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Introduction: Trade, Industrialization, and Structural Reform in Southeast Asia¹

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Abstract: This special issue of the *Journal of Asian Economics* is the outgrowth of a conference held in Ho Chi Minh City in October, 2016, with support from the Centre on Asia and Globalisation of the Lee Kuan Yew School of Public Policy, National University of Singapore. The conference focused on the implications of a changing regional economic landscape for Southeast Asian economies. The seven studies contained in this issue are consistent in affirming the welfare improving impact of reductions in tariff and non-tariff barriers to trade under evolving regional arrangements while nevertheless recognizing challenges in organizing global value chains and expanding the involvement of local firms in production networks. Considering the different stages of development of the economies in the Asia region, the potential for growth to be spurred by further pursuit of comparative advantage is compelling. The key will be to manage domestic industrial transitions in accordance with participation in trade agreements and expansion of regional integration.

JEL classification: C68, F13, F14, F15, F17, O24

Keywords: Mega-regional trade agreements; global value chains; computable general equilibrium models; ASEAN; Vietnam's economy

Regional integration in Asia is at a crossroads. The Association of Southeast Asian Nations (ASEAN) launched the ASEAN Economic Community (AEC) in December 2015. The Trans-Pacific Partnership (TPP) negotiations were concluded in October 2015 among twelve member states. In January 2017, however, President Trump declared the withdrawal of the United States from TPP. The remaining eleven member states decided to proceed with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) without the US, with ratification by the member states now pending. On the other hand, negotiation of

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the Regional Comprehensive Economic Partnership (RCEP) reached a 20th round in October 2017 with no end in sight. Hence, a great deal of uncertainty hangs over regional integration in Asia. It is not clear whether the US will ever come back to TPP. The US is not part of RCEP and China is not part of TPP. Moreover, major conflicts of interest between India and other negotiating parties beset the RCEP. Meanwhile, China's Belt and Road Initiative (BRI) has emerged as a competing framework for regionalism.

Against this backdrop, the Centre on Asia and Globalisation, Lee Kuan Yew School of Public Policy, National University of Singapore, organized a conference on "Trade, Industrialization, and Structural Reforms in ASEAN," hosted by the Center for Vietnamese and Southeast Asian Studies, Vietnam National University - University of Social Sciences and Humanities in Ho Chi Minh City on October 20-21, 2016. The purpose was to discuss the implications of this changing regional landscape for ASEAN. This special issue of the *Journal of Asian Economics* brings together seven papers from that conference that coalesce around three themes: 1) free trade agreements and ASEAN economies (Kikuchi, Yanagida, and Vo; Lee and Itakura; and Thorbecke); 2) Vietnam's economy especially in relation to exports and domestic reforms (Kikuchi, Yanagida, and Vo; Minor, Walmsley, and Strutt; Doan and Xing; and Trinh and Doan); and 3) the application of computable general equilibrium models to economies in the region (Kikuchi, Yanagida and Vo; Lee and Itakura; Minor, Walmsley and Strutt; and Zhai).

Mega-regional trade agreements involving ASEAN

Which mega-regional trade agreements eventually prevail holds immense implications for regional integration and the individual economies involved. The studies in this special issue are not conclusive. While Kikuchi, Yanagida, and Vo find that for Vietnam, a Free Trade Area of the Asia-Pacific (FTAAP) modeled on the TPP template brings the greatest increase in GDP at 27.1% (USD 41.5 billion) by 2035, Lee and Itakura conclude that for ASEAN as a whole an alternative vision of FTAPP modeled on the RCEP template brings about higher welfare gains. The differing results stem from Kikuchi, Yanagida, and Vo assuming greater reduction in non-tariff barriers under the TPP template than under the RCEP template. However, the two studies agree that Vietnam is the most adversely affected country in the region as a result of the US withdrawal from TPP. Both studies further show that the benefits from liberalization under a trade agreement increase as the number of member countries and

their overall GDP increase. Beyond this, the details of liberalization matter, particularly with respect to reduction in non-tariff barriers.

The importance of the details of liberalization is highlighted by Doan and Xing, who focus on the need for relaxation in rules of origin to achieve export efficiency, and by Minor, Walmsley, and Strutt, who study the potential impact of the reform of state owned enterprises (SOEs) in Vietnam. Doan and Xing show that the existing volume of Vietnam's exports is far below the efficient level. They find that membership in ASEAN contributed positively to the country's trade efficiency while rules of origin and non-membership in the European Union and the North American Free Trade Agreement had a negative impact. Minor, Walmsley, and Strutt study how a limited reform of SOEs might affect the structure of output, trade, and employment. Even if only 50 percent of SOEs are reformed over a five-year period from 2016, real GDP could increase by nearly nine percent by 2035.

