

# East Asian Development and Challenges of International Cooperation

— with Special Reference to  
the World Bank's "East Asian  
Miracle."

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## Introduction: Five Trends Seen in Developing Countries

Observing the current economy of developing countries, we find five kinds of trends, which appear to be very important factors in formulating a framework for international economic cooperation for them.

The first trend is that developing countries have made a major progress in solving external debt problems, which gripped them severely throughout the 1980s. Many Latin American countries, most of them middle-income countries, were able to achieve economic growth in the 1990s. But most of indebted countries, particularly low income countries, are still far from settling debt problems. Moreover, it is necessary to continue in developing countries, the structural adjustment and reforms indispensable to solve structural problems generally believed as a major cause of the debt crisis.

The second trend to be mentioned is a steady economic development in East Asia, which shows a stark contrast with the situation in Latin America, which, because of the debt crisis, faced the serious economic stagnation in the 1980s. East Asian nations have continued dynamic growth in the 1990s. As

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the success of East Asia is remarkable, it should attract much attention. In fact, many research works were done on this topic, including a report entitled "The East Asian Miracle: Economic Growth and Public Policy," written recently by the World Bank.<sup>1</sup>

The third trend is the increased attention given to the question of how a smooth shift to market-oriented economy can be achieved in many of developing countries. This topic became more focused following the collapse of centrally planned economies in the former Soviet Union and East European countries. Latin American countries which went into the debt crisis are also looking for ways in the long run to transfer to market economy from a "populist" mixed economic system.

Turning to Asia, China already declared that the country will shift to the "socialist market economy." Many other Asian countries are continuously facing various challenges, such as deregulation, privatization and external liberalization.

The fourth trend is a growing awareness for the importance of linking economic development with environmental

preservation. The concept is aimed at achieving sustainable economic development without deterioration of global environment. Needless to say, the international awareness for such a concept has increased rapidly since the United Nations Conference on Environment and Development in Rio de Janeiro in 1992.

The fifth trend, the last of its kind, is the spread of regionalism in the global economy. The most relevant feature for us is the movement toward cooperation and integration between industrial countries and developing countries. While in Europe, for example, the European Community (EC) nations are aiming for a complete integration, an important new move is now seen among the United States, Canada and Mexico under the North American Free Trade Agreement (NAFTA). Also a plan is proposed to build a free trade zone in the Western Hemisphere (WHFTA), which is seen as a geographical extension of NAFTA. A framework agreement on mutual trade and investment has been already signed between the United States and most of the Latin American countries. Looking over to the Asia-Pacific area, efforts to strengthen regional economic ties in investment and trade are going on between industrial and develop-

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<sup>1</sup> World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, Oxford Univ. Press, 1993.

ing countries mainly through the Asia-Pacific Economic Cooperation (APEC) forum. These kinds of movement toward economic regionalism are considered as a new wave and different from conventional international trading system, which have been established based on the General Agreement on Tariffs and Trade (GATT). These are also intended to build a new kind of relationship between developing countries and industrialized countries.

The five points discussed above are closely related to five most important challenges facing developing countries at present. They are the solution to external debt problems and structural adjustment, maintenance of dynamism in East Asia, further shift to market-based economy, sustainable economic growth coexistent with environmental preservation, and new regionalism.

The following sections will discuss the prospect hence forward of the developing economies and how the international cooperation should be rendered to them, focusing on the above mentioned five trends and challenges.

#### I . Latin America : External Debt Problems and Progress in Structural Adjustment

The outstanding balance of external

debts owed by developing countries stood at an estimated 1.35 trillion dollars at the end of 1992.<sup>2</sup> According to the World Bank, two-thirds of all developing countries are classified as "heavily indebted" or "indebted" countries. In that sense, their debt problems continue to be one of the most serious problems even for now.

However the situation in Latin America and other middle-income countries, where the scale of their debts were relatively large and borrowings from commercial banks accounted for the largest part of their total debts, showed a remarkable improvement in the early 1990s. In Latin American countries an economic slump had lasted for a long period of time since the outbreak of the Mexican debt crisis in August 1982. The period of the 1980s in this region was called "the lost decade." But in recent years, many of the countries saw their economies recover, with both the debt service ratio (DSR) and the interest payment ratio (IPR) declining steadily. They were also successful in curbing inflation. It took about 10 years since the outbreak of the first debt crisis before economic recovery was put on a right

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<sup>2</sup> According to the World Bank, *World Debt Table*, 1993.

track in these countries and their economies entered a new phase. The ratio of the interest payment against exports of goods and services (IPR) dropped to 19.6 percent in Latin America in 1992 from a sharp 38.9 percent in 1983.<sup>3</sup> Inflation was put under control in all Latin American countries except Brazil in a very significant and impressive manner. Their growth rates showed a conspicuous pickup in 1991 and beyond.

