Free Trade and Growth in the World Economy

by

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I want to address a set of issues I believe are fundamental to the future of the world economy. And I am not referring to the global economic crisis. Rather I am referring to the issues surrounding improved cross-border access to the world's markets for goods and services. The WTO Doha Development Round negotiations stalled again in December 2008 and little has changed since then. The global economic crisis has shifted public attention away from these negotiations. This is quite understandable but we must not allow them to recede as, arguably, the success or failure of these negotiations will have as much effect on the world economy in the medium and longer run as the pace of recovery from the current crisis.

In Sections 1-4 I present the case for trade liberalisation as the main engine of growth of the world economy and review progress towards the goal of free trade through multilateral and regional negotiations. Section 5 draws out some of the implications of this analysis for East Asia.

1. Free trade is best

The unanimous view of trade economists today is that free trade is the best policy for a single small (=price taking) economy, irrespective of the policies pursued by its trading partners. This is the old story that free trade allows a country to specialise according to its comparative advantage. Departures from free trade, therefore, reduce national welfare. We are all thoroughly familiar with this story too. There are now numerous measures of the deadweight losses from border protection for most countries of the world and the gains from trade liberalisation, thanks to the efforts of the GTAP and the World Bank and other teams of cge researchers.

Yet, I want to argue that we still substantially underestimate the gains from trade liberalisation. The principal reason[1] is that the standard gains from liberalising trade are comparative statics. They increase the *level* of real incomes and incomes per capita. The literature of the 1990s introduced an important distinction between the level effect and the rate of growth effect of trade liberalisation (for example, Grossman and Helpman, 1990). Old growth theory suggests that trade liberalisation may raise the rate of capital formation by lowering the price of fixed capital (Estevadeordal and Taylor, 2008) and possibly also increasing the rate of return on

capital and the savings rate or net capital inflow. This increase in capital formation in turn raises the *rate of growth* of real outputs and real incomes. New Growth theory has added a number of other growth-inducing effects; trade liberalisation may increase the variety of capital and intermediate inputs, or increase the productivity of R& D (Taylor, 1999). The level effect is once-for-all whereas the growth effect is continuing.

A number of cross-sectional studies have found that countries that are more open to trade have higher growth rates; see especially the influential study of Sachs and Warner (1995). This became the consensus view. It supported advocacy of continued trade liberalisation in Developing Countries by economists and institutions such as the World Bank and the IMF.

However, recently some economists in the US have questioned this view on several econometric grounds; see especially Rodriguez and Rodrik (2001) and Easterly (2005). These criticisms represent a major challenge to advocacy of trade liberalisation. In particular, they assert it is not clear what is cause and what is effect. More trade could have been induced by faster economic growth caused by other omitted variables. They stress the importance of institutions and claim that trade policies have little or no effect on the rate of growth.

One finding on which empirical studies are remarkably consistent is the statistical association between the rate of growth of real GDP and that of exports. Holding other growth-inducing effects constant, a one percentage increase in the growth of exports is associated with a one fifth percentage point increase in real GDP per capita (Lewer and van Berg, 2003). This is a strong association, however, it is not proof of cause and effect. It leaves unanswered the precise mechanism by which opening of trade may boost the rate of growth of real output and incomes. The debate is still not settled.

Most recently, Estevadeordal and Taylor (2008) have re-examined the theory and evidence using time series for individual countries and a difference-in-difference approach. The mechanism for a causal link which they advanced is the increase in imports of fixed capital imports and intermediates following liberalisation. They

found that, in trade-liberalising countries, an opening up of trade in the post -1975 period is associated with an acceleration in the rate of growth that is greater than that in the control group of non-opening countries. They interpret trade liberalisation as the main cause because it led to an increase in capital formation and to increased imports of fixed capital goods and intermediates.[2]

If the growth-inducing effect of trade liberalisation holds, trade liberalisation has a much greater effect on real incomes in the liberalising countries than indicated by traditional comparative static gains. Simulations using the first generation cge models derived from old trade theory and without growth effects almost invariably show these gains are less than 1 per cent of national income. These gains are larger with second generation models that incorporate economies of scale and imperfect competition from so-called New Trade Theory. Third generation models allow for an increase in the capital stock.[3] However, if we raise the gains to say 2-3 per cent of national income they are still once-for-all effects only. By contrast, Estevadeordal and Taylor (2008) estimate that the growth acceleration in favour of trade liberalisers is about 1 per cent of GDP *per year*! Similarly, the association between growth of output and of trade noted above means that if the rate of growth of exports is raised by five per cent per year, a common occurrence among developing countries in recent decades, the rate of growth of real output per capita increases by 1 per cent.

