Intra-Regional Trade in East Asia: The Decoupling Fallacy, Crisis, and Policy Challenges

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Purpose/scope

- **Examine trends and patterns of intra-regional trade in East Asia paying attention to the process of global production sharing (international production fragmentation) and East Asia’s “especial” position within global production networks**

- **Undertake a preliminary analysis of export trends against the backdrop of pre-crisis exports patterns**

- **Discuss the ‘new’ policy challenges faced by the East Asian economies, with emphasis on the ‘rebalancing’ debate**

Global production sharing (international production fragmentation): 'splitting of the production process into discrete activities which are then allocated across countries'

- **The difference between <u>conventional intermediate goods</u> and <u>parts and components (</u>middle products)**

- **Perils of not paying attention to network related trade in trade flow analysis and trade policy formulation/analysis**

Country coverage/data

East Asia: Northeast Asia (South Korea, Taiwan and Hong Kong), China and ASEAN

ASEAN+3 = ASEAN + China + Japan + Korea

Developing East Asia: ASEAN + Northeast Asia

Comparators: NAFTA and EU15

Data: Comtrade database, SITC, Rev 3

Focus on manufacturing trade - SITC 5 though 8 net of SITC 68

Parts & components (P&C) are separated total trade at the 5-digit level

The list of P&C is not complete, so the estimates are an indictor of a reliable lower minimum

Structure

Section 2: Pre-crisis Trade patterns in East Asia

- East Asia's' especial position in network trade

- Decoupling hypothesis

Section 3: Trade performance in the aftermath of the crisis

Section 4: Policy options

Section 5: Concluding remarks

Section 2: Pre-crisis trade patterns Trade patterns

- **The decoupling thesis is based on the traditional notion of horizontal specialization:**

  international trade is an exchange of goods that are produced from start to finish in just one country.

- **In a context where network trade is growing rapidly, failure to distinguish between trade in parts and components (middle product) and trade in final goods can lead to misleading inferences as to the nature and extent of trade integration among countries.**

Why?

1. **Parts and components (P&C) are double-counted in trade data because goods in process cross multiple international borders before getting embodied in the final product.**

2. **P&C trade and trade in related final goods (‘final trade’) are unlikely to follow the same geographic patterns.**

3. **The intra-regional trade ratio estimated by lumping imports exports tends to hides a significant asymmetry in regional trade patterns on import and export sides**

These considerations are far more important for trade flow analysis in East Asia compared to total global trade or trade patterns of EU or any other region in the world.

Network trade is far more important in East Asia, than elsewhere in the world and it is growing rapidly (Table 1)

China's role as the premier final assembly centre in the world based on parts and components imported from the rest of East Asia.

Table 2: Intra-regional shares of manufacturing trade disaggregated into parts and final goods.

Intra-regional trade shares based on total trade (the conventional measure of trade integration) are generally consistent with the view that Asia, in particular East Asia, has become increasingly integrated through merchandise trade.

BUT

- **The increase over time in intraregional trade ratio has emanated largely from rapid increase in intra-regional imports; intra-regional exports expansion has lagged behind persistently.**

- **The asymmetry in intra-regional shares between imports and exports is much sharper when reported trade data are adjusted for trade in parts and components. Clearly, the region's dependence of the rest of the world for its trade expansion has <u>increased</u> over the time.**

Table 3: Intra-regional trade of selected major export categories disaggregated into parts and components and final goods.

- **The patterns across the product categories are broadly consistent with the overall patterns noted in the previous discussion.**
- **In particular, there is clear evidence of the heavy dependence of ICT trade in East Asia on extra-regional markets.**
- **Electrical goods (SITC 77-772-776) are the only notable major product category in which intra-regional final trade has increased between 1994/5 and 2004/5.**

