Introduction to EASE 14

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This volume contains papers from the fourteenth annual *East Asian Seminar on Economics*. EASE 14 was held in Taipei, China on September 5-7 2003 (after a delay of almost three months due to the SARS epidemic during the Winter/Spring of 2003). The local sponsors were the Chung-Hua Institution for Economic Research and Academia Sinica.

EASE 14 was concerned with the topic of international trade, one of the most prominent fields of economics that has attracted scholars since at least the time of Adam Smith and David Ricardo. This topic is of special concern to East Asian countries, for a few reasons. A number of countries achieved high rates of economic growth since WW2, at least in part due to their export performances. This includes Japan in the 1950s and 1960s, the Newly Industrialized Economies (NIEs) in the 1970s and 1980s, and other Southeast Asian countries in the 1980s and 1990s. All these countries have benefited from a global trend towards trade liberalization. Some of the NIEs and Southeast Asian countries accelerated their growth by accepting foreign direct investment. The high economic growth rates sometimes caused trade tensions. Often exporters (Japan and Korea in the past, China more recently) have been targeted by advanced economies for dumping or some other violations of fair trading practices, though some of the charges have been disputed by exporters. Before the World Trade Organization (WTO) was created, disputes were often settled bilaterally with import quotas or export restraints. These disputes are now typically taken to the recently created WTO dispute settlement mechanism.

In the 1990s, there have been an increasing number of regional trade agreements in the world. NAFTA has been quite prominent, but MERCOSUR and the EC/EU have also prompted much debate, especially concerning the consistency between these regional agreements and the WTO. EASE 6, "Regionalism versus Multilateral Trade Arrangements" in 1997 dealt with many of these issues. Until recently, the Asian region has been slow to adopt regional trading arrangements. If any, Asians tended to favor "open regionalism" in that a "most favored nation" clause was activated so that any regional concessions were also applicable to others. However, in the last few years, great interest in regional trade arrangement has been observed in Asia. AFTA (ASEAN free trade agreement) is making progress in eliminating tariffs among ten Southeast Asian countries. Japan has concluded an economic partnership agreement (a free trade agreement plus) with Singapore, and is now negotiating with Korea, the Philippines, and Thailand. China has entered negotiations with ASEAN for a free trade agreement. The Asian countries appear to have entered a new stage of their trade relationship among themselves and between them and the rest of the world.

The participants of EASE 14 were particularly interested in empirical aspects of international trade of relevance to East Asia. Topics of interest included: the existence of regional trading blocks; strategies for improving productivity and facilitating technological change through trade; barriers to international trade; and the determinants of international integration.

International trade is by its very nature a general equilibrium phenomenon. For instance, production patterns are both important determinants of trade patterns, and are also importantly determined by trade. Naturally enough, a number of the papers in the volume are concerned with either the determinants of trade patterns (such as productivity, or R&D), or their consequences (for e.g., employment). Again: nature of man-made trade barriers is an important cause of trade flows, but protectionism is in turn importantly affected by trade patterns. Accordingly, a number of the papers are thus concerned with either the effects or causes of protectionism (or both); these can be either regional or multilateral, and either conventional (e.g., the MFA or antidumping procedures) or unusual (e.g., border delays).

The feedback between the causes and consequents of international trade means that it is not easy to group papers together into easily identifiable clusters, or, rather, that there are many alternative ways to think about how the pieces of EASE-14 fit together. But certainly one major theme of EASE-14 was the relationship between productivity and trade. In "Physical and Human Capital Deepening and New Trade Patterns in Japan," Keiko Ito and Kyoji Fukao seek to explain the rising capital/labor ratios experienced in Japan during the last couple of decades (a phenomenon common to a number of OECD countries). As has long been recognized, a primary suspect for trend changes in factor intensities is growing international openness, since trade naturally leads to specialization in industries of comparative advantage as dictated by factor abundance. Does a growing international division of labor explain changing Japanese factor intensities? No. While Ito and Fukao use a massive disaggregated empirical data set to document the fact that Japanese trade (especially with China) has changed the factor content of net exports of Japanese labor. This naturally leads one to suspect that Japanese firms outsourcing production to China to take advantage of abundant cheap Chinese labor are the primary culprits. Nevertheless, it turns out that the changes take place across all industries, while the trend differences between industries are relatively small. Thus the "within-industry" changes swamp the differences between sectors. The mystery remains, though Ito and Fukao have provided a service to the profession by ruling out trade as an important determinant of trending Japanese factor intensities.

The Ito and Fukao work is implicitly based on the fundamental importance of factor proportions in driving trade patterns, an idea with a long and honorable heritage in the field stemming back at least to the work of Heckscher and Ohlin. An even older approach stretching back to Ricardo emphasizes the role of labor productivity. Of late, researchers have stopped taken productivity as given and started to focus on the determinants of technological productivity to ask simple questions like "What drives exports?" More particularly, what are the forces that drive firms and industries to be able to sell not only at home but also abroad. Are exporter firms that have been proven in a "trial by fire" domestically who are then able to compete successfully abroad through some sort of Darwinian process? Or does exporting lead a firm to acquire new skills and knowledge which then enables them to be more productive at home and abroad? Chin Hee Hahn uses a disaggregated Korean data set to answer this fundamental question and finds evidence for both lines of causality; exporting improves productivity, while it is also true that more productive firms tend to export.

