

## **East Asian Trade and Investment Facilitation and Institutional Connectivity: Challenges and Obstacles**

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### 1. Challenges : What are the challenges?

The purpose of facilitation and institutional connectivity is to expand intra-regional trade and investment. Then, are there any challenges in the expansion of intra-regional trade and investment? Currently, three ASEAN +3 FTAs are in effect in the East Asian region and Korea, Japan and China have already signed or are considering bilateral FTAs with individual ASEAN countries. In addition, these three major players of North East Asia are in the process of a joint study, for which the fifth meeting was held in Tokyo a few days ago and which is expected to conclude within the year. All of the above attest that even if there is no further progress on an EAFTA, the institutional connectivity within the region has made remarkable progress.

Intra-regional trade and investment are also on the rise. In 2001, Korea's export to the US was as much as 20.8% of total exports while those of Japan and ASEAN posted 30.4% and 18.0% respectively. The US has always been a determining force in the performance of the East Asian economy. However, the US' current share has decreased to 10.7%, 15.6%, and 8.7%, respectively. Even in China's case, exports declined to 18.0% from 20.4%. As a result, export shares of the US of ASEAN+3 decreased from 23.0% in 2001 to 14.3% in 2010.

Meanwhile, the share of exports to the ASEAN+3 has increased –increasing from 34.0% in 2001 to 42.5% in 2010 for Korea and from 34.0% to 42.2% for Japan. Although Japan marks the fastest speed of increase in the ratio of intra-exports, ASEAN's share of intra-exports has also increased from 40.5% to 45.5%. Therefore, with the exclusion of China, the majority of the ASEAN+3 countries saw an increase in the ratio of intra-exports, proving that connectivity has been strengthened via market activities. Simply put, there is an overall consensus of satisfaction under the current trade conditions, and no lingering doubts of what the future has in store.

Table 1 ASEAN+3's Export Share to Main Destinations

(Unit:%)

	US		China		ASEAN		ASEAN+3	
	2001	2010	2001	2010	2001	2010	2001	2010
Korea	20.8	10.7	12.1	25.0	10.9	11.4	34.0	42.5
Japan	30.4	15.6	7.7	19.4	13.5	14.7	27.4	42.2
China	20.4	18.0			6.9	8.8	28.5	20.8
ASEAN	18.0	8.7	4.3	11.0	19.0	21.5	40.5	45.5
ASEAN+3	23.0	14.3	5.5	9.9	13.5	13.5	32.6	34.1

Source: Calculated by author with ITC

In the case of China, the declining trend in the ratio of intra-regional trade does not pose a serious threat due to the recent significant increase in total exports to the East Asian region. The main reason behind the decline in China's exports to East Asia was the sluggish demand for imports due to Japan's slow economic growth. Regardless, China has also increased its market share in Japan from 14.5% in 2000 to 22.2% in 2009. In the ASEAN market, China took a 5% share in 2000, but doubled it in 2005 to 10.5%, finally posting 13.4% in 2009. In particular, its market share in Vietnam, Cambodia, and Myanmar showed a higher proportion than other countries.

Table 2 China's Market Share in the ASEAN+3's Import

(Unit:%)

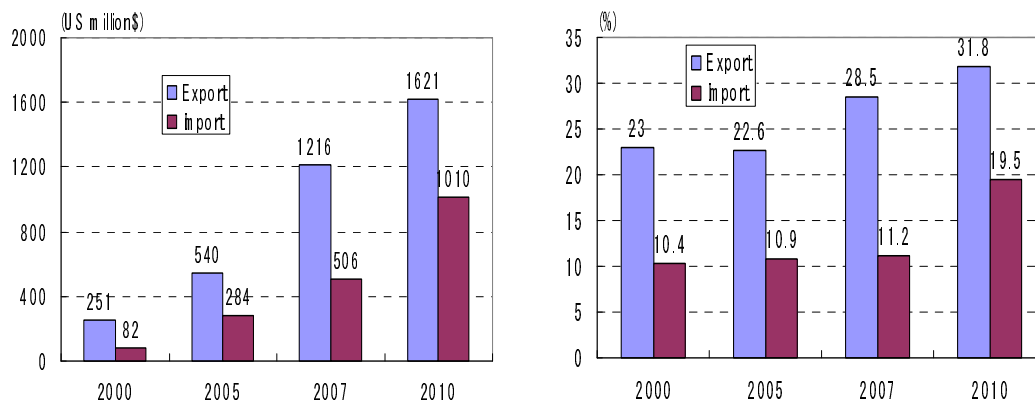
	2000	2005	2009
Korea	8.0	14.8	16.8
Japan	14.5	21.0	22.2
ASEAN	5.0	10.5	13.4
- Singapore	5.3	10.3	10.6
- Malaysia	3.9	11.6	14.0
- Thailand	5.5	9.4	12.7
- Indonesia	6.0	10.1	14.7
- Philippines	2.3	6.3	8.8
- Vietnam	9.0	16.0	23.5
- Cambodia	7.9	16.6	22.6
- Lao PDR	5.5	9.1	14.3
- Myanmar	18.0	28.7	35.4
- Brunei	1.2	3.5	6.0

