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Directions for the Twenty-first Century

REGIONAL COOPERATION IN A CHANGING GLOBAL ENVIRONMENT: SUCCESS AND FAILURE OF EAST ASIA

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REGIONAL COOPERATION IN A CHANGING GLOBAL ENVIRONMENT: SUCCESS AND FAILURE OF EAST ASIA*

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* The views expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD secretariat.

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Executive Summary

Developing economies inevitably have become involved in this process of globalization today. Since economic development has been transmitted from advanced to developing economies through movements of capital and technology, globalization can accelerate this transmission process and benefit developing economies. However, not all developing economies are in a position to gain from globalization, as they have not yet developed the market mechanism to gain fully from the opportunities it presents. Some suffer from frictions between global standards and local values in the process of exposing their economies and social systems to global competition. Furthermore, globalization is inevitably accompanied by global constraints and amplified disturbances in factor supply and movements, to which developing economies are particularly vulnerable. A deliberate response to globalization is needed for developing economies to take advantage of its benefits and avoid its harmful effects.

This paper presents an overview of the experiences of the East Asian developing economies in responding to the globalization challenge, and examines how regional cooperation helps them. Developing economies in East Asia grew rapidly for a decade until 1997 in what was regarded as a successful response to globalization. They benefited from such good fundamentals as high savings ratios, hard working habits, and active entrepreneurship. At the same time, their rapid growth was directly attributed to active trade and investment through open economic policies and the de facto pegging of their currencies to the United States dollar. However, their rapid growth came to an abrupt halt owing to the Asian currency crisis in mid-1997, and they suffered a serious setback in their real economy during 1997/98. Their setback was viewed as a failed response to globalization caused by volatile capital flows and deficient economic structures, as well as weak financial regimes.

Regional cooperation groupings in East Asia, such as Asia Pacific Economic Cooperation (APEC) and ASEAN, which were progressively strengthened during their rapid growth period, were not able to prevent the Asian economic crisis. APEC, composed of both developing and advanced economy members, has a unique agenda which combines liberalization efforts with facilitation and economic and technical cooperation. Facilitation, such as streamlining customs procedures and harmonizing rules and standards, enhances the effect of liberalization, while technical assistance to developing human resources and upgrading science and technology helps capacity-building. This can be utilized to help its developing country members to continue to pursue their open economic policies and, at the same time, prevent them from falling victims to the adverse effects of global disturbances.

This paper concludes with a series of prescriptions for actions needed at the national, regional and global levels to address some of the harmful effects of globalization and to enable economies to take advantage of the many opportunities it presents.

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I. DEVELOPING ECONOMIES IN THE CONTEXT OF GLOBALIZATION

With major advances in information processing, telecommunications, and transportation in the second half of this century, firms have intensified their business activities across national borders and created production and distribution systems spanning the globe in a major shift to borderless manufacturing and marketing. A firm that is active only in its home market cannot possibly remain competitive, and this applies not only to the big firms but also to small- and medium-sized firms.

Developing economies have inevitably become involved in the process of corporate globalization today. Since economic development has been transmitted from advanced to developing economies through transfers of capital, technology, and management know-how, globalization tends to accelerate this transmission and thus benefits developing economies. This is evidenced in the much higher growth rates and speed of catching up of some contemporary developing economies than those experienced by their predecessors before World War II.

However, not all developing economies have gained from globalization. Some have enjoyed rapid growth over decades, while others have remained underdeveloped for decades. Those economies that are not benefiting from globalization but, rather, suffering from its adverse effects usually have not yet developed the market mechanisms to gain fully from the opportunities it offers. Others suffer from frictions between global standards and local values in the process of exposing their economies and social systems to global competition. Furthermore, developing countries have become vulnerable to the global constraints and the amplified disturbances in factor supply movements that inevitably accompany globalization. However, the globalization trend is irreversible and developing economies can no longer develop behind protected walls. A balanced approach to globalization is needed for developing economies to take advantage of its benefits and avoid its evils.

The response of developing economies to globalization differs between regions, stages of development and resource endowments. Policy prescriptions are required through three levels: self-help at the national level; group efforts in regional integration or cooperation; and global support, such as that provided by UNCTAD and WTO, to cope with the global disturbances. It is important for economists to discuss not merely the theoretical responses needed but also to examine actual responses as witnessed in various parts of the world; to identify best practices in both taking advantage of globalization and avoiding its evils; and to prescribe effective means to respond to the challenges of globalization.

This paper focuses on the second level, namely, the regional approach. Recent years have witnessed a proliferation of regional groupings in various parts of the world. In identifying the reasons for this increasing regionalism, the first place to look is at corporate globalization and Governments' responses to it. In responding to the corporate mobility mentioned above, Governments are trying to sustain economic growth at home and to expand income and employment by seeking to attract both indigenous and foreign firms. They are having to dismantle impediments to trade and investment and standardize the regulations and practices that affect corporate activity, not only to attract foreign firms but also to keep their own indigenous firms from relocating to other countries where the business climate is better. Yet reaching global agreement on liberalization, deregulation and harmonization is a long and laborious process, and regionalism is seen as a practical shortcut to this end.

II. REGIONAL APPROACH: AN OVERVIEW

A. Open economic policies

The process of globalization had already started in the 1960s – a few East Asian economies, such as Hong Kong (China), Taiwan Province of China and the Republic of Korea, geared their development strategies towards outward-looking, export-oriented industrialization, and achieved high growth by the end of the decade. They were followed by several countries in Europe, South-East Asia and Latin America in the 1970s, which, together with their East Asian predecessors, were designated as newly industrializing economies (NIEs) in an OECD report (OECD, 1979). Developed markets viewed their trade performance as an import threat, but in reality this performance responded to the outsourcing strategy of American and European multinational companies. The NIEs should thus be regarded as having pioneered the developing economies' response to globalization.

