

**INTO THE DUSTBIN OF HISTORY:  
ECONOMISTS AND ASIA-PACIFIC ECONOMIC COOPERATION**

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## INTO THE DUSTBIN OF HISTORY: APEC\*

Asia-Pacific Economic Cooperation (APEC) is a proposed Free Trade Area among the nations of the Asia-Pacific. The idea of a Pacific Free Trade Area was first conceived in the 1960s principally in academic and business circles as a response to the establishment of the EC, a closed, discriminatory Free Trade Area (FTA). Over the next thirty years, economists developed and nurtured an alternative vision of FTAs, open regionalism: non-discriminatory FTAs. In 1989, that vision became the spawning seed of APEC. Within four short years APEC had grabbed headlines around the world when President Clinton and other world leaders attended APEC's Seattle summit, raising the organization to its highest status. At the 1994 meeting in Bogor, Indonesia, APEC leaders issued a declaration to implement open regionalism in the Pacific, to free trade in the region by 2020. Unfortunately, this did not represent a victory for free trade economists or the open regionalists. This free trade declaration in reality signaled a shift away from pure open regionalism. "Open regionalism" had become a buzzword and was no longer central to APEC. It no longer meant what the economists had so carefully proposed.

### I. Introduction

Why do policy-makers refuse to implement free trade policies? Most economists blame special interest groups and politicians seeking only to maximize their chances for re-election. But that is only part of the story. Certain mindsets repel free trade argument, regardless of the merits of the policy.

How can there be a policy stronger than free trade, when economists are adamant that free trade is generally the best? Worldviews interfere. It is difficult to convince, for instance, a Marxist that free trade is best for them. Even if it is in their economic self-interest. Hence, free trade is not hijacked just by special interests. Politicians are not just hypocrites with only the desire to be re-elected. Maybe they actually believe what they are saying. If true, economists are partly to blame for free trade's failure to become reality.

This paper is the story of one partially successful attempt to win over those with differing worldviews. Australian economists penned open regionalism, a second-best solution to multilateral free trade. Open regionalism, which evolved from the Asia-Pacific region in the early 1970s, is a proposal for a non-discriminatory Free Trade Area (FTA) in the Asia-Pacific. Open regionalism became a reality when Asia-Pacific Economic Cooperation (APEC) was formed in 1989. The founding members were Australia, U.S., Canada, Indonesia, the Philippines, Japan, Singapore, Malaysia, New Zealand, South Korea, Hong Kong and Brunei. Mexico, China and Taiwan were admitted later.

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\* I would like to thank my adviser Professor Craufurd Goodwin for his guidance and tutelage.



In APEC, free trade did not win, but neither did it lose. APEC, like free trade, was not a zero-sum game, and the end-result for economists was ambiguous. Open regionalism came up against resistance from many other competing ideas, including:

- (1) Multilateral Free Trade
- (2) Closed Regionalism, as in the EC
- (3) Fair Trade, a power politics conception of trade
- (4) Free Trade pragmatism, the hallmark of the Institute for International Economics.

The crucial point for economists is that if we are to make headway on convincing policy-makers and the public on implementing a policy of free trade, we must seriously analyze why the harmful ideas are spreading and defeating the free trade. In essence, most of the economists in this paper recognize that the concept of pure free trade cannot survive outside of the sanitized environment of Academia. Only mutant forms survive. Consequently, some economists, often in NGROs, actively alter the pure free trade idea to create more virulent strains. They identify the pathogens of protectionism and find ways to immunize those who are at risk of infection.

## II. The Economist's Envisage Pacific Cooperation

### The Literature on Free Trade Areas

Normally economists support reductions in trade barriers because they inhibit economic integration and skew market signals, causing a misallocation of resources and diverting trade from the lowest cost suppliers. However, FTAs (groups of countries which lower trade barriers amongst themselves but maintain the barriers against the rest of the world) complicate the economists' position on free trade. As Jacob Viner pointed out in his seminal work The Customs Union Issue (1950), FTAs might divert more trade than they create. Unless the income-increasing effects of the FTA are very large compared with other economic effects, world welfare will suffer. Furthermore, FTAs disturb non-member nations because their exporters are discriminated against by differential rates in trade barriers. Most economists today still use Viner's test (whether trade creation will outweigh trade diversion) to judge proposed FTAs.<sup>1</sup>

### The Traditional Multilateralists

After 1960, regionalism became popular and many FTAs were created including one in Europe (EFTA) and a number in the U.S. (U.S.-Israel, U.S.-Canada, NAFTA). The heresy of regionalism of course provoked a backlash from the traditional free

<sup>1</sup>Custom Unions have a common external tariff level while FTAs allow each country to set its own tariff levels vis-a-vis non-members. Otherwise, Custom Unions and FTAs are essentially the same.

traders. Economists such as Jagdish Bhagwati and Anne Krueger opposed FTAs on principle. Many of these multilateralists are extremely active inside and outside the academy.

Multilateral reductions in trade barriers unambiguously raise the welfare of both the individual country and the world. FTAs cannot guarantee an improvement in world welfare. Furthermore, there are a number of technical problems with FTAs:

(1) The sequencing problem - some argue that FTAs can be extended one country at a time, leading eventually to a worldwide FTA. However partner countries, having gained preferential access to some markets, might oppose extending the membership of their FTA and making concessions in the GATT. For instance, when the U.S. lowers trade barriers to others, it undercuts the value of the preferences won by Mexico and Canada. Therefore, FTAs cannot realistically be extended one country at a time.

(2) Rules of origin - partner countries in FTAs maintain different external tariff levels. This provides a loop-hole for third parties: importers from non-member nations can avoid higher tariffs by transshipping through the FTA member with the lowest external tariff. To close this loophole, FTA agreements contain rules of origin clauses. But as more and more bilateral FTAs are formed, "a mass of paperwork is created for customs officials as they try to certify which shipment could benefit from which set of preferences."<sup>2</sup>

(3) Dispute settlement mechanisms - with a separate dispute settlement mechanism for each FTA, there could be different interpretations of U.S. laws by different dispute settlement panels. Anne Krueger, at a conference hosted by the Institute for International Economics, blasted America's conception of FTAs as being inconsistent with the GATT. The recent U.S. agreements have not freed "substantially all" trade within the FTA. "At best [they] provide assurances to American trading partners that protectionism will go no further with them."<sup>3</sup> She argues that FTAs are likely to lead to trading blocs, an outcome that spells death for the GATT.

### Open Regionalism

The mainstream debate between multilateralists and regionalists suffered from a narrowness of focus. They focused mainly on overt, official barriers to trade, such as tariffs and subsidies, essentially ignoring other resistances to trade. Proponents of regionalism usually envisaged economic integration (defined as the movement towards one price throughout the global economy) through institutional integration, exemplified by the EC. In this conception, integration is achieved

<sup>2</sup>Schott, Jeffrey J., More Free Trade Areas?: 23

<sup>3</sup>Krueger, Anne, Comments on An FTA with Australia. In Free Trade Areas and U.S. Trade Policy, p. 197



top-down and by discrimination, diverting trade flows to member nations: barriers to the rest of the world are raised whilst barriers to member nations are lowered.

Some Australian economists explored an alternative way to bring about economic integration.<sup>4</sup> Australian economists, in particular Peter Drysdale and Ross Garnaut,<sup>5</sup> were the key developers of Open Regionalism, the conception of a non-discriminatory FTA. East Asia was the catalyst for this new theory: "it was the increasingly open character of East Asian economies through the 1970s, with non-discriminatory liberalization ... that generated the initial discussion of open regionalism."<sup>6</sup> Open regionalists were full supporters of the multilateral approach to free trade but noted with alarm that the Uruguay Round (UR) had been dragging on for many years. Some commentators had pronounced the GATT dead and predicted the world would descend into trading blocs. While this was considered an extreme viewpoint at the time, regionalism was undeniably becoming fashionable.<sup>7</sup> Open regionalists wanted to direct that regionalist wave in a GATT-friendly direction.

There are three precepts to open regionalism:

(1) Liberalization of trade barriers in a unilateral and non-discriminatory fashion.

In the 1970s, and especially the 1980s, almost all market-oriented Western Pacific economies liberalized trade in a non-discriminatory and unilateral (non-reciprocal) fashion. Unilateralism is quite the opposite of the GATT approach in which trade barriers become bargaining chips. The GATT talks give trade barriers an unnatural

<sup>4</sup>To be fair, R. Cooper was the originator of this line of research, beginning in the 1970s.

<sup>5</sup>Peter Drysdale is Professorial Fellow and Executive Director of the Australia-Japan Research Centre, Research School of Pacific Studies, Australian National University; Ross Garnaut, former Australian Ambassador to China, is a Senior Fellow in the Department of Economics, Research School of Pacific Studies, Australian National University.

<sup>6</sup>Garnaut, R., Open Regionalism: Its Analytic Basis and Relevance to the International System, 280. The success of Guangdong, China, is an example of open regionalism. Hong Kong businesspeople circumvented the archaic institutional barriers which China had not gotten around to removing in its mad rush from a planned to a market economy. Barriers were de facto removed, and phenomenal growth resulted. All that was left was for China to remove them formally.

<sup>7</sup>NAFTA, Canada-U.S. Trade Agreement (CUSTA), U.S.-Israel FTA, Australia-New Zealand FTA, and an ASEAN FTA are just a small sampling of the FTAs either under discussion or implemented at the time.

value (precisely the trade liberalization bundle for which the barrier can be swapped). There is an incentive for countries to retain protection until a GATT round comes along, to extract the maximum concessions from others.

Drysdale and Garnaut argue that unilateralism works by osmosis. As each country gets wealthy as a result of such unilateral trade liberalization, other countries will observe the prosperity of their neighbors and follow. They back up this argument by pointing to what happened in Asia over the 1970s and 1980s. However, they recognize that some members in an FTA may find it politically difficult to liberalize unilaterally. Nonetheless, a non-discriminatory FTA would still be quite feasible in the Asia-Pacific region because it contains the world's lowest-cost suppliers in its most protected sectors. Most of the gains from non-discriminatory liberalization in sectors such as textiles, steel and wheat, would accrue to the Asia-Pacific region itself. Therefore, trade deals could be struck which would benefit *just* the Asia Pacific, avoiding the free-rider problem while still being undertaken on a non-discriminatory basis. Open regionalism is a politically palatable alternative to the disintegrating multilateral system and to discriminatory regionalism.