The economic recovery in Latin America was not brought about by temporary or contingent factors at all. That was a product of major factors that will be explained in the following.

The first factor is that their long-running efforts for structural adjustment and reforms began to produce desired results. Under the reform efforts, they tried to remove or eradicate the very elements that had exactly triggered the debt crisis. Each country tried to expand fiscal revenues through tax reforms and reduce budget deficits or turn the balance around via spending cuts. Moreover, they liberalized trade, privatized government run corporations, implemented deregulations, relaxed con-

trol on foreign direct investment. These efforts were aimed to make their economic structure more competitive in global trade areas. In Mexico, for example, the government took a drastic adjustment policy in a turnabout from the conventional economic policy seen until the 1970s. Those who had observed the change of Mexico's economy for a long time applauded the recent structural adjustment and reforms and described them as "the Salinas Revolution."

The second element is an impressive achievement in international cooperation designed to ease indebted countries burden of debt-servicing payments. Immediately after the onset of the Mexican debt crisis, the IMF took a strong leadership and programs to reschedule its debt principal to commercial banks were formulated. In 1985, then U.S. Treasury Secretary James Baker devised a relief program for the indebted countries. And the World Bank formulated structural adjustment programs for the struggling countries. The efforts, however, did not make a quick contribution to settling the problems. It was in 1989 that then U.S. Treasury Secretary Nicholas Brady proposed a new relief strategy that called for a cut in one-third of debts under a debt-to-bond swap arrangement.

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<sup>3</sup> According to the CEPAL, *Balance Preliminar de la Economía de América Latina y el Caribe*, 1992.

The scheme was implemented not only in Mexico but in other Latin American countries such as Venezuela and Argentina as well. In the plan, Mexico's debt-servicing burden was slashed by 35 percent from about 43 billion dollars debts. The Brady plan (or "New Debt Strategy") had an extremely significant meaning in global efforts to relieve the indebted developing countries. Before the scheme, a debt reduction of as much as 35 percent was almost inconceivable.

The third element that should be pointed out is a recovery of fund flows to major Latin American countries. This reflected an increased international confidence in credit standing of Latin American countries, due to the falling external debts under the successful implementation of the Brady plan as well as control of inflation and steady economic growth thanks to structural reform efforts. At the same time, foreign direct investment in these countries increased sharply, reflecting their liberalization of trading system and a policy to accept foreign capital. As a result, fund flows to Latin American countries showed a big change in the 1990s. Capital transfer to these countries, or a capital inflow minus interest payments, scored a net inflow in 1991 for the first time in 10

years. The amount reached 27.4 billion dollars in 1992.<sup>4</sup>

Nevertheless, more efforts for structural adjustment and reforms need to be made in order for full-fledged economic recovery to be smoothly achieved in Latin American countries, except Chile, in the 1990s. Without such efforts, these countries are feared to plunge again into the economic doldrums they experienced before. So no optimism is warranted. One example illustrating such a concern is Brazil where inflation is running at a hopping 30 to 35 percent a month, a situation which is defined as hyperinflation. Brazil started efforts for economic restructuring, such as trade liberalization and privatization of state-run corporations, under the previous administration. But they are still in the initial stage. It can be said that full-fledged enforcement of economic stability and structural adjustment policy play an important role in Brazilian development on a long-term basis.

In many other developing countries, economic stabilization and adjustment policy showed significant success while their economies recovered. But such success have yet to develop into full-scale recovery, mainly due to failure of

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4 *Ibid.*

restructuring efforts in some sectors. Exchange rates of Mexico, Peru and Argentina, for example, are overvalued. In these countries, exports tended to be checked substantially by fluctuations in exchange rate levels. In Mexico and Peru, in spite that financial sectors were liberalized to some extent, the spread between lending rates and deposit (saving) rates remains very wide, hampering stable supply of funds which are needed for promotion of production related investment. In these two countries, external trade was drastically liberalized, because, on the trade front, they were required to remove protection in order to maximize effects of restructuring measures. But under the situation described above—overvalued exchange rates and high domestic interest rates—, manufacturing sectors in these countries have a difficulty in expanding investment, technological transfer and productivity, all necessary for enhancing competitiveness.

Finally under the long lasting structural adjustment during the 1980s, the living standard of poor people deteriorated. In countries like Brazil, security worsened. Many Latin American countries established various funds with names like Emergency Social Fund, Social Investment Fund, etc. as a relief measure for the

poorer people. Moreover, the “Solidaridad” program (Pronasol) started in Mexico for a similar purpose. But more efforts should be made to create a society where low income people can participate and integrate themselves into economic development in a productive manner.