In the 1980s the outward-looking strategy further spread to socialist economies in Asia and Europe. Open economic policy became a new campaign for China in the 1980s, and other socialist economies followed suit, liberalizing their trade and inviting foreign investment to spur their economic growth. This policy spread further to South Asia, the Middle East and Africa in the 1990s. East and South-East Asian economies including China and Viet Nam, continued to experience a 7–10 per cent annual GDP growth for a decade until 1997, and the World Bank (1993) hailed them as the "East Asian Miracle".

The Uruguay Round (UR) negotiations under GATT provided another spur to the developing economies' response to globalization. They were the first trade negotiations where major developing economies participated together with developed economies. Under GATT's Development Clause (Part IV), they were not obliged to commit to substantial liberalization, but their East Asian members voluntarily implemented tariff reductions beyond their UR commitments in order to strengthen their response to globalization.

B. Spread of regionalism

Regionalism has proliferated in the world since the mid-1980s. The European Union (EU) now has 15 members and is moving towards the adoption of a single currency. The free trade agreement between the United States and Canada was renamed the North American Free Trade Agreement (NAFTA), and expanded to include Mexico in 1994, while Chile also expected to join before long. Inspired by these moves, the ASEAN countries have created the ASEAN Free Trade Agreement (AFTA), four Latin-American countries (Argentina, Brazil, Uruguay and Paraguay) have joined together to form MERCOSUR (Common Market of the Southern Cone), and there are moves afoot for regional integration among the developing countries of the Middle East, Africa and South Asia. Indeed, UNCTAD (1995) listed 22 regional integration groups among the developing countries. Of course, some regions are more integrated than others, but most of these efforts for regional integration may be expected to lower or eliminate barriers to trade and investment to harmonize the member countries' domestic regulations, practices and procedures, and to seek a higher degree of policy coordination. These efforts aimed at promoting liberalization and facilitation among neighbours at the regional level.

At the same time, moves are also under way to promote liberalization and cooperation at the global level. However, these efforts are both slower and weaker than the push for regionalism. The UR negotiations, for example, were scheduled to take four years to complete but actually took seven years. Since then, GATT has evolved into the World Trade Organization (WTO), which now also covers services and intellectual property rights. The main accomplishment of the First WTO Ministerial Meeting in Singapore in December 1996 did not go beyond a reaffirmation of the participants' commitment to fully implement the UR Agreements. Meanwhile, as regionalism seems to be pushing ahead of globalism, some have expressed concern that this might not be in the long-term interests of the world economy, and that we should perhaps curtail regionalism and encourage globalism.

International economics textbooks typically describe regional integration as going through the five stages of a free trade area, customs union, common market, economic union, and complete economic union. The regional groupings of NAFTA, AFTA, and Mercosur are all in the free trade area stage, with tariffs eliminated on trade within the region but all of the member countries maintaining their own tariffs on imports from outside. Since its founding in 1958, the Economic Commission (EC) has worked to eliminate intra-regional tariffs and to set common tariffs for imports from outside the region. In 1992, the member countries signed the Maastricht Treaty, agreeing to eliminate over 280 physical, technical, and fiscal barriers to the creation of a single market, and moved one step closer to the final stage of currency union.

C. New pragmatic approach

The forming of a free trade area typically has a trade-creation effect, as the elimination of tariffs stimulates trade within the region, as well as a trade-diversion effect, as it impedes trade with outside partners. Not surprisingly, non-members complain that the arrangement is discriminatory. Yet, in theory, it is fully possible for the trade-creation effect to invigorate the economies of the region, for example, by creating an increased demand for imports from outside the region; and there is no reason why the effect of such trade could not be to pull in more imports from outside partners than the trade diversion deters, in which case the free trade area would have a net trade-creation impact.

Empirical studies have shown that free trade areas do serve to enhance trade within the region, but there are no clear cases in which they have had a net trade-creation impact. Article 1 of GATT calls for most-favoured nation treatment (MFN) for all trade partners, and Article 24 expresses the hope that regional liberalization will lead to global liberalization, allowing regional free trade agreements as exceptions to Article 1. However, this exception is conditional upon their covering substantially all of the trade in goods and services, on their setting a clear schedule for liberalization, and on their barriers to non-members being no higher or no more restrictive than before the free trade agreement's coming into force. This is very vague, and the EU, NAFTA, and other free trade agreements are neither condoned nor condemned. Rather than trying to regulate free trade agreements through GATT and now WTO, it is both more realistic and more practical to monitor each agreement to ensure that it does not in fact lead to increased discrimination.

Of course, the advocates of regionalism argue that it will expand intra-regional trade, which will then lead to trade expansion worldwide. In fact, none of the free trade agreements or other regional groupings to date have suggested that they intend to stimulate intra-regional activity by shutting out extra-regional trade. Yet there have been a number of instances in which extra-regional participants have been excluded from certain sectors (for example, as a result of NAFTA's very rigorous rules of origin regulations), and it is essential that such situations be monitored and publicized in order to reverse such protectionist trends.

To conclude this overview, the benefits of globalization are evident in the high growth performance of many developing economies, although its adverse impacts have not been monitored in empirical studies until recently. One of the few recent examples of the evils of globalization is the East Asian economic crisis, which brought to a halt the regions' decade-long miraculous growth. The following sections examine the beneficial and harmful effects of globalization on the growth performance of the East Asian economies over the past decade and offer prescriptions at three levels – national, regional and global – for tackling the challenges ahead based on these experiences.

III. THE EAST ASIAN "MIRACLE": A SUCCESSFUL RESPONSE TO GLOBALIZATION

East Asian economies as a group, including China, experienced rapid GDP growth of 7–10 per cent per annum for a decade until 1997. It was preceded by the economic setback of the oil and primary products exporters in 1983–1985 resulting from a global depression after the second oil shock in 1979/80. Many ASEAN members suffered from zero growth during this period and cautiously rescheduled their development plans to a lower rate of growth. But they quickly returned to high growth levels in 1987/88, partly helped by the rapid appreciation of the yen, and consequently by accelerated investment by Japanese firms in South-East Asia.

