THE NEW ASIAN DRAMA: GLOBALISATION AND TRADE POLICY IN ASIA

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Gunnar Myrdal's *Asian Drama*, written in the 1960s, painted a bleak picture of Asia then and its prospects. This was a continent hobbled by colonial exploitation, trapped in unequal commercial exchange with the West, and mired in myriad market failures. Only massive infusions of Western aid, Soviet-style planning and import-substituting protection could kick-start industrialisation, growth and development.

How different the Asian Drama looks now – the exact opposite of Myrdal's diagnosis and prognosis. Northeast and southeast-Asian Tigers have undergone fast-paced export-oriented industrialisation and catch-up growth. They have had stable macroeconomic policies and domestic competition, and opened to the world economy. They were followed by China, whose massive opening to the world economy was crowned by its accession to the WTO. Vietnam has followed a similar trajectory. India made a decisive break with the "licence raj" in 1991, and has since been opening gradually to the world economy.

Of course the story is more complicated. There were lots of factors at play, not least vast differences between countries in historical legacies, policies and institutions. To varying degrees, and with the exception of free-trade, *laisser faire* Hong Kong, government intervention, including industrial policies, import protection and capital controls, coexisted with domestic market-oriented policies and external liberalisation.

Now take a look at Asia in the world economy, and then at Asian trade-policy reforms. The focus is on east and south Asia – "globalising Asia" -- not less or non-globalised north and west Asia.

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Asia and globalisation

Asia was conspicuously absent from the world economy from the Industrial Revolution to relatively recent times. This began to change with the post-1950 rise of Japan and the east-Asian Tigers, and then changed faster with the opening of first China and then India (Diagram 1). Asia now accounts for about 40 per cent of global GDP (at purchasing power parity), over 25 per cent of global exports and imports, and over 20 per cent of global inflows of foreign direct investment (FDI) (Diagram 2). China and India alone are home to 40 per cent of humanity. With still low levels of per-capita income, and huge supplies of cheap, productive labour, they have the potential for stellar catch-up growth rates for decades ahead. Their integration into the world economy, still in its early stages, promises to be as momentous as the rise of the US, Germany and Japan as global economic powers in the late nineteenth century, and may bring about the biggest political and economic transformation of the world since the Industrial Revolution.

Japan still dominates Asian economic activity, accounting for over 50 per cent of east and south Asian combined GDP (at market prices). But China is catching up fast. It is already more globally integrated than Japan in terms of trade and FDI penetration; and has recently displaced Japan as the world's third largest trading nation. It accounts for 8 per cent of global trade, and attracts over one-third of FDI flows to the developing world. India's global integration pales in comparison, but it has come far by its own standards. As for other south-Asian countries, severe political instability and ethnic strife hamper their global integration and economic progress. Finally, countries in southeast Asia are highly dependent on the world economy. Like China, FDI-driven exports are central to their growth models. (See Table 1 for economic and trade indicators for Asian countries.)

What does this tell us about the emerging international and Asian division of labour? Japan, South Korea, Taiwan, Hong Kong and Singapore have comparative advantage in high-value goods and services. China has clear-cut comparative advantage in labour-intensive manufacturing exports, and increasingly in labour-intensive agricultural exports. Given its huge pool of cheap labour, India too should be a labour-intensive, FDI-driven exporting powerhouse in industrial goods, as well as a budding exporter of labour-intensive agricultural products. But severe labour-market restrictions, and remaining external and internal trade restrictions, strangulate production and employment. Southeast Asia in between stands to gain from deeper integration into east-Asian manufacturing supply chains, now including China. The newer, poorer ASEAN members can exploit cheap-labour advantage, especially as relative incomes rise in China.

