AN INQUIRY INTO THE NATURE OF ECONOMIC INTEGRATION IN PACIFIC ASIA

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I. INTRODUCTION

A. The Scope of This Paper

In recent years there have been talks about and attempts at forming regional economic blocs, such as the European Economic Community (European Community by 1992) has done. Although there are still many internal disputes among the members of the EEC over the division of power and distribution of the benefits of integration, the fact that the hitherto economically competing countries have agreed to a target date of 1992 to achieve a status akin to an economic union has made a dramatic impact on countries in other regions of the world. Already there are talks about the formation of a North American Free Trade Area that will include the United States, Canada and Mexico. Then, of course, there have been activities by countries on both sides of the Pacific that are leading to some kind of Pacific region integration scheme.

If economic integration means the combining of several economies to enlarge the market size, it is not a new phenomenon. The pre-W. W. II British Commonwealth preferential system was a form of integration. Also, the German Zollverein, which was a customs union, was formed as early as in 1834. Since the end of W. W. II, there have been many more examples of attempts at achieving some form of economic integration. In Latin America, there have been schemes such as the Latin American Free Trade Association, the Central American Common Market, the Caribbean Free Trade Association. In Asia, one finds the Association of Southeast Asian Nations (ASEAN), and the Regional Cooperation for Development (Iran, Turkey, and Pakistan). For Africa and Middle East, there have been East African Community, the Central African Customs and Economic Union; the Arab Common Market, the West African Customs Union, and the Cooperation Among Maghreb Countries.

Unlike the aforementioned integration schemes which had as their primary goal an expansion of the market size, the integration schemes being contemplated today, such as the North American Free Trade Area and the Pacific Rim Trade Area, seek integration also partly as a defensive measure against the European Community. This trend, if it should continue, may eventually lead to the division of the world into three major trading blocs consisting of the EC, North American Trade Area, and Pacific Rim Free Trade Area. Such an outcome would be contrary to the purpose of the GATT, which, for nearly half a century, has promoted multilateralism in international trade.

Whether or not the world is breaking up into three major trading blocs is a question that remains to be answered, and is not a question this paper will pursue. Rather, this paper attempts to examine the viability of various schemes of integration in Pacific Asia in light of the economic forces at work there.

B. The Concept of Economic Integration

Economic integration may assume various forms, starting from a free trade area to a customs union, to a common market and ultimately to an economic union.

In a free trade area, member countries remove trade barriers among themselves, but each member country still maintains her own independent trade barriers against non-member countries. A customs union raises the level of integration a step further by requiring member countries to form common trade barriers against non-member countries. Moving a step further, if member countries allow free movement of factors of production among themselves, a common market is then established. If member countries also coordinate and harmonize their fiscal and monetary policies, the trading bloc becomes an economic union.

There are two kinds of effects that may arise from an economic integration scheme — viz., static effects and dynamic effects. The static effects refer to trade creade creation effects and trade diversion effects.[1] Trade creation occurs when resources used in production are shifted from least efficient users to the most efficent users. Conversely, trade diversion occurs when resources are shifted from efficient users to less efficient users, as for example, a member of a free trade area (or a customs union) divert her imports from the more efficient producers outside of the free trade area to less efficient producers of the partner countries of the same free trade area. Whether trade creation effects will outweigh trade diversion effects or not depends on how competitive economically partner countries are among themselves. The more competitive partners' economies are with each other, the more likely trade creation effects will outweigh trade diversion effects.

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(1) See Jacob Viner, *The Coustoms Union Issue* (New York: Carnegie Endowment for International Peace, 1950), Chapter IV, especially pp.43-46.

Even when trade diversion effects outweigh trade creation effects in an economically integrated area, there are other effects that arise from the economic integration itself. These effects include the economies of scale afforded by larger combined markets of partner countries and increased economic efficiency that will result from increased competition in an enlarged free trade area. These effects are also called dynamic effects because they promote economic growth. However, the extent to which such dynamic effects can take place depends on how far the partner countries in an economically integrated area allow free trade of goods and services. In reality, most of the integration schemes referred to in the previous part (Part A) have not been able to exploit the potential of dynamic effects because of the unwillingness of partner countries to allow truly free flow of goods and services. This paper will examine whether the conditions are ripe in Pacific Asia for any meaningful economic integration that will produce beneficial effects of integration.

II. Economic Integration Schemes in Pacific Asia

One of the earlier proposals for an economic integration scheme involving Pacific countries came from Japan, although from non-government (unofficial) circles. In his *Japan and Pacific Free Trade Area*, published in 1971, Professor Kojima of Hitotsubashi University proposed formation of a free trade area that would comprise the United States, Japan, Canada, Australia, and New Zealand.[2] He made this proposal, in part, as a defensive measure

(2) See Kiyoshi Kojima, *Japan and a Pacific Free Trade Area* (Berkley: University of California Press, 1971).

against the discriminatory tendency of the growing European Economic Community; and, in part, a regional arrangement was considered the second-best approach to promote free trade, even if on a regional basis, given the gloomy prospect at that time for further multilateral trade liberalization under the GATT. Since the membership of the free trade area includes only industrialized countries that produce competitive goods rather than complementary goods, he proposed specialization in production for member countries.

The proposal also would draw Pacific Asia's developing countries into the free trade area by offering them the most-favored-nation clause and by granting them preferential treatment for their exports which were primarily agricultural products and raw materials. In effect, Kojima's proposal strived to achieve horizontal specialization among the industrialized countries and vertical specialization between the industrialized countries on the one hand, and developing countries on the other.

The proposal for a PAFTA, however, did not receive a favorable response from the other proposed member countries because they felt the distribution of benefits were inequitable and that the scheme also contained too much constraint on their freedom to pursue domestic agricultural policy. Neither was the proposal received favorably by the developing countries because they viewed the proposed organization as a "rich man's club,".[3]

At about the same time the Japanese concerns were seeking a new regional arrangement in the Pacific Basin, the potential of economically growing economies in that region did not escape the

(3) W. Kraus and W. Lukenhorst, *The Economic Development of the Pacific Basin*, (New York: St. Martin's Press, 1986), pp.97-100.

attention of the United States. In a study commissioned by the U.S. Congress, Professors Drysdale and Patrick proposed a structure for the Organization of Pacific Trade and Development that was to be less institutionalized and less policy-making oriented. Rather, their proposed structure stressed coordination and consultation, and that the OPTAD was to be used as a forum for these functions. Their proposal also recognized the growing interdependence among Pacific Basin economies; accordingly, they also proposed codes of business conduct that would expedite the interactions arising from this interdependence.[4] Thus, the United States viewed the need for an organization of Pacific Basin countries more from the perspective of how growing business interactions in diverse environments may be expedited rather than committing herself formally to institutional arrangements of a free trade area.

