Economic development and Structural Changes in East Asia: Overview
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The United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Institute of Developing Economies/ Japan External Trade Organization (IDE/JETRO), and the Instituto de Economia/ Universidade Federal do Rio de Janeiro (IE/UFRJ) jointly organize two international seminars, one in Santiago on April 29-30 and another in Rio de Janeiro on May 2-3, on “Promoting Growth and Welfare: The Role of Institutions and Structural Changes in Asia”. The ALAC seminar is organized to focus on recent and prospective Asian development experiences and draw lessons for Latin America. Ten Asian economists are invited to present their analyses and views on respectively assigned topics and Latin American economists comment on them so that relevant lessons are derived from intensive discussion at the seminars.

This paper aims to overview the current state of East Asian economies and their future prospect and introduce participants to the individual topics to be elaborated by other nine papers. The first section overviews the steady development of East Asian economies leading to its miraculous growth and its underlying mechanism, ‘catching-up industrialization across the region. The second section analyses the Asian financial crisis with its causes and contagion spread to the region. The third section examines the recovery process from the crises and reviews tasks of avoiding recurrence of the crisis, structural deficiencies, social welfare net, and the new role of the governments.

The fourth section focuses on two major phenomena in East Asia, an emerging regionalism and China’s advancement and derive a strong case for closer regional cooperation among East Asian economies. The fifth section identifies two major tracks of action on the cooperation agenda. One is liberalization and structural reform and another is financial cooperation. They both emphasize the need for joint implementation in order to correct structural deficiencies commonly shared by east Asian economies as analyzed in Section 3. The last section summarizes policy implications derived from the foregoing analyses. It will also suggest that we should take advantage of the existing cooperation network of Asia Pacific Economic Cooperation (APEC) for the sake of East
Asian development. The section will be concluded with a short remark of implications for Asian-Latin American cooperation.

1. East Asian Economic Miracle and its Mechanism

Let me start with a quick overview of East Asia, which includes Japan, South Korea, China, Hong Kong, Taiwan, and ASEAN’s ten members. Hong Kong now belongs to China but as a separate administrative area. East Asia is a big region with unique characteristics. It stretches from 50 degree north to 15 degree south of latitude and from 90 degree to 150 degree of east longitude. Its total population is 1980 million, including 1267 million of China. A majority of them have more than middle sized population of 40 million. Its total gross domestic products is 7,347 billion US dollars (in 2000). They differ greatly in their stage of economic development; in terms of per capita GDP from US$37,546 for Japan, US$28,265 for Singapore and US$24,403 for Hong Kong, down to US$136 for Myanmar, US$260 for Cambodia, US$280 for Laos, US$404 for Vietnam (CLMV in Indo-China Peninsula and late-members of ASEAN), US$728 for Indonesia and US$855 for China (all in 2000).

<Insert Fig. 1 here>

The different stage of development has mainly resulted from different timing of starting modern economic growth at the market economy. Japan started the MEG in 1985, while other East Asian economies started it after World War Two in successive order; Newly Industrializing Economies (NIEs) such as Hong Kong, South Korea, Taiwan, and Singapore, started in the 1960s, then original ASEAN members (Thailand, Malaysia, Philippines, and Indonesia) followed in the 1970s, to be followed further by China since early 1980s and CLMV in the 1990s when the last two groups adopted open economy policy and started transition process from centrally-planned economies to market economies. In a decade from 1987, East Asian economies responded successfully to the globalization challenge and achieved a steady high growth both individually and as a whole region. Most of them achieved a rapid steady growth of 6-8 percent, except for Japan after 1992, China and Hong Kong during 1989-1992 and Philippines for 1990-94 because of political reasons for the last two. Their rapid growth was described as ‘East Asian miracle’ in the World Bank’s report (1993).

<Insert Fig. 2 A & B here>
Catching-up Industrialization

The primary mechanism of their rapid development was a catching-up industrialization; introducing new products to domestic market through import, developing domestic production to substitute import, and exporting their products abroad, often referred as ‘Catching-up Product Cycle’ (CPC) or ‘Flying Wild-geese’. named after a sequence of inverse V-shaped growth curves of import, production and export. The CPC development has been empirically substantiated in major manufacturing industries such as cotton textile, iron and steel, chemical, machinery industries in Japan (Yamazawa 1990 & 1992). It has two variations. Variation I refers to the transmission of CPC development from one industry to other related industries. The successful CPC development of cotton textile industry induced a successful CPC development of synthetic dyestuff industry, the first chemical industry, and another successful CPC development of textile machinery industry, the first machinery industry in Japan, both through backward linkage effects. Variation II refers to the transmission of a successful CPC development of one industry from early starters to next tiers, from Japan to NIEs, to original ASEAN members, China, and then to CLMV.

The CPC model well fitted Japan’s industrial growth until the late 1960s but Japan outgrew this catching-up development and has been exploring industrial frontiers such as liquid crystal and robots since the 1970s. However, the CPC model still fit the catching-up industrialization of other East Asian economies. Variation I of the transmission of industrial development from labor-intensive manufactures such as clothing, footwear, textiles, and household electronics to more capital and technology-intensive ones such as steel and machinery is partly witnessed within individual economies of NIEs and China.

Variation II have been witnessed across East Asia for the past two decades. As late comers catch up, early starters decrease their market shares and change to reverse import. Fig. 3 shows one of the recent examples, China’s catching up with Japan in TV production. The vertical axis measures domestic production divided by consumption, which shows a net import when the ratio falls short of 1.0 and a net export when it exceeds 1.0. China has entered the export stage in 1989 and reached 1.3 in 2000, while Japan entered the reverse import stage in 1994 and decreased down to 0.26 in 2000.
Table 1 also gives the catching-up by seven East Asian economies in five products, clothing, textiles, household electronics, steel and automobile. It was measured in terms of their shares in world export market over the 1990s. The shares are affected by the size of individual economies but the table shows that China has already exceeded Japan, Korea, and Taiwan in the first three products but not yet in the last two products and that ASEAN members have increased their shares in the first four products.