Source: ITC

Another example with regards to China is that geographically, trade among neighboring countries is sharply increasing in East Asia. In particular, Yunnan

province's trade with Vietnam, Thailand, Laos, and Myanmar has increased significantly. Total export and total import to these 4 countries increased from US\$0.25 billion and US\$82 million in 2001 to US\$1.6 billion and US\$1.0 billion in 2010 respectively. Consequently, from Yunnan's total exports, the share of exports to these countries increased from 23.3% and 10.4% in 2001 to 31.8% and 19.5% in 2010, thus showing the rapid progress of the regional integration between China and East Asia.

**Figure 1 Yunnan Province's trade with Indochina 4 countries**



Source: Chinese Customs

## 2. Yes, there are challenges

Regardless of the increase in the amount of trade in the ASEAN +3 countries; there are two major challenges to overcome in order to achieve investment liberalization. First, formal linkage is achieved at the connectivity level, however, actual connection is rarely maintained, for instance, the utilization of FTAs in trade. In the case of Korea, the actual utilization rate of the Korea-ASEAN FTA is very low. According to a KCS (Korea Custom Services) survey, a mere 28.7% of bilateral exports and 58.5% of bilateral imports were affected by the FTA.

One of the main reasons for the low utilization rate is companies' lack of understanding of the FTA Rules of Origin and the complex customs procedures in some countries. There have also been reports that although they have knowledge of the preferential tax rates, the customs authorities in certain developing countries in South East Asia choose to ignore them.

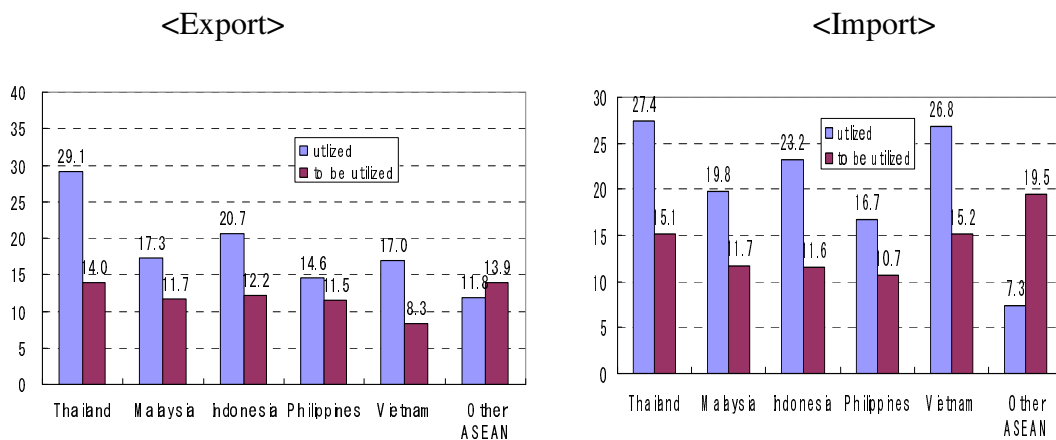
Table 3 Utilization of FTA in Korea

	Export utilization	Import utilization	Utilization
Chile(2004.4)	90% level	90% level	High
Singapore(2006.6)	-	93%	High
ASEAN(2007.6)	28.7%	58.5%	Low
India(2010.1)	16.4%	44.7%	Low

Source: Korea Customs Service

The low utilization rate of FTAs is not just a problem in Korea. According to a JETRO survey in Japan (Oct. 2010 survey), Japanese companies also failed to take advantage of the various FTAs. In Japan’s case, the reasons for such a low utilization rate are that Japan has already invested in ASEAN extensively, therefore, the proportion of inter-trade between the parent company and subsidiaries is high, also, not only are companies blind to the necessity of FTAs due to pre-existing customs-free trade and subsidies, but they are also oblivious of the FTA system.

