

# A PACIFIC FREE TRADE AREA: A NEW DESIGN FOR WORLD TRADE EXPANSION

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## I. *Closer Pacific Trade Partnership*

Stresses within the world trading system since the conclusion of the Kennedy Round of tariff reductions (May 1967) and within the international monetary system, particularly since the devaluation of sterling (November 1967) suggest that there is need for a new design for further trade liberalisation and fostering the continued expansion of world trade as well as for stabilisation of the world monetary system. At the same time, developing countries expect more aid and assistance with trade expansion through the extension of general trade preferences. Rigid adherence to multilateral and nondiscriminatory free trade principles seems a questionable guideline, and it might well be more sensible to seek the benefits of trade expansion through a regional or free trade area approach to trade liberalisation. The EEC and EFTA both suggest the effectiveness of the regional approach to trade liberalisation. Recently, the formation of a North Atlantic Free Trade Area has been strongly advocated.<sup>1</sup> Why should the five Pacific countries, the United States, Canada, Japan, Australia, and New Zealand, not prepare for the formation of a Pacific Free Trade Area and welcome British participation? Could not PAFTA and NAFTA be linked through common United States-Canadian participation?

The Pacific ranks alongside Western Europe as one of the two major centres of world trade. Trade among the five advanced Pacific countries, the United States, Canada, Japan, Australia, and New Zealand, increased by 97 per cent between 1958 and 1965, from \$US 9.16 billion to \$US 18.02 billion, and their share in world trade rose from 7.99 per cent to 10.38 per cent. Trade within the EEC grew from \$US 6.86 billion to \$US 20.84 billion over the same period.

Furthermore, mutual trade amongst advanced Pacific countries intensified over the years. Intra-areal trade constituted 32.5 per cent of total Pacific country trade in 1958, but 37.3 per cent in 1965. In contrast, intra-areal trade was 30.1 per cent of total EEC trade in 1958 and 43.5 per cent in 1965.

The formation of a Pacific Free Trade Area would, in fact, bring about a comprehensive

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<sup>1</sup> Maxwell Stamp Associates, *The Free Trade Area Option, Opportunity for Britain*, The Atlantic Trade Study, London, 1967. See also Theodore Geiger and Sperry Lea, "The Free Trade Area Concept as Applied to the United States," *Issues and Objectives of US Foreign Trade Policy*, A Compendium of Statements, Congress of the United States, September 1967.

trade liberalisation amongst participating countries, with the elimination of tariffs on a substantial proportion of their commodity trade. The impact effect of Pacific tariff elimination would be to increase trade by \$US 5,000 million. This represents an expansion of 28 per cent on intra-areal trade, or 10.3 per cent on Pacific country exports to, and 11.9 per cent on imports from the whole world. In other words, there would be significant trade expansion, a far greater trade expansion than can be expected under Kennedy Round tariff reductions. Kennedy Round tariff reductions will probably only lead to a 5.5 per cent increase in exports and a 7.7 per cent increase in imports.

Complete regional trade liberalisation would appear to have considerable advantages over partial trade liberalisation in world markets. This is especially true if, as is most probable, another major round of global tariff reductions is not feasible within the next ten or twenty years. In that event, the formation of PAFTA would seem an effective alternative for mutual trade expansion among the five advanced Pacific countries.

At this stage, however, the PAFTA proposal seems premature, unless there is some further unforeseen disturbance in the free world economy. It is as yet neither economically nor politically feasible. Firstly, American interests are presently world-wide and the United States could not participate readily either in a Pacific or a European regional grouping. For the moment the United States appears committed to a global non-discriminatory approach to freer trade.<sup>2</sup>

Secondly, the five Pacific countries still lack the solidarity and degree of integration that would be necessary for dispensing with protective measures for the main sectors of their economies involved in regional trade—the labour-intensive industries in some countries, the agricultural and pastoral industries in other countries.<sup>3</sup>

Thirdly, the static gains from complete trade liberalisation would differ widely from one country to another because of the disparity in stages of industrialisation within the region.

However, the realisation of PAFTA might be precipitated by a shock which came from outside the area. Greater European integration between EEC and EFTA could produce an "inward looking" Europe whereupon the United States might well find closer integration in the Pacific desirable and necessary. Should the United Kingdom fail again to join the EEC, she might probe the establishment of a North Atlantic Free Trade Area with the United States and Canada. In that case, Japan, Australia and New Zealand would have to consider seriously steps towards closer integration within the region.

