

# The Euro-area Crisis: Impact on Asia (and other regions)

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# How to think about the impact?

- Channels for transmission

- Trade

- Finance

- Applicable to

- Latin America

- Africa

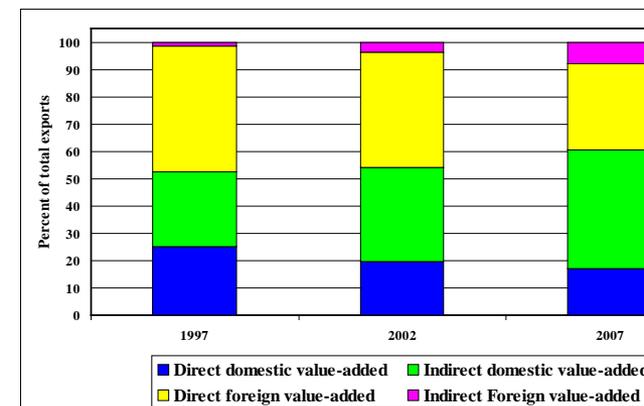


# Trade Effect (1)

- Most countries in Asia have a high trade/GDP ratio, and Europe is often  $\frac{1}{4}$  of the total export market.
  - Trade openness is higher in East Asia than South Asia
  - But the raw “trade openness” can be misleading ...
  - True dependence should be based on the domestic content in exports
  - Koopman, Wang and Wei: Estimating domestic content in exports while taking into account processing trade

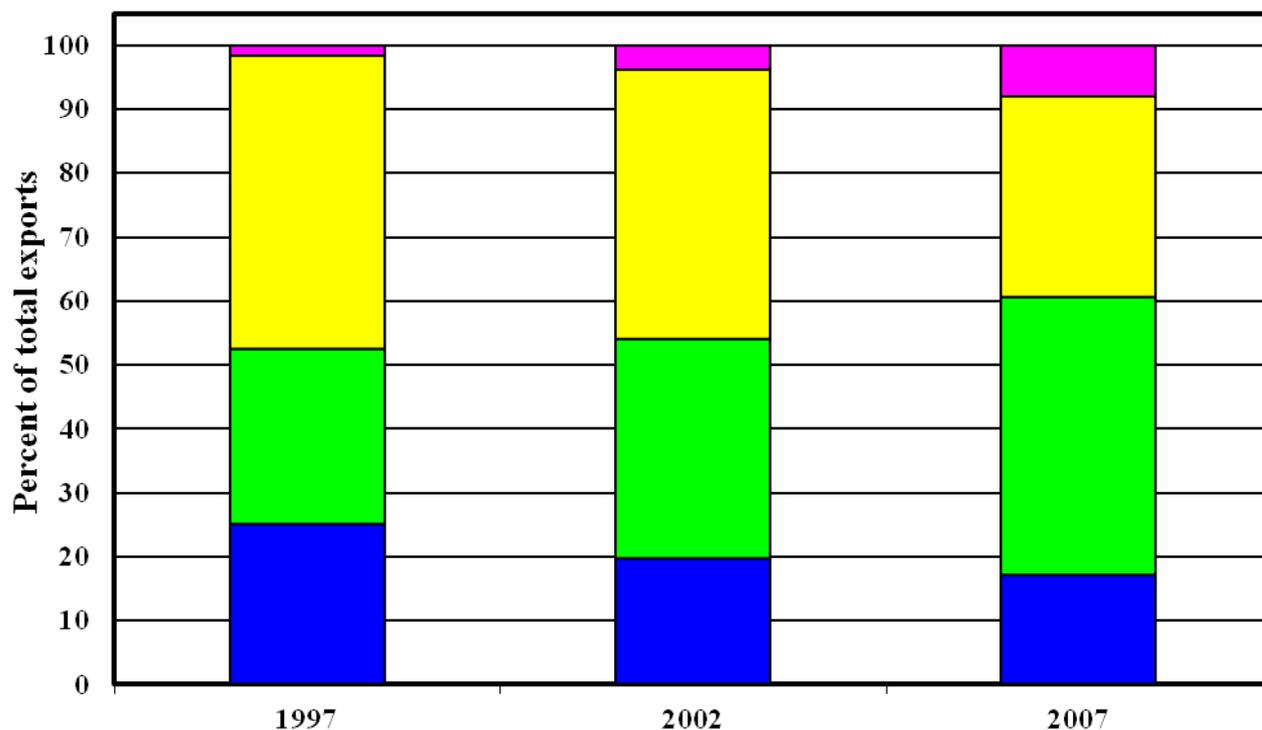


Source:  
[static6.businessinsider.com/.../foxconn.jpg](http://static6.businessinsider.com/.../foxconn.jpg)



