ECONOMIC INTEGRATION IN THE ASIAN PACIFIC: ISSUES AND PROSPECTS

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ABSTRACT

This paper examines the scope, broad principles, and characteristics of Pacific Asia's economic relationships and cooperation at the regional level. The author addresses the broad issue of whether Asian efforts for regional cooperation and integration have been compatible with similar arrangements elsewhere or with an open multilateral trading system at the global level. The paper also assesses the changing dynamics of regional integration and its future prospects and explores the possibilities and implications of Asian integration for the United States and the rest of the world.

RESUMEN

El presente trabajo analiza el alcance, los principios generales y las características de las relaciones económicas y la cooperación a nivel regional en el Asia del Pacífico. El autor aborda el tema de si los esfuerzos asiáticos para la cooperación e integración regionales han sido compatibles con otros arreglos similares o con un sistema multilateral de comercio abierto a nivel global. El trabajo también evalúa la dinámica del cambio de la integración regional así como sus perspectivas futuras y explora las posibilidades y las implicaciones de la integración asiática para los Estados Unidos y el resto del mundo.

1. Introduction

The post–World War II era has witnessed stunning developments in the countries in East Asia along the Western Rim of the Pacific Basin, referred to here as the Asian Pacific Region (APR), which includes Japan, China, and those newly industrialized and industrializing countries in northeast and southeast Asia. Only a half-century ago, this region—currently with 60 percent of the world population and producing nearly a half of the world's manufactured goods—had all the characteristics of underdevelopment with widespread poverty, high rates of unemployment and illiteracy, and poor health standards.

The region as a whole has for some time been undergoing a process of natural integration in trade and capital flows, which has contributed to its economic dynamism and vitality. Amid this dynamic growth, a new environment is being created in which to lay the foundations for 'forward-looking economic ties' among East Asian nations. Nonetheless, in recent years many Asian governments were concerned with the global trend toward closer regional economic cooperation elsewhere, such as the European Community (EC) and the North American Free Trade Area (NAFTA). They began to see a need to define a clear vision for future area cooperation in the face of regional bloc formation in the global economy.

Much of the earlier discussions on Asian integration have, however, been concerned with economic achievements and structural changes in the region as well as their implications for regional integration (see for example, Kojima 1980; Yamazawa et al. 1991; Riedel 1991; Wade 1992; and Wu 1991). Digressing somewhat from these pervasive themes, this paper focuses on twofold objectives: First, it analyzes the scope, broad principles, and characteristics underlying the economic cooperation in the APR. One broad issue that will be examined is whether Asian efforts for regional cooperation have been compatible with similar arrangements elsewhere or with an open multilateral trading system at the global level. Second, the paper assesses the changing dynamics in the region and the prospects for regional integration, exploring further the possibilities and implications of Asian integration for the United States and the rest of the world.

2. The Economic Profile of the Region

Table 1-A compares the economic size of the world's three largest regions proceeding toward ever higher levels of economic interdependency: they consist of the North American region which is exemplified by the latest effort for the creation of a free trade area among the United States, Canada, and Mexico; the European Community (EC); and the Asian Pacific

Region. The APR, although largest in population and still smallest in terms of the total GDP, has nonetheless been the most dynamically expanding area in the global economy.[1]

TABLE 1-A

Asian Pacific Region: Comparative Macroeconomic Indicators (1991)

	GNP (billion US dollars)[a]	Population (100 millions)	Per capita GNP (US dollars)	Rate of economic growth (percent)	Exports (billion US dollars)
APR	3861.4	5.07	7,609	4.9	579.4
Japan	2989.8	1.24	24,201	4.1 (1.5)[b]	287.6
ANICs	585.6	0.72	8,187	6.8 (5.3)	205.6
ASEAN	286.0	3.12	916	6.3 (5.8)[c]	86.2
China	369.8	11.22	329	5.8 (12.8)	60.9
EC	5958.3	3.43	17,363	1.4 (0.9)	1446.9
NAFTA	6527.8	3.63	18,001	-0.6	552.3
USA	5672.6	2.50	22,693	-0.7 (2.1)	393.6
Canada	572.7	0.27	21,595	-1.7 (0.7)	131.7
Mexico	282.5	0.86	3,279	3.6 (2.6)	27.0

[a] GDP and export figures are based on official exchange rates.
[b] Figures in parentheses are for 1992.
[c] This figure includes Vietnam, Cambodia, and Laos, in addition to the six ASEAN countries listed below.
Sources: IMF, Asian Development Bank, and Economic Planning Bureau (Japan)

During the 1970s and 1980s, the APR as a whole enjoyed annual real growth rates of 6 to 7 percent while the rest of the world has stagnated at 2 to 3 percent. In particular, both the ANICs (Asian Newly Industrialized Countries—South Korea, Taiwan, Singapore, and Hong Kong) and ASEAN (Association of Southeast Asian Nations—including Singapore, Thailand, Malaysia, Indonesia, the Philippines, and Brunei) economies, with the exception of the Philippines, expanded at two to three times the rate of growth in the global economy as a whole (Table 1-B). Calculations by the Asian Development Bank (1993) show that in 1965 the APR produced goods and services at a level 75 percent below the combined total of the US and Canada. By 1983, the total production increased more than eightfold to a level only 50 percent below the combined production of the United States and Canada and 30 percent below West European production. The dynamism of robust expansion in the regional economies has been continuing in the midst of

[1] The GNP measures here are based on official exchange rates. If measured in terms of the currency's comparable purchasing power, the importance of the East Asian economy would rise. Recent IMF calculations using the method of purchasing power parity ranked China as the world's third largest economy.

the recent global recession: while economic growth in the United States and Germany has hovered at the rates ranging from a negative to a positive two percent in 1991–92, the APR's annual GDP growth rate accelerated to 7 percent in 1992 from the previous year's 6.1 percent.[2]

TABLE 1-B

Average Annual Economic Growth Rates in APR
(unit: percent)