Meantime, the Japanese interest in a Pacific regional scheme became more official. In 1980, the then Prime Minister Ohira set up a Pacific Basin Cooperation Study Group and charged it with the task of devising a Pacific organization. Unlike the earlier Kojima proposal which confined its scope to economic policy matters, the scheme the Ohira's group came up with covered broader areas of interaction, including cultural and educational exchanges. By broadening the avenues of contact among the Pacific Basin countries, the group hoped to arouse these countries, awareness in a Pacific identity, even if it would take a long time to accomplish. One may aptly describe this approach as an informal, grass-roots approach.

The Ohira Group's found its implementation in 1980 in the

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(4) P. Drysdale and H. Patrick, *An Asian-Pacific Regional Economic Organization: An Exploratory Concept Paper* (Washington D.C.: Government Printing Office, 1979).

establishment of the Pacific Cooperation Committee (PECC) that holds annual conference attended by representatives from the governments, business and academia of Pacific countries. Since 1989, the PECC has been supplemented with Asia Pacific Economic Conference (APEC) which is attended only by cabinet members of Pacific countries.

In addition to broad Pacific Area schemes, there are also smaller regional arrangements, of which one is in existence and the others being talked about in the news media. The Association of Southeast Asian Nations (ASEAN), comprising Indonesia, Malaysia, The Philippines, Singapore, Thailand, and later Brunei, has been in existence since 1967. Some segments of Japan, in particular the areas along the Sea of Japan, are promoting a Sea of Japan regional scheme that will include Japan, Korea and Eastern Siberia.(5) The Chinese press, too, from time to time has promoted the schemes of Bo Hai Economic Region and Yellow Sea Economic Region, both of which will encompass North and Northeast China, Korea, and Southern Japan.

In recent years, the press in China and Hong Kong has been highlighting the emergence of South China Economic Region which encompasses not only the coastal provinces of south China but also Taiwan, Hong Kong, Singapore, and some economies in Southeast Asia. What is unique about this region is that it is the private market forces, rather than official government efforts that are pushing for some kind of economic integration.

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(5) For recent developments in the Sea of Japan Economic Region, see the series on "Kan Nihonkai Keizaiken No Tanjo," (The Birth of the Sea of Japan Economic Region), *Nihon Keizai Shimbun*, various issues in January and February, 1991. Also for an analysis of the viability of this scheme, see Teruji Sakiyama, "Trade and Regional Imbalance in the Sea of Japan and Okhotsk," *Bulletin of the Sohei Nakayama IUJ Asia Development Research Programme*, Vol.2, March 1990, pp.135-162.

III. Economic Linkage in Pacific Asia

In terms of the stages of industrialization they are in, the countries of Pacific Asia are likened to a flock of geese in the sky, with Japan leading the way and the four tigers (Taiwan, S. Korea, Hong Kong and Singapore) in the middle followed by other countries in Southeast Asia. The lineup in this analogy also implies a close economic linkage among the three groups of countries. However, such may be an over-simplification of the actual pattern of linkage.

First of all, the economic linkage each country in the region maintains may be more interregional than intraregional. Secondly, there is the implication of the development of China's economy on the linkage in Pacific Asia. Thirdly, there is also the implication of the increasing Pacific orientation of Australia and New Zealand on the alignment in the region. Fourthly, if linkage is established by trade and investment, the United States is a major force that must be reckoned with. Lastly, there is a possibility of a "glasnost" of the Eastern Siberia and Vietnam, with their unknown implications on the Pacific linkage. Part III of this paper attempts to discern the characteristics of the economic linkage by examining the external economic relations of some selected countries in the Pacific region.

A. Japan

As the second largest economy in the world, Japan's economic interests are global. The following tables indicate the extent of her global interests.

As late as 1987, Japanese exports to North America and Western Europe accounted for 62.3% of the total exports compared with a combined share of 21.2% for Pacific Asia (i.e., Northeast Asia, China

TABLE 3-1

Japan's Pacific and World Trade Share, 1965 and 1987
(as a percentage of the total)

Trading Partners

	North America		China		ASEAN		Other North East Asia[a]		Australia[b]	
	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
Japan's										
Export	35.7	41.4	3.2	3.8	8.8	7.2	6.1	10.2	5.0	2.9
Import	35.3	26.5	2.9	5.2	6.9	13.8	1.0	6.8	8.0	6.4
	West Europe		**Middle East**		**Mexico**		**Latin America**		**Rest of World**	
	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
Japan's										
Export	14.2	20.9	3.8	4.0	0.5	0.6	5.9	3.7	17.2	5.7
Import	9.4	15.9	13.9	14.1	1.9	1.1	9.2	4.3	13.0	6.7

Note: a Taiwan, S. Korea, and Hong Kong
b Australia and New Zealand

Source: Adopted from P. Drysdale and R. Garnant, "A Pacific Free Trade Area?", in J.J. Schott, ed., *Free Trade Areas and U.S. Trade Policy* (Washington D.C.: Institute of International Economics, 1989), pp.224-225, Table 9.2.

and ASEAN in TABLE 3-1). On the import side, the shares were 42.4% for North America and Western Europe and 25.8% for Pacific Asia. In the realm of direct foreign investment, the lion's share of Japanese investments still were destined, even as late as 1988, for North America and Europe (TABLE 3-2). If the multilateralism in international trade espoused by the GATT were to prevail, there would be little economic incentive for Japan to redirect her trade flows and foreign investments away from North America and Western

TABLE 3-2

Japan's Direct Foreign Investments, by Geographical Area
(in Million of U.S. Dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
North America	1,596	2,322	2,905	2,701	3,544	5,495	10,441	15,357	22,328
Central & South America	588	1,181	1,503	1,878	2,290	2,616	4,737	4,816	6,428
Asia	1,186	3,339	1,385	1,847	1,628	1,435	2,327	4,868	5,569
Middle East	158	96	124	175	273	45	44	62	259
Europe	578	798	876	990	1,937	1,930	3,469	6,576	9,116
Africa	139	573	489	364	326	172	309	272	653
Oceana	448	424	421	191	157	525	992	1,413	2,669

Source: *1989 Economic White Paper* (Tokyo: The Economic Planning Agency, 1990), p.574, Table 3-2-7. (Translated from the Japanese language edition.)

Europe to Pacific Asia.

In spite of her global interests in trade and investments, Japan is also a pioneer and an ardent supporter of various forms of Pacific Basin integration. In fact, the birth of the Pacific Economic Cooperation Conference (PECC) and later the Asia Pacific Economic Cooperation (APEC) owe much to the initiative and efforts of the Japanese government, academia and business. In order to understand the seeming contradiction between the global orientation of Japanese economic interests and Japanese efforts to promote Pacific regional integration, one needs to look at Japan's position in the world economy from different perspectives, in particular, from those that involve U.S.-Japan trade frictions, the implication of the European

Community on Japan's economic well-being, and the global strategies of Japanese industries.(6)

1. U.S.-Japan Trade Frictions

One may consider it ironic that Japan, which has benefitted from the growth of world trade fostered by GATT's promotion of multilateralism should now consider retreating from that multilateral trade regime. But events have changed and bilateralism in trade settlement is on the rise, GATT's efforts notwithstanding. In particular, the increase in U.S.-Japan trade frictions now requires more and more bilateral settlements that include specific reciprocity. Meantime, other countries in Pacific Asia are also experiencing trade frictions with the United States as well as with Japan. Rather than solving trade frictions bilaterally which is cumbersome, a more efficient solution will be to solve them in a regional context.

