



# Evaluation of Value Chains and Regional Integration in Asia<sup>1</sup>



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Recently, global value chains have risen due to various reasons including global trade and investment liberalization, wage gaps between developed and developing countries, and information and communication technologies. More specifically, Asia's participation in global value chains suddenly rose as the ICT revolution took off around 1990, to surpass North America and Europe by the late 1990s, as Baldwin (2013) indicates.<sup>2</sup> When we investigate the World Input-Output Database, it turns out that the Asian share in world value added in exports and imports increased substantially between 1995 and 2015.

The share of trade in intermediate goods has been dominant in Asia compared to those of Europe, America, and the rest of the world. Interestingly, the American as well as the European share in world value added in exports has decreased steadily but their respective shares in world value added in imports still remain high during the same period.

<sup>1</sup> This opinion is based on Choi, Nakgyoon. 2019. "Deeper Regional Integration and Global Value Chains." KIEP Working Paper 19-02. Korea Institute for International Economic Policy.

<sup>2</sup> Baldwin (2013) explained that "before the ICT revolution, most of the international sourcing was done among mature economies, such as the United States and Canada in the auto industry or as in intra-EU trade in machinery." Refer to Baldwin (2013), pp. 17-19.

Production has become increasingly concentrated in regional hubs which are closer to the final goods markets.<sup>3</sup>

Previous literature indicates that regional hubs such as the US for America, Germany for Europe, and China for East Asia have played a central role in global value chains trade.<sup>4</sup> In addition, the three regional clusters have been the major designers of mega FTAs such as the USMCA, EU-Japan FTA, CPTPP and RCEP. The deeper trade agreements have boosted up global value chains because the international trade in global value chains was regional rather than multilateral.<sup>5</sup> When we analyzed the World Bank database on the content of preferential trade agreements, however, the regional trade agreements in Asia did not turn out to be as deep as those in America and Europe.<sup>6</sup>

Notably, the United States announced that it would launch formal negotiations for a new regional trade agreement with the European Union. The United States also made it public that it would renegotiate with the CPTPP member countries if the CPTPP would reflect the US' concerns. Meanwhile, the European Union finalized the EU-Japan Economic Partnership Agreement in 2017. It also agreed to resume trade agreement negotiations with the United States after the two sides failed to find a compromise for the so-called Transatlantic Trade and Investment Partnership (TTIP). Japan played a leading role in finalizing the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which entered into force in December 2018. The CPTPP aims to form Trans-Pacific value chains by introducing the cumulative rules of origin and improving the trade rules on trade facilitation, state trading, government procurement, and intellectual property rights among others.

These changes in the international trade negotiations have many implications for the global trading system as follows. First, mega FTAs such as the USMCA, CPTPP, EU-Japan FTA, and RCEP are expected to consolidate global value chains which have risen as new platforms for national development strategies. Furthermore, the US-EU FTA and US-Japan FTA, if finalized sometime in the future, will strengthen the pivotal roles played by these econo-

<sup>3</sup> OECD (2017b) pointed out that companies are increasingly changing their sourcing strategies by localizing their production. Refer to OECD (2017b), p. 17.

<sup>4</sup> According to Diakantoni et al. (2017), "the East Asia and Europe regional value-chains include several smaller clusters organized around, for example, Japan or the UK." Refer to Diakantoni et al. (2017), p. 27.

<sup>5</sup> According to Baldwin (2013), the GATT rules were not sufficient for the cross-border relations and the deeper disciplines were placed in regional trade agreements. Refer to Baldwin (2013), p. 40.

<sup>6</sup> Choi (2019) investigated the information on the legal enforceability according to texts that specify clear legal obligations. Refer to Choi (2019), pp.13-15.

mies as the regional hubs in production networks. Second, recent trade agreements have deepened regional integration by improving trade rules already covered by the WTO agreements and by including new rules which are not addressed in the WTO agreements. The recent trade agreements could possibly serve as stepping stones for multilateral agreements in that they are complementary to the traditional rule-making.

According to Choi (2019), deeper regional integration contributes to the organization of global value chains along the regional clusters. In addition, Asia centered around China turns out to import more intermediate goods than Europe and America because it assembles the parts and components to export the final goods to foreign countries. In particular, the so-called Factory Asia is much closer to a network rather than the hub-and-spoke pattern observed in Factory North America and Factory Europe, as Baldwin and Lopez-Gonzalez (2015) claims.<sup>7</sup>

Therefore Asian value chains are exposed to more serious risk sources. When the global economy experienced the East Japanese earthquake and the massive flooding in Thailand, the shocks on only a small number of production stages turned out to have a substantially negative impact on the whole electronics industry. One of the implications of rising global value chains for Asian economic development is that they need to be resilient against shocks from risk sources including natural disruptions because there is a potential for these shocks to propagate throughout the region. **KIEP**

<sup>7</sup> Baldwin and Lopez-Gonzalez (2015) points out that "Factory North America is a simple hub-and-spoke system because importing to export is mostly bilateral." Refer to Baldwin and Lopez-Gonzalez (2015), pp. 1711-1712.