## II. Development of East Asia

In contrast to the long lasting economic stagnation that hit Latin America in the 1980s, many Asian countries were able to achieve high economic growth for a long time.<sup>5</sup> East Asian countries' income distribution improved, and the absolutely poor segment of the population decreased substantially. Development of Asia, particularly of East Asia, caught a strong global attention, prompting the World Bank to write a report entitled “The East Asian Miracle: Economic Growth and Public Policy.” The achievement in East Asia was enabled by export-oriented policies as well as trade liberalization and liberal policy toward foreign direct investment. For East Asian nations to see further development, they

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5 Regarding the comparison between economic development of East Asia and Latin America, see Akio Hosono, “‘East Asian Miracle’ and Latin America”, *Journal of Research Institute for International Investment and Development*, Vol. 20, No. 5 (May 1994), pp. 4-35.

need to continue liberalization and reforms notwithstanding certain degree of differences among them. The step will serve as an important factor to help them maintain dynamism and secure stable growth in the future. Meanwhile, socialist countries in Asia like China and Vietnam are proceeding with reforms in a bid to make transition to market-oriented economy. China, for example, achieved high economic growth in recent years under the goal of shifting to socialist market economy. Such achievement was particularly conspicuous in the southern coastal area of the country. China is challenging the important task of combatting hardship which comes with economic reforms as well as inflation which comes with high economic growth for the eventual goal of establishing market economy and keeping a strong dynamism that gets the current China rolling.

### III. Factors of Economic Development and Economic Policy: Experiences of East Asia

As discussed before, the economic development trend in the 1980s or prior to that time shows a contrasting difference between developing countries in East Asia on one hand, and Latin

America and other developing countries on the other. The author believes it is very valuable to shed a light on what factors brought this difference, as it may have a significant bearing on the studies of development from now on. This also has much to do with the most important tasks that developing countries are tackling now. This is so because studies should be made to explore what type of market economy is appropriate for the future development and what policies are desirable in this regard.

In this context, the above cited World Bank report "The East Asian Miracle: Economic Growth and Public Policy" appears to be highly relevant. (For the convenience of discussion, hereinafter referred to as "the World Bank report".) The report analyzes features of economic development, factors, and economic policies that made possible the remarkable growth in East Asia. The report is timely and provides an interesting and thought provoking reference for considering issues faced by many of the developing countries.

#### (1) Factors of East Asian Success

The important conclusions the report reached regarding the factors of East Asian success can be summarized as

follows. First, appropriate and through macroeconomic management; second, superior accumulation of human and physical capital. Particularly for the latter, the importance of education is stressed. In economic policy front, the report took special notice of the importance of export promotion policies adopted in common by East Asian countries.

In the following, let us examine factors of economic development as well as some of the relevant issues involved in economic policies of developing countries referring to this timely World Bank report.

The report says, "most of East Asia's extraordinary growth is due to superior accumulation of physical and human capital"<sup>6</sup> and "private domestic investment and rapidly growing human

capital were the principal engines of growth."<sup>7</sup> The report mentions on the other hand: "Productivity increase (TFP growth) has been higher than in other developing economies and is important to the East Asian success story. But it is not the dominant factor."<sup>8</sup> On these interesting and important aspects, the following two points merit consideration.

The first is linkage between "accumulation of physical and human capital" and "productivity increase." The second is which one of the two was more important essentially. Analyzing the linkage between the two can provide us a clue for understanding which was more important

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large measure the HPAEs achieved high growth by getting the basics right. Private domestic investment and rapidly growing human capital were the principal engines of growth."

<sup>8</sup> *Ibid.*, p.58. The full paragraph where appears these sentences is the following:

"The HPAEs are unusual among development economies because of the relatively important role of TFP growth. Even so, we find, consistent with our previous findings with cross-economy regressions, that between 60 and 90 percent of their output growth derives from accumulation of physical and human capital. Productivity change has been higher than in other developing economies and is important to the East Asian success story. But it is not the dominant factor." Here HPAEs stands for high-performing Asian economies: Japan, "The Four Tigers" (Hong Kong, the Republic of Korea, Singapore, and Taiwan, China) and the newly industrializing economies (Indonesia, Malaysia and Thailand), and TFP stands for total factor productivity in growth accounting analysis.

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<sup>6</sup> World Bank, *The East Asian ...*, p.v.

The full paragraph where appears this sentence is the following: "What does this report tell us about the East Asian miracle? The research shows that most of East Asia's extraordinary growth is due to superior accumulation of physical and human capital. But these economies were also better able than most to allocate physical and human resources to highly productive investments and to acquire and master technology. In this sense there is nothing "miraculous" about the East Asian economies' success: each has performed these essential functions of growth better than most other economies."