A regional settlement of this sort creates a "mini-multilateral" regime which can only be the "second best" solution compared with the world-wide multilateralism promoted by GATT. Given the precedence of the European Economic Community which practiced mini-multilateralism, the promoters of this scheme in Japan apparently consider it workable in the Pacific Basin.

2. The Implication of the EC on Japan

The completion of the EC by 1992 will create an economic bloc very similar to an economic union, although whether the EC will

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(6) Discussion and debates on these aspects are diffused among various books, newspapers, journals and magazines. In particular, see J.J. Schott, ed., *Free Trade Areas and U.S. Trade Policy* (Washington D.C.: Institute of International Economics, 1989). pp.241-252. Also, PECC of Japan, ed., *21 Seiki No Taiheiyo Kyoryoku* (Tokyo: Jiji Tsushinsha, 1988). Also C. Smith and L. do Rosario, "Empire of the Sun," *Far Eastern Economic Review*, May 3, 1990. pp.46-48.

become a "Fortress Europe" or not remains to be seen. However, the power to discriminate or retaliate by a unified Europe will dwarf that of an individual country. Moreover, the increase in the intraregional competition resulting from the integration in the EC and the measures adopted by the EC countries to facilitate the pooling of resources to accelerate industrial developments are bound to increase the competitiveness of European industries in the global markets.

In preparation for "EC 1992," the Japanese firms, like their counterparts in the United States, are stepping up their investments in the EC countries before the protective walls are built around that larger integrated region. Another approach or option to meet the competitive threat from the larger EC will be for Japan to lead and promote the formation of a similar bloc in the Pacific Basin as a counter-force. With some economic interests in the United States also promoting the idea of a North American Free Trade Area (encompassing the United States, Canada, and Mexico), whether or not the world will be divided up into three major trading blocs remains to be seen.

3. The Global Strategies of Japanese Industries

Foreign investments can be used as vehicle to foster economic ties between different countries. As for Japanese foreign investments, they have gone through several phases, with each having a rationale that reflected the needs and the strategy of the Japanese industries at the time.(7)

The first phase of Japanese foreign investments, which started in

(7) For a concise description of the different phases of Japanese foreign investments, see P.N. Nemetz, ed., *The Pacific Rim: Investment, Development and Trade* (Vancouver: University of British Columbia Press, 1987), pp.53-73.

the late 1950s through 1970s, saw, first, the resource-poor Japan dependent on the import of natural resources for processing and fabricating at home. To insure Japan of secure and stable sources of raw materials supply, Japanese foreign investments went primarily into natural resource developments. A lion's share of these investments were made in the resource-rich Southeast Asian countries. Then, as the economies of the host countries developed, the governments of these countries began to encourage the movement of industrial activities downstream, into processing and fabrication of raw materials. At the same time, economic development in Japan had reached the level at which the pollution of the environment became a serious social problem. In addition, the rising energy costs also had made energy-consuming activities of processing and fabrication uneconomical in Japan. The stage was set then for Japan, through her foreign investment, to transfer processing and fabrication activities to the resource-producing countries. This kind of linkage is a form of vertical integration.

As the labor costs rose and the Yen appreciated, the next phase of Japanese foreign investments shifted to offshore manufacturing for outsourcing of labor-intensive manufactured products, in countries that possessed low labor-cost advantage. But this kind of investment tends to be footloose, and once the host country loses its labor cost advantage, foreign investments can just as easily move out as they moved in. Such has been the case with the shift of Japanese foreign investments from Asia's NICs to the developing countries in Southeast Asia.

Vertical integration and offshore manufacturing that link the producer and the user located in different countries do not necessarily require nor lead to regional integration. Under vertical integration, the producer and the user are bound to trade, because they depend on each other. Such interdependence makes the preferential arrangements of a free trade area a moot issue. Offshore manufacturing, as stated earlier, tends to be footloose, and cannot be confined to a geographical region indefinitely time-wise.

One possibility of forming a regional bloc in Pacific Asia through Japanese investments will be for each country in the region to specialize in production — the kind of division of labor the Japanese industries would prefer. The economies of the region in this horizontal integration scheme become interdependent and, therefore, do not compete intraregionally. However, competition will be at the global level, on a regional-bloc-to-regional-bloc basis. At the micro-firm level, firms that are horizontally integrated becomes a consortium that compete interregionally. A global competition of this kind requires a high degree of coordination of the activities of the consortium member firms located in different countries of the same region. The firm best equipped to execute coordination will be the lead firm of the consortium, presumably a firm with home base in Japan. This scenario, however, runs counter to some realities.

First of all, for a horizontal integration scheme to succeed, it requires a fair amount of technology transfer from the developed country (or countries) to the developing countries in the region. There have been disputes already between Japan and her Asian neighbors on how much is the right amount of technology transfer. Moreover, the requirement of division of labor runs smack into the very aspirations of the developing countries. For their primary goal in economic development is to industrialize, not specialize.

Secondly, as for the Asian NICs which have already established some industrial and technology bases, their next moves are to upgrade technology in the existing industries when possible and also move into new industries so they will become better global competitors on their own strength. Even if they should decide to specialize, as for example, in a niche in the market in products such as the automobile, electronics, etc., they prefer to build an integrated industry at home with high local contents. Also, given their trade surplus, they are in a position to purchase foreign technology outright rather than accepting investments from the region's lead country which may impose conditions for those investments, such as product specialization requirement.

Thirdly, before a regional integration scheme can be implemented, there are political considerations that need to be carefully weighed, considerations that include the possibility of an adverse response from the United States to a Japan-led regional bloc (give the current U.S.-Japan trade frictions) and the remnant of anti-Japanese sentiment in Southeast Asia that stems from W.W.II. (Pure economics alone cannot achieve what is referred to as "economic" integration.) To overcome such adverse factors, the scope of a regional scheme may have to be broadened, to include all countries in the Pacific Rim. However, the broader the geographical scope of a region is, the less cohesive it becomes, and with that the concept of "regionalization" loses its meaning. For the broadest form of regionalization is a world-wide economic integration, something like the multilateral free trade scheme espoused by the GATT, not the exception to the rules of GATT.

There is, however, a market-led force that will strengthen the economic linkage between Japan and her Pacific Asian neighbors. As economies of the Pacific Basin countries develop, they also become markets instead of just as platforms of outsourcing for foreign multinational enterprises. Investments to exploit the market potential of a developing country requires long-term commitments of foreign investors; such investments also need to be localized to serve local interests. These commitments can expedite better the interactions between the foreign investors and the host countries than the temporary commitments of footloose short-term investments. Meantime, additional means must be utilized to promote the concept of a Pacific identity if some form of economic integration is desired for that region. In this respect, the Japanese proposals at PECC and APEC for greater intra-Pacific regional cultural and educational exchanges are on the right track. Even if the results of the economic developments in Pacific Basin countries should turn out to be centrifugal, if that centrifugal force should create multiple competing economic centers, the case for economic integration actually would be strengthened. For the more competitive the economies of the members of a regional bloc is, the greater will be the trade creation (as opposed to trade diversion) that will result from economic integration.

