

A PACIFIC FREE TRADE AREA?

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Vigorous expansion of trade, investment and other economic ties within the East Asian and Pacific economy has been crucially important to the region's extraordinary growth in recent decades. This expansion has taken place without the framework of formal regional institutional arrangements that fostered integration across the Atlantic among the original OECD countries.<sup>1</sup> The growth of Pacific economic integration represents an impressive example of 'market integration' around institutional and legal barriers to trade, capital movements and other forms of economic interchange.<sup>2</sup> Integration has occurred despite persistent political resistance to the domestic structural implications of internationally oriented growth. In the course of growth, some barriers have been lowered, others have been introduced anew, or raised, and many remain.

This paper takes as the central objective of international economic diplomacy in the Pacific region, the preservation and enhancement of the conditions for continued economic growth in the style of recent decades. The international system that has supported vigorous trade expansion is under threat from several directions: tension between the United States and Japan (and to a lesser extent between the United States and Taiwan and Korea) over large trade and payments imbalances; the prospect of increased economic introversion in Europe as 1992 approaches; the accommodation of new patterns of comparative advantage in the Asian newly industrialised economies (NIEs) as they compress into a few years adjustments to a decade of rapid economic growth; and

the new challenge of managing the emergence of China, with its partially reformed centrally planned system, as a major player in Pacific economic relations. It is important for peace and political stability, too, that the environment of relatively open economic relations that made a realistic alternative to autarky available to China at a crucial point in its political history, is preserved to provide similarly reliable alternatives for the states of Indochina, the Soviet Union and the Democratic People's Republic of Korea (DPRK), at a time of opportunity for progress on reducing longstanding sources of conflict.

The central objective is thus a conservative one: to preserve the current system of relatively open economic relations in the Pacific, however imperfect that may be. We would then add as second and third objectives, the reduction of barriers to intra-Pacific trade, and the reduction of barriers to trade with major economies outside the region, particularly the European Communities.

This paper examines whether these objectives would be enhanced by the formation of a Pacific Free Trade Area.

One question that must be addressed is whether the central, conservative objective can be achieved without progress on the second and third objectives. Frustration at the lack of progress in reducing Northeast Asian and European barriers to trade, especially on agricultural products, has been an important element in the corrosion of political support in the United

States and elsewhere for the multilateral system. We can expect this frustration to intensify if the Uruguay Round delivers disappointing results.

We have been asked to assess the merits of and prospects for a Free Trade Area encompassing the market economies of the Western Pacific, together with the United States and Canada. Trade and other economic relations among these countries have been characterised by high intensity and rapid growth. They are thus a convenient group of economies to consider in this context. The role of the People's Republic of China must also be discussed as a trading economy similar in scale of total trade to Taiwan and the Republic of Korea, experiencing similarly rapid growth, specialised in labour-intensive manufactured exports in the early style of other Northeast Asian economies, and oriented towards the Pacific region in its foreign economic relations.

Thus when, for brevity, we refer to 'the Pacific region', we include the United States, Canada, the Western Pacific market economies, and the People's Republic of China. Later we make separate reference to the circumstances of Mexico, lacking close economic ties across the Pacific but trading intensively with the United States, and to the centrally planned economies of the Western Pacific which as yet have only slender economic links with their Pacific neighbours.

## Pacific Trade and Growth

East Asian economies in recent decades have experienced stronger growth than the world had previously known on a sustained basis. From the mid-fifties, Japan grew at a rate that more than doubled output each decade, until, by the time of the first oil shock, its production per capita was close to the frontiers of the world industrial economy. The four Asian NIEs started their high growth later, in the early sixties, and from lower bases than Japan, but on average have grown even more rapidly. Three of them, Taiwan, Singapore and Hong Kong, have already surpassed the average per capita output in lower-income OECD countries. Korea, starting from a lower base, still seems likely to attain the living standards of OECD laggards before the end of the century.

Over the past decade, China has joined the ranks of the high-growth East Asian economies. It has been exceeding the goal that it set itself, to double real output each decade.

In the principal ASEAN economies other than Singapore, that is, in Indonesia, the Philippines, Thailand and Malaysia, growth has been less consistent and more modest, but has comfortably exceeded average performance in world developed and developing economies alike since the late 1960s.

Japan's growth since it broadly 'caught up' with productivity levels elsewhere in the OECD in the mid-1970s has been less

spectacular, but has remained above the average for advanced economies.

One result has been an historic shift in the centre of gravity of world production. In the early postwar period, when the liberal trading system around the GATT was being established, North America accounted for one-half of world GNP, and East Asia, devastated by war and civil strife, for only a few per cent. By the early 1960s, the North American share of world production was still extremely large, at around 40 per cent, while East Asia's share had increased to 9 per cent. By the early 1980s, North America's share of world GNP had fallen to 27 per cent while East Asia's had more than doubled, to 19 per cent. These trends have continued, and it seems that in the 1990s East Asia will contribute as much as North America to world GNP, with the two region's accounting for over one-half of world output.<sup>3</sup>

These shifts in the locus of world economic power have implications for the leadership and management of the international trading system, and these are addressed later in the paper.

East Asia's growth in recent decades has been associated with a certain style of relating to the international economy. The share of trade in output has expanded rapidly. The early years of rapid growth have been associated with powerful specialisation in the export of labour-intensive manufactures, but patterns of export specialisation have then progressed rapidly into more

capital-intensive production with growth in living standards. Trade growth has been geographically focussed in the Pacific region.

These trends, and some reasons for them, are illustrated in Tables 1 and 2.

Table 1 demonstrates the vast potential for intra-Pacific trade based on differences in relative endowments of natural resources, labour and capital. The theory of changing comparative advantage in the process of economic growth postulates that a poor country will initially have comparative advantage in production of natural resource-based products; that growth of the capital stock will cause comparative advantage to shift towards labour-intensive manufactures and services if the country's per capita natural resource endowment is poor, but not otherwise; and that continued growth, reflected in higher per capita income, will cause comparative advantage to shift successively into more capital-intensive manufactures and services.<sup>4</sup>

This pattern has been demonstrated by the growth experience of the Pacific. Wide variations in per capita natural resource endowments, represented crudely by population density in Table 1, suggest high complementarity between Australasia and North America on the one hand, and East Asia, particularly Japan and the Asian NIE's, on the other. The large variations in per capita income provide opportunities for trading capital-intensive

Table 1

**RESOURCE ENDOWMENTS, SECTORAL SHARES OF TOTAL TRADE AND  
'REVEALED' COMPARATIVE ADVANTAGE IN DEVELOPED AND  
DEVELOPING PACIFIC BASIN COUNTRIES, 1986<sup>a</sup>**

	Australasia <sup>b</sup>	North America <sup>c</sup>	Japan	China	Asian NICs	Other market ASEAN economies	Industrial economies	Developing economies <sup>d</sup>
<u>Population density</u> (persons per km <sup>2</sup> )	2.4	13.8	326.6	110.2	507.0	95.4	24.0	53.0
<u>GNP per capita (US\$)</u>	11.157	17.158	12.840	300	3,308	647	12,960	610
<u>Real GNP per capita</u> <u>growth rate, 1965-86</u> (per cent per annum)	1.7	1.7	4.3	5.1	6.8	4.0	2.3	2.9
<u>Sectoral shares of</u> <u>total trade (per cent)</u>								
<u>Agriculture</u>								
- Exports	46	17	1	22	11	33	13	22
- Imports	0	9	25	10	14	12	14	15
<u>Fuels, minerals and metals</u>								
- Exports	34	10	1	16	9	34	8	37
- Imports	7	12	40	4	16	14	16	11
<u>Light Manufactures</u>								
- Exports	3	5	10	44	43	14	11	19
- Imports	14	13	8	13	18	10	13	14
<u>Heavy manufactures</u>								
- Exports	15	64	87	17	65	16	66	26
- Imports	68	63	25	70	51	58	55	58
<u>'Revealed' comparative advantage</u>								
Agriculture	3.3	1.2	0.1	1.6	0.8	2.3	0.9	1.6
Fuels, minerals and metals	2.2	0.7	0.1	1.0	0.6	2.3	0.6	2.5
Light manufactures	0.3	0.4	0.8	3.4	3.3	1.1	0.9	1.5
Heavy manufactures	0.3	1.1	1.6	0.3	1.2	0.3	1.2	0.5

Notes: a Exports and imports refer to export and import shares, respectively. 'Revealed' comparative advantage is defined as the ratio of the share of a commodity group in total exports for a country or group of countries to that commodity group's share of world exports.

b Australia and New Zealand.

c United States and Canada.

d Excludes high-income oil exporters.

Source: Peter Drysdale, International Economic Pluralism: Economic Policy in East Asia and the Pacific. New York: Columbia University Press, 1986; updated from the International and World Bank, World Development Report. New York: Oxford University Press, 1988.



