

Provisional PARFTA (Pacific Rim Free Trade Agreement) and Its Economic Effect*

Myung-Gun Choo

Sejong Institute of Economics

Abstract

The U.S. economy, which has experienced huge trade deficits in 1980s, on the one hand, has launched the NAFTA against the European Community and Japan and, on the other hand, has forced the Asian countries to open their domestic market. However, in order to maintain a mutually beneficial world economic order and to maximize the effect of integration, it is necessary for the U.S. to expand the scope of NAFTA and to form PARFTA (Pacific Rim Free Trade Area). It is because PARFTA can attain remarkable level of intra-regional trade dependency, market size and negotiating power in comparison with NAFTA. In fact, market opening of Korea and Taiwan has not been as beneficial to the U.S. as it had hoped, while it further expanded Japanese surplus. A plausible way for the U.S. to ease the trade deficit is to use Korea and Taiwan as export bases to the Japanese market. This could be effective strategy to integrate world markets, while increasing negotiating power with Japan.

I. Introduction

As the U.S. economy, which has advocated the trade liberalization since the World War II, has experienced the huge trade deficits in 1980s, its trade policy

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has turned into the protectionism. Two notable features of the changes in the U.S. trade policy are the formation of NAFTA and the pressure of market opening on the Asian countries in trade surplus with the U.S.

This paper proposes PARFTA (Pacific Rim Free Trade Area) as the provisional step to the complete economic integration of the world. The NAFTA, which will be effectuated in 1993, will be not beneficial to the U.S. economy because of high ratio of non-tariffable items in their trade. In comparison with NAFTA, PARFTA, whose immediate candidates are Korea, Taiwan, Australia and New Zealand, enhances the success and effect of the economic integration due to their high complementary industrial structure and intra-regional trade dependency with the U.S. economy.

The plan of the paper is as follows. In section II I present the current status and prospect of world economy. In section III I examine the necessity and scope of PARFTA as alternative proposal to NAFTA. In section IV I analyze the provisional PARFTA's economic effects. Finally, some concluding remarks are made in section V.

II. Current Status of World Economy, and Its Prospects

The European economy has taken off since the 1950s and economic integration following the Treaty of Rome has resulted in market expansion and international specialization. Japan, on the other hand, has enjoyed continuous economic development and huge trade surplus since the outbreak of the Korean War. As the competitiveness of the U.S. industries has weakened gradually in the world market, the trade deficits of the U.S. economy has aggravated accordingly in 1980s. Finally the world's economy entered into a new phase as Korea, Taiwan, Hong Kong and Singapore accelerated their economic growth.

This indicates that economic development is not the exclusive domain of any particular nation, but a general provision which can be attained by any nation if its people lead diligent lives and it adapts itself to the international market by readjusting its industrial structures. This can be construed as the most noteworthy change of perception in human history since the Industrial Revolution. Moreover, considering the fact that four-fifths of the world's population live in poverty, the implications are very significant.

Human tendency to observe a neighbor's prosperity with envy may apply equal-

ly to nations. After all, jealousy is the most honest form of giving a praise. The problem, however, is that this aspect of human nature may cause unnecessary and irrecoverable waste of resources and labor in a vicious circle of trade disputes.

The U.S. has been complimented world-wide for having formed Pax Americana after the Second World War. In the early 1980s, however, protectionists in the U.S. began to gain power as the general public became increasingly annoyed by chronic trade deficits. At first, countries enjoying the surplus in the trade with the U.S. have adopted apologetic postures. But the matter has now reached a point of no longer being a simple economic subject, as the countries concerned became weary of continuous threats of retaliatory restrictions and pressures for opening domestic markets.

Since 1985, the speed of market openings has been apparently accelerated, following the application of the Section 301. However, anti-American sentiments have been deepened at the same time. The U.S.'s pressure has not brought forth substantial benefit to the U.S. while widening the trade deficit of Asian countries to Japan. Moreover, Japan has taken advantage of this opportunity to expand her market share in Asia, while using East-Asia as an exporting base to the U.S. market. Regardless of how the U.S. may act, protectionism will only create discord with many countries, without solving the immediate problem. The most pressing question for the U.S. now is how to pursue strategies in the trade and national defense diplomacy, when there is no need for Japan to worry about the feelings of the U.S. following the collapse of the U.S.S.R.

