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Implications for Foreign Economic Policy of Japan and the US

by

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Ulrich Hiemenz

March 1991

Asian-Pacific Leadership: Implications for Foreign Economic Policy of Japan and the US*

1. Introduction

In the 1980s, the Western Pacific hemisphere ranging from Japan and the PR China to Australia and New Zealand has remained the growth pole of the world economy. Real per capita incomes of East and Southeast Asian developing economies grew even faster in this decade than in the 1970s [World Bank, 1990: Table 1.3] despite major disturbances in their global environment such as the world-wide recession in the early 1980s, increasing protectionism in the EC and the US, large exchange rate fluctuations, high and volatile real interest rates, and commodity price shocks. The integration into the international division of labour in manufactures was a driving force behind the favourable economic performance of Asian-Pacific economies in the 1980s. This is reflected in the growing importance of manufactures and in particular capital goods in their export basket. In 1988, about 44 per cent of all developing countries' exports originated from the Asian-Pacific region [World Bank, 1990: Table 14], and Asian NIEs and Near NIEs participated overproportionately in the expansion of highly income elastic intra-industry trade with capital goods [GATT, 1989: Table 4].

Japan and the US played a key role in stimulating economic prosperity in the Asian-Pacific region. Japan was a major supplier of capital and technology; the US provided a vast market for manufactured exports and an attractive destination for foreign direct investment. The question addressed in this paper is whether Japan and the US will remain catalysts for economic development of the Asian-

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Pacific region in the 1990s, and which foreign economic policy initiatives may be necessary by these two countries as well as by the region as a whole to ensure continued Asian-Pacific leadership in a changing world economy. Such initiatives are badly needed since the generally good prospects for the 1990s are overshadowed by a number of uncertainties and concerns:

- Severe trade imbalances of Japan, the US, Germany and some NIEs have drawn the attention of policy makers to bilateral trade imbalances. Although nonsensical from an economic point of view, bilateral trade surpluses and deficits have nonetheless equipped the protectionist lobbies with seemingly convincing arguments for more trade intervention, in particular in the US.

- It is feared that a failure of the Uruguay Round may pave the way towards more bilateralism and regionalism in world trade. A similar danger is associated with the completion of the Single European Market if the EC should attempt to facilitate structural adjustment in member countries by reducing competition from non-member countries (fortress Europe).

- The collapse of socialism in Eastern Europe could create trade diversion and a redirection of investment flows to the detriment of developing Asian economies.

- And finally, the Gulf crisis bears uncontrollable risks concerning future oil supplies, its impact on the availability and the price of capital and the long-term costs of maintaining political stability in this sensitive part of the world.

These challenges but also the economic potential associated with European integration and a recovery of Eastern Europe have to be taken into account when shaping foreign economic policies in Japan and the US as well as a closer cooperation among Asian-Pacific economies. An evaluation of different policy options will be based on an analysis of the changing economic impact of Japan and the US on the world economy in the 1980s (Section 2). In Section 3, foreign economic policies of the two countries are assessed and some suggestions are derived concerning what Japan and the US can do to support and stabilise economic development in the Asian-Pacific region and beyond. Section 4 focuses on cooperation among Asian-Pacific economies and the question whether institutional reform is needed to adequately react to the challenges of the 1990s.

2. The Changing Role of Japan and the US in the World Economy

2.1 The balance of external transactions

It is a well-known fact that the US became the most important net importer of goods and services as well as of capital in the 1980s while Japan was a major net exporter of goods and financial capital. A closer look at the respective balance of payments positions (Table 1) reveals a few interesting changes in the course of the decade. Trade balances of the US, Japan and other Asia-Pacific economies reflect the movement of the US-$ exchange rate, however, with a lag of two years. Trade balances improved in all countries except the US in the first half of the 1980s when the US currency appreciated strongly. However, they continued to improve even after the Plaza Accord in 1985 which marked the beginning of a prolonged period of a depreciating US currency. The US trade deficit peaked in 1987, and the international realignment of currencies was likewise changing the trend of trade surpluses or deficits in the other countries. In addition to Japan, Korea and Taiwan emerged as countries with trade and current account surpluses in the 1980s while Malaysia and Thailand remained net importers of capital.

The reversal of the trend in current accounts in 1987 was accompanied by a significant shift in the composition of long-term capital flows. In 1988 (not shown in Table 1) and 1989, the US were able to attract large amounts of foreign direct investment (FDI) in addition to portfolio investment which used to be almost the only source of financing the current account deficit prior to 1988. Likewise,

Table 1: Balance of Payments Data for Japan, the US and Selected Asia-Pacific Economies, 1980-1989 (in US-$ bill.)

