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East Asian trade and the new world trade order

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One consequence of the prolongation of Uruguay Round negotiations three years beyond the original 1990 deadline was that uncertainties surrounding the world trading system multiplied. Combined with the renewal of regionalism as an alternative to the multilateral approach to trade liberalisation, these uncertainties created conflicting forces in trade policy among industrial countries and between industrial and developing countries. During the Uruguay Round negotiations, which began in 1986, many developing countries experienced changes in policies, switching from mainly import-substitution strategies to accept new economic opportunities from trade liberalisation and financial deregulation. These revisions to established economic policies evolved partly from the educational effects of participating in the GATT trade negotiations, because more contracting parties were active participants in the Uruguay Round than in any of the previous seven rounds. In addition, the economic performance of some East Asian economies in the previous twenty years provided an incentive for other countries to adopt their export-oriented strategies, a challenge taken up by ASEAN and in Latin America. During the Uruguay Round negotiations, Vietnam, China and transitional economies in Central Europe also began to open to market forces and trade.

The changes taking place during the seven years of the Uruguay Round negotiations interacted with the negotiations themselves. Regionalism achieved renewed support in both industrial and developing countries, partly as a bargaining device in the negotiating process and partly as a protectionist counter to progress in the Round. The political debate about the costs and benefits of regional economic integration was re-opened. The movement for closer economic and political union in Western Europe took another step with the proposal to complete the internal market by 1992, announced almost as soon as the Uruguay Round began. This stimulated the Canada–US Trade Agreement (CUSTA) (1989), which evolved into the North American Free-Trade Agreement (NAFTA) (1992). Both were consistent with the shift of US policy towards more emphasis on reciprocity and managed bilateralism in trade relations. With these two major economic blocs dominating the international trade debate, just when the Uruguay Round negotiations moved into crisis in 1990, it was not surprising that defensive regional trade agreements became an alternative for other countries. European countries not members of the European Union (EU), including transitional economies in Central Europe, sought special trade arrangements, which resulted in the European Economic Area (EEA) coming into effect at the beginning of 1995. Mediterranean economies and the Lomé countries also sought closer trade links with the EU to protect their preferential access. Latin American governments tried to find ways to associate with NAFTA; enticed by ill-defined initiatives from the United States, they took up new regional agreements among themselves as preliminary steps to creating a western hemisphere trade bloc, along the lines of President Bush's Enterprise for the Americas initiative (1992).

One perverse development in the new regionalism was the acceptance that a new Asian trade bloc based on the Japanese yen would arise as a counterweight to the EU and NAFTA. This concept was employed with some success by protectionists in Europe and NAFTA to pursue policies to discriminate against exports from the highly competitive East Asian economies, with little regard for the economic and political realities of East Asian development. When the proposal for Asia Pacific Economic Cooperation (APEC) was made in 1989, the East Asian countries responded enthusiastically, mainly because it would create links with the United States, which remained much the largest market for their exports. It was links across the Pacific and the informal, consultative nature of the APEC proposal that appealed to the East Asian countries. This contradicts the conventional European and North American view about East Asia as a new trade bloc.

This combination of regional initiatives and new protectionism based on 'grey-area' measures and lax implementation of GATT rules was the climate into which the Dunkel draft of the Uruguay Round Final Act was launched in 1991. In spite of last-minute compromises among the major players and some weakening of the Dunkel draft in the closing stages, the completion of the Uruguay Round in December 1993 came as something of a surprise. The Final Act represented the most comprehensive agreement ever reached on international trade. It established a new institution, the World Trade Organisation (WTO) built on the foundations of the GATT, comprising not only rules governing merchandise trade but also agreements on trade in services, intellectual property and new dispute settlement procedures. The whole Final Act requires a single undertaking, meaning that ratifying countries have to accept it in its entirety. (Only the four plurilateral trade agreements on trade in civil aircraft, dairy products, bovine meat and government procurement were subject to separate signature and applied conditionally to adherents.) At the final Ministerial Conference in Marrakesh in April 1994, representatives from 120 countries signed the Final Act, and more have sought membership since.

