

Comments on the Freund-Ornelas Paper

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1. Overall appreciation

- Extremely useful and instructive literature survey covering both theory and empirics
- Major conclusions: empirics matters
 - Trade diversion
 - Theory: can be serious or negligible
 - Empirics: trade creation dominates; less serious
 - Causality from regionalism to multilateralism
 - Theory: can be good or bad
 - Empirics: liberalization in regionalism seems to accelerate liberalization in multilateral context
 - Does regionalism undermine multilateralism?
 - Theory: can be in both ways
 - Empirics: ??

2. Contents of “trade creation”

- Gravity equation exercises
 - Detecting “crude” effects, including overall efforts of economic integration, together with tariff reduction
 - Theoretical/econometric underpinnings beyond “dummies” are required.
 - Is empirical decomposition implementable?
 - The timing of actual trade liberalization and FTA utilization may matter though being not carefully conducted

- E.g., “trade creation” in East Asia in 2001-2007 is due to
 - Direct effects of trade liberalization by AFTA and China’s WTO accession; effects of other FTAs came later
 - AFTA => reshuffling of production sites for plant-level economies of scale => more trade
 - Trade liberalization and WTO+ => more viable for production networks => more trade
 - Growth in productive sectors => employment creation => growing middle-income population => more demand for tradables => more trade

	Japan	Korea	China	ASEAN	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam	CLM	India	Australia	New Zealand
Japan		○ (suspended)	△	⊙: 2008 -	⊙: 2008	⊙: 2008	⊙: 2006	⊙: 2008	⊙: 2002	⊙: 2007	⊙		○	○	
Korea	○ (suspended)		△	⊙: 2007 -					⊙: 2006				⊙	○	○
China	△	△		⊙: 2005 -					⊙: 2009				△	○	⊙: 2008
ASEAN	⊙: 2008 -	⊙: 2007 -	⊙: 2005 -	⊙: 1993 -	(1992)	(1992)	(1992)	(1992)	(1992)	(1992)	(1995)	(LM:1997/C:1999)	⊙	⊙: 2010 -	⊙: 2010 -
Brunei	⊙: 2008			(1992)		(1992)	(1992)	(1992)	(1992)	(1992)	(1995)	(LM:1997/C:1999)			⊙: 2006
Indonesia	⊙: 2008			(1992)	(1992)		(1992)	(1992)	(1992)	(1992)	(1995)	(LM:1997/C:1999)		△	
Malaysia	⊙: 2006			(1992)	(1992)	(1992)		(1992)	(1992)	(1992)	(1995)	(LM:1997/C:1999)	○	○	⊙
Philippines	⊙: 2008			(1992)	(1992)	(1992)	(1992)		(1992)	(1992)	(1995)	(LM:1997/C:1999)			
Singapore	⊙: 2002	⊙: 2006	⊙: 2009	(1992)	(1992)	(1992)	(1992)	(1992)		(1992)	(1995)	(LM:1997/C:1999)	⊙: 2005	⊙: 2003	⊙: 2001
Thailand	⊙: 2007			(1992)	(1992)	(1992)	(1992)	(1992)	(1992)		(1995)	(LM:1997/C:1999)	△	⊙: 2005	⊙: 2005
Vietnam	⊙			(1995)	(1995)	(1995)	(1995)	(1995)	(1995)	(1995)		(LM:1997/C:1999)			
CLM				(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)	(LM:1997/C:1999)				
India	○	⊙	△	⊙			○		⊙: 2005	△				△	△
Australia	○	○	○	⊙: 2010 -		△	○		⊙: 2003	⊙: 2005			△		⊙: 1983
New Zealand		○	⊙: 2008	⊙: 2010 -	⊙: 2006		⊙		⊙: 2001	⊙: 2005			△	⊙: 1983	

Notes: ⊙: signed or being effective, ○: under negotiation or agreed to negotiate, △: feasibility study or preparatory talks. The year indicates when the concerned FTA was in force. "-" after the year means that some ASEAN countries are under the corresponding FTAs in force and other countries follow later. Dark blue indicates FTAs signed before or in the 1990s, blue indicates FTAs signed in the first half of the 2000s, and light blue indicates FTAs signed in the second half of the 2000s. For some FTAs, their status in this table is based on the agreement of trade in goods; negotiations may be still ongoing over other areas such as investment and services even if the agreements are identified as those signed or being effective here. The year in parenthesis shows the year for the corresponding ASEAN country to be the member of ASEAN/AFTA.

Sources: Websites of trade ministries in each country and others including JETRO website (<http://www.jetro.go.jp/world/>).

