

Asia-Pacific Economic Cooperation

APEC's Trade Liberalization at the Crossroad: An Overview

APEC

March 2000

APEC's Trade Liberalization at the Crossroad: An Overview

-Contents-

1. Background
2. What is questioned?
3. Trade liberalization in the good old days and the recent disagreement.
4. Does further trade liberalization pay?
5. New problems: Changes in the world economic environments.
6. Who should enjoy trade liberalization? (The role of a nation state)
7. Will bilateral free trade agreements strengthen APEC?

Appendix 1. Quantified IAP "UR Plus" Tariff Reduction

Appendix 2. Intraregional Multiplier Effects through Trade Linkages

March 2000

by

Hiroshi Osada

APEC Study Center

Graduate School of International Development

Nagoya University

1. Background

It was November 1989 that the first Ministerial Meeting of Asia Pacific Economic Cooperation (APEC) was held in Canberra. More than 10 years has past since then and APEC has gone through, roughly speaking, the three stages of evolution. Facing the new millenium, there seems to be a lot to be done for effective continuation of economic cooperation in the APEC's framework.

In the first stage of the APEC remained as a forum of Pacific Rim countries as it was designed in the process of APEC's formation. The existence of APEC itself was meaningful at its initial stage because the forum gave another opportunity to discuss the trade problems in a collective and comprehensive way in addition to the harsh bilateral trade negotiations between the countries on both sides of the pacific. Also, member countries did not have clear consensus on the approach and the concrete strategy at the beginning and it needed a few years for each country until they decide to devote a great deal of effort in the APEC's process. The disagreements on the approach were known as "Asian View vs. Western View" and found mainly in two areas, namely, in the degree of bindings of resolutions and the attitude to nonmember countries. The solution for the first problem was later found in the "voluntary" principle under "peer pressure". The solution for the second is still not reached, but so far, reciprocity is not required to nonmembers and the "open" regionalism is literally maintained. The disagreement for the strategy was on the emphasis of the areas for collective actions. While the advanced economy members hoped the early implementation of trade and investment liberalization and facilitation (TILF), developing economy members hope much to be done in the economic and technical cooperation (ECOTECH). This ECOTECH is one of the secrets of APEC's success, which enabled the inclusion of both advanced and

developing countries. These differences did not become much of a problem when the member economies were enjoying rapid growth. It gradually shows up in the adverse situations.

The main achievement of the first stage is the generation of the atmosphere for cooperation through the mutual understanding in the APEC's fora. This paved the way to the first unofficial Leaders Meeting in the Blake Islands, which drastically increased the commitments of each member country to the APEC's activity and also made possible to push the stumbled negotiations of the Uruguay round further.

The second stage of the APEC's evolution was marked by the Bogor declaration in November 1994. As is well known, the unofficial Leaders Meeting became a regular one since then, and it worked as pressure for the leaders of the hosting country to add something new in each APEC's annual meeting. The Bogor declaration gave concrete target years for complete trade liberalization: 2010 for advanced countries and 2020 for developing countries. There was a strong drive for trade liberalization in the following two annual meetings. In 1995, the Osaka Action Agenda, a general guideline for trade liberalization, was agreed and member countries were expected to bring a concrete liberalization plan to the next Meeting in Manila. Also, there was a progress in the activities of ECOTECH by the initiative of the Japanese government. Some countries already announced individual action plans (IAP) in Osaka. In Manila in 1996, member countries brought IAPs and the implementation of a collective action plan (CAP) was agreed. Besides, the participation of the business community in the APEC was highlighted by the slogan of "APEC is business". These were the first rosy days for APEC. Major developing countries in APEC, namely ASEAN countries, were enjoying rapid economic growth through trade and investment liberalization, and these countries did not feel difficulties in preparing IAPs

since they had only to list up what they had planned voluntarily from its own strategic point of view. The progress in the voluntary liberalization has, on the other side, brought in the new issue of how to monitor the progress of IAP so that each country will “voluntarily” implement what the colleague members expect to be implemented through the “peer pressure”.

The Third stage began with the 9th Ministerial Meeting and the 5th Leaders Meeting held in Vancouver in November 1997 in the midst of Asian currency crisis. The crisis began with the attack on Thai Baht in May 1997. It then diffused to Malaysian Ringgit in July and to Indonesian Rupiah in August. Later, Korean Won also had to face the crisis due to the excessive private foreign borrowing. The entire crisis hit countries and the advanced Pacific countries were busy to bail out the economies from this turmoil. At that moment, the impacts of the currency crisis to each economy were not fully understood and the people were discussing the appropriateness of IMF policies. Under such circumstances, APEC could not show substantive initiatives for recovery from the crisis. Recovery process was basically planned by the IMF's initiative, and Japan and USA promised additional lending through two channels: through bilateral negotiations and through multilateral organizations. APEC was not ready to cope with the problems other than TILF and ECHOTECH. The trade liberalization drive after Manila was continued in the initiation of negotiation for Early Voluntary Sectoral Liberalization (EVSL). EVSL is a collective action by the member countries for the early liberalization of the fifteen specific sectors. However, the negotiation could not reach the full agreement because some countries including Japan were reluctant to liberalize the heavily protected sectors. The negotiation was carried over to the Kuala Lumpur meeting in 1998. Such disappointment and poor attainment in the Vancouver was one of the turning points for the APEC.

