Global Imbalances and Regional Economic Integration in East Asia[1]

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Although the expression "global imbalances" comprises the word *global*, most contributions to this topic have centred on the bilateral imbalances between the US and China, and the Chinese dollar peg as an underlying factor in particular. Given that the US has the world's largest current account deficit and China the largest current account surplus, this bilateral focus is understandable. However, it is helpful to take a broader perspective when discussing the underlying factors contributing to the Sino-American imbalances, especially when thinking about possible solutions to the problem. This brief note discusses the development of the East Asian trade-production network as one of the underlying reasons for China's current account surplus and the role that regional economic cooperation in East Asia, including regional monetary cooperation, can play in reducing global imbalances.

China's rapid economic growth has been closely associated with its integration into the world economy. China's trade expansion has also been linked to the development of an extensive regional trade-production-network which has made use of a division of labour across East Asian economies. A regional production and trade pattern has emerged, in which parts and components are shipped from other (Southeast) Asian countries to China where they are processed and assembled, before the final goods are being exported to the market of final demand, often the US and Europe.[3] China's bilateral trade surplus vis-à-vis the US and Europe, respectively, is hence also a consequence of a distinct mode of production across East Asia, with China absorbing exports from other East Asian countries before they are exported after relatively little value has been added. Therefore, parts of China's exports to the US and Europe can be characterised as "regional" exports from East Asia, rather than solely Chinese exports.[4] Table 1 shows China's trade balance with the US, the EU and its East Asian

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[3] According to the UN Comtrade Database, 70% of Chinese imports from Emerging East and Southeast Asia are parts and components. According to the ADB (2010), total final demand outside Asia makes up 71.1% of total Asian exports, of which 23.9% go to the US and 22.5% go to the EU.
[4] One should also note that these regional trade production networks are to a large extent owned by European, US, Japanese and Korean multinationals, which have outsourced production from their home markets to produce

neighbours. Besides the huge surplus vis-à-vis the US it shows that, on an aggregate level, China has had a trade deficit the East Asian region as a whole.

Table 1: Trade balance of China with the US, the EU and East Asian countries (in million USD)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
US	29,785.6	28,174.1	42,812.4	58,694.3	80,382.4	114,353.5	144,571.9	163,183.4	171,063.4	173,483.9
EU	8,630.8	5874.8	8,974.1	17,618.4	28,667.0	57,207.0	79,437.8	107,340.7	130,703.9	96,013.8
ASEAN	-4,791.1	-4,527.3	-7,398.5	-16,123.1	-19,872.2	-19,383.4	-18,104.8	-13,999.7	-2,915.9	-1,312.2
ASEAN+3	-16,572.8	-13,110.7	-25,477.5	-53,889.6	-75,161.4	-77,511.2	-87,403.7	-93,703.2	-75,817.7	-57,193.5
Brunei	-48.3	-131.0	-220.8	-278.4	-203.2	-154.5	-115.7	-128.8	46.8	-18.1
Cambodia	104.6	170.9	227.1	268.7	422.6	508.8	662.6	830.2	1,056.4	860.4
Indonesia	-1,340.1	-1,040.9	-1,074.1	-1,267.6	-966.8	-61.4	-163.7	238.4	2,827.0	4,656.9
Japan	133.7	2,267.9	-5,006.0	-14,728.2	-20,857.8	-16,370.8	-24,038.5	-31,787.0	-34,632.0	-20,804.0
Korea	-11,915.4	-10,851.3	-13,073.0	-23,038.3	-34,431.4	-41,757.0	-45,260.4	-47,916.5	-38,269.8	-35,077.3
Lao	28.0	47.0	44.6	87.0	88.2	79.8	119.1	92.4	118.7	42.8
Malaysia	-2,915.0	-2,982.1	-4,320.0	-7,845.6	-10,087.5	-9,490.1	-10,036.5	-11,035.5	-10,747.6	-8,547.9
Myanmar	371.6	363.3	587.9	738.2	731.7	660.5	954.6	1,321.4	1,334.7	1,397.4
Philippines	-213.0	-323.5	-1,174.2	-3,212.5	-4,790.0	-8,181.4	-11,938.3	-15,623.3	-10,419.5	-4,220.7
Singapore	701.5	651.7	-85.6	-1,615.3	-1,309.3	185.5	5,513.4	12,159.4	12,233.1	2,379.3
Thailand	-2,136.8	-2,209.2	-2,639.5	-4,998.8	-5,740.0	-6,175.2	-8,198.4	-10,673.0	-10,115.5	-6,054.1
Vietnam	608.2	795.6	1,035.4	1,722.7	1,778.9	3,090.0	4,982.4	8,691.2	10,796.9	8,173.8

