East Asian Regionalism: Managing the Noodle Bowl

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ESRI, Tokyo, 23 January 2006
Plan of talk

• Introduction
  – Paper vs the talk
  – Bottomline: East Asia’s pressing need is for management, not vision.
• Current state of play
• Causes of East Asian regionalism
• Likely trajectory of EA regionalism
• Fragility of the current ‘system’
• Solutions
East Asian Regionalism

• The ‘state of play’ in EA is easy to summarise:
• “It’s a mess”
Mistaken view of EA regionalism

- ASEAN-China FTA
- ASEAN-Korea FTA
- ASEAN-Japan FTA
- AFTA
AFTA

- AFTA, 1992 to 2010 (2015 for poorer ASEANs)
  - At first: ‘conditional MFN’ & partial tariff cutting.
  - After AC FTA got going ASEANs agree to go to zero (Bali II).
  - Each nation’s “sensitive” lists:
    - don’t get preferential tariff on items on your sensitive list;
    - pay the higher of your tariff and ASEAN partner’s.

- Net effect: each bilateral trade flows faces a different tariff structure.
- ERGO, AFTA operates like 45 bilaterals
  - Some coordination (not as bad as could be).
AFTA’s true nature
Low utilisation rates

- Almost no one uses the AFTA preferences!
- “Utilisation rates” for AFTA under 10%
  - JETRO (2003): 11.2% of Thailand's imports from AFTA used CEPT.
  - 4.1% of Malaysia's exports to AFTA used CEPT.

![Form D Utilisation (% of Intra-ASEAN trade)](image)

Source: PriceCooperWaterhouse
AC FTA

• Signed Nov 2004.
• Nation-specific sensitive lists & conditional MFN, so de facto 10 bilaterals.
  – But AFTA ROOs, maybe common dispute settlement procedure (so not as bad as it could have been).
• Appears to be some ratification problems in ASEANs. (watch carefully in 2006).
• Has not been notified to WTO.
• Tariff cutting started mid 2005, to zero by 2010.
ASEAN Korea FTA

- Similar to AC FTA, but more political difficulties & started later.
- de facto 10 bilaterals.
- Tariff cutting to start in 2006, to zero by 2010 (’09?).
ASEAN Japan Bilaterals

• Japan-Malaysia signed Dec 05.
  – Very different agreement to AFTA & ACFTA; reads like European or US FTA; much more structured.
  – Form may matter (watch ACFTA).
• Soon with Indonesia, Thailand, Philippines, likely soon with Vietnam & Brunei.
• In parallel, AJ FTA with ASEAN as whole.
• Tariff cutting to start in 2006, to zero by 2010.
Noodle Bowl Syndrome
Causes of East Asian Regionalism

• Triggers & Dominos
Dynamic development of Noodle Bowl

• FTAs spreading like wildfire, but recently EA only region with them.
  – Trigger = China’s approach to ASEAN in Nov 2000,
  – Domino theory but important precursors.

• Three phases of East Asian regionalism.
Phase I (1980s to 1990)

- “Rampant unilateralism”
- Unilateral tariff cutting
  - competition for jobs and investment linked to development of “Asian Manufacturing Matrix.”
- 3 key factors in development of the Asian Manufacturing Matrix
  1. Erosion of Japan’s comparative advantage in manufacturing.
    - EA divides into “HQ economies” (Japan only to start with) & “Factory Economies” (Advanced ASEANs).
    - Korea, Taiwan, Hong Kong & Singapore join later
    - “Triangle trade” becomes important.
  2. Reduced cost of moving goods and ideas.
  3. China’s emergence & domestic reforms
Phase II (1990 to 2000)

- “Regionalism delayed”
  - Accelerated the widening and deepening of Asian Manufacturing Matrix;
  - intra-EA begins to matter.
  - Malaysian Premier Mahathir’s EAEC.
- US’s APEC diversionary tactic.
  - Classic tactic (UK used in Europe in 1950s)
- Setting stage for Phase III:
  - 1997 Asian Crisis: APEC’s hollowness & brotherhood
  - China’s impeding WTO membership: end of status quo.
  - A new player was joining the game; all must re-evaluate their tactics and strategies.
Rampant Unilateralism

Unilateral tariff cutting in Phases I & II.

- **Philippine**
- **Thailand**
- **Korea**
- **Malaysia**
- **China**
- **Indonesia**
- **Singapore**
Phase III (2000 to now)

• “Rampant regionalism”
Chinese premier Zhu Rongji broached the idea of an FTA between China and ASEAN at ASEAN-China summit.

