OUR OWN TRADE BLOC: IT'S NOT THAT EASY

WHY GATT REMAINS AUSTRALIA'S BEST HOPE

by NICHOLAS COLCHESTER

The rest of the world is re-aligning into cooperative economic unions—but cultural barriers will make heavy going of trade reform in Pacific Asia, limiting Australia's options.

This year's International Monetary Fund meeting took place in Bangkok, in the "third world". Suddenly, that label has become nonsense. For the first world is the capitalist, industrial world. And the second world is the communist command-economy world. And the third world is the developing, ex-colonial world that is meant to be deciding which of the first two to emulate. It is obvious that the multi-world world does not exist any more. The term "third world" can be honourably retired.

Today, give or take a China or a North Korea or a Myanmar, we are all in the first, or would-be first, world. After 70 years, the inventor of the Marxist-Leninist command economy, the Soviet Union, had achieved a GDP estimated by the IMF at $1,700 a head, less than those of Mexico or Malaysia.

Unlike Mexico, it was spending 25 per cent of that GDP on defence, with an annual deficit of 30 per cent of GDP. It was economic failure that brought the Soviet experiment to a close. And with its closing ended an "alternative model" that has dignified the claims of numerous governments that they could embody the freedom, and plan the wealth, of their citizens better than citizens and businesses could do it themselves.

So there should now be a new dawn — a return to that golden, pre-ideological time of the late nineteenth century, when the mature world was trading with, and investing in, the developing world so heavily that Argentina could grow by 6.4 per cent annually between 1870 and 1913, when US and Canada were achieving 4 per cent and Australia 3.2 per cent. That vibrant world saw a 25-fold increase in the volume of its trade in the century to 1913.

It was also a golden age for foreign direct investment. It is often assumed that it is today's high-tech world that has given us the global capital market. But an IMF paper published in 1989 showed that international flows of savings were, relative to GNP, much greater in the 30 years to 1913 than they are today.

A combination of the colonial system and the gold standard made the wealth of the developed world much more inclined to invest in the wealth of the less developed world or, to put it in today's terms, non-inflationary currencies and blocs of countries in which common economic rules apply. That economically progressive phase was ended by a nationalistic war that bankrupted the primary capital exporters — Britain, France and Germany. It resulted, in turn, in three-quarters of a century of ideological competition.

Now that competition is over. *The Economist* has called the result the

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"one-mountain world" where every government's success can be measured by the same yardsticks — democracy, human rights, freedom of economic choice, growing prosperity and an unspoilt environment.

Considerations of great power politics should no longer distort the institutions that provide development finance. The IMF and World Bank can become genuine world bodies. Both the right of property of a foreign investor, and the obligation of international borrower to international lender, should be more strictly enforced and respected. In short, something closer to the favourable nineteenth-century conditions for the rich investing in the wealth of the poor should be recreated.

Already something of that effect is visible. More of the countries of Latin America, for instance, are accepting the disciplines of rigorous fiscal and monetary policies and the rules of the market-place. Mexico is top of the class. The result is that flows of finance into Latin America from all private sources went up from $6 billion in 1986 to $15 billion in 1989 and $24 billion in 1990.

Suddenly a new potential appetite for capital has been released, that of the former members of Comecon. Some including the IMF fear that this might divert funds away from other deserving countries. I wonder. With the exception of East Germany, which put its entire management in the hands of West Germany, the build-up of investment in Eastern Europe is going to be painfully slow.

The main reason is *vested interests*. The Soviet Union has now gone through nine "economic reform plans" as it has drifted towards break-up, but the logic of all such plans has no hope against one undodgeable fact. Namely, it takes not just a saint but a madman to reform himself out of a job in the Soviet Union.

The hyper-inflation now unleashed there arises because millions of state employees are being paid with the printing press, and cannot be dismissed because they have nothing else to do, and almost nowhere to look for something else to do. So the roubles roll out, although they are running out of paper to print them on.

But I want to talk mainly of trade. And there is plenty of scope for argument about trade in the one-mountain world. First, argument between rich and poor countries. Second, argument between rich and rich. In both cases, it is the struggling Uruguay Round of the GATT that both sets the scene and provides the main hope for answers. Both arguments involve Pacific Asia's "Flying Geese" — that formation of Japan followed by Singapore, Hong Kong, South Korea and Taiwan, followed by the rest of ASEAN. And both affect those two Pacific economies apart — Australia and New Zealand.