Source: Own calculations with IMF DTS.

While the existence of this regional trade-production network within East Asia has contributed to China's current account surplus, further regional economic cooperation and integration can also help addressing the problem of China's external – and hence also global – imbalances.

First, with prospective slower growth in the advanced economies of Europe and the US, demand for Chinese exports is likely to increasingly come from developing East Asia. East Asian economies are getting more and more important as destination for Chinese exports. The facilitation of trade between China and ASEAN, Korea and Japan can further enhance business opportunities within the region and reduce export dependency of China (and other East Asian economies) on exports to the US and Europe.

Second, China has increasingly become an investor in other developing East Asian economies, following the examples of Japan and Korea. China has already become the largest source of FDI to some low-income ASEAN countries such as Cambodia and Lao PDR. Further Chinese investment in the region would not only help position Chinese firms in the regional and international market, it would also help alleviate its balance of payments problems by shifting production abroad. Moreover, by creating employment in the host countries, Chinese FDI is likely to boost employment and income in these economies, contributing to demand for Chinese exports.

cheaply in developing East Asia in order to ship the final goods to advanced economies. Foreign direct investment from these firms has significantly contributed to China's status as the world's factory and the resulting current account surpluses.

Third, the causes for the resurrection of the East Asian dollar standard (or Bretton Woods II) regime – the situation where basically all East Asian countries except Japan maintain pegs or soft pegs to the US dollar – should not only (or even predominantly) be seen in East Asian countries' attempts to seek export competitiveness through an undervalued exchange rate. Indeed, given the magnitude of exports to the US (which for most countries in the region are roughly as important as exports to Japan and Europe), pegging to the dollar makes limited sense from a trade perspective. However, the dollar pegs make sense when taking into account that the joint pegging of East Asian currencies to the dollar as an external anchor has provided a significant degree of intra-regional exchange rate stability. Arguably, the trade-production networks described above have only been able to develop in an environment of relative intra-regional exchange rate stability. Given that intra-regional trade by now accounts for about 60% of total trade of East Asian countries (and that East Asian countries are also competing against each other in external markets), this intra-regional exchange rate stability is an important regional public good. It is therefore time to discuss alternatives to the East Asian dollar standard that will provide the benefit of intra-regional exchange rate stability without the problems of the current practice of dollar (soft) pegging. In my view, intra-regional monetary and exchange rate cooperation provide a sensible way forward.[5]

Fourth, global imbalances have to be seen in the light of the role of the US dollar in the global (and regional) monetary system. Given the importance of the dollar not only in the denomination of intra-regional trade but also in the assets and liabilities of East Asian countries' balance sheets, it is rational for these countries to try maintain relative exchange rate stability against the dollar in order to avoid destabilising balance sheet effects. Again, regional financial and monetary co-operation that can gradually reduce dependency on the dollar is the way forward. Positive examples in this direction are the Chiang Mai Initiative Mulilateralisation process and initiatives by ASEAN+3 and EMEAP to foster the development of local currency bond markets.

References

ADB (2010): *Institutions for Asian Integration*, Asian Development Bank, Manila.

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[5] See Volz (2010) for an analysis of the prospects for regional monetary cooperation in East Asia.