	1970-80	1980-85	1985-90
Japan	4.7	3.8	4.7
ANICs	9.1	6.8	8.6
S. Korea	8.2	8.4	10.8
Hong Kong	9.3	5.6	7.8
Taiwan	9.7	6.8	9.2
Singapore	9.0	6.2	7.9
ASEAN 4	7.5	6.7	6.8
Indonesia	8.0	4.7	6.3
Malaysia	8.0	4.4	6.3
Thailand	6.8	5.5	10.0
Philippines	6.3	-1.0	4.6
China	5.7	10.1	7.9
USA	2.8	2.6	2.8
EC	4.5	2.2	4.5
World	3.6	2.6	2.9

Source: Institute of Asian Economic Research 1993, p. 290

In tandem with the rapid economic growth, the volume of trade has also expanded at a similar pace. In particular, the intra-regional trade in Asia has grown at twice the rate of the world as a whole. The large picture in Asia's emerging markets is the expansion of the domestic demand stimulated by the economic reforms aimed at attracting foreign investment, lowering inflation through reductions in budget deficits, privatizing inefficient state enterprises, and liberalizing trade (the latter mainly as a result of decisions taken unilaterally to pursue each country's own self-interest). Combined with increasingly educated work forces capable of adapting easily to the introduction of new technology, these measures greatly stimulated foreign investment in these countries, which contributed to the region's dynamism.

The APR contains countries with vast differences in population, land size, resource endowments, and levels of development. It will thus be useful for purposes of analysis to divide

2 The average inflation rate for the region as a whole was held down to 6.7 percent in 1992, reflecting the reduction from 8.4 percent in 1991. The average output growth rate for the developing world as a whole was 5.1 percent with the average inflation rate at 48 percent (Asian Development Bank 1993).

the region into four groups of countries, classified by the level of the country's industrialization: First, Japan, with a per capita income in excess of $24,000 in 1991, stands as the only industrialized country in the region that belongs to the Organization of Economic Cooperation and Development (OECD) group of countries. It is the region's dominant economy, accounting for close to 40 percent of the APR's trade volume. Next comes the group of the so-called Asian Newly Industrialized Countries (ANICs). This tier of countries exhibited per capita income ranging from $6,500 in Korea to $14,000 in Hong Kong in 1992, accounting for another third of the region's trade. The third tier is made up of the newly industrializing Association of Southeast Asian Nations (ASEAN). Singapore, which in terms of its stage of development belongs to the ANIC, is an ASEAN member because of its political and economic association with other member countries. Excluding Singapore, the ASEAN group exhibits per capita income ranging from $600 in the Philippines to $2,000 in Malaysia. The ASEAN countries already have a strong industrial base and have been vigorously pursuing an export-oriented industrialization strategy, filling the gap left behind by the ANICs. The higher wages in the latter have been edging out their comparative advantage in labor-intensive exports to the ASEAN countries. The fourth category is mainland China itself. China, with an immense population in excess of one billion, has per capita income estimated at $450 in terms of official exchange rates but a much larger figure of $1,600 when measured on the basis of purchasing power parity.[3] Although it has not yet officially been accepted as a full member of the integration in the region, it deserves separate attention because of its size and the dynamic vitality of its economy and the consequent impacts on the rest of the region and the world.

Although the ANICs experienced the world's fastest growth rates in the decades of the 1960s and 1970s, the 1980s saw the fastest growth in the late-comers of the ASEAN group, excluding the Philippines.[4] In the early 1990s, the East Asian region as a whole has been characterized by a mixture of different levels of performance in the subregional groups; there was a sharp acceleration in growth in China, a slowdown in the ANICs,[5] and continued progress in the newly industrializing economies of ASEAN. In the case of the four ASEAN economies of Indonesia, Thailand, Malaysia, and the Philippines, in 1990 the proportion of the agricultural work force fell below 50 percent for the first time in their history. Moreover, industrialization in these

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[3] IMF's estimate in 1993. This places China as the world's economically third largest country. See *Wall Street Journal,* 24 September 1993, R6.

[4] The Philippines, owing largely to the mismanagement of the economy under Marcos's regime, performed very poorly in the 1960s and the 1970s. The country, which still lags behind other ASEAN partners, has been implementing new policies focused on catch-up growth with some success since the mid-1980s.

[5] South Korea, for instance, experienced a significant slowing down in economic growth in the early 1990s in the wake of government efforts to dampen domestic demand. The growth rate of investment fell sharply, and that of private consumption also declined.

countries has proceeded with an increasing diversification in exports and a deepened vertical integration in their industrial structure. Combining the four countries together, the share of manufacturing exports in the total jumped from an average of 17 percent in 1980 to 51 percent by 1990. Moving gradually away from the export concentration in rubber, tin, rice, palm oil, and crude oil, these ASEAN countries have succeeded in exporting such sophisticated products as machinery and electronic goods, and in the case of Malaysia and Indonesia, even automobiles and aircraft (Wu 1991). Those countries have at the same time succeeded in reducing dependence on imported components in their manufacturing activities. In 1985, the ratio of locally made parts ranged from 64.6 percent in Malaysia to 80.7 percent in Indonesia (Institute for Development Economics 1985). These figures contrast greatly with a Latin American country such as Mexico, in whose manufacturing sector parts and components imported from abroad typically exceed 60 percent. The strong performance in Asia's late-industrializers has been helped by the growth momentum of international capital and trade flows stimulated by market reform and liberalization policies adopted in recent past;[6] private investment and trade flows in these countries expanded rapidly, aided by the concomitant increase in public spending on infrastructural improvements.

3. Regional Interdependency: Features and Schemes

In East Asia, unlike the EC, there have been no really serious movements to create a regional trade bloc that would turn inward rather than outward. The issue that needs to be addressed is whether any compelling rationale can be found to create a regional trading bloc in East Asia. Before the discussion on prospects for Asian integration, it will be useful to outline the nature and extent of trade and investment linkages that prevail among the countries in the region.

