

APEC needs a wake up call more than trade liberalization

Alan Oxley

Chairman

Australian APEC Study Centre, Monash University

Summary

Since the Asian currency crisis, there has been a flurry of proposals for new instruments to facilitate economic integration among countries in the APEC region. Most are for new bilateral or regional trade agreements. Some are to create new regional monetary arrangements.

The interest in creating new arrangements stands in contrast with the lack of preparedness or capacity to tackle fundamental economic problems in domestic economies.

APEC economies would definitely benefit from greater trade liberalization. However proposals to do so will come to naught while there is unwillingness to undertake reform to allow markets to work more effectively in domestic economies.

The major issue in Asia today is not how to achieve trade liberalization, as important as that is, it is how to revitalize markets to achieve growth.

APEC Finance Ministers need to develop strategies for that purpose.

The post currency crisis environment

It is now nearly four years since the massive currency devaluations occurred. The expectation at the time was that the impact would be short term, that within three years the economies worst affected would return to sound economic condition. This has not happened. With the exceptions of China, Chinese Taipei, and Singapore, no one else in Asia is achieving steady or sustainable growth. Circumstances vary, but the overall picture is staggering levels of unserviceable debt in the private sector, steadily growing debt in the public sector and falling foreign investment. In some countries there have been some individual years where GDP and export growth has been good. But the overall situation is that economies are weak and highly vulnerable to external shocks and, despite the devaluations, many industries are not globally competitive.

The external environment is threatening. Until there is sustained reform of the Japanese economy, Japan can provide neither the investment nor the markets to support growth in

other economies in the region. With the US moving into recession, demand in the US market, a major factor in East Asian growth will continue to weaken.

The economic governance reforms which all governments determined were necessary to strengthen their economies to protect against a repeat of the currency crises have not been completed.

There are still some who believe that the fundamental protection against a repeat of a massive currency devaluation is to build a stock of funds to defend currencies and provide emergency finance. Those who believe this is the root cause of the currency crisis tend to be political figures. Most economic and finance experts around the region know this is either not the core problem or not an adequate solution in its own right. The experts know that economic and governance structures and monetary policies need to be changed. It is political forces in East Asian economies which are preventing the necessary reforms from being implemented. There is no one today who can say the weaknesses in domestic regulatory laws and practices which were responsible for severe effects in the economies most affected by the currency devaluations have been properly corrected.

What is not yet understood by political leaders in many countries in the region is that these reforms are necessary if sustained growth is to be restored. It may take another two or three years of uneven performance, falling foreign investment and perhaps even recession before the linkage is understood and action is taken.

Attitudes to trade liberalization

There has been a lack of enthusiasm for trade liberalization in East Asia since the currency crisis. The first casualty was the liberalization program in the ASEAN Free Trade Area (AFTA). While the scope of the Area expanded with the addition of new members, implementation of commitments faltered. The gap between the rhetoric and the implementation widened. Commitments to liberalize services were modest and important areas of trade were still yet to be subject to effective commitments to liberalize.

In APEC, the first sign was the failure to adopt the program of Early Voluntary Sectoral Liberalization (EVSL) at the Kuala Lumpur Summit in 1998. This was a major setback. The remainder of the package of proposals for reform were forwarded to the WTO as the Advanced Trade Liberalization package (ATL) where they remain dormant. Last year a proposal to create a single free trade area between AFTA and Closer Economic Relations Agreement (CER) between Australia and New Zealand stalled and has been turned into a more general proposal to build a Closer Economic Partnership. At the same meeting in Chiang Mai, Malaysia announced that it was not ready to subject its tariffs on automobiles to AFTA disciplines, effectively stalling the AFTA liberalization process.

The lack of interest in trade liberalization had its global counterpart with the failure at Seattle in 1999 to agree to launch a new round of WTO negotiations. Several East Asian

economies subsequently supported the contention by developing economies that conditions for further global trade liberalization were not ripe until commitments made in the Uruguay Round had been implemented and until developing economies had the capacity to implement all Uruguay Round obligations.

It is clear, with the exception of China and Chinese Taipei, both of who are ready to accept significant obligations to liberalize as a consequence of accession to the WTO, that the political will in the East Asian region to liberalize is low. This is mirrored in the hesitation to complete the post Asian-crisis economic governance reforms.

There is some consonance with a wider mood. The capacity of the Clinton Administration to commit to trade reform was limited. This was one of the reasons for the failure at Seattle. The New Zealand Government has resiled from commitments by its predecessor to move all tariffs to zero. The Australian Government has put a temporary pause in its program to bring all industrial tariffs to the five percent average and has been notable in its failure to indicate how it plans to achieve the Bogor targets of zero tariffs by 2010.

