

CONNECTION SERIES: 1 OF 4

## Asian Intra-Trade Connectivity: Strength in diversity

Asia’s diversity has enabled it to create integrated supply chains that supported global trade over the last 25 years. In the next 25, Asia’s diversity will create a dynamic ecosystem of buyers and sellers, in an era where Asia increasingly caters to its own final demand.

Asia is a key driver of global trade growth, contributing around 62% of the growth in global trade in 2017<sup>1</sup>. This is made possible by Asia’s integrated supply chains which has over the years, evolved along with the changing environment.

Asia’s production hubs were initially set up in the 1980s to meet the demands of Japanese manufacturers. The Plaza Agreement (1985) had caused the yen to appreciate sharply against the USD, which increased the cost of domestic production and drove Japanese manufacturers to relocate their production bases in Asia. Asia’s factories then became even more cost competitive following the sharp depreciation of the Asian currencies during the Asian crisis in 1997. Subsequently, China became the “factory of the world” after it became a member of the World Trade Organisation (WTO) in 2001.

### How has trade in Asia evolved?





### CHANGING ROLES

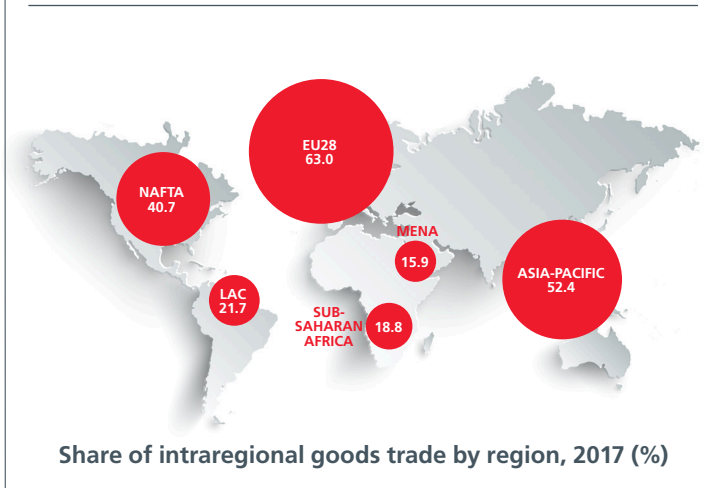
Asia's cross-border supply networks are shaped by the countries' comparative advantages and specialisations. The networks also reflect the region's structural diversity and heterogeneity. Back in 2005, the Newly Industrialised Economies (NIE) of Korea, Singapore and Taiwan produced and exported large amounts of computer and electronic equipment. Given their natural endowments, Indonesia and Thailand exported crude oil and rice respectively. China, on the other hand, was a big exporter of labour-intensive manufactured goods<sup>2</sup>.

Fast forward to today, economic growth and the rise in wages have changed the roles of various economies. Simon Liu, CIO of Eastspring Taiwan notes that Taiwan has shifted away from labour intensive exports such as textiles and household appliances in the 1990s to higher value output including semiconductor chips, smartphones and petrochemicals in 2010s.

In 1996, the gap between the wages in Japan and China was 46 times. By 2016, this has narrowed to four times. With the rise in China's wages, Vietnam became the hub for manufacturing labour-intensive exports, attracting significant investments from Japan and Korea. Meanwhile, through rapid industrial upgrading, more than 40% of China's total exports is now made up of electrical machinery, equipment and computers<sup>3</sup>.

Research states that as the per capita income of an economy rises, it should shift the share of its industrial output from primary to secondary, and then from secondary to tertiary industries<sup>4</sup>. Yet, despite the changing roles, Asia maintained strong trade links with each other. Research shows that Korea especially forged stronger value chain links