Trade interdependency

A distinctive feature of East Asian trade is a growing importance of intra-industry trade and interdependency in trade relations within the region. This development is accompanied by continuing regionwide reductions in trade barriers and convergence in income levels, as the lower-tier ASEAN economies begin to attain higher levels of industrialization. To quantify the extent of trade interdependency, we have relied on a measure of the intensity of trade

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6 The examples include Malaysia's Privatization Master Plan, which targets more than 200 state enterprises for privatization; Singapore's 10-year program to privatize 41 government-linked firms; and privatization plans of large-scale infrastructural projects in Thailand and the Philippines. In the recent past there have been increased commitments among the ASEAN governments toward the deregulation of foreign and domestic businesses, reduction of tariff rates, and liberalization in the area of banking and finance.

interdependency (ITI) calculated between a pair of subregions. The indicator, for example, defined for exports from country i to country j is calculated as the ratio of the share of country j's imports in country i's total exports to the share of country j's total imports in the world's total imports:[7] Thus, the larger the indicator, the more important is the particular importing country as a market to the exporting country. If the particular market facing an exporter is relatively equally important, the index will be one. In this case, the importer's share in the exporter's total exports equals the importer's relative share in the world.

The calculations in Table 2 show that for the ANICs and the group of ASEAN and China, the markets of each other are the most important. Closer trade relations between these two groups bear out the feature of inter-industry trade and a complementarity trade structure in which the conventional forces of comparative advantage operate. Although a majority of East Asia's developing countries began to pursue the strategy of export-oriented industrialization, they have been able to achieve rapid growth all at the same time. The regional economies in Asia, by and large, are at different stages of industrialization and do not produce the same type of industrial products. There has been a well-defined, natural division of labor in East Asia.

TABLE 2

Intensity of Trade Interdependency (ITI) within and between Regional Blocs (1990)

Importer / Exporter	USA	ANICs	ASEAN	Japan	EC
USA	-	1.98	0.54	1.71	1.91
ANICs	1.74	6.24[a]	5.69	2.39	1.09
ASEAN	0.52	6.58	2.13	1.49	0.52
Japan	1.68	2.68	1.48	-	1.11
EC	1.83	1.24	0.54	1.11	16.29

[a] Intra-regional trade figures are calculated by adding the exports of all member countries.
Source: MITI 1992, p. 29

Figure 1 illustrates the different stages of industrialization in which large countries and subregions of the APR find themselves.[8] If the stages of industrialization can be classified in a chronological sequence of labor-intensive industries (e.g., food processing, textiles, leather

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7 The index of interdependency in exports between two countries A and B is calculated as:

ITI = (exports from A to B/A's total exports) / (B's total imports/world total imports).

The index for the case of imports can be similarly defined.

8 China has the capacity to compete with Japan and the ANICs in some areas. Given the advantage of an abundant labor force, China, by and large, is competing with the ASEAN countries in the downstream labor-intensive products.

products), capital-intensive industries (steel, chemicals, petroleum refining), technology-intensive industries (durable consumer goods, automobiles, capital and intermediate goods), and finally high-tech industries (electronics, informatics, biotechnics, and material science), one can envision a ‘flying geese’ pattern (Akamatsu 1962) in technological capabilities, which have been led by Japan and closely followed by the ANICs. The ‘flying geese’ pattern implies a complementarity structure in East Asian trade: different stages require different factor intensities, which reflects the dynamic evolution in the patterns of comparative advantage for the regional economies. It is worth noting that this subregional division of labor in East Asia has been facilitated by increased foreign direct investment from the countries producing the upstream capital-and skill-intensive products in the less industrialized counties. The trade-enhancing role of foreign investment is further discussed in the next section. Yokota and Imaoka (1993) have reached similar conclusions concerning the structure of trade interdependency in Asia. They find that the overall regional complementarities in trade are higher in the APR than elsewhere. Moreover, trade complementarity is found to have been increasing as many countries in the two subregional groups continue to specialize in products in which they have comparative advantage, thereby expanding the volume of trade.

FIGURE 1

Subregional Division of Labor in the APR

Labor-intensive stage; Capital-intensive stage; Technology-intensive stage; High-tech stage.

ASEAN ------------------------------------
ANICs ---
China -------------------------------------
Japan ---

Intra-industry trade is another distinctive feature of East Asian trade. The greater levels of interdependency in the trade among the ANICs and between Japan and the US can be seen as reflecting the pattern of intra-industry trade as each country tends to specialize in some differentiated products based on economies of scale in production. Yokota and Imaoka, (1993, pp. 34–40) find pronounced similarity in the commodity structure of trade among the ANICs and Japan, which can be attributed to the rising trend of intra-industry trade in manufacturing.[9] For most of the developing Asian economies, Japan emerges as a more important trade partner than the United States in both the volume of trade and in measures of interdependency. Exports of

9 For a similar finding, see Kreinin and Plummer (1992).

the ANICs, however, have been far greater to the US market than to Japan, while they import more from Japan.[10]

Kellman, Cahn, and Glass (1986) explained the larger trade flows, as shown in Table 2, among the ANICs and, to a less extent, the ASEAN economies in terms of similarity in commodity composition of trade, which in turn reflects similarity in incomes and taste or preference within each subregion.[11] Furthermore, geographical distance, cross-cultural differences, and language barriers are relatively small within each of the subregions, which should lessen transaction costs imposed on trade and capital flows.

Intra-regional trade in the APR has been stimulated from the continuing process of specialization within the region, the consequent rise in foreign direct investment from Japan and the ANICs for the relocation of their production capacity to other Asian countries, and recently from the rapid growth in the Chinese economy. The root cause for the vibrant trade flows in Asia is the policies of trade and investment liberalization adopted—often unilaterally—by the ANICs and ASEAN countries in the 1980s. Their policies of more liberal foreign investment increased flows of foreign direct investment, particularly from Japan, which has resulted in the formation of the networks for intra-firm trade and the consequent increase in intra-regional trade. As shown in Table 3, intra-regional trade has become increasingly important, especially for the developing Asian economies,[12] as its expansion began to contribute to sustained growth in the regional economies. More recently, the dynamism of intra-regional trade has been playing a critical role in sheltering the regional economies from the stagnant growth of the global economy.