(2) Expanding the provision of public goods

Public goods can make trade between nations more efficient. APEC can achieve great gains by reducing physical impediments to trade by improving information exchange, pinpointing future bottlenecks, funding infrastructure investments and standardizing rules. These types of initiatives are politically possible because they are both mutually beneficial and of no obvious benefit to outsiders (no free-rider problem). They are GATT-friendly because they neither impose costs on outsiders nor give APEC a trade bloc image.<sup>8</sup>

(3) Trade Facilitation

Trade facilitation (or market integration) means to allow and encourage the market actors to naturally reduce resistances to trade. A resistance to trade is anything that prevents or retards the prompt movement of commodities in response to relative prices, thwarting economic integration. There are two types of resistances to trade. Objective resistances include both official barriers, like tariffs, and non-official barriers, like transport costs and regulations. Subjective resistances include perceptions of risk, imperfect information and language barriers. A good example of reducing subjective resistances is encouraging travel. When transport costs are low, market participants are more likely to visit foreign countries (i.e. a potential market). This facilitates human contact and disseminates information about the foreign market. The transfer of information reduces subjective resistances such as misperceptions (misjudging risk) and ignorance (imperfect information). Furthermore, this process is trade creating since it is unlikely to divert trade from lower cost to higher cost sources. Trade facilitation

<sup>8</sup>Elek, A., Trade Policy Options for the Asia-Pacific Region in the 1990s: The Potential of Open Regionalism. Andrew Elek is a Senior Research Fellow in the Department of Economics, Australian National University



unambiguously raises world welfare whilst assisting economic integration, unlike EC-style integration.

The insight of open regionalism is that there exist many other damaging resistances to trade. Indeed, empirical studies show that tariffs are less detrimental to economic integration than many objective resistances, such as transport costs. And subjective resistances can be more important than objective resistances in blocking economic integration.<sup>9</sup> Gains to member nations are large, possibly even larger than gains from reductions in official trade barriers. Asia's dynamism "derives from [this market-driven] reduction of subjective and objective, but non-official, resistances to trade."<sup>10</sup> Why then are free-traders walking in a political minefield, trying to reduce tariffs and such, when subjective resistances can be reduced at relatively little political cost?

Open regionalism is a means to regional economic integration without the discriminatory, institutionally driven approach of the EC. The process does not aim at political or monetary union. It entirely complements the GATT because of its non-discriminatory nature.

The open regionalists were a driving force behind the creation of APEC and advocated that APEC's agenda center around open regionalism. In the 1960s and 1970s, Peter Drysdale, with economist Kiyoshi Kojima of Japan, proposed the formation of a regional economic grouping in the Asia-Pacific. The Pacific Basin Economic Council (1967) and the Pacific Economic Cooperation Council (1980) were formed: "Much of the leadership to this growing Asia-Pacific economic regionalization movement came from Japan and Australia."<sup>11</sup> Drysdale wrote articles calling for the creation of a Pacific FTA for the Institute for International Economics in 1989 and in 1992, and co-wrote, with American economist Hugh Patrick, a position paper for the U.S. Congress in 1979 on U.S.-Asia economic cooperation. Ross Garnaut advocated open regionalism through his position as a consultant on Australia-East Asian relations to both the Australian Prime Minister Bob Hawke (who is credited with organizing the first APEC conference) and the Minister for Foreign Affairs and Trade.<sup>12</sup> It seems likely that they had the ears of Australian and Japanese policy-makers (however their writing was not as easily accessible to Americans, rarely appearing in any major journals). As we shall see,

open regionalism became the guiding philosophy behind APEC's steering committee, the Eminent Person's Group (EPG).

### The Perspective of Asian Economists

Many Asian economists also contributed to the debate and were adamant that the U.S. should make a strong commitment to APEC. In particular, Asian economists were disturbed by NAFTA and the possibility that NAFTA might be expanded to include all the Americas (the Enterprise for the America's Initiative).<sup>13</sup> They, like the Australian economists, wanted to block this detour and steer the U.S. back towards a commitment to the GATT. And they too were less than thrilled by the prospect of a discriminatory Asia-Pacific FTA. Ippei Yamazawa<sup>14</sup> exemplifies the Asian viewpoint and highlights the main differences between Asian and American perspectives on APEC (Table 1). There is a surprising unity of perspective amongst the Asian economists.

**Table 1: Contrasting American and Asian Perspectives on APEC**

	American Approach	Asian Approach
Trade Liberalize vs. Trade Facilitate	APEC should mainly promote trade liberalization.	APEC should mainly promote cooperation, such as technical cooperation, an investment code, information sharing, some policy coordination as well as some liberalization. Monitor and guide sub-regional groups (NAFTA, AFTA) to minimize discrimination against non-members.
Open vs. Closed	Ratcheting-up theory of global liberalization. Liberalization is done through regional negotiation, on a reciprocal basis. Non-members are offered same deal on a conditional MFN basis. APEC liberalization as a lever to push global liberalization.	Global liberalization under WTO supplemented by APEC liberalization. Apply to non-members on unconditional MFN basis. Encourage unilateral liberalization. Liberalization deals unlikely in most sectors because of free-rider problems, vested interests, and the dependence of developing countries on certain levels of protection.
Broad vs. Narrow	APEC liberalization puts everything on the table.	APEC liberalization in selected areas.
Reciprocal vs. Non-reciprocal	Open regionalism means open to any country willing to make the same concessions	Open regionalism means loose regionalism with minimum discrimination against non-members
Timetable vs. Voluntary	Timetable and targets for liberalization. Institutionalize APEC.	APEC should be loosely structured, using a voluntary and gradual approach.

*This table is adapted from Ippei Yamazawa (1994), with some modifications based on what other Asian writers have argued.*

13 Two indications of the U.S. shunning Asia are NAFTA and the Enterprise for the Americas Initiative (EAI). The EAI is beyond the scope of this paper, but in 1994 serious meetings took place with South and Central America nations to discuss the possibility of a hemispheric FTA.

14 Ippei Yamazawa is a Professor in the Department of Economics, Hitotsubashi University, Kunitachi, Tokyo, Japan. Other Asian economists examined were Zhang Zhongli and Zhou Jianming (1994); Jang-Hee Yoo and Keuk-Je Sung (1994); Liu Jing-Tong (1985).

9 Garnaut, R., Australian Trade with Southeast Asia: A Study of Resistances to Bilateral Trade Flows, Unpublished doctoral dissertation, Australian National University, 1972

10 Garnaut, R., Open Regionalism: Its Analytic Basis and Relevance to the International System, 278

11 Dutta, M., APEC: Toward a Supra-National Macroeconomic Core?, 446

12 Andrew Elek, another Open Regionalism theorist, worked for the Department of Foreign Affairs and Trade in Australia.



The Asian proposals for APEC are entirely in the vein of open regionalism: investment codes, reducing subjective resistances, improving information flows, and so on. This similarity would be expected if open regionalism did emerge from the Asia-Pacific and was the guiding philosophy behind the region's dynamism, as Garnaut and Drysdale contend.

#### Supporters of the European Community Retort

Supporters of the EC took issue with the open regionalists. They were quite adamant that discriminatory, institutional integration was not detrimental to the multilateral trading system, as the open regionalists had charged. The EC, they argued, not only created more trade than it diverted, but was the best path to the true benefits of integration.

Regionalism is not the result of rising protectionism but of natural forces driving nations to search for regional stability. M. Dutta<sup>15</sup> argues that the emerging regionalism is not a threat to the multilateral trading system. Today, sovereign nation-states with independent national currencies "may be sub-optimal economic units for the present international economic order."<sup>16</sup> Nation-states must coordinate their macroeconomic policies to provide the monetary and fiscal stability necessary for optimizing their microeconomic activities. Detlef Lorenz, a German defender of the EC, agrees.<sup>17</sup> Lorenz blasts Drysdale and Garnaut's contention that EC-style integration is inherently trade diverting and discriminatory. The EC is open to the world economy, he argues, and its formation has benefited world trade.

So in the economics literature, the crucial argument for APEC is whether the EC has been beneficial or not. The Australian economists charge the EC with detrimental and unrequited trade diversion. The Europeans reply that the EC's brand of economic integration is not fortress regionalism. It has adhered to the principle of inclusion, and trade with the rest of the world has not declined, only grown at a slower rate than intra-regional EC trade. Many studies have been conducted to try to settle this dispute, to see whether the EC has satisfied Viner's test. None has been definitive, for they are all open to methodological criticisms. Furthermore, it is interesting to note that where economists stand on the issue of regionalism seems to depend on where they sit.

#### Conclusion on the Role of Economists in the APEC Debate

How important were the open regionalists in this endeavor? They cannot take full credit for the formation of APEC and APEC's acceptance of open regionalism because "[open regionalism] emerged from and helped to shape the practice of economic cooperation in the Asia Pacific region"<sup>18</sup> and therefore APEC itself. But nor were they mere messengers. These economists observed and developed the theory of open regionalism and lobbied for it all around the Pacific. Open regionalism caught on because it was a consensus-building idea, a widely-acceptable second-best solution for freeing trade. It avoids conflict, not directly attacking overt barriers to trade, looking for pareto-optimal deals in which everyone gains. Unfortunately, few American economists took up the idea; and surprisingly few even studied APEC.

### III. The View from the Political Scientists

#### Introduction

Economists often develop wonderful plans to improve welfare by freeing up trade, only to stand befuddled when politicians refuse to implement them. As one international political economist says, "Economists have struggled to make the real world of trade policy conform to their model, with limited success."<sup>19</sup> International cooperation and integration theory are core fields in political science and at the heart of the study of regionalism. APEC, arguably the economist's political maneuver to defeat protectionist interests, could benefit from some of their learned knowledge. Do political scientists think that the FTA gambit might succeed in hindering protectionism? Was the EC a success? At times political scientists suggest helpful strategies to secure the goal of free trade. More often they advocate policies inimical to the economists' norms and these policies, either directly or indirectly, substantially impacted APEC's development.