**Fig. 1: More than half of goods trade in the Asia-Pacific region is intraregional<sup>6</sup>**



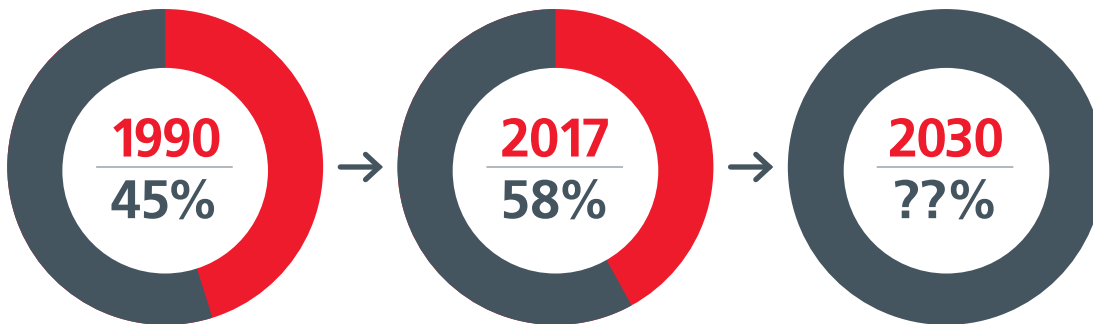
with India while ASEAN4 (Indonesia, Malaysia, Philippines and Thailand) maintained strong links with China, India and Singapore<sup>5</sup>.

Intraregional trade share reached a record of 57.8% (by value) in 2017, up from around 45% in 1990, reflecting the deepening trade ties within Asia. (See Fig. 1.)

While the European Union (EU) appears to be an even more tightly integrated trade entity with an intra-regional trade share of 63% (From Fig 1.), trade linkages within Asean are actually be denser. Asean's intraregional trade intensity index (TII) was 3.70 in 2017, higher than 1.90 for the EU<sup>7</sup>. A higher TII number implies that the region's trade is oriented more towards its member countries than towards the rest of the world. The difference arises because unlike the TII, the intraregional trade share suffers from a size bias. So the larger the region, the larger the intraregional trade share. Hence Asean's high TII reflects its dense production networks.

## Moving into an era where Asia produces for itself

### The rise of intraregional trade



#### THE TIES THAT BIND

The interdependence of the region's economies is a double-edged sword. The negative spillover from China's recent trade spat with the US is evident from the declining exports experienced by Taiwan, Singapore and Korea in the earlier months of 2019. With manufacturers looking for alternative locations to service the US market, Asia's supply chain is likely to undergo further changes, creating both winners and losers.

Yet at the same time, this interdependence may be a blessing. Rising income levels within Asia means that Asia is starting to produce more for its own consumption. With companies increasingly focused on speed to market and greater visibility across their entire supply chain, supply chains are becoming shorter and more localised. There is a new trend of firms building self-contained regional supply chains just to service Asian markets<sup>8</sup>.

#### STANDING SHOULDER TO SHOULDER

According to the International Monetary Fund (IMF), in an ambitious scenario where Asia eliminates goods tariffs and reduces non-tariff barriers on services to the world, Asia's GDP would rise on average by 12% and some economies could see output increases approaching 20%<sup>9</sup>.

Admittedly this is easier said than done. Japan's latest ban on selected Korean exports is a reminder that relationships may not always run smooth, even amongst neighbours. Asia however, has made some

progress in pushing for greater market access within the region. In 2017, ASEAN signed a Free Trade Agreement (FTA) with Hong Kong, China – the first ASEAN FTA signed in a decade. Meanwhile, the Regional Comprehensive Economic Partnership (RCEP) remains under negotiation. Parties to the negotiations include 10 ASEAN countries and trading partners Australia, China, India, Japan, Korea and New Zealand. If concluded, RCEP would be the world's largest trading bloc – home to nearly 50% of the global population and more than 30% of global trade. Woong Park, CIO of Eastspring Korea, believes that RCEP will increase the region's portion of global trade and result in better resource allocation, which will in turn benefit many Asian economies including Korea.

With protectionistic sentiment on the rise in the west, it is timely for Asia to reconsider its current export model, from one that is oriented towards meeting final demand in other regions, to a model that is increasingly catered to meeting final demand within the region. This will once again be made possible by Asia's diversity, where different stages of growth, varying income levels and specialisations create a dynamic ecosystem of buyers and sellers.

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Sources: <sup>1</sup>Trade and the Global Value Chain. <sup>2</sup>Patterns and Global Value Chains in East Asia. <sup>3</sup>2018 figures. <http://www.worldstopexports.com/chinas-top-10-exports>. <sup>4</sup>The law of Petty-Clark. <sup>5</sup>Over 2010 – 2017. Asian Economic Integration Reports. 2018. <sup>6</sup>Asia' future is now. McKinsey Global Institute. 2019. <sup>7</sup><https://artnet.unescap.org>, Asia Regional Integration Centre. <sup>8</sup>Asia's future is now. McKinsey Global Institute. 2019. <sup>9</sup>Asia at the forefront: Growth challenges for the next decade and beyond. Internal Monetary Fund. October 2018.

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