Interdependency in Capital Flows

Along with intra-regional trade, intra-regional capital flows—private and public—have played a complementary role in the process of Asian integration. The striking feature of capital movements in East Asia is that the developing Asian countries have increasingly relied on the sources of capital from within rather than from without the region. During the 1980s, foreign direct investment (FDI) in the region not only rose in amounts but the share of intra-regional investment, primarily from Japan and the more developed ANICs, also expanded rapidly. While the total FDI in the region increased 1.6 times between 1982 and 1986 and another 2.4 times

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[10] In 1990, the ANICs exported $730 billion worth of goods and services to the US, while importing $410 billion from it. In the same year, ANICs' exports to Japan amounted to $370 billion while they imported from Japan $570 billion worth of goods and services.

[11] Excluding entrepot Singapore, the trend in intra-ASEAN trade shows a very small increase in the eight years between 1984 and 1992.

[12] Trade among developing Asian countries expanded by 23 percent in 1991, while their exports to the rest of the world increased only 14.8 percent. In particular, exports from the developing Asian economies (the ANICs and ASEAN) reached more than 60 percent of China's total imports in 1991 (Asian Development Bank 1993).

between 1986 and 1990, the share of intra-regional investment from Japan and the ANICs reached a half by 1990 (Kohosaka 1993, pp. 79–90 and 100).

TABLE 3

Trade Shares of the ANICs and ASEAN Nations

	ANICs		ASEAN		Japan		USA		W. Europe[a]		Total	
	E[b]	M[c]	E	M	E	M	E	M	E	M	E	M
ANICs												
1985	8.9	8.2	7.6	9.6	10.0	22.8	34.8	16.8	8.0	8.5	100.0	100.0
1991	13.7	10.7	9.2	8.5	10.5	22.7	24.5	16.4	11.1	8.9	100.0	100.0
ASEAN												
1985	20.0	16.5	4.5	5.9	31.1	23.3	19.7	15.9	6.4	11.5	100.0	100.0
1991	23.2	21.2	4.0	3.8	22.9	26.0	18.3	13.7	10.6	11.5	100.0	100.0

[a] W. Europe comprises the UK, Germany, France, and Italy
[b] Exports to
[c] Imports from
Source: Economic Planning Bureau 1992

The recent surge in FDI in the developing Asian countries is attributable to the region's economic dynamism in the wake of its unilateral trade and investment liberalization. The bulk of the increase in FDI has been concentrated in such emerging markets as China,[13] Indonesia, Malaysia, and Thailand. The yen's steady strengthening against the dollar has also prompted Japan's FDI in southeast Asia, triggering further expansion of intra-regional trade through increased demands for imports from the region.

It is also worth pointing out that increased foreign investments in the APR have been accompanied by financial-sector reforms in the developing Asian countries. Financial intermediaries and markets in the APR, which were highly regulated until the early 1980s, expanded rapidly thereafter as a result of efforts by Asian governments to liberalize their financial sectors. The reforms, by focusing on a wider choice of ways to raise funds and special financial instruments to permit investment risks to be traded, had generally beneficial effects on the level of domestic and foreign savings and the efficiency of investment.

The development of financial markets through reform measures in the APR appears to have led to the strengthening of links among national economies, thereby enhancing opportunities of foreign investment. Also, well-developed financial markets are instrumental in

[13] PRC received $11 billion in foreign investment in 1992, of which Japan, Hong Kong, and Taiwan were responsible for more than 85 percent.

mobilizing savings and improving efficiency in the allocation of resources. Table 4 shows for selected developing Asian countries the turnover levels in the financial markets consisting of money, foreign exchange, bonds, and equities. Market turnover is used here as a crude measure of financial markets development. Financial liberalization is seen as resulting in increased turnover levels. Comparisons between 1985 and 1991 data show that most rapid growth in financial markets occurred in the two financial centers of Hong Kong and Singapore, followed by South Korea, Taiwan and, more recently, by ASEAN and China as those countries pursued subsequent liberalization measures in their financial sectors. Overall, foreign exchange markets grew rapidly in most developing Asian economies, helped by the elimination or easing of foreign-exchange controls and the consequent expansion of trade and foreign investment flows.

TABLE 4

Turnover in Financial Markets as Percent of GDP

	Money Market		Foreign Exchange Market		Government Bond Market		Equity Market	
	1985	1991	1985	1991	1985	1991	1985	1991
ANICs								
S. Korea	0	44	117	124	-	-	4	30
Taiwan	231	443	3	-	0	70	8	205
Hong Kong	0	191	7730	17800	-	-	29	54
Singapore	-	-	71[a]	187[a]	8	76	24	89
ASEAN								
Indonesia	22	84	0	87	-	-	-	3
Malaysia	416	369	-	-	0	6	8	23
Thailand	85	83	76	137	-	18	0	34
Philippines	88	134	57	36	-	-	-	3
China	0	16	-	-	0	2	0	-

[a] Figures refer to daily average.
Source: Asian Development Bank 1993, p. 49

Japan has been the principal supplier of capital in the region. The broad objectives of Japanese multinationals in East Asia are to secure access to the region's abundant natural and human resources and to the rapidly expanding regional markets by establishing a production base locally that will be complementary to the domestic production structure. Such a strategy has resulted in fostering a distinct regional division of labor, with the allocation of higher value-added intermediate products to be manufactured in the more industrialized ANICs and the lower value-added in the ASEAN countries where low wages, rather than a skilled labor force, would serve as the main inducement for Japanese investment.