The rich-poor argument features rich countries newly on the defensive against the countries that have now been released to compete with them. Although the GATT has brought tariffs down, it has not been applied to trade in farm products or to textiles or to non-tariff barriers to trade.

When the Uruguay Round opened in 1986 it was the rich countries that were on the offensive and the poor ones on the defensive. The deal envisaged was that producers in the richer parts of the world would make concessions in all three of those areas — textiles, farm products and non-tariff trickery.

The developing world would agree, in turn, to tougher laws on intellectual property — trade marks and so forth — and to be less protectionist against trade in services. At the start it was the developing countries which felt pressured by this envisaged deal.

Now the boot is on the other foot. It is developing countries that are tending unilaterally to open their economies to the world market, and encourage trade and investment in services. It is the rich who are foot-dragging.

They have nastily increased the use of non-tariff barriers against imports: the GATT recently compiled a list of 280 separate demands by Europe and America as a price of entry into their markets.

They have been unable to muster the courage to abandon the Multi-Fibre Arrangement quickly, and unable to open up their agriculture markets, whether it be Japan's rice market or the infamous Common Agriculture Policy of the European Community.

The selling countries used to be distant places that could complain in vain. Now they include ex-communist countries on Europe's doorstep, threatening to send people if they cannot sell goods. And Australia's leadership in the Cairns group has been most effective. This is a nice irony of the change to a one-mountain world.

An American economist, David Hale, pointed out recently that America used to see developing countries either as friends against the Soviet Union or as potential communist menaces. Today they are just a problem. If they are successful they are a trade problem, and if they are a failure they are a credit problem.

And this leads straight to the rich-rich argument — a battle between the capitalisms. Until recently this battle took the form of complaints against this or that non-tariff barrier in this or that country. But it is steadily becoming clearer that there is a clash between Anglo-American liberal capitalism and Japano-German collective capitalism.

I call the latter collective capitalism because it is not socialist capitalism, dependent upon a high degree of state control. Rather, it is capitalism in which the market is rigged by mutual agreement between the players. It is characterised by clubs of companies and banks, longer-term commitment by investors in place of "short-termism", studious involvement of the workforce in the affairs of companies, and constant consultation with government — in short, the sort of relationship between the different actors in society that Anglo-Americans would expect within a company.

During the 1980s, liberal capitalism had a glorious phase because it was rising triumphantly against government planning and socialism. Reaganism swept America and Thatcherism swept Britain and infected a lot of other countries, and all forms of interference with the market were on the defensive.

The paradox is that now, at the moment of that movement's triumph, the collective version is forging ahead in Western opinion — coming through on the rails. This is because of the perception that America and Britain, the two arch-proponents of the liberal version, are not performing as strongly as Japan and Germany and the formidable flying geese.

This is most confusing for Australia, which has still to shed elements of socialist capitalism but which has experienced a full helping of free market excess, and now notes that the tide is moving in the other direction.

I could digress into an argument about this and point out that collective capitalism demands a naturally self-disciplined society; otherwise co-operation is degraded into our old friend the vested interest, with all the inflexibility and inefficiency that can create. But I will not, for my purpose now is not to decide which of these models should win, but only to point out that they clash through trade and the rules of trade.

There are three reasons for this. First, the "non-tariff barriers" just referred to are often one and the same as the rules that determine the collective economic style. Any attempt to tackle such barriers amounts to an assault on that style. An obvious example is the Structural Impediments Initiative that the US is pursuing with Japan. America is saying, in effect: "Your Japanese collective way of running a market economy is not compatible with our free-market way".

In devising the rules of Europe's internal market, Brussels, too, is finding itself involved in the war of economic styles. The Germans like setting tough standards — to decide collectively what their consumers should get, to protect its financial system from itself in the way America and Australia didn't. The British prefer to let the customer decide, to let the bank take the risk and learn from the result. They regard too much standardising as thinly disguised protectionism.

The second reason that the rules of trade become more intrusive and expose the clash of economic styles is the rise of service trade. The rich countries now have some two-thirds of their workforces producing products that you cannot drop on your foot.

Such countries are naturally inclined to trade them as their comparative advantage switches away from making things or crops. At the moment services account for one-fifth of world trade but between 1980 and 1989 they grew at annual compound real rate of 6.5 per cent compared with 4.5 per cent for trade in goods.

