ASIA SOCIETY POLICY INSTITUTE

THE EVOLUTION OF THE GLOBAL TRADING SYSTEM:

How the Rise of Asia and Next Generation Challenges Will Shape the Future Economy

ANNEX: ASIA AND THE RISE OF GLOBAL TRADE

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INTRODUCTION

Trade patterns have changed dramatically since World War II, with international trade flows rising to unprecedented levels, a steady decline in trade barriers, and Asian countries representing an ever-growing share of world trade. The creation of the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO) established the rules-based trading system, setting the stage for multilateral cooperation and dispute resolution.

The Asian economies that emerged as a rising force in global trade benefited enormously from this system, with some of the most significant impacts in Japan, China, and the "Four Asian Tigers"—Hong Kong, Singapore, South Korea, and Taiwan.

This annex provides a brief overview of the history behind the remarkable rise of Asia in the global trading system. It charts major events and outlines economic developments in Asia from World War II until shortly after the WTO's creation in 1995.

THE GATT CREATES POST-WWII "UNHAMPERED TRADE"

World War II, with its ensuing destruction and human suffering, significantly disrupted world trade. As countries recovered from the war, they quickly recognized that a new economic order and trade arrangements were needed. Western industrialized countries, particularly the United States, sought new markets to achieve growth in the postwar era and opened their domestic markets to help grow those economies that could serve as bulwarks against communism. Cordell Hull, President Franklin D. Roosevelt's Secretary of State, captured the prevailing sentiment of the time: "unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair competition with war."

This policy meant embracing trade liberalization as driving and defining force. In 1947, twenty-three countries representing half of the world's trade signed the GATT, which focused on lowering tariffs. The GATT also enshrined the critical principle of most favored nation (MFN) treatment requiring governments not to discriminate against one country over another when they trade.

After the signing of GATT, exports grew faster than the global economy, rising by over 8 percent annually from 1950-1973.[1] Even as most countries saw slower economic growth in the 1970s, world trade continued to increase, tripling between 1973 and 1979.[2] The Kennedy Round under the GATT, which concluded in 1967, saw industrialized countries further reducing average tariffs on non-agricultural goods to under 9 percent.[3]

JAPAN'S ECONOMIC MIRACLE

After World War II, Japan saw spectacular economic growth. Unlike most of Asia, Japan was already an industrialized economy, and this boom was driven by a rapidly developing manufacturing sector that focused on exports. Throughout the 1960s and 1970s, Japanese exports grew at an average annual rate of 19 percent.[4] Beyond export promotion, the government pursued other economic reforms and invested in education and infrastructure. Japan kept its markets closed, and used industrial policy to pour government funds into developing globally competitive industries, ranging from autos to semiconductors.

Initially, in the postwar years, labor-intensive products such as clothing, toys, raw materials, and light industrial goods were the mainstay of Japanese exports. In the 1960s, Japan started moving up the value chain and turned to producing more sophisticated products. These included "heavy" industrial products like steel, ships, autos, and industrial machines that eventually became Japan's primary export items. By the 1970s and 1980s, the global competitiveness of Japanese industry increased further, and processed and assembled products, such as electrical equipment, transportation equipment, and precision instruments, took over as the leading exports.

By 1968, Japan was the second largest economy in the world, and by 1973 Japan's exports amounted to half of those of the U.S. and growing.[5] During Japan's rapid economic growth, trade friction with the U.S. escalated due to growing trade imbalances. As a result, Japanese manufacturers, particularly in the automotive sector, shifted certain operations and production to the United States and Europe to lessen the tensions and reduce the imbalances.

NEWLY FREE NATIONS PURSUE PROTECTIONISM

As industrialized countries established a new economic system under the GATT, colonialism was also collapsing across Asia, Africa, and Latin America. By the early 1950s, almost all of Asia had achieved independence. The Japanese left Korea and Taiwan, the French departed Indochina (later Vietnam, Cambodia, and Laos), the Dutch recognized Indonesia's independence, the United States withdrew from the Philippines, and the British exited India, which became India, Pakistan, Myanmar, and Sri Lanka. Malaysia remained a British colony until 1957, and Singapore until 1963.

Now on their own, these former colonies needed a strategy to grow their economies. They were not already industrialized like Japan and so didn't have an existing manufacturing sector, but they did have more natural resources at their disposal. In most cases, they chose to pursue "import substitution industrialization," an inward-looking policy that shields domestic industries from foreign competition to allow the development of industrial capacity. Rather than importing manufactured goods, countries tried to produce these goods themselves.

