# Trade Trends and Issues in East Asian Developing Economies

*William E. James*
*Chief, Research Division*
*International Center for the Study of East Asian Development*

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William E. James, International Center for the Study of East Asian Development
11-4 Otemachi, Kokurakita, Kitakyushu, 803, Japan
Tel. (81-93) 583-6202 Fax. (81-93) 583-6576
Email: james@icsead.or.jp

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The share of ten East Asian developing economies in world trade in goods has risen sharply between 1990 and 1996, despite a deceleration of growth after 1995. Indications are that East Asian international services transactions are also rising relative to the global trend. The paper highlights the high trade dependence of East Asia and provides a synopsis of the key trade policy issues for these economies at the multilateral, regional and national levels. At the multilateral level these economies have a large stake in the successful implementation of the Uruguay Round Agreement, particularly the phasing out of the Multi-Fiber Arrangement. They also have much riding on the outcome of on going World Trade Organization (WTO) negotiations in services, the WTO work agenda, and in future directions of the WTO, including membership questions. At the regional level, the ASEAN Free Trade Agreement (AFTA) and the Asia-Pacific Economic Cooperation (APEC) agenda will influence the regional trading environment. Unilateral liberalization of international trade in goods and services and investment has enabled East Asia to capture the gains from freer international trade. This paper sets forth the author's views as to how East Asian developing countries may advance their commercial interests in a manner consistent with multilateral free trade. Problems of contingent forms of protection such as anti-dumping, restrictive rules of origin and other regulatory issues are addressed in this context.

TRADE TRENDS AND ISSUES IN EAST ASIAN DEVELOPING ECONOMIES

By William E. James

## A. TRENDS IN WORLD TRADE AND PRODUCTION: IMPLICATIONS FOR EAST ASIAN DEVELOPING ECONOMIES

World goods and services trade volume has been expanding more rapidly than real world output during the last decade (Table 1). This can be seen from estimates of actual growth and forecasts of future growth of world production and trade volume. The high elasticity of world trade with respect to world output may be explained by:

1. Improvements in transport and communications technologies that have lowered the cost of conducting international transactions;

2. Liberalization of international trade through elimination of traditional non-tariff barriers coupled with tariff reductions that have been undertaken unilaterally, regionally and multilaterally; and

3. The increasing role of transnational corporations brought about by liberalization and expansion of flows of foreign direct investment.

East Asian developing economies, in particular, have enjoyed a rising share of world trade, as income growth has been extremely rapid in recent decades (World Bank 1993, Oshima 1993, James, Naya and Meier 1987). Between 1990 and 1996, the share in world merchandise trade of ten East Asian developing economies (China, Korea, Taiwan, Hong Kong, Philippines, Indonesia, Singapore, Malaysia, Vietnam and Thailand) rose from 11 to 17 percent.[1] Unilateral liberalization measures have helped these economies to achieve such a phenomenal increase in world trade share. For example, large emerging economies in East Asia, including China and Indonesia, have increasingly relied on market forces and have consequently boosted their share of world

[1] International Monetary Fund, *Direction of Trade Statistics Yearbook 1997*, Washington, D.C.

exports of non-oil manufactured goods. Indeed, the market share of East Asian economy exports in the total apparent consumption of manufactured goods in the OECD countries has risen sharply between 1980 and 1993 (Lloyd and Toguchi 1996).[2]

In future, long-term trend growth in East Asian developing economies' trade is likely to be more closely in line with expansion of world trade than in the recent past, when growth was much higher in East Asia. Short-term growth in international trade is subject to cyclical fluctuations that are influenced by exchange rates and other factors. However, domestic trade may become a strong future source of growth in these economies as they mature. Currently, in some East Asian economies expansion of domestic trade has been constrained by a combination of infrastructure bottlenecks, restrictions on foreign investment in retail trade and distribution and a plethora of local and province-level trade restrictions and formal and informal levies. Easing these obstacles will accelerate growth in domestic trade. Both China and Indonesia can expect to depend more on the growth of the domestic market as a major impetus to economic growth rather than upon exports. It is likely that domestic trade growth rates will exceed those of international trade. Indeed, it would be realistic to accept medium to long-term forecasts of world trade and production as benchmarks for the future expansion of the real volume of international trade in the coming decade in the large East Asian economies.

Exports and imports of goods and services as a percentage of GDP are already quite high in East Asian developing economies compared with the United States and Japan (table 2). It is still probable that the growth in the real value of international trade may exceed real income growth in East Asia. Hence, some expansion above the benchmarks is still plausible and in some cases is even likely (e.g. India, Indonesia, Philippines, and Vietnam). With the achievement of long-term liberalization of international trade through the Uruguay Round Agreement of 1994 and with the establishment of the World

[2] Lloyd and Togouchi show that increases in market share of East Asian developing economies largely accounts for the difference between the growth in East Asian exports to industrially advanced economies and growth in apparent consumption of manufactures in industrially advanced economies between 1980 and 1993.

Trade Organization (WTO) with an ambitious future agenda, world trade is set to expand more rapidly than would have been the case otherwise.

