Chapter X

Intensifying Competition for a More Sophisticated Industrial System — Some Suggested Solutions

1. The Search for Industrial Restructuring

As we have seen in the preceding chapters, most of the nine Asian economies are now suffering from such new problems as (1) stagnation in industries that are the main engines for growth, (2) declining exports, (3) a reduced rate of growth, (4) increasing current account and public finance sector deficits, and (5) financial instability. The most significant cause of the slackening in economic growth in 1996 was sluggish growth in the export of manufactured goods, this sluggish growth being in turn due to reduced demand from developed countries, a decline in the comparative advantage of labor-intensive industries, and the low yen. This state of affairs demonstrates that the level of demand in the advanced economies has a major knock-on effect and that the Asian economy does not, in itself, constitute a complete and self-sustaining system. It can also be taken as a sign that, against the background of constant change in the international division of labor, the competitiveness of each country and the comparative advantage that determines that competitiveness are both in a state of constant flux.

The favorable economic development enjoyed by Asian countries since the middle of 1980s came about in the context of industrial restructuring through the emergence of industries which acted as engines of growth, expanding manufactured exports, and increasing investment. It is therefore apparent that the economic conditions of each country in 1996 call for urgent consideration of both further restructuring through the creation of new growth-propelling industries and of the fundamental adjustments that would make such restructuring possible. As we have already seen, each of the economies is starting to take its own steps to tackle industrial restructuring, but the issues to be addressed are many and serious.

2. Developments in International Division of Labor and Structural Adjustments

(1) Developments in International Division of Labor due to Currency Realignments

As is well known, it was in the second half of the 1980s that Asia first began to attract attention as a dynamic economic area. This economic dynamism was due to vigorous economic activity in the private sector and to macroeconomic policies that encouraged foreign direct investment and international trade.

The immediate cause of this vigorous economic activity in the private sector was the worldwide boom in foreign direct investment. From the early 1980s, the globalization of capital gathered pace throughout the world, and an international adjustment in exchange rates in the autumn of 1985 triggered a sudden increase in overseas investment by Japan and the NIEs. This increase was a major factor in the spread of globalization to the other countries of Asia.

The advance of globalization brought about major changes in the international division of labor, quickened the pace of reorganization in competitiveness at the international level, and had a major influence on the industrial structures of Japan and the NIEs. In addition, large-scale exchange-rate realignments agreed in the Plaza Accord of autumn 1985 made it inevitable that first the Japanese yen and then the Korean won and the new Taiwan dollar all appreciated sharply. This led to rapid changes in the comparative advantage of, respectively, Japan and the NIEs, and the NIEs and ASEAN countries. It was for this reason that manufacturing companies in all those countries commenced en masse to relocate their production facilities overseas. This furthered their intra-firm division of labor based on the comparative advantages of China and the ASEAN countries.

Thanks to the appreciation of major currencies, a new industrial division of labor took shape in Japan and in the other countries of the Asian region. This was achieved by mobilizing foreign direct investment and organized in line with the comparative advantage of each country. As a result, in each of these countries' economies, the following relationship took shape between three key economic indicators: the rate of increase in foreign direct investment was greater than the rate of increase in exports which in turn was greater than the rate of increase in real economic growth. From the mid-1980s, there was an almost direct linkage between foreign direct investment rates and growth rates in the economies of Asia.

(1) The NIEs

The NIEs pioneered foreign direct investment- and export-led economic growth in Asia and were a major influence on the economic development strategies of the ASEAN member states and other developing countries. Along with Japan, the NIEs, in their role as foreign investors, also promoted the economic development of the entire region. As we have already seen, at a time of currency realignments and rising production costs, the NIEs made strenuous efforts to upgrade their own industrial structures by bringing in foreign direct investment. It goes without saying that structural adjustments in the NIEs were substantially promoted by an increase of Japanese foreign direct investment and imports from those countries. But the NIEs in turn made use of their own overseas investment to shift to neighboring countries those industries which had lost the competitive edge and, in so doing, helped enhance their productive capacity and trading strength. Through the medium of this dual capacity – receiving foreign direct investment and promoting foreign investment – the NIEs brought economic dynamism to nearby developing regions and this was a factor in the emergence of a number of localized economic zones. These zones include the Huanan economic zone centered on Hong Kong and Guangdong province, the Liang'an economic zone made up of Taiwan and the southern part of Fujian province, the Yellow Sea economic zone made up of Korea, Shandong province and Liaoning province, and the Growth Triangle made up by Singapore, Malaysia and Indonesia. The birth of economic zones mainly made up of three territories – Taiwan, Hong Kong and Singapore – with Chinese identity turned the attention of Chinese-origin businessmen throughout the world to the Asian region. The growth of a Chinese network alongside the network of multinational companies both broadened and deepened the international division of labor in Asia.

