Economic Interdependence In Asia and the Pacific

By Akira Hirata

The Asia-Pacific region as a whole has seen a phenomenal growth in the last two decades. One salient feature of its growth process is a very strong link between trade and production. Trade expands as a result of high growth, and at the same time plays an important role to lead it. Thus trade, together with financial flows, works as a prime mover to give rise to an Asia-Pacific "zone," which socially and culturally, as well as economically, is rich in diversity. Growth in East and Southeast Asian countries, in particular, has been a key element in the trade-cum-production link for the trade expansion of the whole area. Their trade prospects are likely to continue to affect the overall development of the region.

Export-led growth

East and Southeast Asian countries are sometimes called "the growth center of the world," and their growth performance has in recent years been consistently better than the world average by a wide margin. Even in the world recession of the first half of 1980s, they maintained a relative growth edge over other countries. In the economic recovery of the latter half of the decade, they were again among the first to improve growth performance.

Their rapid growth is described as "export-led." As Table 1 shows, rapid GDP growth is accompanied by even more rapid growth of the manufacturing sector and of exports. That manufactures spearheaded the export expansion is well-known. Indeed, the term newly industrializing countries, or NICs (now NIEs), first appeared in 1978 in an OECD document, in response to the rapid market penetration of a handful of developing countries, including the so-called "four tigers" (South Korea, Taiwan, Hong Kong and Singapore), into industrial country markets in manufactures. ASEAN countries, notably Thailand and Malaysia, joined their ranks to form, again following the OECD terminology, the Dynamic Asian Economies (DAEs). Two other ASEAN countries, the Philippines and Indonesia, although at a lower level, are also following the growth path. The share of manufactures in their total exports continuously went up (Table 2), and as a result, the export structures of some of them no longer resemble those of developing countries.

Their export-led growth is summarized as below: export expansion brings about expansion of foreign exchange earnings, which means an import capacity expansion. Thus imports of machinery and intermediate goods which are not domestically produced can be made possible, which leads to the expansion of fixed capital formation. Production expansion ensues, leading to a further export expansion. When a part of the newly expanded production is exported, the "virtuous circle" is complete.

The role of imports should be noted. In spite of their high growth, or rather because of it, East and Southeast Asian countries are heavily dependent on industrial countries for the supply of machinery and equipment, as well as intermediate goods. Even for the NIEs, import dependence is still high, particularly in high technology industries. This is an important aspect of economic interdependence in Asia and the Pacific.

The virtuous circle also gives a clue to the policy measures necessary for export-led growth. Unlike the old "vicious circles of poverty," the virtuous circle is not an automatic, or stable, process, and requires policy efforts to maintain and strengthen its momentum. Two passages are important in particular: first, the expanded import capacity does not automatically bring about larger imports of production goods, and secondly, expanded production needs price and quality competitiveness to be exported.

In the case of East and Southeast Asian countries, the first path, at the beginning at least, was supported by various fiscal and trade measures to enhance investment. It started as an import substitution type of industrial promotion with tax holidays and protection. An invest-

Table 1 **Growth Performance in Asia and the Pacific** (%)

	GDP		Manufacturing		Exports		Imports	
	1965–80	1980–89	1965–80	1980–89	1965–80	1980–89	1965–80	1980–89
Japan	6.6	4.0	8.2	6.7	11.4	4.6	4.9	5.4
United States	2.7	3.3	2.5	3.8	6.4	2.3	5.5	8.2
Canada	5.1	3.3*	3.9	3.6*	5.4	6.0	2.5	8.8
Australia	4.0	3.5	–	1.7	5.4	4.1	1.0	5.0
New Zealand	2.4	2.2	–	–	3.8	3.5	1.1	3.4
Singapore	10.0	6.1	13.2	5.9	4.7	8.1	7.0	5.8
Hong Kong	8.6	7.1	–	–	9.1	6.2	8.3	11.0
Taiwan	9.7**	8.1	12.8**	8.1***	15.6	13.4	12.2	9.6
South Korea	9.9	9.7	18.7	13.1	27.2	13.8	15.2	10.4
Malaysia	7.4	4.9	–	8.0	4.6	9.8	2.2	3.7
Thailand	7.3	7.0	11.2	8.1	8.6	12.8	4.1	8.4
Philippines	5.9	0.7	7.5	0.5	4.6	1.3	2.9	0.4
Indonesia	7.0	5.3	12.0	12.7	9.6	2.4	–	–0.4
China	6.9	9.7	9.5	14.5	–	11.5	–	11.7

Note: *1980–88 **1971–80 ***Whole industry
Source: *World Development Report 1991*, World Bank; *Asian Development Outlook 1990*, ADB

ment incentives law is the typical policy tool for this purpose. At a later stage, in the early 1960s for the NIEs and around 1970 for other ASEAN countries, a new aspect of export promotion of manufactures was added to the policy package. "Added" is the key word here, for import substitution was still sought in order to expand industrial bases, together with a degree of protection. Indeed, export promotion measures were needed to offset, or partly compensate for, the disadvantages caused by domestic industrial promotion.