**Table 2**  
**PACIFIC AND WORLD TRADE SHARES, 1965 AND 1987**  
**(per cent)**

Reporter		<u>Partner</u>		<u>Japan</u>		<u>Other</u>		<u>ASEAN</u>		<u>China</u>	
		<u>Australia &amp; NZ</u>				<u>Northeast Asia</u>					
		1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
Australia & NZ	X	6.2	8.2	14.4	24.8	1.9	7.2	1.3	6.7	4.5	3.9
	M	5.6	7.6	9.3	20.4	1.1	4.7	2.0	5.4	0.6	1.7
Japan	X	5.0	2.9	-	-	6.1	10.2	8.8	7.2	3.2	3.8
	M	8.0	6.4	-	-	1.0	6.8	6.9	13.8	2.9	5.2
Other Northeast Asia <sup>a</sup>	X	3.8	1.9	9.5	11.8	1.4	3.8	6.4	5.4	1.1	12.2
	M	2.2	2.6	23.0	27.8	0.9	3.1	3.8	7.7	21.3	18.3
ASEAN	X	3.7	2.6	24.0	21.9	3.4	7.9	2.9	16.8	2.2	2.4
	M	2.1	3.2	27.9	24.9	2.2	5.7	5.0	16.1	4.5	4.2
China	X	2.1	0.9	15.9	16.2	28.8	34.9	7.1	5.9	-	-
	M	13.3	3.6	19.0	23.7	1.0	19.8	3.1	4.8	-	-
North America <sup>b</sup>	X	3.1	2.1	6.8	10.0	1.4	4.0	1.5	3.2	0.3	1.4
	M	1.7	1.0	9.1	19.2	1.5	6.3	2.0	3.8	0.1	1.5
<u>Pacific Total<sup>c</sup></u>	X	<u>3.7</u>	<u>2.5</u>	<u>7.3</u>	<u>9.5</u>	<u>2.9</u>	<u>7.7</u>	<u>2.9</u>	<u>6.1</u>	<u>1.1</u>	<u>3.4</u>
	M	<u>3.6</u>	<u>2.8</u>	<u>9.3</u>	<u>17.6</u>	<u>1.4</u>	<u>6.6</u>	<u>3.0</u>	<u>6.9</u>	<u>1.6</u>	<u>3.9</u>
Western Europe	X	2.2	0.8	0.8	1.7	0.5	1.1	0.7	1.1	0.5	0.7
	M	2.2	0.6	1.2	4.6	0.5	1.5	0.6	1.2	0.4	0.6
Middle East	X	3.0	1.1	13.6	23.7	0.6	3.5	0.9	6.6	0.4	0.4
	M	1.5	2.0	5.4	12.4	0.5	3.6	0.2	2.7	0.9	2.1
Mexico	X	0.4	0.2	8.2	5.9	0.2	0.9	0.4	0.4	0.3	0.3
	M	1.3	0.3	2.5	7.3	0.1	0.9	0.0	0.2	0.0	0.1
Latin America <sup>d</sup>	X	0.2	0.4	4.0	6.2	0.2	1.3	0.2	0.7	0.8	1.2
	M	0.6	0.6	3.8	8.0	0.2	2.1	0.2	0.8	0.0	0.8
Rest of World	X	1.0	0.5	4.3	6.7	0.6	1.6	0.5	1.3	1.4	2.6
	M	1.4	1.4	6.0	9.0	0.6	2.7	0.7	2.8	1.1	3.8
<u>World</u>	X	<u>2.4</u>	<u>1.4</u>	<u>3.9</u>	<u>5.8</u>	<u>1.2</u>	<u>3.6</u>	<u>1.3</u>	<u>3.1</u>	<u>0.8</u>	<u>1.8</u>
	M	<u>2.4</u>	<u>1.5</u>	<u>4.4</u>	<u>10.2</u>	<u>0.7</u>	<u>3.6</u>	<u>1.3</u>	<u>3.5</u>	<u>0.8</u>	<u>2.1</u>

Notes: X = exports.

M = imports.

a Korea, Taiwan and Hong Kong.

b United States and Canada.

c Australia, New Zealand, Japan, Other Northeast Asia, ASEAN, China, North America and the Pacific Islands.

d Includes Mexico, the Caribbean and other Latin American countries.

Source: IMF Direction of Trade Statistics, International Economic Data Bank, Research School of Pacific Studies, Australian National University.

North America		Pacific Total		Western Europe		Middle East		Mexico		Latin America		Rest of World	
1965	1987	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
13.3	14.4	<u>44.8</u>	<u>68.2</u>	44.4	19.8	1.7	4.8	0.5	0.2	1.2	1.4	7.9	6.1
25.8	23.3	<u>45.1</u>	<u>63.8</u>	45.3	29.4	4.6	2.9	0.1	0.2	0.8	1.2	4.4	2.7
35.7	41.4	<u>58.9</u>	<u>65.7</u>	14.2	20.9	3.8	4.0	0.5	0.6	5.9	3.7	17.2	5.7
35.3	26.5	<u>54.5</u>	<u>58.2</u>	9.4	15.9	13.9	14.1	1.9	1.1	9.2	4.3	13.0	6.7
34.6	37.2	<u>57.0</u>	<u>72.2</u>	28.6	18.2	2.5	3.1	0.2	0.2	2.0	2.0	9.8	4.6
19.6	17.2	<u>70.7</u>	<u>76.8</u>	20.6	14.8	1.6	3.5	0.3	0.3	1.6	1.9	5.5	2.8
29.3	23.4	<u>65.6</u>	<u>74.7</u>	25.1	15.6	0.8	2.8	0.0	0.0	0.8	0.9	7.6	5.3
23.8	16.4	<u>65.5</u>	<u>70.1</u>	24.8	18.1	2.9	7.6	0.3	0.1	0.6	1.0	6.2	2.6
1.1	8.7	<u>55.0</u>	<u>66.7</u>	23.5	11.4	3.2	6.5	0.0	0.0	0.3	1.2	17.9	14.3
7.5	14.6	<u>44.0</u>	<u>66.7</u>	27.3	20.7	2.0	0.9	0.2	0.2	7.5	2.9	19.3	8.9
29.6	38.3	<u>42.7</u>	<u>58.9</u>	31.4	22.7	3.0	3.6	3.3	4.5	13.3	11.0	9.7	3.9
36.2	27.9	<u>50.5</u>	<u>59.7</u>	25.2	22.8	1.8	2.7	2.3	4.4	16.8	10.6	5.6	4.2
28.6	35.2	<u>46.8</u>	<u>64.5</u>	29.4	20.4	2.9	3.7	2.4	2.1	10.1	6.1	10.8	5.2
32.9	24.8	<u>51.9</u>	<u>62.5</u>	24.6	20.7	4.0	5.0	1.8	2.7	12.5	7.2	7.0	4.5
9.5	9.8	<u>14.3</u>	<u>15.2</u>	65.0	71.4	3.0	3.8	0.5	0.2	4.1	2.1	13.7	7.5
13.5	7.6	<u>18.4</u>	<u>16.2</u>	57.8	70.7	4.8	2.8	0.3	0.3	5.5	2.4	13.6	7.8
7.9	15.2	<u>26.3</u>	<u>50.5</u>	53.7	37.4	9.1	4.5	0.0	0.0	1.7	4.2	9.1	3.5
18.2	14.2	<u>26.8</u>	<u>36.9</u>	47.3	55.6	13.7	4.7	0.0	0.0	0.8	0.7	11.4	2.2
64.2	76.7	<u>73.6</u>	<u>84.3</u>	9.4	13.3	0.1	0.0	-	-	8.5	2.1	8.4	0.2
68.4	77.5	<u>72.3</u>	<u>86.1</u>	24.5	12.8	0.0	0.1	-	-	2.6	0.5	0.7	0.5
38.2	53.3	<u>43.7</u>	<u>63.2</u>	34.7	27.1	0.4	0.5	0.2	0.1	17.0	7.2	4.2	1.9
42.0	45.3	<u>46.8</u>	<u>57.5</u>	30.0	28.0	1.5	4.4	0.7	0.7	19.4	8.2	2.3	2.0
8.0	13.7	<u>15.8</u>	<u>26.3</u>	57.2	61.1	2.9	1.4	0.1	0.1	1.3	1.0	22.8	10.1
15.9	9.3	<u>25.7</u>	<u>29.0</u>	49.6	58.5	2.3	2.2	0.4	0.0	2.4	1.2	20.1	9.2
17.2	21.1	<u>27.0</u>	<u>36.9</u>	50.6	49.3	3.0	3.5	1.0	0.9	6.5	3.8	13.0	6.5
21.1	15.8	<u>30.7</u>	<u>36.8</u>	45.4	48.9	4.3	3.7	0.7	1.2	7.8	4.3	11.8	6.3

for labour-intensive manufactures. And the ascension of Japan and several of the NIEs into the ranks of relatively high income economies is opening rich new opportunities for intra-industry specialisation in trade in technologically sophisticated goods and services, especially amongst the adjacent economies of Northeast Asia.

A distinctive feature of high growth in East Asia has been the rising shares of foreign trade in production, as the economies of the region put to good use the potential gains from trade deriving from widely different relative resource endowments. East Asian and Pacific trade is growing more rapidly than world trade. The dollar value of Europe-North America two-way trade increased slightly more than sixfold between the beginning of the 1970s and 1987; Japan-North America trade increased almost tenfold; trade between Japan and the newly industrialising countries of Northeast Asia increased eighteenfold; and trade between North America and the latter countries jumped more than forty-eightfold in the same period.<sup>5</sup> Already the East Asian and Pacific region accounts for 37 per cent of total world trade.

The huge economic transformation that has been taking place in East Asia brought with it a major shift towards the Pacific and away from the Atlantic as the focus of world trade. Table 2 sets out changes in the geographic structure of Pacific and world trade flows between 1965 and 1987. Over this period, the Pacific share in world trade grew from around 30 per cent to almost 37 per cent. Intra-regional trade grew from less than 50 per cent

to around 63 per cent of Pacific countries' trade. The latter proportion approached that of Europe's intra-regional trade: in 1987, intra-regional trade amounted to 71 per cent of Western Europe's total trade. Pacific countries' trade with each other is almost twice as large as their share in world trade. For Australasia, Northeast Asia other than Japan, ASEAN and China, the share of other Pacific countries in export and import trade is commonly higher, around 70 per cent of their total trade.

#### **Barriers to Pacific Trade**

The trade expansion that has supported East Asian growth and structural change represents an historic achievement of the international system. Nevertheless, old and new barriers have prevented realisation of substantial additional gains from trade amongst Pacific countries.

Rapid economic growth has generated rapid change in comparative advantage, both in the East Asian economies and in their trading partners. The general record of structural adjustment in response to changing comparative advantage has been a good one - as attested by the expansion and change in commodity composition of trade. But there are important examples of governments in East Asia and elsewhere in the Pacific intervening to block the structural implications of growth.

The major instances of high protection dissipating potential gains from intra-Pacific trade occur in large industries which

were rapidly losing comparative advantage as a result of economic change in Northeast Asia. Principal examples in industries producing goods include foodstuffs in Japan, Korea and Taiwan, and labour-intensive commodities (textiles, clothing and footwear, and consumer electronics) and standard technology manufacturing industries (metals, motor vehicles) in North America and Australasia.

The outstanding example of barriers to intra-Pacific trade is provided by Northeast Asian agricultural protection (Table 3). In the period covered by the table, Australia had negative protection for all agriculture. The United States had no protection on average for agriculture but high protection for sugar in the first half of the 1980s. The introduction of the export enhancement program and other agricultural assistance in recent years would have modified this picture, while leaving average United States assistance to agriculture at moderate levels in international terms. Japan, Korea and Taiwan, by contrast, provide extraordinarily high levels of assistance for all agriculture, and for the commodities that are of greatest importance in Pacific trade. The major liberalisation of Japanese beef imports announced in 1988 will significantly moderate protection levels for this commodity.