The successful industrial development of East Asian economies was attributed to many factors. The World Bank report (1993) listed such good fundamentals as high saving ratios, good work ethics, propensity for education, and cautious macro-economic policy management. It also mentioned their governments’ industrial policy which guided the catching-up industrialization and provided financial support to promising industries. Their potential advantage in those industries were apparent from their predecessors’ experiences and indeed was realized. In addition to these, the geographical proximity should be stressed as a factor contributing to their success as the whole region. They traded intensively with each other, thus enabling the provision of parts and materials for assemblers. The trade intensity indexes as high as 2 to 3 were recorded among East Asian economies in spite of the absence of formal regional integration except for ASEAN.

The catching-up was achieved by indigenous firms but it was helped by foreign direct investment (FDI) by preceding economies. Firms in early starting economies moved productive capacities to late-comer economies aiming to sell at domestic market under protection, which promoted import substitution by the latter. The former firms also invested in the latter to take advantage of its cheap labor and to export its products to a third market or even back to their own home market, which promoted export and reverse import.¹

¹ The possibility of ‘frog leap’ pattern, short-cutting the sequence of transmission of industrial development from early starters to late comers and a late-comer initiating new industry directly from advanced economies, was first mentioned by Chen (1992) and has become popular among East Asian economists. This is certainly encouraging for late-comer economies to skip lengthy development and jump to be a front runner in industrial development. However, reality seldom frog leaps. It may be witnessed in a few high tech products but seldom occurs in major industries of standard matured
The Locomotive Role of Japan

During a decade from 1987, Japan played a locomotive role through active FDI to its neighbor East Asian economies. These economies suffered from the setback in the mid-1980s when prices of petroleum and other primary products reached their peaks in 1980-82 after the second oil shock and declined sharply thereafter. Malaysia, Singapore, and Indonesia experienced a serious setback of their economic growth, even showing zero growth, as their export earnings decreased in 1984-86. However, they recovered strongly toward the late 1980s and continued rapid growth through the 1990s until 1997 (Fig 2 A & B above).

Table 2 shows the macroeconomic performance of Japan for 1987-2000. The Japanese economy grew at around 3 per cent during the first half of 1980s but gained 4-6 per cent growth in 1987-91. This was proceeded by the accumulation of the twin deficits in the United States, aggravated trade conflicts between the United States and Japan, and the Plaza agreement on multiple currency alignment. The yen-dollar rate doubled from 265 to 138 yen per dollar in two years then leveled off. Japanese production at home quickly became less competitive on the world market and its exports decreased. The Japanese government boosted domestic demand through expansionary monetary and fiscal policies so that the 4-6 per cent growth of GDP was contributed wholly by domestic demand while foreign demand decreased and tended to offset the domestic demand. Imports increased and the current account surplus more than halved from the record-high 13 trillion yen (U.S.$ 94 billion) for 1987-90. Japanese manufacturing firms in automobiles and electronics relocated their production capacity abroad to North America, Western Europe, and East Asia. East Asia's exports to Japan doubled between 1986 and 1991 and its accumulated sum for the period amounted to U.S.$342 billion. East Asia also received Japanese FDI of U.S.$28 billion for 1986-90. Japan thus promoted the catching-up industrialization of East Asian neighbors and contributed to their rapid growth since 1987. ²

² Some experts in Latin America and Africa noted that the catching-up industrialization technology.

However, East Asian economies got stumbled at Asian financial crisis in 1997-98. A speculative run on Thai bath and its drastic depreciation quickly transmitted to its ASEAN neighbors and Korea and other NIEs. Figure 4 shows changes in the nominal exchange rates of East Asian currencies vis-a-vis the U.S. dollar since January 1997. They are indicated in an index form with the base year of January 1997. They are denominated in the U.S. dollar per individual currency units so that a downward movement indicates depreciation in the Asian currencies while an upward movement indicates their appreciation against the U.S. dollar. This figure will show how East Asian currencies have floated for the past six years and been converging to different levels, mostly depreciated from their pre-crisis rates.

<Insert Fig. 4 here>

Until July 1997 Asian currencies were pegged with the U.S. dollar and were stable. To be exact, the Asian economies determined their exchange rates with currency baskets composed of the U.S. dollar, the Japanese yen, the German mark, and other European currencies, but the weight of the U.S. dollar was so dominant that they were often regarded de facto as pegged to the U.S. dollar. The exchange rate indexes of Asian currencies were almost flat at 100 and stable until July 1997. There were only two exceptions. The Chinese renminbi was devalued by 33 per cent in January 1994 but remained unchanged thereafter. The Japanese yen floated against the U.S. dollar all through the period.

has not occurred in their spheres. They attributed the absence of the CPC development to the failure of leading economies to facilitate successful transmission to their next tier economies, the United States in the case of Latin America and EU member economies in the case of Africa. However, the author would suggest alternative hypothesis that intermediate tier economies, Mexico, Brasil and Chile in Latin America and Egypt and South Africa in Africa have failed to transmit the CPC development to late tier economies. East Asian NIEs, on the other hand, transmitted the industrial development to ASEAN members and China in order to facilitate further upgrading partly because of their limited supply of labor and other resources.
However, price increases continued in those Asian economies that had stable exchange rates pegged to the U.S. dollar. From January 1995 to June 1997 consumer prices in China, the Philippines, Indonesia, Thailand, and Hong Kong (relative to that of the United States in the same index form as the nominal exchange rates) increased by 5 to 10 per cent. Korean, Malaysian, and Chinese Taipei’s prices remained at the same level, while Singapore and Japanese prices decreased by 3 to 5 per cent for the same period. The currencies with increased relative prices were overvalued in real terms even though the nominal rates remained unchanged. Many Asian currencies became overvalued and tended to weaken the international competitiveness of their production. Nevertheless, trade and investment expanded steadily during this period, and nobody predicted a sudden stop in the high growth of East Asia.

But this high growth was interrupted abruptly. During the run on the baht on July 2, the Thai government abandoned its peg with the U.S. dollar and moved to a floating rate. The baht depreciated in the market by 14 per cent within a month and depreciated further by 33 per cent by November. A similar run took place on the Indonesian rupiah, Philippine peso, Malaysian ringgit, and Singapore dollar, and they depreciated by 27 per cent, 24 per cent, 26 per cent, and 10 per cent respectively by November. The Taiwan dollar and Korean won were also affected in October and November. In December and January another round of currency runs attacked the rupiah, baht, and won causing 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 devaluation of the Hong Kong dollar and renminbi was anticipated by the market following the depreciation of other Asian currency in October and November, but both governments resolutely kept their exchange rates unchanged.

