ASIAN MARKET ECONOMIES

Challenges of a Changing International Environment

Ross Garnaut

INSTITUTE OF SOUTHEAST ASIAN STUDIES

ISEAS Current Economic Affairs Series

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I THE ASIAN MARKET ECONOMIES

In the early 1980s, the geographic boundaries defined in the title of this paper would have been drawn very differently from today.

Then, as now, there would have been no ambiguity about the inclusion of the ASEAN economies, Japan, Hong Kong, Taiwan and the Republic of Korea. Then, as now, there would have been no ambiguity about the exclusion of the Democratic People's Republic of Korea. But that is the end of the consistency over time.

The People's Republic of China is now best considered as an Asian market economy. It was certainly not a market economy a decade ago. A large majority of production of goods and services is now independent of the state plan, and what is left of the plan scrambles to keep up with the signals emitted by powerful market forces.

When did the switch-over take place in China? There is no need, and no opportunity, to be precise. I would date it somewhere between the Thirteenth Communist Party Congress in 1987 and the Fourteenth in 1992 — between the Chinese Communist Party's acceptance of the doctrine of the "preliminary stage of socialism", and its acceptance that China was a "socialist market economy". If a journalist were pressing me for a single date, and I was too tired to resist, I would say May 1991, when large price adjustments for agricultural products including grain paved the path for market determination of food prices.

Are the economies of Indochina market economies? Vietnam's price and enterprise reforms are much younger than China's, but have proceeded more rapidly. The dynamic rural enterprises that have defined the "market-oriented" character of the Chinese economy since the mid-1980s do not so far have counterparts in Vietnam. The inflationary macro-economic environment is less conducive to smooth operation of markets than in China. But there is no doubt about the direction of change in Vietnam, and it is, as least, an Asian emerging market economy.

South Asia is hardest of all to define. Markets, relative to state power, are now less important in resource allocation in india than in China. The Indian economy is much less oriented towards international markets — although the difference is not so great if we adjust China's GDP for obvious miscalculation in the standard international data. In these past two years, India, too, is changing in the direction of a market economy, carrying with it the pressures and constraints of a huge and rambling democracy. The collapse of the Soviet Union dealt a fatal blow to the failing intellectual support for command planning in India, and reduced India's options as a major market almost disappeared almost overnight. The economic success of China has placed international geostrategic and domestic political pressure on Indian economic policy and performance. It will take longer in India. However, over the past two years India has entered a period of market-oriented reform which will lead to much more intense interaction with the international and Asia-Pacific economies, and substantially more rapid economic growth — if several notches below the strongest performers of East Asia. The most telling sign that India is firmly, if slowly, on the path of market-oriented reform, is the changed tone of debate about economic policy, in intellectual circles, and more broadly in policy-relevant public discussion.

The changed climate of opinion in India is affecting discussion and policy elsewhere in South Asia, including Pakistan.

So where are the boundaries of the Asian market economies? This paper focuses primarily on the East Asian economies that are participating in the Asia-Pacific Economic Co-operation (APEC) forum. And I will keep in mind the economies of Indochina and South Asia, as emerging market economies.

II THE INTERNATIONAL ENVIRONMENT

When discussing in international economic environment, the political and strategic environment cannot be ignored, however — if only because it intrudes directly into the forces shaping the international trading rules.

The end of the Cold War is reshaping the international environment of the East Asian market economies, as decisively as the Cold War itself shaped international economic relations in the 1950s and 1960s. The end of the Cold War has brought new opportunities: through the spur it has given to internationally-oriented growth in India and Indochina; and the opportunity it has provided for gradual economic change in North Korea in ways that will eventually facilitate internationally-oriented integration of the two Korean economies. It has also brought opportunities to China, as the greater security on its long land borders allows more confident and complete application of national energies to the tasks of economic reform and development.

But there are also challenges, and threats, to the continuation of internationally-oriented growth in the new environment.

