NON-INSTITUTIONAL ECONOMIC REGIONALIZATION IN EAST ASIA

by

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ABSTRACT

Economic regionalization in East Asia has been the subject of considerable research in economics and political science. The literature on Asia Pacific economic relations has generally focused on efforts to build intergovernmental organizations or comprehensive legal agreements. Such efforts are referred to in this thesis as institutional regionalization. Less attention has been paid to the role played by the private sector and market forces.

This thesis is an attempt to fill this gap. It addresses three major forms of what it calls non-institutional regionalization in East Asia: (1) a multi-tier division of labor, which promotes economic regionalization along the lines of industrial production; (2) subregional economic zones, organized on the basis of production orientation and geographical proximity; and (3) Asian business networks, formed along ethnic and cultural ties. All three forms of regionalization are non-institutional in the sense that they do not involve the creation of formal institutions.

The thesis concludes that economic regionalization in East Asia has been driven by the private sector. East Asian governments are reacting to economic changes initiated by the private sector. This weak institutional pattern of economic regionalization is not likely to change in the near future due to the heterogeneity of the region. In addition, East Asian countries prefer the Asian way of regionalization, that is, by consensus, without imposed deadlines for free trade or the use of discriminatory trade practices. Thus, efforts to promote institutional economic regionalization in East Asia should be gradual, patient and oriented toward the long term.

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LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Agreement
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEM	Asia Europe Meeting
APEC	Asia Pacific Economic Cooperation Forum
EAEC	East Asian Economic Caucus
EC	European Community
EU	European Union
FDI	Foreign Direct Investment
FEER	Far Eastern Economic Review
FTA	Free Trade Area
GSC	The Greater South China Subregional Economic Zone
MFN	The Most Favored Nation
MNCs	Multinational Corporations
NAFTA	North America Free Trade Agreement
NICs	Newly Industrializing Countries
NIEs	Newly Industrializing Economies
PAFTAD	Pacific Trade and Development Conference
PBEC	Pacific Basin Economic Council
PECC	Pacific Economic Cooperation Conference
SEZs	Special Economic Zones
SREZs	Subregional Economic Zones

TNCs	Transnational Corporations
UNCTAD	The United Nations Conference on Trade and Development
UNDP	The United Nations Development Project

CHAPTER 1 INTRODUCTION

1.1 Introduction

The development of regional economic blocs has been surprising in the past few years. NAFTA was originally thought unlikely by many, but now it is the largest free trade area (FTA) in the world. Even though Western European Economic Union was once believed to be going nowhere, today Europe is moving toward stronger economic integration, particularly after the Maastricht treaty. Regionalization is apparently a global trend. This fits Robert Gilpin's prediction that the world is likely to break up into regional blocs as American hegemony gradually declines.[1] Will this trend gain momentum and lead to a free trade area in East Asia and the Asia Pacific?[2] This enduring question seems to gain new significance in the current historical era.

What is striking about the East Asia region – compared with Europe and North America – is that its regionalization has been driven by the private sector rather than by governments or any specific agreements.[3] In many ways, the region's governments are

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[1] Gilpin, 1987, pp. 406-408.

[2] The definitions of East Asia and Asia Pacific have not been unanimously established by academics. In this thesis, East Asia refers to the following countries and economies collectively: the ASEAN-4, consisting of Indonesia, Malaysia, the Philippines and Thailand; the Newly Industrializing Economies (NIEs), comprising Hong Kong, South Korea, Singapore and Taiwan; China and Japan. Asia Pacific includes all East Asia countries plus the United States, Canada, Australia and other APEC member countries. The focus of this paper is on the pattern of East Asia's non-institutional economic regionalization. However, the importance of the United States, and increasingly Canada and Australia, have made Asia Pacific become the broader context and supplement to the analysis. Even though the three forms of regionalization mainly occur in East Asia, it is important for the countries on the other side of the Pacific Ocean to realize and take into account the pattern when they come to push for the institutionlization of regionalization in the Asia Pacific region. Whether or not the non-institutional pattern can apply to the entire Asia Pacific region still remains to be seen.

[3] Helleiner, 1994, p. 5.

still trying to tackle the rapid economic changes initiated by the private sector.[4] In other words, it is the non-institutional track of economic regionalization that has been the driving force for investment and trade flows in this region. Formal institutions still are weak. Thus, the East Asian region as a whole has a pattern of "strong non-institutional and weak institutional economic regionalization." The purpose of this thesis is to systematically analyze this non-institutional form of economic regionalization.

What does non-institutional economic regionalization exactly mean? Unfortunately, the term "non-institutional" has been used by many scholars when they discuss regionalization in the Asia Pacific region, often with different connotations. For instance, when Peter Drysdale refers to non-institutional regionalization, he is actually talking about nondiscriminatory regionalization, or "market integration," while he uses "discriminatory integration" to refer to European style "institutional integration."[5] What Drysdale defines as "non-institutional" is still a kind of institutional regionalization, although it is looser than the European style of regionalization.

Economic regionalization refers to the disproportionate concentration of economic flows or the coordination of foreign economic policies among a group of countries in close geographic proximity to one another.[6] There are two forms of economic regionalization: institutional and non-institutional regionalization. In this thesis, institutional regionalization refers to economic cooperation which involves governmental policy cooperation over a range of activities, from consultation about a specific economic issue (usually to avoid conflict) and collusion in non-competitive or discriminatory

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[4] Stubbs, 1995, p. 786.

[5] Drysdale & Garnaut, 1993, pp. 188-189.

[6] Mansfield and Milner, 1997, p. 3.

market behaviour, to forms of market integration or even policy coordination.[7] This is normally at the state or state-agency level, such as a free trade treaty.

In contrast, non-institutional regionalization is linked to the actions of individuals or individual enterprises (the private sector) rather than to states or state agencies. Even though national governments influence the institutional framework of laws, regulations and comprehensive agreements, operators in the market are commonly from the private sector. International cooperative activities in these markets may consist of relatively simple processes of exchange, or involve functional links, such as production networks involving nationals of two or more countries.[8] Therefore, compared with institutional economic regionalization, non-institutional economic regionalization is less formal. There are less formal organizations or less comprehensive legal agreements involved. The private sector and market forces play a major role.

This thesis examines three major forms of non-institutional regionalization: (1) the multi-tier division of labor, which promotes economic regionalization along the lines of industrial production; (2) subregional economic zones, which is regionalization based on production arrangements and geographical proximity; and (3) Asian business networks, which is regionalization within ethnic and cultural lines. In all three forms of non-institutional regionalization, the operations are mainly determined by market factors. The private sector plays a major role, although their formation may be linked to government sponsorship.

The degree of formal institutionalization can be a good measurement for economic regionalization in Europe and North America. In these regions, countries have similar trade and business practices. Political and cultural gaps are also relatively small

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[7] Harris, 1993, p. 273.

[8] Ibid.

compared with countries in the Asia Pacific region. In Europe and North America, countries pay great attention to rules and standards, and use them to govern their economic activities. Therefore economic institutions and economic factor movements are closely related.[9]

However, it has become more and more apparent that this measurement of economic regionalization does not work well in the Asia Pacific region. According to the measurement of formal institutionalization, the degree of economic regionalization in the Asia Pacific region should be low, given that APEC is just a loosely organized forum. But in 1992, intra-regional trade accounted for 65 percent of the total trade of the sixteen APEC countries, while intra-regional trade of the twelve EC countries was only 58

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[9] In fact, when some economists talk about economic regionalization, they do not distinguish economic factor movement from free trade institutions. For example, Peter H. Lindert and Charles P. Kindleburger in their 1982 publication divided economic regionalization into four levels: free trade area, custom union, common market, and economic union. In a free trade area, all the tariff and non-tariff barriers among the members are removed but separate national barriers against trade with the outside are kept. In a custom union, members adopt a common set of external barriers so that there is no need for customs inspection at internal borders. In a common market, in addition to free trade, other economic factors (such as capital and labor) are also free to move among the member states. Full economic union is the most advanced of the four levels of economic regionalization. In an economic union, member countries unify all their economic policies, including monetary, fiscal, and welfare policies toward trade and factors movement. Therefore both Lindert and Kindleburger measure economic regionalization only by levels of institutionalization.

Furthermore, in their collective work, Richard J. Grant, Maria C. Papadakis and J. David Richardson pointed out that there are two methods for measuring the strength of a trade bloc formation and the impact of the bloc on the trade system: free trade area and shared membership pattern in intergovernmental organizations. Although they realize that those two forms may not percent.[10] This is really something unexpected for many political economists. That is why observers have kept predicting that there will be a breakthrough of institutionalization in the direction of establishing a free trade area since the mid-1960s. However, such a breakthrough has never occurred.

In 1993, when U.S. President Bill Clinton proposed an informal APEC summit in Seattle, his proposal was met by quick support from other APEC countries. Many observers thought that this might be a first step in establishing a free trade area in the Asia Pacific region. The success of the Clinton Administration in pushing the NAFTA treaty through Congress led observers to believe that the U.S. efforts would result in an expanded NAFTA across the Pacific Basin. But contrary to their expectations, during the Seattle meeting, the Asian leaders were not even willing to discuss concrete measures to establish a free trade area. At the 1994 APEC meeting in Bogor, the U.S. quest for a timetable of free trade within the 18 - member group was only reluctantly approved by some Asian countries and immediately rejected by Malaysia. While opposing America's "institutional" approach and "legalistic" stance, these Asian countries called for a more gradual development of regional ties and rejected anything resembling a trade bloc.

The 1996 APEC Meeting in Manila ended with more promises on tariff-cutting from its member countries. But most of the individual plans were mere briefs on current programs which member countries have been undertaking either unilaterally or as part of their economic reforms or for GATT's Uruguay Round.[11] The 1997 APEC meeting in Vancouver was over-shadowed by the Asian financial crisis. The showcase agreement on

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be a good way to measure the regionalization of "an East Asian or Pacific bloc," they do not give their own alternatives.

[10] Calculated from Direction of Trade Statistics (1993).

[11] FEER, Dec. 5, 1996, p.18.

lifting trade tariffs in nine specific sectors by 1999 was voluntary. While the goal was zero tariffs, the phase-in period and the reduction schedule were left for individual members to decide. Immediately after the list of nine sectors was announced, a Japanese spokesman admitted that abolishing tariffs on fish and forest products was pretty much out of the question. The Vancouver meeting underscored just how difficult it is to get consensus from Asia Pacific leaders around a common cause, even during a time of wide-spread economic trouble.[12]

The problem is that the institutional approach may not be the preferred way of economic regionalization for East Asian countries.[13] In fact, the East Asian way of economic regionalization takes a non-institutional form which has been driving trade and investment in the absence of formal economic institutions. Its importance exceeds that of institutionalization which is still weak. The literature on Asia Pacific economic relations has generally observed this phenomenon.[14] Yet, comparatively little attention has been paid to non-institutional regionalization in East Asia. This thesis attempts to fill this void.

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[12] FEER, Dec. 4, 1997, pp. 16-18.

[13] There are many occasions that Asian leaders request respect for the interest of the developing countries and emphasized that APEC should be a loose consultative forum based on consensus rather than a institutionalized forum or a free trade area.

[14] The prominent scholars and their publications include: Drysdale (1988) and Kojima (1985) on the whole framework and dynamics of Asia Pacific economic regionalization; Helleiner (1994), Higgott (1993), Higgott and Cooper and Bonnor (1991), Aggarwal (1993) and Stubbs (1995) on theoretical approaches and their relationship to the major economic trends in the region; Harris (1991) and (1993), Elek (1992) and (1995), Panagariya (1994), and Crone (1993) on different forms of regionalization especially institutional configurations in this region; Woods (1993) and (1995) on non-governmental organizations including PAFTAD, PBEC, and PECC and their role for economic regionalization.

1.2 Research Questions and Hypothesis

This thesis addresses the following questions:

1. Why does East Asia as a whole have a pattern of strong non-institutional economic regionalization and weak institutional economic regionalization?
2. What is East Asian non-institutional economic regionalization? What are the forms of non-institutional economic regionalization and their results?
3. What are the policy implications of non-institutional economic regionalization? What will be the general trend of economic regionalization in East Asia?

Through an examination of the whole process of development of economic regionalization among East Asian countries, the thesis argues that:

Non-institutional regionalization, that is, regionalization based on the private sector and not on intergovernmental or regional organizations, is playing an important role in regional economic development in the East Asia region. This pattern is not likely to change in the near future for two reasons: (1) the heterogeneity of the region greatly increases the transaction costs[15] of institutionalization and also makes it very difficult to reach broad and deep region-wide institutional agreement in either the East Asia or the Asia Pacific region. And, (2) East Asian countries prefer the Asian way of regionalization, that is, by consensus, without externally imposed deadlines for free trade or the use of discriminatory trade practices.

1.3 Layout of the Thesis

Chapter Two will examine the process of economic regionalization in the East Asian and Asia Pacific regions and demonstrate the paradox of a high level of economic regionalization in terms of factors movement and a low level of regionalization in institutional terms. It also will review the regional and extra-regional factors affecting the institutionalization of regionalization and show how heterogeneity tends to hinder institutionalization and homogeneity promotes institutionalization. The next three chapters will elaborate on three selected aspects of non-institutional regionalization: production structure, foreign direct investment (FDI), and cultural/ethnic ties. The conclusion will assess the three forms of non-institutional economic regionalization in East Asia together with their policy implications and a prospective agenda for future research.

[15] This term refer to the costs of effecting an exchange or other economic transaction, including those of negotiating and drafting contracts and the subsequent costs of adjusting. This concept is fundamental to the analysis of economic regulation, labour market, foreign direct investment and regionalization.

CHAPTER 2 THE SLOW INSTITUTIONALIZATION OF THE ASIA PACIFIC ECONOMY

2.1 First Wave of Economic Institutionalization

The history of the post-World War II years has been filled with failed efforts at creation of formal institutions in economic regionalization in the Asia Pacific region. This chapter first reviews the past attempts for institutionalization. Then, it will argue that the slow institutionalization is largely because of heterogeneity in the region.

The Japanese were pioneers of contemporary Asia Pacific economic regionalization. As early as in 1960, when the Japanese economy had just recovered from the war, some Japanese businessmen and scholars already raised the issue of economic regionalization. In that year, Morinosuke Kajima, a famous Japanese entrepreneur, proposed the idea of establishing a pan-Pacific organization. He pointed out that as technology advances rapidly, the enhancement of economic regionalization was inevitable.[16] Some other proposals were also made. These initiatives formed what we call the first wave of economic regionalization in the Asia Pacific region.

Among the proposals for economic regionalization in 1960s, the most influential one was from Kiyoshi Kojima, a professor at Hitotsubashi University. In November 1965, at the Conference on Trade and Development for Developing Countries held at the Center of Japanese Economic Research in Tokyo, Kojima proposed that a Pacific Free Trade Area (PAFTA) be established and tariffs be eliminated among the five Pacific developed nations. Gradually a Pacific trade and development institution, a Pacific Currency Area, and a Pacific Reserve and Development Bank would be established. Kojima was the first person who made specific suggestions on organizing a Pacific

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[16] Kajima, 1973, pp. 61-67.

community. Apparently, facing the emerging European Common Market, what he had in mind then was a Pacific version of the European Economic Community.

Kojima's proposal soon aroused great interest from some businessmen, scholars, and even government officials. Kojima supported his argument by pointing out that the level of intra-regional trade of the five Pacific industrialized countries was at least that of the six EC countries. But Kojima soon found that establishing a PAFTA was not possible at that time. The United States wanted to be a global power and was not interested in forming a regional grouping in the Pacific. The result of the first wave of economic regionalization was the funding of two regional cooperative organizations: the Pacific Basin Economic Council (PBEC) and the Pacific Trade and Development Conference (PAFTAD).[17]

The Pacific Basin Economic Council was created in 1967 as a forum for business leaders to discuss issues of common concerns. PBEC and its more than 1,000 member firms support the elimination of trade and investment barriers within the region. PBEC has a secretariat in Honolulu and member committees in several Asia Pacific countries. It is composed of entrepreneurs from Asia Pacific countries. Its goal is to discuss trade, investment, and cooperation in the Asia Pacific region.

The Pacific Trade and Development Conference was established by scholars of the Pacific countries. Whereas PBEC's business is business, PAFTAD adopts a policy-oriented, scholarly approach to regional economic questions.[18] It mainly discusses foreign direct investment, trade barriers, adjustment of trade structure, and other regionalization problems. Both PBEC and PAFTAD are private organizations which have limited influence on economic regionalization in East Asia and the Asia Pacific region.

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[17] Woods, 1989, p. 7.

