Three topics:

• Regionalism’s Rationale
• Structural Trade Barriers and Infrastructure
• Demand Side Perspective
Asian Trade and Growth Patterns

A Schematic View of ADB Developing Member Countries

- East and Central Asia
  - Mongolia
  - People’s Rep. of China
  - Hong Kong, China
  - Republic of Korea
  - Taipei, China
  - Central Asia
- South Asia
  - India
  - Nepal
  - Pakistan
  - Sri Lanka
  - Bangladesh
- Southeast Asia
- ASEAN
- Oceana
Macro Conditions, 2005

Population

GDP

Trade

Pan Asia Conference, SCID and SIEPR, Stanford
Extra-regional demand remains a primary economic driver.

Intra-Asian trade is far from reaching its potential.
Baseline Per Capita GDP Growth
(annualized percent change, 2005-2025)

On a global basis, Asia continues to represent superior growth.

Sources: DRI, Oxford Econometrics, IMF.
Asian regional integration offers three opportunities:

1. Immense new market potential
2. Diversification toward superior growth rates
3. Structural differentiation – more rapid evolution from established North-South patterns of trade and specialization
4. Convergence – Leveraging regional dynamism for the poorest neighbors
Beyond WTO, FTA, etc…
Structural Barriers to Trade

- Structural barriers to regional trade are now more important than tariffs.
- Policies and investments that reduce trade margins and transactions costs can accelerate regional growth dramatically.
- Infrastructure, both hard (roads and bridges) and soft (“Asian OECD”), is the key to meeting this challenge.
Trade Costs Have Fallen, but Remain High

Table 1. Representative International Trade Costs of Industrialized Countries (percent)

<table>
<thead>
<tr>
<th>Category</th>
<th>Cost (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Trade Costs</td>
<td>74</td>
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<tr>
<td>Border-related Trade Barriers</td>
<td>44</td>
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<td>Policy</td>
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<td>Currency</td>
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<td>Security</td>
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<tr>
<td>Transportation Cost</td>
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<td>Freight</td>
<td>11</td>
</tr>
<tr>
<td>Time</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Anderson and van Wincoop (2004).
Structural Barriers Matter More than Tariffs/NTBs
(2025 Real GDP, percent change from Baseline)

Global
AsiaFTA
AsiaFTA2
2% annual reduction in trade margins

East and Central Asia
Southeast Asia
South Asia

PRC, Japan, Korea, Hong Kong, China, Taiwan, China, Indonesia, Malaysia, Philippines, Singapore, Thailand, Viet Nam, Bangladesh, India, Sri Lanka
Infrastructure’s contribution can be seen from three perspectives:

1. Keynesian – Aggregate demand and employment stimulus.


Keynesian Stimulus

• Infrastructure spending is a popular means of direct long term or transitory employment stimulus
  – Examples: WPA (US), Work Relief (PRC), Japan (heavy counter-cyclical and recurrent fiscal commitments)
• Because of its generality, this kind of spending can be targeted across a wide spectrum of regions and socio economic groups
• For public good infrastructure multiplier effects are generally quite substantial
By reducing trade margins, infrastructure:

1. Intensifies comparative advantage
   \[ \frac{P_H + M}{P_F + M} \xrightarrow[M \to \infty]{M} 1 \]

2. Improves international terms of trade
   \[ M \downarrow \Rightarrow \frac{PWE - M}{P_D} \uparrow \text{ and } \frac{PWM + M}{P_D} \downarrow \]

3. Improves rural terms of trade (pro-poor)
   \[ \rho = \frac{P_{R}^R}{P_{U}^R} = \frac{P_D - M}{P_D + M} \quad \text{and} \quad \frac{\partial \rho}{\partial M} = -2 \frac{P_D}{(P_D + M)^2} \]

4. Extends the horizon of profitable investment and marketing
Modern economic theory recognizes many endogenous growth factors, and these can be greatly facilitated by infrastructure:

- Productivity enhancement
- Technology diffusion
- Information diffusion
- Supply chain articulation and other network externalities
- Human capital development (migration)
Demand as a Regional Growth Driver:
Regional Import Demand Composition (2005)
East Asian Trade Triangle 2000

China

Rest of E&SE Asia

Rest of World

2 June 2006

Pan Asia Conference, SCID and SIEPR, Stanford

Roland-Holst 15
East Asian Trade Triangle 2020

China

Rest of E&SE Asia

Rest of World

2 June 2006

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Roland-Holst 16
China’s Net Oil Exports

Million Metric Tons

-120 -100 -80 -60 -40 -20 0 20 40 60

Oil Imports Now Equal China’s Trade Surplus

The graph illustrates the comparison between oil imports and China’s trade surplus over the years from 1996 to 2004. The x-axis represents the years, while the y-axis shows the percent of GDP. The graph includes three lines:

- **Red line**: Oil Imports
- **Green line**: Trade Surplus
- **Yellow line**: Surplus Before Oil

From the graph, it can be observed that oil imports have increased as a percentage of GDP, reaching a peak and then declining, while the trade surplus shows a decrease before oil imports become a significant factor.
China net trade in soybeans, oil and meal, 1980-2003

Note: net trade = exports - imports.
Source: USDA, Production, Supply, and Distribution data.
China and East Asia

• Head-to-head export global competition with China will continue to be difficult.

• More attention should be given to leveraging opportunities presented by East Asia’s fastest growing internal market.

• In these areas, the best strategy for East and Southeast Asia is to pursue globalism through more comprehensive regionalism.
Other Issues

- ASEAN and Japan
- The Role of Private Agency
- China, India, and Initial Conditions – a cautionary perspective
Thank You
The Asian Trade Triangle

• My own forecasts indicate the emergence of a systematic pattern of triangular trade between China, the Rest of East and Southeast Asia, and the Rest of the World

• This Trade Triangle reveals that China’s export expansion offers significant growth leverage to its neighbors.

• Chinese absorption will emerge to dominate regional demand. Provided Asian economies do not isolate themselves from this process, the net effect of China’s growth can be hugely positive.
• Supply chain decomposition has been a salient trend in recent Asian growth
• The corresponding intermediate trade linkages are increasingly responsible for the majority of value creation
• The foreign capital, technology, and demand allocation accompanying this propagates growth and, because of wage competition, can promote convergence
• Infrastructure is a prerequisite for effective participation in this regional production sharing
A Regional Example - Bamboo Capitalism

- Network externalities in local production and finance allow complete markets to sprout from nodes in a global root system of intermediate supply.
- This culminating aspect of global supply chain decomposition has created a diverse and vibrant population of independent local industries around the East Asian region.
- Many emergent enterprises are still bound to their roots by ownership or contracts.
- But increasingly they arise independently, promoting the dynamics of global competitiveness and innovation.
Clearly, we have entered an Age of Complementarity.
Asian FDI – Top Ten Destinations

FDI is very unequally distributed.

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics).
1 Ranked on the basis of the magnitude of 2003 FDI inflows.