B. The Position of the United States in Pacific Asia

Like Japan, U.S. Economic interests are also global. U.S. economic ties with Europe are historical, and the prospect of the EC in 1992 only added more pressure on U.S. multinational companies to increase their presence in Europe. U.S. economic ties with Latin America are also historical. In many industries, the United States and Latin America are interdependent. The Middle East, an important oil-producing region, is vital to U.S. economic interests. In contrast, U.S. economic presence in Pacific Asian countries (excluding that in Japan) is more of recent origin. Even though Pacific Asian countries are gaining importance as trading partners to the United States, their

TABLE 3-3

MARKET SHARE IN THE ASIAN ECONOMIES

Four Asian economies combined	1982	1987	1988
Private consumption expenditures U.S. Market share	0.3	0.5	0.6
Market share for imports from all sources	5.9	4.7	5.1
U.S. share of consumer goods imports	5.3	10.2	12.2
Capital equipment expenditures U.S. market share	27.4	17.3	17.9
Market share for imports from all sources	60.1	68.7	67.9
U.S. share of capital equipment imports	40.0	26.9	25.0

Taiwan	1982	1987	1988
Private consumption expenditures U.S. Market share	0.5	0.9	1.2
Market share for imports from all sources	5.1	5.2	6.4
U.S. share of consumer goods imports	10.4	17.5	18.3
Capital equipment expenditures U.S. market share	23.6	23.7	24.6
Market share for imports from all sources	38.0	59.1	60.6
U.S. share of capital equipment imports	62.1	40.1	40.6
Automotive products U.S. market share	3.0	10.8	25.3
Market share for imports from all sources	20.8	24.4	38.7

TABLE 3-3 (continued)

South Korea	1982	1987	1988
Private consumption expenditures U.S. Market share	0.2	0.3	0.4
Market share for imports from all sources	1.6	2.9	2.6
U.S. share of consumer goods imports	13.7	11.7	17.1
Capital equipment expenditures U.S. market share	31.5	13.9	14.4
Market share for imports from all sources	83.8	73.8	71.6
U.S. share of capital equipment imports	37.6	18.9	20.1

Malaysia	1982	1987	1988
Private consumption expenditures U.S. Market share	0.4	0.3	0.3
Market share for imports from all sources	27.0	14.0	17.5
U.S. share of consumer goods imports	1.6	2.0	1.8
Capital equipment U.S. share of capital equipment imports	35.8	45.7	35.4

Thailand	1982	1987	1988
Private consumption expenditures U.S. Market share	0.2	0.2	0.3
Market share of consumer goods imports	7.5	7.3	9.8
Capital equipment U.S. share of capital equipment imports	24.6	18.0	13.0

Source: Federal Reserve Bank of New York, *Quarterly Review*, Winter 1989-90, Vol.14, No.4, p.41.

TABLE 3-4

Foreign Direct investment inflows in 1987 and 1988 Combined
(Billions of Dollars)

	Total	From the United States	From Japan
Taiwan	1.7	0.7	0.7
South Korea	1.5	0.5	1.1
Malaysia	1.1	0.3	0.6
Thailand	1.5	0.0	0.6
Above four economies	5.8	1.5	3.0

Source: Federal Reserve Bank of New York, *Quarterly Review*, Winter 1989-90, Vol.14, No.4, p.45.

importance fades by comparison with the weights of other regions' trade with the United States.

TABLE 3-3 shows U.S. shares in the four Asian markets (Taiwan, S. Korea, Malaysia, Thailand). TABLE 3-4 shows how the United States has allocated her investments in the world. These figures show that while U.S. export of consumer's goods has been rising at a crisp pace from a small 5.2% of the total imports of the four Asian economies in 1982 to 12.2% in 1988, the U.S. export of capital goods actually declined precipitously from 40% of these economies import of capital goods in 1982 to 25% in 1988. This could be interpreted as a result of a continuing low level of U.S. investments in these economies. For, in the face of the competition from the Japanese and the European capital goods exporters, the way to increase U.S. export of capital goods to the Asian countries would be for the United States to step up her investments in those countries. TABLE 3-5 shows the lion's share of U.S. investments had gone to Europe and Latin

TABLE 3-5

MARKET SHARE IN THE ASIAN ECONOMIES
(Table 5 of Fed of NY Winter, 89-90)

U.S. Investment Position Abroad, By Country (In Millions of Dollars)

	1980	1984	1986	1988			
				Total	Mgf.	Petrol.	Fin
All Countries	$215,375	211,480	259,800	326,900	133,819	59,658	60,604
Canada	45,119	46,730	50,629	61,244	28,141	11,711	10,377
Europe	96,287	91,589	120,724	152,232	67,930	21,323	29,810
	(44.7%)	(43.3%)	(46.5%)	(46.6%)			
Japan	6,225	7,936	11,472	16,868	7,876	3,468	
	(2.9%)	(3.8%)	(4.4%)	(5.2%)			
Australia, New Zealand, & S. Africa	10,583	10,868	11,455	15,154	4,903	3,798	1,795
Latin America	38,761	24,627	36,851	49,283	17,850	4,974	14,535
	(18%)	(11.6%)	(14%)	(15.1%)			
Middle East	2,163	5,025	4,891	4,090	522	2,317	779
Other Asia & Pacific	8,505	15,045	15,332	18,860	6,286	5,168	1,685
	(4%)	(7.1%)	(5.9%)	(5.8%)	(4.7%)	(8.7%)	(2.8%)
Taiwan	498	736	869	1,546	1,161	(D)	(D)
Hong Kong	2,078	3,253	3,912	5,028	594	237	1,253
Indonesia	1,314	4,093	3,217	3,006	92	2,638	46
Malaysia	632	1,101	1,021	1,363	521	735	29
Philippines	1,259	1,263	1,299	1,305	612	127	145
Singapore	1,204	1,932	2,256	3,005	2,000	559	35
South	575	716	782	1,302	497	10	137
Thailand	361	1,081	1,078	1,126	326	596	(D)

Note: D: Suppressed to avoid disclosure of data of individual companies

Source: U.S. Department of commerce, Bureau of the Census, *Statistical Abstract of the United States, 1990* (Washington, D.C.: Government Printing Office, 1990), p.797.

America, while a minor share (5.8% in 1988) had gone to Pacific Asia. Although in terms of the dollar value the U.S. capital goods exports increased, some of the increases were due to the higher prices of the export.