#### Regional Integration Theory

In the 1950s, the field of international relations was revolutionized. Integration theorists, spurred by the prospect of Western European integration in the 1950s, challenged the realist orthodoxy in which conflict is considered the staple of the international system. Realism could not adequately explain international relations: international cooperation was simply too prevalent to be an aberration. Integration theorists proceeded to study the evolution of transnational political units and, in particular, attempted to forecast and map out Western European integration.

Karl Deutsch, the most famous of integration theorists, dreamt of a world at peace and believed that transnational integration might lead to it. Deutsch argued that

18 Garnaut, R., Open Regionalism: Its Analytic Basis and Relevance to the International System, 273

19 David A. Lake in Cohen, Benjamin J., The Political Economy of International Trade: 272

15 Dutta, M. is a Professor in the Department of Economics, Rutgers University, New Brunswick, NJ.

16 Dutta, M., Asia-Pacific Economic Cooperation, 13

17 Detlef Lorenz is a Professor of Economics at the University of Berlin



sustainable peace could only be achieved through international cooperation and integration, not through the realist tools of balance of power and deterrence. He studied how to achieve integration, a question which plagued the professional economists in their studies of FTAs, though his end-goal was quite different. Deutsch does not limit himself to the political realm, focusing on economic and cultural factors as well.

Political unification, he concluded, may be neither necessary nor sufficient to achieve the end-goal of peace; it may even be counterproductive, by destroying local autonomy, leading to domestic conflict and societal disintegration. Deutsch argued that a collective consciousness (defined as shared values and sentiments, a commonality of interest and expectations of joint rewards) is necessary for social cohesion and a peaceful society. A collective consciousness creates a common moral base which binds the state and society together, helping to coordinate behavior and maintain law and order without the need for coercive state power. If communication between the state and society were to become slow or unresponsive, this moral base would erode and non-coercive channels of communication would no longer be successful at coordinating behavior. Therefore, in the process of *peaceful* political integration, it is essential to maintain effective feedback mechanisms between the state and society and to mold a collective consciousness. Integration should be from the bottom up and transnational communities should exist prior to the formation of transnational institutions.

Deutsch's "bottom-up" approach is complementary to the open regionalist philosophy, where integration is led by the private sector and low-key trade facilitation precedes the institutionalization of APEC. The great diversity and lack of a real community within APEC could lead to friction, as the Asian economists cautioned. The peoples of APEC seem to share few sentiments beyond economic self-interest.<sup>20</sup> Some economists and government officials argued that economic gain is sufficient for creating a successful FTA. The Deutschian literature would suggest otherwise: negotiations will yield few benefits because of the lack of shared values. Deutsch's arguments would suggest that a slower, less forceful approach would be better at first.

Unfortunately, by the early 1970s many integration theorists had become pessimistic about the chances for much international integration in the coming decades.<sup>21</sup> Integration theorists could not comprehend the swings in opinion and sentiment which often stalled further progress toward EC integration. They lamented that integration was too difficult to predict. There are too many

<sup>20</sup>In section The History of APEC: U.S. Government Views and Actions, President Clinton claims that a real Pacific Community exists. However, most commentators view this as mere rhetoric compared with the vast diversity of opinion and frequent conflicts, both verbal and military, within the region.  
<sup>21</sup> Donald J. Puchala and Ernst B. Haas indicate that their disillusionment is widespread.

exogenous variables, they moaned, and too much uncertainty in predicting changes in actor sentiments: "[we erred] in taking the actors at their word when they described themselves as engaged in building communities."<sup>22</sup> Ironically, just at the moment they lost faith, the whole EC integration movement reanimated, but integration theorists were too destitute to ride that wagon again. The theories they developed had "a tendency not to predict very accurately the events which come about."<sup>23</sup> Many integration theorists bowed to the realists.

Their disillusionment with the prospects for political integration should serve as a warning to economists. FTAs are not solely economic phenomena. Even when FTAs are pareto-optimal there are many other factors to consider: the existence of a community consciousness, the political will, and security interests. Unfortunately, the disillusionment of integration theorists caused them to neglect APEC. Their expertise and experience would have been useful in the APEC debate. Is APEC too diverse? Will an FTA unduly strain social cohesion in the Asia-Pacific? Political scientists might have resolved the crucial debate over whether EC integration was successful, by looking at criteria other than Viner's Test. Unfortunately, integration theorists nowadays have retreated to the sheltered cave of technical, in-house issues. They contributed almost nothing to the APEC debate.<sup>24</sup>

### International Political Economy

Modern-day political scientists take a different approach to the study of international cooperation. The field that emerged, International Political Economy (IPE), asks what motivates government behavior in foreign economic relations? With the help of a minority of economists,<sup>25</sup> these researchers examine the sorts of questions relevant to the creation of a successful FTA.

The neorealist group of IPE theorists take anarchy as the staple of the international system, where the state reacts exclusively to the constraints and opportunities presented by the international system. They use game-theoretic, bargaining metaphors to explain under what conditions international cooperation occurs.<sup>26</sup> The prisoner's dilemma highlights the key issues: there is little incentive for

<sup>22</sup> Haas, Ernst B., Obsolescence of Regional Integration Theory: 5

<sup>23</sup> Haas, Ernst B., Obsolescence of Regional Integration Theory: 1

<sup>24</sup> Integration theory continues to be studied, but on a much more technical, non-predictive level. Take Gerald Schneider's article (1994).

<sup>25</sup> Charles Kindleberger, Public Choice theorists and strategic trade theorists are the main contributors. In addition to my own thoughts, much of this section stems from Cohen, Benjamin J., The Political Economy of International Trade

<sup>26</sup> Robert Axelrod's Evolution of Cooperation is probably the most cited work in this field.



nations to cooperate initially, but cooperation can be induced by increasing the costs of non-cooperation.

Many neorealists advocate reciprocity as a trade bargaining tactic.<sup>27</sup> Recalcitrant nations will be induced to cooperate when good behavior is reinforced ('carrot') and bad behavior is retaliated against ('stick'). Carolyn Rhodes argues that the free trade norm, established by post-World War II economists, is not sufficient to constrain harmful behavior. Bilateral reciprocity is needed. While she admits that bilateral reciprocity violates the GATT principle of non-discrimination, she contends that it upholds the spirit of the GATT by helping to maintain free trade: "the general commitment to liberal trade and fairness is embedded [in the GATT] principle of balanced treatment."<sup>28</sup> In the face of protectionist pressures, reciprocity, especially the threat of retaliation, is necessary to maintain open trade and "ensure commitment when adherence [to free trade] has conflicted with other interests."<sup>29</sup> I might add that Rhodes is heavily influenced by the strategic trade literature, as are many neorealists.

These views starkly contrast with those of most economists. The Australian economists and multilateral free traders do not view free trade as a prisoner's dilemma but as a game in which everybody wins. Unilateral liberalization is the dominant strategy, a winning move regardless of the actions of others. Free trade is the relevant goal of GATT, not balanced treatment and fairness. Bilateral actions are discouraged by most economists. But for these political scientists, bilateral actions are the best enforcement mechanism; breaking GATT laws is fine if you mean well. But who, if not the GATT, is the impartial judge that decides what constitutes fairness? While Rhodes mentions that retaliation might degenerate into a trade war, she never considers the expected utility of a reciprocity strategy: the value and probability of success versus the costs and risk of a trade war. Nor is she concerned with the soliciting the consumer's opinion. She is interested in the effectiveness of coercive tactics for inducing the desired cooperative response. She is interested in winning a game that is considered unloseable by many economists, unless you rationalize the irrational strategy.

Some IPE theorists are more sympathetic to free trade goals. They propose less costly, and less confrontational, bargaining tactics for inducing cooperation. Their key insight is that international bargaining is more than a simple binary phenomenon (cooperation or defection). A wide range of mutually beneficial deals exist in the game of free trade bargaining, but in practice suboptimal levels of international cooperation are common. There are many efficient points on the Pareto frontier of negotiation outcomes, differing only in the distribution of those

27 Rhodes, Carolyn, Reciprocity in trade: the utility of a bargaining strategy: 273; also Keohane, Robert O., Reciprocity in International Relations.

28 Rhodes, Carolyn, Reciprocity in trade: the utility of a bargaining strategy: 276

29 Rhodes, Carolyn, Reciprocity in trade: the utility of a bargaining strategy: 275

gains. Geoffrey Garrett<sup>30</sup> argues that the real question is why a particular point on the Pareto frontier is chosen and concludes that power imbalances are to blame. To achieve better outcomes from international negotiations, they advocate the use of internal side-payments to factional interests. Then free trade deals can improve agreements for everyone. Institutions such as Fast Track and permanent standing committees can facilitate the use of such side-payments. Furthermore, coalition building within APEC might give weaker states like Malaysia the leverage to counterbalance stronger ones.<sup>31</sup>

Unfortunately, political scientists were not very vocal in the APEC debate. While IPE theorists agree on the importance of bargaining tactics, there are no clear recommendations. Conclusions can be altered by the slightest modification in the specifications of the models. As an example, limited information models assume that some actors possess private information, giving them the power to bluff.<sup>32</sup> A laggard state that desires only minimal integration, such as Malaysia, may pretend to be extremely reluctant to ensure only a modest agreement. But the bluff may backfire, leading to the outcome of non-cooperation, despite true preferences for integration. Should Malaysia bluff or form coalitions? No consensus exists.

#### The Sole Analysis of APEC in IPE

There is only one study of APEC in the field of IPE. Donald Crone uses APEC as a case study and explains, from a political science viewpoint, how APEC came to be.<sup>33</sup>

From the 1960s to the 1980s, neither the U.S. nor most of the Asian nations saw economic regime formation as being in their interest. ASEAN nations preferred bilateral relations with the U.S. The U.S. also preferred the bilateral approach, its great relative power giving it enough bargaining leverage so that it was "largely able to satisfy its objectives."<sup>34</sup> Only Japan and Australia were protagonists for greater regional cooperation, prompted by fears of EFTA.

