FRED BERGSTEN

Plan B for world trade: go regional

The indefinite suspension of the Doha round of world trade talks creates his plan for the world economy. A new coalition of discriminatory bilateral and regional trade agreements is likely to substitute for global liberalisation. This will inevitably smother the multilateral rule-based system of the World Trade Organization. The backlash against globalisation will generate more protectionism in the vacuum left as momentum towards widespread reduction of barriers eases, especially as the world economy slows and global trade imbalances continue to rise. Financial markets will become more unstable as international economic co-operation breaks down further. Hence there is an urgent need for a "plan B" to gain world trade policy back on track. That strategy should have three key objectives to spur the revival of Doha to offer an additional alternative to restart the process of liberalisation on the widest possible basis if that primary goal fails, and to encourage the proliferation of preferential deals among small groups of countries.

The best candidate for this is for leaders of the Asia-Pacific Economic Cooperation (APEC) to launch a free trade area of the Asia-Pacific region (FTAAP) when they meet in Hanoi in November. The 11 Apec members account for more than half the global economy and almost half world trade. The group includes most of the world's most dynamic economies. Apec leaders committed themselves to achieve "open and open trade and investment in the region" at their initial summit meetings in 1991 and 1992. They promised that goal effectively over the last 20 years, but the effort has faltered of late. Apec's business advisory council has thus recommended since 2004 that the leaders undertake an urgent study of how to realize their ambitions by negotiating an FTAAP. If Apec continues to languish, the study could be commissioned in November and negotiations begun under the chairmanship of pro-trade Australia in 2007.

Achievement of an FTAAP would have huge positive effects on global output. Realising of anything close to free trade by half the world would deliver much larger benefits than even the most ambitious outcome of Doha, which at best seeks modest reductions in market impediments. The distributional impact would be quite different from a multilateral deal: the gains would accrue to Apec members while busy outsiders would suffer from trade diversion. But the net outcome would be far superior to a world without substantial new liberalisation or even with a panoply of additional bilateral preferential agreements. Indeed, one of the key advantages of the FTAAP is that it would sweep together: the smaller deals already in place and head off those that will otherwise arise.

An important element in this picture is a possible east Asia free trade area, whose creation is virtually certain to accelerate with the demise of Doha and erosion of the WTO system. Japan's new proposal for a "mini-Asian comprehensive economic partnership" would expand the idea to include India, Australia and New Zealand. Either of these would create a new Asia bloc that, along with the European Union and the US, could then hold together the two- or three-way game.

By contrast, an FTAAP would embed these mini-bloc arrangements in a broader Asia-Pacific framework. It would prevent the creation of a new division across the Pacific, with its adverse effects as well as economic consequences for relations between East Asia and the US. The US and China would be the natural leaders of an FTAAP and would simultaneously improve the prospects for achieving their bilateral trade talks through a regional framework.

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