	1980	1985	1987	1989	1980	1985	1987	1989
		US				Japan		
Current Account	1.84	-112.75	-143.70	-105.90	-10.75	49.17	87.02	56.78
Trade Balance	-25.50	-122.16	-159.49	-113.24	2.13	55.99	96.42	77.11
Long Term Capital Flows	-8.48	73.42	32.97	76.57	2.39	-63.26	-133.98	-92.36
Direct Investment	-2.30	0.96	2.69	28.99	-2.11	-5.81	-18.35	-44.91
Portfolio Investment	2.85	64.43	31.06	45.00	9.43	-41.75	-91.33	-32.62
Short Term Capital Flows	-27.43	29.86	51.99	12.32	16.49	9.73	88.61	45.81
		Korea, Rep.				Taiwan		
Current Account	-5.32	-0.89	9.85	5.16	-0.91	9.20	18.00	11.38
Trade Balance	-4.38	-19.00	7.66	4.60	0.08	11.17	20.29	16.20
Long Term Capital Flows	1.99	2.30	-8.47	-3.90	1.08	-1.02	-2.59	-7.76
Direct Investment	-0.01	0.20	0.42	0.45	0.12	0.26	0.01	-5.35
Portfolio Investment	0.04	0.98	-0.11	-0.03	0.05	-0.05	-0.37	-0.90
Short Term Capital Flows	3.98	-0.33	-0.46	1.28	1.13	-2.14	12.98	-4.37
		Malaysia				Thailand		
Current Account	-0.29	-0.61	2.63	-0.15	-2.07	-1.54	-0.37	-2.46
Trade Balance	2.41	3.58	5.84	3.78	-1.90	-1.33	-0.42	-2.95
Long Term Capital Flows	1.02	1.58	-0.53	0.83	2.11	1.64	0.60	4.25
Direct Investment	0.93	0.70	0.42	1.85	0.19	0.16	0.18	1.65
Portfolio Investment	-0.01	0.34	-0.95	-0.16	0.10	0.90	0.35	1.47
Short Term Capital Flows	0.41	0.35	-0.99	0.30	-0.06	-0.10	0.46	2.29

Source: IMF, International Financial Statistics, various issues.

Japan and Taiwan, the major long term capital suppliers in the region, significantly increased the share of FDI in net outflows in the late 1980s. In fact, Taiwan emerged as a major foreign investor for the first time in the country's economic history. In Japan, on the other hand, long term capital outflows were partly offset by a large annual volume of short-term borrowing.

These observations suggest a number of conclusions on the role of the US and Japan in the world economy. After stimulating the expansion of world trade by accepting large and increasing trade deficits in the first half of the 1980s, the US became more competitive in terms of exports and more attractive for international risk capital. There are two obvious explanations for this shift. Firstly, the depreciation of the US currency improved the competitiveness of US exports and rendered goods production in the US more profitable than exporting to the US. And secondly, FDI inflows to the US coincide with the resurgence of protectionist thinking in the US Congress (301 legislation in 1988) and the resulting threat of increased trade barriers, especially against potent suppliers from the Asian-Pacific region [for details, see Tucker, 1991].

Japan has increasingly performed the function of international financial intermediation, lending long and borrowing short [Arndt, 1990]. The shift toward FDI reflects both a changing attitude towards the US and new prospects associated with the EC decision to establish a common market by 1993 which was launched with the EC White Paper in 1985 and ratified with the Single European Act in 1987. As in the case of the US, the perceived threat of increasing EC protectionism to facilitate structural adjustment towards a common market is likely to have stimulated Japanese investment and that of other advanced Asian-Pacific economies in the EC as a replacement for exports. This raises the question to which extent developments in the US and Japan have weakened or strengthened Asia-Pacific economic integration.

2.2 The direction of trade and capital flows

Export flows by destination (Table 2) sharply mirror exchange rate changes. Until the mid-1980s, Japanese (and EC) exports to the US increased steeply at the expense of exports to developing countries (including those in Asia) and the EC. In 1985, 37.6 per cent of total Japanese exports went to the US, compared to about 14 per cent to Europe (EC and EFTA) and almost 26 per cent to developing Asian countries. The US had focused exports much more on Europe which accounted for a bit over 25 per cent of the total. The shares of Japan and developing Asia were 10.5 and about 13 per cent, respectively.

The regional pattern of export destinations altered significantly with the currency realignment and the approach to the European Single Market. Japan's exports to the US market declined, and the country exported more to the EC and the EFTA while trade with the group of developing countries declined throughout the 1980s. Comparing 1980 and 1989, Japan exported more to industrialised countries with the US and Europe as prime targets, accounting for 34 and 20.4 per cent of total 1989 exports, respectively. However, this trend did not loosen Japanese trade relations with other Asian economies which also gained in importance both as export destination and source of imports (bottom part of Table 2).

Concerning the US, the share of exports to Japan and Europe increased after 1985, and so did the share of exports to developing Asia. In terms of trade directions, the US obviously reduced their Atlantic engagement (i.e. trade with the EC and the EFTA) in favour of trade relations with the Pacific in the 1980s. Exports to Europe amounting to almost 30 per cent of the total in 1980 declined to roughly 27 per cent, but exports to Japan and developing Asia increased from 22 per cent in 1980 to almost 28 per cent in 1989. This trend is even more pronounced when sources of imports are considered (bottom of Table 2) where Asia and Japan accounted for 39 per cent of total US imports in 1989 (up from slightly over 26 per cent in 1980) while the share of Europe increased from 19 per cent in 1980

Table 2: Inter Regional Trade Flows - Exports and Imports, 1980-1989 (in per cent of total trade)