Source: Kimura (2009b).

Export structure of East Asian countries

(a) By-destination shares and annual average growth rates

	1994	1997	2001	2007	1994-1997	1997-2001	2001-2007
Within East Asia	43.6%	45.3%	43.5%	45.1%	5.6%	-0.9%	14.2%
United States	30.2%	28.1%	29.0%	22.6%	1.8%	1.0%	8.9%
European Union	17.2%	17.5%	18.0%	18.4%	4.9%	0.8%	14.0%
Others	9.0%	9.1%	9.5%	13.8%	4.4%	1.3%	20.9%
Total	100.0%	100.0%	100.0%	100.0%	4.3%	0.1%	13.5%

(b) By-commodity shares and annual average growth rates

	1994	1997	2001	2007	1994-1997	1997-2001	2001-2007
Machinery parts and components	24.0%	24.7%	25.8%	24.3%	5.3%	1.2%	12.4%
Machinery finished products	29.5%	28.1%	27.2%	26.4%	2.6%	-0.6%	13.0%
Other manufactured goods	31.4%	31.2%	30.6%	32.2%	4.0%	-0.3%	14.5%
Non-manufactured goods	15.1%	16.0%	16.3%	17.1%	6.3%	0.6%	14.4%
Total	100.0%	100.0%	100.0%	100.0%	4.3%	0.1%	13.5%

East Asia includes ASEAN10, Japan, Korea, China, Australia, New Zealand, and India.

Annual average growth rates are calculated by using export data deflated by the US CPI (2005 basis).

Data source: UN Comtrade.

Source: ERIA (2010).