The World Bank (1993) praised their performance, calling it the East Asian "miracle", and it was seen as an example of a successful response to globalization. The factors that contributed to this success are discussed below.

One was the good fundamentals these economies achieved for their continued development. Their savings ratios are as high as 32.7 per cent on average, compared with 26.1 per cent in other developing economies and 20.4 per cent in industrialized economies (IDE, 1999). And their investment ratios are even higher – 38.3 per cent on average – due to their active entrepreneurship and to a sizeable inflow of foreign capital. Their hard-working habits and traditional emphasis on higher education helped to enhance the level of qualified and skilled labour, and active entrepreneurship strengthened local responses to globalization. East Asian economies have been known for prudent management of their macroeconomic policies, and until recently this had kept their public debt and current account deficits at a minimum.

On the basis of these good fundamentals East Asian economies implemented liberalization and deregulation policies. Tariffs and non-tariff measures restricting foreign access to their markets were removed unilaterally, and domestic regulations restricting foreign firms' activities at home were reduced or eased to attract foreign firms to operate within their borders. Nevertheless, they tended to retain governmental guidance and interventions in sectors of high growth potential. These remaining interventions conflicted with the free trade principle of GATT and the World Bank, but as they did not impede high growth in these economies, the World Bank (1993) accepted them as "market-friendly" policies.

Paul Krugman (1994) contested the "miracle" by pointing out that the high growth performance of East Asian economies was not accompanied by productivity growth but by an increase in factor inputs, and that if the supply of labour and capital were to cease to increase eventually East Asian growth would stop. His conclusion was based on an empirical study of low productivity growth of the manufacturing sector in Singapore and other ASEAN members States. However, he missed the point that, although the productivity of manufacturing had not grown remarkably, the sector still enjoyed a high productivity level, and that the productivity growth of an economy as a whole is sustained by an incessant flow of factors from low productivity sectors to high productivity sectors (EPA, 1998).

It is also important to note that, while almost all the East Asian developing economies achieved a 7–10 per cent annual growth of GDP, they did not grow independently. Rather, their growth was interrelated with each other through steady expansion of trade and investment across borders. Their export and import trade source increased by 15–20 per cent annually, and the inflow of foreign direct investment (FDI) continued to grow by 18 per cent annually.

What was not highlighted in the argument for the East Asian "miracle", but was crucial to its sustained miraculous growth for a decade, was the region's currency regime, which was de facto pegged to the United States dollar. The stable currency value reduced uncertainty associated with foreign transactions, and assured foreign investors of the United States dollar value of their invested assets in the region, thereby contributing to the steady expansion of trade and investment in the region.

IV. THE EAST ASIAN ECONOMIC CRISIS: AN UNSUCCESSFUL RESPONSE

While the East Asian "miracle" represents a successful response to globalization, the East Asian crisis of 1997 exemplified failure when the high growth of these economies was interrupted abruptly. Let us follow the changes in Asian exchange rates after July 1997 in table 1. The run on the baht led the Thai Government to abandon its peg with the United States dollar and moved it to a floating rate on 2 July. As a result, the baht depreciated in the market by 14 per cent within a month and by a further 33 per cent by November that year. A similar run on the Indonesian rupiah, Philippine peso, Malaysian ringgit and Singapore dollar caused these currencies to depreciate by 27 per cent, 24 per cent, 26 per cent and 10 per cent, respectively, by November. The Taiwanese dollar and Korean won were also affected in October and November. In December 1997 and January 1998, another round of currency runs caused the rupiah to depreciate by 68 per cent, the baht by 56 per cent, the won by 42 per cent, the ringgit by 43 per cent and the peso by 36 per cent in seven months.

The market anticipated a devaluation of the Hong Kong dollar and China's yuan following the other Asian currency depreciations in October and November, but both economies resolutely kept their exchange rates unchanged. The yen depreciated by 29 per cent during the seven months to February 1998. This whole shift in currency rates reflected the strong position of the United States economy and its dollar. The European currency (euro) also depreciated by 15 per cent, as did the German mark by 22 per cent during the same period.

A. Impacts on the real economy

The currency crisis disrupted the region's trade and investment and abruptly halted its economic growth. Thailand, Indonesia and the Republic of Korea, which sought rescue from the IMF, had to resort to severe contractionary policies and experienced slow growth. Other

Table 1

Nominal exchange rates of Asian currencies against United States dollar

(January 1997 = 100, in United States dollar per own currency)

