The Big Choices for Asia in the Decades Ahead

Who can say what Asia might look like in 20 years’ time? No one with any real degree of certainty, but the events and trends of today give pointers. North Korea’s continuing nuclearization, military build-ups around the region, Japan’s probing constitutional reforms, swelling mega-cities and shifting demographics across Asia — all are examples of changes under way that will see a dramatically different Asia in coming decades.
THE ECONOMIC DEVELOPMENT of East Asia after the Second World War has been dubbed “the East Asian miracle” (World Bank 1993). While individual performances have varied, East Asian countries became richer faster than any other in the world (Sarel 1996). The region’s remarkable, sustained economic growth over the past five decades can be best illustrated by the region’s increasing share in global trade flows, particularly over the last 35 years. In 1980, 13 East Asian countries accounted for 13 percent of world merchandise trade (US$485 billion). Over the last 35 years, the region’s share of world trade has almost doubled, reaching 25.5 percent (US$8.45 trillion) in 2015 (International Monetary Fund 1980-2015).

It is also remarkable that intra-regional trade during the same period grew on average by more than 10 percent per year, twice as fast as in other parts of the world (IMF, 2014: 47). East Asia’s total trade has increased on average by 9.1 percent during the period. As of 2015, almost 20 percent of East Asia’s total trade was conducted within the region (See Figure 1).

In the 1980s and 1990s, the United States was the market of choice, accounting for an average of 27.8 percent of East Asia’s total exports. In recent years, however, the importance of the US as an export destination for East Asian countries has declined, with its share falling to 18.2 percent in 2015. The importance of the European Union as a final destination for East Asia’s exports has also decreased steadily over the past three decades. The EU’s share of East Asia’s total exports, which averaged 17.5 percent during the 1980s and the 1990s, decreased to 13.8 percent in 2015 (See Figure 2).

By contrast, China has become a key focus for the rest of East Asia’s total exports, rising dramatically from 0.9 percent in 1980 to 15.6 percent in 2015. It is now the largest trading partner for most East Asian countries, with the exception of the Philippines and Brunei. The dependence of East Asian countries on China has increased significantly as its share of East Asia’s total trade (imports plus exports) increased from 1.4 percent in 1980 to 19.4 percent in 2015. In 2015, for instance, five East Asian countries — Japan, South Korea, Laos, Myanmar and Vietnam — relied on China for more than 20 percent of their total trade. In the same year, Myanmar’s dependence reached almost 40 percent (See Figure 3 overleaf).

One word more than any other captures the key to East Asia’s ‘economic miracle’ spanning the decades after the Second World War — trade. The growth model built around exports has served the region well for years, but ominously, that model is no longer assured and faces a host of challenges. Risks abound, and new approaches are needed, write Vinod K. Aggarwal and Min Gyo Koo.
well as a focus on mega-FTAs to rationalize the noodle bowl of accords that both facilitate and impede trade, with their varying provisions.

Second, growing protectionism in Western markets poses a threat to East Asia’s outward focus. An expanding regional production network centered on China has reduced the dependence of other East Asian countries on the Western market. Yet the US and EU remain critically important final destinations for East Asian exports processed and assembled with intermediate parts in China. The present backlash against open trade in the Western world could seriously damage the trade triangle among 12 East Asian countries, China, and the West. The current anti-Trans Pacific Partnership (TPP) sentiment in the US provides a clear manifestation of this trend.

Third, while China remains the largest importer for most East Asian exports, this is changing. According to the WTO (2016), China’s recent import contraction has been caused by fewer imports of manufactured products from its East Asian neighbors as well as lower prices for oil and other commodities. In addition, manufactured products as the dominant component of Chinese exports have found a shrinking Western market over the past few years. China’s dependence on Western markets remains significant, at more than 16 percent on average, but Figure 3 shows a clear downward trend. The simultaneous declines in China’s imports from its Asian neighbors and its exports to the West are clearly correlated.

The following sections discuss the challenges in more detail and examine East Asian responses.

