Session 1:

The financial and economic crisis and FTAs:

How can intra-regional export growth through FTAs help tackle the crisis?

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In the 2008, a comment was made that negotiations on FTAs responded to global crisis by *"incorporating deeper integration mechanisms that cover cooperation in issues which were previously considered as non-core trade. FTAs widened the scope of cooperation by mainstreaming issues such as health, energy, food security, migration, and others."* In addition, *"constant interaction thru FTA negotiations has developed a built-in level of relational confidence among country-officials thereby facilitating the urgent mobilization of regional and global cooperation in response to any crises."* And that in this crisis, it was observed that, *"the value of new and deeper FTA models is that they enlarge the menu to beyond spaghetti and noodles . . . they provide logical reasons, specific opportunities, and productive occasions for parties to continue engaging in meaningful cooperation."* [1]

Today, please allow me to build on our discussions last year and explore ideas towards enhancing the contribution of trade to finding a solution out of the present crisis.

Global trade can be characterized by both concentration and fragmentation.

- The United States is still the world's largest importing country, steadily accounting for about 15% of total global imports for the past three decades. It is a

[1] Comments by Dr. Thomas G. Aquino in "*Session 1: Stocktaking of bilateral and regional FTAs in Asia-Pacific region"* of the international symposium "EAFTA, CEPEA, FTAAP and beyond," held in Kuala Lumpur, Malaysia, on October 30-31, 2008.

consumption-driven economy, with household final consumption expenditure accounting for about 70% of total US GDP (2006). We can generally say that global final consumption is still concentrated in the US and with Europe and Japan, as these three economies account anywhere from 40% to 50% of total global economy.

- Global production, on the other hand, has become fragmented. Supply networks have become global, resulting in fragmented production systems—with a great number of countries contributing diverse component parts of an assembled, finished product. These components are presently assembled primarily in China and then shipped to the global consumption centers. In 1993, China accounted for only 1.2% of total global exports; in 2007, this had jumped to 8.9%.

Characteristics of global trade

Markets	Production
• Continued concentration of markets, especially in the United States, Europe, and Japan.	• Increased fragmentation of production, with many countries providing inputs to global supply chains; presently centered on China as the world's manufacturing hub.

Complementing reduction of trade barriers and the drastic improvements in technology, trade growth was also driven by a continuous search for efficiency via cost reductions and quality enhancement. Trade allows producers to explore economies of scale in the various segments of the value chain—from research and development to production to marketing and distribution. Moreover, as supply possibilities are theoretically open to companies all over the world, significant comparative advantages emerged and complementarities were pursued.

Push and pull of trade

Drivers of trade	Limits to trade
• Larger markets mean cost reductions and quality improvements associated with economies of scale of serving a larger market (than one's own domestic economy) • Wider array of country-sources of products and components mean a more diverse supplier base with potentially greater benefits from comparative advantages.	• Logistics costs have been more pronounced with fuel price increases. • Coordination costs of managing a complex production chain. • Associated risks of: (1) being exposed to a wider range of uncertainties, even to factors not directly related to domestic country-economies; and (2) domestic industries are now part of production chains, supplying parts and components but are not producing any complete finished product.

Trade is however restrained by its natural limits: the cost of physically transporting raw materials, components, and finished products; as well as the cost of coordinating the complex sourcing, production, and marketing and distribution systems. With fuel prices expected to increase in the long-term, logistics and coordination costs are likewise expected to resume their upward movement. Trade also exposes countries to a wider range of uncertainties--even to factors only remotely related to their domestic economies. Local export manufacturers also become hostage to other players in the global production chain as they are now supplying just parts and components and are not producing any complete finished product.

Advantages of Asian regional trade

- Regional trade, especially among Asian countries, allows optimal balancing of benefits and costs of trade
  - Asia is a large-enough market, in terms of population and income, to allow substantial economies of scale.
  - Region hosts diverse countries in terms of socio-economic, cultural and political conditions, and factors of production, to allow significant comparative advantages to occur along complementary resources / factor endowments.

With its population size, market power, cultural diversity, geographic configuration, natural resources, and factor endowments, Asia—or trade within Asia—can provide the optimal balance between the drivers of and the critical limits to trade. In 2007, Asia accounted for about 28% of the world's total merchandise exports and 25% of its imports. About 60% of all people in the world are Asians. And the region is home to three of the five biggest economies in the world—China, Japan and India. These three account for nearly ¼ of total global GDP.