Figure 1: Intra-regional share in East Asian manufacturing trade

A: Total (parts and component + final) trade

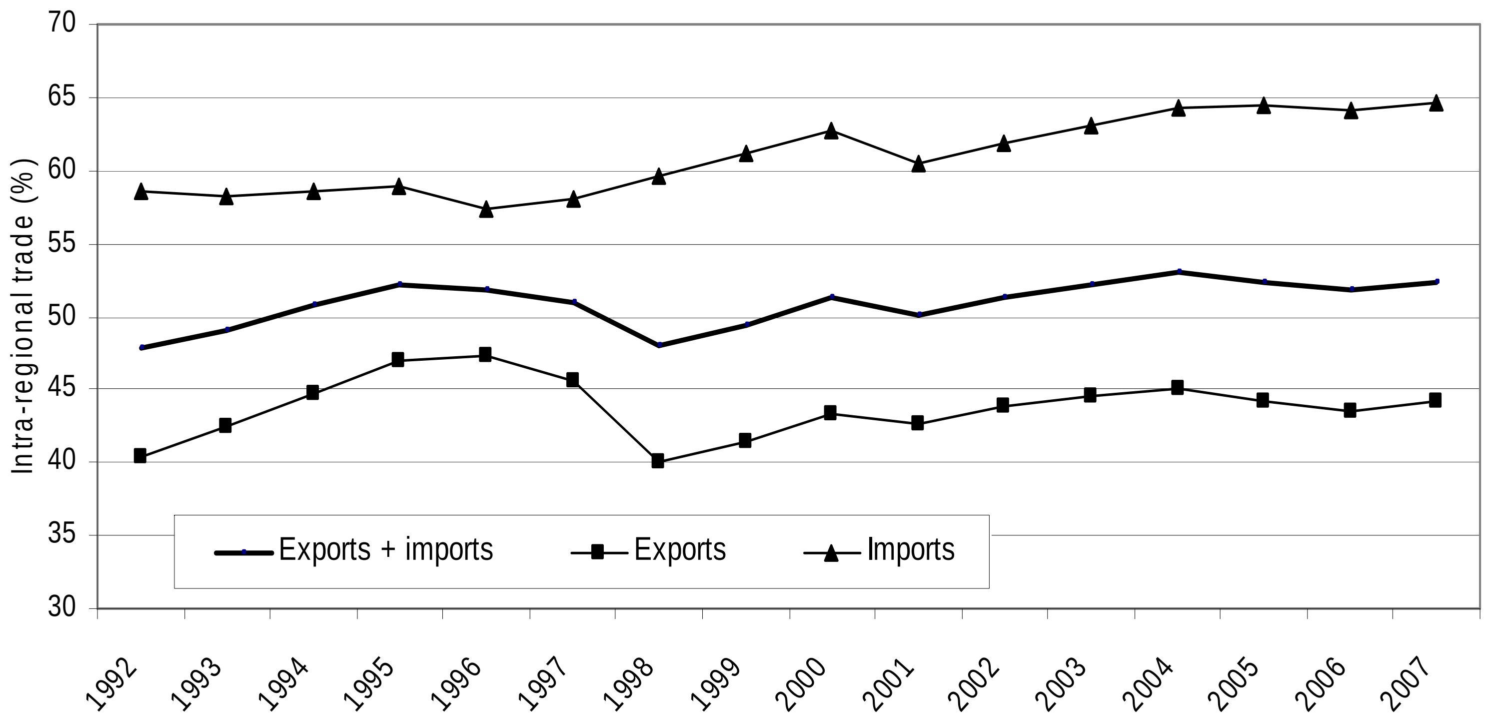


Figure 1: Intra-regional share in East Asian manufacturing trade

B: Parts and components

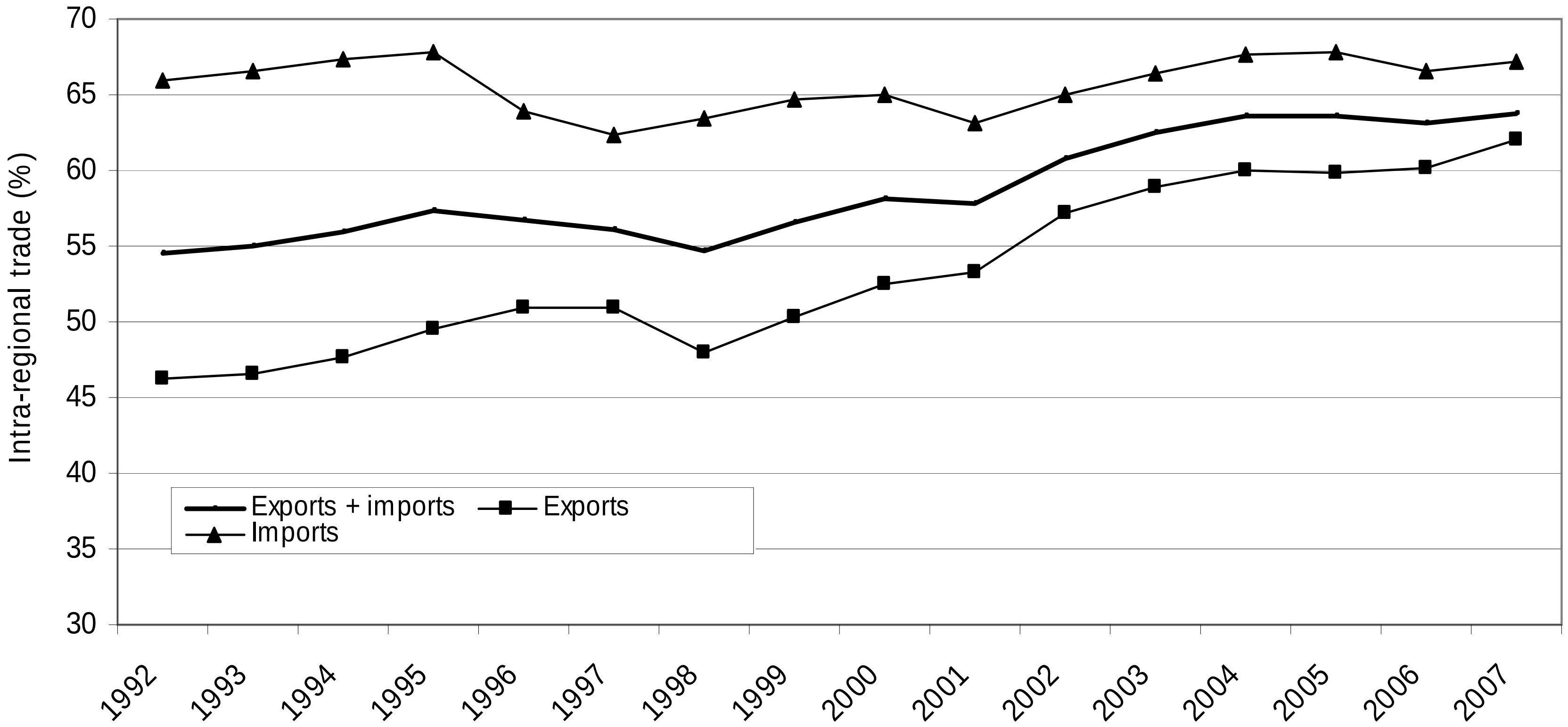


Figure 1: Intra-regional share in East Asian manufacturing trade

C: Final (total – parts and components)