Economic integration in the Pacific should take the form of a free trade area rather than a customs union or political union. A free trade area arrangement would have advantages over the alternatives from several points of view; it is consistent with the rules of the General Agreement on Tariffs and Trade; it preserves the autonomy of members with respect to

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<sup>2</sup> See, for example, Sperry Lea, "The Future Shape of U.S. Trade Policy: Multilateral or Free Trade Approaches?" Kiyoshi Kojima, ed., *Pacific Trade and Development, II*, The Japan Economic Research Center, April 1969.

<sup>3</sup> A comment against PAFTA is presented by H.W. Arndt, "PAFTA: An Australian Assessment," *Intereconomics*, Hamburg, October 1967, (reprinted in his *A Small Rich Industrial Country, Studies in Australian Development, Aid and Trade*, Melbourne, 1968.) to which there is a reply by Kiyoshi Kojima, "A Pacific Free Trade Area: Reconsidered," *ibid.*, March 1968. There also exists a favourable Australian view of PAFTA, for example, Peter Drysdale, "Pacific Economic Integration, An Australian View," Kiyoshi Kojima, ed., *Pacific Trade and Development*, The Japan Economic Research Center, February 1968.

their tariff policies vis-à-vis non-participants; and it is a purely commercial arrangement, carrying no obligation for eventual political federation or union.<sup>4</sup>

Whether or not a free trade area can ultimately be established, the five advanced Pacific countries should now set about establishing closer and more profitable trade partnerships with each other. To date, the United States has tended to look toward the possibility of ultimately 'going in with Europe', and has tended to neglect the Pacific region. The flow of financial resources and direct investment from America to Pacific basin countries, including Asian and Latin American countries, has lagged behind that going to Europe. The Pacific, Asian, and Latin American region has a huge potential for trade growth and development compared with Europe, and it should be looked at more closely.

Studies of, and proposals for Pacific trade expansion have been quite limited. However, recently movement in this direction has been initiated. The Canada—United States Automotive Agreement took effect from January 1965. This should be given much attention as a pioneer project in selective industrial integration.<sup>5</sup> The Australia—New Zealand Free Trade Agreement was initiated in January 1966.<sup>6</sup> The Pacific Basin Economic Co-operation Committee was established among business circles in the five Pacific countries in April 1967; and a number of bilateral co-operative activities have also been promoted within business circles. It is also worth noting that Mr. Takeo Miki, Japan's former Foreign Minister, and Mr. Kiichi Miyazawa, former Minister of Economic Planning Agency, are keenly interested in promoting economic co-operation in the Pacific and Asian region. Academic circles have also begun hard to probe the foundations for economic integration in this region.<sup>7</sup>

Before the establishment of PAFTA, several steps towards closer Pacific economic co-operation might be practicable immediately. Five main objectives suggest themselves:

1. To increase the flow of financial resources from the United States to other Pacific countries, as well as to Asian and Latin American developing countries.
2. To stimulate horizontal trade among the five advanced Pacific countries in heavy manufactures and chemicals and to expand production and trade of raw materials and intermediate goods more efficiently for the region as a whole.
3. To readjust production and trade in agricultural commodities among the five Pacific countries, taking into consideration their relationship with Asian and Latin American developing countries.
4. To readjust production and trade in light manufactures, which are labour intensive, with the aim of providing greater access for Asian and Latin American countries in advanced country markets.
5. To co-ordinate the aid policy of the five advanced Pacific countries towards Asian and Latin American developing countries.

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<sup>4</sup> Harry G. Johnson, "A New World Trade Policy in the Post-Kennedy Round Era: A Survey of Alternative, with Special Reference to the Position of the Pacific and Asian Regions," Kiyoshi Kojima, ed., *Pacific Trade and Development*, The Japan Economic Research Center, February 1968 (reprinted in *The Economic Record*, June 1968).

<sup>5</sup> See, Sperry Lea, "Free Trade by Sectors," NPA, *Looking Ahead*, September 1966.

