New Regionalism in East Asia: How Does it Relate to the East Asian Economic Development Model?

Charles Harvie
Department of Economics
University of Wollongong
NSW
Australia 2522

and

Hyun-Hoon Lee
Division of Economics and International Trade
Kangwon National University
Chuncheon, 200-701
South Korea

1. Introduction

In recent years a new regionalism has begun to emerge in East Asia that represents a clear break from the region's strong history of multilateralism. The countries of East Asia have been giving more attention to ways of expanding intra regional trade that include: the establishment of regional trade agreements (RTAs) such as ASEAN+3; plans to establish a free trade area involving the economies of ASEAN and China; as well as moves towards bilateral trade agreements (BTAs). Such a development is important given that an export led growth and development strategy provided the platform for the region's remarkable, and prolonged, period of high and sustained economic growth dating back to the 1960s, and that lies at the core of the East Asian Development Model (EADM). Export growth will remain a key ingredient for the recovery of the region after the financial and economic crisis of 1997-98. The trend towards this new regionalism, the reasons for it, its impact upon the region, its future evolution and prospects are, therefore, of profound regional, and indeed global, significance

This paper focuses upon the meaning and implications of this new regionalism for the "old" EADM, and explores the key ingredients of an emerging "new" EADM growth and development paradigm, incorporating the new regionalism, that appears to be emerging in the wake of the 1997-98 crisis. In doing so the paper proceeds as follows. Section 2 summarises recent developments in regional trade agreements in East Asia, and discusses the factors behind this new tide of regionalism. Section 3 discusses the implications of the new regionalism in the context of the EADM past and present. Section 4 presents some concluding remarks.

2. Recent Development of RTAs in East Asia

2.1. Recent Developments

Until the Asian crisis erupted in 1997 the East Asian economies pursued a multilateral approach to trade throughout the post-war period, unlike Western European countries and the United States. In particular, Japan, China and South Korea were the world's only major economies that had yet to conclude a free trade area (FTA). The sole exception was the Association of South-East Asian Nations (ASEAN), which has been planning an FTA for several years with a target date of 2002. However, a new regionalism is emerging in East Asia. A number of bilateral agreements have been concluded and are being negotiated or studied. Japan signed an agreement in January 2002 with Singapore to create an FTA. Japan has also negotiated, studied, or considered bilateral FTAs, with Korea, Chile, Mexico, Canada, Australia, New Zealand, Switzerland, Taiwan, and Thailand. Korea is also negotiating with Chile, and studying bilateral FTAs with New Zealand, Mexico, Thailand as well as Japan. Singapore and New Zealand signed an agreement in November 2000 to form a Closer Economic Partnership, based on a free trade area. Singapore is currently negotiating a bilateral regional arrangement with Australia, and is laying the groundwork for similar agreements with Canada, Mexico, India, and the United States. Hence, in the East Asian region, Japan, Korea and Singapore are involved in negotiations with more than one other country about the formation of bilateral agreements[1]. This trend towards bilateralism is likely to spread to other East Asian countries.

Many-country agreements are also being negotiated or studied in East Asia. ASEAN and the Closer Economic Relations (CER) countries discussed a link between the two free trade areas in November 2000, even though the recommendation from a High-Level Taskforce to proceed with negotiations was not adopted by the Meeting of the ASEAN-CER Ministers. A North-East Asian Free Trade Area (NEAFTA) consisting of China, Japan and Korea is also being studied. At the "ASEAN Plus Three" summit in November 1999, Japan, Korea, and China agreed to launch a joint research project involving institutes of the three countries to discuss the possibility of forming an FTA among themselves in Northeast Asia. Since then the three countries have held a summit every year at the ASEAN+3 meetings, and have held regular meetings of their finance ministers.[2]

During the recent summit of the ASEAN+3 countries in November 2001, China and ASEAN announced that they had decided to create an FTA within ten years. Only one year ago, China had proposed an FTA with ASEAN at the summit with ASEAN leaders. The Philippines has also proposed the East Asian Free Trade Area (EAFTA), which is a

