Helping the NICs Help the World Economy

By Toshio Watanabe

The past several years have been a time for both Japan and the United States to adjust their demand structures, and it will probably be some time before the world economy is back on a smooth expansionary course. With the traditional leaders temporarily out of the fray, there is a real possibility that the Asian newly industrialized countries (NICs), together with the six members of the Association of Southeast Asian Nations (ASEAN), China and other developing countries in the Western Pacific region could become the locomotive pulling the world toward balanced economic expansion in the post-adjustment period. Given these nations' remarkable growth performance and their future growth potential, it would well behoove the industrially advanced countries with relatively low growth rates not to engage in a cutthroat scramble for slices of a slowly expanding market, but to help their developing colleagues enhance their vitality even further to make the region the new frontier of the world economy.

The growth rates achieved by the Asian NICs—South Korea, Taiwan, Hong Kong and Singapore—since the early 1960s are among the highest in the world. Economic growth took off in the ASEAN countries—Indonesia, Malaysia, Thailand, Singapore and the Philippines—in the 1970s when other economies stagnated under the impact of the oil crises. And in the second half of the 1970s, China, for long a slumbering giant, at last began to stir.

A number of factors have gone into the high industrial growth rates of the countries in the Western Pacific. Having industrialized in a relatively short time, these countries proceeded to strengthen their export capability. Nine Western Pacific countries, including Japan, the Asian NICs and the ASEAN countries, expanded their share of the world's total industrial exports from around 10% in the mid-1960s to 23% by the mid-1980s. What is now being seen is a dramatic global re-

Table 1 The Share of Western Pacific Nations in World Trade (%)

		1965	1970	1975	1980	1985	1986
Exports	Asian NICs	1.6	2.2	2.6	4.0	6.2	6.5
	ASEAN-4	1.9	1.6	1.9	2.5	2.5	2.1
	Japan	4.9	6.6	6.7	6.8	9.7	10.4
	U.S.	15.8	14.8	13.1	11.5	11.7	10.7
Imports	Asian NICs	2.1	2.9	3.3	4.5	5.6	5.6
	ASEAN-4	1.9	1.6	1.8	2.0	1.9	1.7
	Japan	4.5	6.2	6.9	7.2	6.8	6.1
	U.S.	12.7	14.0	12.5	13.1	18.9	18.5

Notes: 1. The Asian NICs are South Korea, Taiwan, Hong Kong and Singapore.
2. The ASEAN-4 are Thailand, Malaysia, Indonesia and the Philippines. The other two ASEAN members, Brunei (which joined in 1984) and Singapore, are excluded.
Source: *Yearbook of International Trade Statistics*, United Nations

location of industrial production bases to the western rim of the Pacific.

Any great expansion of exports is synonymous with a concurrent strengthening of import capacity. It is the countries of the Western Pacific that today underpin the world economy on the demand side. Their share of total world imports went from 8.5% in 1965 to 13.4% in 1986 (Table 1). While creating "competitive relationships" with the rest of the world economy through exports, these countries have also strengthened their "complementary relations" through imports. In short, they have firmly consolidated their presence in the world economy.

The earnings ratios of the industrial sectors of Western Pacific developing countries are higher than those of any other region. Noting the high profitability attainable in this region, industrially advanced countries are stepping up their direct investment. It is also the Western Pacific where multinational enterprises are at their most vigorous. These activities, in turn, play an important part in drawing out the latent vitality of the countries of the region.

Cause for concern

Western Pacific countries have such high growth potential that they seem certain to sustain their high economic growth rates. In its medium-term outlook for the world economy, the Research Department of the Industrial Bank of Japan predicts that the 10 developing countries of the region, including the Asian NICs, the ASEAN countries and China, will account for 23.1% of the world's real GNP growth and 41.9% of the increase in world trade from 1986 through 1990.

This is not to say that there are no clouds on the horizon. One matter of serious concern is the possibility that efforts by the U.S. to reduce its fiscal deficit will have a large deflationary impact on countries in the Western Pacific. The developing countries of the region, without exception, have achieved their economic growth largely through exports, pulled along by constantly expanding demand in the U.S.

South Korean exports to the U.S. contributed no less than 42% to its economic growth between 1981 and 1986, while the figure for Taiwan was 74%. It is feared that changes in U.S. macroeconomic policy could impair the great vitality of the developing countries of the region, and hamper their ability to serve as the locomotive pulling the world economy toward expansion.