At the world level, these growth effects of trade liberalisation interact positively among countries. Each country benefits from trade liberalisation in other countries directly through the increase in demand in these countries for exports from the country and indirectly by raising real incomes and total imports in these other countries. That is, the growth effects of trade liberalisation in one country spill over into other countries. These global growth effects of trade liberalisation in many countries are, in my view, a major part of the explanation of the record rate of growth of aggregate world GDP over the last 25 years.

All of this adds up to a case for a renewal of reductions in cross-border restrictions on trade in goods and services which is much stronger than usually realised.

2. Progress towards free trade in the GATT/WTO era

The consensus view that liberalising trade has efficiency and growth-promoting effects led to a world wide reduction in border barriers to international trade. Cross-border trade in goods and services have become much freer in the period of GATT/WTO trade regulation. But how much freer?

It is surprisingly difficult to get long term series covering the whole period and most countries to document this trend. Data areavailable for industrialised countries for some years. A group of economic historians has compiled data of (unweighted) average tariffs for 35 countries over the long period from 1870 to the 1990s (Williamson (2006, Figure 8.1)). It is reproduced as Figure 1. This shows a trend in average tariffs that is downward but irregular since about 1970. It also shows the great increase in protection in the Great Depression and the lasting effect this has had on the history of tariffs for the whole of the 20th Century.

As an illustration of this trend, I shall use long term series of average tariffs for the US and Australia that have recently been compiled. Figure 2 reproduces 100 year series of the average tariff for the two countries, the US and Australia (Lloyd, 2008). The main interest is of course in the US series. This was compiled by the US International Trade Commission. The Australian series is for comparison. Fortunately, both series have been compiled on an almost identical basis; they are the trade-weighted average duties, both MFN and preferential duties, expressed as a percentage of the fob value of dutiable imports only.[4]

Individually these two country series follow quite closely the general trends for the industrialised countries series. The US series too shows the great importance of the Great Depression years. These raised average tariff levels to their all time peak. The infamous 1930 Smoot-Hawley tariff played a major part in the stimulation of competitive tariff raising during the years of the Great Depression. Much of the history of tariffs in the US is the unwinding of these high levels. The series also has trended downwards steadily throughout the whole GATT/WTO period from 1947. The Australian series has a similar general profile. It has a peak at the same time in the Great Depression. It has trended downwards since then too, but with brief periods of reversal as tariffs were raised on some goods.

The similarity of these two country series is remarkable. In each country changes in tariffs reflect domestic politics and are often associated with changes in government. Yet, they have moved together most of the time. Clearly there is something much larger than domestic politics at work. One might suspect that it is the influence of the GATT/WTO rounds but this cannot explain the co-movements of tariff levels across the two countries. In the US, the reductions are mainly due to US "concessions" made in the various GATT/WTO rounds of multilateral negotiations (see WTO, 2007, Tables 6, 7 and 8). However, Australia avoided any significant multilateral concessions until the Uruguay Round; its reduction in average tariffs is the result of unilateral actions.

Australia is representative of smaller Developed and Developing countries. While Australia was a founding member of GATT, it was not required to make significant tariff cuts in GATT rounds until the Uruguay Round. Many Developing countries did not accede to the GATT until late in the 20th century. Consequently, the cuts in tariff rates occurred later than in the major industrialised countries. From the mid-1980s tariff reductions occurred in almost all countries in the world economy. Many countries moved sharply towards free trade.[5] This gradual spread of trade liberalisation was the result of a process of transfer between governments of policy views and modalities as the consensus view was adopted.

Consequently, we can be sure that trade has become much freer during the GATT/WTO era, particularly since about the mid 1980s. However, cross-border access to markets is still far from free for the world as a whole.

There is a danger of some backsliding as countries raise tariffs and ntms to protect vulnerable producers in the current global economic crisis. Fortunately, we now have in place trade policy transparency mechanisms which monitor this danger. Under the Trade Policy Review Mechanism, the WTO now periodically reports new measures introduced by members. There is also an independent monitoring of all trade measures by the Global Trade Alert organisation.[6] These monitoring exercises indicate that since the onset of the crisis some countries have indeed raised tariffs, export subsidies, production subsidies and tightened regulations to restrict imports.

However, to date these reported reversals are few and most are concentrated in measures that are subject to no or weak WTO discipline such as production subsidies, government purchasing and anti-dumping actions. The WTO has succeeded in avoiding the danger of backsliding. This is in marked contrast to the early stages of the Great Depression, as shown in Figures 1 and 2 above, when there was no multilateral organisation regulating world trade.