		China	*Hong Kong (China)*	*Indonesia*	*Japan*	*Malaysia*	*Philippines*	*Republic of Korea*	*Singapore*	*Taiwan Province of China*	*Thailand*
1997	Jan.	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
	Feb.	100.03	99.90	99.58	95.95	100.20	99.91	98.04	99.08	99.67	99.15
	Mar.	100.00	99.91	99.13	96.24	100.61	99.95	94.83	97.91	99.70	99.07
	Apr.	100.00	99.89	98.60	94.04	99.72	99.82	95.11	97.57	99.42	98.68
	May	100.05	99.94	98.14	99.19	99.40	99.79	95.27	97.91	98.86	99.37
	Jun.	100.05	99.94	97.80	103.35	99.05	99.78	95.55	98.52	98.47	99.72
	Jul.	100.06	99.94	95.02	102.49	96.74	95.12	95.44	96.96	98.12	84.79
	Aug.	100.08	99.95	85.45	100.11	90.69	89.73	94.86	93.92	95.56	79.14
	Sep.	100.11	99.95	78.32	97.74	82.55	81.24	93.44	92.62	95.92	70.81
	Oct.	100.14	100.05	66.17	97.49	75.75	76.36	92.19	90.24	93.16	68.74
	Nov.	100.18	100.10	68.52	94.22	73.51	74.77	82.87	88.87	86.83	65.41
	Dec.	100.19	99.92	48.75	91.16	66.03	70.80	57.27	85.11	84.75	56.76
1998	Jan.	99.95	99.99	24.76	91.17	56.64	61.69	49.79	80.34	81.09	47.77
	Feb.	99.71	99.99	26.74	93.67	65.41	65.13	52.36	84.70	83.69	56.10
	Mar.	100.19	99.86	24.71	91.71	66.63	67.65	57.04	86.79	84.54	62.32
	Apr.	100.19	99.86	29.29	89.64	66.63	68.18	61.22	87.87	83.26	64.92
	May	100.19	99.86	23.62	87.43	65.41	67.03	61.06	85.73	82.16	65.80
	Jun.	100.19	99.95	17.68	83.96	62.30	65.15	60.91	82.82	85.75	60.68
	Jul.	100.19	99.96	17.14	83.86	59.91	62.99	65.69	82.08	85.96	62.41
	Aug.	100.19	99.95	20.02	81.59	59.34	61.15	64.77	80.06	85.12	61.83
	Sep.	100.28	99.95	22.31	87.69	65.55	60.96	61.92	81.33	85.47	64.07
	Oct.	100.19	99.95	28.87	97.30	65.56	61.36	63.60	87.64	83.12	67.40
	Nov.	100.19	99.95	31.13	97.88	65.56	65.89	65.87	87.64	84.40	70.50
	Dec.	100.19	99.95	30.86	100.34	65.56	65.84	70.15	87.11	85.00	70.91
1999	Jan.	100.19	99.95	27.46	104.28	65.56	69.18	72.39	85.56	85.11	70.20
	Feb.	100.19	99.95	27.42	101.17	65.56	67.86	71.47	84.55	84.30	69.36
	Mar.	100.19	99.95	26.92	98.53	65.56	67.64	69.16	83.08	85.48	68.53
	Apr.	100.19	99.95	27.99	98.52	65.56	68.82	70.48	84.06	83.45	68.37
	May	100.19	99.95	30.08	98.19	65.56	69.53	71.02	84.06	83.81	69.46
	Jun.	100.19	99.95	32.48	97.82	65.56	69.42	72.74	84.06	84.56	69.59
	Jul.	100.19	99.73	34.26	101.95	65.56	68.73	70.32	85.05	85.05	68.88

economies in the region responded to the currency crisis by raising interest rates, tightening their budgets, and suspending development plans, along similar lines to the IMF's prescription. With their growth decelerating considerably, the East Asian "miracle" disappeared. China and Hong Kong (China) maintained their exchange rates, but the currency crisis also had a severe impact on their real economies – so profound, in fact, that it was more appropriate to call it an economic crisis.

Big fluctuations in exchange rates have not left trade and investment in the region unaffected. In Thailand and the Republic of Korea, export prices declined abruptly and boosted manufactured exports. Exports of primary products increased in Malaysia and Indonesia, and overall exports increased in other Asian economies as well. To be sure, manufactured export prices did not decline as much as their exchange rate depreciation. Production in manufactures in the Asian economies was highly dependent on imported parts and materials, the prices of which increased as a result of currency depreciation. This depreciation tended not only to raise the import prices of industrial materials (and foodstuffs in the case of Indonesia), but also to raise domestic prices and discourage exports. Furthermore, the depressed domestic economies dampened imports, as a result of which a trade deficit changed to a surplus in many economies. On the other hand, exports from China and Hong Kong (China) – which maintained exchange rates and export prices – were depressed, and exporters cried for help from the authorities. The impact of big depreciation had a strong "beggar thy neighbour" element and inevitably tended to aggravate conflicts among Asian exporters.

In the first half of 1998 many East Asian economies fell into a trap, recording minus growth rates. During the preceding period of rapid growth they had benefited from a virtuous circle of exports and investment; exports led to growth, while the high prospect of growth encouraged investment in capacity expansion and improved competitiveness. This has now changed to a vicious circle of depressed exports which discouraged investment, and vice versa; the depression spread over the region and dampened exports which, together with low consumption – resulting from uncertain economic prospects – decreased aggregate demand and discouraged investment for the future. Individual economies have tried hard to get out of this trap, but it will take a strong stimulus of external demand, together with resumed currency stability and the recovery of a functioning financial system, to draw them out of the trap.

Often neglected by observers is the social impact of the crisis on poverty, education, health and nutrition, and social infrastructure. In these developing economies increased unemployment has resulted not in the increased payment of insurance, but in households without any income, and increased poverty. It has tended to decrease the enrolment rate for elementary education. Household eating patterns have also been affected, and the malnutrition rate especially among children has increased. Public expenditure for these purposes has also been squeezed. The need for building a social safety net has often been stressed, but it is yet to be implemented. Owing to these adverse social effects, it will take the East Asian developing economies a longer time to return to their former growth paths (Alburo, 1999).

What caused the currency and economic crisis in East Asia? Many analyses have been done, which are summarized below. The causes of the crisis show defects in the East Asian economies' response to globalization.

B. Rapid outflow of foreign capital

The currency crisis was, for the most part, triggered by a liquidity crisis which resulted from a large and rapid outflow of foreign short-term capital. Large amounts of short-term capital flowed into Asian emerging markets in the 1990s. This inflow was attracted by the promise of high returns, liberalized markets, and the apparently stable values of the host currencies that were pegged to the dollar. However, as signals increased of weakened financial systems, accumulated external debts and possible defaults, foreign capital rapidly fled through the liberalized market channels.