<sup>6</sup> F.W. Holmes, "Australia and New Zealand in the World Economy," *The Economic Record*, March 1967.

<sup>7</sup> Two conferences were held, one by the Japan Economic Research Center, Tokyo, in January 1968 and one by the East-West Center, Honolulu, in January 1969. A third conference was held in Australia, and a related conference was held in Chile during 1970.

Practical steps towards closer Pacific economic co-operation can be taken by strengthening *functional*, rather than *institutional* integration, and thus attempting to attain the favourable benefits of a free trade area whilst avoiding the unfavourable impact effects. To realise these objectives, I suggest the initiation of three codes of international behaviour and the formation of two new regional institutions.

1. A *code of good conduct* in the field of trade policy, under which countries would relinquish the right to raise tariffs or impose other forms of trade restriction,<sup>8</sup> and would gradually reduce those trade barriers particularly on the import of agricultural products and labour intensive light manufactures, should be promulgated.

2. A *code of overseas investment* to promote mutual investment among the five advanced Pacific countries, most effectively from the United States, and to foster the activity of joint ventures is much needed to promote trade expansion, especially horizontal trade expansion in heavy manufactures,<sup>9</sup> and for the development of the vast mineral resources of the Pacific region. A code which minimises the fear of American capital domination and maximises protection for America's balance of payments would greatly facilitate overseas investment and the better allocation of regional resources.

3. A *code of aid and trade policies towards associated developing countries* is also required, so that Asian and Latin American countries might enjoy the benefits of larger markets for their agricultural products and light manufactures. The flow of developmental aid must be increased, appropriate aid projects selected, and domestic industrial structures adjusted to meet the legitimate trade needs of affiliated less developed countries.

An *Organisation for Pacific Trade and Development* (OPTAD) should be established in order to give effect to these codes of international behaviour. Its main features would be similar to those of the OECD, and it could be structured in the same way, with three committees on trade, investment, and aid.<sup>10</sup>

Further, a *Pacific Currency Area* and *Pacific Reserve and Development Bank*<sup>11</sup> would be established with the aim of strengthening international monetary system and facilitating economic development within the Pacific, Asian, and Latin American region.

## II. Options for the Pacific

The best choice for Japan is to expand and free mutual trade with every trading region. The present stage of her industrialisation, her dual pattern of trade with developed and

<sup>8</sup> Assurance against the reimposition of duties in a free trade area would induce enterprises to expand trade and investment abroad. The code of good conduct would reduce uncertainty in international trade and be a partial substitute for the formation of free trade area. See, Bela Balassa, *Trade Liberalization Among Industrial Countries*, Council on Foreign Relations, 1967, pp. 160-161.

<sup>9</sup> N.P.G. Elkan suggests an interesting scheme for promoting horizontal trade in his article, "How to Beat Backwash: The Case for Customs-Drawback Unions," *Economic Journal*, March 1965. His plan may be applicable to trade between small economies like Australia and New Zealand but would be too cumbersome to work in wider markets. It seems to me that horizontal trade would be fostered most efficiently through the expansion of joint ventures and other private investment activities.

<sup>10</sup> Aid Committee could be set up first because of urgency for increasing aid and trade with developing countries.

<sup>11</sup> See, Kiyoshi Kojima, "A Pacific Currency Area: A New Approach to International Monetary Reform," *Hitotsubashi Journal of Economics*, February 1970.

developing countries, and her geographical location dictate such a choice. However, if a further global tariff reduction is not likely to be feasible in the near future and if, moreover, the compartmentalisation of world trade is promoted further, a serious concern for Japan would be to devise measures for expanding trade on an assured basis through establishing the Pacific Free Trade Area or some such alternative.

The establishment of PAFTA would bring the largest static gains to Japan among the five Pacific countries. Japan's exports would increase by \$US 1,740 million or 20.6 per cent of her total exports and her balance of trade with area would improve by \$US 1,310 million, based upon the 1965 trade figures. These gains would be far greater than in the case of global tariff reductions on the scale undertaking through the Kennedy Round: they are likely to increase Japan's exports by a mere 8.8 per cent.

The big gains for Japan from the establishment of PAFTA derive, firstly, from the fact that Japan's exports depend as much as 37 per cent upon the PAFTA markets. Compared with other PAFTA countries, European markets are not so important (13 per cent) for Japan.