The standard conclusion that international trade leads to welfare gains from comparative advantage is confirmed through the application of computable general equilibrium models by Kikuchi, Yanagida, and Vo; Lee and Itakura; and Minor, Walmsley, and Strutt. These studies show that under mega-regional free trade agreements some sectors expand and others contract as factors of production are reallocated. The upshot is that further integration of value chains in Asia resulting from elimination of tariffs and reduction in non-tariff barriers will increase aggregate output in the region. The process can be augmented in Vietnam, according to Minor, Walmsley, and Strutt, by SOE reform that will raise wages for all occupation groups. Kikuchi, Yanagida, and Vo, and also Lee and Itakura, show that the production and export of electronic goods (e.g., smartphones and computers) and labor intensive goods (e.g., footwear and clothing) will increase significantly for Vietnam specifically as well as for ASEAN as a whole. Thorbecke shows that foreign direct investment (FDI) deepens the electronics value chain in ASEAN countries. He also finds that price competition between China and ASEAN in labor-intensive goods has abated since 2001. China is now the leading supplier of intermediate goods for ASEAN's labor-intensive exports. Thus regional supply chains are playing an increasing role in driving ASEAN's exports.

Global value chains

The emergence of global value chains, in which firms optimize their production processes by locating various stages of production across different countries, has changed the nature of international trade over the last few decades. Through global value chains, multinational

corporations have found ways to circumvent traditional tariff barriers even as non-tariff barriers have gained in importance. Thorbecke notes that improving the business climate will help to mitigate barriers and deepen national participation in global value chains. He argues that multinational corporations tend to procure more from local firms as they become more established in host countries. As clusters of industrial activity form, local engineers and workers migrate across firms and sectors thereby diffusing their accumulated human capital throughout the economy and promoting technological assimilation and economic growth. Similarly, Doan and Xing point out that FDI within the context of global value chains contributes positively to trade efficiency.

In fact, FDI inflows have been crucial to economic growth for many ASEAN countries. For gains to be sustained over time, countries must find opportunity to absorb new technology through FDI. This is stressed by Kikuchi, Yanagida, and Vo in their “middle income trap” scenarios for Vietnam which demonstrate the importance of productivity growth for maintaining the momentum derived from trade liberalization. Trinh and Doan shed light on the importance of firms maintaining continuity in their engagement in internationalization activities for maximum gains to be realized. In their study of Vietnamese micro, small, and medium sized manufacturing enterprises, they find further that firms that both export and sell domestically to foreign invested enterprises enjoy higher growth than those that engage in only one of these forms of internationalization. They argue based on their findings that government should encourage firms to participate in international production networks and expand vertical linkages with foreign invested firms.

Whither regionalism?

China’s Belt and Road Initiative (BRI) has emerged as a competing concept of regionalism. Unlike TPP, BRI does not demand reduction in non-tariff barriers and other deregulation. Indeed, unlike even RCEP, BRI is not a free trade agreement at all. However, BRI does aim to deepen regional integration across Eurasia, placing China at the nexus through its investment in cross border infrastructure, export of capital and investment goods, and import of natural resource products. In this respect, BRI rests on classical foundations of achieving integration through the exploitation of comparative advantage. Zhai finds that BRI can increase world GDP to the tune of 1.3 percent by 2030 on the back of a trade increase of 5 percent. Zhai’s model takes account of the externalities of infrastructure investment in the form of trade cost reduction and energy efficiency gains. Zhai recognizes, however, that

serious obstacles stand in the way of a full realization of the BRI vision, among these political risk, lack of a cohesive legal and institutional environment, human capital limitations, and massive funding requirements.

The studies in this special issue point to challenges in this era of regional integration in facilitating the organization of global value chains and expanding the involvement of local firms in production networks. At the same time, considering the different stages of development of the economies in the Asia region, the potential for growth to be spurred by further pursuit of comparative advantage is compelling. The studies are consistent in affirming the welfare improving impact of reductions in tariff and non-tariff barriers to trade, and highlight in diverse ways the importance of negotiated agreements and other government outreach to promote greater openness. A message of encouragement comes through for ASEAN countries to manage their domestic industrial transitions in accordance with participation in trade agreements and expansion of regional integration.