[1] In the case of Singapore the adoption of this so called hub and spokes approach has led to a questioning of whether such BTAs could undermine the AFTA process and RTAs in general. Mexico is another example of a country that has also successfully adopted a hub and spokes approach to trade liberalisation.
[2] Among the three, each country is one of the largest trading partners of the other two. For China, Japan is its largest trading partner and Korea the third. For Japan, China (including Taiwan) ranks the second and

grouping that covers the whole area of East Asia. At the ASEAN+3 summit in November 2001 Korea also called for the formation of an East Asian economic community, which is equivalent to the EAFTA.

The recent regionalism of East Asia is not altogether "new", as Mahathir Mohamed, the Prime Minister of Malaysia, proposed an East Asian Economic Group (EAEG) a decade ago. But the EAEG proposal was not pursued, largely because the United States strongly objected and proposed member countries, Japan and Korea in particular, were reluctant in the face of this objection. With little attention from the West, East Asia created the "ASEAN+3" forum in 1997, with the same membership (the ten members of the ASEAN, China, Japan and Korea) envisaged by Prime Minister Mahathir. Even though it will take quite a while to launch an FTA and to form an East Asian economic community, this trend in East Asia represents a clear break from a strong history of multilateralism.

The new regionalism in East Asia has been proceeding more rapidly on financial issues than on trade. For example, the Manila Framework was drawn up in November 1997, aimed at achieving financial stability in the region through cooperation between the East Asian countries. Fourteen countries from the Asia-Pacific region have participated in the Framework, which involves working on many issues including intra-regional financial cooperation, mutual cooperation to strengthen the financial architecture and surveillance, and on cooperation to monitor intra-regional capital movements.

In May 2000 the member countries of ASEAN+3 announced the Chiang Mai Initiative, and agreed to build a network of currency swap arrangements. A currency swap agreement was signed at their annual summit meeting in Singapore in November 2000, and there has been much discussion about creating an Asian Monetary Fund (AMF) and common currency baskets[3]. The idea of an AMF was proposed by Japan in September 1997. Japan expressed its willingness to contribute more than half of the funds amounting to US$100 billion. Hong Kong, Taiwan and Singapore have also indicated their intent to participate in the AMF. Korea and most other East Asian countries agreed to the idea. Even China, which was against the idea at first, has changed its attitude[4].

Korea the third. For Korea, Japan and China are the second and the third trading partners, respectively.

[3] See for example Wang (2000), Kim, Ryou and Wang (2000), Ogawa (2001), and Lamberte, Milo and Pontines (2001).

[4] Nonetheless, the AMF has still not made any tangible progress, due to strong opposition by the United States.

Hong Kong and the Philippines have proposed the creation of the Asian Currency Unit (ACU). An Asian Bank for Reconstruction and Development and an Asian BIS (Bank for International Settlement) have also been discussed.

During a summit of the ASEAN+3 in 1999, South Korea proposed the establishment of an expert panel, the East Asia Vision Group, as the first step in exploring the possibility of forging a regional cooperation mechanism. This group discussed ways to develop the ASEAN+3 grouping into a regional cooperation forum. A joint surveillance of short-term capital movements and an early warning system in East Asia have also been studied. The group later proposed the establishment of an East Asian Monetary Fund and a regional exchange rate coordination mechanism, with the long-term goal of creating a common currency area. Other recommendations included upgrading the annual ASEAN+3 meetings to an East Asian summit.

2.2. Factors behind the new regionalism

The important question is why the East Asian countries have changed their course of direction toward pursuing preferential arrangements? There are three main factors relating to the world economy that are relevant to this issue. The first factor is the slow process of liberalisation under the WTO. Specifically, the failure of the WTO to begin a new round of multilateral negotiations in Seattle in 1999, illustrated the difficulty of pushing through comprehensive multilateral liberalisation. In addition countries such as the US and those of the EU have stronger negotiating power than the developing countries in the WTO and their agendas can be quite different. Accordingly, negotiations within the WTO have, increasingly, seen a movement of agendas towards issues other than tariffs, such as the environment, intellectual property rights, labour standards and competition policy, which are of more interest to the U.S. and the EU but of less interest to the East Asian countries.