Exports of to	OECD-Total 1980	1985	1987	1988	1989	EC-12 1980	1985	1987	1988	1989	US 1980	1985	1987	1988	1989	Japan 1980	1985	1987	1988	1989
USA	9.5	16.7	14.8	13.9	12.9	5.5	10.1	8.7	7.9	7.7						24.4	37.6	36.8	34.1	34.0
Japan	3.1	3.4	3.4	4.0	4.0	1.0	1.2	1.6	1.9	2.1	9.6	10.5	11.0	11.9	12.3					
EC-12	42.7	39.0	44.1	44.2	47.3	55.4	54.7	58.7	59.5	62.5	26.2	22.7	23.4	23.4	23.8	13.9	11.9	16.6	17.8	17.5
EFTA	8.2	7.1	8.3	8.0	7.6	10.9	10.0	10.9	10.7	9.7	3.1	2.5	2.5	2.6	3.1	2.5	2.2	3.1	3.2	2.9
CMEA	3.4	2.7	2.2	2.2	2.2	3.4	2.8	2.3	2.3	2.2	1.8	1.6	0.9	1.2	1.5	2.8	1.9	1.4	1.5	1.4
DCs	26.0	23.0	19.8	20.8	19.4	20.0	17.5	14.3	12.5	13.0	39.6	35.1	33.2	34.7	34.6	50.9	39.6	36.5	37.8	38.1
Asia	7.5	8.9	8.7	9.8	9.1	3.0	4.1	4.1	4.5	3.9	12.4	13.1	13.6	14.8	15.5	27.5	25.9	26.6	28.5	29.4
South Asia	0.9	1.1	1.0	0.9	0.8	0.8	1.0	1.0	0.9	0.7	1.2	1.3	1.0	1.1	1.0	1.7	1.8	1.6	1.2	1.1
ASEAN	2.7	2.4	2.3	2.6	2.8	1.1	1.2	1.1	1.2	1.2	4.1	3.7	3.9	4.0	4.4	10.1	6.4	6.8	8.1	9.4
PR China	1.1	2.0	1.2	1.3	1.0	0.4	0.8	0.7	0.6	0.5	1.8	1.8	1.4	1.6	1.6	3.9	7.1	3.6	3.6	3.1
NIEs	2.8	3.4	4.2	5.0	4.5	0.8	1.1	1.4	1.7	1.5	5.2	6.1	7.3	8.0	8.6	11.8	10.6	14.6	15.7	15.8

Imports of from	OECD-Total 1980	1985	1987	1988	1989	EC-12 1980	1985	1987	1988	1989	US 1980	1985	1987	1988	1989	Japan 1980	1985	1987	1988	1989
USA	10.3	10.7	9.6	10.4	11.1	8.3	8.0	7.0	7.4	8.9						17.5	20.3	21.7	22.6	23.0
Japan	4.6	8.1	8.4	8.1	7.6	2.6	3.4	4.4	4.5	4.7	13.1	20.2	20.9	20.4	19.8					
EC-12	37.0	37.0	42.8	42.6	43.7	48.6	52.5	58.0	58.1	58.5	15.8	19.9	20.0	19.3	18.0	5.8	6.9	11.9	12.9	13.4
EFTA	6.5	6.5	7.5	7.6	7.1	8.0	9.0	9.8	9.8	8.9	3.2	3.1	3.1	3.1	3.0	1.2	1.6	2.3	3.2	3.2
CMEA	3.0	2.7	2.2	2.2	2.1	3.6	3.7	2.8	2.6	2.5	0.6	0.6	0.5	0.5	0.4	1.5	1.2	1.6	1.8	1.8
DCs	31.8	26.6	22.6	22.2	21.7	24.5	19.9	15.1	12.5	14.0	49.5	36.0	37.5	37.2	38.8	64.9	59.6	52.3	48.3	47.9
Asia	7.6	9.7	11.3	10.7	10.2	3.5	3.8	4.9	5.0	5.6	13.2	17.0	20.0	20.0	19.2	25.7	28.1	31.4	30.0	29.7
South Asia	0.5	0.7	0.7	0.6	0.6	0.5	0.6	0.6	0.6	0.5	0.6	0.9	1.0	0.8	0.8	0.9	1.4	1.5	1.3	1.2
ASEAN	3.6	3.4	2.9	3.0	3.1	1.2	1.2	1.3	1.3	2.1	5.3	4.4	4.3	4.7	4.5	17.5	15.1	13.4	11.4	11.7
PR China	0.6	1.1	1.2	1.4	1.5	0.4	0.4	0.6	0.8	0.7	0.5	1.2	1.6	1.9	2.5	3.1	5.1	5.1	5.3	5.3
NIEs	2.7	4.6	6.4	5.7	5.0	1.5	1.5	2.4	2.4	2.2	6.8	10.5	13.2	12.6	11.4	4.2	6.5	11.5	12.1	11.5

NOTE: EC-12 = Belgium, Luxembourg, Denmark, France, FRG, Greece, Ireland, Italy, Netherlands, Portugal, Spain, UK; EFTA = Austria, Finland, Iceland, Norway, Sweden, Switzerland; CMEA = USSR, GDR, Poland, CSFR, Hungary, Romania, Bulgaria.

Source: OECD, Foreign Trade by Commodities, Series C, Paris, various issues. - EUROSTAT, Foreign Trade Statistics, Countries by Products, Microfishes SCE - 2311. - OECD, Monthly Statistics of Foreign Trade, October 1990, Department of Economic and Statistics.

to merely 21 per cent in 1989. The loosers were the debt-ridden Latinamerican countries (not shown in Table 2) which suffered from significantly declining market shares in the US.

The data presented in Table 2 indicate a trend toward closer economic interaction among industrialised countries at the expense of developing countries. This tendency was even stronger when the regional pattern of FDI is considered. Alworth and Turner [1990: Table 6] showed that the share of developing countries in total FDI flows declined from an average of 31.2 per cent in 1980-1984 to only 6.8 per cent in 1989. Data from major home countries of foreign investors (Table 3) support this finding. In particular Japan (and the UK) has focused on the US and the EC as the most important destinations for FDI in the 1980s while US investors increased their already substantial engagement in the EC and almost doubled their FDI stocks in Japan. It is noteworthy, though, that the Asian share in US FDI did also increase in the 1980s and Asia remained the second most important destination for Japanese foreign investors.