2.2 Second Wave of Economic Institutionalization

Having experienced the difficulties of establishing a Pacific version of the EC, Kojima then turned to support Drysdale's idea of founding a Pacific version of the Organization for Economic Cooperation and Development (OECD). At the first PAFTAD Conference in Tokyo in 1968, Drysdale, a professor of Economics at Australian National University, proposed an Organization for Pacific Trade and Development (OPTAD). Having recognized the extreme heterogeneity and lack of regional consciousness of the Pacific countries, Drysdale considered the Pacific free trade area "overambitious."[19]

However, the rapidly expanding Asia Pacific economies and increasing interdependence made the existing regional arrangements and organizations inadequate. Therefore, Drysdale thought that there was a need for "a wide, flexible and non-bureaucratic institution for East Asian and Asia Pacific economies committed to outward-looking trade and development."[20] He thought that the PAFTA proposal provided a "useful starting point"[21] for other options like the OPTAD proposal. He suggested that the Asia Pacific region should develop into a "pluralistic community" in which heterogeneity could be accommodated.

Furthermore, Drysdale argued that the high growth of East Asian countries was related to their outward-looking policies. The outward-looking nature of East Asian economies determined that economic regionalization would not be like EU-style discriminatory trading arrangements, but would rather be an "open regionalism" that promotes intra-regional transaction without discriminating against countries outside of

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[18] Ibid.

[19] Drysdale, 1988, p. 208.

[20] Ibid., p. 211.

[21] Ibid., p. 209.

the region. The "OPTAD" he proposed would be a very loose intergovernmental cooperative institution, with only a small administrative apparatus. Issues would be handled by specific functional task forces. The style of operation would be consultative, informal, and communicative.

Drysdale's theory of open regionalism supported the institutionalization of Asia Pacific regionalization and was influential in the eventual establishment of the Asia Pacific Economic Cooperation Forum (APEC). But in the late 1960s, even a suggestion for a very loose intergovernmental organization proved premature. In fact, the first comprehensive unofficial regional organization, the Pacific Economic Cooperation Council (PECC), was not founded until more than a decade later, and the first intergovernmental regional institution, the Asia Pacific Economic Cooperation forum, had to wait for another decade to be established.

The Pacific Economic Cooperation Council (PECC) was created in 1980. It is a forum of academics, businessmen, and government officials acting in their personal capacities.[22] PECC working groups provide analysis and make policy recommendations to governments in areas such as economic policy, trade, energy and minerals, fisheries, and science and technology. The council's secretariat is in Singapore. The central principle promoted by PECC has been the idea of open regionalism, which has become a prominent feature of APEC.[23] PECC has established a consensus style of decision-making and an informational base for more liberal Asia Pacific economic regionalization.

APEC was established in 1989 for the purpose of trade and investment facilitation and liberalization through cooperation and consultation. Member countries have grown from 12 to 21 since 1989. It holds annual ministerial meetings and has 10 technically oriented working committees. In 1992, a small secretariat was established in Singapore.

[22] Woods, 1989, p. 8.

In 1993, associated with its 5th Ministerial Meeting, an "informal leadership conference" was held in Seattle. The Joint Statement of the first APEC Ministerial Meeting in Canberra noted that "every economy represented in Canberra relies heavily on a strong and open multilateral trading system, and none believes that Asia Pacific Economic Cooperation should be directed to the formation of a trading bloc."[24] The spirit of open regionalism has been constantly reaffirmed since then.

To date, APEC's accomplishments have been very limited. The small secretariat has confined itself almost entirely to regional information exchange and technical cooperation. The annual APEC ministerial meetings have been used primarily as a forum where resolutions stressing global economic goals have been framed and endorsed. APEC has not dealt, in a concrete way, with significant regional economic issues such as harmonizing regional economic policies or resolving regional economic disputes.[25] For example, the 1997 APEC meeting failed to provide an effective scheme to manage the Asian financial crisis.

2.3 East Asian Economic Caucus (EAEC)

In 1990, Malaysian Prime Minister Mahathir called for the creation of an East Asian Economic Group (EAEG) consisting of Japan, the East Asian newly industrializing economies (NIEs), China, and the other economies of the Association of Southeast Asian Nations (ASEAN). Although the precise role that such an economic grouping might play was never set out in detail, EAEG was meant to be the East Asian response to emerging

[23] Aggarwal, 1993, p. 1033.

[24] APEC Economic Committee, 1997a, p. 9.

[25] Saxonhouse, 1993, p. 412.

trade blocs like EU and NAFTA.[26] The lack of effectiveness of APEC in addressing regional economic interests contributed to the initiative as well.

Mahathir's proposal was strongly opposed by the United States, Australia and New Zealand. They all wished East Asian regionalization to be undertaken in the context of APEC. Strong pressure from the United States also led Japan to publicly oppose EAEG. The opposition to the original Mahathir Plan led to changes in this proposal. EAEG was eventually changed to East Asian Economic Caucus (EAEC), a periodic consultative mechanism. Whether this East Asian consultation will deal chiefly with the coordination of East Asian positions on global trade policy or whether it will extend to economic regionalization remains to be seen.[27]

One phenomenon worth mentioning here is that although not directly connected to the EAEC, the newly institutionalized Asia-Europe Meeting (ASEM) on its Asian side has some of the qualities of the EAEC. The Asian ASEM participants, the ASEAN members, China, South Korea, and Japan have coordinated their positions so as to have a common stance across the table from their fifteen European counterparts.[28]

2.4 Heterogeneity in Asia Pacific Region

The above overview strongly suggests that the process of institutionalization has been slow in the Asia Pacific region. Why is it so difficult to form a regional economic institution like a free trade area in the Asia Pacific region given economic transaction within the region? It is because heterogeneity tends to hinder institutional economic regionalization by increasing transaction costs. Economic institutionalization requires the participating countries to have similar laws and regulations governing trade and

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[26] Aggarwal, 1993, p. 1037.

[27] Saxonhouse, 1993, p. 411-412.

[28] Weatherbee, 1997, p.48.

investment flows. However, Asia Pacific countries have a diverse range of political and economic systems, making it difficult to harmonize trade and investment practices. The considerable national changes involved in the formal institutionalization may take long periods of time to negotiate and implement.[29] The process of adjusting will be more costly.

The sheer heterogeneity of the APEC members' political economy is the most fundamental difficulty APEC needs to overcome.[30] There are significant political, cultural, geographical, and most importantly, economic differences among the leading nations of the Asia Pacific region. The major heterogeneities in the Asia Pacific area can be summarized as follows.

A. *Political Heterogeneity*

Historically, the major countries in the Asia Pacific region have been political rivals. This situation has been changed only recently.[31] Trade and intra-regional investment have gone a long way toward bringing the former enemies together. This situation is fundamentally different from Europe. Europeans were able to move into treaties backed by the United States after World War II. However, in the Asia Pacific, before the mid-1980s, the U.S. was not interested in forming a regional trade bloc. Even today, some Asian economies that had emerged only recently from colonial status are still hesitant about a formal commitment to an economic cooperation process.[32]

Theoretically, three political systems exist among the Asia Pacific countries: the communist system, the authoritarian capitalist system, and the democratic capitalist

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[29] Tang and Thant, 1994, p. 5, and Turner, 1995, p. 639.

[30] Beeson, 1996, p. 41.

[31] See Pempel, 1997, pp. 13-15 for details.

[32] Harris, 1993, p. 277.

system. China, North Korea and Vietnam are still under the rule of communist parties; Singapore , Thailand, Indonesia, Malaysia, the Philippines and Brunei are authoritarian countries; the United States, Canada, Australia, New Zealand, Japan, Taiwan and South Korea are democratic countries. Even among the "democratic countries," there exist great variations in terms of the role of government in the economy, legal and administrative systems.

Communism in theory is based on public ownership and capitalism on private ownership. In reality, there is little hope to formally integrate these two systems. One of the main reasons why China, and later Vietnam, were able to integrate themselves into the world economy is that their economic reform has reduced the difference between them and other market economies. In other words, they have become more "capitalist-like."

B. *Heterogeneity in Economic Development*

If the political differences are difficult to measure, the economic disparity is much clearer. The level of economic development of Asia Pacific countries varies greatly. As the table shows, the per capita GDP of Japan was $36,497[33] in 1996, while that of China was only $662. The ratio was more than 55 times. In 1997, the per capita GNP of Japan is $34,630 - 173 times that of Vietnam ($200), 65 times that of China ($530) and 36 times that of the Philippines.[34] These differences are much larger than those among EU and North American countries. In the same year, the biggest GNP gap in EU was only 3.11 times - between Denmark ($32,500) and Portugal ($10,450), and that of North America was 7.8 times - between the U.S. (28,740) and Mexico (3,680).[35]

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[33] In this thesis, $ stands for US dollar unless otherwise indicated.

[34] FEER, *Asia 1997 Yearbook*, p. 15.

[35] The World Bank, *World Development Report*, 1998/99, pp. 190-191.

Table 1 GDP Per Capita of APEC Countries (in US Dollars)[36]

Country	1991	1992	1993	1994	1995	1996
Canada	21,026	20,042	19,121	18,283	19,121	19,542
USA	23,466	24,484	25,439	26,683	27,650	28,794
Mexico	3,414	4,246	4,616	4,723	3,147	3,608
Japan	27,573	29,926	34,397	37,602	40,926	36,497
South Korea	6,797	7,038	7,529	8,528	10,124	10,639
Taiwan	8,726	10,227	10,630	11,406	12,216	12,665
Hong Kong	14,828	17,362	19,661	21,800	22,710	24,603
China	351	412	507	451	576	662
Singapore	15,761	17,589	20,244	24,198	28,528	30,921
Thailand	1,721	1,922	2,137	2,416	2,781	3,072
Indonesia	701	748	835	914	1,012	1,113
Malaysia	2,604	3,022	3,153	3,718	4,284	4,656
Philippines	713	812	813	934	1,054	1,166

Economic disparity reflects the differences in the levels of industrialization, technology, labor costs and export capacity. One of the preconditions for institutional regionalization is that per capita income levels of member countries should be close enough so that adjustments in trade flows do not cause massive changes in the distribution of income and employment.[37] However, the vast differential of income level in the Asia Pacific area caused a wide gap in wage rates.

China had a monthly wage of only $36.51 in 1991, while in Japan the equivalent number was as high as $3,073.38. The ratio was 84 times. In contrast, in the EU in 1993,

[36] Calculated from APEC Economic Committee, *APEC Economic Outlook*, 1997.

[37] Schott, 1991, p. 6.

Denmark had the highest gross hourly wage for manual workers in industry (ECU[38] 13.49), with Germany (not including former East Germany) was close to this level (ECU 12.60). The lowest wages for manual workers are recorded in Portugal and in Greece, with five times less than that of a German manual worker.[39] The acceptance of low-wage Portugal and Greece into the EU has caused many problems for the EU. The farmers and manufacturers of relatively labor-intensive industries in the high-income EU countries are troubled by their counterparts in low-wage new members. The wage differential is also a major problem for NAFTA. Therefore, the much greater difference in labor costs in the Asia Pacific region makes institutional regionalization very difficult.

C. *Cultural Heterogeneity*

Cultural heterogeneity can also raise transaction costs. In the APEC countries, there are six major cultures and religions: Confucianism, Buddhism, Christianity, Islam, Taoism, and Shintoism. Meanwhile all the EU countries are largely Christian. The ethnic diversity in the Asia Pacific is also much greater than that of Europe. Sociologists often use families of language to measure cultural and ethnic diversity. If we count only the primary language of the member countries, all the EU countries belong to the Indo-European language family.

In contrast, APEC countries belong to six language groups: Sino-Tibetan (China, Singapore, Taiwan, Hong Kong), Japanese (Japan), Korean (Korea), Austronesian (Malaysia, Indonesia, the Philippines, Brunei), Thai (Thailand), and Indo-European (US, Canada, Australia and New Zealand).[40] Cultural heterogeneity not only includes language diversity, but also extends to much broader categories like consumption behavior,

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[38] European currency unit.

[39] Eurostat, *Europe in Figures*, 1995, p. 198.

[40] Wright, 1990, p. 306.

business practices, methods of management, and so on. All those cultural differences are major sources of non-tariff barriers and increase the costs of institutionalization.

D. *Heterogeneity in Security Interests*

APEC members have very different and sometimes even conflicting security interests. There is no hard, region-wide multilateral security agreement in the Asia Pacific region. Furthermore, there is a potential danger that military conflict may take place between some APEC members. For instance, China refuses to renounce using military means to unify with Taiwan if Taiwan declares independence. China, Japan and some ASEAN countries still have security-related disputes with one another.

E. *Other Barriers*

There are many other dimensions of the heterogeneity of or political disagreements in the region, for example, problems left by Japan's aggression, including the evaluation of Japan's aggression and compensation problems.[41] In addition, concerns about the potential dominance of Japan in East Asia still persist in many countries. Territorial disputes among East Asian countries, like the Spratly disputes (among China, Vietnam, Taiwan, the Philippines, Malaysia and Brunei) and the Sabah dispute (between Malaysia and the Philippines), could have a potentially damaging impact on regionalization as well.

2.5 Negative Impacts of Heterogeneity on Institutional Regionalization

In general, the considerable heterogeneity of the region results in a number of barriers to institutional regionalization. Drysdale and Garnaut use the term "trade

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[41] See Deng, 1997, and Kristof, 1998 for further discussion.

resistance" to describe most of the barriers.[42] Differentiation of economic levels often leads to stronger tariff barriers, and non-economic heterogeneity tends to produce stronger non-tariff or even non-economic barriers. For example, developing countries in East Asia such as Malaysia and Indonesia have a high tariff system. Their average tariff rates for consumer goods are as high as 60 percent.[43] In addition to tariffs, imports by East Asian countries are heavily protected by non-tariff barriers, such as quotas, restrictive licensing and import prohibition. Many other barriers are non-economic in nature, such as Taiwan's ban on direct trade with Mainland China and America's prohibition on investment in North Korea.

Moreover, East Asian developing countries are very sensitive to possible U.S. and Japanese dominance through regional institutions. They are not eager to sign a free trade arrangement with developed countries since they do not believe that free trade is fair competition for the less industrialized countries. Their long history of being colonized and strong desire for economic independence have made them very afraid of being locked into the current international hierarchy of economic divisions.[44]

To overcome those barriers, it is often not enough to be just economically competitive. Formal economic institutions have proved to be ineffective in dealing with "subjective resistance" to economic regionalization. However, non-institutional regionalization can be an effective way to get around those barriers. A multi-tier division of labor creates structural dependence of the lower-tier economies on the higher-tier ones. This division explains why Japan can maintain high trade surpluses with other East Asian countries. Subregional economic zones[45] aim to attract foreign direct investment and help

[42] Drysdale & Garnaut, 1993, pp. 189-190.

[43] Goto and Hamada, 1993, p. 20.

[44] See Suzuki, 1984, and Saravanamuttu, 1988 for further discussion.

[45] Economic sub-regions that connect only parts of two or more economies. Refer to Chapter 4 for details.

participating countries gain market access. The overseas Chinese network helps surmount political barriers in China-Taiwan economic relations.

2.6 ASEAN and AFTA - An Exception?

Underscoring the difficulties for regional economic institutionalization is the ASEAN Free Trade Arrangement (AFTA). In fact, AFTA has been the only significant attempt at regional trade liberalization in East Asia. The Association of Southeast Asian Nations (ASEAN) was established in 1967 by the five original member countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Brunei and Vietnam joined in 1984 and 1995 respectively. Laos and Myanmar joined in 1997. And Burma became a full member in 1998.[46]

The three major objectives of ASEAN are: to safeguard the political and economic stability of the region; promote the economic, social, and cultural development of the region; and serve as a forum for the resolution of intra-regional differences.[47] ASEAN was formed in the middle of the Cold War. Thus, for many years the grouping was preoccupied with regional political and security issues. Now, in the post-Cold War and post-Indochina War era, ASEAN's security concerns have been given an organizational form in the ASEAN Regional Forum (ARF).[48]

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[46] FEER, *Asia 1997 Yearbook*, p. 73.

[47] APEC Economic Committee, 1997a, p. 14.

[48] In July 1994, the ASEAN Regional Forum (ARF) held its inaugural meeting in Bangkok. It brought together the Foreign Ministers of eighteen Asian Pacific countries for a multilateral dialogue on regional security issues, such as the South China Sea conflict, confidence building measures, and aspects of preventive diplomacy. It is a annual forum following ASEAN's Annual Ministerial Meeting. Participants include Malaysia, Indonesia, Singapore, Thailand, the Philippines, Brunei, Cambodia, India, Myanmar, Vietnam, Laos, China, South Korea, Japan, Russia, the U.S., the EU, Canada, Australia, New Zealand, and Papau New Guinea. For further discussion, see Acharya, A. 1997, *The ASEAN Regional Forum: Confidence-Building*, Department of Foreign Affairs and International Trade, Canada.