Secondly, about 95 per cent of Japan's exports to other Pacific countries are manufactures which would enjoy a greater expansion from trade liberalisation, while about 71 per cent of Japan's imports are primary products, which would not increase very much in consequence of tariff reductions.

When the time comes for Japan to consider economic integration, a Pacific Free Trade Area would certainly be her best choice. Japan is destined by geography to participate in political arrangements in the Pacific rather than in Europe. On the other hand, economic integration without the United States, which holds a 30 per cent share in Japan's trade, would appear a less attractive choice.

Thus, Japan would benefit from the establishment of PAFTA, or from some other alternative, through the cheaper import of raw materials and other primary products, the expansion of her exports of light manufactures, and the promotion of horizontal trade in heavy manufactures and chemicals.

The formation of PAFTA or some other alternative for economic co-operation among the five Pacific countries is desirable for Japan for another reason. Collective measures by Pacific countries are especially desirable for assisting economic development and trade growth in Southeast Asian countries.

Asian markets are very important for Japan even relative to other Pacific advanced countries. The share of Asia (excluding Mainland China) in Japan's total exports remains as large as 28 per cent, though it has been decreasing. Japan cannot disregard the interests of developing countries, especially in South and Southeast Asia, and the same applies to the United States vis-à-vis Latin America. The question is often raised: should Japan rely on the rapidly increasing but competitive markets in developed countries, or on the complementary but more slowly expanding markets in developing countries? She has to expand trade in both directions.

If the five Pacific countries were to establish PAFTA, they should welcome as associated members those developing countries in Asia and Latin America who wish to join. Or, they might provide PAFTA preferential tariffs in favour of the developing countries. Moreover, the five Pacific countries should provide more effective assistance on a larger scale to foster structural adjustment within their own economies in order to open wider markets for developing country exports. Concerted policy measures among the five Pacific countries are urgently

required for this purpose.

In this context, Japan's attitude towards Mainland China might present problems. Political, military, and ideological troubles aside, however, it is obvious that the main supply sources for natural resources and the most profitable markets for Japan are not on the Asian mainland but within the extended Pacific region.

Although the establishment of a Pacific Free Trade Area seems quite beneficial to Japan, there is hesitation and/or caution in Japan about stepping out in that direction. One of the reasons for hesitation is that agriculture remains heavily protected and agricultural rationalisation will take considerable time. The other is fear about the penetration and domination of American capital. These difficulties and worries should be subordinated to a wider view of economic co-operation within the extended Pacific region.

The proposal for the formation of North Atlantic Free Trade Area<sup>12</sup> deserves attention. The NAFTA proposal aims at the establishment of a broad, open-ended, Atlantic based free trade area embracing almost all industrially advanced nations, but its core is to be Britain, Canada and the United States. Proposals for integration between Canada and the United States have a much longer history,<sup>13</sup> but the suggested North American-United Kingdom link is of more recent origin. If only non-agricultural trade is freed among Canada, Britain, and the United States, the Maxwell Stamp report estimates that Britain's balance of trade in manufactures with the USA and Canada "would improve quite substantially in NAFTA provided British export prices could be held down,"<sup>14</sup> and the improvement would be far greater than Britain's joining EEC. A larger part of these increases in British exports in NAFTA are brought about from the trade diversion effect rather than from the trade creation effect. The report calculated that "the UK would deflect \$ 261 m. of EEC exports from the US market and \$ 43 m. from the Canadian market. On similar assumptions the UK could capture about 10 per cent<sup>15</sup> of Japanese trade in North American markets, if Japan were not in NAFTA." (See Table 1.)<sup>16</sup>

TABLE 1. EFFECTS ON U.K. TRADE BALANCE OF JOINING NAFTA AND EEC

(million US dollars)

Export Increase	NAFTA			EEC
	U.S.	Canada	Total	
Trade Creation	243	49	292	316
Trade Diversion	485	67	552	191
Import Increase	186	3	189	286
Gain to trade balance	542	113	655	221

<sup>12</sup> Maxwell Stamp Associates, *The Free Trade Area Option, Opportunity for Britain*, The Atlantic Trade Study, London, 1967. A counterpart study in America was presented by Thomas M. Franck and Edward Weisband, ed., *A Free Trade Association*, New York University Press, New York, 1968.