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Amongst Pacific countries not represented in the Table 3, New Zealand, following major liberalisation initiatives since 1984, provides virtually no assistance to agriculture. Canada

Table 3

**SELECTED PACIFIC COUNTRIES' AGRICULTURAL PROTECTION, 1980**  
(per cent)

	Australia	United States	Japan	Korea	Taiwan
Rice	-12	3	192	156	135
Wheat	-6	-18	261	33	81
Barley	-14	-5	307	90	73
Sugar	-1	45	141	-	-3
Beef	-1	5	100	67	76
Agriculture	-2	0	85	117	52

Notes: These figures are rates of agricultural protection, defined as the percentage by which the producer price exceeds the border price. The estimates shown are the weighted averages for twelve commodities, using production valued at border prices as weights.

Source: Kym Anderson and Yujiro Hayami eds, The Political Economic of Agricultural Protection Sydney: Allen & Unwin, 1986. Table 2.5; 2.6.

generally provides low protection to agriculture, although dairy products, and to a lesser extent sugar, are exceptions.<sup>6</sup> China and the ASEAN countries have highly distorted agriculture, but at current international prices probably low net assistance. In the case of China - important amongst other reasons for being the world's largest producer and consumer of grains and a range of other foodstuffs and agricultural raw materials - there may be little or no net assistance to the foodstuffs that are <sup>most</sup> ~~not~~ important in current consumption, but high protection for meat and other high quality foodstuffs which are increasingly important in consumption as incomes rise.

By comparison, the European countries assistance for agriculture is very high, but well below the levels in Japan, Korea and Taiwan.<sup>7</sup>

The general pattern of protection in manufacturing is more complex, and less easily summarised. Average tariff levels are now low in the United States, Canada and Japan, although by no means negligible in all commodities.<sup>8</sup> Low nominal rates of tariffs nevertheless provide substantial effective protection for some metals and metals products where little value is added in the manufacturing process.

Average rates of nominal <sup>tariff</sup> protection on all industrial products are much higher in Korea (23.5 per cent) and Taiwan (13.8 per cent).<sup>9</sup> Highly protected categories in Korea include machinery and transport equipment (21.4 per cent), chemicals (21.4 per

cent) and miscellaneous manufactures (28.2 per cent) In Taiwan, highly protected categories include textiles (16 per cent), machinery and transport equipment (14.5 per cent) and chemicals (14.2 per cent).

Australia and New Zealand for some years have had the highest average tariff levels on manufactured goods of all OECD countries.<sup>10</sup> Recent policy initiatives have reduced rates substantially, but averages remain high by OECD standards, although lower than for Korea and Taiwan. After the implementation of recently announced liberalisation measures, tariffs in Australia will remain very high only for passenger motor vehicles (35 per cent) and textiles, footwear and clothing (up to 35, 45 and 55 per cent respectively).<sup>11</sup> New Zealand tariffs remain especially high for a similar range of goods.

The proliferation of non-tariff protection devices during and since the mid-1970s recession have caused tariffs to be a most unreliable guide to manufacturing protection levels. Over this period we have seen the United States introduce major non-tariff protective devices in textiles, apparel, footwear, steel, automobiles and motorcycles, and consumer electronic goods (television and radios).<sup>12</sup> Recent policy initiatives have left Australia and New Zealand relatively clear of non-tariff barriers for manufactured goods. In Australia, quantitative restrictions in the form of tariff quotas (the main non-tariff barriers) now apply only to textiles, clothing and footwear. These



restrictions are being phased out in an announced series of steps ending in 1994.

Contrary to international perceptions, Japan has the cleanest import system for manufactured goods amongst OECD countries; official non-tariff barriers have almost no effect on trade.<sup>13</sup> The relatively low proportion of manufactured goods in Japanese imports, and low import penetration ratios in manufactured commodities in which other developed countries are major importers, have led protectionist interests in North America, Europe and Australasia, and sometimes officials and independent commentators in those same countries, to postulate a major role for non-official barriers, perhaps with official sanction. It is true that the Japanese distribution systems contain powerful conservative bias, delaying the emergence of large scale imports well beyond the time when imports appear to have become competitive. Such biases are not unique to Japan.<sup>14</sup> Moreover, the evidence since the appreciation of the yen in 1985 suggests that, despite long lags the normal competitive pressures operate for Japan. Japan's imports of manufactured goods from Asian developing countries have been increasing at around 50 per cent per annum since 1985. The share of manufactures in Japanese total imports has also been increasing rapidly over this period, although not so strongly from the United States (see Table 4).<sup>15</sup>

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Non-tariff barriers are high for manufactured goods in Korea and Taiwan, although liberalising steps are being taken in both economies.

Table 4

**JAPAN: SHARE OF MANUFACTURED GOODS IN TOTAL IMPORTS, 1979-1988**  
(per cent)

	Share in all imports	Share in imports from United States	Share in imports from Australia
1979	26.0	42.3	8.8
1980	22.8	44.1	9.2
1981	24.3	45.3	10.0
1982	24.9	47.4	8.6
1983	26.6	52.4	10.5
1984	29.8	52.0	11.7
1985	31.0	55.2	12.9
1986	41.8	60.7	18.0
1987	44.1	56.1	22.5
1988 January	45.0	56.4	29.0
February	48.8	61.9	26.1
March	47.7	56.0	23.9
April	49.9	55.1	33.0
May	48.6	54.1	26.6
June	48.2	56.9	23.0
August	49.2	51.6	26.0

Note: Manufactured goods comprise the categories of 'Chemicals', 'Machinery & Equipment' and 'Others'. Petroleum Products are not included.

Source: Japan Tariff Association, The Summary Report on Trade of Japan, (various issues).

Manufacturing ~~for~~ production in China and other ASEAN countries is highly distorted by protection in the forms of high tariffs, quantitative restrictions and local content schemes. In China and the Philippines this is exacerbated by exchange controls, and in China by a large proportion of production still being allocated at arbitrary prices through state corporations.

Recent attempts to measure protection in the other ASEAN countries have generated figures like 109 per cent effective protection for import-competing manufacturing in Indonesia,<sup>16</sup> 36 per cent effective protection for all manufacturing in the Philippines,<sup>17</sup> and 50 per cent (Corden method) or 71 per cent (Balassa) effective protection on importable manufacturing in Thailand.<sup>18</sup> Malaysian average effective protection is probably close to the lowest in other ASEAN for manufacturing as a whole, but the most recent estimates suggest very high levels for such large categories as non-durable consumer goods (85 per cent), consumer durables (173 per cent) and machinery (39 per cent).<sup>19</sup>

Each of the other ASEAN countries has attempted major liberalisation efforts over the past decade. There has been some modest progress, particularly in Indonesia and Thailand, and some retrogression. The general picture of variable and extremely high protection remains.

China and other ASEAN would benefit greatly by participation in international trade negotiations that provided incentives on the export side to liberalisation and rationalisation of their import

regimes. Indeed, the extension of East Asian high growth on a sustained basis to these important countries would seem to require such initiatives, which would also help to sustain growth elsewhere in the region.

At a time when macro-economic frustrations in the United States have been generating aggressive reactions against all of the successful economies in East Asia, it should not be neglected that two economies in the region, Singapore and Hong Kong, have by far the cleanest import systems in the world, with barely a hint of restriction against trade in goods, and relatively few barriers to trade in services.

For the other higher-income Pacific countries, protective barriers are highest in foodstuffs, textiles, clothing and footwear, and motor vehicles. They are significantly distorting in the production of domestic electrical equipment, iron and steel and (because of tariff escalation) non-ferrous metals.

Table 5 sets out in some detail participation in world trade in commodities in which some Pacific countries have high protection. A striking feature of the table is the tendency for Pacific countries' exports to be heavily concentrated in commodities against which other Pacific countries impose high barriers to trade.

Table 5

**PACIFIC COMMODITY EXPORTS AND IMPORTS, 1986**  
(US\$ million, percentage of country/  
region's total exports/imports)

		Textiles, Clothing & Footwear		Domestic Electrical Equipment		Road Motor Vehicles		Iron & Steel		Non-Ferrous Metals	
United States	X	3,605	1.8	510	0.3	18,514	9.1	1,081	0.5	1,841	0.9
	M	31,386	8.2	2,573	0.7	69,421	18.2	9,556	2.5	7,976	2.1
Canada	X	733	0.9	99	0.1	23,916	28.3	1,749	2.1	3,232	3.8
	M	3,795	4.8	614	0.8	21,696	27.3	1,386	1.7	812	1.0
Australia & NZ	X	351	1.3	50	0.2	184	0.7	439	1.6	1,615	6.0
	M	2,147	7.0	278	0.9	2,562	8.4	666	2.2	213	0.7
Japan	X	6,242	3.0	1,799	0.9	52,993	25.4	12,706	6.1	1,567	0.8
	M	5,520	4.6	104	0.1	1,398	1.2	1,762	1.5	3,655	3.1
Korea	X	10,740	31.0	583	1.7	1,514	4.4	1,971	5.7	143	0.4
	M	947	3.0	119	0.4	378	1.2	1,344	4.3	702	2.2
China	X	10,725	34.4	129	0.4	15	0.1	141	0.5	212	0.7
	M	2,572	7.9	145	0.4	1,402	4.3	4,411	13.5	570	1.7
Taiwan	X	10,234	25.9	601	1.5	616	1.6	566	1.4	132	0.3
	M	565	2.4	58	0.2	587	2.4	1,112	4.6	781	3.3
Hong Kong	X	8,228	41.7	624	3.2	2	0.0	16	0.1	37	0.2
	M	8,201	23.2	280	0.8	482	1.4	880	2.5	528	1.5
ASEAN	X	4,388	6.6	242	0.4	191	0.3	479	0.7	1,264	1.9
	M	2,644	4.2	220	0.4	1,606	2.6	2,611	4.2	858	1.4
World	X	142,815	7.2	11,751	0.6	194,610	9.8	68,696	3.5	38,916	2.0
	M	147,744	7.2	12,022	0.6	192,318	9.3	71,261	3.5	40,817	2.0
Pacific <sup>c</sup>	X	55,254	7.7	4,636	0.7	97,947	13.7	19,285	2.7	10,048	1.4
(US\$ million)	M	57,856	7.3	4,403	0.6	99,706	12.5	23,764	3.0	16,102	2.0
Pacific Share	X	38.7		39.4		50.3		28.1		25.8	
in World (%)	M	39.2		36.6		51.8		33.3		39.4	
Pacific Share	X	52.4		56.9		67.1		38.5		33.7	
in World Less	M	52.1		53.0		68.5		45.4		51.2	
Intra-EEC Trade											
(%)											

**Notes:** a Unmilled barley, maize, rye, oats and other cereals (excluding wheat and rice).

b Raw beet and cane sugar, refined sugar, etc., and molasses.

c Pacific comprises the countries specified above and the Pacific island states.

