

Changing Trade Patterns in East Asia and Implications for Regional Cooperation

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I. Introduction

Since the mid-1980s, the East Asian economies have experienced drastic changes in their industrial structures and trade patterns and achieved remarkable growth rates unprecedented in the history of regional growth. The East Asian growth has been so successful that it has attracted worldwide attention and it is now called as the “East Asian miracle”

Vigorous expansion of trade and investment within the region has been crucially important in this transformation. Among the many factors that have driven this market led regional concentration of economic activities, the following three changes should be mentioned.

First, following the collapse of primary commodity prices in the early 1980s, the ASEAN countries stepped up efforts to industrialize their economies based on an outward-oriented growth strategy. China also accelerated its transition into a market economy by liberalization and reform policies since the mid-1980s. These policy changes provided favorable environments for foreign capital inflows and export industries, mostly labor-intensive, proliferated in these countries. The participation of these countries into the regional division of manufacturing production led to a sharper specialization among the regional economies and expanded trade flows based on the traditional principle of comparative advantage.

Second, after the Plaza Agreement in 1985, the steep appreciation of the yen was a blow to the Japanese export industries. The yen appreciated from about US\$1= Y240 in 1985 to US\$1= Y100 in 1994. To preserve their international competitiveness, these industries began a move towards an internationalization of production. Their manufacturing activities were relocated into the East Asian developing economies in the form of foreign direct investment and the regional networks of production generated considerable new trade flows of capital and intermediate goods.

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Third, the Asian Newly Industrializing Economies (ANIEs) were also affected by these realignments of foreign exchange rates regional division of manufacturing activities. Their currencies also appreciated in the late-1980s and wage rates became too high compared to the ASEAN countries and China. Their traditional labor-intensive export industries lost competitiveness and relocated into other developing economies, while their industrial structures have undergone a process of adjustment into more capital-intensive, technologically sophisticated manufacturing sectors. These structural adjustments created flows of foreign direct investment followed by expansion of capital and intermediate goods trade among the regional economies.

In what follows, I will closely examine the changes that have taken place in East Asia since the mid-1980s : shifting comparative advantages, changing structures, patterns and directions of trade in region. And then I will draw some characteristic features of the East Asian trading system. This is followed by a discussion on the implications for regional cooperation. For the purpose of analytical simplicity, the following countries in East Asia are aggregated into three groups according to their factor endowments, industrial and trade structures:

- (1) Japan
- (2) ANIEs: Korea, Taiwan, Hong Kong, Singapore.
- (3) ASEAN and China: Indonesia, Malaysia, Philippines, Thailand and China.

The trade relations with the United States are included in this analysis on the ground that the US has played a pivotal role in the East Asian trading system. Although these countries are conducting trade globally, only regional trade relations (including the US) are examined in this analysis. Nothing is lost by this regional focusing of attention because nearly eighty percent of their trade are covered in this framework and major changes that have taken place in the last decade were mostly originated in the region.

II. The Growing Weight of the East Asian Economies

East Asia has achieved a remarkable rate of growth since the mid-1980s. The growing weight of East Asia can be clearly seen from Table 1 which compares the GDP (gross domestic products) of East Asia in 1985 and 1994 with those of the US-the most powerful economy that has been producing a quarter of the world output. In 1985 the size of the East Asian GDP was only a half of the US GDP. In 1994, it has grown to 96 percent of the US GDP, accounting for another quarter of the world output. By some accounts, from the mid- 1980s, more than half of the increase in world production of goods and services has taken place in East Asia (Garnaut, 1994:7).

The growth of East Asian trade has been also spectacular. As illustrated in Table 2, East Asia accounted for 18 percent of the world trade in 1985. In 1994, however, the region accounts for exactly a quarter of the world trade-a considerably greater than the share of US trade (14 percent in 1994). This growth was mainly led by extraordinarily high performance of the East Asian developing economies. The ANIEs achieved nearly 15 percent average annual growth rates of trade

during the period ; those for ASEAN and China was 14 percent and 13 percent respectively. As a consequence, the ANIES have become the largest trading group in the region (ANIES trade share : 10.5 percent) surpassing Japan (8 percent) in 1994.

(Table 1) GDP by Major Groups

(billion US dollars, %)

	1985	1994
Japan	1328(34)	4591(69)
ANIES	196(5)	819(12)
ASEAN	188(4)	453(7)
China	266(7)	522(8)
East Asia	1978(50)	6385(96)
US	3947(100)	6648(100)
World		25.223

Source : World Bank, *World Development Report* and ADB, *Key Indicators*.