**THE TROUBLED WTO AND THE RISE OF ALTERNATIVE TRADE ARRANGEMENTS**

The so-called San Francisco system, codified through the 1951 San Francisco Peace Treaty between the Allies and Japan, provided East Asian countries with a unique institutional mix of bilateralism and multilateralism. It offered America’s East Asian allies access to the US market in return for a bilateral security alliance with the US. It also encouraged East Asian countries to participate in the global trading regime underpinned by GATT. Indeed, all 13 East Asian countries are members of the WTO (GATT’s successor), and nine were founding members. This system benefitted most East Asian nations and thus created few incentives for them to develop regional arrangements until the mid-1990s. For East Asia, the multilateral trading regime and other informal business networks centered on ethnic ties and alliance relationships provided a sufficient institutional architecture for its export strategy (Aggarwal and Koo 2008).

While benefitting from the open trading system, East Asian countries are still criticized for their protectionist practices — especially non-tariff barriers.2 But the focus on the WTO by East Asian countries as the sole institutional forum to liberalize trade has come under challenge as well. With growing concerns about the slow progress of the Doha Round, East Asian countries have sought alternative trading accords as insurance. Although the WTO reached an agreement in November 2014 on trade facilitation, both protectionist rhetoric and trade-restrictive measures are on the rise, and by December 2015, the Doha Round was essentially being declared dead.

The most important locus of trade accords is the active pursuit of a web of bilateral FTAs or mega-FTAs (Ravennaill 2001; Aggarwal and Koo 2006, 2008; Dent 2006; Solis, Stallings and Katada 2009; Aggarwal and Lee 2011).3 The Japan-Singapore Agreement for New Age Economic Partnership, agreed in October 2001, ushered in a series of bilateral FTAs in the following years, including agreements between South Korea and Chile (2003), and Japan and Mexico (2004).4 In addition to pure bilateral accords, so-called ASEAN+1 agreements also proliferated. In February 2003, China signed an FTA framework agreement with the 10 ASEAN members, pledging free trade by 2010, which has now been implemented. Japan followed by starting negotiations in October 2003, but South Korea jumped ahead and signed an FTA with ASEAN in May 2006. As of 2015, the number of FTAs specific to Asia was around 40. If trans-regional accords with countries outside Asia are included, the number rises to over 120. In addition to their geostategic value, both bilateral and ASEAN+1 accords have been seen as a catalyst by East Asian policymakers to reform their trading regimes and other informal business networks.

Yet bilateral FTAs, with their varying provisions, can also lead to significant discrimination and impede trade. Indeed, this growing complexity provided one of the key motives for countries to turn to mega-FTAs—multi-lateralized FTAs that involve a large number of participants across vast distances. The goal of these agreements has been to rationalize the multiplicity of bilateral FTAs.

Concluded by 12 Pacific Rim countries in October 2015, but still to be ratified, the Trans-Pacific Partnership (TPP) has become the center of cross-regional trade policy in the Asia-Pacific region. Alongside the US and Canada, the accord includes three Latin American countries (Chile, Mexico and Peru), four Southeast Asian countries (Brunei, Malaysia, Singapore and Vietnam) and three traditional US partners in the region (Australia, Japan and New Zealand). The TPP would create a free trade area encompassing 800 million people and almost 40 percent of global GDP (Office of the United States Trade Representative 2015).

The origins of the TPP are illustrative of the importance of small trading countries in driving the trade agenda forward. The first step toward a Pan-Pacific trade accord was broached in the 1960s, but with the launch of the Asia-Pacific Economic Cooperation (APEC) forum in 1989, further impetus was given to this effort. Yet, given APEC’s lack of an institutional mechanism to negotiate trade agreements, as well as its large membership of 21 economies, efforts to promote a Free Trade Agreement of the Asia Pacific (FTAAP) faced strong headwinds (Aggarwal 2016).

