



APEC Study Centre

The Chinese University of Hong Kong

Free Trade Area of the Asia-Pacific

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Teaching Objectives

Since the proposal of the Free Trade Area of the Asia Pacific (FTAAP) at the 13th APEC Economic Leaders' meeting in 2005, the realization of free trade has been top of the agenda among APEC member economies.

This teaching case provides a comprehensive overview of FTAAP and thought-provoking materials to inspire our students on free trade issues



Learning Goals

We established 5 general learning goals for students to accomplish through learning this case.



Framework of
FTAAP



Implementation
of FTAAP



Issues ensued from
FTAAP



Tariff profile of 21
APEC countries



Effectiveness &
Limitations of FTAAP

This teaching case provides holistic contents and materials for interactive teaching and active learning. Teachers can find useful materials when designing assignments and projects for students

1. Clear teaching theme & learning goal are stated for each section.
2. Additional notes on relevant concepts are provided.
3. Additional multi-media learning support is also provided for different topics.
4. Suggested assignments and projects are provided after each chapter.

I Introduction

I-I Background of the FTAAP

Bogor Declaration¹ in 1994 marked the APEC members' commitment to the realization of a free trade area in the Asia Pacific region by 2010 for the industrialised economies and 2020 for the developing economies². The regional consensus on achieving **Bogor Goals** shows that the liberalisation of trade and investment, and facilitation of economic integration are essential to the region's economic growth.

Factors like the ever-changing economic landscape, complex business environments, and obsolete growth model, have sent a wake-up call to the highly interdependent region that in order to achieve sustainable economic growth, trade cooperation is genuinely needed. Recognizing the potentials through free trade, the APEC Business Advisory Council introduced FTAAP and envisioned a future of a more inclusive and integrated Asia-Pacific economy³.

Bogor Goals

- Enhancing competition policies
- Lowering restrictions on government procurement
- Reducing business costs
- Continuous expansion of trade agreements
- Tariff reduction
- Non-tariff measures
- Improving market access
- Relaxing conditions for foreign ownership
- Facilitating customs procedures

¹ Bogor Declaration: The Bogor Declaration was in 1994 in Bogor, Indonesia

² APEC's Bogor Goals Progress Report

³ Free Trade Area of the Asia Pacific

To find out more about:

APEC's Bogor Goals
Progress Report



In 2006, the APEC Leaders officially announced the vision of a FTAAP in response to the proposal of ABAC in Hanoi meeting⁴. Since then, the FTAAP has been seen as a key instrument to APEC's Regional Economic Integration (REI) agenda, streamlining cross-border procedures of people, goods and services.

Throughout the past few decades, APEC has been transforming the FTAAP from an aspirational vision to a more concrete establishment.

Initiatives toward REI

- The Free Trade Area of the Asia-Pacific (FTAAP)
- Improving Ease of Doing Business
- Streamlining Customs Procedures
- Implementation of Structural Reform Projects in Member Economies

⁴ The Beijing Roadmap for APEC's Contribution to the Realization of the FTAAP

To find out more about:

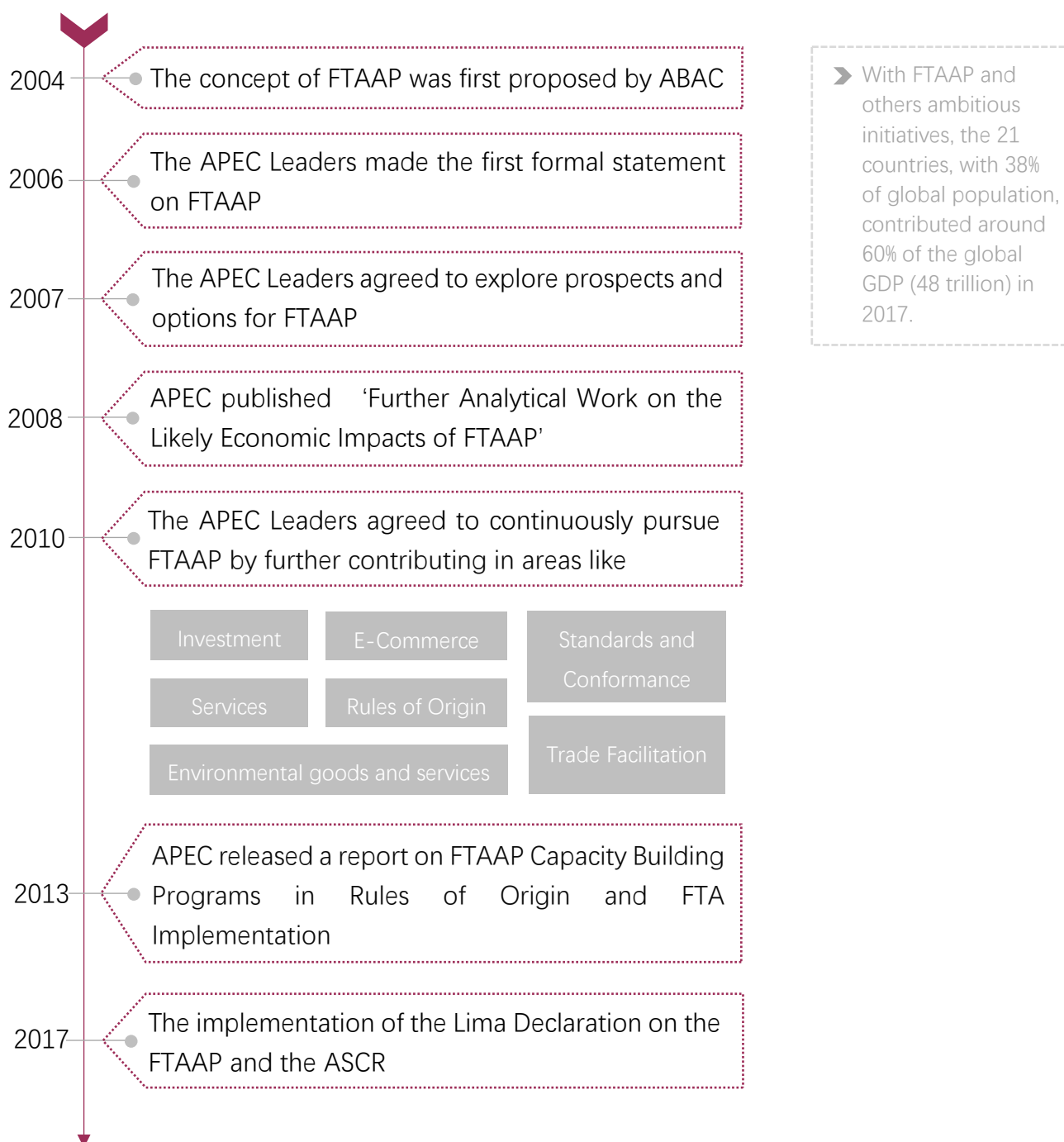
APEC News release
issued by the ABAC



Beijing Roadmap for
APEC's Contribution



Development and Achievement of FTAAP



To find out more about:

FTAAP Capacity Building
Program in ROO and FTA




APEC in Chart 2019



I-II Framework & Details of FTAAP

To APEC economies, FTAAP is crucial to regional economic integration. Once wholly realized, the FTAAP will be the most diverse and the largest trade agreement in the world (Petri, Findlay, Plummer and Wignarajia, 2015). It is also recognized as a comprehensive initiative that could not only achieve trade liberalization but also address the 'next generation' trade issues.

How can FTAAP  contribute to deeper integration?

The 4 pillars:

- Inclusivity
- Comprehensiveness
- Consultation
- Transparency

FTAAP has been operated under a consensus-based and step-by-step approach. The 21 member countries have been contributing to the overall prosperity in the region by committing to the realization of free trade in the region.

To find out more about:

Progress Report on Implementation
of the Beijing Roadmap



APEC Beijing Roadmap

Common views of the leaders⁵

- The FTAAP should be pursued with complementing and supporting the multilateral trading system.
- The FTAAP should achieve liberalization in a broader sense; it should be high quality, comprehensive and incorporate. Meanwhile, “next generation” trade and investment issues should be addressed.
- Achieving the Bogor Goals by 2020 has always been APEC’s core objective, and progress towards the goals will contribute significantly to the realization of FTAAP.
- The FTAAP will be realized parallel with the APEC process, outside of APEC. APEC should uphold its principles of non-binding, voluntary cooperation in its contributions to the FTAAP’s realization. APEC will continue its role as an incubator of the FTAAP by encouraging more unilateral trade and investment liberalization, and provide intellectual input and leadership to its realization.
- Greater efforts should be made to exploring the possible pathways to the FTAAP, including the RCEP and TPP.
- To help interested APEC economies with participating in preparation for the FTAAP’s realization, APEC should continue to provide effective technical and economic cooperation activities that assist developing economies, including in human resource, structural reform, SME development and integration.