Asia-driven globalisation demands massive adjustments. It is triggering mounting protectionist pressures and threatens an anti-globalisation backlash. Labour-abundant east and south Asia stands to gain most through fast, catch-up, trade and investment-driven growth, which feeds through to poverty reduction and improvement of life-chances for the broad majority of people. Developed and other developing countries will gain too through exploitation of their comparative advantages in capital, land and resource-intensive products. But they will be under increasing pressure in labour-intensive products. This will squeeze not just unskilled and low-skilled workers' real incomes, but also those of the middle classes. Thus the future holds out the prospect of greater prosperity overall, but with bigger inequality within and between nations. The political challenge is to keep borders open and extend market-based reforms, while containing inevitable protectionist pressures.

Trade policy in Asia

The global climate for further liberalisation is worse now compared with the heyday of the "Washington Consensus" in the 1980s and '90s. Reforms have not been reversed, but their forward momentum has slowed. This is true of the West, and of most developing-country regions. China is the conspicuous exception: liberalisation proceeded apace before and after WTO accession.

A variety of factors accounts for liberalisation-scepticism today. External liberalisation has not been seen to deliver sufficient growth, employment generation and poverty reduction in much of the developing world – outside east and south Asia. Caution has been the watchword after the Asian crisis. Not least, the climate of ideas has changed. Arguments against developing-country trade liberalisation and in favour of "policy space" for industrial policies, e.g. to promote infant industries, are more popular now than they were a decade ago.

It is important to confront the sceptics and interventionists head on. Protectionism and industrial-policy intervention has mostly failed across the developing world. East-Asian success is not primarily a result of effective industrial policies in "developmental states": that is quite the wrong lesson to draw. By and large, developing countries that have gone further with opening their economies to global competition are those that have grown faster and had more success with poverty reduction and improvements in human welfare. This is overwhelmingly an east-Asian phenomenon, but one can also point to examples from Latin America (notably Chile) and south Asia (first Sri Lanka, and now India). It is dramatically true of eastern Europe.

How does east and south Asia fit into the picture?

Japan, South Korea and Taiwan are relatively open economies after decades of gradual liberalisation, but they have sent mixed signals on market-based reforms recently. China has come far, especially with the biggest dose of trade-and-FDI liberalisation the world has ever seen. The protective impact of classic non-tariff barriers has come down to less than 5 per cent. The simple average tariff has come down from 42 per cent in 1992 to 9.8 per cent after WTO accession. China's WTO commitments are by far the strongest of any developing country in the WTO. As a result, its levels of trade protection are distinctly low by developing-country standards.

India's trade-policy reforms have not been as dramatic, but are still considerable. The average tariff is coming down to about 20 per cent from 125 per cent in 1991. Most border NTBs, internal licensing restrictions and restrictions on manufacturing FDI have gone. This still leaves high protection in agriculture and services. Southeast Asia presents a mixed picture: free-trade Singapore is at one extreme; other old ASEAN members have relatively liberal trade policies (with average tariffs under 10 per cent and an open FDI regime in manufacturing), but with large pockets of protection in agriculture and services; and the new ASEAN members have higher levels of protection. Vietnam, however, has accelerated external liberalisation and internal reforms in the run-up to its WTO accession, and is now rapidly integrating into the global economy through FDI-driven exports. (See Table 2 on tariff levels in Asia.)

Now turn to Asia in trade negotiations, starting with the WTO.

The big news for Asia in the WTO is China's accession in 2001. As a result of unilateral liberalisation and very strong WTO commitments, China has acquired a strong stake in a rules-based multilateral trading system. Hence it has been decidedly non-dogmatic and non-confrontational in the Doha Round, though in a quiet, behind-the-scenes manner. In contrast, India's WTO commitments are much weaker than China's, and it has been generally defensive in the Doha Round. Other east and south-Asian countries have a kaleidoscope of negotiating positions, with several being particularly defensive on agriculture.