Another disappointment came from the last 11th APEC annual meeting in Auckland. One of the important agenda and resolution of the meeting were the strong support to begin the new round in the WTO meeting in Seattle. However, the negotiation among the major trading countries in the APEC proved not to have been enough in Seattle. The USA was not flexible enough to bring an agreement and many other new issues appeared; firstly trade and labor, secondly trade and environment, and thirdly the method of decision-making.

The third stage was a difficult period for APEC. The reform such as TILF is rather easy when the economy is booming. The unfavourable economic environment made it difficult to deal with the adjustment cost of the liberalization. There is also an open disagreement on the free movement of capitals. After the currency crisis and also with the emergence of the risks of the globalization, the advantages of "liberalization" itself began to be questioned.

With these two symbolic events, Asian currency crisis and the failure of the launch of new round in WTO, peoples' enthusiasm for APEC seems to be cooling down. Some people question even its worthiness. APEC is at the crossroads not only because of the marginal accomplishment in TILF but also because of the emergence of new economic environments. To list up the main challenges of the new millenium, they are the continuation of globalization, emergence of information technology (Internet), environmental problem as a constraint for economic growth, unsolved unemployment problem under the enforcement of efficiency principle, and the proliferation of increasing returns to scale to various industrial sectors.

The problem is that the causes of slow down of the APEC's process, especially in the field of TILF, is not fully discussed from various aspects.

The report by the APEC Economic Committee (1999a) predicts that the Asian economies will grow faster in 2000 and propose that the temporal efforts should be directed to strengthening the financial institution and the progress in the ECOTECH area until the Asian economies' recovery. Yamazawa (2000) proposed three-tier prescription for the global challenge to trade and development at the Bangkok UNCTAD meeting. At the national level, the institutional building is needed together with temporal restriction on capital transactions. At the regional level, regional cooperation for "capacity building" is needed in order to maintain the "competition principal". At the global level, to retain the economic stability, he points out the needs for the introduction of appropriate regulatory measures against disruptive capital flows; strengthening of the IMF's capability to cope with currency crisis; cooperation of UNCTAD, WTO and World Bank. Although all these proposals are reasonable ones, the success of such policies will not bring back the enthusiasm for trade liberalization as before. There are some other fundamental changes to be examined. In the APEC's context, the recovery of the Asian economies will not put the TILF back to its rosy days. In a word, the easy phase of the TILF is over and in addition we have to cope with the new circumstances.

The purpose of this paper is to give an overview, from such point of view, for further progress of APEC, especially for the promotion of trade liberalization. Firstly, after identifying the problems, we examine the significance of trade liberalization from the cost and benefit point of view. Secondly, we discuss the appropriateness of trade liberalization in the new circumstances of the new century. Thirdly, the role of nation state in the globalized world will be asked. In other words, the meaning of waning "nation state" will also be considered in the infant industry argument context. Fourthly, in consideration of recent developments at WTO Seattle,

UNCTAD Bangkok, we will ask if the emerging movements toward bilateral free trade agreements ultimately lead to the liberalization in WTO.

This paper picks up various new factors to be considered for further liberalization. It is filled with questions towards a naïve belief of gains from free trade. However, author's position is not to criticize trade liberalization. On the contrary, his intention is to explain the background of recent reluctance toward the trade liberalization and find practical ways for further trade liberalization. Also, the discussion here suggests the flexible approach toward liberalization is needed according to the economic environment. In particular, for the Asian countries which is on the way to recovery from the financial crisis, some slow down in TILF and intensification of ECOTECH will be appropriate.

2. What is questioned?

The first question is not APEC specific. It asks whether the trade liberalization improves the welfare of the country. This is an old question. Although the comparative advantage theory provides a strong theoretical base for free trade in the textbook world, there had been to date so many reservations and disagreements when it comes to the practice of policies. The well-accepted exception was the import substitution that put its theoretical base on the infant industry argument. However, beside this infant industry argument, none of the opposing theories has become the major stream. Especially, since the emergence of NICs in the mid-1970s, the outward looking policy has become popular. Many developing countries have enjoyed export led rapid growth in the circumstances of worldwide trade liberalization. The Kennedy round and the Tokyo round have contributed a great deal in cutting the tariff rates of manufacturing goods at the sizable scale. In this line, there was acceleration in globalization in the last 20 years, being assisted by the improvement of transportation and the fast development of the information technology. However, with the increasing extent of globalization, people began to feel uneasiness. Globalization increased opportunities for some but the instability built in by the globalization hit many as observed in the case of financial crisis.