What is spaghetti bowl phenomenon?



Spaghetti bowl effect is a term describing there are multilateral crisscrossing FTAs Free Trade Agreements (FTAs) signed across nations. To determine the preferential tariffs for goods, countries imposed specific requirements for Rule of Origin (RoO) and the Rule of cumulation (RoC) in each FTAs. However, the rules may be found to be contradictory when countries signed multiple FTAs. This may incur high administrative cost of enforcing these complex and numerous rules and lead to economic inefficiency.

⁵ The Beijing Roadmap for APEC’s Contribution to the Realization of the FTAAP

Actions undertaken to pursue FTAAP

- Launch a comprehensive strategic study on issues related to FTAAP's realization,
 - o Provide an analysis of potential social and economic benefits and costs
 - o Analyze the various pathways towards FTAAP
 - o Assess effects of the "spaghetti bowl" phenomenon on the economies
 - o Identify trade and investment barriers
 - o Identify challenges economies may face in realizing FTAAP
 - o Consider recommendations based on the study's findings.
- Continue the capacity building work in pursuit of the FTAAP under the Action Plan Framework of the 2nd Capacity Building Needs Initiative (CBNI). The results of the programs conducted under the 2nd CBNI will be reviewed periodically with the goal of building up the capacity of economies to participate in ongoing regional undertakings and realize the FTAAP.
- Advance "at the border" trade facilitation and liberalization efforts, enhance the business environment "behind the border" , and improve regional connectivity "across the border" .
 - o This includes advancing initiatives in areas such as:



Investment



E-commerce



Rules of Origin



Environmental
goods and services



Next generation trade
and investment issues

and more...

Lima Declaration on FTAAP

Goals and Principles⁶

- Reaffirmation the commitment to better the process in a systematic and comprehensive manner towards the realization of the FTAAP as a major instrument to pursue APEC's regional economic integration agenda.
- Recognition of APEC's critical role to play in nurturing and shaping regional economic integration, upholding the principles of inclusiveness, openness and cooperation, advocating profound economic restructuring, strengthening and deepening regional economic integration, and give impetus to the Asia-Pacific's sustainable development. APEC encourages unilateral economic reforms and the conclusion of comprehensive and high-quality RTAs/FTAs.

⁵ Lima Declaration on FTAAP

To find out more about:

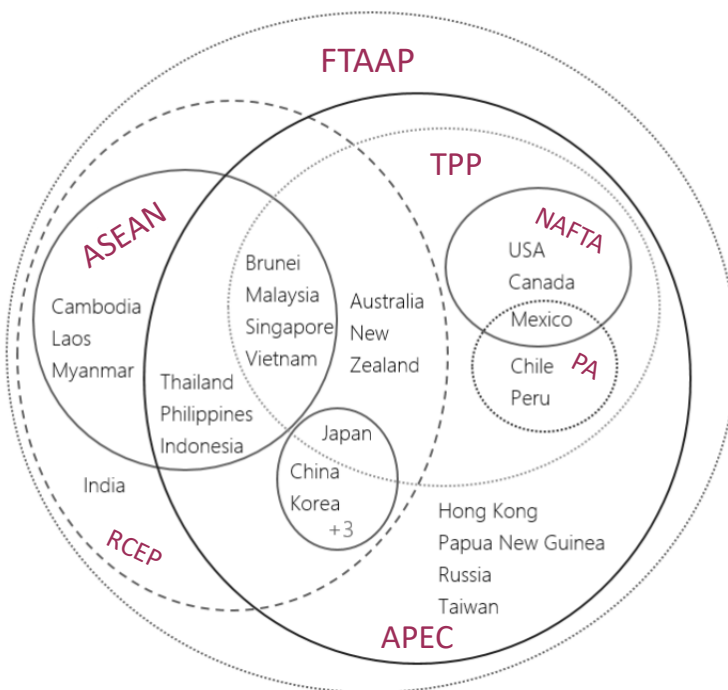
Lima Declaration on FTAAP



Lima Declaration on FTAAP

The APEC affirm their commitment that the FTAAP would be built upon ongoing regional integration undertakings, and through multiple pathways like the Regional Comprehensive Economic Partnership (RCEP) and Trans-Pacific Partnership (TPP).

	TPP	RCEP	PA	FTAAP
Year	2015	2012	2012	2006
Countries involved	Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam	Chile, Colombia, Mexico and Peru	The 21 countries of Asia Pacific Economic Cooperation
Goals	<ul style="list-style-type: none"> Promote mutually beneficial trade among the members Strengthen economic cooperation and eliminate trade barriers among the parties Raise living standards and lower poverty in the countries 			



FTAAP = Free Trade Area of the Asia- Pacific

RCEP = Regional Comprehensive Economic Partnership

NAFTA = North America Free Trade Agreement

APEC = Asia- Pacific Economic Cooperation Forum

TPP = Trans- Pacific Partnership

ASEAN = Association of Southeast Asian Nations

PA = 4 members Pacific Alliance (including Colombia)

CJK = China- Japan Korea trilateral

To find out more about:

Summary of the Trans-Pacific Partnership Agreement



Guiding principles and objectives for negotiating the RCEP

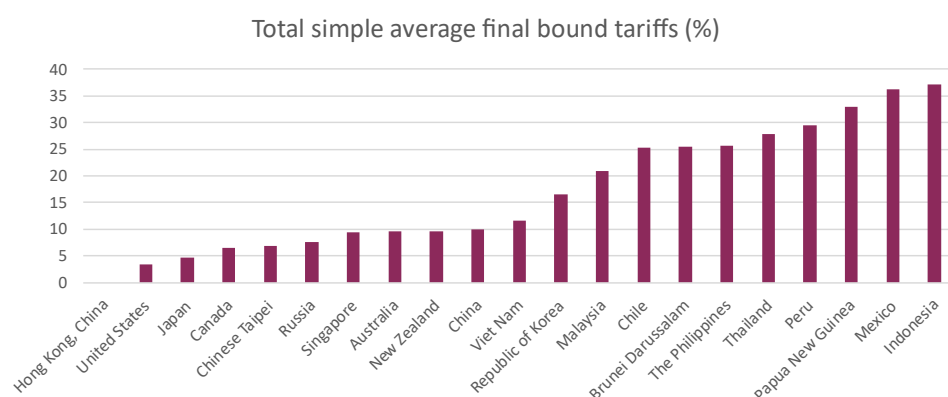


What is the Pacific Alliance?



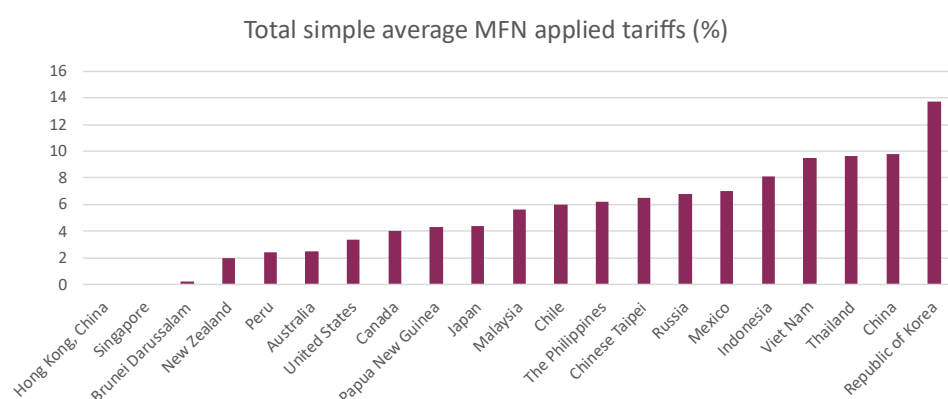
I-III Tariff Profile Analysis

To protect the interest of domestic industries (which this concept will be further elaborated in the next chapter), countries usually impose trade barriers like tariff on imported goods and services. This tariff profile⁷ analysis helps presenting the tariff charged among the member countries, and thereby demonstrating the trade condition without FTA.