- denotes a nil value or share.

0 denotes a value less than \$500 thousand.

0.0 denotes a share less than 0.05 per cent.

**Sources:** United Nations trade data, International Economic Data Bank, Research School of Pacific Studies, Australian National University.

Unmilled Wheat		Unmilled Feedgrains <sup>a</sup>		Rice		Sugar <sup>b</sup>		Beef		Total Commodities
3,006	1.5	3,265	1.6	621	0.3	-	-	606	0.3	204,654
27	0.0	102	0.0	38	0.0	821	0.2	1,258	0.3	381,362
2,041	2.4	503	0.6	-	-	35	0.0	143	0.2	84,381
0	0.0	79	0.1	42	0.1	195	0.2	187	0.2	79,631
1,915	7.2	427	1.6	58	0.2	454	1.7	1,446	5.4	26,749
4	0.0	7	0.0	10	0.0	24	0.1	4	0.0	30,471
-	-	0	0.0	0	0.0	1	0.0	2	0.0	209,081
886	0.7	2,358	2.0	4	0.0	338	0.3	553	0.5	119,424
-	-	0	0.0	0	0.0	54	0.2	0	0.0	34,702
425	1.4	397	1.3	0	0.0	183	0.6	0	0.0	31,518
2	0.0	393	1.3	104	0.3	37	0.1	34	0.1	31,158
607	1.9	88	0.3	43	0.1	40	0.1	91	0.0	32,720
-	-	0	0.0	20	0.1	30	0.1	-	-	39,486
125	0.5	466	1.9	1	0.0	32	0.1	81	0.3	24,023
-	-	-	-	-	-	1	0.0	-	-	19,734
21	0.1	24	0.1	112	0.3	37	0.1	67	0.2	35,366
1	0.0	384	0.6	802	1.2	484	0.7	3	0.0	66,531
545	0.9	150	0.2	119	0.2	183	0.3	67	0.1	62,399
11,328	0.6	10,147	0.5	2,743	0.1	4,040	0.2	8,182	0.4	1,984,670
12,112	0.6	10,947	0.5	2,758	0.1	4,916	0.2	8,338	0.4	2,062,575
6,964	1.0	4,973	0.7	1,606	0.2	1,221	0.2	2,236	0.3	715,949
2,658	0.3	3,674	0.5	365	0.1	1,860	0.2	2,243	0.3	798,199
61.5		49.0		58.5		25.2		27.3		36.1
21.9		33.6		13.2		37.8		26.9		38.7
78.7		67.4		69.4		28.4		51.4		46.7
27.7		44.9		15.2		41.6		49.2		49.3

Textiles, clothing and footwear accounted for a third of the total exports of Korea, mainland China and Hong Kong in 1986, a quarter of the exports of Taiwan, and a high proportion of ASEAN manufactured exports. Significantly, excluding intra-EEC trade from the total, Pacific countries account for more than one half of total world exports in these commodities. Despite high protection (matched by similarly high barriers elsewhere), Pacific countries account for a similar proportion of world imports.

A similar pattern emerges for trade in other commodities in which Pacific trade barriers are high. Excluding intra-EEC trade, Pacific countries account for two thirds of world motor vehicle exports. Amongst agricultural commodities, Pacific countries dominate world markets for wheat, feedgrains and rice, and supply half of the world's exports of beef. The proportion is lower for sugar in which tropical developing countries outside the Pacific are the important suppliers.

This pattern has not emerged by accident. In the process of rapid economic growth in East Asia and changing comparative advantage throughout the region, all Pacific countries have moved to protect those industries in which they have most profoundly lost comparative advantage as a result of East Asian growth.

From these data we can draw the strong conclusion that, should Pacific countries reduce assistance to their most highly protected industries on a non-discriminatory basis, the

associated expansion of exports is likely to be concentrated in other Pacific countries simply on grounds of competitiveness.

There is certainly considerable scope for further expansion of trade by Pacific countries through measures that provide more confident market access and that reduce the trade barriers that limit the realisation of the potentially strong complementarity within the region. Given the low resistances to regional trade reflected in regional trade concentration, the reduction of trade barriers on a most-favoured-nation basis, in a way which does not offend Pacific countries' global trading interests, is likely to mean that most new suppliers of imports will come from within the region rather than from non-Pacific countries.

The growth of East Asian and Pacific markets has made the major contribution to world trade growth over the last two decades, and especially over the past decade. Table 6 reveals that net of intra-European trade, around 50 per cent of world trade growth in this period has been in the Pacific market.

Table 7 shows that Pacific markets have absorbed two thirds of the strong growth in East Asia's exports over the past two decades. East Asian import growth itself has absorbed one third of the total. The United States' role as a market was especially important in the decade from the mid-1970s recession, but has slowed since the macroeconomic adjustments of 1985. Europe's role as a market, though much smaller, was nevertheless too significant for East Asian countries to ignore as a focus of



Table 6  
CONTRIBUTIONS TO THE GROWTH IN WORLD TRADE,  
EXCLUDING INTRA-EEC TRADE  
(per cent)

Country		Share in World Trade			Contribution to World Trade Growth		
		1965	1975	1986	1965-75	1975-86	1965-86
Australia	X	2.1	1.7	1.4	1.6	1.1	1.3
	M	2.3	1.4	1.5	1.2	1.6	1.4
Japan	X	6.0	8.3	13.6	9.0	17.7	14.4
	M	5.6	8.4	7.4	9.2	6.6	7.6
China	X	1.2	0.9	2.0	0.9	2.9	2.1
	M	0.9	0.9	2.0	0.8	2.9	2.1
Other Northeast Asia <sup>a</sup>	X	1.1	2.2	6.1	2.6	9.1	6.6
	M	1.8	2.9	5.6	3.2	7.6	6.0
ASEAN	X	3.1	3.3	4.3	3.3	5.2	4.5
	M	3.2	3.4	3.9	3.5	4.2	3.9
<u>East Asia, Total</u>	X	<u>11.3</u>	<u>14.8</u>	<u>26.1</u>	<u>15.7</u>	<u>34.8</u>	<u>27.6</u>
	M	<u>11.5</u>	<u>15.6</u>	<u>18.9</u>	<u>16.7</u>	<u>21.3</u>	<u>19.6</u>
North America <sup>b</sup>	X	24.9	20.7	18.8	19.6	17.4	18.2
	M	19.9	19.0	28.5	18.7	35.6	29.4
New Zealand and Other Pacific	X	0.8	0.5	0.5	0.4	0.5	0.4
	M	1.0	0.7	0.5	0.6	0.4	0.5
<u>Pacific Total<sup>c</sup></u>	X	<u>39.1</u>	<u>37.6</u>	<u>46.7</u>	<u>37.2</u>	<u>53.6</u>	<u>47.4</u>
	M	<u>34.6</u>	<u>36.7</u>	<u>49.3</u>	<u>37.2</u>	<u>58.8</u>	<u>50.8</u>
EEC	X	23.5	21.9	22.0	21.4	22.2	21.9
	M	27.7	23.2	20.5	22.0	18.5	19.8
Middle East	X	5.2	11.4	4.9	13.1	-0.2	4.8
	M	3.4	6.0	4.7	6.8	3.8	4.9
<u>Rest of World</u>	X	<u>32.2</u>	<u>29.1</u>	<u>26.4</u>	<u>28.3</u>	<u>24.3</u>	<u>25.8</u>
	M	<u>34.3</u>	<u>34.1</u>	<u>25.4</u>	<u>34.0</u>	<u>19.0</u>	<u>24.5</u>

Notes: X - exports.

M - imports.

a Korea, Taiwan and Hong Kong.

b United States and Canada.

c Australia, New Zealand, Japan, Other Northeast Asia, ASEAN, China, North America and the Pacific Islands.

Source: International Economic Data Bank, Research School of Pacific Studies, Australian

Table 7

**THE CONTRIBUTION OF MAJOR MARKETS TO EAST ASIA'S<sup>a</sup>  
EXPORT GROWTH IN REAL TERMS<sup>b</sup> 1965-88**

	Share (per cent)					Contribution <sup>c</sup> (per cent)				
	1965	1975	1985	1987	1988 <sup>d</sup>	65-75	75-85	85-88	65-87	65-88
Japan	6.4	10.7	9.2	8.0	11.0	12.9	8.1	14.7	8.2	11.5
East Asia	23.9	32.5	33.6	32.1	33.7	36.8	34.4	33.8	33.1	34.7
North America	30.9	23.0	33.8	34.2	29.2	19.1	41.7	19.7	34.6	29.0
Pacific <sup>e</sup>	59.4	59.2	70.5	68.8	65.1	59.1	78.7	54.2	69.9	65.7
EEC 12	15.2	13.9	11.7	15.8	16.7	13.3	10.1	27.0	13.9	16.9
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

**Notes:** a Japan, Korea, China, Hong Kong and ASEAN. Taiwan is not included.

b The unit value index for exports from all Asian developing countries except Taiwan and China was used as a deflator. The 1987 and 1988 data were deflated by data available for the first three quarters of 1987.

c The increase in East Asian exports to each region as a proportion of the total increase in East Asian exports.

d The 1988 data are estimates of annual exports based on performance in the first quarter of 1988.

e East Asia, North America and Oceania.

**Sources:** IMF, Direction of Trade Statistics, Washington DC, (various issues):

UN, Monthly Bulletin of Statistics, New York, 1988.

trade policy interest. It is noteworthy too, that Japan absorbed a significantly higher proportion of other East Asian economies' exports in the recent period of lower United States imports.

The mutual trading interests among Pacific countries, together with the strong commitment to trade-oriented development strategies among the developing countries within the region, provide a likely springboard for trade and other foreign economic policy measures not only to accommodate the trade and development needs of all the countries with the region but also to strengthen the global system of commitments to an open international trade regime.

#### Origins of the Pacific Free Trade Area Proposal

The growth of the East Asian economy and of Pacific economic interdependence, the shift of world economic power away from Europe and the Atlantic towards East Asia and the Pacific, and the changed status of Japan and the United States in world affairs have all encouraged suggestions for a new focus in dealings among Pacific economies.<sup>20</sup> Prominent in this discussion has been the notion of a developing community of interests in the Pacific and the recognition of advantages in closer Pacific economic cooperation; but the debate about what forms of institution-building might best serve the interests of Pacific countries in managing and further developing their already substantial economic interrelationship has, until recently, eschewed the idea of integration European style. It is

illuminating to recall the context in which the Pacific free trade area (PAFTA) idea first emerged, and of its revival as a focus in trade diplomacy.