Now the question is twofold. Firstly, the question is related with the distribution of gains from free trade in a country. Although the national welfare might increase through trade liberalization, will there be a case that the majority of people in the country lose? So far, it was generally accepted that there will be temporal losers due to the required structural adjustment but such loss could be in the short run and structural adjustment will not happen so often. These days, there is an increasing amount of assertion that gains will be concentrated to some but losses will incur to many. Secondly,

the question is related to the frequency of changes. In the free trade world with many competitors, the buyers can change the suppliers easily. However, the speed of adjustment in factories is much slower. Workers also need a longer adjustment time if they move to other industries that require different skills. The instability of demand will increase the adjustment costs. It is in these contexts that the gain from trade is questioned. There are many quantitative studies which predicts the gain from the multilateral tariff liberalization and conclude that “tariff still matter” (e.g. Dessus et al. (1999)). The problem is that the dimension of the question asked and the dimension of answer prepared are different.

The second question is related with links between liberalization in the regional trading arrangements (RTA) and the liberalization at WTO. The question is whether the RTA or specifically APEC will enhance the worldwide liberalization. It is well known that the RTA is not against WTO as long as it does not bring any adverse effects to nonmembers and as long as it is non-discriminatory to sectors. APEC has been an exceptional example of RTA that literally implemented the “open regionalism.” The liberalization in APEC has been applied unilaterally to nonmembers. APEC has functioned as the driving force of the Uruguay round in the GATT. The function has weakened in the launch of new round for WTO in Seattle. As a result, some APEC members including Japan and Singapore are now moving to bilateral free trade agreements. It need to be examined such new movement will really contribute to the worldwide trade liberalization. There is a concern that multilateral agreements and bilateral agreements will have some fundamental difference.

3. Trade Liberalization in the good old days and the recent disagreement

If there are an easy phase and the subsequent difficult phase in the process of trade liberalization as is often pointed out in the case of import substitution, the easy phase for trade liberalization is over. It means that the domestic adjustment costs are becoming higher and the need for cost and benefit consideration with regard to trade liberalization is becoming large. This section briefly reviews such process.

At the early stage of the GATT system, the main vehicle of trade liberalization was tariff reduction. The first five trade rounds were for tariff reduction basically among advanced countries. The sixth round (Kennedy Round: 1964-1967) marked a big push for this goal. Numbers of countries that participated was 62 and the rate of average tariff cut was 35%. The Tokyo Round (1973-1979) was the last place for the major tariff reduction in industrial products. 102 countries participated and the average tariff cut of industrial products was 33%. As a result, the average tariff rate of industrial products became as low as 4.7%¹. At the same time the focus of trade liberalization began to diversify to the tropical goods and non-tariff measures (NTMs). The last Uruguay Round (1986-1993) paved the way to WTO. In terms of trade liberalization this round covered most of the left over areas from the previous rounds, which became a major reason for difficult and prolonged negotiation. It covered such sensitive areas for tariff reduction as agriculture, tropical goods, and textile goods and clothing. It also for the first time began to cover service trade and trade related investment measures. Such changes of emphasized areas imply the end of the easy phase of tariff reduction.

APEC economies observed the more accelerated trend in trade liberalization. Table 1 shows the reduction of import-weighted tariff rates and the incidents of non-tariff barrier as percentage of total commodities.

Table 1. Trade liberalization in several APEC countries (%)

Country		Primary products	Manufactured products	All commodities
Chile				
mean tariff	1984-87	20.0	18.5	19.0
	1991-93	11.0	10.6	10.7
NTB incidents	1984-87	4.5	6.5	16.1
	1991-93	0.3	0.0	0.4
China				
mean tariff	1980-83	22.7	36.6	31.9
	1991-93	17.8	37.1	30.6
NTB incidents	1984-87	19.7	16.1	17.2
	1991-93	40.7	19.2	26.4
Indonesia				
mean tariff	1980-83	13.6	28.5	23.5
	1991-93	8.5	14.7	12.6
NTB incidents	1984-87	98.4	89.8	92.5
	1991-93	11.2	5.3	7.3
Malaysia				
mean tariff	1980-83	2.0	13.0	9.7
	1991-93	5.3	14.1	11.2
NTB incidents	1984-87	6.3	9.1	8.2
	1991-93	1.6	7.0	5.1
Thailand				
mean tariff	1980-83	13.7	28.7	24.8
	1991-93	26.4	41.6	36.9
NTB incidents	1984-87	28.6	16.3	20.2
	1991-93	12.0	6.2	8.2

Source: PECC (1995) *One in APEC Liberalization: A Map of Market Measures by APEC Economies*.

During the ten years before 1993, sizable trade liberalization was observed either in the reduction of tariff rates or in the tariffication of NTBs. Tariff rates of Malaysia and Thailand went up due to tariffication of NTBs. Exceptional move is the increase of NTBs in China. The reduction of unweighted mean tariff rates during 1988-1998 for most of the APEC member countries is available in Table 2. By 1998, advanced countries reduced tariff rates as low as 5% through the implementation of the Uruguay Round commitments and IAP commitments. Developing countries almost halved the tariff rates during the period, but the rate remained at around 10%.

