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US AND EU TRADE POLICIES AND EAST ASIA

Peter Drysdale and Christopher Findlay



PACIFIC ECONOMIC PAPERS
No. 353, 2006





PACIFIC ECONOMIC PAPER NO. 353

2006

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Papers submitted for publication in this series are subject to double-blind external review by two referees.

The Australia–Japan Research Centre is part of the Asia Pacific School of Economics and Government, The Australian National University, Canberra.

ISSN 0 728 8409
ISBN 0 86413 306 5

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US AND EU TRADE POLICIES AND EAST ASIA

This article identifies a number of examples of apparent lack of coherence in United States and European Union trade policies. They include the effect of preferential policies that lock in trade shares and inhibit growth promoting structural adjustment, biases in tariff structures, policies that affect incentives of developing countries to make commitments in the World Trade Organisation, the use of anti-dumping actions and the nature of tariff peaks and escalation. The origins of the lack of policy coherence lie within the domestic policy-making processes of the developed economies. An important question, then, is whether opportunity exists for East Asian economies to mobilise to induce an external shock sufficient to shift policy consensus in the United States and the European Union – The key elements of such a grand bargain on trade in manufactured goods would include an explicit East Asian commitment to bind more tariff lines, initiatives to resolve the problem of accelerating anti-dumping actions and a replacement for the program of tariff preferences. A package of trade policy reforms of this type in East Asia would constitute a substantial offer and benefit to the United States and the European Union. It has the potential to trigger a response of equal benefit to East Asian economies.

Introduction

East Asia benefited hugely from the post-war multilateral trade regime and the establishment of a confident basis on which economies in the region could commit to specialisation in international trade. Although discrimination against Japan continued under Article XXXV of the GATT early in the period and later the Multi-Fibre Arrangement (MFA)¹ restricted access to most developed markets for exports of textiles and clothing, the regime provided the platform on which countries could successfully build outward-oriented development strategies. Japan, Korea, Chinese Taipei, Hong Kong, China and Singapore have more or less achieved economic parity with Western industrial economies, significantly because of the favourable international trading environment created through the GATT.

The United States and Europe were both key players in entrenching the GATT system. The United States was long the leading champion of the core GATT principles on non-discrimination and most favoured nation (MFN) treatment in international trade policy. These principles had crucial importance for new, developing country entrants to the international marketplace. Under the terms of the San Francisco Peace Treaty, the United States also never exercised its right as an original signatory



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of GATT to discriminate against Japan under Article XXXV. Europe, of course, through the establishment of the Common Market and the Common Agricultural Policy, discriminated against developing-country partners in East Asia. It joined fully, however, in the successive rounds of GATT liberalisation with the United States through the 1950s, 1960s and 1970s that saw industrial tariffs in the major industrial countries virtually eliminated. Both, however, participated actively in the MFA and have yet to eliminate the remaining vestiges of this system of protection against textile exports that was negotiated away under the Uruguay Round.

The United States and Europe remain key players in international trade policy through their impact on developing-country access to international markets for manufactured goods. Their markets occupy a large proportion of the international market. They also play the main role in shaping international trade diplomacy. Japan is also important. It and Australia were the only two industrial countries not to join the MFA restrictions on textile exports from developing countries, but in international trade diplomacy Japan now tends to play a less active role and to influence outcomes more by default than by the prosecution of proactive policy strategy.

The impact on trading partners in East Asia of current trade policy choices in the United States and the EU and their implications for policy coherence are the subjects of this article. It limits its scope to manufactured products and excludes agricultural products². Although the analysis might also apply to EU and US policy choices in the service sector, that topic also is beyond its scope. The interest lies in the coherence of policies in their international dimensions. A distinction is sometimes made between trade policy coherence at the national and international levels. The former refers to the adoption of complementary national policies that support a liberalisation program, to the design of trade policies linked to national development strategies and to achieving consistent positions across the elements of government. The later refers to the consistency of positions taken with respect to the various instruments of trade policy. Policy coherence at an international level is also sometimes defined to refer to the design and application of aid policy and could be extended to policy on foreign direct investment. Those matters, too, are left aside here.

This article first reviews briefly a framework that allows more careful specification of the set of international economic policies that matter for a consideration of coherence. It then discusses some aspects of current policy in both the EU and the United States and provides some examples of lack of coherence in that policy mix. It concludes with comments on how contradictions in policy choices might be tackled and focuses, in that context, on the core elements of an East Asian international trade policy response.



Framework

Previous work on trade patterns in East Asia has highlighted the transition in the export mix, the accumulation of capital and the shift in the combination of factor endowments during economic development (see, for example, Findlay, 2001). Manufactured-goods trade can include labour-intensive, capital-intensive and technology-intensive products. The decline in the importance of labour-intensive products in exports from Japan led the transition, followed by a similar shift for Hong Kong, China (data in the figures for Hong Kong, China are net of re-exports from China) and later for Korea and Chinese Taipei. Simultaneously, shares of these products in the exports of China, ASEAN and India have risen. The shares in exports of capital-intensive products of developing economies remain much lower than those of labour-intensive products, and the adjustment process in developed economies started more recently, but still with Japan leading the way. No sign has yet appeared of any significant adjustment in technology-intensive goods. Their shares in the exports of developing economies have started to rise, but this may reflect merely a change in the production processes of these items still classified as technology-intensive. This topic needs further study. The key lesson to take from this work on trade patterns concerns the significance of the transition with respect to labour-intensive and capital-intensive products.

This transition also plays out in more dramatic form in world markets. Labour-intensive products show a wider set of changes, with the economies experiencing rising shares of world markets on the left-hand side and those experiencing declining shares on the right. In capital-intensive products, Japan so far has made space for newcomer suppliers, and a similar story applies to technology-intensive products.

Some important drivers of this process of particular note in the East Asian region differentiate it from the rest of the world. First, the adjustment process and the gains from trade associated with it drive the accumulation of capital and the changes in factor endowments that in turn reinforce structural change. The origins of this process often lie in the initial, successful export of agricultural products. The changes just discussed are follow-on events, reinforced by the complementarity between the region's economies. Even before China's reform program began, the value of this complementarity was evident. China has now become the main driver of structural change in the region.

A second driver is the growing sophistication of supply chains in the region. This interacts strongly with the emergence of China as a regional processing zone. The divisions in production processes are becoming finer. This is made possible by technological change linked to the standardisation of various parts of the production process of particular products, facilitating their relocation.

