Balancing Trade Growth and Trade Security

Kristy Hsu

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Kristy Hsu is a program director and associate research fellow at the Taiwan
ASEAN Studies Center at the Chung-Hua Institution for Economic Research.
The close economic ties driven by various accelerated integration mechanisms in the Asia-Pacific region, particularly among the Southeast and East Asian countries, have contributed significantly to economic growth and shared prosperity in the region in the past decades. Most economies, especially those benefiting from enhanced trade and investment activities with their neighbor countries, believe economic integration brings positive effects and reduces political and security risks in the region. However, economic integration may also pose unpredictable risks and hence require more balancing and calculation to avoid possible negative consequences.

The Association of the Southeast Asian Nations (ASEAN) proposed to accelerate regional economic integration by developing a Regional Comprehensive Economic Partnership (RCEP) agreement among its 10 Member States and 6 free-trade agreement (FTA) partner countries (China, Japan, South Korea, Australia, New Zealand, and India). The major rationale behind the RCEP initiative is the strong political will of ASEAN to counterbalance the US-led trade initiative—the Trans-Pacific Partnership (TPP)—and other major powers in the region. Likewise, the initiative also raises the issues of security and stability.

The first part of this paper aims to examine both the rise of China as an impetus for ASEAN integration and economic growth and some of the economic tensions in the past months resulting from close economic ties in the region. The second part aims to analyze the possible development of the RCEP initiative and the risks of further integration.

**The Rise of China as an Impetus for ASEAN Integration**

The rise of China as an economic powerhouse is no doubt an important driving force for the phenomenal economic performance in the East Asia region in the past two decades. Although some countries in the region have been skeptical about China’s fast-growing economic, political, and military influence, no countries have ever tried to refuse opportunities to take advantage of China’s huge market demands.
China joined the World Trade Organization (WTO) in 2001, and within about a decade, the country has become the world’s largest trading nation, with a trade-to-GDP ratio of 53 percent (2012).\(^1\) China’s share of world trade increased from 3.64 percent in 2000 to 10.48 percent in 2012.

China and ASEAN signed the Framework Agreement on Comprehensive Economic Cooperation in November 2002 to establish the ASEAN-China Free Trade Area (ACFTA). The ACFTA came into effect on January 1, 2010, and since then, tariffs on almost 97 percent of products classified by the ASEAN-6 (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) and China in the Normal Track have been eliminated. The tariffs of the other four less-developed members (Cambodia, Laos, Myanmar, and Vietnam, the CLMV countries) will be fully eliminated on January 1, 2015.

The average tariff of the ASEAN-6 was sliced from 12.8 percent to 0.6 percent as a result of the ACFTA.\(^2\) China exported an increasing volume of goods, both intermediate and final, to ASEAN. According to ASEAN Secretariat statistics, in 2012 China maintained its position as ASEAN’s largest trading partner, accounting for 12.9 percent of ASEAN’s total trade.\(^3\) ASEAN’s exports to China reached US$145.6 billion in 2012, accounting for 11.3 percent of ASEAN’s total exports and making China ASEAN’s largest export destination.\(^4\) ASEAN’s imports from China reached US$177 billion in 2012, accounting for 14.5 percent of ASEAN’s total imports, significantly ahead of Japan, ASEAN’s second largest import source, which accounted for 11.2 percent.\(^5\) China’s exports to ASEAN were 8.2 times higher in 2012 than in 2001.\(^6\)

Many have pointed out that the global financial crisis has made ASEAN more dependent on China as a result of shrinking demand in the Western countries. Table 1 shows the vital growth of bilateral trade, where imports from most countries enjoy more significant growth rates.
On the other hand, according to ASEAN statistics, the foreign direct investment (FDI) flow from China to ASEAN reached US$10.7 billion in 2009–11, with the share of total inflows reaching 4.2 percent.7 Although in terms of total FDI stock, China was behind most major investing countries in the region, in 2009–11, China’s FDI flows ranked as the third-largest source FDI resources in ASEAN member states. The first and second FDI sources were Japan (11.7 percent) and the United States (9.6 percent). China exceeded South Korea (3 percent), Hong Kong (4 percent), and Taiwan (1.6 percent).