III. Necessity and Scope of PARFTA

With the advent of 1992, the EC (European Community) has become a solid economic bloc comprising a population of 340 million people, with a GNP of 4.8 trillion dollars. Japan has surpassed the U.S. in international competitiveness in most fields, forcing the U.S. to take drastic action to alleviate her accumulated trade and fiscal deficits. The U.S. government effectuated FTA with Canada in 1989, as a part of her countermeasures, and began FTA negotiations with Mexico in 1991. If NAFTA is formed, it will bring into being another economic bloc, with a population of 360 million people and a GNP of 5.9 trillion dollars.

The size of the economies of Canada and Mexico is, however, far less than that of the U.S. Intra-regional import dependency, therefore, is not more than 33%

while their exports to the U.S. have already reached over 75% of their total exports. Furthermore, more than 40% of the U.S.-Canada trade and 70% of the U.S.-Mexico trade are non-tariffable items, thus limiting the integration effect.

In addition, EAEG (East Asian Economic Group), proposed by Malaysia to cope with this situation, would establish a Yen bloc in the East-Asian region of the highest growth rate. This proposed bloc, with a population of 530 million people and a GNP of 3.6 trillion dollars, is creating the fear that the world could become an arena of competition among economic blocs.

In order to maintain a mutually beneficial world economic order and to maximize the effect of integration, therefore, it is necessary to expand the scope of NAFTA and to form PARFTA (Pacific Rim Free Trade Agreement). The immediate candidates for membership of PARFTA would be Korea, Taiwan, Australia, and New Zealand, which depend heavily on their trade and have complementary industrial structures with the U.S. This, however, does not exclude Japan or any other coun-

Table 1
Economic Power of PARFTA, and Dependency on Trade with the U.S.

(Unit: billion dollars, ratios in percentage)

	Population	GNP	Total Export (A)	Export to the U.S. (B)	B/A	Total import (C)	Import from the U.S. (D)	D/C
U.S.	250.0	5,465.2	393	•	•	516	•	•
Canada	26.2	528.9	131	95	72.5	121	75	61.9
Mexico	86.2	200.9	27	21	77.7	29	15	51.7
Korea	42.8	237.9	64	19	29.6	69	15	21.7
Taiwan	20.1	161.7	67	21	31.3	54	12	22.2
Australia	17.1	294.6	39	4	10.2	38	9	23.6
New Zealand	3.4	38.8	9	1	11.1	9	1	1.1
Total	445.8	6,928.0	730 (337)	161	47.8	836 (320)	127	39.7

Source: IMF, IFS Yearbook, 1991

IMF, Direction of Trade Yearbook, 1991

Note: Total export and import figures in parenthesis are excluding the U.S. to compute the ratios

tries from joining in PARFTA. To the contrary, the ultimate goal of PARFTA is and should be nothing less than the complete economic integration of the world. Taking provisionary steps of PARFTA is only to hasten the process.

The economic power and dependency of these countries on trade with the U.S. is shown in table 1. In comparison with NAFTA, a remarkable level of intra-regional trade dependency, the size of the market, and negotiating power can be attained by PARFTA.

Furthermore, as shown in table 2, the industrial structures and trade patterns of these countries have not only high complementarity with the U.S., but also high intra-regional trade dependency, which enhances the potentiality of success and the effect of PARFTA. This is because FTA, by its very nature, can only be successful if it has sufficient size, intra-regional trade dependency, and complementarity of industrial structure in the participating nations.