## B. MACRO AND MICRO TRENDS IN EAST ASIAN TRADE

A pronounced slowing down in the growth of East Asian merchandise trade has occurred beginning in the latter half of 1995 and continuing in 1996. This slow-down can be seen in the case of exports (table 3) and imports (table 4) comparing 1995 and 1996 growth rates. Macroeconomic causes of slower growth included, in some cases, real appreciation of the exchange rate that left some currencies over-valued and that led to a shift of investment and production from internationally traded goods and services to non-traded goods and services (i.e., real estate, property development and construction). In other cases, more rapid growth in domestic consumption and demand than in production took place. Finally, the slowdown in the region's imports reinforces the slower growth of exports because a significant share of trade is intra-regional.[3]

Microeconomic causes included the slump in worldwide electronics prices and demand (East Asian economies' exports and imports have a large electronics component). Infrastructure bottlenecks are another plausible reason at the micro-level for a slowdown. Moreover, some countries have implemented intervention policies that are unfavorable for expansion of trade by restricting certain imports in the name of reducing current account deficits (e.g., Korea's austerity program, China's non-transparent restrictions and procurement policies, and the rising use of anti-dumping as a new trade restriction in Southeast Asia).

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[3] It is sometimes claimed that East Asian developing economies trade with one another is sufficiently large for the region to continue to grow even if developed economy markets cease to expand. It is estimated that about half of East Asia's merchandise trade is intra-regional (including China, Hong Kong, Taiwan, Korea, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam). However, large elements of double counting result from inclusion of Singapore and Hong Kong, with large amounts of re-exports. Self-sustained trade may be illusory, particularly if the region's economic growth declines.

The slowdown in the growth of international trade may be a precursor of slower real economic growth in select East Asian economies: Thailand, Malaysia, Korea and Indonesia. The medium-term outlook is for continued growth of output and trade but at a more sustainable pace than before.

## C. KEY ISSUES IN WORLD TRADE IN GOODS AND SERVICES

From the perspective of East Asian developing economies, key international trade policy issues are those that are likely to influence the market access of East Asian export-oriented manufacturing and service industries as well as those that impose adjustments upon domestic import-competing industries, including agriculture. These issues arise at the multilateral, regional and bilateral levels.

### 1. Implementation of the Uruguay Round Agreement

At the multilateral level the first priority of East Asian developing countries (aside from China and Taiwan) is the implementation of the Uruguay Round Agreement of 1994.[4] The Uruguay Round Agreement offers East Asia improved market access for manufactured exports through the reduction of tariffs. It also means that agriculture and textiles will be brought under GATT/WTO rules. A key concern is in the implementation of the textile agreement. Thus far, quotas have been relaxed on items that have little commercial impact. There are questions over whether developed countries in Europe and North America will be able to muster the political will necessary to abolish quotas in textile and apparel particularly when the time comes to do so in 2004. An added concern is whether certain East Asian textile and apparel manufacturers will be able to adjust to freer trade without the market distorting MFA-quotas. Uncertainty over whether the quota markets will indeed implement fully the agreement may lead some East Asian producers to delay making necessary adjustments in a timely fashion.

### 2. On-Going Services Negotiations

[4] For China and Taiwan, membership in the WTO is presently a high priority.

The satisfactory conclusion of negotiations in the area of commercial services remains to be achieved. The General Agreement on Trade in Services (GATS) provides a framework within which negotiations on service sectors may be conducted. Negotiations over telecommunications, financial services, maritime transportation, civil aviation, business and professional services, and the movement of natural persons are being carried out and are of strong interest to East Asia. Achievement of improved market access is one object. However, East Asian economies that are large net importers of commercial services should also recognize the economy-wide benefits that can be gained through greater openness and efficiency in traded services. The improved efficiency of services can come about through increased competition provided by foreign suppliers of services. Lower prices of such services can lower the costs of domestic firms in non-service sectors, including manufacturing. In turn, the lower cost of services in the domestic economy will enhance exports by other sectors.

3. The WTO Work Agenda: Present and On-Going

The following is a partial list of items that are in various stages of completion in the WTO:

a. Non-Preferential Rules of Origin;
b. Customs Procedures and Valuation;
c. Article XXIV and Regional Trading Arrangements;
d. Standards and Product Testing;
e. Functioning of the Dispute Settlement Mechanism; and
f. The Question of New Members.

In each of the above work agenda items, individual East Asian developing economies have particular interests. However, for some items (e.g. rules of origin) they have a common interest in seeing that these so-called technical matters are not turned to protective uses.[5] In the area of standards and testing

[5] For example, the United States in 1996 changed its textiles and apparel non-preferential rules of origin in a manner that potentially had rather severe consequences for East Asian exporters. See James (1997a).

the principle of mutual recognition may be agreeable to East Asian developing economies so that their exporters are not put at a disadvantage by adoption of only European or U.S. standards.

