

Pacific Asia as an Open Economic Region

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1. Introduction

In recent years, the growing world-wide trade disputes have raised the specter of a world divided into different economic blocs. The completion of the targeted EC '92 and the formation of the North American Free Trade Area have been perceived in Pacific Asia as discriminatory trading blocs and have prompted a call for the formation of a similar bloc, the East Asian Economic Group, by Prime Minister Mahathir of Malaysia last year.

In the original Malaysian proposal, this group was to serve as an economic bloc to counter and offset the discriminatory impact of the European Community and the North American Free Trade Area on Pacific Asia. However, the proposal did not win approval, from Japan or from the ASEAN (Association of Southeast Asian Nations). As a result of this lack of support, Mahathir modified his position and changed the proposal to an East Asian Economic Caucus, which was to act as a consultative body instead of a policy-making organization.

Aside from Malaysia's proposal, there have been in existence, in East Asia, organizations such as the PECC (Pacific Economic Cooperation Conference) and the APEC (Asian Pacific Economic Conference) on a Pacific-Rim wide scale and the ASEAN, all of which have as their goals creation of stronger ties within the Pacific region. However, they have all remained more as consultative bodies than policy-making ones, in part because the economic interests of most countries in Pacific Asia are global rather than regional.

Countries such as Japan, Asian NICs, and lately China and the Southeast Asian countries are pursuing or have pursued in the past an export-oriented industrialization policy and benefitted from a relatively free world trade regime (in the framework of the GATT) that have provided absorbers for their exports to the West, in particular to North America. However, such global interest and global trade orientation do not necessarily preclude the emergence of an economic "region" or "regions" in Pacific Asia.

If an economic region is to emerge, how is it going to happen? It will not happen by building protective walls around the neighboring countries such as in the European Community. For the diverse global interests of the countries in the Pacific Asian region will preclude that possibility. On the other hand, there are market forces that will act as catalysts to trigger an integration process at the micro industry and firm levels. These market forces provide the thrust for transnational expansion of industrial bases from one country to another, creating linkages among the economies of the neighboring countries in a region. This paper attempts to examine those market forces as well as the configuration of an economic region that results from the working of those market forces.

II. Market Forces in Economic Integration

Firms and nations seek competitive advantages in order to improve their market position. Those objectives lead to cost reduction attempts and the development of new technology which are supply oriented strategies. They also seek new markets for the existing products or by developing new products, which are demand-oriented strategies. Which of these strategies (or a combination of both strategies) will be chosen depends on factor conditions, demand conditions, the availability of related, supporting industries, and the structure of the industry and the kind of competitive environment that exist

in a nation.¹

The development of new technology enables a nation to utilize her resources more efficiently, or to redirect her resources to better use, to higher value-added industries offshore. Rising costs of production caused by rising wages force labor-intensive industries to move offshore also. Growing scarcity of natural resources prompt a search for new sources of supply or development of new substitutes. Some products have their life cycle and when their overseas markets expand and become large enough to permit economies of scale, offshore manufacturing takes place. Expansion of manufacturing activities and distribution network overseas also lead to the creation of a host of related support industries through forward and backward linkages. How such linkages will be configured depends, in part, on the degree of competitive pressure both at home and globally.

The determinants briefly cited above are "market-bred", and through their interaction an economic region can be formed, even in the absence of official, governmental arrangements to create an economic bloc. A region of this kind is a natural one, and it differs from a domestic economic region only in that the former is transnational.

III. An Emerging Economic Region—The Pacific Asia

This chapter offers a hypothesis that the driving forces behind a market-led integrative process in Pacific Asia are investments by Japan and by ethnic Chinese capital (both inside and outside China).

1. The Integrative Role of Japanese Investments

Japan's economic interests are global rather than regional. Such global interests are reflected in the way Japan's foreign investments are allocated, as indicated in the following table.

