

**DRAFT**

**Seeking the optimum framework for Regional Economic Integration in the Asia-Pacific Region**

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**The post-financial and economic crisis and FTAs**

**Gary Hawke  
Emeritus Professor, VUW**

**1. FTAs?**

The title of this session includes reference to “FTAs” the Open Forum as a whole refers to “Regional Economic Integration”. The terminology does not matter provided FTAs is understood to refer to the modern agenda of trade diplomacy but it does matter if journalists and other commentators, let alone participants, are encouraged to persist in outdated thinking about tariffs and the exchange of products of distinct national industries. That is true whether they are proponents of international trade or critics.

The relevant topic is how we facilitate the operation of economic activities throughout the region in such a way as to maximize their contribution to the welfare of the region as a whole (whether the region is Asia or Asia Pacific). That conception is conventional in relation to economic thinking – the most fundamental question of economics since Adam Smith has been under what conditions self-interest achieves a social optimum – but it is less instinctive for thinkers accustomed to zero-sum games, whether sporting contests or national struggles for position and status. “Regional economic integration” points towards the central issue of using the region’s resources to maximum effect – and so minimizing the impact of national boundaries whether by tariffs or other barriers – while preserving rules and institutions which make private interests compatible with social ambitions.

The point goes beyond terminology and conceptions of what we are about. Too much thinking is in terms of completed and printed agreements when what is required is removal of barriers to cross-border economic transactions – note barriers, not rules and institutions which promote compatibility of private and social interests. I am reminded of what I read recently in a review of a diplomatic history by Jonathan Schneer <sup>1</sup>

Many of the British diplomatic papers Schneer examines were brilliantly written. At times it seems that these dispatches and reports, rather than analyses of foreign policy, were the exercises of frustrated poets and writers educated at Eton and Oxford, who hoped for posterity in the Public Record Office. Much of what they wrote led nowhere, An excessive concern with style relative to content is not peculiar to British diplomats (although they tend to be better stylists than most). My point here is that we find the same characteristic among diplomats and trade negotiators. Achieving an agreement with all the chapters of a model agreement, and creating agreements in a specific order in accordance with an elegant architecture can easily come to loom larger than providing arrangements which facilitate an allocation of resources which can maximize welfare.

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<sup>1</sup> Tom Segev “View with Favour”, a review of Jonathan Schneer *The Balfour Declaration: The Origins of the Arab-Israeli Conflict* (Random House) in *New York Times Books Update* (20 August 2010).

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### 2. Post Crisis

We should first acknowledge that Asia was relatively little affected by the most recent economic and financial crisis. We should not buy in to the American and European beliefs that what was central to them must necessarily be central to the rest of the world. Of course the collapse of markets in Europe and America had an impact on Asian exports. This was especially so for durable goods for which replacement could be postponed and so the Singapore electronics industry was especially hard hit. All aspects of supply chains linked to exports were necessarily affected, and this flowed through to employment levels. I do not seek to minimize the impact of the crisis. But it was a very traditional trade crisis, and the recovery came equally through traditional trade channels – with supply chains enhancing vitality as much as they disseminated recession – and it was modest compared with experience in America and Europe. We should not buy into a sense of victimhood whereby Asia is always at the mercy of initiative from elsewhere.

Nevertheless, the Crisis has had an impact on economic integration in Asia. First, Asia has shared with Europe and North America a change in political mood, one in a direction not favourable to economic integration. Greed and immoral behaviour can be discerned in the lead up to the Crisis and it may even have played a part in causing what was encountered. But it was surely less unusual and less influential than the enormous outburst of public righteousness would suggest. Envy has had a field day and those who thought they were missing out on newly-acquired wealth or even of influence in setting the agenda of public policy have sought revenge with enthusiasm. We can expect that to pass, but it has fed a widespread political movement of caution. We may have avoided protectionism of the 1930s kind, and we can hope to avoid currency wars despite much of the rhetoric of the US Congress – we may even still hope to circumvent the follies of sub-national governments<sup>2</sup>, but we can hardly hope to avoid the irrationality of one-step logic that elevates the appearance of jobs now above the long-term gains in welfare that come from intensified regional integration. The first point to make about the the post-financial and economic crisis and FTAs is that they are going to require focused political effort.

Secondly, the crisis has ensured that the real economy and the monetary system are brought together in the policy debate. We have yet to see discussion of the RMB-\$US exchange rate set within a conception of an international economy with many participants rather than two, and with understanding of monetary flows as well as the relative process of exports and imports. It is not unusual for political salience to be inversely related to economic understanding but there is a more general recognition that monetary events cannot be kept distinct from flows of goods and services. Trade negotiators have had to add nontariff barriers, government procurement codes, services, investment and even intellectual property to their agendas, they have recognized the importance of facilitation, and they know that environmental issues and labour standards cannot be far behind. But we need more than a thicker book of chapter templates – we need a recognition of the interdependence of all aspects of economies and a focus on barriers to cross-border business rather than the conventions of traditional trade diplomacy.

