

THE U.S. EXITS, THE EU ENTERS: WHAT PROSPECTS FOR WESTERN FTA INITIATIVES IN THE ASIA-PACIFIC?

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Abstract:

The year 2007 may well represent a turning point in the trade relations between Asian nations and their Western counterparts. At the very moment when the European Union is set to launch free trade agreement (FTA) negotiations with several countries in East and South Asia, for principally internal reasons the United States is winding down its FTA activity in the region and is experiencing considerable difficulty in completing existing FTA initiatives. In addition, the likelihood that the Doha Round begins to drift for several years, if not fail outright, has grown and this may well colour bilateral relations. The purpose of this paper is to discuss these developments and examine their implications for trade policymakers in the Asia-Pacific region.

Key words: free trade agreements, Asia-Pacific, European Union, United States, commercial policy.

JEL codes: F13, F15.

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1. Introduction.

Although much ink has been spilt in recent years on the resurgence of preferential trade liberalisation important variation within and between regions is sometimes overlooked. Bilateral trade relations between the Western trading powers (taken here to be the United States and the European Union) and the nations of the Asia-Pacific may well be a case in point. For almost 10 years after 1997 the European Union stuck to a moratorium on launching new negotiations towards free trade agreements (FTAs).² Whereas the United States (U.S.) has for much of the duration of the Administration of President George W. Bush avidly pursued a policy of "Competitive Liberalization" that has resulted in the conclusion of FTA negotiations with several nations in the Asia-Pacific (including Australia, Singapore, and Korea.³) By the middle of 2007, however, the U.S. Administration was set to lose its authority to negotiate trade agreements and present them for essentially up-or-down votes to the U.S. Congress. Meanwhile, in October 2006 the European Commission (EC) announced a new trade policy that includes the launch of FTA negotiations with selected Asian trading partners. The year 2007 may well then represent a turning point in the Western chase for preferential access to Asian markets.

At the multilateral level the year 2007 may well also represent a break with the past, especially if the Doha Round negotiations collapse outright or are allowed to drift (if so, probably until the next U.S. presidential administration takes office in 2009 at the earliest.) This depressing, yet increasingly likely, outcome may colour Western trading relations with Asia, not least because India and China are seen (in different ways) to be significant parties to the Doha Round negotiations. Much may well depend on how any impasse in 2007 arises and the nature of any associated "blame game."

The purpose of this paper is to describe and analyse these developments, paying particular attention to the FTA policies of Asia's largest Western suitors, namely, the United States and the European Union (EU). To sharpen the analysis it may be useful to pose a few of the questions that this paper seeks to address, namely: To what extent are the factors that underlie the U.S.' exit from FTA negotiations likely to affect the adoption and implementation of U.S.-Asian FTA initiatives, including the recently concluded U.S.-Korea FTA? What factors are likely to determine the likely length of the U.S. absence from FTA negotiations in the Asia-Pacific? Is the EU's new FTA policy motivated by considerations distinct from those that drove the U.S. policy of Competitive Liberalization? Which of the European Commission's stated negotiating priorities for its FTAs are in fact likely to receive greater emphasis? Moreover, can Asian policymakers expect to receive the same demands from European trade negotiators as from their American counterparts? These questions ought to be of interest to Asian trade policymakers, to scholars, and to other analysts following commercial policymaking in the Asia-Pacific.

A few comments on the boundaries and approach taken in this study are in order. First, my focus on the FTA policies of the U.S. and EU does not imply that these policies are the only commercial policy initiatives between the Asia-Pacific and the Western trading powers. Bilateral trade disputes, which can escalate into dispute settlement proceedings at the World Trade Organization, are another source of interaction. With surging bilateral trade deficits between China and on the one hand the U.S. and on the other the EU, trade policy analysts would be

² It should be noted that during this period the European Council, comprising the ministers of the member states of the European Union, still allowed the European Commission (EC) to complete any FTA negotiations that had been launched before the moratorium came into effect. The last FTA that the EC concluded was with Chile in 2002.

³ At the time of writing separate FTA negotiations with Thailand and Malaysia had yet to be concluded.

unwise to overlook the potential for greater frictions in these two sizeable bilateral relationships. In short, I make no claim that the U.S. and EC's trade policies towards Asia are dictated solely by their respective FTA initiatives.

The second remark is that 2007 may well be, relatively speaking, an unremarkable year in the development of trade relations within the Asia-Pacific. As is well known and commented upon, FTAs and similar initiatives are multiplying within the region and these are surely an important element in the analysis of the trade policy options of Asia-Pacific nations. The fact that I focus in this paper on U.S. and EC FTA policy should not be taken to imply that I believe that Asian nations should necessarily privilege these preferential trade initiatives over intra-regional initiatives. The latter choice probably is, or should be, influenced by certain other factors in addition to those discussed in this paper.

Many papers that analyse FTA policies, associated options, and their effects employ econometric methods or computable general equilibrium models to support their arguments. These approaches are not used here. My arguments are principally qualitative in nature and emphasise the importance of political economy factors internal to the United States and the European Union. This is not to say that external factors, not least the magnitude of any expected commercial opportunities are irrelevant to understanding the leading Western trading powers' FTA policies. Rather, I believe it is important for Asian observers to appreciate the various internal factors that importantly shape EU and U.S. preferential trade policies. In what follows I will draw on legislation, announcements, speeches, government reports, and other official and non-official sources.

The remainder of this paper is organised as follows. The second section discusses the important multilateral context that may well shape Asian-Western trade relations in the years to come. The third section discusses the impending exit of the U.S. from FTA activity in the Asia-Pacific, considers how long the U.S. absence is likely to be, and identifies some implications of the U.S. exit for Asian trading nations. The fourth section discusses the new trade policy of the European Union and its member states, titled "Global Europe" and first announced in October 2006. The motivation and content of this EU initiative are contrasted with the U.S. trade policy of Competitive Liberalization. Developments since the former was officially launched are discussed and some implications for Asia-Pacific nations drawn. Concluding remarks are presented in the fifth and final section of the paper.

2. The multilateral backdrop to trade relations between the West and the Asia-Pacific.

In principle the bilateral trade relationships between Western and Asian nations could be conditioned by developments in the multilateral trade arena. In this section I will describe the latter and argue that their impact, now and in the near future, is likely to be limited for most Western-Asian bilateral trading relationships, with the significant exception of EU and U.S. commercial relations with China. The likely absence of any significant multilateral influences, I argue, allows me to focus on other matters in the later sections of this paper.

There are a number of potential means by which developments in the multilateral trade arena can affect bilateral trade relations, and perhaps two of the most important concern the enforcement of existing multilateral obligations and the effect that progress (or more tellingly, its absence) in multilateral trade negotiations may have on the desire to launch new FTA negotiations. I discuss these arguments in turn.

With respect to enforcing existing multilateral obligations, the principal source of controversy concerns China's compliance with its WTO accession obligations. The so-called honeymoon that China enjoyed after its accession to the WTO is over and substantial pressures are build-

ing up on both sides of the Atlantic for more robust trade policies towards China. The U.S. and EC both recognise, however, that significant commercial interests gain from existing trade policies towards China and it has proved increasingly difficult to reconcile the opposing domestic constituencies. When substantial pressure from textile interests, for example, encouraged the European Commission to restrict Chinese imports of underwear in 2005, the reaction of European retailers (which purchase goods months in advance of major sales periods, such as the sales at Christmas) was sharp. Since then the European Commission has reviewed the use of its so-called trade defence instruments (anti-dumping, counter-vailing duties, and safeguard measures), a step which too has proved very controversial within the European Union.

European and U.S. policymakers have also been very critical of certain Chinese government policies. U.S. complaints concerning what it perceives as an enforced cheap renminbi exchange rate policy have become louder over time and the risk of Congressional legislation on this matter grew markedly in mid-2007. These complaints are in addition to long-standing concerns about access to Chinese markets, protection of intellectual property, and state subsidies. On the other side of the Atlantic, in the last year the European Commission has voiced its concerns more frequently and in February 2007 it published a detailed sectoral study of "challenges" in EU-Chinese trade and investment relations (EC 2007). Empirical evidence was presented in this study that purported to show that EU firms (including their subsidiaries) lost €21.4 billion a year in business opportunities, principally due to non-tariff barriers. The report also identified biased government procurement policies, non-transparent and discriminatory regulations in China, "substantial" subsidies, and the lax enforcement of intellectual property rights in China as factors impeding European business operations in China. By June 2007, when estimates of China's trade surplus with the European Union reached €170 billion, Mr. Peter Mandelson, European Trade Commissioner, warned that the current trading patterns were becoming "unsustainable."⁴

Recognising these difficulties European and U.S. policymakers have attempted to contain protectionist pressures at home by creating high-level dialogues with their Chinese counterparts (much as the United States conducted such dialogues with Japan in the late 1980s and 1990s.) Arguably, to date this strategy has been more successful in Europe than in the United States, where Congressional bills to levy tariffs on Chinese imports because of its alleged cheap renminbi policy have been introduced. Even so, the pressures on both sides of the Atlantic have not been contained completely, and the United States, the European Commission, and for that matter Canada, have brought WTO dispute settlement cases against China in the past year.

From the perspective of assessing current and likely future bilateral trade relations between the EU and the U.S. and their Asia-Pacific trading partners, what are the implications of the above developments for Asian nations other than China? Surely one reaction is to argue just how unique China's experience is--at present no other Asia-Pacific trading partner of the EU or the U.S. receives the same degree of press coverage and criticism as China. Nor is this likely to change in the foreseeable future. This is not to say that the Western trading powers are perfectly happy with the trade policies of the other Asia-Pacific trading partners (after all, the European Commission has taken a complaint against Indian policies towards wine to the World Trade Organization), just that China appears to be the exception and not the rule. By implication, then, the increasingly harsh treatment of China is most unlikely to spread to its regional trading partners. It would seem, then, that the compliance aspect of the multilateral trading system does not appear to be casting much of a shadow over most Western/Asia-Pacific bilateral trade relations.

⁴ *Financial Times*, "EU trade chief warns China's surplus is 'unsustainable'," 12 June 2007, page 4.

Apart from litigation and encouraging compliance, the other major function of the WTO is to facilitate the negotiation of new commercial accords between its members. Since 2001 WTO members have been negotiating a set of agreements as part of the so-called Doha Development Agenda. This is not the place to reprise the twists and turns of this multilateral negotiation (a summary can be found in Evenett 2007a) or to dwell on the causes and consequences of the inability to conclude these negotiations with an agreement (Evenett 2007b). Certain Asia-Pacific nations (notably Australia, China, India, Indonesia, Japan, and Korea) have played (arguably at different times) prominent roles in this negotiation, as have the two long-standing poles of the world trading system, the EU and the U.S. What has been the effect of being unable to conclude the Doha Round on bilateral trade relations between the West and the Asia-Pacific and within the latter region?

One effect highlighted by, amongst others, Asian trade policymakers is that the slow progress in the Doha Round has contributed to the resurgence of interest in recent years in bilateral trade agreements. According to Dr. Mari Pangestu, the Minister of Trade of the Republic of Indonesia, in a speech in Brussels in 2007 this tendency towards bilateral initiatives was reinforced as some (presumably influential) businessmen realised that they could be left at a commercial disadvantage from other countries' FTAs (EPICE 2007). As a result bilateral initiatives have multiplied, one result of which was that many East Asian nations have signed or sought to sign FTAs with China.