The evidence reviewed so far does not lend much support to the conventional wisdom of the emergence of trading blocs in the world economy. Trade and investment flows rather suggest the development of closer economic links between the major industrialised countries with Asian developing countries becoming increasingly integrated into the division of labour among industrialised countries. This conclusion does not only apply to the economic exchange between these countries and Japan or the US but also to Europe. The EC remained the second most important market for East and Southeast Asian exports to OECD countries in general and for manufactured exports in particular (Table 4). If there is a missing link, it is the insufficient presence of European investors in Asia-Pacific [Hiemenz, Langhammer et al., 1987].

Independent of this general finding it has to be acknowledged that Japan developed from a regional to an international economic power in the 1980s without significantly loosening ties with the region. The US, on the other hand, became a very important coun-

Table 3: FDI Stocks by Home and Host Countries/Regions, 1980 and 1988 (in per cent)

	US		Japan		Germany, FR		UK	
	1980	1988	1980	1988	1980	1988	1981[a]	1987
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Industrialised Countries	73.6	75.1	45.7	61.4	82.8	89.1	57.2	84.0
US			24.8	38.8	20.9	29.8	28.0	35.3
Japan	2.9	5.2			1.3	2.1	0.7	1.1
EC-12	37.4	38.7	11.1	15.0	36.8	39.6	20.7	27.9
Developing Countries	24.7	23.5	53.8	38.5	17.1	12.4	21.8	16.0
Asia[b]	3.8	5.5	27.0	17.3	2.1	2.2	8.3	5.6
South Asia	0.2	0.1	0.1	0.1	0.3	0.3	1.5	0.6
ASEAN	2.2	3.0	19.6	10.0	1.2	1.0	3.9	2.8
PR China			0.1	1.1		0.1		
NIEs	1.4	2.4	7.3	6.1	0.6	0.8	2.9	2.2

[a]Excluding oil companies, banks and insurance companies. - [b]Sum of South Asia, ASEAN, PR China, NIEs.

Source: Die Kapitalverflechtung der Unternehmen mit dem Ausland nach Ländern und Wirtschaftszweigen, Beilage zu "Statistische Beiheft zu den Monatsberichten der Deutschen Bundesbank", Reihe 3, Zahlungsbilanzstatistik, various issues. - Business Monitor, Census of overseas assets, Central Statistical Office, a publication of the Government of Statistical Service, various issues. - US, Department of Commerce, Survey of Current Business, various issues. - Japan, Ministry of Finance, Zaisei Kingu Tokei Geppo (Monetary and Financial Statistics Monthly), various issues.

Table 4: Regional Distribution of Developing Countries' Exports to OECD Countries, 1980-1989 (in per cent of total exports)

Exports to	EC-12					US					Japan				
from	1980	1985	1987	1988	1989	1980	1985	1987	1988	1989	1980	1985	1987	1988	1989
Total Exports															
Developing countries	43.0	36.0	34.7	30.0	36.6	28.3	35.4	38.4	36.0	35.1	20.7	20.8	18.5	19.9	19.3
Asia	26.2	18.6	22.6	24.9	30.8	31.6	45.7	41.3	40.0	37.0	34.6	26.8	22.4	25.6	25.4
South Asia	51.2	38.9	42.4	52.1	46.9	21.5	35.4	31.9	28.2	27.2	17.7	18.2	17.1	19.5	18.2
ASEAN	18.4	17.4	22.6	23.3	39.2	26.5	33.4	33.8	33.7	28.8	49.0	41.3	36.7	34.5	33.3
PR China	30.8	20.2	26.3	28.8	27.6	13.0	28.8	31.1	29.8	33.0	48.5	44.2	33.2	34.5	30.7
NIEs	30.3	16.1	19.6	21.9	24.9	44.7	60.4	47.7	47.1	44.3	15.5	13.2	14.4	19.3	19.9
Exports of Manufactures															
Developing countries	39.1	24.9	29.2			43.8	58.2	52.0			8.9	7.2	9.0		
Asia	35.0	21.0	26.3			43.8	59.9	52.7			10.8	8.9	11.0		
South Asia	55.3	41.4	46.0			26.9	40.1	34.9			6.2	9.3	9.4		
ASEAN	33.3	25.2	29.0			48.2	60.0	54.1			8.8	6.8	8.9		
PR China	40.1	25.3	29.2			20.9	41.2	41.1			24.7	22.5	17.9		
NIEs	32.1	17.3	23.3			47.4	64.0	55.8			10.5	7.7	10.7		

NOTE: Manufactures = SITC 5 + 6 + 7 + 8 without 67 + 68; EC-12 = Belgium, Luxembourg, Denmark, France, FRG, Greece, Ireland, Italy, Netherlands, Portugal, Spain, UK; EFTA = Austria, Finland, Iceland, Norway, Sweden, Switzerland; CMEA = USSR, GDR, Poland, CSFR, Hungary, Romania, Bulgaria.

Source: OECD, Foreign Trade by Commodities, Series C, Paris, various issues. - EUROSTAT, Foreign Trade Statistics,Countries by Products, Microfiche SCE-2311. - OECD, Monthly Statistics of Foreign Trade, October 1990, Department of Economics and Statistics.

terpart in the Asian-Pacific division of labour without sacrificing economic interests across the Atlantic. This proves once more that participation in world trade and international capital markets is not a zero-sum game where intensified economic relations with one region automatically reduce the importance of others.

2.3 Japan, the US, and Asia-Pacific integration

The preceding analysis suggests a changing role of Japan and the US in Asian-Pacific integration in the 1980s. In the first half of the decade, regional economic development was enhanced because the US provided the markets for a rapid expansion of manufactured exports and Japan acted as a financial intermediary for the whole region and in particular the US. Export dependence on the US lessened in the second half of the decade in favour of closer trade ties to Japan (and the EC). An additional stimulus was derived from a deepening subdivision of labour within the region. High income growth, the realignment of exchange rates, China's open door policy, and restructuring of Asian economies had provided new opportunities for intra-regional specialisation which led to rapidly expanding trade between Asian NIEs and Japan, among the NIEs themselves, and between NIEs and Southeast Asian countries [Kwan, 1990: 60 sqq.; ADO, 1990: 30 sqq.]. Trade expansion was facilitated and encouraged by a North-South migration of capital which contributed to the globalisation of production within the region and to more intra-industry trade in manufactures [e.g. Langhammer, 1989].