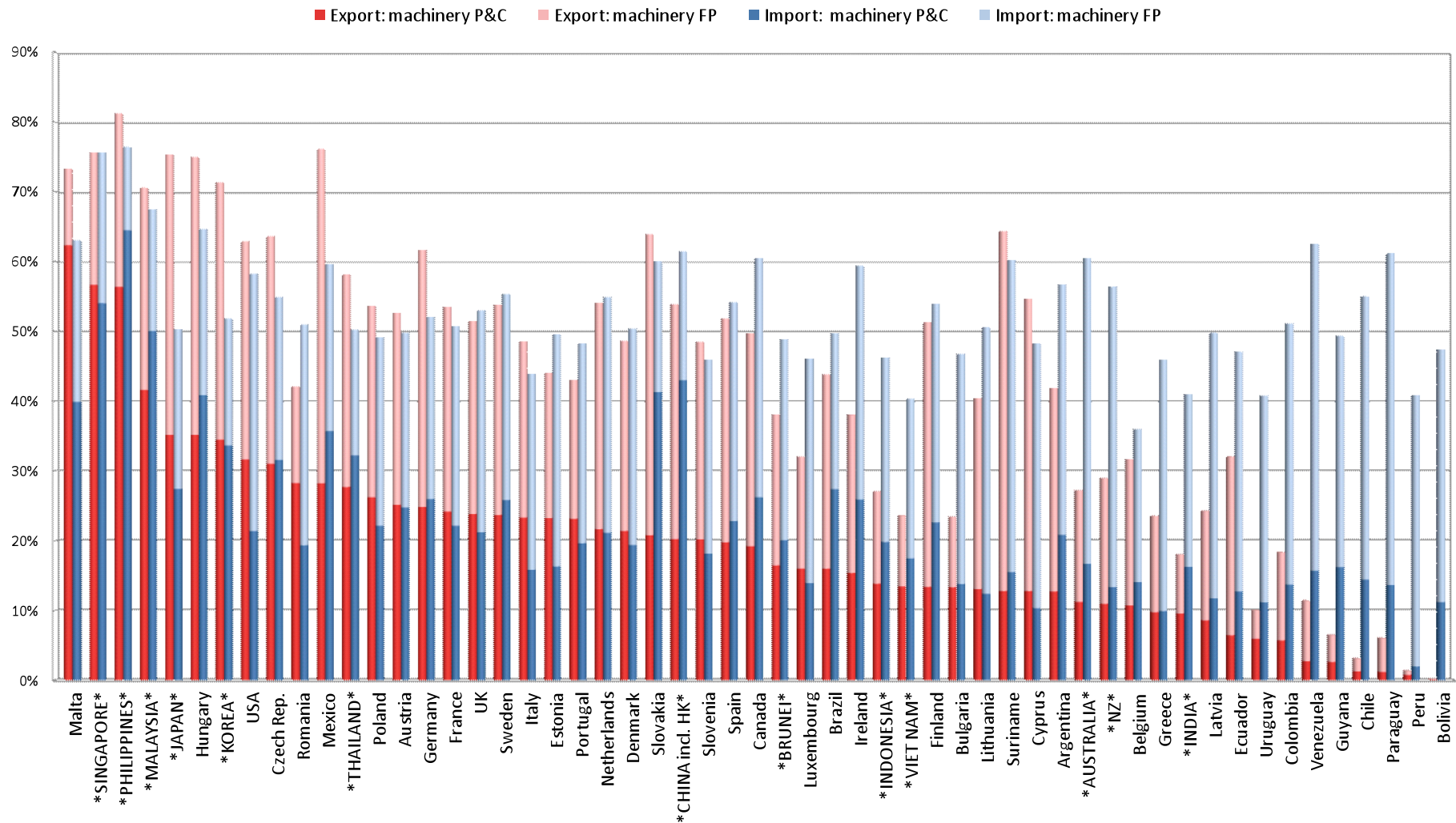
Table 8

The number of production sites of Japanese electric companies in ASEAN

	Refrigerator			Electric washer			Ventilator			Microwave		
	2000	2009	Change	2000	2009	Change	2000	2009	Change	2000	2009	Change
ASEAN	17	14	-3	14	10	-4	8	7	-1	4	2	-2
Thailand	7	6	-1	5	4	-1	4	3	-1	2	2	0
Malaysia	2	0	-2	2	0	-2	1	1	0	1	0	-1
Philippines	2	1	-1	3	2	-1	1	1	0	0	0	0
Indonesia	5	4	-1	3	2	-1	2	2	0	0	0	0
Singapore	0	0	0	0	0	0	0	0	0	1	0	-1
Vietnam	1	3	2	1	2	1	0	0	0	0	0	0