(Table 2) Changes in the Weight of East Asian Trade

(billion US dollars, %)

	1985	1994	average growth rates
Japan	307(8.3)	669(7.9)	8.1
ANIES	221(6.0)	890(10.5)	14.9
ASEAN	83(2.2)	319(3.8)	14.1
China	69(1.9)	236(2.8)	13.1
East Asia	680(18.4)	2,114(25)	12.0
US	571(15.4)	1,201(14.1)	7.7
World	3,710 (100)	8,499(100)	8.6

Source : IMF, *Direction of Trade Statistics*

III. Factor Endowments and Shifting Comparative Advantages in East Asia

The East Asian countries exhibit a reasonable degree of complementarity in factor endowments. As can be seen from Table 3, natural resource endowments represented by the proxy of population densities differ widely. While Japan and the ANIES are extremely resource-poor countries, ASEAN countries are relatively well endowed with natural resources. As to the capital/labor ratio represented by GNP per capita, Japan is well ahead of other developing countries in its capital endowment but the gap between Japan and the ANIES has been considerably narrowed

due to the rapid growth of the latter. The comparison of GNP by PPP (purchasing power parity) measures show that income differentials are even narrower than GNP by market exchange rates indicates.

(Table 3) Population Density, Income Levels and Growth Rates

(1994)

	Population density (km ⁽²⁾)	per capita GNP		growth rates (1985-94)
		market rates(dollar)	PPP (dollar ⁽¹⁾)	
Japan	331	34,630	21,140	3.2
Korea	449	8,260	10,330	7.8
Taiwan	574	11,604	13,200 ⁽²⁾	7.0
Hong Kong	6,100	21,650	23,900 ⁽²⁾	5.3
Singapore	2,900	22,500	21,900	6.1
Indonesia	100	880	3,600	6.0
Malaysia	60	3,480	8,440	5.6
Philippines	223	950	2,740	1.7
Thailand	113	2,410	6,970	8.6
China	125	530	2,520	7.8
US	28	25,880	25,880	1.3

⁽¹⁾ purchasing power parity rates

⁽²⁾1995

Source : World Bank, *World Development Report*, 1996. *The Economist*, March 1, 1997 : 23

As physical capital has become more mobile in recent years in the forms of foreign direct investment, bank loan and portfolio investment, capital/labor endowments may no longer be a criterion whether a country has a comparative advantage in capital-intensive industries or labor-intensive industries. Instead, human capital or the skill contents of labor forces have become an important determinant of an industrial structure and comparative advantage of a country. Thus, education indexes of the East Asian countries are presented in Table 4 as a proxy for human capital endowment.

(Table 4) Education Indicators

(%)

	Gross secondary enrollment ratio (male)		Tertiary enrollment ratio
	1985	1993	1993
Japan	94	97	30
Korea	93	92	48
Taiwan	89	94	21
Hong Kong	70	73	21
Singapore	61	70	...
Indonesia	53	47	10
Malaysia	53	58	7
Philippines	62	71	26
Thailand	30	34	19
China	45	59	4
Cambodia
Lao	28	27	2
Vietnam	44	43	2
Myanmar	24	23	...

Source : ADB, *Key indicators*

As can be seen from this table, changes in the accumulation of human capital have been modest compared to other drastic changes that have taken place over the period. It also shows that despite their recent successes in economic growth and trade, the East Asian developing countries need further investments in human capital development to sustain their growth rates and to upgrade their industrial structures.

Given these information on factor endowments, let us consider shifting comparative advantages and changing structures of exports in the region. Table 5 shows changes in the structure of exports from 1985 to 1994 by examining the shares of manufactures in total exports, shares of textiles and clothing exports, and shares of machinery exports including transport equipment. Textiles and clothing exports are used as a proxy for unskilled labor-intensive exports and machines and transport equipment can be used as a proxy for exports of physical or human capital-intensive sector.

(Table 5) Structure of Exports and Revealed Comparative Advantages

(%)

	Manufactures		textiles and clothing		machinery and transport equipment ⁽¹⁾	
	1985	1994	1985	1994	1985	1994
Korea	92	94	23	19	38(3)	49(11)
Taiwan	91	94	n.a.	15	28(20)	45(12)
Hong Kong ⁽²⁾	97	96	32	n.a.	22(n.a.)	28(n.a.)
Singapore	54	85	4	4	33(-5)	64(3)
Indonesia	14	53	2	17	0.5(-95)	8(-62)
Malaysia	32	75	3	6	18(-31)	55(-7)
Philippines	62	79	7	9	7(-27)	19(-45)
Thailand	43	73	13	15	9(-61)	34(-27)
China ⁽³⁾	49	82	24	31	3(-91)	17(-49)

⁽¹⁾ Figures in the parenthesis are revealed comparative advantages as represented by the net export ratios. Net Exports = $[(X-M)/(X+M)] 100$, where X and M are exports and imports of machinery and transport equipment.