One of the signs of real progress would be a bringing together within APEC of the Finance Ministers' Process and the trade preoccupations of the Committee on Trade & Investment and the Senior Officials' Meetings. That will require senior officials with economic understanding rather than only expertise in trade diplomacy.

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<sup>2</sup> .Jacob Kirkegaard, Peterson Institute “Ohio’s outsourcing ban – an ominous canary” *East Asia Forum* 28 September 2010

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It will also direct attention to the Leaders' Agenda for Implementing Structural Reform, the process for tackling "behind the border" barriers to trans-border boundaries. The proposed APEC Growth Agenda, advocates economic growth that is "balanced, inclusive, innovative, sustainable and secure". Those could be empty words, but they could also be means of ensuring that the APEC agenda address the post-crisis world.

Of particular relevance in the present context is the concern with "balanced growth". Much discussion refers to "imbalances", usually relating to the excess savings of Asia and the balance of payments deficit of the US. The terminology of "imbalances" might suggest that the balances themselves should be eliminated, but that would be absurd. We no more want to abolish capital flows than we want to abolish international trade. We have to form some judgment of optimal capital flows and then define a strategy for achieving them. The strategy will surely include regulatory reform which promotes intermediation of Asian savings through non-Asian institutions, and it will involve institutional reform which promotes Asian investment and consumption relative to Asian savings.

Structural reform is at the heart of post-crisis adjustment. It is going a little too far to say that Asia is recovering from a *trade* crisis; while Europe and the US have yet to overcome a *financial* crisis since the Asian trade crisis was indissolubly linked with the North Atlantic financial crisis, but it is right to observe,

There is never a politically 'right' time to undertake policy reform. When an economy is doing well, reform risks seeming unnecessary: when an economy is doing badly, reform and particularly structural policy reform, may seem like one burden too many.<sup>3</sup>

FTAs in the post financial and economic crisis era should be guided by their contribution to structural reform.

### 3. Form Follows Function, not Monumental Architecture

So we want trade agreements to follow an economic conception rather than traditional trade diplomacy, and to focus on removing barriers rather than achieving elegant agreements. This implies that we must accept changes to traditional thinking.

Despite ritualistic references to the Doha Development Agenda, and while preserving the option of taking advantage of an unexpected political constellation which makes multilateral agreement possible, we have to be prepared for a world from which WTO "rounds" are absent. The agenda is too wide and the number of significant players too great to repeat what was a major instrument of the second half of the twentieth century. The challenge now is to preserve the dispute resolution mechanisms of the WTO without the support of negotiating rounds.

The "single undertaking", the arrangement that nothing was agreed until all was agreed, and that the outcome of a Round had to be accepted as a whole, was formalized in the Uruguay Round in response to unhappiness about the decision of many members of GATT to remain aloof from various codes which had been negotiated in previous rounds, and to prevent opting out from agreements on new agenda items. However, its essentials go back to the origins of GATT and the idea that a comprehensive package allowed tradeoffs among components and facilitated consensus. The idea remains attractive, not least to participants who give high importance to a

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<sup>3</sup> John Llewelly and Bimal Dharmasena "Conditions for Growth: What government can do to promote long-term growth" (London: Centre for Policy Studies, 2010), p.3

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component which other participants find especially difficult, notably agriculture. However, the agenda is now too wide and significant participants too numerous for nostalgia to be accommodated. Countries like New Zealand have to find new mechanisms to ensure that their particular concerns do not slip off the international agenda.

In the absence of a single undertaking, we must expect a messy arrangement of overlapping agreements with variable membership and variable coverage. Theoretical arguments in favour of multilateralism are as valid as ever, but they will not prevail in the world we live in. So the issue is to preserve as much of the advantage of multilateralism as possible while using the tools which are available to minimize barriers to cross-border business. That is, we should seek to achieve “open regionalism” through open accession clauses.

This has implications not only for the balance of regional trade agreements and multilateral rules, but for the nature of regional trade agreements. A Free Trade Area of Asia Pacific would be a little less difficult to secure than a WTO round – the Europeans would not be at the table – but only utopians would believe that a single complete agreement akin to NAFTA or even ANZCERTA is attainable. Nor can we expect an orderly succession of agreements. The idea of a sequence of ASEAN + 1, ASEAN + 3 (EAFTA), ASEAN + 6 (CEPEA), extensions to America (FTAAP) and to Europe, while attractive to orderly diplomatic minds is a pipedream. Barriers to business was be disassembled where political will and economic pressure prevails, and a pattern will be discerned only in retrospect.

The “Comprehensive Asian Development Plan” which ERIA will present to EAS in late 2010 reflects this reality. It is not an example of the “planning” of the 60s, whether indicator, imperative or decorative. It uses modern economic analysis to define corridors of economic interaction in which supply chains can operate to promote cross-border business and contribute to regional economic welfare. It builds on the idea of connectivity, and links infrastructural development with regulatory reform, and demonstrates that economic integration is consistent with reducing development gaps. It draws on the ideas of innovative and inclusive growth as expressed in the APEC growth agenda. It provides a basis for reconciling business-led integration with official processes promoting economic integration. That is the future of post financial and economic crisis FTAs.