While the growth of East Asian and Pacific economic interdependence did not originate in the establishment of formal regional institutional arrangements, two important elements in the nexus of political and commercial history in which it took place can be identified easily. The first is the role played by the GATT in postwar recovery and growth; the second is the dominance of the United States through this formative period.

First, postwar trade and economic growth flourished within the framework of the GATT-based international trading system under the leadership of the United States. The GATT-based trade regime grew out of the Atlantic Charter and the Mutual Aid Agreements of the wartime period<sup>21</sup> and served well the cause of reconstruction and liberalisation of trade and economic activity for the first few decades or so after the Second World War. It provided the essentials of a global trade regime, far from comprehensive in its coverage of commodities or commercial interests (as some hoped the aborted plan for an International Trade Organisation might have been), yet hugely supportive of trade expansion and world economic recovery and growth generally.<sup>22</sup> This was critical to countries in East Asia and the Western Pacific which were not immediate or direct beneficiaries under the initial rules and terms of GATT. But it also directed and limited trade and economic growth in some areas.

Second, the United States dominated the Pacific economy during that period. American leadership, regional as well as global, was comprehensive and hegemonic, combining military-strategic, political and economic interests. In this period the Pacific alliance against the Soviet-bloc in the Cold War era was conceived and executed.

The GATT framework (and importantly Japan's eventual accommodation within it under the aegis of the United States) and the framework of the Pacific security alliances provided the underpinnings for the confident development of trading links within the East Asian and Pacific economy.

The idea of a community of Pacific countries associated in some form of regional arrangement began to emerge in the middle of the 1960s, principally in business and academic circles, and later, tentatively, in official quarters.<sup>23</sup> The motive for the interest in this idea was the preservation of the opportunities for internationally oriented economic development which had generated such spectacular results, against corrosive pressures generated by that growth itself, and against emergence of economic introversion in Europe associated with the entrenchment and expansion of the EEC.

At that time, as still now, the United States-Japan relationship was the most important single relationship within the Pacific region. But Australia and Japan were already developing a quite significant bilateral economic relationship, which had grown out

of commercial initiatives in the mid-1950s. In their subsequent reactions to the changing international economic environment, both countries moved towards closer involvement with each other. There is no better illustration of this than their response to the emergence of the EEC and the problems of global market access in the middle of the 1960s.<sup>24</sup>

Australia's response to the damaging effects of the European Common Agricultural Policy on the prospects for Australian economic growth based on the expansion of its traditional markets for agricultural exports was to intensify the development of new markets in Japan, the Pacific and East Asia.<sup>25</sup> Japan's response to the emergence of a discriminatory bloc in Western Europe and increasing dependence on raw materials supplies from the region was to encourage closer economic relations with its main Pacific trading partners, and to pursue a line of commercial diplomacy designed to counter the effects of intensified European protectionism by developing an alignment of interests within the Pacific economy.<sup>26</sup>

The first detailed proposal for a Pacific regional economic association took the form of a free trade area scheme and emerged in Japan.<sup>27</sup> The rationale advanced for institutional integration, involving discriminatory treatment in international trade, was based upon analysis of the effects of the formation of the European Economic Community upon the Pacific five advanced industrial countries and upon the relations between them and the developing countries of Asia and the Pacific (the 'extended

Pacific area').<sup>28</sup> The starting point in this argument was that 'each time a shock was felt from outside the five Pacific countries, the necessity for closer Pacific integration was felt more seriously'.<sup>29</sup>

The proposal for a Pacific free trade area, consisting of the Pacific five as full members and incorporating East Asian developing countries as associate members enjoying non-reciprocated tariff concessions, was primarily a reaction to the establishment of the European Economic Community.<sup>30</sup> The EEC was destined, it was felt, not only to have a huge impact on international trade and investment flows, but also of world economic power. The completion of the EEC's internal tariff elimination in 1968 added to fears of an increasingly inward looking and self-sufficient European bloc damaging to Pacific interests in global market access.<sup>31</sup> The logic of Pacific economic integration was urged, both in response to the threat of institutional integration in Europe and as a vehicle for realising the potential of the East Asian and Pacific region. The completion of the Kennedy Round of negotiations in 1967 gave tactical point to the PAFTA proposal.<sup>32</sup>

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The most important factor working against the earlier Pacific free trade area proposal was the global interest in United States commercial diplomacy. The United States could not easily or sensibly participate in discriminatory regional trading arrangements through a grouping of either European or Pacific countries; this course would have been quite incompatible with

its stature in world trade at that time, and contrary to the main thrust of its approach to international trade policy.<sup>33</sup> Moreover, the Pacific five included countries of disparate size and lacked the degree of integration required to make the dismantling of protective measures within the group politically or economically feasible.<sup>34</sup>

Nonetheless, the foreign economic policy interest which underlay the Pacific free trade area proposal, while perhaps over-ambitious and of limited immediate policy relevance, contained the seeds of a useful approach to important problems which were emerging in the growing economic and other relations among the diverse economies and societies of the East Asian and Pacific region.<sup>35</sup> The huge growth of trade, investment and aid relationships among the countries of East Asia and the Pacific was spawning not only opportunities but quite predictable policy problems that would be managed less and less well within established bilateral arrangements or by individual countries unilaterally. In this context the first exposure of a Pacific free trade area proposal provided a useful impetus to the evaluation of other ideas directed towards the objectives of closer Pacific economic cooperation.

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In the following two decades, Pacific economic cooperation interests came to focus heavily on building institutions that were functionally related to the economic interests of individual Pacific countries and to the region as a whole, and on the evolution of support for an open global economic regime within



which East Asian and Pacific countries could continue their economic expansion. In 1980, a meeting in Canberra saw the establishment of the Pacific Economic Cooperation Conference (PECC).<sup>36</sup> The PECC meetings, with the involvement of government officials, industry leaders, and people from the research community, have led to productive exchanges on trade policy issues. They were part of the intellectual background to an early call for a new round of multilateral trade negotiations in December 1983, and for consultations among the officials of several Western Pacific countries, in preparation for what became the Uruguay Round of trade negotiations.

Such mechanisms are evolving because an infrastructure of regional consultation and cooperation is necessary to make the development of Pacific positions practicable; because of the region's growing industrial might and economic interdependence; because reduction of policy uncertainties offers large potential gain through a stronger framework for regional economic relations; and because they assist the communication of the diverse policy objectives of very different countries and of smaller and weaker economic partners in the Pacific. Growing knowledge among Pacific countries of each other's institutions and policy practices strengthens the level of mutual confidence in national economic policies and reduces psychological and political barriers to the movement of commodities, capital and the relocation of production, all of which can serve to enhance international welfare.

### Free Trade Areas Resuscitated

In the contemporary international economic policy environment, serious challenges to East Asian development ambitions have again emerged in the area of trade policy. A characteristic of industrial transformation in East Asian countries is that their trade growth has required the taking over of market shares from established exporters, first in labour-intensive manufactured goods, as Japan did from Britain and Europe in both the prewar and postwar periods, and as the other newly industrialising countries of East Asia have done from Japan and in recent decades from one another.<sup>37</sup> It follows that arrangements which limit or discriminate against this type of trade growth and transformation would, by ossifying established trade shares, frustrate East Asian development ambitions, adversely affect Pacific trade interests and, thereby, limit the growth potential of the world economy.

The thrust of the GATT trade regime and other international institutions established after the Second World War was towards the establishment of an open trade regime which embodied, importantly, the principles of 'non-discrimination', 'predictability', 'transparency' and 'openness'.<sup>38</sup> These principles steadily gained expression in successive GATT reviews and rounds of trade liberalisation, in the unconditional most-favourable-nation rule, in the adoption of tariffs as the principal and 'acceptable' form of trade protection, and in the 'binding' of tariff rates to negotiated levels.<sup>39</sup> In applying

these principles and rules the architects of the GATT sought to avoid the experience of trade restrictions, bilateralism and uncertainty of the interwar years and develop a confident global framework within which the benefits of trade liberalisation would flow to all from the action of a relatively small number of major trading nations.<sup>40</sup>

A trading system incorporating these principles and rules was of particular importance to smaller countries seeking economic growth through trade expansion. One of the great achievements of the United States and multilateral commercial diplomacy in the postwar period was undoubtedly the accommodation of Japan within the GATT most-favoured-nation trading framework, despite the initial application of Article XXXV permitting discrimination against Japan by many trading nations until the 1960s. Without appeal to GATT principles and the GATT framework, Japan would hardly have been able to achieve so smoothly the economic growth and trade expansion that it did achieve in the first few decades after the war. An open international market where trade discrimination is constrained by general adherence to the most-favoured-nation rule allows the accommodation of new and competitive suppliers, for whom trade is a central factor to economic growth and industrialisation. And so, in the postwar period, the GATT regime has facilitated a major transformation in the geographic structure of world trade and the emergence of East Asia's economy. The main 'internal' influence on the trade policy interests of East Asian and Western Pacific countries continues to lie in the economic relationships of these countries

with the United States. The United States is a major market for manufactured goods exports from the region. The Northeast Asian countries in particular are likely to see more value in trade liberalisation movements if they include the United States. For its part, the United States has shown an increasing interest in the Western Pacific as the region has grown in importance, and the share of United States trade with the region has increased. Thus far, as is evident even in respect of Japan, the United States has tended to approach trade relations with particular East Asian countries in a case-by-case bilateral manner, the results of which have not always been consistent with most-favoured-nation principles.

In the lead-up to launching the new GATT round, the United States shifted towards a trade diplomacy based on the conditional most-favoured-nation approach, seeking 'free trade area solutions' to its trade policy problems.<sup>41</sup> The agreement with Israel and the negotiation of a free trade arrangement with Canada were important targets in this policy approach (as well as the much-heralded Caribbean free trade arrangement). There seems to be strong interest within the United States for entering closer economic arrangements with Mexico, thus moving towards a North American Free Trade Area. There are also suggestions at this time for some sort of 'free trade area' associations between the United States and Western Pacific countries (ASEAN, Australia and others). On the face of it, it seems that these United States suggestions are not aimed at the ultimate establishment of a Pacific free trade area but rather at setting up a bilateral

dealing mechanism between the United States and some Western Pacific countries on a different footing from, and separate from, United States bilateral dealings with Japan. Whichever is the case, Western Pacific countries have been given reasons to consider a 'free trade area' association in the Pacific.

