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The US crisis and the future of East Asian production sharing

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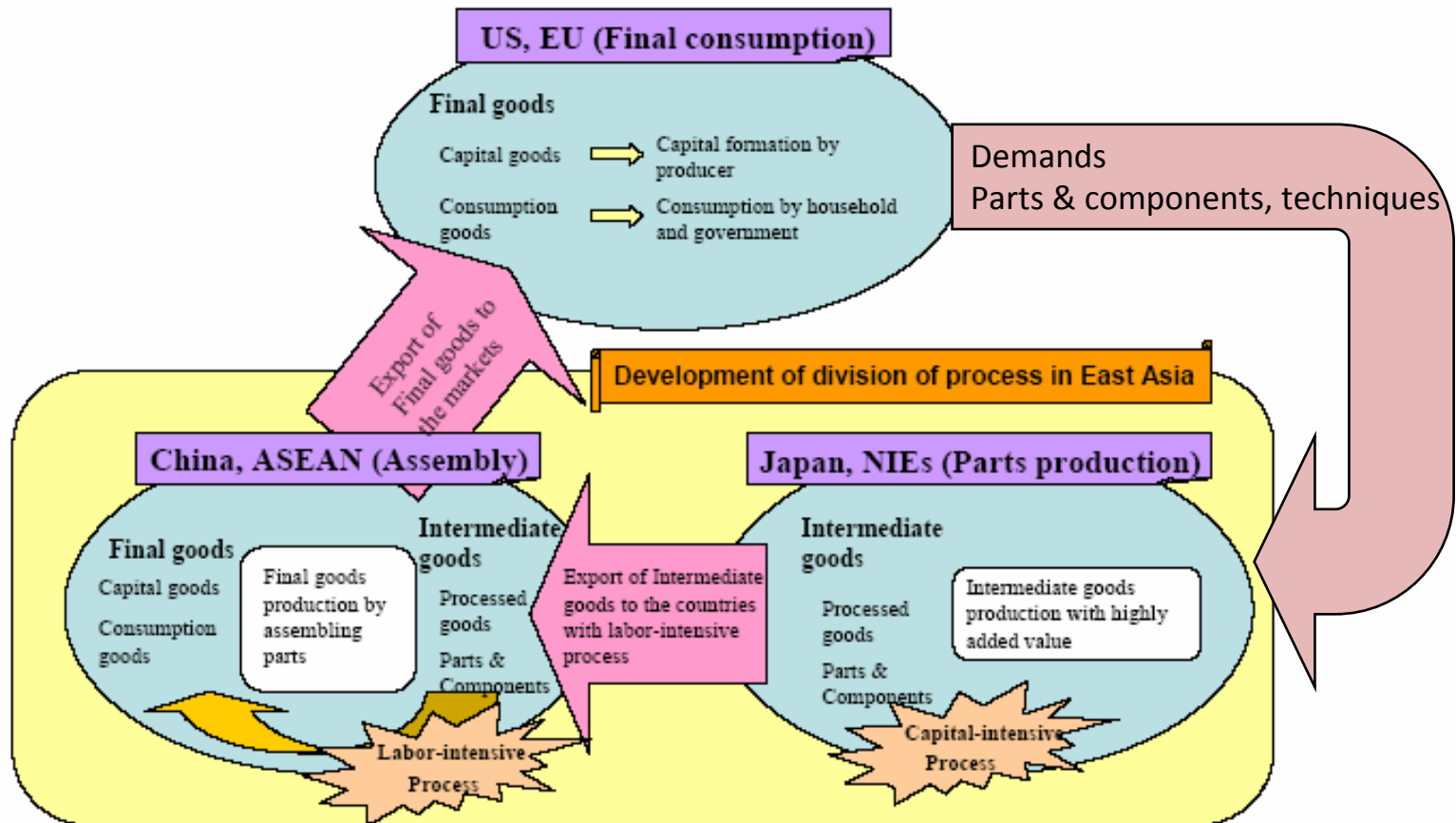
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The Crisis in the U.S. and the Future of East Asian Production Sharing