It should be noted, however, that while the Pacific Asian countries other than Japan have not been major trading partners to the United States, the United States has been a major trading partner to them. In fact, the U.S. markets have been the major sources of foreign exchange earnings of the Asian NICs and lately also of southeast Asian countries. Like in the U.S.-Japan economic relations, trade frictions between the United States and some Pacific Asian countries have been on the rise also. For the United States, individual bilateral settlements dealing with many countries can be unwieldy undertakings. As for the Pacific Asian countries, as their economies develop and their industries become more competitive, they too will be under increasing pressure to open their markets to imports. A "mini-multilateralism" as a settlement mechanism for trade disputes in the Pacific region warrants a serious consideration.

One may surmise that whatever interest the United States may show in a Pacific integration, it will probably be confined to a scheme of no more than a "free trade area" in its rudimentary form. A firm, long-term commitment by the United States to a more fully integrated Pacific scheme will not be made until the private sector in the United States, the industries and their firms, are ready to step up their long-term investments in the Pacific region. That probably will not happen until there are signs to confirm the market potential in the Pacific region countries. Until then, U.S. investments in Pacific Asian countries, other than in Japan, will be limited mostly in resource development and in offshore manufacturing for outsourcing.

Investments in offshore manufacturing, by the nature of their objective, tend to be footloose and short-term.

C. The East Asia's Newly Industrialized Countries (NICs).[8]

The NICs of East Asia, viz., Taiwan, South Korea, Hong Kong, and Singapore have been the beneficiaries of multilateral trade liberalization promoted by the GATT and supported by the United States. It was the great absorptive capacity of the American markets that provided outlets for the goods produced by the export-driven economies of these NICs.

Although their economic policies differ in minor detail, the Asian NICs, with the exception of the laissez-faire Hong Kong, have gone through two phases of industrialization approaches, from import substitution phase to export promotion phase. Of the four NICs, industries in Taiwan and South Korea are more broadly diversified than those in Hong Kong and Singapore. That means that Taiwan and South Korea compete over a wide range of products internationally, although at the same time each country also finds some niches in international markets where she excels.

Differences in government policies have led Taiwan to emphasize the development of small-scale labor and knowledge intensive industries while in South Korea the development of large scale, capital intensive industries was emphasized. This difference in emphasis also has resulted in the predominance of small to medium sized firms in Taiwan and the predominance of large conglomerates in South Korea.

Both Taiwan and South Korea have been heavily dependent on U.S. Markets for their exports, although they are currently attempting

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(8) *Nihon Keizai Shimbun, Far Eastern Economic Review*, and *Asian Wall Street Journal* are the major sources of information for this part.

to diversify their markets in order to reduce this dependence and at the same time reduce trade frictions with the United States. Both of them, however, incur trade deficits with Japan. Nevertheless, they enjoy trade surpluses world-wide, and with the rising labor and land costs at home, they have been transferring some manufacturing activities to the neighboring countries in Pacific Asia.

Investments in offshore manufacturing, as the experiences with those made by the United States and Japan indicate, can be footloose and short-term. However, in the case of Taiwan's investments, many of the investments in offshore manufacturing are made by myriads of small-to-medium sized firms, and often in partnership with ethnic Chinese firms in the host countries. As such, Taiwan's way of direct foreign investments can be likened to a grass-roots approach, and is conducive to their localization.

Direct foreign investments from South Korea are dominated by the large conglomerate groups, as opposed to the predominance of free-standing firms as in the case of Taiwan. Therefore, direct foreign investments from South Korea tend to be centrally controlled in order to achieve the global objectives of the parent firm. In direct foreign investments, a conglomerate may seek horizontal or vertical specialization among countries and turn them into an integrated region; but because of the centralized control exercised by the parent firm (in a globalized system) in the conglomerate and because investment in offshore manufacturing tend to be footloose, local interests of the host countries are often overlooked in favor of the parent firm's global needs. The pursuit of the global objectives of the parent firm may then lead to conflict with the host country's partners or government, and destroy any opportunity there is for the development of a common interest-whichis the very basic base on which the feeling of regional identity is founded. Moreover, the case for a regional integration weakens when partners in different countries complement each other rather than compete with each other. For in a case like this, trade diversion is likely to outweigh trade creation.

The island states of Hong Kong and Singapore historically have performed a unique entrepot function that extends economic linkage to the neighboring countries — i.e., Hong Kong for China Mainland and Singapore for the neighboring Southeast Asian countries. The industrialization and the creation of new industries in these islands since 1950, however, have changed the characters of their economic linkage in their region.

For Hong Kong, there was, in the 1950s, the loss of entrepot trading activities linked to China Mainland. At the same time, there was also a great influx of people from China Mainland. Industrialization became imperative in order to provide employment opportunities for the newcomers. The island exploited the abundance of low-cost labor and developed industries in textiles, clothing, toys, electronics and watches, all of which were export-oriented. This industrialization was carried out, to a great extent with the help of the former entrepreneurs in China Mainland, who arrived in Hong Kong with capital, management and technical know-how. Over the years, many firms set up by these refugee capitalists became localized and their industries continually upgraded and expanded. When China opened her door to foreign investments in the 1970s, Hong Kong's industries were among the first to expand their operations into China, in particular to Guangdon Province located just north of Hong Kong.

Hong Kong is also a major financial center in Pacific Asia. While there are other financial centers in the same region, most of them (with the exception of Japan) lack well-developed capital markets. In contrast, money markets and capital markets are very well-developed in Hong Kong. The capital markets, which include both markets for long-term debt and markets for equity shares (i.e., stock markets), act as intermediaries to channel funds into long-term investment. Undoubtedly, the well-developed state of Hong Kong's capital markets is due in part to the localization of industries. When industries in Hong Kong are localized, they make the island their home base. When their firms issue new equity shares, these shares will be issued and registered in Hong Kong (the home base) and listed and traded in Hong Kong's equity markets. These equity markets in turn attract risk capital that is channelled into new ventures. The sources of capital may originate in Hong Kong or from Southeast Asian countries (presumably from ethnic Chinese). As Hong Kong's industries expand into Guangdon Province in South China, Hong Kong's equity markets will provide a pivotal role in financing this expansion. In this way, Hong Kong's financial markets complement the extension of Hong Kong's industrial base into South China, the consequence of which is the making of a mini-economic region.

Singapore is a much smaller area than Hong Kong, but the records of her industrialization have been just as outstanding. Although Singapore has a locational advantage to serve as an entrepot for the neighboring countries in Southeast Asia, the severance of her union with the Federation of Malaysia and Indonesia's attempt to develop her own ports and conduct direct trade in the post-W. W. II years threatened Singapore's economic survival. Faced with this crisis, Singapore has inaugurated various industrialization programs beginning from the 1950s, starting with labor-intensive manufacturing industries. Over the years, this island nation has found a niche in petrochemical, communications, and finance industries utilizing her natural locational advantages. With these developments, Singapore has become a regional base for the subsidiaries of many foreign multinational corporations and financial institutions.

