>8</sup> Almost all recent PTAs contain chapters dealing with opportunities to facilitate trade or investment, for example by enhancing the business mobility and encouraging greater use of e-commerce. Typically these are statements of positive intentions. Substantive cooperation on these behind-the-border issues then requires capacity-building. For example, free movement of business people cannot be achieved by negotiation, but needs patient work to set up compatible information technology to allow such movement to be combined with obvious security concerns.

inter-governmental negotiations are not needed, but have no comparative advantage in trying, then failing, to deal with issues where negotiations are needed. Issues where negotiations are needed should be left to institutions or processes designed to conduct negotiations.

We could then use processes and organizations like APEC to help design and implement cooperative arrangements to seize potential mutual benefits where negotiations are not needed. As discussed already, there is enormous scope for all-round gains from work on mutual recognition of standards and harmonizing administrative procedures, including to improve the efficiency and security of supply chains.

On other issues where negotiations are needed for short-term progress on liberalising or facilitating trade and investment, it should be possible to use the WTO. Both APEC and the WTO need new strategies and a new sense of direction to rise to the many remaining challenges of economic integration.

## **6. The limits of Asia Pacific cooperation**

For much of its life, the APEC process has been distracted by calls to negotiate an APEC-wide trade deal (in the 1990s it was called PAFTA, more recently it is called a FTAAP). As already explained, this is not a realistic prospect, but the pressure for APEC to try to imitate the WTO is not likely to recede for some time. This distraction will continue to limit the capacity to deal with the matters where APEC has comparative advantage. APEC will continue to do useful work on facilitation, but on a very modest scale, falling well short of the vast potential of APEC to integrate Asia Pacific economies.

While many dimensions of economic integration, particularly trade facilitation, do not need negotiations, that does not mean they are easy. Implementing practical arrangements, for example to improve supply chains need capacity building. For example, the returns from investment in transport infrastructure are multiplied if combined with programs to strengthen human resources, policy frameworks and institutions.

A wide-ranging capacity-building effort to support many opportunities to facilitate trade and investment will need substantial human resources. And deploying a large number of people with relevant expertise to support APEC-wide capacity-building efforts will need financing which is considerably greater than the capacity-building resources currently available to APEC, including from bilateral development agencies.

The challenge is to mobilize more resources for capacity-building, without turning APEC into an aid organization. APEC is not designed to implement large, region-wide capacity-building programs. Moreover, the resources needed are well in excess of what APEC governments would grant to an APEC bureaucracy.

Just as APEC needs to learn to use the WTO, rather than to imitate it, APEC will need to learn to catalyze the resources needed for mutually beneficial economic integration in the

region from the private sector and international financial institutions such as the World Bank and the Asian Development Bank.

The APEC process has not been able to do much along these lines so far. And it will not be able to do much better while the attention of APEC leaders is distracted by the futile dream of a FTAAP.

## 7. Focusing the WTO

Unlike earlier rounds, the Doha Round of WTO negotiations are not likely to be followed by another. There are too many issues and too many players to expect a worthwhile outcome in a reasonable time. That creates a high risk that most negotiations to reduce those impediments where negotiations are still needed will shift to more and more PTAs.

To avoid a continued drift away for non-discriminatory trade, the WTO needs a new strategy.

It is urgent to escape from the self-imposed constraint of seeking a single undertaking on a wide range of often unrelated issues. Experience has shown that it is possible to deal separately with different set of issues in the WTO. The plurilateral protocol of government procurement and the WTO information technology agreement are useful precedents. It should be able to build on them.

Options include:

- negotiations focused on limiting the uncertainty due to the scope for WTO-consistent protectionism, for example by contingent protection, such as anti-dumping and trade-distorting subsidies, and the option of raising applied rates to bound rates of protection;<sup>9</sup>
- negotiations on trade in services could lead to an agreement which consolidates the gains which are being made in PTAs;
- a plurilateral agreement on international investment;
- the information technology agreement and the ongoing work towards free trade in environmental products could lead to an agreement to immunise all new products from rent-seeking protectionists (Elek, 2009);
- seeking consensus on limiting new protectionism as part of the negotiations to limit greenhouse gases in the atmosphere.