Table 1A Share of parts and components in world manufactures trade (percentage)

| A. Exports Country/region | Share of parts and components | | | Export growth | Contribution of parts and components to export growth |
|------------------------------|-------------------------------|------|------|---------------|--|
| | 1992 | 1996 | 2000 | 1992–2000 | 1992–2000 |
| East Asia | 21.3 | 28.0 | 32.0 | 3.8 | 43.5 |
| Developing East Asia | 19.7 | 26.7 | 32.8 | 5.1 | 41.9 |
| ASEAN | 26.4 | 35.0 | 44.4 | 5.6 | 55.0 |
| Japan | 22.9 | 30.2 | 30.6 | 1.8 | 50.4 |
| Indonesia | 4.0 | 7.4 | 14.2 | 4.4 | 22.7 |
| Malaysia | 40.4 | 42.6 | 49.7 | 6.2 | 54.3 |
| Philippines | 23.9 | 52.5 | 64 | 9.0 | 74.3 |
| Singapore | 28.2 | 39.7 | 49.6 | 4.9 | 64.5 |
| Thailand | 21.2 | 23.4 | 35.9 | 4.80 | 46.7 |
| Viet Nam | 2.0 | 5.2 | 8.7 | 21.0 | 8.9 |
| China | 6.7 | 9.8 | 14.5 | 6.7 | 17.9 |
| Hong Kong, China | 21.5 | 26.7 | 25.8 | -3.2 | 16.3 |
| Korea | 17.8 | 25.2 | 30.6 | 4.5 | 41.0 |
| Chinese Taipei | 20.1 | 28.8 | 37.8 | 5.8 | 47.4 |
| South Asia | 4.7 | 4.9 | 0.7 | 14.4 | 0.3 |
| Oceania | 6.4 | 18.9 | 15.2 | 12.6 | 16.3 |
| NAFTA | 26.2 | 27.2 | 28.1 | 4.1 | 30.0 |
| USA | 26.9 | 30.5 | 31.6 | 3.3 | 37.5 |
| Canada | 19.4 | 19.7 | 18.0 | 4.2 | 16.8 |
| Mexico | 21.5 | 19.4 | 21.1 | 8.1 | 21.0 |
| Europe | 13.9 | 16.2 | 17.5 | 3.6 | 21.4 |
| EU | 15.5 | 17.7 | 18.9 | 3.9 | 22.2 |
| Latin America | 8.6 | 11.7 | 10.2 | 11.6 | 10.5 |
| Middle East | 3.0 | 13.6 | 18.9 | 13.9 | 20.5 |
| Africa | 6.9 | 8.0 | 8.6 | 8.0 | 9.2 |
| World | 20.7 | 21.7 | 25.4 | 4.2 | 29.5 |

Reductions in transport and communication costs also have important roles. A consequence is the growth in component trade, evident in Table 1. Component products accounted for over 40 per cent of East Asia's and 55 per cent of ASEAN's export growth in the 1990s. The contribution of these products to China's export performance remains relatively low, but their share in China's import growth is much larger. In other economies, components contribute to trade growth in both directions, indicating a new degree of developing complexity in regional trade patterns.

Table 1B Share of parts and components in world manufactures trade (percentage)

| B. Imports Country/region | Share of parts and components | | | Import growth | Contribution of parts and components to export growth |
|------------------------------|-------------------------------|------|------|---------------|--|
| | 1992 | 1996 | 2000 | 1992–2000 | 1992–2000 |
| East Asia | 22.8 | 27.8 | 35.4 | 4.4 | 45.9 |
| Developing East Asia | 24.8 | 30.2 | 38.4 | 4.5 | 49.3 |
| ASEAN | 30.4 | 39.3 | 48.6 | 3.6 | 68.2 |
| Japan | 15.4 | 19.3 | 24.2 | 4.1 | 32.1 |
| Indonesia | 20.5 | 23.8 | 19.4 | -0.1 | 63.6 |
| Malaysia | 37.9 | 47.5 | 58.8 | 4.2 | 77.5 |
| Philippines | 32.6 | 43.6 | 55.1 | 6.9 | 64.4 |
| Singapore | 32.0 | 42.8 | 51.7 | 3.9 | 70.7 |
| Thailand | 26.6 | 32.9 | 39.8 | 2.6 | 62.0 |
| Viet Nam | 4.2 | 11.1 | 19.1 | 10.1 | 22.1 |
| China | 19.5 | 21.1 | 33.5 | 5.4 | 42.0 |
| Hong Kong, China | 15.1 | 20.4 | 28.2 | 5.2 | 36.7 |
| Korea | 26.7 | 27.4 | 38.9 | 3.6 | 52.1 |
| Chinese Taipei | 20.1 | 35.0 | 37.3 | 5.1 | 42.5 |
| South Asia | 14.0 | 14.6 | 7.2 | 7.9 | 5.0 |
| Oceania | 10.4 | 15.2 | 15.6 | 12.9 | 16.2 |
| NAFTA | 20.4 | 23.6 | 22.8 | 4.8 | 24.6 |
| USA | 18.2 | 21.7 | 19.4 | 4.7 | 20.3 |
| Canada | 24.6 | 28.7 | 26.3 | 3.8 | 28.0 |
| Mexico | 19.1 | 30.6 | 30.7 | 7.3 | 35.1 |
| Europe | 15.2 | 16.6 | 18.7 | 3.4 | 22.8 |
| EU | 16.0 | 18.9 | 20.3 | 2.4 | 28.0 |
| Latin America | 14.4 | 14.6 | 15.1 | 12.6 | 15.2 |
| Middle East | 23.6 | 18.5 | 16.7 | 2.3 | 3.5 |
| Africa | 11.8 | 14.5 | 10.7 | 6.7 | 10.2 |
| World | 21.7 | 21.4 | 24.5 | 5.9 | 26.0 |

Source: Table 4 in Athukorala (2003).

Rapid growth of regional trade might lead to the expectation that the region is becoming more self-reliant. Yet growth of intra-regional trade in finished goods does not necessarily accompany the growth of intra-regional trade in components. Table 2 shows the destinations of final products, or total exports net of parts and components. The striking result is that the geographic structure of East Asian exports changed little over the 1990s – about 38 per cent of exports of final products stay in the region, with 28 per cent going to the United States and 18 per cent to the EU. That is, nearly half of the region's exports of final goods go to these two developed regions (the US share is a little lower when Japan is excluded)³.