There are some on-going developments in Singapore which are pushing Singapore closer to a "mini" regional integration with the neighboring areas. Given the limited space on the island and the rising wages, the Singaporean industries have been transferring some of their manufacturing activities to the neighboring islands such as Sumatra (in Indonesia) and the north to Johore (in the southern tip of the Malayan peninsula). These moves resemble Hong Kong's industrial expansion into Guangdon in South China and should result in an enlarged industrial base for Singapore.

As the center of the "Asian-dollar" market, the Singaporean financial markets are in a position to attract and absorb capital from Southeast Asian countries (much of it probably from overseas Chinese) for reinvestment elsewhere, presumably in China, either directly from Singapore or indirectly through Hong Kong's capital markets. In the latter case, a triangular Singapore-Hong Kong-China linkage is being forged, and through this linkage overseas Chinese capital finds its way into China, in particular to the more market-oriented coastal provinces of South China. A linkage of this kind strengthens the prospect of an emerging South China economic region.

D. The Association of Southeast Asian Nations

The Association of Southeast Asian Nations, shortened as ASEAN, was formed in 1967. Initially, the ASEAN comprised five countries — Indonesia, Malaysia, the Philippines, Singapore, and Thailand. In 1984, Brunei also joined the ASEAN. Members of the ASEAN, with the exception of Singapore, are heavily dependent on the export of primary products. In econonic policies, they range from the laissez-faire economic policy (for both domestic and foreign trade) of Singapore to a protectionist, import substitution policy of Indonesia. A brief description to highlight the characteristics of each ASEAN's economy (with the exception of that of Singapore which is already covered under the Asian NICs) is provided in the following:(9)

Indonesia

Historically Indonesia has been a primary products producers, although in recent years the Indonesian government has actively sought to promote industrialization. However, more than half of Indonesian exports are oil/gas and their related products and Indonesian imports are predominantly non-oil/gas products. In response to the declining prices in the 1980s, Indonesia has shifted from a strategy of import substitution to that of export promotion to promote industrial development. In conjunction with this shift, the government has also implemented a wide range of reforms aimed at restructuring the economy towards greater market orientation. Some of these reforms include, among others, deregulation to remove burdensome government regulations and privatization of some state enterprises. Because the government policy in the past was protectionist-oriented, this switch into a more market-oriented policy was intended to improve the economic climate of Indonesia for foreign investment.

Malaysia

Malaysia is a country with a generally open, market-oriented

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(9) For a more detail description, see U.S. Department of State, *Country Reports on Economic Policy and Trade Practices; Report Submitted to the Committee on Foreign Relations, Committee on the Senate and the Committee on Foreign Affairs, Committee on Ways and Means of the U.S. House of Representatives* (Washington, D.C.: Government Printing Office, 1990), pp.238-364.

economy. The government of Malaysia has encouraged foreign direct investment into the country, particularly in export-oriented manufacturing. As an instrument to stimulate foreign investment, the New Economic Policy (NEP), which sets up a target of 30% ownership of private industries by native Malays, has been relaxed for foreign investors. Partly as a result of these efforts, Malaysia has been able to diversify her economy from dependence on two primary commodities (tin and rubber) to dependence on a more diversified range of industrial product, such as electronic components, consumer electronics, petroleum products, textiles, vehicle assembly, steel, cement, electric machinery and rubber products. (In fact, Malaysia is the third largest producer of integrated circuits in the world, after the United States and Japan). However, most of the new industries produce for export markets, and are dominated by foreign investors, in particular by multinational companies from the United States and Japan. Thus, Malaysia has become another offshore manufacturing center for foreign multinational companies.

The Philippines

Unlike other ASEAN countries (save Singapore), the Philippines is natural-resource-poor, but she has an abundant supply of well-educated labor. In recent years, the Philippines has been receiving foreign investments, in particular from Japan and Taiwan, in low-skill labor-intensive industries. However, because the Philippines is resource-poor, her export sector is dependent on the import of raw materials. Thus, the Philippines economy is highly foreign-trade dependent.

Thailand

Although the Thailand economic development policies are based on a competitive, export-oriented, free market philosophy, structurally the

Thai economy is a mixed one consisting of state-owned and private-owned enterprises. The Thai government still maintains some foreign exchange controls and import restrictions, although attempts are being made to either remove them or at least avoid using them. Also, in an effort to improve the competitiveness of Thai industries, the government has proceeded to privatize some state-owned enterprises. The favorable investment environment in Thailand, environment which includes the availability of low cost labor and land as well as sound fiscal and monetary policies, has in recent years attracted direct foreign investments from firms in Japan, Taiwan and the United States. However, the majority of the foreign investment projects in Thailand involve production of goods for export. Thus, Thailand has become another offshore manufacturing center for foreign firms that compete globally.

The ASEAN

There are some common features in the economies of the ASEAN countries: (1) with the exception of Singapore, they are all endowed with some kinds of natural resources needed in the industrialized countries; (2) in addition, they have comparative advantage in low cost labor (but unskilled) and low cost land (due to lack of industrialization). As such, the ASEAN countries, trading partners historically have been industrialized countries outside of the ASEAN region. (See TABLE 3-6).

Even after the ASEAN countries began their industrialization, the ASEAN intra-regional trade did not expand and remained low as before. (See TABLE 3-7). For, in the schemes of these countries' industrialization, they capitalize on their lowcost labor and land and woo foreign investors with similar fiscal and monetary incentive packages, and often with similar export requirements for the

TABLE 3-6 Direction of trade of ASEAN member countries (% of total exports and imports)

	Exports						Imports					
	1970		1980		1985		1970		1980		1985	
	DCs	Other LDCs	DCs	Other LDCs	DCs	Other LDCs	DCs	Other LDCs	DCs	Other LDCs	DCs	Other LDCs
Indonesia	68.9	5.8	79.3	7.9	77.8	11.3	78.4	13.8	68.3	18.6	72.9	18.1
Malaysia	62.6	4.1	62.4	14.2	56.7	16.7	67.3	11.3	65.0	18.2	63.4	13.5
Philippines	91.9	7.0	79.3	13.8	75.7	12.6	87.3	7.8	62.4	31.4	55.9	29.3
Singapore	55.2	7.7	41.6	31.9	48.0	27.3	64.6	2.0	50.0	22.4	50.8	25.1
Thailand	62.7	22.1	60.3	22.8	58.5	26.6	85.0	12.2	57.5	32.6	61.4	23.3

Notes: DCs for developed countries. LDCs for less-developed countries.

Source: Adopted from V.N. Balasubramanyam, "ASEAN and Regional Trade Cooperation in Southeast Asia," in D. Greenway et al., *Economic Aspects of Regional Trading Arrangements* (New York: New York University Press, 1989), p.176.