Yet the euphoria of completing the Uruguay Round cannot hide the confusion into which the WTO has been born. There are evident weaknesses in the Final Act, notwithstanding the triumphs of including agricultural trade, phasing-out the Multifibre Arrangement (MFA), the framework agreement on trade in services, accords on intellectual property and counterfeit, trade-related investment measures and government procurement, plus improvements to existing codes such as safeguards and subsidies. Sources of new uncertainties are largely untouched by the Uruguay Round Final Act. Regionalism and the most-favoured-nation (Mfn) treatment embodied in Article I of the General Agreement were not reviewed in the Uruguay Round; only perfunctory amendments were made to Article XXIV on free-trade areas and customs unions. Furthermore, access to anti-dumping protection was probably, on balance, made easier by amendments on circumvention in the Uruguay Round code. The effectiveness of the new safeguards code in removing voluntary export restraints (VERs) remains to be tested.

The circumstances in which the WTO is to be implemented have been complicated by the so-called 'new trade agenda'. This comprises a collection of new trade issues that were raised during the closing three years of the Uruguay Round, after the breakdown of negotiations in Brussels in December 1990. They include trade and the environment, labour standards, investment policies and competition policies. The first two are only marginally linked to trade policy and the GATT, but they have become socially sensitive issues in industrial countries and accepted as considerations in determining any economic policy (Robertson, 1994). The latter two have become increasingly exposed as influencing trade flows as conventional border measures affecting trade have been reduced by successive rounds of GATT negotiations and other liberalisations.

The successful conclusion of the Uruguay Round should restore faith in the multilateral trading system. Order restored by the WTO should reduce the attractions of regionalism and discriminatory trade measures, even if the Uruguay Round did not entirely satisfy the need to strengthen GATT rules affecting these exceptions to Mfn treatment. The liberalisations agreed will be implemented over ten years and will bring significant gains in global economic growth and welfare, as quantitative estimates have already demonstrated. Moreover, several of the agreements include commitments to further negotiation; for example, agriculture and services. The trade climate should become less confused as the WTO becomes accepted and the Uruguay Round agreements are implemented.

The WTO and East Asia

The Uruguay Round Final Act will have far-reaching effects on the rapidly changing, dynamic economies of East Asia (the ASEAN4 – Indonesia, Malaysia, Thailand, Philippines; the 4 NIEs – Hong Kong, Singapore, Korea, Taiwan; and China). During the more than seven years of negotiations these economies underwent major changes. GNP growth rates of 8–10 per cent per annum were achieved; manufactured exports from rapidly growing and modernising industrial sectors became centres for growth; and their integration into the global economy, through trade and foreign investment flows, was established. Much research has been undertaken into the reasons for the high performance of these economies (World Bank, 1993, 1994b; Lau, 1990). In all cases a major cause was the rapid adaptation of economic policies to changing circumstances and underlying macroeconomic stability. For the first time all these countries participated actively in the GATT negotiations (Taiwan and China as 'observers'), undoubtedly influencing their policies and exposing them to the benefits from liberal trade.

By the time the Uruguay Round was completed in December 1993, the dynamic East Asian economies had become firmly established as exporters of manufactures, and China had become a major exporter and the largest single recipient of foreign direct investment (FDI) in the region. In circumstances of growing trade uncertainties, with new trade issues occupying industrial countries' negotiators even before the implementation of the Uruguay Round Final Act had commenced, it is important to assess the overall effects that the Uruguay Round outcome might have on the trade and economic development of East Asia. With so much uncertainty surrounding the WTO, with continuing negotiations on aspects of trade in services and the new trade issues raised in the final stages of the negotiations, any assessment of the effects of the Uruguay Round outcome are prone to risk. In the following chapters, attempts are made to evaluate some of the agreements achieved in the negotiations, but the treatment is necessarily selective and neglects many important accords, such as intellectual property and trade-related investment measures.

World trade after the Uruguay Round

The Uruguay Round Final Act contains twenty-two Agreements, covering goods, services, investment measures, intellectual property rights, dispute settlement and the trade policy review mechanism. In addition it contains eight Understandings, twenty Decisions, three Declarations and a Protocol. It is the most comprehensive and far-reaching trade agreement ever concluded, and its repercussions are still being assessed around the globe. Part I of this volume comprises four chapters that attempt to assess the effects of the Uruguay Round Final Act on the world trade outlook.