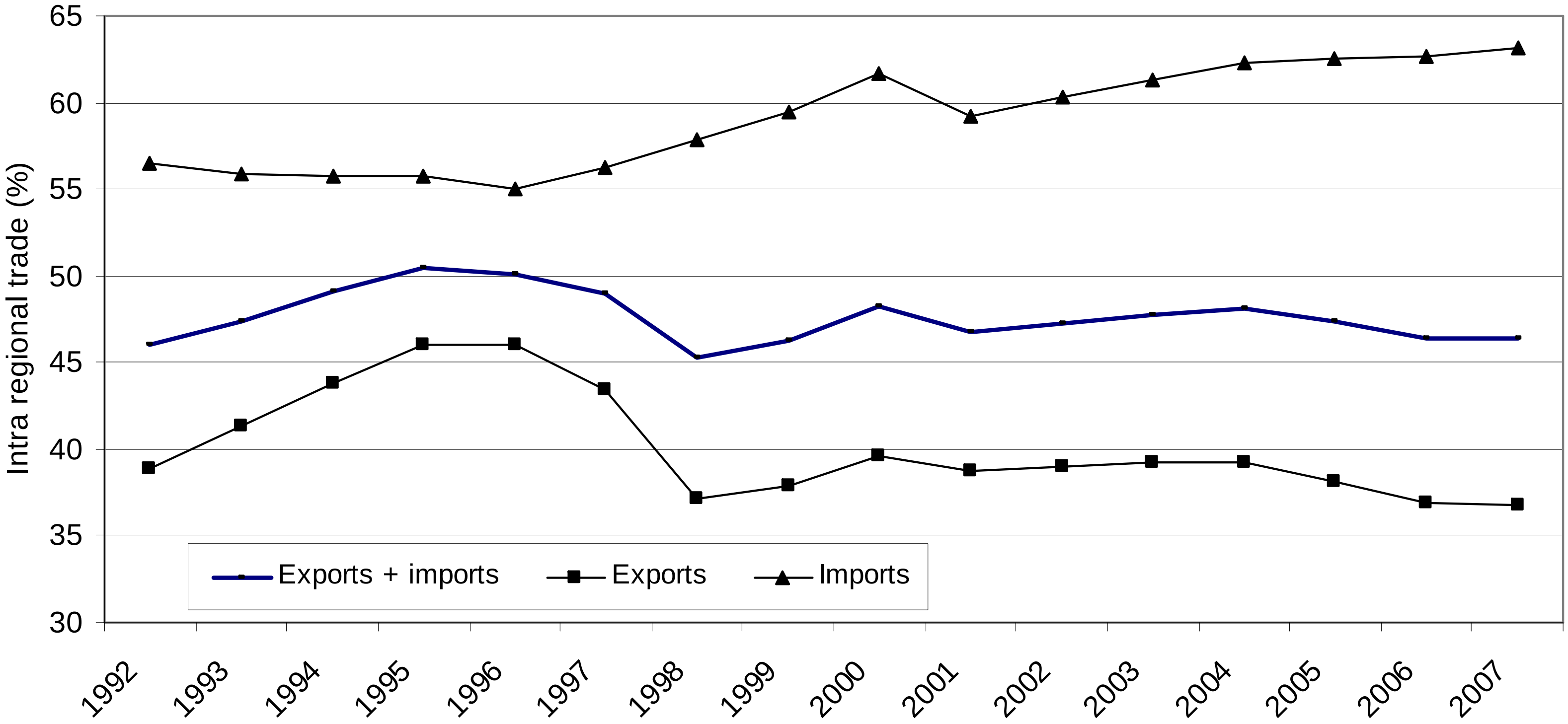