The second factor is the enlargements of the EU and growing Pan-American moves to increase free trade arrangements, such as expanding the North American Free Trade Agreement (NAFTA) into the proposed Free Trade Areas of the Americas (FTAA) that includes the entire American continent except Cuba. Thus the EU process of economic integration has resulted in the proliferation of RTAs in the rest of the world.[5]

The third factor is the East Asian financial crisis of 1997-98, which demonstrated the risk of contagion and investors' perception of the region as a "single market". This factor may have operated as a trigger, which explains the timing of the recent movement towards regionalism in East Asia, given the underlying changes outlined in the first two factors. Moreover, approaches to the crisis by the International Monetary Fund (IMF), backed by the US., have been criticised. Thus, "no longer trusting the U.S. or the international institutions for protection, Asian leaders are searching for home-grown defences against the wild swings in global money markets" Feinberg (2000). This is why the new regionalism in East Asia has been proceeding more rapidly on the financial side than on trade, unlike the case of the EU and other RTA predecessors. The impotence of the Asia Pacific Economic Cooperation Forum (APEC) and ASEAN in the wake of the financial crisis added to the grievance of the crisis-hit East Asian countries.[6]

3. The East Asian Development Model: Past and present

3.1. Ingredients of the old EADM

Until the financial and economic crisis of 1997-98 East Asia had achieved a remarkable record of high and sustained economic growth. In particular, Japan, Hong Kong, Singapore, South Korea, Taiwan, Indonesia, Malaysia, and Thailand had been the high-performing East Asian economies (HPAEs). This remarkable achievement was once considered by a number of observers, including the World Bank, as "the East Asian miracle".[7] The East Asian economies were hailed as models of achievement for other emerging economies to emulate.

Before discussing how the recent trend of regionalism in East Asia relates with the region's development model, we start with a summary of the main elements of the EADM. There have been numerous attempts to explain the so-called "miracle" performance of the rapidly developing economies of East Asia. Table 1 summarises the

[5] For a discussion of this trend, see WTO (1999, 2000b).
[6] Lloyd and Lee (2001) discuss how recent developments in regionalism in East Asia relate with APEC.
[7] World Bank (1993)

Table 1. The "old" East Asian Development Model – key ingredients

Initial Conditions:

. Backward economies

. Sound work ethic and low labour costs

. High sprit of education and good primary education system

External Environment:

. Trade liberalisation under the GATT

. Free trade approach by the U.S.

. Flying geese pattern pioneered by Japan

. Global capital flow/international capital markets

Policy Factors:

. Primarily market based mechanisms of competitive discipline

. Tailored government intervention

. Outward orientation

. Stable macroeconomic management

. Emphasis on education

Interim Outcome:

. High savings

. High investment

. Increasing human capital

. Rapid growth of exports

. Rapid catching-up of technology

. Rapid demographic change

Final Outcome:

. Rapid industrialisation

. Rapid and sustained economic growth

. Reduced poverty

. Improving social indicators

major determinants of the East Asian performance. As seen in the table we attempt to divide the framework into initial conditions, external environment, policy factors, and interim and final outcomes.

Initial Conditions

First, in many East Asian countries rapid development took place from an initial position of "economic backwardness", characterised by a low level of national income and income per capita. The historical record strongly suggests that really rapid growth of real income per capita is confined to cases where countries, that initially lag behind the leaders in terms of income and productivity levels, go through a phase of rapid catching up (Crafts, 1998). But catching-up is not automatic. In his famous discussion of the opportunities and difficulties of "economic backwardness," Gerschenkron (1962) suggested that economically backward countries could achieve a take-off into very rapid growth only if they take radical measures to promote development through institutional innovations and controlled capital markets. With the exception of Hong Kong, the development strategies of most of the East Asian countries to achieve rapid catch-up growth bear strong resemblance to Gerschenkron's recipe (Crafts, 1998).