If the WTO could concentrate on a few issues which governments and the private sector both see as important, rather than trying to negotiate everything at once, there would be less need to resort to discriminatory PTAs.

In some cases, negotiations can be conducted among those governments who are

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<sup>9</sup> Aaditya Mattoo and Arvind Subramanian (2009) have recently called for a crisis round of WTO negotiations to address this set of issues.

genuinely interested in dealing with such issues. Progress need not be held hostage to the most recalcitrant. The gains from new agreements will accrue mostly to those involved. The costs will largely fall on those who forego the opportunity to shape new agreements on important new issues. To protect the long-term interests of those not initially involved in plurilateral arrangements, it would be essential to design all new arrangements so that others could join them as soon as they demonstrated their willingness and ability to adhere to relevant disciplines and undertakings.

APEC leaders represent a very significant proportion of the global economy. It could be possible for them to exercise collective leadership in the WTO to set such a new strategy and the agenda for the coming decade. Unfortunately, APEC leaders have not been able to act cohesively on strategic issues in the WTO so far. It may be necessary to look to the G20 to bring about major reform.

## 8. Opportunities for the G20<sup>10</sup>

The global economy has become more integrated since the APEC process was established in 1989 and most Asia Pacific economies have strong and growing links to the rest of the world.

China is already an economic giant and India may be able to become one quite soon. The structural changes needed to accommodate either of these emerging giants will not be easy. We cannot expect such politically difficult adjustments to be possible in anything less than a global scale. Therefore, it is time to think about facilitating economic integration among all the significant economies of the world rather than in just in the Asia Pacific.

The G20 process could rise to this challenge provided it can gain momentum and legitimacy – that, of course, remains to be seen.

The second, April 2009 meeting of leaders give hope that the G20 can become an ongoing process which can help solve the current short-term global financial crisis and the associated temptation to flirt with protectionism. G20 leaders could then address other looming problems such as climate change. Then it may be possible to move on to promoting global economic integration.

For the foreseeable future the G20 will be a voluntary process of cooperation. There is no expectation of a new supra-national authority to enforce G20 decisions. As in the first two meetings, any agreements to coordinate policies will be based on consensus. At the same time, a consensus among such an influential group of economies and governments can be expected to lead to agreements in international bodies, including the WTO, which are designed to reach binding undertakings.

In the near future, G20 leaders can help to complete the Doha Round. That will not be

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<sup>10</sup> This section draws on Elek (2009).

easy, so there is little prospect of agreement to launch another one. Rather than trying to launch a new round, it would be more efficient for G20 leaders to use their influence to achieve WTO agreement on specific matters, including the list of options discussed above.

Since the G20 is a voluntary process of cooperation, it should not seek to conduct negotiations in that forum. In particular, G20 leaders will be also be aware that any attempt to negotiate a PTA among themselves would be just as difficult as a new WTO round. They should also realise that an attempt to set up a trading arrangement to discriminate against all the smaller economies of the world would undermine the need to establish their legitimacy.

It should be possible for the G20 to promote economic integration, in line with the comparative advantage of the WTO and of voluntary cooperation, by:

- using the WTO to address issues where negotiations are needed
- promoting voluntary cooperation on the many issues where inter-governmental negotiations are not needed.

### *8.1. Learning from experience*

The G20 could draw on the experience of APEC to address the many opportunities to promote further economic integration among their economies and the rest of the world. G20 leaders could begin by assessing whether some of the successes of APEC in facilitating trade and investment could be extended to a wider geographic coverage.

They could also learn from some of the problems encountered by the APEC process. One of these is to avoid creating excessive expectations.

The EU has achieved a much higher degree of integration than the Asia Pacific. However, even the EU has more to do. For example, the recent debate about 'Polish plumbers' demonstrated that there is no single market for many services. Moreover, as technology evolves, there will always be more scope to reduce costs and risks of international economic transactions. The task of economic integration is never-ending.

Therefore, the G20 should avoid setting deadlines such as APEC's Bogor goal of achieving free and open trade and investment by 2010 for developed economies and 2020 for others. Despite its record of promoting practical economic integration, as summarised above, APEC is widely dismissed as a failure because it is not going to achieve the ideal of fully free and open trade and investment by these dates.