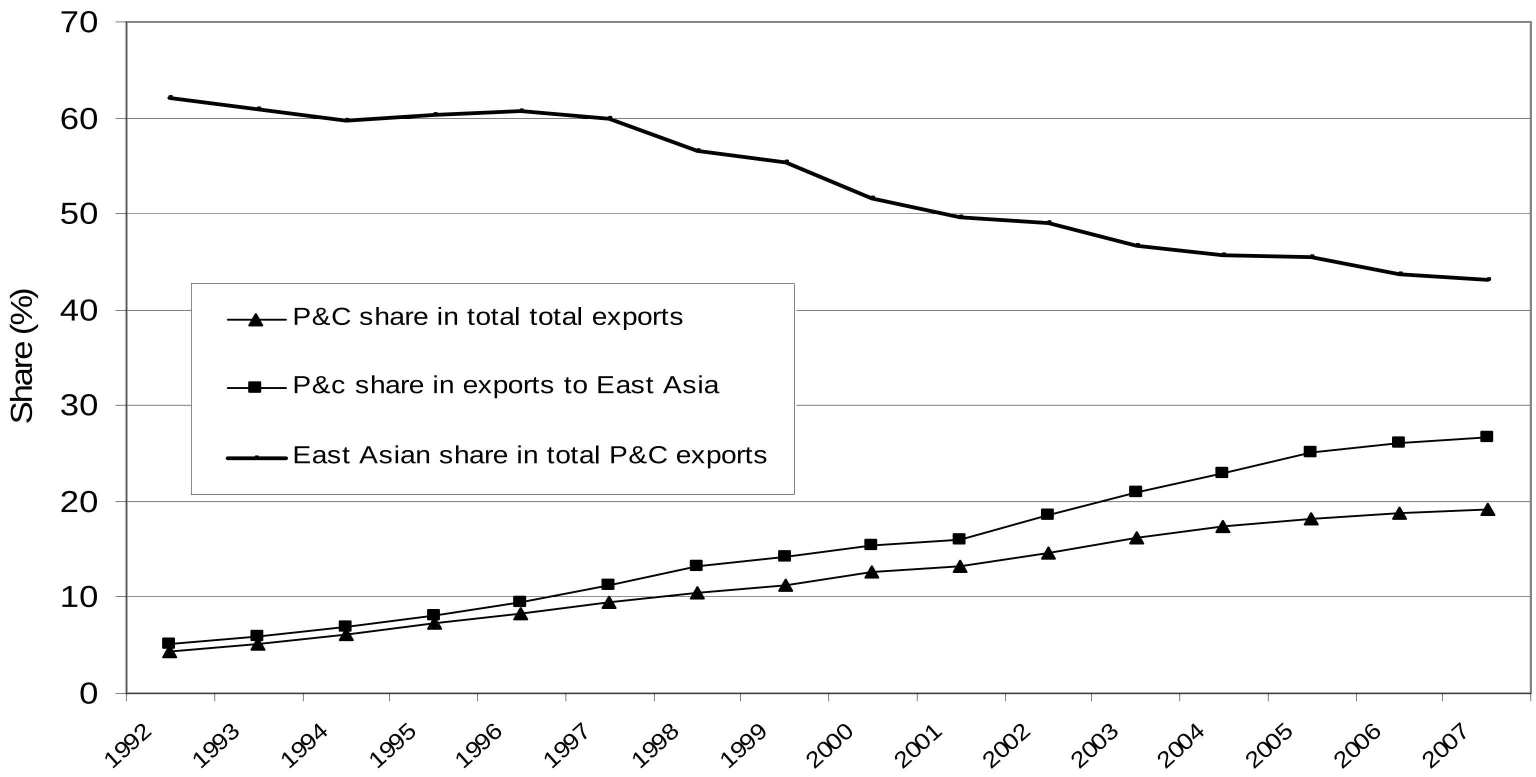