One consequence of the revival of interest in bilateral FTAs is that it has probably created the impression that there is a pervasive and potentially commercially significant alternative to liberalisation through the WTO. This may well have led some policymakers to conclude that the price of a stalled--or even failed--Doha Round negotiation is lower than it might otherwise be, making it easier to rebuff tough demands to liberalise from trading partners. Over time, the stalling of the Doha Round and the proliferation of bilateral FTAs may well be mutually reinforcing.⁵

Another factor likely responsible for the stalled Doha Round is the lack of overlap in liberalising ambition in agricultural trade reform between the major parties to that negotiation. As I have argued elsewhere (Evenett 2007a) the United States found itself only able to support big cuts in payments to its farmers in return for sizeable improvements in the access to foreign agricultural markets. Whereas, the EU, China, and India preferred to limit the ambition of any liberalising measures in agriculture. This stalemate has persisted. In the first half of 2007 there was some convergence in the EU and the U.S. positions on possible multilateral agricultural trade reforms but this appears to have triggered additional (non-agricultural) demands from India and reduced Brazil's willingness to liberalise its goods market. If this situation persists then the Doha Round is likely to unravel and the prospects of completing this multilateral negotiation in 2007 look particularly bleak (see Evenett 2007d for further details).

The stalemate over agricultural trade reform in the Doha Round may not prove to be much of an impediment to any future bilateral FTA negotiations between the European Commission and certain Asian nations. For example, since agricultural trade reform is a sensitive matter in both India and Europe and any FTA negotiation between them could involve setting agricultural trade matters to one side. Negotiators of an EU-Korea FTA might do likewise or at least find some compromise on sensitive products, such as rice. (Whether this makes good sense from an economic point of view is quite another matter.)

⁵ After the Doha Round stalled in mid-2006 the negotiations were temporarily "suspended." In Evenett (2007c) I describe some of the lessons for trade policy analysts and researchers of this suspension. Many of the factors identified there probably apply to the stalemate in the Doha Round negotiations reached in June 2007.

Another deeper question raised by the Doha Round stalemate is what it reveals about certain countries' willingness to liberalise through reciprocal trade agreements. If in a given country such willingness is low, then the prospects of any FTAs with that country are pretty dim. Here it is worth noting that neither China nor India have substantially liberalised their trade regimes through reciprocal trade agreements. China, for sure, liberalised its commercial policies a lot when it joined the WTO, but the associated accession negotiations are not a form of reciprocal trade liberalisation as traditionally understood. India's considerable liberalisation of its trade policy regime since 1991 has been almost entirely unilateral in nature. These observations are reinforced by what is known about the apparently reciprocal trade agreements that India and China have signed in recent years. India's FTA with Singapore, which some of its trade officials tout as its most ambitious reciprocal trade agreement, excludes outright 6551 tariff lines from liberalisation. A further 2407 tariff lines are scheduled for only a 50 percent reduction in applied tariff rates, to be phased in over 10 years. Together these exclusions and phased-in reductions account for 76 percent of India's tariff line commitments in its FTA with Singapore. Moreover, many of the liberalising measures in the service sector in this FTA are subject to various provisions that effectively give the Indian government rights to deny market access to foreign firms. A similar analysis of China's first FTA (with Chile) should a similar marked reluctance to liberalise in many areas (for details on both of these FTAs see Evenett 2007e).⁶

What can one conclude from the various findings above? As far as the bigger economies in Asia are concerned, then, there is something of a mixed bag. China, India, Korea, (and Japan for that matter) have politically sensitive agricultural sectors which may require their effective exclusion from any bilateral FTA, or at a minimum some form of special treatment. Moreover, there are real question marks over how far China and India are willing to liberalise in the context of reciprocal trade agreements. Both factors qualify the extent to which any ambitious Western-Asian FTAs are likely to be spurred on by the demise of or further delay to the Doha Round. Finally, to the extent that the latter reduces any restraint in bringing dispute settlement cases to the WTO, given the current trading partners and political climate in the U.S. and in Europe, the principal likely target will be China. Other Asia-Pacific nations are in this respect in a more favourable position.

For completeness sake I ought to consider the potential implications for Western-Asia/Pacific bilateral trade relations in the unlikely event that the Doha Round is completed in 2007. Should this happen the most likely outcome will be a multilateral accord that reduces much of the gap between bound and applied tariff rates on manufactured goods and agricultural products, rather than cutting applied rates much. Moreover, at most agricultural subsidies would be trimmed and limited commercial opportunities created in service sector reforms. In which case, much of the discrimination against foreign commerce that exists today in the Asia-Pacific, U.S., and EU would remain and, therefore, one important determinant of the incentive to negotiate bilateral trade agreements is unlikely to be diminished. An ambitious Doha Round outcome, however, may require some time to be digested and implemented, so possibly delaying the initiation of new FTA initiatives. Given the latter outcome is most unlikely, at least in 2007, on net the near-term legacy of recent events in the multilateral trade arena is to stimulate bilateral FTAs with (and probably between) Asia-Pacific trading partners. Next I turn to discussing the factors, principally internal to the United States, that are almost certain to result in that country remaining on the sidelines as far as negotiating additional FTAs is concerned, at least until the next U.S. presidential administration is installed, determines its trade policy, and wins Congressional support for the latter.

⁶ Many have criticised the U.S. and EU for negotiating FTAs that give precious little to trading partners and make considerable demands on this. As far as the former is concerned, one wonders if China and India will in time face similar criticism should they make no changes in the types of FTA that they negotiate.

3. The U.S. exits...but when will it return?

The Administration of President George W. Bush, which took office in January 2001, has actively engaged in trade policy discussions and negotiations with many nations in the Asia-Pacific region. After Congress granted in mid-2002 the Administration so-called Trade Promotion Authority (the politically palatable successor to the phrase Fast Track), U.S. trade officials were able to negotiate FTAs (and other trade agreements including the Doha Round) with trading partners and, with some caveats, essentially put the resulting agreements to up-or-down votes in both houses of the United States Congress. This procedure was said to inspire confidence in U.S. trading partners that Congress would not undo the specifics of any trade deal negotiated by the U.S. Administration. Therefore, even though the U.S. Constitution gives the right to regulate commerce to Congress, this procedure effectively meant that trading partners would only have to negotiate with the U.S. once, rather than twice.⁷ Congress, of course, did not grant this authority without laying out very clearly what it thought U.S. trade negotiating objectives should be and insisting on periodic and frequent consultation. U.S. trade officials for their part listened closely to the mood of Congress, or at least to the Congressmen necessary to get any trade agreements approved.

With the authority to negotiate trade agreements in hand, the U.S. Administration sought to implement its trade policy of Competitive Liberalization. Ambassador Robert Zoellick, the United States Trade Representative during the first Administration of President George W. Bush, forcefully argued for a U.S. trade policy that could simultaneously generate trade reform abroad (and therefore commercial opportunities for U.S. business) in a number of trade policy arenas--multilateral, regional, sub-regional, and bilateral. U.S. negotiating leverage, Zoellick argued, would be maximised if the U.S. consciously pursued trade agreements along a number of paths--thereby making clear to those trading partners that blocked reform in one arena that other initiatives could be found where they would be excluded. This, plus the apparent lure of better access to the large United States' market, was thought to be enough to induce U.S. trading partners to compete by offering to liberalise more of their own economies. (For an extensive treatment of the motivation, apparent rationale, and implementation of the U.S. policy of Competitive Liberalization see Evenett and Meier 2007).

The United States sought to implement its policy of Competitive Liberalization in every region of the world economy. In the Asia-Pacific, the United States started and concluded FTAs with Singapore, Australia, and Korea. Negotiations with Thailand and Malaysia on potential FTAs began in 2004 and 2006, respectively, but have not been concluded at the time of writing. President Bush also proposed an Enterprise for ASEAN Initiative and Trade and Investment Framework Agreements (signed often as a precursor to negotiating FTAs) were initialled with Afghanistan, the Association of South East Asian nations (ASEAN), Brunei, Cambodia, Malaysia, Mongolia, Pakistan, Sri Lanka, Thailand, and Vietnam. This represents an extensive amount of negotiations and consultation between the United States and its trading partners in the Asia-Pacific, and is in addition to U.S. participation in fora such as APEC and the WTO.

Undoubtedly the jewel in the crown of the U.S. FTAs negotiated by the Bush Administration is its agreement with Korea. In April 2007 the U.S. Administration notified Congress that it had concluded its FTA negotiations with Korea, just meeting the Congressionally imposed deadline for this FTA to be treated under the rules governing Trade Promotion Authority. (The latter authority expires on 30 June 2007). At the time of writing certain legal amendments to this FTA are being sought and so a comprehensive assessment of its possible effects

⁷ This arrangement was undermined in May 2007 by an agreement between Congress and the Administration that effectively forced the Peruvian government to restart negotiations with the U.S. on a FTA that both sides had mutually concluded. For details and implications see Evenett (2007d).

is premature. Having said that, it is worth noting that Korea is the seventh largest foreign market for U.S. exporters, which totalled \$33 billion in 2006. The United States imported \$46 billion of Korea's goods in 2006, amounting to 13 percent of Korea's total exports. By some estimates Korea levies almost nine percent in tariffs and charges on American exports, whereas the U.S. levies a 3.5 percent average tariff, suggesting that the FTA will give American exporters greater scope to lower prices than their Korean counterparts (ACTPN 2007). The Advisory Committee for Trade Policy and Negotiations (ACTPN), a presidentially-appointed group of persons comprised of corporate executives, lobbyists, and former elected officials that conducts analyses and provides recommendations to the U.S. Administration and Congress about trade agreements, endorsed the proposed U.S.-Korea FTA and noted:

"Korea is by far the largest of the countries with which the United States has negotiated a free trade agreement in recent years--the largest since the NAFTA agreement" (ACTPN 2007, page 2.)

The prospect of a U.S.-Korea FTA led some analysts to argue for U.S. FTA negotiations with Japan. These analysts were joined by several Japanese business associations and some Japanese government officials. Interestingly, in a February 2007 speech to senior Japanese businessmen, a middle-ranking U.S. trade official went on record to pour cold water on such proposals. Five obstacles, it was said, would impede the negotiation of a FTA between Japan and the United States. These obstacles were said to include an unwillingness of Japan to reform its agricultural sector, likely resistance by Japanese officials to undertake the reforms attendant with U.S. FTAs, the various non-tariff barriers that many Japanese firms benefit from, and likely Japanese demands that the U.S. reform its anti-dumping and costal shipping laws (TBC-World.com 2007). It is unlikely that this official was speaking in such stark terms without clearance from superiors in Washington, D.C. Moreover, an extensive review of U.S. media and other sources on trade policy discussions in Washington, D.C., in mid-2007 found no significant traction behind a U.S.-Japan FTA negotiation. Nor was the potential for such a negotiation widely advanced as a reason for the Congress to extend further Trade Promotion Authority to President Bush.

Observers in the Asia-Pacific would get a particularly biased view of trade policy developments in 2007 in Washington, D.C. if they forced solely on the "conclusion" of the FTA negotiations between Korea and the United States. A potentially far more important development has been hardening Congressional opposition to the ratification of certain FTAs that the United States has signed in the last year and to the renewal of Trade Promotion Authority (which, as noted earlier, expires on 30 June 2007). The proximate cause of this Congressional opposition was the election of a large number of trade sceptics to the U.S. Congress in the November 2006 elections, many of whom replaced pro-trade incumbents. In an analysis of the new Congressmen's campaigns, including a comparison with the trade votes of the incumbents that they were destined to replace, Michael Meier and I found that 6 trade-friendly Senators were to be replaced by individuals whose campaigns were, at best, described as trade sceptic. In the House of Representatives the comparable figure was 17. We found no instances of a trade-sceptic incumbent being replaced by a supporter of trade-reform. Moreover, we noted that of the 65 new members of Congress, 31 had explicitly mentioned FTAs (almost always in opposition to them) in their campaigns. The great majority of FTA opponents were Democrats, the party that now controls both the U.S. House and Senate (Evenett and Meier 2006).