- Surprise move.
- Why?

ASEAN are receptive; study grp formed.

Red lights begin to flash all over region.
Japan and Korea “HAD” to have a plan to redress ACFTA discrimination, if it should arise.
Japan’s options in 2000-2002

• Plan A: join ACFTA
  – Domino theory & history predicts, BUT
  – 1. ad hoc nature of ACFTA rules out enlargement (ACFTA is not a group, so it cannot to be joined).
  – 2. China & ASEANs fear Japanese industry
    • Lock in as Factory Economy status; prevent development of new Sonys, Hondas, Samsungs.

• Plan B? Two classic responses
  – Form own trade bloc with other excluded nations.
    • EFTA in 1959; Mercosur 1991.
    • => JKFTA
  – Sign FTA with smaller partner.
    • Chile, Caricom with Mexico.
    • =>AJ FTA
Table 1: Actual and projected “exclusion indices”

<table>
<thead>
<tr>
<th></th>
<th>Japan</th>
<th>Korea</th>
<th><strong>China</strong></th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Indonesia</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Vietnam</th>
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<td></td>
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<tr>
<td>ASEAN</td>
<td>17%</td>
<td>13%</td>
<td>8%</td>
<td>29%</td>
<td>22%</td>
<td>11%</td>
<td>19%</td>
<td>31%</td>
<td>15%</td>
</tr>
<tr>
<td>ASEAN+China</td>
<td>36%</td>
<td>43%</td>
<td>8%</td>
<td>43%</td>
<td>36%</td>
<td>22%</td>
<td>34%</td>
<td>45%</td>
<td>23%</td>
</tr>
<tr>
<td>Japan</td>
<td>10%</td>
<td></td>
<td><strong>14%</strong></td>
<td>10%</td>
<td>15%</td>
<td>25%</td>
<td>· 14%</td>
<td>6%</td>
<td>15%</td>
</tr>
<tr>
<td>Korea</td>
<td>8%</td>
<td></td>
<td>4%</td>
<td>4%</td>
<td>2%</td>
<td>8%</td>
<td>4%</td>
<td>4%</td>
<td>2%</td>
</tr>
<tr>
<td><strong>2015</strong></td>
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<tr>
<td>ASEAN</td>
<td>18%</td>
<td>14%</td>
<td>11%</td>
<td>31%</td>
<td>25%</td>
<td>14%</td>
<td>21%</td>
<td>35%</td>
<td>17%</td>
</tr>
<tr>
<td>ASEAN+China</td>
<td>47%</td>
<td>56%</td>
<td>11%</td>
<td>51%</td>
<td>46%</td>
<td>30%</td>
<td>45%</td>
<td>55%</td>
<td>31%</td>
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<tr>
<td>Japan</td>
<td>7%</td>
<td>12%</td>
<td>8%</td>
<td>12%</td>
<td>20%</td>
<td>11%</td>
<td>4%</td>
<td>13%</td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>8%</td>
<td>5%</td>
<td>1%</td>
<td>3%</td>
<td>9%</td>
<td>4%</td>
<td>4%</td>
<td>3%</td>
<td></td>
</tr>
</tbody>
</table>

Note: The exclusion index shows that share of a nation’s exports that would be discriminated against by an FTA among the listed partners. Figures show share of column nation’s exports to the markets listed on the rows. Projections are based on standard gravity model estimates of the impact of importer and exporter GDP growth on bilateral trade. Projections assume no change in trade policy. GDP growth rates equal to IMF’s projected growth rates for 2007 for all the major trade nations in the world.

Source: Author’s projection
Likely Trajectory?

- AK FTA will get done
- Japan bilaterals with big ASEANs will get done
- AJ FTA ??
  - Opportunity for largesse
  - Fast or slow, doesn’t matter much to other nations; basically more GSP.
- Next round of dominos (if any)
  - Hub-hub (JK, KC, JKC)
  - US moves? (K US?)
- If domino theory is right, it will spread beyond EA.
  - cf. EU has preferences with 141 of 148 WTO members.
Conjectures about hub-hub FTAs

• JK FTA is most likely, but still difficult
  – Pressure to finish depends upon whether ACFTA turns out to be ‘for real’ i.e. create discrimination for J & K exporters.