The collapse of the Soviet Union, and the difficulties that its successor states and the states of Eastern Europe are having in establishing institutional bases for market-oriented development, are placing great strain on the whole European economy. In Germany this is compounded by the special problems of reunification. This has deepened and attenuated recession, and turned community opinion defensively inward on all matters related to the international trading system. The problems of Western European adjustment to market-oriented development in the East are formidable, and as yet only faintly appreciated. There will be exacerbation of inter-continental discrimination in European trade, in result if not intent. But even the intent will be increasingly unreliable, as jarring comparisons of East Asian and European economic performance, and a persistent competitive challenge in global including European markets, breeds resentment, at its worst paranoia, and more defensive and inward-looking approaches to trade policy.

There are still, and there will remain, forces in support of open trade in Western Europe. But the whole polity of Western Europe cannot be expected to provide leadership of, or on balance, consistent support for, the open, multilateral trading system.

The effects of the end of the Cold War on U.S. support for the post-war framework of open multilateral trade are at once more complex, more important to economic development in East Asia and the Western Pacific, and potentially more dangerous.

Rapid, internationally-oriented economic growth was established in Japan and Hong Kong in the early 1950s, in Taiwan, Singapore and Korea in the early and mid-1960s, and later in Malaysia, Thailand, mainland China and Indonesia. It was established in the context of the open, multilateral trading system based on the General Agreement on Tariffs and Trade (GATT) that was built in the immediate aftermath of World War II. The system through its strongest years depended heavily on the United States' commitment, leadership, and preparedness to accept adjustment in response to developments in the comparative advantage and export capacity of East Asian economies.

While the post-war trading system, and American support for it, had its origins in the memory of the trade-destroying policies of the 1930s and in post-war idealism, American commitment was sustained by the geostrategic imperatives of the Cold War. The tensions that have arisen in the United States' relations with the international economy in recent years are reminders of this powerful reality.

Richard Snape remarked recently that, for all the imperfections of GATT, it provides the essential legal framework of U.S. trade policy that superseded the Smoot-Hawley tariff of 1931 (Snape 1993). Without GATT, or a viable successor, the law and the political economy of trade policy are subject to powerful pressures in the direction of the protectionism and bilateralism of the 1930s.

Without the United States' perception of an overwhelming strategic interest in the prosperity and stability of Japan, Korea, Taiwan and the ASEAN states, and in the entrenchment of internationally-oriented growth in China, the political balance is much more open to the old, prosaic domestic pressures on trade policy.

This is the new environment of diminished U.S. commitment to open and multilateral trade. It is the environment of the damaging tensions in Japanese-American trade relations. And it is part of the immensely complex environment of Sino-American economic relations, which is then overlain by divergent perspectives on human rights, and concerns about the implications of Chinese arms sales on the stability of relations amongst states in the new strategic order that is emerging in the aftermath of the Cold War.

It is powerfully in the interests of Western Pacific including East Asian states that a framework of open and multilateral trade is maintained in this new environment. It is an essential interest of the emerging market economies of Asia — India and the South Asian states, Vietnam and Indochina — and also of Russia, and of the large part of the world that would benefit from economic stability and development in the Commonwealth of Independent States (CIS).

With colleagues throughout the Western Pacific, and with some in North America, I have been saying for several years that the new model of trade policy and economic growth that has emerged in the Western Pacific since the mid-1980s provides an opportunity for maintaining open, multilateral trade now that the United States has lost the will to lead. I have argued that APEC, with full North American participation provides the vehicle for binding the two sides of the Pacific into commitment to open trade.

It is necessary to explore the contemporary relevance of this vision of the Asia-Pacific and international trading system. This vision must now contend with an awkward reality, that a substantial part of the intellectual and political constituency for open trade in the United States has formed the view that multilateral free trade is no longer politically viable; that "Congress would not tolerate free riders" on any unilateral or regional trade liberalization on a most-favoured-nation basis.

This is the great immediate challenge to the Asian market economies in the changing international economic environment.

III RECENT DEVELOPMENTS IN EAST ASIAN ECONOMIES

Since the mid-1980s, more than half of the increase in world production of goods and services has occurred in East Asia. Between 1986 and 1991, growth in Japan added annual output equivalent to an economy the size of France. Internationally-oriented growth became firmly entrenched in East Asia's most populous economies, China and Indonesia, and commenced in Vietnam. Most remarkably, strong growth in the region's developing countries continued undiminished in the early 1990s, despite deep and prolonged recession in the advanced industrial economies of the northern hemisphere. As rapid growth has become established in each of these countries, foreign trade has expanded more rapidly than output and expenditure, although less outstandingly so in Japan than in the region's developing economies.