Figure 2: Parts and components in China's Manufacturing trade, 1992 -2007

A: Exports



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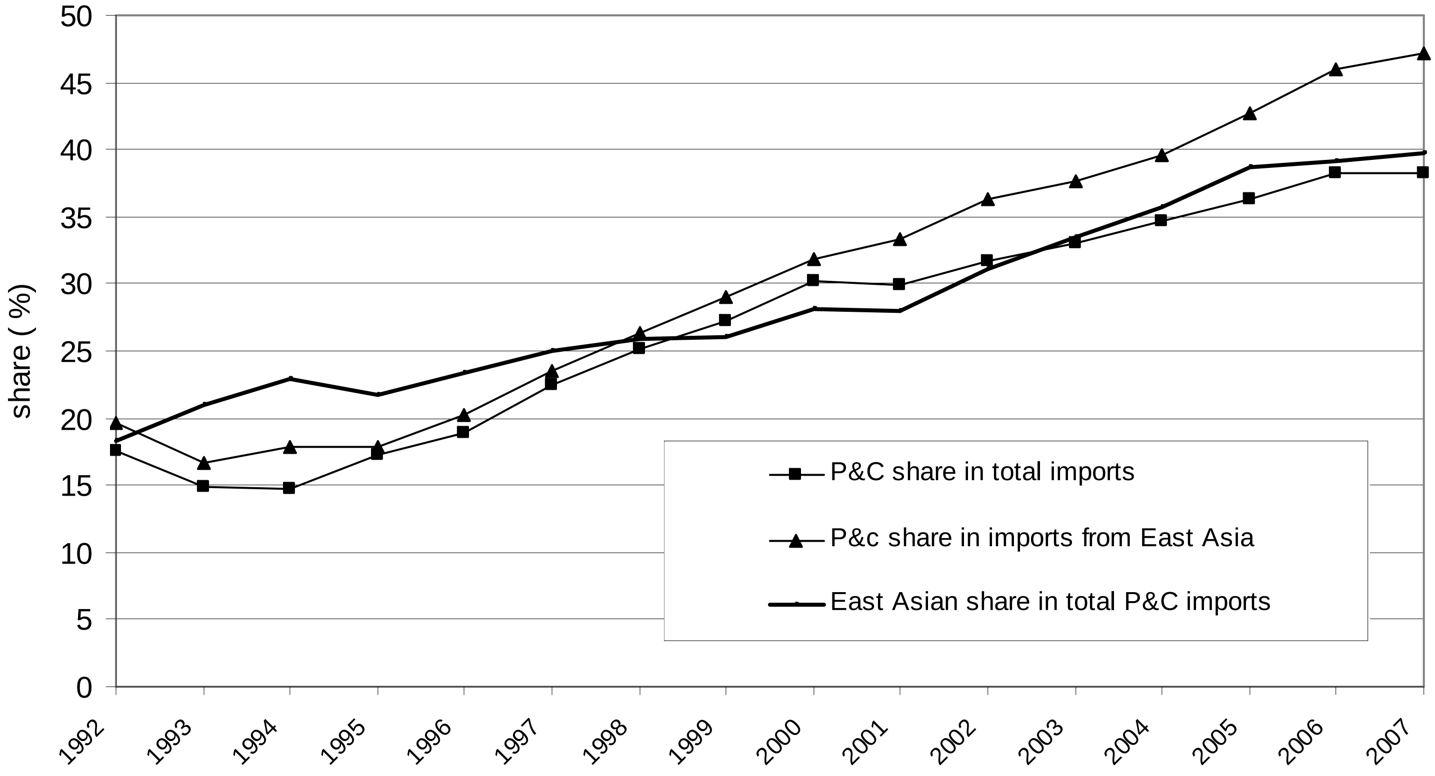


3: Trade performance after the onset of the crisis

Table 6, Figure 3 and 4: Trade growth of East Asian countries

- **The remarkably synchronized nature of the trade contraction across countries in the region is generally consistent with their common position within regional production networks (<u>but other factors such as drying up of trade credit and traders over reaction would have played a role</u>).**

- **Naturally, the rate of contrition of exports from the East Asia and all individual countries to the USA has been much sharper compared to that in exports to China and other designation.**