The host Governments tried to stop this outflow by selling United States dollars to maintain their exchange rates. This quickly drained their dollar reserves, giving them no choice but to quit the dollar peg and let their currencies depreciate. However, as local currencies depreciated, external debt payments which fell due became an incessantly growing burden, thereby pushing banks and firms into genuine default. Three Governments sought relief from the IMF to ease their liquidity crisis. The IMF, however, was originally designed to help finance current account deficits and was not prepared for disruptive capital outflows. The IMF rescue package came too late to prevent defaults and was conditional on severe reforms aimed at restoring their current account balances.

C. Excessive inflow of short-term capital

In the 1990s, there emerged a huge loanable fund in industrialized economies ready for profitable investment abroad. At the same time, developing economies needed foreign funds for further development – to fill the domestic investment savings gap, and to finance deficits in the current accounts which had emerged over the preceding few years. Meanwhile, some East Asian economies had hastily liberalized their capital markets in order to attract portfolio investment, while their FDI was not completely liberalized, especially with regard to the right of establishment and other aspects of national treatment (Yamazawa, 1998a, 1998b). The rapid inflow of short-term capital caused excess liquidity in host markets, which could not be absorbed into long-term and productive investment projects. Instead, it flowed into risky investment in real estate and other non-competitive businesses, which resulted in local banks having a high volume of non-performing loans, aggravating financial weakness in the host economy.

This was an unlucky mismatch between demand and supply. Few foreign investors, except shrewd professional speculators, gained from the hasty inflow and outflow of funds during the currency crisis. If foreign funds had been invested in an orderly manner, they would have contributed to efficient industrialization of the host economies and brought investors high and stable returns. No developing economies are perfect in their economic systems and conduct. However, if foreign investors had been provided with sufficient information about host economies and conducted their investments with appropriate caution, excessive inflow and abrupt outflow could have been averted – thus avoiding the Asian economic crisis. There is no way to stop market forces, but are investor country Governments not partly responsible for guiding their private investors with information about the developing economies in which they invest?

D. Deficiencies in the economic structure

East Asian economies still maintain the economic fundamentals, such as high saving ratios, hard working habits and active entrepreneurship, which supported rapid growth. However, a few major deficiencies in their economic structures and operation prevented sustained growth. Their financial system has developed non-competitively under governmental protection, and unsound government-business relationships have sometimes been aggravated by paternalistic industrial policies. These structural deficiencies were concealed during rapid growth but were revealed immediately after the crisis struck. They afflicted the arteries of economic growth and quickly brought it to a halt. These structural deficiencies should be corrected in order to prevent a recurrence of the crisis.

East Asian economies have been implementing a variety of structural reforms. Almost all of them have been strengthening their domestic financial system, encouraging the disposal of non-performing loans, even through providing public money and allowing non-bank financial corporations to go bankrupt. The Governments of Malaysia and the Republic of Korea are pushing hard for the merger of smaller banks into a few competitive groups. The Government of the Republic of Korea has gone further in streamlining the corporate governance of its business groups, the *chaebols*. Various institutional reforms are being attempted to improve their competitiveness. China has tackled the rationalization of its ineffective State-owned firms.

Problems with their industrial structure also need to be addressed. Many developing economies in East Asia successfully expanded their production and export of labour-intensive products in a relatively short period. However, their production has relied heavily on imported parts and materials, which in turn made these economies vulnerable to currency instability and frequent current account deficits. They have made significant progress in upgrading their industrialization in order to substitute these imports. This has been due not to a lack of funds, but to the lack of capacity for absorbing technology and to the lack of skilled personnel. This structural deficiency would have stopped the East Asian “miracle” sooner or later, even in the absence of the currency crisis.

Signs of the recovery of the real economy were witnessed across East Asia in May and June of 1999. Many economies, notably the Philippines, the Republic of Korea, and Thailand, improved their growth rates from negative growth in 1998 to positive growth. Industrial production has resumed one more and imports of industrial materials have been increasing. Foreign investments, both direct and portfolio, are rapidly returning to the region. The recovery has been more evident in the second quarter of 1999, even in Indonesia, where no effective reform measures have been implemented due to continued political disorder.

As regards the East Asian currencies, their exchange rates have become stable since September 1998. The competitive devaluation of ASEAN currencies and the Korean won against the United States dollar has ceased, and these currencies have rebounded since their trough in January 1998. Political disturbances in Indonesia from March to May and rapid depreciation of the yen in June and July tended to delay the region's recovery, but since September 1998 we have witnessed the convergence of Asian currencies – exchange rates of the baht, ringgit, won and peso have been converging to a 30–35 per cent depreciation from the pre-crisis level, and the Taiwan and Singapore dollars have been converging to a 10–15 per cent depreciation (see figure 1). Except for a speculated devaluation of the Chinese yuan, we may have got over the currency crisis in Asia.

Will these economies really be able to resume their pre-crisis growth path? In order to answer this question, we need to examine whether the causes of the crisis have really been tackled so as to prevent its recurrence.

V. REGIONAL COOPERATION: PAST, PRESENT AND FUTURE

So far, we have examined both the successes and failure resulting from the East Asian response to globalization. We have mainly monitored individual efforts and found that regional cooperation was not the direct cause of either of them. Their success was achieved by the development efforts of individual economies: good fundamentals, open economic policy, and cautious macroeconomics management. Their failure resulted from hasty liberalization by individual economies and their structural deficiencies. Nevertheless, their regional cooperation proceeded in parallel, indirectly affecting their response and helping their success. However, it did not prevent their failure. We now examine what role regional cooperation played throughout their miraculous growth and through the recent crisis.

