Research Focus

Strategies for East Asia growth and openness

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Outward-oriented growth strategies have been widely deemed to be one of the important factors behind the remarkable economic performance in East Asia. As barriers to trade are removed, openness enhances economic efficiency by bringing competition, creating employment, and facilitating the flow of technical knowledge. Moving towards greater openness has enabled the East Asian group of countries to achieve rapid acceleration in economic growth. The Asian financial crisis that hindered the process of rapid economic growth in the region during 1997–1998 now appears as only a temporary deviation, as the levels of per capita income in most of the crisis-stricken countries have returned to their pre-crisis levels relatively quickly. This article summarises the outcome of the conference Strategies for East Asia Growth and Openness, Bogor held in August 2005 as part of the ongoing Australian National University research project on East Asian economic integration. (Conference papers are available from the website.)

The importance of the role of outward-oriented strategies in promoting sound economic performance has long been recognised in economic theory. According to conventional wisdom, the multilateral approach to trade liberalisation is considered the 'first best' solution for attaining the greatest potential benefits for global economic growth in a more open world economy. In practice, however, the road to multilateral trade liberalisation appears to be a difficult one. Instead, what is often observed is the pursuit of regional integration through the creation of preferential trade agreements (PTAs) and economic partnership agreements. Although it is often seen as a potential stepping stone for moving toward the first best solution by promoting trade, a regional integration process can also create trade diversion. Therefore, in order to make regional integration an effective vehicle toward achieving a more open world economy, it should ideally be directed to advancing more trade creation while at the same time minimising trade diversion.

In theory, two propositions underlie the revealed preference for PTAs. Economic integration is perceived to be good for promoting growth, and PTAs are seen as an effective way to promote economic integration. In the case of East Asian economic integration, empirical examination shows that the likely welfare gain from the currently followed scheme would be minuscule compared to the gains if the region pursues a comprehensive unilateral regulatory reform program. PTAs tend to be selective in two important ways that tend to constrain their capacity to remove main impediments to growth. They tend to be preferential and target only the provisions that explicitly discriminate against foreigners, and they don’t normally target provisions that prevent more efficient market operations that apply to the entire market structure. Hence they can only add trivially to the welfare gains of the countries involved.

The above finding raises questions on the effectiveness of PTAs to usefully supplement...
domestic regulatory reform programs in order to gain heavily in welfare. There are also issues on the potential of PTAs to be used as a means for penetrating developing markets. The problem is also made more complicated by the rules of origin that tend to be scattered and inconsistent with one another. To this end, East Asia needs to think about where exactly they want to go with their process of integration. It will be necessary to rework the vehicles through which regionalism is implemented, such as APEC, ASEAN etc. to focus more on the above-mentioned concerns. Further, greater harmonisation in regulatory reforms in East Asia is needed.

Together with foreign trade activities, foreign direct investment (FDI) has been contributing significantly to the economic growth in the region. As evidence suggests that the two are closely related, FDI is also viewed as delivering additional benefits for the recipient economy by enhancing productivity. Therefore, the need to remove obstacles to foreign trade and FDI in order to promote growth in the economies of the region remains important.

To get the most out of FDI, it has to be coupled with the right environment within the recipient economy. A stable and favourable macroeconomic environment, supporting institutions for private sector activities, labour and infrastructure availability are among the key enabling factors. Particularly on infrastructure provision, massive physical and financial challenges continue to require effective planning and vision, especially given the changing trend of a more urbanised, decentralised and privatised environment commonly faced by the region. Macro-economic stability that is conducive to creating a supportive regulatory regime for infrastructure development is a key factor to guaranteeing sustainability in infrastructure development. It should also be accompanied by sustainability in terms of financing. Given that urgency, a model of optimal balance between government and private financing for infrastructure needs to be developed.

Under a more open economic environment, the current global imbalances pose another potential threat for ongoing development in the region. This situation is mainly of concern due to the high level of current account deficit in the United States. Whether or not this deficit is sustainable is a puzzle. In the search for answers on this question, the Australian experience of maintaining sizeable current account deficits for many years without obvious harmful effects can be used as a comparison. It suggests that the US current account deficit may also be sustained in the years ahead. Although the two economies differ in size, the argument carries weight because the asset composition of the wealth portfolio that the average non-US citizen holds in the US asset position would not need to change by too much even with big US current account deficits over the next decade. Furthermore, the risk premium on US assets might also remain quite stable.

The most serious risk with the US economy, however, comes from continued large fiscal deficits rather than the current account deficits on their own. These can force a rise in the risk premium and may further endanger the sustainability of US current account deficits. To reduce the risk of this global imbalance, the United States needs to change its attitude towards fiscal deficits, and transnational cooperation may be necessary to avoid the worst outcome.

Lastly, as the Asian financial crisis has highlighted, it is urgent for regional economies to have a sound macroeconomic policy framework for ensuring growth sustainability. Responsible fiscal management should be one of the priorities. Proper institutional reforms that reduce debt to prudent levels and precautionary management of fiscal risks will help in delivering a strong fiscal position. The mechanisms behind those processes also need to be refreshed continually to retain their effectiveness.

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**School seminars**

21 February, Brian van Ronyen, Australian Wool Innovation, Chinese and Australian wool: a globally integrated industry

28 February, Yusaku Horiuchi, APSEG, Corruption and economic growth: Evidence from cross-section data for the United States

7 March, Bart Philomen, Treasurer PNG Government, Development challenges of PNG: Delivery of services to rural PNG (commences at 11.00am, Shine Dome)

14 March, Irvin Studin, Canadian, Privy Council Office, Tyrannies of distance and proximity: Post-election comparisons between Australian and Canadian politics and policy

21 March, Michael Carnahan, VF, APSEG, The economic impact of peacekeeping missions

28 March, Richard McLoughlin, Australian Fisheries Management Authority, Turning a financially failing and environmentally struggling industry around – policy and resource management development in the Australian fishing industry

*Seminars are held at 12.30pm in Seminar Room 4, First Floor, Crawford Building

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