



Comments on Asian Trade and Regional Integration

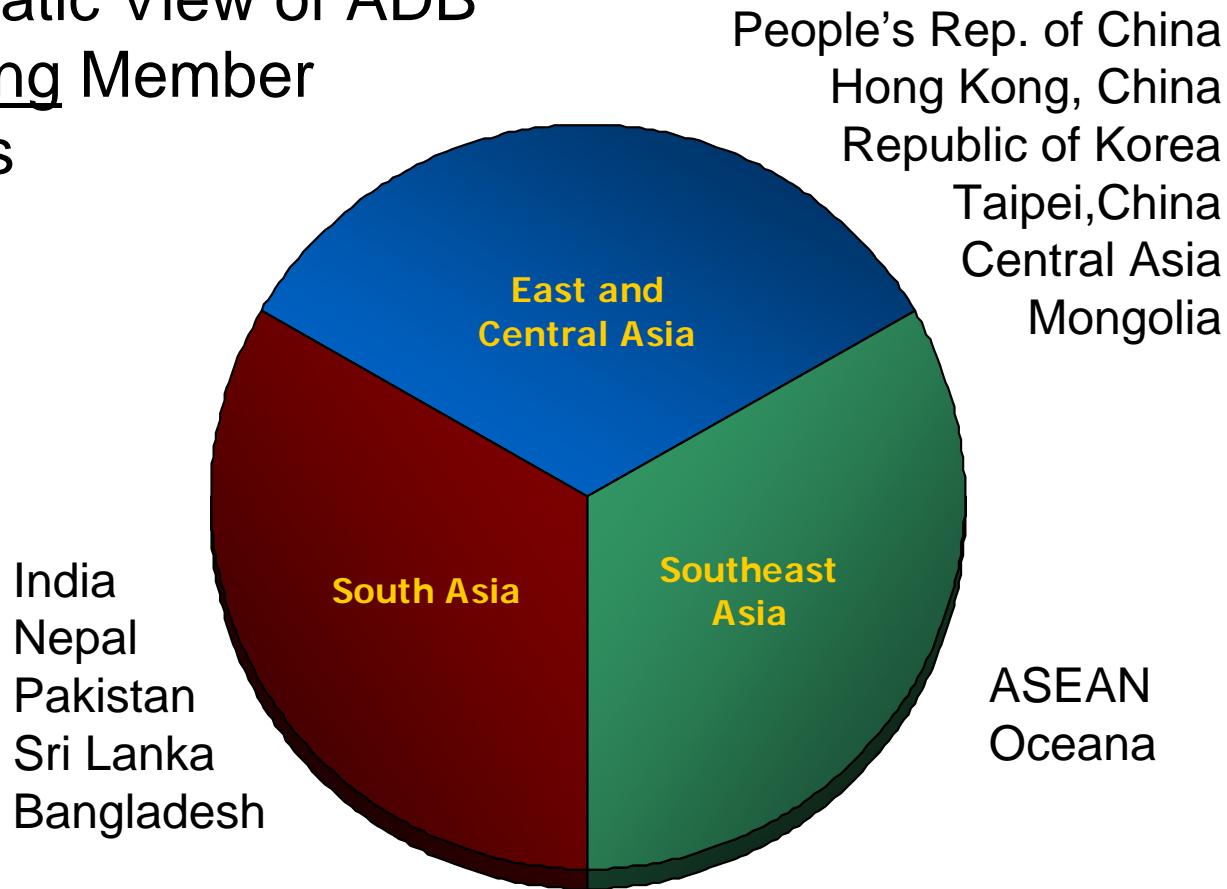
David Roland-Holst, UC Berkeley

Three topics:

- Regionalism's Rationale
- Structural Trade Barriers and Infrastructure
- Demand Side Perspective