<sup>13</sup> Canadian-American Committee, *A Canada-U.S. Free Trade Arrangement, Survey of Possible Characteristics*, October 1963. *Ditto.*, *A Possible Plan for Canada-U.S. Free Trade Area, A Staff Report*, February 1965. *Ditto.*, *A New Trade Strategy for Canada and the United States*, May 1966.

<sup>14</sup> Maxwell Stamp Associates, *loc. cit.*, p. 42.

<sup>15</sup> This comprises \$225 m. from the US market and \$43 m. from the Canadian market.

<sup>16</sup> Maxwell Stamp Associates, *loc. cit.*, p. 44.

The NAFTA plan treats Japan, Australia and New Zealand lightly, although it allows for their accommodation as fringe members. From our standpoint, this hardly seems satisfactory. What course, then, should Japan, Australia, and New Zealand follow in the Pacific?

If NAFTA were successfully initiated among Britain, Canada and the United States prior to the establishment of closer Pacific integration, Japan should not hesitate to put for NAFTA membership else she would suffer largescale trade diversion effects.<sup>17</sup> Since the NAFTA proposal only aims at freeing non-agricultural trade, Australia and New Zealand would probably be less interested in joining.<sup>18</sup>

Both for NAFTA and PAFTA, a crucial question is: "Would the Americans accept the free trade area concept of a new Grand Design?"<sup>19</sup> If so, PAFTA and NAFTA might be linked together through the U.S. and Canada which are included in both free trade area proposals. The U.S.A. could move towards the Free Trade Area approach if multilateral, non-discriminatory approaches to the reduction of tariff and non-tariff barriers prove too difficult within the next five years. It is to be hoped that the new administration resists following the course of protectionism and isolationism that otherwise might gather strength.<sup>20</sup>

It should be noted that the Pacific basin countries have their own reasons to promote economic integration through the establishment of PAFTA and a Pacific Currency Area. Their major interests differ widely from those of Europeans. The Pacific basin region has a huge potential for trade growth and development which should be cultivated through coordinated efforts. Countries belonging to this region have already given recognition to the twin common aims of promoting freer trade growth among five Pacific advanced countries and of expanding aid and trade growth between these advanced countries and neighbouring less developed countries. Regional solidarity in measures for supporting the dollar so that American economic potential can exercise a more positive role is urgently required. Solidarity in the political and military objectives of these countries could also be developed further.

Even if PAFTA would seem likely to be ultimately linked with the NAFTA scheme, prior progress towards trade liberalisation within both the Pacific and Atlantic regions is desirable. A broad free trade agreement covering a wide range of commitments could be most readily negotiated within a small group. The unification of PAFTA and NAFTA could eventually become possible through some measure similar to the dominant supplier authority of the US Trade Expansion Act of 1962.

Thus, a Pacific Free Trade Area is by no means isolated with an Atlantic Free Trade Area; rather, the two represent complementary instruments for advancing towards the ultimate objective of freer world trade.

In the event that the United States hesitates to move towards any kind of free trade area

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<sup>17</sup> "If NAFTA actually came into existence Japan would almost certainly be anxious to join it, for she could not contemplate being isolated from a bloc which included the U.S.A. She might find it difficult to meet fully the conditions of participation if NAFTA were to be established in (say) the next five years, but with a steady transformation of agriculture and the modification of traditional social attitude, the barriers to free trade in agricultural products and to industrial investment by foreigners are likely to crumble." G.C. Allen, *Japan's Place in Trade Strategy, Larger Role in Pacific Region*, The Atlantic Trade Study, London, 1968, pp. 60-61.

<sup>18</sup> Maxwell Stamp Associate, *loc. cit.*, p. 38.

<sup>19</sup> *Loc. cit.*, p. 78.