### 4. The Future Agenda: New Issues and the 'Social Clause'

Another priority common to East Asian developing economies is that of the future work agenda of the WTO. Leaders of East Asian developing countries have voiced the concern that developed countries are attempting to influence the future work agenda to give priority to issues that are not directly related to international trade and investment. They object to attempts to establish "linkage" between trade and issues of labor standards and rights, environmental standards, and human rights. The European call for a so-called social clause covering various elements of a society's safety net may appear as an attempt to impose added protection against East Asian exports.

It will be difficult for East Asian leaders to block efforts to link trade with environmental issues, particularly when they are clearly linked such as in transportation of petrochemicals or other potentially hazardous materials in international sea-lanes. Moreover, it may be better to accept discussion of these issues at the multilateral level of WTO rather than to be subject to direct bilateral pressure alone. East Asian leaders may also wish to take a proactive stance and set forth issues they believe have priority in future WTO work (i.e., tightening of anti-dumping regulations, market access for laborers from developing economies in developed economies, etc.).

## D. KEY ISSUES IN REGIONAL TRADE AND ASEAN ECONOMIC COOPERATION: AFTA

The Association of Southeast Asian Nations (ASEAN) has steadily progressed in its efforts to deepen and broaden economic cooperation in the region. The following are some of the main issues facing ASEAN in regional trade:

1. The Enlargement Issue

ASEAN almost achieved its objective of broadening membership to all ten countries in the region in 1997. Political turmoil created by the Hun Sen coup in Cambodia prevented the entry of that country into the group. However, Vietnam (1996), Laos (1997) and Myanmar (1997) did join ASEAN. The entry of Myanmar is controversial and has drawn criticism from western democratic countries. Yet ASEAN has shown in its decision to delay the entry of Cambodia that the group maintains its interest in a stable and democratically elected government there. The position with regard to Myanmar may seem at odds with the group's resolute stand on Cambodia. However, ASEAN's approach of "constructive engagement" with Myanmar appears to be paying dividends. The democratic opposition has been allowed to openly hold a party convention. Understanding of ASEAN's varying approach must take into account the group's long-term commitment to a peaceful and stable Cambodia. Indeed the issue of Cambodia has been crucial in strengthening ASEAN as a cohesive grouping.

As these new members have much lower per capita GDP and are less developed than the other six members, there are concerns that ASEAN may turn into a two-tier organization. If they are to catch-up with the rest of East Asia, all three new members will have to undergo trade policy reforms and economic restructuring. Development of market-oriented policies is essential in meeting the requirements for full participation in ASEAN economic cooperation. It is not clear what effects the recent financial and exchange rate crisis will have on the willingness of these transitional economies to expedite economic reforms. Their ability to implement liberalization programs is still in doubt. Through the act of joining ASEAN they have indicated a willingness to proceed with serious reform efforts in the near future.

2. The AFTA Common Effective Preferential Tariff (CEPT) Scheme

The ASEAN Free Trade Agreement (AFTA) is being launched on an accelerated timetable as a result of the Bangkok Summit in 1995. Essentially by the year 2003 tariffs on almost all intra-ASEAN trade will be between zero and five percent. In fact, much of the CEPT program will be implemented by the year

2000. Nearly all manufactured goods are included in the program. And although some items are on temporary or special exclusion lists (for a period of ten years), few items are on the permanent exclusion list. The CEPT scheme will thus bring almost all merchandise trade within AFTA.

In addition to CEPT, the group has launched the ASEAN Industrial Cooperation (AICO) program that will allow manufacturing firms meeting certain minimal criteria within member countries to benefit immediately from import duty relief. AICO could prove to be important in sectors where import duties are set to remain high (for example in autos, chemicals and metals) because the items are temporarily excluded from CEPT or simply have high tariffs until 2003. Thailand and the Philippines have approved import duty relief for auto parts producers in the two countries. Though Indonesia and Malaysia have in principle agreed to AICO, they have not yet approved any specific cases of relief from tariffs under the scheme.

ASEAN members are also engaged in MFN tariff reductions. Unilateral trade liberalization is being undertaken by Indonesia, the Philippines, Thailand and Malaysia. In the case of Indonesia, the simple unweighted average tariff has been reduced from 20 percent in 1992 to 12 percent in 1997. Further reductions according to a published schedule will reduce almost all tariffs to a maximum of 10 percent in 2003. Thus, the margin of preference given by Indonesia to other ASEAN members will be at most 10 percent and in many cases only 5 or 2.5 percent as of 2003. There will be little trade diversion in the case of Indonesia. Cuts in MFN tariffs by other members similarly will reduce the AFTA margin of preference and limit the amount of trade diversion.

The increased import competition will create pressures to improve efficiency in ASEAN industries and the enlarged market will stimulate large-scale manufacturing facilities that can capture economies of scale and scope. However, there is bound to be some restructuring and painful adjustment for some firms in import sensitive sectors. Without such adjustment, the gains from trade creation cannot be realized. There will be pressure on bureaucrats from formerly protected industries to implement safeguards, or even worse, anti-dumping measures.