In the 1980s and 1990s, the production network of East Asia was structured in a flying geese pattern, with Japan as the leading goose, Taiwan and Korea in the second tier, and ASEAN countries in the third. Japan supplied the East Asian production network with its technologies and capital. The most sophisticated materials and components were made in Japan, the less sophisticated ones were made in Taiwan and Korea, and the assembly was done in ASEAN countries. However, the rise of China transformed the production structures in ASEAN countries. Internal liberalization through the ASEAN Free Trade Area (AFTA), complemented by the ASEAN-China FTA, accelerated the integration process. A fragmented production structure in ASEAN began to be consolidated, and several industry clusters emerged. Although the level of liberalization of AFTA is higher than that of the ASEAN-China FTA, the latter seemed to have a greater impact on ASEAN integration. In 2006–12, intra-ASEAN trade as a

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Table 1. China’s Trade with Asian Countries in 2012

<table>
<thead>
<tr>
<th></th>
<th>Bilateral Trade (US$ 100m)</th>
<th>Growth Rate</th>
<th>Exports (US$ 100m)</th>
<th>Growth Rate</th>
<th>Imports (US$ 100m)</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>3,294.51</td>
<td>−3.9</td>
<td>1,516.43</td>
<td>2.3</td>
<td>1,778.09</td>
<td>−8.6</td>
</tr>
<tr>
<td>Korea</td>
<td>2,563.29</td>
<td>4.4</td>
<td>876.81</td>
<td>5.7</td>
<td>1,686.48</td>
<td>3.7</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1,689.63</td>
<td>5.6</td>
<td>367.79</td>
<td>4.8</td>
<td>1,321.84</td>
<td>5.8</td>
</tr>
<tr>
<td>India</td>
<td>664.72</td>
<td>−10.1</td>
<td>476.73</td>
<td>−5.7</td>
<td>187.99</td>
<td>−19.6</td>
</tr>
<tr>
<td>Indonesia</td>
<td>662.19</td>
<td>9.4</td>
<td>342.89</td>
<td>17.4</td>
<td>319.30</td>
<td>1.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>948.13</td>
<td>5.3</td>
<td>365.18</td>
<td>31.0</td>
<td>582.95</td>
<td>−6.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>363.70</td>
<td>12.8</td>
<td>167.32</td>
<td>17.4</td>
<td>196.38</td>
<td>9.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>692.76</td>
<td>8.7</td>
<td>407.52</td>
<td>14.6</td>
<td>285.24</td>
<td>1.4</td>
</tr>
<tr>
<td>Thailand</td>
<td>697.45</td>
<td>7.7</td>
<td>312.00</td>
<td>21.4</td>
<td>385.45</td>
<td>−1.3</td>
</tr>
<tr>
<td>Vietnam</td>
<td>504.40</td>
<td>25.4</td>
<td>342.10</td>
<td>17.6</td>
<td>162.29</td>
<td>46.0</td>
</tr>
<tr>
<td>Asia</td>
<td>20,449.30</td>
<td>7.5</td>
<td>10,069.63</td>
<td>12.0</td>
<td>10,379.67</td>
<td>3.4</td>
</tr>
<tr>
<td>Total Trade</td>
<td>38,667.60</td>
<td>6.2</td>
<td>20,489.35</td>
<td>7.9</td>
<td>18,178.26</td>
<td>4.3</td>
</tr>
</tbody>
</table>

share of ASEAN imports actually declined from 24.59 percent to 22.78 percent, while China-ASEAN trade rose quickly.\(^8\)

China’s advantage in mass production has enabled ASEAN countries to be part of the global value chains. However, it also created the so-called “global imbalance” problem.