The problem is that trade in services also tends to be more intrusive on societies than trade in goods. Financial services are a prime example — specifically, insurance for cars. The British industry likes to assess individual risk and charge accordingly: the price of each insurance policy depends upon the size of the car and the age and record of the driver, and whether or not he's a journalist. In Germany, the insurance industry takes a collective approach: its insurance rates are fixed to spread the risk between bad drivers and good.

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Imagine Germany's difficulty in allowing British companies to sell personal insurance policies in Germany. For it tends to be the collective system that is vulnerable to openness. Sold freely across Europe, British policies would undermine the German market; but the German one simply would not work in the British market, for it would attract all the bad risks and none of the good ones. Hence the fears in parts of Europe that the single market is imposing economic liberalism on countries that do not believe in it.

The last factor in the changing — and more intrusive — nature of trade is foreign direct investment. The rate of such flows has risen at a compound annual rate of 27 per cent since 1984. In fact, the G5 industrial countries' portfolio of foreign direct investments went from $300 billion to about $1,000 billion over the 1980s. At the beginning of the eighties that stock was dominated by America, whereas today the European Community's stock of investments outside the community matches America's overseas; and Japan, which had a minuscule portfolio in 1980, is now the biggest annual investor and will match America's stock in a little over five years.

Why this explosion? First, trade in services. You can sell a machine tool straight out of America, but to sell a service — such as Disneyland — you need to build a Disneyland. Service businesses already account for about half of the world's stock of foreign direct investment.

Second, Japan. The past decade has been remarkable for Japanese foreign direct investment. In 1980 Germany had direct investments abroad 40 per cent larger than Japan's: now Japan's are 70 per cent larger than Germany's. A combination of a stronger yen in the late eighties, and political pressure on Japan-the-exporter from America and Europe, turned Japan into an avid overseas investor. It is now, in terms of annual flows, the largest in the world. And there's more to come. An excellent study by Washington's Group of Thirty of foreign direct investment (FDI) found that only about 6 per cent of the production of Japanese firms takes place outside Japan. The equivalent figure for Germany and America is about one-fifth.

The third reason for the rapidly rising power of FDI is bloc-building. A recent study by the UN centre on transnational corporations found that foreign direct investment tends to develop in clusters. American companies account for two-thirds of FDI into Mexico, Japanese companies for half that in South Korea. The moral from the UN report is that if regional economic associations start to form you ought to get involved in them. This logic is driving Scandinavian countries, and even the usually aloof Switzerland, to move towards asking for full membership of the European Community.

That brings us to the forming of an Asian regional trade bloc. It stands to reason that if trade and its rules are becoming more intrusive, it is easier to forge such rules between countries that share a common culture. Bloc-building is a cultural thing just as much as geographic — with important implications for Australia.

Europe has led the way. America is following with its North American Free Trade Area, stretching from the Yukon to the Yucatan. Some Latin-American countries are talking of their own common market —

the Mercosul, embracing Brazil, Argentina, Uruguay and Paraguay — and others envisage a revived Andean Pact on the west coast.

In Asia there seem to be three rival concepts: APEC (Asia-Pacific Economic Co-operation), embracing America, Australia and New Zealand; ASEAN, more narrowly focused in South-East Asia; and the mooted East-Asian Economic Grouping, whose membership seems to expand or contract or disappear depending upon whom you talk to. Which of these will form a trade bloc? And *should* they form a trade bloc?

To take the last question first: my newspaper, *The Economist*, has a deep suspicion of trade blocs. They threaten to become an alternative to the GATT process of steadily improving multilateral trade. They threaten to ignore whatever GATT regime exists, in favour of bilateral bargaining. They threaten significant numbers of deserving countries with exclusion, just by accident of geography or culture — and Australia and New Zealand spring immediately to mind.

So barely an issue of *The Economist* is published that does not attack the lack of courage with which the G7 leaders have pushed to bring the Uruguay round of GATT negotiations to a close. As I mentioned at the start, there is a fantastic world deal waiting to be done — less protection against textiles and farm products, less use of non-tariff barriers, less protection against service and inwards investment, more protection of the rights of intellectual property. The G7 leaders endlessly intone that that is the deal they want to do. But they won't get down to it. The most wonderful crack has appeared in the edifice of the CAP with the apparent German insistence that the CAP adapt to what is needed by the GATT — Eastern European driven.