In the NIEs, expansion of consumption demand derived from rising per capita incomes made governments change their economic development policies in favor of growth led by domestic demand. At the same time, corporations made use of the opportunities for expansion offered by their large accumulation of capital (due to earlier growth) and their ability to price competitively because of the high yen. By increasing both their investment in capital- and technology-intensive industries and the level of their exports to Asia, they facilitated the ongoing sophistication of their countries' industrial structures. Around 1990, the NIEs simultaneously achieved rapid changes to their industrial structures and deepening ties with Asia.

Faced with a low yen, rising production costs and intensifying competition in domestic and foreign markets, they are now striving to upgrade their industries still further.

(2) The ASEAN Countries

Thanks to the liberalization of trade and investment policies, Thailand, Malaysia and the other ASEAN countries succeeded in attracting the influx of direct investment from Japan and NIEs countries. From about 1986, both the proportion of GDP accounted for by manufacturing industry and the proportion of exports accounted for by manufactured goods increased sharply, and the ASEAN countries achieved a historic transformation of their industrial and trading structures. From the late 1980s, in ASEAN countries, especially in Thailand and Malaysia, machinery (SITC7) accounted for an increasing proportion of both manufactured goods and exports, and there was continued upgrading of industrial structures. These countries have further relaxed their internal regulatory regimes, as well as those governing foreign direct investment and other matters. Economies in the ASEAN region are currently characterized by several features: (1) They have continued to receive foreign direct investment from Japan (due to further appreciation of the yen) and from other countries seeking to reduce their manufacturing costs. In the case of Japan there has been increasing overseas investment in machinery industries, especially electronics, to expand productive capacity and to manufacture new products and components. (2) Due to higher levels of demand, foreign and domestic investment has increased both in the industrial materials sector and in such consumer durables as automobiles. (3) The creation of the ASEAN Free Trade Area (AFTA) in 1993 gave further impetus to fresh waves of foreign direct investment and to industrial specialization within the Area.

At present, however, rising production costs and labor shortages have become a problem not only in Thailand and Malaysia, but also in Indonesia and the Philippines. In the face of reduced exports of labor-intensive goods due to reduced competitiveness and declining demand in key markets, the switch to capital-intensive industry has become an urgent task.

It was for these reasons that ASEAN set up AFTA in order to increase trade within the region. It has since revitalized the regional trading network by increasing internal investment (within ASEAN), strengthening economic cooperation and recruiting new member states in pursuit of a more resilient and stable South-Asian economy.

(3) China

China has embarked on a policy of economic liberalization, and links have now been established between the surrounding regions and China's vast market with its huge reserve of human resources. This gives the Asian economies opportunities for further development, but at the same time, China's capacity to absorb foreign direct investment and its flourishing export strength have fostered a cautious attitude in the surrounding regions. Since 1979, China has pursued a policy of reform and liberalization centered on the specific zones along the coast and has mobilized foreign capital to promote its export industries. Although the Tiananmen massacre brought a temporary halt to the development of a free market led by foreign direct investment, enormous increases since then in capital flow from foreign countries demonstrated the effectiveness of that policy. In view of this success, in the late 1980s, China stepped up its strategy of opening up the entire coastal region to foreign capital. Under the slogan 'further liberalization and faster growth,' the government in 1991 took several proactive steps to attract foreign money, including increasing the number of industrial sectors eligible for foreign direct investment, opening up the interior to overseas capital and promoting the export of light industrial goods. At the same time, imports increased thanks to heightened domestic demand, especially in the consumer sector, itself the result of a domestic consumer boom. To cope with this demand, the government formulated a policy for the domestic production of such consumer durables as household electrical appliances and automobiles, and promoted the sophistication of the industrial structure through accelerated foreign and domestic investment.