China’s huge market demands have not only made it a most desired market in the world, but have also made an increasing number of countries become increasingly dependent on the Chinese economy for economic growth. One important indicator that always attracts a lot of world attention and discussion is the Global Risk Report (GRR). According to the GRR released by the Switzerland-based World Economic Forum (WEF), despite the fact that the rise of the Chinese economy has benefited the world economy, it has also become a risk factor as it has immediate negative impacts on the world economy when Chinese market demands are shrinking. While ASEAN member states benefit from China’s economic growth, their increasing dependence on the Chinese economy also seems more acute.

Based on a comprehensive survey of experts and opinion leaders from around the world, since 2007 the GRR has graded a “Chinese economic hard landing” as one of the top global risks for the world economy. In 2009 and 2010, “the slowing down of Chinese economy (<6%)” was graded in the two consecutive years as the second global risk for the world economy.\(^9\)

These phenomena indicated the increasing dependence of a great number of countries, on China as both a major destination for their exports and an import source for parts and semifinished materials in supply chains, particularly after the global financial crisis in 2008. This dependence on China reflects the dilemma these countries are facing. According to a Chinese saying, China to these countries is like “the water,” as “the water that bears the boat is the same that swallows it up.”

**The China-Philippines Island Dispute**

The rise of Chinese economic influence in recent decades has demonstrated that close economic relations have made ASEAN countries beneficiaries of the Chinese economy. But in the meantime, this influence can also pose challenges and risks.
One recent example is China-Philippines relations. China and the Philippines are among the six claimants to waters and island groups in the South China Sea, which boasts some of the world’s most heavily traveled maritime lanes and rich fishing grounds with a reported potential wealth of mineral resources.

The latest standoff between China and the Philippines began on April 10, 2012, when the Philippine navy accused Chinese fishing boats of fishing illegally around the Panatag Shoal—otherwise known as the Scarborough Shoal or, in Chinese, Huangyan Island—over which the Philippines claimed to have full sovereignty. In May of 2012, China was reported to have unilaterally suspended various forms of bilateral exchanges and activities with the country, including halting imports from the Philippines that included one million tons of bananas, the major trade item between the two countries. China was also reported to have restricted Chinese tourism to the country and suspended various infrastructure investments and loans in the Philippines. As a result of China’s unilateral actions, the business community in the Philippines began to pressure their government to restore normal relations with China to save its trade and commercial activities from disaster.

In 2011, Philippine exports to China reached US$18 billion, increasing by 11 percent as compared with 2010. China was the Philippines’ fifth-largest export destination and fourth-largest import source. In terms of the banana industry, the Philippines’ fifth-largest export industry, Japan is the country’s biggest export market for bananas, while China comes in second place. China also ranks fourth in the country’s tourist market. In 2011, a total number of 243,137 Chinese tourist arrivals visited the Philippines, accounting for around 6.21 percent of the total arrivals.

Overdependence on a foreign country poses risks to a nation’s balanced and sustainable economic development, and those risks are heightened if unexpected political and diplomatic relations interrupt normal economic ties. The recent incidents in the region suggest that economic integration may have significant impacts on national economic security.

**The Initiative of the RCEP: Will It Address the Security Issue?**

The accelerated, sometimes overlapping and competing, development of regional economic integration mechanisms in East and Southeast Asia may lead
to positive competition or complications in the integration processes, higher transaction costs, and increased instability and unpredictability.\textsuperscript{10} The political wrestling between major economic powers behind various integration mechanisms may very likely give little policy space for smaller economies in the region. Bigger powers may gain more political and economic benefits at the cost of smaller economies.

Since the US announced its “Pivot to Asia” strategy, the TPP has been the center of US economic engagement policy in the East Asian region. However, the recently emerging RCEP, driven by ASEAN, has received growing attention and is regarded as a peer, if not a rival, to the TPP amidst the various integration initiatives.