It should be stressed that an adequate balance between the two should be maintained. Too much emphasis on industrial promotion makes export promotion measures ineffective, since investing for the domestic market is made artificially more profitable. Very often, this is the case for developing countries. Most of them have export promotion measures as a part of their policy packages. Yet only a handful of them, among which East and Southeast Asian countries are prominent, have succeeded in attaining satisfactory export performance. This may well indicate that in East and Southeast Asian countries such a balance, or policy consistency, has been operative. Looked at from a different viewpoint, it may also suggest that they did not overdo their industrial promotion efforts.

Their export-led growth, with import expansion as an important aspect of it, stimulated closer economic links in the region. The interdependence is particularly important in their trade with Japan, which accounts for the lion's share of their imports of machinery and intermediate goods. Production expansion in these countries, therefore, either for the domestic market or export, leads inevitably to the expansion of imports from Japan. Developments in South Korea in 1986 and 1987 in this regard are noteworthy. The rapid appreciation of the yen from September 1985 substantially improved South Korea's price competitiveness vis-à-vis Japan, and its exports to Japan as well as to the rest of the world increased rapidly. Yet the expanded production induced imports from Japan even more rapidly, and its trade deficit with Japan increased rather than decreased.

International market

East and Southeast Asian countries are highly dependent on industrial countries also in the export market. The overall dependence in 1989 was as high as 60% of their total exports. The U.S. market is particularly important, as is apparent from the trade matrix (Table 3). The matrix shows bilateral export flows reading across each row from the country name in the left-hand column. Values for 1970 and 1989 are shown with the rate of expansion between those dates in parentheses. For example, Japan's total exports are shown at the end of the horizontal row for Japan, while other countries' total exports to Japan–or its de facto total imports–are shown at the foot of the vertical column for Japan. The table shows that Japan, the NIEs and the ASEAN4 (Indonesia, Malaysia, the Philippines and Thailand), as well as China, achieved trade expansion at a rate that was better than the world average.

The importance of the U.S. market is easily understood from the fact that the NIEs send around 30% of their total exports to the United States. The corresponding figure for the ASEAN4 is lower at around 20%, but it is again around 30% for their manufactured exports. Indeed, these countries maintained their positive export growth to the U.S. market even during the period of world recession in the early 1980s, which may well have been one of the key factors in their relatively good growth performance.

An important point regarding the U.S. market is also evident from the trade matrix. In 1970 the U.S. had a comfortable trade surplus. Since then, however, while its imports have expanded faster than the world average, as shown by the rate of expansion between 1970 and 1989 in parentheses in the table, its exports have lagged behind the world average. Its imports have grown almost twice as fast as its exports. Apparently the faster import growth supported the export-led growth of East and Southeast Asian countries. But the same factor also gave rise to one side of the notorious "twin deficits."

That a trade deficit of this size could not be maintained was clear in the late 1980s. The U.S. government took various measures to remedy it. The exchange rate realignment of 1985 was one of the major moves. Reduction of the trade deficit was, and still is, necessary to restore the health of the U.S. economy, and it is quite desirable for the world economy as a whole. It clearly points to slower import growth, however, and poses great uncertainty for the trade prospects of East and Southeast Asian countries. In the event

Table 2 **Industrialization Rate of Exports** (%)

	1965	1970	1975	1980	1985	1986	1987	1988	1989
South Korea	59.4	76.7	81.6	89.9	91.4	92.0	92.4	93.1	93
Hong Kong	87.1	92.9	93.2	92.4	91.6	92.1	92.4	91.6	96
Taiwan	41.5	76.1	81.1	87.9	90.5	91.0	91.8	NA	NA
Singapore	34.4	30:5	43.3	53.9	58.4	65.5	71.7	74.4	73
Malaysia	NA	7.4	17.9	19.0	27.3	37.3	39.5	43.9	44
Philippines	5.7	7.6	17.2	37.0	57.1	58.0	NA	62.2	62
Thailand	4.8	10.7	18.1	29.0	39.3	44.6	52.5	NA	54
Indonesia	NA	1.4	1.2	2.4	13.2	19.5	26.2	30.9	32

Source: IDE Trade Data Search System (AIDXT) for the years 1965–1988. Data for 1989 was obtained from *World Development Report 1991.*

of slower U.S. import growth, East and Southeast Asian economies will require alternative market outlets to maintain their export-led growth.

