

# East Asian Dynamism and Pacific Cooperation

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*Fading prospects for a successful conclusion to the GATT Uruguay Round are directing attention to regional trading arrangements. Ippei Yamazawa, Professor of Economics at Tokyo's Hitotsubashi University, advocates an 'open economic association' for the Asia-Pacific region that provides for trade facilitation rather than trade preferences.*

As the Uruguay Round of GATT negotiations has stalled, regional integration has proliferated in the world's major economic areas. The Uruguay Round is likely to achieve less than was expected when it was launched in 1986; and the contracting parties will inevitably try to pursue their goals by the alternative means of regional liberalisation efforts among like-minded countries. East Asia, with its dynamic development record, can be no exception to this tendency. However, its form and extent differ from those in Europe and North America.

This article aims to show that the East Asian economies have so far achieved dynamic growth without formal integration, but now seek regional integration covering the whole Pacific. The goal is a weak form of integration that avoids a discriminatory impact on outsiders. Nevertheless, weak integration will help the East Asian economies to realise their high growth potential.

## **Industrial Transfer: The Core Mechanism of East Asian Development**

During the first half of the 1990s, East Asian economic success is helping to sustain a troubled world economy. The collapse of the Soviet Union and the dissolution of the East European communist bloc is straining the economies of Germany and other West European countries. The American economy is still struggling to recover from recession. Few African, South Asian or Latin American countries have achieved sustained economic growth. In contrast, the East Asian economies, including the ASEAN countries, the newly industrialising economies (NIEs), as well as China and Japan, have been expanding since the mid-1980s and maintain strong growth potential.

Economic relations among the East Asian economies are different from those among the European Community (EC) or North America. Productive factors are not distributed uniformly, and there are wide differences in industrialisation and wage levels. Exchange rates have fluctuated among these countries, and tended to promote cross-border investment. How-

ever, technology transfers are being actively pursued, and trade patterns are moving steadily towards greater interdependence. This interdependence is responsible for the East Asian countries' high growth rates. Whereas the EC's single market and North America's free-trade pact (NAFTA) are designed to encourage European and North American companies by providing access to larger markets, East Asian companies are banking on the benefits of interdependence in an economically diverse region. The Pacific region as a whole has been stimulated by East Asian growth through trade, investment and other activities. During the second half of the 1980s, developed economies in North America and Oceania achieved growth rates of 3–5 per cent, moderate by East Asian standards but fairly high by their own. They absorbed exports from East Asia, which further stimulated East Asian growth.

The main mechanism underlying this increased interdependence in the Asia-Pacific region is the transfer of industries, particularly manufacturing industries, from early-starter countries to late-comer countries. Comparative advantage in mature industries such as textiles and steel has shifted from the US and Japan to the Asian NIEs, and from the Asian NIEs to ASEAN countries. This pattern of industrial development has been a catalyst for increasing interdependence, and has been extended to the development of electronic and automobile industries in ASEAN. Its continuation is the key to the future success of industrialisation in ASEAN and the Pacific (Okita, 1987; Yamazawa, 1990).

Two types of enterprise have promoted this industrial transfer. Local enterprises in the late-comer countries are eager to acquire new technology so as to catch up with the early-starter countries; this makes them the prime movers in import substitution. Multinational enterprises (MNEs) in the early starters are the source of this transfer. Which type of enterprise becomes the main catalyst of transfer depends on both the industry and the particular late-comer country. Local enterprises initiated catch-up activity in technically mature industries like textiles and steel; MNEs played a larger role in industries like electronics and fine chemicals,

where new products and technologies are constantly emerging. Since MNEs are familiar with overseas markets, they are dominant where domestic demand for new products is limited and export orientation is necessary from the beginning. In some cases local enterprises and MNEs work together.

The international development of these enterprises represents an attempt to confront rapid adjustments in the exchange rates, wage increases, and labour shortages. They have taken advantage of regional differences in stages of development and in wage levels. This process continues: industries that were transferred to ASEAN countries from the NIEs are attracted to countries with more abundant labour and lower wages, such as China and the countries of Indochina and South Asia.

It is important to ensure that the policy environment is favourable to the industrial-transfer process. The governments of the East Asian NIEs and ASEAN countries have encouraged the process with outward-looking policies. But future growth in East Asia requires trade and investment liberalisation outside the region and well as within it. Hence the need for a successful conclusion to the Uruguay Round.

### East Asian Subregional Groupings

**ASEAN.** The interdependent growth of the East Asian countries was achieved without much in the way of formal integration. ASEAN is an important exception. The five member countries — Indonesia, Malaysia, the Philippines, Singapore and Thailand — initiated a formal framework for economic cooperation and were later joined by Brunei Darussalem. They implemented a preferential tariff arrangement, joint industrial projects (sharing large-scale production of selected heavy industrial products for the common ASEAN market), and industrial complementation schemes (developing common-parts supply networks). None of these has been very successful because of the member countries' limited markets.