According to the RCEP Framework document the ASEAN Secretariat released in 2011, the RCEP will include the 10 ASEAN Member Nations and their six FTA partner countries and may expand to the United States and Russia in the future if the two conduct FTA negotiations with ASEAN.\textsuperscript{11} The integration process encompasses a population of 3.5 billion, with its GDP reaching US$32 trillion, comprising more than 28.4 percent of global GDP and 27.7 percent of global merchandise trade.

In terms of economic incentives or potential gains, the RCEP has appeared to have greater incentives for individual ASEAN member states and their FTA partners. First, the potential economic gains are greater than under the TPP, particularly with China and India as partners in the RCEP. Second, the flexibility of determining different members’ liberalization levels makes it easier to join the RCEP than the “high-standard” TPP.

Most of all, the ASEAN-led integration process that will build on the existing FTAs with ASEAN will make RCEP negotiations less difficult for both ASEAN member states and the ASEAN+1 countries (China, Japan, South Korea, India, Australia, and New Zealand). ASEAN member states kicked off negotiations in May 2013. The momentum was accelerating in mid-2013. On the contrary, the TPP negotiations have faced increasing pressure in the region. For example, the Malaysian and Brunei governments expressed their concerns after Malaysian former Prime Minister Tun Dr. Mahathir Mohamad openly asked the Malaysian government to pull out from the TPP negotiations in August.\textsuperscript{12}
The RCEP will enhance comprehensively the level of trade and investment liberalization commitments in the existing five ASEAN+1 FTAs. ASEAN member states also agree to address nontariff barrier issues and pursue further cooperation. The RCEP will accelerate economic integration, furthering the existing regional and global production networks. On the other hand, if there is not a clearly regulated dispute-settlement mechanism and fully supported implementation in the RCEP, smaller and weaker economies in the RCEP may be exposed to even more risks.

Conclusions and Policy Implications

The past decade has seen the accelerated proliferation of FTAs and RTAs in Asia. ASEAN has played a key role in driving economic integration within the region and with external trade partners. There have been overlapping proposals and initiatives, such as the ASEAN+3 (China, Japan, South Korea), the ASEAN+6 (China, Japan, South Korea, India, Australia, New Zealand), East Asia Summit, and East Asia Free Trade Agreement. The development of the RCEP in the future raises some questions, one of which is whether this ASEAN-led integration process will provide ASEAN with more economic autonomy and less dependence on big external economic powers, such as China. Given the influence of the Chinese economy regionally and nationally, the RCEP or other integration mechanisms will by no means have to face the rising concerns of balancing trade growth and trade security along their integration plans. On the one hand, the ASEAN member states need China for their economic growth; on the other hand, they also have to live with potential future risks that close trade ties with China may have negative impacts when political relations get sour, for example.

The recent development of China-Philippines relations is a timely example that economic integration and interdependence can bring both opportunities and challenges. In the context of comprehensive and deep economic integration, the WTO or other global trade institutions can hardly provide an effective remedy. This will be a difficult issue for ASEAN and other RCEP members to address in the trade negotiations to come.

Notes


5 Ibid.

6 Chen Tain-Jy, “East Asian Integration and Its Challenges to Taiwan” (presentation, National Taiwan University, October 11, 2013), 6, http://iis-db.stanford.edu/events/7924/Chen_TJ.East_Asian_Integration_and_Its_Challenges_to_Taiwan.pdf.


8 Chen Tain-Jy, “East Asia Integration and Its Challenges to Taiwan,” (paper presented at conference on RCEP, TPP and Asian Integration, Taipei, Taiwan, October 2, 2013).


10 To name some, these include East Asia Free Trade Agreement, based on the ASEAN+3 and favored by China, and the Comprehensive Economic Partnership in East Asia, based on the East Asia Summit and favored by Japan.

11 Being part of the ASEAN+8, the US and Russia were invited to participated in the East Asia Summit and became formal partners in 2012.