At first certain prominent members of Washington, D.C.'s trade cognoscenti tried to argue that the implications for the U.S. trade policy were not particularly dire. After all, it was said, the persons in charge of the Congressional committees with responsibility for trade legislation were on the whole supporters of trade reform. Plus there was the logical possibility that the newly elected Congressmen and Senators might be less opposed to trade reform after taking

office than on the campaign trail. Developments in the first six months of 2007 have called into question this optimism (although in an excellent piece Destler (2007) tries to put a brave face on these matters.) The new Democratic congressmen have taken an active interest in trade policy matters, repeatedly raising associated matters at the Democratic Caucus and reminding Democratic chairman of the relevant committees of their views. Having reviewed numerous media and other reports on related matters in the first half of 2007 it would be very difficult to make the case that this group of newcomers have been divided, sidelined, or have moderated their apparently trenchant opposition to FTAs in particular (and to the broad thrust of U.S. trade policy in general.) These congressmen have argued that their party leaders negotiate or develop on their own a new trade policy for the United States that gives greater attention to labour and environmental policies, that strengthens U.S. public procurement policies, and that weakens the protection of intellectual property rights codified in U.S. FTAs, amongst others. The Congressional leadership has responded to these demands and I shall return to this matter later.

Although the proximate cause of the recent shift in domestic support for U.S. trade policy was the outcome of the 2006 Congressional elections, some analysts have correctly argued that deeper factors are responsible. Destler (2007) rightly argues that the particular manner in which the Republicans organised trade policy matters in the House of Representatives during the first six years of the Bush Administration antagonised many potential Democratic supporters of trade agreements. In this regard it is worth recalling that only 25 of the 208 Democrats in the House of Representatives voted in favour of granting President Bush Trade Promotion Authority in the first place (in contrast Republicans voted 190-27 in favour on 27 July 2002.) Such partisanship was (and remains) important when the votes on trade matters are so tight. (For example, the overall vote on Trade Promotion Authority mentioned above was 215-212, yielding a very small majority.) As Congressman Sander Levin (who after the Democratic takeover of the House of Representatives is now Chairman of its Subcommittee on Trade) was to note in 2002:

"This is not the type of authority which facilitates a broadly bipartisan trade policy."

One can also point to other factors that have been at work. The long term decline in Democratic support for trade agreements since the passage of the NAFTA agreement in 1993 is surely a significant conditioning factor (Devereaux, Lawrence, and Watkins 2006). So is the declining power of committee chairmen in Congress, who are unable to set the agenda and votes of their committees as freely as in the past. The proliferation of Congressional committees with some authority on international trade matters is another complicating factor (see Destler (2005) for an expert account of these matters.) In sum, then, the 2006 U.S. Congressional election may not have been dominated by debates over trade policy (concerns about the status of the occupation of Iraq received far more media attention etc), but it did result in a sizeable group of Congressmen being elected with strong--and it seems resilient--views on the need for a new direction in U.S. trade policy. The question arises as to what are the possible implications for Asia-Pacific nations.

The first implication, which receives a lot of press attention and which at first may not seem directly relevant to many Asia-Pacific nations, is that there is a substantial question mark over the ratification of the four FTAs that the U.S. has concluded. Only one of these four FTAs involves an Asian nation (Korea). At the time of writing gauging the degree of Congressional support for the ratification of U.S.-Korea FTA is difficult precisely because so many significant interest groups in the U.S. have not stated their positions before reviewing the final legal text of the agreement. What is clear is that certain candidates for the Democratic nomination for President in 2008 have publicly stated their opposition to the U.S.-Korea FTA, including the frontrunner. Moreover, leading firms in the U.S. automobile, paper, and

textile and apparel industries have already expressed opposition to this agreement. It seems very likely that Congressional consideration of the legislation to ratify this FTA will not taken place until well into the second half of 2007 and further delays are possible.

These considerations have direct implications for Korea's commercial interests and for the many East Asian countries whose exporters' products compete with Korean firms in the U.S. market. Indeed, failure to ratify the U.S.-Korea FTA may well undermine much of the support in Japan for launching FTA negotiations with the U.S. It should also be added, however, that of the four FTAs that could be brought before Congress for legislation, the U.S. FTA with Colombia appears, to my reading of available statements by Congressmen and Senators, to be the most in jeopardy. Moreover, given the strong foreign and military policy interests that the U.S. has in the Korean peninsula one can expect that many non-economic arguments will be advanced in Washington, D.C., in support of the ratification of the U.S.-Korea FTA.

Second, a recent agreement between the Administration and the Congressional leadership of both parties on a "template" that future US FTAs should adhere to also has implications for the Asia-Pacific region. This agreement, announced on 10 May 2007, formally applies to the Peruvian and Panamanian FTAs that the U.S. has concluded, although it could well end up applying to the U.S.-Columbian and U.S.-Korean FTAs and to any FTAs that the U.S. signs in the future. The agreement was the product of intensive negotiations between the U.S. Administration and senior members of both parties with either committee responsibilities for trade policy matters or for the overall development of policy and procedure (such as the Speaker of the House of Representatives.) Later, rank-and-file Democrats and some Republicans complained that they had not been consulted on the agreement's contents. Moreover, although the broad outlines of the agreement were announced on 10 May 2007, at the time of writing the precise legal text of this agreement had not been put forward by the Administration. As a result, certainly potentially influential interests have reserved their positions.

What do we know at this stage? First, the agreement calls for FTA parties to "adopt, maintain, and enforce" labour laws and practices that are consistent with five internationally recognised labour standards. These standards are drawn from the 1998 International Labour Organization (ILO) Declaration on the Fundamental Principles and Rights at Work. Moreover, these obligations are to be enforceable using the FTA's dispute settlement obligations, just like other more "traditional trade" obligations. Second, FTA partners must "adopt, implement, and effectively enforce laws, regulations and other measures" to fulfil the obligations of seven multilateral environmental agreements (MEAs). These obligations are to be enforceable too. Third, specific provisions were to be adopted with respect to logging in Peru. Fourth, a number of measures that appear to weaken previous FTA provisions on intellectual property rights and patents were included. Fifth, measures were taken to clarify that certain public procurement-related requirements of bidders would not be interpreted as obstacles to trade. Sixth, measures on port security, investment rights, and assistance to workers adversely affected by international commerce were adopted. The agreement, therefore, covers some matters that have traditionally been very controversial for many developing countries and others that protect certain U.S. interests.

What should Asia-Pacific nations make of this agreement? First, it is important to appreciate that this agreement has not been subject to any Congressional vote. Only when the Peruvian and Panamanian FTAs are voted on will observers be able to discern whether this agreement has the support of a majority of Congress. If it does not, then the agreement will have failed in its purpose to find some new common ground for U.S. trade policy. Second, the interesting question that arises is how many of the four "concluded" FTAs need to be formally renegotiated to meet the requirements of this agreement. The trading partners concerned may feel that they entered their negotiations for FTAs with the U.S. with the undertaking that they had to negotiate only with the U.S. Administration and that Congress would not subsequently im-

pose conditions. Renegotiation clearly violates this expectation and clearly calls into question whether any U.S. trading partner can seriously expect Congress not to intervene in the negotiation of a future FTA. Moreover, expectations of a second round of negotiations may influence the concessions a trading partner makes with the U.S. Administration in the first round; a consideration that ought to concern U.S. trade negotiators too. A number of tactical as well as strategic considerations are therefore raised for the U.S. trading partners by the May 2007 agreement between the U.S. Administration and Congress.

Even if an agreement does not need to be formally renegotiated then a U.S. trading partner may still find itself encouraged to sign legally-binding side letters etc. Again, this represents a deviation from trading partner's legitimate expectations at the time the FTA negotiation was initiated. Of course, it may still be in the interest of the trading partner to acquiesce in signing such side letters (or their alternatives). Still, the trading partner has some grounds for feeling that the "rules of the game" have changed and that negotiations with the United States have become a more complicated and uncertain matter.

Third, not only will the substance of some of the measures in the agreement likely be of concern to some Asia-Pacific nations, but the manner in which the agreement came about suggests that other unattractive measures may well be inserted into future agreements. All of these considerations are likely to undermine those parties in a trading partner arguing for positive engagement (through trade negotiations) with the United States. Moreover, these factors may tip the balance in some Asia-Pacific nations between negotiating a FTA with the United States to negotiating with some other party.

The fourth implication is that there is nothing to suggest that this agreement is sufficient to encourage the United States Congress to renew President Bush's Trade Promotion Authority. Should renewal not occur then this does affect nations in the Asia-Pacific as the U.S. cannot conclude any further FTA negotiations, or the Doha Round for that matter, without the fear that Congress will amend, unpick, rewrite, or effectively force the renegotiation of any agreement put to it. (Given the Congress has effectively done the latter, at least with the Peruvian FTA, then the current Congressional leadership in both parties can hardly inspire foreign trading partners' confidence on this matter.) More generally, on the basis of specialist press reports coming out of Washington, D.C., it would be very difficult to confidently predict that Trade Promotion Authority would be renewed. In which case the U.S. will effectively exit from future FTA negotiations in the Asia-Pacific region. In principle, nothing stops the U.S. Administration from launching new negotiations but given the manifest uncertainties described above how many informed trading partners would be willing to put themselves through essentially two set of negotiations with the United States?

Part of the underlying problem is that the current U.S. Administration does not enjoy the minimum necessary level of confidence of many of Congressional representatives. Without a modicum of confidence the latter are unwilling to transfer part of their constitutionally-given rights to regulate foreign trade to the U.S. Administration. (A similar impasse occurred in the late 1990s when President Clinton faced a hostile Republican Congress.) This consideration suggests that the earliest likely resumption of Trade Promotion Authority is after the next U.S. presidential election and only if the persons elected at both ends of Pennsylvania Avenue share enough common ground on trade-related matters. Given that renewing Trade Promotion Authority is rarely one of the highest priorities of any incoming U.S. Administration, it may well be 2010 before the U.S. can re-enter serious FTA negotiations in the Asia-Pacific. This leaves to door wide open for three years to the European Union's member states, represented by the European Commission, to strengthen commercial ties with the Asia-Pacific without fear of competition from U.S. trade negotiators. What the European Commission might do with this opportunity and what it might mean for the Asia-Pacific region is the subject of the next section.

4. Europe enters...so what?

In order to understand current EU FTA policy towards the Asia-Pacific it should be appreciated that the European Union effectively enforced a moratorium on launching new FTAs from 1997 to 2006. In 1997 the European Council of Ministers decided that "the fundamental architecture of the EU's policy on preferential trade agreements has been put in place and should be preserved" (WTO 1997), a remark that concluded a two year-long debate between various European nations and parties on the merits of signing further FTAs. After the Doha Round was launched, this moratorium on FTAs implied that the EU's principal negotiating priorities were multilateral in nature and, therefore, not diffused among different negotiating fora as in the case of the United States after the latter adopted the policy of Competitive Liberalization in 2001.