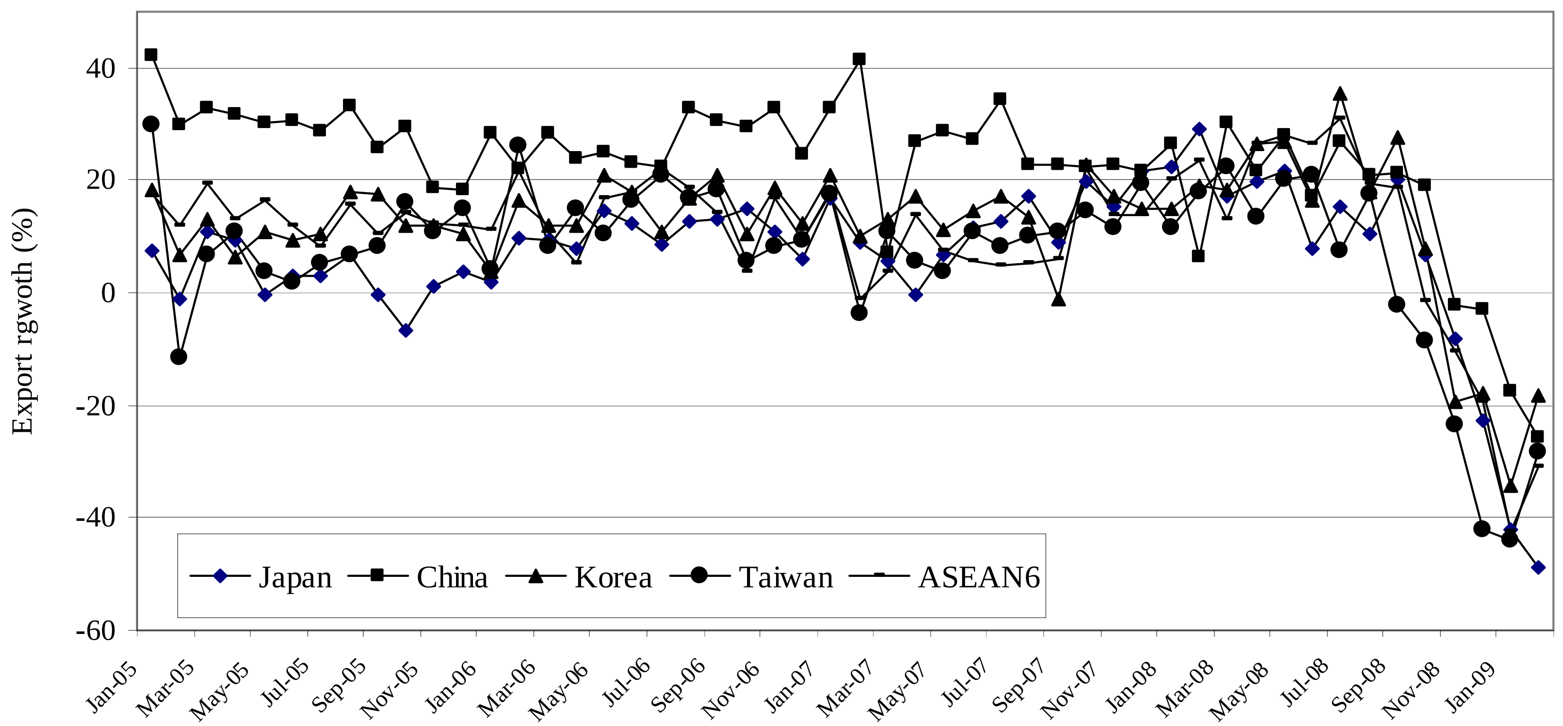
- **But, China has failed to provide cushion giants this export contraction as postulated by the decoupling thesis.**

Table 8 and Figure 4: Trade growth of China

- **Taiwan and Korea and Japan have suffered the highest rates of contraction in exports to China compared to the other countries in the region reflecting their greater dependence on that market**
- **China imports from most countries in the region have contracted at a much faster rate compared to exports, perhaps an indication of destocking of imported parts and components by Chinese firms given the gloomy outlook for exports.**
- **Overall China's intra-regional imports have contracted at a much faster rate compared to her imports from the USA and EU.**

Figure 3 : Trade growth: Japan, China, Korea, Taiwan and ASEAN6, Jan 2005 – March 2009