Table 1
Japan's Direct Foreign Investments Overseas
(Cumulative, In Millions of U.S. Dollars)

	1969-1973		1978-1984		1986-1989	
	Value	% of Total	Value	% of Total	Value	% of Total
North America	\$ 1,870	22.6	\$ 16,070	32.6	\$ 82,028	48.2
Asia	\$ 2,000	24.2	\$ 11,699	23.8	\$ 21,002	12.3
Western Europe	\$ 1,784	21.6	\$ 5,997	12.2	\$ 33,969	20.0
Latin America	\$ 1,390	16.8	\$ 9,262	18.8	\$ 21,219	12.5

Source: Japan External Trade Organization, *1991 Jetro White Paper, Volume on Direct Overseas Investments (in Japanese)* Tokyo: Japan External Trade Organization, 1991), p.16.

As Table 1 reveals, more of Japan's overseas investments flowed into North America and Western Europe than into Asia. In spite of this world-wide global interest, Japan's investments in Asia do have integrative effect on the economies of Pacific Asia.

In terms of the characteristics of investments, there are three phases in Japan's investments in Pacific Asia. In the first phase (circa Mid-1960s to Mid-1970s), Japan's investments went into low-technology, labor-intensive manufacturing in Asian NICs (in particular Taiwan, Hong Kong and Singapore) and into natural resource development in Indonesia and Thailand². In the second phase (circa Mid-1970s to Mid-1980s), rising labor and land costs in the NICs began to force Japanese firms to shift low-technology, labor-intensive manufacturing from the NICs to the developing countries in Pacific Asia. At the same time, the NICs also began to (1) upgrade their

technology and move upscale into capital and knowledge-intensive industries such as producing OEM (Original Equipment Manufacturing) and (2) shift the low technology labor intensive industries to Pacific Asia's developing countries. Thus, a vertically integrated chain of production system was established that linked (1) Japan, the terminal manufacturer, (2) the NICs, the OEM manufacturer, and (3) the developing countries, the assembler and manufacturer of low-technology, labor-intensive products.

The third phase occurred in the 1980s and is still in process. By the late 1980s, a sufficient amount of technology had been transferred from Japan to the developing countries in Pacific Asia enabling the latter to produce upscale products, such as auto parts, electronic products and appliances instead of their assembly. The Japanese manufacturers began to divide manufacturing activities among the host countries, so that each country would specialize in a particular segment of a given industry, such as the auto industry or the electronic industry. The advantages of this "horizontal" division of labor (or manufacturing activities) are (1) the economies of scale realized from specialization, and (2) tapping of a growing local market which can be made easier if some segment of an industry is present locally. In these respects, the horizontal specialization pursued by Japanese manufacturers in Pacific Asia is no different from that pursued by the European Community, in particular, by the European Airbus consortium. However, in Pacific Asia's case, all segments of an industry is ultimately tied to Japan, for research and development, for market distribution, or for finance.

Also, in the third phase, as Japan, the NICs, and the developing countries in Pacific Asia reach three different levels of technology, each group produces products of different technology intensity, with Japan producing the highest-end products. But Japanese manufacturers are involved at all levels through joint ventures and direct subsidiary, thus achieving a horizontal integration in some industries and a vertical-integration in some others.

Regardless of which type of integration takes place — vertical or horizontal — industries spread from the center to the periphery, forming an economic region in which different economies are linked through their interdependence.

2. The Integrative Role of Investments by Ethnic Chinese Capital

Much has been highlighted in the Chinese language media about the emergence of a South China Economic Region, created largely through the investment linkages of ethnic Chinese capital that link Taiwan, Hong Kong, Singapore and the coastal provinces of South China (in particular, Guangdong and Fujian); and the linkages extend even to Southeast Asian countries where ethnic Chinese play an active role in commerce, finance, and industry.³ To show the extent of the involvement of ethnic Chinese capital, the following statistics are rather revealing:

Table 2
Direct Foreign Investments in ASEANs
(In Millions of U.S. Dollars)

1989		First half of 1990	
Value	As of % of total foreign Investment in ASEANs	Value	As of % of total foreign Investment in ASEANs
From: Japan \$4,844	32.8	\$2,882	26.2
Asian NICs \$3,955	26.9	\$3,730	33.8

Source: Compiled from Japan External Trade Organization, *1991 JETRO White Paper, Volume on Direct Overseas Investments (in Japanese)* (Tokyo: Japan External Trade Organization, 1991), pp. 6-7.