In this regard, the main objective of Japan's official aid policy in East Asia has been in promoting its business interests in the region. East Asian countries have received some 60 percent of Japanese bilateral aid, and about a third of it has been spent on physical infrastructure building—mainly on transportation and energy. The attention to infrastructure is meant to help Japanese multinationals operating in the region (Unger 1993). More recently, Japanese investments in Asia have increasingly been shifting toward the assembling of capital—and technology-intensive goods and the manufacturing of their parts and components. There have been increased needs to shift to the intra-industrial division of labor involving international subcontracting and outward processing through subsidiaries of big Japanese companies, as the regional economy undergoes a structural change.[14]

The ANICs, as the latecomers in investment, have also been important in FDI in neighboring Asian countries in the past decade.[15] As investment commitments from Japan began to fall during the prolonged recession in early 1990, the slack was quickly taken up by increased investment by the ANICs[16] and the US. The former have been adopting a strategy to shift from export-oriented growth to domestic demand-led growth and were moving unprofitable manufacturing bases into lower-wage ASEAN nations and China.

Rising capital flows are accompanied by rising trade in East Asia. During the late 1980s, when FDI inflows in Southeast Asia rapidly rose, their exports more than doubled. In East Asia, the rapidly growing capital flows led to a regional division of labor as a way for the regional economies to forge a pattern of trade complementary to each other. This investment pattern contrasts with the ANICs' or Japanese investment in the US and the European Community, where investment tends to be undertaken for purposes of getting behind the protective walls of the host countries in order to secure market access as an 'insider.' Many Asian multinationals operating in North America and Europe have in the past succeeded in building the networks of their own suppliers to serve their overseas affiliates' marketing in the host country. This has been especially the case with Japanese FDI in sectors such as automobiles and electronics. Thus,

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[14] Japan's MITI claims that this pattern of investment during the decades of the 1970s and 1980s improved the host countries' trade deficits by stimulating export promotion and improving the competitive conditions of host countries through transfer of technology and know-how (MITI 1991, p. 209).

[15] The combined ANICs' FDI in the ASEAN countries is currently greater than that of Japan's. The emergence of the ANICs as capital exporters on a significant scale is attributed to (1) the appreciation of their currencies and the consequent search for lower cost production sites, (2) the removal of the Generalized System of Preferences (GSP) privilege by the US in 1989, and (3) the current account surpluses that some of them (especially Taiwan) had for much of the 1980s.

[16] From 1988 through 1991, the largest buyers of exports from China and ASEAN were the ANICs, which accounted for 46 percent, or $68.7 billion, of the Asia Pacific region's total increase in trade of $161 billion over the four-year period. The ANICs have now emerged as the largest investors in ASEAN since 1990.

unlike the case of investment within the region that enhances intra-regional trade flows, East Asian capital exports to other industrialized economies are trade-replacing.

In sum, trade activities in East Asia must be understood in relation to the changing patterns of international division of labor that have been brought about by the complementary role played by capital movements within the region. This pattern of economic interdependency has been the key element in East Asian efforts for regional collaboration.

Open Regionalism

Despite the marked trends of increasing intra-regional trade, the inter-regional trade still accounts for a larger share of East Asia's trade (Table 3).[17] East Asia's close economic links with non-Asian countries essentially reflect a potential for, and possibilities of, an open-ended character of regional integration. A study by Yokota and Imaoka (1993) corroborates that, unlike the case of the EC, which moves toward 'regional autarky,' the APR's complementarity in terms of comparative advantage rests more on its inter-regional trade than on its intra-regional trade.[18]

East Asian countries' enthusiasm for an open multilateral trading and investment system is consistent with their outward-oriented industrialization strategy. Following the steps of Japan, the ANICs have pursued outward-looking policies from the outset. The adoption of outward orientation was a necessity for these economies with the limitations of their relatively small domestic markets and the lack of basic raw materials for industry. The resource-rich ASEAN countries were slower to adopt outward-looking policies. Beginning in the 1970s, they also initiated a process of shift in trade regime toward export promotion as a means to diversify their exports and accelerate economic growth. Relatively low primary-goods prices in the 1980s forced these countries to further expand manufacturing activities for export. Coming to the 1990s, most East Asian economies have been pursuing a strategy for export-led growth along with their unilateral, nondiscriminatory trade and foreign investment liberalization.[19] To many East Asian countries, closer trade relations with external regions continue to remain equally or perhaps more important.

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[17] Similar to the NAFTA countries' 40 percent but unlike the EC's 75 percent, the intra-regional share in East Asian trade is currently around 35 percent.

[18] Complementarity in trade structure reflects the case of each country's specializing in a set of goods in which it has a comparative advantage. The inter-industry trade volume is thus expected to increase under a complementary trade structure. According to the authors' calculations (1993, p. 43), a 1% increase of complementarity in the intra-regional trade of East Asia would raise the export volume by 0.59 percent, whereas in EC that would increase the export volume by 1.49.

[19] While for 1987, all of the ANICs and the ASEAN except the Philippines and Indonesia were classified as countries adopting outward-looking policies, only Brazil and Chile in Latin America were considered by the World Bank (*World Development Report 1987*) as moderately outward-oriented.

Thus unlike the case of the EC and possibly NAFTA, whose primary objective of integration is to spur growth in their member countries through mutual cooperation, the general direction of development strategy in East Asian countries has been to expand inter-regional trading frontiers under the framework of freer, multilateral capital movements, while simultaneously strengthening intra-regional economic cooperation. In East Asia, a virtuous circle among trade, investment, and economic growth in the setting of an open regionalism has been operating for some time. There seems no really convincing economic rationality for introducing a discriminatory, exclusive integration scheme at this stage. In effect, many East Asian economies have for some time been pursuing both intra- and inter-regional divisions of labor simultaneously, making it possible for economic growth in the region to positively contribute to a multilateral trade regime in the global economy. In this context, Frankel (1993) argues that for East Asia, a preferential regional trading arrangement that goes beyond some 'natural' level[20] of regional trade and that is justified by cultural and physical proximity of member countries is more likely to induce trade-diversion than trade-creation.

Current Schemes for Economic Cooperation

In contrast to the proliferation of regional arrangements in other parts of the world, there have been relatively few intergovernmental efforts made in Pacific Asia for the institutionalization of regional integration. The existing proposals for integration, which currently are split in two directions, differ primarily on the question of whom to include. The earlier Malaysian-initiated East Asia Economic Caucus (EAEC) as a forum for regional cooperation in trade and investment restricted the participation of members to Asian nations. It included the ASEAN (Association of Southeast Asian Nations) countries as principal members, with the option to invite other Asian countries, such as Japan, China, South Korea, and Vietnam. Various economic cooperation schemes adopted by ASEAN had limited success, as the member countries ran into difficulties in collective decision-making. A low degree of economic complementarity with each other in the ASEAN bloc continued to hamper growth in intra-ASEAN trade.