This doesn't mean they didn't export entirely. In many cases, primary commodities—food, raw materials like rubber and timber, crude oil, metals and minerals—were exported to finance imports of capital goods that were then used to develop domestic industries.

With many developing countries pursuing this strategy, the GATT provided them with certain exceptions from its rules and obligations. Therefore, much of the developing world did not take part in the postwar trade boom. As an example, India's share of world exports dropped from 2.6 percent in 1948 following independence to 0.7 percent in 1970.[6] Yet their economies still experienced rapid economic growth and industrial development.

THE RISE OF FOUR ASIAN TIGERS

A small number of economies in East Asia looking at Japan's progress took a different approach. South Korea, Taiwan, Singapore, and Hong Kong encouraged manufacturers to export, principally to developed countries. Their governments provided subsidies, incentives, and other support to export-oriented industries. This facilitated the development of globally competitive industries that met high-quality standards while keeping prices low.

This was a strategy of necessity. Unlike other former colonies, these four East Asian economies had few natural resources, limiting their options to acquire foreign currency to pay for needed imports. In the case of Taiwan and Korea, U.S. assistance financed economic growth in the postwar years, but it eventually came to an end, forcing them to find an alternative strategy.[7]

Export promotion was the strategy that helped these countries grow and succeed. The result was a dramatic economic transformation. The Four Tigers had average annual growth rates of output per capita above 6 percent for more than three decades.[8] South Korean and Taiwanese exports grew by 20 percent and 16 percent, respectively, between 1950 and 1973,[9] and with it came rapid economic growth and rising incomes.

CHINA OPENS UP

By the late 1970s, China faced severe economic problems following the upheaval of the Cultural Revolution. Beijing enacted a series of serious economic reforms under Deng Xiaoping. The initial focus of the reforms was on decollectivizing the agricultural sector, which saw incomes increase, and a wave of new private non-agricultural enterprises. Further efforts included liberalizing foreign trade and investment, encouraging private sector activity, and introducing greater reliance on market forces in some industries while reducing the role of state planning.

China also started to open to international trade. The Chinese government created special export-oriented economic zones, welcomed foreign investment, and decentralized economic policymaking. As its economy grew, Beijing also pressured state-owned enterprises to reform. Initially, exports focused on textiles and light manufacturing but moved to more sophisticated electronics and industrial machinery. By 2000, the year before China officially joined the WTO, exports had grown to $250 billion, up from $14 billion in 1979.[10]

China became a major part of the global economy, with average annual GDP growth of 9.5 percent between 1979 to 2018.[11] It emerged as the world's largest exporter by 2009 and the second-largest global economy in 2010, surpassing Japan.

ASEAN BECOMES A PRODUCTION HUB

Postwar Southeast Asia experienced intense conflict with Communist insurgencies in the 1950s, decades of war in Indochina, and numerous other internal disputes. In response, the Association of Southeast Asian Nations (ASEAN) was founded in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand. While the organization's initial focus was on regional security, members recognized that regional economic cooperation would be key to reducing political tensions and conflict in the region. However, formal economic integration efforts didn't come until much later.

Following independence, most Southeast Asian countries adopted an import substitution strategy leading to a shift from agriculture toward manufacturing and modest economic growth. In the 1960s and 1970s, growth accelerated in three of them—Indonesia, Malaysia, and Thailand—led by labor-intensive manufacturing for export. Malaysia and Thailand saw manufacturing as a percentage of GDP rise from about 10 percent in the late 1950s to more than 20 percent in the late 1970s. Indonesia followed a similar trajectory starting in the 1970s.[12]

Attracted by lower costs, countries like Japan began to relocate some assembly activities to Malaysia and Thailand. Between 1970 and 2002, manufactured goods as a share of exports in the ASEAN-5* rose from 18 to 79 percent. Countries in Southeast Asia became more tightly linked to production networks driven by neighbors in Northeast Asia, contributing to a weighted-average annual growth rate for the ASEAN-5 of about 7 percent between 1960 and 1996.[13]

INDIA REFORMS

Post-colonial India's economic policy was mostly protectionist, with a strong focus on import substitution. However, a balance of payments crisis in 1990 paved the way for economic reforms. Though previous prime ministers had loosened some of the restrictions on foreign investment, the 1991 reforms removed licensing restrictions for most industries and the 40 percent cap on foreign equity investment. Subsequent reforms led to tariff reductions, greater transparency, and improved trade facilitation. As a result, FDI in India increased from $91 million in 1991 to $82 billion in 2021, which has helped transform India into the world's fifth-largest economy.