We need to note that the situation is different for trade in agricultural products. In contrast to industrial products, much of the assistance to agricultural products is assistance to exporters and, for import-competing agricultural producers, much of the assistance is from production subsidies and other fiscal assistance rather than tariffs. The World Bank has recently compiled a superb global panel dataset that contains comparable estimates of annual nominal rates of assistance to producers and consumer tax equivalents for a wide range of agricultural products for 75 countries since 1955, that is, since soon after the establishment of the GATT (Anderson and Valenzuela, 2008). This gives us more accurate long terms series for agriculture than we have for industrial products. The graph of average nominal rate of assistance to farmers in High-income and in Developing Countries is reproduced as Figures 3. Unlike industrial products, there is no clear long term decline throughout the GATT/WTO period. In High-income Countries, agricultural protection grew after the 1950s and began to reverse only after the mid-1980s. In Developing Countries, agricultural policies taxed their farmers through to the 1980s and since then it has shifted to slightly positive assistance (Lloyd, Croser and Anderson, 2009, Figures 12.1 and 12.2).

3 Advancing multilateral negotiations in the WTO

As we all know, the current Doha Round negotiations have stalled, the members having failed to reach agreement at the Cancun Ministerial Conference in September 2003, July 2006 and again in July 2008 and in December 2008. The WTO Ministerial Conference in September 2009 agreed to aim to conclude the round in 2010. Even if this is achieved, it will have been 17 years since the conclusion of the previous multilateral round. This lack of progress means that trade liberalisation in the world

economy at present depends on regional actions, which the WTO is supposed to eliminate, and unilateral actions, which it cannot control.

This has led to an enormous amount of soul searching both inside and outside the WTO. Some trade economists have suggested that safeguarding the rules of the world trading system and preventing an outbreak of new protectionism is more important now than further multilateral liberalisation (Evenett, 2008 and Sally 2008). Sally advocates a shift from multilateral action to unilateral action in order to liberalise world trade. The WTO certainly needs to tighten its rules regarding measures such as subsidies[7], anti-dumping actions and government purchasing which, in some countries, are being substituted for reduced tariffs. However, unilateral action has always been selective. Unilateral tariff reductions have occurred almost entirely in small Developed and in Developing countries; the US, EU and Japan have rarely reduced tariffs unilaterally. Unilateral action has focussed on tariffs though some countries have unilaterally cut subsidies and eliminated some ntbs. After the 1997 Asian crisis unilateral reductions in trade barriers have diminished in Asia and elsewhere though a handful of countries still regularly cut tariffs (eg Chile, Australia and New Zealand).

I do not subscribe to this downgrading of multilateral trade liberalisation. Multilateral negotiations in the WTO are crucial to the world economy for two reasons. First, they are needed to maintain the trade liberalisation engine of growth. Second, multilateral reductions in trade barriers are the best step the WTO could take to reduce the costs of trade discrimination for outsiders and to reduce the cost of complex regional rules for insiders. We need multilateral liberalisation more than ever.

What are the causes of WTO negotiation failure? Some commentators blame the intransigent attitudes of certain countries. Some blame the large agenda. Some blame the modalities that emerged in the critical areas of agriculture and NAMA. But the negotiation problems in the last GATT Uruguay Round and in the current WTO are persistent and the causes are deep rooted.

After the July 2008 failure, in a keynote address to the 2008 WTO Public Forum the Director-General outlined the negotiation problem in the following terms:

> "Three principal constraints today represent a challenge to our work: the first is the bottom-up approach, under which members must themselves always take the lead in tabling negotiating proposals and compromise solutions; the second is the concept of a "single undertaking", which implies that in a round of negotiations with 20 different topics, nothing is agreed until all is agreed; and the third is the decision-taking by consensus, which is reasonably close to unanimity." (Lamy, 2008).

The first allows Member governments to pursue their own objectives which are generally mercantilistic, pushing for improved export access and resisting all attempts to lower their own import barriers. The last two give a veto to those members who do not agree with a result in any area. These three features operating together have made negotiations very difficult in many areas.

To get around these features, different methods of negotiation have been suggested; these include reviving the "critical mass" method used in the negotiation of the Information Technology Agreement and the services agreements in the period after the conclusion of the Uruguay Round and before the start of the Doha Round, the use of the successful modalities employed in the Uruguay Round, and abandoning modalities and moving immediately to the scheduling phase of negotiations. After Doha, whatever the outcome, Sally (2008) suggests that negotiations be confined to OECD countries plus the twenty or so largest trading Developing Countries, giving about 100 other smaller trading Developing Countries a free ride. This would return the method of negotiations to something like that which applied in earlier GATT rounds.