<sup>7</sup> *Ibid.*, p.5. The full paragraph where appears this sentence is the following:

"What caused East Asia's success? In



as engine of growth.

Among East Asian countries, in cases of Japan, South Korea, Hong Kong, Thailand, and Taiwan (China), the contribution of productivity (TFP) increase to growth was over 33%. It was particularly high for Japan at 55%.<sup>9</sup> These are countries which are very short of agricultural land, energy and other natural resources as compared with the size of population. Moreover, there was an extreme shortage of capital in the initial years of development. The reason why these countries, despite these conditions, were able to maintain high economic growth for such a long time of 30 years is because they were able to achieve constantly more growth than what usually comes from accumulation of human and physical capitals, due to the much higher productivity increase. The process led to higher accumulation and higher productivity increase. The process was cumulative, creating a favorable virtuous circle, maintained on the basis of permanent high increase of productivity, which at the same time permitted higher rate of accumulation. The important aspects are: (i) higher

income attained through higher growth was channeled to further physical and human capital accumulation through savings, and (ii) high productivity increase was maintained continuously. Productivity increase is basically attained by technological progress in its broad sense. In the initial stage of development, technologically catching up with the developed countries is important. Later, technological innovation and development of industries having high level of technology and high productivity become important. At the same time, realization of external economies especially through development of efficient supporting industries (composed of small and medium suppliers of parts and components); basic industries capable of supplying steel and other industrial materials; machine tool industry, etc., gives immense impact on enhancing efficiency and competitiveness of the manufacturing industry as a whole. This aspect will be explained later. What was equally important, was for the firms to make innovation and improvement efforts in organization, management, technological application, etc. Company-wide quality control movement or TQC, promotion of in-house education, OJTs, cooperation amongst related supporting companies on technology and manage-

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<sup>9</sup> Calculated from the Figure 1-11 of the World Bank, *The East Asian...*, p.58.

ment, efforts to shorten delivery time for "just in time" or to reduce inventory and standardization of industrial standards for parts etc. would contribute to this.

The macroeconomic and microeconomic activities which made possible the continued productivity increase were fundamentally prompted by the competition in the market. Moreover policies and institutions which provided for the market to fully play its function and which encouraged the initiatives to be taken by enterprises brought forward the competition in the market.

## (2) Roles of government and market

The second point to be discussed is relationship between market and government. In Japan, it is fair to say that the government has been taking active economic policies geared to make market mechanism to work to its fullest.

The first area which was important in this regard was the cooperation between the government and private sector in formulating a vision for Japan's overall direction for its economic development, and this was presented as a reference point. Programs on the macroeconomic front were worked out by the government's Economic

Council, while visions for industry in general or for each specific sector were crafted by the Industrial Structural Council and other councils and they have acted as a valuable guideline for corporate activities.

The vision was instrumental in filling the information gap at each enterprises. Given the fact that signals coming from the market are short-term in nature, it is difficult for a business to obtain comprehensive, detailed and medium- or long-term information pertaining to the future of economy and industry in general. Thus if it were not for the vision, the businesses have had to conduct corporate activities based on the insufficient information regarding medium to long term outlook of the market. The vision can serve roles of informing corporations in advance of signals to be sent from the market and providing information that could not be gathered from individual business operations. The vision on economy and industry has thus made possible technological development, investment, and human resource development to be done from medium to long term perspective.

On this point, the World Bank report made various important pointouts: "Government-business cooperation was

promoted through creation of forums, called councils.”<sup>10</sup> The report also said “the councils supplemented the market’s information-transmitting function,”<sup>11</sup> making it possible for East Asian economies to respond to a change in market environments more flexibly than other economies. A framework proposed by the World Bank report for what it calls “a functional approach to growth” is insightful and, in particular, the concept of contest-based competition is full of deep thoughts.<sup>12</sup>

However, it should be emphasized that economic planning by councils and government and a long term industrial vision put forward by the Industrial Structural Council did play an important role in providing useful information for medium and long term business activities in Japan such as investment, training, education, and technological development. While taking advantage of market function, it provided not only for the pursuit of short-term gain but also for companies to engage in activities from medium to long term perspective.