A: Exports



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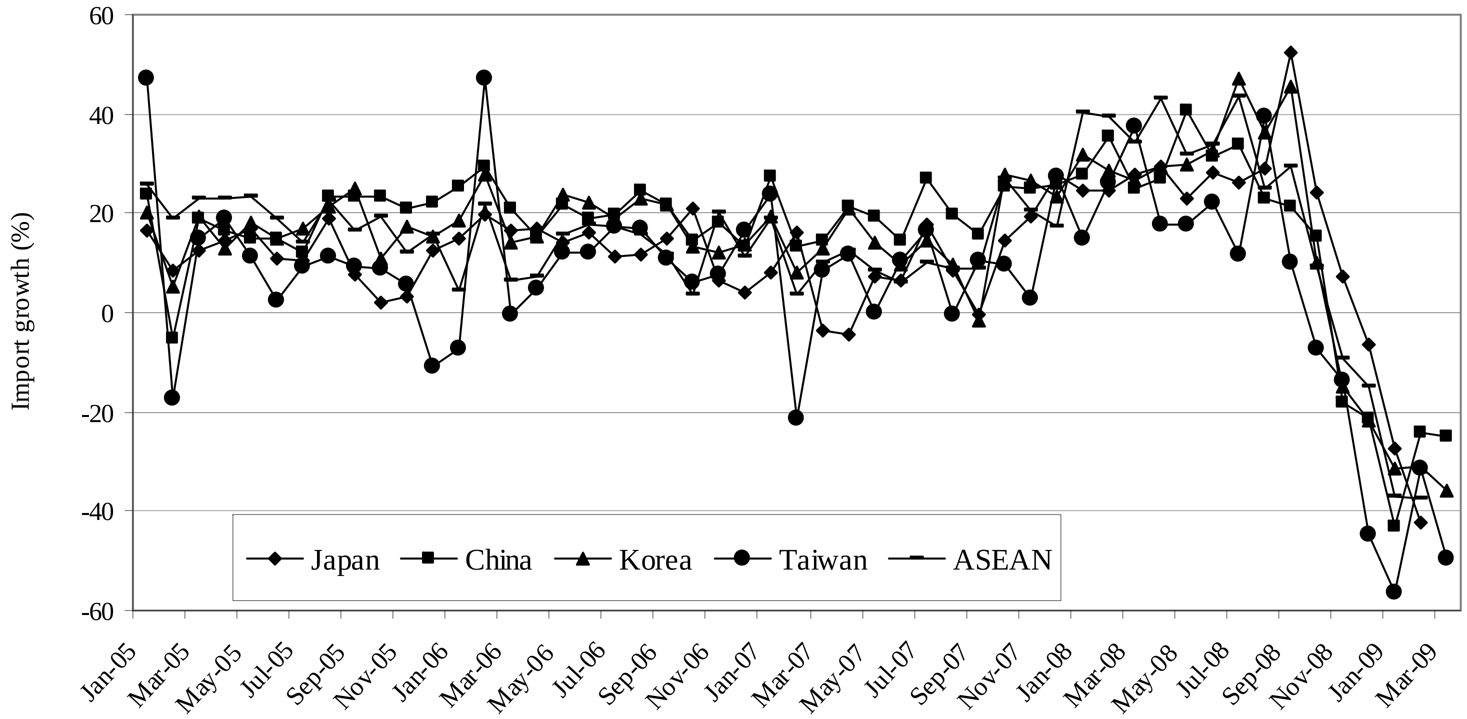
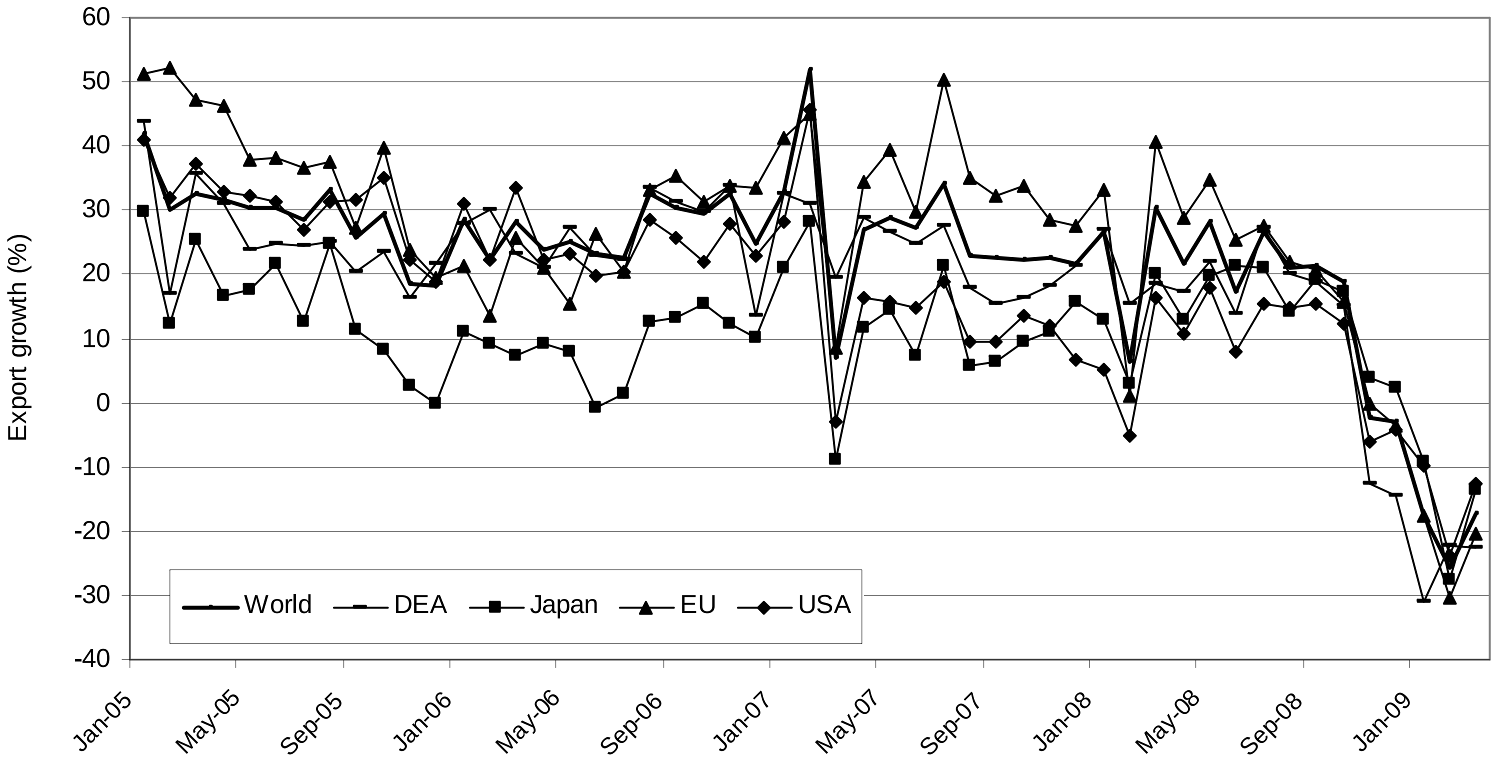