Table 2 Direction of world manufactured exports net of parts and components (per cent of total; final column in \$ billion)

| Origin | Destination | EAS | JPN | DEA | ASEAN | NAFTA | USA | EU | Other | World |
|------------------------------|-------------|------|------|------|-------|-------|------|------|-------|--------|
| East Asia | 1992 | 37.5 | 4.8 | 32.8 | 10.1 | 29.7 | 27.6 | 18.4 | 14.4 | 511.5 |
| | 1996 | 43.2 | 7.7 | 35.5 | 13.1 | 25.9 | 23.1 | 16.4 | 14.5 | 715.7 |
| | 2000 | 38.4 | 7.6 | 30.8 | 9.9 | 29.9 | 27.6 | 17.5 | 14.2 | 881.9 |
| Japan | 1992 | 29.0 | 0 | 29.0 | 9.8 | 31.5 | 28.2 | 21.8 | 17.7 | 241.1 |
| | 1996 | 38.0 | 0 | 38.0 | 14.7 | 29.8 | 27.9 | 17.0 | 15.2 | 261.7 |
| | 2000 | 33.9 | 0 | 33.9 | 10.4 | 35.0 | 32.5 | 17.8 | 13.3 | 302.1 |
| East Asia excluding Japan | 1992 | 45.1 | 9.1 | 36.3 | 10.3 | 28.1 | 26.9 | 15.3 | 11.4 | 270.3 |
| | 1996 | 46.1 | 12.1 | 34.1 | 12.2 | 23.6 | 20.3 | 16.1 | 14.1 | 454.0 |
| | 2000 | 40.8 | 11.5 | 29.3 | 9.7 | 27.2 | 25.0 | 17.3 | 14.7 | 579.7 |
| ASEAN | 1992 | 37.0 | 8.7 | 28.3 | 16.6 | 28.7 | 27.0 | 21.1 | 13.2 | 86.3 |
| | 1996 | 46.1 | 12.5 | 33.7 | 19.1 | 24.9 | 23.6 | 18.1 | 10.9 | 159.9 |
| | 2000 | 43.2 | 12.3 | 30.9 | 17.2 | 25.2 | 23.7 | 18.5 | 13.1 | 179.9 |
| NAFTA | 1992 | 18.2 | 6.6 | 11.6 | 3.7 | 44.8 | 23.1 | 20.2 | 16.9 | 316.8 |
| | 1996 | 18.5 | 6.6 | 11.9 | 4.2 | 50.4 | 29.1 | 15.3 | 15.8 | 468.4 |
| | 2000 | 13.7 | 4.7 | 9.0 | 2.6 | 58.3 | 34.9 | 15.7 | 12.2 | 641.2 |
| USA | 1992 | 23.7 | 8.6 | 15.1 | 4.8 | 29.2 | 0 | 25.7 | 21.4 | 231.9 |
| | 1996 | 26.3 | 9.5 | 16.8 | 5.9 | 31.5 | 0 | 21.2 | 21.0 | 311.3 |
| | 2000 | 21.4 | 7.4 | 14 | 4.1 | 37.3 | 0 | 23.6 | 17.7 | 394.4 |
| European Union EU | 1992 | 4.4 | 1.4 | 3.0 | 1.3 | 6.6 | 5.6 | 70.2 | 18.9 | 705.7 |
| | 1996 | 8.6 | 2.5 | 6.1 | 2.4 | 8.2 | 7.3 | 60.0 | 23.2 | 1283.3 |
| | 2000 | 6.4 | 2.1 | 4.3 | 1.3 | 11.6 | 10.2 | 60.1 | 21.9 | 1394.8 |
| World | 1992 | 21.4 | 4.2 | 17.2 | 5.4 | 27.1 | 19.8 | 32.9 | 18.6 | 1057.5 |
| | 1996 | 18.4 | 4.3 | 14.1 | 5.2 | 20.2 | 15.5 | 40.1 | 21.3 | 2632.0 |
| | 2000 | 15.1 | 3.7 | 11.4 | 3.6 | 26.0 | 20.3 | 39.4 | 19.5 | 3087.2 |

Note: DEA= Developing East Asia.

Source: Extracted from Table 5 in Athukorala, 2003.

As a corollary of the growth of component trade and the impact of China in the region, one might expect China to take over from its regional trade partners some export markets in the United States and the EU. The integration of the supply chain means, however, that China's component suppliers retain a strong interest in the openness and coherence of US and EU trade policies, even though those economies may no longer be supplying those markets directly. Weiss (2005) in a study of these trends came to the following conclusion:

[The] PRC's recent rapid growth has generated substantial opportunities for trade and investment in regional partner economies. This rapid growth has sucked in large volumes of imports of both



primary and manufactured goods that have, compensated its neighbours for their losses of market share in the US and Japan. Even the concern over FDI diversion, which appeared an obvious ‘threat’ a few years ago, can be set aside on the basis of substantial empirical evidence. Central to the growth of intra-industry trade in the region has been the spread of global production networks either between units of the same firm or with independent contract manufacturers, who provide goods to the buyer’s specification. Hence final products made in PRC may contain parts and components from many different parts of the region with value added at stages in a production chain that stretches across a number of countries. FDI has been a prime mover in this process in integrating PRC-based firms in these global networks and in developing the ‘triangular trade’ between PRC, the rest of East–Southeast Asia and the large markets in the US and Europe. In this emerging specialisation its regional neighbours provide the inputs for manufactures from PRC, which are then exported out of the region. Currently this is proving strongly mutually beneficial.

(p. 19)

The rate at which ‘triangular trade’ develops will be limited by policy applying in both the exporting countries and their trading partners. The former affects the ability of a country to shift its production mix and to locate itself at the right place in the supply chain. The main focus here, however, is the policy mix in developed-country export markets, in particular the United States and the EU.

Trade policy is not all that matters. As Weiss’s conclusion implies, the capacity to undertake the adjustments necessary for trade and economic growth in East Asia is supported by large capital flows between economies in the region, promoting the relocation of production and the upgrading of industrial structures. Capital flows from major industrial trading partners such as the EU and the United States are central to this process. Most of the policy questions with respect to FDI arise in the host rather than in the home countries, although recently out-sourcing has become a focus of interest in the United States and other countries. Therefore, consideration of FDI policies within the broad topic of coherence is not dealt with here.

The capacity to undertake adjustment relatively quickly in fast-growing economies depends on a range of domestic policies affecting human resource development, R&D and the acquisition of physical infrastructure. Those policies are often the focus of international aid and other programmes provided through the institutions of international cooperation. While important, their management and the contributions of the EU and United States to them also lie outside the scope of this article (see Soesastro, 2005).