# Chinese domestic content in exports is low (about 50%) but increasing overtime

source: Koopman, Wang, and Wei (JDE 2012)



- China's exports are about 32% of GDP
- Its domestic content in exports is about 18% of GDP
- Domestic content in exports to Europe is about 5%
- Cutting exports to Europe by half would mean a reduction in total demand by 2.5%

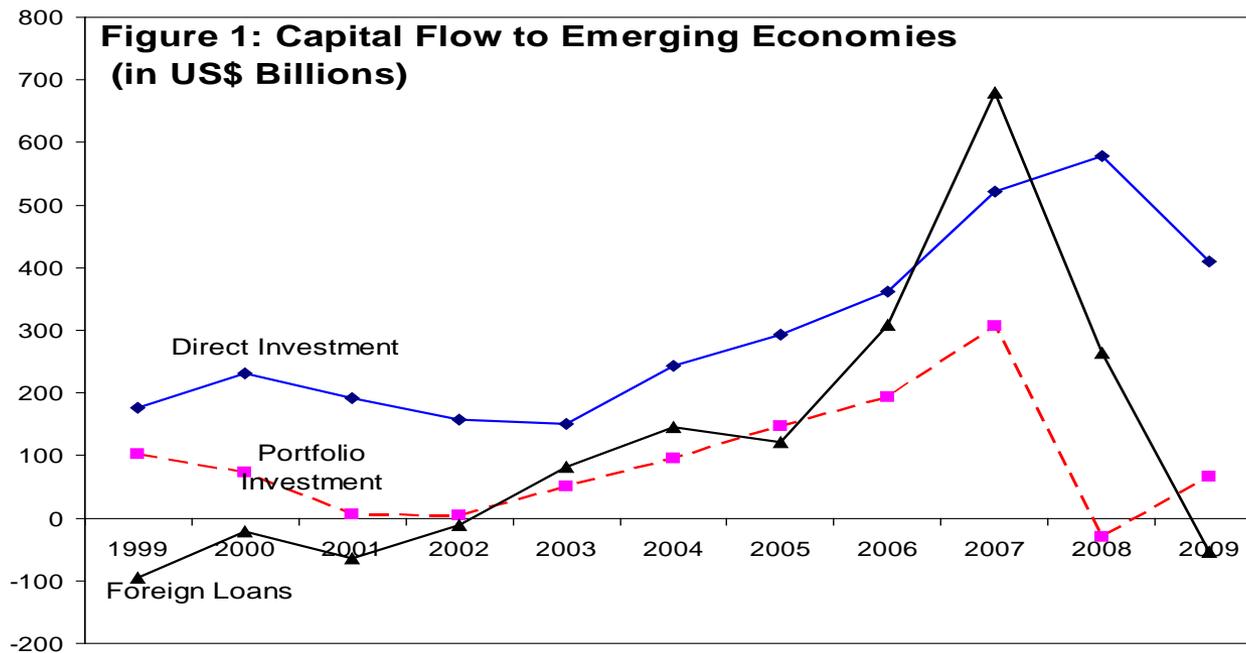
Source: Koopman, Wang, and Wei, Journal of Development Economics 2012

# Trade Effect (2)

- **How large is the trade effect?** Ability to replace reduced external demand by increased domestic demand differ across countries
  - Depends on country size (or the relative importance of exports)
  - Fiscal capacity
- Country conditions matter; no homogenous effect
  - China has both the size and capacity advantage
  - Singapore has a relatively strong fiscal position but too small a domestic market
  - India has the size edge but weak fiscal capacity
  - The Philippines has disadvantages in both size and capacity.
- Similar criteria should help us think about Latin America and Africa

# The Finance Effect (1)

- Many countries have a high exposure to international capital flows, including bank loans and FDI from Europe
- How much would a deeper crisis in Europe affect developing countries depends on
  - Total volume of exposure
  - Structure of exposure (the ratio of FDI to non-FDI flows) [Tong and Wei, RFS 2010](#)



Source: Tong and Wei, Review of Financial Studies, 2010

# The Finance Effect (2)

- Country conditions matter
  - Korea has a high volume exposure, and relies mostly on foreign bank loans
    - Strongly vulnerable to a worsening Euro crisis
  - India has a medium level of exposure, but also relies relatively more on non-FDI flows
    - Also vulnerable to a worsening Euro crisis
  - China has a high volume exposure, but relies overwhelming on inward FDIs
    - Less vulnerable to a worsening Euro crisis

# “A rich man is someone who is richer than his brother-in-law”

- While a deeper crisis in Europe represents a negative shock to almost all countries in Asia, and indeed to almost all countries anywhere in the world,
- ... it creates differentiations
  - China will emerge relatively stronger
    - Because
      - Both the trade effect and the finance effect will be relatively milder for the country than elsewhere



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