	Electric cooker			Electric fan			Air conditioner			Cum. # of production sites		
	2000	2009	Change	2000	2009	Change	2000	2009	Change	2000	2009	Change
ASEAN	9	7	-2	10	6	-4	17	12	-5	79	58	-21
Thailand	5	6	1	5	3	-2	7	6	-1	35	30	-5
Malaysia	1	1	0	1	1	0	3	3	0	11	6	-5
Philippines	1	0	-1	2	1	-1	3	2	-1	12	7	-5
Indonesia	1	0	-1	2	1	-1	3	1	-2	16	10	-6
Singapore	0	0	0	0	0	0	1	0	-1	2	0	-2
Vietnam	1	0	-1	0	0	0	0	0	0	3	5	2

Source: Sukegawa (2009).

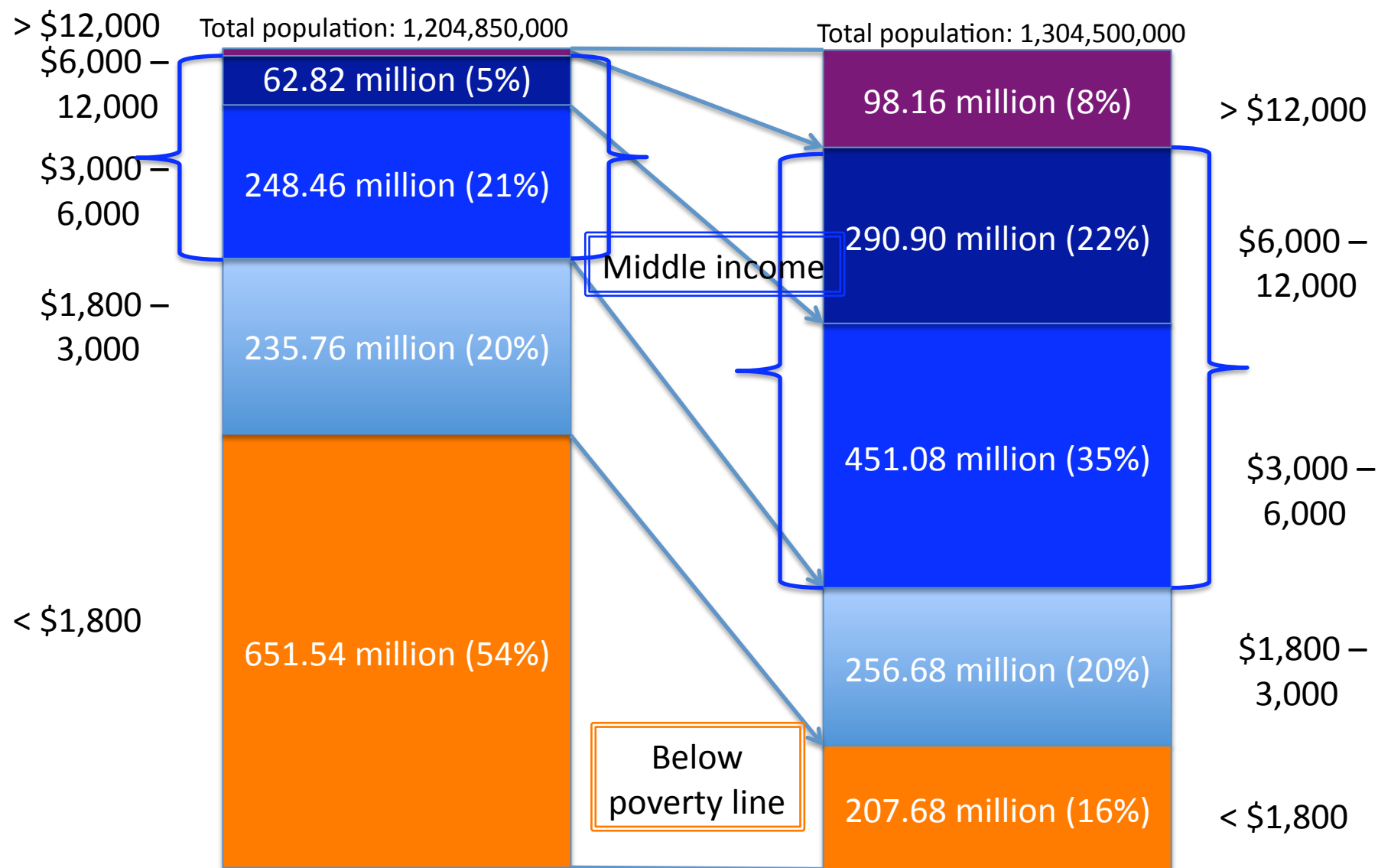
➤ Shares of machineries in total exports/imports of manufacturing goods to the world in 2007