US and EU trade policies

Incidence of protection

A number of aspects of US and EU trade policies impede the movement of the East Asian economies along the 'ladder of development' evident in the framework just discussed. Table 3 shows US and EU applied and bound tariff rates compared with those in East Asia⁴. The United States and the EU have bound all their tariff rates, although the proportion of tariff lines that are actually duty-free is low relative to Japan, for example (but significantly higher than in Australia). A relatively high proportion of imports is duty-free and average applied tariff rates are low. The United States particularly, however, has a significant number of tariff lines with rates above 15 per cent ('international peaks'). Depending on the pattern of East Asian exports, these remaining peak tariffs could have a significant effect on trade growth. The impact of US or EU tariffs very much depends on the distribution of East Asian exports by tariff line. Data relevant to this question are available for East Asian exports to all industrial countries. In 1997, East Asia faced average tariffs of 5.1 per cent on all exports of non-agricultural products to the industrial countries⁵. This is relatively low compared with an average tariff of 8.2 per cent on exports of those products within the region, 15.1 per cent on exports to Latin America and 28.1 per cent on those to South Asia (Table 9 in Messerlin and Zedillo, 2004).

Table 3 also highlights two other features of the tariff structures in these economies. First, some East Asian economies, particularly in ASEAN but also Korea, have relatively high average tariff rates. Second, note the gap between applied and bound tariff rates for the East Asian economies (and Australia). These features of the structure of protection within and outside the region suggest elements of a strategy for designing an East Asian trade coalition in response to the problems and lack of coherence identified in the industrial countries, and the conclusion of this article returns to this question. The following subsection turns to other aspects of trade policy, including the impact of trade preferences, both reciprocal and non-reciprocal, tariff escalation and of the use of anti-dumping.

Trade discrimination

Consideration of preferential arrangements must include the impact of the sector-specific preferences in the MFA. The experience of East Asian economies in exporting to Japan and Australia compared with the United States and the EU illustrates the impact of the MFA. Japan and Australia were not members of the MFA while the US and the EU both were. Figure 1A shows the East Asian share of imports of clothing into these four markets. Japan is the benchmark. The East Asian share of imports of clothing

Table 3 Bound and applied tariffs on industrial products (East Asia, US, EU)
(Tariff rates in per cent ad valorem, other measures as noted. Shares are shares of total tariff lines)

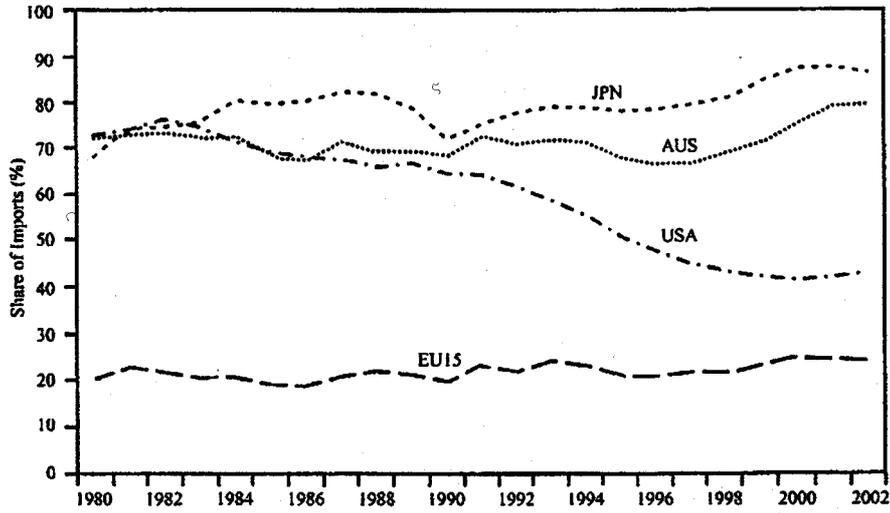
| A. MFN Bound tariffs | | | | | | | | |
|-----------------------------|----------------------|----------------|--------------------------|--------------------|-----------------------------|---------------|--------------------|---------------------|
| Import markets | Binding coverage (%) | Simple average | Coefficient of variation | Maximum ad valorem | Last year of implementation | Duty free (%) | Non ad-valorem (%) | International peaks |
| United States | 100.0 | 3.2 | 1.3 | 48.0 | 2004 | 38.5 | 4.8 | 1.8 |
| European Union | 100.0 | 3.9 | 0.9 | 26.0 | 2004 | 23.9 | 0.7 | 0.8 |
| Australia | 96.5 | 11.0 | 1.0 | 55.0 | 2000 | 17.2 | 0.1 | 14.9 |
| Japan | 99.5 | 2.3 | 1.5 | 30.0 | 2004 | 57.1 | 3.6 | 0.6 |
| Korea | 93.7 | 10.2 | 0.8 | 80.0 | 2009 | 15.1 | 0.1 | 11.9 |
| Hong Kong, China | 37.4 | 0 | 0 | 0 | 2000 | 37.4 | 0 | 0 |
| Chinese Taipei | 100.0 | 4.8 | 1.2 | 90.0 | 2011 | 29.0 | 0.9 | 1.7 |
| Singapore | 64.5 | 6.3 | 0.7 | 10.0 | 2004 | 17.4 | 0 | 0 |
| Malaysia | 81.2 | 14.9 | 0.7 | 40.0 | 2005 | 4.1 | 0.1 | 38.5 |
| Thailand | 70.9 | 24.2 | 0.4 | 80.0 | 2005 | 2.5 | 14.9 | 47.2 |
| Philippines | 61.8 | 23.4 | 0.5 | 50.0 | 2005 | 2.2 | 0 | 50.2 |
| Indonesia | 96.1 | 35.6 | 0.2 | 150.0 | 2005 | 2.2 | 0 | 89.8 |