• Possible counter by China is to push forcefully for JKC talks on a long deadline for talks and long deadline for transition.
  – Might be a good idea to diffuse tensions.
  – No one “in charge” talks would be long & slow but better than not talking.
Fragility of the Current situation

• 1. Extreme interdependence of ‘Factory Asia’
  – Worrying asymmetry of interdependence
• 2. Lack of WTO discipline
  – ‘tariff bindings overhang’
Interdependence (asymmetric)

- Source of manufactured intermediate inputs of manufacturing sector:

2. Natural leaders care less.
## Lack of WTO discipline

<table>
<thead>
<tr>
<th></th>
<th>Binding Coverage</th>
<th>Final bound</th>
<th>Applied</th>
<th>Import duties as share of total imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>99.6</td>
<td>2.3</td>
<td>2.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>Korea</td>
<td>94.5</td>
<td>10.1</td>
<td>6.7</td>
<td>3.2</td>
</tr>
<tr>
<td>China</td>
<td>100.0</td>
<td>9.1</td>
<td>9.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>83.7</td>
<td>14.9</td>
<td>9.1</td>
<td>3.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>74.7</td>
<td>24.2</td>
<td>13.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>96.6</td>
<td>35.6</td>
<td>6.7</td>
<td>1.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>66.8</td>
<td>23.4</td>
<td>5.8</td>
<td>5.4</td>
</tr>
<tr>
<td>Vietnam</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>100.0</td>
<td>4.8</td>
<td>5.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>Singapore</td>
<td>69.2</td>
<td>6.3</td>
<td>0.0</td>
<td>0.3</td>
</tr>
</tbody>
</table>
EXAMPLE: Parts Procurement of a Hard Disc Drive Assembler Located in Thailand

- **Thailand**: SPNDLE MOTOR BASE, CARRIAGE, FLEX CABLE, PIVOT, SEAL, VCM, TOP COVER, PCBA, HGA, HAS.
- **Japan**: COVER DISK, SCREW, SEAL, RAMP, TOP CLAMP, LATCH, PLATE CASE, LABEL, FILTER, PCBA, SUSPENSION.
- **USA**: DISK HEAD SUSPENSION.
- **Mexico**: HEAD.
- **China**: PCBA, CARRIAGE, HGA, BASE, HEAD SUSPENSION.
- **Taiwan**: TOP CLAMP.
- **Philippines**: DAMPING PLATE, COIL SUPPORT, PCBA.
- **Singapore**: COVER, SCREW, PIVOT, PC ADP, DISC.
- **Indonesia**: W.SUSPENSION, VCM, PCBA.
- **Hong Kong**: FILTER CAP.
System Fragility

- Think of East Asia as a magnificent factory.
- Think of regional trade as “conveyor belts” in fantastically complicated, just-in-time factory.
- If a few ‘conveyor belts’ break down, whole factory suffers.
  - Competitiveness of Japanese firms in US market depends upon intra-regional trade.
  - Ditto Korean & Chinese firms.
- Set up and run by companies (middle-level managers).
  - They’ve done a great jobs, but
System Fragility

• Where is the top-level management?
• East Asia’s collective action problem.
• Asymmetric dependence makes matters worse.
  – ASEANs are more dependent on the conveyor belts than China and Japan.
Solutions

• What East Asia needs now:
  – Management, not vision

• Urgent
  – Discrimination is a source of conflict.
  – Discrimination is scheduled to start 2006 – 2010.

• New East Asian Management Effort:
  – 1. Use ASEAN+3 group & add a Secretariat.
    • Management is a ‘club good’;
    • Membership should be limited to those most involved in the collective action problem.
    • Reduce likelihood of free-rider or strategic behaviour.
    • Include all that are most affected.
Solutions

2. Management priorities:

- #1: Bind the MFN applied rates.
  - Get credit in DDA.

- #2: Transparency and confidence building deliverables
  - information clearinghouse,
  - ASEAN+3 compliant standards for new FTAs,
  - ROOs & cumulation (European example, PECS).
  - customs cooperation,
  - trade facilitation,
  - Keep talking.
  - etc.
Solutions

• Longer term goals:
  – Set up a proper organisation akin to EFTA.
    – EU’s institutions are too supranational.
    – NAFTA’s institutions are too intergovernmental.
    – EFTA’s are in between.

• Begin trilateral talks, CJK
  – Aim to finish talks by 2010 with FTA within 15 years later.
    • Long, long horizon reduces resistance.
  – Keep talking; no one nation ‘in charge’
  – Avoid tensions from next hub-hub domino effect.
Bottomline

• East Asian regionalism based on a grand vision would have been best.
  – Window of opportunity was missed.

• Concrete foundations of EA regionalism have already been poured and are hardening.

• What East Asian needs now is management, not vision.