The Asian currency crisis passed its peak in January 1998 when most Asian currencies recorded their lowest levels and turned upward in February to April (Figure 1). The baht regained 16.6 per cent of its value, the won 10.6 per cent, and the ringgit 10.2 per cent. However, domestic political instability caused further depreciation of the Indonesian rupiah in May, which impeded the recovery of other Asian currencies thereafter.

**Real economy effects of the crisis**
The currency crisis disrupted their trade and investment and abruptly stopped the economic growth. Thailand, Indonesia, and Korea, which sought help from the IMF, had to resort to severe contractionary policies and have fallen into slow growth. Other economies in the region have responded to the currency crisis by constraining their budgets, suspending development plans, and reducing their growth rates considerably. The East Asian miracle disappeared abruptly. China and Hong Kong maintained their exchange rates, but both suffered from the same severe impact of the currency crisis on their real economies. Its impact has been so profound that it would be better to call it an economic crisis.

Big fluctuation of exchange rates never left trade and investment unaffected. In Thailand and Korea, export prices decreased abruptly and boosted manufactured exports. Exports of primary products were boosted in Malaysia and Indonesia. Exports increased in other Asian economies as well. To be sure, manufactured export prices did not decrease as much as their exchange rate depreciation. Manufacturing production in the Asian economies depended highly on imported parts and materials whose prices increased under depreciation. Exchange rate depreciation tended to increase the import prices of industrial materials, and foodstuffs in case of Indonesia, and tended to raise domestic prices and discourage exports. Furthermore, a depressed domestic economy dampened imports and a trade deficit changed to a surplus in many economies. On the other hand, exports from China and Hong Kong, which maintained exchange rates and export prices, were depressed, and exporters requested help from their governments. The impact of big depreciations has a strong "beggar thy neighbor" element and inevitably tended to aggravate conflicts among Asian exporters and between Asian exporters and their main market, the United States.

The foreign trade of East Asia is characterized by its high intra-regional trade, 35 per cent of its total trade. In 1998 it became evident that, because of the prolonged depression in the whole region, the intra-region exports of all East Asian economies were dampened, which came on top of the impact of their currency changes. Both their exports and imports shrunk and their trade imbalances aggravated. The depressed Asian market was reflected in decreased exports by American and European firms and it was worried that their deteriorated yields would cause declines in their stock prices and eventually lead to the downturn of the global economy.
East Asian economies as a whole fell in a trap. During their rapid growth they benefited from a virtuous circle of exports and investment; exports led growth while the high prospect of growth encouraged investment in capacity expansion and improved competitiveness. During the crisis this changed to a vicious circle of depressed exports and discouraged investment; the depression spread over the region dampened exports which, together with inactive consumption resulting from uncertain economic prospects, decreased aggregate demand and discouraged investment for the future. In 1998 individual governments tried hard to get out of this trap but in vain. Strong stimulus by external demand could draw them out of the trap, together with resumed currency stability and the recovery of a functioning financial system.

3. Recovery from the Crisis

In 1998, most of the region’s economies recorded negative or very slow economic growth rates. In 1999, however, they began to recover more quickly than had been expected, many with a growth rate of between three to five percent but some with much higher rates. The Korean economy, for example, made a V-shaped recovery of nine percent. It’s likely that most of these former crisis-hit economies have achieved a growth rate of more than five percent in the first half of 2000 (Fig. 2 and 3 in Section 1).

At the same time, a bipolar trend began to emerge in early 2000. While the dynamic recovery of Northeast Asian economies such as China, Taiwan, HK and Korea continues, ASEAN economies, including Indonesia, the Philippines and Thailand remained weak because the crisis brought to the surface previously latent political unrest. The recovery of East Asian economies was decelerated in 2001 due to the break of the IT bubble and resulting economy-wide recession, and the after effect of the September 11 terrorism in the Untied States. Their growth rates were reduced by 3 – 5 percent except for China. However, they all turned upward again in early 2002 again thanks to the quick recovery of the US economy.

Have East Asian economies recovered the pre-crisis level of their production? Table 3 gives the changes of real GDP in respective currencies in index form of 1996=100. The figures give a different picture of the recovery of their production from that of the growth rates. Korea’s real GDP declined by 2% in 1998 but exceeded the pre-crisis level (the values in 1996) in 1999, and achieved a 18.2 % higher level in
2000. Taiwan continued steadily by 5-6% over the crisis and exceeded the pre-crisis level by 24.5% in 2000. China also continued to grow by 7-8% and exceeded the pre-crisis level by 35.6% in 2000. On the other hand, in Thailand, the real GDP declined by 12.1% in 1998 and still 4.3% lower than its pre-crisis level in 2000. In Indonesia, its real GDP declined by 9% in 1998 and still fell short of its pre-crisis level by 3.9% in 2000. The decrease of production was smaller for Malaysia and Philippines. Real GDP of both economies fell by 0.6% in 1998 but recovered their pre-crisis level by 19999. The recovery of ASEAN members were much less than those of Korea, Taiwan, and China, endorsing the bi-polar trend.

<Insert Table 3 here>

Overviewing the changes of exchange rates of the East Asian currencies against the US dollar for the past three years, there is witnessed a convergence to respective levels of depreciation from the pre-crisis levels. Having regained by 5 – 10 percent in 1999 and the first half of 2000, they all tended to depreciate again after the mid-2000 and have stayed still for a year (Fig 4 above). From their pre-crisis levels, rupiah depreciated roughly by 80 percent, peso by 50 percent, bath by 45 percent, won by 35 percent, Singapore and Taiwan dollar by 22 percent, and yen by 10 percent. Ringgit stayed pegged at 35 percent depreciated level. Both renminbi and Hong Kong dollar stayed still at their pre-crisis levels.

If measured at constant US dollar prices, the real GDP of East Asian economies have not recovered their pre-crisis levels except for China and Taiwan. The index of the year 2000’s real GDP in US dollar with 1996=100 are 67.0 for Thailand, 67.4 for Indonesia, 87.9 for Korea, 89.1 for Malaysia, and 90.4 for Philippines, while they were 132.2 for China and 110.4 for Taiwan.