⁽²⁾ Excluding re-exports in Hong Kong.

⁽³⁾ Figures for China are 1993.

Source : ADB, *Key Indicators*, 1995 and World Bank, *World Development Report* 1995

The first striking change in the period is the rapidly rising share of manufactures in the exports of ASEAN countries and China. For instance, It rose from 14 percent to 53 percent in Indonesia and from 32 percent to 75 percent in Malaysia. Thus, the ASEAN countries are no longer exporters of primary commodities and are now becoming exporters of manufactures. In China, it rose from 49 percent to 82 percent--also a drastic increase in a relatively short time span.

Second, the shares of textiles and clothing exports also rose in ASEAN and China. In Indonesia, the share of textiles and clothing were a meager 2 percent in 1985 but it rose to 17 percent in 1994. In China, it is now the largest export sector accounting for 31 percent of the export earnings. Although the ANIEs are losing competitiveness in this sector, it still accounts for a sizable share in their total exports. Thus the East Asian developing countries are the major exporters of textiles and clothing in the world, accounting for nearly 40 percent of global trade in textiles and 55 percent of global trade in clothing (ADB, 1997 : 180).

Third, changes in the shares of machinery and transport equipment shows another aspect of shifting comparative advantages in the region. All developing East Asian countries have shown marked increase in machinery exports. In Singapore, the share was 64 percent in 1994 and Malaysia recorded 55 percent. In Korea, the share rose from 38 percent to 49 percent. In Thailand, it rose from 9 percent to 34 percent and in China it rose from 3 percent to 17 percent.

Despite these impressive overall increases, however, if we consider comparative advantage or disadvantage in terms of net exports, there are important qualitative differences among these countries. All ANIEs are net exporters of machinery indicating that they have comparative advantages in machinery sector while all ASEAN countries and China are still net importers of machinery indicating that they have comparative disadvantages despite a sizable exports of machinery. In other words, machinery exports of the ANIEs conform to their physical and human capital endowments while those of ASEAN and China are not based on their overall factor endowments situations. One explanation for this discrepancy is that some machinery industries are simple labor-intensive assembling industries. The other explanation is the recent proliferation of foreign direct investment. Some foreign direct investments are based on locational advantage of cheap and abundant labor. Other types of foreign direct investments are based on internalization advantage of a firm motivated by vertical integration or horizontal diversification. The resulting trade in this case would create intra-firm trade that does not necessarily conform to a country's overall factor endowment or comparative advantage. Thus those countries that have received a considerable amount of foreign direct investment of this kind such as Malaysia, Thailand and China recorded rapid increases in machinery exports that exceed their factor proportions. The recent upsurge in foreign direct inflows into ASEAN and China are presented in Table 6.

(Table 6) Foreign Direct Investment : 1989-1994

(million US\$)

	1989	1990	1991	1992	1993	1994	1989-1994
China	3,393	3,487	4,336	11,156	27,515	33,787	83,704
(ASEAN-4)	(4,668)	(6,339)	(8,038)	(9,304)	(9,499)	(8,223)	(46,151)
Indonesia	682	1,093	1,482	1,777	2,004	2,109	9,147
Malaysia	1,668	2,332	3,998	5,183	5,006	4,338	22,535
Philippines	563	530	544	228	763	1,126	3,754
Thailand	1,775	2,444	2,014	2,116	1,726	640	10,705

Source : ADB, *Asian Development Outlook*, 1996-97

IV. Changing Directions of Trade in East Asia

As the East Asian developing countries began their trade expansion since mid-1980s, directions and pattern of their trade undergone substantial changes. Table 7 examines these changes by aggregating individual countries into three groups in East Asia plus their important trading partner, the US. The period under consideration is from 1988 to 1994 ---a relatively short time span but nevertheless a turbulent period in which dramatic changes in trade flows have taken place.

1. Japan

The most distinguishing changes of the Japanese trade over the period is an increasing dependence of Japan's exports on East Asia. The share of East Asian developing economies in Japan's exports rose from 27 percent to 39 percent due mainly to increased sales of capital and intermediate goods to these countries while the share of US declined from 34 percent to 30 percent. In fact, exports to East Asia surpassed exports to US in 1991 and the Asianization of Japanese export trend continued ever since. It was accompanied by a structural change in the composition of Japanese exports. The share of consumption goods in Japan's exports declined from 31 percent to 20 percent and the share of capital goods rose from 47 percent to 60 percent (The Economist, April, 22, 1995 : 18).