30Garrett, Geoffrey, International cooperation and institutional choice: the European Community's internal market

31 Higgott, Richard A., and Cooper, Andrew F., Middle power leadership and coalition building: Australia, the Cairns Group and the Uruguay Round of trade negotiations

32 Schneider, Gerald and Cederman, Lars-Erik, The change of tide in political cooperation: a limited information model of European integration; and Morrow, James D., Modeling the forms of international cooperation: distribution versus information

33Crone, Donald, Does Hegemony Matter? The Reorganization of the Pacific Political Economy

34ibid., 517



After the Cold War, an American security presence in Asia was necessary only as a balancing force: "The need for an American military umbrella is simply less salient during the dry season."<sup>35</sup> And "a Pacific organization might stop the slide of United States power,"<sup>36</sup> preserving a cheaper U.S. security umbrella, supporting democracy, and of lesser importance, preserving its markets. The prospect of an FTA was not the main motivation: "while [the U.S. and the EC] asserted that the purpose was to free, not restrict, trade, the reception in Asia has been profoundly skeptical."<sup>37</sup> On the Asian side, rising prosperity softened fears of exploitation. And Asian nations preferred cooperation with the U.S. over suffering discrimination from rising U.S. protectionism and the possibility of isolation if the world were to degenerate into trading blocs. And so, "despite widespread reluctance [from many], a new organization became strategically rational for all."<sup>38</sup>

Crone also judges APEC's prospects for the future. Drawing on the work of Deutsch, Crone argues that cooperation after hegemony requires extensive shared interests, and shared values. "Regimes are thus facilitated by shared values [and a common cultural basis], not just the desire for collective goods."<sup>39</sup> Vast economic disparities and diverse cultural traditions imply that APEC has vast potential for irreconcilable frictions. The Pacific regime is a weak one.

Donald Crone's article sheds light on many issues that supporters of APEC face. He demonstrates the value of Deutsch's integration theories in assessing APEC. He shows that, at least for the U.S., the economic incentive for an FTA is not the most important factor. One also infers that APEC might stand a better chance if it were to concentrate on the creation of a collective consciousness.

But Donald Crone is unique among the political scientists, the only writer to address APEC. Interdependence theories and bargaining are clearly essential to understanding APEC, for "studies that concentrate solely on the shared interests of states and ignore the conflicts between them will be inadequate."<sup>40</sup> Furthermore, political scientists might have been instrumental in settling the debate over the EC. While the economic evidence is ambiguous, if the EC increased the prospects for peace then maybe, on the whole, it was a worthwhile endeavor. Unfortunately, IPE theorists focus mostly on negotiations long-gone, using *post hoc*

35*ibid.*, 510

36*ibid.*, 518

37*ibid.*, 519

38*ibid.*, 522

39*ibid.*, 506

40Garrett, Geoffrey, International cooperation and institutional choice: the European Community's internal market, 533

rationalizations as their evidence and stimulus for new theories. Consequently, only one offered strategies for a successful Asia-Pacific FTA.

### The Role of Political Science in the APEC debate

There are many non-economic facets to APEC which deserve consideration: regional security, bargaining strategy, balance of power, the creation of a community consciousness. Karl Deutsch adds social and moral aspects to this list, in particular whether regional groupings increase the prospects for peace.

Economists have ignored important aspects of FTAs. They should be more involved in the study of IPE (if only to counterbalance the dearth of free trade supporters). They should incorporate non-economic determinants of state motivations into their analysis of FTAs. Doing so would improve their analysis and their arguments. A pot of gold exists at the end of the free trade rainbow but maybe that is insufficient incentive to convince nations to make the journey. In the face of protectionist pressures, a greater incentive is needed to create a proper FTA in which substantially all trade is liberalized. Maybe some of the arguments from IPE theorists can persuade nations to make this journey.

But at least some economists are involved in the field of IPE. The problem with IPE is that the theorists do not apply their theories. There is only one APEC specific study in the whole political science literature. Political scientists are preoccupied with methodological, theoretical issues. At the moment, IPE theorists only have a taxonomy of factors relevant to the analysis of international cooperation and not much else. Technical squabbles are common ('you didn't pay enough attention to this factor'), much more so than in the economics literature I examined. There are too many different recommendations. Cohen's comment says it all: "can anyone blame economists for finding it all a bit confusing ... It seems merely a game of idle speculation or casual empiricism."<sup>41</sup>

Possibly IPE theorists, after their string of failures in forecasting European integration, have become timid. Donald Crone is the only one to bravely attempt to forecast the outcome of events in the Asia-Pacific. There is a burning need for more of these types of applied studies. IPE theorists have the tools to do so. Political scientists, some of whom have the same reverence for free trade as economists, have contributed little directly to the APEC debate.

But, as is the way with the scribbles of academic theorists, their ideas still had an enormous indirect effect on the development of APEC. The IPE theorists that advocate retaliation and reciprocity, "fairness" in trade policy, and strategic trade influenced the actions of key U.S. government officials and the President himself; either that, or the similarity between the viewpoints government and IPE theorists indicates that IPE theorists help entrench the notion that one cannot have free trade without fair trade. Either way, the economists proposing FTAs misjudged their enemy, which are not protectionists in the traditional sense. Supporters of

41Cohen, Benjamin J., The Political Economy of International Trade: 281



protectionism are not limited to those with an economic self-interest in it. Many of these political scientists are probably hurting their economic self-interest by advocating fair trade, retaliation and other anti-free trade policies. The idea of Fair Trade may be irrational and against the political scientists' own economic self-interest. But it is very persuasive to those with a Neorealist worldview, including politicians themselves. Economists have mis-modeled political actors. Maybe the politicians who spout fair trade rhetoric do so for reasons other than populism. Maybe politicians partly believe what they are saying.

#### IV. The History of APEC 1989-1994: U.S. Government Views and Actions

##### The 1989 Minister's Meeting in Canberra

For years Australia and Japan had been pushing for a Pacific economic grouping to counter the threat posed by the EC. Finally, in 1989 APEC was born. Its first meeting was in Canberra, Australia, the home of the open regionalists.

In the beginning, APEC's guiding philosophy was open regionalism. The 1989 Ministers' Joint Statement made it clear that the overriding objective was to conclude the Uruguay Round (UR) and discuss trade facilitation issues. Specific work programs were implemented to the study need for unplugging infrastructure bottlenecks, managing marine resources, and harmonizing telecommunications standards and customs practices in the region.<sup>42</sup> These topics were congruent with the precepts of open regionalism, namely precept (2), the cooperative provision of public goods, and precept (3), the reduction in non-official objective and subjective resistances to trade.

What happened to the other precept of open regionalism, the non-discriminatory and unilateral liberalization of trade (precept (1))? Some at the 1989 meeting tried to steer APEC in the trade liberalization direction. However, Australia stressed that any APEC trade liberalization must be non-discriminatory and non-reciprocal. Japan agreed and urged that APEC not be used as a lever in the UR against the EC: it should avoid any moves that might be construed as trade bloc formation.<sup>43</sup> The APEC Ministers, in the end, avoided regional trade liberalization.

Open regionalists would applaud. Since not all members could agree to the principle of non-discriminatory and non-reciprocal regional trade liberalization, the topic was dropped. The open regionalists also opposed regional trade liberalization of the discriminatory form, and in fact recognized that non-discriminatory liberalization was politically unlikely. The absence of regional trade liberalization from APEC's original platform, and focus on trade facilitation, is entirely in line with the views of open regionalists.

<sup>42</sup>APEC Ministerial Meeting, *Specific Elements of a Work Program*, 1989: section B

<sup>43</sup>Department of State, Press Conference on APEC, Canberra, November 1989, 19

The success of the first meeting was the result of the work of the open regionalists. They highlighted the potential for non-contentious, yet mutually beneficial, agreements. Trade facilitation was quite simply much less confrontational than regional trade liberalization, in which powerful domestic interests must be confronted. The economic self-interest of each APEC member was allowed to prevail over the political, domestic forces so often aligned against it. But economic self-interest had always been there. Economic self-interest cannot explain why APEC occurred when it did, and why the first meeting was so successful. Open regionalism was the necessary ingredient which created a common consciousness among APEC members to allow them to strike deals, as Deutsch predicted long ago. The existence of a common consciousness based around the shared value of open regionalism was needed for APEC to come about.

##### The U.S. State Department in 1989

While not using the term open regionalism, the concept of open regionalism is evident in the U.S. State Department's press conferences. The State Department stated a desire for a regional forum to identify and help remove barriers to trade, to enhance regional economic growth, and, particularly, to reduce informal barriers to trade. They cited infrastructure, human resources and cultural interaction as important areas in which APEC could improve efficiency and investment. Furthermore, the State Department preferred the multilateral approach to regional trade liberalization: "the United States has had a long-term post-war interest in that [GATT] system, because it's associated with other values that we want to try and perpetuate."<sup>44</sup> Open regionalism provided the basis for a substantial congruence between the views of the State Department and those of other Pacific nations.

Of course, there were many reasons for the U.S. to join that were independent of the open regionalists' influence. For instance, U.S. support for GATT was not due to the ideas of open regionalists. And the U.S. had argued for years that regional groupings like APEC could be used as building blocks for multilateral free trade, by helping to form a consensus at the regional level to jump-start multilateral agreements.<sup>45</sup>

But despite these difficulties in assessing the open regionalists' impact on U.S. policy towards APEC, we can draw the conclusion that their influence was quite strong. APEC originally avoided the political and security focus that the U.S. desired. While it may have been inevitable that an Asia-Pacific organization would form, it was not inevitable that APEC should focus solely on economic issues. The State Department wished to promote U.S. political and economic values in Asia and improve security in the region. Nonetheless, the State Department concurred with limiting APEC's focus to economics: "the process is primarily an economic one

<sup>44</sup>Department of State, Press Conference on APEC, Canberra, November 1989, 8

<sup>45</sup> This proved true. By 1994, APEC nations had agreed to a non-binding commitment to free trade and investment in the Asia-Pacific region.



and not a political one"<sup>46</sup> (Secretary of State Baker). In contrast, by 1993 political and security issues were an important component of the APEC agenda.

In the early years, APEC avoided the contentious issues, such as trade deficits and trade liberalization, that might interfere with the more promising thrust of trade facilitation and joining forces to conclude the UR. The U.S. consented to spoke the language of open regionalism. APEC's original mission was largely in congruence with the views of the Australian economists and the Asian-born open regionalism from which their views sprang forth.

### **The Minister's Meetings, 1990-1992**

Open regionalism's influence on APEC became even more palpable over the next few years. APEC made significant strides in the realm of trade facilitation.