However, from 1994, the government took steps to counteract symptoms of structural distortion such as inflationary pressures due to sudden growth, trading deficits due to sharp rises in the import of manufactured goods and materials, and losses by state enterprises in the traditional industrial sectors. It embarked on an ambitious program to secure the simultaneous restructuring and upgrading of its industrial base by reforming state enterprises, promoting basic industries such as energy and industrial materials, upgrading the processing industries, fostering high-technology manufacture, and developing the capacity for provision of infrastructures.

3. Background to the Slackening Pace of Asian Economic Liberalization

As already explained, the countries of Asia have specialized in industries appropriate to their comparative advantages and have pursued a path of economic development based on the premise that high export growth would guarantee rapid economic growth. This development policy came about because each of the countries concerned proactively pursued liberalization and deregulation policies so as to promote investment and trading activity. In the case of ASEAN, the liberalization measures mentioned have been mobilized as part of a new experiment to further intra-regional cooperation. However, as we shall demonstrate later, a change of tone has become apparent in the direction of liberalization in the various Asian countries.

During 1996 a series of international conferences on liberalization and the future of economic cooperation were held in the Asian region. These were the first Asia- Europe Summit Meeting (ASEM) in Thailand (March), the Ministerial and Leaders Conference of Asia-Pacific Economic Cooperation (APEC) in the Philippines (November) and the first Ministerial Conference of the World Trading Organization (WTO) in Singapore (December). Following the collapse of the Cold War order in the late 1980s, the world economy has been in a continuous state of flux and conflict between globalism on the one hand and, on the other hand, regionalism and the formation of economic blocs. As a result, the formation of a new world economic order has been delayed. These international conferences were therefore worthy of attention from several different points of view. The conclusions they reached not only gave a sign of the general direction of the world economic order in the twenty-first century. They also offered some indication as to how much of a positive contribution the countries of Asia, a high-growth region which had already developed to the extent that it had become one of the motive forces of the world economy, would make to the formation of that new order. From the point of view of the Asian countries, in contrast, the future direction of world liberalization was a matter of the greatest possible concern. The major worries for Asia were the trading policies of such important partners as the United States and Europe, and the developing trend toward systematic regional integration (EU and NAFTA) in those regions.

From an Asian standpoint, the most important of these three conferences were APEC and ASEM. Both conferences attracted a high degree of attention for several reasons, including the fact that they were centered on Asia, took 'equal partnership' with North America and the European countries as their common ideal, and aimed to create 'open regionalism' as an economic model. These experiments were without precedent in other arrangements for regional economic integration. The conferences were also noteworthy as it was expected that they would work out mechanism of adjustment and complementation among AFTA, the EU and NAFTA as the institutional frameworks of regional economic cooperation which the three leading regions of the world economy had respectively established.

In conclusion it must be said that the position of the Asian countries, as revealed by these conferences, failed to fully satisfy the expectations of the rest of the world. Although, at previous APEC conferences, the ASEAN countries had assumed a leadership role in promoting debate about liberalization, it was noted that their words and actions at the first ASEM conference, in which they played a prominent part, represented a retreat from their earlier position.

We shall now introduce the attitudes of the Asian countries that were shown at these conferences, and discuss the likely future direction of their policy toward liberalization.

(1) APEC Manila

The highlight of the eighth APEC conference in Manila was the adoption of the Manila Action Plan for APEC (MAPA). This was based upon concrete proposals for liberalization submitted by the participating countries and represented a more decisive version of the 1994 Bogor Declaration, with target dates for liberalization set at 2010 for developed countries and 2020 for developing countries. MAPA comprises three sections: (1) the Individual Action Plans submitted by each member economy and relating to fifteen specific areas for liberalization and facilitation, including tariffs, non-tariff measures, services, investment and regulation; (2) the Collective Action Plans dealing with common policies for liberalization and facilitation by APEC; and (3) the Progress Reports on Joint Activities especially in economic and technical cooperation. Needless to say, the Individual Action Plans attracted the most attention since they gave some indication of the degree of each country's commitment to liberalization. However, in the liberalization plans submitted by the various developing countries, not many of the national submissions included anything that went beyond the proposals for liberalization that had been included in the 1994 Uruguay Round, and there were few concrete results to be shown. This gave rise to severe criticism from the United States and other developed countries.