Table 2. Unweighted Mean Tariff Rates, 1988-1998

	1988	1993	1996	1998
				(%)
Australia	15.6	9.0	6.1	5.3
Brunei	3.9	3.9	2.0	n.a.
Canada	9.1	8.8	6.7	5.2
Chile	19.9	14.9	10.9	11.0
China	40.3	37.5	23.0	17.0
Hong Kong	0.0	0.0	0.0	0.0
Indonesia	20.3	17.0	13.1	11.7
Japan	7.2	6.5	9.0	5.7
Korea	19.2	11.6	7.9	n.a.
Malaysia	13.0	12.8	9.0	9.1
Mexico	10.6	12.8	12.5	13.3
New Zealand	15.0	8.0	7.0	4.5
Philippines	27.9	23.5	15.6	9.4
Singapore	0.4	0.4	0.0	0.0
Taipei	12.6	8.9	8.6	8.3
Thailand	40.8	37.8	17.0	n.a.
USA	6.6	6.6	6.4	5.2
Average	15.4	12.9	9.1	7.6

Citation from Lee (1999) Table 1.
Original source: PECC (1996)

The member countries of ASEAN will further reduce tariff rates according to the agreements of ASEAN Free Trade Area (AFTA). The

schedule of tariff reduction was accelerated in the ministerial meetings held in 1999. The original members of AFTA cut tariff rates of more than 90% of tariff line to 5-0% by the year 2000. The coverage will be enlarged to 100% by 2002. The complete reduction to zero tariff will be realized by 2015, which is 5 years earlier than the goal decided at APEC's Bogor Declaration. Table 2 shows that China had the higher tariff rate at 17% in 1998. The rate will be reduced further in order to materialize its accession to WTO. The negotiations with Japan and USA are over, and the negotiation with EC is in process.

The trade liberalization, in summary, has progressed to a certain degree in the area of tariff reduction. Especially for APEC economies, the high tariffs remain mostly in the sensitive sectors. The number of NTBs has also been reduced and at present the quota or licensing system is maintained mostly for sensitive sectors. The impacts of further tariff reduction on the prices of the traded goods will be small in comparison with those in the 1970s and 1980s since the absolute percentage points of tariff cut is much smaller now. However, the tariffication of quota or licensing system will still have significant impacts on the trade. Moreover, there still is a lot to be done about the facilitation. Its impacts on prices can not be neglected and the implementation will not face many objections if the government is determined to do so. It is the time to consider the cost and benefits among various alternatives for trade liberalization.

The increasing difficulties and disagreements observed in the recent trade negotiations are generally related with so called "sensitive" items of each economy. They are mainly related with agriculture or labour employment.

The failure of the WTO Seattle meeting could be found in the disagreements in various agenda (see Table 3). In the area of goods trade, liberalization of agricultural sector and the preferential treatment for the imports from developing economies were the source of disagreement. Although the negotiation for the agricultural sector reached compromised agreement, the discussion for preferential treatment could not find the clue for implementation. It even related to the opposition to the conventional method of “green room” decision-making. Here, the problem lies in the difficulty of finding the areas for symmetric burden on the side of advanced countries and developing countries. While advanced countries are interested in the liberalization in service trade, e-commerce, and investment, developing countries are interested in the liberalization of agricultural and labor-intensive manufacturing goods markets. For advanced countries, agriculture is a politically sensitive area. The liberalization of

Table 3. Each Country or Group's Position in main items at WTO Seattle

	Japan	USA	EU	Developing Countries
Anti-dumping Rule	Affirmative to Make new rules	oppose to Negotiation	enforcement of present rule	Enforcement of Present rule
Liberalization in agriculture	Cautious Emphasis on the Multiple function.	Aggressive	Cautious emphasis on the multiple function.	Divided
E-commerce	Free trade	free trade and zero tariff	Control	Against zero Tariff
Investment Rule	Affirmative to Make rules	oppose to Negotiation	very affirmative to make rules	Oppose to Negotiation
Preferential treatments for developing countries	Flexible	Cautious	a little cautious	Requesting Strongly

Source: Translated from the article of Nikkei Shinbun (Japan Economic Journal), 25 December 1999.

a labor-intensive area was feared because it might worsen the unsatisfactory employment situation. Unemployment problem is, even though it is considered temporal, always a politically sensitive matter.

APEC also had similar problem. It is the case of EVSL. The APEC Ministerial Meeting in Vancouver in 1997 agreed to promote ESVL in 15 sectors. The 15 sectors are environmental goods and services; fish and fish products; toys; forest products; gems and jewelry; medical equipment and instruments; chemicals; energy; telecommunications mutual recognition arrangement (MRA); food; natural and synthetic rubber; fertilizers; automotive; oilseeds and oilseed products; and, civil aircraft. The 1998 Ministerial Meeting decided that the consultations should begin with the first nine sectors respectively through three approaches, namely, liberalization, facilitation and economic cooperation. The remaining 6 sectors were left for consultation in 1999. However, the discussion was divided on the method of consensus building. The USA took so-called "Package approach" to agree for the whole sectors liberalization as a package. However, countries like Japan insisted voluntary approach. Japan was reluctant to commit to the liberalization in fishery and forest products. In this way, the liberalization under the ESVL scheme was given up and the negotiation for liberalization of these areas was left to WTO Seattle meeting. Again, this incident implies that the easy phase of trade liberalization in APEC is ending.