Between 1990 and 1992, APEC created ten Working Groups, all charged with trade facilitation goals. There were no Working Groups on regional trade liberalization in these years.<sup>47</sup> Instead, the Working Groups studied public infrastructure (e.g. Telecommunications Working Group), public goods (e.g. Marine Resource Conservation Working Group), and trade promotion programs (e.g. Trade and Investment Data Working Group). By 1992 many Working Groups had made considerable progress: a trade and investment database was well underway; an electronic network had been created for exchanging trade and business information between members governments; trade documents had been placed on-line, making them easily accessible to businesses and other interested parties; numerous educational exchange programs had been organized. Trade facilitation was progressing, albeit somewhat slowly.

With the GATT still as APEC's top priority, the member governments avoided and enshrined trade facilitation as the focus of their meetings. The 1991 Seoul Declaration laid out APEC's Scope of Activity:

- "(a) exchange of information and consultation of policies...
- (b) development of strategies to reduce impediments to the flow of goods and services...
- (c) promotion of infrastructure development, human resource development, industrial cooperation, ...
- (d) cooperation in specific sectors such as energy, environment, fisheries ..."<sup>48</sup>

<sup>46</sup>Department of State, Press Conference by APEC ministers, November 7, 1989, 6

<sup>47</sup>There were a couple of informal groups of Senior Officials which studied trade liberalization. Neither recommended going down the regional trade liberalization path, preferring a focus on concluding the UR and trade facilitation.

<sup>48</sup>APEC Ministerial Meeting, 1990 Joint Statement: Section 19

This statement demonstrates that, in 1991, APEC discussion were fully in-line with the open regionalist philosophy. In fact, the first usage of the term "open regionalism" by APEC was in the 1991 Joint Statement.

APEC members saw themselves as role models for the world, "examples of good GATT abiding citizens ... and in that way we will contribute to world economic growth."<sup>49</sup> Trade liberalization by example is textbook open regionalism. In their Joint Statements, APEC members demonstrated an understanding of the concept of trade diversion, an aversion to EC-style regionalism, and an approval of open regionalism.

Was the youthful APEC simply a puppet of the open regionalists? Not quite. Most damning was the slow progress made on trade facilitation. Do several studies and the creation of a few databases really amount to that much of a reduction in objective and subjective resistances? The achievements do not seem to live up to the dreams of Drysdale and Garnaut. Despite a Ministerial mandate in 1992 for the establishment of an electronic tariff database and the harmonization of customs procedures, by the end of 1994 these projects were still only a paper reality. On the other hand, how slow is slow? Much of the groundwork for future trade facilitation was accomplished in these years. For example, the Non-Binding Investment Principles were essentially written in these years, though they were not passed until 1994.<sup>50</sup> Furthermore, by the end of 1995, the only palpable results from APEC had come from these Working Groups and not from the regional trade liberalization agenda.

APEC meetings were less beneficial than they could have been, only attended by "mere" ministers of the member nations who had little power to make decisions. But open regionalists would have preferred slow progress to the alternative on the horizon: the creation of a discriminatory FTA. Impressively, open regionalism managed to become the agenda for APEC. That was the achievement of the effort of the Australian economists, the efficacy of the open regionalist idea, and the worldview of Asia, the fertile birth-ground of open regionalism itself. The U.S., sincerely or insincerely, tagged along.

### **The Turning Point: the 1993 Leaders' Meeting in Seattle**

The 1993 Leaders' Meeting in Seattle marked a number of firsts for APEC. It was the first meeting to be held in the USA, the first under President Clinton's presidency, the first to be attended by leaders, not just ministers. The attendance by the President and other world leaders upgraded APEC's importance, blessing

<sup>49</sup>APEC Ministerial Meeting, 1990 Joint Statement: section 3

<sup>50</sup>In 1992, APEC ministers explicitly called for the implementation of such an investment guidebook.(APEC Ministerial Meeting, 1992 Joint Statement: section 15)



APEC with prominence and purposeness. The news media, sensing this shift, began to devote serious attention to APEC.<sup>51</sup>

The Seattle meeting also marked the moment when APEC shifted its emphasis from trade facilitation to regional trade liberalization. Many leaders later remarked that the regional trade liberalization process began in Seattle.<sup>52</sup> A State Department release confirms this, stating that the U.S. (with the consent of APEC ministers) requested that trade and investment liberalization be the focus of the 1993 Ministerial meeting. So we must return to Seattle, 1993, to discover why and how open regionalism ceased to hold sway over APEC.

### The Administration and the State Department in 1993

Several months before the Seattle meeting, the President and the State Department released their vision for a New Pacific Community (NPC). The U.S. had decided to take the reins of APEC: "quite simply, the economic dynamism of the region ... demands U.S. engagement."<sup>53</sup> As APEC's most powerful member, few explicitly opposed this move; some wholeheartedly supported it. But many APEC members realized that the NPC fundamentally clashed with the open regionalism which had hitherto defined APEC.

The NPC was based on the three pillars of prosperity, security and democracy. These three pillars changed APEC's agenda. Regional security and the expansion of democracy vied for attention, stealing away some of the limelight from its purely economic purpose. The NPC created some friction within APEC, in particular the democracy pillar which was viewed by China as an attack on their Human Rights record. Malaysia boycotted the meeting, ostensibly because of the NPC. APEC Leaders nonetheless endorsed the NPC vision. However, these U.S.-imposed democracy and security goals have yet to become a high priority in APEC.

The substantial effect was on APEC's economic goals. In 1989 there was only brief mention of freeing trade, and little mention of the effects of freeing trade on jobs and exports. In 1993, State Department officials and the President had a tunnel focus on freeing foreign official barriers to trade. The President stressed that the U.S. government needed to link arms with the private sector, helping it compete in the new, global economy, because the private sector had failed when left to its own devices. In practical terms, this meant increasing exports, opening foreign markets and reducing the U.S. trade deficit.

<sup>51</sup>Prior to 1993, one heard barely a whisper about APEC from the news media, especially from the U.S. press. It was not until October and November of 1993 that the U.S. media shone the spotlight on APEC.

<sup>52</sup>Remarks by leaders at the Jakarta Summit, 1994

<sup>53</sup>Spero, Joan, Economics and Foreign Policy: The New Pacific Community. September 21, 1993, 701

In 1993, the U.S. and the EPG embraced a regional trade liberalization agenda for APEC (the EPG's role will be analyzed in the section V). Trade facilitation was put on the backburner. The APEC Working Groups, devoted to trade facilitation issues, continued to meet; but they were no longer the central focus. Some objected to the newer trade liberalization priority: Malaysia's Prime Minister refused to attend, and Thailand's minister made a special statement reiterating that APEC's priorities should be the GATT, enhancing cooperation and trade facilitation.

This shift towards a regional trade liberalization agenda can best be understood in the broader context of U.S. trade policy. The U.S. had become obsessed with opening foreign markets: "economic security is America's top foreign policy priority."<sup>54</sup> They began using a plethora of approaches to achieve their goals.<sup>55</sup>

According to the State Department, the multilateral approach was the highest priority: "we are not interested in regional trade blocs ... we want to head them off."<sup>56</sup> On a regional level, APEC was the "cornerstone." Bilaterally the U.S.-Japan relationship was the "most important" and bilateral frameworks generally were still "very effective" at opening foreign markets. A new set of U.S.-Japan talks, the U.S.-Japan Economic Framework, was established just months before the Seattle summit. In addition, America was sometimes a Pacific Nation (Secretary Christopher), sometimes an Atlantic nation (Clinton), and sometimes a global nation (Spero). Regional economic objectives overlapped with similar bilateral and multilateral initiatives, and U.S. trade policy began to look like a confusing mess.

The President saw no conflict between these approaches as, he argued, there would always be outstanding issues that needed to be discussed. This may be true, but there should have been some sensitivity to the unique aspects of the different approaches and the conflicts between them. As most economists point out, FTA formation can undermine the GATT. Most economists warned that regional initiatives, regardless of the denials to the contrary, would be seen as bloc formation (indeed, to help conclude the UR, the U.S. explicitly reminded the EC that the U.S. had alternatives to the GATT, namely a Pacific bloc). However, the "multilateralism vs. regionalism" debate in the economics literature was not reflected in State Department policy.

A perfect example is in November 1993 when the U.S. simultaneously established the "closed regionalism" of NAFTA whilst mouthing the buzzword of "open

<sup>54</sup>Christopher, Warren, 1993 Hearings before the Senate Foreign Relations Committee.

<sup>55</sup>In this paper, the term "approach" or "level of approach" refers to the whether negotiations and actions are undertaken on a multilateral, regional or unilateral basis.

<sup>56</sup>Vision for A New Pacific Community, Winston Lord at a news briefing in Dispatch, August 31, 1993: 613



regionalism" in the Pacific. One journalist asked the President to reconcile these contradictory approaches, namely, how he viewed the closed NAFTA operating within a broader, nondiscriminatory APEC. President Clinton replied, they both "free" trade and so are fully complementary. Besides, "most of what we do [with NAFTA] would have marginal or no impact on Asia."<sup>57</sup> Then why do "the Asians, to put it bluntly, hate the NAFTA."<sup>58</sup>

The Administration failed to demonstrate an understanding of the subtle (and not-so subtle) differences between multilateral, regional and bilateral approaches to freeing trade. These differences are, of course, the subject of intense discussion in the economics literature. Bilateralism and regionalism usually result in discriminatory deals, resulting in trade diversion which is harmful not only to other nations but to a continuing confidence in the multilateral trading system. There is little evidence that these dilemmas permeated the Administration's mind. In the NPC framework, APEC is simply another way of freeing trade: "if we encounter obstacles in a bilateral negotiation, we should be able to appeal to other APEC members to help us resolve the disputes ... if our efforts to secure global trade agreements falter, then APEC still offers us a way to expand markets."<sup>59</sup> Multilateralism vs. regionalism vs. bilateralism is not the issue: "Our goal is simple: to open markets, not close them; to create more trade and jobs, not less" (Warren Christopher).<sup>60</sup> (This lack of a guiding philosophy behind U.S. trade policy mirrors the methodological problem of the IPE theorists: "... It seems merely a game of idle speculation or casual empiricism.")<sup>61</sup>