In the 1990s, Asian-Pacific economies should be able to benefit from the greater regional dispersion of external economic relations achieved in the past decade. Expanding intra-regional trade and increasing exports to Europe provide a buffer for declining export opportunities in US markets. In the short term, slackening demand due to the US recession can be balanced by the still robust growth performance of Japan and many European economies. In the medium term, an intensified globalisation of production with partners from both within and beyond the region offers chances for continued trade-driven economic development. Such chances will, however, not be exploited automatically. Japan has only recently become a major market for manufactured exports; there are strong protectionist sentiments in the US; and trade barriers among developing Asian countries are still high. The question is, therefore, which policy actions are required by Japan and the US as well as possibly the Asian-Pacific community as a whole to reap the potential benefits of closer trade integration. First clues in the latter respect can be derived from an analysis of economic integration in Asia-Pacific as it has emerged in the past decade.

The Kiel Institute of World Economics has undertaken a series of studies on the development and determinants of economic subregions in Asia-Pacific covering the 1981-1987 period. Economic subregions were defined as comprising countries with above-average bilateral trade relations. Hierarchical cluster analysis shows that three such subregions can be identified [Amelung, 1990a]. The four ASEAN countries Indonesia, Malaysia, Singapore, and Thailand; a North-Pacific group including the PR China, Hong Kong, South Korea, Taiwan as well as Japan and the US; and Australia, New Zealand, and Papua New Guinea as a third economic subregion. In this latter case trade integration was definitely stimulated by the Australia-New Zealand free trade agreement concluded in 1965. Institutional integration could also have played an important role for intensified trade relations among the four ASEAN countries while North-Pacific integration must have been driven by market forces and unilateral policy changes such as the opening up of the PR China and trade liberalisation in Japan, Korea, and Taiwan.

This experience suggests that institutional arrangements are not a necessary precondition for trade integration. A closer scrutinity of ASEAN shows, furthermore, that progress in mutual trade relations was not achieved due to trade preferences or industrial cooperation but to other factors [Langhammer, Hiemenz, 1990: 54 sqq.]. Tariff preferences did not play a significant role in intra-ASEAN trade, and it is very unlikely that this will change in the future. This assessment is first witnessed by the fact that no regular statistical record on the amount of intra-ASEAN trade receiving preferences exists. An approximate information referring to intra-regional exports supported by rules-of-origin certificates suggests that this trade had amounted to only US $ 45 mill. in 1982 [Chng, 1985: p. 33], that is 1 per cent of total intra-ASEAN non-oil exports. The overwhelming part of intra-ASEAN trade occurs either in primary commodities not eligible for preferential treatment, or in entrepôt trade, or in manufactures which do not meet rules of origin requirements [Rieger, 1985]. This is hardly surprising since it is doubtful whether tariff barriers are really an important impediment to intra-ASEAN trade. Recent empirical evidence has supported the view that there is much water in legal tariff rates [Langhammer, 1988] and that NTBs are looked upon as the more relevant obstacles to trade by ASEAN traders [Sanchez, 1987].

Institutional integration in a wider sense has, nonetheless, contributed to the expansion of intra-ASEAN trade. ASEAN member countries shared common views on the principles of a division of labour between the private and the public sector. Basically, all ASEAN member countries are efficiency-oriented and perceive market forces as the driving element of development [Hughes, 1989]. This common approach to economic policy making made integration beneficial in at least two respects. First, ASEAN member countries have established a strong internal network of consultations and software cooperation without surrendering national sovereignty in major economic policies. Software cooperation, e.g. in science and technology, culture and information, social development, and sectoral policies, is institutionally channelled through respective ASEAN committees and has received increasing attention in recent years [ASEAN, 1988]. This network contributed to lower costs of information for trading partners and made national policies more predictable for neighbouring countries. And secondly, ASEAN countries spoke with one voice in foreign policy matters and in international economic negotiations. As a group, they are engaged in a permanent dialogue with the major OECD countries on market accessibility and achieved some success in raising their collective bargaining power, e.g. in negotiations with the EC on the Generalised System of Preferences (GSP) and the Multi Fibre Agreement (MFA) [Langhammer, 1985].

Analyses on the determinants of trade integration suggest that the ASEAN experience can be generalised in so far as intensive trade relations do not only depend on differences in factor endowments, transportation costs and trade barriers, but on total transaction costs associated with importing or exporting to/from a particular partner country [Amelung, 1990b]. Transaction costs essentially comprise procurement of information, marketing, payments modalities, and a risk element. These costs are lower in the case of well established trading partners than for new markets; among culturally homogenuous groups than for inter-cultural relationships; and when exchange rates to not fluctuate heavily between countries. Furthermore, transaction costs depend on the stage of integration of the services' sector and in particular the ease with which capital can be transferred across borders [Langhammer, 1991]. In the ASEAN group, transaction costs were lowered through the emergence of Singapore as a regional trading and services center and the software cooperation among member countries. In the North-Pacific it was unilateral policy action such as the partial liberalisation of goods and services trade which served the same purpose of reducing transaction costs and thereby stimulating trade integration. These findings contain the important lesson that trade expansion depends on a wide range of interlinked influences and not just on discriminatory trade preferences. This should be taken into account when designing foreign economic policies in the Asian-Pacific region.