Figure 5 : China: Growth of Merchandise Trade, Jan 5 – March 2009

A: Exports



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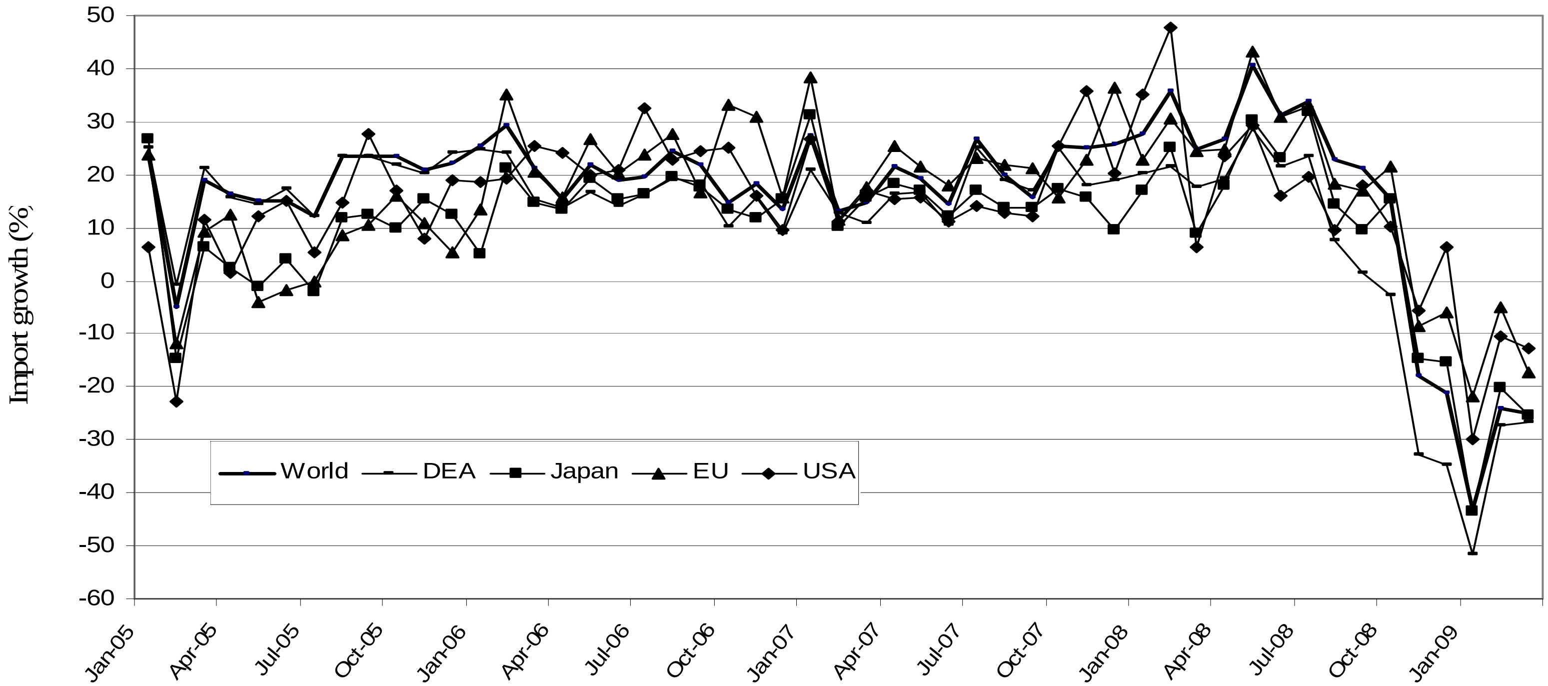

Policy Option

The case for rebalancing growth in the region through the expansion of domestic demand, particularly in China.

- **Emphasis should be on removing constraints on domestic demand expansion and redressing incentive biases in favor of (and against exports). Direct policy actions that violate this time-honored economic policy rule is going to be counter productive.**

- **there is strong domestic pressure in China to maintain the momentum of employment-intensive growth through export orientation (Yongding Yu 2008, Fan Gan 2008).**

- **China has immense potential for efficient export-oriented growth – still a labour-surplus economy; given that capital is mobile, export-orientation and import-substitution are not mutually exclusive policy priorities.**

- **Signs of resurgence of new protectionism**

  - pressure for maintain export competitiveness in face shrinking export demand leads to protectionist tendencies.

- **Recent policy initiatives by China to help export producers**
- **Administrative measures by Indonesia to control imports from China.**

- Can a region wide FTA help rebalancing East Asian growth?

  - opportunities and limitations.

- A strong case for devising strategies to fifght new protectionism as part of a long term commitment to non-discriminatory multilateral and unilateral trade liberalization.

  - The example of ITC Agreement.
  - Can this be extended to cover electrical goods?