4. Does further trade liberalization pay?

The previous section has indicated that the easy phase of the trade liberalization is ending and we are entering the difficult phase of trade liberalization. The first reason for such difficulty lies in the phenomenon that the adjustment cost is economically and politically becoming high in comparison to the return from the liberalization. The second reason for such difficulty exists in the exhaustion of easy sectors for trade liberalization. The Uruguay round and WTO have expanded sectors for trade liberalization. In addition to the agricultural sector and tropical products, which has been negotiated for a long time, service, e-commerce, investments are the new areas. It can be accepted without question that the liberalization of these sectors is beneficial for national welfare at the aggregate level as long as we neglect the adjustment cost or consider the benefit in the long run. However, if we begin to pay attention to the distribution of welfare gains, the answer is not clear. Moreover, there even exist the cases that the free trade will not improve the national welfare, which is the topic for the next section.

The first reason for the difficulty can be regarded as a normal economic phenomenon. It simply means that the marginal productivity of trade liberalization, especially in the form of tariff reduction, has become low according to the rule of diminishing returns to scale. The cost of high protection is the inefficiency in the resource allocation. When an industry is heavily protected the fruits from tariff reduction or abolishment of import licensing system is large. This was explicitly observed in the case of Indonesia's trade liberalization after mid-1980s. Trade liberalization has not only closed down inefficient industries but also contributed to the export promotion through bringing down the prices of imported input used for export production². The average tariff rates of APEC's Asian developing countries were around 10 % in 1998. At this tariff level, will another 5%

reduction of tariff give visible impacts to resource allocation? Also, after a consecutive tariff reduction in the past 10 ten years, the room for efficiency increase on the side of survived firms will be small. If such firm belongs to the industry that has potential or near comparative advantage, there is a case that the few more years of low tariff protection will change them to exporters. Under the flexible exchange rate regime, exchange rate can change 5 % at any time. In this case, low tariff rate could work as a means of protection against instability. Although we can not conclude anything here before we look into each case, there is a need for examination of the trade liberalization from such point of view. Such opinion may not hold to advanced countries or in the long run, but could hold in the case of developing economies that fulfill two conditions. Firstly, an economy should have implemented extensive liberalization in the last few years and not ready for another liberalization. Secondly, an economy should be in the severe economic situation like the ones in or shortly after the currency crisis. In the APEC's scheme, such treatment is to be taken care of through ECOTECH. However, slowing down the pace of liberalization for a short while could also be regarded as a kind of substitute for ECOTECH.

Another aspect of the problem is the political one. This makes the further trade liberalization in both advanced and developing countries difficult. It is the unemployment problem. These days, the firms are trying to chop down the unnecessary labour as far as possible. Firms grow and GDP increases, but the recovery of employment situation is hard to see. In sum, the number of newly unemployed due to rationalization will outweigh the number of newly employed due to the growth of firms. This is the so-called "growth without employment increase." Many Asian countries are in such situation. Then, it is quite natural that a certain numbers of politicians will become reluctant to trade liberalization, and workers carry on the campaign against it.

The second reason of the sector specific difficulties is quite often argued. Liberalization of agricultural sector is a long-time discussed problem. In the textbook world of the comparative advantage theory, there is no rationality in their protection as long as free trade is maintained. However, there is a variety of non-economic reasoning, both reasonable and unreasonable. Among them are, food securities, safety of foods from chemical contamination, conservation of land and environments. These are related to value of judgement of a people in a nation. Especially, the last two reasons are acceptable and it is basically a matter of balance between economic factors and non-economic factors. Of course, the strong lobbying by farmers' associations and politicians who depend heavily on farmers' votes during elections are unreasonable, but it is a political fact. Government agencies supervising the agricultural sector is often problematic since they retained large share in the government despite the decline of weights of agriculture in each economy.

The problem of unequal distribution of welfare gains is a matter that needs extensive empirical study. Also, it is a problem of politics, or choice of a nation. On one extreme there are people who want to secure the equality in opportunity, and on the other there are people who want to see the equality in results. From the social stability point of view, there is a need to compromise and decide the appropriate degree of mixture according to the culture of each nation.

At the present stage of relatively low tariff rates, will the welfare gains of further worldwide or regional trade liberalization at the macro level be large or small? There are a few recent quantitative studies on this matter. Dessus et. Al (1999) did a simulation analysis of multilateral tariff liberalization in agricultural and industrial products and concluded that

there is welfare gain if liberalization will increase total factor productivity (TFP). They used LINKAGE model of OECD Development Center and did three kinds of simulations. The modest liberalization simulation assumes zero tariffs for OECD countries and 5% flat tariff rates for non-OECD countries. If TFP is treated exogenous (constant), then the GDP will increase 0.2% for all countries, 0.1% for OECD countries and 0.4% for non-OECD countries. If TFP is endogenized and grows with the degree of openness, the impacts on GDP will change to 3.0%, 2.4%, and 4.9% respectively. It is quite interesting that the gains are conditional. The paper concludes that “trade still matters”, but it implies at the same time we need to ensure the link between TFP and openness of countries by various policy measures.