Until the end of the 1980s, ASEAN as a regional political organization had been quite successful, but in the economic arena its progress was slow. In its first two decades, the centerpiece of ASEAN economic regionalization was schemes of industrial cooperation, such as the ASEAN Industrial Projects (AIPs) and the ASEAN Industrial Joint Ventures (AIJVs). But the results were disappointing.[49] In 1977, ASEAN agreed on the Preferential Trade Agreement (PTA) to promote intra-regional trade.

The rapid economic development of ASEAN members in the 1980s and into the 1990s had substantially increased the volume of trade among member economies. In 1992, ASEAN member countries agreed to set up the ASEAN Free Trade Area (AFTA), with the goal of reducing tariffs on intra-ASEAN trade in manufactures within 15 years.[50] Two major economic events have accelerated the AFTA process: the conclusion of the Uruguay Round negotiations in 1993 and the 1994 APEC declaration committing members to liberalize trade and investment by 2010/2020. Therefore, in 1994, ASEAN decided to reduce the implementation period of AFTA from 15 years to 10 years, i.e., to achieve it by January 1, 2003 (AFTA 2003 Scheme).[51]

Given the fact that AFTA has been in place only a short time, assessment of its impact on trade and investment flows of ASEAN members is difficult. The empirical work on AFTA at this stage is still limited. The case against AFTA lies primarily in the small size of the regional market.[52] Trade among AFTA countries comprises 0.9 percent of world trade in 1992 and 1.3 percent in 1995.[53] In 1993, intra-ASEAN trade accounted for 19.3 percent of the total trade of the ASEAN-6 (Brunei, Indonesia, Malaysia,

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[49] Weatherbee, 1997, p. 49.

[50] Ravenhill, 1995, p. 857.

[51] APEC Economic Committee, 1997a, p. 15.

[52] Panagariya, 1994, p. 817. For more effects of AFTA, see Ravenhill 1995, Ramasamy, 1995, Bowles, 1997 and Chia, 1998.

Philippines, Singapore, Thailand).[54] Vatikos has suggested that AFTA is saddled by its vagueness, extensive exemptions, and the differential rates at which members are required to cut their tariffs. Furthermore, non-tariff barriers have yet to be addressed.[55] AFTA's strategy does not expand the productive base of the national economies through conscious resource sharing or reallocation of investment.[56]

Moreover, the recent Asian financial crisis seems to has increased resistance to the implementation of the AFTA plan. There is concern that growing protection of local industry will delay the enforcement of trade liberalization. This concern is reflected by the following statement: "There may be certain industries which will be exempted to some extent from the AFTA 2003 Scheme, such as the petrochemical industry which is important to Malaysia and Indonesia. It is also possible that tariff reductions will not conform to the original scheme."[57] To date, the ASEAN economies may be too similar to generate large gains from the projected liberalization. Most ASEAN countries have similar levels of industrial competence, produce largely similar processed resources and labor-intensive manufactures and have to look beyond the region for technology and capital goods, and compete with each other for markets.[58] However, the removal of intra-ASEAN barriers may aid the region's efforts to attract more investment.

While ASEAN continues to lack substance as a free trade area, non-institutional economic regionalization within ASEAN countries has deepened considerably. The emergence and rapid expansion of cross-border production operations by multinational corporations (MNCs) have contributed a great deal to the economic regionalization

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[53] APEC Economic Committee, 1997a, p. 38.

[54] Chia, 1998, pp. 215-217.

[55] Vatikos, 1993, p. 15.

[56] See Bowles, 1997, 106., and Weatherbee, 1997, p. 50.

[57] Nagasaka, 1998, p. 25.

[58] Chia, 1998, p. 217.

within ASEAN. The influx of foreign direct investment from Japan and East Asian NIEs has prompted economic regionalization on a smaller scale, i.e., subregional economic zones. Much of the extraordinary development of China and part of Malaysia, Indonesia, and Thailand in recent years can be attributed directly to this kind of economic arrangement. Also, overseas Chinese networks in East Asia have exerted a great influence on this economic regionalization. In sum, AFTA does not constitute an exception to my assessment that Asia Pacific has only weak institutional regionalization.

2.7 Conclusion

East Asia in general has a pattern of strong non-institutional and weak institutional economic regionalization. Heterogeneity in this region tends to hinder regional economic institutionalization. Even though Southeast Asian nations have a formal agreement on free trade among themselves, it has taken 25 years for the six countries to reach the agreement and progress on serious liberalization is still out of sight.[59]

For the past two decades, East Asia was the most dynamic and fastest growing region in the world. To meet the need for economic internationalization and regionalization, East Asians tried to find their own ways to overcome barriers caused by heterogeneity. Since formal linkages are difficult, informal linkages through lines of industrial division, geographical proximity, and human networks have flourished in the region. Those informal linkages within East Asia have accommodated the needs of East Asian countries very well.

In the remaining chapters, three major forms of non-institutional regionalization will be studied: multi-tier division of labor, subregional economic zones, and Asian business networks. Among them the multi-tier division of labor provides a framework for informal regionalization and a basis for other forms of non-institutional economic regionalization. For instance, the complementarity of East Asian economies, resulting from the multi-tier division of labor, is a precondition for subregional economic zones to flourish.

[59] Panagariya, 1994, p. 832.

CHAPTER 3 THE MULTI-TIER DIVISION OF LABOR

According to economic integration theory, it is a general tendency for firms that have lost their comparative advantage[60] to move to less developed countries with lower production costs. In the case of East Asia, the geographical proximity and traditional commercial ties created a tendency for Japan to shift its mature industries to its East Asian neighbors. The dynamic process of expansion of division of labor, mostly through Japanese production networks, facilitates intra-Asian trade and investment and provides the basic economic configuration of East Asia today.

3.1 Product Cycle Theory

The product cycle theory is a well-accepted explanation for industrialization and economic development in East Asia. Economic development in East Asia cannot be understood outside the context of "the fundamental unity and integrity of the regional effort" that began with Japanese colonialism.[61] In the past century, Japan, Korea, and Taiwan have gone through a product cycle industrialization pattern, with Korea and Taiwan following in Japan's lead. The three phases of industrialization that occurred in Japan, and subsequently in Taiwan and Korea, were textile, steel/chemicals/automobiles, and high technology industries such as electronics and computers.

In the 1930s, the Japanese economist Kaname Akamatsu created his famous "flying geese" model to explain Japan's industrial development. Based on his study of the textile industry in Japan, he discovered that the process of Japan's industrialization

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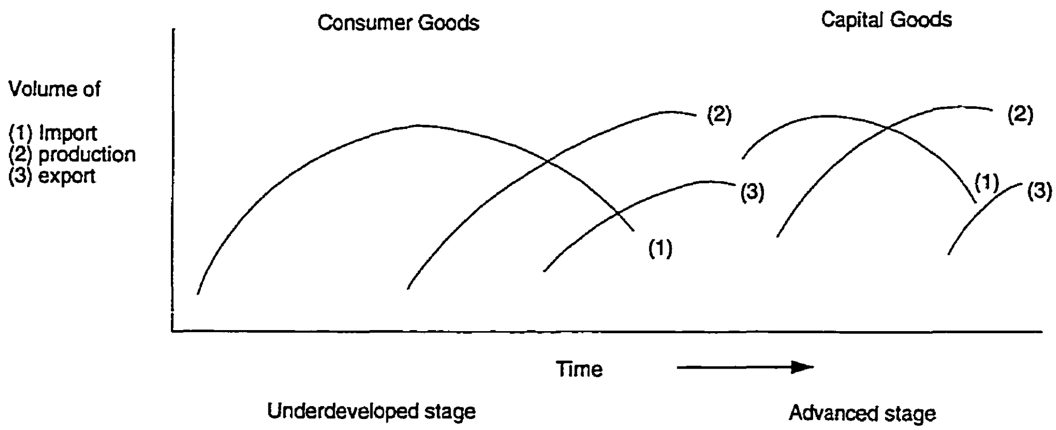
[60] Comparative advantage refers to a country's or area's advantage in the manufacture of a particular item when its production cost for that item is less than the cost experienced by other countries or areas for the same item. See Jerry M. Rosenberg, 1994, *Dictionary of International Trade.*

[61] Cumings, 1984, p. 3.

followed four cycles: imports of new products, import-substitution, export, and re-import. He suggested that diffusion of new products and technologies began with their import into less industrialized countries. Over time, along with the imported techniques and capital goods, "homogeneous industries" were established and the less industrialized countries acquired their own capital goods industries. In the fourth stage of the cycle, local capital goods industries developed export capabilities and exported to the originating countries. This process appeared on the graph in an inverse "V" shape, resembling a wild flying geese pattern.[62] Akamatsu summarized his model in the graph shown in Figure 1.

Figure 1 Akamatsu's flying geese model[63]



The product cycle in given Japanese industries, such as textiles, steel/automobiles, and electronics, indicates the process of origin, rise, apogee, and decline. In each industrial life cycle there is also an appropriate jumping off place, that is, a point at which

[62] Akamatsu, 1962. Also see Inoguchi, 1994 and Korhonen , 1994.

[63] Adapted from Bernard and Ravenhill, 1995, p. 174.

it pays to let others make the product or at least provide the labor. Taiwan and Korea have historically been receptacles for declining Japanese industries.[64] The pattern of industrial diffusion is from Japan to East Asian newly industrializing countries (NICs), then to ASEAN countries, and most recently to China and Vietnam. According to this contemporary "flying geese" analogy, the "flying geese model" and "product cycle theory" will be used interchangeably in this thesis.

Since the 1960s, this pattern has been extended to illustrate the international division of labor in East Asia. According to this pattern, East Asian economic development is divided into three stages in terms of differences of technology intensification: labor and resource-intensive economies, capital-intensive economies, and technology and knowledge-intensive economies. A country usually will experience the above three stages in its economic development. As an economy's industrialization advances and its income level increases, some of its products will lose their competitive advantage, and the economy will have to shift these products to another economy and upgrade itself to more advanced products. In this pattern, Japan is regarded as the leading goose and is placed in the first tier, East Asian NIEs in the second tier, and ASEAN countries in the third tier.[65]

The flying geese model is considered by many, especially the Japanese, as the model of East Asia's economic success. The core assumption is that "the development model adopted by the Japanese may be regarded as a suitable development strategy for newly industrializing economies today."[66] Kiyoshi Kojima, a student of Akamatsu's, argued that the special features of what he terms "Japanese-style DFI" are what enables

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[64] Cumings, 1984, p. 3

[65] For the more recent versions of the "flying geese" model and "product cycle theory," see Vernon, 1971, Kojima, 1985, 1986, Yamazawa, 1990a, chap.2 and 1990b, Rowthorn, 1996, and Pempel, 1998.

[66] Yamazawa, 1990b, p. 27.

developing countries to imitate Japan's development pattern.[67] Even the Japanese Ministry of Finance's Committee on Asia Pacific Economic Research recommended that "it is necessary that what Japan used to do should be done by the Asian NIEs, and what the Asian NIEs used to do should be done by ASEAN countries."[68]

The flying geese model has been a popular approach in North America as well. Apart from Bruce Cumings, economist Peter Petri has employed this model in suggesting that East Asian developmental paths have followed the Japanese pattern. This was partly because the NICs, especially Korea, consciously set out to model their industrialization on the Japanese experience.[69] Another American economist, Paul W. Kuznets, specifically applied this pattern to Korea's industrial development.[70] Political scientists Steve Chan and Cal Clark also suggested that "perhaps the most important explanation" for dependency reversal in East Asia lies in "the international product cycle."[71] According to these writers, the flying geese model describes precisely the postwar developmental success of first Japan, then the four NIEs, and recently the third wave of the ASEAN countries and China.

3.2 Flying Geese Model Reconsidered

Akamatsu's version of the flying geese model reflected Japan's own experience and the country's interests at the time he was writing. Trade was seen as the major vehicle of technology transfer, while MNCs played only a minor role. Moreover, the relationship between follower and leader had a fixed dimension. As the Japanese economy has developed, its economic relations with the rest of East Asia have changed.

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[67] Kojima, 1986.

[68] Foundation for Advanced Information and Research, 1990, p. 64.

[69] Petri, 1988 and 1993.

[70] Kuznets, 1985.

So too has the wild geese model.[72] In his more recent version of the model, Kojima stressed the role of direct investment as a means for transferring technology to follower countries.[73] In industries where the comparative advantage is lost, MNCs relocate production to lower wage countries. The modification of the flying geese model to recognize the activities of MNCs is an obvious advance given the great importance of MNCs in the contemporary world.

Recently the flying geese model has drawn much criticism. Mitchell Bernard and John Ravenhill argue that the application of the product cycle theory to contemporary East Asian experience is misleading. First, the theory makes assumptions about the maturation of products and technology as industries progress through the production cycle, but these do not hold in many sectors such as automobiles, electronics, or even part of the textile industry. Second, the model suggests that production for export in the countries to which manufacturing migrated would build on an experience of import-substituting manufacturing of these products; again such assumptions have decreasing relevance to the East Asian experience. Finally, the theory predicts that in the last stage of the product cycle, firms in the originating country will exit from the market, leaving domestic demand to be met from the exports of the countries to which production has migrated. But this stage of "reverse exporting" has largely failed to occur. This failure is a primary cause of the increasing interstate trade tensions within the region.[74]

The flying geese pattern is hierarchical, although many Japanese scholars would argue otherwise. In this pattern, Japan is placed on the highest tier of the division of labor in East Asia. It stresses that the region as a whole can advance by following the

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[71] Chan and Clark, 1992, p. 11.

[72] Rowthorn, 1996, p. 10.

[73] See Kojima, 1986.

[74] Bernard and Ravenhill, 1995, p. 175.

lead of Japan, and thus Japan is the center in economic regionalization.[75] But, while the formation of such a system of division owed much to Japanese efforts to seek competitiveness for their industries, the existence of American hegemony was essential for this division to work in the postwar period. Without aid from the United States, Japan, as well as South Korea and Taiwan, could not have achieved the high level of industrialization it now enjoys. Even today, the United States is still a major source of technology and investment for East Asian industrial advancement. Moreover, the U.S. market has been a precondition for all the geese to fly.[76]

To make the model more applicable, some have expanded it to include the U.S. in the first tier, so that the model became a double leading geese model. Recently, there were also suggestions to include China and other Southeast Asian countries into the third or even fourth tier of the division.[77] But this is not acceptable to the United States or China. The United States does not want to recognize Japan as the technical leader of East Asia. This was reflected in James Baker's talk on the regional configuration of the Asia Pacific area. He described the structure of the U.S. participation in the Asia Pacific as an open fan. The base was in North America with many spokes extending to the west. The most important ribs were the US-Japan alliance, the U.S.-ROK[78] alliance, and the U.S. relations with ASEAN and with Australia, and so on.[79]

China also has difficulty in finding a position in the model. Based on its average income level, China can be placed only in the third or maybe the fourth tier. But China is huge geographically, owns some high technology, and has strong innovation resources.

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[75] Pempel, 1997, p. 16.

[76] See Helleiner, 1994, pp. 8-9 for details.

[77] Inoguchi, 1994, p. 25., and Zhao, 1998, p. 107.

[78] Refers to Republic of Korea, i.e., South Korea.

[79] James Baker's speech at Japan Institute of International Affairs, November 11, 1991.

Moreover, since China's development will inevitably be unbalanced in different regions as parts of the country upgrade, it will not necessarily shift the mature industries to other countries, but to other regions within the country.[80] Therefore, instead of trying to fit into the model, China focuses on its own ways of regionalization. It quietly makes use of the overseas Chinese network and expands the subregional economic zones.

Despite those modifications to include the U.S. and China in the model, a fundamental problem remaining with the model is that it is static in the sense that while it allows the geese to move forward, they must follow the leading goose. But in reality, the pace of development of different economies is always uneven. The actual development of Asia Pacific economies has been much more dynamic than the model suggests. The change of division between Japan and the U.S. from vertical to horizontal, that is, from different industrialization levels to similar levels is one example.

Today the division between Japan and the East Asian NIEs is also becoming increasingly horizontal. The dynamic process of industrial structural relay itself means that many goods and capital are moving from one tier to another. Moreover, the movement of those goods, especially the transfer of capital and technology, means much more than the value of the goods or capital themselves, since it can greatly enhance the ability of lower tier countries to export and import. "FDI, particularly that to East Asia, was expected to shrink the trade balance .... As a result, the vertical division of labor, in which Japan imports raw materials and exports finished products, would change to a horizontal division of labor, in which Japan imports and exports finished products."[81] Thus, the Asia Pacific region exhibits a mixture of vertical and horizontal divisions. This mixture allows countries in the lower tiers to move upward. That is one of the reasons why some East Asian countries are industrialized or close to being industrialized.