### Problems in the United States-Japan Relationship

For Pacific countries, the most important game-play in international trade diplomacy still revolves around the management of the economic relationship between the United States and Japan.<sup>42</sup> This is the most important relationship within the Pacific economy, and among the most important in the world. The way in which trade and commercial policies had come to be practised in the Pacific by the mid-1980s focussed sharply upon the serious imbalances between the United States and Japan and they were one motivation in the evolution of a new free trade area approach to Pacific trade diplomacy.

Heightened tension in the management of the United States-Japan relationship in the first half of the 1980s resulted mainly from serious miscalculations in the macroeconomic policies of both countries and the lack of effective macroeconomic policy coordination. This was a recurrent problem from the late 1960s, but extreme imbalances, focussed on rising United States current account deficits and Japanese surpluses, emerged very rapidly between 1981 and 1985. The main adjustments for both Japan and the United States had to be on the macroeconomic front, and those

adjustments were set in train, rather belatedly, after the Plaza Agreement of September 1985 forced the pace through the exchange-rate shift.<sup>43</sup>

These developments in the United States-Japan relationship were of some consequence for the shape of Pacific trade diplomacy. Both countries were diverted into attempts to resolve their global trade imbalances by action directed at each other (both negative and positive action: specific restrictions or surcharges; and bilateral market access managements). In the conduct of the United States-Japan relationship, specific trade issues came to dominate the policy approach. A related development, and danger for Western Pacific and other countries, was that Japan-targeting by the United States and the American obsession in Japan led both parties to negotiate bilateral deals which were damaging to third parties and confidence in the whole trading system.

The cry of 'specific reciprocity' as the guiding principle for trade and commercial policy became stronger and stronger in the United States over this period. 'Specific reciprocity' (the careful equilibration of benefits in country-by-country and sector-by-sector settlements in which market-sharing arrangements are the goal and tit for tat is a legitimate strategy) is contrasted with the 'uncertain benefits' of 'diffuse reciprocity' (such as is embedded in the GATT system, under which multilateral negotiations and agreements foster a set of rules and norms in which reciprocity seeks an overall balancing of concessions).<sup>44</sup>

'Strategic trade policy'<sup>45</sup> and 'fair trade' are the intellectual and political slogans heralding this new American policy environment. In the 1980s, the Reagan Administration clung to the rhetoric of 'diffuse reciprocity'; the political processes increasingly demanded the practice of 'specific reciprocity'. The political processes and eventually the intellectual argument targeted on Japan in justifying the retreat from support for a global regime based upon multilateral agreements and 'diffuse reciprocity'.<sup>46</sup>

In the negotiations preparatory to the extension of an international systemic public good, such as are involved in changes to the trade regime through a new GATT round, interplay between the interests of 'specific reciprocity' (among the major groups of trading nations) and 'diffuse reciprocity' (the application of generalised rules and norms of behaviour) is a natural if not essential ingredient.<sup>47</sup> The first step in the process addresses the 'free rider' problem among the principal players, encouraging all of them to join in the exchange of concessions; the second delivers 'stable, beneficial arguments in complex multilateral situations'<sup>48</sup> involving domestic politics and international relations as well as economic interests.

Certainly Japan's role in trade liberalisation and the ~~negotiation of international settlements on other commercial~~ policy, exchange rate and macroeconomic policy issues is a central element in Pacific economic policy, but it will only be supportive of broader Pacific policy objectives if it finally

eschews 'specific reciprocity' in dealings with the United States and does not neglect third country interests. The idea, with which Ambassador Mansfield has been associated, of a United States-Japan free trade area, is not therefore a sensible ultimate goal. The question in this context is whether third country interests are sufficiently encompassed within the Pacific to make attractive the idea of a broader Pacific free trade association. The short answer to that question must be that Japan's interests (as well as those of the newly industrialising countries of East Asia) now extend well beyond any group of Pacific countries which could readily or easily join a Pacific free trade area. The importance of the European relationship, the delicate development of interdependence with China, the emergence of the Soviet bloc and the opportunity for the emergence of Vietnam and the DPRK from their past isolation are only some of the factors which extend East Asia's 'third country' interests and commitments to the multilateral trade and economic system.

#### **Response to Free Trade Area Proposals**

One possible response to United States expressions of interest in special trade relations with various Western Pacific countries is to call for negotiations to establish a Pacific Free Trade Area, covering the United States, Canada, and some combination of economies from the Western Pacific.



Would such a response be helpful to the key strategic objectives we identified earlier: the shoring up of the system of imperfectly open trade in the Pacific that has facilitated rapid growth encompassing successively most of East Asia; the reduction of barriers to intra-Pacific trade; and the reduction of European barriers to Pacific trade?

A free trade area is more likely to bring net benefits the larger the economic size of the union envisaged. We have observed that the Pacific, as we have defined it, accounts for just under one-half of world production of goods and services, and is likely to account for a higher proportion in future.

The Pacific countries are more important to each other's trade and potential trade than these output figures alone would suggest. The exceptionally high complementarity discussed earlier in the paper, and the economic advantages of intense Western Pacific trade that derive from location, each point to an increased likelihood that a Pacific Free Trade Area would generate net benefits for its members and, though less powerfully, for the world as a whole.

We have observed that barriers to trade in Pacific countries are highest in precisely those commodities within which the comparative advantage of other Pacific countries is strongest: protection in Japan, Taiwan and South Korea against agricultural exports from Australasia and North America; protection in Australasia and North America against labour-intensive exports

from China, the Asian NIEs and other ASEAN countries, and against exports of a range of more capital-intensive standard technology products, especially motor vehicles, from Japan and the Asian NIEs. This increases the likelihood of net gains from a Pacific Free Trade Area that is not subject to important exemptions.

The last qualification is important. The reality of free trade areas and customs unions in practice is that exceptions have been important at least in their early years; and where they have not, the establishment of the area has been associated with increased barriers to trade with the rest of the world. This outcome is driven by an important asymmetry in the political economy of protection policy, between the highly focussed opposition to trade creation by established interests in protected industries, together with the highly focussed support of established interests in trade diversion, on the one hand, and the diffuse beneficiaries from trade creation on the other.<sup>49</sup> Hence the tendencies towards higher protection against the rest of the world that can be observed early in the lives of the United States, Canadian, Australian and European customs unions, and the proliferation of exceptions early in the lives of the Australia-New Zealand and United States-Canada Free Trade Areas.

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One would be blind to the realities of the political economy of protection to ignore the likelihood that, in a Pacific Free Trade Area, the process of negotiation and compromise would favour trade diversion over trade creation.

Neither can we presume that all Pacific countries would seek to participate in negotiations to establish a free trade area. China, with its partially reformed prices system, is not now in a position to accept the obligations of participation in a "clean" free trade area. It would be possible in principle to negotiate a range of commitments to open trade by China that led in the direction of more open and even free trade. But the presence of special rules of thumb to govern China's trade relations with the Pacific would invite the proliferation of commitments short of free trade by other participants, especially but not only in developing countries. Yet to exclude China would carry considerable costs. It could retard China's progress towards more open trade relations, thus reducing the chances of ultimate success in the whole modernisation program. Trade diversion from China within a smaller Pacific Free Trade Area would generate tensions and retaliation that would carry costs of their own. And if China continued to grow strongly despite these new obstacles, over time a progressively smaller proportion of opportunities for profitable intra-Pacific trade would be covered by the free trade area, thus weakening the presumption of net benefits for members and the world as a whole.

Nor is it likely that the ASEAN countries would accept membership of a clean free trade area. Governments in Indonesia, the Philippines, Malaysia and even Thailand have all compromised heavily in implementing trade liberalisation programs over the past decade.<sup>50</sup> Attempts at intra-ASEAN liberalisation have yielded much more trade diversion than trade creation. Despite

the attraction of open access to North American and Australasian markets it is unlikely that the ASEAN states would agree to participate fully. To exclude ASEAN and to expose its members to trade diversion in favour of other Pacific economies would reduce the gains from Pacific integration, and set back the hesitant process of trade liberalisation in the ASEAN economies themselves. To welcome ASEAN membership on a non-reciprocal or incompletely reciprocal basis would invite pressures elsewhere for the proliferation of exceptions.

We defined our first objective as the preservation of the relatively but imperfectly open trading environment that had supported the productive extension of rapid growth in East Asia in recent decades. This objective seems to us to rule out embarkation on an integration process that runs a severe risk of setting back severely the prospects for internationally oriented growth in China and the ASEAN states.

Now let us presume for analytic purposes that it was possible to wave a magic diplomatic wand and embark on a process of negotiation that actually delivers a clean and comprehensive Pacific Free Trade Area. Would such a process help or hinder the reduction of barriers to trade between Pacific countries and trading partners in the rest of the world?

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The process of establishment of a Pacific Free Trade Area would require a huge concentration of political and administrative effort within all member countries. This would inevitably divert

attention from wider trade policy objectives in the international system.

The effort would follow perceptions of failure in the Uruguay Round of trade negotiations and disillusionment with the multilateral trading system. But the fact of disappointment with the GATT-based system would not in itself demonstrate that an imperfect system of wider international trading relations could not get worse.

It is not clear to us how a commitment to a Pacific Free Trade Area, involving substantial trade diversion away from the rest of the world in the best of scenarios, would facilitate the negotiations of lower trade barriers with the European Communities. It is possible that the threat of such developments would focus European governments more clearly on the need for success in the Uruguay Round. But action to implement this threat would have the effect of, at best, suspending progress on the negotiation of reciprocal liberalisation with Europe during a long transitional process.

Similarly, the diversion of trade policy-making resources into the development of PAFTA, and the diversion of trade from the rest of the world, would weaken the region's capacity to respond to early stirrings of interest in <sup>actively</sup> ~~internally~~-oriented development in the Soviet Union and Indochina, and the tentative signs of possible future stirrings in the DPRK that can be read into recent statements on Korea from the Soviet Union. For the

foreseeable future, the expansion of trade relations between the Pacific countries and these centrally planned economies is of minor importance in narrowly economic terms. But it would be foolish to diminish the potential for reduction in political tension and the threat of war, and eventually reduction in military expenditure, that would over time be associated with constructive Pacific responses to these centrally planned economies' interest in closer economic relations.

The United States at least would be mindful of Mexican and other Latin American interests in the process of Pacific integration. The accommodation of these interests would further increase the likelihood of special arrangements and exceptions within PAFTA.