The slow progress of the Doha Round that has failed to satisfy the overseas objectives of certain influential European industries and sectors, plus the prospect that the current senior leadership on trade policy matters in Brussels would have little to show for their time in office if the moratorium had stayed in place, are thought to have contributed to the rethink on the EU's part. The October 2006 Communication (EC 2006a)⁸ on the European Union's new trade policy was the result (along with a new Communication on relations with China that has a strong trade dimension and a renewed Market Access Strategy announced in 2007).

The motivation stated in the Communication of the new EU trade policy differs from the multifaceted objectives of the U.S. policy of Competitive Liberalization. The European Commission argued that its new trade policy should be seen as part of the so-called Lisbon Agenda (of reforms to improve the performance of the European economy), by improving the competitiveness of European firms (through intensifying competition in European markets) and by opening markets abroad, so giving European firms more commercial opportunities overseas. In this regard the following quotation from the Communication is particularly revealing:

"There are two critical and linked requirements for European competitiveness. First, having the right internal policies, which reflect the external competitive challenge and maintain our openness to trade and investment. Second, ensuring greater openness and fair rules in other markets, in particular [in] our future major trading partners. Both must be underpinned by transparent and effective rules – domestic, bilateral, and multilateral" (EC 2006a, page 4).

One interpretation of the latter part of the above paragraph is that the EC believes that the rise of the new major trading powers ("our future major trading partners") will require both accommodation and restraint on the part of the European Union member states as well as new initiatives to ensure "greater openness and fairness in other markets." It is almost as if the European Commission is preparing to fight on two fronts: at home and abroad. These considerations suggest that whatever the independent room for manoeuvre the European Commission has will be devoted to these internal and external objectives and that it is probably not appropriate to think that the European Commission is merely a cipher for the defensive commercial interests of the European Union's member states. Governments in the Asia-Pacific region may find these observations particularly pertinent precisely because they represent many of the rising trading powers that the European Commission has in mind and because their national industries are probably responsible for many of the import surges into the European Union.

Although the focus of this section is on EU FTA policies towards the Asia-Pacific, it is important to appreciate that launching new FTA negotiations is just one of seven trade policy

⁸ Along with this Communication the European Commission issued an informative staff document, see EC (2006b).

priorities identified by the European Commission. The other six are: maintaining the EU's commitments to the Doha Round and to the WTO; developing new proposals on trade and investment relations with China; launching a second phase in the EU's strategy towards protecting intellectual property; renewing and reinforcing the EU's Market Access strategy; proposing new measures to open government procurement markets abroad; and conducting a review of the EU's "trade defence" instruments, such as anti-dumping, countervailing duties, and subsidies (EC 2006a, pages 18 and 19.) In short, the EU's new trade policy could be thought of as a mix of new rules, new markets, and new negotiating partners.

Before considering the EU's FTA policy in a little more detail, a final contextual comment on the EU's 2006 Communication is in order. Observers may well ask just how "new" its contents really are. Elsewhere (Evenett 2006 pages 382-385) I have documented the similarities and differences between the current EU trade policy as articulated by the present European Trade Commissioner and that of his two most recent predecessors. I argued there, and would argue that subsequent events have borne this out, that the 2006 Communication is much closer in motivation to its 1996 predecessor (presented by Sir Leon Brittan) with its emphasis (but no means exclusive) on market access than to the EU trade policy articulated by Mr. Pascal Lamy, with its focus on rule-making and global economic governance. This is not to imply that current EU trade policy does not seek to develop new commercial rules, rather that current negotiating objectives in this area relate to furthering European commercial interests and not to broadening popular support for globalisation and international market integration.

In terms of which countries are being targeted for potential FTAs with the EU a number of points should be borne in mind. First, it is worth recalling just how important foreign policy and so-called neighbourhood considerations were in determining EU FTA partner selection in the past; in this respect given that the EC could not conduct its own formal foreign policy in the past, its FTA and aid policies became important parts of its *de facto* foreign policy. Second, as a result of the first consideration the patchwork of EU FTAs in place tended to omit countries in East Asia, South Asia, and Latin America. (Eastern Europe, Central Asia, and the Middle East and North Africa, as well as the smaller former island colonies being the principal recipients of preferential access to European markets.) One can imagine prominent European commercial interests (in both manufacturing and services) being frustrated with prior FTA policy, as it was delivering little in terms of preferential access to the fast growing emerging markets of Asia and the Pacific.

Third, arguably the 2006 EC Communication remedies any previous tendency to overlook the potential partner's economic size in the FTA selection process. Indeed, the European Commission appears to have gone to considerable lengths to calculate the so-called market potential over the years 2005-2025 of a number of candidate FTA partners. The EC argues that this factor was an important consideration in choosing among possible FTA candidates this time around. However, market potential is evidently not the only consideration as the omission of the United States, Japan, China, and Canada from this list of potential FTA partners attests. (EC (2006b) reports the EC's calculations in this respect.)

Other economic factors were also taken into account in the selection of potential FTA partners including the level of protection (including non-tariff barriers) applied against EU export interests, whether and with whom a candidate partner is negotiating or has negotiated FTAs with third parties, and the risk that any steps taken by the candidate country would erode any preferential market access that the EU may already have. On the basis of these economic criteria, the EC has stated that FTA negotiations with ASEAN, Korea, and MERCOSUR are "priorities." India, Russia, and the members of the Gulf Cooperation Council, because they combine both high levels of protection and substantial market potential, were identified as candidate FTA countries too. In sum, then, the legacy of prior FTA negotiations plus certain economic metrics appear to account for a large part of the EU's selection criteria for partners

for FTAs. However, given the fact that several very large economies are not being considered as potential FTA partners for the EU, then this argument should not be taken too far.

In terms of content the FTAs, the EC is arguing for a comprehensive treatment of market access, including improvements in the service sector, a tough approach to tackling non-tariff barriers, and improved trade facilitation measures. Interestingly the European Commission appears to be less emphatic about the inclusion of controversial labour and environmental standards in the new set of FTAs (quite unlike the May 2007 agreement between the U.S. Administration and the Congressional leadership described in the last section.) As part of measures to promote sustainable development, the EC argues, the latter provisions "could" be included. The EC also commits to take into account the developmental significance of its FTAs on its potential FTA partners and on other developing countries also receiving preferential access to the markets of the European Union. In concluding its discussion of these matters the Communication argues that the goals for its FTAs are ambitious and that the degree of potential FTA partner support for the EC's goals should be taken into account.

In what remains of this section I will describe the pertinent developments since the Global Europe Communication was issued in October 2006. Particular attention will be given to the matters that could be sensitive for Asian and Pacific governments. The first major matter is the treatment of potential labour and environmental standards in the next generation of EU FTAs. Mr. Mandelson appears to recognise just how sensitive labour and environmental standards are to some developing countries. Indeed, in a column he wrote for the Indian newspaper *Financial Express* on 13 October 2006⁹, he acknowledged that these were sensitive negotiating matters but omitted any explicit mention of labour and environmental standards. At a conference held to discuss the Global Europe Communication in Brussels on 13 November 2006¹⁰, Mr. Mandelson indirectly referred to labour and environmental standards in the context of sustainable development provisions of FTAs and argued that he sought non-sanctions-based and cooperative approaches for dealing with "standards" (as he referred to them.) He also noted that the EU would not seek to impose its standards on other nations. Finally, and more recently, in remarks to the European Parliament on 22 May 2007, Mr. Mandelson reiterated his view that incentives, not sanctions, should be used to enhance labour and environmental standards.¹¹ This suggests that labour and environmental standards may not be such a controversial matter after all. Their inclusion in FTAs will, it seems, be sought by the EC but the latter has indicated (with its repeated references to incentives) that it is willing to pay a price for them.

Second, it is unclear just how hard the European Commission will insist that FTA partners sign up to new disciplines on the so-called Singapore Issues.¹² The following remark by Mr. Mandelson, which came in response to several statements made at the European Parliament and concerning the inclusion of these issues in potential FTAs, is revealing:

"All I can say in this regard is that, if partner countries decide that they wish to discuss these issues bilaterally with the European Union as a means of promoting

⁹ "Global Europe meets India Inc.," *Financial Express*, 13 October 2006.

¹⁰ "Remarks to the Global Europe Conference. Peter Mandelson at the External Trade Conference on Global Europe: Competing in the World. The Way Forward. Brussels, 13 November 2006." Available from the website of DG Trade, Brussels.

¹¹ "European Parliament Debate on Global Europe. Transcript of Remarks by Peter Mandelson, Strasbourg, 22 May 2007". Available from the website of DG Trade, Brussels.

¹² This is the collective term to describe those governmental policies that became the subject of discussions (on the merits of potential multilateral disciplines on these policies) in the WTO after the Singapore Ministerial Meeting in 1996. Typically, the Singapore Issues are taken to include: trade and investment policies, competition policies, transparency in public procurement policies, and trade facilitation.

their own development and creating economic opportunities for them, why should they not do so? I do not think it is for us in Europe to tell developing countries and emerging markets that they should not be addressing issues like investment, competition, and transparency in government procurement."

Arguably this statement leaves open the possibility that Europe's new FTA partners could rebuff any overtures to include provisions on the Singapore Issues. However, this may be too naïve an interpretation, especially if the European Commission makes it clear to a trading partner that the inclusion of some or all of the Singapore Issues is necessary for the EC to win support for the final agreement from the member states of the European Union.

A third consideration is that at its meeting on 23-24 April 2007 the European Council insisted that FTA partners negotiate not just a trade agreement but also a Partnership and Cooperation Agreement (PCA). The latter seek, amongst others, to strengthen political ties with the EU and to affirm certain fundamental values that the EU subscribes to, such as democracy. In the case of ASEAN, the European Council explicitly insisted that the conclusion of the PCA and FTA be linked. This raises the possibility that certain South-East Asian nations could be excluded from FTA negotiations because of political considerations. Under these circumstances negotiations with the current governments of Thailand and Burma are most unlikely, which in turn could have implications for the EC negotiation with ASEAN, especially if the latter insists on negotiating *en bloc* with the EC. In contrast, political considerations do not appear to be a constraint in potential EU FTA negotiations with India and Korea. To the extent that there are any major changes in the political regimes of the EU's prospective FTA partners, Asian analysts should not assume that they will have no bearing on any ongoing negotiations with the EU. It should be recalled that even though the European Commission negotiates FTAs it is the European Council, whose membership is made up of the ministers of the 27 EU member states, that decide (by qualified majority votes) to approve FTA agreements. An Asia-Pacific nation's overall relationship with the leading member states may well colour the latter body's decision-making, suggesting that non-commercial considerations may from time to time be influential.

The purpose of this section was to describe pertinent features of the European Union's new trade policy, Global Europe. The ending of a nearly ten year-long moratorium on the launching of new FTAs is of particular interest to nations in the Asia-Pacific, precisely because the European Commission has indicated that it will join the scramble for preferential access to the region's fast growing markets. In terms of negotiating objectives, even though the European Commission has a large number of stated goals I would argue that certain priorities have emerged. It would seem that proposals for labour and environmental standards and provisions on the Singapore Issues will take second place to steps to expand market access in manufactured goods and services and to improve the protection of intellectual property rights in trading partners. (In that sense the broad thrust of the priorities of the European Commission are not too dissimilar from their American counterparts, even if many of the details differ in important respects.) Moreover, Asia-Pacific nations should not rule out political and diplomatic considerations affecting the launching of, progress in negotiations, and conclusion of FTAs with the European Union. In this respect it is worth recalling that two distinct features of the European Union: first, that in the absence of a formal EU foreign policy, the European Commission has often used its trade policy as a foreign policy instrument, and secondly, that the members states of the EU can play a significant role in commercial policy formation in the EU.