Japan would have a very important role to play in such an eventuality. With its big trade surplus, Japan would be positioned to serve as a "shock absorber," replacing the U.S. as a key importer in order to ease serious deflationary effects on the Western Pacific nations. Japan must be the bulwark preventing the world economy from sliding into a contracting equilibrium.

All the developing countries of the Western Pacific have strong economic ties with Japan. Japan, more than any other advanced country, is in a position to influence their policies and economic behavior. Hopefullv Japan will be wise enough to help promote their economic development, thereby contributing to the realization of an expanding equilibrium in the world economy.

Japan has so far functioned as an efficient base for supplying capital goods to its developing neighbors, and has propped up the expansion of their industrial production and export capability from the supply side. Now, Japan will have to expand its role as importer and increase further its direct investment in and economic assistance to these countries. Only then will it be able to make a significant contribution to drawing out their economic potential. By increasing its imports of their products, Japan will also contribute to the expansion of their own imports from the U.S., which are presently far short of their exports, thus helping avert economic frictions.

The appreciation of the yen is the best thing that could have happened to enhance Japan's contribution to the developing countries of the Western Pacific. The sharp drop in prices for imported goods brought about by the yen's rise has expanded Japan's imports of industrial and manufactured goods on an unprecedented scale. Imports are growing as never before, and the trend is particularly conspicuous for imports from the developing countries in the Western Pacific as prices quickly become more competitive.

The rate of increase in Japan's imports of manufactured goods was particularly high in 1986 and in the January–October period of 1987. The ratio of manufactured goods to total imports now accounts for over 40% as compared with about 30% in 1983–85. But the rate of increase in imports of manufactured goods from Asian NICs is even more spectacular: 59.4% in

A South Korean ship ready for unloading in Japan, which now needs to be an "absorber" of imports from the NICs and Western Pacific nations.

Table 2 Japanese Imports of Manufactured Goods from the Asian NICs ($ million; %)

	Total value	Value of Manufactured goods	Chemical products	Machinery & equipment	Other				Ratio of Manufactured goods
						Steel	Textile	Non-ferrous metals	
1970	658	257	12	35	210	5	–	7	39.0
1975	2,764	1,452	90	323	1,039	23	594	8	52.5
1980	7,366 (−7.6)	4,270 (−7.7)	456 (26.7)	872 (17.5)	2,942 (−16.5)	301 (3.8)	1,377 (−28.2)	48 (17.1)	58.0
1981	8,524 (15.7)	4,843 (13.4)	487 (6.8)	971 (11.4)	3,385 (15.1)	425 (41.2)	1,650 (19.8)	28 (−41.7)	56.8
1982	8,145 (−4.4)	4,599 (−5.0)	467 (−4.1)	808 (−16.8)	3,324 (−1.8)	525 (23.5)	1,583 (−4.1)	34 (21.4)	56.5
1983	8,125 (−0.2)	4,511 (−1.9)	458 (−1.9)	922 (14.1)	3,131 (−5.8)	582 (10.9)	1,217 (−23.1)	35 (2.9)	55.5
1984	10,034 (23.5)	5,733 (27.1)	525 (14.6)	1,286 (39.5)	3,922 (25.3)	636 (9.3)	1,705 (40.1)	61 (74.3)	57.1
1985	9,838 (−2.0)	5,689 (−0.8)	498 (−5.1)	1,271 (−1.2)	3,920 (−0.1)	564 (−11.3)	1,563 (−8.3)	51 (−16.4)	57.8
1986	12,519 (27.3)	7,803 (37.2)	759 (52.4)	1,687 (32.7)	5,358 (36.7)	633 (12.2)	2,206 (41.1)	79 (54.9)	62.3
1987 Jan.-Oct.	14,938 (44.0)	9,904 (59.4)	745 (20.0)	2,200 (61.5)	6,958 (64.5)	690 (29.9)	2,938 (71.6)	129 (108.1)	66.3

Note: Figures in parentheses are percentage changes from the preceding year.
Source: Compiled from "Trade Overview," Ministry of Finance

1987 (Table 2). Moreover, the goods imported are also gradually shifting from the labor-intensive finished goods of the past to technology-intensive parts, semifinished goods and even capital goods. The percentage of such high-tech components as semiconductors and computer parts has risen dramatically.