APEC, argued Secretary of State Christopher, was not created to micro-manage trade but to get bureaucracy out of the way of business. Of course, the "new" government partnership with business is micro-managing trade. Spero and Christopher tell U.S. businessmen at APEC, "our embassies overseas and our people [State Department] in Washington stand ready to assist [U.S. businesses]."<sup>62</sup> This is indicative of the broader trend changing the face of APEC: a U.S. frenzy over foreign market access and increasing jobs and exports. Open regionalism, which Secretary Christopher explicitly (re)defined as "a building block, not a trading

<sup>57</sup>Press Conference by the President and Prime Minister Keating of Australia, September 14, 1993

<sup>58</sup>Bergsten, C. Fred, Hearing before the Committee on Small Business, Feb. 23, 1994: 8

<sup>59</sup>President Clinton in Remarks to the Seattle APEC Host Committee, November 19, 1993, 2402

<sup>60</sup>Christopher, Warren in Focus on Asia-Pacific Economic Cooperation, 642

<sup>61</sup>Cohen, Benjamin J., The Political Economy of International Trade: 281

<sup>62</sup>Spero, Joan, Economics and Foreign Policy: The New Pacific Community, September 21, 1993, 703

bloc,"<sup>63</sup> an inclusive not a closed club, was nonetheless significantly altered from the Australian economists' conception. APEC, while still supporting trade facilitation efforts, bumped up trade liberalization to top priority. The U.S. never conceived of nondiscriminatory trade liberalization, stating "if we're going to have freer trade, it must be fairer."<sup>64</sup> Reciprocity, the hallmark of neorealist political scientists, pulled the rug from underneath the Australian economists.

### Free Trade by 2020: The Bogor Declaration

At the 1994 APEC Leaders Conference in Jakarta, Indonesia, the APEC nations agreed to free trade and investment in the region by 2020. Known as the "Bogor declaration," the developed members of APEC pledged to free their trade in the region by 2010, and developing members pledged to free theirs by 2020. If this agreement were to become a reality, APEC would become the largest FTA the world has ever seen.

How did the Bogor declaration square with open regionalism? Fortunately, the agreement did not specify whether regional trade liberalization would be discriminatory or not. Nevertheless, the U.S. stated publicly that their liberalization would be on a reciprocal, discriminatory basis: no free-riders. According to President Clinton, regional trade liberalization "will be reciprocal as it proceeds."<sup>65</sup> If the U.S. has its way, APEC liberalization will be reciprocal, on a country by country basis.<sup>66</sup> The regional grouping of APEC would be transformed into a web of discriminatory bilateral agreements. Just as the founding economists feared, free-rider resentment overrode the principle of nondiscrimination. The true meaning of open regionalism, which is centered on trade facilitation and non-discrimination, was ignored by the U.S. administration (though they continue to use the term "open regionalism" without abandon).

The U.S. Administration seems incapable of selling the policy of free trade to the American public solely on its own merits. There must be reciprocity, it must appear like America is getting a good deal. One journalist asked, given the tough fight over GATT and NAFTA, how could the President convince Americans they will benefit from free trade with low-wage Asia? Clinton replied that America is walking towards Asia on terms that are fair and that there will be no unilateral

<sup>63</sup>Christopher, Warren, Secretary of State, Developing APEC as a Platform for Prosperity, November 17, 1993: 824

<sup>64</sup>Remarks by the President to Members of the U.S. Business Community and Pacific Business Leaders, Jakarta, Indonesia, November 16, 1994

<sup>65</sup>Background Briefing by Senior Administration Official, November 15, 1994, Jakarta, Indonesia

<sup>66</sup>The U.S. would fulfill its agreement with country A only when country A fulfills its agreement with the U.S. Of course, that would be a neat trick as developing nations need only free their trade by 2020, ten years after the U.S. should have fulfilled its agreement.



reductions. Unlike the open regionalists who support unilateral liberalization, the U.S. argues that free trade is good policy only when it is fair trade, regardless of the benefits to American consumers.

The frenzied urge to aid American businesses seems to be the overriding objective behind the Administration's interest in APEC. "Businesspeople," Clinton proclaims, "tell me that for the first time ever, they see an American State Department interested in economic advancement as well as diplomatic progress."<sup>67</sup> This is untrue: the pre-1993 State Department was a strong supporter of multilateral free trade. However, by 1994 the State Department and the Administration had become a lobbyist for exporters: "we have unashamedly been an active partner in helping our business enterprises to win contracts abroad."<sup>68</sup> This new attitude originates from the U.S. Commerce Department, whose worldview has taken over the Administration.

#### U.S. Department of Commerce in 1994 - Big Emerging Markets Strategy

The Clinton Administration not only brought home the Bogor declaration from Indonesia, it brought home the bacon: \$40 billion worth of contracts for U.S. multinationals.<sup>69</sup> The Commerce Department's Export-Import Bank provided the financing for those foreign projects on the proviso that the contracts be awarded to American companies. Secretary of State Christopher and Secretary of Commerce Brown proudly hosted the signing ceremonies.

This incident gets to the heart of the U.S. commitment to free trade. Before 1993, the State Department was the only U.S. government agency involved in APEC. But that changed when the entire Administration landed in Seattle in 1993. Representatives from the State Department, the Commerce Department, the U.S. House of Representatives, the Customs Service, and the Export-Import Bank, not to mention the President and Vice-President, all attended. Whilst at the Seattle and Jakarta meetings, the Commerce Department took "every opportunity to push projects of U.S. firms in the course of doing other business with foreign governments."<sup>70</sup>

The Commerce Department's mission is called the Big Emerging Markets strategy (BEM). Developed and unleashed over the course of 1994, the Commerce Department mobilized all government forces to implement the BEM. It was endorsed by 19 U.S. agencies and the President. The Commerce Department's

<sup>67</sup>Remarks by the President to Members of the U.S. Business Community and Pacific Business Leaders, Jakarta, Indonesia, November 16, 1994

<sup>68</sup>Remarks by the President to Members of the U.S. Business Community and Pacific Business Leaders, Jakarta, Indonesia, November 16, 1994

<sup>69</sup>Press Release, State Department, Jakarta, Indonesia, November 17, 1994: 1

<sup>70</sup>Garten, J. E., Competing to Win in the Global Marketplace

influence on U.S. policy toward APEC has encroached the views of the rest of the Administration.

The BEM is the strategic capture of key markets. It designates the top ten "markets that hold the greatest potential for dramatic increase in U.S. exports"<sup>71</sup> in the coming decades. However, since severe protectionist barriers inhibit attempts by U.S. businesses to enter these "battlegrounds," the U.S. government must help American businesses by "securing market access, providing financing, and supporting U.S. companies seeking to win major projects on deals which foreign governments play an important decision-making role."<sup>72</sup> Less aggressive strategies include publishing a magazine, Business America, to inform U.S. businesses of the foreign goldmines that had somehow escaped their attention.

The BEM strategy taints U.S. interest in APEC and U.S. support for free trade. The Commerce Department's goal is to pry open *foreign* markets, not domestic ones. They believe trade is war, hence the establishment of "a special advocacy 'war room' ... what Export-Import Bank Chairman Ken Brody calls 'aggressive defense.'"<sup>73</sup> This worldview of "ferocious competition" implies that reciprocity is the only trade liberalization strategy available to the U.S. Unilateral liberalization is viewed as giving in to the enemy. Economists are not heard in these hallowed halls. The Commerce Department's strategy is a country-by-country, firm-by-firm, bilateral approach.

Unfortunately, their worldview of Big Emerging Markets captures the rest of the Administration. How committed can the U.S. Administration be to free trade when they are unashamedly bribing foreign governments to hire U.S. firms, the day after they sign the Bogor free trade pact? The pillars of democracy and security, and even mutual prosperity, were scarcely mentioned in 1994. Nor were the views of open regionalists and Vinerian economists. The Commerce Department's Big Emerging Market vision replaced the State Department's NPC vision and together they spelled death for an open regionalist vision of APEC. The Administration and the State Department were listening to strategic traders, neorealist political scientists and big business exporters. Their method of retaliation and their motivation (increasing exports) is a world away from that of the economists.

#### V. Re-Engineering Ideas: The Role of The Institute for International Economics

One of the Institute for International Economic's (IIE) hallmarks is pragmatism and this pragmatism is evident in its approach to APEC. Originally, the IIE originally played a minor role in the evolution of APEC, and began as an opponent. However, by 1994 the IIE had become the driving intellectual force behind APEC.

<sup>71</sup>Garten, J. E., Deepening Our Ties with the Big Emerging Markets: 1

<sup>72</sup>Garten, J. E., Deepening Our Ties with the Big Emerging Markets: 3

<sup>73</sup>Garten, J. E., Deepening Our Ties with the Big Emerging Markets: 9



The Director of the IIE, C. Fred Bergsten, has chaired APEC's steering committee, the Eminent Persons Group (EPG), from its inception in 1993 to the present day. The IIE was also the most prolific of non-governmental research organizations (NGROs) in publishing on the issues of regionalism, FTAs and APEC. In recognition of their importance, Winston Lord described the work of Bergsten and the EPG as "the most impressive impact on major policy by a non-governmental person/team that I have ever witnessed."<sup>74</sup> Their efforts dwarfed those of any other in U.S. civil society.

### Before APEC

In the 1980s and early 1990s, the IIE urged the U.S. to direct its free trade energies towards completing the UR. Their publications consistently placed GATT on a pedestal. They argued that a large trade liberalization package with extended coverage was necessary to blunt the protectionist pressures that were building in the U.S.<sup>75</sup> Such a free trade victory would "renew confidence in the efficacy of the ... GATT and provide a viable alternative to unilateral actions and regional trading arrangements."<sup>76</sup>

In other words, they generally opposed regional trading arrangements.<sup>77</sup> Nonetheless, they could not ignore recent U.S. flirtations with the FTA concept and hosted a conference in October, 1988, to assess the FTA approach. The IIE was the first NGRO to have a major discussion on FTAs. A clear, unanimous message emerged from that conference: U.S. interest in FTAs undermines the GATT, threatens the world trading system and is therefore contrary to U.S. interests. The conference was attended by Senators, journalists, U.S. Trade Representatives, businessmen and many other influential people. It was quite clearly intended to dam the FTA flood (with the exception of NAFTA), by presenting arguments against the creation of more FTAs to the policy-makers and the wider public.