The results of the Uruguay Round are put in the context of world trade developments in chapter 2, by Kym Anderson, of the University of Adelaide. He notes that the outlook for East Asian trade is crucial for the global trading system. The dynamic evolution of East Asian trade has doubled the region's share of world merchandise trade over thirty years, because East Asia's exports of manufactures increased at three times the rate of world trade. In spite of rapid growth in trade among the East Asian countries (stimulated by strong economic performance generally), these economies remain highly dependent on trade with all regions. Hence, they are dependent on the strength of the WTO multilateral system and its capacity to supervise the implementation of the Uruguay Round results and to manage negotiations on new trade issues: those already nominated and some unforeseen. New challenges will be made to the WTO by lobby groups seeking to use trade instruments to pursue environmentalism, labour standards and harmonisation of competition policies. The success of the GATT in lowering border barriers to trade has placed such issues on the international agenda, so that national governments can avoid unpalatable policies by pushing such matters on to global negotiations and reconciliation. Although these new issues and potential bilateral disputes will be initiated mostly by the EU and the United States, Anderson points out that the increasing weight of the Western Pacific economies (East Asia plus Australasia) in world trade will give them a strong say in the new WTO, as long as coordinated strategies can be established. The scope for special interest groups of industrial and developing countries to cooperate in the pursuit of global trade agreements was demonstrated by the Cairns Group of agricultural exporters in the Uruguay Round. The challenge for the Western Pacific economies, Anderson concludes

> will be to convince the wider world community that trade liberalisation can be consistent not only with economic growth but also with sustainable development, improved labour and environmental standards, and even improved political freedom and other human rights.

The industrial countries' perspective on the Uruguay Round is presented in chapter 3 by Geoff Raby, formerly with the Trade Directorate of the OECD Secretariat in Paris. The OECD Ministers declared in June 1994 that the Final Act will advance trade liberalisation, expand and strengthen GATT rules and promote economic growth. Yet already some OECD governments are showing apprehensions. The new trade agenda is receiving increasing attention even as the implementation of the Uruguay Round agreements begins. By explaining the benefits to be expected from meeting these commitments, Raby draws attention to the dangers inherent in overloading the WTO with disputes and new issues with ill-defined links to trade, such as labour and environmental standards. Exerting too much pressure on the WTO structure before the Uruguay Round agreements are implemented could diminish their value and, more importantly, could create harmful divisions among the enlarged membership along North–South lines. This would be unfortunate, given that one of the major successes of the seven years of Uruguay Round negotiations was to draw many developing countries into active participation in the negotiations and greater acceptance of the mutual benefits that are provided by multilateral trade rules and disciplines. The danger is that just when the GATT founders' dream of universal acceptance of multilateral and liberal trade is within reach, some OECD countries are giving emphasis to regional and bilateral trade policies. Proposals to extend multilateral trade rules to new areas must not be forced before consensus is reached on both the nature of the problem and the rules required. Raby concludes that the success and scope of the Uruguay Round Final Act should not be interpreted as reason to hasten too fast on new issues.

Many uncertainties remain about the trade effects of the Final Act. The scope of the agreements and undertakings have justifiably been accepted in laudatory terms. The conventional measures of liberalisation indicate deeper percentage tariff cuts and more extensive tariff bindings than in any earlier GATT negotiations, and agriculture is included in the liberalisation for the first time. Basic agreements to restrict access to non-tariff protection were reached, including safeguards, subsidies, quantitative regulations, standards and phasing-out the MFA. Nevertheless, there are serious doubts about evasions of commitments in the Agreement on Agriculture – so long the stumbling-block in the negotiations – on anti-dumping and on textiles and clothing.