Table 3
Direct Foreign Investments in China
(In Millions of U.S. Dollars)

	1987		1988		1989	
	Value	As % of the total	Value	As % of the total	Value	As % of the total
From:						
Hong Kong &						
Macao	\$ 1,598	69.1	\$ 2,095	65.6	\$ 2,078	61.2
Japan	\$ 219	9.5	\$ 515	16.1	\$ 356	10.5
U. S.	\$ 263	11.4	\$ 236	7.4	\$ 284	8.4
Singapore	\$ 22	0.9	\$ 28	0.9	\$ 84	2.5
W. Europe	\$ 24	1	\$ 80	2.5	\$ 140	4.1
Australia	\$ 5	0.2	\$ 4	0.1	\$ 44	1.3

Source: Japan External Trade Organization, *1991 JETRO White Paper, Volume on Direct Overseas Investments (in Japanese)* (Tokyo: Japan External Trade Organization, 1991), p.197.

As indicated in Table 2, Asian NICs' investments in the ASEANs since 1990 have surpassed those by Japan. In the investments in China, Asian NICs' investments have accounted for the lion's share, although the large share of Hong Kong and Macao also includes investments by Taiwan, which for political reasons had to be channeled through Hong Kong.

There are various factors that account for the active investments made by Asian NICs in China and in Southeast Asia. They include the loss of competitiveness in low technology labor intensive industries (due to rising wages), lack of space for new industrial expansion, their desire to continually upgrade their technology base to produce more upscale higher value-added products; the attraction of the growing local markets of the host countries, and the use of offshore manufacturing centers to circumvent quotas imposed

on their exports by the United States — the country which has been the largest absorber of Asian NICs' exports.

In Taiwan's case, the direct foreign investments in China and Southeast Asia were small in scale, made predominantly by small to medium-sized firms which did not have much leeway in coping with the rising wages at home. Their direct foreign investments were part of the efforts to restructure Taiwan's industries, by transferring offshore industries which were no longer labor-cost competitive, while the island strived to move up technologically, such as in the manufacturing of OEMs (Original Equipment Manufacturing).

In some respects, the technology transfer from Taiwan to the neighboring developing countries can be quite effective because her technology, being at a lower level than that of Japan, is more compatible with the technology absorptive capacity of the host countries. Moreover, when the government of Taiwan allows direct investments from Taiwan to China, a measure which is currently under consideration in Taiwan, the pace of economic integration between Taiwan and the coastal province of Fujian in China (just across the Taiwan Straits) where people on both sides speak the same Chinese dialect, is bound to increase.

As Taiwan has done, Hong Kong too has been transferring her traditional, labor-intensive manufacturing industries to the north, to Guangdong province in South China. At the same time, Hong Kong is also restructuring her economic bases to become more of a center of trade, finance, and information service. In these capacities, Hong Kong serves as an intermediary for the transnational flows of ethnic Chinese capital and direct investments in South China region. There is, therefore, a revival of Hong Kong as an entrepot, except that this time, she facilitates not only the transnational movements of goods and services, but also those of factors of production (such as capital and technology).

As an entrepot, Singapore is to Southeast Asian countries while Hong Kong

is to South China. Singapore's industrial restructuring calls for the development of capital and knowledge-intensive industries in Singapore and shifting of low technology, labor-intensive industries to Jahore to the north (in the southern tip of Malaysia) and to Sumatra (the largest island in Indonesia) to the west, thus creating a "triangle" region.

Historically, ethnic Chinese capital owners have been known for their entrepreneurship. In China Mailand, the tempo for economic liberalization is on the rise again. A freer economic environment can only strengthen the ethnic Chinese connection as a dynamic force that will push for a closer integration of what may be termed a "South China Economic Region."

3. The Characteristics of the Emerging Pacific Asian Economic Region

The spread of industrialization from Japan to Asian NICs, and then to China and the developing countries in Pacific Asia is creating a transnational conglomeration of firms and industries. The conglomeration is taking place not by government agreements as required of an economic bloc, but by the linking of individual firms that respond to changing factors and demand conditions in the markets, and to changing competitive environment that has become global. In the process of conglomeration, various industries have been restructured and economic linkages, vertical as well as horizontal, have gone beyond national boundaries. In going transnational, firms seek linkages with firms in the neighboring countries because of the locational advantages offered by the distance factor, cultural affinities, and historical ties. This process is no different from that found in the formation of an economic region in a national economy, except that in Pacific Asia the region is transnational.

