On the Feasibility of Economic Cooperation in East Asia: Perspectives from Trade Creation and Trade Diversion

Deng-Shing Huang and Jenn-Hwa Tu*
Institute of Economics, Academia Sinica

Abstract

This paper attempts to measure the feasibility of economic cooperation in East Asia from an economic point of view. To approach this issue, we decompose the effect of economic cooperation into trade creation (TC) and trade diversion (TD) by using the well-known revealed comparative advantage (RCA) index. Diversity in the RCA indices among member countries should be closely related to the magnitude of TC. On the other hand, TD occurs in the case of a union in goods in which the outside region as a whole has a comparative advantage. In addition, members who suffer from TD will be those that have a low RCA index and thus have to import.

The results show that the export structures differ quite significantly between ASEAN and the NICs. Based on the RCA index, we would expect an intraregional trade creation effect in the case of commodity groups 1 (agriculture), 2 (mining), 31 (food, beverages and tobacco), 32 (textiles), 33 (wood & prod-

* Associate Research Fellows, Institute of Economics, Academia Sinica, Nakang, Taipei, Taiwan. The authors would like to thank participants in the Ninth ADIPA Conference on “The Changing World Community: Development Consequences and Adjustments in Asia and the Pacific,” in Macau, 8-11 October 1991 and seminar participants at Academia Sinica. We are also indebted to an anonymous referee for helpful comments on an earlier version. Financial support from NSC, Taiwan, R.O.C., under grant NSC82-0301-H-001-002 is gratefully acknowledged.

©1994 – Institute for International Economics, Sejong Institution. All rights reserved.
ucts) and 39 (other manufactures) if ASEAN and the NICs form a union. Since Japan has a revealed comparative advantage in commodity groups 37 (basic metals) and 38 (metal manufactures), excluding it from the union would induce TD in these goods and the importing member countries will thus suffer.

Therefore, if Japan is included into the union, trade diversion in the case of goods 37 and 38 disappears, and trade creation follows. However, for goods 31 (food, beverages and tobacco), 34 (paper and products), and 35 (chemicals), in which these ten countries, as a whole, have a comparative disadvantage compared with the rest of the world, TD is inevitable. Again, countries that have to import or have a comparative disadvantage in these goods will suffer from trade diversion.

I. Introduction

Ever since the European Single Market Plan was initiated by the Executive Committee of the European Economic Community (EEC) in June 1985, the issue of regional economic cooperation has been the focus of attention in the international economic arena. Partly as a result of the European Single Market concept, the Canada-United States Free Trade Agreement was signed and became effective in January 1989. Furthermore, Canada, Mexico and the United States commenced negotiations on a North-American Free Trade Area agreement in June 1991. In addition to the moves towards cooperation that have taken place in North America, the pessimism surrounding the failure of the Uruguay Round of GATT negotiations to resolve the issue concerning the protection of agricultural products has led to a re-emergence of regional self-protective sentiment around the world. One area in which this has become particularly self-evident is Asia. The formation of a so-called East Asian Economic Grouping, or an East Asian Economic Community has been proposed by Malaysian prime minister Mahathir Mohamad.

Due to various economic and political considerations, the concept of an East Asian Economic Grouping is still under strict scrutiny by all the parties concerned. The extent to which an economic grouping can be successful depends mainly on the magnitude of the net economic gains to be derived