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[80] Rowthorn, 1996, p. 7.

Even though the flying geese analogy of East Asian development fails to grasp the change of economic relations in East Asia, it is still undoubtedly accurate in some respects. First, it is true that economic development in East Asia has generally proceeded in waves, with Japan as the leading goose, then the first-tier NIEs, then the ASEAN-4, and now Thailand, coastal China and even Vietnam. Secondly, it is also true that as the East Asian countries have developed, their production and trade structures generally have undergone the kind of transformation implied by the flying geese model.[82]

3.3 Production Networks in East Asia

As a response to the inadequacy of the flying geese model, the production networks approach has emerged to explain the current regional multi-tier division of labor in East Asia. A production network refers to a system for division of labor centering on manufacturing.[83] Instead of the state-centric notion of countries replicating the development experience suggested by product cycle theory, the production networks focus on inter-firm relationships built around a hierarchy of technological capabilities and production practices. Also, unlike the static flying geese model, the production networks concept helps explain the variations among different patterns of industrialization of the East Asian countries.

Since the negotiation of the Plaza Agreement in September 1985, the regional political economy of East Asia has come to be comprised of clusters of interrelated

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[81] See Nishiguchi, 1993, p. 15.

[82] Rowthorn, 1996, p. 1-2.

[83] Hiroyuki, 1998, p. 19.

manufacturing sectors.[84] Production increasingly takes place in hierarchical networks. These networks are built around production and innovation centered in Japan. Meanwhile, the huge influx of FDI has established export-oriented manufacturing in Malaysia, Thailand and parts of coastal China. This has resulted in their linkage to production in Northeast Asia. Manufacturing is being regionalized in a number of key industries,[85] such as the electronics industry.

Nagasaka Toshihisa describes the Japanese production networks as follows: "the hubs of these networks are the head offices in Japan and their local subsidiaries (as mini-hubs in the case of electric home appliances, particularly in Singapore), from which intra-industry horizontal division of labor, in-house vertical division of labor, and inter-process division of labor focusing on parts procurement networks are being carried forward. Networks are also being formed around these hubs as base functions for supplying a comprehensive range of work and information, from product planning and design to parts know-how."[86]

3.3.1 Formation of the Networks

In his 1984 article, Cumings argued that the regionalization of production in East Asia has its foundations in the Japanese colonial period.[87] Japanese production in Taiwan, Korea, and Manchuria was an integral part of the pre-1945 Japanese empire. The postwar direct investment by Japanese firms in such industries as electronics and machinery manufacturing commenced in the 1950s in Taiwan and the 1960s in South

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[84] The Plaza Agreement took its name from the Plaza Hotel in New York, where a meeting of France, Germany, Japan, U.K. and U.S. adopted on 22 September 1985 a coordinated strategy to devalue the U.S. dollar vs. the currencies of its major partners.

[85] Bernard, 1994, p. 7.

[86] Toshihisa, 1998, p. 23.

Korea. Meanwhile, the U.S. government actively encouraged investment by U.S. corporations in front-line anti-Communist countries.

However, the off-shore production of U.S. corporations contrasted sharply with the Japanese overseas production in East Asia. The off-shore production of U.S. corporations tended to form front-line bases that were quite independent from their domestic production systems in the U.S. and were aimed at supplying the U.S. market. In contrast, the Japanese overseas production was highly integrated with domestic production systems in Japan.[88] In the production structure that emerged, firms in Taiwan, Hong Kong, and South Korea were linked backward to Japanese supplies of key components, capital equipment, and materials, and forward to markets in the U.S. and the E.C.[89]

The combination of changes in Japanese production and investment from Japan, Korea, and Taiwan served to broaden and deepen the regional division of labor in East Asia.[90] First, Japanese corporations reorganized their manufacturing practices by applying advanced American production and management skills and the latest technology to their particular situation. The innovations included the use of flexible machinery, reducing inventories and defects, decentralization of manufacturing-related decision making, and application of microprocessors to production.[91] This reorganization has made Japan the world's primary manufacturing country. Japanese firms have come to dominate key industries such as automobiles, consumer electronics, and precision machinery.

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[87] Cumings, 1984, p. 6.

[88] For more comparision between the U.S. "off-shore productions" and the Japanese "overseas production," see Hiroyuki, 1998, p. 21.

[89] Bernard, 1994, p. 11.

[90] Jomo, 1996, p. 8.

Secondly, the heightened trade tension between Japan and the United States intensified Japanese production links with Taiwan and Korea. The proliferation of nontariff barriers against Japanese exports increased the attractiveness of the East Asian NIEs as export oriented production bases, particularly for small and medium sized firms. In 1986-88, the original tensions between Japan and the U.S. were extended to Korea and Taiwan. A surge in imports from Korea and Taiwan led the U.S. to increase pressure for currency appreciation and to implement non-tariff barriers to restrict the access of their exports to the American market.[92] Eventually, as was true of Japan, Taiwan and Korea invested significant amounts in manufacturing in ASEAN and, later in China.

Economic and political factors combined to encourage manufacturers in Japan, as well as in Taiwan and Korea, to undertake foreign investment. The large currency realignments in the years following the 1985 Plaza Agreement caused dramatic changes in the competitiveness of domestic manufacturing. The yen increased in value by close to 40 percent in the years from 1985-87; the NT dollar (Taiwan) by 28 percent in the same period; and the Korean won by 17 percent from 1986 to 1988.[93] Currency appreciation was accompanied by changes in relative wages and increased cost of local labor. The loss of competitiveness forced manufacturers in Japan and the NIEs to relocate some aspects of their production to lower cost countries.

China and the ASEAN countries were ideal locations because of their geographical proximity and their efforts to attract foreign investment. A key inducement was trade policy reforms which were accelerated in the 1980s in China and Southeast Asia. Governments in Southeast Asia depreciated their currencies, allowed exporters to have freer access to imported capital goods and inputs, reduced uncertainty by signing

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[91] Bernard, 1994, p. 8.

[92] Bernard and Ravenhill, 1992, p. 2.

investment guarantee agreements, and introduced packages of assistance measures such as tax holidays. Also, for Taiwan there was the advantage of the link through overseas Chinese networks. And Malaysia offers an English-speaking workforce. Furthermore, the Southeast Asian countries continued to benefit from the U.S. through its generalized system of preferences (GSP).[94]

3.3.2 Spatial Expansion of Division of Labor

In the second half of the 1980s, the outflow of foreign direct investment from Japan, Korea, and Taiwan increased considerably. Between 1985 and 1990, Japanese firms invested more than $12 billion in East Asia. In the ASEAN region, Japanese FDI grew from $3.7 billion in 1983-1986 to $16.3 billion of 1989-1992.[95] In 1980, the U.S. investment in Asia (except Japan) was over 1.5 times that of Japan. For the past several years, Japanese firms have invested three times as much in Asia as U.S. companies. Japan has thus replaced the U.S. as the preeminent source of Asian capital.[96]

In 1989, Japanese firms invested four times as much money in Taiwan as they had in 1985, five times as much in Malaysia and South Korea, six times as much in Singapore, fifteen times as much in Hong Kong, and twenty-five times as much in Thailand. This trend continued into the 1990s. By mid-1993, Asia accounted for 19 percent of Japan's outstanding FDI, up from 12 percent in 1990. For the year of 1993 alone, 33 percent of total Japanese FDI went to Asia.[97]

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[93] Ibid.

[94] See Riedel, 1997, p. 4. and Bernard and Ravenhill, 1992, pp. 5-6 for further discussion.

[95] Stubbs, 1995, p. 12.

[96] Pempel, 1997, p. 18.

[97] Ibid.

The increase of investment in ASEAN has gone even further. In 1988, Japanese investment in ASEAN countries exceeded that in the Asian NIEs for the first time. Japanese direct investment in ASEAN countries increased from $935 million in 1985 to $4,684 million in 1989.[98] The majority of Japanese overseas production of consumer goods for the global market was shifted from the NIEs to ASEAN. Between 50 and 60 percent of Japan's new investment in East Asia was in manufacturing. Japanese firms, particularly those in the consumer electronics and automobile industries, began moving toward an expanded, intra-industry division of labor throughout the East Asian region.[99]

Taiwanese and, to a lesser extent, South Korean investment in ASEAN also rose substantially as a result of the currency revaluation that followed the Plaza Agreement. At the end of 1987, the total stock of Taiwanese investment in manufacturing in ASEAN stood at $78 million. In the following three years more than $850 million was invested according to official record. In 1985, the cumulative investment from South Korea in ASEAN amounted to $42 million, and in 1989 alone, new Korean investment amounted to $132 million.[100] By the end of the 1980s, Taiwan had replaced the United States as the second most important investor in ASEAN and had overtaken Japan as the single largest investor in Malaysia.[101]

The spatial expansion of production networks has linked Malaysia, Thailand, and coastal China to production in NIEs. Production networks have become regionalized in two ways. The first is the shift from the company to the "network" as the locus of productive and innovative activity. It is the interaction between firms linked by chains of production, exchange, and distribution that now constitutes the basic organizational unit

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[98] Ito, 1993, p. 5.

[99] Pempel, 1997, p. 18.

[100] Bernard and Ravenhill, 1992, p. 3.

[101] Bernard and Ravenhill, 1995, p. 182.

in the region. Firms, or even decentralized divisions within firms, maintain a degree of autonomy, but all significant activity is in some way coordinated with other organizations in the network. Secondly, the production arrangements rely heavily on the procurement of key components and equipment from Japan. Even Taiwanese or Korean firms, with ongoing ties to Japan or to locally based Japanese affiliates, continue these ties in their overseas operations in ASEAN.[102] Now, we may speak of regionalized manufacturing activity in a number of industries as an example.

3.4 Japan's Role in Production Networks

In the 1950s, as Japan's postwar political economy was taking shape, inter-firm production and distribution chains (known as *keiretsu* in Japan) emerged. Some were extended to include alliances between Japanese and Taiwanese or Korean producers. Both of these links were crucial in establishing production bases in Southeast Asia and backward linkages with Japan. During the ten years or so since 1985, Japanese production networks have been rapidly built as the most central industrial networks in East Asia. The division of labor among East Asian countries constructed by Japanese firms and production networks has progressed greatly. Itami Hiroyuki categorized the Japanese production networks into the following three major types.[103]

In the first type of production network system, Japan is the destination of the flow of goods from East Asia. A typical example of industries that employ this system is the sewing segment of the textile industry. Japan's imports of textile products from other East Asian countries increase in proportion to the increased scale of East Asian production. This type of network system can be said to promote imports to Japan since it

[102] See Bernard, 1994, pp. 10-11 for further discussion.

[103] Itami, 1998, p. 20.

aims to supply goods to the Japanese market. This even applies to the electronics industry, such as low-end products in certain categories of consumer goods.

The second type of production network, in which Japan forms the source of the flow of goods, promotes exports from Japan. Factories are built in East Asian countries for conducting the final stage of production activities. But Japan supplies the majority of parts and materials used by those factories. Most of their products are destined for East Asian markets. Thus, Japan's exports to other East Asian countries increased greatly. This pattern occurs in numerous industries, including automobiles, steel, chemicals, and general machinery. Even in the electronics industry, this pattern is also observed in the categories of producers' goods and capital goods.

The third type of production network is formed where the division of labor between Japan and other East Asian countries has advanced to a complicated level that involves many products and processes. This type of division of labor is being employed by such industries as electronics and precision machinery. The division of labor in the computer industry is now emerging as one regional unit which encompasses all of East Asia. Some analysts refer to this type as a "networked" division of labor. The final products manufactured from such a system are mainly destined for markets in the East Asian region, but are also exported to North America and Japan. However, in other industrial fields, the division of labor has not reached the same degree of development. For example, the automobile industry has formed a production system in each country and these systems are only loosely related.

Furthermore, Itami explained different impacts on trade between Japan and other East Asian countries posed by the three types of production networks. In terms of their effects on increasing both exports from and imports to Japan, the three types combined ultimately increase Japan's trade surplus. Even with the third type, export of parts (and related items) from Japan is still large enough to produce a considerable trade surplus.

The second type certainly promotes exports from Japan. Despite the first type's large imports to Japan, a considerable share of required materials is still being exported from Japan and it cannot be said to consist purely of imports.[104]

As a result, Japan's trade with the rest of East Asia has a considerable excess of exports over imports. Since the beginning of the 1990s, Japan's trade surplus with other East Asian countries has rapidly increased. In 1985, Japan exported manufactured goods to other East Asian countries worth US$6,898 million as compared to imports of only $779 million, giving a surplus of $6,119 million. In 1993, the corresponding figures were $31,152 million and $9,959 million, giving a surplus of $21,193. Thus, exports increased by 256 percent as compared to 1,178 percent in the case of imports, yet at the same time the Japanese trade surplus more than doubled.[105] In recent years, there has been an upsurge in Japanese imports of electronic goods from East Asia, but the scale of such trade is still quite small. In 1993, only 10.9 percent of all external exports of machinery and transport equipment from East Asia went to Japan, and the vast majority still goes to other markets in North America and Europe.[106]

Despite the realignment of currencies and despite improvement of export and import capacities of East Asian countries, the United States continues to be the biggest market to East Asia, and to bear the bulk of the burden of adjustment to the industrialization of the East Asian countries. The large imbalances, both within the region and between the region and the U.S., indicate how trade patterns have been

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[104] Ibid.

[105] Rowthorn, 1996, p. 3.

[106] Calculated from UNCTAD Data Base, 1994. For individual East Asian countries' trade deficit with Japan, and U.S. and Japanese shares in East Asian exports of manufacturing goods, see Bernard and Ravenhill, 1992, p. 7. and p. 23.

skewed by the structure of production. It also shows how the product cycle has failed to go full circle in East Asia.[107]

3.5 Implications on Economic Regionalization

The production network is the driving force for investment and trade flows in the East Asian region today. As we know, most East Asian countries have strong protection for their market. However, East Asian countries have fewer restrictions on imports that can increase production capacity, especially for those that will enhance future export capacity. This is because many East Asian developing countries have a very strong desire to upgrade their industries. They even give tariff and tax preferences for the import of important technologies and production equipment. Therefore, as they use direct investment to get around trade barriers in North America and Europe, Japanese use their foreign direct investment and production lines as an effective means to get around trade barriers in other East Asian economies.

While the multi-tier division promotes the industrial upgrading of East Asian economies, it also leads to the dependence of other East Asian economies on Japan's technology and equipment. In the late 1980s, governments of ASEAN countries promoted Japanese firms as preferred partners. Prime Minister Mahatir of Malaysia urged his country to "Look East." However these same governments gradually began to criticize the reluctance of Japanese firms to transfer technology and promote backward linkages with local partners. The high dependence does pose many problems, such as the potential threats to state power or constraints on policy options.

Pointing to this dependency, many people argue that technology has not really been diffused to other developing countries or to the NIEs. This argument is significant because it reminds people that the East Asian NIEs and ASEAN countries are not

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[107] Bernard, 1994, p. 20.

repeating exactly the same technical success that Japan had in its early period. Their economies are less innovative and less technologically independent. Nearly 79 percent of Taiwan's production equipment and parts, for example, are imported from Japan. The key technology and parts of the important industries in South Korea, such as the automobile industry, also rely on Japan. Moreover, for the production networks of East Asia, 80 percent of materials is being imported from Japan.[108]

This kind of production and trade dependency also exists between other tiers, for example, China's dependence on Taiwan. This should not, however, imply that the flying geese model does not work. The dependence of other East Asian economies on Japan and other developed countries clearly did not prevent them from narrowing their general distance in economic development levels from the developed countries. In fact, the East Asian NIEs are playing a much more important role in the regional economy than many people may have realized. In 1992, the total foreign trade of the four East Asian NIEs was $678.54 billion, significantly more than Japan's $572.94 billion (1.18 times). But only six years earlier (in 1986), the total foreign trade of the four East Asian NIEs was only $249.29 billion, less than 0.74 times of Japan's total foreign trade.[109] Today, the investment of the East Asian NIEs in the lower tier developing countries of the region is no less important than Japanese and U.S. investment. Most of the dynamism of East Asia now is in the middle and low tiers rather than in the upper tier.

In our highly interdependent world, given the small size and limited resources of the East Asian NIEs, it is often more efficient for these NIEs to rely on foreign technology than to create their own. The high dependence does create many problems. But on balance it is favorable to both sides. The general trend is for the gaps among the different tiers to continue to narrow. Moreover, economic interdependence has made the

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[108] Toshihisa, 1998, p. 23.