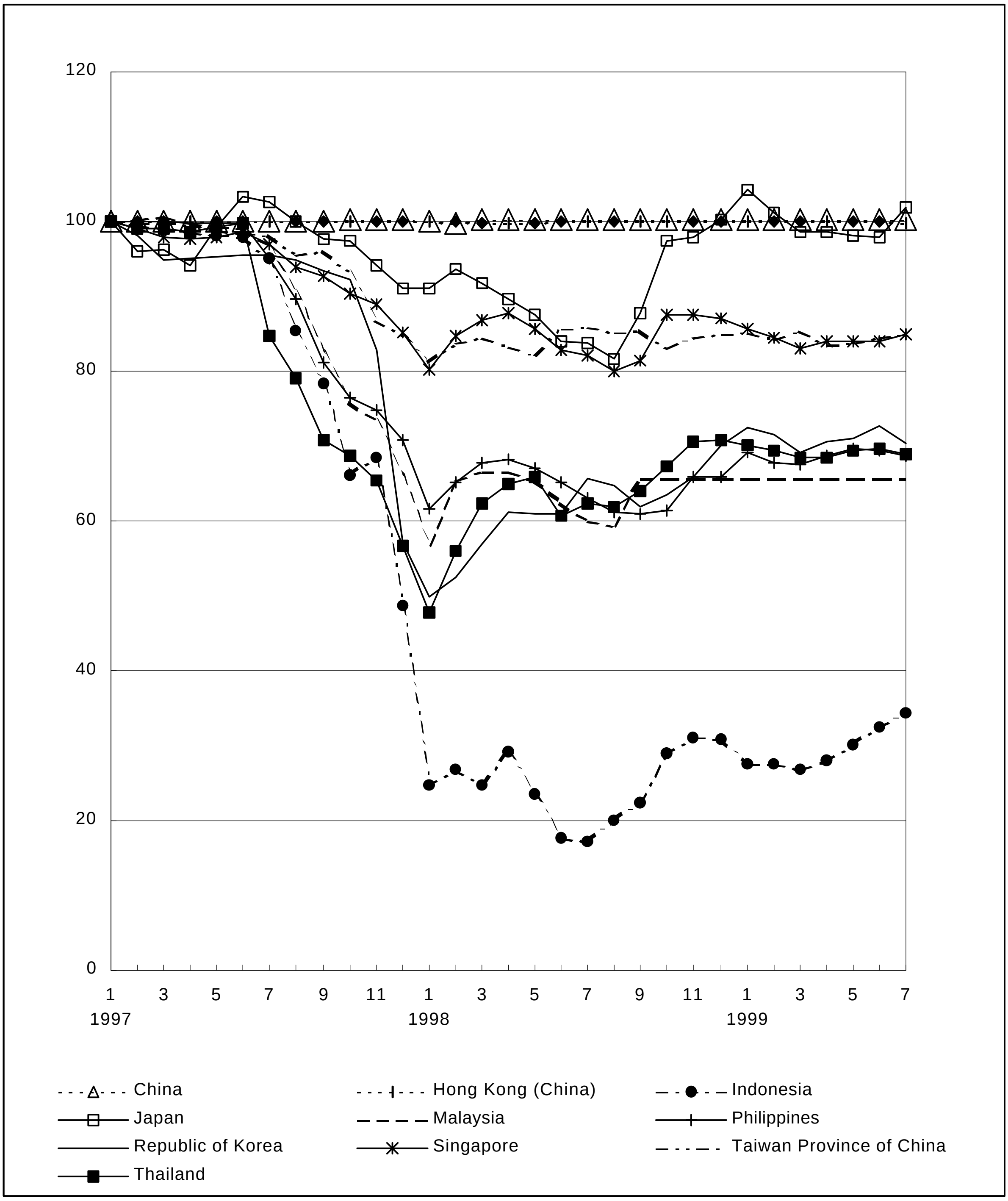
A. High growth as an engine of regional cooperation

It is important to understand the unique characteristics of regional integration in East Asia. Regional cooperation groups involving developing economies in East Asia are the Association of South-East Asia Nations (ASEAN), formed in 1967, and APEC, formed in 1989. Initially, ASEAN – comprising Indonesia, Malaysia, the Philippines, Singapore and Thailand – remained preoccupied with joint diplomacy and negotiation outside the region, and only since its twentieth anniversary in 1987 has the expanded grouping (now comprising 10 member countries with the

Figure 1

Nominal exchange rates of Asian currencies against United States dollar

(January 1997 = 100, in United States dollar per own currency)



Source: EPA (1998).

addition of Cambodia, Lao People’s Democratic Republic, Myanmar and Viet Nam) started to promote economic cooperation among its members. Its preferential trade arrangement (ASEAN PTA) has been strengthened, and various programmes for industrial cooperation, such as AIP (AEAN Industrial Project), AICP (ASEAN Industrial Complementation Project), and AICO (ASEAN Industrial Cooperation), have been implemented.

On the other hand, APEC was launched in 1989 for economic cooperation. It was sparked by Europe’s drive for economic union and consisted of 12 members: five advanced economies (Australia, Canada, Japan, New Zealand and the United States), six ASEAN members (its five original members plus Brunei Darussalam), and the Republic of Korea. In 1992 they were joined by China, Hong Kong (China) and Taiwan Province of China. APEC developed from an Australian proposal, and ASEAN members were initially hesitant to join because they were afraid that their own regional group would be overshadowed by this larger group. However, they have since adopted the APEC cause as their own and upgraded their ASEAN PTA to ASEAN Free Trade Arrangement (AFTA). AFTA aimed to reduce many tariffs to 0–5 per cent by 2008, and the goal for reduction was later accelerated to be completed by 2003. ASEAN has expanded to 10 members, with the admission of the Laos People’s Democratic Republic, Myanmar, Viet Nam and Cambodia.

In the last several years, APEC has made major progress in liberalization and facilitation. In 1993, the United States hosted the first Economic Leaders’ Meeting in Seattle and proposed that work be started on the creation of an Asia Pacific economic community. The following year, the APEC meetings in Indonesia resulted in the adoption of the ambitious Bogor Declaration, which specified targets for liberalization within the region: by 2010 for the industrial countries, and 2020 for the other members.