However, there is an even more fundamental problem in my view. The WTO lacks a clear objective and, because of this, it lacks a vision of where it is heading. The Preamble to the Marrakesh Agreement setting up the WTO, like the Preamble to the GATT before it, has two proximate objectives; the first is "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade" and the second is "the elimination of discriminatory treatment in international trade relations". The first of these objectives, coupled with the other bottoms-up feature of the negotiations strategy noted by the present Director-General, have brought about negotiations in which attempts to reduce border barriers to trade

are essentially directionless incrementalism.[8] They have been swamped by the perceived mercantilistic self-interest of the participating Members that led them to resist almost every attempt to lower barriers. The WTO has failed abysmally on the second front of eliminating trade discrimination.

The WTO desperately needs, in my opinion, a strong and clear objective. Without such an objective, the WTO negotiations to improve market access and reduce subsidies will remain directionless. I believe the WTO should adopt the objective of free trade. Indeed, it is hard to conceive of any other long term objective. A "free trade" objective implies the removal of all border measures that restrict or distort trade.[9] Free trade is non-discriminatory as well as free. The WTO could amend its objectives at any time.

This objective of free trade should apply to all Members, Developed Countries and Developing Countries alike. In the current negotiations, the offers from Developing countries for liberalisation in agriculture and NAMA ranged from modest to none.[10] The Doha Declaration (2001, para 16) encouraged Developing Countries to resist reductions in tariffs and other measures by declaring that "The negotiations shall take fully into account the special needs and interests of developing and least developed country participants, including through less than full reciprocity in reduction commitments," or LTFR as it is known in WTO-speak.

Economic theory shows clearly that all countries gain from reciprocal trade liberalisation. Developing Country members have in general much higher average tariff levels and in particular they have much higher peak rates than Developed Country members (see WTO Tariff Profiles 2008 database on the WTO website.) Simulations done at the World Bank during the current negotiations using a cge model show that proposed WTO scenarios would benefit Developing Countries to a greater extent in relation to their GDPs than the rest of the world (see Anderson and Martin, 2009). Moreover, these gains would come more from cuts in their own border restrictions than from improved export market access. And we must add the growth effects of trade liberalisation. Far from assisting Developing Country Members, the LTFR interpretation of Special and Differential treatment has imposed a severe barrier to their gains from trade liberalisation and lowered their growth rates.

However, the adoption of a clear objective of free trade in the WTO is not going to happen in the foreseeable future.

4. The spread of regionalism

Regionalism offers an alternative route to trade liberalisation. In the limit, if all pairs of countries participated in bilateral or group agreements that completely freed trade between them, global free trade would result.

There has been a rapid spread of regional trading agreements (RTAs), especially since the early 1990s. Countries that had opposed the formation of RTAs for decades began to sign their own; this applies most notably to the US (beginning with the agreement with Israel which entered into force in 1985). It is often noted that every Member of the WTO except Mongolia is a signatory to at least one RTA. Moreover, most Members have signed more than one agreement. Medvedev (2006) calculated that the average number of agreements per country was five in 2002 (excluding non-reciprocal preference agreements such as GSP and EBA). It must be more than 6 now.

One concern is the regional trade liberalisation may have weakened multilateral liberalisation because it reduces the incentive for multilateral reductions in some countries. There is, however, little evidence to support this view. We have noted that multilateral negotiations in the WTO have collapsed of their own accord, due to several features of the negotiations. Indeed, the evidence seems to be for a reverse causation. Regional trade agreements increased rapidly when the Uruguay Round negotiations languished, and again when the Doha Round negotiations faltered.

The predominant concerns in the debate over the proliferation of RTAs are over the growth of trade discrimination and the enormously complicated set of rules for trade between nations overlapping RTAs have produced. Each RTA has its own unique coverage and sets of rules. A country which is a member of more than one RTA – and this applies now to the great majority of countries – has different rules for imports sourced from countries exporting to it under different RTAs; different rates of duty for imports from different sources, different standards requirements, different rules of

origin and so on. Bhagwati has captured this complexity in his memorable phrase the "spaghetti bowl".

However, trade discrimination and complex rules are part of the once-for-all effects of regional trade liberalisation. If the growth-inducing effect of trade liberalisation dominate the resource reallocation effects, we should focus on the growth effects of regional trade liberalisation.[11] In this context, the important question is - how large has been the contribution of regional trade liberalisation to the opening up of border barriers worldwide, and how large may it be in the future?

Some economists argue that regionalism is less important than indicated by the rapid growth in the number of regional agreements. The usual approach is to estimate the share of world trade which takes place between countries which have signed RTAs. The most comprehensive study is that by Medvedev (2006). He conducted a study of regional preferential trade for a panel of 150 countries, including those agreements not notified to the WTO as well as those notified, at the tariff line level of trade. He calculates that 32 per cent of total world merchandise trade was conducted between pairs of countries which are partners in an RTA. (The share would have risen a few percentage points by the present time.) Thus, a clear majority of trade takes place outside regional agreements.