With the exception of China, east-Asian countries have been neglecting the Doha Round in favour of free trade agreements (FTAs). In addition to India's defensiveness and inflexibility, this has contributed to the collapse of the Doha Round and undermined the longer-term credibility of the WTO. That is extremely myopic. Asia needs an effective WTO. East Asia's integration with the world economy gives it a long-term stake in a liberal trading system underpinned by strong, non-discriminatory rules. A patchwork of overlapping and discriminatory FTAs is not enough; and, in the absence of a healthy multilateral system, will probably be damaging. This logic applies compellingly to south-Asian countries too, given their increasing integration into the world economy.

Japan, South Korea, Taiwan, Hong Kong, China, India and the more advanced ASEAN members are in an outer core of about 50 countries that need to be active to set the WTO on its legs again. That requires forging like-minded coalitions to advance market-access (i.e. liberalisation) and rules priorities. This group comprises the OECD plus about 20 developing countries which collectively account for close to 90 per cent of world trade and FDI. China, India and perhaps Japan are in an inner core (including the USA, EU and Brazil) that needs to exercise leadership. Most important will be a Chinese helping hand: it is vital that China move to the WTO foreground and play an active co-leadership role.

A crippled WTO has allowed FTAs to spread like wildfire across Asia-Pacific. As of 2005, there were 17 FTAs in force and about 60 more in the pipeline in China, India and southeast Asia alone (see Figure 1). All the major regional powers – China, India and Japan – are involved, as are the USA, South Korea, Australia, New Zealand, Hong Kong, other south-Asian countries and the ASEAN countries. Bilateral (country-to-country) FTAs are most in evidence, but there are plurilateral negotiations too, especially those involving ASEAN collectively. An east-Asian FTA uniting southeast and northeast Asia has been proposed; and there is even talk of a pan-Asian FTA and an APEC FTA.

Government-led conventional wisdom holds that FTAs can take liberalisation and regulatory reform further than would be the case in the WTO. This can in turn stimulate multilateral liberalisation. But the emerging picture looks rather different. Nearly all negotiations in east and south Asia look like delivering weak, partial, trade-light agreements. Negotiations tend to be driven by vague, muddled and trivial foreign-policy goals and empty gesture politics, with little sense of economic strategy. They involve patchy, quick-fix sectoral deals while sensitive areas (especially in agriculture and services) are carved out. They hardly go beyond WTO commitments, deliver little, if any, net liberalisation and regulatory reform, and get tied up in knots of restrictive, overlapping rules of origin.

Hence there should be much more caution with FTAs. Existing FTAs should be cleaned up (i.e. with comprehensive coverage, stronger rules and liberal rules of origin), and new initiatives only launched with a credible economic strategy. FTAs are a reality; they cannot be wished away; but they can be improved; and they can fit better with trade policy on unilateral and multilateral tracks.

Trade negotiations have their place; but they have distinct limits. The transition from GATT to WTO has narrowed the possibilities for multilateral liberalisation and rule strengthening – as the Doha Round has amply demonstrated. Similarly, much-hyped bilateral and regional FTAs are unlikely to inject large doses of additional liberalisation, but will create extra political and economic complications. Therefore, governments in Asia cannot rely on external negotiations for meaningful trade-policy reform. Rather the bulk of external liberalisation and associated "second-generation" domestic and institutional reforms will likely come from unilateral measures that spread through competitive emulation – outside trade negotiations.

That is indeed the recent track record. The World Bank estimates that 65 per cent of developing-country tariff liberalisation since the 1980s has come about unilaterally.
This is especially true of east Asia, and now applies to south Asia too. Most recently, the bulk of China's massive external liberalisation was done unilaterally, not through international negotiations, and *before* WTO accession. China is in many ways today what Britain was in the second half of the nineteenth century: the unilateral engine of freer trade. It is probably spurring a pickup in trade-and-FDI liberalisation elsewhere in east and south Asia – notably in India. Would all this have happened, or happened as fast, if China had not concentrated minds? Probably not. Hence, for further liberalisation to occur in Asia and beyond, it is vital that this Chinese engine does not stall.