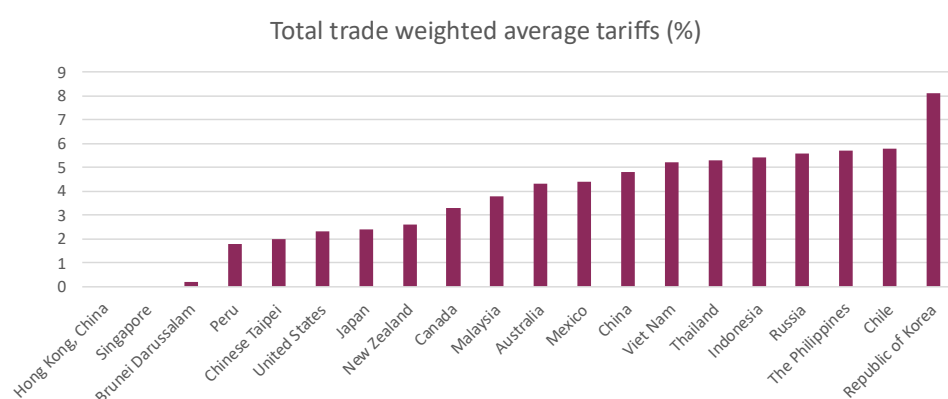
Total Simple Average Final Bound

It is the simple average of final bound duties (for both the agricultural and non-agricultural products) excluding unbound tariff lines.



Total Simple Average MFN Applied

It is the simple average of most favoured nation (MFN) applied duties for both the agricultural and non-agricultural products.



Total Simple Average MFN Applied

It is the HS six-digit MFN tariff averages weighted with HS six-digit import flows for both the agricultural and non-agricultural products.

Being one of the world's freest economy, Hong Kong imposes zero tariff among all the three tariff categories, while others have different extent of tariff measures.

⁷ World Tariff Profile 2019

Exports to major trading partners

For all the 21 APEC economies, their major trading partners (for both the agricultural products and the non-agricultural products), are the rest of the APEC members. Therefore, any trade barrier imposed in the trade within APEC would affect the trade and the benefits of the countries severely.

Australia

Agricultural products	Non-agricultural products
1) China	1) China
2) Japan	2) Japan
3) USA	3) Republic of Korea
4) Indonesia	4) EU
5) Republic of Korea	5) India

Brunei Darussalam

Agricultural products	Non-agricultural products
1) Egypt	1) Japan
2) Canada	2) Republic of Korea
3) Malaysia	3) India
4) South Africa	4) Thailand
5) Thailand	5) Australia

Canada

Agricultural products	Non-agricultural products
1) USA	1) USA
2) China	2) EU
3) Japan	3) China
4) EU	4) Mexico
5) Mexico	5) Japan

Chile

Agricultural products	Non-agricultural products
1) USA	1) China
2) EU	2) USA
3) China	3) EU
4) Hong Kong, China	4) Japan
5) Japan	5) Republic of Korea

China

Agricultural products	Non-agricultural products
1) Japan	1) USA
2) EU	2) EU
3) Hong Kong, China	3) Hong Kong, China
4) USA	4) Japan
5) Republic of Korea	5) Republic of Korea

Hong Kong, China

Agricultural products	Non-agricultural products
1) China	1) EU
2) USA	2) Switzerland
3) Macao, China	3) India
4) Singapore	4) China
5) EU	5) USA

Indonesia

Agricultural products	Non-agricultural products
1) India	1) Japan
2) EU	2) China
3) China	3) USA
4) USA	4) Singapore
5) Malaysia	5) EU

Japan

Agricultural products	Non-agricultural products
1) Hong Kong, China	1) China
2) Chinese Taipei	2) USA
3) USA	3) EU
4) China	4) Republic of Korea
5) EU	5) Chinese Taipei

Republic of Korea

Agricultural products	Non-agricultural products
1) Japan	1) China
2) China	2) USA
3) USA	3) EU
4) Hong Kong, China	4) Hong Kong, China
5) Chinese Taipei	5) Vietnam

Malaysia

Agricultural products	Non-agricultural products
1) China	1) China
2) India	2) USA
3) Singapore	3) Singapore
4) EU	4) EU
5) USA	5) Hong Kong, China

Mexico

Agricultural products	Non-agricultural products
1) USA	1) USA
2) Canada	2) Canada
3) EU	3) EU
4) Japan	4) China
5) USA	5) Japan

New Zealand

Agricultural products	Non-agricultural products
1) China	1) China
2) USA	2) Australia
3) Australia	3) USA
4) EU	4) Japan
5) Japan	5) EU

Papua New Guinea

Agricultural products	Non-agricultural products
1) US	1) Australia
2) Malaysia	2) Japan
3) USA	3) China
4) Philippines	4) Chinese Taipei
5) Australia	5) Singapore

Peru

Agricultural products	Non-agricultural products
1) EU	1) China
2) USA	2) USA
3) Canada	3) EU
4) China	4) Switzerland
5) Ecuador	5) Canada

The Philippines

Agricultural products	Non-agricultural products
1) USA	1) China
2) Japan	2) Thailand
3) EU	3) Hong Kong, China
4) China	4) USA
5) Republic of Korea	5) Japan

Russia

Agricultural products	Non-agricultural products
1) Turkey	1) EU
2) EU	2) China
3) Egypt	3) Belarus
4) Kazakhstan	4) USA
5) Belarus	5) Japan

Singapore

Agricultural products	Non-agricultural products
1) Australia	1) China
2) Malaysia	2) EU
3) Japan	3) USA
4) Philippines	4) Malaysia
5) China	5) Indonesia

Chinese Taipei

Agricultural products	Non-agricultural products
1) China	1) China
2) USA	2) Hong Kong, China
3) Japan	3) USA
4) Hong Kong, China	4) EU
5) EU	5) Singapore

The Thailand

Agricultural products	Non-agricultural products
1) China	1) China
2) Japan	2) USA
3) EU	3) EU
4) USA	4) Japan
5) Indonesia	5) Hong Kong, China

The United State of America

Agricultural products	Non-agricultural products
1) USA	1) EU
2) Canada	2) Canada
3) Mexico	3) Mexico
4) Japan	4) China
5) EU	5) Japan

Vietnam

Agricultural products	Non-agricultural products
1) EU	1) USA
2) China	2) EU
3) USA	3) China
4) Japan	4) Japan
5) Philippines	5) Republic of Korea

To find out more about:

World Tariff Profile 2019



I-IV Additional Resources

Suggested Questions for Students

Q1. Who are the participating countries of the FTAAP? [Framework and details of FTAAP]

ANS: 21 member countries of APEC.

Q2. How, or through which channel, does the FTAAP benefit member countries?

[Background of the FTAAP]

ANS: Reducing trade barriers, such as tariffs and quotas.

Q3. List 3 key areas that are targeted under the realization of FTAAP. [Actions undertaken to pursue the FTAAP]

ANS: Investment. E-commerce, Rules of Origin, Environmental goods and services, Next generation trade and investment issues (any 3).

Multi-media Learning Resources

1. APEC Today in 60 seconds: Historic FTAAP
roadmap reached



2. What is the Free Trade Area of the Asia-Pacific?



II

International Trade Theory

II-I Definition

International Trade

David Ricardo developed the international trade theory that explains why having trade among countries is better than just one country producing all the stuff, even when one country is more efficient and productive in all kind of production.

Supported by the principle of comparative advantage, the international trade theory reveals why the FTAAP, an initiative lowering international trade barriers among the APEC countries, is crucial in improving both the economies and the well-being of us all.

- Comparative Advantage and Absolute Advantage
 - o Country with absolute advantage on a product: it needs a smaller quantity of inputs to produce the good
 - o Country with comparative advantage on a product: the opportunity cost of producing the good is lower

To find out more about:

Introduction to International
Trade



- Principle of Comparative Advantage: if every country specializes in the production of goods with the comparative advantage, the total world output will increase.

This supports why the FTAAP initiative is important to all the countries for it can increase the total output of the APEC economies.

Example 1

By how much output can one unit of resources produced

	Clothes	Phones
Country A	30	60
Country B	100	40
Total Output	130 Clothes	100 Phones

	Cost of 1 Clothes	Cost of 1 Phone
Country A	2 Phones	0.5 Clothes
Country B	0.4 Phone	2.5 Clothes

From the example, Country A can produce phone at a lower opportunity cost (0.5 clothes < 2.5 clothes) while Country B can produce clothes at a lower opportunity cost (0.4 phone < 2 phones).

From the results,

- Country A has a comparative advantage in producing phone and a comparative disadvantage in producing clothes compared with Country B.
- Country B has a comparative advantage in producing clothes and a comparative disadvantage in producing phone compared with Country A

To increase the total output and better off the standard of living, Country A should then produce phone while Country B should focus on the production of clothes.

	Clothes	Phones
Country A	0	120
Country B	200	0
Total Output	200 Clothes	120 Phones

If the two countries focus on the production of the products which they have the comparative advantage, the total output can be substantially increased (200 clothes > 130 clothes and 120 phones > 100 phones).