Source: Kimura and Obashi (2010).
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Population by income groups: China

(US dollars; 2005 PPP adjusted; annual total income of a family with four members)

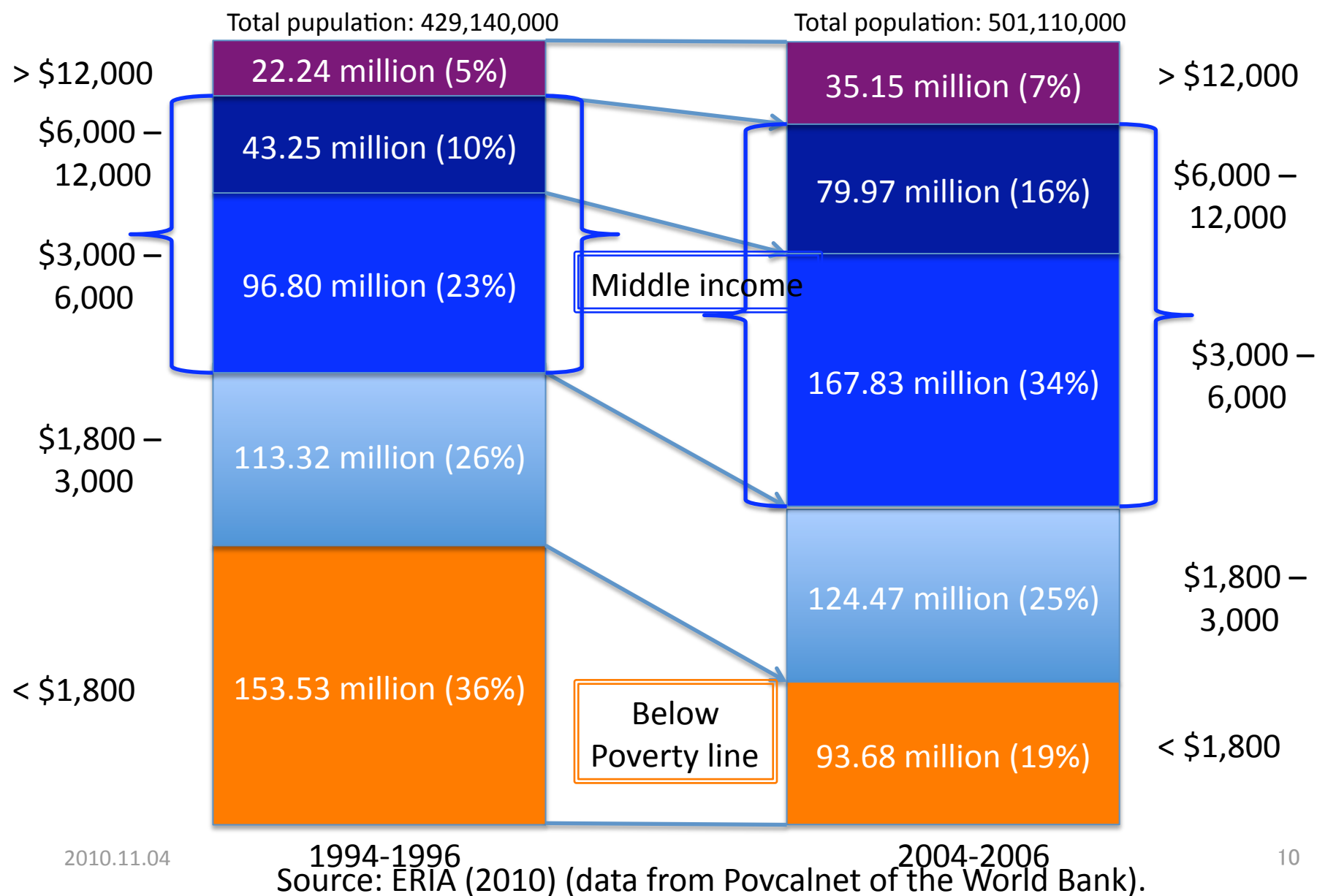


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1995
Source: ERIA (2010) (data from Povcalnet of the World Bank).