Structural deficiencies

In the midst of the crisis, Asian countries analyzed their predicament and concluded that although the crash may have been directly caused by huge amounts of capital withdrawal from Asia, its foundation lay in the vulnerable economic systems of the country’s themselves such as the vulnerability of financial systems, the immaturity of corporate governance and the lack of transparency in the market systems of Asian economies. 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 all at once by the current crisis. While these sort of structural weaknesses were masked by the performance of the so-called ‘miraculous growth’ of East Asia, they came to the surface once the currency crisis broke. These structural deficiencies should be corrected in order to prevent the resurgence of the crisis.

Economists were happy at the unexpectedly quick recovery of the region but expressed concern that structural reforms were progressing. The bipolar nature of the recovery is also reflected in efforts to promote these reforms. Korea, with strong initiatives from President Kim, is working hard to dissolve financial combines (chaebols), strengthen the financial sector by clearing bad debts, and introduce foreign capital. In China, all-out reform of state-owned enterprises is being promoted. These kind of efforts cannot proceed without strong government initiatives. On the other hand, in Indonesia and the Philippines, where civil war and social unrest continues, governments could not afford to implement drastic reform programs. In Thailand, where the foundation of the governing party is weak and there is ongoing political strife, the issue of bad debts is hardly being dealt with.3

The need for structural reform is shared by transition economies as well. China and Vietnam, under tight regulation, could avoid the detrimental effects of the crisis and have continued high growth but they share the same structural deficiencies. The recent access to WTO brings forth to Chinese firms both encouragement in globalizing activities and difficulties to adjust their system and practices to the market economy. It depends on their success in their reform efforts whether they really resume a steady growth path or not. Sohn (Chapter XX) conveys a successful restructuring of business groups and improvement of their corporate structure under strong governmental leadership in Korea, while Djisman (Chapter XX) reports a prolonged and indecisive adjustment efforts in the void of political initiative in Indonesia.

Financial systems of East Asian economies are crippled by a few common impediments; they all suffer from accumulated non-performing loans which tend to

3 New Tacsin government has started reform programs since early 2001.
cause a serious credit crunch to the real economy sector. Badly regulated financial sectors tend to bear unsustainably high risks, inducing great vulnerability to national economies. The post-crisis scenario is demanding a significant revision of the financial sector-productive sector relationships and it became a case in point on how the productive sector will re-institute their financial strategy. New agencies, regulations, terms of credit, sources of financing are emerging, still without a sustainable predictability in terms of guaranteeing adequate support for fixed investment. Kunimune (Chapter XX) overviews these issues across the region.

**Social welfare net**

Economic liberalization and deregulation induce corporate efficiency, thus unleashing forces that, theoretically, would facilitate the process of economic growth. However, growth opportunities are unevenly distributed among economic agents and actors. As the economic power of economic agents is disproportionate, there maybe a substantial risk that the wealth generated by efficiency gains may not be widely distributed. The aggravation of income inequality among different social classes and productive sectors is a strong possibility in the process of economic restructuring.

Unequal development may cause unfavorable feedbacks to growth by intensifying socio-political conflict. In a similar vein, market mechanisms cannot fully incorporate and resolve growth externalities, such as environmental degradation and urban congestion which may hinder economic growth in the long-run. These issues may be conductive to local conflicts when particular economic agents are considerably internationalized in terms of scope of action, thus not necessarily concerned about local welfare. Medhi (Chapter XX) and Alburo (Chapter XX) discuss theses issues in Thailand and Philippines respectively and introduced institutional arrangements implemented in their countries in order to alleviate potential negative impacts of growth on welfare.

**Role of governments**

Problems with the industrial structure in developing economies should also be addressed. Many developing economies in East Asia successfully expanded their
production and export of labor-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. The upgrading of their industrialization in order to substitute these imports has not made significant progress. This has been due not to the lack of funds but to the lack of capacity for absorbing technology and to the insufficient availability of skilled personnel. This structural deficiency would have stopped the East Asian miracle sooner or later even in the absence of the currency crisis. These tasks cannot be left to private sector but many Asian economists expect governments to play some roles. Government can give a guide post for industrial up-grading and engage in fostering skilled workers to enable it (Chapter XX by Jomo).

**Limited contribution by Japan**

What role can Japan play in this recovery process? The Japanese contribution to this recovery process turned out to be limited by its poor performance in domestic economy (Table 2 above). The medium growth of Japan in 1987-91 included elements of a bubble economy which showed up in skyrocketing land prices and a boom in real estate investment. The bubble broke in 1992 and brought everything down. Almost all financial institutions suffered from decreased prices in their mortgage assets and huge non-performing loans. Manufacturing firms too suffered from decreased asset values and reduced their investment both at home and abroad. Domestic demand stagnated and was assisted by export increases which pushed the current account surplus up again to 15 trillion yen (U.S.$141 billion) in 1993 which aggravated U.S.-Japan trade relations. The GDP growth rate went as low as 0-1 per cent in 1992-95, while the yen-dollar rate continued to appreciate to 79 yen per dollar in February 1995. In 1996 the growth was regained through increased domestic demand because of the government's strong burst of fiscal expansion, and the current account surplus almost halved again.

However, the recovery did not last long and the Japanese economy fell back into minus growth in 1997, -0.4 per cent, the lowest since World War II. Personal consumption, housing investment, and government consumption decreased and the contribution of domestic demand turned out to be -2.2 per cent, which was offset by a foreign demand contribution of 1.5 per cent. The current account surplus increased
again from 1.4 per cent of GDP up to 2.6 per cent, while the yen-dollar rate continued to
depreciate. The impact of the Japanese economy on its Asian neighbors has decreased
from that of the 1980s. Japan will achieve at most 2 percent growth hereafter and play
only a modest engine role in East Asia.

Nevertheless Japan's imports from East Asia increased steadily, although at a
decelerated rate from the 1980s, due partly to intra-firm trade between parent companies
in Japan and their subsidiaries in Asia. Japan's FDI decreased to Europe and North
America, but it increased to China and ASEAN reflecting Japanese manufacturers'
continued strategy of relocating production capacity to other parts of Asia until the
current crisis occurred.