The lack of substance in the liberalization plans was caused by the fact that discussions on 'liberalization' at APEC took as their guiding principle the Concerted Unilateral Approach to that term as agreed at the 1995 Osaka conference. It can be fairly said that this approach lacked real force and also that, due to unsettled economic circumstances, some countries started to adopt a rather cautious attitude towards liberalization. The ASEAN countries other than Singapore announced that the cornerstone of their position was that liberalization was a matter for the independent plans of each member state. Others argued that the full realization of AFTA was a prerequisite for further liberalization or that (a discussion by Malaysia) regional integration should be the priority.

Thus, it can be seen that Manila APEC failed to achieve much in the way of trade and investment liberalization. On the other hand, it was observed that the conference did achieve some movement in other areas. The Declaration of a Framework of Principles for Economic Cooperation and Development in APEC was adopted, offering a new development model related to the conference's founding principle of cooperative development, and the APEC Business Advisory Council (ABAC), set up as a permanent organization, got to work for the first time. Given that there was, especially among ASEAN countries, a cautious attitude towards government-led, and especially towards United States-led liberalization policies, the participation of private enterprise in APEC's activities was welcomed since private businesses were playing an increasing role in economic development. For example, they were extending the role of private enterprise in the provision of industrial infrastructure and the privatization of state corporations. Although the Manila Conference showed that it was possible for the activities of APEC, until that time initiated by governments, to be carried out in future by private businesses in concert with development cooperation policies by public sector, it cannot be denied that there is a likelihood that the pace of economic liberalization will slacken.

(2) ASEM

The first ASEM summit conference was held in Bangkok with twenty-five participating countries from Europe and Asia. Its aim, in the words of Mohamed Ariff, Professor at the University of Malaya, was to 'reconfirm for our modern age the principle of market accessibility between Asia and Europe.' The background to the conference was the growth of trade between the two sides and the resultant convergence of interests – convergence between, on the one hand, the European countries wishing to exploit the economic prosperity of Asia, and, on the other hand, the Asian countries (especially ASEAN) seeking to activate European investment and economic cooperation or to prevent the formation of an increasingly integrated European bloc.

From the late 1980s to the early 1990s, trade and investment relations between the two areas had stagnated due to the fact that both Asia and Europe had placed greater stress on intra-regional trade and trade with the United States. Thus, there was a kind of 'missing link' in that, among the world's three leading economic regions (North America, Europe and Asia), it was only the economic relationship between Europe and Asia that had declined. For this reason, it could be said that the aim of ASEM was to strengthen relations between Europe and Asia and to increase the ability of all three areas to lead the world's economy by bringing them closer together.

Despite the fact that the host nation, Thailand, had proposed in advance a concrete arrangement related to the liberalization of trade and investment between the two regions, differences between the two sides emerged even before the first ASEM conference had begun. While the European countries wished to raise, in addition to the economic agenda, non-economic matters such as problems of human rights and democratization, the ASEAN countries were hesitant about extending to the European economies the fruits of the liberalization measures agreed at previous APEC conferences. The first ASEM conference drew to its conclusion with a chairman's statement full of fine words about the formation of an Asia-Europe partnership for the promotion of further growth, continuation of political dialogue between the two regions, and continuing liberalization and facilitation of trade and investment to support WTO.