In the middle of 1992, the Japanese government released a new five year

plan entitled “Sharing the better quality of life around the globe.” The plan says that economic plan has a role of presenting a medium and long term guideline under the market economy, and its basic roles are depicted to be: (i) to make clear the outlook for a desirable and feasible economy and society; (ii) setting a basic course of the government’s medium to long term economic management and identifying priority policy objectives and measures; and (iii) providing households and businesses with guidelines for their activities. The plan also pointed out the “growing need for Japanese economy to have a medium to long term guideline particularly so as the economy is in a valuable transition to 21st century.”<sup>13</sup>

### (3) Importance of small and medium enterprises

The second area where the relationship between the government and market is equally important constitutes promotion of small and medium sized enterprises (SMEs). For market to function most effectively, it is indispensable to have competition among as many companies as possible.

10 *Ibid.*, p.14.

11 *Ibid.*, p.14.

12 *Ibid.*, p.88.

13 Translated by the author from Economic Planning Agency, *Seikatsu Taikoku Gokanen Keikaku*, June 1992.

In Japan, a large number of SMEs have entered the market and vitalized the market. Many of major Japanese companies started as SMEs and achieved a remarkable growth over a relatively short period of time since the WW. Regarding the role of SMEs in Japan and other East Asian countries, The World Bank report mentions as follows:

“Just as numerous small land holdings improved equity and efficiency, the HPAEs benefited from a profusion of small and medium-size enterprises(SMEs). The large number of SMEs generally reflected market forces rather than government intervention. But several of these economies supported SMEs with preferential credits and specific support services. Rapid growth of labor-intensive manufacturing in these firms absorbed large numbers of workers, reducing unemployment and attracting rural labor. As firms shifted to more sophisticated production, efficiency rose and workers' real incomes increased.”<sup>14</sup>

Here, the effects of SMEs on employment, workers' real incomes increase and hence improvement in equity is stressed. For this reason, the SMEs promotion policy is included in the chapter discussing “institutional basis for shared growth” in the World Bank report.<sup>15</sup>

However, their role is more important, at least for the following three reasons: First, they stimulate competition in the market, to make it perform its full function. SMEs perform a big role competing with large corporations and the competition among SMEs themselves stimulates the entire market and maintains the healthy development of the economy.

The other role of SMEs is that of vanguard activities for taking innovational initiatives. Honda and Sony could be cited as representative enterprises of this nature.

Another very important role is that of serving as an excellent, stable and reliable supplier of parts and components for the large enterprises, based in many cases on stable and long-term subcontracting relationships. In actual fact, in performing this function, SMEs act as a pool of “supporting industries” for large enterprises and also for SMEs. To put it more precisely, SMEs in this way play the role of external economy among themselves and for large enterprises. Where there are not enough SMEs to play fully this role, considerable weakness is introduced in the competitive

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14 World Bank, *The East Asian...*, p.161.

15 See the Chapter 4 of the Report.

capability of certain industries, as happened in the case of the Republic of Korea (South Korea), so much so that when that country realized what was happening it instituted a strong policy designed to foster development of small and medium enterprises to supply parts and components. In contrast with Korea, sustained development of SMEs is observed in Taiwan.

These roles of SMEs are crucial for the development of competitive industries. We should also emphasize the case of certain SMEs that are key players in the development of their local areas, which are in many cases very distant from the big cities. These are enterprises which process local raw materials, sometimes using traditional techniques and knowhow and sometimes new technologies, and which play an important role in stimulating the local economy. Japan has a large number of enterprises of this sort that are based on local specialities; examples of the best known are cutlery in Tsubame, which is considered the Solingen of Japan, ceramics in Seto, silk Kimonos in Kyoto, etc.

To sum up, we can state that in Japan SMEs have served to vitalize the market through the constant entry into it of enterprises of this category; they

have displayed a readiness to take innovational initiatives and in many instances have grown into large enterprises in a relatively short space of time, and in their capacity as suppliers of parts and components they have become outstanding supporting industries while also providing a valuable stimulus for local economies.

Nurturing and promotion of SMEs in Japan were done broadly and comprehensively. What to be stressed are the efforts made to promote the development of SMEs from the two important aspects, namely, finance and technology.<sup>16</sup>

The third area to be discussed is the importance of many of the policies which were meant to increase efficiency and productivity of economy as a whole without distorting the market mechanism. Broadly defined external economy which was important to manufacturing industry as a whole was formed. The industrial areas indispensable to manufacturing such as production sector of high quality and competitive materials, parts and ma-

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<sup>16</sup> For further details regarding SMEs development and their roles as well as policies to promote them, see, Akio Hosono, "Small and medium-sized enterprises in economic development in Japan," Inter-American Development Bank, *Experiences in Development of Small and Medium-sized Enterprises* (to be published).

chining tools have been widely developed in Japan. In this country, steel is often called "the rice of industry." This notion stems from the thinking that it is impossible to have the development of competitive manufacturing sector without high-quality materials or components. Many of parts and machine tool industries are supported by smaller firms. The government's policy to promote SMEs played a great role in fostering these supporting industries. Equally important were policies to promote standardization of industrial standards, to establish nationwide testing and research facilities, and to construct industrial parks across the nation. On the other hand, as it was emphasized by the World Bank report, the export promotion policy was also important. It was apparently conducive to placing many industrial sectors under international competition and have called for the improvement of productivity.