APEC Economic Committee (1999b) also estimated the dynamic impacts of trade liberalization using Computable General Equilibrium (CGE) model. The study is more practical in estimating the case of the existence of sluggishness in factor mobility and referring to the adjustment costs. The simulation was made on the assumption that all tariff reduction so far planned by the year 2010 are implemented by the member economies. The summary of the assumptions is given in the Appendix 1. The study simulates the impacts of the tariff reduction agreed in the Uruguay Round. The summary result is given in Table 4. The liberalization under the APEC will increase the regional GDP by 0.42% in comparison with the baseline case, of which 0.16% can be attributed to the trade liberalization and 0.25% to the trade facilitation. It is worthwhile to note that the impact of facilitation is more important in the APEC. The impact of Uruguay Round is much larger to the regional economy, generating the additional 0.7% of regional GDP. The distribution of the impacts to the member economies is given in Table 5. It is a general observation that the impacts on developing economies are much larger than the impacts on developed economies. In

particular, Chile, China, Malaysia, Philippines and Thailand increase their GDP at the amount of 2-4%. Another simulation result that includes the extreme cases of sluggish factor mobility in the developing member economies is given in Table 6. It indicates that the sluggish mobility both in labor and capital will reduce the impacts on GDP into half. The simulation on the adjustment cost is not done, but the paper points out that such cost could be minimized through the implementation of government policies assisted by ECOTECH. The study concludes that the APEC trade liberalization and facilitation should have sizable favourable impacts on the regional income. However, the result can also be understood in the following way. First, that the impact of trade liberalization is not so big as expected, especially under the sluggish factor mobility. Second, it is not a unreasonable choice that we focus on the facilitation and ECOTECH when the regional economy has difficult adjustment problems.

Table 4. Estimated Change in Real Income in APEC
Impact of Trade Liberalization and Facilitation

	Amount (US\$ Billion in 1997)	Percentage Change (GDP)
UR Commitments	113.8	0.7
APEC: Total	75.3	0.42
Liberalization	29.5	0.16
Facilitation	45.8	0.25
UR and APEC	189.1	1.1

Source: Cited from APEC Economic Committee (1999b) p.19

The last point to be made is that none of these quantitative studies estimates the impacts on the income distribution and incorporate the adjustment costs. However, it is a generally accepted observation that the income equality will worsen when the developing economies are growing rapidly although the absolute level of income increases at all income groups.

This will be true for the ASEAN dynamic economies before the currency crisis. But, the currency crisis has drastically increased a number of people living under poverty level. Also, the recovery from the crisis will experience a harsh structural and institutional adjustment, which in turn requires the efficiency improvement in various sectors particularly by way of cutting the unnecessary labor. The quantitative analyses on the distribution of the income generation and adjustment costs through APEC TILF is urgently needed for an assessment of the liberalization impact and deciding the strategic focus in various stages of APEC activities.

Table 5. Income Effects of APEC Measures
 Table 5. Estimated Real Income Effects on APEC Economies

Economies/Regions	Amount (1997 US\$ billions)	Percentage Change (GDP)
Australia	1.1	0.3
Canada	4.4	0.7
Chile	2.4	3.1
China	25.5	2.8
Hong Kong, China	0.1	0.1
Indonesia	2.1	1.0
Japan	5.3	0.1
Korea	3.4	0.8
Malaysia	4.5	4.5
Mexico	3.4	0.8
New Zealand	0.7	1.1
Philippines	3.6	4.4
Russia	0.8	0.2
Singapore	1.6	1.6
Chinese Taipei	5.4	1.9
Thailand	3.6	2.4
USA	7.5	0.1
Viet Nam	0.1	0.6
APEC Total	75.3	0.4

Source: Cited from APEC Economic Committee (1999b) p.21

Table 6. Effects of Sluggishness in Mobility of Factors of Production
Impacts of Trade Liberalization and Facilitation APEC Economies

	Export Volume (%)	Real Income (%)
Perfect Factor Mobility	3.3	0.42
Labor Sluggish	3.0	0.37
Capital Sluggish	2.9	0.35
Unskilled Labor and Capital Sluggish	2.5	0.24

Source: Cited from APEC Economic Committee (1999b) p.29

5. New problems: changes in the world economic environments

The WTO has published a resource booklet (1999) for the Seattle Ministerial Meeting, the title of which is “ Seattle: What’s at Stake?” This booklet is symbolic in representing the critics toward WTO or promotion of free trade in the recent environment. The section of “ Concerns ... and responses have the following 6 topics.

1. The WTO is unrepresentative and undemocratic, and undermines the sovereignty of governments.
2. The WTO is concerned only with free trade.
3. WTO rules and liberalization destroy jobs, depress wages and ignore worker’s rights.
4. Does the WTO put trade ahead of economic development, and ignore problems of developing countries?
5. Does the WTO rules and dispute rulings menace the environment, health, and safety?
6. With so much at stake, the WTO must respond to its critics.

The topic 5 is related with the emergence of non-economic values and topics 2-4 indicate that the questions are increasing with respect to the gains from free trade in the recent world economic circumstances. In this line, the new problems could be classified into economic ones and non-economic ones. The former is related to the assumptions of the free trade, namely diminishing returns to scale and unlimited number of atomic agents in the market. It is also related with the increasing interdependence among economies under the globalization trend and with sharing common information through Internet in every part of the world.