## 3. Contingent Protection in ASEAN: the Rise of Anti-Dumping

The experience of Europe, Australia, and North America indicates that contingent forms of protection, particularly the use of anti-dumping regulations, have proliferated as traditional non-tariff and tariff protection has been progressively weakened through the several GATT rounds. Since the GATT system was established average tariffs in the industrial countries have fallen from around 30 percent to just about 5 percent. Import-competing industries that have problems meeting import competition in the absence of NTBs and high tariffs have sought out and often received special protection through the anti-dumping mechanism. In Europe, Australia, Canada and the US, the anti-dumping mechanism has often been used against exports from Japan and East Asian developing countries, including Indonesia and other ASEAN members. For example, in 1996 and 1997, the EU imposed dumping duties on Indonesian exports of unbleached cotton fabric, plastic sacks, and bicycles. Unlike safeguards, which are clearly designed to provide import-competing industries with temporary relief from strong import competition, anti-dumping claims to check "unfair competition".

While Australia and New Zealand have eliminated the use of anti-dumping against one another through the harmonization of competition policies and laws, this is not the usual case in free trade areas. It is therefore unsurprising to observe the rise of anti-dumping within the ASEAN region as traditional barriers to imports are brought down.

In 1996 Malaysia imposed duties on two Indonesian paper products exporters accused of dumping their products. In 1997, Thailand opened an anti-dumping investigation against Indonesian exporters of tinted glass. Indonesia itself has imposed anti-dumping duties on stainless steel imports from a number of developing countries and has begun investigations on a number of other cases including imports of carbon black from Thailand. The Philippines is probably the most prolific user of anti-dumping in ASEAN. There is no economic justification for the regulations on anti-dumping.[6] In fact, anti-dumping processes as practiced by the EU, Australia, Canada and the US have unduly

[6] See Deardorf 1992 for an exposition on the economics of anti-dumping.

restricted trade, raising prices and, often providing rents to producers at home and abroad. It would be unfortunate if ASEAN were to follow such a path as this could have a chilling effect on the expansion of trade within the region. The Uruguay Round Agreement brought a bit more discipline to the use of anti-dumping, but still leaves much to be desired. ASEAN may wish to strengthen disciplines in the use of anti-dumping in order to prevent its widespread use and the attendant abuses and rent-seeking.

## 4. The ASEAN Services Framework

ASEAN leaders agreed to extend free trade to services in 1995 and placed priority on negotiations aimed at liberalization of telecommunications, transportation, tourism and financial services scheduled for completion by the end of 1998. The framework adopted is intended to be comprehensive, hence, a negative list approach is being taken. It would be unrealistic for ASEAN members to attempt to harmonize all their regulations in the services industries; thus a form of mutual recognition of regulatory frameworks is likely to be adopted with certain minimal requirements. In this context, the principle of subsidiarity or decentralization of decision-making so that appropriate levels of government are permitted to take initiatives to facilitate trade and investment in services has some relevance. This is particularly the case for the numerous sub-regional zones or growth triangles within ASEAN.

The extension of AFTA to the commercial services sectors is to be applauded as it indicates ASEAN is intent on expanding economic cooperation to fast-growing tertiary sectors. Aside from the negative list approach and the mutual recognition principle, preferential liberalization of commercial service transactions should also seek to liberalize all modes of supply and to adopt a national treatment principle.[7] Such a comprehensive approach will ensure the maximum benefits from liberalization. The freeing of all modes of supply means that customers and producers of services can choose the mode that is most convenient and least costly. It also means that investment; right of establishment and movement of natural persons are included in the framework. National treatment is defined as treatment of foreign services and services

[7] For discussion see James 1997b.

suppliers “as treatment no less favorable than that accorded to like domestic services and services suppliers.”[8] However, it is sometimes difficult to interpret the meaning of national treatment in practice as domestic regulatory requirements that appear to be non-discriminatory may actually penalize foreign firms relative to domestic firms. Hence, flexibility in implementation of the principle is necessary.

## E. APEC AND ‘EARLY LIBERALIZATION’

The Asia-Pacific Economic Cooperation (APEC) forum established a fairly long-term program for trade and investment liberalization in the region, with free trade targets of 2010 for developed and 2020 for developing economies. The vision offered at Bogor in 1994, however, did not establish modes for implementing the leaders’ declaration. Consequently, in recent years APEC leaders and ministers have attempted to put teeth into the agreement through “down payments” (Osaka 1995), “individual action plans” (Manila 1996), and “early liberalization” (Vancouver 1997).

APEC itself has thus far shunned attempts at a formal regional trading arrangement or free trade agreement for the group as a whole. However, there is a danger that a complex system of hub and spoke discriminatory regional trading arrangements may evolve that will leave some APEC members at a distinct disadvantage. For example, the attempt to establish a Western Hemisphere-wide Free Trade Area of the Americas (FTAA) will evolve in a hub and spoke fashion, with the US or NAFTA as the main hub but with non-APEC spokes such as the members of the South American Customs Union (MERCOSUR). Similarly, the enlargement of ASEAN to non-APEC members also presents an element of extra-APEC discriminatory treatment. There is also the Australia-New Zealand Closer Economic Relations (ANCERTA) pact, which may work out separate arrangements with the other regional groupings. The WTO does not cover preferential rules of origin in its work program. APEC members (particularly those that are non-members of regional trading arrangements) will favor a strengthened article XXIV of the GATT. At the same time, APEC itself might develop an approach to limit protectionist uses of rules

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[8] UCTAD and World Bank (1994), p. 143.

of origin in the context of preferential trading arrangements.[9] The model for such an approach is likely to be based on WTO and World Customs Organization (WCO) decisions regarding non-preferential rules of origin.

