

# F or Sustained High Economic Growth in Asia

By Shujiro URATA

## Secret behind Fast Economic Growth in Asia

Since the end of World War II, the East Asian region has sustained high economic growth over 60 years, with its leading player changing in succession from Japan to the newly industrializing economies (NIEs) of South Korea, Taiwan, Hong Kong and Singapore, and to such member states of the Association of Southeast Asian Nations (ASEAN) as Indonesia, Malaysia and Thailand. Currently, China is the driving force. The region's growth was temporarily dented by the 1997-1998 Asian currency crisis and the 2008-2009 global financial meltdown. Except these periods, however, the regional economy has been growing remarkably. Factors behind the solid growth in East Asia include effective economic policy measures conducive to maintaining a stable macroeconomic environment; active investment made on the back of swelling savings; and diligent and competent labor forces. Particularly significant was the rapid expansion of trade and foreign direct investment (FDI).

This article is intended to clarify trade and investment mechanisms that have brought about the rapid economic growth in East Asia in recent years. It will also seek to figure out problems associated with further expansion of trade and investment, which are considered to play pivotal roles in further growth, and look into ways to find solutions to them.

## Growth Led by Trade/Investment Interdependence

East Asian economies have grown under the lead of such international economic activities as trade and FDI. This can be confirmed if you trace the trends of gross domestic product (GDP), the benchmark for domestic economic activity, and international economic activity.

*Photo: Prime Minister's Office*



Japanese Prime Minister Yukio Hatoyama (4th from right) poses with other Asia-Pacific leaders at the fourth East Asia Summit in Cha-am and Hua Hin, Thailand, on Oct. 25, 2009.

From 1980 to 2008, East Asia's GDP attained a 6.7-fold expansion. Exports from, and FDI into, the region grew even more strongly during that period, showing 13.3-fold and 59.6-fold surges, respectively.

Exports enabled East Asian economies to import intermediate and capital goods that are vital for economic growth. Meanwhile, FDI spurred capital and technology transfers, thus greatly contributing to their growth. Further, FDI in the region by multinational corporations (MNCs) enabled FDI recipient countries to cash in on the MNCs' networks for procuring parts and marketing products, resulting in more efficient production and greater sales in these countries. One of the main reasons for the expanded trade and FDI lies in the liberalization of trade and FDI. East Asian countries pushed forward trade liberalization in the 1970s and thereafter. In the latter half of the 1980s, they steadily implemented deregulatory measures for FDI as well. In line with these policy steps, a larger amount of trade-oriented FDI was made in the region, leading to expanded trade. This in turn spurred trade-oriented FDI even further. In this way, interdependent relations between trade and FDI grew to create a virtuous circle for high economic growth.

Electric and electronic machinery are cited as industries that have advanced on the back of expanded trade and FDI, and greatly helped the region achieve strong economic growth. In fact, East Asia is now called "the factory of the world," supplying electrical and electronic appliances and many other machinery products to the rest of the world. Behind the expansion of machinery exports by East Asian countries lie MNC strategies for international fragmentation of production. In general, MNCs used to undertake all steps of a production process in a single country. But the liberalization of trade and investment lowered barriers to these two segments of economic activities and brought about advancement of technology. This resulted in significant drops in international transportation and communication costs. Given these circumstances, MNCs began to adopt international fragmentation strategies under which stages of production are unbundled so that each stage can be located in what they see as most appropriate countries through FDI. As a result, regional production systems involving multiple countries have been created in East Asia for a variety of industries.

Multinational electrical/electronic appliance manufacturers adopted transborder production fragmentation strategies for several reasons. First, some stages of the production process in that industrial sector have become standardized methods in which production does not require high technology, with components and parts assembled into finished products. Second, East Asian countries differ in terms of economic development. This means wage levels vary from one country to another according to the development stage, thus having brought cost benefits to MNCs by allowing them to place different production processes in different countries. Furthermore, the fragmentation process has been spurred by lower tariffs on component trade stemming from such preferential measures as import duty drawback schemes adopted by some East Asian countries.

## Challenges & Solutions for Further Growth

East Asian countries have attained solid economic growth largely thanks to trade/investment interdependent relations. To secure further growth, a host of problems need to be resolved. First, trade and investment policies should be liberalized even further. To be sure, trade and investment have been liberalized, but there is still much room for more liberalization. In the sphere of trade, tariff and nontariff barriers remain. For FDI, there are still limitations to foreign ownership of equity in domestic companies and regulations on employment of foreign workers.

On top of these, there are serious problems hampering the smooth facilitation of trade and investment, including opaque, unstable and uncertain ways of conducting trade and investment policies. To lure more FDI, it is imperative to upgrade infrastructure in both “soft” and “hard” terms, and create an environment comfortable for MNCs to operate in. “Hard” infrastructure includes traffic and communication facilities, among others, while “soft” infrastructure means an environment in which legal, economic and educational systems work effectively. Fostering competent human resources with education and training should be reinforced since it is not only effective in attracting more FDI from MNCs but vital for absorbing a broad array of technologies.