Overseas advantages

Japan's role as an "absorber" of industrial products manufactured by Western Pacific developing countries can only grow in the future. The strong yen will continue to slash yen-denominated production costs overseas, increasing the comparative advantage of overseas production. More Japanese enterprises will relocate production overseas, and Japan will import more of the products manufactured at their relocated plants. This so-called out-sourcing will eventually develop into full-scale production.

In time, Japanese firms will go overseas in earnest to procure goods and supplies, while the parts, semifinished products and capital goods they import from overseas will become an integral part of their production activities. In this way, Japanese enterprises themselves are already beginning to acquire the capability to absorb manufactured goods imported from the Western Pacific. Their moves offshore will further increase Japan's overall imports through out-sourcing on the one hand, while helping decrease Japan's exports on the other through increased sales in the host countries and increased exports to third countries. In other words, the advance of Japanese firms overseas functions in effect as a kind of "export substitution." Direct investment will increasingly work to reduce Japan's troublesome trade surplus.

By upgrading their production and trade structures, the Asian NICs have emerged as a new "growth axis" in Asia, ending Japan's monopoly of the title. This signals the transformation of Asia's growth structure from a "monoaxis" to a "multiple-axis" structure. Through this change, Asia as a whole has gained a wide range of strong, mutually growth-inducing relationships. The striking changes now taking place in the production and trade structures of the Asian NICs hold out the strong possibility of new complementary relations between the NICs and ASEAN countries, and also between the NICs and China.

Fig. 1 takes a look at changes in the international competitiveness of South Korean and Thai manufactured goods, in order of their value added, from left to right. The purpose is to show changes in each product's international competitiveness. South Korea's low value-added products, for instance, have lost international competitiveness, while its high value-added products have rapidly gained a competitive edge. It would seem the Asian NICs are gradually catching up with the advanced countries in sophisticated capital- and technology-intensive goods. In contrast, Thailand has conspicuously sharpened its competitive edge in the same low value-added areas where South Korea is fast losing its international competitiveness. The ASEAN countries are also playing catch-up, this time with the NICs.

The shifting comparative advantages of the NICs and the ASEAN countries resulting from their dynamic race to catch up with more advanced countries will bring further sophistication to the production and trade structures of the NICs. Complementary relationships between the NICs and ASEAN will strengthen. Nor will this be a product of trade alone. Another factor strengthening complementary ties will be the NICs' own investment in ASEAN countries.

Today, Japan, the U.S. and other advanced countries are not the only countries investing in ASEAN. As they gradually lose their competitive edge in labor-intensive goods, the NICs are also shifting their priorities to capital- and technology-intensive goods. And they, too, have begun to relocate production of their older lines of labor-intensive products to neighboring ASEAN countries where labor costs are low. Taiwan, Hong Kong and Singapore, with their large Chinese populations, have close ties with Chinese business interests throughout the ASEAN countries, making such relocation of production far easier. In fact, the outstanding balance of investment by the Asian NICs in Indonesia, Malaysia, the Philippines and Thailand has already reached 31%, 43%, 30% and 46%, respectively, of Japan's direct investment in these countries. These percentages are almost certain to rise.

Looking to China

The division of labor in the Western Pacific is progressing not only between Japan and the NICs and between Japan and the ASEAN countries, but between the NICs and ASEAN as well. The Western Pacific promises to become a growth region marked by truly organic relations among Japan and both groups of developing countries.

The Asian NICs are also rapidly drawing closer to China, with possible major ramifications for the future. The economic structures of the NICs and China are strikingly complementary. It is entirely possible that trade relations between the two could grow significantly in parallel with improving political relations.

Take the example of China and South Korea. South Korea exports color television sets, steel products, synthetic fiber and textiles to China, while China exports raw cotton, silk yarn and textiles to South Korea. Although their trade relations have deepened rapidly in recent years, in 1985 South Korea's exports to China still accounted for only 1.2% of its total exports and its imports from China for only 0.8% of its total imports. There is thus great potential for a sharp increase in trade between the two countries in the near future. South Korean investment in China is already serving to strengthen trade relations between them. Indeed, there have been news reports of joint ventures between the two countries in Hong Kong.