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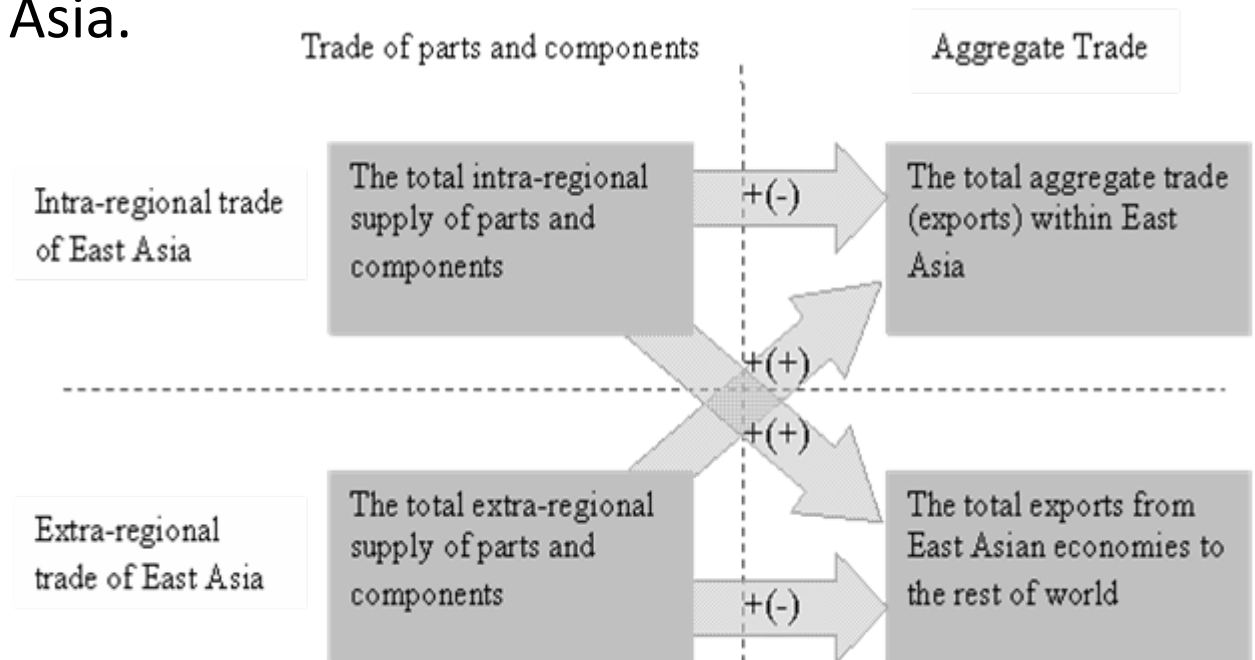
The triangular trading system



Source: METI

THE GLOBAL DIMENSION OF EAST ASIAN PRODUCTION SHARING

- The export-oriented economic growth
- The “import-supported” competitiveness
- Followers in technological progress
- The “dual” linkages between intra-regional and extra-regional trade in East Asia.



Challenges Faced by East Asia

1. Value losses in foreign exchange reserves
2. Export and import collapse
3. Capital outflow
4. Unemployment and social instability

(1) Value losses in foreign exchange reserves

- Six of the world's top ten countries/ monetary authorities with the largest foreign reserves in 2008 were in East Asia.
- On average, more than 40 percent of East Asia's total foreign exchange reserves are in the form of U.S. treasury securities.
- Unexpected major fluctuations on the exchange rate of the U.S. dollar can lower the real purchasing power of the reserves.

Table 2: Foreign exchange reserves and official gold holdings, world and selected countries

Rank	Country/monetary authority	Foreign exchange reserves ⁱ⁾ (billions of USD)	Foreign holdings of US treasury securities, as of April 2009 ⁱⁱ⁾		In volume (tonnes)	Official gold holdings, as of March 2009 ⁱⁱⁱ⁾	
			In value (billions of USD)	As share of total reserves		In value ^{iv)} (billions of USD)	As share of total reserves
	World ^{v)}	7471	3262.6	43.7%	29691.7	877.8	11.7%
	East Asia ^{vi)}	4195.7	1735.8	41.4%	2280	67.4	1.6%
1	China	1953	763.5	39.1%	600	17.7	0.9%
2	Japan	1019	685.9	67.3%	765.2	22.6	2.2%
4	Chinese Taipei	312.6	78.3	25.0%	423.6	12.5	4.0%
6	South Korea	226.8	35.4	15.6%	14.3	0.4	0.2%
8	Hong Kong SAR	193.4	80.9	41.8%	2.1	0.1	0.0%
9	Singapore	166.1	39.7	23.9%	127.4	3.8	2.3%
12	Thailand	120.5	28.5	23.7%	84	2.5	2.1%
15	Malaysia	87.7	11.6	13.2%	36.4	1.1	1.2%
25	Indonesia	56.6	n.a.	n.a.	73.1	2.2	3.8%
33	Philippines	39.3	12	30.5%	153.9	4.5	11.6%
50	Vietnam	20.7	n.a.	n.a.	n.a.	n.a.	n.a.

(2) Export and import collapse

- The weakened demand from the global market in the aftermath of the U.S. crisis.
- The contraction of global demand triggered a link effect in the regional production sharing network.
- The link effect also exists on the supply side.

