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East Asian Cooperation, Social Policies and the WTO

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I like the discourse of Yung Chul Park and his colleagues very much for a number of reasons: it is provocative, intellectually challenging and ambitious. The chapter is an attempt to redefine the "East Asian model" of economic development. I have considered this model to be probably one of the most successful development experiments in recent economic history with spectacular achievements in a very short period of time. This model is now being put in doubt. The second reason is that the chapter is written by economists who come from the region and not from Columbia University – with all due respect to Professor Ramos. This shows that there is a lot of thinking among East Asians about the idea of "what next". The third reason why I liked the chapter is that it asks extremely important questions.

Let me give you two examples of why I think the chapter is important. The authors emphasise the importance of the political changes that are taking place, including primarily the process of democratisation. These changes must surely have important implications for how governments manage their economies. The democratisation will undoubtedly affect the way labour markets operate. This has something to do with how labour is organised and with how labour is trained and mobile. Democratisation is also likely to affect the claims on budgetary resources of states and provinces. It may also affect claims on social spending, and so forth. In brief, the question asked by the authors is extremely important: "Is the current system capable of coping with all these political and economic changes in an economically efficient and effective way, and in a manner that will not be politically destabilising?"

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A second example of the usefulness of the chapter is only implicit in the text. What are the broad implications of economic liberalisation on the society and on the operation of markets? For example, what will the effects of liberalisation of financial markets in the region be and how will the goods and services markets be affected by further opening? Again, these are important questions and even though they are not fully spelled out in the chapter it is clear that they must be on the minds of the authors as well as politicians and the business community.

I find it somewhat curious that the authors seek to reform their development paradigm for another reason. As economists we typically point to failures of policies that can be measured. For example, we assess economic performance in terms of a slowdown of economic growth, the rate of unemployment or the persistence of unemployment, inflation, the ability to cope with inflation pressures, the flexibility of the system to adjust to external shocks etc. None of this is brought out in the chapter.

I would argue that East Asia did remarkably well before the financial crisis of 1997 as well as after the crisis. When we look at the numbers on trade flows in recent years, East Asia has not only recovered from the crisis but it has also been one of the engines of global economic growth. If we did not have East Asian growth, the global economy would have been in a dramatic stagnation in the beginning of this decade. It has been East Asian intra-regional trade that has driven the global growth of world trade as the adjustments of individual countries after the crisis – such as Korea (the authors' own country) Indonesia, and Thailand – have been remarkable.

In brief, I am somewhat puzzled as to why the authors are so hard pressed to seek a new paradigm if the main economic indicators are not all that disturbing. This is how the East Asian picture appears to an outsider. On the other hand, strong undercurrents of fears and concerns may exist in the society and the markets that are only known to those who are part of those societies. Notwithstanding the questions that I have just mentioned on the role of democratisation and economic liberalisation, these fears and concerns could have been more strongly articulated.

The authors mention essentially four reasons for the need to reform the economic and political system: (i) they are concerned about a weak financial sector; (ii) the system of the "consultative polities" is breaking down; (iii) corporate governance is plagued by problems of non-transparency and corruption. Finally, (iv) the authors are also concerned about the countries' strategy that is heavily dependent on export-led growth.

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Let me pause briefly and make a brief comment on the last of their worries – the issue of export-led growth. Once again, I am somewhat puzzled that this is raised as an issue. On the one hand, there can hardly be any doubt that the success of the East Asian "miracle" was brought about by the countries' openness to markets and by their willingness to expose domestic firms to competition in global markets. The authors recognise the importance and positive features of the export-led growth but their concerns are less clear. It would help the reader to know the reasons for their scepticism. It would also be helpful to better understand the origins of their concerns.

These are small points that can be handled by a minor editing work. Let me now turn to what are relatively more substantive issues. I shall focus in the rest of my comments on the second group of issues that Professor Ramos mentioned. While he discusses the main features of the East Asian model, I shall look at the future of the paradigm and "dream" essentially with the authors. Our comments are, therefore, complementary because of the way we have divided them.

