Trade Integration and Growth of Regional Value Chains: The Future Looks Promising

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Japan suffered one of the worst natural disasters just as the global economy was struggling to recover from the economic downturn that had not been seen for several decades. Although the economic downturn since 2008 impacted most economies, including the more vibrant economies in the Asia-Pacific region, perhaps the sole redeeming feature of the developments that took place in its aftermath was that the major economies did not resort to trade protectionism. In fact, countries in the Asia-Pacific region have continued to explore ways of deepening their level of economic integration and this happened despite the fact that the multilateral trade liberalisation being attempted under the aegis of the World Trade Organization (WTO) has not been making much progress.

Economic integration in the Asia-Pacific region has been moving on several tracks. The road map for economic integration among the East Asian Summit Members was provided by the Track II study, Comprehensive Economic Partnership for East Asia (CEPEA), which was accepted by the leaders in their meeting in 2009. At the same time, leaders of the APEC member countries decided to take concrete steps toward realization of a Free Trade Area of the Asia-Pacific (FTAAP) in adopting the Declaration, "The Yokohama Vision - Bogor and Beyond," at the conclusion of the Summit in 2010. According to the leaders, the FTAAP, which is a major instrument to further APEC's regional economic integration agenda, "should be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership, among others." Towards this end, APEC is being seen to be making important and meaningful contributions "as an incubator of an FTAAP by providing leadership and intellectual input into the process of its

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development, and by playing a critical role in defining, shaping, and addressing the "next-generation" trade and investment issues that FTAAP should contain.

These regional integration efforts are being reinforced by a series of comprehensive economic partnership agreements that are taking place at the bilateral level. This process has seen active involvement of India, which, for a long time was a reluctant participant in the economic integration efforts. Over the past few years, India has been one of the most proactive countries, having initiated or concluded comprehensive economic partnership agreements with most of the EAS members. The most recent of these agreements to get implemented is the Japan-India agreement, an agreement which will enable businesses in both countries to explore new vistas of collaboration. With its partners in the ASEAN, India has adopted a two-track approach: an agreement covering the goods sector with the ASEAN as a whole was concluded in 2009 and this is being followed by a series of agreements with a number of individual countries, Malaysia, Indonesia and Thailand.

Integration among countries in the region can give rise to tremendous opportunities if they are backed by well organised value chains. Fragmentation of production is now a well-established business model and such ventures can see a widening of their scope through the formalisation of the economic integration agreements taking place at various levels. Once triggered, regional value chains (RVCs) can strengthen the trade integration, in other words, they mutually reinforce each other. Experiences of several emerging economies have shown that regional trade could be substantially enhanced by the RVCs. Studies examining benefits accruing from regional trade liberalisation, particularly through PTAs/FTAs, have estimated that the magnitude of gains could be between 2-4% of GDP[1] in Asia. In contrast, gains from the operation of the RVCs are expected to be much higher than that obtaining from regional trade liberalisation. Some estimates show that that the RVC-induced gains induced could be as high as 10 to 20 times of trade liberalisation (Moran, 2002)[2].

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[1] Mohanty, S.K. and Sanjeeb Pohit (2007), "Welfare Gains from Regional Economic Integration in Asia: ASEAN+3 or EAS," RIS Discussion Paper No. 126, available at www.ris.org.in; Kawai, Masahiro and Ganeshan Wignaraja (2007), "ASEAN+3 or ASEAN+6: Which Way Forward?" ADBI Discussion Paper No. 77. Tokyo: Asian Development Bank Institute.

[2] Moran, Theodore H. (2002), Strategy and Tactics for the Doha Round: Capturing the Benefits of Foreign Direct Investment, Manila, Asian Development Bank.

Recent trends in exports corroborate the key role played by the RVC in expediting production and trade activities. In the early part of the present decade, growth rate of global export expanded four times higher than that of global output. Exports of some sectors expanded more swiftly than others on account of their strong linkages with the value chains; prominent among and these are textiles & apparel, electronic and auto components.[3]