The success of industrialization in Pacific Asia, beginning with Japan, then with the NICs, and now with the developing countries, owes much to the export-oriented development policies adopted by these countries. The outward

orientation of these economies requires an "open" Pacific Asian region — open in the framework of the GATT free trade principles. There is a consensus on this matter from policy makers in Japan, in China, and in the ASEANs.⁴

A question is often raised as to whether the emerging Pacific Asian region will be Japan-led or Japan dominated. If the growth of the region is expedited by technology transfer from Japan to the NICs and to the developing countries, then the region is Japan-led by definition. Will the region be Japan-dominated? This is not a question of semantics but rather a question on how the market functions.

If a region is formed by industrial conglomeration led by market forces, governments are not a factor in the domination of that region. More likely, the domination of the region by any party will be exercised through a market structure in the mode of a monopoly or an oligopoly. And the region will be Japan-dominated if the monopoly or the oligopoly power is rested in the firms based in Japan. But if the region is an open region, a firm can choose its coalition partner from inside the region or from outside the region, such as a North American - or an EC-based MNC which surely would be eager to seek a linkage with a dynamic Pacific Asian region. Also, the ethnic Chinese capital, with its growing global network and technological sophistication and in coalition with MNCs outside of the region, can gain sufficient leverage to neutralize the market power emanating from Japan-based MNCs.

The scenarios painted above are only some possible features of the Pacific Asian region. In actuality, however, global competition requires a global strategy that calls for the creation of an international consortium consisting of multinational coalition partners.⁵ These consortia will compete for market dominance inside as well as outside of the Pacific Asian region.

Naturally, there will be a dominant firm or the leading firm in each consortium. In some consortia, the leading firms undoubtedly will be

Japan-based MNCs. But, then, in some other consortia, the leading firms may very well be MNCs based in countries outside of Japan. The key point is, however, that competition for market domination will be between different multinational consortia, *not* between different nation-states. And market dominance is achieved by improvement in the competitiveness of a consortium, not by an artificial coalition among the consortia. In this respect, the role of governments in an open region is to ensure the openness in the region so that free competition will always prevail.

IV. Sub-regions in Pacific Asia

A large economic region grows from a small region or by conglomeration of mini regions. In Pacific Asia, there are several mini-regions — the Hong Kong-Guangdong region, the Taiwan-Fujian region which by conglomeration add up to the South China economic region, then there is the ASEANs. In the case of HongKong-Guangdong and Taiwan-Fujian regions, the regionalization was swift because the linkage was bilateral. It was bilateral in that the labor and land short areas simply extended their operations to the areas with abundant supplies of those factors of production and by building new plants in the latter without having to cope with the problems of the existing, obsolete industries. The cultural affinities and common ethnic roots of the areas also helped in expediting their regionalization.

In the case of the ASEANs, the integration of the economies requires multilateral approaches, in an economically, politically, and socially more diverse environment. The process of integration, therefore, is slow as the history of the ASEANs (which was formed in 1967) reveals. It requires a third party outside of the region to expedite the integration of the region. That boost was provided by Japan-based firms. Once that happens, the economic integration of the region would be also swift as the growing horizontal integration of industries in the ASEANs indicates.

There is another sub-region in Pacific Asia which is still not in existence, but potentially could reap a great deal of benefits from some form of economic integration. On the other hand, the obstacles to integration there are much more serious than those in other sub-regions. That region is the Sea of Japan region.

At first glance, the Sea of Japan region has the appearance of a naturally-made candidate for economic integration. It encompasses Japan and Korea which are capital-and-technology-rich but short in labor and land; Northeast China which is endowed with a combination of abundant labor supply, rich agricultural resources and a substantial heavy industrial base which is in need of modernization; and the Russian Far East which is sparsely populated but is endowed with abundant natural resources and some industrial bases which are also in need of modernization.

There are also some obstacles to a swift integration of the Sea of Japan region. Because one of the attractions of Northeast China and the Russian Far East is their natural resources potential, their development and the infrastructure that needs to be built require an enormous amount of capital investment that does *not* yield returns in the short run. This stands in good contrast with the other sub-regions in Pacific Asia where the capital payout period is shorter. But this obstacle can be overcome if there is an assurance of political stability in those areas so that the long-term view of the investments from the capital-rich partners will prevail.