Considering the unique role of the IIE in the history of APEC, it is worthwhile examining precisely what it advocated in 1988. Jeffrey Schott<sup>78</sup> argued that FTAs are no panacea (Bergsten shares Schott's skeptical view of FTAs, at least in 1988, advocating a conclusion to the UR, reducing the budget deficit, and coordinating

<sup>74</sup>Winston Lord, *Memo to C. Fred Bergsten*, November or December, 1994

<sup>75</sup>Over the 1980s, the IIE released a plethora of studies on the UR, offering suggestions on how to make agreements in contentious areas such as agriculture and subsidies.

<sup>76</sup>Schott, Jeffrey J., *The Global Trade Negotiations: What can be Achieved?*: 5

<sup>77</sup>One exception was CUSTA; the other was NAFTA.

<sup>78</sup>Schott, Jeffrey J., *More Free Trade Areas?*

international macroeconomic policy).<sup>79</sup> One popular argument for FTAs is that they can help push along the GATT talks. Agreement are more likely to be reached in smaller groups (such as FTAs) and these agreements can then form the basis for and be extended to the multilateral realm. Hence, FTAs can speed up the pace of negotiations. Furthermore, FTAs can act as credible threat. If the EC believes the U.S. can guarantee markets through FTAs and without a free multilateral trading system, the EC may be forced to make the concessions necessary to conclude the UR.

Schott, while a little sympathetic, responds that this strategy is not likely to boost the GATT. Firstly, the benefits of smaller groups are exaggerated<sup>80</sup> and many protectionist devices, such as subsidies, cannot be reduced bilaterally. Secondly, U.S. pursuit of FTAs will send a signal that the U.S. is turning inward and becoming protectionist, which may inadvertently trigger a rush to secure market access to the U.S. rather than help conclude the UR. "At the very least, it would be evident that the U.S. was diverting scarce resources away from the GATT round."<sup>81</sup> Thirdly, the trade diversion from FTAs would create friction between nations and would put "regional discrimination [in place of] the MFN principle which is the foundation of the GATT system."<sup>82</sup> Fourthly, FTAs have a sequencing problem.<sup>83</sup> Fifthly, most FTAs have not been consistent with GATT rules, which specify that substantially all trade barriers be reduced between the member nations (only then is trade creation likely to outweigh trade diversion). Only four FTAs out the 69 ever created have been endorsed by GATT. In the Canada-U.S. FTA, the main U.S. concessions were a dispute settlement mechanism and a greater certainty about how U.S. trade laws would be administered: "proponents of FTAs seem to believe the U.S. can negotiate reductions in foreign trade barriers in return for tariff cuts and a promise not to raise U.S. non-tariff barriers."<sup>84</sup>

While many excellent papers were presented at the conference, the most relevant for APEC's future was presented by Drysdale and Garnaut. This paper considered the prospects for an Asia-Pacific FTA. While the buzzword "open regionalism" was not used, the concepts expressed were essentially the same. They argued that an Asia-Pacific FTA might be attractive if it at least preserved the system of relatively open economic relations in the Pacific and the world. Asia-Pacific dynamism, they

<sup>79</sup>Bergsten, C. Fred, *America in the World Economy: A Strategy for the 1990s*, November 1988. Bergsten spends no more than a few sentences on FTAs in this game plan for the 1990s.

<sup>80</sup>Consider the NAFTA negotiations, which took over four years to come to agreement.

<sup>81</sup>Schott, Jeffrey J., *More Free Trade Areas?*: 52

<sup>82</sup>Schott, Jeffrey J., *The Global Trade Negotiations: What can be Achieved?*: 7

<sup>83</sup>See the section, *The Traditional Multilateralists*.

<sup>84</sup>Schott, Jeffrey J., *More Free Trade Areas?*: 12



say, has relied crucially on an open trading system, so free trade has strong support in Asia. This might help the U.S. throw off its current affection for protectionism (this argument, that FTAs can help deflect clamoring by U.S. lobbies for aggressive trade policies, becomes a key component of the IIE's platform after 1989). Arguing against a *discriminatory* FTA, which would only inflame the EC and divert attention away from the GATT, they propose a non-discriminatory FTA in the open regionalist vein. In other words, the IIE conference unveiled open regionalism to the American public.

Indeed, all conference participants berated recent U.S. trade policy. Their arguments were all along the same lines. FTAs are being discussed for all the wrong reasons. U.S. interest in FTAs stems from U.S. disillusionment with the GATT and their rising trade deficits. While GATT's weaknesses are real,<sup>85</sup> FTAs are not the panacea that some Americans imagine them to be. U.S. interest in FTAs is fueled by a U.S. obsession with rising trade deficits. They said that U.S. Congress, business and labor interests had become strong advocates of aggressive trade policies to force open foreign markets, claiming that these policies would reduce U.S. trade deficits. In this atmosphere, many Americans believed that (bilateral) FTAs were a solution to both trade deficits and the failures of the GATT. They believed that U.S. economic and political leverage would be stronger in a bilateral or regional context than a multilateral context (reflecting the views of neorealist IPE theorists). Conference participants pleaded for the U.S. to abandon its misperceptions and misguided policies.

In fact, it was the IIE that was doing the pleading on behalf of economists. The conference was organized primarily to dam the FTA flood and criticize current U.S. trade policy. The cards were stacked. I believe the conference participants were chosen because it was known, a priori, that they would urge the U.S. to eschew the FTA approach and focus instead on the GATT. Many of the participants were long-time free traders (Anne Krueger, Gardner Patterson, former Deputy Director-General of the GATT); most of the others were foreigners, many from Asian nations, who could be relied upon to come down against FTAs in general, and in particular, against proposed FTAs between the U.S. and their respective countries.<sup>86</sup> Their audience consisted of policy-makers and journalists, people who might help dam the FTA flood.

One final point: although Schott and the IIE opposed FTAs in general, there were two exceptions. The U.S.-Mexico and U.S.-Canada FTAs were intellectually defensible according to Schott. The Canada-U.S. FTA was natural, and focused mainly on rule-making, not market access. The services agreement could be a building block, as services were not covered by GATT at the time. The U.S.-

<sup>85</sup>Negotiations are slow, coverage excludes subsidies and services, and Americans feel snookered by free-riding developing nations.

<sup>86</sup>Proposed FTAs considered at the conference included a U.S. Mexico, U.S.-Japan, U.S.-Korea, and a Pacific FTA.

Mexico FTA would have limited potential for trade diversion and would be jolly neighborly, supporting Mexico's economic development. However, Schott opposed a Pacific Rim FTA in 1988: "consideration should be given to FTAs with countries in the Pacific Rim only if the GATT round falters."<sup>87</sup> A few years later, the IIE completely reversed their position and became one of the strongest proponents of a Pacific FTA. Over those years, there emerged a new trend in U.S. trade policy, or an old trend that had become more immediate, which necessitated such a reversal by the IIE.

### The Dissemination of the Theory of Open Regionalism

In 1992, the IIE's director, C. Fred Bergsten, became chairman of APEC's intellectual task force, the Eminent Persons Group (EPG).<sup>88</sup> The IIE was in a powerful position to guide APEC and in 1992 they hosted a conference on the Pacific Rim to discuss APEC's future. This conference, like the one in 1988, was focused on the issue of regionalism vs. multilateralism, but involved a smaller audience, attended almost exclusively by academics and researchers from other NGROs. This conference was a brainstorming session for the IIE rather than an attempt to directly influence policy-makers. It also signified the IIE's more serious interest in FTAs.

At the conference Bergsten outlined his bicycle theory of trade liberalization to justify the FTA approach. The bicycle theory is that unless a new GATT round follows immediately after the previous one is concluded, backpedaling towards protectionism will occur. Therefore, after every GATT round is concluded, a new one should begin. For Bergsten, APEC could be instrumental in this regard, building free trade agreements at a regional level to be extended to the global level (a building block). Alternatively, if this proved politically untenable, APEC could simply become an Asian OECD, facilitating trade as the open regionalists suggested (the EPG's 1994 report includes both as possibilities). He concluded by reminding the U.S. that trade policies are not an instrument for correcting trade imbalances. To fix its trade imbalances the U.S. must get its domestic house in order.

The most influential article that emerged from this conference came from Drysdale and Garnaut. They presented the same open regionalist proposal as they did in 1988, supplemented with a massive amount of empirical evidence. But in 1992 they are even more pessimistic about the future of the world trading system. NAFTA and the EAI pose a serious threat to the GATT, as does the disappointing results of the UR. They propose that open regionalism might be able to mitigate this threat, because it can divert the FTA flood towards the cause of multilateralism. But they have very modest hopes: "at best [APEC under open regionalism] could become a substantial agent of expanding Asia-Pacific trade and economic

<sup>87</sup>Schott, Jeffrey J., *More Free Trade Areas?*: 55

<sup>88</sup>The EPG was charged by APEC to create a Vision for APEC. The vision they constructed was wholeheartedly approved by APEC in 1993.



welfare."<sup>89</sup> They have no illusions that an open regionalist APEC would even resemble a true FTA, given the current climate. They end with a warning: "the whole framework of open regionalism would fail unless [nondiscrimination is adhered to because discriminatory liberalization] ... would entrench the European-Pacific trade tensions and division that they were designed partially to avoid."<sup>90</sup>

Through the boom-box of the IIE, the term and concept of open regionalism found its way outside the Academy and into the U.S. public sphere. The news release for Pacific Dynamism focused on Drysdale and Garnaut's ideas and specifically mentioned the term "open regionalism." It argued that open regionalism offers a good way to avoid a world of trading blocs. After 1992, the theory of open regionalism began to appear in a wide variety of forums in the U.S. Harry Harding, at the Brookings Institution, supported their ideas in an article in Foreign Policy.<sup>91</sup> The Economist magazine reported on it. President Clinton himself used the term open regionalism to describe the Bogor Declaration in 1994. Before 1992, open regionalism, as a theory and a term, was unheard of in the U.S. The theory of open regionalism was aired in an IIE conference in 1988 but nothing happened. It was only after 1992, and after the IIE became interested in supporting FTAs, that the theory of open regionalism was disseminated far and wide, demonstrating the crucial importance of NGROs in turning economic theories into reality.