| B. Applied tariffs | | | | | | | | |
|---------------------------|------|------------------------------|----------------|--------------------------|---------|---------------|--------------------|-------------------------|
| Import markets | Year | Total number of tariff lines | Simple average | Coefficient of variation | Maximum | Duty free (%) | Non ad-valorem (%) | International peaks (%) |
| United States | 2001 | 8,447 | 3.8 | 1.2 | 109.7 | 31.1 | 0 | 4.1 |
| European Union | 2002 | 8,305 | 4.2 | 0.9 | 26.0 | 17.1 | 0.7 | 0.9 |
| Australia | 2001 | 5,019 | 4.6 | 1.3 | 25.0 | 43.1 | 0 | 4.8 |
| Japan | 2001 | 7,243 | 2.7 | 1.4 | 33.8 | 47.7 | 3.9 | 0.7 |
| Korea | 2001 | 9,767 | 7.5 | 0.4 | 30.0 | 5.4 | 0.1 | 1.6 |
| Hong Kong, China | 2002 | 5,645 | 0 | 0 | 0 | 100.0 | 0 | 0 |
| Chinese Taipei | 2001 | 7,183 | 6.3 | 0.9 | 50.0 | 13.9 | 1.1 | 4.3 |
| Singapore | 2001 | 5,133 | 0 | 0 | 0 | 100.0 | 0 | 0 |
| Malaysia | 2001 | 9,215 | 8.1 | 1.3 | 300.0 | 51.4 | 0.2 | 23.3 |
| Thailand | 1999 | 5,866 | 15.5 | 0.9 | 80.0 | 1.2 | 18 | 31.2 |
| Philippines | 2002 | 4,852 | 5.2 | 0.9 | 30.0 | 2.4 | 0 | 0.4 |
| Indonesia | 2002 | 6,450 | 6.7 | 0.9 | 170.0 | 20.6 | 0 | 2.6 |

into Japan, already high, grew steadily after 1990. Australia reveals a similar story. The share of imports in the United States has fallen steadily since 1980, however, and is now much lower than that of Japan and Australia. The EU's share was always much lower and changed little. The penetration of East Asia into textiles markets in Japan is more dramatic than that for clothing; a rising share is also evident in Australia (Figure 1B). Little change has occurred in the East Asian textile import share in the United States since 1990, and only a small change in East Asia's share in the EU.

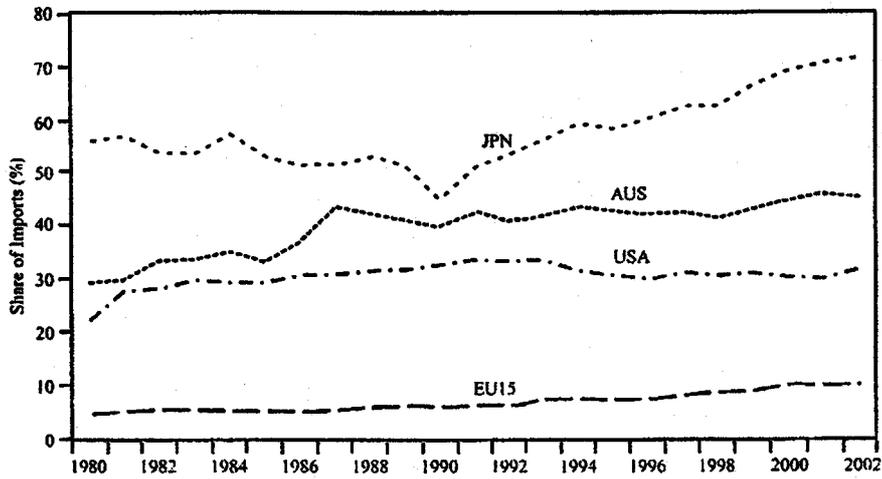


Figure 1A East Asian shares of imports of clothing



Source: International Economic Data Bank, The Australian National University.

Figure 1B East Asian shares of imports of textiles



Source: International Economic Data Bank, The Australian National University.



More detailed information is needed to identify the determinants of these changing trade shares. The extent of the trade covered by quotas is one consideration but more important is whether the quotas are binding. Evans and Harrigan (2004) conclude that, overall, the shares of US imports under binding textile or clothing quotas remained steady during the 1990s. From this perspective no significant liberalisation of market access occurred over these years. They also report that the presence of binding quotas has a significant effect on US prices of the imported products (on average lifting prices 6.3 percentage points) and also has generated substantial quota rents (estimated at US\$6.71 billion between 1990 and 1998).

Evans and Harrigan also find that the degree to which various East Asian exporters faced binding quotas varied considerably given the differences in the export mixes of these economies. No clear pattern appears of effects related to stages of development. The share of US imports under binding quotas fell between 1991 and 1998 from 74 per cent to 57 per cent for China, from 73 per cent to 57 per cent for Hong Kong, China and from 83 per cent to 58 per cent for Chinese Taipei. For other countries, however, such as Thailand (59 per cent by 1998), Indonesia (99 per cent), Korea (65 per cent) and the Philippines (70 per cent), the coverage increased.

Evans and Harrigan (2004) note too that tariff liberalisation favouring Mexico and the Caribbean also favoured those countries as sources of imports, subject to the constraint that import quotas were also more likely to bind as tariffs were cut preferentially. In addition, they identify a significant contribution to trade growth from proximity, especially when demand is sensitive to delivery times and reliability.

Messerlin and Zedillo (2004) make the important point that the Agreement on Textiles and Clothing (ATC) under the Uruguay Round phases out quotas (see their Box 25), even though that process is subject to back-loading, but it does not remove tariffs. They stress that this sector will continue to provide examples of tariff peaks and tariff escalation and therefore high levels of effective protection. They remain concerned that the phase-in of the ATC will lead to an increase in anti-dumping actions. By way of assessment of the significance of the current policy mix, they report IMF/World Bank estimates (p. 102) that every job saved by protection in this sector in a developed economy costs 35 jobs in developing countries.

The United States and the EU provide non-reciprocal preferences, and some East Asian economies benefit from them⁶. Hoekman (2005) concludes, however, that, 'preferences do little good' (p. 27). He cites several factors that contribute to this result. They include: the difficulty of meeting the necessary rules of origin (which leads to low utilisation rates of preferential quotas); the lack of preferences offered for products in which developing countries have comparative advantage; the risk



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of unilateral change or withdrawal; and the imposition of other conditions unrelated to trade (for example, labour rights or environmental standards). He notes that a substantial share of the rents created by quotas is captured in the importing country and stresses that 'preferences may impede own liberalization by recipient countries by reducing domestic political pressure to reduce anti-export bias' (p. 28). Hoekman also points out that not all developing countries are beneficiaries, and trade gets diverted away from those who have export patterns similar to those of the recipients of the preferences.

The United States and the EU also apply reciprocal preferential policies. East Asian economies (apart from Singapore) have no preferential agreements with either economy, but US and EU preferential trade policies with other trading partners affect East Asia. An instance of this evidently occurs in the substitution already noted of textile and clothing imports into both the US and Europe from Mexico and other Latin American countries.