The 'continuing negotiations' left over from the Uruguay Round Final Act raise some serious questions, after the Tokyo Round negotiations continued in the Safeguards Committee failed to reach any conclusions. The framework agreement on trade in services contains several key areas

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where agreement was not reached and negotiations are continuing: shipping, finance, professional qualifications and accounting practices. At the same time, differences exist over interpretations in other agreements – for example, those on intellectual property, subsidies, safeguards, processes and production methods in the 'standards code', transparency in quarantine regulations and technical standards. By extending the coverage of the WTO with many new agreements, the Uruguay Round has created a permanent negotiating process in many traditional areas of trade, as well as opening the opportunity to raise new trade issues. The WTO will require a settling-in period during which the formula for dealing with continuing negotiations will have to be resolved. During this time, developing countries, including the East Asian economies, will need to form coalitions and establish positions to protect their interests on a continuing basis. As full members of the WTO, due to the 'single undertaking' requirement of the Uruguay Round Final Act, some of these countries' interests will no longer be protected by the 1979 Enabling Clause which provides special and differential treatment to developing countries. More attention will have to be given to day-to-day processes in WTO committees.

No review of the Uruguay Round as it affects East Asia would be complete without consideration of the MFA, because its quantitative restrictions have influenced industrial development throughout the region. Speculating about what phasing-out the MFA might mean, assuming the schedule agreed in the Uruguay Round is achieved, is best done using a CGE model (see chapters 6 and 7). Kala Krishna and Ling Hui Tan of the Pennsylvania State University and the Brookings Institution, respectively, have chosen in chapter 4 to question the relevance of a simple static competitive model as used in most empirical and policy studies. Export restraints are administered by governments and different methods of implementation influence the allocation of 'quota rents'. Using available data, Krishna and Tan assess whether the rents accrue to exporting countries completely, as usually assumed, and they then model the alternative allocation systems according to observable data.

The analysis in chapter 4 suggests that quota implementation and market imperfections (both among potential exporters at export quota auctions and on final markets for clothing) do affect the rent transfers between countries and producers. Such non-conventional distributions of licences and rents will influence the way phasing-out the MFA will affect producers' and consumers' welfare and redistributions of production.

The Uruguay Round Final Act includes for the first time recognition that policies affecting trade, international monetary issues and development need to show coherence. A Ministerial Declaration calls for the WTO to pursue and develop cooperation with the IMF and the World Bank to achieve greater coherence in global economic policy making. This comprehensive approach acknowledges the progress during the past decade in parallel liberalisation of trade and financial regulations. In particular in East Asia, authorities have recognised that exchange rate stability is necessary to support expansion of trade and economic growth.

Suiwah Leung, from the National Centre for Development Studies, reviews in chapter 5 the evidence linking exchange rate volatility to trade. After examining empirical studies, she finds there is no consistent systematic relationship between short-term exchange rate fluctuations and bilateral or multilateral trade flows. Even in periods where a statistically significant relationship existed, the actual impact is much smaller than other factors that affect trade. Leung argues that currency hedging provides a satisfactory instrument to overcome short-term exchange rate fluctuations.

The deregulation of financial markets in East Asia in recent years has facilitated trade expansion and economic growth, by increasing exchange rate stability in face of fluctuations in external economic imbalances. Continuing financial deregulation in the Asia Pacific countries will make financial hedging more available. Exchange rate risks can then be managed in a cost-effective manner. As regards the effect of currency misalignments on the growth of protectionism, Leung argues that there are major gaps in current knowledge about the causes of misalignments, the efficiency of foreign exchange markets, the working of sterilised intervention, and what represents an appropriate 'equilibrium' real exchange rate. Against these uncertainties, there are real risks of disruption to the payments system if political commitments to a stable exchange rate are ever put to the test. To the extent that misalignments have fiscal causes, international economic policy coordination focusing on exchange rates would not solve the problem, and could undermine policy credibility. The WTO will contribute more economic coherence by introducing more discipline into the use of trade restraints as contingency protection and for balance of payments reasons. Institutional cooperation that incorporates WTO officials into IMF and World Bank committees should also enhance policy coherence.

Modelling changes in world trade

A perennial question that plagues trade negotiators in all countries is: what will be the economic benefits arising from mutual reduction in trade protection? Or, how will the benefits from reciprocal multilateral bargaining to reduce protection be distributed among participating countries? The underlying logic is usually related to tariff reductions or similar easily quantifiable measures. Probably the largest change from the Uruguay Round is the strengthening of the multilateral trade rules and disciplines embodied in the GATT. Yet the benefits from many of these changes cannot be measured.