Conclusion: the bigger picture

There is much unfinished business in terms of liberalising trade, capital flows and the cross-border movement of labour across the world. Reduction of what are still high barriers to international commerce holds out the promise of higher growth, and significant poverty reduction and improvements in human welfare. Stalled reforms and reform reversal threaten to deprive hundreds of millions of people of the life-chances they deserve. These are the stakes.

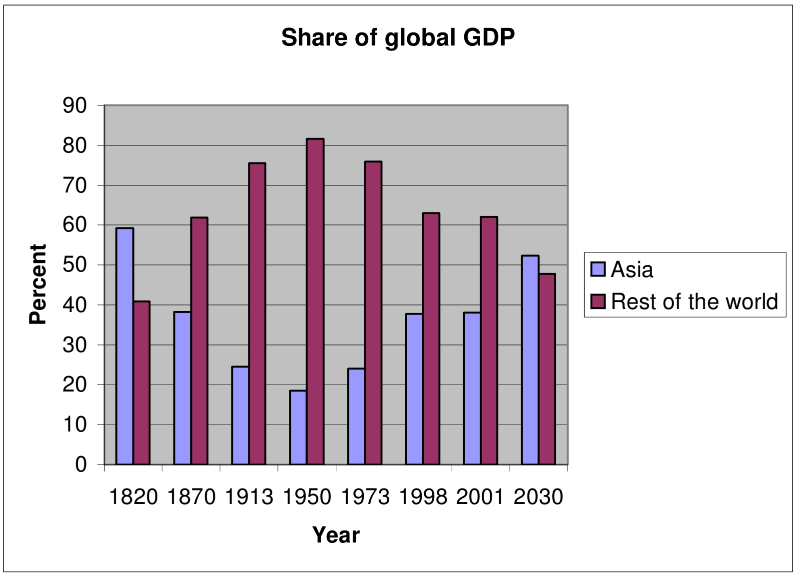
Trade policy, in Asia as elsewhere, must of course be seen in a larger context: domestic policies and institutions in the countries concerned; national and global macroeconomic policies; and the international political environment. Here there are three basic challenges.

First, global macroeconomic imbalances need to be unwound in an orderly manner if the world economy is to have a "soft landing". That requires a US lead and Chinese cooperation. Second, further trade and FDI liberalisation must be buttressed with more deep-seated – and politically sensitive – market-based domestic reforms. The latter are basically about restructuring the state, away from the large overactive state that intervenes badly across the range of economic activity, and towards the limited state that performs a smaller number of core functions well. The latter should focus on providing and enforcing a framework of rules for market-based competition.

Third, a functioning global economy depends on international political stability. Enlightened US leadership, "constructive engagement" among major powers, and workable multilateral institutions are all important. In contrast, the global *Pax* will be undermined by an inward-looking USA, tension and conflict among rising and declining powers, and unworkable UN-style multilateralism. It is vital that the USA in the first instance, and then the EU, deepen cooperation with the rising powers of Asia, and contain belligerent and protectionist forces within.