Japanese economy so interwoven with other Asian economies that it is extremely difficult to distinguish one from the other. "This, in turn, makes the Japanese economy dependent, rather than the other way around, upon the region's economy as a whole."[110]

The division of labor puts Japan in a favorable position in its competition with the United States. By the end of the 1980s, Japan had successfully established an extremely extensive production network throughout the region. This, combined with Japanese firms' resistance to imports from other countries and problems in selling in the Japanese market, has made the U.S. trade deficit with Japan structural. Japan is now the largest investor, exporter, and aid donor in East Asia and has become the unrivaled economic power in the region. The United States and other countries also try to take advantage of the desire of East Asian developing countries for industrialization and increased exports. But as a whole they are much less successful than the Japanese, either because they are less aware of the importance of adopting this production network strategy or because they are less capable of doing so (due to lack of experience, information, coordinated efforts, etc.).

3.6 Conclusion

The flying geese model is a useful model to analyze non-institutional economic regionalization in East Asia. It reflects Japan's own industrialization experience and highlights a process in which the advanced countries shift mature industries to less developed countries. The successes of South Korea, Taiwan, and other East Asian NIEs were generally achieved through this path. The significance of this model lies in its analysis of the linkages among the different countries in the hierarchy and the process of diffusion of development from one country to another.

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[109] Ibid.

However, there is more at stake in the contemporary economic configuration than the flying geese model suggests. The changing economic context, especially the spatial expansion of production networks after the Plaza Agreement, made some analysts suggest that the production networks approach might be a better way to explain the current economic regionalization. What the two have in common is that both the flying geese model and the production network approach are focused on production side rather than on trade. While the flying geese model analyzes the regionalization of production based on connections among individual countries, the production network approach focuses on inter-firm relationships. And the multi-tier division of labor here refers to the economic structure formed by production networks among multiple countries.

The multi-tier division of labor is a very important form of non-institutional economic regionalization in the Asia Pacific region. It involves no formal institutions or intergovernmental agreements, but works almost purely according to the market mechanism. Private industries and firms are the major players in the process. Strong production linkages are formed among firms in different countries. Technology transfer, building of production chains, and coordination of international operations are all done by private firms. At the center of this division are Japan and the United States. But the Japanese are much more successful in the regionalization of production.

The dispute about whether a flying geese pattern really exists in East Asia or the broader Asia Pacific region can be continued without a definite conclusion. However, few people would deny that a multi-tier division of labor is at work in the region. This hierarchical division is the most important form of non-institutional regionalization in this region, regardless of whether its pattern of development looks exactly like flying

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[110] Suzuki, 1992, p. 9.

geese or not. Therefore we can avoid using the term of "flying geese model," but we should not ignore the importance of this kind of regionalization.

CHAPTER 4 SUBREGIONAL ECONOMIC ZONES

4.1 Introduction

The concept of subregional economic zones (SREZs) was first created by East Asians. As early as the 1960s, Japanese businessman Takeo Touma proposed Japan's involvement in East Sea development issues, and thus should be credited with the conception of the SREZs in East Asia.[111] But Japan was not very strong economically at that time. More importantly, international relations in East Asia were then far from being favorable to economic regionalization. By the middle of the 1980s, Japan and the East Asian NIEs greatly enhanced their economic strength. China's open-door policy has also gained remarkable achievements. The strengthening of the Japanese yen after the Plaza Agreement made Japanese overseas investment much more profitable. As the demand for regionalization increased, SREZs, as an effective form of informal regionalization, attracted wide attention among East Asian scholars and they began to propose a number of subregional economic zones.

The formation of a subregional economic zone, in many cases, is a natural result of growing economic ties within a subregion. The Greater South China (GSC) subregional zone, the first SREZ in East Asia, was actually developed spontaneously through the business activities of Hong Kong and Taiwanese firms in South China. This led to proposals for other SREZs. For example, South Korean scholars proposed a Yellow Sea subregional zone in the middle 1980s which links China, Japan, and South Korea.[112] The United Nations Development Project (UNDP) has organized a series of research projects and meetings about the feasibility of multilateral economic cooperation in the Tumen River Delta Area among China, North Korea and Russia, with Mongolian,

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[111] Aldrich, 1997, p. 305.

Japanese and South Korean participation.[113] Other prominent initiatives were Growth Triangles in Southeast Asia, such as the Southern Growth Triangle (SIJORI) connecting Singapore, Malaysia and Indonesia, and the Northern Growth Triangle linking Indonesia, Malaysia and Thailand.[114]

Among all the existing subregional economic zones, the first and the largest one is the Greater South China SREZ, which is one of the most important factors behind the high growth rate of Southern China.[115] The unique development of regionalization without formal agreement within GSC highlights the non-institutional regionalization that has been fostered by the private sector. Another good example is the Southern Growth Triangle which is the only substantive SREZ in the ASEAN region.[116] It represents the combination of private sector initiative and government sponsorship. This chapter will examine the concept of SREZs and their effects for economic regionalization. Then, two established SREZs, the GSC and SIJORI will be introduced as successful examples.

4.2 What are SREZs?

Subregional economic zones are called by various names such as growth triangles,[117] regional growth zones,[118] subregional economic groupings, transnational export processing zones, natural economic territories,[119] and extended metropolitan

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[112] Zhao, 1998, p. 110.

[113] Kakazu, 1994, p. 245. For a systematic study of the Tumen River Area Projects, see Marton, Mcgee and Paterson, 1995.

[114] Thambipillai, 1998, pp. 252-255.

[115] See Petri, 1993.

[116] Naidu, 1994, p. 219.

[117] Tang and Thant, 1994.

[118] Weatherbee, 1997.

[119] Scalapino, 1992.

regions.[120] These ongoing economic regionalization processes cut across political boundaries and systems, and occur without formal institutions or structures, although sometimes with the help of government initiatives. Table 2 lists subregional economic zones in East Asia. They include those that already exist as well as those still in the conceptual stage.

Table 2 Subregional Economic Zones in East Asia[121]

Name of SREZs	Form	No. of countries	Component countries/areas
Northeast Asia			
Greater South China Economic Zone	Private sector activity	3	Guangdong and Fujian province (China), Hong Kong, Taiwan
Yellow Sea Economic Zone	private sector activity	3	Northern China, Japan, South Korea
Japan Sea Economic Zone	concept phase	5	East Russia, Northeast China, Mongolia, South Korea, North Korea
Tumen River Area Development Program	concept phase	6	East Russia, China, North Korea, Mongolia, South Korea and Japan
Southeast Asia			
SIJORI Growth Triangle	private sector activity	3	Singapore, Johor (Malaysia), Riau (Indonesia)
Northern Growth Triangle	government initiative	3	West Indonesia, Northern Malaysia, Southern Thailand
East ASEAN Growth Triangle	government initiative	4	Brunei, Indonesia, Malaysia and Philippines
Greater Mekong Growth Zone	ADB initiative	6	Yunnan (China), Vietnam, Cambodia Laos, Thailand and Myanmar

[120] McGee and MacLeod, 1992.

[121] Adapted from Chia and Lee, 1992, Kakazu, 1994 and Weatherbee, 1997.

A subregional economic zone is a transnational economic sub-region that connects only parts of two or more economies (with the exception of city states), often from different tiers of the multi-tier regional economy. For example, the Greater South China economic zone comprises Taiwan and Hong Kong, but only two provinces of China: Guangdong and Fujian. The North Growth Triangle involves the western part of Indonesia, the northern part of Malaysia, and the southern part of Thailand. The South Growth Triangle includes Singapore, the Riau Islands of Indonesia, and Johor state of Malaysia.[122] The Tumen River Area Development Program involves parts of Jilin province in China, the Russian Far East, North Korea, Mongolia, South Korea and Japan.[123]

The purpose of SREZs is to link geographically proximate areas from different tiers to create a larger regional market to exploit economic complementarities. Experience shows that each SREZ has a group of investing countries and a group of receiving countries. The investing countries provide capital, technology, and management skills and so far have included Hong Kong, South Korea, Singapore, and Taiwan. The receiving group of a SREZ has skilled and non-skilled labor, land, and other natural resources.[124] For instance, the Southern Growth Triangle is a combination of the cheap labor, land, and rich resources of Indonesia and Malaysia, with the abundant capital and technology of Singapore.

A subregional economic zone is not an economic organization or comprehensive legal agreement, although some SREZs are established through deliberate initiatives of related governments. Mainly the private sector and market forces have driven their formation and development. For instance, the Singapore-Johor-Riau (SIJORI) growth

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[122] Thambipillai, 1998, pp. 252-256.

[123] Aldrich, 1997, p. 300.

triangle had the endorsement of all three governments. However, the endorsement came about only after the member countries recognized the viability and usefulness of SIJORI.[125] There is no formal trilateral agreement involved. Compared with SIJORI, the economic regionalization of GSC has been more market-driven. Both the formation of the GSC and its development have been driven by business activities of firms from Hong Kong and Taiwan.[126]

4.3 Conditions for SREZs

Subregional economic zones are a natural result of regional economic development in East Asia. According to the law of economics, it is inevitable that capital will move to places where labor and raw materials are cheap and abundant, just as water will always flow downhill. From a regional perspective, the economic configuration of multi-tier division of labor is the very condition of SREZs. Geographically contiguous areas of different tiers create good conditions for the countries in higher tiers, with abundant capital and advanced techniques, but expensive labor and high production costs, to establish ties with economies that have cheap labor and production materials.[127]

Foreign direct investment is both a condition for and a desired result of the development of SREZs.[128] Intra-Asian investment to relocate labor-intensive manufacturing to low wage countries grew sharply after the currency realignments

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[124] Turner, 1995, p. 639.

[125] Naidu, 1994, p. 221.

[126] Chia and Lee, 1992, p. 27, Tang and Thant, 1994, p. 13.

[127] In a recent article, Zhao supports the argument that a multi-tier division of labor in East Asia makes their economies mutually supplementary and produces economic interdepence which leads to the emergence of "growth clusters"-SREZs. See Zhao, 1998, pp. 107-111 for further discussion.

[128] Weatherbee especially singled out FDI as an important economic variable at work in making a SREZ "efficient, attrative to capital, productive, and competitive." Weatherbee, 1997, p. 55.

following the Plaza Agreement. The rapid growth in investment from Japan and later Northeast Asian NIEs has been accompanied by rapid increases in wages in the host countries. Therefore, SREZs are a sensible solution for countries that still rely on massive inflow of FDI, but also face rising labor costs. By removing barriers to flows of inputs and capital, those geographically contiguous countries can maintain their export competitiveness.

Most studies conclude that economic complementarity, geographical proximity, political commitment, and infrastructure development are key factors in determining the success of SREZs.[129] Indeed, these factors are considered preconditions to winning commitment from the private sector. Among those requirements, the existence of economic complementarity is a prime matter. Differentials in factor endowment make economic regionalization between countries or parts of countries mutually beneficial.

4.3.1 Economic Complementarity

Economic complementarity arises from different levels of economic development and different resource endowments. On the one hand, there are developed areas that have strong manufacturing sectors, well-developed financial markets, advanced transportation capabilities, advanced information technology, and skilled labor forces. Their economic growth has brought the problems of an unskilled labor shortage and land scarcity. On the other hand, across the border, there exists a complementary economy, which lacks capital and managerial skills, and has an abundant supply of labor and land.

Both the GSC and SIJORI subregional economic zones have economic complementarity by containing both well developed and less developed low-income

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[129] Chia and Lee, 1992; Tang and Thant, 1994; Chen and Ho, 1994 ; Naidu 1994; EAAU, 1995; Weatherbee, 1997. The following analysis is based on these studies.

areas. They are basically combined production bases of newly industrialized economies (Taiwan, Hong Kong, South Korea, and Singapore) and developing countries (China, Indonesia, and Malaysia). The rich industrial and financial technologies in Hong Kong and Taiwan are capable of serving a wider economic and geographic base, such as the coastal provinces of China. Meanwhile the SIJORI growth triangle is a combination of the cheap labor, cheap land, and rich resources of Indonesia and Malaysia with the abundant capital and technology of Singapore.[130]

4.3.2 Geographical Proximity

Geographical proximity is an important consideration when transportation and communication costs need to be minimized.[131] Although modern technology offers effective methods of communication, for instance, internet, electronic mail, and multi-media, it still is not as good as face-to-face interaction. In the case of the GSC and SIJORI, geographical proximity has made it possible for the managers and professionals in Hong Kong and Singapore to return home for dinner everyday (if they wish) after working in Guangdong and Johor.

In addition, geographically proximate areas often share similarities in language and cultural background. Family and kinship ties often minimize communication costs and create better understanding and business trust.[132] A good example is the GSC: there is a strong interpersonal and cultural bonding between Cantonese-speaking people of Hong Kong and Guangdong and the Fujianese-speaking people of Taiwan and Fujian. Linguistic affinity and cultural bonding are less evident in SIJORI. However, the

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[130] See Tang and Thant, 1994, pp. 9-11 for further discussion.

[131] Chia and Lee, 1992, p. 12.

[132] Ibid.

overseas Chinese network is strong in promoting business between Singapore and Indonesia.[133]

4.3.3 *Political Commitment*

The SREZs are investment driven,[134] so the removal of restrictions on investment capital and labor is a precondition for the success of SREZs. At the national level, the governments need to initiate and implement appropriate policies in term of tariffs, foreign investment, finance, foreign exchange, employment, and real estate. Those policies and regulations must be supported and implemented by both central and local governments.[135] For example, the Indonesian government designated Batam as a duty-free area in 1978. Its relaxation of regulations and restrictions on FDI in Batam made the SIJORI possible.[136] Formal policy coordination is comparatively weak in the GSC. But China's economic reforms and "open door" policy did lay the foundation for the influx of capital from Hong Kong and Taiwan.[137]

4.3.4 *Infrastructure Development*

Infrastructure is the most important factor to create an economic environment for the development of SREZs. In SIJORI, Singapore's well-developed sea and air transport and telecommunication facilities have opened up access to the world market. In GSC, the

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133 Naidu, 1994, p. 225.

134 Chia and Lee, 1992, p. 12.

135 Tang and Thant, 1994, p. 13.

136 Thambipillai, 1998, p. 253.

137 Wu, 1997, p. 771.

preparation for the Special Economic Zones (SEZs)[138] involved large scale land development and capital construction. Later, an infrastructure development program focused on expressway, railway, and air links to the rest of the country and the world. Massive investment was also directed to the development of electrical power and telecommunications projects.[139] Also, inadequate infrastructure development continues to pose serious impediments to the Tumen River Area Development Program.[140]

4.4 Effects and Implications

SREZs are based more on production than on mutual trade.[141] This is consistent with the function of the multi-tier division of labor. The production side is where the break-throughs are made to facilitate regionalization. The free movement of capital within SREZs is more important than the unobstructed movement of merchandise. Although Asian governments tend to establish high trade barriers to imports, they often encourage imports that are production-related, especially those leading to future expansion of exports. The export-oriented nature of production within SREZs will provide access to new and more demanding overseas markets,[142] and lead to the upgrading of the labor forces and technology transfer in the long run.

Eventually the SREZs have trade-creating effects.[143] The participating governments usually grant tariff and administrative privileges to foreign firms that do

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[138] In 1978, China initiated its economic reform and open-door policy. As an experiment of the policy, Guangdong and Fujian provinces were authorized in 1979 to implement special autonomous policies, namely Special Economic Zones (SEZs) to attract foreign investment.

[139] See Tang and Thant, 1994, pp. 13-14, for a discussion..

[140] Aldrich, 1997, pp. 318-319.

[141] Chia and Lee, 1992, p. 4.

[142] Weatherbee, 1997, p. 54.

[143] APEC Economic Committee, 1997a, p. 32.

business in the zones. This greatly increases trade within the zone and among the participating economies. Moreover, the formation of SREZs greatly increases the export capacity of participating economies since it both increases the production (by adopting more advanced technologies and equipment from the NIEs) and reduces production costs (by using cheaper labor and resources).

SREZs build investor confidence and encourage entrepreneurial activity. The private sector plays a major role in both their formation and their development.[144] The facilitating role of government is to secure the openness of an economy by removing barriers to the flow of capital, labor, and goods both from the outside and between members of the zones. Additionally, governments may be called upon to provide infrastructure and forge bilateral and multilateral agreements, which further facilitate economic regionalization while maintaining export competitiveness.

In theory, SREZs combine the international mobility of capital with existing labor resources to enhance the individual countries' competitiveness in export capacity. In reality, SREZs also pose considerable challenges for participating countries.[145] While SREZs generate employment, they also create income differentials between SREZs and the rest of the country. Costs are incurred to prevent social unrest and huge labor migration to the SREZs. This has caused inefficient labor use as well as distorted the labor market.[146] The dominant foreign ownership and imported technology, combined with the absence of local R & D, limits technology transfer and creates dependency of FDI receiving countries.[147] Furthermore, the deregulation of customs, labor, and

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[144] Turner, 1995, p. 640.