Another obstacle to an effective industrial linkage of the region is the price distortions created under the socialist economic system. This distortion is especially serious in the Russian Far East.⁶ The price distortion arises from the subsidization of industrial production at the expense of raw material production i.e., by artificially raising the price of industrial products and depressing the price of the raw materials input. As a result, the relative price differential between the industrial products and the raw material inputs

compared with their relative price differential in the world market, is so high that it encourages wasteful use of raw material input in the industries in the Russian Far East. The correction of this distortion calls for a drastic restructuring of the existing industrial facilities which may cost more capital expenditure than is required in building new facilities.

The obstacles to a swift economic integration in the Sea of Japan region should not obscure that region's potential for integration because of the complementarity of the economic bases of the partners that surround the Sea of Japan. It appears that what is needed is a long-term political stability in the socialist countries so that the economic reform in the socialist system will continue. That will increase the pace of privatization of industries under the socialist system, making them more compatible for linkage with those in the capital-and-technology-rich countries.

V. Conclusion

From the beginning this paper has stressed the importance of market forces as prime movers behind economic integration. Market forces act as triggers and movers in the growth of an economic region. But market forces function well only when there is no artificial control presents.

In a world which is becoming divided into different protective economic blocs, the Pacific Asian region stands out because it is relatively free and open. Where other economic blocs may languish in stagnation, the Pacific Asian region continues to be dynamic largely because of its openness to let market forces dictate the allocation of resources.

One may raise a legitimate concern about the potential for the exploitation of the market by firms with the monopoly or oligopoly power. In an open economy, however, competition is global. And it is this global competition among multinational consortia that keep the potential monopoly and oligopoly power under check.

Ultimately, the ideal goal of economic integration is the integration of the world as a region because the market-driven competition functions best in a globalized economic region unfettered with artificial controls. That goal is not beyond reach. As Haberler observed, in his American Economic Association presidential address in 1964, the world as a whole was once a single integrated economic region in the late nineteenth century, but under a free regime.⁷

Notes

1. To see how nations gain competitive advantages by responding to these conditions, see Porter, Michael E., *Competitive Advantage of Nations*. New York: Free Press, 1990.
2. For a concise description of Japan's investments in Pacific Asia, see Ohta, H., "Japanese Foreign Investment in the Asia-Pacific Region", *East Asian Executive Reports*, Volume 13, No. 7, July 1991, p.9, pp. 12-15.
3. For the importance of ethnic Chinese connection as an integrative force, see Yu, Chukun (ed.), *Ethnic Chinese Overseas: Their Expanding Economic Power* (Tokyo: The Simul Press, 1991). — in Japanese. Also see Sender, H., "Inside the Overseas Chinese Network," *Institutional Investor*, September 1991, pp. 37-42.
4. On APEC's agreement on this matter, see "APEC Kyodai Kyogitai E Ririku," *Nihon Keizai Shinbun*, November 15, 1991, p.3. Yu Takagaki, "Nippon to NIEs, ASEANs," *Toyo Keizai*, June 29, 1991, pp. 161-171. Also a special article on Sino-Japanese economic cooperation in *Remmin Ribao* (People's Daily Overseas Edition), November 15, 1991, p.3.

5. A case in point is the rivalry between the Mitsui group (which included Marathon and McDermot) and the Exxon group (which included Royal Dutch, British Dutch, SODECO, C-ITO, Idemitsu, Amoco, Mobil) in the bidding for the oil rights in Sakhalin. See *Nihon Keizai Shinbun*.

6. For more detail about the price distortions in the Russian Far East, see Thornton, Judith and Mikheeva, N. V., "Structural Change and Integration of the Soviet Far East into the World Market: The Case of Negative Value Added," a paper presented at the 66th Annual Conference of the Western Economic Association International in Seattle, June 30 - July 3, 1991.

7. Haberler, Gottfried, "Integration and Growth of the World Economy," *The American Economic Review*, Vol. LIV, No. 2, Part I, March 1964, pp. 4-6.

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