Chart 1: Export performance of selected Asian countries, 2008
(percentage changes of 3mma, SAAR, U.S. dollar basis)

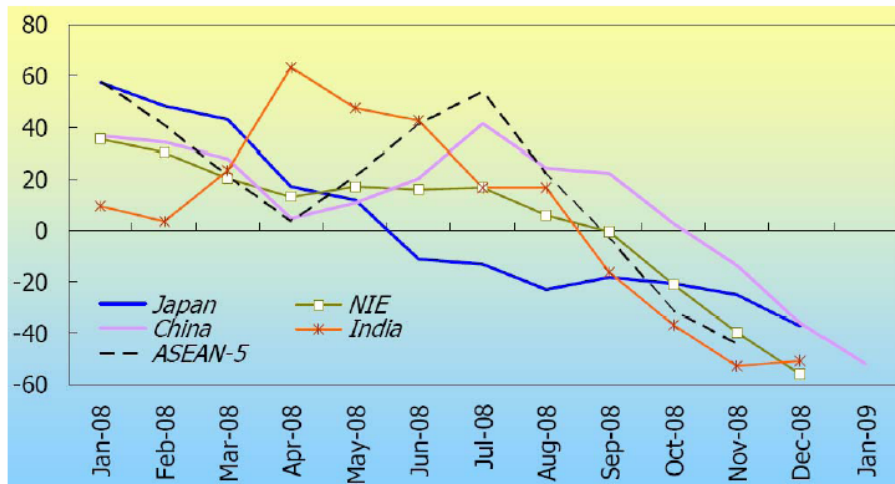
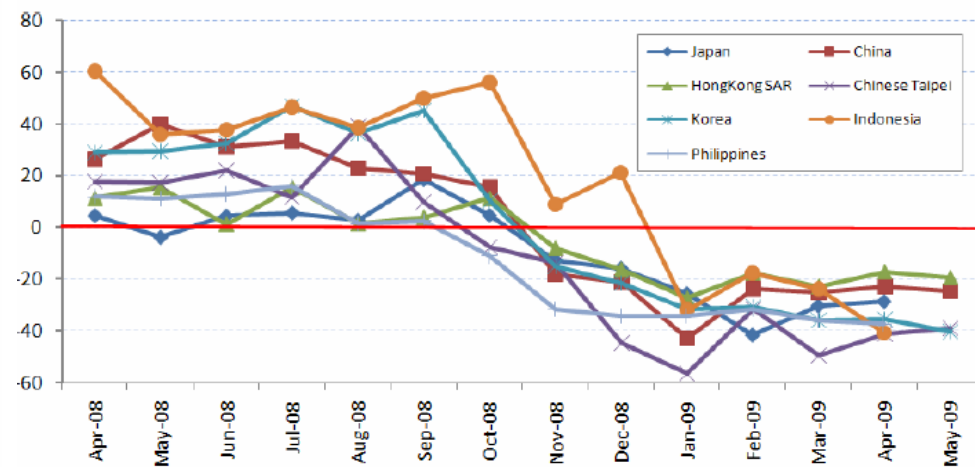


Chart 2: Monthly Import Growth Rates (Year-on-year, percentage)



(3) Capital outflow

- The current financial turmoil may still transfer to the region because of the region's high degree of integration in the global financial market (Kato, 2009).
- Many banks in the region were exposed to the process of global de-leveraging because of their reliance on international wholesale funding.
 - The global financial crisis caused dramatic capital outflows from East Asia as global investors rushed to sell the Asian assets they held during the boom.
 - This made it increasingly difficult for the private sector to borrow abroad when domestic credit was tightened.
 - Many producers in the export-oriented industry were forced into bankruptcy under double hits:
sudden market contraction + difficulties in refinancing external debts