Some of the fast growing regions of the developing world have taken the fast movers' advantage from the RVCs. The regional and sectoral polices of ASEAN and Mercosur have enabled them to take advantage from the production networks present in their regions. ASEAN members have signed a series of regional agreements including ASEAN Industrial Cooperation (AIC) scheme in 1981, Brand-to-Brand Complementation (BBC) scheme in 1988 and ASEAN Industrial cooperation organization (AICO) scheme in 1996 for the auto industry; and these agreements, in effect, promoted their national auto industries.[4] The complementarities generated by these agreements have spilled over to other sectors. Moreover, emergence of China as the production hub for the East and South-East regions has expedited this process further. An increase in production sharing as a result of vertical specialization has led to acquiring of competitive advantage in the downstream stages of production. Gradually China has emerged as the assembly centre for many exports from the region. In the process, the structure of intra-regional export of the ASEAN members moved to more of high-technology and high-value added sectors such as electrical machinery, transport equipments and precision equipments. With higher level of specialization in production, no country in the region could have the comparative advantage in all products or all stages of production. With the rise of trade interdependence, intra-regional trade increased voluminously. Similarly, two member countries in Mercosur, namely Brazil and Argentina have agreed to cooperate in the auto sector and signed an Agreement in 1990. The process of bilateral trade liberalization followed in phases since then. Within a period of six years, the bilateral flow of vehicle trade increased from US$ 18 million to more than on US$ 1 billion. Gradually a regional automotive production system developed in the region, based on a division of labour in auto sector spreading to other parts of the region.

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[3] UNCAD (2004), Trade and Development Report, Geneva, United Nations Conference on Trade and Development.

[4] Humphrey, John and Olga Memedovic (2003), 'The global automotive industry value chain: what prospects for upgrading by developing countries', Sectoral Studies Series, Vienna, UNIDO.

One of the least integrated regions of the world, the South Asian region, is also showing signs of change through the emergence of RVCs. For example, India has already into the production and export activities of the RVC in textiles & apparel and auto component sectors. Similarly Nepal and Pakistan are also into other RVCs. The region has the potential to integrate itself in several RVCs, particularly in sectors like textiles and apparels, leather, food processing, automobiles, pharmaceuticals, including traditional medicines, information technology (IT) and IT enabled services. Local firms are gradually engaging themselves in efficiency seeking activities, ranging from production to packaging and also to distribution channels. Some of these sectors in individual countries have received policy impetus from the national governments: sectoral liberalization being one such policy measure. Harmonization of trade facilitation measures is also taking place within the region to reduce trade transaction cost. Trade and FDI policies are liberalized along with IPR regimes. Trade policy regimes are gradually liberalized but harmonization of policy liberalization across regional economies is not properly coordinated. In isolated manner, policies of the regional economies are set for promoting its local firms to join the RVC.

The contribution that RVCs can make in promoting regional trade has been documented extensively in the recent JETRO-WTO study.[5] This study has pointed out that in 2009, Asia imported more intermediate goods than it exported, which shows that this region has a high level of engagement in production chains. Developing countries from the region were the principal contributors to this outcome since the more advanced economies like Japan and Korea exported more intermediate goods than they imported. China has been playing the role of the assembler within the region, with its imports in intermediate goods accounting for more than 33%of Asian imports of intermediates in 2009.

This study also provided evidence to the effect that the list of countries participating in these value chains is increasing. In recent years, India and Viet Nam also had markedly higher shares of intermediates in their imports than in their exports. The opposite was the case for Japan and Chinese Taipei. Chinese Taipei had the highest share of intermediate goods in its exports among the major Asian traders.

[5] JETRO and WTP (2011),Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks,

For most of the major Asian trading countries, the share of intra-regional imports of intermediate goods increased significantly between 1995 and 2009. In case of Hong Kong, over 83% for its imports in 2009 were intermediate products. For almost all economies, intra- Asian trade accounted for more than one-half of their trade in intermediate products. The solitary exception was India: intermediate goods accounted for 40% of both its exports and imports in 2009. The importance of the regional market has remained more or less stable for China's imports. However, it fell for its exports from 70% in 1995 to 51% in 2009. This is linked to China's growing integration in world markets (the growing global diversification of China's markets, both for final and intermediate goods) and the generally strong increase in China's trade volume. China's trade surplus is generally explained by this large volume of processing trade activities. As a result, the country has positive trade balances with developed economies in processing trade, while it runs trade deficits with most of its East-Asian partners. In case of India, its intra-Asian share in total exports of intermediate goods has remained almost unchanged between 1995 and 2009, at around 40%, while its share of imports has increased.

The emergence of new players in the production networks that have emerged in several sectors or are emerging in many others, provides enough scope for optimism that the losses suffered from the disruption of the value chains caused by the tsunami can be overcome. With countries like India joining in the efforts to deepen the level of integration among countries of the region, Asia-Pacific economies will continue to perform strongly, thus providing the hope that they will be the anchor which would prevent its destabilisation.