Figure 2 Utilization of FTAs by Japanese companies



Source: JETRO

The second challenge is the slow progress of the various discussions regarding the regional architecture. For instance, although East Asia simultaneously concluded research on an EAFTA and a CEPEA, it failed to proceed with further follow-up research due to indecisiveness between an EAFTA and CEPEA. Furthermore, the East Asian Summit proposed by the EAVG and EASG for an East Asian community, is in reality much different.

### 3. Obstacles

Then, what causes such challenges? There are many reasons. For instance, liberalization in trade investment widens the economic gap among the ASEAN member countries. However, two points merit special attention.

#### (1) Uncertain benefits of ASEAN

The fact that the liberalization of trade and investment would be beneficial for the whole East Asian region could be correct in economic terms. However, certain aspects are hard to accept for politicians who manage the economy with the countries respective interests in mind. Firstly, among the ASEAN+3 countries, those with relatively low economic development have recorded enormous trade deficits. For example, countries such as Cambodia, Philippines, and Vietnam have large trade deficits which have placed a burden on economic management. In the Philippines' case, trade deficits were countered with the export of the labor force, despite strong opposition from political leaders. However, for countries that do not even have such measures, there is an inevitable accumulation of foreign bonds. Therefore, whether these countries will benefit from the trade liberalization of the ASEAN region is far from definite.

Table 4 Ratio of GDP to Trade balance in major ASEAN Countries

(unit:%)

	2000	2002	2004	2005	2006	2007	2008	2009
Cambodia	-14.7	-13.8	-12.7	-16	-14.8	-15.6	-16.4	n.a
Laos	-11.8	-8	-13.9	-11.5	-5.1	-3.4	-5.9	-7.3
Myanmar	-0.1	0	0	0.1	0.1	0.1	0.1	0
Philippines	-7.9	-7.2	-6.5	-7.9	-5.7	-5.8	-7.7	-5.5
Vietnam	1.2	-3	-5	-4.6	-4.6	-14.6	-14	-8.5

Source: ADB

Another important fact is related to the growth of China in the intra-regional trade of East Asia. With advances in China's industrial technology and foreign direct investment, the nation's competitiveness in export commodity has also improved. As a result, China's export specialized industry has expanded and replaced imports. Based on an analysis of trade specialization, assuming anything above 0.5 is an export specialization commodity and anything below -0.5 is an import specialization commodity, it has been calculated that the number of export specialization products continues to increase while

that of import specialization products is decreasing in China's trade with East Asia.

When comparing China's exports to the ASEAN region with those to Korea and Japan, the amount of export specialization goods exceeds the amount of import specialization goods. Specifically, in the trade with ASEAN, Korea and Japan, the number of export specialization goods has increased significantly while import specialization goods have failed to do so. In other words, the changes that have been brought about with the progress of market openness have been beneficial to China in terms of trade with ASEAN countries.

Table 5 Number of China's Export and Import Specialization Products (HS 4-digit)

		2001	2003	2005	2007	2009	2010
Korea	Over 0.5	510	521	561	603	575	576
	Below -0.5	441	376	319	276	288	286
Japan	Over 0.5	515	519	522	516	582	566
	Below -0.5	422	431	386	356	383	393
Singapore	Over 0.5	630	634	697	743	753	756
	Below -0.5	233	233	190	134	125	127
Malaysia	Over 0.5	666	681	723	788	791	771
	Below -0.5	215	197	178	153	149	156
Thailand	Over 0.5	591	632	686	724	713	732
	Below -0.5	254	219	191	189	188	188
Indonesia	Over 0.5	688	724	769	795	789	810
	Below -0.5	188	185	167	154	138	154
Vietnam	Over 0.5	750	840	837	860	878	866
	Below -0.5	108	93	92	97	108	100
Philippines	Over 0.5	721	772	783	802	814	840
	Below -0.5	117	110	102	106	116	103

Source: Calculated by author with Chinese Statistics

The asymmetric feature of the China-ASEAN trade can be understood in yet another dimension. It is widely known that the increase in trade within the ASEAN+3 regions is attributed to the expansion of parts and components in the electronic and machinery industries. In other words, as fragmentation and production sharing spurs production in East Asia, there also been an increase in intra-regional trade. However, China's overwhelming productivity is transforming the structure of intra-regional trade. In fact, as China's competitive edge in export grows, it is emerging as the main export nation of parts and components. Specifically, within the ASEAN+3 regions, if Japan was the hub of this trade in the past, the trend is now shifting to China.