Tariff escalation distorts movements along the production chain. Flowers and Bosworth (2002) report average tariffs by sectors where these calculations can be made by stage of processing for the EU

Table 4 Bound tariffs on industrial products: simple average tariff rates by stage of processing in the United States, the EU and Australia

| Import markets | European Community | | | United States | | | Australia | | |
|---|--------------------|-------------------|-------------------|---------------|-------------------|-------------------|---------------|-------------------|-------------------|
| | Raw materials | Semi-manufactures | Finished products | Raw materials | Semi-manufactures | Finished products | Raw materials | Semi-manufactures | Finished products |
| Wood, pulp, paper and Furniture | 0 | 1.0 | 0.5 | 0 | 0.7 | 0.7 | 0.3 | 7.0 | 0.9 |
| Textiles and clothing | 2.6 | 6.6 | 9.7 | 2.8 | 9.1 | 9.1 | 1.5 | 22.9 | 35.7 |
| Leather, rubber, footwear and travel goods | 0.1 | 2.4 | 7.0 | 0 | 2.3 | 11.7 | 4.2 | 11.5 | 22.0 |
| Metals | 0 | 1.2 | 2.8 | 0.8 | 1.1 | 2.9 | 0.6 | 0.8 | 11.8 |
| Chemicals and photographic supplies | – | 5.2 | 3.4 | – | 4.1 | 2.3 | – | 9.8 | 7.6 |
| Transport equipment | – | – | 4.7 | – | – | 2.7 | – | – | 15.1 |
| Non-electric machinery | – | – | 1.8 | – | – | 1.2 | – | – | 9.1 |
| Electric machinery | – | – | 3.3 | – | – | 2.1 | – | – | 13.3 |
| Mineral products and precious stones and metals | 0.4 | 2.4 | 3.7 | 0.6 | 1.3 | 5.3 | 2.4 | 6.0 | 11.1 |
| Manufactured articles not elsewhere specified | – | – | 2.7 | – | – | 3.0 | – | – | 7.0 |
| Fish and fish products | 11.2 | 13.3 | 14.1 | 0.7 | 1.7 | 4.0 | 0.4 | 0 | 3.2 |

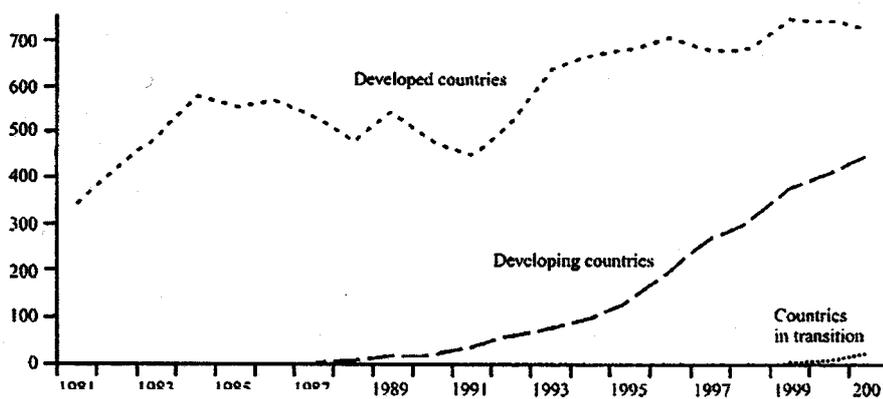
Source: Flowers and Bosworth (2002).

of escalation, significant for all the products shown, is especially striking for textiles, clothing and footwear. Not shown in the table is the pattern of protection for processed food, but Messerlin and The and the United States, including a comparison with Australia. Table 4 shows these data. The degree of escalation, significant for all the products shown, is especially striking for textiles, clothing and footwear. Not shown in the table is the pattern of protection for processed food, but Messerlin and Zedillo (2004) report high rates of escalation in that sector as well. They recount the story of the cocoa bean. The EU tariff on it is 0.5 per cent and its tariff on chocolate is over 30 per cent, so that while developing countries grow 90 per cent of the world's cocoa beans, they account for just 4 per cent of chocolate production.

Anti-dumping measures

Developed countries have used anti-dumping measures extensively since 1981, but developing economies apply them increasingly as well (Figure 2). Zanardi (2004) finds that their traditional users, measured by the number of actions, were the United States, the EU, Australia and Canada. From 1981 to 2001, this group accounted for 64 per cent of all anti-dumping petitions (the United States and the EU accounted for 35 per cent, shared equally). The pattern shifted in the more recent years. Between 1995 and 2001, the seven largest users imposed 64 per cent of all anti-dumping actions, and they

Figure 2 Anti-dumping measures in force by groups of countries



Source: Figure 4 in Zanardi (2004).



included the original four plus India, South Africa and Argentina, with the new users taking larger shares than Australia or Canada.

China was the most targeted country in all anti-dumping actions from 1995 to 2001⁷. Korea and Chinese Taipei have also moved up the ranks. Zanardi (2004) finds that nearly 70 per cent of the anti-dumping actions initiated by developed countries target developing economies or those in economic transition. Yet he stresses that developing countries and those in transition (which together account for about as many actions as developed countries) tend to target economies at the same stage of development, i.e. the distribution of actions is similar for both groups. He suggests, therefore, that analysis of options for restraining the use of anti-dumping actions should not be built on a perspective in which the conflict on this matter arises only between developed and developing countries.

Messerlin and Zedillo (2004) report anti-dumping actions per dollar of imports as a measure of the intensity of their use. While the United States initiated more cases than other countries between 1995 and 2002, other countries — such as Brazil, Australia, South Africa, India and Argentina — showed much higher intensity of use by this measures⁸. Developing countries were the targets in 58 per cent of the anti-dumping actions in the period, compared with 28 per cent for developed economies and 14 per cent for transition economies⁹.

Since 2001, the number of anti-dumping investigations in the EU declined from over 60 in 1999 to about 30 in 2000 and 2001 and fewer than ten in the first six months of 2003. Evenett and Vermulst (2004) attribute this fall in part, but not necessarily completely, to the ‘politicisation’ of the process. In response to a complaint, the European Commission will investigate the claim, establish ‘injury’ and then determine a tariff that is ‘in the Community’s interest’ (p. 3). Until March 2004, before the duties were imposed, a majority in the European Council had to vote in favour of the Commission proposal. The initial steps may have been political, but the voting was overtly so. Since then, an anti-dumping measure recommended by the Commission is adopted unless a simple majority of the European Council rejects it, within one month after submission of the proposal by the Commission.