I would like to suggest two issues that might be of interest, and which, in my view, need to be addressed in any future reform of government policies. The first issue is the question of regional cooperation. Unfortunately, the question receives relatively minor attention. The authors only make passing comment at the end of their presentation even though regional cooperation is already raising hot debates in the region. The second issue concerns the implementation of government policies. Following the IMF interventions in the area during the 1997-98 crisis, interventions that were deeply resented, the authors criticise the influence of outside bodies on the domestic process of policymaking. This raises an interesting question about the role of multilateral institutions in domestic policymaking. What I would like to do is to briefly discuss the importance of the WTO agreements and rules on how future economic reform might have to be conceived and implemented.

Let me start with the first issue – the issue of regional cooperation. The authors say something very interesting on page 165:

> Unless they [the countries] are prepared to coordinate their policies and pool resources to guard against future crises through forming regional cooperative arrangements, there is the concern that their institution-building reforms and future policies regarding market opening are likely to be dictated by international financial institutions and advanced economies in Europe and North America.

This is clearly a heavy stuff, which permeates with the authors' dislike of IMF interventions. It shows their desire to maintain "indigenous" East Asian policies. Moreover, the authors raise the limits of regional cooperation to highly ambitious levels.

What kind of regional cooperation would be required to ensure that the cooperation is effective? My answer is that such a new regional cooperation would have to go far beyond what has been contemplated in the ASEAN until now. What the ASEAN has done so far is very modest in terms of both the scope of measures and depth of integration, a process that has been very slow, and certainly not adequate to address the authors' concerns. In other words, the present shape of trade policies, which are the single target of ASEAN cooperation policies, will not be enough to make the cooperation work. Being focused on border measures, the present structure of ASEAN is far too limited. In brief, what needs to be done is to extend the scope well beyond the border measures to inside-the-border measures to make the cooperation effective.

Moreover, trade policy measures are the wrong policies for targeting financial instability, which is one of the major concerns of the authors. The theory of balance of payment adjustment is quite clear on this point. The origin of balance of payments crises or of financial crises does not typically lie in distortions of trade flows. More likely, the crises originate in poor macroeconomic management or in distortions of financial markets. In either case, the cure for instability lies in domestic macroeconomic management; trade policy measures can only serve as temporary instruments.[1]

Given the theory of macroeconomic management, let me make three snap suggestions from the empirical literature, which might give us some further guidance on the kind of regional cooperation required to reduce to mitigate financial instability.

Notwithstanding my comment on border measures above, one would have to start with further coordination of border measures. This means the completion of the process of removing the barriers to the internal (intra-regional) trade flows. This will further call for a coordination of trade policy measures toward third countries. These are no minor tasks. They would require a considerable degree of fine-tuning of trade policies without introducing further distortions.

[1] For more details see Zdeněk Drábek, "Trade and Macroeconomic Policy", Working Paper, World Trade Organization, Geneva, 2004 (forthcoming).

In addition, one would need to adopt measures for deeper integration, which nobody is contemplating as far as I know. Empirical literature provides strong support for the claim that a necessary condition for effective cooperative arrangements, defined in terms of efficient trade dynamics, must involve arrangements for deep integration. I am referring to the literature on currency arrangements, currency unions, and their effects on trade flows and welfare.[2]

We have recently done a study using a few case studies of countries that apply different models of regional arrangements. We have asked which arrangements have been more successful in targeting the question of financial stability and crisis prevention. The study shows that the conditions for a successful prevention for financial crises must include a set of at least three important measures: first, cooperation on standards, including standards such as technical standards, sanitary standards, prudential laws in the financial sector etc. Second, one also needs to think in terms of further liberalisation of capital and labour markets. Third, and certainly not in the order of importance, is the argument that countries aiming at avoiding or, at least, at minimising the risk of financial crisis it would have to consider cooperation on the level of macroeconomic policy as well.[3]

This has been my comment on regional cooperation. My second comment is about the degree to which government policies are constrained by WTO rules. WTO rules could affect government policies in two areas. It is clear that the area in which WTO rules are extremely influential is the area of industrial policies. However, that is such a big issue that it would require separate treatment. What I shall do instead is to refer another area – the area of social policies.