The guidelines for implementing this were embodied in the Osaka Action Agenda adopted in 1995 at Japan’s urging, and were further specified in the APEC Manila Action Plans in 1996. This voluntary liberalization is without precedent or parallel. Its comprehensive coverage requires not only the reduction of tariff and non-tariff barriers and elimination of regulations on services and investment, but also the harmonization of rules and standards and other facilitation measures. All 18 members announced their individual action plans (IAPs) at the APEC meeting in Manila in 1996 and started to implement them in January 1997 (Yamazawa, 1998b). Unlike the EU and NAFTA, APEC does not have a treaty to back it up or a blueprint to guide it. Rather, it is gradually organizing and getting structured, starting with the areas that all of the members can agree upon, which means that it is still largely undefined.

AFTA and APEC have provided a favourable environment for individual member economies to pursue an open economic policy and they have supported the steady expansion of trade and investment in the region contributing to the East Asian “miracle”. At the same time, looking at it another way, the miraculous growth of the region’s economies underlay the speedy formation of AFTA and APEC and provided a strong basis for their successful development.

B. Weak financial cooperation in the region

For the last decade the East Asian economies have been watching over the financial aspects of rapid growth, mainly through their individual efforts at maintaining the dollar peg and through their prudent management of macroeconomic policies, but all of them were caught by the current crisis. As regards ASEAN, financial cooperation was totally lacking from its agenda, and ASEAN finance ministers met for the first time in 1998. As all its major members were caught by the currency crisis, they were not capable of helping each other.

Both ASEAN and APEC were totally unprepared for the Asian currency crisis. Increased interdependence between East Asian economies through steady expansion of trade and investment had been accompanied by rapid financial integration in terms of increased flow of foreign capital across money and capital markets in the region. The de facto dollar peg and capital account liberalization supported this integration process. Financial cooperation facilitated this integration but did not work in time to prevent the crisis.

Major efforts towards financial cooperation in the Asia Pacific region have been made through the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP), the APEC Finance Ministers' Meetings (FMM), and the Pacific Economic Cooperation Council (PECC) Financial Market Development (FMD) Taskforce. The EMEAP started in the 1980s and conducted frequent exchanges of information. It also aimed at building a network of repurchase arrangements in order to cope with any possible currency and financial crisis. The APEC/FMM started in 1994 and has had regular exchanges of information and policy forums regarding financial development in the region (APEC, 1995). The PECC/FMD organized an expert group on developing financial markets and has promoted personnel training; its analyses and recommendations provided an input into the APEC/FMM (PECC, 1997).

It was from these dialogues that the proposal for an Asian Monetary Fund was developed, which called for Asian APEC members to establish a common fund in order to better prepare for a liquidity crisis in the region. But it failed to materialize because of the strong objections of some non-Asian members who did not want to see an increase in fund-pooling outside the IMF.

It was only in November 1997 that the APEC leaders suggested, in their Vancouver Declaration (APEC, 1997), that cooperation in both financial and real sector cooperation should be promoted in parallel and incorporated into the full APEC process. Deputies to finance ministers and central bank governors of 14 APEC members met a week before the APEC summit and set a Manila framework for cooperation in finance and macroeconomic policies to be endorsed by the heads of States (MAFCBD, 1997). A second meeting was held in late August 1999 to further develop this aspect of cooperation. But APEC began to help East Asia to return to high growth only in the later phase of the crisis.

C. The need for closer financial cooperation

It is difficult for individual developing economies to get integrated successfully into the world of globalized financial market and huge capital flows. Even after recovey from the present hardship, East Asian economies may be caught again by a currency crisis in the absence of effective financial cooperation. They require a closer regional cooperation framework than that provided by their earlier currency regime. Two years after the crisis, there are rumours of a possible devaluation of the Chinese yuan. The yuan is overvalued in comparison with other East Asian currencies and, in spite of repeated denials by the Chinese Government, it may be devalued. If this were to happen (which could be at any time), it could trigger competitive devaluation of other East Asian currencies.

East Asian Governments should jointly undertake a realignment of their exchange rates along the line of the Plaza or Smithsonian Agreements. In addition, it is preferable for the current United States dollar exchange rate for the yuan to remain unchanged while other Asian currencies are revalued, so as to correct the current undervaluation of their real exchange rates. This will correct the current overvaluation of the yuan and allay concerns about its possible devaluation.

This region-wide arrangement would result in a stable set of cross exchange rates between East Asian currencies. Individual currencies would be pegged jointly with a currency basket that includes the United States dollar, the yen and the ECU, with their composition reflecting their weights in trade and investment in the region. A common wide band of 5–10 per cent should be allowed for individual currencies in order to enable them to adjust in response to changes in the market.

In addition, East Asian economies should introduce a minimum coordination of macroeconomic policies among themselves. This means that they need to set targets for their inflation rate and to introduce a set of maximum ratios for their government debts, balance-of-payment deficits, external debt to GDP. These target ratios need to be sustained through mutual surveillance and early warning in order to avoid the recurrence of large macroeconomic disturbances. It is important to make the market believe in the sustainability of the stable currency regimes in East Asia for some length of time.

D. Regional facilitation, and economic and technical cooperation

The currency crisis was a stumbling block for the East Asian developing economies in their efforts to meet the challenge of globalization. Neither ASEAN nor APEC could help them to avoid it in time, but both are now emerging to help them to get back on the growth path. Closer regional cooperation will enable these economies respond more effectively to globalization and to gain more from its benefits while minimizing its harmful effects.