4. Concluding remarks.

Undoubtedly nations in the Asia-Pacific region will continue to negotiate a range of bilateral and sub-regional FTAs among themselves. However, during 2007 these nations will see one important change in the FTA opportunities that they have from outside of the region. For entirely internal political reasons U.S. trade negotiators have effectively retreated from the Asia-Pacific. In contrast, EU trade negotiations were given a mandate in April 2007 from the European Union's member states to start FTA negotiations with the ASEAN nations, Korea, and India (amongst others). This paper has examined the causes of these changes and what, if anything, they might mean for officials and trade policy analysts in the Asia-Pacific region.

A number of similarities and differences between the EU and the U.S. approaches to FTAs were identified. Both were keen on the comprehensive opening of trading partners' markets (if not exactly keen on opening all of their own markets!), including public procurement markets, and on strengthened provisions on the protection of intellectual property rights. The approaches taken by the EU and U.S. do differ in motivation; the latter has constructed an elaborate rationalisation of its trade policy called Competitive Liberalization, whereas the former stresses the effects on European competitiveness and living standards.

Differences also appear in the logic underlying partner selection. The EC has deliberately tried to shift the weight in its selection criteria towards economic considerations, including the current and potential market size of a trading partner. There are limits to this shift, however, as evidenced by the omission of China and Japan from the list of potential EU FTA partners in the Asia-Pacific. Meanwhile, the U.S. appeared to place more weight on whether a country indicated that they were prepared to take on demanding set of provisions, so deliberately by-passing those trading partners reluctant to reform whatever their market size.

In practice the EU and the U.S. could well diverge in their treatment of labour and environmental provisions in FTAs. The U.S. Congress is now insisting on such provisions being enforceable, whereas the EC has repeatedly stated that it seeks an incentive-based and not a sanctions-based approach. With respect to provisions on the Singapore Issues, the EU's approach seems to be weakening whereas the U.S. has tended to insist on their inclusion. (This should not be taken to imply that both sought exactly the same types of provision for each Singapore Issue.) Differences also emerged over the role of political and diplomatic considerations, with the EU insisting that any FTA be complemented by the negotiation of a Political and Cooperation Agreement.

Looking forward it seems that, given the developments in the United States, the EU probably has three years when it will not face any FTA-related competition in the Asia-Pacific from the U.S. Given the length of time it has taken to negotiate some of the U.S. FTAs, this window of opportunity for the EC may not be as long as some might think. Moreover, even if the EC faces no FTA competition from the U.S. other nations may well be willing to offer preferential market access on less demanding terms than the EC. These considerations, plus the desire of certain EU officials to have something to show for their time in office (the current term of Barroso Commission ending in 2009), will probably generate pressure on the EC to moderate its demands over time. Indeed, compared to the tough rhetoric of American trade negotiators with all of their talk of "gold standard" FTAs, trade negotiators from the Asia-Pacific nations may well find their European counterparts to be far more amenable. This is not to say that the latter will be a pushover, especially as they are likely to make serious market access-related demands that probably go beyond what many Asia-Pacific nations have been willing to sign in FTAs among themselves.

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Globalization and Economic Growth

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I. Economic Effects of Globalization

1. Theoretical Analysis

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2. Positive Analysis

- A. Openness, Growth and Income
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- C. Openness and Technology Transfer

Globalization?

- Do you love Globalization?
- Do you hate Globalization?
- G-Lovers argue
 - Indispensable, Irreversible,
 - Best way to achieve the sustainable economic development
 - Good guy
- G-Haters argue
 - Make worse environment and labor and the poor
 - Increase the income gap between haves and have-nots
 - Bad guy

- Wider meaning: Keohane and Nye(2000); a process that erodes national boundaries, integrates national economies, cultures, technologies and governance and produces complex relations of mutual dependence
- Narrower meaning: Economic integration on a global scale ► openness in trade, financial liberalization, migration of workers, etc.

Openness and Growth (1)

1. Theoretical Background

- Solow's neo-classical growth model (1956) and Endogenous growth model
- Solow: If the efficiency of resource allocation is improved through openness, the steady-state level of income increases.
- Main idea of Endogenous growth model : openness leads to endogenous technological progress and in turn, this promotes the long-term development by driving up productivity.

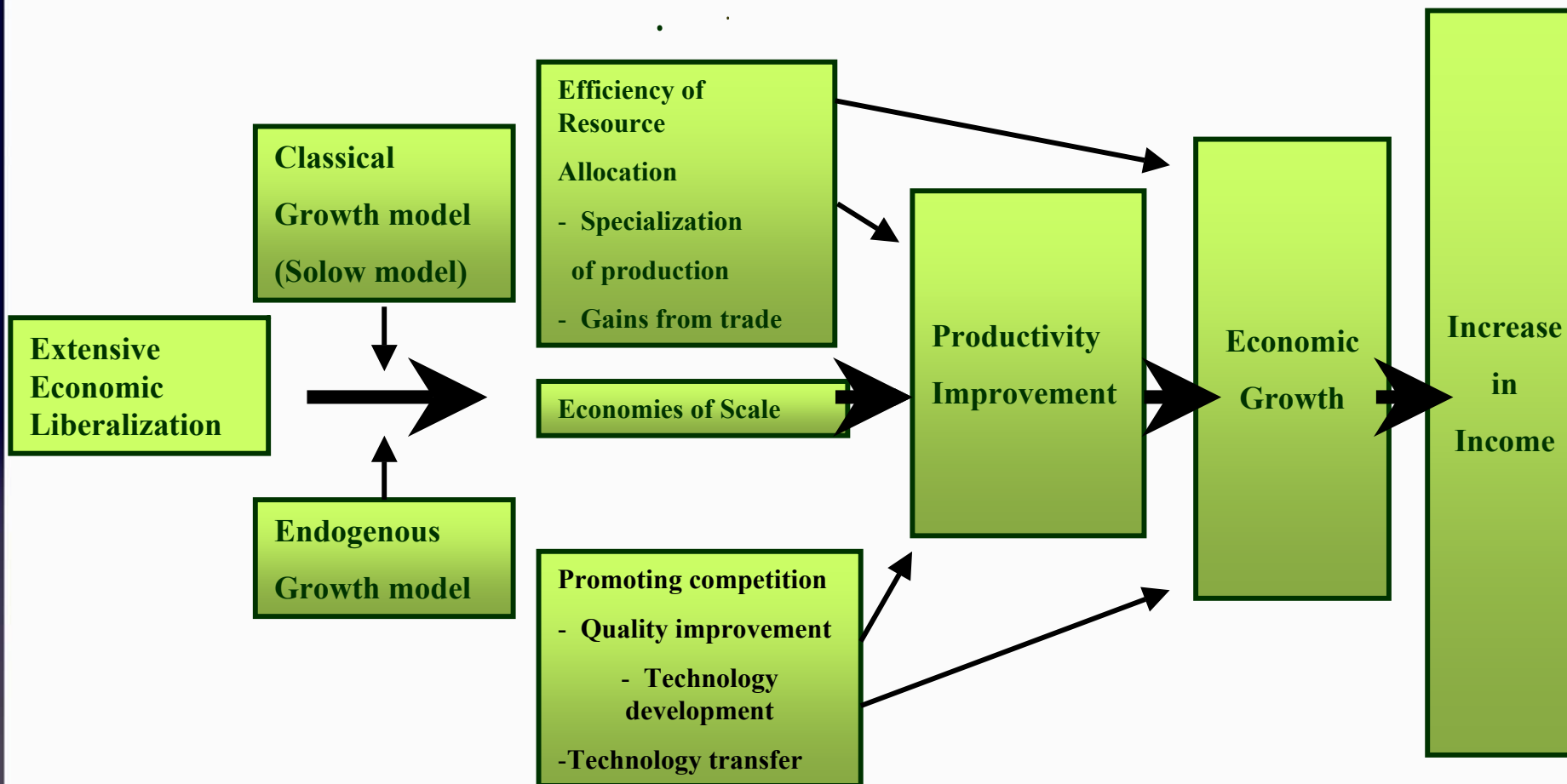
Baldwin(1989, 1992) applying Solow model

- Two stage effects :
 - 1) Trade liberalization shifts factors of production to the higher value-added industry and thus, generates more outputs with same quantity of input derived from improved efficiency.
 - 2) Total outputs increase in the first stage and part of them is accumulated leading to increase in capital stock.
- Promoting Economic Growth

Endogenous growth model

- Helpman and Grossman(1991) : Globalization attracts more FDI coupled with technology diffusion.
- Bhagwati(1988), Kruger(1980) : Industrial specialization
- Lucas(1998) and Young(1991) : Learning by doing
- Romer(1990) : Developed countries' R&D can affect the level of productivity of its trade partners. (Spillover effects)
- Promoting Economic Growth

Openness and Growth (2)



Openness and Growth (3)

2. Contribution Mechanism of Openness to Growth

1) Improving efficiency of resource allocation

- Adam Smith: Absolute advantage
 - Specializing industry that has higher productivity based on a absolutely lower cost.
 - Trade with other countries with goods in which its absolute advantage lies.
- David Ricardo: Comparative advantage
 - Specializing industry that has a lower relative cost of producing some goods.
 - Trade with other countries with goods in which its comparative advantage lies. (Importance of opportunity costs)
- ➔ Both theories : All countries can benefit from specializing in and exporting those products that are relatively more effective to produce.

Producer's Side	Consumer's Side
Tariff elimination and removal of trade barriers through globalization	Lower price for imported goods Wider selection of the goods
Relocation of factor endowment from inefficient sector to more efficient sector : Same input → More output	Access to the differentiated goods Enhanced consumer's welfare

Openness and Growth (4)

2) Economies of scale

- Trade liberalization: Eliminating excessive profits (price - marginal cost) after easy market access
- Corporations : Less in number but bigger in size
- Rationalization effect : As the scale of production increases, economies of scale occurs.
- In the long run, a decrease in average costs of each unit due to larger market after trade liberalization

3) Promoting competition

- Openness : Not only a new opportunity to access bigger markets but also a challenge in respect to intensified price and quality competition among domestic goods
 - **Quality improvement** : Export countries' efforts to innovate technology and make more higher value-added products (Boorstein and Freenstra, 1991)
 - **Technological development** : Promoting development for new technology to develop inimitable technology (Thoeing and Verdier, 2003)
 - **Technology transfer** : Initiating competitiveness through indirect technology transfer and accumulating technological knowledge

Openness and Growth (5)

4) FDI

- Openness helps to attract more FDI with easier access to domestic market.
- Positive external effects increasing productivity in domestic market : Technology and management

5) Institutional Advancement

- Institutional advancement in various areas such as economic infrastructure, capital market and property rights system
- Stimulating incentives to seize the expanded trade opportunities

Openness and Productivity

- Technological advancement and productivity improvement → Key factors for economic growth
 - Lewis(2004)
 - Society with higher level of productivity replaces society with lower level of productivity.
 - Liberalization in a country with lower level of productivity is a path to improve its productivity by trade and investment which transfer the higher productivity.
 - Alesina, Spolaore and Wacziarg(2000) :
 - Market liberalization : A key factor to improve productivity.
- According to the studies having conducted so far, liberalization affects productivity improvement in two ways.
 - 1) Expanded trade : Direct way to affect productivity.
 - Proposed long ago but still supported by many scholars
 - 2) Technology corporation and institutional reform : Non-tradable factor
 - Highlighted more recently but further positive analysis is needed.
 - Increased FDI promotes market competition resulting in technological innovation.
 - In particular, importing capital and intermediate goods increases efficiency of capital accumulation and allows reverse-engineering that helps to learn advanced technology and production methods.
 - Globalization : Not just importing tradable goods but also leading to increase in human capital, change technology, induce positive effects between intra-industry and intra-corporation (Grossman and Helpman, 1991)

Economic Effects of Financial Openness

- Financial Openness : Benefits for both capital exporting and importing country
 - Capital exporting country
 - Portfolio diversification effects reduce its risk.
 - Capital importing country
 - Financial liberalization is to cushion negative effects from the external impact stabilizing consumption pattern.
 - In the emerging economies, however, economic cost for rapid capital flow can in no way be negligible.