The East Asian region is the home base for the Japanese economy. Ever since
the appreciation of the yen in the late 1980s, Japanese companies have been moving out
of Japan and establishing business networks in the East Asian region. This continued
even during the prolonged domestic recession of the 1990s. It is important for Japanese
companies and the Japanese economy that East Asian countries and regions move
forward with structural reforms and return to the path of steady economic growth. The
keys to this are the promotion of trade and investment liberalization, the reinforcement
of market competition functions, and the resolution of remaining structural problems.
This requires support for capacity building, and economic cooperation will be vital in
this.

4. Emerging Regionalism in East Asia

Global prevalence of regionalism

Regionalism is currently in fashion around the world. During the last decade we
witnessed the global prevalence of regional trading arrangements (RTAs). RTAs are
exempted from the GATT/WTO rule of non-discrimination and need to be notified
whenever they are concluded. Since the start of GATT in 1947, 214 RTAs have been
notified and 120 of them are still effective. 88 of the 120 effective RTAs were concluded
after 1990, 60 of which were concluded from 1995 to 2000.

The most advanced region in this respect is Europe. The European Community
(EC) has 15 member countries and has evolved into the European Union (EU) with its
integrated currency. Negotiations are now underway for the participation of eight additional members from Eastern Europe. In North America, the NAFTA free-trade pact between United States and Canada was expanded to include Mexico, and is in the process of expanding further to include Chile. Agreement has been reached among 34 countries in North, Central and South America to negotiate for the Free Trade Agreement of the Americas (FTAA), which will take effect in 2005.  

**Emergence in East Asia**

Regionalism has also emerged in East Asia. The six members of ASEAN formed the ASEAN Free Trade Agreement (AFTA) in 1992, and AFTA is now in the process of expansion with the inclusion in ASEAN of Vietnam, Laos, Cambodia and Myanmar. Among the ASEAN members, Singapore has been particularly active. It has already signed a free-trade agreement with New Zealand and Japan, and is negotiating a similar agreement with United States. Japan and Korea have traditionally emphasized multilateralism, but over the past three years there have been news reports of free trade agreements under consideration between Japan and Korea, Japan and Mexico, and Korea and Chile. A network of currency swap agreements are being formed among the ASEAN plus Three members.

The proposal of an East Asian Free Trade Area mentioned in the beginning came in the middle of this increased momentum for regional cooperation in East Asia. Furthermore, sub-regional groupings of different combinations for FTAs or closer economic cooperation are going on among this ASEAN + Three members. Nowadays there are plenty opportunities such as APEC, ASEAN plus Three, and ADB meetings for leaders and ministers of East Asian economies to discuss strengthening cooperation. The ASEAN plus Three Economic Ministers’ Meeting in Bandal Seri Begawan on September 13-15, 2002 provided the most recent occasions to promote the China-ASEAN and Japan-ASEAN FTAs. China and ASEAN leaders had agreed on forming a FTA within ten years in November 2001. This time their economic ministers added an

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4 This process will be strongly supported by the pass of the Trade Promotion Authority Act at the US Congress in early August 2002.
early harvest implementation of tariff reduction of hundreds items in eight agricultural sectors within 2004-2006. A framework agreement incorporating all these is to be signed by their leaders at the Summit Meeting in November 2002. On the other hand, economic ministers of Japan and ASEAN agreed to conclude an Economic Partnership Agreement including FTA within ten years and to start its negotiation in 2003. Korean economic minister also stated about his efforts to explore the possibility of forming a FTA with ASEAN members.\(^5\)

China, Japan and Korea have started their consultation on strengthening regional cooperation among the three. According to the proposal by Korean President Kim Dae Jung at the Three’s summit meeting in Manila in November 1999, three research institutes representing the Three respectively have started a joint study in how to promote trade and investment facilitation among the three since January 2000.\(^6\)

We should note, however, that East Asia has been slow to come around to the global fashion for regionalism. Negotiations are only taking place among a few countries, and in most cases they have so far been at the joint research and preparatory consultation stages. Nevertheless East Asian economies share needs for strengthening economic cooperation among themselves as we discuss below.

Nevertheless, there is heard a criticism against the FTA initiatives based on its inconsistency with multilateral liberalization. It is correct in theory because a FTA incurs a trade diverting effect on non-member countries. This is based on the negative static effects of the elimination of tariffs and non-tariff measures between members resulting from the formation of FTA but many economists admit it is likely to be more than offset by positive dynamic effects of intensified competition, economies of greater scale, promotion of investment and technology flow. Furthermore, the criticism is addressed to the conventional concept of FTA focusing on the elimination of tariffs defined by Article 24 of GATT fifty three years ago. Many of the current FTA initiatives aim to include a greater coverage such as investment and services, rules of origin, harmonization of rules and standards, intellectual property rights, and dispute settlement.

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\(^5\) Nihon Keizai Shinbun, September 14, 2002  
mechanism as well as tariffs and NTM as is shown in the ‘new age FTA’s mentioned by Singaporean Prime Minister Goh Chok Tong and to pursue the dynamic effects mentioned above. This provides a new type of regional integration different from free trade area which minimizes its discrimination against non-members and is strengthened by facilitation and Ecotech.

Cooperation for revitalizing East Asia

East Asian economies need these dynamic effects for revitalizing their economies. They continued a decade long ‘miraculous growth’ before it was stopped by the financial crisis in 1997-98. Their macro economies have recovered quicker than had been anticipated since 1999, but their structural deficiencies have remained uncorrected. Liberalization momentum heightened during the miraculous growth has tended to decrease in many economies. The return to a steady growth cannot be secured with liberalization and structural reform efforts. While sharing the recognition of these problems and strengthening regional cooperation toward a FTA, liberalization and structural reform will be secured through dynamic effects of FTA in individual economies. It should be a New Age FTA incorporating a wide variety of measures rather than a traditional one. The shared recognition of this need underlies the increased momentum of East Asian regionalism.

Is China a Threat or Support?