The incidences of the oligopolistic competition are quite rapidly increasing in the real world. The assumptions of Heckscher- Ohlin theory is violated. Although the theory assumes decreasing returns to scale, the cases for increasing returns to scale are quite often observed in the real world now. The promotion of free trade, reduction of transportation cost and the progress of information technology cause this. If we measure the efficiency of a company not only from the production point of view but also from the comprehensive point of view including the management side, the cases of increasing returns to scale could happen more often. As a result, we hear the new of mergers, acquisitions, and partnerships between companies quite often. In the manufacturing sector, the automobile industry is a good example. In the service sector, the phenomenon is more common. There are so many news of mergers among financial institutions and telecommunication companies. The domestic companies in developing countries have more possibilities to be acquired by multinationals or form a partnership with multinationals. Also, to cope with such multinationals, the mergers of domestic companies are also promoted. In this way, the market is quickly becoming oligopolistic. In such situation, there is no guarantee that all the countries engaged in trade will get gains to some extent. There will be a case that some countries will lose from trade.

In the domestic market of each country, such oligopolistic situation on the producers' side and the keen competition with foreign producers will increase the possibility that the workers will lose. The labour market will become buyers' market. Therefore, the distribution of value added between capital and labor will tend to move in the unfavorable direction for labor. This is also accelerated through free trade especially in advanced countrys' labor markets after the massive inflow of labor intensive products from developing countries. We now can observe the factor price equalization theorem of Heckscher-Ohlin theory in the real world. Maybe, this is a good

phenomenon from the world point of view, but it is different from the eyes of newly unemployed people. While the real wage rate is increasing, such trend may be acceptable for advanced countries' workers. But, the story is different when it comes to the drop of the real wage. In this context, APEC is correct in addressing to the competition policy.

The second problem is the increase of instability in the world economy. This was caused as a combined effect of trade liberalization, capital investment liberalization, revolution in the information technology. The trade liberalization has naturally increased the trade dependency of each economy and thus the economic interdependence among nations became large. The Appendix 2 shows how the APEC economies are interdependent by measuring the intra-regional income multipliers. So, small countries can easily be influenced by the economic shocks elsewhere in the world. It is now commonly perceived that the free capital transaction, quick acquisition of common knowledge through Internet and the financial engineering with basis on the information technology all together are to be blamed to a considerable extent for the currency, financial and economic crisis of Asia. Especially, the "herding" is a problem. It is not realistic to assume all the people or companies behave on the assumption of perfect information. Many will depend on someone else's information. In the case of Asian Crisis, rating companies were blamed. Information exists in an asymmetric way in many cases. All these will increase the instability of the economies. For each economy, globalization is a chance for rapid growth, but it at the same time brings the risks.

When there is some shocks in the monetary sector in terms of capital flow or exchange rate, it diffuses to the real sector. The problem is the difference of adjustment speed between the monetary sector and the real sector. The big adjustments in the real sector accompany closing or

establishing a firm. Such adjustment will take a year. However, the adjustment in the monetary sector is overnight. Therefore, the increase of such instability will dampen the investment mind to the industrial sector. It looks like the world economy is approaching the point that needs the consideration for the balance between the growth and instability. As is often pointed out we surely need good world governance, but the contents are not clear yet. The macroeconomic policy coordination should also be intensified, but it accompanies the problem of national sovereignty.

Non-economic factors are also important. First, the environmental concern should also be included in trade. Free trade is often accused for damaging the environment. The rapid industrialization through export promotion policies has increased air and water pollution in many developing countries. The high price of shrimp and increase of export to Japan damaged the mangrove forests in tropical countries. Basically, pollution by industrialization is the problem of pollution control of each developing country. However, the case for shrimp as well as logging is somewhat different. Free trade promotion without an appropriate consideration of environmental cost damages the environment. Environmental cost is not counted in the pricing of the products. This is the case that the government should intervene into the market and tax. The most effective way is imposing tax on such import on the side of importing country. The problem of "green trade" will be another important topic for APEC in order to protect the environment in the region.

Other new phenomenon is e-business. Since this topic is intensively worked out in the APEC's committee, we had better wait and see the result. Although USA insists not to impose any tariff on the e-commerce, we still need a careful examination from various aspects. The child labor abuse or human right problem related with labor intensive export should not be

judged only from advance countries' point of view, but examined from the practical point of view. The link of this matter with trade will not be a wiser choice.

6. Who should enjoy trade liberalization? (The role of a nation state)

If we look at the recent problem associated with the trade liberalization from a single country's point of view, the role of the nation state should be re-defined in accordance with the new environment. The fundamental question is to what extent each nation state should maintain its sovereignty in the economic activity. It is a kind of trade off between the governability of world institutions and governability of each country's government. The problem could be discussed in two separate ways.

Trade and investment liberalization of agricultural sector, financial sector, and other service sector may still need some government intervention in case of most developing countries. The need for liberalization is clear but it is practical to proceed with it according to the progress of institutional building. If we assume less international mobility of labor, a nation state is in a position to secure the life of the people. Opening up the sector quickly and implementing the social safety net for that will be a heavy budgetary burden for developing countries.