TABLE 3-7 Intra-regional trade of ASEAN member countries

	Exports to ASEAN (% of total exports)			Imports from ASEAN (% of total imports)		
	1970	1980	1985	1970	1980	1985
Indonesia	26.3	12.9	10.9	7.8	13.1	9.1
Malaysia	33.3	23.4	26.6	21.5	16.7	23.1
The Philippins	1.1	6.9	11.7	4.9	6.2	14.8
Singapore	37.1	26.5	24.7	33.4	27.6	24.1
Thailand	15.2	16.9	14.8	2.8	9.9	15.3

Source: Adopted from V.N. Balasubramanyam, "ASEAN and Regional Trade Cooperation in Southeast Asia," in D. Greenway et al., *Economic Aspects of Regional Trading Arrangements* (New York: New York University Press, 1989), p.175.

manufactured output. Under these circumstances the kinds of foreign direct investments attracted to the ASEAN countries tend to be footloose investment projects for offshore manufacturing. As a result the ASEAN countries have followed a similar pattern of industrial development producing similar manufactured products.

Given this pattern of industrial development, it could be argued that the potential for the realization of the economies of scale through intra-regional trade should be great if there is free competition (to weed out inefficient producers) within the region, assuming the region is protected under some form of integration scheme, as for example, a customs union. But that will require the willingness of the member countries to sacrifice some national objectives for the good of the group. That has proved to be infeasible so far. Instead, the ASEAN countries have approached the regional economic integration by way of preferential trade arrangements (PTA) which have turned out to obstruct rather than promote economic integration.[10] In fact, in the intra-regional PTA negotiations, the ASEAN countries are known to have offered tariff concessions on items they either do not import or the other member countries do not (produce for) export — as for example, the Philippines offering a tariff concession on the import of snowblowers and Indonesia on nuclearplants.[11]

In spite of the dismal achievements of the ASEAN in the regional economic integration, the ASEAN as an organization performs some useful functions which in the long-run will harmonize the relations

(10) For a pessimistic outlook for the ASEAN as a viable economic bloc, see David Greenway et al., ed., *Economic Aspects of Regional Trading Arrangements* (New York: New York University Press, 1989), pp.167-189.

(11) For a detailed empirical study of ASEAN intra-regional trade, see Tan, "Intra-ASEAN Trade Liberalization: An Empirical Analysis," *Journal of Common Market Studies* No.20 (1981/1982), pp.321-331.

among the member countries. Its periodic meetings of the member countries provide a forum in which these countries can discuss their common problems, and perhaps even settle grievances they may have against each other before they reach the explosion point. These meetings can also be used as a convenient vehicle to facilitate the formation of a common front against countries outside of the region, particularly the industrialized countries when there is a serious conflict of interest between them. One area in which such a common front could be formed is in the harmonization of their fiscal and monetary incentives for foreign direct investments so that foreign investors will not be able to play one country against another to exact more favorable terms for their investment — i.e., in effect to reduce economic rent earned by foreign investors. In the long-run, perhaps it will be the market forces that emerge with ASEAN countries' economic development, rather than government measures, that will contribute to a more effective form of economic integration than what exists currently.

E. The Northeast Asian Economic Region

There have been talks about the makeup of the Sea of Japan Economic Region, the Yellow Sea Economic Region, and the Northeast Asian Economic Region. Geographically they overlap, and can be covered under the Northeast Asian Economic Region. Broadly, the region encompasses the Western Japan that faces the Sea of Japan, Korea, Maritime Soviet Siberia and China of the Northeast and of the coastal area in the North. To some extent, these areas are natural trading areas because they are economically complementary to each other.

The Soviet Siberia is endowed with rich natural resources such as timber and minerals. Northeast China and the coastal area of North

China are China's major industrial bases. They concentrate in chemical, metal and manufacturing industries, although these industres need modernization. In addition, they are also resource rich — in agriculture, coal and minerals. Of the two Koreas, S. Korea is one of the Asian NICs. And Japan, at the head of the Asian flock of geese, is industrially far ahead of other areas in the region. Given these economic profiles, the economies of these areas are, to a large extent, complenentary. Until recently, it was the political factor of the Cold war that kept them from extending economic contact with each other.

When restrictions on trade and foreign investments are removed in the region, the intraregional trade and investments are bound to increase. A relevant question that may be posed at this juncture is whether or not the intraregional economic relations in Northeast Asia are any different from those that govern the relations among Japan, the Asian NICs, other parts of China, and the Southeast Asian countries. Given the global orientation of the economic interests of Japan and S. Korea, will they not turn the less developed areas of the Northeast Asian region into another base for natural resource supply and offshore manufacturing? If such is the case, this relationship is no more different from that between Japan and the Asian NICs in the 1960s and 1970s, and between Japan and the ASEAN countries today. This is not to say that this kind of relationship is undesirable for all partners in the region. For given the complementarity and interdependence in their current natural endowments, the Northeast Asian region can become a natural free trade area that does not require the arrangements of an artificial free trade area or of a customs union to keep the region intact. But then the same can be also said of the economic relationship between Japan and Southeast Asian countries or between Japan and Australia.

The major draw back with this "perceived" natural free trade area is that it ignores the national aspirations of the less developed areas of the region. In particular, it ignores the aspirations of China and the network of economic relations that link the northeastern part and the northern part of China to the rest of that country. Even if the economy of China should decentralize far enough to allow a high degree of autonomy for Northeast and Northern China, those geographical areas too will in time develop a global economic interest of their own. And, as long as they possess competitive advantages in certain categories of economic advantages, they too will use those attractions to seek economic linkage with countries outside of the Northeast Asian region. The recent formation of joint venture between the First Automotive Works of Northeast China and the Volkswagen of Germany to manufacture vehicles in China is a case in point. Then, there is a potential conflict of economic interest between Japan and S. Korea, conflict which may contribute more to the centrifugal force than to the integrative force of the region. But, above all, the most serious question about the viability of the perceived Northeast Asian Economic Region is that it leaves out a large part of China from that region.

F. The Chinese Connections

After more than a decade of economic reform (since the 1970s), the world saw some drastic changes in the Chinese economy, from an inward-looking autarky to a trade-dependent open economy, and from a highly centralized command economy to a decentralized and somewhat "regionalized" economy. During the decade of 1980s, the Special Economic Zones and major municipalities (mostly in the coastal areas) saw much two-way flows in foreign trade and a one-way flow of foreign investments into China. The privatization of industries and the adoption of market mechanism, though limited in scope, was of help also in expediting the Chinese "reachout" attempt.

In spite of the current attempt of the central government in Beijing to recentralize the economy, the trend toward de facto economic decentralization continues. In fact, it is reported that non-state enterprises that scatter around in the provinces now account for more than 60% of the industrial output of China. In South China, foreign direct investments have now spread beyond the Special Economic Zones into the neighboring provinces. It is said that Guangdon and Fujian Provinces in South China are respectively fast becoming "Hong-Konized" and "Taiwanized." As an indication of further decentralization, a new region know as Pudong (around Shanghai in Yangtze River delta) is being developed with ambitious plans to transform it into a megalopolis of industries and world trade.

Because of the long economic isolation of China from her neighbors, most Pacific integration schemes have left out China as a player. Yet, given the enormous size of China's economy and China's commitment to an open economy, the outcome of economic development in China is bound to have great impact on the trade positions of her Pacific neighbors.