Evenett and Vermulst inspect the publicly available material on the debates surrounding proposals for anti-dumping duties¹⁰. They find that some member states have shifted from a ‘live and let live’ position on them to one of questioning each Commission proposal. Proposals are most often supported by a group of five states – Portugal, France, Italy, Greece and Spain. Another seven, on the basis of their commercial interests, support them far less frequently. They are Luxembourg, the Netherlands, Finland, Germany, Sweden, Denmark and the United Kingdom. Belgium, Austria and Ireland took a middle position. The expansion of the EU in 1995, when Austria, Finland and Sweden joined, therefore tended to strengthen the anti-duty block. Evenett and Vermulst also note that the

usual prescription for reducing the risks of excessive use of anti-dumping actions is to hand the procedure to a technocratic system. As noted, such a system does operate in the EU, but it does not appear to have been driving the drop in actions. The diverse economic interests of member states play the more important role. A similar approach, bringing to bear the different interests of trading partners, might also be adopted within other regions like East Asia, to try to limit the application of anti-dumping duties. At the least, knowledge of the dynamics of anti-dumping decision making in the EU helps non-members build strategies of advocacy in the short term and of new rule making in the longer term, aimed at reducing the risks of EU anti-dumping duties¹¹.

Table 5 provides an indication of the orders of magnitude of the gains that might flow from policy reform to resolve some of these issues. The country aggregates used in this table (reported by Anderson, 2004) are wider than the immediate interest here, but they provide some indication of the priorities. The table shows estimates of the gains from removing goods-trade barriers following the Uruguay

Table 5 Sectoral and regional contributions to comparative static estimates of economic welfare gains from completely removing goods trade barriers globally, post-Uruguay-Round, 2005 (per cent of total global gains ^a)

| Liberalising region: | Benefiting region | Agriculture and food | Other primary | Textiles and clothing | Other manufactures | Total |
|----------------------|-------------------|----------------------|---------------|-----------------------|--------------------|-------|
| <i>High Income</i> | | | | | | |
| | high income | 43.4 | 0 | -2.3 | -3.2 | 38.0 |
| | low income | 4.6 | 0.1 | 3.5 | 8.8 | 16.9 |
| | total | 48.0 | 0 | 1.3 | 5.6 | 54.9 |
| <i>Low Income</i> | | | | | | |
| | high income | 4.4 | 0.1 | 4.1 | 10.9 | 19.5 |
| | low income | 12.3 | 1.0 | 1.4 | 10.9 | 25.6 |
| | total | 16.7 | 1.1 | 5.5 | 21.7 | 45.1 |
| <i>All Countries</i> | | | | | | |
| | high income | 47.9 | 0.1 | 1.9 | 7.7 | 57.5 |
| | low income | 16.9 | 1.0 | 4.9 | 19.6 | 42.5 |
| | total | 64.8 | 1.1 | 6.8 | 27.3 | 100.0 |

Note: a The total value of the welfare gain from full liberalisation for all economies in the study from which this decomposition is derived is US\$254 billion and the value to developing ('low income') economies is US\$108 billion (1995 US dollars).

Source: Reported by Anderson (2004).



Round. It divides the effects between the liberalising group (high or low income as well as total) and the affected group of economies. Shown in the table are the percentage distributions of the gains. The total gain from full liberalisation for all economies was US\$254 billion, and the value to developing economies was US\$108 billion (in 1995 dollars). Policy change initiated by developed economies generates about 55 per cent of the total gain, of which about 30 per cent goes to developing countries. Reform of trade policy affecting manufactured goods accounts for about 72 per cent of the gains received by developing countries from all policy reform in developed countries¹².

While developing countries gain from manufacturing-sector policy reform in developed economies, the latter do not gain from their own reform, at least in the aggregate. According to Table 5, reform in developed economies alone in the manufacturing sector leads to a welfare loss for those economies.

The removal of protection and the increase in imports shifts the terms of trade against these economies. Their reform leads to higher world prices for the previously protected products. To the extent that social evaluations of welfare drive policy choices, this result suggests that developed economies will be less willing to take the initiative in these areas.

Concluding remarks

This review reveals a number of examples of incoherence in the application of trade policies in the United States and the EU, even within the scope of tariff policy as discussed here. Some of the more serious examples include the following.

1. Changes in market shares are important to successful development built on trade specialisation, a point well understood by footloose investors home-based in developed economies. Yet preferential trade policies try to lock in the market shares of particular suppliers, both through the ATC and in bilateral agreements.
2. Developed countries argue for mainstreaming trade into development strategies on the basis of the gains to exporting countries. Yet their tariff structures are biased against trade in products in which developing countries are likely to be more competitive, and their use of preferential policies helps transfer the rents created by restrictions to their own importers.
3. Developed economies urge developing ones to undertake reform through the WTO, for which they also provide capacity-building support, but the application of preferential policies reduces the incentives to make commitments in the WTO.



4. Developed economies laud China's reform program, but reward it with anti-dumping actions that in turn encourage China and other developing economies to join in the protectionist anti-dumping 'game'.
5. The field of contradictions would be even larger if aid policy were included in this review. Aid policy is often designed to promote industrial upgrading, the scope for which is seriously limited by tariff escalation, a common feature of developed-country tariff structures. A look at policies affecting services trade would also increase the incidence of policy incoherence. The United States, for example, extols the virtues of participation in the world economy but inhibits the reform of the maritime and air transport sectors, setting a bad example for developing countries in the regulation of services industries.
6. There is an evident contradiction between protection in the United States and the European Union in aggregate or average terms and in the details of its application. In aggregate terms these economies are quite open, with low average applied rates, all tariffs bound and small gaps between bound and applied tariffs. The issues for developing East Asian economies, as illustrated in the examples just presented, arise in the instruments applied to 'tailor make' policy for the sensitive sectors. These instruments include the remaining tariff peaks and tariff escalation. They arise in measures designed to deal with the interests of favoured trading partners, i.e. the use of preferential tariffs (reciprocal or not) and the threat of anti-dumping actions. The policy instruments necessarily involve more discretion in their implementation and it is more difficult to establish rules on their application, not just politically but also in technical terms. These aspects of policy all tend to be biased against East Asian exporters.