ASEAN's external trade has expanded as fast as intra-ASEAN trade, which has remained constant at 21 per cent of total trade; of this, 80 per cent consists of trade between Singapore and other member countries. In January 1992 the Fourth ASEAN Summit meeting reactivated their integration efforts by initiating an ASEAN Free Trade Area (AFTA). But ASEAN has not contributed much to the spectacular development of East Asia as a whole.

**Subregional economic zones.** An informal development in East Asia is the subregional economic zone (SREZ). There are five of these, as follows (from south to north):

- **The Growth Triangle**, centred on Singapore and including the adjacent Malaysian State of Johore and Indonesia's Batam Island.
- **The Baht Zone** in the border area of Thailand, Laos, Cambodia, and Vietnam.

- **The Greater South China Economic Zone**, centred on Hong Kong and including China's Gwandong and Fuchen provinces, and Taiwan.
- **The Yellow Sea Economic Zone**, including the coastal areas facing the Yellow Sea of north and north-east China, North and South Korea, and Japan.
- **The Japan Sea Economic Zone**, including the coastal areas of north-west China, Far East Russia, South and North Korea, and Japan.

Not all these SREZs are equally active. The Growth Triangle and the Greater South China Economic Zone have developed rapidly since the mid-1980s; the Yellow Sea Economic Zone has started only recently; and the Japan Sea Economic Zone remains a proposal. They have common characteristics:

- Each forms a natural economic territory across national boundaries.
- Each has a centre that transmits growth to a periphery.
- The governments concerned have entered no formal agreements, apart from free-trade zones established by local governments in the peripheries to accelerate the transmission of growth from the centre.
- Apart from the Growth Triangle, all SREZs border on socialist economies, trade with which used to be severely restricted. Since the end of the Cold War and the adoption of open economic policies by the Asian socialist countries, natural cross-border trade and investment have resumed, though without any central coordinating agencies.

The real driving force behind East Asian development is market-based trade and investment over the whole region. As each subregional group develops, its coverage will grow and make contact with the coverage of other groups so as to form the great East Asian group. This happens to coincide with the geographical coverage of the East Asian Economic Caucus (EAEC) proposed by Malaysian Prime Minister Mahathir in December 1990, immediately after the GATT ministerial meeting failed to conclude the Uruguay Round by the scheduled time. The EAEC proposal reflected East Asian reality despite its lack of diplomatic success.

### Why Do We Need a Formal Framework?

Several problems have emerged in the process of rapid development over the last two decades.

- Interdependent growth inevitably leads to macro-economic imbalances. Some countries tend to incur persistent trade deficits, others persistent trade surpluses. The leading imbalance is that between the US on the one hand and Japan and the NIEs on the other. Other Asian countries are afraid of being affected by the growing frictions between the US and Japan.

- Restrictions on imports into the region remain, but more important are the increasing restrictions, such as voluntary export restraints and orderly-marketing arrangements, on manufactured exports to American and European markets. The region's exports of textiles and clothing have been tightly managed for individual product types and markets under the Multi-fibre Arrangement (MFA). ASEAN countries were given export quota originally far beyond their capacities, and they have been able to expand their exports. But sooner or later their quota will be exceeded by their increasing capacity and the MFA will deter further export expansion. The MFA will also restrict further exports of textiles and clothing to Asian socialist economies and South Asia. The phasing out of the MFA under the Uruguay Round is therefore essential for the further expansion of trade in textiles and clothing.
- Foreign investment and services trade are still subject to more regulation than commodity trade. On the other hand, a variety of incentive measures have been provided to compensate for these regulations. The Uruguay Round negotiations on trade-related investment measures will help resolve these complications up to a point. But as these negotiations are stalled a regional initiative is called for.
- Rapid changes in trade and production structures are accompanied by serious adjustment difficulties. These, together with the macroeconomic imbalances referred to above, cause severe friction among trading partners. This has tended to stimulate foreign direct investment to replace exports, thus further promoting closer relationships in the region.
- Tacit political assurance of some form is the prerequisite for the recent development of sub-regional groups along the borders between socialist and market regimes. However, such assurance could be cancelled at any moment; and this uncertainty deters further development of trade between the two kinds of regime. A regional framework could serve as a collective guarantee against such political disturbances.

A consultative body could deal with these problems and help mitigate disputes among trading partners. Its geographical coverage would ideally include not only East Asia but North America and Oceania. The latter two are by and large complementary in their resource endowments, provide East Asia with energy and resources and markets, and are very keen to strengthen trade and investment links with East Asia. A consultative body could help prevent trans-Pacific tensions from spreading over the Pacific as a whole and killing the region's growth potential.

Consultation often takes the form of bilateral arrangements between the countries concerned. The US and Japan have been implementing several forms of

these, including the US-Japan Structural Impediments Initiative (SII). The SII has covered such broad issues as corporate behaviour, distribution systems, saving and investment patterns, and educational systems, with the aim of improving mutual understanding of each other's systems and institutions affecting economic performance, and of coordinating conflicting differences. But although the SII mitigated mounting irritations, it is not free from conflict over the pressures and concessions needed to settle them. Furthermore, bilateral agreements often adversely affect third countries with similar interests, as in the case of the US-Japan semi-conductor agreement. Regional consultation could resolve such disputes without unnecessary confrontation and without spillover effects on other parties.