3. Foreign Economic Policy of Japan and the US in the 1990s

Forecasts of economic development in the 1990s confirm continued Asian-Pacific leadership in the world economy (Table 5). Both World Bank and Nomura projections suggest that Japan and the US can expand economic activities at a pace comparable to the 1980s while per capita income growth in the developing Asian countries is likely to slow down a bit on average, but to remain by far in excess of economic growth in other regions of the world. On the whole, the Nomura Research Institute is considerably more optimistic about future prospects for economic growth in Asia-Pacific than the World Bank,

Table 5: Growth of Real Per Capita Income, 1980-2000 (in per cent per year)

Region	Annual average rate of growth 1980-1989		1990-2000[a]	
	W[b]	N[c]	W[b]	N[c]
World		3.0		3.2
Industrialised countries	2.5		2.6	
Japan		4.3		4.0
US		2.8		2.5
Developing countries	2.3		3.2	
East and Southeast Asia	6.7		5.1	
Asian NIEs[d]		8.3		7.3
ASEAN[e]		5.0		7.1
PR China	8.7	8.3	5.4	7.6

[a]Projections. - [b]W = World Bank. - [c]N = Nomura Research Institute. - [d]South Korea, Taiwan, Hong Kong, Singapore. - [e]Excluding Singapore.

Source: World Bank, 1990: Table 1.3; Kwan, 1990: Table 1.

but both estimates rest on the assumptions that Japan can increasingly absorb exports from the region to balance trade frictions with the US while the intra-regional division of labour intensifies [World Bank, 1990: 18; Kwan, 1990: Figure 1 and p. 68]. The subsequent sections attempt to assess the validity of these assumptions and to highlight some foreign economic policy actions that may be required to promote Asian-Pacific integration.

3.1 Unilateral policy initiatives - Japan

In the 1980s, the main preoccupation of Japanese foreign economic policy was placed on the evasion and relaxation of trade conflicts with industrialised countries, in particular the US [for details, see Yamazawa, Hirata, Urata, 1991]. In dealing with these conflicts, the stance of Japanese government appears to have been fluctuating between bilateral and multilateral solutions, perhaps in response to the demands of the US counterpart. In the various voluntary export restraint negotiations, for example, agreements were reached clearly bilaterally, although they do not openly violate GATT rules. The semi-conductor arrangement under the market oriented sector specific (MOSS) talks is an interesting example, in which the Japanese government is believed to have conceded a share of 20 per cent to the United States in the countries' domestic market.

However, the main measures of Japan to cope with the situation have been import liberalisation and easier market access under the most favoured nation (MFN) principle. The liberalisation efforts through reductions of tariffs and relaxation of import controls including import procedures have been by no means marginal. Structural change in the Japanese economy also contributed to lessen trade imbalance. A clear shift towards more emphasis on domestic consumption was observed. Together with the rapid and large appreciation of the yen since 1985, imports, especially manufactured imports started to grow faster than exports. The import/GDP ratio in constant prices showed a steady increase in the second half of the 1980s, but was still much lower than in other industrialised countries, especially with respect to manufactured imports [5.5 per cent in 1988 compared to an OECD average of 21.5 per cent (1987); Yamazawa, Hirata, Urata, 1991: Table 4]. Import expansion has mainly benefitted Asian NIEs and to some degree also the PR China.

Japan's import regime in the formal sense is one of the most open among industrialised countries. The number of quantitative restrictions is small and declining, although there still remain tight controls on some agricultural commodities. Tariff rates are also generally low, especially on manufactured imports. The main trade barriers appear to arise from structural impediments and institutional arrangements as is evident from the SII talks between Japan and the US.

The distribution system in Japan is often pointed out as an import impediment. Statistical evidence suggests that productivity and efficiency of Japan's wholesale and retail outlets are at a level comparable to most industrialised countries, in spite of their multi-layered features. Some aspects of the distribution system are, however, undoubtedly limiting imports. First, 'keiretsu' or company groups favour local producers of parts and components over overseas suppliers. And secondly, the 'Large-Scale Retail Store Law' is a clear institutional trade barrier, under which establishment and enlargement of department stores and supermarkets are controled. Since large stores are instrumental in increasing imports of consumer goods, tight entry regulations inevitably work against import expansion.

Trade policies specifically aimed at developing countries are few in Japan, with the Generalized System of Preferences (GSP) as the only major exception. Japan does not participate in any regional free trade areas or extends special trade preferences to any group of countries. However, some policies, by their nature or coverage, affect developing countries more than other countries. Tariff discrimination between rather homogenous products (e.g. coniferous and tropical plywood) and tariff escalation led to trade conflicts. Yet, such conflicts were mainly caused by structural reasons, namely the one-way dependence of Asian developing countries on imports of capital and intermediate goods from Japan. Growth of production in these countries tends to induce imports from Japan, while Japan depends on these countries primarily with respect to natural resources. As a consequence, economic development is likely to bring about larger imports from Japan than exports to Japan. The Korean bilateral trade deficit vis-à-vis Japan increased rather than decreased despite the rapid yen appreciation, although the exchange rate change largely contributed to Korea's overall export expansion because of its effect on strengthening the Korean price-competitiveness.

These observations suggest a number of unilateral initiatives which the Japanese government can take to support trade expansion and economic development in the Asian-Pacific region. There is obviously scope for liberalising trade in agricultural products, a dismantling of tariff discrimination and escalation, as well as some improvements of the GSP [Yamazawa, 1988]. In addition, the government should not abide to newly emerging protectionist demands. Industries with declining competitiveness, textiles in particular, have been feeling the pressure of imports from developing countries. Quantitative import restrictions under the umbrella of the MFA are strongly advocated. To date, the Japanese government has only conceded minimal protection, but the voluntary export restraint agreement on knitwears with Korea may prove to be the forerunner of further protectionist moves.