Example 2

How much resources is needed to product one unit of output

	Handbag	Computer
Country C	5h	10h
Country D	2h	5h
Total Resources needed	7h	15h

	Handbag	Computer
Country C	0.5 Computer	2 Handbag
Country D	0.4 Computer	2.5 Handbag

From the example, Country D has an absolute advantage over Country C in the production of handbag and computer when it takes a smaller number of resources to produce the same amount of goods for the both products.

From the results,

- For Country C, the cost of producing a unit of computer is lower than that of Country D. Therefore, Country C has a comparative advantage in producing computer over handbag.
- For Country D, the cost of producing a unit of handbag is lower than that of Country C. Therefore, Country D has a comparative advantage in producing handbag over computer.

Under the international trade theory, Country C should focus on the production of computer as the country has a comparative advantage in computer production. Country D, on the other hand, should produce more handbag as the country has a comparative advantage in handbag production.

The above examples illustrate the benefits brought by trade cooperation, and thereby explaining the importance of FTA, which facilitates trade via trade barriers reduction.

II-II Barriers in Trade

Though boosting trade among countries could create mutual benefits to the parties, out of protectionism (practice of shielding the domestic industries of a country from foreign competition) and other concerns, trade barriers are widely imposed on imported goods and services. The followings are the examples of trade barriers:

Tariff

Taxes or duties imposed on imports with the aim to raise the price level of foreign goods above the existing price of domestic products.

Subsidy

A form of governmental financial support or aid to encourage production or consumption.

Quota

A maximum limit imposed on the import quantity.

Embargo

The official ban on commercial activity and trade with a specific country.

How does trade barrier harm the trade?

We all understand that trade barrier will bring benefits and harms to different parties of the trading economies. Let us have a better understanding on the mechanism behind with the following illustrations.

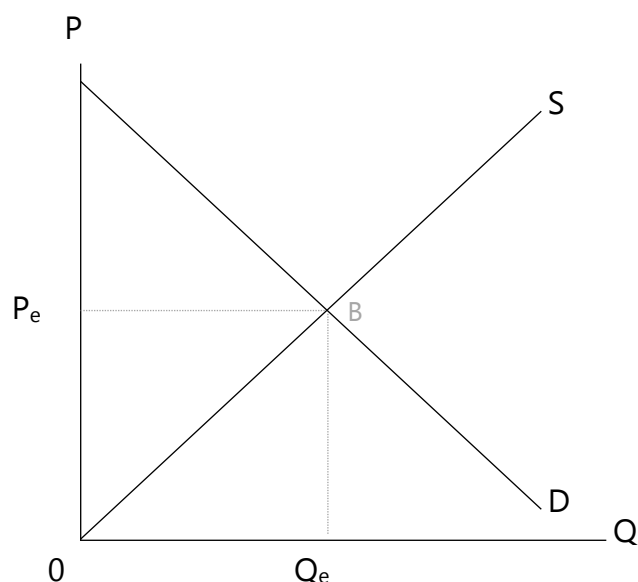
To find out more about:

Trade protectionism methods
with examples, pros, and cons



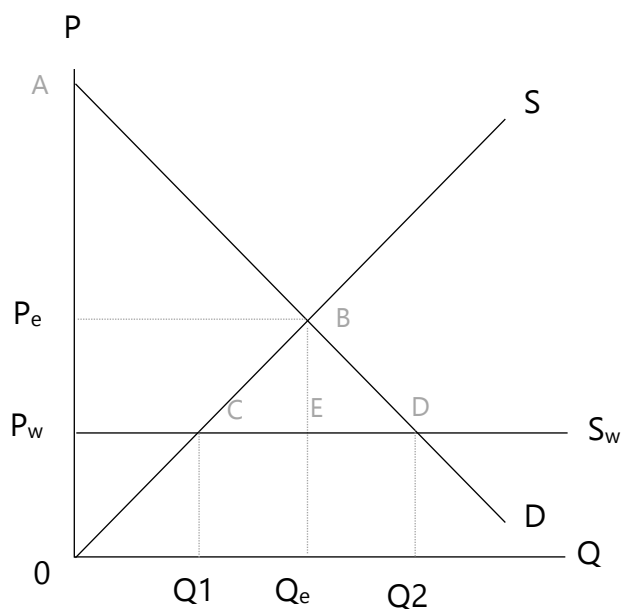
Example 3

Baseline scenario: Supply and Demand Curve of domestic country that does not trade computer with other countries



- Price: P_e
- Domestic quantity: Q_e
- Quantity transacted: Q_e
- Consumer Surplus: AP_eB
- Producer Surplus: $Pe0B$

Baseline scenario: Supply and Demand Curve of domestic country that trades computers with other countries



- Price: ↓ from P_e to P_w
- Domestic quantity: supplied: ↓ from Q_e to Q_1
- Quantity transacted: Q_2
- Quantity imported: Q_1Q_2
- Consumer Surplus: ↑ from AP_eB to AP_wD
- Producer Surplus: ↓ from $Pe0B$ to P_w0C

The price of computer is determined by the world demand and supply of computer. Given the much larger size of the international market than the domestic one, the domestic consumers and producers do not have power to influence the world price (P_w), and thus making the world supply curve a perfectly elastic one (S_w). If the country trade with other nations, the consumers will then be able to buy the computer at (P_w) and the producers will then be able to sell the computer at (P_w).

However, as world price is lower than the domestic equilibrium price (P_e), the domestic producers would not produce as many computers as they can in Q_e , but in a lower quantity at Q_w .

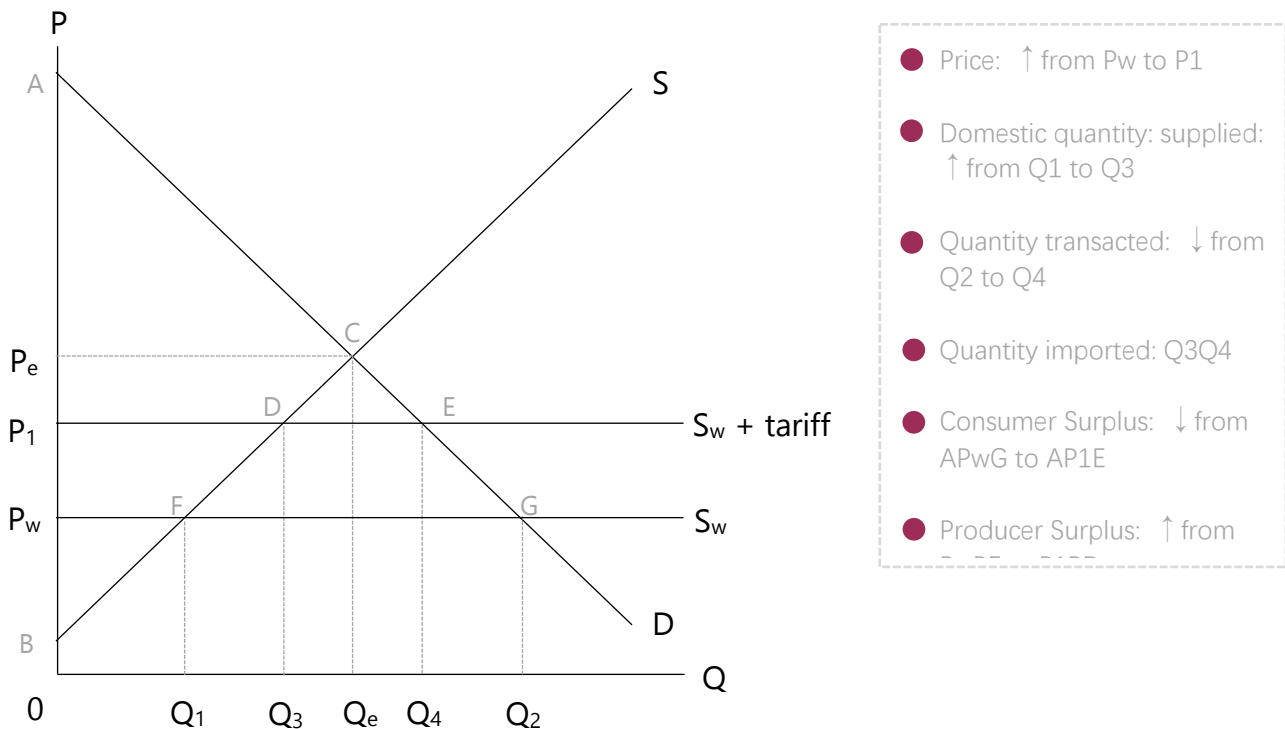
Due to the lower P_w , producer surplus decline as they are less competitive, in terms of their prices for computer, than the world market. On the other hand, consumers surplus increase significantly, by more than the loss in producer surplus, as they can now buy computers at a much lower price in the international market. Therefore, with trade with the international market, the total economic surplus (consumer surplus + producer surplus) of the domestic market increases.