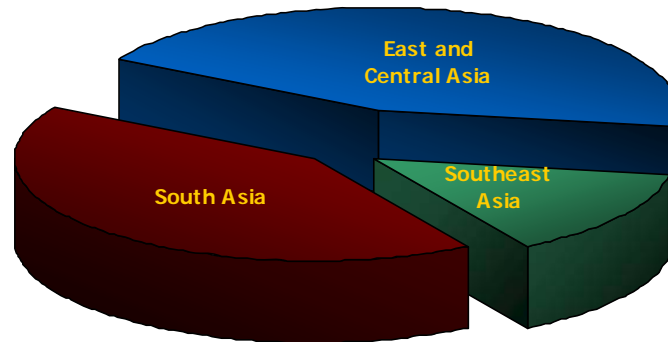
Asian Trade and Growth Patterns

A Schematic View of ADB Developing Member Countries

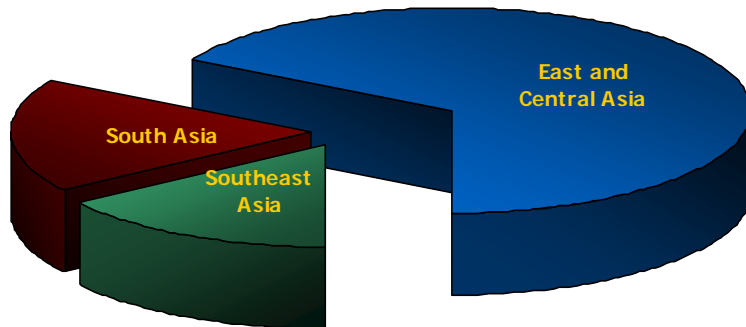


Macro Conditions, 2005

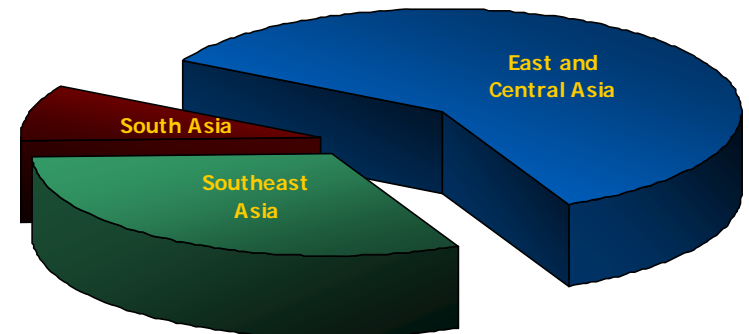
Population



GDP



Trade

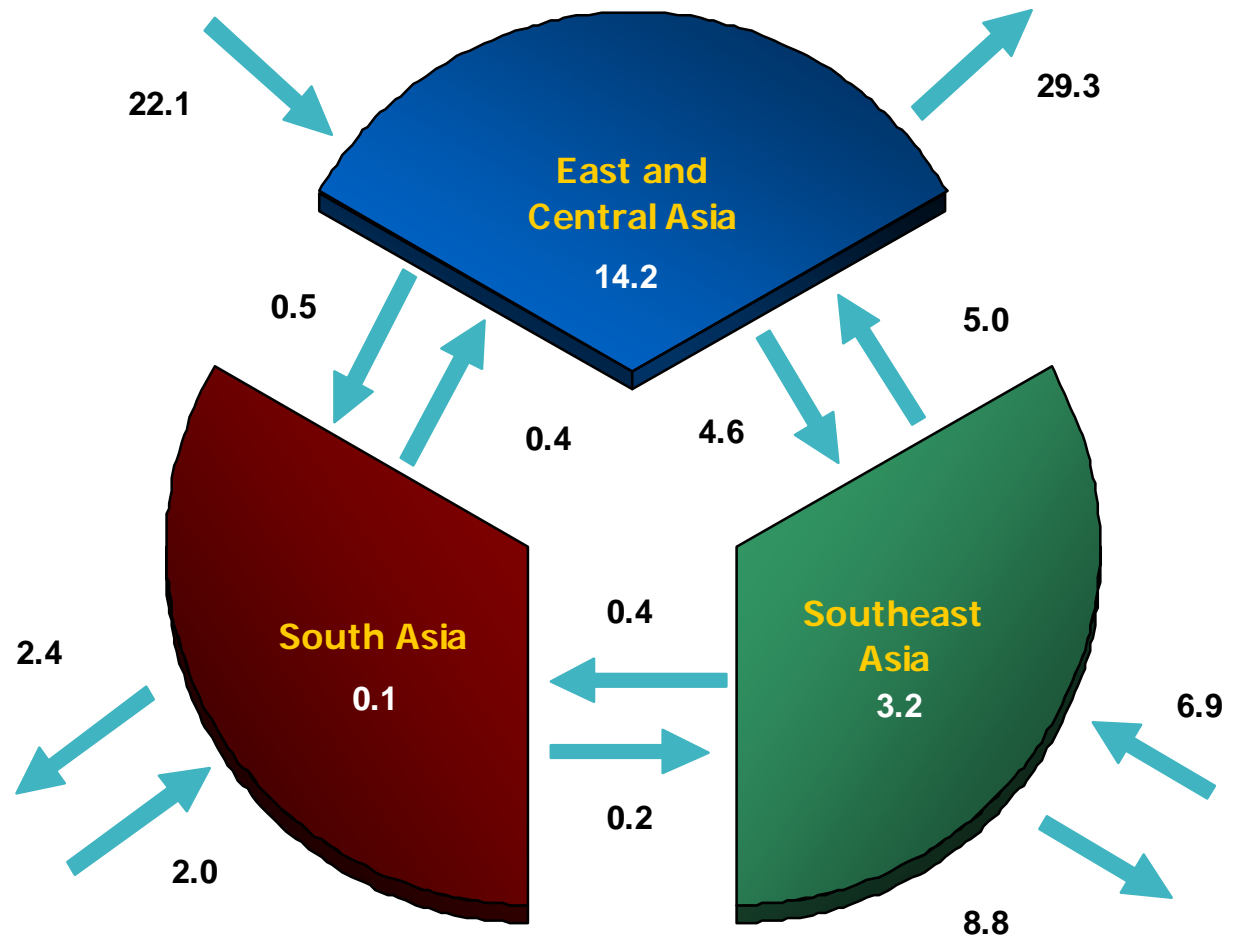


Asian Trade Flows, 2005

(percent of total Asian trade)

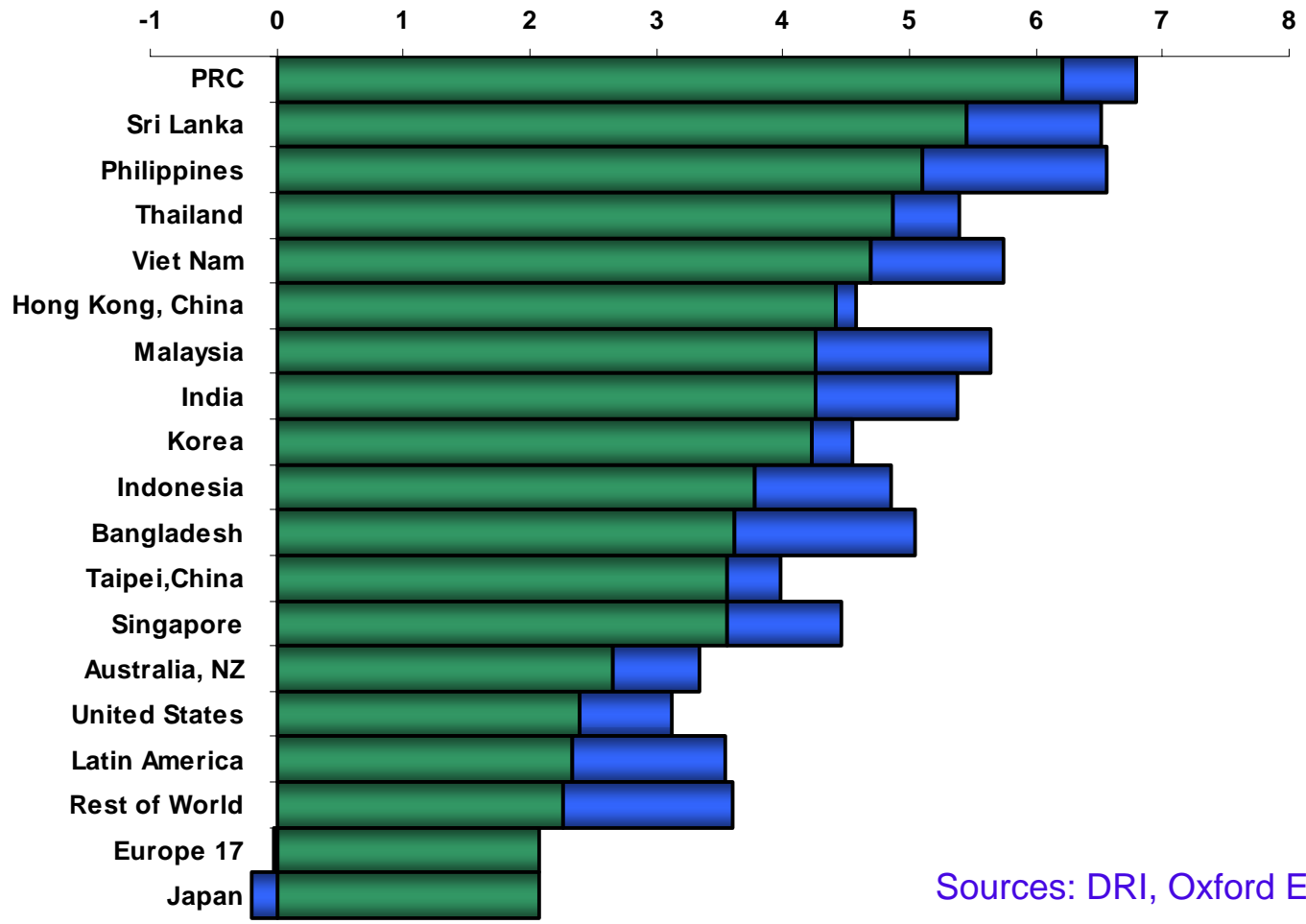
Extra-regional demand remains a primary economic driver.