## F. FUTURE INTERNATIONAL TRADE TRENDS AND East Asian DEVELOPING ECONOMIES

### 1. The Rising Role of Services in International Trade

International trade in commercial services is rising as a share of international commercial transactions and this trend is likely to grow stronger as information-based activities become more important in global economic activity. Technological advances in telecommunications and the conclusion of negotiated agreements to expand market access in basic telecommunications, financial services, civil aviation and maritime transport, and business and professional services will reinforce the trend.

East Asian countries, particularly ASEAN members, have recently experienced financial crises and extreme exchange rate and stock market fluctuations. Large effective exchange rate depreciation has occurred in Thailand, Malaysia, Indonesia, and the Philippines. Among other East Asian economies, the Korean won has also depreciated sharply in 1997. WTO negotiations on financial services liberalization is set to conclude by the end of 1997 and the turmoil in financial markets has cast doubt on whether East Asian developing countries will be prepared to offer much in the negotiations. Japan, however, is adopting a "big bang" approach that will open its financial services markets after April 1, 1998. Hence, it is setting a positive example in this regard. It may be argued that further opening of financial services will strengthen ASEAN financial markets and improve the standards upheld by financial institutions in the region. There is no question that serious restructuring in banking, real estate and other types of financial services is going to take place. Hence, rather than pulling back from the negotiations, East Asian negotiators had better advance their own long-term interests by seeking to take advantage

[9] See James 1997a for recommendations in this regard. The NAFTA rules of origin have led to massive diversion of textiles trade from Asia to Mexico.

of opportunities to gain market access to the huge European, US and Japanese markets for financial services.

Similarly, in transportation, tourism, and other services of interest to East Asia as exports, renewed efforts to make progress in negotiations are in order. In service industries where service providers and consumers cannot be separated, there are close links between investment, particularly foreign direct investment, and services trade. Liberalization of the temporary movement of natural persons is also a key to expanding trade in non-separable services.

## 2. Globalization and East Asia

Several East Asian developing countries experienced large and increasing current account deficits in recent years (Figures 1a-1d).[10] Initially the response was to blame the problem on "loss of competitiveness" resulting in a slowing of export growth and rising imports. In a number of cases governments have sought quick fixes. The implementation of special programs to "reduce imports and boost exports" in cases such as Indonesia, Malaysia, Korea and Thailand is indicative of the lingering strength of mercantilism in the thinking of bureaucrats. Domestic firms and industries are perceived to be vulnerable to foreign competitors. Globalization is both inevitable and relentless in its impact. Some leaders have viewed globalization as an onslaught of competition for domestic firms from powerful multinational corporations in manufacturing, agriculture and services. The impact of globalization in the real sector is partially deflected by restrictions on ownership, foreign investment and, of course, by trade barriers. However, in the financial sector, reliance on external finance has driven most East Asian economies to open up capital markets, though in an incomplete manner. Banking and stock market regulation has placed some limits on foreign ownership. However, the main purpose has been to influence credit allocation in favor of projects given priority by government. Prudential regulations have not been sufficiently developed and investments have been funded through offshore borrowing thus exposing these economies to

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[10] Investment and current account deficits as ratios of GDP are shown. The figures are from James (1998, forthcoming). As saving and consumption ratios are fairly stable, most of the changes in current account balances can be related to changes in investment in East Asia.

exchange rate risk. The recent turbulence in the region's financial markets and currencies underscores the danger of excessive adverse investment selection.

In the era of globalization as before, international trade remains a positive sum game with mutual benefits for participants. Fears of domination of domestic industry by transnational corporations are misplaced. The law of comparative advantage provides assurance that there will always be industries and services in which a country is relatively competitive in international markets. Indeed with large and growing domestic markets, including the ASEAN-wide market, competition among producers will ensure that in certain products and industries, world-class capabilities will emerge among the successful firms.

The recent financial problems experienced in Thailand and, more generally in the region, in fact result from internal inefficiencies and excessive debt financed investments in non-viable projects and protected industries. Excessive investment in property and real estate development has created a bubble that inevitably burst. Tightening government expenditures, floating of exchange rates and allowing investment decisions to be driven by market forces rather that intervention will help stabilize the situation. With effective depreciation, export-oriented industries and projects will become more attractive. Further real sector deregulation and liberalization will be essential to putting these economies back on track. East Asian economies have widely varying practices in restricting foreign ownership and the free flow of funds. Hong Kong provides a free market model while Taiwan and Korea have been reluctant to fully liberalize their financial markets. One reason for Hong Kong's success in weathering the recent turbulence is that it has refused to protect industry or to attempt to direct credit flows to favored interests.