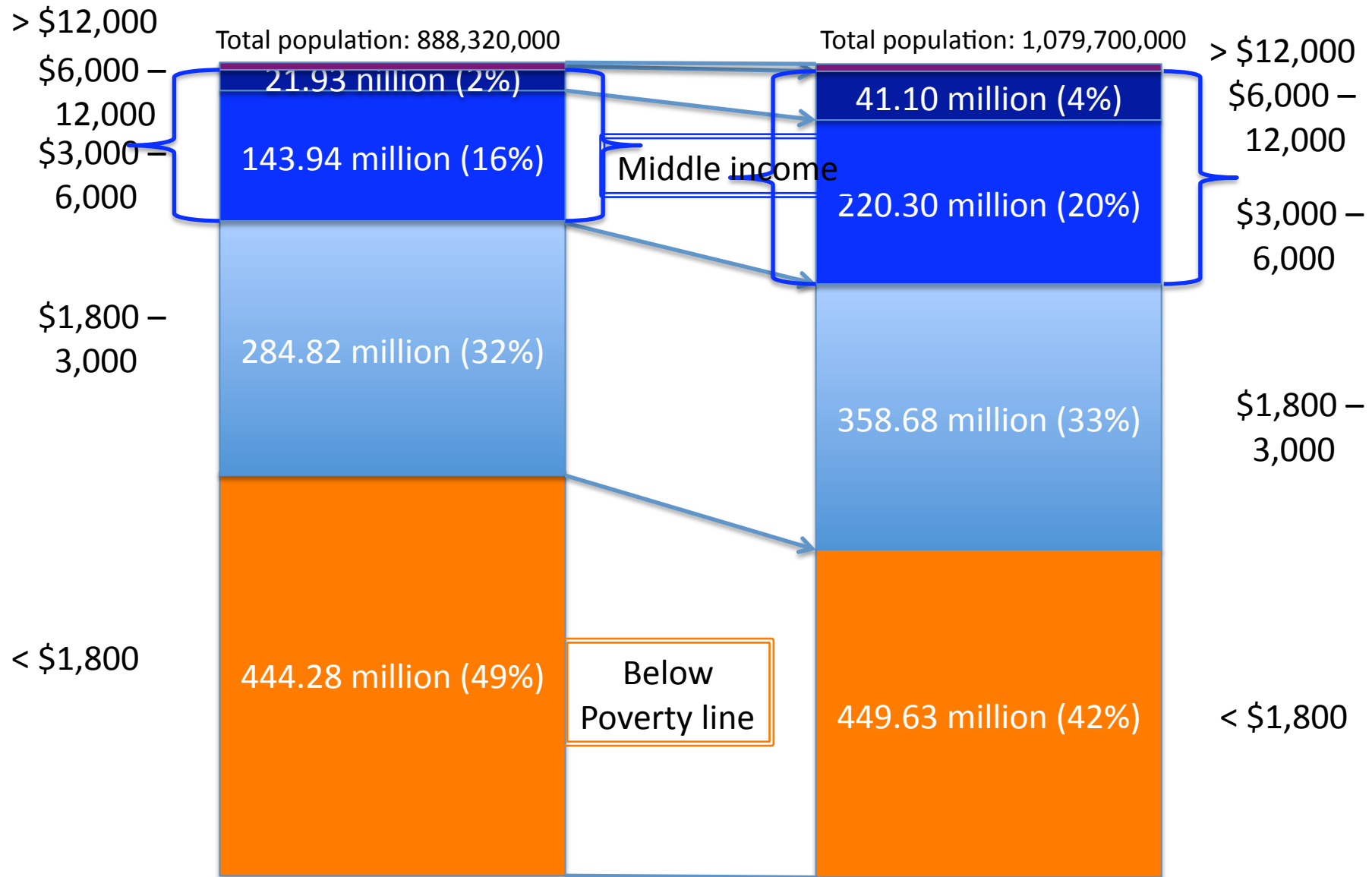
2005

Population by income groups: ASEAN (excl. Singapore, Brunei, and Myanmar)
(US dollars; 2005 PPP adjusted; annual total income of a family with four members)



Population by income groups: India

(US dollars; 2005 PPP adjusted; annual total income of a family with four members)



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1993
Source: ERIA (2010) (data from Povcalnet of the World Bank).

2004

- The nature of the economy (i.e., the existence of production networks) and WTO+ (functional tie-ups by other policy channels) can make trade creation much larger than the standard theoretical intuition.
- Possible strong points of regionalism.

3. “Trade diversion” in the real world

- The threat perceived by the 3rd country’s industry is real, but both the structure (not a simple “countries A=B and C”) and remedies are diversified.
 - Structure, e.g., for Japan,
 - NAFTA and EU-Mexico FTA (against US and EU firms in Mexico);
 - ASEAN-China FTA (rather political, leadership issues in the region);
 - US-Korea and EU-Korea FTAs (against Korean firms; classic!)
 - Responses
 - #1: FDI in a country with the concerned outside-FTA
 - Strong weapon for FTA-concluding countries to attract FDI
 - » E.g., EU for electric appliances; Thailand for automotives
 - #2: expanding FTA networking (a sort of domino effects)
 - Flexibility of FTAs vis-à-vis CUs in sequencing works.
 - » E.g., Japan’s participation in TPP??