Meanwhile, the Trans-Pacific Strategic Economic Partnership Agreement, known as the P4, begun in 2002 by Chile, New Zealand and Singapore, with Brunei joining the negotiations in 2005, began to move forward. This P4 agreement called for trade liberalization that went beyond traditional border barriers to include such elements as the regulation of intellectual property rights, rules of origin and government procurement — often referred to as “behind-the-border” measures. The
P4 FTA left the door open for other countries in the region to join. The US was the first to take up this invitation. In September 2008, the administration of US President George W. Bush signaled its intent to become part of the P4, as part of its own Asian engagement strategy. Soon thereafter, Australia, Peru and Vietnam announced their intention to participate (Aggarwal 2016).

In November 2009, the administration of President Barack Obama affirmed that it intended to take part in TPP negotiations and made it the centerpiece of US trade policy as well as its so-called pivot to Asia. Although negotiations have been concluded, TPP ratification is hardly a foregone conclusion. A number of specific areas of the agreement, particularly provisions requiring that these disputes will continue to fester as the TPP moves toward ratification. These include concerns about the US imposing its intellectual property rules on other states; controversy over pharmaceuticals, including the length of protection that biologics will receive; currency manipulation issues; and the treatment of state-owned enterprises. In addition, the TPP’s Investor-State Dispute Settlement (ISDS) clause, which enables foreign companies to sue national governments in binding arbitration for regulations that may diminish profitability, has proven contentious. As we note in the next section, the growing anti-trade sentiment more generally has also cast doubts on TPP’s ratification, particularly in the US, leading the Obama administration to overshoot the agreement based on a security rationale (Aggarwal 2016).

In response to the US move toward mega-FTAs, China has also been actively pursuing intra- and cross-regional trade accords. The most important new institutional development endorsed by China centers on the creation of a Regional Comprehensive Economic Partnership (RCEP), which consists of 16 members and is entering its 15th round of negotiations in October 2016. This grouping brings together the 10 ASEAN countries and six major regional economic partners — Australia, China, India, Japan, South Korea and New Zealand (Aggarwal and Koo forthcoming).

In terms of proposed institutional strength, RCEP is likely to remain weak, both in terms of the degree of institutionalization and the hardness of rules. RCEP draws on ASEAN’s original norms of consensual decision-making and mutual non-interference in the domestic affairs of member states, but has not become more deeply institutionalized along the lines of ASEAN efforts, as noted above. Although RCEP has discussed a wide range of trade issues, it is likely to follow East Asian traditions in containing elements of “sign first” and negotiate later (Aggarwal and Koo forthcoming).

RISING PROTECTIONISM IN THE WEST

Although declining as a destination for East Asian exports, the US and the EU still account for about 32 percent of their exports. This, in turn, raises the question of East Asia’s vulnerability as the shadow of protectionism looms larger than ever before in the sluggish Western economies. A wholesale protectionist revival is unlikely, nevertheless, anti-globalization sentiment poses significant danger for the East Asian economies.

The Brexit referendum and US presidential candidacy of Donald Trump are the latest signs of a wave of populist politics washing over the world. The UK’s decision to leave the EU in June 2016 is most likely to dampen consumer and business sentiment in Western Europe, resulting in further deepening of recession and fiscal crisis there. Against the backdrop of rising protectionist sentiment in the US, the prospects for ratification of the TPP by the US Congress (and the other signatories) appear ever less certain. The origins of this populist vogue lie in the global macroeconomic imbalances that burst forth during the global financial crisis in 2007-2008 and subsequently resulted in severe economic hardship, particularly in the rich world (Economist Intelligence Unit 2016a).

According to the WTO’s trade monitoring report released in July 2016, the volume of world trade continued to grow slowly in 2015, at 2.7 percent, roughly in line with world GDP growth of 2.4 percent. Despite positive growth in trade volume terms, the current dollar value of world merchandise exports declined severely by 14 percent, as export prices fell by 15 percent. Along with protectionist rhetoric, WTO member countries have in fact shown greater appetite for actual protectionism, as illustrated by the growing number of new trade-restrictive measures (WTO 2016: 66).