He then notes that this share overstates the extent of preferential trade among them because of the presence of zero MFN tariff rates for many tariff lines, the presence of zero preference margins for some lines where there is a strictly positive MFN rate and long phase-in periods, and the non-satisfaction of strict rules of origin (ROOs) where positive preferential margins do apply. These factors reduce the impact of the proliferation of RTAs.

The number of zero MFN lines has increased in most countries, partly as a result of GATT rounds, particularly the effects of such measures as the zero-for-zero agreements in the Uruguay Round. The share of total world trade which is admitted duty-free is probably between one third and one half.[12] When these duty-free imports are removed from intra-RTA trade, only 22 per cent of world trade is subject to preferences. To take account of the costs of ROOs compliance, he defines

preferential trade to include only trade flows in tariff lines where the MFN rate is above 6 or 3 per cent. When this is done the share of preferential trade comes down to 11-15 per cent. This implies that less than one half of the trade between countries which are partners in an RTA is actually preferential trade. This is still an upper limit of preferential trade as no allowance has been made for the presence of zero preference margins when MFN rates are above 3 or 6 per cent. However, in most recently-formed RTAs the share of tariff lines with zero Preferential rates is converging to 100 per cent. "Thus, it appears that despite the growing number of agreements and the increased resources dedicated to PTA negotiations, the role of PTA tariff preferences in global trade is relatively small." (Medvedev, 2006, p.25).

On the basis of trends in regionalisation up to the present time, it appears that RTAs have a limited potential for opening world markets and stimulating world growth. Major segments of world trade are unlikely to be covered by regional agreements in the foreseeable future.

One segment is the intra-country trade among the four largest trading countries in the world economy – the EU, USA, Japan and China. There is no RTA between any pair of them, despite each of these now being a hub with many bilateral spokes. And there is no sign of any possible agreement among them. Growth of these markets is crucial to sustained growth of exports of Developing countries. More than 60 per cent of Developing country exports go directly to the High-Income countries.

A second segment is the trade of Developing Countries. Developing Countries have, as a generalisation, participated less in regional liberalisation than have Developed Countries. Again Medvedev (2006, Table 11) provides the best estimates. For the world as whole, we noted above that the share of intra-RTA imports was 32 per cent of total trade with all countries. For the North, this share was 37 per cent. For East Asia and the Pacific, the corresponding share was 9 per cent, for South Asia it was 15 per cent and for Sub-Saharan Africa it was 20 per cent. However, for the Developing Countries in Latin America and those in East Europe that linked to (and later joined) the EU, the percentages were well above the average North share. A few Developing Countries have been able to make agreements with all of their major markets; notably Mexico and Chile. On the other hand, the Least Developed Countries have improved

their access to the world markets least of all. Furthermore, it is sometimes argued that, because of asymmetry in bargaining power, smaller Developing countries have got less favourable terms from their RTAs with larger Developed countries.

This does not mean that these Developing Countries as a group have lost from the rapid progress of the world economy towards regionalism. For most, it means that they have gained less than richer countries.

A third segment is trade in agricultural products. Regional trade liberalisation, as with multilateral trade liberalisation, has had much less success in liberalising trade among its partners in agricultural goods.

These limitations to regionalism as a route to open up world trade and stimulate growth in the world economy reinforce the urgent need to break the deadlock in the multilateral negotiations.

5. Asia in the world economy

East Asia fits into this general picture of the growth of world trade and regionalism in a distinctive way.

First, the East Asian countries have been trade liberalisers throughout the last 30 years. Among the Developing countries, they were early liberalisers. Of course three of them (Singapore, Hong Kong, Brunei) have been close to free traders in goods throughout the GATT/WTO post- Second World War period. All other East Asian countries have substantially lowered barriers to trade in goods. This process began with the Asian NICs, the Republic of Korea and Taiwan in the mid-1960s. Then the four major ASEAN economies of the time, apart from the free traders Singapore and Brunei – that is, Indonesia, Malaysia, Philippines and Thailand – began to liberalise their goods trade substantially in the 1970s. China and other East Asian economies followed these trends in the 1990s. In some cases, this process began in the negotiations to accede to the WTO: for example, China and Vietnam. This record is documented in Drabek and Laird (1998) and ADB (1999).