Table 2
Export and Import Structure of the U.S. (1990)

(Unit: billion dollars, % in parenthesis)

	Export	Import
Canada	69.1 (21.1)	76.1 (18.1)
Mexico	23.6 (7.2)	25.1 (6.0)
Korea	12.0 (3.7)	15.4 (3.7)
Taiwan	9.6 (3.0)	18.9 (4.6)
Australia	7.1 (2.2)	3.7 (1.0)
New Zealand	0.9 (0.3)	1.0 (0.3)
Sub Total	122.3 (37.5)	140.2 (33.7)
Japan	40.5 (12.3)	74.7 (18.0)
ASEAN	15.7 (4.8)	22.9 (5.5)
Total	178.5 (54.6)	237.8 (57.2)

Source: IMF, Direction of Trade Yearbook, 1991

Note: The number of parenthesis is the share of each country in the U.S. total exports or imports

International competitiveness can be strengthened only when the industrial structure is attuned to a production environment, and each producer is capable of produc-

ing quality goods at cheap prices. Should either of the above conditions be lacking, it would be left behind in ever-intensifying international competition.

The problem, however, arises because a production environment changes constantly, as a result of economic development, technological innovation, and income change. Accordingly, countries which have been exporting labor-intensive products based on cheap labor, will become unable to continue exporting such products in the end, as incomes reach higher levels. If they are not able to readjust their industrial structures to produce more technology- and capital-intensive products, their competitiveness will be weakened.

Countries with similar levels of capital accumulation can act differently depending on population, natural resources, technological level and industrial structure. Japan, for instance, enjoys strong international competitiveness because she coped intelligently and promptly with rapidly changing situations. As in the case of human health, international competitiveness is a temporary state, and can be rapidly weakened unless a country continuously adapts herself properly to changing international environments and production conditions.

Throughout human history, the rise and fall of superpowers has been witnessed over and over again. The U.S., at one time, producing more than half of the world's industrial output and much of the trade surplus in the world, played the role of a generous benefactor in rehabilitating the world's economy after the Second World War. More than forty years have passed since then and, although the U.S. now has absolute superiority in military power, her negotiating power has decreased due to the weakened U.S. industrial competitiveness and the Japan's independence from the U.S. nuclear umbrella.

The Liberal Democratic Party of Japan has been able to hold on to power for a long period of time. It has concentrated the national energy solely on strengthening international competitiveness through the government's guidance, the strong entrepreneurship, and a nation-wide consensus to build the country into an export-oriented economic power.

In addition, the Japanese government weeded out declining industries, while supporting the industries which promised to further her export strategy, regardless of their prevailing competitiveness. Thus, effectively restructuring her industrial base, as a result, Japan today has become the world's largest foreign exchange holder and creditor. However, due to the Japanese niggardliness in opening its domestic market, Japan brings about international trade tension.

As long as Japan complies with GATT (General Agreement on Tariffs and Trade) regulations externally, nothing can be done against her import restraints manipulated subtly through a variety of non-tariff barriers, such as the tacit agreement and window guidance of the government and industrial associations. The biggest obstacle to establishing a world economic order today is, Japan's unfair trade policy and practices: If any individual country were to raise an objection to her conduct, it would only receive a cold reception or even be retaliated against. One of the most effective way to overcome this impasse for other nations is to strengthen their negotiating power through market integrations such as PARFTA, and to seek ways to increase international competitiveness by expanding markets while minimizing the uncertainty and the risk of international trade.

IV. Provisional PARFTA and Its Economic Effects

PARFTA has the following additional merits as compared with NAFTA: First, since only Canada and Australia have a surplus in trade with Japan, the formation of PARFTA will divert a large portion of current imports from Japan into internal trade, resulting in stronger negotiating power against Japan.

As shown in Table 3, Japan relies about 50% of her exports on PARFTA members, thus even if the negotiating power of any individual country is weak, this collective power can be exercised effectively for the opening of the Japanese market. This applies equally to EC. PARFTA could be one of the most plausible ways to prevent EC from becoming a trade fortress.

Second, we can expect an external economic effect such as reduced production costs through market expansion and investment increase. In addition, market expansion would induce greater competition within PARFTA and increase employment by reducing consumer prices and promoting technological innovation. In addition, consumers are protected, as a result of putting those monopolistic industries under the cover of a small domestic market into competition.