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.



Four Virtues of Asian Regionalism

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

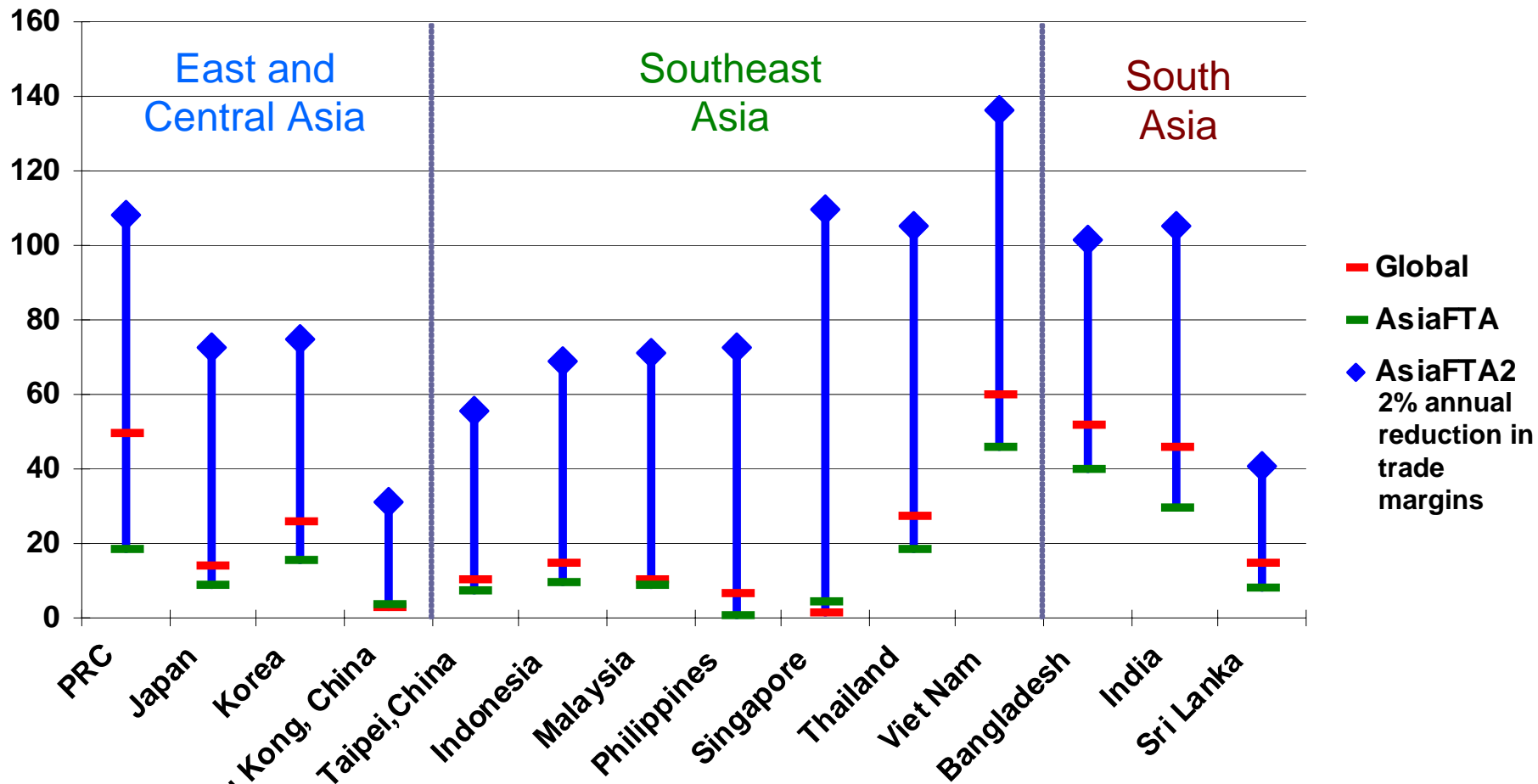
**Table 1. Representative International Trade Costs
of Industrialized Countries (percent)**

International Trade Costs	74
Border-related Trade Barriers	44
Policy	8
Language	7
Currency	14
Information cost	6
Security	3
Transportation Cost	21
Freight	11
Time	9

Source: Anderson and van Wincoop (2004).

Structural Barriers Matter More than Tariffs/NTBs

(2025 Real GDP, percent change from Baseline)





Structural Barriers and Infrastructure

Infrastructure's contribution can be seen from three perspectives:

1. Keynesian – Aggregate demand and employment stimulus.
2. Ricardian – Reducing trade margins and intensifying comparative advantage.
3. Neoclassical – Endogenous growth benefits.