### If You Can't Beat Them, Join Them

Why did the IIE so dramatically change its attitude towards FTAs? Why did it initially oppose the FTA approach, only to become one of its strongest advocates by 1993?

It became clear that the U.S. was unable to deal rationally with its trade imbalances, blaming them on foreign protectionist barriers. This myth spawned a rise in U.S. protectionism and aggressive trade policies, and an increasing flirtation with FTAs. A number of NGROs found themselves devoting an enormous amount of time trying to stop these harmful U.S. reactions to the "evil foreigner" myth.

Brookings Institution, for example, focused on macroeconomic policy coordination, which was touted by the U.S. Congress as a way to reduce the trade imbalance. Brookings released many studies on international policy coordination in the late 1980s and early 1990s, all of which concluded that such a solution was unlikely to be beneficial. Mis-coordination was the more likely outcome, sometimes with disastrous consequences. One example should suffice.

<sup>89</sup>Drysdale, P. and Garnaut, R., The Pacific: An Application of a General Theory of Economic Integration: 220

<sup>90</sup>Drysdale, P. and Garnaut, R., The Pacific: An Application of a General Theory of Economic Integration: 220

<sup>91</sup>Harding, Harry, Asia Policy to the Brink, *Foreign Policy*, Fall 1994

Brookings senior fellow Warwick J. McKibbin and professional economist Jeffrey D. Sachs tested several models of macroeconomic coordination on data from the 1980s to see if coordination of macroeconomic policies would have reduced U.S. trade deficits. They discovered that monetary policy coordination, in particular depreciating the dollar, would have had little effect on U.S. trade deficits. Turning to fiscal policy, they found that foreign fiscal policies only weakly affects U.S. trade imbalances. Furthermore, correctly coordinating those policies would have been very difficult since there is no optimal rule to follow: the best policy depends on the (unpredictable) shocks. Indeed, fiscal policy co-ordination may well have worsened the U.S. trade imbalances. They concluded that "of the policies explored, we find that ... [only] changes in the U.S. fiscal balance can have a substantial effect on the U.S. external imbalance. But even an elimination of the U.S. budget deficit would not entirely eliminate the U.S. trade deficit, ... there must be an additional rise in U.S. private savings rates or, less desirable, a downward shift in U.S. investment rates."<sup>92</sup> McKibbin and Sachs argue that attempts to reduce foreign, especially Japanese, protectionism should focus on the right issues, the prospects of U.S. firms and industries, not illusory reductions in trade deficits. U.S. trade deficits cannot be blamed on Japanese protectionism: U.S. trade deficits worsened with all OECD countries in the 1980s.

### Conclusion on the Role of NGROs in the APEC debate

Many U.S. NGROs are still battling today to contain the forces against free trade. But it is strange battle, not directed at protectionists in the traditional sense. It is partly a battle against the neorealist political scientists, who advocate retaliatory tactics to open foreign markets. But it is a mainly a battle to contain the fallout from America's misconception about trade deficits. To be sure, the trade deficits are not by any means the sole cause of America's rising protectionism. Disillusionment with the GATT stems from understandable frustration with a reluctant EC and problems inherent in the GATT bargaining system. Nevertheless, trade deficits have been the main justification for increasing the level of U.S. protectionism and for various other irrational policies that are independent of national self-interest. The new U.S. trade policy interest in FTAs lie "in the [American] polity's incapacity to come to grips with profound macroeconomic imbalances ... Other countries' protection policies are blamed for a payments imbalance that has its origins in domestic budgetary policy."<sup>93</sup>

In this atmosphere, the U.S. government thought that macroeconomic policy coordination might be the solution to its trade imbalances. So Brookings asked economists like Jeffrey Frankel and Jeffrey Sachs, who had for years opposed macroeconomic coordination, to study that possibility, and they concluded that the solution lies in reducing America's budget deficit. In this atmosphere, the U.S.

<sup>92</sup>Sachs, Jeffrey D. and McKibbin, Warwick J., Global Linkages: Macroeconomic Interdependence and Cooperation in the World Economy: 11

<sup>93</sup>Drysdale, Peter and Garnaut, Ross, A Pacific Free Trade Area?: 249



government thought that FTAs might be the solution to its trade imbalances. So the IIE held a conference on FTAs, stacked with GATT supporters, and concluded that America should reduce its budget deficit and stick with the GATT. Everyone is attempting to contain the fallout from trade deficits but none are able to deal head-on with the true cause: the budget deficit! None can debunk the misconception that protectionism causes trade imbalances. None can debunk the mercantilist notion that trade deficits are somehow inherently bad.

Today, in the year 1995, the NGROs are still dealing with these same misconceptions. The pragmatic and well-intentioned IIE is turning to FTAs and open regionalism to hopefully halt America's rising protectionism. Even former Deputy Director-General of the GATT, Gardner Patterson, is willing to give the FTA his blessing, as the lesser of two evils, if it can counter the much more destructive policies of managed trade, such as Voluntary Export Restraints and Super 301.<sup>94</sup> Unfortunately, these pragmatic approach simply postpone dealing with the true causes of this new U.S. attitude: the trade and budget deficits.

The IIE, faced with the above dilemma, tried (and are still trying) to inoculate U.S. interest in FTAs by mixing in the open regionalist idea. Open regionalism, they believed, might be catchy enough to attract U.S. policymakers. But they also modified open regionalism, creating a variant that had more to do with regional trade liberalization and less to do with trade facilitation. Against the warnings of Drysdale and Garnaut, they are toying with an open regionalism that may lead to a discriminatory FTA. The IIE hopes that regional trade liberalization in APEC, discriminatory or not, will be extended to the multilateral realm and lead to a new round of GATT agreements. If making APEC into a forum for regional trade liberalization is what is needed to keep the U.S. interested in an Asia-Pacific FTA, and if the U.S. would otherwise descend into protectionism, then the IIE's strategy may be the best one around. Or it may kill the fruitful consensus in APEC that open regionalism raised and nurtured. Either way, the Australian economist's conception of open regionalism began to die the day the IIE began to promote it.

On a more positive note, open regionalism proved it power, creating a "common consciousness" within the EPG and within APEC. Open regionalism reflected the values of Asian nations, because the theories were derived from the Asian reality of the 1970s and 1980s. Asia's agreement was assured. More impressively, open regionalism also won over Bergsten and the IIE, guaranteeing its place in APEC. As Warren Christopher wrote, "[the Bogor agreement] would not have happened without you [Bergsten] and the EPG."<sup>95</sup> While Bergsten and the IIE deserve the credit for making Bogor happen, the ideas and groundwork that made Bogor a reality were those of the Australian economists. Open regionalism created a shared space from which these later agreements could occur.

## Conclusion

APEC is the story of the idea of open regionalism. It is an idea that was created in the growing markets of Asia in the 1970s. Long-time Asia watchers, Peter Drysdale and Ross Garnaut, witnessed open regionalism in action and developed a theory that open regionalism could be applied anywhere in the world. Open regionalism spread with incredible speed all over Asia and finally into America, in economic journals as prestigious as the *American Economic Review*, and in NGROs as clever as the IIE. Through the IIE, open regionalism was re-engineered to penetrate the minds of American government officials (no easy task!), and became the guiding principle behind APEC. The EPG advocated that Asia and America make use of open regionalism for the mutual prosperity of both. But wait, Asia was the founder of open regionalism. Asian nations already lower their trade barriers unilaterally, and allow the private sector to break down barriers between Taiwan and the China are ignored by the traders who integrate these two economies. So why is the EPG advocating that APEC adopt open regionalism? It is for America's benefit, for America's ears. In the perfect example of Deutsch's concept of a shared consciousness, open regionalism is APEC's shared value. If all members accept the precepts of open regionalism, then there is ample room for mutually beneficial cooperation. Trade facilitation was a good antidote to America's increasing protectionism. It would avoid the two economic disasters: reciprocal (and hence discriminatory) trading agreements and trading blocs. Open regionalism was working in APEC until 1993.

But the value of open regionalism was not shared by all: it was not shared by America. The neorealist political scientist definition of "fairness", misapplied to free trade (win-win situation), permeates the views of the Administration and Congress. It is a modern day version of mercantilism, but so intuitively appealing that it seems impossible to debunk. The notion of "fairness," of mutually reciprocal reductions in trade barriers, is almost the only interpretation available to a non-economist public citizen; this worldview, not the free trade idea, has captured the minds of policy-makers. Unilateral liberalization is seen as giving in to the enemy. APEC, consequently, was derailed from its natural course of open regionalism and modified, potentially becoming a dangerous detour from addressing the real causes of the trade deficit.

Open regionalism was not thwarted by those special interests with their own economic self-interest tied to protectionism, or at least not directly. While it is well-known that there exist strong protectionist interests in society that thwart attempts to free trade, this paper has demonstrated that there are other forces out opposed to free trade for reasons other than self-interest. The notion of that only free trade must be fair does not simply stem from protectionist interests; it stems from an ingrained belief in U.S. civil society, a belief strongly perpetuated by the neorealist political scientists. The pervasiveness of this misconception can partly be explained by the lack of activist American economists. Few American economists have written anything in the media on APEC (not even Bhagwati, who wrote on NAFTA for the mass media). In the professional literature, it was mostly

<sup>94</sup>Patterson, Gardner, *Implications for the GATT and the World Trading System*

<sup>95</sup>Warren Christopher, *Memo to C. Fred Bergsten*, November 22, 1994



foreign economists, by suggesting open regionalism, who tried to find a way to help America back onto the multilateralism track. Their efforts were less than successful because of the ingrained perception that only reciprocation is fair. However, this paper demonstrates that there is hope for those like Drysdale and Garnaut who advocate and lobby for free trade solutions. There are many unbelievers who are ripe for conversion because their anti-free trade views are not tied to any economic self-interest. The open regionalists made significant strides towards a free-trading world. But convincing people of the righteousness of a free trade policy goes beyond addressing their economic self-interest. It means changing their worldview.

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**REACTIONS TO THE PHENOMENON OF FOREIGN  
DIRECT INVESTMENT IN THE UNITED STATES**

**STEPHEN MOON**