Gain in Consumer Surplus	Loss in Producer Surplus	Overall Net Gain
Area BCD	Area BCE	Area BED

From the above scenario, it is obvious that the domestic producers will then suffer great harm from the opening of the domestic market. The domestic workers will suffer from a higher unemployment rate and the producers will generate less profits, severely hitting that industry and thus the domestic production.

Tariff

To help with the domestic producers, government may impose tariff on the goods imported to the country.



For the computers being imposed with tariff, the price (P_1) would be higher than the original world price (P_w), but still lower than that of the domestic prices, if not the foreign producers will have no incentive to enter the domestic market at all (as they would not be competitive enough in the market). The world supply curve will then shift upward from S_w to ' $S_w + \text{tariff}$ ' as the price increases. At the new price (P_1), domestic producers will be able to produce more unit of computer as they do not have to pay the tariff as the foreign producers do. The domestic production will increase from Q_1 to Q_3 . However, at the new price (P_1), the domestic demand would be at point E. Therefore, there will be a import of computer (Q_3Q_4). And this amount of import is fewer than the previous one (Q_1Q_2) as the consumers demand less units at a higher price.

Loss in Consumer Surplus	Gain in Producer Surplus	Overall Net Loss
Area P_1P_wGE	Area P_1P_wFD	Area $DFGE$

The above theory and examples prove the significance of FTAAP realization, when it can help boosting mutual benefits brought by increasing trade cooperation. In the next chapter, we are going to learn more on the feasibility, advantages and the drawbacks of FTAAP via multiple case studies.

II-III Additional Resources

Suggested Questions for Students

Q1a. Browse the following websites under the Observatory of Economic Complexity (OEC):

United States



Brazil



Click countries, search the United States and Brazil. Now look at the figure of exports. Each color represents a category of products, and the categories are given by the icons under the figures. What are the two largest categories of exports of the two countries?

ANS:

US: Machines and Transportation

Brazil: Mineral Products and Vegetable products

Q1b.

According to the theory of comparative advantage, the United States has lower opportunity costs of producing/providing machines and transportation goods/services while Brazil has lower opportunity costs of producing minerals and vegetables. Could you explain the reason(s) behind?

ANS: (Suggested answer only, acceptable as long as makes sense)

Machines and Transportations are both capital-intensive products, while minerals and vegetables are labour-intensive products. These mean that the previous two products require a lot of capital

goods relative to labour, vice versa for the latter. From the U.S. 's perspective, given the high labour cost relative to the cost of capital, producing one unit of mineral or vegetable has an opportunity cost of multiple units of machines or transportations. However, Brazil, having a lower labour cost relative to the cost of capital, can produce minerals or vegetables at a lower opportunity cost. Thus they will be specializing in products stated in Q1a.

Q1c.

According to OEC, China is the largest importer of soybean, while the U.S. and Brazil are two major exporters at the global level. The general administration of custom, China states that for soybeans, she has a positive tax rate for regular imports while 0 tax for most favoured countries. Assume that she only classifies countries in the FTAAP as most favoured countries and US soybeans are more expensive than Brazilian soybeans, explain a simple demand and supply analysis if Brazil joins the FTAAP.

ANS: (Suggested answer only, acceptable as long as makes sense)

If Brazil joins the FTAAP, she would be classified as a most favoured country by China. Instead of a positive tax rate, her soybeans would enjoy zero tax in China. The relative price of US soybeans to Brazilian soybeans would increase. The quantity demanded for Brazilian soybeans shall increase. Meanwhile, the supply of brazilian soybeans will increase due to tax reduction, leading to, in the overall soybean market, an increase in equilibrium quantity and a decrease in equilibrium price.

Multi-media Learning Resources

1. Trade Barriers



2. Tariffs and Barriers to Trade



3. How do tariffs work?

| CNBC Explains





Effectiveness & Limitations of FTAAP

III-I Feasibility of FTAAP – Case Studies and Learning Corner

Case Studies

Task:

- In this exercise, students will need to read a copy of the select news articles, with reference to the relevant concepts in the learning corner.
- For each article think about the following
 - o What are the key issues and broader implications?
 - o What is the potential impact on different stakeholders?
 - o What are the potential risks and opportunities for achieving free trade?

Feasibility of FTAAP

Articles:

- US-China trade deal at APEC would be temporary pause in ‘a growing storm’, experts say

Source: SCMP



- APEC leaders debate approach to trade tensions, WTO issues at Port Moresby summit

Source: ICTSD



- APEC becomes battleground for US, China

Source: Inquirer.net



Key Takeaways of the Articles

- Imposing high tariffs on imported goods could bring huge impacts not only to bilateral terms of trade but also to the international market
- Given the global influence of the two 'super nations', the Sino-US trade tension does not only add uncertainties to FTAAP and APEC, but also to the normal functioning of many other multinational or even international trade organizations. This leads to the uncertainty of FTAAP's feasibility.

Questions to guide students' learning

- Please suggest 2 reasons for imposing high tariffs on imported goods (i.e. how does tariff benefit their nation?)
- Please suggest 2 detrimental effects brought to the nation or even to global trade when the nation impose high tariffs on imported goods
- How could APEC economies alleviate trade tensions between nations and pave the way for the realization of FTAAP?
- How to balance the benefits and harms of international trade? Is there any appropriate strategy than waging a tariff war?

Learning Corner - Feasibility of FTAAP

The proliferation in regional FTAs suggests the demand across countries to achieve free trade, reduce and remove tariffs. However, ever since the global free trade arrangement Doha Development Round, it has been a long time to have the global communities on the same page for a large scale free trade agreement.

The realization of free trade is more promising than ever when APEC leaders, amid a meeting in the town of Bogor, Indonesia, saw eye to eye for a 'long-term goal of free and open trade and investment in the Asia-Pacific', with a concrete timeline no later than the year 2020. This is the story of the Bogor Declaration, albeit without prescribing any specific actions, nor with any guidance provided back then. But a more specific timeline came in 1995, Bogor Goals Progress Report is released annually to ensure free trade realization is on the top of the agenda among APEC leaders⁸.

Removing tariffs to promote trade is not only crucial for businesses in APEC, but also for boosting world GDP growth. According to estimates by Kuriyama and San Andres, in the period 1989–2013, a 10% growth in trade in APEC was correlated with a 5.6% growth in GDP⁹. And since the APEC region accounts for approximately 60% of the world's GDP, there is no doubt that any free trade agreements in APEC would be significant to changing the global economic landscape.

As mentioned, there already long existed a plethora of bilateral and regional trade agreements in the APEC region before the FTAAP. They are, however, not operated efficiently, nor optimizing regional economic performance. These RTAs (Regional Trade Agreement) or FTAs are commonly called 'noodle bowl' of agreements for their intersecting, overlapping, and potentially confusing nature. Member economies have made efforts to collaborate strategically and reduce market inefficiency. But with the rise of economic activities, increasing global integration, and complexity in those treaties, it is difficult for member economies to cooperate and costly to control each trading relationship.

⁸ APEC's Bogor Goals Progress Report

⁹ Assessment of the APEC Leaders' Growth Strategy

Therefore, there comes the need to have one free trade agreement for regional convergence. Some may argue that the proliferation of RTAs/FTAs underlines the fact that the varied nature of economies in the region requires a different approach of economic collaboration, or even possessing the power to control over their trade negotiations. This argument is solid but the yearning for FTAAP in the first place is to have a 'laboratory' to experiment economic cooperation options and pave the way for economic liberalization. Positive experiences in sub-regional agreements will improve the likelihood of full economic liberalization in the future.

The APEC economies are the most dynamic, fast-growing, and vital economic region in the world and likely to remain so in the foreseeable future. Any attempts in liberalizing the economies will pave the way for success and be an exemplar for global communities on how division and fragmentation could be resolved.

III-II Benefit of FTAAP – Case Studies and Learning Corner

Benefits of FTAAP

Articles:

- PH expected to benefit from 'mega' free trade deal

Source: nquirer.net

- PHL, South Korea launch free trade agreement negotiations

Source: Business World

- Call for APEC to press on towards free trade area of Asia-Pacific

Source: The Straits Times



Key Takeaways of the Articles

- FTAAP could potentially bring huge benefits to the APEC member countries, including the US, China, Japan, and the Philippines.
- Some more concrete benefits brought by the FTAAP would be larger market access for services and goods, more favourable tariff rates to boost trade.
- Although the potential benefits brought by the FTAAP is enormous, how to reach the agreement is still a question not yet answered.