In 2009 Indonesia, Malaysia, and Thailand, excluding the Philippines, recorded trade surpluses and the latter two even posted surpluses in the electronics and machinery industries. However, such achievements have taken a turn for the worse, especially with regards to parts and components. All four countries recorded a considerable amount of trade deficit. The majority of the deficit in Indonesia and Malaysia were with China while that of the Philippines and Thailand were with Japan. Moreover, when comparing with the deficit structure of 2005, these nations excluding Malaysia have all generated a huge deficit with Japan. Interestingly, in 2000, the ASEAN deficit in relation to China was negligible.

In other words, due to improvements in industrial technology, base expansion of the components industry and trade liberalization within East Asia, China now has the potential to surpass Japan and grow into the primary outlet of the components industry. However, the problem is that this generates a negative impact on the industries in the ASEAN region because while Japan's components are based on relatively sophisticated technology, the main focus of China's components is scale. Under the circumstance, it is difficult to see that a China-ASEAN FTA could be qualitatively enhanced.

Table 6 ASEAN's parts and components trade balance

(unit:100million dollars)

		1980	1985	1990	1995	2000	2005	2009
Indonesia	Total balance	110.7	83.3	38.4	47.9	286.1	279.6	196.8
	Electronics & machinery(SITC 7&8)	-36.9	-34.1	-70.0	-59.7	105.5	71.5	-111.3
	- Parts and components	-6.1	-12.4	-25.2	-49.2	9.2	-4.1	-71.6
	-China	-0.1	-0.1	-0.2	-0.8	-0.5	-3.7	-29.6
	-Japan	-2.2	-3.1	-12.2	-28.8	-6.9	-13.3	-14.3
	-Korea	0.0	-0.3	-0.3	-0.8	-0.4	-0.9	-4.6
Malaysia	Total balance	21.8	30.4	2.1	-32.7	169.4	273.3	336.2
	Electronics & machinery(SITC 7&8)	-28.1	-26.8	-29.2	-28.6	136.8	167.2	172.1
	- Parts and components	-7.9	-17.4	-30.1	-75.6	-0.4	-46.2	-59.9
	-China	0.0	0.0	0.0	-1.4	-3.4	-32.2	-36.0
	-Japan	-2.4	-4.7	-14.0	-42.6	-26.1	-24.0	-21.5
	-Korea	0.0	-0.4	0.0	-1.4	0.0	-13.1	-10.0
Philippines	Total balance	-25.1	-8.2	-48.6	-110.4	10.7	-82.3	-74.4

	Electronics & machinery(SITC 7&8)	-14.3	-0.2	-13.4	-41.3	110.3	45.2	68.0
	- Parts and components	-5.3	-3.2	-11.2	-27.1	-77.6	-143.6	-56.2
	-China	0.0	-0.0	-0.0	-0.3	0.5	-3.9	-9.1
	-Japan	-1.8	-1.0	-5.0	-9.8	-24.5	-43.1	-15.8
	-Korea	-0.0	0.0	-0.1	-1.4	-6.2	-5.2	-5.0
Thailand	Total balance	-29.5	-21.2	-103.0	-143.4	69.0	-80.5	187.3
	Electronics & machinery(SITC 7&8)	-17.5	-13.1	-40.2	-50.3	85.1	104.3	200.0
	- Parts and components	-5.5	-6.3	-34.8	-65.8	-7.5	-43.8	-52.2
	-China	-0.1	0.0	-0.2	-1.4	-2.2	-17.7	-29.5
	-Japan	-4.0	-5.1	-26.9	-52.6	-22.9	-38.6	-47.7
	-Korea	0.1	-0.1	-0.4	-0.7	-1.0	-5.3	-6.0