Some years ago, there was a theory developed in China known as "The Big Circulatory Linkage Theory." According to this theory, the coastal provinces should open their economies to foreign investments, import raw materials for processing and parts and components for assembly. As capital surplus is generated and the level of technology rises in the coastal provinces, investments would then flow from there to the hinterland provinces, thus industrially linking the latter to the former. As the industrialization spreads from the coast to the hinterland, the industries in the coastal areas are expected to upgrade technologically and go upscale, so that the coastal-hinterland economic complementarity-interdependence would remain in place.

The trouble with the above scenario is that, once the coastal provinces develop the economic linkage with the Pacific Basin countries, there is no assurance that they would want to reverse this linkage. Moreover, coastal-hinterland linkage requires an enormous amount of investment in new infrastructure, especially in land transportation, whereas Pacific linkage provides the coastal provinces with access to easy and cheap ocean transportation network. Moreover, there is also the influence of foreign investments, especially those from Taiwan and Southeast Asia (including Hong Kong), on the direction of linkage to consider. These investments tend to be concentrated in the coastal provinces in South China. The presence of these investments in the coast area can only strengthen China's linkage with her Pacific neighbors.

The Overseas Chinese Factors

Overseas Chinese investments have flowed into China and Southeast Asia. As implied previously, the provinces of Guangdon and Fujian in South China are fast becoming extensions of manufacturing activities of Hong Kong and Taiwan. So are Thailand, Malaysia, Indonesia, and the Philippines in Southeast Asia. Much of overseas Chinese investments into these countries either originated from or are channelled through Taiwan, Hong Kong, and Singapore.

At present, investments in manufacturing by overseas Chinese enterprises (including those from Taiwan) in China and Southeast Asia are predominantly of the kinds that are low-tech, labor intensive, and in some cases also land-intensive — such as assembly operations and manufacturing of parts and components. In time, however, these investments will move upscale and their technologies upgraded. This scenario is not the result of a farfetched imagination because of at least two elements in the nature of overseas Chinese investments: (1) Investments by overseas Chinese enterprises into China often seek their ethnic ties with the recipient provinces (as for example, Hong Kong with Guangdon and Taiwan with Fujian). This ethnic tie is conducive to the development of a sense of common interest. (2) When the capital of overseas Chinese investments in Southeast Asia is channelled through Taiwan, Hong Kong, and Singapore, the financial markets in these centers are performing their intermediary functions of pooling capital resources and repacking them to reduce risk for the suppliers of capital. These are positive financial functions that help broaden and deepen the sources of capital. But what is more germane to the scenario pictured above is that the recipients of overseas Chinese investments in Southeast Asia are often residents of the recipient countries and are themselves contributors to the pool of capital. Given their local roots in the recipient countries, the recipients have a vested interest in seeing these investments upgraded in time.

There is also a pattern unique in the foreign investment practices of overseas Chinese enterprises. Unlike the Japanese foreign investments which stress specialization by geographical areas (which create geographical complementarity and interdependence), foreign investments made by overseas Chinese enterprises tend to create enterprises in the same industry that compete from different geographical locations. For example, a proposed investment by a Taiwanese multinational enterprise in a petrochemical complex in Fujian Province will in time compete with a petrochemical complex in Guangdon Province; they will be competing not only in international markets but also in markets inside China. Likewise, Taiwanese investments in footwear in Indonesia will be competing in international markets with the same kind of Taiwanese investment in Fujian. Even in the same geographical location, as for instance in Guangdon, investments in electronics by Hong Kong enterprises and by Taiwan enterprises will be competing in the local markets as well as in the international markets, by themselves as well as through their parent companies. Thus, the market structure forged by overseas Chinese investments in China and Southeast Asia will resemble that of the European Community where there are various firms competing in each industry. It is this competitive market structure that provides an impetus for the rationalization of the industries in the E.C.

In essence, a significant ramification of overseas Chinese investments in China and Southeast Asia is the creation of structurally competitive markets in Pacific Asia. In time, the competitive pressure of the markets will compel competing firms to seek alliance under various forms of business coalitions. These coalitions, be they technology development coalitions, operations and logistics coalitions, marketing and service coalitions or any other multi-activity coalitions, will pull together enterprises of different countries in Pacific Asia. This integration process will be expedited further by the trend toward decentralization and privatization of industries in China and Southeast Asia. It should be pointed out that this kind of integration is integration by market forces, and its process is more natural than that of a free trade area or a customs union; for the latter is economic integration by government regulation. It needs to be pointed out further that overseas Chinese capital plays a pivotal role as a catalyst in this economic integration.

IV. CONCLUSION

As an inquiry to the nature of the Pacific economic integration schemes that have surfaced since the 1960s, this paper has questioned the logic behind those schemes. Those schemes seem to have left out the national aspirations of the nations that emerged after W. W. II. Unlike the Western European nations which have existed for centuries as independent nation-states and have learned to coexist, many nations in Pacific Asia are still in the early stage of their nation-state building process. At this stage, their national aspirations call for economic independence and any integration scheme that will reduce that independence is bound to meet serious if not fatal political opposition. Therefore, for any integration scheme to become politically acceptable, it must be loosely conceived — to the point it becomes ineffective.

It needs to be emphasized that, for any Pacific economic or trading bloc to become viable, China must be a party to it. Yet, China has been left out in all economic integration schemes that have surfaced so far. In time China can become an economic bloc in herself if she is left out, and her economic power to counter any discriminatory act by her Pacific neighbors against her can be very formidable.

There is merit in the formation of a Pacific trading bloc as a counter force to the power of the European Community or the North American Free Trade Area. This view assumes that the world is being divided into three non-free-trade trading blocs. But, then, how can the world be divided into three trading blocs when a broader Pacific trading area, such as the PECC, also calls for the membership of the United States and Canada? Even if the E.C. and the North American Free Trade Area should become discriminatory trading blocs, there are other ways to counter their discriminatory practices — as for example, foreign direct investments by U.S. firms in the E.C. and by the Japanese firms in the E.C. and in North America. These foreign direct investments, in the long run, lead to more interdependence than polarization between trading blocs.

If the Pacific nations are to form a closer tie among themselves, they must overcome the centrifugal force that arises from their diversity. A go-slow, grassroots approach to cultivate a Pacific identity has a great deal of merit as a way to build a cornerstone of a Pacific Community. In this respect, the recent Japanese efforts to expand cultural and educational exchanges with her Pacific neighbors are steps in the right direction toward that goal.

Meantime, market forces will perform their integrative role in linking markets in Pacific Asia. Competitive needs of industries and their firms — from Japan, the Asian NICs, the ASEANS, and China Mainland — will compel them to form international coalitions. International coalition is a form of economic integration because member firms in the same coalition are economically linked to each other in various ways. International competition then becomes less "inter-national" but more "inter-consortia," in which each consortium comprises firms from different countries. When firms of different national origins are linked in this manner, it amounts to a form of economic integration.

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