[145] See Tang and Thant, 1994, pp. 19-21, Chia and Lee, pp. 41-43 for further discussion.

[146] Pang, 1993, p. 19-20.

[147] See Chen and Ho, p. 65 for example within GSC. This occurs to SIJORI too.

industrial policies is a contentious issue of economic sovereignty for participating countries.[148]

Notwithstanding, SREZs are a practical way for East Asian regionalization. Unlike the institutional form of regionalization, SREZs can be established at relatively low cost within a short period of time. Countries in East Asia see SREZs as a means to increase their competitiveness without great sacrifices in economic sovereignty. Also, SREZs can localize the impacts of liberalization. Successful regionalization can be extended while negative consequences can be restricted to the SREZ area.[149] This is particularly attractive for countries that are in a transition to a new economic system such as China. Finally, SREZs are more export-oriented than trade-oriented blocs, and less likely to provoke retaliatory action from other countries. Countries may also be attracted to SREZs by the possibility of utilizing them as a means of protecting themselves from trade blocs and increasing protectionism in other parts of the world.[150]

4.5 The Greater South China SREZ (GSC)

The Greater South China subregional economic zone currently consists of Hong Kong, Taiwan, the four SEZs in South coastal China, and surrounding areas. The four SEZs comprise Shenzhen, Zhuhai and Shantou in Guangdong province and Xiamen in Fujian province.[151] The emergence of the zone has been driven predominantly by the private sector seeking to exploit the existing factor price differentials. Complementarities in the comparative advantages of Guangdong and Fujian provinces of China, Hong Kong

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[148] Chia and Lee, p. 42.

[149] Turner, 1995, p. 639.

[150] For further discussion, see Tang and Thant, 1994, p. 23.

[151] Chen and Ho, 1994, p. 29.

and Taiwan have also been a major driving force.[152] Moreover, government policies, geographical proximity, and cultural affinities have facilitated regionalization as well.

Compared with other SREZs formed mostly through deliberate initiatives of the authorities, economic regionalization of GSC has been driven by the private sector and market forces.[153] There were no official negotiations between the member economies. It developed spontaneously through the business activities of Hong Kong and Taiwanese firms in South China.[154] As firms in Hong Kong and Taiwan shifted their production in accordance with comparative advantage, they also brought foreign direct investment and technology to China.

The division of labor in the GSC lay the economic foundation for regionalization. The economic complementarity derives from member economies at different tiers of the division of labor. Guangdong and Fujian are abundant in natural resources and labor. Taiwan and Hong Kong have strong industrial sectors, well-established financial markets, rich technological capability, a large pool of technical and managerial personnel, and plentiful capital. As a result, many manufacturing firms and labor-intensive industries in Taiwan and Hong Kong have relocated their activities to the SEZs in South China and its surrounding areas.[155] Also, the choice of Guangdong and Fujian as sites for business relocation was due in part to considerations of geographical proximity, linguistic affinity, and cultural similarity.[156]

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[152] Funabashi, Oksenberg and Weiss, 1994, p. 21.

[153] APEC Economic Committee, 1997a, p. 20.

[154] Zhao, 1998, p. 114.

[155] APEC Economic Committee, 1997a, p. 20.

[156] See Wu, 1997, pp. 776-783 for further discussion.

However, public policies have also been important in determining the extent to which economic regionalization has advanced.[157] After the economic reform and the open-door policies were initiated in China in 1978, four SEZs in Guangdong and Fujian provinces were established in 1980 to attract foreign investment. A number of preferential policies related to tax reduction, land use, finance, etc., were applied in these SEZs.[158] Hong Kong has always been a free port and has maintained close economic ties with both Taiwan and China. The government has been implementing a very liberal economic policy, with virtually no restrictions on firms relocating their manufacturing processes to China. In Taiwan, government controls on trade and investment have been gradually liberalized since 1987. This policy change is a key factor in the emergence of the GSC as well.

4.5.1 Regionalization within the GSC

The GSC has greatly enhanced the regionalization among the three economies involved. An indication is the impact of GSC dynamism on international trade. The GSC's share of world trade grew from about 3.0 percent in 1980 to about 8.4 percent in 1996. At the same time, intra-GSC trade grew from about 10 percent of those economies' total trade in 1978 to more than 30 percent in 1995. Between 1978 and 1996, China's merchandise trade grew at an average annual rate of 15.8 percent, Taiwan's at 13.1 percent, and Hong Kong's at 19.6 percent. World merchandise trade grew, on average, by about 7 percent per year. Thus all three economies increased their shares of global

[157] Chia and Lee, 1992, p. 27.

[158] Chen and Ho, 1994, p. 42.

trade. China and Taiwan increased theirs by almost 100 percent, and Hong Kong by almost 200 percent.[159]

As the middleman for expanding trading channels, Hong Kong's role in intermediation has become more prominent. Hong Kong's re-exports of Chinese products to world market expanded at a 26 percent annual rate between 1980 and 1992.[160] Most of the trade involved outward processing production, which constituted nearly 70 percent of Hong Kong's total imports from China, more than 76 percent of domestic exports, 48 percent of re-exports, and 55 percent of total exports to China.[161] Meanwhile, Taiwan's total indirect trade with China (direct trade is still not allowed) increased from less than US$50 million in 1978 to US$11.5 billion in 1995, with a substantial surplus in favor of Taiwan. Imports from China, which are restricted primarily to raw materials, accounted for only 1.5 percent of Taiwan's total imports in 1995.[162]

Hong Kong and Taiwan provided two-thirds of the cumulative realized external direct investment in China at the end of 1996. The cumulative value of realized direct investment by Hong Kong amounted to $100 billion, accounting for 56 percent of total external direct investment. Hong Kong's investment in Guangdong has an estimated five million employees working for Hong Kong firms at present. China's statistics show that at the end of 1996, Taiwan became the second largest investor in China just after Hong Kong, accounting for about 8 percent of total realized external direct investment. Taiwan's cumulative direct investment in Guangdong alone was estimated at approximately $1.5 billion.[163]

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[159] APEC Economic Committee, 1997a, p. 21-22.

[160] Wu, 1997, p. 783.

[161] Chen and Ho, 1994, p.57.

[162] APEC Economic Committee, 1997a, p. 21.

[163] Ibid.

In return, China dominates Hong Kong's entrepot trade, accounting for 59 percent of source and 29 percent of destination in 1991. An increasing share of Hong Kong's domestic exports are also China-bound, rising from 0.2 percent in 1978 to 23.5 percent in 1991. Hong Kong and China are each other's most important trading partner.[164] Also, China's investment in Hong Kong has become significant (it is not permitted yet in Taiwan). China is now the second largest external investor in Hong Kong just after the United Kingdom. Hong Kong's latest survey shows that at the end of 1995, China's cumulative realized direct investment in Hong Kong amounted to $14 billion while the corresponding figures for Japan and the United States were $11 billion and $9 billion, respectively.[165]

4.5.2 Prospects for the GSC

The challenge facing further development of the GSC lies in the wide differences in the political, legal and economic systems among its members and uneven economic regionalization in the SREZ.[166] Within the GSC, the movement of goods is relatively open, whereas controls on capital and foreign exchange are stricter and controls on migration are strictest of all.[167] Also, the SEZ policy has resulted in unbalanced investments in the different parts of China and internal distortions may have arisen.[168] Moreover, outward processing production caused a massive trade surplus with the U.S.

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[164] Chia and Lee, 1992, p. 33.

[165] APEC Economic Committee, 1997a, p. 21.

[166] See Chen and Ho, 1994, p. 63.

[167] APEC Economic Committee, 1997a, p. 31.

[168] Chia and Lee, 1992, p. 42.

and over-dependence of the GSC on the most favored nation (MFN) trade status granted by the U.S. to China.[169]

Despite these problems, the prospects for the GSC on the whole are encouraging. The dynamic performance of the GSC partially is the result of the re-establishment of trade links (albeit still indirect between China and Taiwan) among China, Hong Kong and Taiwan. With the resumption of direct shipping between Fuzhou/Xiamen in China and Kaohsiung in Taiwan, trade between China and Taiwan has grown more rapidly. Also, Hong Kong's sustainable prosperity is a key factor to continued success in the GSC area. Most 1997 indicators about Hong Kong are favorable at this point.[170]

Furthermore, the prospects for the GSC depend on the economic development of the member economies. The extensive integration of its economy with the global economic system has made it virtually impossible for China to discontinue its open door policy and economic reforms. The tremendous economic benefits for Taiwan from participating in the activities of the GSC will keep Taiwan in economic interaction with Hong Kong and China. As land prices and wages rise in Guangdong and Fujian, the GSC will most likely enlarge and expand northward into the mainland. The relocation of some industries from Guangdong to neighboring provinces is an example.[171] As the member economies move towards more liberalized economic policies, the GSC will geographically expand and widen the scope of economic regionalization.

4.6 The Singapore-Johor-Riau Growth Triangle (SIJORI)

Another set of subregional economic zones is called growth triangles in Southeast Asia. In 1989, Singapore's then Deputy Prime Minister Goh Chok Tong, now prime

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[169] Chen and Ho, 1994, p. 64.

[170] APEC Economic Committee 1997a, p. 31.

[171] Chia and Lee, 1992, p. 45.

minister, coined the phrase "growth triangle" to describe the transnational economic interactions linking Singapore through investment, infrastructure development and resource exploitation to the export-oriented economic development programs in the geographically contiguous regions of Malaysia's Johor state and Indonesia's Riau island. The South Growth Triangle, or SIJORI, is a new form of sub-regional economic regionalization within ASEAN to exploit economic complementarities of different factor endowments and levels of economic development. As the oldest and most successful SREZ in Southeast Asia, SIJORI thus has received considerable academic and policy attention as the model for SREZs elsewhere in the region.[172]

SIJORI developed effectively through links between Singapore and Johor on the one hand, and between Singapore and Riau on the other. Singapore and Johor have a long history of economic interaction driven mainly by market forces. By contrast, the Singapore-Riau link was created by government-led initiatives.[173] In August 1990, a bilateral agreement between Singapore and Indonesia was signed jointly to develop Riau, which broadened the triangle to include the Riau islands.[174] In June 1991, a further agreement was signed to develop jointly and share Riau's water resources.[175] With the flow of joint venture investment capital from Singapore private enterprises, and increasing investment from Japan, Taiwan and South Korea, the Riau industrializing base of the SIJORI is ever expanding.

The economic link between Johor and Riau is the least developed.[176] The primary transaction along this side of the triangle is Indonesian labor, legal and illegal, to fill the

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[172] See Chia and Lee, 1992, Naidu, 1994, Kumar, 1994 and Weatherbee, 1997.

[173] See Thambipillai, 1998, p. 253 for details.

[174] Naidu, 1994, p. 228.

[175] Ibid., p. 229.

[176] Chia and Lee, 1992, p. 15.

labor intensive manufacturing jobs in Johor created by Singapore capital. Johor has already complained that Singapore investment has been too labor oriented rather than transferring capital and technology.[177] Also, the emerging shortage of labor in Johor led firms to consider the possibility of investing in Indonesia. Eventually, it was not until 1993 that the Malaysia Federal Government officially approved Johor's participation in the growth triangle. This approval made possible the signing in December 1994 of an official trilateral agreement on the development of the SIJORI growth triangle.[178]

The objective of the agreement, as stated in Article one of the Memorandum of Understanding (MOU), is to promote development, expansion and integration in the areas of trade and transport, tourism, shipping and communications, agriculture, forestry, development of industrial infrastructure, and supporting industries.[179] Singapore is the principal force behind this triangle, with excellent infrastructure, well-developed financial markets, comprehensive sea and air transport, and advanced telecommunication facilities. However, rapid industrialization caused shortages of labor, land and water as well as rising production costs. Johor and Riau possess cheap land and labor. Under the growth triangle arrangements, the products in Johor and Riau could be designed, marketed, and distributed by service industries in Singapore, where they would benefit from the excellent infrastructure.

The regionalization of the SIJORI is non-institutional. Natural economic complementarities have induced the flow of Singapore's investment to Johor or the Riau island. This economic transaction would have occurred even without the political framework of an MOU. Moreover, the real lead in export oriented production in the SIJORI is not given by the states but by entrepreneurial capital. In other words, market

[177] Weatherbee, 1997, p. 52.

[178] APEC Economic Committee, 1997a, p. 22.

forces are the driving force, not political or bureaucratic planning. Therefore, governments are facilitators, not originators.[180]

Nevertheless, the facilitating role of government is critical. The SIJORI seek to exploit economic complementarities by reducing regulatory barriers in order to attract domestic and foreign investment and to promote exports. The governments of the different national economies are expected to provide the necessary legal framework, investment incentives, export promotion and infrastructure development to meet the growing requirements of the private sector.[181] In addition, they began to harmonize and simplify investment rules, taxes, land laws, labor market policies, and immigration and customs procedures to improve their competitiveness and to attract and facilitate foreign investment.[182]

4.7 Conclusion

Both the GSC and SIJORI represent market and private sector-led integrated SREZs in which the three economies play different roles and exploit complementarities among themselves. They are non-institutional and differ from regional groupings such as NAFTA and EU. First, the formation is not formal, as no official negotiations took place between the member economies.[183] Government policy coordination is a response to existing economic interactions. Secondly, regionalization within the two SREZs is largely production-based. Trade within SREZs comprises more of intra-industrial and commodity trade rather than trade in final goods.

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[179] Ibid., p. 22-23.

[180] Weatherbee, 1997, p. 53.

[181] For policies changes instituted by Indonesia and Malaysia to attract investment, see Naidu, 1994, pp. 225-227.

[182] APEC Economic Committee, 1997a, p. 23.

Four conditions underlying the success of GSC and SIJORI are: economic complementarity, geographical proximity, policy coordination and infrastructure development. They help reduce transaction costs and generate foreign investment and industrial production, thus contributing considerably to economic regionalization in East Asia.[184] However, these four conditions are largely absent in other proposed SREZs in the region. That is why other SREZs either have very limited success in generating private sector activities or simply have remained at the proposal stage.

The SREZs serve well in overcoming high trade barriers in East Asia, particularly non-tariff and non-economic barriers. They can overcome political differences among governments to facilitate economic regionalization. In the GSC, for example, the informal nature of the grouping helps economic regionalization between China and Taiwan despite the political confrontation of the two governments. The proposed Tumen River Area Development Programe may help to create communication ties between South Korea and North Korea.[185]

SREZs tend to promote trade among the members and to strengthen their external orientation. According to an assessment by PECC in 1996, all members of the GSC and SIJORI have substantially reduced tariffs in recent years. Indeed, China, Hong Kong, Indonesia and Singapore are considered "champions" in either their low tariffs or extensive tariff reductions. Hong Kong and Singapore, which already had zero tariffs in 1996, made a commitment to maintain their tariffs at zero. Between 1988 and 1996, China reduced its average applied tariff from 39.5 percent to 23 percent; Indonesia from

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[183] Ibid., p. 20.

[184] Tang and Thant, 1994, pp. 23-24.

[185] Aldrich, 1997, p. 302.

18.1percent to 13.4 percent; Malaysia from 13.6 percent to 9 percent; and Taiwan from 12.6 percent to 8.6 percent.[186]

If Japan is in a leading place in the multi-tier division of labor, China is well positioned in the SREZs. China has a favorable geographical location. In its northeast, it neighbors Russia, Korea, Mongolia and Japan. If the proposal of Tumen River Area Development Program materializes, China will be in a most prominent position. Its eastern part is very close to Japan and Korea, and will benefit from the proposed Yellow Sea economic zone. Southern China has already gained a great deal from the SREZ formed with Hong Kong and Taiwan. Southwest China will also be in a good position in the Indochina subregional zone. As for northwest China, it is considered part of the "Eurasian continental bridge." There is a whole set of existing and proposed SREZs surrounding China. This will enable China to take an important position in the future non-institutional economic regionalization.

Subregional economic zones as a form of informal economic regionalization are gaining importance. As China further opens and Russia stabilizes, subregional groupings may become even more important in the future. Also, it should be noted that SREZs are investment-led and not trade-led, and thus do not detract from formal economic regionalization, such as APEC and AFTA. On the contrary, by improving factor utilization and expanding their markets for other members, SREZs can improve their members' ability to participate in formal liberalization processes. Therefore, more subregional economic zones should eventually facilitate economic regionalization.

Gilpin predicted that as U.S. hegemony declines, the world will break into several regional blocs.[187] Since trade blocs seems to be very difficult to form in East Asia,[188]

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[186] APEC Economic Committee, 1997a, p. 26.