Benefits of Openness

- Consumption Smoothing
- Contribution to increase in domestic investment and growth
- Enhancing efficiency of macroeconomic policy
- Contribution to the domestic financial market growth

Costs of Openness

- Intensified misallocation
- Impediment to the macroeconomic stability
- Procyclical problem of short-term capital
- Problems of herding behavior or contagion effects

Benefits of Openness (1)

1) Consumption Smoothing

- Capital importing country: Increase in national wealth by risk sharing and consumption smoothing
 - During stagnation or decline of terms of trade : Capital inflow for reducing the degree of consumption contraction
 - During excessive economic boom: Capital outflow for reducing the degree of consumption fluctuation
- ➔ This intertemporal consumption by capital flows is known to increase national wealth in the long run.

2) Contribution to increase in domestic investment and growth

- Attracting foreign investment to the country with a shortage of capital
 - Foreign capital inflow supplements a short capital supply from savings → accumulation of domestic capital → increase in domestic investment
 - Higher quality of living comes from increase in growth rate accompanied by increase in the domestic investment.
 - Also, FDI inflow brings with management and technology know-how.

Benefits of Openness (2)

3) Enhancing efficiency of macroeconomic policy

- Increase in capital flows improves efficiency of macroeconomic policy
 - Formation of a new environment:
 - Enforcement of a good policy → More positive effects on the market
 - Enforcement of a bad policy → Being shunned by the market
 - Strengthening the consistency and efficiency of macroeconomic policy and reducing the frequency of policy failures
 - Positive effects on financial stabilization → Effective allocation of resources which lead to economic growth

4) Contribution to the domestic financial market growth

- Positive effect of financial liberalization on development of domestic financial market
 - Extensive entry of foreign financial institution to the domestic market : Constraining domestic banks' monopolistic or oligopolistic status and reducing the costs for financial intermediation → Increase in investment
 - Improving competitiveness of the domestic financial services and establishing risk management system
 - Foreign financial institution helps to establish supervision system and legal system effectively.
 - In the case of failure of financial institution and impediment to the stability: Control the capital outflow through foreign financial institution instead of a capital flight

Costs of Openness

1) Intensified misallocation

- Some foreign capital inflows' concentration on ineffective sector entails negative effects on long-term development.
- Speculative capital, hedge funds or excessive investment on real estate intensifies the degree of existing distortion of domestic resource allocation.
- In particular, distortions can get worsened in immature and inefficient financial markets.

2) Impediment to the macroeconomic stability

- Rapid foreign capital inflow → entails monetary expansion → causes inflation → appreciation of the currency → current account deficit
- Negative effects on macroeconomic stability

3) Procyclical problem of short-term capital

- Net capital inflows are procyclical (i.e., capital inflows increase in good times and decrease in bad times) in most developing countries

4) Problems of herding behavior or contagion effects

- Sometimes, herding behavior that is irrational and driven by emotion determines international capital flow.
- Volatility of asset price and capital increases.
- Increased macroeconomic volatility could cause contagion effects which spreads one country's risk to other countries with no direct connections.

Financial Policy Making

- Financial Openness: Benefits and Costs
 - Policymakers' prudent approach to maximize long-term benefits and minimize short-term risks is required.
 - To minimize negative effects of capital flow,
 - Maintaining consistency of macroeconomic policy
 - Making efforts to advance supervision system
 - To enhance efficiency of macroeconomic policy,
 - Maintaining optimal exchange rate
 - Providing sound financial basis
 - Necessary to strengthen domestic financial system and prudential oversight measures for proactive globalisation

Empirical Analysis to the Effects of Financial Openness (1)

1) Openness and economic growth

- The empirical study results for the question of whether or not financial openness promoted economic growth vary depending on the pattern of capital inflows.
- Borenstein De Gregorio and Lee (1998)
 - Positive effects of OECD countries' FDI inflows on economic growth
- Reison and Soto (2001)
 - The study measures the independent growth effect of foreign direct investment, portfolio equity investment, bond flows, as well as short-term and long-term bank lending in 44 countries.
 - The findings suggest that only foreign direct investment and portfolio equity inflows stimulate long-term growth prospects.
- World Bank (2001)
 - Positive effects of FDI on domestic economic growth

Empirical Analysis to the Effects of Financial Openness (2)

2) Capital inflow and business fluctuation

- Claesens, Dooley and Warner (1995)
 - FDI is as volatile as short-term and long-term bond and portfolio flows.
 - But in a different study : Lower volatility of FDI
- Razin and Rose (1994)
 - The degree of capital mobility is not strongly correlated with the volatility of economy. (based on a data set of 138 countries from 1950 to 1988)
- Gavin and Hausmann (1996)
 - On the contrary to Razin and Rose, the study concludes that the volatility of capital flows has close relationship the volatility of GDP in developing economies.
 - Possible negative effects of openness to developing countries
- O'Donnell (2001)
 - Study on the correlation between the volatility of capital flows and the volatility of economic production (based on a data set of 93 countries from 1971 to 1994)
 - In comparison to OECD countries, developing countries show higher correlation. That is capital flows raise capital volatility.

Empirical Analysis to the Effects of Financial Openness (3)

3) Capital flow and macroeconomic variables

- Fernandez-Arias and Montiel(1996)
 - The surge of capital inflows can entail inflation, real exchange rate appreciation and current account deficit in recipient countries.
 - Particularly, higher negative effects on fixed exchange regime

4) Entry of foreign banks to domestic market

- Claessens, Demiguc-Kunt and Huzinga(2000)
 - The role of foreign banks in domestic system is to reduce exclusive advantages and status enjoyed by domestic banks.
 - In particular, lowering domestic banks' net interest margin and profits → Promoting competitiveness in domestic banking sector
- Clark, Cull and Martinez Peria(2001)
 - Entry of foreign banks contributes to overall effectiveness of domestic banks as well as facilitate competition.

Positive Analysis: Openness, Growth and Income (1)

- OECD reports: “Open Markets Matters” (1998), “Trade, Investment and Development” (1999)
 - Extensive openness improves economic efficiency by efficient allocation of resources and also, contributes to increase in national income as well as economic growth.
 - More open and outward-oriented economies consistently outperform countries with restrictive trade and investment regimes.
 - However, restrictions on trade and investment, in common with other economic distortions, shift an economy to a less efficient and sustainable mix of investment, production and consumption patterns, thus depressing economic growth prospects and reducing attendant benefits such as job creation and innovation.

<The benefits of openness: Trade and Living Standards in Developing Countries>

	Average annual growth GNP per capita (%)		
	1963 ~ 1973	1974 ~ 1985	1986 ~ 1992
Strong outward oriented Country	6.90%	6.00%	5.80%
Moderate outward oriented Country	4.90%	2.20%	2.50%
Moderate inward oriented Country	3.90%	1.80%	-0.10%
Strong inward oriented Country	1.60%	-0.30%	-0.10%

Source: OECD(1998) "Open Markets Matters"

<Openness of 89 Developing Countries and Average Growth per capita>

No. of Countries / Level of openness	Average annual growth GNP per capita (%)
	1970 - 1989
15 Open economies	4.50%
74 Economies not always open	0.70%
OECD Economies average	2.30%

Source: OECD(1999) "Trade, Investment and Development"

Openness, Growth and Income (2)

- Dollar and Kraay (2001)
 - Relationship between the market openness (expansive trade and decrease in tariff rate) and economic growth
 - Results: Globalization leads to faster growth
 - Globalizers having expanded trade or lowered tariff experienced higher growth rate.
 - Globalizers : Growth rates of 5.0% per year in the 1990s while rich country growth rates marked 2.2% per year.
 - Non-globalizers : Only 1.4% in the 1990s

<Degree of Globalization and Average Annual GDP Growth Rate (%)>

	Average Annual GDP growth rate (%)	
	1980 ~ 1989	1990 ~1999
Globalizer	3.1%	5.0%
Non-Globalizer	0.8%	1.4%

Rich countries refers to the 24 OECD economies before recent expansions, plus Chile, Hong Kong, Korea, Taiwan, and Singapore. Globalizers refers to the top one-third in terms of their growth in trade relative to GDP between 1975-79 and 1995-97 of a group of 72 developing countries for which we have data on trade as a share of GDP in constant local currency units since the mid-1970s. Non-globalizers refers to the remaining developing countries in this group. Averages decadal and are population-weighted.

Openness, Growth and Income (3)

- Frankel and Romer(1999)
 - Relationship between share of imports and exports relative to GDP and income per capita
 - (Based on trade and income data set of 63 countries in 1985)
 - Using instrument variable to resolve endogeneity issue
 - one percent increase in share of imports and exports relative to GDP raises income per capita by two percent.
 - Openness is a key factor to decide level of real income per capita.

- Sachs and Warner(1995)
 - Using a measurement based on trade policy to find the effect of trade liberalization on economic growth
 - (Based on a data set of 122 countries from 1970 to 1989)
 - Timing of trade openness is fundamental; countries that liberalized the trade since 1975 experienced higher growth.
 - All countries that opened markets in 1970s showed absolute convergence. (developing countries growth rate is higher than that of the developed.)

Openness, Growth and Income (4)

- Frankel and Rose(2002)
 - Implications of common currencies for trade and income
 - Currency unions lower the transaction cost →promoting trade. This expanded trade comes through higher income.
 - one percent increase in a country's openness raises income per capita by two percent.

- Deininger and Squire(1996), Bhagawati and Srinivasan(2002)
 - High growth rate in developing economies help to diminish poverty in those countries.
 - Deininger and squire(1996): 77 developing countries out of 88 countries showed to increase average income in proportion to the income increase of the people living in poverty.(25% from the bottom of income distribution)
 - Bhagawati and Srinivasan(2002): Economic growth alleviates poverty. China and India are typical examples.
 - China : Annual average GDP growth rate (10% from 1980~2000)
Poverty rate (28% in 1978 to 9% in 1998)
 - India : Annual average GDP growth rate (6% from 1980~2000)
Poverty rate (51% in 1977/78 to 27% in 1999/2000)

Positive Analysis: Openness and Productivity (1)

- KIEP (Lee, 2006)
 - Effects of productivity improvement affecting Korean industry and economy as a whole in by RTA including FTA
 - RTA brings trade promotion along with institutional advancement, enhancement of corporate management transparency and efficiency and improvement of higher value-added domestic industry.
 - (Base on a data base set of 186 countries every 5 years from 1970 to 2000)
 - Every 1 percent increase in a country's real openness raises productivity by 0.1 percent.
 - Every 1 percent increase in RTA intensity raises productivity by 0.1 percent.