(4) Unemployment and social instability

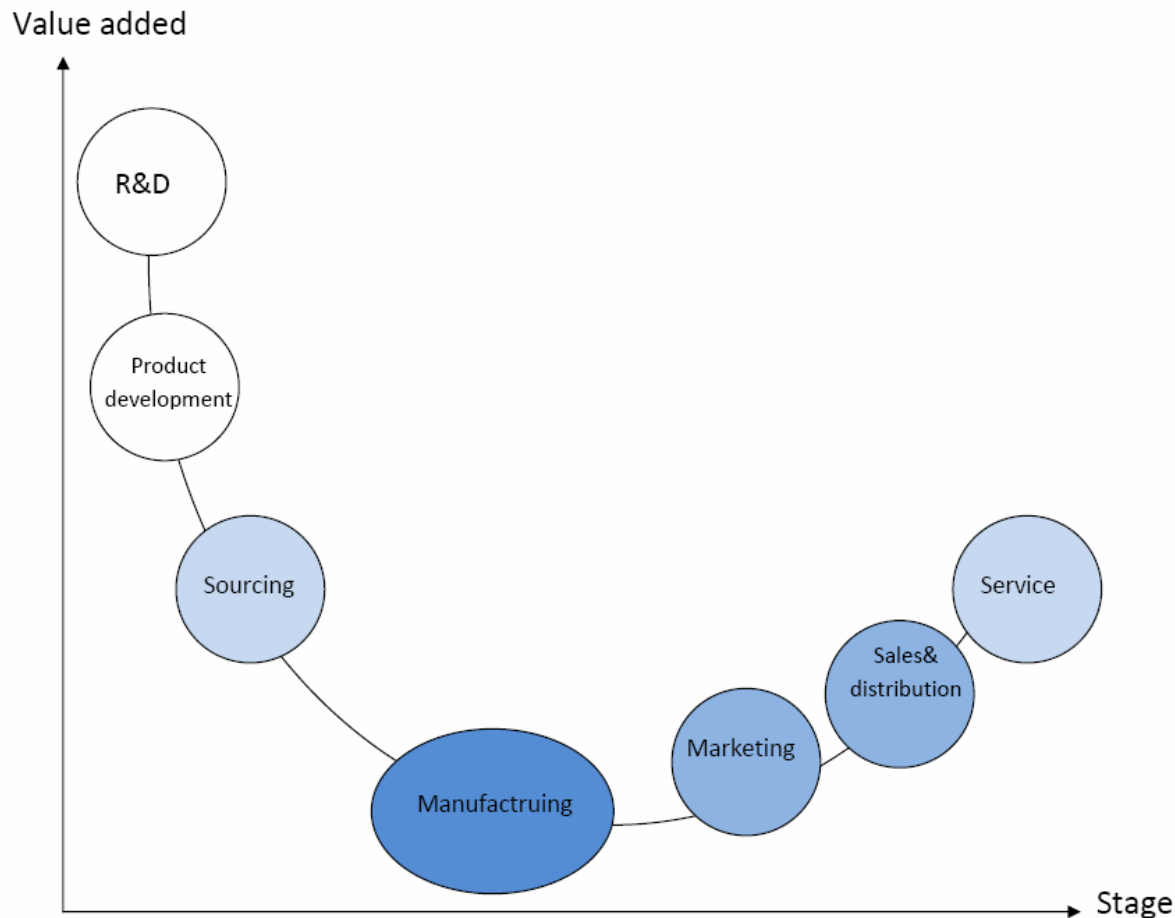
- East Asia accounts approximately for one-eighth of the world's GDP, but hosts one-third of the world's total population.
- The ILO (2009) estimated in 2009 the unemployed population in East Asia could reach 34 million.
- Solving unemployment was still the most serious problem that China faced. (Hu, 2006)
- The social security systems in most East Asian countries/regions rank very low in a global perspective.
- Maintaining high-speed economic growth to create new job opportunities.
- The current crisis: has reduced the market's capability of job creation; caused thousands of new unemployed workers flowed into the market.
- There is a potential risk of triggering social instability.

Suggestions

1. Increase the level of technical/knowledge intensity of regional production sharing
2. Build an effective social safety net
3. Promote regional financial integration
4. Construct a multi-oriented production sharing network

(1) Increase the level of technical/knowledge intensity of regional production sharing

East Asia should change its relatively passive position in the global market by promoting a domestic technical innovation process.



(2) Build an effective social safety net

It is necessary for emerging economies in East Asia to set up an effective social safety net that could function as a buffer to support temporarily unemployed workers especially when economic crises attack. The existence of this system would leave policymakers more space to evaluate the situation and better prepare the policy instruments to combat the crisis.

Table 4: Global social security rankings, East Asia

Country/region	Ranking
Japan	20
Chinese Hong Kong SAR	75
China	80
The Philippines	89
Chinese Taiwan	93
Singapore	117
Malaysia	125
Vietnam	131
Thailand	141
Indonesia	151

(3) Promote regional financial integration

- An integrated regional economy of a larger size would be more effective in fighting against economic turmoil in the global market.
- The global financial crisis pushed forward the decision-making process of the CMI and contributed to the birth of the \$120 billion emergency fund.
- The creation of the joint emergency fund might counteract the negative effects of the financial crisis.
- In the long run, further integration of financial sectors could actually grant East Asian countries power, as long as they move synchronically as a group to defend themselves.

(4) construct a multi-oriented production sharing network

- The crisis could be a factor in accelerating the process of East Asian regional integration.
 - The outcome was a “spaghetti bowl” style of East Asian regionalism: dozens of agreements were initialized, yet, none of which were actually appealing.
 - The consensus and cooperation between Japan and China is vital in promoting an integrated regional market.
 - The composition of the Asian emergency fund balances the positions of both Japan and of China
- East Asia will support the multilateral trade negotiation system in order to secure free trade and capital movement
- Boost the intra-regional market
- Explore new markets in developing economies