(Table 7) Intra-regional Trade Flows and Shares by Major Groups

(billion US dollars, %)

	Exports		Imports	
	1988	1994	1988	1994
Japan	50(19)	93(24)	25(13)	31(11)
ANIEs	22(8)	59(15)	29(15)	59(22)
A+C				
East Asia	72(27)	152(39)	54(28)	90(33)
US	90(34)	118(30)	42(23)	63(23)
Total Trade	265(100)	395(100)	187(100)	274(100)
ANIEs	28(13)	39(9)	52(25)	98(22)
Japan	24(11)	59(14)	22(11)	53(12)
ANIEs				
A+C	33(15)	119(27)	38(18)	116(26)
East Asia	85(39)	217(50)	112(54)	267(60)
US	70(31)	98(22)	38(18)	67(15)
Total Trade	224(100)	437(100)	209(100)	452(100)
A+C	24(21)	50(18)	25(22)	73(26)
Japan	33(29)	79(29)	24(21)	68(24)
ANIEs				
A + C	5(4)	15(5)	6(5)	17(6)
East Asia	62(54)	144(52)	55(48)	158(56)
US	16(14)	55(20)	16(14)	37(13)
Total Trade	112(100)	273(100)	114(100)	283(100)
US	38(12)	53(10)	93(20)	122(18)
Japan	25(11)	59(12)	66(15)	74(11)
ANIEs				
A + C	12(3)	28(5)	23(5)	79(11)
East Asia	84(26)	140(27)	182(40)	275(40)
Total Trade	319(100)	512(100)	459(100)	689(100)
E.A. to E.A.	219(44)	513(52)	221(53)	515(58)
US	176(35)	271(28)	96(23)	167(19)
Total Trade	498(100)	980(100)	419(100)	888(100)
The World Total	2,743	4,185	2,837	4,315

Note : A+C stands for ASEAN and China

Source : IMF, *Direction of Trade Statistics*

The Asianization of Japanese trade can also be seen on its import side. Imports from East Asia rose from 28 percent to 33 percent over the period. Especially, imports from ASEAN and China rose from 15 percent to 22 percent, due mainly to increase in imports of manufactured goods rather than primary commodities. A considerable part of this increase was re-exports from Japanese subsidiaries relocated in these countries.

Despite increasing re-exports, Japan experienced large trade surpluses with the East Asian developing countries with the exception of China and Indonesia. Its overall trade surplus with the East-Asian developing countries reached 62 billion dollars in 1994---a larger sum than the surplus with the US of 55 billion dollars. So far these trade imbalances have not caused serious trade tensions, but if persisted, it will clearly be a major concern for Japanese policy makers. It is noteworthy in this context that the Japanese bargaining power vis-a-vis the East-Asian developing countries measured by the market share of has declined over the period. Japan's share of ANIE's exports declined from 13 percent to 9 percent while ASEAN and China's declined from 21 percent to 18 percent reflecting the Japanese recession in the early 1990s.

2. ANIEs

The ANIEs also experienced drastic changes in their trade flows during the period. The ANIE's exports to ASEAN and China increased from 15 percent in 1988 to 27 percent in 1994. The increase is surprising even if we consider that due to the rapid growth of these countries over the period, we can expect a large increase in their imports. The share of total East Asian trade rose from 39 percent to 50 percent, which was even higher ratio of Asianization than Japan's trade.

These changes could not be accomplished without changes in their trade structures. They have transformed their industrial structures from producers of consumption goods to producers and exporters of capital and intermediate goods. The traditional exports of consumption goods declined and the ANIEs' dependence on US markets fell from 31 percent to 22 percent. The ANIEs' foreign direct investments and relocation of their labor-intensive industries into ASEAN and China have also contributed to the structural adjustments in their industries. On the import side, the traditionally high dependence on Japan declined from 25 percent to 22 percent as they have become producers of capital goods. Imports from ASEAN and China rose rapidly from 18 percent to 26 percent, reflecting the impact of foreign direct investment and intra-firm trade.

3. ASEAN and China

As ASEAN and China accelerated their specialization on labor-intensive sectors, their exports of these commodities rose drastically, particularly in US market. Their dependence on US market rose from 14 percent to 20 percent, with China's exports to the US rising from 7 percent to 18 percent. This is sharp contrast to the recent decline of ANIEs' exports to the US---an evidence

that these countries are replacing the ANIEs as main exporters of labor-intensive consumption goods in the industrialized countries' markets.

Their share of exports to Japan and the ANIEs have slightly decreased, from 50 percent to 47 percent, despite the rising exports of labor-intensive commodities and other re-exports from subsidiaries. Exports of labor-intensive commodities to the ANIEs, which are losing competitiveness in this sector, have not increased as rapidly as expected from shifting comparative advantages. The reason for this can be explained in the following manner. The ANIEs were until recently formidable producers and exporters of the labor intensive commodities in the world market. Even though these industries are losing competitiveness in the foreign market, they can still be competitive in their home markets due to the difference of transaction costs--for instance, transport costs or tariffs are virtually zero for them. Thus, the response to the shifting comparative advantage tends to be sharper in the home market than in the third-country market.