Notwithstanding difficulties in estimating the effects of trade liberalisation on economic activity, efforts must be made to show sceptics in the protectionist lobbies that substantial real gains come from trade liberalisation. Estimating techniques improve all the time. Part II of this volume contains three chapters that model the welfare effects of aspects of the Uruguay Round Final Act and their distribution among different regions. The simplifications made to produce manageable models are the key determinants of the results of trade-policy changes. The computable general equilibrium (CGE) models used in chapters 6 and 7 allow for interrelationships between sectors and economies, with complicated feedback mechanisms. Each employs a new sophistication to refine the results.

The most sophisticated model and most comprehensive coverage is used in chapter 6 by Joe Francois, Bradley McDonald and Håkan Nordström, of the WTO. This model forecasts gains in global output and trade expected by the year 2005, based on 1990 data. This analysis relies on a fifteen-sector, nine-region CGE model of the world economy. This general equilibrium approach, based on an input–output framework, links together all parts of the world economy through a network of direct and indirect relationships. The changes introduced as a result of the Uruguay Round are fed into this general equilibrium framework in three stages:

- Initially, the effects of tariff reductions and import quota liberalisation are analysed with constant return to scale (CES) technologies, competitive domestic markets for capital and labour but no international movements of factor inputs.
- Next, industry-wide economies of scale are introduced within each industry, allowing production costs to decline as aggregate output increases.
- Finally, the model incorporates imperfect competition and scale economies for firms in each industry. This allows two-way trade in specialised goods, rather than simple comparative advantage.

The model in chapter 6 estimates the trade and income effects of the market access outcomes of the Uruguay Round resulting from tariff reductions, phase-out of industrial quotas and agricultural reforms. According to which version of the model is used, the merchandise trade volume in 2005 may be 10 per cent (constant returns) or 22 per cent (increasing returns and monopolistic competition) higher after full implementation of these Uruguay Round changes. A similar range of results is obtained for increases in annual global income in 2005 (1990 prices); US$200 billion increasing to US$510 billion according to the assumptions. Estimates based on perfect competition and constant returns to scale, used in all earlier estimates of global effects of the Uruguay Round, assume away important multiplier effects in the inter-sectoral relationships (Goldin *et al.*, 1993). Yet even the third version of the Francois–McDonald–Nordström model ignores major dynamic effects on expenditures and incomes through international capital flows and investment flows. Moreover, if the model allowed for more disaggregation of 'regions' and 'sectors', additional linkages would introduce new multipliers. The model does not attempt to estimate some of the most radical reforms resulting from Uruguay Round agreements, affecting non-tariff measures, trade-related investment measures, intellectual property, trade in services and general tightening of GATT rules, which are not readily quantifiable.

Hence, the large benefits claimed from the Uruguay Round by the Francois–McDonald–Nordström model are still under-estimates. Increases in trade volumes and incomes expected in 2005, compared with what would have happened without the Uruguay Round (based on 1990 data and OECD no-change projections), will be multiplied by allowing for dynamic and spread effects. This makes the overall effects even larger than was estimated when the negotiations were completed: merchandise trade volumes are larger by one-quarter than otherwise, and global income is 1.4 per cent higher. The distribution of these gains shows, not unexpectedly, that the major regions (EU and United States) are the largest gainers – largely because of the dominant effects of the agreement on agriculture on those regions' highly distorted domestic agricultural sectors. (Subsequent estimates of the liberalisation in agriculture suggest that these gains have been over-stated, Hathaway and Ingco, 1996.) Developing countries together share welfare benefits equal (approximately) to each of the major industrial regions. (Since developing countries are treated as one region in the Francois–McDonald–Nordström model, the trade and income gains are probably under-estimated because within-group trade is not allowed for in the results.)

The East Asian economies have demonstrated strong linkages between export expansion and income growth for over thirty years (World Bank, 1993). In chapter 7, Yongzheng Yang, from the National Centre for Development Studies, introduces the growth effects and conventional resource allocation effects of trade liberalisation into a comparative static CGE model using export externalities. In this case, the effects of Uruguay