It happens that the East Asian economies which have grown rapidly through the post-war period have had initial relative resource endowments that are very different from those of the established industrial economies. Japan, Hong Kong, Taiwan, Singapore, Korea and the coastal provinces of mainland China are all densely populated by the standards of the established industrial economies of the North Atlantic, or the rest of the world. Their patterns of specialization in international trade are therefore distinctive, both in the early stages of industrialization when incomes are low, and later when they are high. This increases pressures for structural adjustment in the rest of the world as their foreign trade expands, at the same time as it expands the potential gains from trade. It also leads to criticism that East Asia does not behave "normally" in its trade relations with the rest of the world, and to arguments that the old trade rules are not suitable for the new big players.

The emergence of East Asia as one of three major centres of production and trade, alongside Western Europe and North America has placed great strain on the international trading system. The adjustment strains associated with East Asian growth, coming as they did at a time of slower growth and higher unemployment in the North Atlantic economies, fractured the system in several ways: most importantly, the huge exceptions in the rules on textiles, and the 'grey areas'.

The exception for agriculture had different origins, and once created by the North Atlantic, was accepted readily as an excuse for avoiding adjustment in the newly rich Northeast Asian economies.

Separately, by the 1980s, the post-war rules were recognized as being inadequate, and requiring development for the management of new forms of trade, including in services, and the related matters of intellectual property rights.

Hence the Uruguay Round. It was supported by the

United States and Japan (and some in Europe) to extend the rules to new areas. It was supported in the Americas, Australasia and Southeast Asia to bring in one old exception (agriculture) and to commit developing countries more tightly to the rules. The Uruguay Round was supported (and on some issues led) by Western Pacific, including developing, economies to constrain the exceptions related to manufactured goods and (for Southeast Asia and Australasia) also to remove the exception for agriculture.

There is an important sense in which the weight and adjustment strain of East Asia's internationally oriented growth, and East Asia's comparative success through the 1980s and early 1990s, increased tendencies to discriminatory regionalism in Europe and North America. It was this factor in the acceleration of moves towards Western European economic integration, and, alongside frustration with slow progress in the Uruguay Round, towards the formation of the North American Free Trade Area (NAFTA).

By the early 1990s, these and other moves towards discriminatory regionalism constituted threats to the liberal multilateral trading system as important as those that the Uruguay Round had been established to remove.

IV THE GROWING WEIGHT OF EAST ASIA

As the weight of East Asia and the Pacific in world affairs continues to increase, the commitment to the old verities of liberal trade in this region could be crucial in holding back the new tides in the old, North Atlantic industrial countries.

Continued growth in East Asia is likely to be the primary influence on world trade and economic growth in the next quarter century and beyond, just as it has been in the last. The emergence of East Asia has had a dramatic effect on the structure of world output, and even more so on the structure of world trade. Charts 1 and 2 illustrate these huge shifts in the structure of world production, trade and global economic power.

East Asia accounted for just over 17 per cent of world production in 1980; at the end of the century it can be expected to be over 28 per cent. Already the region accounts for a fifth of world trade, a larger share than North America, and by the year 2000, East Asia's share is expected to be closer to one-third of world trade. These ratios will not stop changing at the millennium. One consequence is that, in the future, the rest of the world will find itself reacting to the forces of economic policy-making in East Asia, as it has done to those of the United States for the past half century.

In East Asia in recent years, structural change and growth have been mutually reinforcing; providing new markets, and an increasingly sophisticated and dynamic regional economy.

There has been extensive unilateral market opening and deregulation in most Western Pacific economies. Their remarkable growth performance has confirmed the prediction of economic theory that the greatest benefit from unilateral trade liberalization accrues to those who undertake it. The benefits have been multiplied by the fact that many neighbouring economies have taken similar unilateral market-opening decisions. The process of progressive trade liberalization amongst Northeast and Southeast Asian economies, has been described elsewhere as a game of "prisoners delight" (Garnaut 1991; Drysdale and Garnaut 1993) built around