<sup>20</sup> Sperry Lea, *loc. cit.*, pp. 40-42.

approach, another alternative presents itself: that is, the proposal for a Japanese–Australian–New Zealand Free Trade Area or Western Pacific Economic Integration. “For the nearer term,” Harry G. Johnson pointed out, “it would seem more realistic to concentrate attention on the probable benefits, drawbacks, and constitutional problems of a narrower Pacific free trade arrangement among Australia, New Zealand, and Japan. ...A free trade area among these three countries could in addition—like EFTA in the European context—serve as a pilot model of free trade for the rest of the world, and possibly in the course of time be one of the building blocks out of which a world-wide system to free trade could be constructed.”<sup>21</sup>

In 1965 the total population of the three countries was approximately 115 million which is 35 million less than the population of the European Economic Community immediately prior to its formation. In 1965 Australia’s Gross National Product was \$US 21,587 million, Japan’s G.N.P. \$US 84,324 million and New Zealand’s G.N.P. \$US 3,933 million giving a G.N.P. for the entire area in 1965 of approximately \$US 110,000 million. On a per capita basis the relevant figures are Australia \$US 1,900, Japan \$US 861 and New Zealand \$US 1,490 which gives an average per capita income for the area as a whole of \$US 981. In real terms this figure compares favourably with that of the EEC countries in 1955.<sup>22</sup>

Since the enforcement of Australia–New Zealand Free Trade Agreement in January 1966, the two countries have endeavoured to promote economic integration but with some difficulty because of the lack of fundamental complementarity and the small size of both economies prevents realisation of economies of scale. It is expected that closer union with a large complementary economy, like Japan, would make Western Pacific integration more successful and fruitful. Thus, the gains from trade liberalisation among the three countries and the feasibility of sectoral integration in such key industries as motor vehicles, iron and steel, non-ferrous metals (especially aluminium), and meat and dairy products have been explored.<sup>23</sup>

The negotiability of a free trade area among these countries faces two main problems: first, the existing Japanese policies of agricultural protection, and secondly, Australian and New Zealand policies of protection for their manufacturing industries. Moreover, while JANFTA could be of considerable benefit to the Australian and New Zealand economies, the small increase in the size of Japan’s market deriving from union, diminishes the importance of the benefits.

The formation of free trade area or the alternative of closer economic cooperation among Australia, New Zealand, and Japan is important from two points of view. First, it would accelerate economic growth, based upon the highly complementary nature of the three economies, and it would strengthen their capacity to export to third countries outside the area, especially to North American and Western European Markets. It would also be useful for

<sup>21</sup> Harry G. Johnson, “A New World Trade Policy in the Post-Kennedy Round Era: A Survey of Alternatives, with special reference to the position of the Pacific and Asian regions,” Kiyoshi Kojima, ed., *Pacific Trade and Development*, The Japan Economic Research Center, February 1968, p. 250.

<sup>22</sup> I.A. McDougall, “Prospects of the Economic Integration of Japan, Australia and New Zealand,” Kiyoshi Kojima, ed., *Pacific Trade and Development*, The Japan Economic Research Center, February 1968, p. 115.

<sup>23</sup> Peter D. Drysdale, “Japan, Australia, New Zealand: The Prospect for Western Pacific Economic Integration,” Kiyoshi Kojima, ed., *Pacific Trade and Development, II*, The Japan Economic Research Center, April 1969. I.A. McDougall, “JANFTA and Asian Developing Countries: Sectoral Analysis,” *loc. cit.* L.V. Castle, “Alternative Policies in Trade Cooperation of the Advanced Pacific Countries in the Next Five Years,” *loc. cit.*



the three countries to develop a negotiating bloc for obtaining concessions on a broader front, especially from the United States. A free trade area between these three countries is justifiable and necessary as a means of preparing a favourable position for their joining, or for their providing a jolt towards the formation of, a Pacific Free Trade Area or a wider free trade area among almost all industrial nations.

Secondly, closer co-operation between Australia, New Zealand and Japan is especially desirable in order to increase aid to and to facilitate trade growth with neighbouring Asian developing countries in which the three countries are greatly interested and commonly involved.

Obviously, the establishment of a Pacific Free Trade Area is far from realisation. But publicity for the benefits of free trade in whatever form will be salutary in the post-Kennedy Round era, as the forces of protectionism threaten to gather strength. Exploration of the probable effects of a Pacific Free Trade Area and a Pacific Currency Area will enable the formation of better trade and monetary policies even though they fall short of the desired objective. And study of these proposals in the context of the development problem is independently useful in working towards some solution to the North-South problem, one of the most important problems that has been side-stepped in the process of trade liberalisation in the postwar world.