On the import side, however, their dependence on East Asia rose from 48 percent to 56 percent, reflecting growing imports of capital and intermediate goods from Japan and the ANIEs. One other trend that should be mentioned is the low share of intra-group trade among ASEAN countries and China. Trade among these countries excluding Singapore have been only 5-6 percent of their total trade, reflecting similar structures in production and trade.

4. The United States

Since the US has played a pivotal role in the East Asian trade system, some changes in US trade with East Asia should be mentioned. The importance of the US as a market decreased for Japan and the ANIEs but increased for ASEAN and China. However, the overall dependence of East Asia on the US market declined from 35 percent to 28 percent, which is nevertheless a considerable proportion. If the size of market is a measure of bargaining power in trade negotiations, then the US influence is clearly declining in East Asia.

The share of US imports from East Asia was unchanged at 40 percent. However, it is interesting to note that the share of Japan and the ANIEs fell 6 points, while that of ASEAN and China rose 6 points, exactly offsetting the loss of Japan and the ANIEs. Since ASEAN and China are only replacing exports from Japan and the ANIEs in the US market, they would face less severe protectionist pressure than the ANIEs in the seventies and eighties.

5. Changes in Trade Intensities

The above share analysis clearly indicates that for all countries in East Asia, the share of intra-regional trade has substantially increased over the period. The question naturally arises, then, whether this trend also indicates a rising regional bias discriminating and diverting trade from the rest of the world. One appropriate measure to assess the bias is the trade intensity index, which

compares actual trade flows to flows expected from the partners size in world trade. Thus a value of intensity greater than one indicates a closer trade relations than the world average and less than one higher trade resistance.

(Table 8) Changes in the Trade Intensities

		Japan	ANIEs	ASEAN and China	US
Japan	1988		2.39	1.93	1.96
	1994		2.10	2.13	1.75
ANIEs	1988	1.74	1.35	3.40	1.60
	1994	1.26	1.15	3.72	1.26
ASEAN+ China	1988	3.12	3.84	1.07	0.85
	1994	2.70	2.58	0.78	1.18
US	1988	1.51	1.25	0.78	
	1994	1.37	0.92	0.70	

Source : IMF, *Direction of Trade Statistics*

The changes in trade intensities are shown in Table 8. It reveals that in most cases, the intensities are above one, reflecting geographical, cultural proximity among the countries in the region. It also reveals that intensities have declined in most cases. One explanation is that the East Asian countries' share of world trade have increased due to the higher growth than the rest of the world. The other explanation is that unlike other regional trade bloc, East Asia's *de facto* trade integration has not resulted in trade diversion from other regions.

V. Some Characteristic Features of the East Asian Trading System

1. The New Division of Labor in East Asia and Trade Expansion

A new pattern of trade based on division of labor emerged in East Asia since the mid 1980s. The ANIEs have upgraded their industrial structures and capital and intermediate commodities are now their major export commodities. ASEAN and China have transformed from producers of primary commodities into leading producers labor-intensive commodities and their exports of these commodities now surpass those of the ANIEs. This specialization reflected utilization of complementarity and wide differences in factor endowments among the countries in the region made possible by the policy changes toward an outward-oriented industrialization. The mutual gains from trade expansion were considerable as can be seen from a synchronized upsurge in growth rates of the developing countries in the region.

2. Foreign Direct Investment and Trade Expansion

The surge of foreign direct investment by Japan and the ANIEs seeking locational advantage also promoted trade expansion in two ways. First, it assisted structural changes along the lines of comparative advantages by relocating labor-intensive industries in high-wage countries and creating export industries in host countries. Second, it was instrumental in the internationalization strategy of the multinational corporations and resulted in a new division of labor at the industry level. In some industries, for instance in electronics industry, the production processes are divided into simple labor-intensive assembling processes and more sophisticated technology-intensive processes. The former processes were relocated from Japan and the ANIEs into ASEAN and China, while the latter were retained in the more advanced countries, creating hierarchical regional production networks. The resulting trade pattern appears to be intra-industry trade between home and host countries but it is not caused by economies of scale as the conventional definition assumes. It is rather intra-firm trade by multinational corporations---a parent company exporting intermediate goods while subsidiaries re-exporting parts and final goods.