### **The APEC-PECC Process and 'Open Economic Association'**

East Asia has not been keen on formal economic integration arrangements such as the EC. But when trans-Pacific trade started to grow in the late 1960s, businessmen and economists were inspired by the EC and the European Free Trade Area to begin discussions on regional economic cooperation through two series of conferences: the Pacific Basin Economic Council (PBECC since 1967) and the Pacific Trade and Development Conference (PAFTAD since 1968).

Tripartite discussion by businessmen, academics and government officials (in their private capacities) was initiated by the Pacific Economic Cooperation Council (PECC) in 1980; and in 1989 the Asia Pacific Economic Cooperation (APEC) ministerial meeting was inaugurated. Both involve close partnership between Japan and Australia. PECC now has 20 member national committees and APEC has 15 participating governments; both are equipped with small secretariats in Singapore. They have both grown beyond series of annual meetings and are now supported by regular taskforce or work-project activities on individual cooperation issues, in close mutual cooperation. This is best termed 'the APEC-PECC process'.

Many APEC members have recently liberalised their markets in trade and investment unilaterally; and all have supported the Uruguay Round negotiations. But the limited prospects for the success of these negotiations has encouraged member countries to look towards a regional initiative for further trade and investment liberalisation. In September 1992 the Ninth PECC meeting issued its San Francisco statement on 'open regionalism' as the main policy stance of the Asia-Pacific region. However, some economists find this concept difficult. In contrast to globalism, regionalism focuses policy implementation on a particular region at the expense of countries outside the region. Since it tends to discriminate against outsiders, whether intentionally or otherwise, the idea of 'regionalism open to outsiders' seems contradictory. The strong regional measures of the EC, for example, tend to divert trade and investment from outsiders to insiders; on the

other hand, weak regionalism that does not discriminate against outsiders would not redirect demand towards regional partners. But the Asia-Pacific region does not discriminate against outsiders; its weak regionalism sustains high growth rates because of the vigorous development of insider firms, its diversity in development stages, the size of its economies, and its resource endowments. Despite increased intra-regional trade, East Asia remains highly reliant on extra-regional trade.

However, trade is only a part of the liberalisation agenda. Nowadays, the region is engaged also in investment, services and other types of transaction

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across national borders, and these are restricted by a variety of national regulations and rules. Harmonising these rules and making them transparent would encourage intraregional transactions without necessarily discriminating against outsiders. Free-trade agreements negotiated nowadays all include such harmonisation, and are thus much wider than the classic concept of a free-trade area (FTA), in which internal tariffs are eliminated while different external tariffs remain. In the Asia-Pacific region, not even this low level of regional integration is contemplated. The modern version of the FTA is better understood as providing an environment in which goods, money, people and information move across borders, and enterprise is encouraged to extend its horizons and promote global operations. Tariffs and non-tariff barriers of course deter such activity, but bottlenecks in transportation and communications, insufficient information, limited availability of skilled personnel, and environmental restrictions also discourage enterprise. But the continued use of the old FTA model with a substantially changed content would give an unnecessarily negative impression of discrimination against

outsiders. It may be better to adopt a term like 'open economic association' (OEA) to emphasise its much less discriminatory impact on outsiders.

### **An Agenda for APEC**

A consensus is emerging in the Asia-Pacific region that its integration should contain an OEA in a loose regional framework. The APEC-PECC process fulfils this requirement. Many member governments and committees appear to favour further institutionalising and intensifying its activities so as to meet the region's emerging needs, though its extent and form have yet to be agreed. The following agenda is suggested, based on the preceding discussion (Yamazawa et al., 1992):

- The successful conclusion of the Uruguay Round, even if its achievement is small, is imperative to the APEC-PECC process. A global free-trade and investment environment is a necessary condition of the further development of Asia-Pacific integration.
- In the post-Uruguay Round period, APEC members will continue their efforts to liberalise those impediments to trade and investment that will be left unresolved by the Uruguay Round, most likely in areas such as services, trade-related intellectual property rights, and trade-related investment measures.
- Post-Uruguay Round efforts should be broadened to promote the new OEA in the region, including policy dialogues, elimination of physical bottlenecks, reduction of uncertainty, and harmonisation of rules and regulations.
- APEC should accommodate such subregional groupings as NAFTA, ASEAN and the Australia-New Zealand CER as well as such independent trading nations as Japan and Korea. It would encourage their individual development along GATT-consistent lines.
- APEC would be open to outside regions such as Europe, South Asia and Latin America through its OEA approach. It would encourage its firms to participate in development outside the Asia-Pacific region and invite firms outside the region to participate in the development of the region, thereby contributing to global development.

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