Second, the Asian economies have been among the fastest growing economies in the world in recent decades. The World Bank (1993) study of *The East Asian Miracle* identified eight fast-growing (or "high-performing") economies over the period 1960-85 – Japan, the "four tigers" (Singapore, Hong Kong, Republic of Korea and Taiwan), and the Newly Industrialising countries (Indonesia, Malaysia and Thailand). China and Vietnam joined the group of fast-growers soon after. Growth accelerated for almost all of East Asia after 2000. During the 8-year period 2000-2007, before the onset of the global crisis in 2008, the world economy grew at over 3 per cent a year, the highest rate of growth for at least four decades (World Bank, 2009b, Table 3). For Developing Countries as a group, average annual growth of real GDP was 6.5 per cent. Again, East Asian growth rates at 8.9 per cent have been among the highest in the world, as shown in Table 1. (This conclusion is strengthened if one includes Central Asia. Several Central Asian republics achieved average annual growth rates for the recent 8-year period in excess of 10 per cent and in excess of that of China: Armenia, Azerbaijan, Kazakhstan and Turkmenistan.)

This growth acceleration in Developing Countries was "export led": "Growth in low- and middle-income countries was led by exports, which grew at an average annual rate of 12 per cent over 2000-07." (World Bank, 2009a, p. 2). Among East Asian economists, the consensus view is that there is a linkage between their trade liberalisation and their fast growth. East Asian economists have not shared in the scepticism about the growth-inducing effects of trade liberalisation. The predominant view is one of "export-led" growth, or sometimes a view of export-and-FDI-led growth. (see Won, Tsiao and Yang, 2008 and references therein). Some of the multilateral institutions, however, have challenged the view of export-led Asian growth. They have advanced the reverse causation; in countries such as Korea and Taiwan it was an investment boom that led to an increased demand for imports of capital goods, which in turn required increased exports (World Bank, 1995 and Asian Development Bank, 1999). However, there is in East Asia, as in the world as a whole, a strong statistical correlation between the rate of growth of exports and that of real GDP. Table 1 reports the rate of growth of merchandise exports (in current prices) alongside the rates of growth of real GDP.[13] On average the value of exports grew at roughly twice the rate of growth of real GDP. (See also ADB, 1999, Figure 3.1).

East Asia was a latecomer to regionalism, apart from the 10 Southeast Asian countries of ASEAN. (The original 5 countries signed the Bangkok Agreement in 1967 and Brunei Darussalam joined in 1984. The four CMLV countries began their participation in RTAs by becoming members of ASEAN in the period 1996-1999.) However, East Asia has embraced the trend in the last decade. Japan signed its first the agreement with Singapore in 2002, China its first with ASEAN in 2003 and Korea its first with Chile in 2004. Within a few years each of these had several agreements. This has produced the Asian version of the spaghetti bowl, the "noodle bowl".

There have been many proposals in East Asia and in the Asia-Pacific region more broadly for an Asian Community or an Asia-Pacific Community. In July, negotiations began between the present four members of the Trans-Pacific Partnership Agreement (TPA) – Brunei Darussalam, Chile, New Zealand and Singapore – and the US, Australia, Peru and Vietnam to expand the agreement in terms of both members and rules coverage. Some economists see these negotiations as a possible basis of an agreement extending to the whole of the Asia-Pacific region and incorporating the best practice rules.

There is another important link between East Asia and world trade liberalisation. Agur (2008) offers a joint explanation for the growth of regional trade and the failure of multilateral negotiations. Since the early 1990s, the US current account deficit has soared, from 1 per cent of GDP to more than 6 per cent of GDP. This has made it both less willing to participate in multilateral negotiations and more willing to negotiate regional agreements, especially with countries with which it has a small bilateral deficit. In the WTO multilateral trade negotiations this autumn, many delegates are blaming the lack of political will in the US for the continued stalemate. On the other side of the ledger, China has the largest current account surplus of any country. It rose sharply from 2 per cent of GDP in 2000 to an average of 10 per cent during 2005-07. The Agur model predicts that US exports to China would have to triple for a WTO round to stand a chance.

These growing imbalances are a major problem for the world economy that will require adjustment after recovery from the global crisis. They also raise the question

of real exchange rate misalignments. Some economists in the US believe that the renmenbi is undervalued but this is strenuously denied by Chinese economists. The answer to this question depends on how much the US wants to borrow from the rest of the world and how much China wants to lend. The position has become more acute since the steady devaluation of the US dollar after Mmarch 2009, which has meant that the effective exchange rate of the dollar-pegged renmembi has been devalued at a time when it should be appreciating.

6. Concluding remarks

"Free trade is best" is the clarion call of international economists. This traditional belief has been substantially strengthened by the recognition of the positive growth effects of trade liberalisation. The benefits of trade liberalisation apply to Developed and Developing countries alike.

Progress towards this goal can be made by multilateral or regional actions (and by unilateral actions but these are not subject to multi-national rules). Since the early 1990s there has been a dramatic shift in these two sources of action. Multilateral negotiations have stalled badly and regional agreements have proliferated. Regional preferences have caused an increase in trade discrimination and an increase in the trade costs associated with the "spaghetti bowl". From the point of view of growth, they have contributed less to the Developing Countries.