#### IV. Environment and Development — Another experience of Japan

We should discuss two points which were almost never mentioned in the World Bank Report. The first is experience pertaining to environment and development. Perhaps the World Bank Report

did not intend to cover the topic this time. However, in considering the future development and environment of developing countries, the experiences of East Asian countries, particularly that of Japan will be important. The World Bank Report is giving a valuable information in providing a detailed analysis on the aspect that improvement in income distribution came about along with the economic growth in East Asia. Nowadays the attainment not only of growth, efficiency, but also of the improvement of income distribution, eradication of poverty, and the environmental preservation have become major targets of development. Japan's experience in these aspects could be very valuable. Japan is one of the countries which experienced the most extreme case of development as its surprisingly rapid and dense industrialization and urbanization were achieved on extremely small land. As is well known, Japan's population is half that of the United States and its land size is less than one/25th of U.S. About 84 percent of the Japanese land is steep mountains so that flat land are one/100th of that of the U.S. Japan therefore was forced to make urbanization and industrialization under such a harsh geographical

condition of having only 1/50th of flat land per capita than U.S. This was the experience almost never experienced elsewhere in the world.

Since it was the first experience for Japan, for some time, the country suffered from pollution, and large cities also suffered from air and water pollution. Japan had done a great self-reflection on this painful experiences in the meantime to come up with a joint drive between the government and the private sector to improve the environment and promote energy and resources conservation.

The attempts turned out very successful. This experience can be deemed valuable for formulating development policies backed by environmental protection in developing countries. The CO<sub>2</sub> emission per capita in Japan is less than half of the emission in the United States (8.6 tons against 20.0 tons, 1991) and the level of NO<sub>x</sub> and SO<sub>x</sub> emission in Japan is at almost the lowest among OECD countries. (in case of NO<sub>x</sub> 9.7 Kg per capita in Japan against 78.3 Kg per capita in the United States and in case of SO<sub>x</sub>, 6.9 Kg per capita in Japan and 84.3 Kg per capita in the United States.)

#### V. Economic Relations and Cooperation

in NAFTA and APEC

#### — Lessons from Experience with Trade, Investment and Economic Cooperation in East Asia

The other point to be emphasized is the very fast expansion of economic relations within the East Asia. This was not brought about through such institutional arrangement as free trading accord or agreement on a common market. But they were done through a very natural process in which investment, trade and technological transfer made a progress while reflecting a principle of comparative advantage and changes in factors endowment. What is important here is that part of the East Asian success described in the World Bank report was ascribed to an effective and rapid intensification of economic relations and economic cooperation in the area. Trading within the area kept increasing in the past 15 years. Intra-regional exports of industrial goods account for 32.4 percent of the total exports, up from 24.5 percent 15 years ago. Similarly intra-regional imports increased from 43.1 percent to 50.2 percent during the same period. The trend reflected the recent "dynamic" growth in intra-area trade and this contributed greatly to spurring their economic growth. Direct invest-

ment from Japan to the four newly industrializing Asian economies (NIES) surged from 2.5 billion dollars in 1982 to 12.2 billion dollars in 1990. Japanese direct investment to four of the six-member countries of the Association of Southeast Asian Nations (ASEAN) and China increased from 8.9 billion dollars to 33.8 billion dollars in the same period. What is more remarkable is the fact that foreign direct investment of Asian NIES to ASEAN and China scored a 10-fold jump from 2.6 billion dollars to 25.5 billion dollars. Investment among East Asian countries is growing at a higher rate than investment from the United States and the European Community (EC).<sup>17</sup>

In other words, it can be said that increased investment from Japan to other Asian nations, higher investment from South Korea and Taiwan to Southeast Asian countries and their mutual trade expansion, and smooth technological transfer combined to serve as a major leverage to expand their mutual export activity and eventually enhance international competitiveness. Neighboring countries of Japan much benefited from

17 These figures are cited from Koichi Ohno, (ed.), *Regional Integration and Its Impact on Developing Countries*, The Institute of Developing Economies 1994.

utilizing products made by Japan's supporting industries such as high-quality materials, components and machines. The dynamic process of this highly interdependent relations based on trade, investment, technology transfer, reciprocal sharing of external economies was the driving force of intra-regional economic relations in Asia. This process was proven by an empirical researches conducted by professors Toshio Watanabe and Ippei Yamazawa. Prof. Watanabe describes this process in Asia as "Sequences of chain reactions based on the capacity of transformation of the countries of the region."<sup>18</sup> Professor Yamazawa uses the well known concept of "flying wild geese."<sup>19</sup>

A rapid progress in Asian economic cooperation has become an important theme at a time when economic regionalism or drive toward regional groupings have been mounting globally, such as EC, NAFTA and APEC. NAFTA has been closely taken up in many academic

18 See for example, Toshio Watanabe, "How Asia would be transformed by economic development: countries which benefit from late-comers advantages" *Bunka Kaigi*, August, 1993 (in Japanese).