The more fundamental question is whether we should differentiate the industries by its country origin of capital, namely, national or foreign. Asian countries have attained rapid growth with a combination of trade liberalization and attraction of FDIs. However, at the same time, the protection of state owned companies was quite often seen on the ground of infant industry argument. What is unknown is the behavior of joint ventures or 100% foreign owned companies in the future. Do they relocate the firms more easily than the national countries? Do they have the same impacts in terms of technology diffusion in the country? The answer is unknown yet, but it is more probable that the national companies will have stronger tendency to stay in the country.

In this globalization world, we are asked whether to protect national interests or to behave for the worldwide welfare even if our living standard will be lowered. The role of a nation state seems to be waning in this boarder-less world. Without a long tern view on this matter, the government role for trade liberalization will not be clear. If some developing countries believe in the infant industry argument, the exceptions for trade liberalization will remain and continues to be a source of problem, making the negotiations for trade liberalization difficult.

7. Will bilateral free trade agreements strengthen APEC

After the failure of the WTO Seattle meeting, the move for bilateral trade agreements is becoming popular. Singapore has been active in this respect and approached to New Zealand and Japan. With regard to Japan, the bilateral trade agreements with Singapore, Korea and Mexico are under study. Moreover, Australia and Canada are interested in making agreements with Japan. The point is whether such bilateral agreements will lead to the trade liberalization at regional level such as APEC and then to WTO's new round.

The simulation study by Japan Economic Research Center³ suggests that the free trade agreements among Japan, Korea, Singapore, NAFTA will increase Japan's GDP by 0.26% and similar favorable effects to partner countries. On such ground, it is often argued that bilateral approach will lead to world trade liberalization as long as they do not have exception of commodities as stipulated in the WTO rule. However, such effort will also have a risk of losing member countries' enthusiasm for trade liberalization in APEC. In case that each country will move to agree the further liberalization only in the mutually benefitable sectors, then it will become difficult to find common sectors for liberalization in the APEC. Many countries will lose the incentives for joining CAP and offering IAP and those which do not have any such agreement will be left in the slowed down APEC's liberalization scheme. To make success in the bilateral approach, some rules in APEC should be set up. An example is to include major fruits from the bilateral negotiation in the next year's IAP of APEC.

Notes:

¹ WTO homepage: "Roots: from Havana to Marrakesh" in "About the WTO".

² For the process and impacts of the liberalization in Indonesia, see Osada (1997).

³ See the article written by Syujirou Urata on Nihon Keizaishinnbunn, Morning edition of December 10, 1999.

References

APEC Economic Committee (1999a), *APEC Economies beyond the Asian Crisis*, September.

APEC Economic Committee (1999b), *Assessing APEC Trade Liberalization and Facilitation –1999 Update*

Choi, Byung-il (1999) , *Competition Principles and Policy in the APEC: How to Proceed and Link with WTO*, Working paper 99-21, Korean Institute for International Economic Policy.

Dessus, Sebastien, Kiichiro Fukasaku and Raed Safadi (1999), *Multilateral Tariff Liberalization and the Developing Countries*, OECD Policy Brief No.18

Lee, Hongguue (1999), *An Assessment of the APEC's Progress toward the Bogor Goals: A Political Economy Approach to Tariff Reductions*, APEC Analysis Series 99-01, Korea Institute for International Economic Policy.

Moore, Mike (2000), "Back on Track for Trade and Development" a keynote Address at the 10th UNCTAD conference in Bangkok.

Osada, Hiroshi (1997), "Trade Liberalization and the growth of the Potential Leading Sectors – A Study of the Indonesian Manufacturing Industries –,"APEC Discussion Paper No.12, Graduate School of International Development, Nagoya University.

Osada, Hiroshi (1998), "The ASEAN-Type Development Strategy and the Currency Crisis – A Preliminary Note-," APEC Discussion Paper No.22, Graduate School of International Development, Nagoya University

Osada, Hiroshi (1998), "Interregional Multiplier Effects through Trade Linkages," a paper presented at the Japan ASC study meeting at Yokohama University.

Pacific Economic Cooperation Council (1995), *Milestone in APEC Liberalization: A Map of Market Measures by APEC Economies*.

Pacific Economic Cooperation Council (1996), *APEC Members' IAPs of 1998*.

Yamazawa, Ippei and Shujiro Urata (1999) "Trade and Investment Liberalization and Facilitation", a paper presented at the 25th PAFTAD conference in Osaka.

Yamazawa, Ippei (2000), "Regional Cooperation in a Changing Global Environment: Success and Failure of the East Asia", a paper presented at the 10th UNCTAD conference in Bangkok.

WTO (1999), *Seattle: What's at Stake?* Resource booklet for the Seattle Ministerial meeting.

Others

APEC Secretariat homepage

ASEAN Secretariat homepage

APEC Auckland homepage

UNCTAD Bangkok homepage

WTO Seattle homepage

Nihon Keizai Shinbun (Japan Economic Journal; daily news paper),
various articles

APPENDIX 1 (abbreviated)