Questions to guide students' learning

- What are the economic structures (in terms of Primary, Secondary and Tertiary sectors) of South Korea and the Philippines? What are their trade conditions with each other and how can they benefit from the FTAAP respectively, through bilateral trade?
- For both high-level South Korean businesses and the Philippines, what are the advantages of locating and expanding their operations in the Philippines? With the FTAAP, what policies can the Philippines government roll out to facilitate this?
- Which sector does each country specialize, or probably has a comparative advantage in? The articles focus primarily on the macro-benefits for the countries, such as more favourable tariffs and better investment opportunities. Can you think of the pros for residents in each country, out of these macro-benefits?

Learning Corner - Feasibility of FTAAP

The effort of APEC in reducing barriers (average tariffs of APEC members fell from 17% in 1989 to 5.3% in 2018¹⁰) has led to the huge increase in prosperity. During that same period, the member's trade increased for more than 7 times, which out-performed the rest of the world.

¹⁰ APEC – Achievements and Benefits

The collaboration not only ranges from merely reducing tariffs, but also to multilateral economic cooperation, breaking down barriers to trade, such as faster customs procedures, improvement of coordinating mechanisms, etc. The FTAAP is a role model for globalization and economic integration, especially on how well it complements global economic initiatives such as that led by China, the renowned Belt and Road initiative.

These cooperation efforts do not simply lie in the scope of economic integration, but also in fighting against environmental issues, enhancing social equity, as well as increasing energy efficiency.

An ambitious and inclusive FTAAP would have the possibility to strengthen global trade with sustainable growth and thereby leading to comprehensive economic progress. A FTAAP would generate significant benefits via the facilitation of access to different crucial resources, like labour,

To find out more about:

Collective Strategic Study on
Issues Related to the Realization
of the FTAAP



Scenario 1:

Trade liberalization via tariff elimination (full elimination of agricultural and manufactured goods tariffs)

- Long-term growth is promoted under the liberalization of goods trade.
- The real GDP of the APEC region could be increased by 0.4%
- Welfare would surge by 0.38%
- Exports and imports would boost by 2.45% and 2.49% respectively
- One thing to note is that the above indicators show marginally negative results on Chile, Peru and Singapore as those nations already have relatively low average tariffs. Moreover, they have implemented different FTAs with most APEC economies. Therefore, the realization of FTAAP may not do good to them when they will lose their advantages.

Scenario 2:

(Scenario 1) + enhanced trade facilitation (reduction of trade costs by 5% via enhanced trade facilitation)

- It yields higher economic benefits for all the members in terms of real GDP, trade flows and welfare comparing to those in Scenario 1
- Among the APEC member economies, Hong Kong, China; Korea; Malaysia; Singapore; Chinese Taipei; Thailand and Vietnam would be the major beneficiaries under this scenario.

Scenario 3:

(Scenario 2) + liberalization of trade in services (reduce the tariff-equivalent barriers in services by 10%)

- The magnitude of a positive increase in real GDP, trade flows and welfare of all the member economies is the greatest in this scenario.
- The liberalization of trade in services brings enhanced efficiency and competitiveness as services contribute to primary and secondary production.

Effects of an FTAAP on APEC as a whole:
comparison by scenarios, using a capital
accumulation CGE model.
(% deviation from the base)

Scenario	Real GDP	Welfare	Export	Import
I	0.4	0.38	2.45	2.49
II	3.45	3.09	9.31	9.24
III	3.54	3.18	9.55	9.48

The results prove that with more opened trade and less tariffs, the member countries can enjoy growths in terms of real GDP, welfare, export and import. This suggests the importance of FTAAP for the good of APEC countries.

III-III Shortcomings of FTAAP – Case Studies and Learning Corner

Shortcomings of FTAAP

Articles:

- Mushrooming of free trade pacts can be detrimental

Source: Business Line



- Why India needs to rethink its decision to opt-out of RCEP

Source: The Economic Times



Key Takeaways of the Articles

- Free trade agreements not necessarily result in trade creation, but also diversion that adversely impacts domestic industries
- Domestic producers can be squeezed out by global rivals with huge economies of scale (E.g. Indians farmers hurt by competition from New Zealand's dairy products)
- Trade deals might pose benefits mostly to multinational corporates which have experience in cross-border trade, rather than benefiting small companies

Questions to guide students' learning

- Will trade deals be harder to achieve among countries that have huge economic and technology gaps?
- Will protectionism hinder the progress of innovation and productivity as countries are not open to international competition?
- Liberalization will bring benefits to India's ICT and software industry; meanwhile, however, it will pose a threat to the primary sector. How to weigh the benefits and costs?
- Do you agree with the author of the article 'Why India needs to rethink...' that economic growth alone will help embrace challenges ensued from free trade?
- After studying the news, do you see any difficulties in achieving a regional free trade agreement? Are they solvable?

Learning Corner -Shortcomings of FTAAP

Readers may have learned well from the fact that the plethora of free trade agreements outline the varied needs and interests of different participants, especially when the 21 member economies have great diversity in terms of politics, economic development, history and culture. The case in point is that developed countries such as the USA, China, Japan, and Australia have more bargaining power than those of under-developing countries such as Myanmar, the Philippines, Laos etc. It would be a challenge for all the APEC members to come into consensus on addressing various economic issues.

Not only that, but the global economic slowdown has also posed a great threat to further economic liberalization. Politicians are accounted for by their voters and attend to multifaceted domestic political concerns, which may or may not be at odds with supporting the global trading system. It is incumbent on policymakers to balance legitimate public policy concerns while maintaining an open trade environment and carefully looking after each trading relationship. APEC economies are diverse, both in terms of levels of development, but also in terms of trade capacity and interests. All these factors present huge obstacles as to each economy's readiness to participate in a high-level economic liberalization.

Things worsened especially when one of the APEC leaders, USA, launched a series of tariffs on Chinese imports. The ongoing trade war and heated competition between the two nations which play a key role as the most important economic powerhouse. The deal on liberalizing economic borders and opening up its market to foreign players has stagnated ever since the tension. Now that the two nations are negotiating a deal on rectifying their trade relationships, it may also pose a threat to the establishment of FTAAP. Imagine that the USA and China agreed upon a bilateral trade treaty, the significance of having economic collaboration through FTAAP would be discounted.

To find out more about:

Easily grasp the concept of FTAAP –
from APEC Policy Support Unit



A Free Trade Area of the Asia Pacific
(FTAAP): is it desirable?



The Free Trade Area of the Asia
Pacific: a constructive approach to
multilateralizing Asia regionalism



The FTAAP and Economic Integration
in East Asia: Japan' s approach to
regionalism and US engagement in
East Asia



III-IV Additional Resources

Suggested Questions for Students

Q1

Explain a difficulty in realizing the FTAAP. [Feasibility of the FTAAP]

ANS:

(Regional trade conflicts) Member countries may have trade conflicts. For example, the ongoing controversy over the infringement of intellectual property rights had driven to the trade war between the US and China, who are both member countries of FTAAP. Tariffs and bans on businesses have been imposed, instead of loosening trade barriers. With these conflicts, the realization of the FTAAP could be hard to achieve.

(Political pressure) Though the FTAAP promotes regional economic growth, some people could be harmed. A typical example would be agricultural producers. As foreign goods enter the country more easily, their relative price would decrease, compared to local goods. In the fierce competition of agricultural products market, farmers could suffer huge loss, causing a great political pressure on the government when they try to push forward the FTAAP. Unless the potential drawbacks are well-handled or compensated, it is not easy for governments to further advocate the agreement.

Q2a.

Why might countries still be willing to join the FTAAP or engage in free trade, given that potentially their local producers will be harmed or lose market share? [Advantages of the FTAAP]

ANS: (Suggested answer, acceptable as long as makes sense)

Beside using protectionism to safeguard local industries, governments might open up markets or reduce tariffs to stimulate competition in the local market. This gives incentive to producers to

conduct measures to combat with foreign competitors. Possible methods are enhancing production efficiency and improving product quality. Both of them will require further investment, which could stimulate economic growth, as well as enhancing productivity in the long run. Resulting from successful investments, lower prices or better quality could also facilitate exports to foreign countries in the future, further promoting economic growth.

Q2b.

Why would the FTAAP facilitate access to different crucial resources? Alternatively speaking, why would countries be willing to exchange those resources? Explain some possible reasons. [Advantages of the FTAAP]

ANS: (Suggested answer, acceptable as long as makes sense)

As different countries have different resources, they specialize in different areas based on their opportunity costs. For example, Germany is good at producing machinery and the United States engages in Research and Development works. A single country could not have generous resources put on every aspect of productions while countries need various kinds of resources to facilitate their development. Thus trading crucial resources has been a long practice for it can help nations obtain necessary resources for growth without the need to produce every goods, notably those with high opportunity costs to them. With the FTAAP, it is expected that nations will further open up, allowing higher mobility of labour, capital, technology and other strategic resources, namely crucial resources, observing the advantage of further economic growth.