More important promotion measures do, however, not relate to trade policies but to the removal of structural and institutional impediments. Continued adjustment of industrial production structures to changing comparative advantages, increased competition in the distribution system, and a relaxation of zoning regulations top the agenda, although none of these measures are likely to have a short-term effect on import growth. Therefore, it would be a dangerous illusion to believe that Japanese markets could assume a locomotive function for continued export-led growth of the whole Asia-Pacific region. To sustain the past growth record, the region will not only have to maintain but to intensify trade relations with other regions in the world, in particular Europe.

Japan will have to play an important role in this process. Having turned from a predominantly regional to an international power, Japan can serve as a catalyst for a further 'internationalisation' of the whole region. As far as financial markets are concerned, the country has already acted as an international financial intermediary. Likewise, it was shown that Japanese FDI is no longer biased in favour of neighbouring countries in the region but spreads more evenly across developing and industrialised regions. This globalisation of Japanese financial and investment activities provides an international network of information and services which other countries of the region can tap to reduce their transaction costs in trade relations with partners both inside and outside the region. On the basis of her own experience, Japan can also offer assistance to neighbouring countries on how to promote the globalisation of their international relations. Some institutional and other preconditions for facilitating such a cooperation among Asian-Pacific economies will be discussed in Section 4.

3.2 Unilateral policy initiatives - the US

The US trade policy stance is characterised by a two-track approach. While the US administration emphasises MFN treatment in multilateral negotiations, the US trade act has always contained a bias towards bilateralism. This inclination to solve trade conflicts on a bilateral or plurilateral basis became stronger in the 1980s when the trade balance deteriorated and bilateral trade deficits attracted the attention of policy makers. The 1988 trade act with its sharpened section 301 legislation puts pressure on the executive branch to vigorously pursue bilateral negotiations to liberalise foreign markets supported by threats of trade sanctions [for details, see Tucker, 1991: Chapter 5). Although such negotiations were actually started with only three countries (Japan, Brazil, India), the legislation has induced a number of other countries such as Korea and Taiwan to grant unilateral concessions in order to escape an identification under section 301.

Another aspect of bilateralism inherent in US trade promotion policies concerns the membership in actually implemented or envisaged free trade areas (FTA). The US-Canada FTA with its planned extension to Mexico and the Caribbean Basin Initiative (CBI) suggests an attempt to create a North American trading bloc as a countervailing force to European integration. President Bush's Enterprise of the Americas Initiative launched in July 1990, appears to be a further step in this direction. It invites Latinamerican countries to enter into bilateral negotiations with the US concerning trade preferences up to the level of FTA, liberalisation of capital and investment flows and solutions for debt problems. The underlying rationale of all these preferential arrangements is to promote US exports although it has to be acknowledged that partner countries can benefit from easier access to US markets and from an inflow of US capital. Such benefits must, however, remain limited since most partner countries were covered by the GSP, and US FDI focused on industrialised rather than on developing countries as was shown above.

The multilateral aspect of US trade policies includes primarily the push towards a liberalisation of trade in agricultural products and services in the framework of the Uruguay Round as well as the attempt to include TRIPS and TRIMS in the GATT code. At the same time, the US has increasingly protected domestic producers against foreign competition. In addition to the long-standing agricultural protectionism and trade restrictions under the umbrella of the MFA, new non-tariff barriers were erected against imports of e.g. steel, passenger cars, machine tools, footwear, and semiconductors. Many of these barriers were specifically targeted against exporters from developing countries in Asia [Tucker, 1991: Chapter 3].

From an economic viewpoint, the two-track approach of the US appears to be inconsistent and doubtful. Trade and investment agreements with economically rather weak partners on the American continent are likely to create more trade diversion than trade expansion. The highly indebted countries of this region will hardly be able to absorb a substantially larger volume of US exports for many years to come even if some alleviation of their debt burden could be negotiated. Furthermore, the US runs the danger of invalidating their own GATT initiatives because bilateral arrangements raise suspicion among other negotiating parties about the true intentions of the US. And finally, rapid economic growth in the Asian-Pacific region provides a much more promising market for US exports, and it would make more economic sense for the US to actively engage in improving market access in this region [for a similar reasoning, see Krause, 1990: 15].

In terms of policy conclusions, the above observations suggest that it would be in the best self-interest of the US to reduce trade frictions by domestic adjustment rather than by a network of trade preferences. Domestic adjustment does not only mean a reduction of the budget deficit which makes the US dependent on unsustainable capital inflows, but also an adjustment of production structures to improve the international competitiveness of US exports in all foreign markets. Concerning trade negotiations, the multilateral approach appears as more credible and more promising and should, therefore, dominate trade related policy initiatives of the US in the 1990s. A stronger push towards world-wide trade liberalisation should be supported by a unilateral liberalisation of US import markets which would in turn facilitate structural adjustment and reduce the incentive to circumvent entry barriers by foreign direct investment. Such a basic foreign economic policy orientation would, however, not preclude a closer economic cooperation with Asian-Pacific economies with the aim of reducing transaction costs for trade in both directions. In particular Japan, but also the NIEs and ASEAN, can become important partners in multilateral negotiations if the region and the US succeed to resolve mutual trade disputes in an MFN fashion, i.e. without resorting to preferential agreements or bilateral economic pressure. Most importantly, the US has to seek agreement with Japan over bilateral trade frictions so that both countries can join forces against perceived protectionist threats in Europe and elsewhere. Continued growth of demand which would provide the scope for expanding US manufactured exports requires improved trade relations among all partners and not just on a bilateral basis.