FORMATION OF NEW TRADE GROUPINGS

Starting in the late 1980s, as the Berlin Wall fell and the Soviet Union began to disintegrate, there was an upswing in trade liberalization.

The European Union deepened its economic integration, aiming to rejuvenate the European economy. In 1993, a single market was launched, allowing for the free movement of people, goods, services, and money. The European Economic Area extended this single market to additional countries.

There were also efforts at North American integration. The U.S. and Canada signed an FTA in 1987, and in 1994 Mexico joined in with the North American Free Trade Agreement (NAFTA). By removing virtually all barriers to the movement of goods, capital, and services among the three countries, NAFTA deepened the economic integration of the three economies.

These regional integration efforts in Europe and the Americas spurred Asian countries to rethink their dependence on the GATT's multilateral rules and to pursue regional and bilateral partnerships. While

* ASEAN-5 are Indonesia, Malaysia, Philippines, Singapore, and Thailand.

Asian countries came to the FTA game relatively late, they moved quickly and were soon at the forefront of FTA activity.

STAGNATION AT THE WTO

The 123 members of GATT created the World Trade Organization (WTO) in 1994. This event marked a significant transformation of the multilateral trade system by creating a permanent organization to govern international trade in goods as well as other areas such as services and intellectual property. "Today, the world has chosen openness and cooperation instead of uncertainty and conflict," said chair Peter Sutherland when concluding the Uruguay round negotiations, which led to the creation of the WTO. "This is a success that will reinforce economic growth."

This initial optimism was followed by increasingly ambitious negotiations. The 2001 Doha Development Round aimed to converge the complex interests of many countries into a single package of outcomes covering a range of topics while considering the differences in the circumstances of developed and developing members.

The negotiations stalled amidst differences among the WTO's diverse and growing membership. Many developing countries, including advanced developing countries, insisted on "special and differential" treatment while expecting the developed countries to provide trade-related capacity building and greater market access. China became a WTO member that same year and declared itself a developing country. Over time, China failed to implement commitments in key areas, even as it emerged as a major exporter, earning a reputation at the bargaining table for abiding by the letter but not the spirit of the WTO.

With negotiations stalled, the WTO's dispute settlement function has also faltered in recent years. As the global trading system evolves, WTO members file increasingly complex cases. A lack of updated rules has led to complaints of "judicial overreach." Asian countries are frequently involved in dispute settlement cases as complainants and responders.

FIGURE 1 **NUMBER OF WTO DISPUTE SETTLEMENT CASES (1995-JULY 2022)**

WTO MEMBERS	AS COMPLAINANT	AS RESPONDENT	AS THIRD PARTY
ASEAN-10	39	26	298
Australia	11	17	117
China	22	49	192
EU	110	91	216
India	24	32	177
Japan	28	16	255
Korea	21	19	139
US	124	156	172

Source: Disputes by member, World Trade Organization, accessed September 23, 2022, https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm.

Today WTO membership has reached 164 economies that account for 98 percent of global trade. While the consensus principle has prevented WTO members from making progress in many areas, there have been some successes. In 2014, WTO members reached a multilateral agreement on a Trade Facilitation Agreement, which aims to make trade easier, more efficient, and cheaper. More recently, in June 2022, WTO members agreed to prohibit harmful fisheries subsidies after more than two decades of negotiations.

ENTER PLURILATERAL AGREEMENTS

With challenges in reaching full consensus among all members of the WTO, members have turned to plurilateral agreements negotiated among a subset of members. Some WTO members, such as India and South Africa argue that tariff cuts agreed to in these negotiations must be applied on an MFN basis to all WTO members rather than only signatories. This means that even countries not participating in a plurilateral could benefit from any tariff reductions without being required to reciprocate.

FIGURE 2 **SELECT WTO PLURILATERAL INITIATIVES**

TOPIC	PARTICIPANTS	STATUS
Domestic Services Regulation	67 Members	Negotiations concluded (2021)
E-commerce	87 Members	Negotiations ongoing
Investment Facilitation for Development	110 Members	Negotiations ongoing
Micro, Small, and Medium-sized Enterprises (MSMEs)	94 Members	Work ongoing
The Trade and Environmental Sustainability Structured Discussions (TESSD)	74 Members	Work ongoing

Source: "Joint Initiatives." World Trade Organization, https://www.wto.org/english/tratop_e/jsi_e/jsi_e.htm; "Trade and Environmental Stability." World Trade Organization, https://www.wto.org/english/tratop_e/tessd_e/tessd_e.htm.

Plurilateral agreements are also being forged outside the WTO, with Asian countries particularly active on this front.

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