However, economic and market size, diversity, geographic location, and factor endowments alone are not enough to result in increased trade. Neither does trade automatically ensue from lowering of barriers. Trade is a dynamic activity that requires interaction among a number of enabling elements, including: friendly and stable business environments, the availability of hard and soft infrastructure, access to financing, sustained international marketing programs, constant product development, and a host of other factors.

What have we learned?

- First, trade does not happen in a vacuum. Trade occurs as a result of a number of enabling elements such as business environments, hard and soft infrastructure, financing, and international marketing programs, among others.
- Second, trade alone is not enough to bring about development nor to make development more inclusive. Existing real and financial investment flows and structures, technology pools, migration patterns, and others are just as important—including the global institutions (or lack thereof) that govern them.

And, neither can trade alone bring about growth and development to developing countries. Global or regional lowering of barriers to merchandise trade would have to be accompanied by complementary components of regional integration: flow of real and financial investments, opening of foreign country markets to migration of professionals, and development of regional institutions that would govern and promote regional trade, among others.

The multilateral trading system is still the basic platform for international trade. We see regional trade arrangements as part of the building block approach towards liberalization of global trade. Asian regional trade will allow us to manage trade liberalization, i.e. maximizing the benefits from enlarged markets while managing costs and associated risks. Regional trade should be pursued not only for reasons internal to Asia but, equally important, for competitive realities outside of the region.

To enhance Asian regional integration, however, we must aggressively pursue integration in both investments and migration of professionals. Most Asian countries already apply low MFN (most favoured nation) tariff rates and have thus already opened-up their markets to both Asian and non-Asian merchandise exporters. Regional preferential trade can most effectively be undertaken, therefore, in the trade-complementing areas of investments and migration.

What the current global crisis has exposed is that Western economies have been able to sustain their consumerist societies, because of the inflow of real and financial investments from other countries—including Asian economies. These investments are however feeding demand which, to a large extent, is somewhat ostentatious—slimmer TV sets, smaller cellular phones, lighter running shoes, etc.

What can be done in Asia?

- Confirm "building blocks" approach to regional trade.
- Enhance trade integration within Asia in two areas:
  - First, move towards greater inflow of investments to countries within the region;
  - Second, open more developed Asian economies to migration of professionals.
- Current global crisis exposed weaknesses of consumer-oriented western societies.
- Asia is home to a talented and diverse people. Migration patterns indicate that western countries attracted the most talented professionals globally.

In response to these types of consumer demand, production chains around the world—increasingly centered in Asia—have to constantly re-tool and re-wire in order to meet ever-shortening product life cycles. In contrast, large segments of Asian population can still benefit from greater investments in basic services and productivity-enhancing industries, e.g. health and education, utilities, ICT, and others.

We must also highlight that other global regions, which maintained fairly open migration policies, have benefited from the talent of Asians. For example, Western countries have benefited from the talent and skills of foreign professionals who virtually laid the foundation for some of their high-technology industries. In contrast, barriers to movement of professionals still persist in Asia, among Asian economies. We should maximize complementary comparative advantages in a wide range of factors of production, including labor, capital and technology. This will ensure sustained growth for Asian countries which have already reached a high level of development and, at the same time, open opportunities for those still in the earlier stages of the development cycle.

In summary, please allow me to suggest a number of action steps:

- Strengthen and accelerate efforts at studying the continuing impact and consequences of an enlarged market;
- Promote greater opportunities for interaction among aspiring regional businesses, including confidence-building face-to-face meetings, "on-the-ground" regional market promotion activities, and timely, continuous exchange of relevant business information;
- Undertake studies on "barriers to doing (and expanding) business" in the region, oriented towards those already present in the region and who aspire to expand their scope of operations;
- Initiate study on the creation of a regional institution to champion regional trade, possibly working towards transforming the region into an economic community;
- Adopt a concrete, initial project on a critical issue in order to gain relational confidence and introduce a bonding element among public and private regional

stakeholders, e.g. work on a region-wide contribution to the global issue of "trade and climate change."

To end, I would like to share what I observe is the emerging paradox of global trade: while global integration has exposed economies to greater risks, the domestic and international competition it fosters and the accompanying domestic reforms it required has forced companies to be efficient and in the process become more flexible and resilient. As FTAs are among the different mechanisms for promoting trade, it is in this context that we see how intra-regional exports can help tackle the crisis—we anchor our hopes not on trade alone, but also on the other complementing measures that allow us to truly maximize the benefits from trade, including investment flows, opening markets access for services, and domestic reform.