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

Ricardian Stimulus

By reducing trade margins, infrastructure:

1. Intensifies comparative advantage

$$\frac{P_H + M}{P_F + M} \xrightarrow{M \rightarrow \infty} 1$$

2. Improves international terms of trade

$$M \downarrow \Rightarrow \frac{P_{WE} - M}{P_D} \uparrow \text{ and } \frac{P_{WM} + M}{P_D} \downarrow$$

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

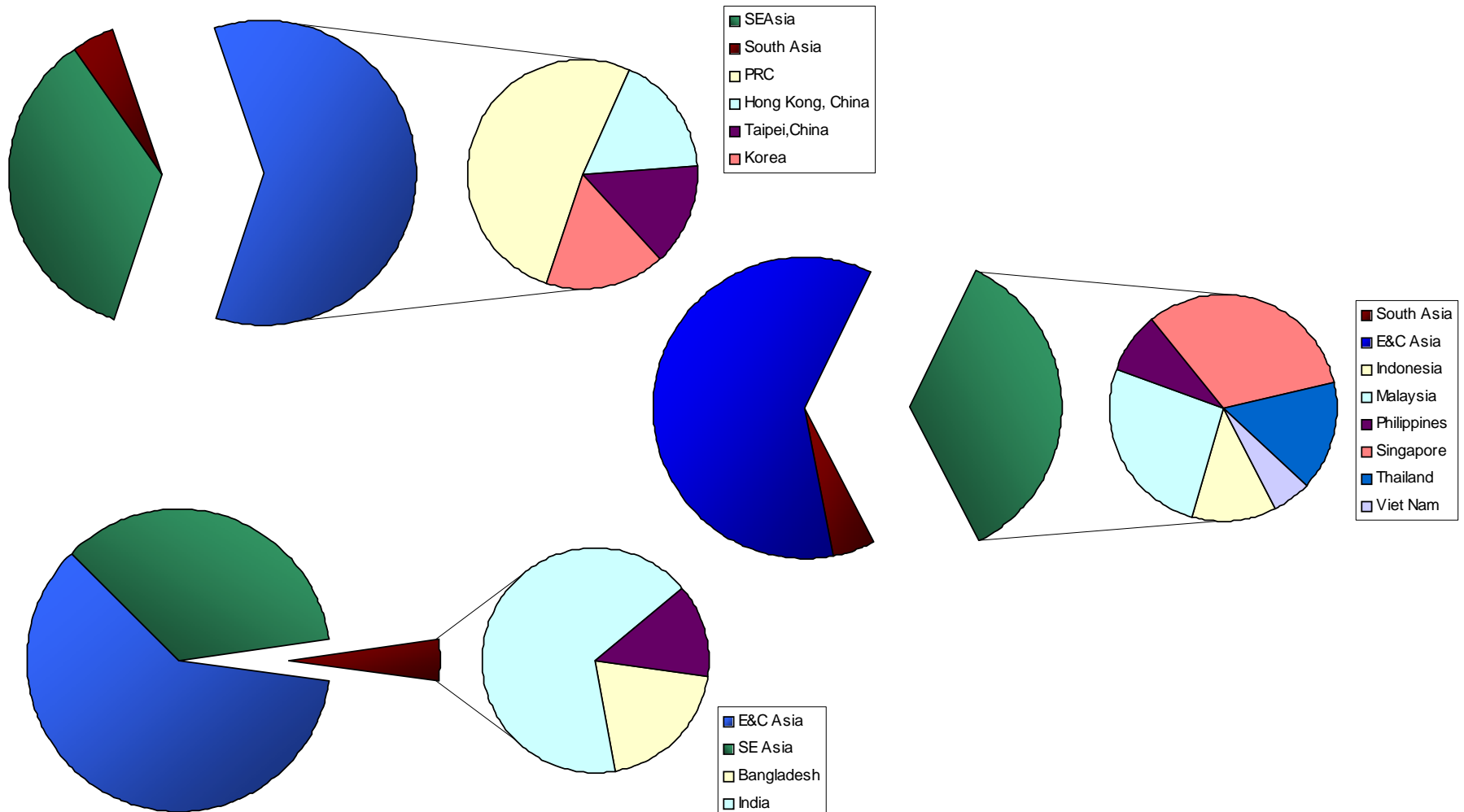


Neoclassical Stimulus

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)