Protectionism and economic blocs

Even more serious is the possible growth of protectionism and formation or intensification of regional economic blocs. Under the GATT system, tariffs, especially those on manufactures, have been substantially reduced in industrial countries, thereby contributing to the expansion of world trade. This factor has certainly contributed much to the expansion of exports of manufactured items from Asian developing countries. As a result of its success, however, the room for further tariff reduction became very limited in the 1980s. The period also saw the proliferation of various non-tariff barriers in response to the market penetration by these countries. Voluntary export restraints are widespread, with the Multi-Fiber Arrangements forming an apex of the scheme. "Procedural protection" is also prevalent in many commodities.

Non-tariff barriers were not devised with the intention of directly violating GATT rules. But they certainly violate GATT principles, and actually cause substantial damage to exporters of manufactured goods in developing countries. East and Southeast Asian countries are among the hardest hit.

Intensified blocs would also damage these countries. The single European market to be realized by the end of 1992 has been a cause of concern for some time due to the possible creation of a "Fortress Europe." From a larger perspective, rapid liberalization in Eastern Europe would lead to some arrangements to incorporate them to form an enlarged European market, possibly with some diversion of trade and investment.

Negotiations are under way to form a North American Free Trade Area (NAFTA), and an initiative to establish a free trade area for both North and South America is talked about. If such moves lead to regional blocs, market access for extra-regional countries, particularly East and Southeast Asian countries, will be interrupted, and their export-led growth severely affected.

Table 3 Trade Matrix for All Commodities ($ million)

From \ To		Asia	Japan	NIEs	ASEAN4	China	U.S.	EC12	World
Asia	1970	9,771	2,234	4,534	2,379	624	8,948	4,401	31,886
	1989	246,554	57,219	119,399	39,802	30,134	187,093	98,073	648,608
		(25.2)	(25.6)	'26.3)	(16.7)	(48.3)	(20.9)	(22.3)	(20.3)
Japan	1970	4,611		2,647	1,395	569	6,015	2,332	19,318
	1989	77,564		52,511	16,576	8,477	93,954	47,986	274,597
		(16.8)		(19.8)	(11.9)	(14.9)	(15.6)	(20.6)	(14.2)
NIEs	1970	1,936	746	502	655	33	2,029	1,021	6,376
	1989	97,820	30,876	28,162	18,766	20,016	73,804	34,058	247,493
		(50.5)	(41.4)	(56.1)	(28.7)	(606.5)	(36.4)	(33.4)	(38.8)
ASEAN4	1970	2,367	1,260	851	234	22	904	742	4,512
	1989	37,979	18,163	15,081	3,094	1,641	15,347	11,309	74,767
		(16.0)	(14.4)	(17.7)	(13.2)	(74.6)	(17.0)	(15.2)	(16.6)
China	1970	857	228	534	95		0	306	1,680
	1989	33,191	8,180	23,645	1,366		3,988	4,720	51,751
		(38.7)	(35.9)	(44.3)	(14.4)		(3,988.0)	(15.4)	(30.8)
U.S.	1970	6,901	4,569	1,486	846	0		11,952	42,590
	1989	97,478	44,584	38,458	8,629	5,807		86,570	363,807
		(14.1)	(9.8)	(25.9)	(10.2)	(5,807.0)		(7.2)	(8.5)
EC12	1970	3,912	1,410	1,116	931	455	9,612	61,893	116,037
	1989	63,170	23,215	24,232	8,811	6,912	84,477	677,825	1,133,700
		(16.1)	(16.5)	(21.7)	(9.5)	(15.2)	(8.8)	(11.0)	(9.8)
World	1970	31,363	16,993	8,157	4,317	1,896	35,956	111,893	282,638
	1989	580,924	209,635	237,457	75,516	58,316	493,652	1,165,800	2,912,200
		(18.5)	(12.3)	(29.1)	(17.5)	(30.8)	(13.7)	(10.4)	(10.3)

Notes: 1. Asia includes only Japan, NIEs, ASEAN4 and China.
2. Figures in parentheses show the rate of expansion between 1970 and 1989.
Sources: IDE Trade Data Search System (AIDXT); *Direction of Trade*, IMF.

Are the economic blocs really a threat?