• Need is urgent since discrimination is about to begin to emerge & discrimination can foster tensions.
End.

Thank you for listening.

Papers (Domino theory, 1994 book, etc) can be downloaded from hei.unige.ch/baldwin
AMM pressure continues

• Doha round and AMM pressure continues to reduce applied MFN rates
  – Reduces the possibility discrimination.
Trade realities

• Market size (GDPs)
• Direction of Trade flows
• Very uneven market sizes
• 2 big
• 1 medium
• many small or tiny
• ASEAN-10 is about 9% of EA GDP
• ASEAN-4 & Vietnam
Intra East Asian Trade, 2002 (rounded to nearest $10 bill)

- Dominance of N.E. Asia in regional trade flows.
- Hub & Spoke pattern (J, C, K)
- Almost no spoke-spoke trade (ex. Singapore)
East Asian Trade, rounded to nearest 1%, 2002; Width proportional to %.
Eliminate flows without international FTAs

East Asian Trade, rounded to nearest 1%, 2002; Width proportional to %.
AFTA didn’t work

• Utilisation rates for AFTA under 10%
  – JETRO (2003) 11.2% of Thailand's imports from AFTA took advantage of the CEPT. Malaysia's data suggest that just 4.1% of its exports to AFTA enjoyed the CEPT preference.

Table 3: Intra-ASEAN exports as a share ASEANs total exports, 1985 to 2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra-ASEAN exports</td>
<td>16%</td>
<td>17%</td>
<td>21%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Source: DOTS database.
Why didn’t AFTA work?

- Political economy of failure is easy
- Facts suggesting this happened.
What do ASEANs trade?
### Table 1: Intra-East Asian preference margins vis-à-vis EU and North America

<table>
<thead>
<tr>
<th>Sector:</th>
<th>Exporter to East Asia</th>
<th>Preference margins:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>East Asia</td>
<td>North America</td>
<td>EU</td>
<td>over N.Amer. Exporters</td>
</tr>
<tr>
<td>Mining products (HS25-27)</td>
<td>1.7</td>
<td>2.6</td>
<td>1.7</td>
<td>0.9</td>
</tr>
<tr>
<td>General machinery (HS 84)</td>
<td>1.5</td>
<td>1.9</td>
<td>2.5</td>
<td>0.4</td>
</tr>
<tr>
<td>Electrical machinery (HS 85)</td>
<td>1.4</td>
<td>1.5</td>
<td>2.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Others</td>
<td>1.4</td>
<td>1.7</td>
<td>2.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Wood and paper</td>
<td>1.4</td>
<td>1.3</td>
<td>1.5</td>
<td>-0.1</td>
</tr>
<tr>
<td>Precision apparatus</td>
<td>1.2</td>
<td>1.3</td>
<td>2.0</td>
<td>-1.0</td>
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<tr>
<td>Agriculture</td>
<td>41.4</td>
<td>29.7</td>
<td>30.9</td>
<td>-11.3</td>
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<tr>
<td>Light industry</td>
<td>26.8</td>
<td>8.3</td>
<td>12.8</td>
<td>-18.5</td>
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<td>Food and beverages</td>
<td>21.8</td>
<td>26.4</td>
<td>25.8</td>
<td>4.6</td>
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<td>Textiles and clothing</td>
<td>7.3</td>
<td>7.6</td>
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<td>Pottery products</td>
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<td>Basic metals</td>
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<td>2.3</td>
<td>0.8</td>
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<tr>
<td>All products</td>
<td>7.4</td>
<td>5.5</td>
<td>7.2</td>
<td>-1.9</td>
</tr>
</tbody>
</table>

Note: Tariff data for 2002; see the paper for aggregation schemes.

Source: Author’s reorganisation of data drawn from Freudenberg and Paulmier (2005), Table 3.
Eliminate flows without international FTAs & well-functioning FTAs

Hub & Spoke system with 3 hubs
Asian Manufacturing Matrix

• Add back complexity
- The hubs all care more about extra-regional markets.
- Same for most small nations in the region.
Figure 1  Machinery goods and the parts and components: shares in total exports and imports in 2000

Data source: Authors’ calculation, based on PC-TAS (UN Comtrade only for exports of Hong Kong and exports and imports of Russia and Slovakia).
- About ½ of EA exports are to EA.
- About 60% of EA-EA & EA-RoW exports are Machinery
- EA-EA, parts are dominant
- EA-RoW final goods dominant
- $=>$

Source: Ando & Kimura (2005)

> “Triangle Trade”