There are some signs of progress. In October, a conference of European and Asian business leaders was held in Paris and confirmed the private sector's support for strengthened relations at government level. In February 1997, there was a meeting of ASEM foreign ministers which agreed to intensify economic ties between the two regions by (1) trade promotion, (2) investment exchange, (3) economic cooperation, and (4) regional exchange. At the present stage, it is impossible to tell whether ASEM will, like APEC, become an organization for the promotion of liberalization. However the improvement in economic relations at both private and government levels suggests that rapid progress has already been achieved in the mutual appreciation, which had been interrupted for historical reasons, of the other side's cultural values. There is no doubt that this constitutes a major advance in the quest for stability and development of the world economy.

(3) WTO

Following the conclusion of the GATT Uruguay Round, WTO was set up in January 1995 as a permanent international trade organization. Unlike GATT, WTO is concerned not only with trade in goods, but also serves as an agency for discussing and laying down international rules in many fields, including trade in services, intellectual property right and investment. In addition, it includes a mechanism for settling disputes through the promotion of 'the rule of law.' For these reasons, much is expected of WTO as the international trade regime for the twenty-first century. The only noteworthy achievement of WTO immediately after its establishment was to put in hand procedures for the settlement of disputes. At its first ministerial meeting, the following important matters were on the agenda: (1) checks on the implementation of the Uruguay Round, (2) consideration of the practical steps to be taken in several areas of negotiation, including agriculture and services, (3) research into further liberalization, and (4) discussion about new fields such as information and telecommunications.

Because they are now seen as global trading powers, the countries of Asia are expected to make a positive contribution in all these contentious areas. However, in many areas – including labor, textiles, agriculture and investment – disagreements between developing and developed countries have grown more intense and conflicts of interest among the Asia countries have come to the surface. ASEAN in particular had, until now, taken a common line at international conferences with all the members united in their cautious stance on new issues in such fields as labor, the environment and investment. However during negotiations for the International Telecommunications Agreement (ITA), Singapore distanced itself from the other ASEAN countries by expressing its positive support at the start of the discussions. In future it is likely that the countries of Asia will, within the framework of WTO, become more acutely aware of the need to strike a balance between the benefits of free markets and their corresponding obligations.

4. Advantages and Disadvantages of Foreign Investment-Led Development

As we have already seen, foreign direct investment creates and deepens the relationship of economic interdependence between the investing and receiving countries and has a profound effect on the development processes of both. As was previously explained, the flow of foreign direct investment into Asian countries since 1985 has fostered mutually dependent relationships with the economies of advanced countries through the development of export industries, and has played a role in the integration of each country's economy into the world economy. It has also fostered similar relationships within, and pushed forward the integration of national economies into the Asian regional economy. Foreign direct investment, it can be argued, has helped bring about radical change as each economy in turn succeeds in transforming its industrial and trading structures. The long-term dynamism of the Asian economy demonstrates the continual process of structural adjustment that the region has had to undergo. As has already been shown, this provided the background both for the progress of global liberalization and for the Asian countries' positive efforts to participate in that liberalization.

However, the development of mutually dependent relationships inside and outside the region through the medium of foreign direct investment is not only a sign that the Asian economies are being transformed by their deep-rooted links with the global and regional economies. It also shows that they are growing in importance in the global strategies of the multinational corporations. These, it could be argued, are the circumstances which make it so difficult for Asia to strike a balance between the benefits of free markets and their corresponding obligations under WTO. Furthermore, as we saw in the preceding chapter, the economic instability overcame the Asian countries in 1996. This can be taken as a sign that the negative aspects of a rapid, foreign investment-led development path followed by nearly every country notwithstanding their different levels of economic development are beginning to make themselves felt. These are structural problems, and there is a strong probability that they may hold up each country's future efforts at structural adjustment. The negative aspects currently faced by each country fall into the following four categories.

(1) The Asian Economy is Becoming a High-Exchange Economy

By a 'high exchange economy,' we mean one in which growth in the export of industrial goods is accompanied by corresponding growth in the import of industrial goods. Its causes include the undeveloped state of supporting industries and a strong tendency on the part of foreign companies to import foreign products rather than use locally-made ones. Inward investment influences the balance of trade not only by increasing the host country's dependency on imports, but also by increasing net payment for imported technology and other invisible services and repatriating investment income. If the contribution made by net long term private capital to the basic balance is reduced, the country concerned starts to rely on short-term private capital, giving rise to a growing feeling of financial instability.