Goods trade is still far from free. Economists have won some of the battles in the cause of free trade in different countries but they have not yet won the war.

The failure to maintain multilateral trade liberalisation is switching off the main engine of growth of the world economy. The WTO is persisting with rules that were devised when our understanding of free global trade and free regional trade was quite different than it is today. (However, the WTO has succeeded in holding trade restrictions almost where they were in the worst recession in the world economy. This is a major contribution to recovery from the current global economic crisis, and the dispute settlement procedures have contained potential disputes among Members.)

Economists must not be diverted by the short term global crisis from the vital long term problem of how to sustain trade liberalisation in this century. The current slump in world exports and growth during the global crisis shows that avoidance of recession is necessary for growth in the world economy but the longer term economic history shows the necessity too of trade liberalisation.

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Table 1. Average Growth Rate of Real GDP and Merchandise Exports, East Asia. 2000-2007 Per cent per year

	Real GDP	**Exports**
East Asia		
China, PRC	10.2	26.1
Hong Kong, China	5.2	9.1
Taipei, China	5.2	9.3
Korea, Rep. Of	4.7	13.4
Mongolia	7.3	24.3
ASEAN Countries		
Brunei Darussalam	n.a.	16.1
Indonesia	5.1	11.5
Malaysia	5.1	10.1
Philippines	5.1	5.2
Singapore	5.8	12.0
Thailand	5.4	13.3
Cambodia	9.8	17.3
Lao PDR	6.6	22.6
Myanmar	9.2	22.5
Vietnam	7.8	20.0
Average East Asia and Pacific	8.9	15.6
Average Low Income Countries	5.6	
Average Middle Income Countries	6.2	
Average High Income Countries	2.4	
Average World	3.2	

Sources: Column (2): World Bank, *World Bank Report 2009,* Table 3, except for Taipei, China and Mongolia which are from the ADB.
Column (3): ADB, *Asian Development Outlook, 2005* and *2009.*

Unweighted average of annual growth rates.

Figure 1.
Unweighted world average own tariff, 35 countries
Source: Blattman, Clemens, and Williamson (2002, figure 1)

Figure 2. Australian (solid line) and US (broken line) Tariff Rates

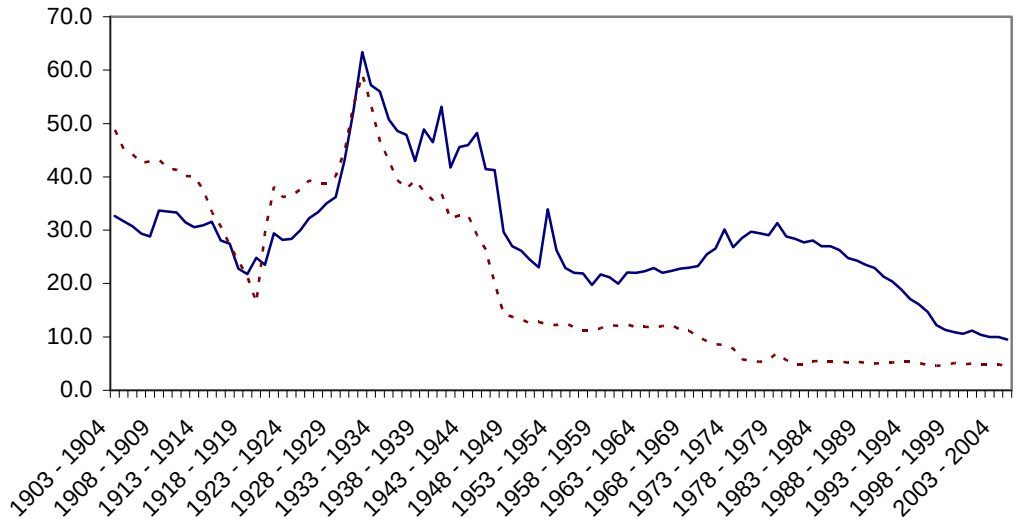
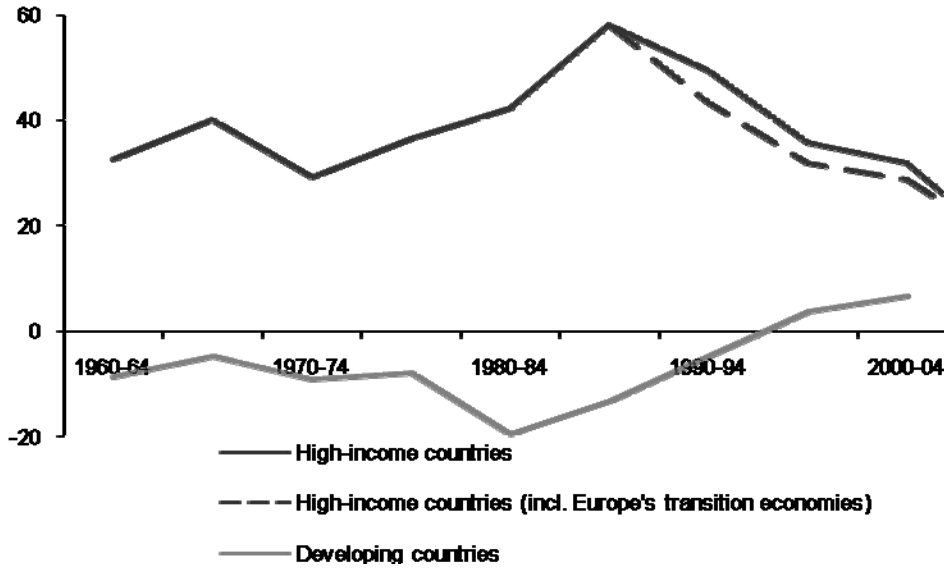


