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Regionalism and Multilateralism: WTO, MERCOSUR et.al.

by

Jagdish Bhagwati

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The Asian financial crisis, which is far from over as the latest news from Indonesia confirm, has brought into the forefront four aspects of Asian growth that have important lessons for South America which I will address today:

First, we have to recognize that there was indeed a “miracle” in growth rates in East Asia, despite the arguments to the contrary; and that miracle had to do with the **outward orientation in trade** of these economies;

Second, that trade orientation was characterised, not by any regional preferences or Preferential Trade Agreements such as the FTAA that is now on the South American agenda, but by **nonregional worldwide orientation** of the trade regimes;

Third, the role of **industrial policy** in that miracle was negligible at the beginning of that miracle, and in fact may well have turned counterproductive in the 1980s and recently, accounting partly for the tremendous financial upheaval; and that

Fourth, the **recent crisis holds cautionary lessons** for, not outward trade orientation, but for capital account convertibility and, equally, for significant reliance on short-term borrowing.

A. Effect on the World Economy

But before I turn to these themes, I must address an issue raised by the Organizers: what is the likely impact of the Asian crisis on the world economy?

I am optimistic for the following reasons:

1. The deflationary effect from the affected Asian economies, in terms of income effects, cannot be significant on OECD countries: the **“locomotive theory**” whereby Japan and Germany’s expansion would pull US up was **discredited** in the 1980s, and the Asian economies are not that powerful a locomotive either.
2. **Japan has already had a sluggish, low-growth economy** for almost 6 years; any continuation or even accentuated decline would still be a small marginal deflationary influence.
3. US growth is not export-led but driven by domestic market and innovation, so the effect from Asian slowdown in demand would in any event not be substantial.
4. As for falling prices of imports from Asia, the robust **US economy today is in the best position to take advantage of these terms-of-trade improvement**, and should **grow** f**aster** rather than slower: I predicted this on TV in January and it has been the case so far.
5. **Contagion has not spread** to other countries so far; it seems confined to those originally hit. Reasons are many but sustainable, in my view.
6. There is **little prospect of Protectionism** for 2 reasons:

   (i) Thanks to the success of the Uruguay Round & earlier commitments, many **tariffs are “bound”;** these bindings are close enough to actual tariff rates (except in agriculture) in the developed countries, while the pressure from Asia is not in agricultural exports from them.

   (ii) It is **unlikely** that many of the modern, multinational US firms that are likely to face Asian competition will take the short view and go for broke **on Anti-dumping actions**, especially as they also have interests in foreign markets that could retaliate tit-for-tat. Also, **VERs are now virtually outlawed** at the WTO.

7. So far, the **OECD stock markets have held up pretty well**, even rsing through new barriers on Wall Street. With the US economy bvasically healthy, this is likely to continue.

B. Was there a "Miracle" in East Asia? Yes!!!

1. Yes, **there was**. First Larry Lau & then Allwyn Young estimated the growth of Total factor Productivity in East Asia to be negligible. Drawing on Lau, T.N. Srinivasan(July 1993); and drawing on Young, Paul Krugman (November/December 1994), both argued that there was no miracle in the sense that capital accumulation had driven the high growth rates.

2. But the **miracle was precisely the immense investment rates**, unprecedented in the history of the world economy, virtually.

3. I explain this miracle of huge investment rates, with excellent productivity, in terms of the **high inducement to invest implied by the outward orientation**. By contrast, the inward orientation of an import-substitution country like India --- and surely many countries of South America in the days of Prebisch doctrines m--- meant that the inducement to invest was limited by the domestic market.

4. In turn, the high export earnings enabled these countries to invest in imported capital equipment with **huge embodied technical change**. In addition, **the high rates of literacy and education** meant that the productivity from the imported equipment was also extremely high.

One final point: The latest empirical research, periodising the estimated TFP, shows what one would expect to find: TFP grows in successive decades, as these economies mature technologically. But that still leaves my basic explanation above intact.

C. Outward Orientation was Worldwide, Not Regional

1. The outward orientation in trade was **not confined to regional trade**. East Asia took the whole world as its destination. This is its **true contribution to the multilateral trading system**, quite aside from becoming a unique region that demonstrated the advantages to developing countries of integration into the world economy when most others were IS-orineted in trade.
2. **APEC also** has followed this model, of **MFN-based regionalism**, in contrast to the FTAA which is Article 24-based and hence discriminatory.
3. The **FTAA is a concept that fits more into South American history of indulgence towards preferences**, whether IS (which is preference for oneself) or GSP (preferences for developing countries). But, like those two, the FTA format is not an attractive one.
4. **It is possible for South America still to turn away from the FTAA framework** and into an APEC mould, sticking to MFN as the sole basis for trade liberalization and pursuing regionalism in several nontrade areas such as human rights, democracy, security etc.
5. **MERCOSUR**, if it aims at a **Common Market** like the EU, would be different in conception and **desirable** relative to NAFTA or FTAA. But it would make sense only if it adopts a truly firm and time-bound program to actually deliver on a Common Market, not otherwise.

D. Industrial Policy Detracted from East Asian Growth

1. It is clear that **Industrial Policy hurt South Korea**, for example. As Ian Little noted long ago, the returns to investment fell sharply in the 1980s when industrial policy shifted from pushing labour-intensive goods in production and exports to investing in heavy industry, semiconductors, shipbuilding etc.

2. So, **the contention of Alice Amsden etc. that it was Industrial Policy that created the East Asian miracle is not persuasive.**
3. In **Japan, on the other hand, the Industrial Policy was not a big problem** because, essentially, Mitsui and Mitsubishi controlled MITI rather than the other way around.
4. The essential point from the Lau-Young calculations should then be that **the miracle was really not due to some exceptional phenomenon like Confucianism or Industrial Policy, but due to heavy investments which must be explained in turn as I have done earlier today.**

E. Cautionary Lessons: Trade Liberalization Excellent, but Watch Short-term Borrowing

1. **The current crisis does not prove that there was no miracle**! What happened was that some of **these economies opened up their financial sectors to permit reckless short-term external borrowing which could not be managed when the crisis arose for different reasons across the affected countries.**
2. The correct lesson to draw is, not to withdraw from the world's trade and equity investment opportunities, but to ensure that short-term borrowing is carefully watched and kept within reasonable bounds. In short, all globalization is not equally benign; some is like riding a tiger, pleasurable but potentially fatal to your health. (See my **Foreign Affairs** , May/June 1998, article on **The Capital Myth: The Difference between Trade in Widgets and Dollars**.)