But I am mindful of an executive of Motorola, the American electronics company, who said at a conference: "Don't tell me what sort of trade system I ought to have. Tell me which one I *will* have, because that I can plan for." So, will there be an Asian bloc that will present Australia with an awful choice?

If I add all the forces that I have been talking about — the mounting intrusiveness of trade, the mounting power of regional direct investment, the sight of Europe building its bloc, the sight of North America building its bloc, the lack of progress in the GATT — the tidy conclusion is that Pacific Asia, too, will have its trade bloc before long. Flying geese — or albatross?

We have listened for years to ASEAN talking about freer trade. I have watched the anguish as Canada and the US — two contiguous capitalist countries with the same language — negotiating a North American tariff-free zone equivalent to the Common Market in about 1960. I am watching the arguments now about local-content regulations between Mexico and America.

And then I think of the disparateness of the countries in the Asia-Pacific, and the number of authoritarian governments, and the vested interests in their societies (to put it politely) and I do not think the time is yet ripe. What has proved true in Europe will prove true in every would-be bloc: trade freedom is, politically, deeply compromising.

And even if South-East Asians protest that all they want is a stronger voice in the GATT negotiations, they must remember that the strength of the voice depends upon the weight of the stick, and the weight of the stick depends upon the degree to which they function as a common market, open to one another but with common trade policies to the world outside. I am afraid that an ASEAN that still can only talk of a 15-year transition to free trade in manufactured goods does not qualify as a trade bloc in the making.

For what distinguishes the flock of flying geese? First, to a European eye they all have, and are expected by their people to have, *strong government*, whether it be the army in Thailand, or the head of state in Singapore, or the never changing LDP in Japan. Second, that strong government expects and is expected to involve itself in business — not as a dead-hand planifier, but rather like the guiding board of some giant conglomerate, nudging, counselling, protecting, orchestrating flows of finance.

Even though they have those assumptions in common, there is an approach to running an economy that makes the creation of a free trade area incompatible with strong, nationalist governments. The European experience is that the simple economic idea of a free trade area has potent political consequences once it starts to bite. It undermines government authority over an economy, its ability to bestow favours, orders, protection. Fine, if you favour liberal capitalism. Not so fine if you are a Lee Kwan Yew.

What is more, the economies of Pacific Asia are not sending an ever-increasing share of trade and foreign direct investment to each other: they preserve immense individual interests in trade with the United States and Europe — and, in the case of the four dragons and Japan — in mounting direct investment into the US. So their interest in confrontational bloc-building is slight. That trans-Pacific interdependence is what lies behind APEC.

I conclude from this that:

- Pacific Asia will be slow to build a bloc, which is good news for Australia because, while it wants to share fully in the wealth of this part of the world, it does not want to find itself making the cultural choices that bloc-building can involve.
- The GATT round is particularly vital to Pacific Asia and Australasia, even if it costs something in terms of more intrusive trade rules, threatening, say, service sectors with more foreign competition. Global openness for today's trade and investment is what they both need.

What can they do to help the GATT round? Australia has already done great work through the Cairns Group. I am delighted that it has provided figures which show how expensive the CAP is to the European-in-the-street. No-one else does

Continued page 8

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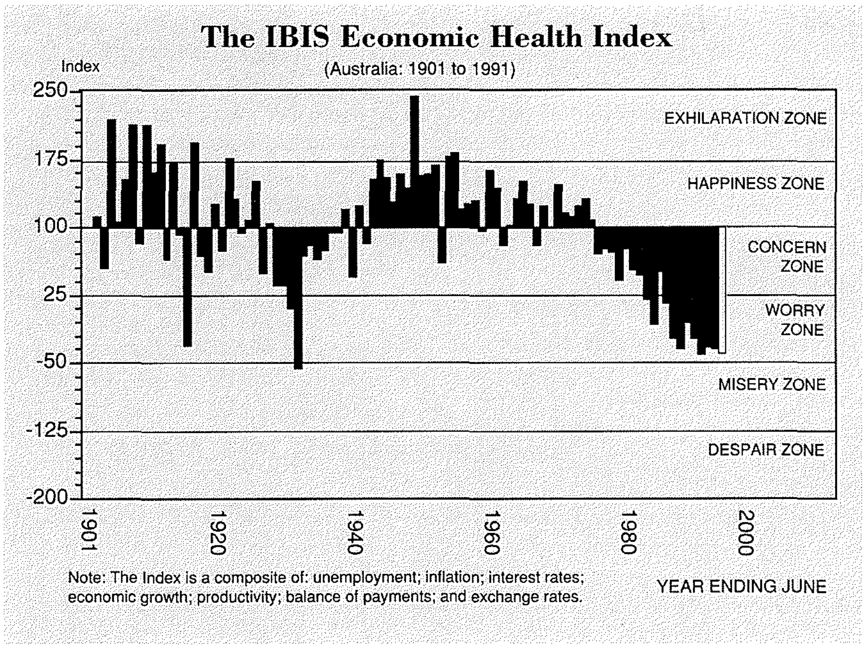
there and done that to the point of creating a blase if not cynical business and social community. It is called flogging a dead horse.