How are social policies of countries affected by WTO agreements and rules? Social policies can be affected directly and indirectly. The direct effect comes from the commitments of countries in the WTO in social sectors such as education, culture and health. Indirect effects affect countries through the operational rules on subsidies and on market access.

The third important area is the intellectual property agreement (TRIPs), which would obviously affect countries through their access to medicine, for example, as a result the provision of health services.

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[2] See, for example, Andrew K. Rose "One Money, One Market: The Effect of Common Currencies on Trade", In: *Economic Policy*, April 2000, pp. 9-45.

[3] The conclusions are based on a project that I have recently completed. See Zdeněk Drábek, *Are Regional Integration Arrangements Able to Enforce Trade Discipline?*, Palgrave Press, London, 2005 (forthcoming).

In order to understand how these agreements affect countries it may be useful to recall the modalities under which these agreements are made in the WTO. There are three important features of those modalities that should be singled out. The first is the concept of what is known as the positive list. This is a *request-offer* kind of a deal, whereby countries make commitments on access and non-discrimination only if they schedule those particular sectors in their offer. This also means that if a country does not want to make any offer outside its list, it does not need to do so – unless of course it will negotiate concessions from their partners.

The second important issue on modalities concerns the agreement on services (GATS). There are four different kinds of *modes of deliveries*: cross-border delivery; consumption abroad; commercial presence, and movement of national persons. The degree to which domestic policies will be affected by the WTO will again depend on the kind of commitments countries make in the negotiations. However, it is evident that each of these four modes of delivery will affect the country in question differently.

Finally, the third element of WTO modalities concerns the question of *bindings*. *In strictu sensu,* the only commitment that fully constraints countries' policies from their undertakings in the WTO are bound commitments. The governments may have to agree to bind only some of their commitments. In contrast, unbound commitments can be changed. If a country schedules a commitment in the WTO and the commitment is not bound, such a commitment is not firm.

Why am I making this elementary introduction to the WTO? When one looks at commitments made by East Asian countries in services negotiations in the WTO, one discovers that there are very few sectors that have been scheduled in GATS by these countries. Furthermore, there are very limited commitments made on the individual modes of delivery and whatever was scheduled, the commitment were made in such a way that they did not restrict in my view domestic policies. Finally, while I do not have the precise numbers, it is very likely that the majority of these countries' commitments have been unbound. In brief, it is not very likely that the domestic policymaking has been significantly constrained by the WTO agreements.

Let me conclude with a minor comment. The East Asian model has been criticised by Krugman[4] and others on the grounds that it is an

[4] Krugman was probably the first to note this feature of East Asian economic model. This would make the model similar to the one practiced by the communist countries until their collapse in 1989. See, Paul Krugman, "What Happened to Asia?", mimeo, 16 January 1998 (in P. Krugman's website).

input-intensive model and, therefore, a highly inefficient one. The empirical evidence is far from conclusive but the issue needs to be emphasised in discussing the strategy. The authors, too, acknowledge that economic growth has been generated by massive capital accumulation, by a rapid growth of labour input, by an extraordinary expansion of intermediate inputs rather than by greater efficiencies. If I understand well the sentiment of the authors' position, they seem to dismiss these arguments on the grounds of statistical shortcomings and other methodological problems. Nevertheless, the argument should not be dismissed out of hand. Take the example of Japan in the 1990s. With savings and investment rates of around 40 percent – historically high levels – economic growth was during the same period about zero and even declining. Surely, this is not a particularly efficient way of using countries' resources. *Pari passu,* this also has important implications for policymaking. Once the criticism is taken seriously, the process economic liberalisation, which brings more competition to markets, and democratisation, which changes the structure of markets, can become key factors in stimulating more competitive and efficient responses of economic agents. Such responses are critical to create conditions for faster economic growth as well as for a greater financial stability.