The cancellation of several huge projects, cuts in overall expenditures by government and increased efforts to enhance domestic savings demonstrates that leaders in Indonesia, Malaysia and Thailand have grasped the fundamental issues underlying their current account deficits and what is necessary to restore a sustainable balance of payments. The task ahead is to follow through with further real and financial sector reforms.

## 3. The Future of Trade Deregulation

The agenda for trade policy reform in East Asia is in flux as traditional forms of protection are gradually reduced, and new issues and areas arise in the course of global negotiations and regional trading arrangements. Moreover, the extent of import barriers and investment restrictions varies across East Asia. For example, transitional economies in East Asia have a longer way to go to attain the objective of a freer and basically neutral trade regime than do the market economies. Services trade liberalization has been discussed above. Hence, the discussion below will focus on trade policy issues that influence goods and services in varying degrees.

### a. Reducing Tariffs and Tariff Escalation

Tariff cuts under the Uruguay Round Agreement in North America, Japan and Europe will benefit East Asian developing economies. Within East Asia, tariff rates vary from negligible (Hong Kong, Singapore) to modest (Indonesia, Malaysia) to high (China, Thailand). While tariff barriers are preferable to non-tariff barriers, in the medium-term reducing the level and dispersion of tariffs is desirable. The "optimal tariff" literature suggests that some dispersion in tariff rates is desirable. Once one takes into account the role of politics and rent seeking in setting tariffs as well as the dynamic effects on resource allocation and investment of such variance in protection a different conclusion might be reached. Experience teaches that a simple system of low and equal tariff rates can be highly successful in promoting growth and efficiency in a country's international trade. Chile's success following adoption of a uniform and low tariff is a case in point.

While tariff levels in the OECD countries are quite low, tariff escalation-the practice of imposing higher tariffs based on the extent of processing-remains a serious problem for less developed exporters. Hence, East Asian trade negotiators might seek to reduce the escalation in tariff rates in more developed countries. They will, however, have to put their own houses in order in this regard (Safadi and Yeats 1994).[11]

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[11] Safadi and Yeats show that East Asian economies' tariffs rise with the degree of processing

b. Non-Tariff Barriers (NTBs)

Quotas and import licensing systems have been greatly reduced in most East Asian economies that have used such restrictions in the past (Japan, Korea, Taiwan, Indonesia, Philippines). For example, in Indonesia as of 1996, fewer than 200 tariff lines had NTBs, down from thousands of such restrictions ten years earlier. The Uruguay Round Agreement requires developing countries to phase out NTBs over a ten year period and also puts a freeze on the introduction of new NTBs. Local content schemes that have been notified to the WTO are an example of an NTB that must be phased out. Many of the remaining NTBs are in agriculture and are to be replaced by tariffs. It would be wise to accelerate the phasing out of remaining NTBs as they create monopolies and interfere with the proper functioning of market mechanisms. For example, local content schemes distort a firm's efforts to reduce costs away from domestic towards imported inputs.

c. Export Restrictions and Taxes

Export restrictions (aside from those involving hazardous or illegal items) have been employed by a number of East Asian economies. The export bans or taxes are designed to encourage the growth of processing industries. Often they have been justified as a counter to tariff escalation in trading partners or have been aimed at improving the terms of trade of an exporter considered to have market power. Prohibitive taxes or bans on exports of raw materials or lightly processed goods can, in the short run, provide assistance to processors and other downstream industries. However, such policies are likely to have damaging medium to long-term effects as they discourage investment in production of raw materials. This has been the case in Indonesian wood-based industries. It would be preferable to directly negotiate with trading partners to reduce tariff escalation harmful to processing industries than to adopt such

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of commodities. However, since import demand elasticities usually increase with processing, tariff escalation is not a necessary condition for trade bias against processed goods. That is, equal tariffs on processed and unprocessed commodities may still impart a trade bias against processed goods.

restrictive policies.

There is also a terms of trade or large country argument for restricting certain exports. In the case of the terms of trade argument, this is likely to be fallacious as substitutes can be found for almost any item. Hence, attempts to exploit market power may temporarily succeed in raising prices; however, this will induce consumers to seek substitutes and to reduce the volume of demand. Suppliers of possible substitutes will seek to capture a larger share of market demand and will most often succeed.

d. Domestic Trade Restrictions

Domestic trade restrictions have the effect of distorting markets, creating rents that can be captured by a monopolist or a cartel. Cartels or monopolies that control distribution of key commodities through collusive behavior have been created by government regulatory controls. This is a common practice in some East Asian cases (e.g., cement, cloves, fertilizer and wheat in Indonesia). However, such restrictions raise costs and hinder the efficiency of industry by not allowing producers to freely compete. Restrictions on wholesale and retail trade in East Asian economies have resulted in inefficient distribution and marketing systems that raise costs to consumers and hamper producers of goods and services from fully developing potential markets. Arguments are made in support of restrictions on distribution by large-scale retail outlets and shopping malls alleging these are harmful to small-scale vendors and hawkers. However, negative effects such as these are often exaggerated, as lower prices brought about by increased competition will benefit consumers many of whom are from households with low incomes. It is likely that different types of retailers serve different market segments and can coexist by serving different niches in markets.