Figure 3: Nominal rate of assistance to farmers in high-income and developing countries, for all covered farm products, 1960 to 2007

(percent, averaged using weights based on the gross value of agricultural production at undistorted prices)



Source: Anderson and Valenzuela (2008)

[1] A second major reason is the omission of intra-industry trade effects. There is a greater variety and greater range of quality of goods when trade is freed. There are lower costs of production in the presence of economies of scale, economies of agglomeration, and increased competition. The New New Trade Theory by Melitz (2003) emphasises firm heterogeneity within industries. It indicates that exiting of low-productivity firms and other firm-level margins of adjustment following the lowering of barriers to trade are a source of improved factor productivity and increases in real income. Most cge studies omit all or some of these effects.

[2] In my own country, Australia, Athukorala and Chand (2007) have formally tested the relationship between average tariff levels and the rate of growth. They use a small scale growth model of the Australian economy, with data covering the period 1871 to 2002. Their study reveals a negative relationship between the average tariff rate and growth of GDP that is persistent and statistically significant. The elasticity of the growth rate with respect to the tariff rate is -0.28 per cent.

[3] This terminology was introduced by Baldwin and Venables (1995) in their discussion of regional integration.

[4] The use of dutiable imports only is considered preferable to the all imports because of the large proportion in both countries of imports that enter duty free. This is, therefore, the average of protective rates.

[5] One should add the effects on nominal rates of protection by means of ntms. For most countries reductions in ntms accompanied or followed tariff reductions. The Uruguay Round introduced much

needed discipline in the multilateral body in regulating quantitative restrictions, subsidies, and other ntms.

[6] This is coordinated by the Centre for Economic Policy Research in the UK (@www.globaltradealert.org).

[7] As an example, in Australia today considerably more assistance is given to producers through subsidies and tax concessions than through tariffs to both industrial and agricultural producers. This is probably true of many OECD countries.

[8] Cf. "In recent years, the impression has often been given of a vehicle with a proliferation of backseat drivers, each seeking a different destination, with no map and no intention of asking the way" (Sutherland Report, 2005).

[9] It should include National Treatment without exceptions. It might also be extended to include ntms such as subsidies which distort trade but it is hard to say how far the WTO should progress towards complete economic integration as beyond-the-border issues involve complex issues of efficiency and sovereignty.
Several writers, including the present writer, have proposed this objective ; see in particular Bergsten (1996).

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[10] For example, in the NAMA negotiations, they pushed successfully for differential and lower coefficients in the NAMA tariff-cutting formula – the present draft calls for a coefficient in the formula applied to individual tariff lines of [8-9] for Developing members compared to one of [19-23] for Developed members. On top of this, Developing members want greater "flexibility" in nominating lines for some products which would be subject to cuts that are up to only 50 per cent of those given by the formula. Then there is extra special treatment for small and vulnerable economies, and Least Developed Members would not have to make any cuts at all.

[11] Cge simulations of regional trade liberalisation in EU, NAFTA and in other RTAs support the view that regional trade liberalisation has both level and rate of growth effects; see Baldwin and Venables (1995) and Kehoe (2003).

[12] The WTO Tariff Profiles Database gives the proportion of HS 6-digit sub-headings which have an MFN rate of zero in each member. For the EU this is 30.9 per cent, for the US 47.1 per cent, for Japan 52.3 per cent and for China 6.7 per cent. For Australia it is 48.8 per cent but the actual share of the value of imports admitted duty-free is 64.6 per cent. Medevedev (2006) estimates that about one third of intra-RTA imports enter duty free.
For Singapore and Hong Kong of course the percentage is 100.

[13] One should probably compare the rate of growth of output in constant prices with the rate of growth of exports in constant prices, but the latter series is not available from these sources.