It may seem that the liberalisation of access to trade in services appears more likely to be susceptible to treatment under the aegis of the 'free trade area' approach. The obstacles to international competition in services do not arise mainly through fiscal mechanisms as they do with tariffs on commodities. They take the form of government monopoly of service (communications); government controls on entry or capacity (aviation); prescriptions of qualifications for entry (professional services); or rules on domestic content (media). Some of the restrictions involve international agreements on rights or conditions of operation. These issues may appear easier to press through arrangements such as the Australia-New Zealand Closer Economic Trade Agreement (CER). However, while their multilateral negotiation may be difficult at this point, they are

not likely to be treated easily within the framework of a Pacific-wide free trade area (as United States-Canada experience attests). Indeed, the complexities of service trade liberalisation would seem equally amenable to negotiation within the framework of broader most-favoured-nation type trade and commerce agreements, alongside commodity trade issues.

We conclude that efforts to establish a Pacific Trade Area are not consistent with Pacific countries' interests in more effective movement towards global trade liberalisation. Discriminatory trade arrangements within the Pacific region, and discriminatory treatment of Japan by the United States and other Western Pacific countries, or of other Western Pacific countries by Japan and the United States, are inconsistent with East Asian and Pacific trade policy interests and are likely to damage the growth performance of other countries in the region. If, on the other hand, the 'free trade area' suggestion were not intended to involve trade discrimination within the Pacific, it may provide an impetus for accelerating movement toward liberalisation on a most-favoured-nation basis, both in the region and more broadly. The important requirement in such discussions would be to avoid any acceptance of the discrimination against non-Pacific countries implied by the term 'free trade area', and to work toward finding areas of reciprocal concession that can be offered on a most-favoured-nation basis. But how can we reconcile this approach with recent tendencies within United States trade policy and, more broadly, with the reduced willingness of the United

States to continue to provide liberal leadership to the multilateral trading system?

### **The Diminished Hegemon**

The diminished relative position of the United States in the Pacific and world economies is an inevitable result of the success of American international economic policy in the postwar period.

The United States has prospered exceptionally in the liberal trading system of which it was the chief sponsor. And this same system has sponsored more rapid growth in smaller and initially much poorer American allies and trading partners as they have utilised opportunities for expanding gains from trade. This is exactly what *a priori* analysis would have led us to expect if we had known that the postwar mechanisms were going to work well. Yet in the place of self-congratulation in the United States, we see recrimination and the adoption of attitudes and policies that threaten to undermine the liberal international system.

Some analysts have sought the explanation for the changed United States approach in a theory of the hegemonic leader in the supply of an international public good, the open multilateral trading system. As by far the largest country in the early postwar system, and by implication the largest beneficiary of it, the United States needed and was prepared to play a leadership role in supplying the 'public good', while letting 'free riders' in



Europe, Australasia, Japan and the developing countries escape the burden of accepting symmetric market-access obligations.<sup>51</sup> But the relative decline of the United States in world production and trade in the subsequent decades has diminished United States preparedness to carry the costs of leadership. Restoration of the health of the system requires the emergence of a new hegemon, willing and able to carry these costs. But there is none in sight.

There is a problem for an economist in this line of analysis. The required leadership, that is, the maintenance oneself of an open system, may carry some adjustment costs, but conveys overall a benefit, presuming that the hegemon does not so dominate world markets that a diminution of the extent of its trade can improve its terms of trade sufficiently to outweigh the allocative costs of reduced specialisation. In circumstances of hegemonic decline, the expectations of the leader gaining from free trade, even if its trading partners impose protection, are even larger, since variations in its own level of trade will be even less influential in determining relative prices. Symmetrically, the small country's imposition of barriers to trade, far from being a 'free ride', imposes costs that, if anything, are greatest when its relative size is least.

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Bhagwati<sup>52</sup> has sought to rationalise observed tendencies in the international system by supposing that the United States earlier was acting as the leader in a different sense by permitting 'justifiable asymmetries' of obligations on a temporary basis.

As the temporary circumstances ended, with recovery in Europe and growth in the Western Pacific, the United States demanded reciprocity of access.

Again, there are problems in this logic if a rationale is sought in the calculation of national economic interest.

There are, however, two possible ways in which the United States might rationally have been pursuing national interest. First, the introduction of distortions into trade, to the cost of itself and its partners in the international system, might be rationally calculated to force partners to drop trade distortions of their own. This is the expressed objective of the massive retaliation against European agricultural subsidies through the United States' export enhancement program.<sup>53</sup> It is incidental to this argument that the retaliatory instruments chosen by the United States imposed proportionately higher costs on innocent bystanders. The key test of rationality is whether the retaliation was well judged to force liberalisation elsewhere. If the realities deny good prospects for such a response in Europe, the retaliation can only damage United States interests.

Second, the descent into bilateralism seems to have had some success in enhancing United States interests at the expense of third parties through trade diversion. The United States has been able to pursue this approach in agriculture, where protection is commonly provided by administered import quotas which may be allocated to discriminate between suppliers. This

might convey a narrow and short-term benefit to the United States alone, but this benefit would be offset to some extent by the indirect cost to the United States of losses borne by other allies and trading partners.

This has been important recently in United States bilateral initiatives towards increasing American shares of East Asian commodity markets. An important case in point concerns the Japanese beef trade. In the minerals trade, coal markets have been affected in a similar but lesser way through different mechanisms. In response to demands by the United States for greater access to the Japanese market, beef import restrictions have been altered so as to allow more United States imports, but this has been at the expense of third countries, particularly Australia. In the four years to 1983, the United States share in the volume of Japanese beef and offal imports rose from 31 per cent to 44 per cent, while the Australian share fell from 62 per cent to 49 per cent. The total import volume rose by less than 10 per cent during the period.<sup>54</sup> This policy approach was turned around in the settlement with Japan in July 1988, when that country delivered reform of its beef trade system consistently with the important GATT principles of 'transparency' and 'non-discrimination'.

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Both in the 'massive retaliation' against European subsidies and in the bilateral initiatives, any case for action in the United States' narrow national interest would have been as strong in earlier times as in recent years. It is not obvious how the

relative decline of the United States in world production and trade would have strengthened the economic case for action in recent times.

The key to understanding the new United States attitudes to the international trading system lies outside anything that is happening mainly in that system itself, namely in the polity's incapacity to come to grips with profound macroeconomic imbalances. Other countries' protection policies are blamed for a payments imbalance that has its origins in domestic budgetary policy. The problem for other countries in managing the United States' challenge to the liberal system is that large scale trade liberalisation in East Asia and Europe is incapable of contributing in a major way to curing the United States current accounts problems. There would seem to be no reliable prospect for addressing current international trade tensions independently of United States progress in moderating domestic demand, in pursuit of balance in current external payments.

This is where hegemonic decline may be important. The United States polity, wounded by macroeconomic difficulties, has lost tolerance for the weaknesses in the trade policy performance of others, independently of rationally calculated national advantage. ~~The increase in relative size and strength of others~~ is important principally for its effects on political reactions at all levels in the United States.

It is a dangerous time to take risks and liberties with the multilateral system.

### **A Pacific Approach to Liberalisation**

How then can the United States' partners in the Pacific respond to these powerful new currents in trade policy, consistently with non-discriminatory liberalisation?

Realisation of the fragility of the system provides strong grounds to work towards success in the Uruguay Round. The United States' administration and wider polity is likely to judge success first of all in terms of progress on agriculture. The European Communities, Japan and also Western Pacific developing countries would be wise to calculate carefully the cost of inadequate movement on agriculture, beyond the usual cost of foregone gains from trade.

Disappointing progress in the GATT Round will herald a highly dangerous period for the international trading system.

This will be a time for re-channelling interests in a Pacific Free Trade Area into renewed regionally based efforts to strengthen the multilateral system.

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The strategic problem in pursuing discussions under the 'free trade area' umbrella, will be to maintain a focus on non-discrimination and to find areas of reciprocal concessions which

are capable of sustaining United States interest in the discussions. From the viewpoint of Western Pacific countries, the most important concessions by the United States would relate to access to the United States markets for manufactured goods in which East Asian countries are most competitive.

For the United States to extend such concessions on a most-favoured-nation basis would not, with the exception of steel, have a strong impact on United States-Europe trade. The areas of greatest Japanese competitiveness do not now coincide closely with European competitiveness in the United States market. In fact, initial United States concessions to Japan could simply consist of the removal of trade arrangements such as 'voluntary export restraints' which discriminate against Japanese goods. However, concessions relevant to East Asian developing countries would affect United States trade with Latin America if offered on a most-favoured-nation basis. For this reason it would be sensible for the United States to engage Latin American countries in the process of reciprocation alongside Pacific discussions.

The main areas of concession which could be offered to the United States by Western Pacific countries are agricultural trade liberalisation and liberalisation of access to trade in services. ~~The involvement of the United States in trade negotiations would~~ make significant progress in agriculture more feasible, both because of United States interest in that area and because of the significance for Northeast Asian countries of the concessions which the United States would be able to offer in exchange.

Western Pacific developing countries would find advantage in increased access for labour-intensive manufactures, and more secure access for more capital-intensive standard technology manufactures in developed country markets.

While the United States may have benefited from its country-by-country bilateral bargaining over access to East Asian commodity markets in the past, the benefits have been severely limited by the quantitative restrictions on overall agricultural trade. Movement towards more liberal agricultural trade would benefit Australasia, for example, relative to the United States by removing present discrimination, but would yield substantially greater gains to all agricultural exporters (including the United States) than have been achieved in existing bilateral dealings. Hence, Australia's initiative in forming the 'Cairns Group' of efficient agricultural exporters has sought to engage the United States and other agricultural exporters in the negotiation of a more general and phased liberalisation of the agricultural trading system.<sup>55</sup>

The approach suggested here draws its prospects for success from the tendency for barriers to intra-Pacific trade to be highest in commodities and markets in which other Pacific economies are competitive suppliers. The incentive for participation, beyond realisation that the liberal trading system is in peril, is the opportunity to shape the agenda. The non-discriminatory nature of concessions avoids carrying the high costs of exclusions of the kind involved in PAFTA. China and the ASEAN countries need

not be excluded by their incapacity to make comprehensive commitments to intra-Pacific free trade, so long as they are able to offer liberalisation that contributes substantially to trade expansion. The 'Pacific Round' would be entered at a time of crisis, and the developed countries and NIEs would be aware of the high consequences of failure to make substantial progress.

There would remain the problem of resentment in the United States polity towards any 'free ride' for European agriculture. There would be pressures for the United States to take its 'massive retaliation' to a conclusion alongside the Pacific Round.

A much better strategy, should the European Community persist in current positions, may be to regionalise the retaliation and its costs in the context of the Pacific Round.