If G20 leaders decide to promote economic integration among such a diverse group, would be advisable to avoid creating such expectations. In the absence of a supra-national authority, progress needs will depend on widening the range of issues where at least some governments see mutual benefits from implement cooperative arrangements: patience will be more useful than deadlines.

## 8.2. A long-term vision

Rather than setting over-ambitious targets, G20 leaders could set out a vision of what is to be achieved a vision which reflects the practical needs of those involved in international commerce, rather than a vague ideal such as free and open trade and investment which can never be reached in full.

Over time the G20 could be help to complement a world of already low border barriers to much of trade and investment with an environment of transparency, best practice, and consistency of regulations, including:

- competition policy, regulations on government procurement;
- mutual recognition of standards and qualifications;
- efficient communications, including e-commerce; and best practice logistics.

Most G20 governments are interested in moving towards a vision of an integrated global economy, in the terms set out above. In many cases, doing so will not require negotiations.

To a large extent, creating such an environment among diverse economies involves helping those that want to adapt current best practice by sharing information, experience, expertise and technology. Best practice will continue to evolve, so there will always be scope for such cooperation.

## 8.3. Setting positive examples

It is not realistic to expect all G20 economies to act simultaneously on particular issues. Not all of them may be able to adopt the same technology at the same time, for example to improve the electronic exchange of information to allow faster security clearances for loading cargo. However, some can set positive examples for others.

In the APEC process, governments that perceive mutual benefits in potential cooperative arrangements are encouraged to implement them. At the same time, such arrangements are designed so that others are encouraged to do so as soon as they wish to do so, helped by the experience acquired by those which pioneered these arrangements.<sup>11</sup>

Such a 'pathfinder' approach can be adopted by the G20. That would make it possible for some G20 economies to pioneer potentially global co-operative arrangements to promote economic integration. Based on the achievements of APEC in terms of trade facilitation, the APEC participants in G20 can be early pathfinders.

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<sup>11</sup> APEC interested in cooperative arrangements are encouraged to set positive examples for others, which can join later if they wish to do so. This pathfinder principle, first noted in the 1994 Bogor Declaration was reaffirmed by APEC leaders in Shanghai in 2001.

APEC governments which have implemented harmonisation and other measures to improve their customs procedures could encourage other economies, including other G20 economies, to adopt similar measures, sharing the information, experience, expertise and technology to help them to do so.

In the longer term, some or all G20 economies could act as pathfinders for the rest of the world. If G20 economies implement practical arrangements to reduce the costs and risks of international commerce among them, others will be interested in joining such cooperative arrangements to facilitate trade and investment. They should be encouraged to do so as soon as they are willing and able to adopt relevant policy norms and administrative arrangements.

#### **8.4. *Mobilising resources***

As mentioned above, implementing arrangements to reduce transactions costs, for example by enhancing the efficiency and security of supply chains needs capacity-building. Tangible progress will, in turn, require considerable human and financial resources. The APEC experience has shown that it is not easy to mobilise resources for capacity-building.

The G20 could anticipate then overcome this potential problem. The initial two meetings have already demonstrated that G20 leaders are quite willing to use their collective influence to direct the structure as well as the priorities of international financial institutions, such as the World Bank. It should be possible to draw the attention of development banks to commercially viable opportunities to invest in the software and hardware needed for a better connected world. The market failures which have led to underinvestment in improving the efficiency of ports and airports in the Asia Pacific and elsewhere could be gradually corrected.

### **9. Conclusion**

In the 21st century, economic integration means much more than "free trade." 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.

Ever-deeper integration in all these ways is being driven by market signals. Such market-driven integration can be accelerated by cooperation among governments to reduce the remaining impediments to international commerce.

Except for a small number of sensitive products, especially in agriculture, most goods and services face no, or very low, formal trade barriers. These days, the problems of most concern of those engaged in international commerce are:

- logistics;
- communications especially the electronic exchange of data;
- coping with security concerns; and
- coping with different regulations in other economies.