Moreover, it has become difficult to expand or even hold steady exports to American and European countries – the main supporter for Asian economic growth until the outbreak of the global financial crisis – where post-crisis recovery is slow. This represents a fresh question facing the region. To address this issue, East Asian economies are in need of boosting intra-Asian trade and domestic demand at the same time.

Possible solutions to the problems as mentioned above include promoting regional economic integration in East Asia, or more specifically, creating a comprehensive free trade agreement (FTA). The envisaged agreement is intended not just for trade liberalization but for trade facilitation and investment liberalization/facilitation, and even closer economic cooperation. Currently, there are a good number of bilateral and multilateral FTAs in East Asia. However, no road map has been set for negotiations to create an FTA of comprehensive nature that would involve all East Asian economies, though some ideas have been floated. One comprehensive FTA now under consideration is the concept of an East Asian Free Trade Agreement (EAFTA) that would group the 10 ASEAN member states plus Japan, China and South Korea. Another idea is a Comprehensive Economic Partnership in East Asia (CEPEA) that would involve these countries plus the three East Asia Summit member countries of Australia, New Zealand and India. To bring these concepts into reality, it is indispensable for the top leaders of the countries involved to be fully aware of the significance of the proposed FTA in ensuring economic prosperity and social and political stability, and resolved to take decisive action and leadership.

### What Are Japan's Roles?

In contrast to Asia's developing countries that have sustained fast economic growth and are projected to continue growing solidly in

## Impact on GDP of CEPEA & EAFTA (% change in GDP)

Country/region	CEPEA			EAFTA	
	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Japan	0.04	0.64	0.56	0.02	0.63
China	-0.03	4.65	4.64	-0.05	4.49
South Korea	0.38	2.67	2.28	0.34	2.64
Indonesia	0.13	4.35	4.13	0.11	4.15
Malaysia	0.62	9.53	8.95	0.57	9.24
Philippines	0.12	5.95	5.51	0.11	5.77
Singapore	-0.02	3.83	3.65	-0.02	3.63
Thailand	0.59	7.46	7.17	0.56	7.21
Vietnam	1.61	11.04	10.17	1.60	10.79
Cambodia	0.38	8.59	7.17	0.29	8.38
Myanmar	0.07	6.15	5.36	0.07	6.00
Laos	0.40	5.99	4.69	0.40	5.94
Brunei (& East Timor)	1.86	6.98	6.14	1.86	6.92
Australia	0.11	1.27	1.20	-0.03	-0.03
New Zealand	0.08	1.94	1.77	-0.04	-0.02
India	0.45	3.40	2.70	-0.03	-0.07
Hong Kong	0.00	0.02	0.02	0.00	0.02
Taiwan	-0.10	-0.18	-0.15	-0.11	-0.17
NAFTA	0.00	-0.02	-0.02	0.00	-0.02
EU25	-0.03	-0.09	-0.09	-0.02	-0.08
Latin America	-0.02	-0.05	-0.05	-0.02	-0.04
Rest of World	-0.03	-0.08	-0.09	-0.03	-0.07

Note: Scenario 1 CEPEA: East Asia Summit members, tariff elimination only  
 Scenario 2 CEPEA: East Asia Summit members, tariff elimination, trade facilitation & cooperation  
 Scenario 3 CEPEA: East Asia Summit members, tariff elimination, trade facilitation & cooperation; all agriculture & food products excluded  
 Scenario 4 EAFTA: ASEAN+3, tariff elimination only  
 Scenario 5 EAFTA: ASEAN+3, tariff elimination, trade facilitation & cooperation  
 Source: Author's calculations

the years ahead, the Japanese economy remains lackluster amid the rapid aging of society and the sinking birthrate as well as the dire fiscal situation. To make matters worse, no optimistic scenarios have been blueprinted for the future of Japan.

To ensure Japanese economic growth, consideration should be paid to both the supply and demand sides. On the supply side, it is necessary to enhance production elements such as labor and investment, and improve productivity. Considering the situation in Japan, bolstering productivity seems a sole, practical solution. As for the demand side, greater consumption, investment, government expenditures and exports are among elements conducive for economic growth. Of these, increased exports, especially to Asian countries with growth potential, are expected to play an important role. Higher productivity and greater exports are known to be interdependent and pushing structural reform and opening markets wider to the rest of the world are considered effective in realizing and reinforcing such interdependent relations.

As discussed above, Japan, with its contributions to creating a comprehensive FTA involving all East Asian economies, is understood to help ensure economic growth in the region as a whole and at the same time secure its own economic growth. Japan finds it hard to take the initiative in establishing such an FTA mostly because it cannot overcome strong opposition from such industrial sectors as agriculture, so far coddled by the government. Expectations are thus rising that Japanese policymakers will deal appropriately with the opposition for the sake of promoting efforts to achieve economic integration in East Asia. **JS**

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