3. Intra-regional Trade Expansion and Open Regionalism

The synchronized trade expansion and economic reforms toward market-friendly direction contributed to a synchronized real output growth in the region. As the region achieved faster rates of growth than the rest of the world, import demand expanded faster than the rest of the world and the share of intra-regional trade rose sharply over the period. Yet, there is no evidence suggesting that the rising share of intra-regional trade was achieved by trade diversion from the rest of the world. On the contrary, the rising intra-regional trade was accompanied by falling intra-regional trade intensities. This implies that trade liberalization and reduction in trade barriers in East Asia was based on the principle of non-discrimination rather than regional preferential trade arrangements, and trade with the outside market increased due to lowering transport costs and diversification of export commodities.

4. The New East Asian Trade Triangle

Despite the recent intra-regional trade expansion, East-Asian trading system is still not self-reliant in the sense that US market plays a critical role in absorbing their exports. Thus, East Asian trading system was described as a triangular system: Japan exported capital and intermediate goods to the ANIEs; the ANIEs in turn exported labor-intensive consumption goods to the US. The system could be viewed as Japan exporting to the US indirectly through the ANIEs and the US incurred heavy trade deficits with both parties. ASEAN and China were left out of this system because they were mostly exporters of primary commodities. However, as these countries have become important exporters of manufactured goods of late, this triangular system should be redefined. In this new triangle, Japan and the ANIEs are grouped together, on the ground that these countries' composition of trade have become similar with the exception of technology-intensive trade by Japan. These

countries are now exporting capital and intermediate goods to ASEAN and China, which in turn export labor-intensive consumption goods to the US. The triangular flows of trade in 1994 and net balance show that despite its declining importance, the US still plays a pivotal role as a market for East-Asian exports.

5. Flying Geese Pattern and Catching-up Development Process

The flying geese model (Akamatsu, 1962) and its variant, the catching-up product cycle theory (Kojima, 1973) have been popular explanations by Japanese scholars: a harmonious development of the neighboring countries are possible by successively shifting production from simple to sophisticated industries following a country's development stage. According to this hypothesis, products or industries would experience a cycle of import, domestic production, export, and re-import stages, which if arranged to match a country's development stage, would enable a catching-up development process for late-starters. Whether the hypothesis is still relevant in the recent experience of East Asia has been questioned by some scholars (Bernard and Ravenhill, 1995). They points out that the argument is no longer relevant in a hierarchical production network in East Asia. The internationalization of production and sourcing of parts supply from subsidiaries in other countries have enabled Japanese firms to retain competitiveness, so that the cyclical rise and fall of industries do not necessarily follow. The other point that limits the application of this hypothesis is that the final stage of re-importing has not materialized in East Asia. Japan's re-imports from foreign subsidiaries are on the rise in the 1990s, but far short of justifying the hypothesis. The ANIEs re-imports of final consumption goods have so far failed to occur for reasons stated above. Thus, it seems that a harmonious and successive regional development model should be applied with caution in the context of hierarchical regional production in East Asia.

6. Intra-group Competition and Exchange-rate Fluctuations

The trade structure of Japan and the ANIEs are increasingly becoming similar with the exception of technology-intensive sectors where Japan enjoys some monopoly position. This change has lowered the dependency of the ANIEs on Japanese capital and intermediate goods and increased competition among these countries. In the 1970s and early 1980s, the ANIEs were a built-in stabilizer for the Japanese economy (Kwan, 1994). A fall in Japanese exports to the industrialized countries due to the yen appreciation increased exports from the ANIEs. The export boom in the ANIEs in turn increased their import demand for Japanese capital and intermediate goods. Thus the initial loss of Japanese exports were compensated by a rise in exports to the ANIEs, stabilizing overall export performance. This linkage between Japan and the ANIEs have weakened in recent years as the ANIEs developed their own capital-goods sectors and their export performances are increasingly affected by exchange rate fluctuations. Thus competition rather than complementarity seems to dominate trade relations of Japan and the ANIEs. Among ASEAN and China, competitive relations also prevail in seeking markets for their labor-intensive commodities and attracting foreign

capital. The ASEAN Free Trade Area expected to be completed in 2003 may have some impact in this regard as market induced foreign investment will flow into the area.

VI. Some Implications for Regional Cooperation

1. Interdependence and Synchronization of Economic Activities

The recent increase in interdependence and surging regional trade and investment flows have resulted in a synchronization of economic activities among the developing countries in the region while reducing dependence on the outside world. In the 1970s, when dependence on the industrialized world was high, one percent increase (decrease) in growth rates of the world tended to raise (reduce) that of the East Asian developing economies by 1.5 percent. The figure has fallen in the last decade to 0.4 percent. The elasticity with the US has also fallen from 1.0 percent to 0.3 percent (Kwan, 1994). Thus the East Asian countries are now less vulnerable to the fluctuations in the outside world and more sensitive to the performance of neighboring countries in the region. The surge of exports and dramatic increase in growth rates since the mid-1980s was one evidence of this synchronization and the overall slowdown and deceleration of export growth rates in 1996 another. Now the regional economies are so closely linked by trade and investment, the need for closer consultations and cooperation are compelling.

