Trade and Economic Integration in the Asia-Pacific Region

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Historical Background

- 1950s – 60s: wide-spread import-substituting policies
  - Distortions and inefficient use of resources
  - High bureaucratic costs
  - Limiting industries to produce in efficient scales

Historical Background

- High-performance Asian economies demonstrated the benefits of active participation in trade.
  - Soon after WWII: Japan.
  - 1960s: four smaller Asian economies (four tigers): Hong Kong, Taiwan, South Korea, Singapore.
  - 1980s: Malaysia, Thailand, Indonesia.
  - 1990s: Mainland China.

Recent Developments

- Export-orientation ≠ free trade
  - Except Hong Kong, many of the Asian economies were still adopting fairly substantial import restrictions.
  - In fact, supporting exporting industries also caused distortions and wasteful use of resources, just like supporting import-competing industries.

Recent Developments

- ASEAN and AFTA
  - Eliminating intra-regional tariffs of products in the Common Effective Preferential Tariff Inclusion List.
  - 2005: tariffs on ~99% of products in the Inclusion List of the ASEAN-6 (five starting members + Brunei Darussalam) → < 5%.
  - > 60% of these products → 0 tariffs.

Recent Developments

- The average tariff for ASEAN-6: > 12% in 1960s → 2% in 2009
- Newer member countries: tariffs on ~81% of their Inclusion List → 0% – 5% range
- Highly Sensitive List (i.e. rice) and the General Exception List (products out of the Inclusion List): reviewed from time to time.
- Eliminating non-tariff barriers

Recent Developments

- Financial and monetary integration
- Trans-ASEAN transportation network: inter-state highway and railway networks; Singapore to Kunming Rail-Link
- Connectivity of telecommunication services
- Intra ASEAN trade / total trade: ~10% (1960s) → >20% (2000)

- ASEAN + 3

Recent Developments

- APEC
  - ~ half of world's GDP, trade, and population
  - To reduce tariffs and other trade barriers
  - Bogor Goals: free and open trade and investment (2010 for industrialized economies; 2020 for developing economies)
  - Promotes high-quality FTAs or RTAs
  - Reducing costs of transactions (e.g., simplifying customs procedures)

Recent Developments

- APEC Business Advisory Council (ABAC): taking opinions and recommendations from the private business sector.
- Tariffs: ~17% (1989) → ~5% (2007) [developed member economies → < 5%]
- Limitation: non-binding commitments, undertaken on voluntary basis
- Effects of the WTO Doha Development Agenda (DDA)

Challenges

- Income distribution implications
  - While trade closes the income gap between poor and rich countries, it may widen the income distribution within each countries.
  - Opposition from unskilled labor in developed countries and capital intensive and land intensive sectors (agriculture) in developing (including Asian) countries.

Challenges

- Other disturbances
  - Market downturns: Asian financial crisis, bursting of IT bubbles, financial tsunami
  - Terrorism: in US, Europe, South and Southeast Asia, etc.
  - Health problems: SARS, H5N1, H1N1, etc.
  - Natural disasters: earthquakes, tsunamis

Theoretical Foundation

- Identical homothetic taste

$$U_j = \left[\sum_i \int_{n_i} c_{ij}(z)^{(\theta-1)/\theta} dz \right]^{\theta/(\theta-1)}$$

$$P_j = \left[\sum_i \int_{n_i} p_{ij}(z)^{1-\theta} dz \right]^{1/(1-\theta)}$$

Theoretical Foundation

- Free trade (ignoring transportation costs and barriers such as tariffs)

$$C_j = s_j Q_w$$

- Countries specialized in differentiated goods:

$$X_{ij} = s_j Y_i$$

Theoretical Foundation

$$T_{ij} = 2Y_i Y_j / Y_w$$

- Helpman (JJIE 1987), Hummels and Levinsohn (QJE 1995), Debaere (JIE 2005)

Theoretical Foundation

- But in reality, trade costs cannot be ignored.
- Redding and Venables (2004)

$$p_{ij} = p_i t_{ij}$$

$$X_{ij} = N_i \left(\frac{p_i t_{ij}}{P_j} \right)^{1-\theta} Y_j$$

Empirical Analysis

- We use the panel data approach to estimate the determinants of exports from country i to country j.
- Our data set contains data of 112 countries for the period of 1988-2008.
  - No. of observations in each year = 12,432

Empirical Analysis

- Bilateral trade data are obtained from IMF, *Directions of Trade.*
- *Gross National Income (GNI) is obtained from the* World Bank, *World Economic Outlook, various issues*.
- We first examined the simplest case—the case of free trade with no transaction cost.

	OLS Without Group Dummy Variables		Least Squares with Group and Period Effects		Random Effects Model	
Constant	-5.5163	**	-5.0669	**	-5.5019	**
	(0.0675)		(0.2903)		(0.0814)	
GNI_I	0.9203	**	0.9173	**	0.9183	**
	(0.0106)		(0.0109)		(0.0105)	
GNI_J	0.7189	**	0.6169	**	0.7174	**
	(0.0106)		(0.0668)		(0.0130)	
Adjusted R-squared	0.4895		0.5235			