Yet at the same time a raft of proposals for new regional and bilateral trade agreements have been proposed. Japan, Korea, Singapore, New Zealand, Australia, Canada, Mexico and Chile area engaged in a large number of discussions about bilateral agreements and the concept of an ASEAN plus three (China, Korea and Japan) agreement is being studied.

What is going on? Is this a new approach to liberalization as some suggest, creation of mini zones of liberalization to serve as standards or stepping-stones for wider liberalization, or is it an effort to give political cover for a situation in which basically there is no inclination for liberalization? The politics of trade liberalization has always been dogged by the preparedness of political leaders to make long-term commitments to liberalize but to avoid the short-term action to realize the commitments.

The answer is both. It is clear that the working presumption in the APEC region that all decisions concerning trade liberalization should taken by consensus is not effective. Countries who have wanted to continue to liberalize have been frustrated by opposition from those who do not. So those who want to move forward have chosen to do so. There is a process of piecemeal liberalization occurring. It carries risks.

The risk of piecemeal liberalization

The literature about the negative consequences of preferential trade agreements is well known. The desire to avoid these consequences was the reason the APEC concept of concurrent unilateral (and non-preferential) liberalization was developed. The concept was intellectually sound, but practicably flawed because it was naive. It presumed that Governments would unilaterally liberalize without wrapping commitments in legally binding obligations. Developments in the APEC region have reconfirmed a fundamental

basic of the political economy of trade liberalization. Governments need to adopt binding international commitments to liberalize if they are to carry domestic constituencies.

A second principle of effective liberalization was ignored in the next attempt at liberalization in APEC. Effective liberalization must be universal. It must cover all sectors of all economies, or the full economic benefits will not be obtained. The EVSL package demonstrated what can happen when governments decide to commit for political reasons to any form of liberalization without regard to the economic effects. At the APEC Study Centre conference in Auckland in 1999, independent econometric modeling by the Australian Productivity Commission, the New Zealand Department of Agriculture and Fisheries and the Taiwan Institute of Economic Research of the economic welfare effects of the EVSL package showed that it was negative for each of those three countries. This was because the package was not comprehensive. It covered only a few sectors and some products.

It demonstrated the same loss of economic benefit that bilateral and regional agreements can cause if the result of commitments is trade diversion instead of trade creation. Where sub agreements in the region are likely to result in negative economic effects, they should therefore be avoided.

This effect is generally not the consequence in economies where trade barriers are low form preferential arrangements. There is no evidence the US Canada free trade agreement resulted in trade diversion. Overall analyses of the NAFTA arrangement suggest that there is little if any diversion. Mexico's overall trade barriers (around 15 percent) were higher than those of Canada and the US (average 4-5 percent), but this difference was not great enough to create diversion or significant diversion.

Free trade agreements in any combination among Australia, US, Chile, New Zealand and Singapore are not likely to cause trade diversion, depending on what sort of commitment the US makes on opening markets for agricultural products where US protection is high for some products. (In its previous negotiations, the US approach has been to defer commitments on liberalization of agriculture to the multilateral processes of the WTO).

A wake up call is needed

While there is little political impetus for trade liberalization in the APEC region today, it is not correct to say that this is the leading economic problem in the region.

The leading problem is the fundamental weaknesses in economies throughout the region and the lack of preparedness of political leaders to act to address it. Economic and financial experts throughout the region, including in Government, know what has to be done. The problem lies at the political level.

APEC needs to give political leaders a wake up call. This is not the task of the Trade and Foreign Ministers because the basic problem is not trade or foreign policy, it is macroeconomic and monetary policy. It is time for Finance Ministers to drive APEC.

The Summit process this year will be the first time that Finance Ministers have met in the immediate period leading up to the Summit. With spluttering growth, high levels of unsustainable private sector debt, rising public sector debt, recession in Japan and recession looming in Japan, they have plenty to talk about. They should not be sidetracked by talk of an Asian Monetary Fund. To do so would be to ignore the central problem which, in a nutshell, is to restore the capacity of markets to drive growth in East Asia.

While there is a need for APEC to concentrate in the next two or three years on macroeconomic and monetary policy, it should not neglect trade liberalization.

The need to restart the WTO process is more urgent than ever in this period of drift. It is vital that APEC support this. APEC countries that wish to advance trade liberalization with others of like mind in bilateral or regional groups should also be encouraged, but counseled to avoid the pitfalls of preferential partial and non-comprehensive liberalization.

APEC Leaders should underscore the Bogor commitments and mandate that all processes of trade liberalization among APEC economies - multilateral, regional and bilateral should be designed to deliver the end result in the Bogor commitments – zero barriers within a fixed timetable.

This paper was prepared for delivery at the APEC Study Centre Network Conference at Nankai University, China on 18 and 19 May 2001