This protectionist pressure is increasingly being felt by low-cost exporters, especially in East Asia. Higher trade barriers are most likely to dampen exports, investment and job creation (Economist Intelligence Unit 2016b). After reaching the fastest rate of growth, at 31.7 percent, in 2010 (as compared to a 19.2-percent decrease in 2009), growth of East Asian trade has fallen significantly, with a decrease of 10.7 percent in 2015. Intra-regional trade also peaked at a growth rate of 33.2 percent in 2010, and dropped suddenly by 8.4 percent in 2015 compared to the previous year (International Monetary Fund 1980-2015).

The China Risk and the Future of East Asia’s Trade Model

East Asia has thus far successfully adapted its trade policy to the first challenge resulting from the stalled multinational trade negotiations under the WTO. Instead of letting the market determine who will gain and who will lose from greater trade openness, East Asian countries have deliberately and proactively chosen the timing, speed and scope of trade liberalization by participating in bilateral and multilateral FTAs. It is unclear, however, whether East Asia will navigate the sea of growing global protectionism successfully, not only due to the high levels of uncertainty in Western markets, but also because of the so-called China risk inherent in the trade strategies and practices of East Asian countries.

China provided a shield for many East Asian countries in the global economic crisis of 2008-2009 by absorbing their distressed goods en route to Western markets. However, East Asia’s growing dependence on China is a double-edged sword. If China fails to properly address its growing economic woes, the negative impact of the China risk will be more significant on the rest of the region.

One way to measure the power relationship between two trading partners is by their trade dependence score, defined as the share of dyadic trade flow (the sum of imports and exports) relative to a country’s GDP. As Figure 4 overleaf shows, the trade dependence of East Asian countries on China has risen steadily, while other trade dependence scores have been falling in recent years. This means that China’s economic slowdown would inflict severe economic troubles on its East Asian trading partners.

According to the WTO’s review of China’s trade policy for the period 2014-2016, China’s economic growth slowed, as indicated by its real GDP growth rate of 6.9 percent in 2015 compared to 7.3 percent in 2014 and 7.7 percent in both 2012 and 2013. The Chinese government is aware that some risks to future growth and development persist, including increasing aggregate debt levels, rising production costs, insufficient financing for small- and medium-sized enterprises (SMEs), oversupply in some industries and shortages in others, and structural bottlenecks (WTO 2016).

The chain reaction from the shrinking Western market can be minimized as long as China’s domestic demand remains strong. However, domestic credit expansion and rising incomes that once supported robust domestic demand face growing uncertainties in today’s China.
CONCLUSION AND IMPLICATIONS
What options do East Asian countries have in the face of growing Western protectionism and problems in the WTO? What is the best way to challenge their export-oriented strategies? For China, one answer has been to shift to a greater domestic focus, investing in the western part of China and using the newly formed Asian Infrastructure Investment Bank (AIIB) to promote development in Central Asia, in particular, to increase market opportunities for its companies. As noted, China has also continued to promote trade accords, including bilateral FTAs and multilateral agreements such as RCEP. But negotiations on the latter have been slow, with the presence of India and other somewhat protectionist countries.

For other East Asian countries, lowering trade dependence on China, while attractive, is not a good short-term option due to the structure of East Asia’s production system. Instead, East Asian countries need to focus on upgrading current and prospective trade agreements among themselves while continuing their efforts to boost domestic demand and generate more jobs in order to prop up employment. And for those countries that are involved with the TPP, while the prospects currently look grim for its passage, a new president in the US and inevitable modifications in the accord as it currently stands may continue to provide access to the critical North American market.

Vinod K. Aggarwal is Travers Family Senior Faculty Fellow and Professor and Director of the Berkeley APEC Study Center at the University of California, Berkeley. Min Gyo Koo is Associate Professor at Seoul National University. Their work has been supported by the National Research Foundation of Korea Grant funded by the Korean Government (NRF-2011-330-B00200).

REFERENCES


Seoel, Michael (1990), Growth in East Asia: What We Can and What We Cannot Infer, Economic Issues 1, Washington, D.C.: International Monetary Fund.


We cannot infer...