Nonetheless, faced with the current global trends of regionalism and the slow progress in their own regional cooperation, the ASEAN group began in 1992 to establish an ASEAN Free Trade Area (AFTA) among its six members. The AFTA may reflect the defensive posture of the ASEAN countries to shield themselves from other trading regions and the desire to use it as a

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20 The argument (Frankel 1993) is that neighboring countries tend to trade more with each other than could be explained by simple economic factors: the reasons include reductions in transaction costs by virtue of a common language and business culture; advance of political good will among neighboring countries via economic relations; and/or the solution of the problems calling for regional cooperation (acid rain, river or air pollution). He also points out that when neighboring countries already trade substantially with each other, trade creation is likely to be enhanced by increased regional trade.

means of regional bargaining leverage in dealing with other trading blocs. More significant, however, will be the economic rationality to use the integration scheme as a mechanism to enhance international competitiveness of the industries of ASEAN through promotion of intra-regional division of labor.

The key provisions of the AFTA have so far been limited to the implementation of a common effective preferential tariff scheme (CEPT), which will reduce tariffs within ASEAN to 0–15 percent in 15 years starting from January 1993. Malaysia and Singapore were the first countries to announce tariff cuts under the scheme. Given the region's highly diversified patterns of trade and high degrees of dependence on extra-regional trade, the progress in intra-regional cooperation is expected to be slow, and the AFTA is not likely to turn into a protectionist trading bloc.

The ASEAN initiative to exclude non-Asian Pacific Rim economies has, on the other hand, aroused considerable apprehension in the US and Australia, along with South Korea and other ANICs. Many of the developing Asian countries, in particular, the ANICs, are highly dependent on external markets, and are seriously concerned with the consequences of trade and investment diversion for a breakdown of the world trading system. Thus, along with other geopolitical reasons that will be discussed later, they have preferred the economic cooperation schemes that include the externally important trade partner, in particular the United States.

As a result, an alternative scheme currently being initiated is Asia-Pacific Economic Cooperation (APEC), which is an intergovernmental forum aimed at enhancing economic cooperation among the Pacific Rim countries which include, in addition to countries in the APR, such non-Asian economies as the US, Canada, Australia, and New Zealand. Despite the enormous hurdles anticipated in harmonizing the conflicts of interests among member countries with different economic conditions, there was a general agreement to accept trade and investment liberalization as an officially stated objective of APEC. Even the original ASEAN members that had insisted on an Asian-only EAEC framework are now seeing the usefulness of APEC as a forum for ASEAN through which multilateral trade issues with North American partners can be taken up. So far, no concrete schemes for liberalization have been discussed. A series of November 1993 meetings in Seattle was characterized by conflicting ideas among APEC members over the agenda and pace at which the region's integration should proceed. Many Asian nations have so far resisted the idea of institutionalizing the fledgling organization for regional integration. Nonetheless, the possibility that APEC might initiate some kind of institutional integration by the end of this century must not be ruled out.

4. Issues in Asian Integration

One immense hurdle that would make the cooperation schemes harder to achieve in Asia is the diversity of culture, history, religion, language, and forms of government and the level of development of countries in the region. This section focuses on the roles of economic and political factors in fostering regional integration in Asia.

Economic Factors

In the case of a closed, intra-Asian integration, the main issue to arise would inevitably be trade diversion. Both the ASEAN economies and the ANICs critically depend on the external markets outside Japan of the US and, to a lesser extent, the EC. Thus, should Asian integration decide to keep out Western Pacific Rim nations, in particular, the United States, there would be substantial economic losses for the region's economy as a whole. Especially in an intra-ASEAN integration, trade diversion would be larger since the ASEAN economies are competitive rather than complementary to each other.[21] With the exception of Singapore, the ASEAN economies produce similar commodities, and there are fewer possibilities for complementarity in trade in the region, especially in the case of primary goods (Imada 1993).

The alternative integration that incorporates a broader area of the Pacific Basin countries would, however, give rise to different kinds of problems. One major issue would be the difficulty in coordinating conflicting interests among member countries with their vast differences in economic conditions that rule out any easy approach to economic integration acceptable to all member countries. Clearly, the conventional customs union approach would likely result in an unequal distribution of economic gains between more and less developed trading partners. Another issue would concern the implementation of trade liberalization based on the concept of open regionalism. If open regionalism implies the removal of trade barriers on an unconditional Most Favored Nation (MFN) basis, the free-rider problem would arise.

The question of inclusion of member countries aside, another common issue to be resolved before any serious efforts for regional integration can get under way would be how to harmonize or coordinate conflicting interests and policies of individual countries.[22] For instance, the current problem with the AFTA plan is the lack of coordination in scheduling tariff reductions of individual member countries. This is likely to raise serious problems, since most ASEAN

[21] Singapore and Malaysia began recently to specialize in relatively more technology-intensive and human capital-intensive goods exports, while the Philippines and Indonesia are exporting relatively unskilled labor-intensive goods. Thailand is positioned in between these two groups. This may indicate a long-run potential for the ASEAN industrial sectors to develop more complementarity in a vertical productive linkage to each other. For theoretical discussions on economic integration, see Arndt (1969) and Corden (1974).

[22] One successful case of harmonized economic policy is the management of the exchange rate in East Asia. The exchange rate has been regularly adjusted to a basket of currencies, which has led to maintenance of a fairly stabilized exchange rate system, thereby contributing to sustained expansion of trade in East Asia.

economies are direct competitors with each other in the same economic sectors. Thus, some arrangements for regional cooperation will be necessary in order to resolve the rising trade imbalances and conflicts among member countries that are expected to occur under trade liberalization. In order for trade and investment activities to continue a sustained expansion, more forceful intra-regional cooperation going beyond a simple freer trade agreement would be imperative if the impediments to trade such as infrastructure bottlenecks, restrictive regulations and foreign investment laws, etc., are to be removed. Furthermore, from the longer-term perspective of integration, a cooperation scheme that requires member countries to agree to the development of industrial complementarity among themselves might be necessary in the East Asian context.