[187] See Gilpin, R. 1987, pp. 397-401.

people suspect that either Gilpin's prediction is wrong or that the U.S. is not really in decline. As we can find here, regionalization is also rising in East Asia. The difference is that regionalization in East Asia has taken a different form from that in Europe and North America. The rise of subregional economic zones is one example. Given the high heterogeneity of the broad region, subregional economic zones are a good way to satisfy the East Asian countries' demand for internationalization without sacrificing much of their protection to their national market, especially for the countries in the lower tiers of the division.

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[188] AFTA is the only one has been formed so far but has imited functions. For more detailed information, refer to Chapter 2.

CHAPTER 5 ASIAN BUSINESS NETWORKS

5.1 Introduction

A third important form of non-institutional economic regionalization is Asian business networks through which Asians organize their own economic activities. Despite a widespread interest in Asian economies, few people have actually studied how Asians create and expand their businesses (by using networks). As we can observe, companies in Europe and North America are more or less autonomous from and competitive with each other. Meanwhile, firms in East Asia are inter-linked to one another and create cooperative networks of independent firms. The difference here is that interpersonal linkages lay the groundwork for inter-firm linkages in East Asia. This chapter will focus on relationships among people and firms along cultural and ethnic lines in East Asia. Such studies should be complementary to the other two forms of regionalization and would contribute to a better understanding of East Asian non-institutional economic regionalization.

5.2 Asian Business Networks

Business networks here refer to international business systems formed along family, kinship, ethnic and/or cultural lines. As Hamilton pointed out, "The key players in East and Southeast Asian economies follow widely accepted and well established procedures for organizing social groups. The groups that they organize are purposefully engaged in economic activity. By constructing groups according to established procedures, these business people create specific kinds of social networks, composed of such people as family members, friends, and trusted colleagues. When viewed in light of their economic characteristics, these social networks consist of clusters of interconnected firms.... We call these inter-firm clusters 'business networks'."[189] Here the "well established procedures" refer to social norms, customs and widely accepted behaviors.

The formation of Asian networks is based on strong East Asian cultural traditions. Confucianism, which has strong influence in all major Northeast Asian societies and overseas Chinese, has always placed great emphasis on human relationships and personal ties. The inescapability of human relationships in Asian society as defined by Confucianism has made business networks in East Asia both highly self-interested and personally restrictive. Therefore, the ability to manipulate and maneuver within networks depends on many things, including one's reputation and moral behavior.

East Asian business networks are very flexible. They include not only enterprises and individuals within the same family, ethnic group or culture, but also the stable connections those enterprises and individuals established with outsiders. As Kao describes in his 1996 article, this type of linkage is accomplished by finding the appropriate person who has ties to a network in which the other person is located and obligated. This "appropriate person" serves not only as bridge between networks, but also as a guarantor of trustworthiness and uprightness of the person who is trying to make the linkage. After the two parties are linked, their subsequent relationship will depend upon their own evaluations; the relationship may become an intimate one and be reinterpreted as belonging to a category of close relationships.[190]

Game theory is very helpful in explaining the operation of East Asian networks. According to game theory, people often fail to cooperate because, in many cases, if one side wants to cooperate, he is likely to be betrayed by the other side. Because of the limited chances of the game being repeated, if one side cooperates, the other side can often benefit from betraying with a low chance of being punished. This is the so-called

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[189] Hamilton, 1996a, pp. 285-286.

"Prisoner's Dilemma."[191] But in a personal network, the establishment of a connection can increase the chances of repeating the game, and thus increasing the incentives for cooperation. Even when the chance of a game being repeated is really low, finding a common tie can often help to build mutual trust, so that both sides know the chance of being betrayed is relatively low. The penalty here is usually "bad reputation," which puts the betrayer in poor connection in the network.

There are three major business networks in East Asia: Chinese, Korean and Japanese, all dominated by family ownership and control. We can examine an economic landscape that consists largely of family owned firms by understanding how families extend into kinship and community networks and how they define and control their assets. In the private sector, Chinese firms of all sizes in Taiwan, Hong Kong, and Southeast Asia are overwhelmingly family owned and controlled. The same is true in South Korea. In Japan, family ownership is the rule in small and medium-sized firms only. As described by Okumura and Orru, in the networks of large firms, shared corporate ownership and managerial control is much more common than family ownership. However, even in the corporate context, family metaphors are still used to define relationships among firms.[192]

Asian business networks are an effective way to overcome political, trade and cultural barriers to international economic exchange. Often family, ethnic and cultural ties are so strong that they help to reduce barriers for economic transactions in this region. The role of Chinese networks in overcoming political barriers between China and Taiwan is already well known. Korean networks are the most important channel to connect North Korea with Japan, the United States and other Western countries despite the high political

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[190] Kao, 1996, pp. 62-63.

[191] Oye, 1986, pp. 7-9.

[192] See Okumura, 1996 and Orru, 1996 for a detailed discussion.

and military tensions between North Korea and those countries. Among the three major Asian business networks, overseas Chinese networks play the most important role in regional investment and trade.[193] Thus, in this chapter, the overseas Chinese networks will be introduced as a successful example.

5.3 Overseas Chinese Business Networks[194]

5.3.1 Distribution of Overseas Chinese

The East Asia Analytical Unit of Australia has produced a detailed study of overseas Chinese business networks in Asia. According to its estimates, the total population of overseas Chinese is around 55 million. Nearly half of them are in Taiwan (20.9 million) and Hong Kong (5.9 million). ASEAN countries (except Brunei) have another 20.9 million overseas Chinese. The rest of them are in the United States (1.8 million), Latin America (1 million), Europe (0.6 million), Canada (0.6 million), and some other countries as the table below shows.

Table 3 Distribution of Overseas Chinese[195]

	Number (Millions)	Per Cent of Ethnic Chinese Population
Asia	50.3	91.3
America	3.4	6.3
Europe	0.6	1.1
Africa	0.1	0.2
Oceania (including Australia)	0.6	1.1
Total	55.0	100

[193] Rowthorn, 1996, p. 6.

[194] "Overseas Chinese" originally is a translation of the Chinese term Hua Qiao ("sojourner"), describing those who temporarily reside outside China and intend to return to China. In this paper, the term "overseas Chinese" is used widely to embrace all Chinese living outside the administration of the People's Republic of China, the vast majority of whom were not even born in China and are citizens of the countries in which they reside.

Overseas Chinese comprise 10 percent of the population of East Asia and 86 percent of the billionaires.[196] The overseas Chinese business entrepreneurs are a driving force in East Asia's economic growth. The 50 million overseas Chinese in East Asia (except China) generated an estimated GDP equivalent of about $500 billion in 1992. More impressively, the overseas Chinese in Asia alone controlled a total of US$220 billion of foreign exchange in 1992, much more than the combined total of Japan and the United States ($162.6 billion).[197] The floating assets of the overseas Chinese were estimated at $2000 billion. The overseas Chinese in East Asia control much of the region's non-land capital and its retail trade, and are major stakeholders in most of the region's economies.[198]

Overseas Chinese are also very powerful in Southeast Asia. Their population is relatively small in proportion to the total population of the countries in which they reside, with the sole exception of Singapore, where they comprise 77 percent of the total population.[199] In Thailand, the Sino-Thai community has played an important role in developing Thailand's private sector even though their population is only 11 percent of the total. It is estimated that they control about 81 percent of listed companies. The overseas Chinese consist of 29 percent of the Malaysian population, but they control 61 percent of Malaysia's private economy. Indonesian Chinese, who are only 3.5 percent of the Indonesian population, control 68 percent of the top 300 conglomerates and nine of the top ten private sector groups. And the overseas Chinese in the Philippines account for

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[195] Adapted from EAAU, 1995b, p. 13.

[196] FEER, "Work Hard, Make Money," August 31, 1995, p. 61.

[197] The Economist, "The Overseas Chinese: A Driving Force", July 18, 1992, p. 19.

[198] EAAU, 1995b, p. 1.

[199] FEER, "Work Hard, Make Money," August 31, 1995, p. 61.

merely 2 percent of the total population in that country, but they control between 50 and 60 percent of share capital by market capitalization.[200]

There are also sizable groups of overseas Chinese in North America, Europe and Latin America. The overseas Chinese in North America do not play a major role in the U.S. and Canadian economies, but they also have their advantages. They are the best-educated overseas Chinese in the world. It is estimated that more than 100,000 overseas Chinese in the U.S. and Canada hold an advanced degree. They have expertise in many fields of advanced science and high technology. Their strength lies more in intellectual rather than material properties. With the rapid increase in the number of advanced degree holders and with many of them going to work in China, Hong Kong, Taiwan and Singapore, the overseas Chinese in North America will play a role in the development of these Chinese regions.

5.3.2 Chinese Ways of Doing Business

In many Western economies, the efficiencies in coordination of businesses derive mainly from large-scale organization. However, in the case of overseas Chinese, the equivalent efficiencies derive from networking.[201] Personal relations often are used by Chinese entrepreneurs to maintain business both domestically and internationally. On the one hand, family ties play a critical role in strengthening the internal organization of Chinese firms. On the other hand, in inter-firm transactions, regional ties based on common territorial origins and common dialects are more important than familism.[202]

Family ties are the core of overseas Chinese networks. Family-based firms are dominant in Hong Kong, Taiwan, Singapore and other overseas Chinese communities.

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[200] Data are generated from EAAU, 1995b, Chapter 3.

[201] Redding, 1996, p. 40.

Family discipline and family coherence, which are at the very heart of Confucian ethics, allow a very small group of owners, often a single individual (head of the family), to make quick decisions, and thus creates business efficiency. Moreover, family ties provide an impetus for innovation and support for risk-taking. Bonds of personal trust among family members serve to reduce the cost of economic transactions.[203]

Meanwhile, regional ties are prominent in expanding inter-firm transactions and establishing a wider business network. Regional ties between overseas Chinese networks play a significant role in foreign direct investment. Entrepreneurs from Hong Kong, Taiwan and Singapore entered the Chinese market and other East Asian countries' market by using their regional ties. A recent good example for the business network practice is Taiwan's Koo family. With the family's strong ties to the region's overseas Chinese business network, the family is building an Asia-wide full-service bank.[204]

5.4 Overseas Chinese Investment in East Asia

Overseas Chinese networks serve Chinese business entrepreneurs well not only in the domestic markets of countries where they reside, but also in most of East Asia's economies providing a seamless web of connections. The region's overseas Chinese business entrepreneurs have created investment flows within East Asia that may exceed flows from Japan, the region's largest foreign investor. The overseas Chinese dominated economies of Hong Kong, Taiwan and Singapore are the major exporters of capital to the region, particularly to the economies of China, Thailand, Indonesia, the Philippines, and more recently, Vietnam. A significant proportion of this investment undoubtedly flows via overseas Chinese connections and networks.

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[202] Lam and Lee, 1992, p. 108.

[203] For more feature of overseas Chinese business practice, see Goodman, 1997, p. 143.

[204] See FEER, "Banking on Buddies," November 13, 1997, pp. 56-61.

Table 4 Overseas Chinese States' Investment in Selected Asian Countries

(According to Rank as Foreign Investor[205])

	Indonesia	Philippines	Thailand
Taiwan	3rd	8th	8th
Hong Kong	2nd	5th	2nd
Singapore	7th	7th	4th

5.4.1 Taiwan

Taiwan has one of the highest foreign reserves in the world. Taiwanese firms started to make substantial direct investment in Southeast Asia in 1987. One of the most distinctive features of that investment has been its concentration on small and medium-sized enterprises.[206] Total investments in South East Asia and Indochina are now at $21.5 billion. Taiwanese investments in the top five destinations in South East Asia are: Malaysia, $7 billion (electronics, keyboards, polyester, textiles, steel, machinery); Thailand, $6 billion (electronics, food processing, textiles, as small and medium-sized businesses are most favored); Indonesia, $6 billion (pulp and paper, machinery, textiles); and the Philippines: $600 million.[207]

5.4.2 Singapore

The Singapore government strongly encourages Singaporean companies to invest in China and other fast-growing East Asian economies. This began as early as 1992. In January 1994, President Ong Teng Cheong in his speech to Parliament outlined the Government's strategies for the "next stage of nation building" and emphasized

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[205] Adapted from EAAU 1995b, p.179. Data for Indonesia relates to cumulative foreign investment between 1967 and 1994; for the Philippines, it relates to foreign investment between 1989 and 1994; and Thailand's is between 1989 and 1993.

[206] See Chen, T. J. 1994.

[207] EAAU, 1995b, p. 190.

"regionalization". Prime Minister Goh added that Singaporeans should concentrate on investing in China, Vietnam and India. The Government's regionalization strategy encourages local companies to take advantage of their ethnic links with China and overseas Chinese.[208] For example, Singapore's investment in Riau Island of Indonesia within the SIJORI Growth Triangle was largely facilitated by the Indonesia Chinese.[209]

5.4.3 Indonesia

As table 4 indicates, from 1967 to 1994, Hong Kong was the second highest cumulative investor in Indonesia with a total investment of $13.5 billion. Taiwan was the third highest with $8.8 billion and Singapore was the seventh highest, investing $6.2 billion.[210] Hong Kong has a significant proportion of Indonesian Chinese population. During the late 1950s, the Indonesian government attempted to curb the commercial power of Indonesia's Chinese. Many Indonesian Chinese fled to China and Hong Kong. Some of them are prominent Indonesian Chinese entrepreneurs.[211] By linking Hong Kong with Indonesia, those people helped transform Indonesia's economy.

5.4.4 the Philippines

From 1989 to 1994, Hong Kong was recorded as the Philippines' fifth largest foreign investor with a cumulative investment of $131.6 million. Singapore was the seventh with investments of $42.7 million, and Taiwan was the eighth with $36.4 million in investment.[212] The Chinese in the Philippines have very strong links with nearby

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[208] EAAU, 1995b, p. 188.

[209] Chia and Lee, 1992, p. 12.

[210] See EAAU, 1995b, p. 180.

[211] See Godley and Coppel, 1990 for a detailed discussion.

[212] EAAU, 1995b, p. 187.

Taiwan and China's Fujian Province. Most of the Filipino Chinese are ancestrally Fujianese. They speak the same dialect as the people in Taiwan and Fujian. The close proximity of the two economies and the extensive family and other ties make it possible for much of the capital coming into the Philippines from Taiwan to be invested through locally based friends and relatives, and to be recorded as domestic investments. So the actual level of investment may be larger than is reflected in these statistics.[213]

5.4.5 Thailand

Between 1989 and 1993, Hong Kong was the second largest foreign investor in Thailand (next to Japan) with cumulative investment of $1,691 million. Singapore was the fourth highest with investment of $1,092 million, and Taiwan was the eighth highest with $72.8 million.[214] The Chinese business community in Thailand maintains its ties by sending their young sons and daughters abroad to China and particularly to Shantou, Hong Kong, and Singapore, where they learn Mandarin and English. This practice strengthens the regional network of personal relationships over generations.[215] It has allowed the Chinese business community in Thailand to remain well-connected to overseas Chinese networks across Asia and later to become significant investors in China.

5.4.6 Malaysia

Malaysia's Chinese have strong links with other overseas Chinese networks, especially with Chinese in the Philippines and Taiwan where most local Chinese also are ancestrally Fujianese. Between 1986 and 1992, Taiwan was the second largest investor in Malaysia with cumulative investment of $501 million. Hong Kong was the third biggest

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[213] See Mackie, J. 1994 for further discussion.

[214] EAAU, 1995b, p. 191.

with investment of $478 million, and Singapore was the sixth highest with $239 million.[216] Business delegations between Taiwan and Malaysia are seldom organized since the level of business interaction between the two is so high that delegations are no longer needed. Now, Taiwanese investment in Malaysia (through ethnic ties) is booming, particularly in electronics and computer companies.

5.4.7 Investment beyond the Region

Overseas Chinese businesses in Hong Kong, Singapore and Taiwan maintain their success by diversifying investment to high-growth developing economies of Malaysia, Vietnam, the Philippines, China, and Indonesia. They are among the leading investors in those countries. However, their effort beyond East Asia has met with mixed success. This is partly because of limited opportunities and different operating conditions in the mature economies of Europe and North America.[217] Also, overseas Chinese business communities in Europe and North America are not as successful as the ones in East Asia.

5.5 Overseas Chinese Investment in China

Overseas Chinese have played an important role in the economic transformation of China. Many people consider China's economic success primarily the result of two factors: agricultural reform and the open door policy. China's open door policy allows many firms to use foreign capital to generate economic growth. Indeed a major source of China's export growth comes from its firms with foreign capital. A detailed study found that between 1985 and 1993, overseas Chinese investment grew from less than 50 percent

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[215] Suehiro, 1994, p. 404.

[216] Riedel, 1997, p. 6.