Q3.

Is the effects of the FTAAP on growth only applicable to the countries within the agreement? Explain. [Advantages of the FTAAP]

ANS: (Suggested answer, acceptable as long as makes sense)

Probably not.

Suppose country A joins the FTAAP and has a good relationship with country B, who has not joined the FTAAP. The benefits country A enjoys, like cheaper or higher quality labour and capital or newer technology, might also be enjoyed by country B. More specifically, the knowledge or technology country A obtains could be transferred to country B through expert communications, given their close relationship. Another story could be a citizen from country A who had been working in more advanced economies under the FTAAP, going to country B afterwards, serving with the skills and knowledge he learnt from the highly developed economies, which helps facilitate the growth in country B. In short, there will be a “spillover effect” of the FTAAP, creating benefits to unattended countries.

Multi-media Learning Resources

1. China Pulse – FTAAP: Disentangle
‘Spaghetti Boal’!



2. Xi: FTAAP should be built as
soon as possible



3. The FTAAP vs TPP Free Trade
Deception – The Truth



IV

More Topics on FTAAP

IV-I How does FTAAP affect HK from the perspective of HK?

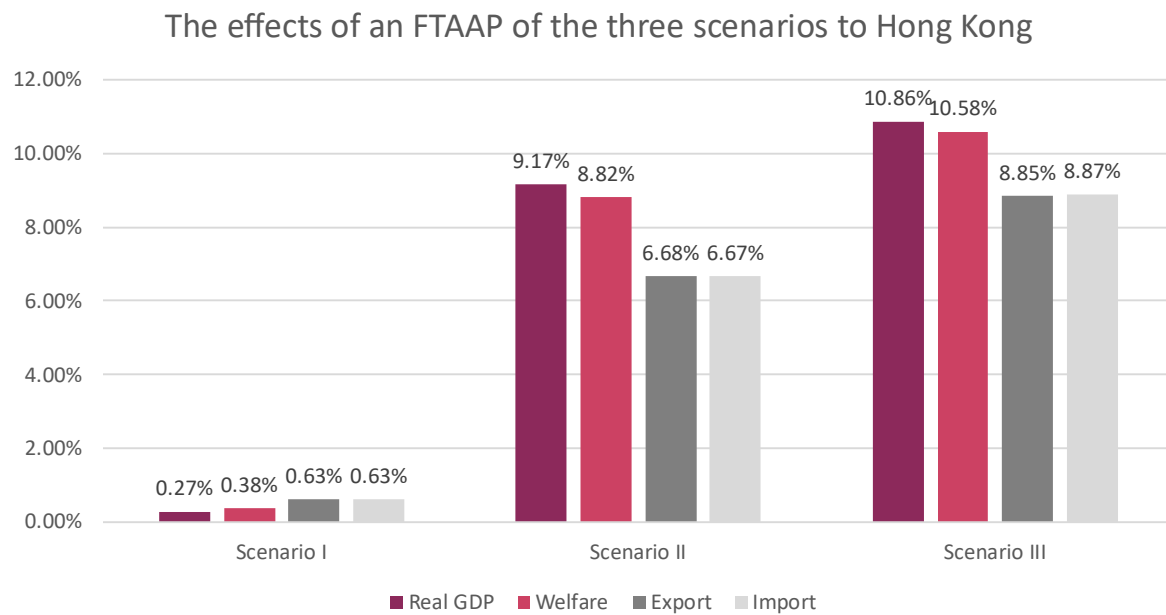
With strong financial muscle and the most investor-friendly business environment, Hong Kong, as a major trading partner with China and ASEAN, is poised to benefit from the realization of FTAAP.

Economy-wise, trading and logistics services account for 22% of Hong Kong GDP¹¹, to which trading activities with APEC economies contribute more than 80%¹². FTAAP will stimulate trade activities in the APEC region. And Hong Kong as a regional hub for trade services will gain momentum in economic growth as a result.

Given its free-port status, Hong Kong might not be in an advantaged position when negotiating for trade deals, especially when it cannot use tariffs cut as a bargaining chip. Some worry that such trade agreements might not yield real benefits to Hong Kong's economy. However, as RTAs and FTAs nowadays lay more emphasis on reducing non-tariff barriers, services, investment, and other economic issues, Hong Kong is poised to bargain for a fair deal, thanks to the city's strengths in financial and business services. Its archrival Singapore might have similar offerings in terms of professional services. Still, Hong Kong's strong connection to the mainland market gives the city's unparalleled advantage in the competition of international trade.

¹¹ HKTDC - Logistics Industry in Hong Kong

¹² TID - APEC and Hong Kong



*Scenario 1: Trade liberalization via tariff elimination (full elimination of agricultural and manufactured goods tariffs)

*Scenario 2: (Scenario 1) + enhanced trade facilitation (reduction of trade costs by 5% via enhanced trade facilitation)

*Scenario 3: (2) + liberalization of trade in services (reduce the tariff-equivalent barriers in services by 10%)

To maintain its bargaining power in FTAAP negotiations, Hong Kong can work in line with “Developing Asia” advocated in its budget speech. Although as mentioned above, Hong Kong can still be benefited from the realization of FTAAP, there are some potential risks the city will face in the future. With more and more FTA and RTA signed between China and ASEAN countries, products targeting the China market from Asian countries may directly enter China with possible agreement on reducing tariffs and eliminating the quota. Hong Kong may gradually lose its advantage of being a free port, which will impose a notable hit to the economic cornerstone of Hong Kong.

However, Hong Kong still has robust strengths in financial and legal services to address companies' different business needs. To fully utilize the capability of Hong Kong, the government

could make more efforts in attracting multinational companies to set up their regional headquarter in Hong Kong via further reduction on profit tax and different business facilitation measures etc. The increase in the headquarters' number not only strengthens the leading position of service hub of Hong Kong but also deepens the "Super-Connector" role of Hong Kong which connects China with the rest of the world.

In particular, the Hong Kong government shall fully utilize the advantage of separate customs territory and play a bigger role in international organizations. Currently, Hong Kong has only participated in the FTAAP for regional trade partnerships. More efforts shall be put in deepening relationships with ASEAN countries and striving to join different trade agreements such as CPTPP, RCEP, and PA.

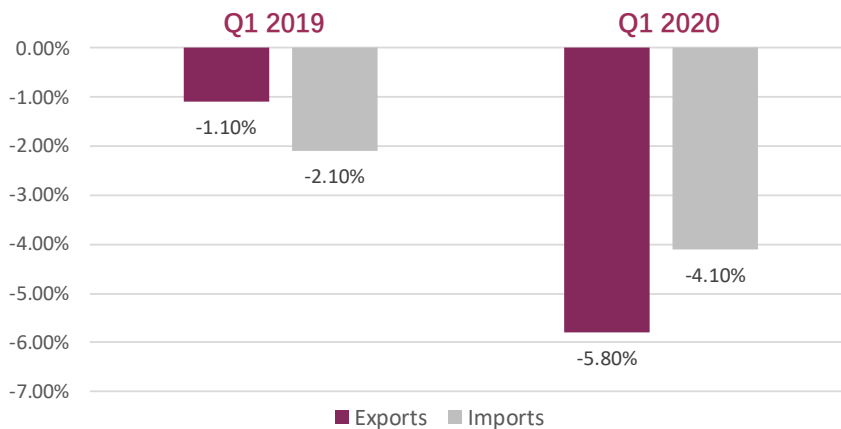
IV-II FTAAP and COVID-19

Few events could entirely alter the course of human history. But the COVID-19 pandemic unprecedentedly shut down global economies with hardly any exceptions. Unsurprisingly, it also took a toll on the member countries of APEC. This highly-regarded economic powerhouse is projected to contract by 3.7%, with a loss in output of about USD 2.9 trillion in 2020¹³. The value of APEC merchandise trade in 1Q20 also recorded a tremendous fall, where the slump is expected to continue in the following quarters.