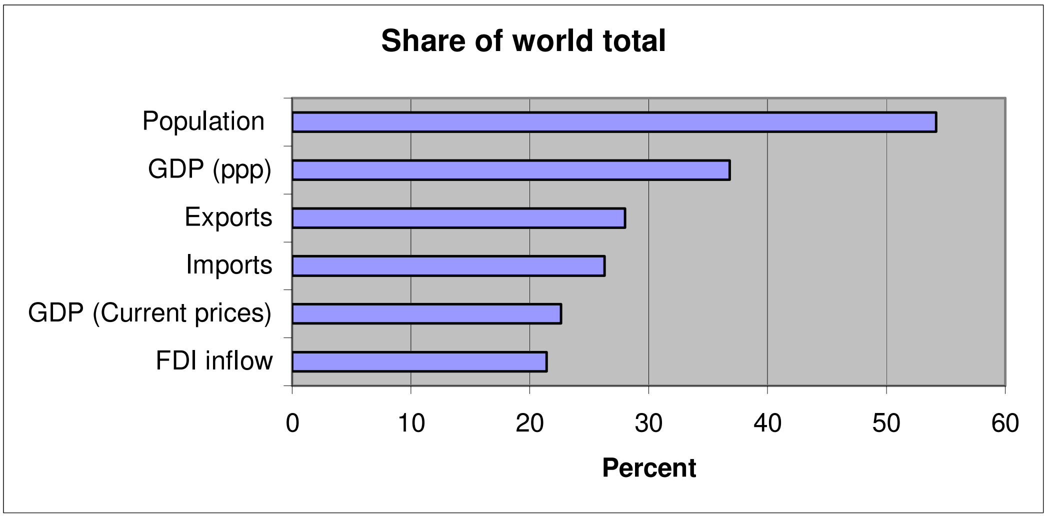
Tables and diagrams

Diagram 1.



(Million 1990 international $) Source: Maddison and OECD

Diagram 2.



Figures are from 2005. Definitions and Sources IMF, World Bank and UNCTAD WIR 2006

Table 1. Asian countries: economic and trade indicators 2005

Countries	GDP	GDP Growth	Population	Per capita GDP	PPP GDP	Merchandise Exports	Service Exports	Total Merchandise Trade	Services Trade	Trade/ GDP	FDI Inflow	FDI/ GDP
	(US$ bn)	(%)	(mn)	(US$)	(US$ bn)	(US$ bn)	(US$ bn)	(US$ bn)	(US$ bn)	(%)	(US$ bn)	(%)
China	2228.8	9.9	1304.5	1708.6	8572.7	761.9	73.9	1422.0	157.1	63.8	72.4	3.2
Indonesia	287.2	5.6	220.6	1302.2	847.4	86.2	5.1	155.7	22.3	54.2	5.3	1.8
Malaysia	130.1	5.3	25.3	5134.4	278.8	140.9	18.95	255.6	40.5	196.5	4.0	3.1
Philippines	89.3	5.1	83.1	1183.6	408.6	41.3	4.5	88.7	10.2	9.9	1.1	1.2
Singapore	116.8	6.4	4.3	26836.1	130.2	229.7	45.1	429.7	89.1	367.9	20.1	17.2
Thailand	176.6	4.5	64.2	2749.4	549.3	110.1	20.5	228.3	48.0	129.3	3.7	2.1
Vietnam	54.4	8.4	83.0	631.7	254.0	31.6	3.9	68.1	8.6	125.2	2.0	3.7
ASEAN-6	854.4	5.9	480.5	1779.1	2468.3	639.8	98.1	1226.1	218.7	143.5	36.2	4.2
India	785.5	8.5	1094.6	717.6	3815.5	95.1	56.1	229.9	108.3	29.3	6.6	0.8
Japan	4505.9	2.7	128.0	35214.5	3943.7	595.0	107.9	1109.8	240.5	24.6	2.8	>0.1
Korea	787.6	4.0	48.3	16309.0	1056.1	284.4	43.9	545.7	101.7	69.3	7.2	0.9
Taipei	346.4	4.1	22.6	15291.8	-	197.8	25.6	280.3	57.1	80.9	1.6*	0.5
HongKong	177.7	7.3	6.9	25593.6	214.5	292.1	62.2	592.3	94.6	333.3	35.9	20.2
TOTAL	9686.3	-	3085.4	3139.4	20070.8	2866.1	467.7	5406.1	978.0	-	162.7	-
World	44384.8	3.3	6400.0	6835.1	61027.5	10431.0	2415	21214.0	4760	47.8	916.3	2.1