2. Negative Aspects of Interdependence

A higher level of openness and regional interdependence would undoubtedly bring about mutual economic benefits and concerted high rates of growth as we have witnessed in the last decade. However it would also cause some serious misconceptions, domestic adjustment problems and cultural clashes, if not managed properly. For instance, the expansion of trade may not be symmetrical in this world of multilateral trade and bilateral imbalances may appear among the countries in the region. Indeed, it is not necessary, nor desirable that each bilateral trade be balanced given the diversity of trade structure of each country. As long as a country is following the norms and rules of the international community, it is a fair trade and the resulting bilateral trade imbalances should not be disputed.

There is also a public misconception about liberalization, often egged on by vested interests, which lead to trade friction based not on reason but by rhetoric of protection. This is not to deny that there are times when each country's domestic problems should receive serious concern. Each country possesses sensitive areas where a rapid liberalization would incur not only economic adjustment costs, but also social and political instability. We must recognize that liberalization is a political process as well as economic, and it needs the support of public consensus. Region-wide, synchronized liberalization would help to mitigate the pressure of the politics of protectionism. Another possible area of tension would be the increasing flow of foreign direct investment and hierarchical production networks. Unlike to simple trade of goods, foreign direct

investment involves a closer human contact, which sometimes causes resentment and a clash of culture.

3. Trade and Exchange-Rate Stabilization

In recent years, trade in East Asia has become very sensitive to the movement of yen-dollar exchange rates as the East Asian economies have become competitive with Japan and Japanese trade is increasingly denominated in the yen. Also the regional production network by the Japanese firms tend to reduce exchange risks by continuously moving production into weak currency area. This may stabilize activities of the Japanese firms but would have destabilizing effect on the host country's economic performance. The use of yen in other financial transactions and yen-denominated external debts are also on the rise in the region.

Despite the growing weight of the yen in trade and finance, many developing countries in the region have continued to peg their exchange rates to the dollar, or to a basket with a large dollar component. Thus these countries have experienced volatility in their real effective exchange rates and suffered wide fluctuations in their competitiveness position. The exchange-rate volatility and uncertainty caused by it is certainly undesirable, and the absence of regional cooperation to stabilize exchange-rate movements is unfortunate.

Yet, despite the critical importance of exchange-rate movements in trade and investment decisions, international monetary matters have been mostly managed by the G-7 or G-5 industrialized countries or coordinated by bilateral consultations between the US and Japan. When a financial talk was first held in the Asia-Pacific region in Tokyo this year, only the US, Japan, Australia, China, Hong Kong and Singapore were represented and the rest East Asian countries were excluded. Whether this forum will develop into a regional forum for exchange rate cooperation remains to be seen, but the exclusion seemed unfair in view of the growing weight of other countries in trade and investment in the region.

4. Bilateral Approach to Regional Problems

Despite these compelling needs for regional framework, formal institutional arrangement to sustain this dynamism is still lacking in East Asia. There is, of course, ASEAN, which this year celebrates thirty years of successful cooperation and expands into ten member countries encompassing the whole Southeast Asia. However, ASEAN's intra-group economic relations are small compared to their relations with the outside world so that the scope for their economic cooperation is limited. There is also APEC (Asia-Pacific Economic Cooperation) forum, which encompasses both side of the Pacific. Although APEC has been successful in launching regional free trade project known as "Bogor Declaration", the prospect for its institutional development is still uncertain due to huge diversities of its member countries. Thus, there is really no effective regional institution or arrangement to manage increasingly interdependent economic relations in East Asia.

This is unfortunate because East Asia is such a dynamic region where rapid changes are taking place. The changes would inevitably create instability which could only be managed by regional coordination and cooperation. It is also undesirable if we consider that East Asia possesses a huge potential for sustainable economic growth and its exploitation is far from complete.

Institution-building in East Asia would be a time-consuming process, however, and requires strong leadership lacking in the region. It is also likely to be met with suspicion and resistance as we have experienced in the EAEC (East Asia Economic Caucus) proposal. In the absence of regional economic regime, therefore, a more practical, second best approach would be to increase bilateral contacts to deal with not only bilateral problems but also regional problems. The first step in this direction would be to identify regional issue-areas, and exchange views and knowledge among the scholars in the region. In this regard, the ASEAN seminar such as this is an appropriate occasion to increase common understanding on such pressing issues as regional trade and investment.