4. Asia-Pacific Integration in the 1990s

If economic cooperation can further Asian-Pacific leadership in the world economy questions arise concerning the substance and the form of this cooperation. There are a number of regional cooperation bodies which differ in focus and country coverage [for details, see Kim, 1990], such as the Pacific Economic Cooperation Conference (PECC), the Pacific Basin Economic Council (PBEC) and the Asia-Pacific Economic Cooperation Conference (APEC). The most recent offspring of the desire to enhance regional economic integration concerns Malaysia's far-reaching proposal to form an East Asian Economic Grouping (EAEG). This proposal envisages the establishment of a regional trading bloc, i.e. an East Asian FTA, 'to counter the emergence of protectionism and regionalism in world trade' as Prime Minister Mahathir pointed out.

It remains a mystery how regionalism can be defeated by regionalism and why a stronger inward-orientation of the Asian-Pacific region should be an economically viable alternative to the present integration into the international division of labour. The lessons from the ASEAN experience as well as from countless other attempts to forge preferential trading arrangements among developing countries are clear-cut [Langhammer, Hiemenz, 1990: Part E): If member countries of trade integration schemes have achieved sustained economic growth and social development they were successful not because but in spite of trade integration which has at best promoted trade diversion and a prolonged process of inefficient regional import substitution. In most integration schemes, however, trade preferences were either not actually implemented or covered only an insignificant part of intra-regional trade as in the ASEAN case. There are many external and internal reasons for the failure of regional trading schemes, but the empirical evidence suggests on balance that the perceived benefits of trade integration among partners with widely differing levels of development were too small to encourage especially the economically weaker partners to open up their markets.

Against this background, the formation of a discriminatory trading bloc cannot be recommended for the Asian-Pacific region [for a similar conclusion, see Chen, 1990, and Drysdale, 1990]. Continued rapid economic growth requires a further globalisation of production on the basis of structural adjustment in individual economies as well as global market access. Insofar, there is a high degree of consistency between regional and international economic policy objectives. To achieve these objectives, intra-regional economic ties would have to be strengthened and the extra-regional negotiating power enhanced. It is suggested, therefore, that Asian-Pacific economies form a liberalisation club with Japan and the US serving as catalysts for intra-regional and international policy coordination. Such a club should - in contrast to APEC - comprise at least all major countries of the region, in particular the PR China, and it should be open to new members from within (such as Vietnam and other former communist countries) and outside the region (e.g. in Latinamerica). The club would provide a lively example of the huge benefits a free flow of goods and factor of production across borders can generate and, thus, invite imitation and participation by other countries.

The rationale behind this proposal is built on past experience. Market integration and specialisation within the region and with other regions can be promoted by reducing transaction costs. Promising avenues are an improved flow of information among countries, increased transparency of economic policy making, lower barriers of access to goods and capital markets, as well as a dialogue about macro-economic policies to reduce exchange rate fluctuations. At the practical level, there is plenty of scope for joint policy initiatives to improve the framework for regional integration through market forces. Concerning information, regional telecommunication networks need to be expanded and the economic data base enlarged, particularly with respect to capital and investment flows. To facilitate these flows, capital market regulations should be dismantled and investment approvals harmonised. Furthermore, the less developed countries of the region could cooperate in human resource development and the provision of adequate educational facilities. Another area for cooperation is related to securing the energy supply for the countries in the region, and there is also a need to develop joint environmental policies so that economic progress does not disrupt the ecological balance or destroy marine resources. And finally, consultative mechanisms should be developed through which governments increase the transparency of their monetary and exchange rate policies and discuss trade liberalisation measures.

Many of these issues are already on the agenda of APEC [APEC, 1990] or other regional institutions. Given the wide range of different topics and the varying relevance of different topics for individual countries, it does neither appear necessary nor advisable to set up a comprehensive regional institution comparable to the EC. Any such attempt would consume a lot of time and energy which could be put to better use when targeted at solving actual regional problems. Rather, countries should get together in problem-oriented working parties which are open to all countries interested in cooperating. In this respect, Japan and the US can play a pivotal role by initiating and supporting such working parties.

Regional economic cooperation should, however, not be limited to intra-regional issues; it should include consultations about the negotiating stance of the region in multilateral economic negotiations. A united and firm opposition of the Asian-Pacific economies against a resurgence of protectionism can be a powerful safeguard against an erosion of an open international trading and investment environment. Both, the European integration and the collapse of socialism in Eastern Europe open up tremendous trade and investment opportunities [Hiemenz, 1991] which can hardly be exploited if the region does not close ranks with the US and increasingly assumes responsibility for maintaining a liberal world trading system. This does not only apply to the current GATT negotiations but also to other international institutions such as IMF, World Bank or OECD. To serve this purpose, Japan should extend the leadership role the country has already assumed e.g. in the Asian Development Bank or the OECD to other international economic policy bodies such as the IMF and the World Bank. And secondly, as the NIEs catch up they cannot expect to hold on to developing country status, either in bilateral or multilateral negotiations. It is now widely recognised that the GATT did great harm to developing countries by excusing them from the normal responsibilities of GATT membership. For the NIEs, the GSP probably had a negative impact because of the high administrative costs for the government and private firms. Therefore, graduation within the GATT and the International Monetary Fund framework has now become a major issue for the NIEs. This might be followed by entry into the OECD with concomitant adherence to OECD rules of conduct. Such a stance would cap the remarkable progress of the NIEs and strengthen the international impact of Asian-Pacific economies.

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