(2) Growing Pressure for Access to Markets

Asian export growth is far in excess of the international average and is seen as a disruptive factor in global trade. This has meant that the Asian countries are faced with growing demands for access to the their markets; it has also meant that protectionism and regionalism are beginning to make themselves felt in the developed countries. Asia is now a global player, accounting for more than 17% of world imports and exports (1996 JETRO White Paper, Trade Chapter), and it is expected to play a role commensurate with its strength in matters of global liberalization and the suppression of protectionism and regionalism. It is well known that, since the 1970s, the NIEs have been under heavy pressure from the United States, their principal export market. The United States places restrictions on exports from NIEs by voluntary restraints on exports and exclusion from the Generalized System of Preferences of January 1989, and presses for open markets through the Comprehensive Trade Act. The U.S. also, in the mid 1980s, sought to impose adjustments in the rates of exchange of the NIE currencies against the US dollar, despite the fact that they had previously and for many years been formally tied to the dollar. Trade friction with the United States has now spread to the ASEAN countries and China, and throughout the world, voices are being raised in favor of wider access to the markets of the region.

(3) Dual Structures

Foreign direct investment is the most effective and successful means for kick-starting the industrialization of a developing country through the creation of new industries. However, foreign investment-led industrialization tends to bring about a dual structure in the receiving country: competitive foreign companies and weak local companies. This dual structure makes it difficult to build up industrial and commercial networks and obstructs the development of peripheral supporting industries. This underdevelopment of peripheral industries, in turn, not only holds up the development of new enterprises by foreign companies needing efficient methods of production, but it also, as already related, increases dependence on imports and helps bring about a deterioration in the current account. Furthermore, the dual structure phenomenon can be a factor in the growth of economic nationalism, as has often been seen in several Asian countries.

(4) Capacity for Autonomous Technological Development

Industrialization led by foreign direct investment leads to technology transfer by foreign companies, and fosters a highly dependent attitude towards technological development, sapping the will of local governments and companies to carry it out for themselves. In China and the ASEAN countries, the ratio of R&D expenditure to GDP was less than 1% in 1992, far below the level of the advanced countries. The reason for this is the inadequate R&D activity by local companies, this in turn being caused not only by deficiencies in socio-economic infrastructures such as a lack of human resources and research and development facilities, but also by the low level of interest shown by the companies themselves. Effective industrial development policies and structures are needed to promote the will to undertake R&D. The stagnant state of autonomous technological development makes it difficult to achieve industrial sophistication with higher value-added, and holds up technology transfer by foreign companies and the localization of R&D capacity.

5. Conclusions

We are now entering an era when more and more latecomer developing countries will join in the competition to attract foreign direct investment and to develop export-oriented industries. As we have already seen with telecommunications and information technology, new technologies will bring accelerated changes in the world's industrial structures. In this new era, the Asian countries' prospects for continued development will depend on ceaseless efforts to introduce new technologies, to improve the sophistication of their industries and to find new ways of maintaining their comparative advantages.

As we have seen, the countries concerned are addressing all the many problems involved in upgrading their industrial structures. However, such measures as positive investment in education, a high savings ratio and the pursuit of relatively stable macro-economic policies have not so far made much difference to the growth of the industrial base or to the flow of foreign direct investment. Existing positive considerations such as latent growth potential and attractiveness to foreign direct investment continue to play crucial roles. But on the other hand it could be argued that there are now a number of additional factors at work, namely the existence of various frameworks and organizations such as APEC, ASEAN and ASEM that promote regional cooperation and the liberalization and harmonization of trade and investment. These organizations are striving, in every country, to create opportunities for harnessing the pressure of free competition to improve national performance, and facilitating all forms of cooperation, including foreign direct investment and technology transfer, from inside and outside the region.

Asia can continue to maintain a high rate of growth provided that national governments are consistent and energetic in taking the actions required to bring this about. They must show greater leadership, secure their potential for growth and cooperate more fully in establishing mutually dependent relationships. The private industrial sector is rapidly becoming more aware of its economic importance, and governments must also take positive steps to cooperate with them and maximize their potential.