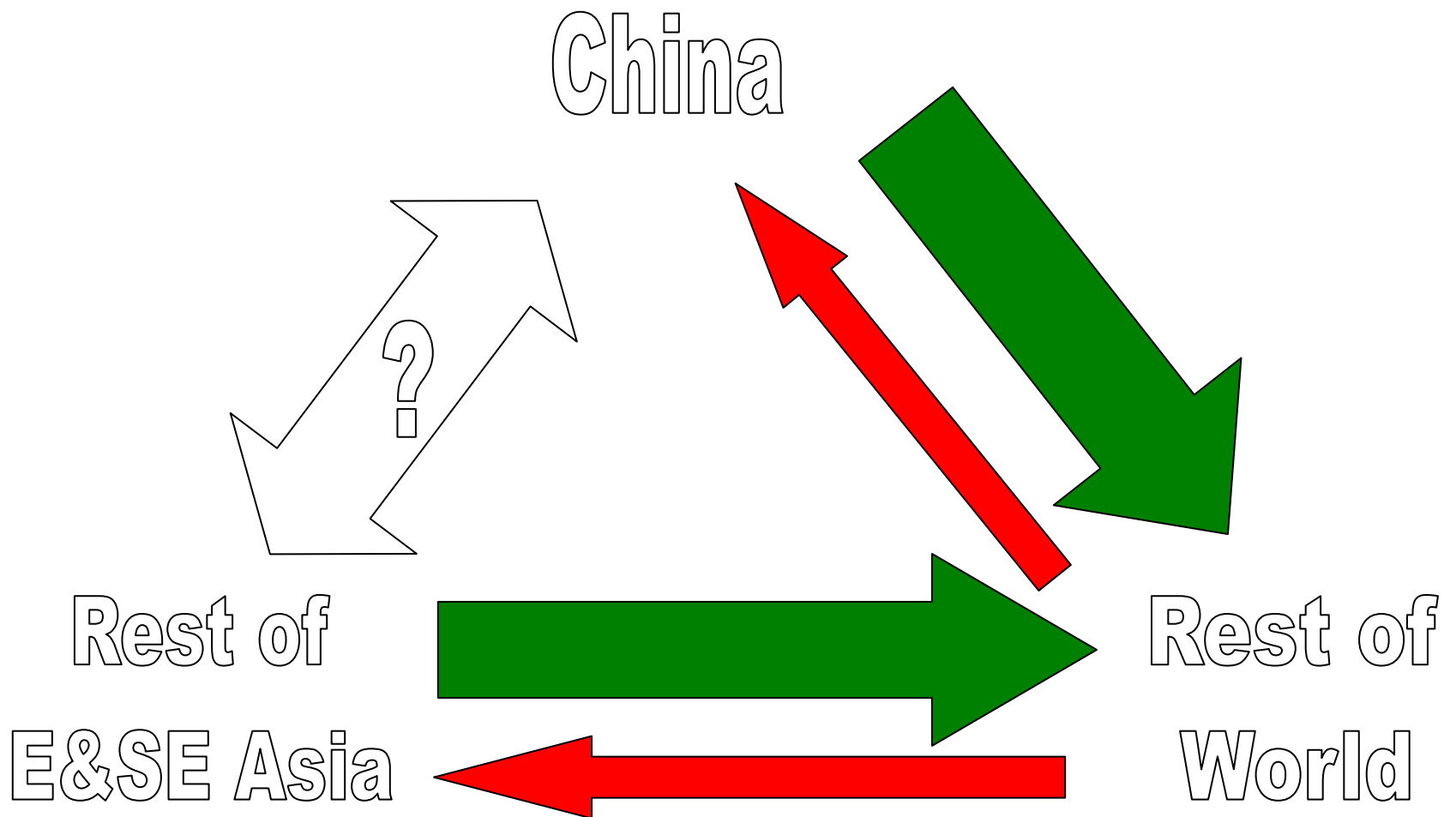


2 June 2006

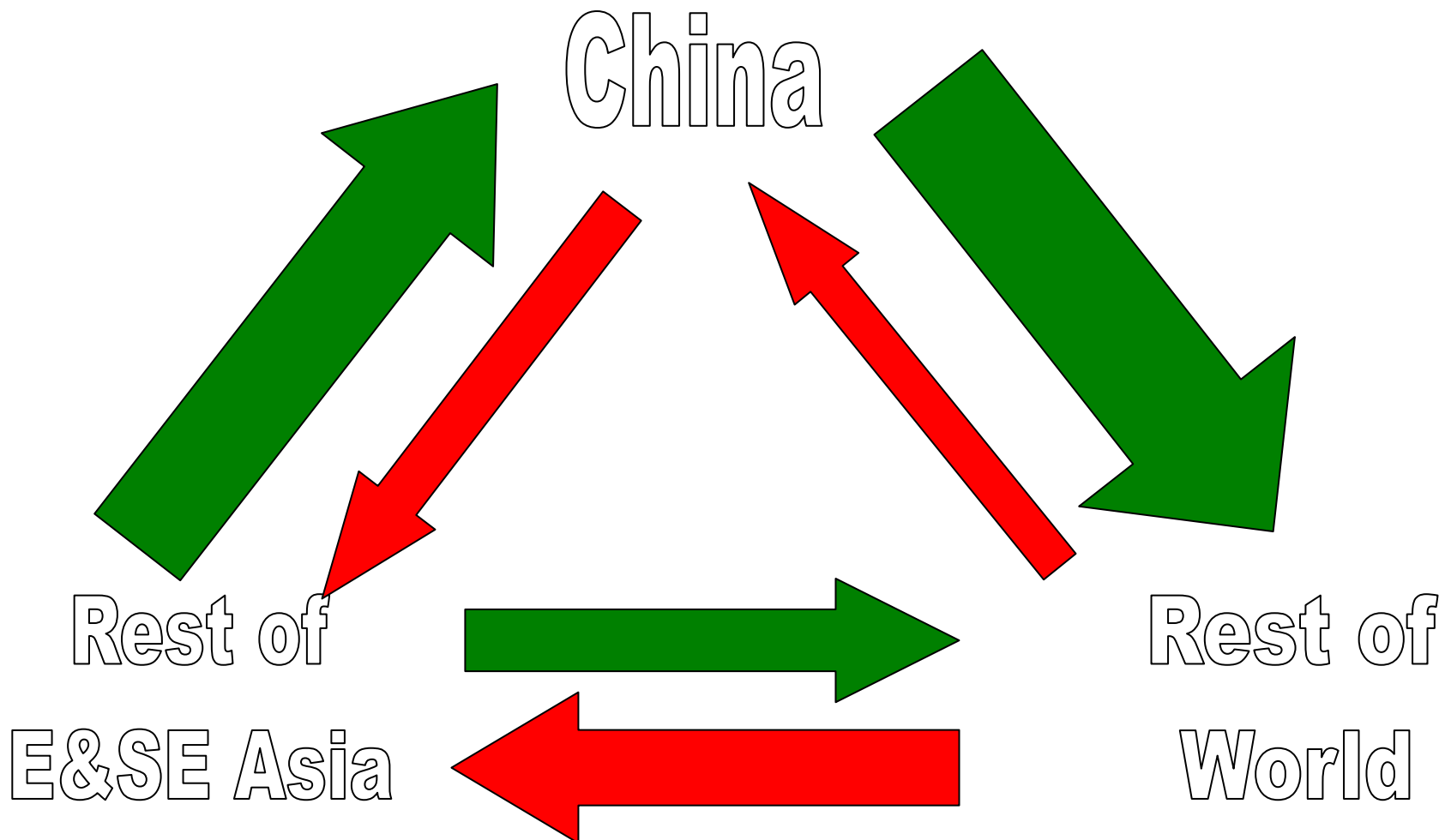
Pan Asia Conference, ~~World Bank~~ and SIEPR, Stanford