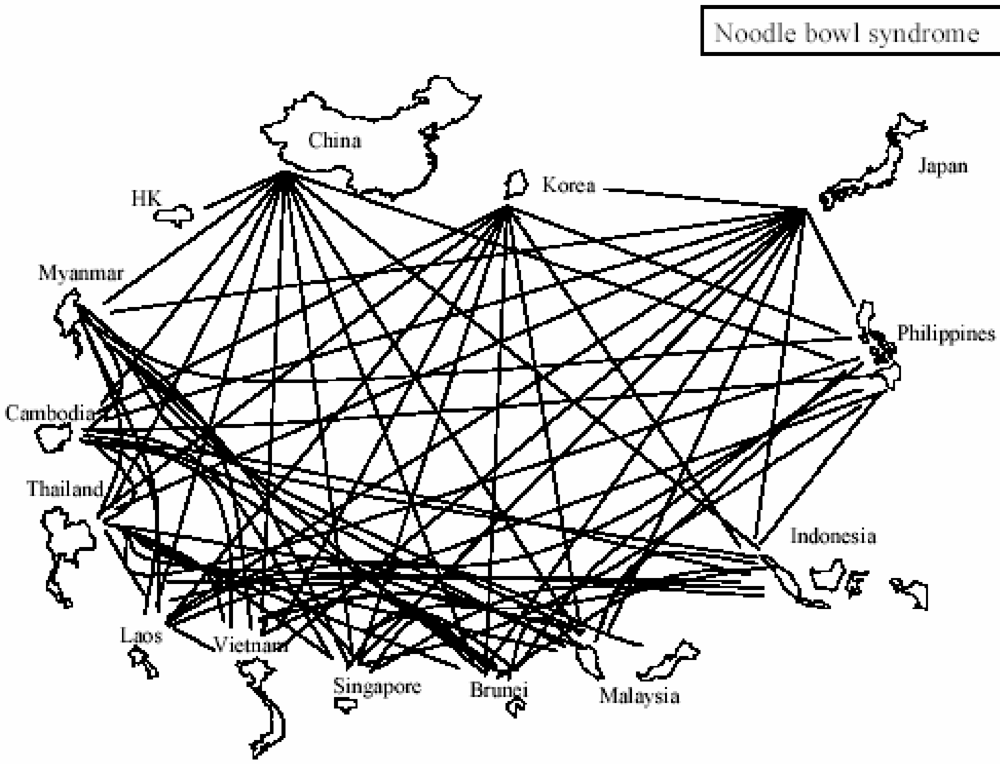
*Whole of Taiwan. Source: World Bank. WTO. UNCTAD WIR and ADB

Table 2. Bound and applied MFN tariffs in Asia

	Binding Coverage	Bound Tariff Rate (All goods)	Applied Tariff Rate (Manufactures)	Applied Tariff Rate (Agriculture)	Overall applied Tariff
Japan	99.6	5.0	3.3	10.4	4.7
Korea	94.4	16.1	6.6	42.5	11.9
China	100	10.0	9.5	15.0	10.3
Hong Kong	45.7	0.0	0.0	0.0	0.0
Malaysia	83.7	14.5	8.1	2.1	7.3
Thailand	74.7	25.7	14.6	16.2	14.7
Indonesia	96.6	37.1	6.1	8.0	6.4
Philippines	66.8	25.6	6.9	11.8	7.5
Vietnam	-	-	12.9	18.1	13.7
Taiwan	100.0	6.1	5.5	16.3	6.9
Singapore	69.2	6.9	0.0	0.0	0.0
India	73.8	49.8	25.3	30.0	28.3
Pakistan	44.3	52.4	16.1	13.9	15.9
Bangladesh	15.8	163.8	19.2	21.7	19.5
Sri Lanka	37.8	29.8	9.6	15.4	10.2

The figures are simple unweighted averages of the tariff rates in percent from the year of 2003 and 2004. *Source: World Bank*

Figure 1. FTAs in Asia



The map shows FTAs signed or under negotiation in January 2006.
East Asia is defined here as the 10 ASEANs, China, Japan and Korea. Source Richard Baldwin 2006