Source: Calculated by author with ITC

## (2) Lack of Trust Among Nations

The lack of trust among the ASEAN+3 nations will be the most important long-term obstacle in accomplishing trade and investment facilitation and connectivity. Currently, it is widely recognized that ASEAN plays a central role in the ASEAN+3-centered institutional connectivity. However, the issue of the longevity of the validness of an ASEAN centrality is under question. Although ASEAN boasts a rich history and has accumulated a wealth of experience and knowledge concerning economic integration, it lags behind East Asia economically. And as a majority of issues concerning trade and investment liberalization and institutional ties are economic, this poses a problem for the economically weak ASEAN. Moreover, it is uncertain whether ASEAN sincerely desires to create institutional ties in East Asia. ASEAN signed a FTA with India and is attempting to secure aid by taking advantage of the competition between China and Japan. It has also demonstrated that it is incapable of resolving problems arising from within. Furthermore, problems such as the Myanmar problem and the border dispute between Thailand and Cambodia have cast serious doubts over ASEAN's ability to lead China, Japan, and Korea to move forward in creating a community.

Despite ASEAN's questionable status and capability, China, Japan, and Korea still insist on an ASEAN centrality, the reason being the lack of cooperation and trust between the three East Asian countries. Japan, for example, has consistently expressed that East Asia must aim for a community based on an ASEAN+6 structure instead of an



ASEAN+3. Consequently, the current East Asia Summit Conference is vastly different from the first. The country that will most benefit from the growth of China and ASEAN+3 institutional ties is Japan. As can be seen from Table 1, Japan's share in ASEAN+3 exports has increased the fastest in the last 10 years, which leads to the question; how many Japanese economists actually believe in the feasibility of a CEPEA?

Then, what are the reasons for such a phenomenon? Mainly, it is due to China's failure to establish trust. Many believe that China's rise in economic influence extends to political and security aspects, which poses a threat. Although China claims good-neighborliness, whether or not its neighbors actually feel this way is a different matter. China's "good-neighborliness" can be witnessed in various territory disputes including the Vietnam-China and Philippines-China disputes over the South China Sea. And the conflict between China and the US has become daily fodder for the ASEAN+3 nations. Therefore, it is only reasonable to assume that the conflict between these two countries has left a huge imprint on the ASEAN+3 nations. As a result, the ASEAN+3 is attempting to gain stability via external connectivity rather than internal.

Even internally, the ASEAN+3 is focused on establishing external ties. Currently, Vietnam and Malaysia are negotiating to join TPP (Trans-pacific partnership). The reason behind such a move in Vietnam's case is that because of its geographical proximity to China, the development of its manufacturing industry is under threat from the increase in productivity of China's manufacturing sector. However, in the case of Malaysia, the reasons are much more complex due to its previous role as leader of the EAEC. TPP has also become a hot topic for Japan. Although talks of joining TPP have been temporarily suspended due to opposition from certain factions and the need to rebuild its national status in the aftermath of the tsunami, Japan maintains the belief that its economic recovery lies with the TPP. Furthermore, Japan also plan to join a US led TPP. In October 2010, Prime Minister Naoto Kan announced that Japan will join TPP through a policy address, and thereafter, the Cabinet approved Japan's participation in the data collection session with other TPP nations.

George Washington University's David Shambaugh argued in his article, 'Beijing: A Global Leader With 'China First' Policy,' that "ASEAN diplomats also complain about a new assertiveness in China's attitude towards regional multilateral institution building – arguing that until recently China had been content to allow ASEAN to "drive the car" of