Growing pains

Growth can also be accompanied by growing pains. The NICs, and most particularly South Korea and Taiwan, have already run up big trade surpluses with the U.S., and are under strong pressure from Washington to open their markets wider to U.S. goods and revalue their currencies upward against the U.S. dollar.

In the autumn of 1985, the U.S. demanded that South Korea do more to protect intellectual property, including copyrights, and invoked Article 301 of the Trade Act, popularly known as the "retaliation clause," to force South Korea to open up its insurance market. No sooner was that done than the U.S. demanded that South Korea open its market to 19 items, including beef, lower its tariffs on another 25 items, expand its market for American tobacco, approve the entry of more American insurance companies, permit American advertising agencies to do business locally, and approve real estate acquisitions by U.S. financial institutions.

That was just for the South Korean domestic market. The U.S. also announced that it was removing 14 South Korean products from its new General System of Preferences when it took effect in July 1987. And then there have been the persistent U.S. demands that South Korea revalue the won. South Korea has resisted many of the U.S. demands on the grounds that it spends 6% of its GNP on defense, thereby contributing to the defense of the Pacific at great cost to itself, and that it is burdened by huge cumulative external debts. Negotiations between the U.S. and South Korea have been and continue to be tense at times. But in fact, South Korea has been pushing up its exchange rate since last year.

South Korea is also moving rapidly to liberalize imports. The liberalization rate—the percentage of products free of all import restraints—exceeded 90% in 1985. By July 1987 South Korea had raised the figure to 93.6% and is now aiming for 95.4% in 1988, or about the same rate as in the advanced industrial nations. After liberalizing imports of color television sets and petrochemical products in 1986 and small computers and passenger cars with engine displacements up to 2,000cc in 1987, South Korea now plans to free imports of VCRs and polyester fiber in 1988.

The NICs have become what they are today by developing export-oriented industries. They have been among the greatest beneficiaries of the free trade system. Now that they are powerful exporters in their own right, they need to assume of their own free will greater responsibility for maintaining the free trade system. They have to take a more positive attitude toward liberalizing tariffs and removing nontariff barriers. They must accept the need to further adjust their foreign exchange rates, surrender their old privilege to enjoy preferential duties, and protect intellectual property rights.

In order to help the NICs assume responsibility for helping sustain the free trade system, the industrially advanced countries should designate South Korea an Article-8 nation of the International Monetary Fund (IMF). The Asian NICs should be brought into the Uruguay Round of GATT (the General Agreement on Tariffs and Trade) to enable them to participate more positively in making new rules for international trade. And action should be taken to enable them to participate in the OECD (the Organization for Economic Cooperation and Development). Japan should play an active part in these efforts as it enhances its own function of an absorber of the products manufactured by the NICs, and encourages these dynamic countries to open their markets and adjust their exchange rates of their own accord.

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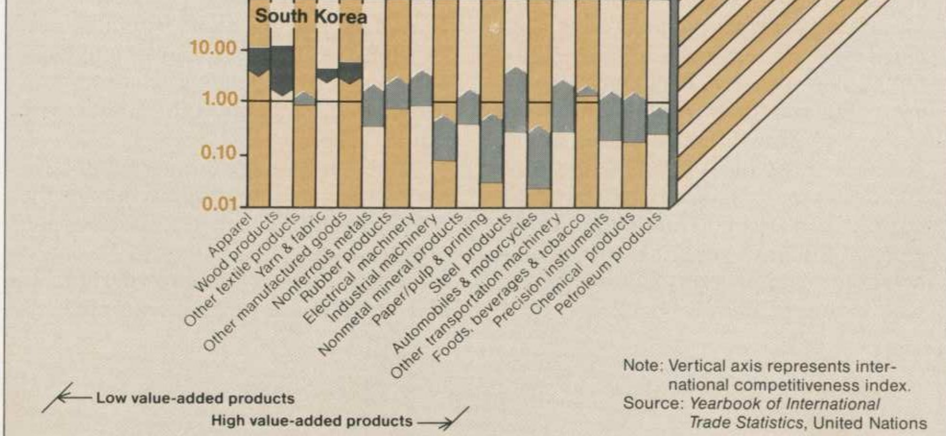
Fig. 1 **Change in International Competitiveness of Two Western Pacific Countries (1970→85)**



Note: Vertical axis represents international competitiveness index.
Source: *Yearbook of International Trade Statistics*, United Nations