There is another complex problem in harmonizing country interests in Asia. In the past, all of the East Asian economies (with the exception of Hong Kong) have to varying degrees adopted, and some at present continue to follow, interventionist policies to promote export-led industrialization.[23] Following the earlier Japanese and the ANICs experiences, the guiding role of the state in industrial development has often been seen as imperative for success in these latecomers' industrialization. This has led to complex policy interventions in the selected economic sphere in many Asian nations. Malaysia's current development plan for 1986–95, which provides for a variety of subsidies and preferences for selected sectors of the economy, is a good example (UNIDO 1991, 53). Any attempt to implement country-specific industrial policies would undoubtedly complicate the task of establishing a level playing field for all participating countries within the context of either AFTA or APEC.

Geopolitical Factors

The nations in the APR, by and large, seem to prefer a regional institution for economic cooperation that is multilateral and broad in the scope of its activities. The preference for multilateralism is based as much on the perceived economic interests of individual countries as the geopolitical conditions in the region. The experience of a cruel Japanese colonial rule still provokes some apprehension of Japan's economic dominance in many of its former colonies. In a different context, Southeast Asian countries also begin to worry about the emerging political and economic threats posed by mainland China. Because of the complex geopolitical conditions in East Asia, it will not be an easy task to achieve political cooperation for the formalization of regional integration.

Japan's dominance in the regional economy is reflected in the region's trade and investment relations with Japan. Japan has been the largest source of imports in most of East

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[23] For the case of South Korea, see Amsden (1989).

Asian economies: in 1989 she accounted for 31.5 percent of the total imports in China, while in the same year the ANICs' imports from Japan ranged from 30.7 percent for Taiwan to 15.3 percent for Hong Kong (MITI 1990). The share of imports from Japan by the ASEAN region as a whole increased from 23.3 percent in 1985 to 26 percent in 1991 (Table 3). By 1993 Asia accounted for 38 percent of Japan's exports, compared to 29.5 percent to the US. Japan's dominance is more pronounced in direct investment. Outpacing the US since 1985, Japan emerged as the leading investing nation in the region, accounting for close to a half of the total direct investments in southeast Asia. The growth in Japan's investment in Asia was in part spurred by the yen's appreciation both in the mid-1980s and in 1993. As Japanese-owned manufacuring assembly industries such as appliances, automobiles, and machinery shifted some of their production facilities to Asian countries where labor costs are much cheaper, demands for Japanese-made parts and components also rose. The growth in Japan's trade surplus with Asia is thus attributable to increased intermediate imports from Asian countries. The sheer size of Japanese FDI itself is sufficient to influence and even control the regional economy.[24] Japan's investment strategy has been to enhance a vertical division of labor, in which raw materials and intermediate goods in the developing Asian countries are traded with Japanese manufactured goods. The vertical linkage in production continues to make the regional economy increasingly dependent on Japan in trade and technology.[25] Along with the dominance in industrial capital, Japan's finance capital also penetrated the banking, commerce, and real estate markets in the region.[26]

Japan's economic influence in East Asia must not, however, be interpreted as simply reflecting her desire to create an exclusive Asian economic bloc. As a successful exporter, Japan's ultimate interest is in the global economy, and the East Asian bloc can serve as both a complement to the global trade system and an alternative to fall back on should the world trading system collapse. Japan has resisted the idea of using the yen as the region's key currency and has not yet endorsed any regional efforts for the formalization of an exclusive Asian bloc. In effect, a key issue expected to emerge in any form of Asian integration would be the leadership of the region by a highly advanced economy. Unlike Germany in the EC and the United States in North America, Japan as the only global economic power has not been keenly anxious to take the

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24 Despite strong financial dominance in the region, Japan has been reluctant to expand the use of the yen as the international currency. The bulk of East Asian trade with Japan continues to be carried out in US dollars.

25 The idea that Japan is the pace-setter in technology, and that the industrial development in the region proceeds through cascading 'follow-the-leader' policies, is encapsuled in the so-called flying geese model of intra-regional trade. See Akamatsu (1962).

26 Driven by the revaluation of the yen in wake of the 1985 Plaza accord, the big four Japanese securities firms of Nomura, Daiwa, Nikko, and Yamaichi expanded their reach in the region's capital markets by establishing both regional and country-specific funds.

leadership for a regional bloc, especially to be burdened with the responsibility for regional structural adjustments that would likely follow the formation of a regional bloc. Moreover, any scheme that allows a sole leadership by Japan would likely be resisted by rival Asian countries.

An unknown factor in the equation for Asia's balance of power is the role of the People's Republic of China. In the wake of the post-Mao economic reform, economic growth has come very fast in China: Agro-industrial output increased by an annual average of more than 9.0 percent in the 1980s, and even in the midst of the recent worldwide recession, China had the fastest rate of growth of 10.5 percent in 1991 and 12.0 percent in 1992. The market competition from the rapidly growing China began to pose a serious threat to many ASEAN countries. There also is the politically sensitive question of allowing 'three Chinas'—mainland China, Taiwan, and Hong Kong—in any formal body for negotiating regional trade and investment cooperation. While many Asian countries may opt for an integration that excludes communist China, questioning whether an effective trading bloc in East Asia could be formed containing the two hegemonic powers of Japan and China, it is difficult at the same time to imagine an Asian integration that excludes participation from China. In this context, many East Asian nations seem to prefer to include the United States as a deterrent force to counterbalance the hegemonic dominance by an Asian superpower in the region.