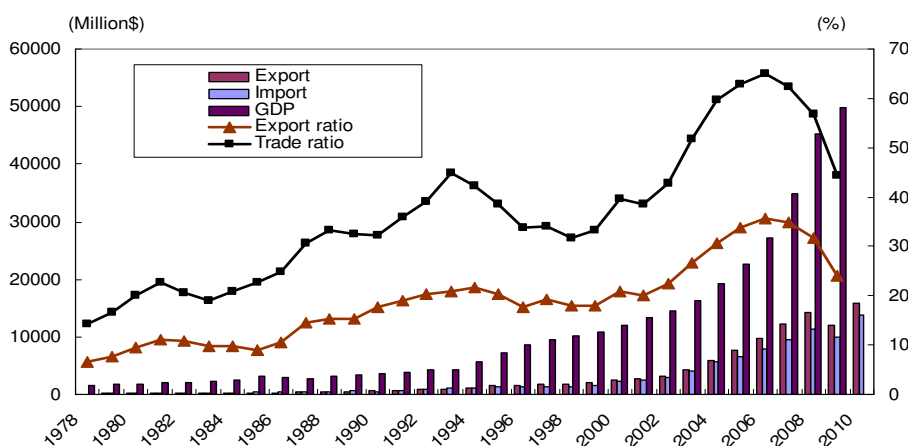
regional policy while remaining a passive passenger in the back seat. But recently, Southeast Asian diplomats note, “Beijing has climbed into the front seat, is holding the map, and trying to instruct ASEAN where to go.” It is only a matter of time, they observe, before Beijing seeks to taking over the steering wheel.” (Yale Global online, 29, June 2010). The article shows that despite the US’ mild opposition to the economic integration of East Asia, in reality, it also enjoys ASEAN’s high level of dependence.

#### 4. A ray of hope

Thankfully, there are reasons for hope. For instance, the three North East Asian countries have decided to finish their tripartite joint study. However, Japan seems to be hesitant to go further with the results of the study, thus, it remains to be seen whether a North East Asian FTA will progress smoothly. Regardless, all three countries will have to come to a decision before the tripartite summit which will be held in China next year.

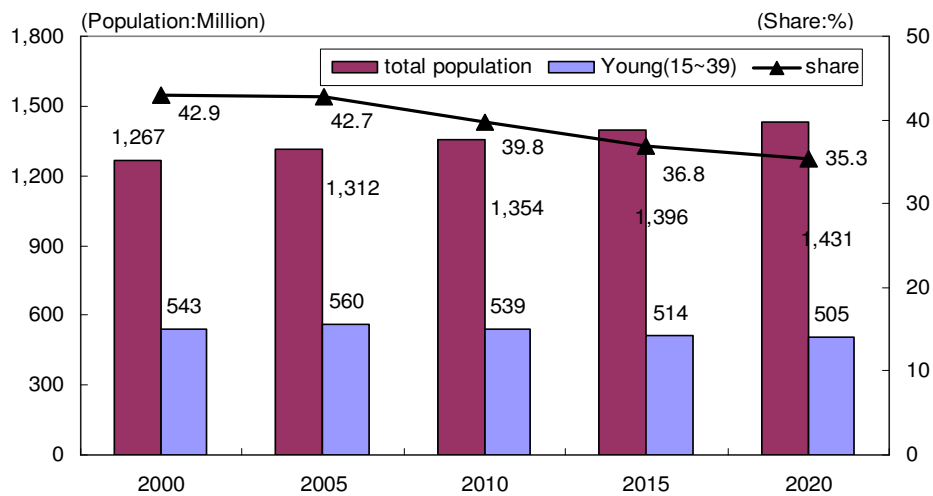
Moreover, changes in China’s business environment will be beneficial to South East Asia’s underdeveloped countries. It is assumed that China cannot continue to expand its economy with an export-led growth. Since the accession of the WTO in 2001, export volume has expanded explosively, and foreign economic reliance also increased until the financial crisis in 2008. However, after the crisis, the export to GDP ratio decreased due to the focus on the domestic market. China needs to further open its market in order to contribute to the world economic system. The Chinese government is also well aware of the problems related to an export-led growth model. In this aspect, China can be a new opportunity for East Asia. This is why transaction cost must be reduced.

Figure 3 Growth in domestic ratio in China



Considering the demographic structure of China, there is a possibility of wage hikes in China's manufacturing sector. In 2010, the 15-39 age-bracket able to work in the manufacturing sector decreased from 560 million in 2005 to 539 million, 38.9% of the total population. By 2015, this proportion is expected to decrease to 36.8%, and the working population will decline to 505 million. Likewise, these changes in demographic structure will cause an increase in wages in the Chinese manufacturing sector. It could be possible that production facilities will migrate to the inland area in order to cope with rising labor costs. However, some low-tech and labor-intensive industries, such as textiles and shoes, will find it difficult to even survive in the inland areas and will have to move to underdeveloped countries in South East Asia where the cost of labor is much lower.

**Figure 4 Number and ratio of Youth in China**



Source: UN Population Programme DB.