Some believe all the clever people, and the novel ideas and inventions, can be marshalled as catalysts or seed-points for new industries and new growth. But how do we identify which of the tens of thousands of concepts — crackpot and good alike — will work?

No, none of these is the answer in itself, although each has a vital and supportive role.

Curiously, our forebears understood the problems and solutions much better than today's sophisticated, "smart" generation, which has tended, unconsciously, to live off the crown jewels bequeathed by yesterday's wealth-originators.

Their success came from observing a few basic rules which must again become the cornerstone of Australia's new economic approach:



1. Understand the marketplace

This includes being alert to overseas needs and trends, national needs and trends, and local (state) needs and trends. That is what the wool pioneer John Macarthur did two hundred years ago and what hundreds of others after him did in relation to export markets. It is what Vic Richardson of Victa lawnmower fame, and hundreds of others, did in relation to domestic markets.

2. Identify the "safe" market and optimise its performance

This involves recognising the imperative of "best practice" in the 65+ per cent of the economy that creates the bulk of the wealth for citizens.

To this should be added the 15-20 per cent of the economy that will need defending, also through "best practice" (and at times some tough tactics, like those other countries employ). In all, this constitutes some 80-85 percent of the economy.

3. Encourage and exploit a new tradeable sector

This means thorough, patient, long-term development of international market niches. What are today's equivalents of yesterday's wool, agricultural equipment and other success stories?

The new markets are to be found not in Europe or America, but in the Asia-Pacific region — which is geographically closer, bigger (1.8 billion people) and faster-growing in terms of GDP than any other part of the world.

4. Match resources to market opportunities

The asset register of natural and developed resources and intellectual resources needs to be matched to the external market opportunities. Only some will be relevant.

The result of this rigorous approach will not be a dramatic change in Australia's industry mix, at least not at the macro-level. Australia's industry mix is not much different from those of other modern economies — most of which are doing much better in standard-of-living terms (if not quality-of-life) than Australia. The US, Holland, Switzerland and more than a dozen other countries have industry profiles similar to our own. This should remind us that *what* we do is not nearly as important as *how well* we do it.

The real imperative, if we are to rejoin the real world and refute the "Buffoons of Asia" tag so hurtfully used in one leading newspaper recently, is to make the non-threatened sectors (80-85 per cent of the economy) perform as they should, can, and must do. □

Continued from page 5

so — not even a supposedly liberal British government.

As for the "flying geese". It is the lead goose, Japan, which holds the cards. Add all the other geese together and multiply by three and you still do not equal Japan's GDP. Because of that FDI revolution I spoke of, Japan's moment to take the lead in GATT has come, just as Germany has suddenly become aware that it is no longer in its best interests to support the CAP that blocks the GATT round. So an increasingly international Japan, facing increasing competition from other Asian economies, will see that it will profit from an improved GATT, not be punished by it.

Five points to summarise:

- In the "one-mountain world" tensions between styles of capitalism will be one of the arguments that replaces the old clash of ideologies.
- Increasingly intrusive trade and investment, and the rules which govern them, will form the battle ground.
- Culturally similar countries or regimes find it easier to write the rules of trade blocs than dissimilar ones.
- Despite this, the "flying geese" of Pacific Asia will find it hard to strike any sort of powerful, regional economic pact quickly, however much they may talk about it.
- Their best bet, and that of Australia, remains the GATT and its Uruguay round. This hangs in the balance but when one adds up the self-interest of the world's biggest economies, and watches how Japan and Germany are waking up to that self-interest, I believe it still has a chance. □