We have analyzed that the flying-geese development, which describes a catching-up industrialization in East Asia by the late 1990s, has extended to China and brought forth a dynamism of East Asia (Section 2 and Table 1). It cannot be denied that the recent advancement of the Chinese economy and Chinese firms has also caused a feeling of uneasiness and threat to the rest of East Asia. Although its majority view the China’s dynamism as a strong engine supporting East Asian development and other economies will benefit from it, there has started to emerge persistent requests for restrictive measures against China by sectors and firms directly competing with China. Closer cooperation is needed in order to prevent these protective moves and enable all

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7 “Buying Fast into Southeast Asia”, in Far eastern Economic Review, March 28, 2002
East Asia benefit from China’s dynamic advancement. The China-ASEAN FTA is partly addressed to mitigate ASEAN members’ uneasiness against China. This adds a strong case for strengthening regional cooperation in East Asia.

5. Two Main Tracks of Action on the Cooperation Agenda

Liberalization and structural reform

Two main tracks of actions are identified on the concrete agenda for regional cooperation. One is liberalization and structural reform and another is financial cooperation.

As we have already analyzed in Section 3, East Asian economies have recovered from the financial crisis of 1997-98 but their structural deficiencies have remained yet to be amended. Their foundation lay in the weak economic systems of the country’s themselves such as the vulnerability of financial systems, the immaturity of corporate governance and the lack of transparency in the market systems of Asian economies. Their financial system has developed non-competitively under governmental protection, while unsound government-business relationships have sometimes been aggravated by paternalistic industrial policies. These sorts of structural deficiencies were concealed during rapid growth but were revealed all at once by the current crisis. Although masked by the performance of the miraculous growth of East Asia, they came to the surface once the currency crisis broke. They should be corrected in order to prevent the resurgence of the crisis.

The need for structural reform is shared by transition economies as well. China and Vietnam, under tight regulation, could avoid the detrimental effects of the crisis and have continued high growth but they share the same structural deficiencies. The recent access to WTO brings forth both encouragement for Chinese firms to globalizing activities and difficulties in adjusting their system and practices to the market economy. It depends on their success in their reform efforts whether they really resume a steady growth path or not.

Need for joint implementation

It cannot be denied that momentum for liberalization has diminished in some ASEAN economies. China, Taiwan, and Vietnam have to adjust their legislature to their
WTO accession. Japan and Korea require revitalization of their economies. All East Asian economies need to intensify their efforts of liberalization, facilitation, and structural reform. They all realize the necessity for these efforts and they will do so voluntarily in economic textbook. However, in the reality of political economy, these efforts meet severe resistance by vested interest groups at home. These groups had benefited from the current economic and social systems and object to any attempt to change it.

Liberalization and structural reform basically depend on self-help efforts, but it is a fact that reforms tend to make little headway due to the resistance from entrenched domestic interests. Here we should remember why our predecessors established GATT. The GATT was created as an international mechanism under which countries could jointly pursue liberalization. Resistance to liberalization in import sectors is counteracted by support for liberalization in export sectors, and a framework of international liberalization commitments is created to move the process forward.

Joint international implementation will also be effective in structural reforms. It will be helpful in this context to provide guidance in the form of success stories from other countries. The structural adjustment lending offered by the World Bank and IMF already play this role. However, when international institutions encourage structural reforms in specific countries, they may not be in line with the circumstances of the country or region and may create an impression within the recipient country that it has been "forced" to make reforms. By contrast the mediation of a regional cooperation organization may be able to induce structural reforms in ways that are better suited to the specific conditions of the region. APEC economic and technical cooperation plays this role in some aspects.

So we rely on closer regional cooperation for joint promotion of liberalization, facilitation, and structural reform. There are two reasons for the joint promotion. First we would better utilize external commitments to the neighbors and peer pressure to break through the vested interest groups’ resistance. Second our companies operate across national borders and concerted efforts are needed to suggest the best practices or encouraging to implement minimum standard at least. This latter point suggests that the East Asian cooperation is good for outside companies and other APEC members as
well.

The dynamic effects of a FTA is realized only through structural changes of status quo and inevitably meets strong resistance by vested interest groups at home. It succeeds only through breaking their resistance, which is common to the WTO liberalization. In this respect forming a FTA serves as a laboratory of breaking through domestic resistance and thus contribute to the preparation for liberalization under a greater coverage such as APEC and WTO.

Regional cooperation also helps East Asian economies to efficiently implement environmental protection and secure supply of food and energy, taking advantage of complementary position of Japan and Asian NIEs with other members. Successful integration in East Asia will also intensify competition and inevitably cause trade disputes between members. Closer cooperation network is required to resolve disputes and implement industrial cooperation in time for early settlement.

**Toward closer financial cooperation**

Increased interdependence between East Asian economies through steady expansion of trade and investment has been accompanied by rapid financial integration in terms of the increased flow of foreign capital across money and capital markets in the region. Before the Asian crisis the dollar peg and capital account liberalization supported this integration process. Financial cooperation had started to facilitate this integration but did not work in time to prevent the crisis.

Financial systems of East Asian economies are crippled by a few common impediments; they all suffer from accumulated non-performing loans which tend to cause a serious credit crunch to the real economy sector. Badly regulated financial sectors tend to bear unsustainably high risks, inducing great vulnerability to national economies.

The proposal for an Asian Monetary Fund came out in the region in Autumn 1997. The proposal was for Asian 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 objection of some non-Asian members which did not want to see an increase of fund pooling outside the IMF. During the miraculous growth the East Asian economies watched over the financial aspects of rapid growth mainly through their
individual efforts of maintaining the dollar peg and their prudent management of macroeconomic policies, but they all were caught by the crisis. This should be contrasted with the progress in trade and investment liberalization and facilitation (TILF) and economic and technical cooperation (Ecotech) projects in APEC. As the APEC leaders suggested in their Vancouver statement, both financial and real sector cooperation should be promoted.

Recovery from the Asian crisis basically depends on the efforts of each country. Nevertheless, wouldn’t regional cooperation help to supplement, strengthen and support the recovery under way, especially the fragile recovery of some ASEAN members? In November 1998, the Deputy Finance Ministers meeting agreed to the Manila Framework, later supported by the APEC Leaders’ Declaration in Kuala Lumpur, which authorized the expansion of a loan system to prevent the spread of the crisis and strengthen the financial supervisory system. At the same Economic Leaders’ Meeting Japan announced the Miyazawa Plan to give $30 billion support to the crisis-hit economies. In addition, ASEAN plus Three met in Chiang Mai, Thailand in May 2001 and reached agreement over currency swaps to provide against the recurrence of a similar crisis. The agreement is designed to supplement emergency loans from the IMF and World Bank by improving regional cooperation. In the immediate aftermath of the Asian crisis, Japan proposed an ‘Asian Monetary Fund’ but opposition from the US and China prevented it from being realized.