- Lee, Won-gi and Kim, Bong-gi(2003)
 - Effects of economic openness (imports and FDI) on productivity improvement of Korean industry.
 - 17 industries (11 manufacturing, 5 services, construction) from 1990 to 2001
 - In Korean case : Imports and FDI contributed to productivity improvement.
 - Every 1 percent increase in imports growth rate raises TFP growth rate for overall industry by 0.11 percent.
 - Every 1 percent increase in FDI growth rate raises TFP growth rate by 0.05 percent.
 - Degree of effects : Less liberalized industry < more liberalized industry,
Service industry < Manufacturing industry

Openness and Productivity (2)

- Ahn, Sang-hoon and Kim, Ki-ho (2005)
 - Relationship between market structure and productivity improvement.
 - The more competitive market structure (perfect competition or open economy) is, the greater contribution to efficient resource allocation and productivity
 - Role of competition : Promoting innovation activates, improving incentive structure, selecting more effective economic subjects
- Baily and Gersbach(1995)
 - Effects of expansive trade and investment openness on productivity improvement.
 - German, Japan, U.S industry are divided into 9 categories.
 - Expansive trade and investment openness promote competition and in turn, contribute to the productivity.
- OECD(1998)
 - Relationship between trade expansion and enhancing competitiveness in individual corporation level
 - US firms (comparison between exporting firms and firms for domestic consumptions) from 1986 to 1994
 - Labor productivity is higher in exporting firms by 40%.
 - Productivity growth rate of exporting firms : 3 times higher than average growth rate in U.S.

Positive Analysis: Openness and Technology Transfer

- Coe and Helpman (1993) “International R&D Spillover”
 - The study estimates the effects of developed countries R&D on its trade partner’s level of technology through trade openness.
 - International trade affects improvement of trade partner’s productivity through technology diffusion.
 - Higher openness means greater influence of foreign R&D on domestic productivity.
 - In a small economy, foreign R&D is as important as domestic R&D.
 - In a large economy such as U.S, Japan, France, Italia, Canada, Germany : G7), domestic R&D is more significant than foreign R&D.

II. Case Studies on Globalization and Growth

China, India, Eastern and Central
EU countries, Latin American
countries

China: High Growth after WTO

- China's openness ratio: higher than other BRICs country
 - China(63.7%), Brazil(25.0%), Russia(44.1%), India(30.1%) based on 2005 IFS data
- WTO commitments
 - Import tariff: 15.3%(2001) → 9.8%(Jan. 2007)
 - Services liberalization: as of 2005. committed 104 out of about 160 services sectors (advanced countries: average committed sectors of 108)
- With China's committed openness policy and reforms, after WTO, China achieves about 9.7% annual average growth rate.

	2000 World Ranking, (billion dollars)	2006 World Ranking, (billion dollars)	ANNUAL AVERAGE GROWTH RATE(%)
GDP	6 (1,198)	3 (2,554)	9.73
Trade	7 (474)	3 (1,765)	24.5
Foreign reserves	7 (165.6)	3 (1,066.3)	36.4

China: actively-growing business activities of Multi-national enterprises (MNEs)

- MNEs establish East Asia Headquarters in China utilizing China as Global Production Chain and Outsourcing Centers
- In 2005, 40 MNEs have 40 headquarters and 750 R&D center in China
- After WTO, with distribution • financial • telecommunication services being liberalized, foreign financial institutions and services enterprises are expediting the establishing of businesses in China

<Services Sector: MNEs' business activities>

Financial Sector	In Dec 2006, foreign bank's retail banking for Chinese consumers was allowed. Nine foreign banks established local subsidiaries, for example, HSBC, Citigroup, Standard Chartered, etc
Distribution	Wall Mart and Carrefour got business in China. China is utilized as global outsourcing center
Express Delivery Services	DHL, FedEx, TNT, UPS have joint ventures in China

China: Openness plays a driving role of sustainable economic development

- Mechanism: Openness \Rightarrow Competition in domestic market \Rightarrow Firms in the market striving to enhance “Efficiency” in order to survive \Rightarrow Sustainable Economic Development
- Efficiency-enhancing drive is transforming SOEs (State owned enterprises) which are the symbols of inefficiency of Chinese economy.
- Evidence for fierce competition : ratio of dependence on imports increased from below 15% in 1985 up to about 30% in China.
- Foreign affiliated companies in China are estimated to supply 60% of their productions to Chinese domestic market and this data shows more competition is being brought into China.

Globalization and Income Disparity in China

- After China's accession to WTO, income disparity among the provincials, between the cities and rural areas, between social classes got worse ⇒ a critical factor causing social instability in China : therefore, Chinese government adopted the 和諧社會 (*he xie*: harmonious society) in 2003 and continues to work on the issues to address.

Gap is widened	2000	2006
Per capita income ratio of city to rural	2.79	3.05

- IMF(2002): the income disparity between the cities and rural areas in the coastal areas (more globalized, more open) is smaller than that in the rural areas (less open areas in the west area of China)
- Globalization is not mainly responsible for the income disparity in China. There are various factors widening income gaps.

Openness in India

- Since 1947, socialist planning economic model: closed system and overburdened regulations ► low investment ► low economic growth called 'Hindi rate'
- After the collapse of communist system, in 1991 India faced the economic crisis
- In order to overcome the crisis, India took new economic reform policy centered on the openness measures

India: dramatic change in policy horizon

	Before the Crisis in 1991	After the Crisis
Growth model	Closed and self-supply model	Market oriented and open model
Trade & Investment system	Positive system	Negative system
Trade/non barriers	High tariffs/non-trade barriers	Gradual tariff-reduction

India: effects of openness

- India's riding on the globalization gives a record high economic performance.
- In particular, since 2003, three year average economic growth rate was 8.1% and the 2006 economic growth rate was 9.2% which is the highest economic growth performance in India's economic history.

India's GDP growth rate by openness periods

Before openness		Partial openness	Financial crisis	Openness	
1951~1974	1975~1984	1985~1990	1991	1992~2000	2001~2006
3.6%	4.6%	6.1%	0.9%	6.0%	7.4%

Source: Global Insight. 2007

India: effects of openness

- India's productivity shows a higher performance after pursuing the open economy
- Income distribution in India are gradually improved
 - Middle & upper class increased: 19.7%(in 1995) to 37.9% (in 2006)
 - Low income class decreased: 23.3% to 6.1%

India's productivity			
IMF		Virmani	
1960s	-1.0 ~ 1.1	1950/51 ~ 1964/65	1.9
1970s	-2.1 ~ 0.3	1965/66 ~ 1979/80	0.1
middle 1990s	1.5 ~ 3.4	1980/81 ~ 1991/92	2.5
late 1990s	0.3 ~ 2.9	1991/92 ~ 2003/04	3.6

T.N. Srinivasan. 2006. 'China and India and the World Economy'

Eastern and Central new EU members' GDP

Countries	2001	2002	2003	2004	2005	2006
Poland	1.1	1.4	3.8	5.3	3.5	5.6
Hungary	4.3	3.8	3.4	5.2	4.1	3.9
Czech	2.5	1.9	3.6	4.2	6.1	6.0
Slovakia	3.2	4.1	4.2	5.4	6.0	7.5
Rumania	5.7	5.0	4.9	8.3	4.1	7.8
Bulgaria	4.1	4.9	4.5	5.7	5.5	5.5
Slovenia	2.7	3.5	2.7	4.4	4.0	4.9
Cyprus	4.1	2.1	1.9	3.9	3.8	3.7
Malta	-1.1	1.9	-2.3	0.8	2.2	2.7
Estonia	7.7	8.0	7.1	8.1	10.5	11.2
Latvia	8.0	6.5	7.2	8.6	10.2	11.6
Lithuania	6.6	6.9	10.3	7.3	7.6	7.4
EU15(average)	1.9	1.1	1.1	2.3	1.5	2.7

Eastern and Central EU member countries

- Since 2001, Eastern & Central new EU member countries shows a rapid economic growth performance
 - Comprehensive trade & Investment liberalization : strong support of openness
 - Reform economic institution
 - Enhance political, economic, & social standard to meet "Copenhagen criteria"
 - EU's assistance programs working to help an integration into EU

Latin America and the Caribbean: Case 1 : Chile

- The successful openness model
- Since 1970, Reform and Open Economic Policy: focused on openness • privatization • stabilization measures
- The key to an economic success of Chile: active open policy (Hernan Buchi Buc, former Finance Minister, 2006)
- Since 2000, Chile taking aggressive FTA policy with the large economies such as EU(Nov.2002), US(June.2003), China(Nov.2005) ► Riding a horse of globalization
- As of March 2007, Chile concluded FTAs with 51 countries and since 2000, it entered into FTAs with 37 countries

Performance of Openness in Chile

- Chile is evaluated to achieve and maintain the most stable and sustainable economic growth in the Central and Latin American countries due to the consistent openness policy

Economic Growth	
Before reform and openness 1941-1973	After reform and openness 1974-2006
3.5%	4.5%

Source: OECD, Global Insight, 2007.

MEXICO: Second Case

- Since the middle of 1980s, Import substitution policy ► Export orientation policy: towards openness
- In 1986, GATT membership: openness, deregulation, privatization pursued and adopted as a national agenda.
- As of March 2007, Mexico concluded 12 FTAs with 43 countries and is the only one country having concluded FTAs with North America, EU, and Japan
- Mexico is one of the successful example of open economy
- Mexico's economic model are evaluated as a successful case by comparing other Latin American countries which show similar economic development path.
 - Achieved stable macroeconomic performances
 - Enhanced firms' international competitiveness
 - Enhanced sovereign rating
- Widened income gap issue
 - Some argue that, after NAFTA, political and social turmoil together with economic crisis are responsible for the widened income gap in Mexico.
- Income gap and some negative performances: peso crisis, a failure of structural adjustment policy, structural problems such as economic policy failure, corruption, etc

MEXICO: Second Case in LAC

- Economic Growth: 1995(peso crisis: -6.2%), 2001~2003 (low growth due to US economy: 0.6%)

periods	1991~93	1994	1996~2000	2004~2006
Growth rate	3.2%	4.5%	5.4	3.9%

- Trade:
 - 1990~93: trade to GDP: 30%
 - 2004~06: trade to GDP: 58%
- FDI:
 - 1993 : 4.4 billion dollars ► 2006: 18.9 billion (in 2001, 27.5 billion dollars, largest amount)

III. Economic Effects of Services Liberalization and Case Study

1. Necessary Requirements for the Economic Development
2. Economic Effects of Service Openness
3. Case Study on Service Openness
 - A. Case 1. Cuba
 - B. Case 2. Mexico
 - C. Case 3. Singapore

Service Openness: Necessary Requirements for the Economic Development

Faster growth of trade in services and FDI compared to trade in goods over the past 10 years

- Rapid technological progress : Expanding the scope of traditional service industries such as education and finance
- Effective telecommunication services : Necessary intermediate inputs for the whole economy by spreading and diffusing knowledge asset
- Effective transportation services : Necessary for the efficient distribution of goods in trade within the each country and in the world trade.
- Professional services
 - Legal and accounting services: Necessary for lowering the transaction costs
 - Education and healthcare services : Necessary for accumulating human capital
- Retail and wholesales services : Connecting producers and consumers. Necessary for efficient allocation of resources
- Software development
- Environmental services : Necessary for the sustainable development

Economic Effects of Service Openness (1)

- Service liberalization
 - Computable General Equilibrium (CGE) model (OECD, 2004) : Positive effects on economy by and large
 - World Bank Report of 2005 : Accelerator effects on economic growth

- GATS : Efforts to multilateral liberalization of services → stimulation for global liberalization of services
 - Service liberalization on FTAs : Complementary for GATS
 - Ultimately accelerate domestic reforms
 - Improves foreign service's market accessibility to developing countries
 - KORUS FTA will stimulate Korean service market reform and increase market access to EU and China

Economic Effects of Service Openness (2)