Roland-Holst 14

East Asian Trade Triangle 2000

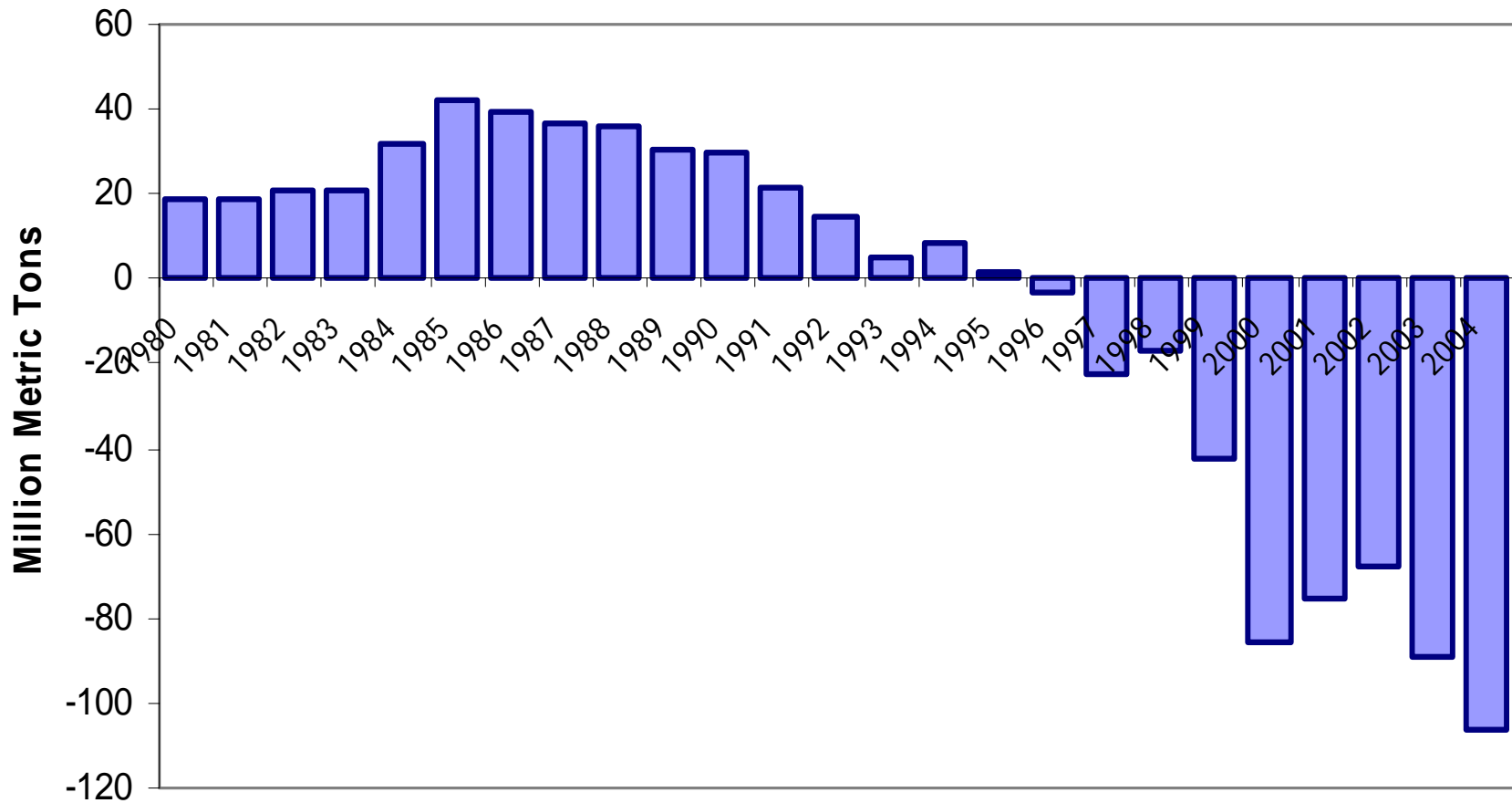


East Asian Trade Triangle 2020

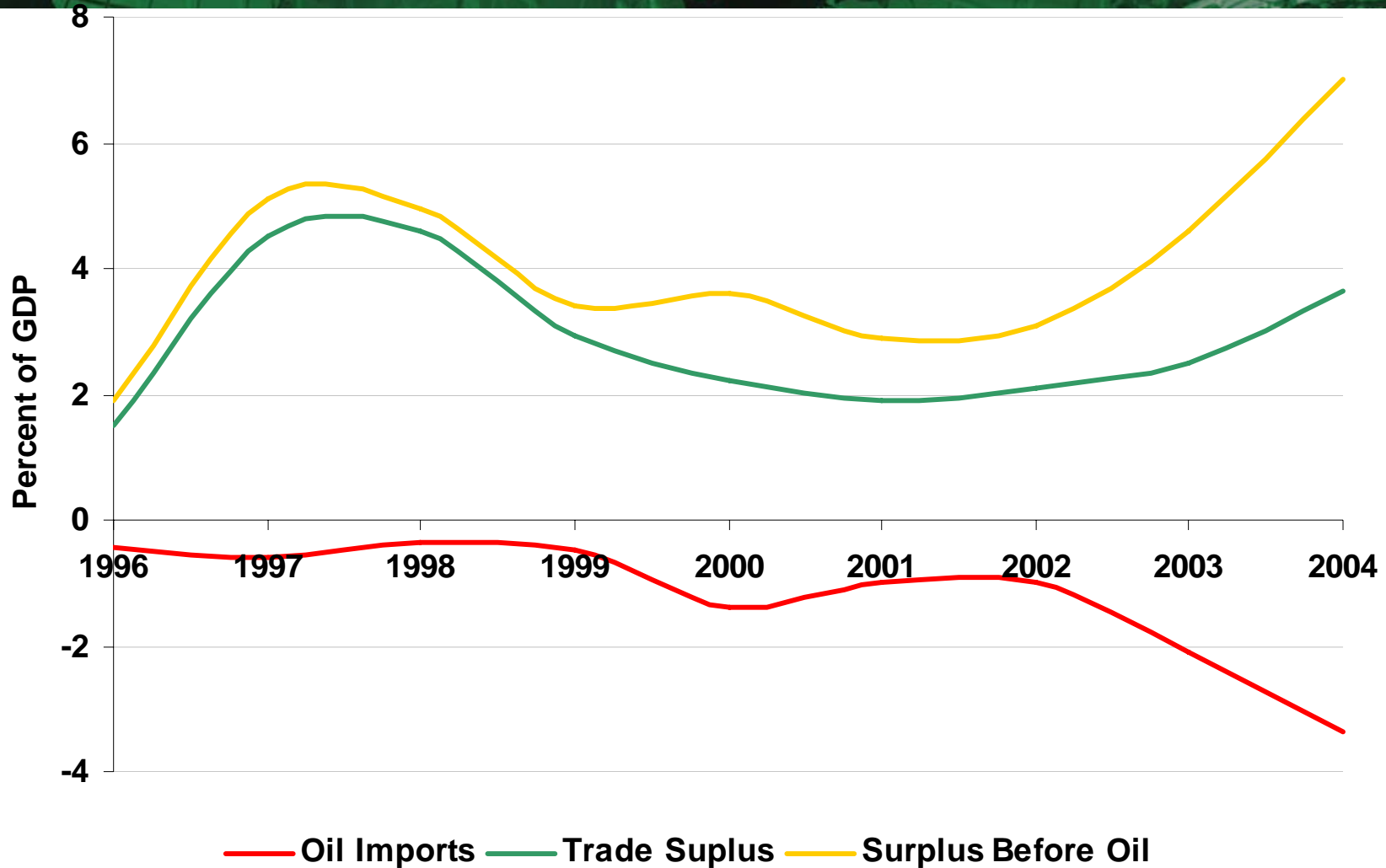


Petroleum