The Chiang Mai agreement makes us feel that the momentum of regional cooperation, while a little late, is building up. The seventh APEC Finance Ministers’ Meeting in Bandar Seri Begawan in 2000 welcomed the Chiang Mai Initiative and confirmed that economies’ integration with the world capital market requires exchange rate policies that are highly credible and consistent with broader economic and financial policies. Finance Ministers also reviewed the activities of APEC forum on financial cooperation for the preceding year, which included Voluntary Action Plan for Promoting Freer and More Stable Capital Flow, Development of Domestic Bond Markets, Bank Failure Management, Financial Regulations Training Initiative, Strengthening Corporate Governance, Insolvency Law, APEC Initiative on Fighting Financial Crisis, and Electronic Financial Transaction System.
Need for a stable exchange rate regime

On the other hand, there has not been much visible progress toward a stable exchange rate regime. While most of the Asian currencies have been floated, the exchange rate movement seems to require further efforts for stabilization. Chart 1 shows the changes of exchange rates of East Asian currencies against the US dollar for the past six years. There is witnessed a convergence to respective levels of depreciation from the pre-crisis levels as described above (Section 2 and Fig. 4).

For almost a decade before the crisis, they were all on the level of 100 but now their cross-rates have changed by 20-75 percent. Do they show new equilibrium cross-rates reflecting their changed competitiveness after the crisis? Economists’ answers differ greatly on this. The depreciation of other Asian currencies has certainly helped the East Asian exports to the US market and contributed to their quick recovery from the crisis. It tended to decelerate Chinese firms’ exports and it was rumored that renminbi would be devalued after the crisis. However, some has been recently suggesting renminbi may be revalued owe to the advancement of China. Indeed, the pre-crisis cross-rates of Asian currencies (all currencies returning to the 100 level) do not reflect their competitiveness after the crisis. It is difficult to find a priori an equilibrium set of exchange rates. Nevertheless, I am concerned about that under the current float regime independently managed by individual monetary authorities another speculative run on an Asian currency may incur a contagion to neighbor currencies and trigger a competitive devaluation, thus resulting another Asian crisis.

Some form of region-wide currency arrangement seems to be needed to assure traders and investors about exchange rate stability in the region. De facto dollar-peg has proved inadequate given diversified trade patterns, greater capital mobility and inadequate monetary policies in each country. There is no guarantee that currency board arrangements escape from the same drawbacks as pegged regime. Free-float has their own costs of possible excessive volatility and free riding risks. Some form of managed exchange rate system with a market basket peg seems to meet the need of the region. Such a system needs to be combined by some form of currency cooperation among the US dollar, Euro, and yen.

Some form of region-wide currency arrangement seems to be needed to bring in the stable exchange rates in the region. A managed exchange rate system with a
market basket peg seems to serve the job, together with a currency cooperation among the US dollar, Euro, and yen. East Asian economies should introduce a minimum coordination of macroeconomic policies among themselves. This means that they need to introduce a set of ceiling ratios for their government debts, balance of payment deficits, external debt to their GDP, and inflation and sustain these target ratios through mutual surveillance and early warning in order to avoid the recurrence of big macroeconomic disturbances. It is important to make the market believe in the sustainability of the stable currency regime in East Asia for some length of time.\(^8\)

6. Tasks Ahead for Further Development

So much are the vision and action agenda for the cooperation for East Asian development. To summarize;

- it aims to help East Asian economies achieve a steady and sustainable growth
- it requires all efforts inclusive of liberalization, facilitation, structural reform as well as financial cooperation in parallel,
- it needs a comprehensive framework agreement like JSEPA to enable joint implementation by all members,
- it needs to be promoted in a stance of open regionalism and avoid unnecessary fear and overreaction by nonmembers.

Its momentum for realization is never as high as bilateral FTAs and sub-regional FTAs. Its proposal emerged from the discussion at the Summit Meeting of ASEAN plus Three in November 2000 without any prior consultation and preparation at official level and the leaders just agreed on starting a study and exchange of views on its feasibility in remote future. Nevertheless, the proposal responds to the need for closer economic cooperation among the East Asian economies resulting from a steadily intensified interdependence in the region and they have already implemented such a needed measure as currency swap agreement at the Chiang Mai Initiative in May 2001. The cooperation will be extended to technical assistance to strengthening financial systems of individual economies, facilitation of trade and investment and capacity building.

\(^8\) Ngiam (Chapter XX) pursues a more ambitious approach of forming a common
East Asian cooperation is not likely to be completed in a few years because many members are not ready yet to participate in such a high level FTA as mentioned above. It will require a series of negotiation at different levels to coordinate between different interests. Nevertheless, the momentum for bilateral FTAs and sub-regional FTAs have gained momentum as is evidenced recently at the ASEAN plus Three Economic Ministers meeting. We have to be pragmatic and patient enough to guide these bilateral and sub-regional moves toward a consolidated cooperation covering the whole East Asia.

We should accommodate all bilateral and sub-regional FTAs reflecting competitive liberalization, the reality of today, and take best advantage of it. But it is a double-edged sword and can change to a stumbling bloc. If only bilateral and sub-regional FTAs are pursued while the region-wide or global liberalization get paralyzed, FTAs will be inward-looking and discriminate non-members. It is very necessary to promote bilateral and sub-regional approach and the East Asian cooperation in parallel.

**Taking Advantage of APEC**

So far a wide variety of cooperative activities have been identified in East Asia. Individual member governments are supposed to pursue most part of them at home by themselves. However, some of them may not be able to do so alone and expect help from fellow members. ASEAN plus Three is still at the stage of talking and preparatory consultation and cannot extend help to those members not sufficiently endowed. Here we should take advantage of APEC forum.