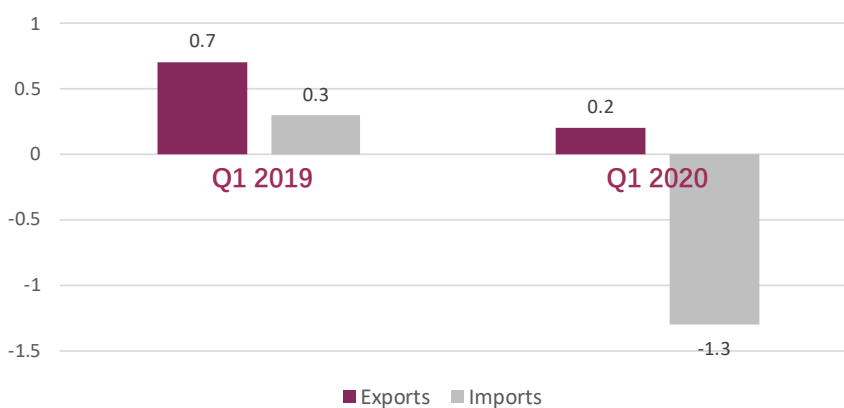
Such a precipitous downturn induced doubts on the strong continuous growth APEC economies had brought over the past few decades.

¹³ APEC Regional Trends Analysis July 2020 Update – Deeper Contraction Calls for Decisive Action

Growth in the Value of APEC Merchandise Trade



Growth in the Volume of APEC Merchandise Trade

**To find out more about:**

APEC Regional Trends
Analysis July 2020
Update

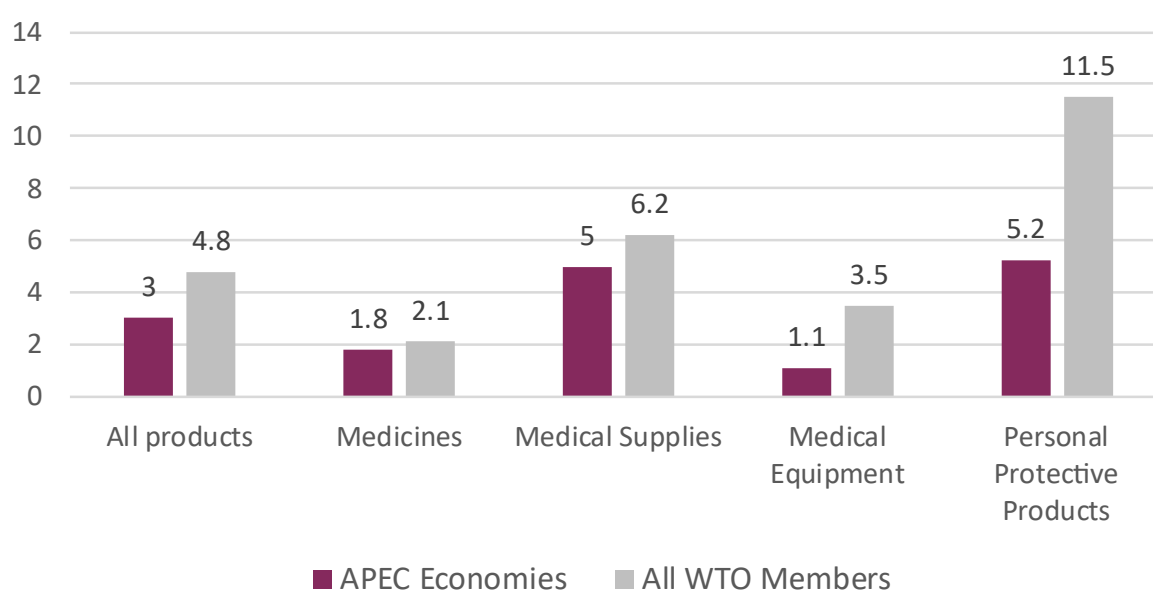


However, the economic forecasts suggested otherwise. APEC economies are expected to rebound with 5.7% in 2021. The bullish outlook is under the assumption of readily available COVID-19 treatments and vaccines in late 2020, along with effective pandemic control as well as strong monetary and fiscal stimulus. More importantly, regional collaboration in both trade and other areas, especially the medical fields, must be reinforced for APEC to revive its prosperity.

Due to this health crisis, a lot of plans and works, including the FTAAP, are also adversely affected. The APEC meeting in 2020 is the first time in APEC history held in a fully digital format to lower the risk of Covid-19 transmission. It is not difficult to imagine how the progress of the discussion would be hindered when the prime agenda nowadays is to curb the pandemic issue. However, the FTAAP could potentially play an important role in the current turmoil. One obvious example is that it could boost the medical trade among members, which is pivotal in fighting the pandemic.

The APEC members account for over 40% (USD 404.5 billion) of the global medical goods imports and 28.8% (USD 271.8 billion) of medical goods exports¹⁴. Yet, most of the APEC members were having tariffs on the essential medical goods including personal protective products and medical supplies during prior to the pandemic. This, undoubtedly, added burden to the countries in curbing the crisis. Below is some of the data showing the situation, when tariffs were imposed on various types of medical products, before COVID-19.

Average MFN tariffs by product category (%)



Number of APEC member economies per range of average MFN tariff

Duty Range	All Medical Goods	Medicines (Pharmaceuticals)	Medical Supplies	Medical Equipment	Personal Protective Products
0	2	9	3	4	2
0<=2.5	9	6	6	14	3
2.6<=5	5	2	4	2	4
5<=7.5	4	3	4	1	9
7.5<=10	0	1	2	0	1
10<=15	1	0	1	0	2
>15	0	0	1	0	0
Average MFN Tariff (%)	3.0	1.8	5.0	1.1	5.2

¹⁴ APEC Policy Support Unit Policy Brief No. 32 April 2020 – Promoting Trade of Medical goods to Tackle COVID-19 Challenges

Highest average MFN tariffs on medical goods in the APEC region

#	Type	Description	Average MFN Tariff (%)
1	MS	Undenatured ethyl alcohol, of actual alcoholic strength of $\geq 80\%$	76.6
2	PPP	Face masks (textile material)	8.4
3	MS	Articles of apparel and clothing accessories produced by the stitching or sticking together of plastic sheeting	6.9
4	PPP	Hand soap (liquid)	6.7
5	PPP	Hand soap (bar)	6.6
6	PPP	Face masks (plastic)	6.0
7	MS	Gloves, mittens and mitts, of vulcanized rubber	5.9
8	MS	Surgical gloves, of vulcanized rubber	5.2
9	PPP	Other cleaning products	5.2
10	PPP	Protective spectacles and visors	4.6

To find out more about:

APEC Policy support Unit Policy

Brief No. 32



It is not difficult to understand that tariffs on medical products are the stumbling blocks for better public health achievement. In times of large-scale pandemic, tariffs could be detrimental to us all. From the above tables and chart, we can observe that the tariffs imposed on medical goods among the APEC members are lower than the global average, which reflects the efforts put by APEC in facilitating medical goods flow for the good of the people. To facilitate the medical goods trade, some governments have put in place temporary measures that waive the tariff of essential medical goods. Yet, terms are set that the short-term waivers would only last for the duration of the pandemic. The Covid-19 taught the globe an important lesson that we all need to be alert and prepared to face any potential public health threat. And long-term promotion of free medical goods flow is important to all the countries. APEC members should continue to work on the realization of FTAAP to promote freer trade, which does more than bringing solely economic benefits, but also saving lives via a better flow of medical supplies in times of public health crisis.

IV-III Additional Resources

Suggested Questions for Students

Q1

How can Hong Kong utilize her strengths throughout the realization of the FTAAP? Pick one aspect of the industry to explain. (Case Studies-How does FTAAP affect Hong Kong from the perspective of Hong Kong)

ANS:

(Logistics) Hong Kong can utilize its sophisticated transport network to catch up with the growing trading amount between China and other countries. The city can maintain its position by emphasizing the ability to process cargos efficiently, under the loosening trade barriers of China.

(legal) With the advantage of the sound legal system and well-established business legal service sector, coupled with a strong business network throughout the world, Hong Kong can continue offering high-quality legal services as region economic relationship becomes closer.

(financial) Although China would be reducing trade barriers through the realization of the FTAAP, Hong Kong still enjoys the advantages of having a free flow of capital whilst being the financial center of China. Demand for financial services would be growing under closer economic relations, which would provide abundant opportunities for the city.

Multi-media Learning Resources

1. COVID-19 response: PPP stimulus, tariff relief and what's on the horizon



2. U.S. tariffs have major impact on PPE imports from China



IV Conclusion

With the rise of unilateralism in the recent years, some people might doubt the functions of multilateralism in the world of trade. However, as the old saying goes, in union there is strength. This is why we have various trade agreement in place to foster the strength of each and all of the APEC members. The example of FTAAP shows the power of trade agreement in terms of what it can achieve other than simply economically, but also socially and politically. Though the pandemic is giving this ship a tough ocean to sail through, with the support of APEC countries and their spirit to achieve goals as a team, FTAAP can surely reinforce the economic strength of the members in a foreseeable future.