Proposed plurilateral FTAs in East Asia and Asia Pacific

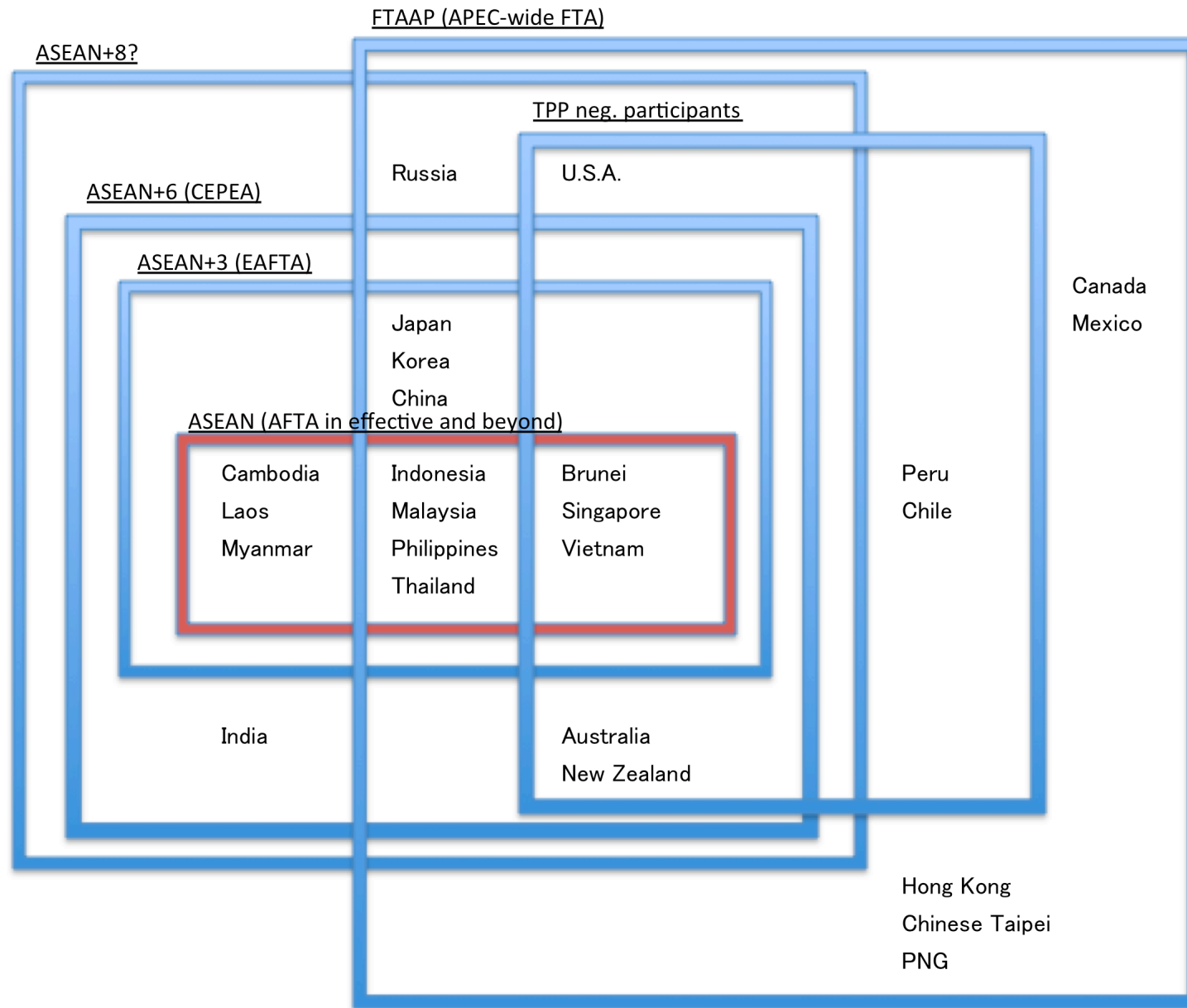
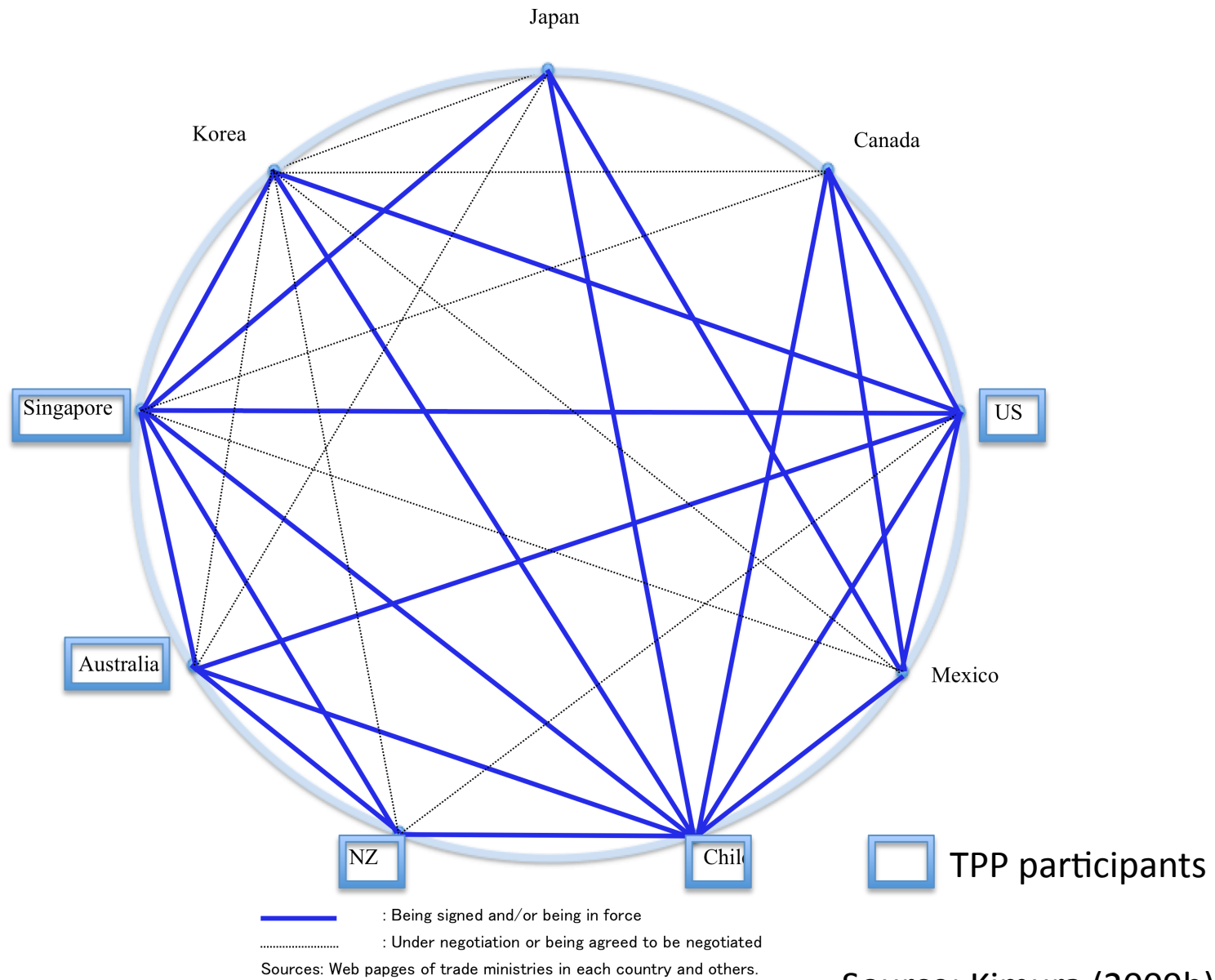