China's Net Oil Exports

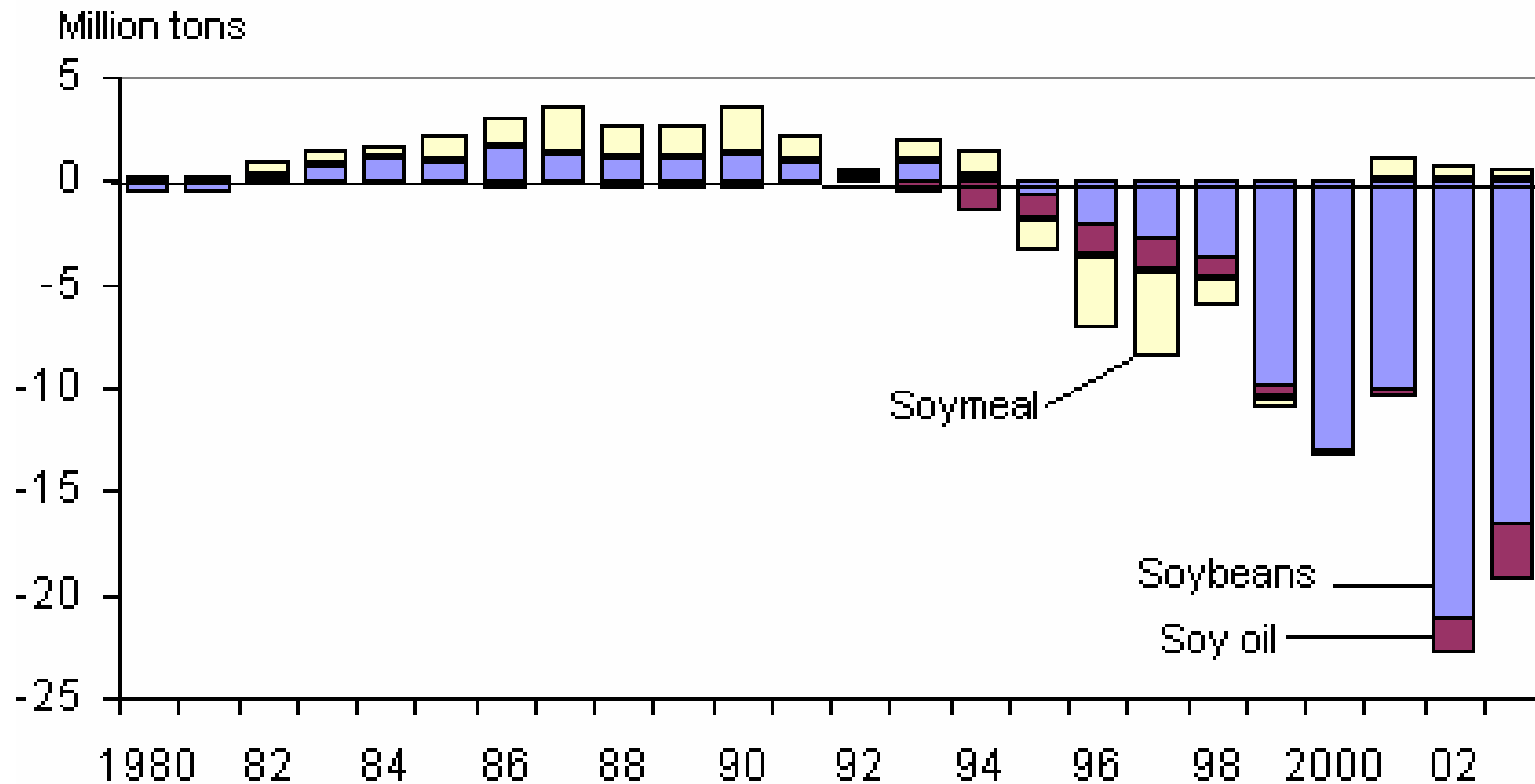


Oil Imports Now Equal China's Trade Surplus



Soy Products

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.