In "International R&D Deployment and Locational Advantage: A Case Study of Taiwan" Meng-Chun Liu and Shin-Horng Chen focus on another key determinant of export success, namely research and development. This can be thought of as another way to go inside the black box of productivity to understand the determinants of technological productivity. Multinationals can perform R&D in a variety of different locales. The choice of R&D location can have important implications for the local economy, yet remains an issue that is under-researched. Liu and Chen seem to fill that void by studying how R&D decisions by multinationals are made using a unique dataset on corporate R&D in Taiwan. They find a large local bias towards R&D activities that are export oriented, and are able to characterize the reasons why multinationals choose to disperse their R&D activities to foreign affiliates.

A different take on the effects of foreign investment is provided by Tain-Jy Chen and Ying-Hua Ku, who are interested in the implications for domestic employment, rather than the importance of multinational activity for trade and production. In "The Effect of Overseas Investment on Domestic Employment" they focus on the Taiwanese manufacturing industry. Since there are both income and substitution effects possible, it is not clear *ex ante* what the effects of foreign investment will be for domestic labor. It turns out in fact to be heterogeneous, typically being positive for labor but differing across occupations.

While there are many "natural" determinants of trade patterns (such as factor abundance, labor productivity, proximity, comparative advantage, etc.), man-made "artificial" trade barriers are also important. Among the most controversial policy issue of late are preferential trading agreements, typically enacted by regional groupings of countries. It has long been recognized that these regional arrangements can lead both to (welfare-enhancing) trade creation as well as (harmful) trade diversion, and there is every reason to believe that there might be analogous effects on international investment flows. Philippa Dee and Jyothi Gali investigate these matters in "The Trade and Investment Effects of Preferential Trading Arrangements". They use a massive bilateral data set involving trade and investment flows between many pairs of countries, and controls for a host of exogenous determinants of international activity, including geographical proximity and the size of the economies (the so-called gravity regression). Their verdict is negative net trade creation by preferential trade agreements, and their work leads us to reflect on the value of further regional integration.

The relationship between integration and trade is explored further in "The Formation of International Production and Distribution Networks in East Asia." In this paper, Mitsuyo Ando and Fukunari Kimura exploit a disaggregated data set of the activities of Japanese firms to explore international networks of production and distribution. East Asia is unusually integrated in terms of production, with high levels of trade in intermediates. In addition, integration in the region has experienced an enormous change with the re-emergence of China, which plays an increasingly important role. Ando and Kimura are able to quantify a number of trends from their Japanese data set, and are able to tease out a rich tapestry of details concerning firm size, industrial differences, the use of affiliates and local firms, and the role of multinationals.

Shujiro Urata and Kozo Kiyota are interested in similar questions, but focus more precisely on formal East Asian trade arrangements. Rather than use a gravity model with its absence of relative prices, they employ a different methodological framework. In particular, they use a computational general equilibrium model with a number of sectors and countries (the Global Trade Analysis Project model). They find similar results, in that the effects of regional arrangements are positive for members, but can adversely affect outsiders, *even though the actual effects on trade patterns may be small in practice*.

Most papers in EASE-14 concentrated on the traditional economic determinants of trade patterns – underlying sources of comparative advantage, whether "natural" or "artificial" such as protectionism. An atypical set of trade determinants which is of considerable interest is financial crises, such as the one that rocked East Asia in late 1997. In "The Effects of Financial Crises on International Trade" Zihui Ma and Leonard Cheng compare the roles of banking and currency crises on exports and imports. They use a traditional gravity model of bilateral trade flows and find relatively strong results, especially for the role of currency crises in export stimulation.

The World Trade Organization (WTO) came into existence in 1995, supplanting its predecessor the General Agreement on Tariffs and Trade (GATT) as the premier international organization in charge of policing and liberalizing international trade. One of the most visible new parts of the WTO is the dispute settlement system, a mechanism for quickly allowing the judicial resolution of disputes involving international trade practices. In his paper "WTO Dispute Settlements in East Asia" Dukgeun Ahn analyzes the incidence of disputes by country and industry, and notes the striking international differences in the use of the system, with Korea and Thailand being prominent users. He concludes with a noteworthy plea for a better alignment between private sector interests and access to the system.

One of the most important types of protectionism in practice currently is antidumping ("AD") policy. In "The Growing Problem of Antidumping Protection" Tom Prusa shows that AD policy is growing quickly, primarily because new users of the legislation are filing at much faster rates than traditional users. Industries which are losing comparative advantage use AD policy, but there a large number of other users as well; countries that have experienced large exchange rate and other macroeconomic shocks also employ it disproportionately. Prusa provides a fine summary and urges both researchers and policymakers to pay more attention to this growing but subtle protectionism.

While the most egregious protectionism is concentrated in agriculture, the textiles industry has long received particularly striking protection under the Multifiber Agreement (MFA). In "Tight Clothing: How the MFA Affects Asian Apparel Exports" James Harrigan and Carolyn Evans engage in a fascinating study of the MFA with a particular emphasis on apparel imports into the US. Above and beyond analyzing the effects of quotas and tariffs, they find that East Asia exporters have suffered a natural loss in comparative advantage to producers in Mexico and the Caribbean as fashion patterns speed up. That is, as fashions begin to change more rapidly, timeliness plays an increasingly important role in production and production naturally shifts to importers in greater proximity.

Another interesting but unconventional type of protectionism is analyzed by Edgar Cudmore and John Whalley. In "Border Delays and Trade Liberalization" they analyze the effects of government-induced border delays on trade. In developing countries (especially poor and/or corrupt ones), customs clearance delays are widespread and extremely costly. The resulting queuing costs can be considerable, and may be exacerbated if queuing rises because of e.g., tariff liberalization. In a partial equilibrium sense, bribes can alleviate border delays and improve welfare. They show that the magnitude of these costs and effects can be large through an illustration to Russian trade data.

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