East Asian economies (at least the developing ones) might reasonably complain about these examples of incoherence in the trade policies of their developed-country partners. They might insist that something be done, appealing perhaps to notions of leadership or duty. Yet the origins of the lack of policy coherence lie within the domestic policy-making processes of the developed economies. The positions they take result from interaction between political constituencies, and any policy change requires some external shock to upset the consensus that the political 'markets' in those countries have produced. An important question, then, is whether there is opportunity for East Asian economies to mobilise with the objective of inducing an external shock sufficient to shift policy consensus in the United States and the European Union.

At one level, success in removing some of the contradictions in US and EU policies requires engaging the domestic political constituencies within each economy. The current WTO negotiations



provide an opportunity to work on this, and given the complexity of the policies, the negotiations also provide an opportunity to achieve more consistency in the development of new rules and procedures.

At a higher level, shifting policy positions in the United States requires leadership in trade diplomacy, not by the United States and the European Union but by East Asia itself. In the past a coalition of developing and developed economies within East Asia (the Western Pacific trade ministers' group) played an effective role in shaping the agenda for the Uruguay Round. The issues in US and EU trade policies that confront East Asian developing countries are not likely to be dealt with unless East Asia can re-group in this way. A foundation for an East Asian trade policy coalition exists in the structure of the trade policy problems outlined in this article. The structure of tariff protection (set out in Table 3) and the modelling results (described in Table 5) provide the rationale for working together in East Asia to deal with these problems in the US and EU markets.

What are the elements of a grand bargain on trade in manufactured goods?

- The first would be an explicit East Asian commitment to bind more tariff lines, to narrow the gap between bound and applied rates and to bind more tariff lines at zero. The East Asian coalition could also commit to reduce bound tariffs under a formula designed to deal with tariff peaks, and it could agree to schedule further reductions in the remaining tariffs, consistent with stated regional objectives. Credit for previous liberalisation could be allowed, for example, for commitments documented in the APEC process. Messerlin and Zedillo (2004) suggest (p. 106) that focusing on bindings offers credit to developing countries for previous reductions in applied tariffs, while rewarding further coverage of bound rates.
- Next, East Asian economies and China in particular have an interest in resolving the problem of accelerating anti-dumping actions. At a minimum, accepting China's status as a 'market economy' could bolster China's interest in the regional coalition and its value to China in the current round of negotiations. That commitment could be accompanied by another one among all East Asian economies (analogous to the outcome of the more formal process in the European Union) to tighten and harmonise their own rules on the application of anti-dumping measures. This involves a clear understanding of their own interests in the contribution of that measure to their own competitiveness and to their full participation in regional supply chains. Potential interlocutors on these matters among EU members were noted earlier¹³.



- The coalition might also propose to abandon the application of preferences to developing countries. Hoekman (2005) suggests complementing this initiative with various capacity-building programs (perhaps valued up to an estimate of the value of the preferences).

A coalition based on these elements could attract wide participation. Not only do the developing and middle-income countries of East Asia have an interest in these proposals, but so also does Japan. It would be in the interests of Australia and New Zealand to support this agenda. These commitments would require a good deal of policy dialogue and interaction on each element, especially on anti-dumping policies. This process would help to cement a co-operative strategy and the coalition. Action by East Asia along these lines would also attract attention from other developing countries for which the East Asian region is a major market (Messerlin and Zedillo, 2004, p. 103).

This package of trade policy reforms in East Asia would constitute a substantial offer and benefit to the United States and the European Union. It has the potential to trigger a response of equal benefit to East Asian economies. The response would have to deal with the problems facing East Asia set out in this paper, including tariff peaks, preferences of various types, anti-dumping measures. A response of that kind would help to resolve some of the contradictions and incoherence in US and EU trade policy.

Notes

This article is also being published as a chapter in a recent publication by the in the OECD Development Centre Studies series entitled *Policy Coherence Towards East Asia: Development Challenges for OECD Countries*, edited by Kiichiro Fukasaku, Masahiro Kawai, Michael G. Plummer, Alexandra Trzeciak-Duval. Paris, 2005.

- 1 This is formally called the 'Arrangement Regarding International Trade in Textiles'.
- 2 See Richard Barichello's chapter 'Economic Development and Poverty Reduction in East Asia: The Impact of OECD Country Agricultural Policies' in K. Fukasaku, M. Kawai, M. G. Plummer, and A. Trzeciak-Duval (eds) *Policy Coherence Towards East Asia: Development Challenges for OECD Countries*. OECD Development Centre, Paris, 2005.
- 3 It is acknowledged that the shares of trade directed to East Asia are lower than they might otherwise have been following the financial crisis, but that observation also makes the point of the value of attention to US and EU trade policies.
- 4 Average applied tariffs are calculated at an earlier year than bound tariffs, which refer to the year of implementation. For that reason average applied tariffs can be higher than bound rates, especially for low tariff rate countries.



- 5 Detail for the United States and the EU is not available from this source.
- 6 Details of preferential access offered by the EU to East Asian economies are available from http://europa.eu.int/comm/taxation_customs/customs/customs_duties/rules_origin/article_403_en.htm. Details of US programs are at http://www.ustr.gov/Trade_Development/Preference_Programs/section_Index.html. Bora (2003) provides a summary of product exclusions and of data showing the significance of the preferential access available for East Asian economies.
- 7 China is also treated as a non-market economy in anti-dumping actions. This means that cost data from a substitute country are used to calculate a normal value against which actual prices can be compared. For market economies, actual prices and costs are listed. China argues that this situation is open to abuse because the criteria for the selection of substitute countries are not well specified. This adds to the likelihood of success in the case and therefore the incentives to take anti-dumping action.
- 8 Another important parameter in assessing the bias in the effect of anti-dumping functions is the duty applied. Messerlin and Zedillo (2004) suggest (p. 109) that perhaps because differences in capacity to defend themselves, developing countries are more likely confronted with higher anti-dumping duties.
- 9 The definition of developing countries in this case includes China but excludes economies in transition, while the EU, Iceland, Japan, Australia, Canada, New Zealand, Norway, Switzerland and the United States are the group of developed economies.
- 10 The target countries in these cases are concentrated in Asia. Of the cases they examine, the most often mentioned trading partners are China, Japan, Thailand and Korea in that order, followed by India, Chinese Taipei and Malaysia.
- 11 This experience also raises the question of why the same political constraints on anti-dumping have not emerged in the United States.
- 12 Developing economies receive larger gains from reform initiated by other developing economies but agricultural reform makes a larger contribution to those gains than does reform to manufacturing sector policies.
- 13 Messerlin and Zedillo (2004, p. 110) make suggestions, which this coalition could explore and rank, for specific initiatives to discipline anti-dumping measures.

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