19 See Ippei Yamazawa, and Sanwa Research Institute (ed.), *Vision of Asia and the Pacific for the Year 2000*, Toyo-Keizai, 1994 (in Japanese).



circles. In this paper, the author would focus on the NAFTA's significance as the first regional economic integration between advanced countries and a developing country, which is a theme that few researchers have dealt with in the past. It will provide a valuable insight into a free trade zone and a new "Asian Pacific economic community" proposed by the wisemen's committee of the APEC.

Economic integration among the United States, Canada and Mexico under NAFTA is likely to produce big merits generated from a division of labor that would reflect a principle of comparative advantage. However, there is a big wage gap among the people of the three countries—one to seven between Mexico and the United States—that is expected to make it difficult for them to devise mutually acceptable environmental standards and adjust unified standards for labor conditions. U.S. President Clinton, in efforts to break through the difficult situation, proposed supplementary accords to cover the two areas of environment and labor issues. Generally speaking, it is not easy to have a free trade agreement or to form a common market among countries with very different income levels. This reminds us of the difficulty that Spain and Portugal faced in their

bid to join the EC. They were finally able to obtain the membership of the Common Market and received an ample amount of subsidies from EC.

Economic cooperation within the Asia-Pacific region through such forums as APEC, PBEC and PECC differs from that under NAFTA where member countries are tied together on FTA. Economic cooperation seen among the Asia-Pacific region is called "open regionalism" due to its lack of a rigid institutional framework.

The open regionalism places emphasis on a global aspect of a trading system, due consideration on diversity within the region, and has a capability to cope flexibly, practically and realistically with possible changes in comparative advantage of countries involved.

## VI. Challenges of International Cooperation

Lastly, let us discuss several issues facing Japan's economic cooperation while taking into account various points that were analysed previously. The Japanese government released a basic outline for its official development assistance (ODA) policy at the end of June, 1992. Specific measures to enforce Japan's economic cooperation were spelled out in the

report prepared by the Economic Council in April 1992, which was taken into account for the preparation of the five-year plan under the theme entitled "Sharing the better quality of life around the globe." Some of the noteworthy points are as follows. They are related to the issues mentioned so far.

The first of all, the program envisages improving the overall quality of Japan's ODA by proposing its effective use for preservation of the global environments and a comprehensive plan to strengthen the cooperation for human resources development. Referring to environmental protection, the report said, "according to the Japanese experience, efforts were made to combat industrial pollution and establish an industrial structure conducive to energy conservation. Using effectively knowhow and technology acquired and accumulated in the process, Japan need to step up economic cooperation to environment related projects in order to make development with environmental protection possible."<sup>20</sup> During the Tokyo summit of the seven industrial nations in June, 1993, the government of then Prime

Minister Kiichi Miyazawa unveiled the fifth five-year ODA outline that called for increasing Japan's ODA by 50 percent to 70 billion to 75 billion dollars during 1993 to 1997. The midterm scheme also envisages earmarking about 120 billion dollars globally during the same period for the international cooperation program, by expanding the scale of the previous program for recycling of capital into developing countries, in addition to the 50 percent increase of ODA.

The above-mentioned report also proposed utilizing Japan's experience in efforts to step up intellectual support to developing countries. The report said the step can be carried out by systematizing various experiences Japan had, establishing a human and organizational network for intellectual assistance and promoting policy dialogue. In the systematization of the Japanese experience, the outline said, "Japan shifted from the status of a developing country to an advanced country 100 years after the Meiji restoration. But information regarding the economic measures, policies and social and political systems adopted and learned during the period remain unsystematized, failing to meet requests from abroad for research about this development experience. Japan therefore

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<sup>20</sup> Translated by the author from Economic Planning Agency, June 1992, *op. cit.* p.157.

should do utmost to make these various unused information and data more accessible so that they could be used abroad. The task might not be easy but it is worthy of attempt because assets such as knowledge and experience could be considered as an international public good and should have a chance of being shared by people around the globe just as if they were displayed at a museum. But Japan should be careful so that this experience museum could be used as part of an approach to complement global aid efforts under the World Bank and other international organizations. It is important to use the approach in a constructive manner by letting foreign countries utilize the useful part of the experience when necessary. The approach should not be allowed to induce a much publicized theory of Japan being unique."<sup>21</sup>