Domestic demand growth is important in sustaining economic growth nowadays in East Asia. Domestic trade is not only restricted by explicit regulatory controls; it is also subject to informal (and illegal) levies that are imposed by local authorities. These levies increase business's costs and discourage investment. Hence, phasing out obsolete regulations limiting investment in domestic retail trade will be important in helping to sustain economic expansion.

e. Foreign Investment Regulations

East Asia economies are among the most open in the world when it comes to foreign direct investment in manufacturing. However, in services and agriculture, restrictions continue to be significant. Foreign ownership restrictions are common in financial services, transportation services, and telecommunications and in retail distribution and trade. In addition, foreign ownership shares of publicly listed companies are usually limited to a minority of shares. Restrictions on foreign ownership of land, property and dwellings are also common. The latter may deter investment from abroad by increasing the costs of sending expatriate managers and skilled personnel to operate subsidiaries. Foreign ownership restrictions are being loosened gradually and will have to be reconsidered as services trade is liberalized.

f. Competition Policy

Business practices that are clearly anti-competitive have been tolerated and even encouraged in East Asia. In some cases, the government itself is the monopolist (typically in hard-wired basic telephone services). In others the government provides extraordinary exemptions from taxes and tariffs to a "national" producer, as in the "national car" programs of Malaysia and Indonesia.[12] These arrangements may be challenged by other governments and may require resolution through the WTO.

Developing East Asian economies often lack the legal and institutional basis for

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[12] Paradoxically, the Indonesian national car program has increased the degree of competition in the domestic market for sedans, leading to lower prices. The new policy states that any auto producer that reaches local content of 60 percent is entitled to the national car program incentives. However, the private company now receiving national car incentives is only required to reach 20 percent local content and has three years to reach 60 percent local content. It is apparent that the government is putting pressure on banks to extend credits to the national car program operated by PT Timor and is also "encouraging" units of government to purchase Timor sedans.

preventing anti-competitive behavior. They have offset this by opening their economies to foreign investment and import competition. However, in future they will have to do more to create a truly competitive market. By doing so they can dispel pressures from powerful trading partners and lessen the disputes they will face in WTO.

### g. Anti-Dumping and the Danger of Contingent Protection

Anti-dumping regulations are now in place throughout East Asia and are likely to be used by governments under pressure from domestic firms that are encountering increased competition from imports. In the absence of harmonization of business laws and practices, foreign business practices are likely to be viewed with suspicion (this is typical in relations between Europe, Japan and the United States). Accusations of unfair business practices are often directed against pricing strategies and anti-dumping serves as the weapon of choice in handling foreign competitors who offer low prices.[13] The anti-dumping process has turned into a major growth industry for lawyers, trade bureaucrats and consultants in the US case. As experience shows, anti-dumping petitions alone usually generate less trade at higher prices, oftentimes through "voluntary restraint agreements" between domestic producers and foreign exporters or the local importer. Hence, the outcome of the US anti-dumping process itself is anti-competitive. At a minimum, East Asian developing economies should make sure their own anti-dumping regulations are consistent with the WTO. It would be even better for East Asia to aim at limiting use of anti-dumping procedures and of adopting open public hearings in alleged cases of dumping.

### h. Intellectual Property Protection

East Asian countries have begun to crack down on rampant piracy in the case of intellectual property under heavy pressure from Europe and the US. However, in the long run it will be to East Asia economies own advantage to improve their

[13] *The Economist*, "Schools Brief", November 8, 1997 pp. 101-2. It cites the WTO in estimating 900 anti-dumping measures that are now in place, with 206 new actions in 1996 alone.

intellectual property protection. Not only is this necessary to encourage development of indigenous talents, technologies and research works but is also essential in attracting higher technology investors from abroad. If developing East Asian economies expect foreign investors to bring in advanced technologies, then the climate must be suitable and secure. Without strong enforcement of intellectual property rights, only standard rather than advanced technologies will be brought in by investors from abroad.

## G. Conclusion

The topic of trends in international trade and trade policy reform in East Asia is certainly one of global interest. In this paper I have attempted to cover broadly the issues that are of key importance from the standpoint of the developing economies. Hence, the issues of linkages between trade and labor standards and trade and environment have only been briefly mentioned. In future, it is likely that East Asia will have to consider these issues. A proactive approach to these new issues at the multilateral level would in all likelihood be preferable to bilateral negotiations in serving the interests of the region's economies.

Currently, controversy is raging throughout the region regarding the merits and demerits of various approaches to financial liberalization and exchange rate management. The success of speculative attacks against ASEAN members' currencies and the problems in the region's financial markets have drawn attention away from the issues of trade policy reform. However, trade liberalization and further deregulation of foreign investment regulations should receive high priority once stabilization is achieved. Stable macroeconomic policies aimed at reducing excessive expenditures and controlling inflation will help to reduce budget and current account deficits. That should stimulate domestic savings and, coupled with real sector reforms and liberalization, investment and financial markets would respond positively. Such a combination of policies would help restore investor confidence and would enhance credibility of economic policy making in the region. The massive real exchange rate depreciation in these economies should spur a very strong surge in export growth in the next couple years. At the same time, trade reform will improve microeconomic performance and help to restore investor confidence in these economies. Trade policy reform is essential to more efficient investment and improving the quality of financial sector performance in the future.