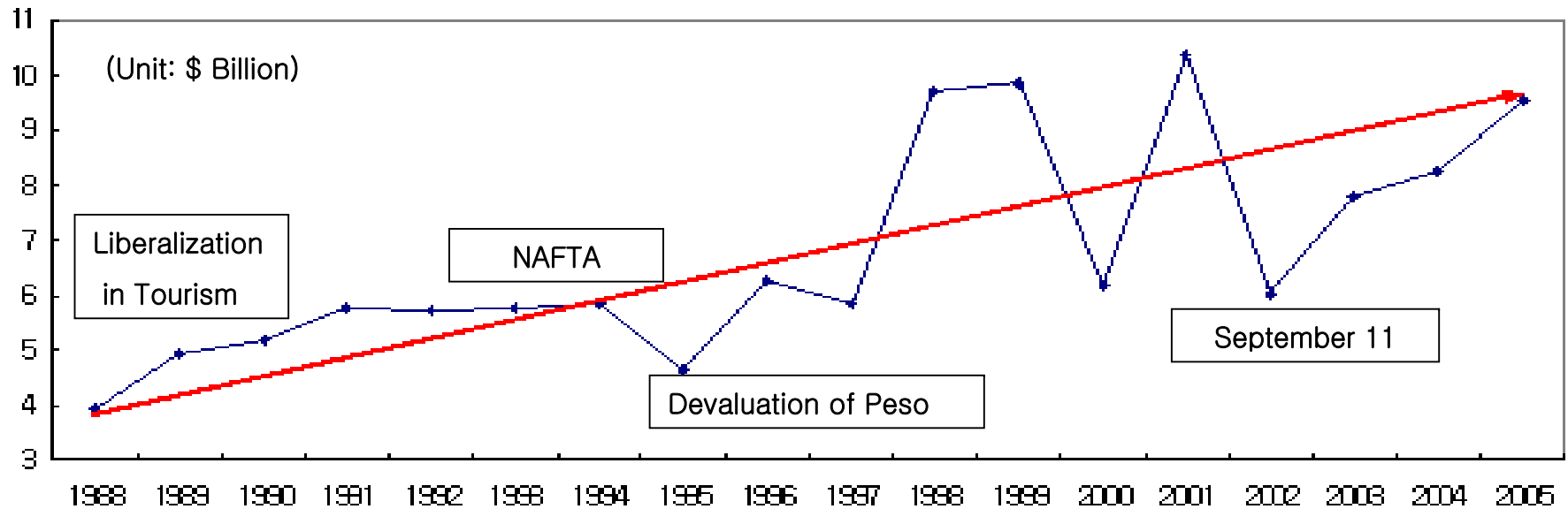
- Classens(2001)
 - Reducing entry barriers for foreign banks increases efficiency of domestic bank industry system
 - Empirical study result : 7,900 banks over 80 countries (weighted least squared panel estimation)
- World Bank(2005), Mattoo(2001)
 - Effect of liberalization in finance and telecommunication sectors on economic growth using Growth prediction model (based on 60 countries' data including 37 developing countries)
 - Countries conducting certain level of liberalization in finance sector : higher growth rate by 0.25%
 - Countries conducting full-scale liberalization in finance sector : higher growth rate by 1.2%
 - Countries conducting full-scale liberalization in both finance and telecommunication sectors: higher growth rate by 1.5%
- Arnold, Javorcik, and Matoo (2006)
 - Productivity effects of services liberalization in Czech Republic
 - Based on business data from 1998 to 2003 : Variables such as foreign firm's entry to domestic market, progress on policy reforms, privatization of service industry are statistically significant in respect to productivity in manufactures.
 - Manufactures using services as intermediate inputs increased productivity by quality improvement and diversification in services.

Case 1. Cuba

- World Bank(2005) : SERVIMED CASE
 - Fostering healthcare service as a export-oriented industry : A successful case
 - Establishing a company, SERVIMED, to sell medical services and travel package as a strategic exporting industry
 - As a result, 25,000 patients and 1,500 medical school students spent 25 million dollar from 1995 to 1996.
 - Increase in service export

Case 2. Mexico (1)

<Investment in Tourism in Mexico>



Source: World Travel & Tourism Council

- Allows foreign investment by 100% in hotel and restaurant facilities since 1989
- Tries to attract private investment so as to modernize travel industry
- Promoting "Open Sky" Agreement

Case 2. Mexico (2)

- Remarkable increase in both domestic and foreign investment in tourism
 - From \$3 billion in 1988 to \$10 billion in 1999
 - From 1999 to 2005, annual average of \$ 600 million by foreign investors (55% from U.S)

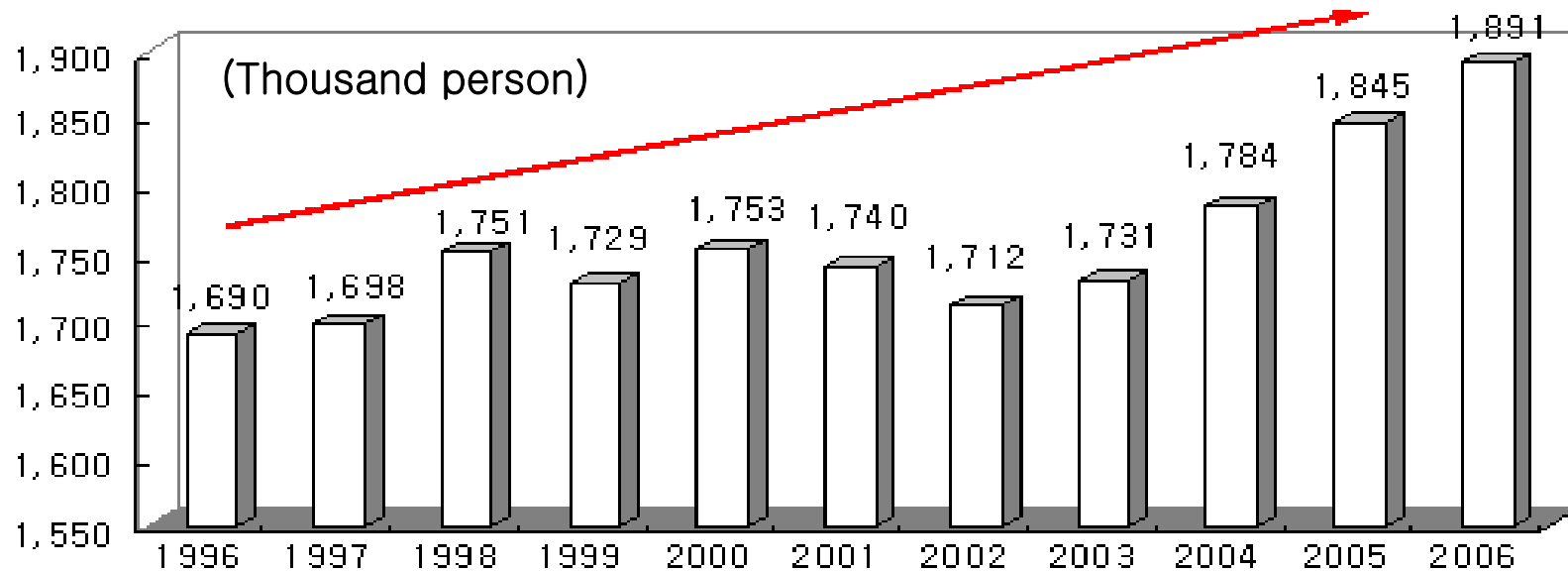
<FDI to Travel Industry in Mexico>

	1999	2000	2001	2002	2003	2004	2005	1999~2005 accumulation	
								US \$ million	Share %
U.S	505	430	266	280	89	317	333	2,220	55.2
Spain	211	21	88	32	63	-10	111	515	12.8
France	33	164	10	54	-6	-18	1	238	5.9
Denmark	98	31	14	13	11	35	2	205	5.1
Netherland	-6	72	42	13	-3	74	-36	156	3.9
Canada	13	42	8	11	4	23	38	139	3.5
Total	959	765	575	471	223	501	529	4,022	100

Source: INEGI

Case 2. Mexico (3)

<Full Time Workers in Tourism>



Source: Tourism Satellite Account Mexico 1997~2003, INEGI

- Sharp increase in the number of employees working for travel industry
- 1.69 million people in 1996 to 1.86 million people in 2005

Case 3. Singapore (1)

- Establishing “Industry 21” in 1998 and “New Challenges, Fresh Goals – Towards a Dynamic Global City” in national strategic report of 2003
 - Aim to foster service industry
 - Promote to liberalize markets in an active way
 - U.S-Singapore FTA in 2004
- Prospects for the knowledge-based industry
 - By 2010, increase up to 40% in total GDP creating 20,000-25,000 new jobs
 - Attracting 10 world top class universities
 - World-Class University Program(WCU)
 - Services industry : 2 years after U.S-Singapore FTA entered into force.
 - Consists of 2/3 of total GDP
 - Marking high production growth rate due to recent economic boom
 - Noticeable booming in financial services and business services by domestic and foreign investors alike
- Increasing tendency in employment
 - Manufacturing and construction in goods producing industry
 - Business services, wholesale and retail trade and financial service in service industry

Case 3. Singapore (2)

<Total GDP and Growth Rate by Industry>

(GDP at current market price)

	Million dollar (Singapore)				Annual percentage %			
	2002	2003	2004	2005	2002	2003	2004	2005
Total GDP	158,410	161,547	181,704	194,360	3.3	2	12.5	7
Goods Producing Industries	48,741	48,566	57,765	62,207	3.2	-0.4	18.9	7.7
Manufacturing	38,220	38,689	47,813	52,128	8.7	1.2	23.6	9
Construction	7,499	6,931	6,819	7,044	-13.4	-7.6	-1.6	3.3
Services Producing Industries	103,100	104,159	113,395	121,901	3.8	1	8.9	7.5
Wholesales and Retail trade	21,905	22,856	26,242	28,838	12	4.3	14.8	9.9
Hotels and Restaurants	3,323	2,983	3,387	3,638	-3.4	-10.2	13.5	7.4
Transportation and Communication	17,916	19,222	21,489	23,143	0.4	7.3	11.8	7.7
Financial Services	18,697	18,025	19,220	20,907	0.1	-3.6	6.6	8.8
Business Services	22,132	21,627	22,516	24,584	0.8	-2.3	4.1	9.2
Other Services	19,127	19,446	20,542	20,791	6.9	1.7	5.6	1.2

Source: Ministry of Trade and Industry. February 2006. *Economic Survey of Singapore 2006*.

Case 3. Singapore (3)

<Changes Employment by Sector 2002~2005>

	2002	2003	2004	2005
Total GDP	-22,900	-12,900	71,400	110,800
Goods Producing Industries	-39,400	-20,900	16,700	39,000
Manufacturing	-5,300	-4,900	27,200	29,500
Construction	-34,300	-17,500	-9,100	8,500
Other	200	1,500	-1,400	1,000
Services Producing Industries	16,500	8,000	54,700	71,800
Wholesales and Retail trade	-100	-2,300	11,000	11,800
Hotels and Restaurants	3,300	1,900	4,100	5,500
Transportation and Communication	2,900	-1,400	3,200	5,000
Financial Services	-2,000	2,200	6,200	7,700
Business Services	100	500	17,600	23,000
Other Services	12,600	7,000	12,500	18,800

Source: Economic Survey of Singapore, 2006

Globalization and Growth

- Go back to the drawing board again?
- Necessary to tweak a little to address some negative outcomes
- Domestic Policy Reform matters

Thank You.