All members of East Asia except for Cambodia, Laos, and Myanmar participate in APEC together with four American and three Oceania members. APEC made a modest start as an annual meeting of foreign and economic ministers in 1989 but it has developed to be a big Asia Pacific cooperation body which, under annual Leaders’ and Ministerial meetings, incorporate annual meetings of finance ministers and trade ministers, and occasional ministerial meetings in charge of small and medium industries, environment, science and technology, and education. Its Osaka Action Agenda of 1994 set two main tracks of actions, liberalization, facilitation, and Ecotech.

currency union in East Asia after the European common currency.
They also include deregulation and competition policies which encourage structural reform efforts and financial cooperation was added after the Asian crisis. APEC organizes more than two hundreds task forces and forum along these tracks all through every year and officials, experts, businessmen, and NGOs participate in these forum.

Its cooperation activities are based on the principle of voluntary participation and are not equipped with legally-binding enforcement such as FTAs let alone the tightly structured European Union. Its liberalization program has not made much achievement because of the lack of legally-biding enforcement and negotiating mandate and only provides technical assistance for liberalization and plays as a catalyst for liberalization through maintaining momentum for liberalization in the region. However, in facilitation, technical cooperation for structural reform, and financial cooperation, its forum have made progress taking advantage of the composition of APEC of both developed and developing members.\(^9\) East Asian members have been participating in these forum activities, which benefit them in achieving steady and sustainable growth. I would like to suggest that East Asian members should take full advantage of these APEC activities on purpose.

Some may object to my suggestion on the ground that APEC cannot be utilized only for the East Asian members. However, with its 21 members scattered around the Pacific, many task forces cannot accommodate the need of all members and inevitably focus on the need of one or another subgroup of members. Under the principle of voluntary participation and flexibility, APEC’s task force is proposed and organized by one or few members and participated only by interested members.(Yamazawa, 2001b) Even non-members are welcome to participate. It is quite legitimate for East Asian members to propose and organize task forces of facilitation, Ecotech, structural reform, and financial cooperation particularly meeting their needs.

On the other hand, American and Oceania members can participate in these task forces if they are interested in doing so. Their participation should be encouraged so long as their firms also participate in trade and investment in East Asia. It will help the

open stance of the East Asian cooperation to the outside of the region. Officials and experts knowledgeable about APEC activities are encouraged to give pragmatic advices to East Asian members about how to utilize them for the sake of the East Asian cooperation.

**Implications for Asia-Latin America cooperation**

A short remark on Latin America will conclude this introductory chapter of Asia-Latin America project. East Asia and Latin America were separated by the Pacific Ocean for centuries but the current wave of globalization is now making the two regions closer. East and Latin America have shared similar economic experiences for the recent decade. Both have experienced success and failure in their responses to globalization. East Asia achieved a miraculous growth over a decade 1987-96 and met across the currency crisis in 1997-1998, while Latin America, after a decade-long stagnation in the 1980s, achieved higher growth in the 1990s with setbacks in 1994-95 and 1998-99. Both East Asia and Latin America have to strengthen financial system and improve corporate governance to avoid the recurrence of setback from the growth path. Latin America has so far performed better in this restructuring but relied more on multinational enterprises in management than East Asia. This volume provides all information about East Asian experiences, while ECLAC (2002) makes its good counterpart about Latin America.

Economic ties between East Asia and Latin America will be intensified and closer in future in the current tidal wave of globalization. This is the reality of business in our world. But their path for closer interaction can be interrupted occasionally as their growth was by crisis and setbacks. Some efforts will be able to make our future course of interaction smoother. Their interaction has already started by mutual advancement of a few early starting firms of both East Asia and Latin America. More firms will be encouraged to get interested in trading and investing across the Pacific in this globalization trend. This can be left to the private sector. But the public sector will play some role. Better and deeper understanding of each other on both sides of the Pacific will help build a smoother pavement for business transaction. Incessant communication
and consultation at national and business leader levels will be useful in this regards. APEC can be utilized for this purpose as was described above. Dialogues between APEC and FTAA and between ABAC (APEC Business Advisory Council) and its Latin American counterpart will play intermediary roles.

References:
Yamazawa, Ippei, 2001b. APEC’s Achievements and Tasks for Shanghai 2001, presented at APEC Study Center International Consortium meeting in Tianjin, China. May
Table 1. Expanding export shares of East Asian countries by major commodities: 1990-1999 (%)

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Sources: IDE/JETRO's AIDXT Data-base, UNPC./AS, Taiwan's Trade Statistics  
Individual country's export divided by world total (84-98 countries). - denotes less than 0.1%
Table 2 MACRO-ECONOMIC PERFORMANCE OF JAPAN: 1987-2000

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<th>Year</th>
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<th>Growth due to domestic demand</th>
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Sources: Bank of Japan
Notes: Contributions of domestic and foreign demands are calculated based on GDE statistics
Table 3  Recovery of the Real Economy: Selected east Asian Economies

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<td>99.4</td>
<td>105.4</td>
<td>114.2</td>
<td>114.9</td>
</tr>
<tr>
<td>Philippines</td>
<td>849</td>
<td>893</td>
<td>888</td>
<td>918</td>
<td>955</td>
<td>981</td>
</tr>
<tr>
<td>(1985 peso, billions)</td>
<td>100</td>
<td>105.2</td>
<td>104.6</td>
<td>108.1</td>
<td>112.5</td>
<td>115.5</td>
</tr>
<tr>
<td>Thailand</td>
<td>3120</td>
<td>3075</td>
<td>2743</td>
<td>2859</td>
<td>2985</td>
<td>3027</td>
</tr>
<tr>
<td>(1988 baht, billions)</td>
<td>100</td>
<td>98.6</td>
<td>87.9</td>
<td>91.6</td>
<td>95.7</td>
<td>97</td>
</tr>
</tbody>
</table>

Source: ICSEAD(2002)
Notes: upper row shows GDP in national currency at constant price, lower row show their indexes of 1996=100. 2001e shows estimated values
Fig. 1 East Asia: Map of Economic Development
Fig. 3  China Catching up with Japan in Color TV

(Note) Domestic production /consumption: import when it falls short of 1.0 and export when it exceeds 1.0.
Calculated from quantity data; consumption = production + import - export.

(Source) Calculated and drawn by Fan Jiang Ta