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Table 1: Growth Rates of World Output and Trade Volume, IMF Estimates

| Variable | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996p | 1997p | 1988-95 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| World Output | 4.6 | 3.7 | 2.6 | 1.5 | 2.4 | 2.4 | 3.7 | 3.5 | 3.8 | 4.3 | 2.9 |
| Goods & services | 8.2 | 7.4 | 5.3 | 3.7 | 4.7 | 3.9 | 8.8 | 8.9 | 6.7 | 7.2 | 6.2 |
| Goods | 8.8 | 6.9 | 4.7 | 3.8 | 6.0 | 3.9 | 9.5 | 9.1 | 6.4 | 7.1 | 6.4 |

Sources: International Monetary Fund, World Economic Outlook, May 1996, October 1996

Table 2: East Asia's Export Growth Slowdown, 1995-1996. IMF Estimates

| Country/Territory | Exports (US $ mil.) | | Growth Rate (% annual change) | |
|---|---|---|---|---|
| | 1995 | 1996 | 1995 | 1996 |
| China | 148,755 | 151,093 | 23.1 | 1.6 |
| Hong Kong | 173,546 | 180,525 | 14.6 | 4 |
| Taiwan | 111,833 | 116,194 | 19.4 | 3.9 |
| Indonesia | 43,285 | 47,823 | 13.3 | 10.5 |
| (non-oil exports) | 34,954 | 38,093 | 15.1 | 9 |
| Japan | 443,005 | 411,242 | 12.1 | -7.2 |
| Korea | 125,365 | 127,592 | 30.5 | 1.8 |
| Malaysia | 73,990 | 77,001 | 25.9 | 4.1 |
| Philippines | 17,249 | 21,466 | 28.4 | 24.4 |
| Singapore | 118,172 | 125,118 | 22.6 | 5.9 |
| Thailand | 56,662 | 57151 | 23.1 | 0.9 |

Sources: IMF, Direction of Trade Statistics, Yearbook 1996 and June 1997.
Taiwan Ministry of Finance 1996.
Indonesia Central Bureau of Statistics, for non-oil exports, Trade Statistics March 1997.

Table 3. East Asia's Export Growth Slowdown 1995-1996. IMF Estimates

| Country/Territory | Exports (US $ mil.) | | Growth Rate (% annual change) | |
|---|---|---|---|---|
| | 1995 | 1996 | 1995 | 1996 |
| China | 148,755 | 151,093 | 23.1 | 1.6 |
| Hong Kong | 173,546 | 180,525 | 14.6 | 4 |
| Taiwan | 111,833 | 116,194 | 19.4 | 3.9 |
| Indonesia | 43,285 | 47,823 | 13.3 | 10.5 |
| (non-oil exports) | 34,954 | 38,093 | 15.1 | 9 |
| Japan | 443,005 | 411,242 | 12.1 | -7.2 |
| Korea | 125,365 | 127,592 | 30.5 | 1.8 |
| Malaysia | 73,990 | 77,001 | 25.9 | 4.1 |
| Philippines | 17,249 | 21,466 | 28.4 | 24.4 |
| Singapore | 118,172 | 125,118 | 22.6 | 5.9 |
| Thailand | 56,662 | 57151 | 23.1 | 0.9 |

Sources: IMF, Direction of Trade Statistics, Yearbook 1996 and June 1997.
Taiwan Ministry of Finance 1996.
Indonesia Central Bureau of Statistics, for non-oil exports, Trade Statistics March 1997.

Table 4. East Asia's Import Growth Slowdown, 1995-1996, IMF Estimates

| Country/Territory | Imports (US $ mil.) | | Growth Rate (% annual change) | |
|---|---|---|---|---|
| | 1995 | 1996 | 1995 | 1996 |
| China | 132,007 | 138,822 | 14.2 | 5.2 |
| Hong Kong | 192,764 | 198,551 | 19.2 | 3 |
| Taiwan | 103,652 | 101,372 | 19.5 | -2.2 |
| Indonesia | 43,285 | 42,830 | 13.3 | -1.1 |
| (non-oil imports) | 37,718 | 39,333 | 27.4 | 4.3 |
| Japan | 335,871 | 349,508 | 22.6 | 4.1 |
| Korea | 135,153 | 147,375 | 32.1 | 9 |
| Malaysia | 77,662 | 77,001 | 30.4 | -0.9 |
| Philippines | 28,419 | 40,038 | 26.1 | 40.9 |
| Singapore | 124,394 | 131,505 | 21.6 | 5.7 |
| Thailand | 73,959 | 74,616 | 35.2 | 0.9 |

Sources: IMF, Direction of Trade Statistics, Yearbook 1996 and June 1997.
Taiwan Ministry of Finance 1996.
Indonesia Central Bureau of Statistics, Trade Statistics, March 1997 for non-oil imports.