As regards liberalization and deregulation, neither ASEAN nor APEC have changed direction in spite of the crisis. The ASEAN Summit in Hanoi in December 1998 confirmed the commitment to pursuing liberalization through AFTA. While a few economies were reported to have reversed their liberalization of a few sensitive sectors, many APEC members have kept their commitments to the UR Agreements and have continued to pursue their unilateral liberalization as expressed in their individual action plans. While the resistance by vested interest groups to reforms increased and protectionism gained momentum in the crisis-hit economies, this joint commitment has helped individual members to stick to their liberalization plans.

The advantage of APEC is its aim to implement facilitation and economic and technical cooperation (Ecotech) together with liberalization, as stipulated in the Osaka Action Agenda (APEC, 1995). The facilitation includes rationalization of customs procedure, harmonization of rules and standards, streamlining visa procedures, and so on. Ecotech is concerned with mainly technical cooperation in human resource development, trade and investment promotion, and environmental protection. These cooperative activities need to be implemented in parallel with liberalization measures. Unlike liberalization, they do not meet strong resistance from vested interest groups at home. In cases where developing economies are not capable of implementing them effectively due a lack of human resources and technological know-how, APEC has provided an effective framework for assistance. Furthermore, since facilitation measures need to be implemented jointly in a concerted manner, APEC has been promoting them in Collective Action Plans, making it more likely that the facilitation measures will progress steadily towards achieving the Bogor targets noted above (Yamazawa, 1998b).

Facilitation and Ecotech constitute a “plus element” over WTO and ordinary free trade agreements (FTAs). Since its inception, APEC has been oriented towards facilitation and Ecotech because it contains many developing economies. The essential elements of Ecotech are stated as follows:

> APEC economies will pursue economic and technical cooperation in order to attain sustainable growth and equitable development in the Asia Pacific region, while reducing economic disparities among APEC economies and improving the economic and social well-being of all our people (APEC, 1995).

On the other hand, other regional cooperation groups which consist of only developing economies are not capable of extending such help to other members. ASEAN could not provide such assistance within the group and only gave new members longer periods to complete committed tariff reductions. Even NAFTA, which is composed of both advanced and developing countries, lacks such assistance from the advanced to the developing members. East Asian developing economies should thus take the best advantage of what regional cooperation offers through APEC.

VI. A THREE-TIER PRESCRIPTION FOR THE GLOBALIZATION CHALLENGE

East Asian developing economies have been a pioneer group in responding successfully to globalization, benefiting from its opportunities and minimizing its harmful effects. Other developing economies will follow suit in their wish to achieve economic development. Thus prescriptions for East Asian economies will be relevant to other developing economies as well.

It is important to note that the mere resumption of production, employment and growth rates is not sufficient for recovery in the East Asian developing economies. In order to prevent a recurrence of the currency crisis and get back along a path of steady growth which they began in early 1999, they need to eliminate the factors that caused the current crisis. The following is a summary of prescriptions for achieving this at three levels: the national, regional and global levels.

At the national level, their economic fundamentals still remain valid and will support the revitalization of their economies. However, their structural deficiencies need to be corrected in the process of recovery. Their financial systems need to be strengthened so as to endure occasional disturbances in the market. The governance of their business firms needs to be improved in order to make them more competitive vis-à-vis multinational firms without governmental assistance. In addition, a temporary freeze on the convertibility of capital accounts may be needed to combat any serious speculative attack.

At the regional level, developing economies, by definition, are not fully capable of making all these efforts on their own. They need assistance in various forms: technical assistance for liberalization and facilitation, strengthening individual financial systems, and moral support or joint commitment for pursuing structural reform. These cooperation measures are already being implemented through APEC. The APEC Leaders' Declaration in Auckland in 1999 endorsed their commitment to utilizing the grouping to its full extent in this direction. The APEC leaders emphasized the "competition principles" in nurturing better and efficient markets – both domestic and international – and made commitments to provide assistance for "capacity building" by the developing members (APEC, 1999; PAFTAD, 1999). APEC finance ministers must strengthen their cooperation in order to avoid recurrence of the currency crisis in the region by stabilizing exchange rates, quickly providing rescue funds in case of liquidity crises, and establishing a network for macroeconomic policy cooperation. Multiple alignment of exchange rates between regional currencies and jointly pegging their currencies to a currency basket, as mentioned earlier, should also be pursued in the context of regional cooperation.

At the global level, several tasks still remain to be undertaken in order to combat the currency and economic crisis. A stable regional currency regime relies critically on deliberate control of volatile capital movements, which is beyond the capability of regional cooperation. A routine procedure should be introduced to prevent disruptive capital movements from engendering a liquidity crisis in a member economy. There is a need to introduce appropriate regulatory measures against disruptive capital flows.

The IMF should be strengthened so that it can provide a quick rescue fund to a member economy trapped in a liquidity crisis. Some form of regional arrangement for borrowing and repurchase should be worked out in the region to supplement the IMF. It is also indispensable to maintain stable exchange rates among major currencies: the United States dollar, the euro and the yen. The Group of Seven meetings of finance ministers and central bank governors and the IMF all have roles to play in this area, including a minimum coordination of macroeconomic policies among major players.

Cooperation at the *global level* is also needed to deal with other issues which developing economies in various regions have in common. International organizations, such as UNCTAD, WTO and the World Bank, as well as regional development banks, have to promote liberalization and facilitation for economic development, while providing needed technical assistance to all developing economies. Such assistance is provided by APEC to its developing members, but it should also be provided to all developing economies which do not have easy access. These organizations should also work for other types of global issues, such as the effects of greenhouse gases, population explosion and possible food shortages. A task force of APEC's (the Food, Economic Development, Energy, Environment and Population Group) is already addressing these global issues, and its efforts should be globalized to effectively deal with them.

Self-help is indispensable for developing economies to respond effectively to the challenges of globalization. At the same time, regional cooperation can help them in these efforts, and a global regime must be strengthened to enable them to benefit from globalization. The recent experience of East Asian economies is an example of how this can be made possible.

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