[217] EAAU, 1995b, pp. 247-248.

of the total to more than 80 percent.[218] Without the success of the overseas Chinese investment, much of the other foreign capital would not have come along. Through the investment of overseas Chinese, South China now is linked with the international economic system, while East China is following suit and has achieved rapid progress. Central China and other parts of China also have begun to open up.

Hong Kong and Taiwan are the two main sources of investment in China. Even though government policies in Taiwan do not encourage investment in China, through overseas Chinese networks, Taiwan's investment in China was booming. By 1993, Hong Kong and Taiwan ranked as the top two foreign investors in China.[219] Taiwan invested US$100 million in China in 1979, 300 million in 1987, and 3.7 billion in 1991.[220] As for Hong Kong, it provided more than half of the total foreign investment in China. In 1994 alone, China attracted US$33.8 billion foreign investment. Hong Kong accounted for around 70 percent of this amount. By the end of 1993, overseas Chinese investment in China employed an estimated 14 million people.[221]

Overseas Chinese investment in China is facilitated by common culture, language and ancestral links. This investment is largely concentrated in the coastal regions which are the ancestral homes of many overseas Chinese, especially Southeast Asian overseas Chinese clan associations.[222] Of the total amount of FDI that China has received since 1989, the coastal areas' share has been over 90 percent.[223] However, as labor and land costs rise and the focus of overseas Chinese investment shifts farther north, clan, dialect

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[218] EAAU, 1995b, p. 197.

[219] Zhao, 1998, p. 118.

[220] Chen & Ho, 1994, p. 52.

[221] EAAU 1995b, p. 194.

[222] Goodman, 1997, p. 148.

[223] Broadman and Sun, 1997, p. 339.

and other historical links became less useful. Consequently, it is likely that overseas Chinese investment may decline as foreign investment moves farther away from the Southeast coastal regions.

5.5.1 Way to succeed

Overseas Chinese entrepreneurs enjoy considerable comparative advantages over non-Chinese competitors in China. Their language and cultural ties and skills in making connections and networking give them ready access to market information and an ability to negotiate their way (by using China's system) to apply their market skills to best advantage.

Networks are essential to overseas Chinese success in China. Family and regional links, linguistic abilities and cultural affinity all contribute to establishing strong ties with central and local officials in China. Those personal ties play a big role for overseas Chinese investors in minimizing the difficulties that non-Chinese investors face. Non-Chinese investors encounter language barriers, the incompatibility of Western styles with Chinese practices, the distinctive bureaucratic organization of the Chinese workplace which makes it difficult to fire workers and to eliminate inefficient work practices, poor quality control, low labor productivity, differences in negotiating practices, the long time-frames needed to negotiate contracts, and particularly, difficulties associated with the lack of a fully established legal framework.[224]

Overseas Chinese entrepreneurs often expand their investment in China by increasing the number of enterprises they control, rather than by making large investments in new enterprises.[225] They do this to ensure that new investments remain

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[224] EAAU, 1995b, p. 203.

[225] Ibid.

below the threshold of direct central government regulation, and within the authority of local governments, with whom good working or personal relations are more easily established (by using family and regional ties and cultural affinity).

5.5.2 The Role of Overseas Chinese in China's International Trade

Overseas Chinese also play an important role in distributing goods produced in China on the world market. Their sound expertise in international trade and marketing networks facilitate China's access to the international market. China has experienced an exceptional growth of export since 1979, with an average growth rate of 16.4 percent over the period from 1979 to 1996. The share of foreign invested firms in the total exports of China increased sharply from 3.3 percent in 1981 to 40.7 percent in 1996. Among that, more than 50 percent of the total exports of foreign invested firms came from Guangdong province where overseas Chinese investment exceeds 80 percent of the total provincial FDI.[226]

China's capacity to import capital items such as plant and machinery depends substantially on increasing volumes of exports from the coastal regions. Without this contribution, China's rapid economic growth and much of its economic reform program would be subject to more severe imbalance of payments and other constraints. Thus, overseas Chinese have played a critical role in China's international trade and its development.

5.6 Conclusion

Asian business networks are based on overlapping networks of people linked together through different social relationships, the main vehicle for organizing economic activities in East Asia. Business networks are more significant than the individual firms that make up the networks. Some people argue that Asian economies are network-based, whereas the United States economy is firm-based.[227] These differences mirror the differences in social structure in the two societies. For example, the family in the West is a discrete organization composed of distinct individuals, but in most East Asian societies, the family or household is part of a web of relationships.[228]

Asian business networks are a highly informal means of economic regionalization. They are by no means formal organizations, nor do they involve comprehensive legal arrangements. In such a heterogeneous region, Asian business networks often can do much that formal cooperative institutions are not capable of doing. Because of the existence of all kinds of barriers in the region, formal agreements are either too difficult to form or, even if formed, incapable of promoting free movements of commodities and capital across national borders. Asian networks are a good means to facilitate such movements in the face of strong non-tariff and non-economic barriers. The huge Taiwanese investment in China, despite political confrontation of the two governments, is a good example.

Most studies on the success of overseas Chinese emphasize their hard work ethics, frugality, and emphasis on education. Their group orientation is less noticed, except for their family ties. However, their concept of family ties is often much broader than many people realize. Relatives beyond the nuclear and even the extended families are also included. Moreover, speaking the same dialect, coming from the same region or even having common last names can be grounds for Chinese to establish mutual connections.[229] Interestingly, the Chinese network would be much less powerful if they involved only

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[226] Sun, 1998, p. 688.

[227] See Hamilton, 1994 and Biggart, 1992 for further discussion.

[228] Hamilton 1996a, p.287.

[229] See Goodman, 1997, p. 154. Note 5.

Chinese. They have strong connections with East Asian governments and Western capitals. Through the networks, they have access to business information in both the Western world and Asian countries and often serve as agents between the two. This provides them with great advantages in their international business activities.

Overseas Chinese investment has made a major contribution to China's economic "take-off." There are arguments that Japan and East Asian NIEs could rise because of good "timing." They took off at a time when the United States was booming and the Cold War was at its height. As a result, Japan and the East Asian NIEs could take advantage of the U.S. aid, investment and markets. But today China, as a "late-comer," no longer has the same favorable conditions. So it is doubtful that China could become industrialized, given the rising protectionism and relatively shrinking U.S. market. However, overseas Chinese investment has compensated, to some extent, for these constraints. Overseas Chinese have brought not only capital, but also management, information, market channels and international business skills to China.[230] It is no exaggeration to state that the activities of Hong Kong and Taiwanese businessmen have laid the external basis for China's economic success

Connections are important for doing business anywhere, but in a business environment such as China, they are especially important. China does not have sufficient, well-functioning rules and regulations. Those who are best at forming connections, or those who already have them, are at an advantage. Family, language and cultural ties allow many overseas Chinese to access business opportunities in China. In those places, the overseas Chinese networks help them prevail while other people, particularly people from North America and Europe, are often at a loss.

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[230] Sun, 1998, p. 678.

However, as China's administrative, legal and institutional infrastructure develops and the "rules of the game" become apparent to all, the advantage overseas Chinese entrepreneurs have probably will lessen. As Singapore's Senior Minister Lee Kuan Yew noted at the Second World Chinese Entrepreneurs Convention, Westerners operating within China's weak legal framework feel vulnerable but overseas Chinese, provided they have the right connections, can protect themselves. "Guanxi ("connection" in Chinese) capability will be of value for the next twenty years at least, until China develops a system based on the rule of law, with sufficient transparency and certainty to satisfy foreign investors."[231]

[231] Lee Kuan Yew, 1994, p. 85.

CHAPTER 6 CONCLUSIONS

Economic regionalization is a global trend. However the APEC scheme of regionalization in the Asia Pacific is not proceeding as successfully as many observers anticipated. The Asia Pacific demonstrates a high degree of regionalization in terms of economic factor movement and a low degree of formal institution building. The vast heterogeneity in the Asia Pacific region hinders institutional regionalization by increasing the cost of economic transaction. Moreover, East Asian non-institutional regionalization has served the demands of East Asian countries for international economic cooperation fairly well. The pattern for East Asian economic regionalization is strong non-institutional regionalization and weak institutional regionalization at this stage.

The existing forms of non-institutional regionalization in East Asia, namely multi-tier division of labor, subregional economic zones and Asian business networks, have been driving investment and trade within the region. The multi-tier division of labor is a well-accepted description of regionalization along production lines. It involves production linkages among different countries or/and different firms in the hierarchy. While the product cycle theory (i.e., flying geese model) focuses on linkages among countries and the process that diffuses development from one country to another, the production network approach emphasizes inter-firm relationships. The multi-tier division of labor works almost purely according to the market mechanism, and private industries and firms are the major players. At the center of the division are Japan and the United States. But the Japanese are much more successful in the regionalization of production due largely to historical ties and geographical proximity.

Subregional economic zones are a relatively recent, but the fastest growing form of non-institutional regionalization. They connect only parts of two or more economies, often from different tiers of the multi-tier regional economy. The economic complementarity of East Asian economies, a result of the multi-tier division of labor, is the most important precondition for SREZs to flourish. Geographical proximity, political commitment and infrastructure development are also critical for the success of SREZs. Those four factors have guaranteed the success of both the GSC and the SIJORI. Their absence has limited the success of other SREZs or prevented them from taking off. The informal nature of SREZs serves well in generating foreign investment and overcoming high trade barriers, particularly non-tariff and non-economic ones. For example, the GSC helps economic transaction between China and Taiwan despite the political confrontation of the two governments.

Asian business networks are the third form of non-institutional regionalization in East Asia. This term refers to international business systems formed along family, kinship, ethnic and/or cultural lines. Confucianism, which emphasizes human relationships and personal ties, has a strong influence on the creation of specific kinds of social networks. Those social networks are composed of such people as family/kinship members, friends, trusted colleagues and people from the same region or who speak the same dialect. When they are purposefully engaged in economic activity, these social networks can be viewed as clusters of inter-connected firms which we call "business networks." The overseas Chinese network is the biggest and best-functioning business network in East Asia. Its role in the transformation of China's economy and investment and trade flows within and outside the region has greatly enhanced economic regionalization.

Of course, an outside factor, like the enhancement of regionalization elsewhere, or the tightening of U.S. protection, may cause disturbances in East Asia and give rise to a call for a broad free trade area or even a regional bloc. This has always been true since the European common market was founded in the late 1950s. But in the near future, the current East Asian pattern is going to persist for some time, unless something very dramatic, such as a full-scale trade war between the U.S. and Japan, takes place.

What are the practical implications of the East Asian pattern of economic regionalization? First, we should not expect a Pacific free trade area any time soon. At this stage, the nature of the international political economy in East Asia requires a different form of economic regionalization. Moreover, East Asian countries feel that non-institutional economic regionalization has been serving their needs quite well; they are not at all in a hurry to accept a region-wide free trade agreement. Unfortunately, those facts have not yet been fully realized in North America. The Clinton Administration again proposed a Pacific free trade zone at the APEC summit in Indonesia. But such a proposal will not lead to any major progress, because any serious proposal for a PAFTA is still premature.

Second, since a broad Asia Pacific free trade area is not likely in the near future, U.S. efforts to promote institutional economic regionalization should be gradual, patient and long-term oriented. While promoting formal regional cooperation, the U.S. also should pay great attention to non-institutional regionalization, and promote better mutual understanding between the U.S. and East Asian countries. In most cases, it is more helpful to understand what others need and cooperate on that basis than to simply tell others what to do.

Thirdly, it may be very beneficial for the United States to participate actively in multi-tier industrial divisions in production. Creating dependence of Asian countries on the U.S. for production will be a very effective way to reduce or even reverse the trade deficit with Asia. What is more, supplying more production equipment and technology to East Asia will reduce the dependence of other East Asian countries on Japan. Many other East Asian countries are equally unhappy about their trade imbalances with Japan. Nevertheless, because of their dependence on Japan's technology, there is not much they can do. If the U.S. can work with other East Asian countries, it will be a much better way to solve its trade problem with Japan than using confrontational measures such as Super 301. The United States still has the greatest potential of any nation in the Asia Pacific region, if not in the whole world, owing to her superiority in industrial capacity, human and natural resources and basic science. If Americans understand East Asia well, and adopt a correct strategy, they will eventually prevail.

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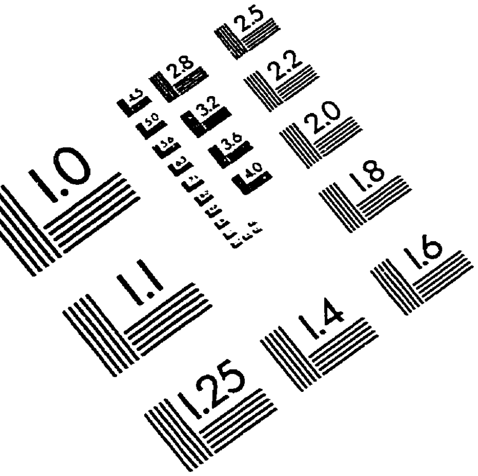
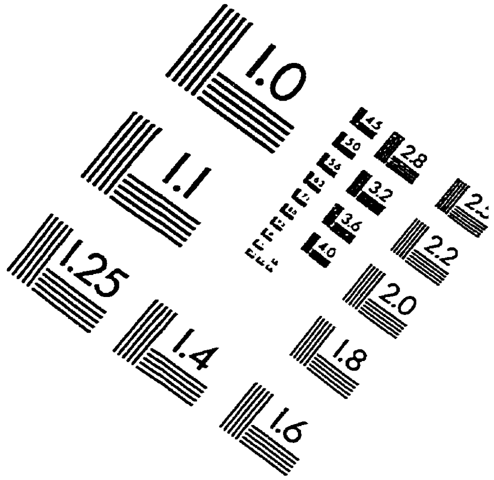
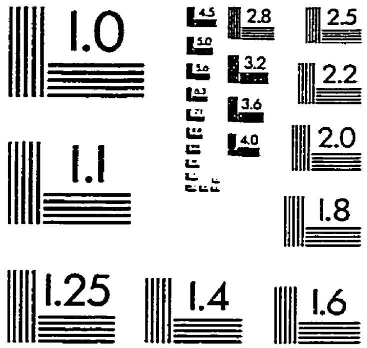
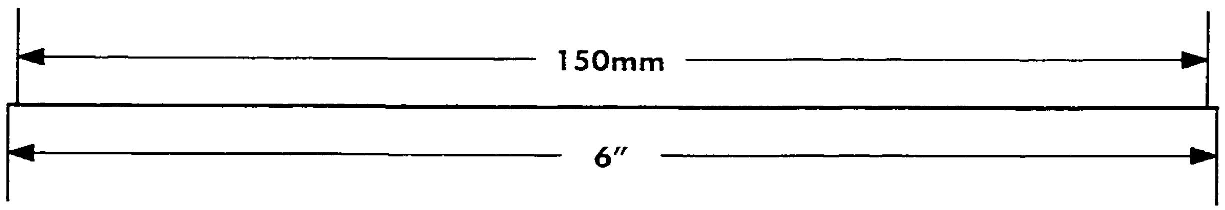
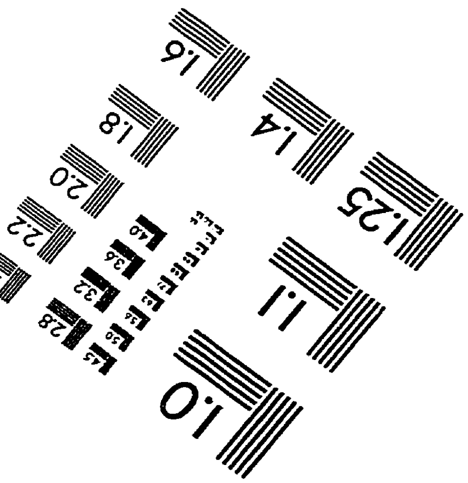
IMAGE EVALUATION TEST TARGET (QA-3)

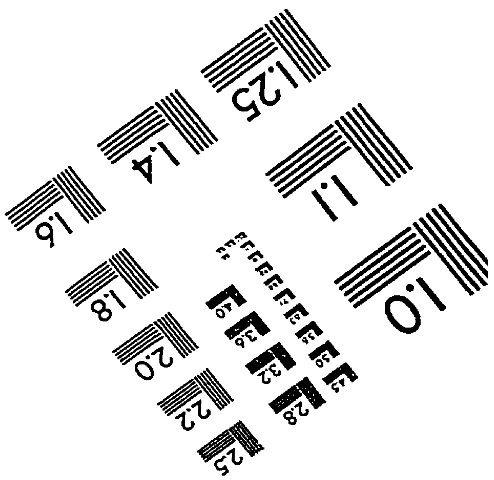












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