5. ASEAN Enlargement and Shifting Comparative Advantages

The joining of new ASEAN members and their participation into the regional division of labor would undoubtedly affect the regional trade pattern in the long-run. At present, their economic weight and trade share are small and their infrastructures for industrialization are lacking. However, as these countries have the advantage of low labor costs, the existing labor-intensive industries of the region will have to face competition from them and other South Asian countries where liberalization is also taking place. In fact, some ASEAN countries' composition of exports have already shown that the share of labor-intensive industries have begun to decline in recent years. Yet, it is well known that labor costs alone cannot determine international competitiveness. The level of productivity is as important as wage level in determining comparative advantage. Thus Japan had comparative advantage in labor-intensive industries until the early 1970s and the ANIEs until the early 1990s.

It appears that a country's comparative advantage is shifting more rapidly in recent years as the barriers to trade and capital mobility are falling. The shift is even faster in East Asia fueled by region-wide dynamism. However, it seems doubtful whether a country's industrial policy should be directed to promote capital-intensive industries excessively accelerating this dynamic shifts. The Korean experience has shown that a premature investment in heavy and chemical industries in the 1970s ended in failure and Korea suffered severe distortions in resource allocation as a consequence. Certainly, the ASEAN countries have a great potential for their own capital and intermediate goods industries in view of its enlargement and formation of a single market by the free trade agreement. However, it seems that resources will be more efficiently allocated if the investment decision is left to the market.

6. Regional Cooperation in the Era of ASEAN-10

Although none of the individual ASEAN states has possessed the power to influence regional affairs alone, ASEAN has exercised its collective power most effectively in regional and international affairs disproportionate to its economic weight by maintaining its solidarity. In APEC forums on many occasions, ASEAN has shown that it has the decisive voice in shaping the future of this Asia-Pacific institution. It also proposed the Asia-Europe Meeting which convened in Bangkok this year and expected to be held regularly. The first ministerial meeting of the World Trade Organization was held in Singapore where ASEAN voice was heard on such new trade issues as labor standards, trade and environment policy and competition policy. The ASEAN Regional Forum under ASEAN initiative is the only regional forum visible in security arena in the Asia-Pacific.

As Asianization of Japan and the ANIEs is expected to continue, ASEAN's position as a central player in the region will be further strengthened. Japan's attempt to hold a regular summit meeting with ASEAN, known as the 'Hashimoto principle' is a recognition of this reality. ASEAN-10, uniting whole Southeast Asia will further enhance its bargaining position in regional economic and political issues.

As the Asia-Pacific is unlikely to be dominated by hegemonic powers in the coming century, the role of middle powers in the region will become critical to maintain stable regional environment in an increasingly interdependent East Asia. The task of trust and institution-building in East Asia seems to have fallen to ASEAN rather than one or two hegemonic powers in the region. Korea is also a middle state strategically positioned between the developed and developing countries. Korea has pursued internationalization of its economy in recent years by trade and financial liberalization. Since the joining of OECD (Organization for Economic Cooperation and Development) in 1996, the trend is expected to be accelerated. Let us hope that these countries, by working together in a more assertive way, would contribute to the shaping of a more peaceful and prosperous Pacific century.

Appendix
Composition of Merchandise Exports : Factor Intensities

	Labor-intensive		Capital-intensive	
	1985	1994	1985	1994
Japan	9	7	87	88
Korea	50	27	40	64
Taiwan	46	26	41	64
Hong Kong ¹	56	45	39	48
Singapore	7	6	43	76
Indonesia	3	23	4	16
Malaysia	5	9	21	61
Philippines	42	51	11	26
Thailand	18	25	15	43
China	48	54	18	31

labor-intensive manufactures

Code	Product
65	Textile yarn, fabric etc
664-6	Glass
735	Ships and boats
81	Plumbing, heating, lighting equip.
82	Furniture
83	Travel goods, handbags
84	Clothing
85	Footwear
893	Articles of plastic nes
894	Office supplies nes
899	Other manuf goods
931	Special transactions(Philippines only)
951	War, firearms ammunition

capital-intensive manufactures

Code	Product
5	Chemicals
62	Rubber manuf nes
64	Paper, paperboard manuf
672-9	Iron & steel excl 670-1
691-4	Metal manuf excl 695-9
698-9	Metal manuf nes
71	Machinery, non-electric
722-6	Electrical machinery excl machinery,nes
731-4	Transport equip excl ships& boats
86	Instruments, watches and clocks
891	Sound recorders, producers
892	Printed matter
896	Works of arts etc
897	Gold, silverware, jewelry

Note : 1. Excluding Re-exports

Source : Asia-Pacific Economic Group, *Asia pacific Profiles, 1997*.

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