Figure 1
FTA networking among Asia-Pacific developed countries
(As of November 2009)



Source: Kimura (2009b).

- Does “middle power” in the world really lead FTAs with trade diversion as the political economy theory suggests (cf. EU)?
 - FTAs make a small advantage in head-to-head competition among the strongest.
 - Lobbying by “middle power” does not seem to be strong in East Asia; FTA formation of partners cannot be stopped; rather simple two-camp settings in the juggernaut story fits.
- Trade diversion or geographical boundary of production networks?
 - Geographical boundaries vary across industries: electronics vs. automotives
 - Unilateral liberalization for electronics vs. FTAs for automotives
 - Production networks in automotive sector by regions, i.e., China and ASEAN separately



Original source: Board of Investment, Thailand.

4. Incomplete liberalization is penalized

- An anecdote: dirty FTAs between Japan and ASEAN retaining a large part of agricultural trade protection
 - Background
 - Side payments allowed Japan to retain protection.
 - Delay in DDA is a necessary condition.
 - Each FTA pushes some new liberalization (juggernaut).
 - New development
 - Japan's FTA strategy loses the degree of freedom for going beyond East Asia.
 - May generate a break-through in the Trans-Pacific Partnership (TPP), with political consideration on China (domino).
 - Both domino and juggernaut effects seem to work strongly.

5. Rules of origin

- The paper rightly points out protectionism in ROO.
- The suggested scenario for “the simplest text” such as a single-digit VA method may not be realized.
- As a second-best choice, the co-equal system should be implemented.
 - Estevadeordal, Harris, and Suominen (2007), Medalla and Balboa (2009)
- The spaghetti/noodle bowl phenomena are not too serious; further facilitation is of course needed though.
 - Microdata analyses: Kawai and Wignaraja (2009), Hayakawa, Hiratsuka, Shiino, and Sukegawa (2009)

RoO in AFTA, ACFTA, AKFTA, and AJCEP

RoO type	AFTA	ACFTA	AKFTA	AJCEP
WO	169	8	465	3
CC		1	61	1,344
CTH			2	434
CTSH				8
RVC(>40)			36	
RVC(40)	146	4,659	22	219
RVC(<40)			2	
CC + RVC(40)			2	1
CTH + RVC			4	
CC or RVC(40)	564	7	487	126
CTH or RVC(>40)			4	
CTH or RVC(40)	2,583	122	4,078	3,056
CTSH or RVC(40)	689		61	33
RVC(40) or Textile Rule		427		
CC or RVC(40) or Textile Rule	300			
CTH or RVC(40) or Textile Rule	327			
Total with alternate rules	4,463	556	4,630	3,215
NA	446			
Total	5,224	5,224	5,224	5,224

WO: wholly obtained

CC: change in commodity classification

CTH: change in tariff heading

CTSH: change in tariff subheading

RVC: regional value content

Source: Medalla and Balboa (2009).

6. WTO+

- The functional approach, rather than rule-making, in East Asia may provide some insights.
 - The target is clearly the improvement of investment climate and the promotion of industrialization.
 - Both within and outside of FTAs, functional elements are included.
 - E.g., trade facilitation, FDI liberalization/facilitation, economic institutions (i.e., IPR), hard and soft infrastructure development, fostering local firms/entrepreneurs, economic/technical cooperation, ...

7. Does the world come back to WTO?

- The enforcement of existing rules including dispute settlements is highly appreciated.
- WTO as a negotiation forum is at risk.
- Even if difficult, the coverage of policy modes should be expanded in order to catch up with globalization.

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