In most of these areas, there is a widespread awareness of shared potential gains from practical arrangements to reduce the costs and risks of international economic transactions. The effective constraint to designing and implementing such arrangement is the capacity to do so, rather than political will. Therefore, negotiations are not always necessary to promote mutual beneficial economic integration.

For the foreseeable future, further reduction of the protection of currently sensitive products will require negotiations. On the other hand, seizing many opportunities to reduce costs or risks of international commerce do not require negotiations, since many governments already see them as be positive-sum games, leading to cooperative arrangements which are in the interest of all those involved. Practical examples include the many opportunities to efficiency and security of supply chains, with potentially huge economic returns to all the economies involved.

It should be possible to have a logical division of effort between APEC, a voluntary process of cooperation, and the WTO in the Asia Pacific with:

- the WTO dealing with those issues that do need to be negotiated; and
- APEC dealing with the many other issues where inter-governmental negotiations are not needed.

At present, we do not have such an efficient division of effort, based on the comparative advantage of APEC and the WTO. It will be difficult to achieve it while attention of APEC leaders is distracted by the false hope of an APEC-wide discriminatory trading arrangement.

In the longer term, an efficient division of labour could emerge between the G20 and the WTO, if the G20 can achieve both momentum and legitimacy.

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## *Appendix<sup>12</sup>*

When considering the merits and feasibility of options for international cooperation, whether it be bilateral, regional or multilateral, it is essential to take account of the incentives for and against cooperation, at least at the level of governments and of economic agents (including individual and firms).

The examples discussed in the text illustrate that inter-governmental negotiations will, or will not, be needed to implement cooperative arrangements, depending on the relative costs and benefits at various levels, and whether the costs and benefits occur at different times.

Those are just a few among many types of potential multi-level games. In some cases, there could be many levels, possibly reflecting the interests of local government authorities, of individual ministries, of individual firms and consumers and of special interest lobby groups.

The following table sets out some more examples.

For each category (there are potentially far more than the four listed) it would be helpful to consider the need for some of the following in order to assess whether voluntary cooperation is feasible and how to improve prospects for successful cooperation:

1. Specific guiding principles
2. Sharing relevant information, experience, expertise and technology
3. Review early implementation to build confidence in the effectiveness and benefits of cooperation
4. Assess the need for any enforcement mechanisms

The first two components are almost certain to be useful for all types of cooperation. Objective monitoring can be particularly useful to encourage voluntary cooperation in the second type of game shown in the table, such as the multi-level game of trade liberalisation. By demonstrating the benefits of liberalisation already undertaken, including by other governments, it is possible to change the perceptions of economic agents. Experience of the benefits of voluntary liberalisation by some economies, including in East Asia, continues to reduce the number of sensitive products where negotiations are still needed for further liberalisation.

Means of enforcement, as against review, are necessary only for the third and fourth types of cooperative games set out in the table. For successful cooperation on such issues, including efforts to harmonise competition laws, it will be essential to develop the capacity to discipline firm-level behaviour in international markets. But cooperation may not require international institutions with powers of enforcement. It can be sufficient to use harmonised

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<sup>12</sup> The appendix draws on Elek(1995).

legal and regulatory domestic powers of individual governments.

Type of game	Incentive to cooperate		Example(s)	Comments
	Government-level	Firms or individuals		
Pure positive-sum game	Positive	Positive	International exchange of data and experience to control pandemics	All governments keen to cooperate, need capacity-building, but no need to negotiate
Mixed-incentive multi-level game	Positive	Positive for most, but negative for some	Trade liberalisation; mutual recognition of standards or qualifications	Negotiations needed if the political power of short-term losers exceeds political gain from economy-wide benefits
Government control of firm-level behaviour in international markets	Positive	Negative in some circumstances	Harmonisation of competition laws	Will need domestic legislation to enforce voluntary harmonisation of laws
Mixed incentives at both levels	Positive in long-term but negative in short-term	Positive in long-term but negative in short-term	Control of emissions of greenhouse gases	Cannot be implemented through voluntary cooperation; international negotiations essential

On the other hand, enforcement of adherence by governments is essential for the fourth type of international game, such as international cooperation to limit greenhouse gases in the atmosphere. Such items do need negotiations and should not be put on the agenda of forums of voluntary cooperation.