Private Agency and Network Externalities

- 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



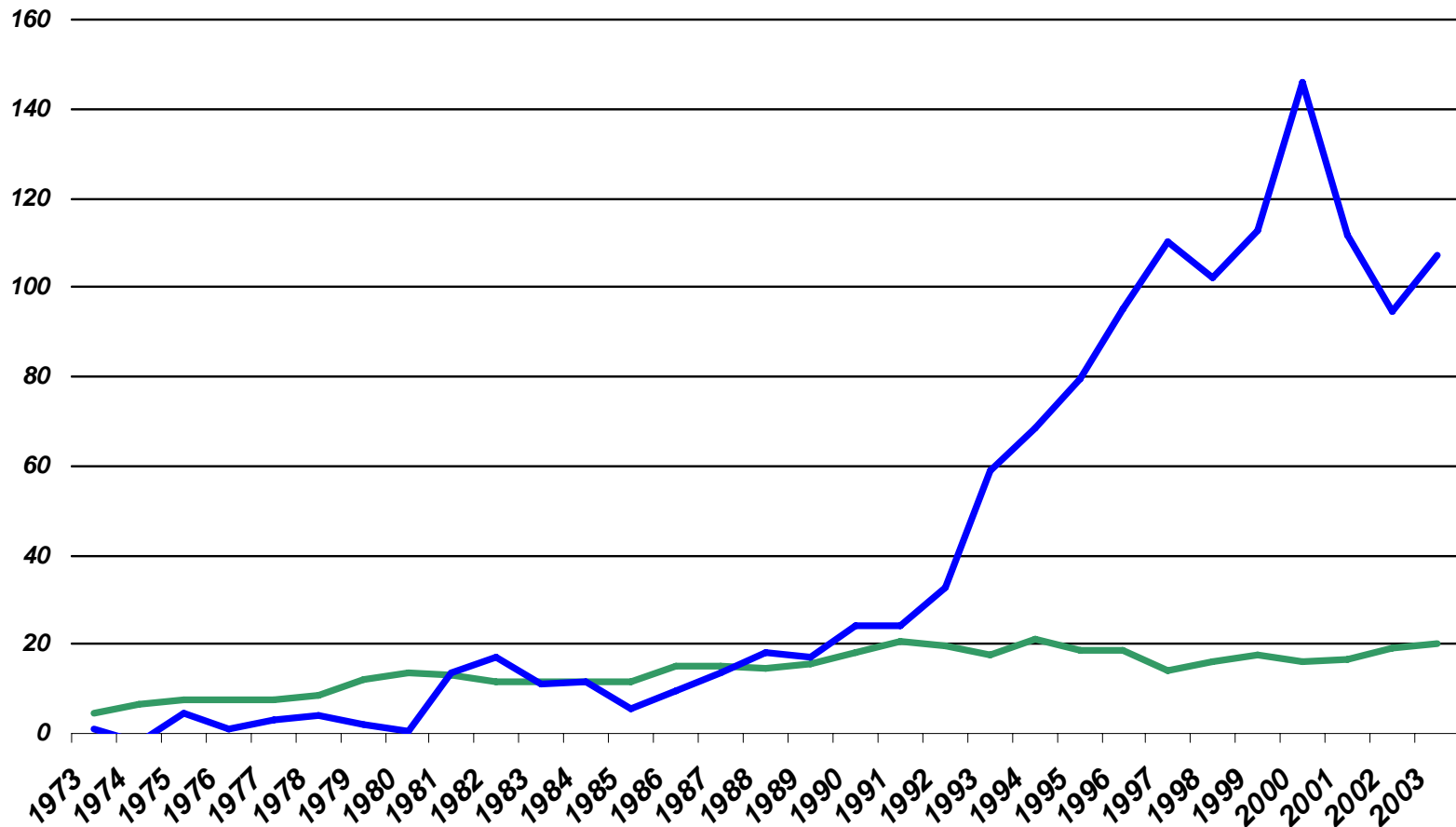
A Regional Example - Bamboo Capitalism

- 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.

Regional Public and Private Investment

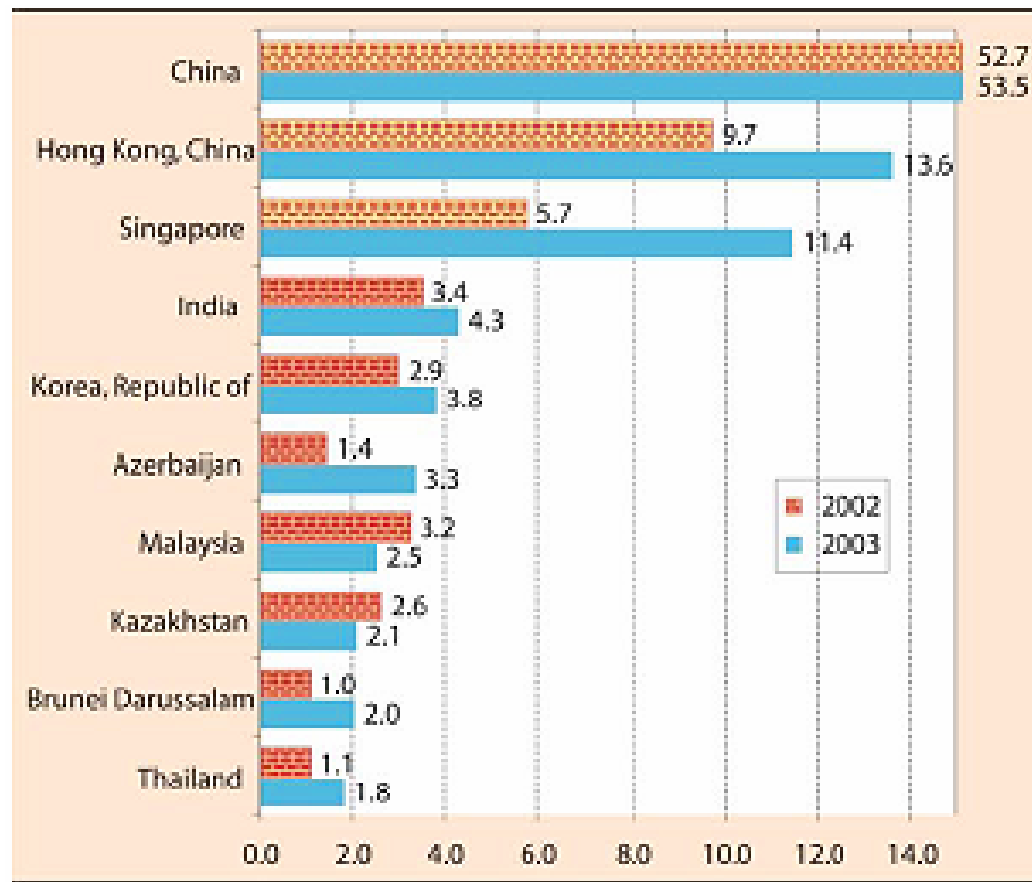
(Asian inbound Aid and FDI, USD Billions)

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.