The fiscal burden could be shared by the developed countries, or by countries with per capita income above a specified level. The burden sharing would be fiscally and psychologically helpful in the United States. The fiscal commitments would be greatly unwelcome elsewhere in this region, but would need to be weighed against the benefits of strengthening the multilateral system and of genuine liberalisation within that system. In Japan, they would need to be judged alongside other politically more difficult pressures for 'burden sharing' with the United States. In Canada, Australia and New Zealand, they would be partially compensated by the alleviation of what has been in recent years a major sectoral problem, generated by the United States'



unilateral implementation of the export enhancement program. In the current fiscal circumstances of the United States, regional burden-sharing, especially the participation of Japan, would substantially enhance the credibility of the retaliation. Hopefully such retaliation would never actually be required.

The central concept of a regional round of negotiations directed towards multilateral concessions, but focussed on issues of high regional interest, has been discussed from time to time over the past decade. It only ever did, and still does, make sense as a complement to the primary goal of a successful GATT round. Its feasibility has been enhanced in recent years by the practice of regional cooperation in a wide range of trade policy matters, including in preparation for the Uruguay Round.<sup>56</sup>

It seems to us that a response to failure in the Uruguay Round along these lines would hold out rather better prospects than PAFTA for holding the line on corrosion of the multilateral system, promoting intra-Pacific liberalisation, and securing progress on reduction of barriers to trade between Europe and the Pacific.

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  2. Richard Cooper, 'Worldwide versus Regional Integration: Is There an Optimal Size of the Integrated Area?' Yale Economic Growth Center Discussion Paper, No.220, November 1974, pp.2-4 makes the useful distinction between 'market' and 'institutional' integration.
  3. These data rely on World Bank, *World Tables*, Washington D.C., 1987; United Nations *Monthly Bulletin of Statistics*, New York (various issues); Council for Economic Planning Development, Taiwan *Statistical Data Book*, 1987, Data for centrally planned economies are net material product. These are the standard measures of GDP used by the World Bank and other international agencies. We are aware that they do not provide perfect measures of the relative output of goods and services in different economic systems. See Robert Summers and Alan Heston, 'Improved International Comparison of Real Product and its Composition: 1950-1980', *Review of Income and Wealth*, June 1984. When adjustments have been attempted for measurement imperfections, they have had the effect of substantially raising East Asia's share of world GDP, especially because they ascribe much higher production to China.
  4. For an approach to the application of the theory of changing comparative advantage to East Asia, see Ross Garnaut and Kym Anderson 'ASEAN Export Specialisation and the Evolution of Comparative Advantage in the Western Pacific Region' in Ross Garnaut (ed.), *ASEAN in a Changing Pacific and World Economy*, Canberra: The Australian National University Press, 1980.
  5. Data drawn from International Monetary Fund, *Direction of Trade*, Washington D.C., 1988.
  6. Dale E. Hathaway, *Agriculture and the GATT: Rewriting the Rules*, Washington D.C.: Institute for International Economics, September 1987, p.91.
  7. *Ibid.*
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28. *Ibid.*
29. *Ibid* and Kiyoshi Kojima, *Japan and a New World Economic Order*, Tokyo: Carlos Tuttle and Co., 1977, p.180.
30. Soesastro, 'Institutional Aspects', pp.28-31.
31. The original contribution to this discussion was made in Kiyoshi Kojima and Hiroshi Kurimoto, 'A Pacific Economic Community and Asian Developing Countries' in *Measures for Trade Expansion of Developing Countries*, Tokyo: Japan Economic Research Center, October 1966, pp.93-134 (also published in *Hitotsubashi Journal of Economics*, Vol.7, No.1, June 1966, pp.17-37). Under the Foreign Ministry of Takeo Miki in Japan, the first Pacific Trade and Development Conference was organised at the Japan Economic Research Center, Tokyo, January 1968, to evaluate Kojima's proposal. See Peter Drysdale, 'Pacific Trade and Development Conference: A Brief History', *Pacific Economic Papers*, No.112, Australian National University, June 1984.
32. Soesastro, 'Institutional Aspects', p.28.
33. Parts of the argument in this section are elaborated in and drawn from Peter Drysdale, *International Economic Pluralism*:

*Economic Policy in East Asia and the Pacific* New York: Columbia University Press, and Sydney: Allen & Unwin, 1988, Chapter 8, pp.207-225.

34. H. W. Arndt, 'PAFTA: An Australian Assessment', *Intereconomics*, Vol.10, 1967, pp.271-6.
35. Peter Drysdale, 'Japan, Australia, and New Zealand: The Prospect for Western Pacific Economic Integration', *Economic Record*, Vol.45, No.111, September 1969, pp.321-42.
36. Drysdale, *International Economic Pluralism*, Chapter 8, *passim*.
37. Ross Garnaut and Kym Anderson, *loc. cit.*; Peter Drysdale, *op.cit.*, Chapter 8.
38. Lydia Dunn, *In the Kingdom of the Blind: A Report on Protectionism and the Asian-Pacific Region*, Special Report No.3, Trade Policy Research Centre, London, 1983, p.109; Crawford, *Australian Trade Policy*, pp.127-76; Richard Snape, 'Australia's Relations with GATT', *Economic Record*, Vol.60, No.168, March 1984, p.17.
39. *Ibid*, p.17, n.2, Snape notes that Harry Johnson says on non-discrimination, 'That principle has absolutely nothing to recommend it on grounds of either economic policy or the realities of international commercial diplomacy', but nevertheless endorses it as the best principle available; see Harry Johnson, *Trade Negotiations and the New International Monetary System*, Geneva: Graduate Institute of Studies, and London: Trade Policy Research Centre, London, 1976, pp.30-31.
40. Dunn, *Protectionism*, Chapter 5.
41. For background to this policy approach, see Keith J. Hay and B. Andrei Sulzenko, 'US Trade Policy and "Reciprocity"', *Journal of World Trade Law*, Vol.16, November-December 1982; William Cline, '"Reciprocity": A New Approach to World Trade Policy?', *Institute for International Economics, Policy Analyses in International Economics*, No.2, Washington DC, September 1982; A.J. Wonnacott, 'Aggressive US Reciprocity Evaluated with a New Analytical Approach to Trade Conflicts', *Institute for Research on Public Policy, Essays in International Economics*, Montreal, Canada, 1984.
42. Among the best reviews of developments in the United States-Japan relationship during this period is Hugh Patrick, 'The Management of the United States-Japan Trade Relationship and Its Implications for Pacific Basin Economies', mimeo., background paper for the Project on the Impact of Japan-US Economic Relations on Other Pacific Basin Nations, US National Committee for Pacific Economic Cooperation, 1987.
43. Drysdale, *International Economic Pluralism*, Chapter 9.

44. Robert O. Keohane, 'Reciprocity in International Relations', *International Organization*, Vol.40, No.1, Winter 1986, pp.1-27 sets out the distinction between 'specific' and 'diffuse' reciprocity most clearly. Stephen D. Krasner, 'Trade Conflicts and Common Defense: The United States and Japan', *Political Science Quarterly*, Vol.101, No.5, 1986, pp.787-806 takes up the distinction to rationalise a strategy of 'specific reciprocity' in United States dealings with Japan.
45. Gene M. Grossman and J. David Richardson, 'Strategic Trade Policy: A Survey of Issues and Early Analysis', *Special Papers in International Economics*, No.15, Princeton University, April 1985, pp.1-34 provides a recent review of this literature. Among the more important contributions in the international relations literature which have encouraged this interest is Robert Axelrod, *The Evolution of Cooperation*, New York: Basic Books, 1983.
46. Krasner, for example, sees Japan as an economy which 'defies external penetration ... Japanese institutions, both public and private, are linked in a dense network of reciprocal obligations' and he goes on to say that 'it is extremely difficult for new actors to pierce this network ...' He concludes that: 'If domestic-political-economic structures vary, then similar universal rules such as those codified in the GATT, can have very different behavioral outcomes. Tariff reductions in a market-oriented system like the United States will offer more opportunities to foreign producers than similar reductions in Japan, because buyers are more likely to consider only the costs and benefits of a specific transaction rather than to also incorporate assessments about past and future relationships with prospective suppliers. Diffuse reciprocity will not work even in the absence of conscious efforts at exploitation by the Japanese. The differences between the domestic structures of these two states guarantees [sic] that a universal open system based upon diffuse reciprocity will leave the United States with the 'sucker's payoff'.' Krasner, 'Trade Conflicts', p.789.
47. Keohane, 'Reciprocity', pp.19-27.
48. *Ibid*, p.19.
49. Kym Anderson and Ross Garnaut, *Australian Protection: Extent, Causes and Effects*, op. cit., Chapter 4.

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50. Christopher Findlay and Ross Garnaut (eds), *The Political Economy of Manufacturing Protection: Experience of ASEAN and Australia*, Sydney: Allen & Unwin, 1987, especially pp.271-3.
51. For a discussion of this idea, see Jagdish Bhagwati, *Ohlin Lectures*, Boston: M.I.T. Press, 1987, Chapter 3 (D).
52. *Ibid*.
53. Colleagues at a seminar that one of us gave recently at the

East Asian Institute at Columbia University pointed to the parallel between the Reagan administration's export enhancement program, directed at the European Communities, and the military build-up, directed at the Soviet Union. At high short-term costs to the United States, these commitments imposed costs on adversaries to provided a congenial environment for negotiations on reciprocal disarmament. The effectiveness of each strategy depends on a series of fine judgements.

54. Kym Anderson and Yûjirô Hayami (eds), *The Political Economy of Agricultural Protection: East Asia in International Perspective*, Sydney: Allen & Unwin, 1986.
55. *Australia and Pacific Cooperation*, Second Report of the Australian National Pacific Cooperation Committee, Canberra, July 1987, p.9; Andy Stoeckel and Sandy Cuthbertson, *Successful Strategies for Australian Trade*, Canberra: Centre for International Economics, 1987, Chapter 2.
56. See Garnaut, 'Australian Trade Policy and Western Pacific Economic Growth', *Economic Papers*, No.65, June 1981, pp. 14-30, part of which is reprinted in John Crawford and Greg Seow (eds), *Pacific Economic Cooperation: Suggestions for Action*, Petaling Jaya, Selangor: Heinemann Asia for the Pacific Community Seminar, 1981. When the Australian Prime Minister, R.J.L. Hawke, called for a new round of multilateral trade negotiation in a speech in Bangkok in December, 1983, he referred to a regional round along the lines suggested here as a fallback should efforts to launch and to implement a new round fail.