The danger of economic blocs, however, tends to be exaggerated. A single European market would not increase common external tariffs. With the unification, or Europeanization, of non-tariff barriers, some trade diversion effect is feasible, but this is unlikely to be very large, especially in manufactures. One estimate puts the effect at 1% of total imports, which is a once and for all figure. If this is the case, the adverse effect may well be easily offset by the growth effect of the single European market, which is expected to be around 1% annually for five years. Thus it could well be a blessing in disguise for developing countries.

The NAFTA is potentially a more serious matter for East and Southeast Asia. With a developing country, Mexico, included, the arrangement may well divert more trade and investment. Again, East and Southeast Asian countries would be among the most seriously affected. The same argument as for the single European market, however, appears to be applicable. The United States and Canada are unlikely to raise their tariff barriers to third-country exporters. And their already low tariff levels, again for manufactures in particular, suggest small intraregional preference margins favoring Mexico.

In order for both the single European market and the NAFTA to create regional "trade blocs" in the true sense of the word, they would have to break away substantially from the present international trade system. In short, this is an unlikely event. The GATT system, though undermined by various non-tariff barriers, still commands a reasonably high degree of commitment from industrial country governments. Or more appropriately, no major trading country could afford the loss of the GATT system.

Photo: Financial Times

A container terminal at the port of Hong Kong, one of the "four tigers" that have contributed to the phenomenal growth of the Asia-Pacific region.

This may sound too optimistic. But a look at its history reveals that the GATT is not even a proper international organization but simply a compilation of broadly agreed ground rules. And these agreements have been reached piecemeal as compromise over a long period of time. As such, the system has a lot of loopholes. Non-tariff barriers and the Multi-Fiber Arrangements are examples, and cause discontent among developing countries. Its loose structure, however, appears to be the very reason why it has been effective for almost half a century. The system is incomplete and will be so for some time, and it needs improvement in many aspects.

Also it is understandable that developing countries are frustrated with the gap between GATT's principles and practices. Also, progress has been slow in the current Uruguay Round negotiations. From a longer-term perspective, however, active participation in GATT negotiations by developing countries for the first time in its history is a very welcome sign. East and Southeast Asian countries in particular now possess a degree of negotiating power in the form of large imports. As seen in the trade matrix, the combined imports of East and Southeast Asia now are even larger than those of Japan. More active participation by these countries is to be hoped for, backed by their negotiating power, in the joint efforts to maintain and strengthen the generally liberal world trade regime.

Having said this, the proposed East Asian Economic Grouping (EAEG; later renamed as the East Asian Economic Caucus or EAEC) should be mentioned. Frustration at the slow progress in the Uruguay Round negotiations is said to be behind the proposal. The unfortunate use of the term "economic bloc" by the chief proponent of the grouping, Malaysian Prime Minister Mahathir Mohamad, is suggestive of this frustration, and the speed with which the scheme was proposed. It has to be said, however, that the idea is a very risky one.

Although the proposal was not specific in policy terms, an economic bloc has dangerous connotations. If the purpose is to improve the members' negotiating power in trade talks, as the Malaysian government claims, such a scheme could easily backfire and seriously damage the credibility of the GATT system as a whole. It is noteworthy that this term has never been used, at least officially, in the case of either the single European market or the NAFTA.

The roles of Japan and the United States

In the framework described, Japan's role is very clear. Provision of production factors, capital and technology, and production goods is one. Marketing know-how specifically may be added to the list to strengthen the export capability of these countries. The other role is the provision of a larger market, which has been emphasized in view of the twin deficits in the United States. The "absorber" function has been widely talked about. The rapid expansion of manufactured imports by Japan since 1985 is a promising sign in this regard. Industrial restructuring that has to ensue is also progressing, especially in the form of increased foreign direct investment in the latter half of the 1980s. Further efforts, however, appear necessary to support their export-led growth.

The United States also has a role as an import market. Even with more rapid import growth in Japan, the sheer weight of U.S. import demand requires steady and reasonable growth of the market in order for the East and Southeast Asian countries to maintain their export-led growth. One simulation indicates that a combination of 7.5% annual growth of Japan's imports and 4% for the U.S. market would be necessary to accommodate a 7% to 7.5% expansion in the exports of the NIEs and ASEAN.

The overriding necessity, however, is a fuller understanding of the nature of economic interdependence. Closer links have made what were formerly purely domestic economic policies into international issues. As a consequence, trade policy, for example, is now very difficult to distinguish from other policies. Adherence to the GATT rules in the narrow sense, therefore, may not be enough to secure a smooth flow of trade. Policy coherence, or consistency, has to be constantly sought after.

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