Third, by abolishing trade barriers in the region, international specialization will be promoted, based on comparative advantage. If the technology and capital of the U.S., and natural resources of Australia and Canada, along with entrepreneurial resources of Korea and Taiwan, and the labor force of Mexico are integrated properly, an external economic effect of price reduction and quality improvements will be attained. not only for the benefit of PARFTA, but also for the entire world.

Table 3
Trade Structure of Japan (1990)

(Unit: billion dollars, % in parenthesis)

	Export	Import
U.S.	91 (31.7)	52 (22.1)
Canada	6 (2.1)	8 (3.4)
Mexico	2 (0.6)	1.9 (0.8)
Korea	17 (5.9)	11 (4.6)
Taiwan	15 (5.2)	8 (3.4)
Australia	7 (2.4)	12 (5.1)
New Zealand	1 (0.3)	1.7 (0.3)
Sub Total	139 (48.4)	94.6 (40.2)

Source: IMF, Direction of Trade Yearbook, 1991

Note: The number in parenthesis is the share of each country in total exports or imports of Japan

Table 4
Intra-Regional Trade of PARFTA (1990)

(Unit: %)

	U.S.	Canada	Mexico	Korea	Taiwan	Australia	New Zealand	Total
Export	34.9	74.4	84.1	35.1	40.0	26.4	38.8	44.7
Import	32.4	66.1	70.4	28.9	27.3	36.7	44.3	42.1

Source: IMF, Direction of Trade Yearbook, 1991

Fourth, a trade creating effect and trade diverting effect could be accomplished. Even if there is no progress in the current Uruguay Round, the formation of PARFTA alone can make a big strides to the ultimate integration of the world economy by expanding trade within the region. In particular, the trade creating effect among the U.S., Korea and Taiwan would be substantial because import restrictions have been widely imposed. This would have the welcome side ef-

fect of posting a warning to Japan not to continue her detrimental actions to the world trade order. This is so because even in the case that trade frictions have been caused by Japanese industries, small NIEs (New Industrializing Countries) have received the blame instead. Furthermore, although PARFTA would be composed of seven countries initially, its ultimate goal would be economic integration on a global scale. Also, it provides the most effective way to deal with those countries which penetrate world markets with government backing while closing their own domestic markets.

Fifth, comprehensive FTA negotiations would be more effective and be done in a more cooperative atmosphere than individual negotiations. Individual negotiations are likely to result in mutual frustration. Accordingly, if such feelings extend over a period of time, the nations involved would suffer fundamental losses beyond the realm of economy. Therefore, negotiations through FTA are considered to be beneficial for the sake of continuing cooperation in the belief that any concessions made in one area can be compensated in other areas. On the other hand, even if the U.S. were able to get some concessions in individual negotiations, the concessionaire is likely to take similar action against the U.S., leading to confrontation of national feelings.

Sixth, PARFTA can assure the U.S. of greater market expansion than it could gain by means of individual negotiation which would benefit Japan more than the U.S. because of the MFN (Most Favored Nation) clause. This clause reinforces a new form of triangular trade policy on the part of Japan by forcing Asian countries to have a balance of payments surplus in trade with the U.S. to make up for deficits incurred in trade with Japan. But PARFTA, however, would provide a new impulse for the U.S. to increase exports to Japan by utilizing its partners for the manufacturing base of intermediate products and technology.

Seventh, since the U.S. has a rather low tariff structure, it can open other markets through PARFTA by making only little additional concessions. Getting concessions from the other parties will be easier, because they are likely to be satisfied with the minimal concessions made by the U.S.

V. Conclusion

From the U.S. point of view, Asia is an area toward which it can not afford to be either indifferent or hostile. Including Japan in FTA may reinforce Japan's

superiority. Yet if the U.S. continues to negotiate on an individual basis, as is the case at the moment, it could cost much without getting a benefit. In fact, market opening of Korea and Taiwan had not been as much profitable to the U.S. as it had been hoped, while further expanding Japanese surpluses. Accordingly, more plausible way to ease the trade deficit is to use Korea and Taiwan as an exporting base to the Japanese market. Also, this could be an effective strategy to integrate world markets, while increasing a negotiating power with Japan.

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