On a policy dialogue to be sought by Japan, the report said the following: "the most prevalent development policy at present is one based on a mechanism of market economy. But government also has a place to play its role in development policies, most important being a role to supplement possible deficiency of the market economy. The most active role

to be played by government is in the field of education, especially establishing elementary and junior high school systems, which is what Japan learned from its past experience. This area cannot work effectively under the market mechanism alone. This is exactly where Japan can share its knowhow and experience with other countries. Meanwhile, other Japanese experiences also extend to such areas as industrial and trade policies. But these can serve as supplementary elements to get the market mechanism working only when they are backed by certain environmental considerations, including the situation of human resources, efficiency of bureaucracy and cultural and historical background,"<sup>22</sup>

The report underlines the need for improving manpower resources and compiling "self-help" statistics considered effective for analyzing macroeconomic policies, as a way of promoting policy dialogue. Japan should promote human and information interchange with the World Bank, the report said, noting the bank has sufficient experience and know-how on global financing while Japan's experience can be reflected in development policies to be formulated by the bank in

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<sup>21</sup> Translated by the author from the same document, pp.314-315.

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<sup>22</sup> Translated by the author from the same document, pp. 316-317.

the future.

Thirdly, the report pointed to the need for a wide-ranging economic cooperation through encouraging recycle of funds into developing countries, enhancing roles of non-governmental organizations (NGO), promoting the "trinity" cooperation scheme, expanding regional cooperation and deepening public understanding.<sup>23</sup> Among these measures, regional cooperation and the trinity scheme are to draw more attention. The report mentioned that the export-led economic growth, with promotion of direct investment has been the most effective strategy for economic development in East Asia and Southeast Asia. To link this export-led economic growth strategy with the ODA is an important modality of Japanese economic cooperation. This trinity cooperation, a method based on the linkage among assistance, direct investment and imports, has been chiefly adopted in Southeast Asia. But there is the possibility of using it in other developing countries. The report said the trinity

scheme can be effective if used properly in light of cultural and historical background and natural and human resources.

The fifth five-year ODA program discussed before also called for a step that can link aid, direct investment and trade in an organic manner, for effective and efficient promotion of economic growth in developing countries. This is nothing but the trinity cooperation policy, which is designed to pursue economic growth based on export-led economic structure. The trinity scheme may be better known as the New Aid Plan (New Asian Industrial Development Plan). Its master plan was drafted for seven Asian countries in 1987. The drafted plan was developed into a more specific form of packages designed to foster particular industrial sectors in six of the seven countries.

The report said regional move toward forming economic group or cooperation is being observed in various part of the globe, including the APEC forum in the Asia-Pacific region. It stressed the need to ensure such regionalism will serve the common interest and economic growth of regions concerned and at the same time, promote open multilateral trade system. It added Japan is prepared to make a due contribution

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23 "Trinity" cooperation scheme means the combination of economic assistance, increase of trade (imports to Japan from recipient countries) and promotion of investment. A more concrete framework of this type of cooperation has been formulated and implemented under the name of New Aid Plan in Asian Countries.

to the regional cooperation.

In summary, the report made clear that Japan is willing to expand assistance both in terms of quality and quantity and provide what it learned in its experience in economic development as well as in its cooperation with Asian nations, pursue a "Japanese style" policy dialogue, extend helping hands in environmental issues and manpower areas, promote the "trinity schemes" and contribute to regional cooperation under the framework such as APEC.

These are the new approaches of Japanese international cooperation together with the four basic principle shown in the ODA outline— (1) coexistence of environment and development, (2) prevention of aid for military use, particularly as means to settle international conflicts, (3) establishment of a checking system on military spending, arms production and arms trade, and (4) democratization, shift to market economy, human rights records and guarantee of freedom.

#### Final Remarks

In this short paper, the author tried to identify, the major aspect of East Asian countries experiences in economic development that appears to be relevant for formulating a strategy of economic

development of other developing regions, especially Latin American countries, with special reference to the World Bank report on "East Asian Miracle." The author also tried to discuss the principle challenges of international cooperation, having explicitly in mind the above-mentioned relevant aspects of the East Asian experiences. Obviously, we need a more detailed comparative analysis of development process of countries of different regions, in order to get more comprehensive conclusions regarding factors which caused differences in growth and equity among East Asia, Latin America and other regions, as well as effects of economic policies adopted in these regions during their respective development process. This paper could be considered a preamble for more comprehensive and systematic comparative studies on development.