Finally, another geopolitical dimension that must be considered is the future roles of Australia and New Zealand. These two nations have long feared that they could be excluded from the emerging markets in the Asian Pacific region. For this reason, it was Australia that initiated the APEC process. Currently, it is seeking much closer economic cooperation with ASEAN. In early 1994, Australian prime minister Keating proposed the idea of fusing the existing economic ties between Australia and New Zealand with ASEAN's free trade area (AFTA). This integration among the eight nations would create a trading bloc worth over $700 billion annually. Australia's new initiative certainly departs from its conventional trade policy for an open regionalism. It remains to be seen, however, how this sudden accommodation of the ASEAN trade bloc will be received in Asia, as Australia is still seen by most Asian nations as belonging to the ideological camp of the Western industrialized nations.

5. Prospects for Regional Development and Integration

Looking ahead toward the next century, East Asia as a whole will continue to be the world's fastest growing region. From a shorter-term perspective, the pace of growth in the region will depend on the speed of world economic recovery, in particular, the major industrialized economies of the US and Europe.[27] As East Asia depends on world markets rather than regional markets, any modest acceleration in the growth of the global economy will translate into considerable gains for the region's exports. Although import growth is also likely to continue to increase in the developing Asian countries as a result of the ongoing progress in trade liberalization, the market-oriented reform measures, in the long run, should have a significantly positive bearing on the economic prospects in these countries.

The question that remains is: How does one assess the prospects for an institutionalized regional economic cooperative scheme in the APR? An exclusive Asian economic bloc is not now the policy preference of any governments in the region, nor is it likely to be in the near future. To date, there has not yet been in East Asia any cohesive driving force toward—nor any particular need for—the formalization of an economic bloc. This is because a process of natural economic interdependency has been taking place for some time. As virtually all the regional economies have been pursuing outward-oriented economic reforms along with trade and investment liberalization policies, an environment conducive to economic cooperation in the region has been created. There have already been a number of institutional arrangements for market-based economic cooperation, albeit within individual countries or at subregional levels. Many of the developing Asian economies host free trade zones within the country, and the so-called 'growth triangle'[28] and the 'Tumen' projects exemplify some of the regional efforts for economic cooperation. These measures deepened the economic interdependency among the regional economies, and at the same time enhanced trading relations with the countries outside the region. Thus, the ultimate interests of the developing Asian countries will continue to be in preserving a balance in their intra- and extra-regional links.

Increased regionalism in North America and Europe and the break-down of a multilateral trading system could conceivably prompt a stepped-up effort for the formalization of regional integration in Asia. Nonetheless, it is unlikely that protectionism outside Asia will lead to the formation of an exclusive Asian economic bloc.[29] If any formalization of integration is to take place, it will likely include the eastern Pacific-Rim nations. The larger economic interest of the region has been a wider regional bloc that includes Eastern Pacific Rim countries, in particular, the United States. Given the importance of American markets for Asian exports, the future of the APR will critically depend on whether the US participates in Pacific Basin trade as a full partner.

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27 On the positive side for East Asia, the North American demand for Asian exports is not likely to be greatly affected by the formation of North America's own regional integration (Kim 1993).

28 The latest program, agreed to in September 1993, facilitates greater economic cooperation by easing the flow of goods, capital, and labor across neighboring borders of the three participating countries—Indonesia, Malaysia, and the Philippines.

29 For instance, the recently created AFTA is consistent with the provision of the GATT (article 24) that prohibits member countries from raising the average tariff rates vis-à-vis nonmember nations.

Likewise from the standpoint of US interest, East Asia has been the fastest growing market for US exports and investment, and will likely become a major potential source of its employment and income, given the fact that almost half of US trade deficits stem from its trade with East Asian economies—Japan, Taiwan, and China.[30] The past several years have witnessed a shifting trend of greater exports to Asia and fewer to Europe. Since the second half of 1992, the total US exports bound for Japan and other Asian Pacific nations have exceeded the total shipment for Western Europe.[31] In particular, the developing East Asian countries are providing a growing outlet for US exports. Exports from the US to ASEAN rose 85 percent from 1988 to 1992, followed by those to China, Taiwan, and Hong Kong which registered more than 50 percent increase over the same period (Table 5). Also, encouraged by the recent trade and investment liberalization in the Asian Pacific region, US companies have boosted their investment in East Asia, far outpacing their investment elsewhere.[32]

TABLE 5

US Exports to East Asia and the EC
(in billions of US dollars)

Region	1988	1989	1990	1991	1992	Growth rate from '88 to '92 (percent)
EC	76	87	98	103	103	36
Japan	38	45	49	48	48	26
ASEAN	13	16	19	21	24	85
South Korea	11	14	14	16	15	36
Taiwan	10	11	12	13	15	50
Hong Kong	6	6	7	8	9	50
China	5	6	7	8	9	60

Source: US-ASEAN Council and *The Nikkei Weekly*, 12 July 1993

There is thus a clear mutual interest in a closer collaboration for freer trade and investment relations among the Pacific Basin economies. The Pacific region, however, is an immense region made up of countries, small and large, diverse in culture and in levels of development. There are other difficult problems that have to be negotiated: for example, any US initiative for a Pacific Free Trade Area is likely to include provisions on working conditions, as has been the case in the US negotiations for NAFTA and a post-GATT trade structure. Increasingly

30 The US registered a deficit of $18.2 billion in trade with China in 1992.

31 *Nikkei Weekly*, 20 September 1993, p. 27.

32 According to the US Commerce Department, between 1989 and 1992 US direct investment in Asia, excluding in Japan, rose by 56 percent, which exceeded the 34 percent increase in Latin America and the 26 percent increase in overall US overseas investment. During the period US corporate investment in Europe expanded at about a 26 percent average pace.

assertive Asian governments would likely view such an attempt to link the issues of trade and labor as an attempt to undermine their competitive edge in labor-intensive exports. It seems clearly unrealistic to expect that APEC can be formalized into a regional bloc in the immediate future. The member countries participating in the APEC forum, in effect, have not yet agreed on any principles, procedures, or workable institutions for regional economic cooperation. There has been only an implicit understanding of the need to continue a dialogue concerning the region's broader based security and economic cooperation based on nondiscriminatory trade liberalization.

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