Economic backwardness has another dimension, not central to Gerschenkron's account. "As economies develop, they typically undergo a demographic transition in which birth and death rates both fall to a much lower level but during which there is an acceleration of population which tends initially to reduce and then significantly to increase the proportion of working age" (Crafts, 1998: p.11). Crafts asserted that the working age group rose rapidly in many cases between the early 1970s and the early 1990s. Bloom and Williamson (1997), suggested that this change in age structure may have offered a substantial growth bonus in East Asia, of the order of 1.5 to 1.9 percent per year.

Second, the sound work ethic of Asian people was another asset. Asian people were diligent as proven by their long working hours and high savings rates. Such diligence in combination with low costs of labour employment made these economies attractive to foreign investors. A high pool of available savings provided the necessary funds for high rates of domestic investment (see Table 2). A number of factors have been advanced to explain the high level of domestic saving in the economies of East Asia (see, for example, World Bank (1993)). First, the rapid economic growth experienced by these countries. Studies suggest that savings are an outcome of high growth (see for example Carroll, Weil and Summers (1993)) although this does vary by country. Second, the rapid demographic transitions experienced by these countries. The size, age distribution, and ratio of working to non-working population can exert an influence on aggregate saving (see for example Ando and Modigliani (1963) and Modigliani (1970)). Third, sound policy fundamentals. Low fiscal budget deficits, and surpluses, focusing upon restraining government spending, enabled public savings to complement private savings including that from the private corporate sector. Fourth, specific policy measures to encourage saving were adopted including: the establishment of financial systems (for example postal savings institutions); effective protection of deposits at financial institutions; tax incentives; restrictions on consumer credit and spending; and forced savings through mandatory pension schemes (important in both Singapore and Malaysia).

Table 2 East Asian Economies – Gross Domestic Savings (percent of GDP)

	1980	1990	2000	2002
China	34.1	38.7	38.0	38.5
Hong Kong	34.5	35.4	32.2	30.0
Indonesia	29.2	32.3	22.0	21.3
South Korea	23.8	37.2	30.9	30.0
Malaysia	32.9	34.4	46.9	46.1
Philippines	26.6	18.7	17.0	15.5
Singapore	38.8	43.4	49.8	52.0
Taiwan	32.6	28.1	24.8	26.6
Thailand	23.0	34.3	30.0	33.1
Vietnam	-	2.9	25.0	24.1

Sources: Asian Development Bank, 2001, *Key Indicators of Developing Asian and Pacific Countries*, Table 15, p.52, Vol. 32 (years 1980 and 1990).

Asian Development Bank, 2001, Asian Development Outlook, Statistical Appendix, Table A7, p.214 (years 2000 and 2002).

Third, in most East Asian countries people were well educated due to the strong Confucian emphasis on education, focusing upon the development of a good primary education system. As can be observed from Table 3 East Asia compared reasonably well with other regions of the global economy during the period of the 1960s in terms of primary enrolment. This performance, however, was outstanding during the period of the 1980s and 1990s, even outperforming that of the high-income economies. In terms of secondary school enrolments, this compared well with other comparable regions. In fact, Rodrik (1994) showed that countries that were poorer, but that had good primary education systems and less inequality of income and land distribution around 1960, grew faster than the others during subsequent periods.

Table 3 Education: percentage of age group enrolled in education

	Primary			Secondary			Tertiary		
	1965	1980	1995	1965	1980	1995	1965	1980	1995
East Asia and the Pacific	88	111	115	-	43	65	1	3	6
High income	104	102	103	61	87	104	21	35	57
South Asia	68	76	99	24	27	49	4	5	6
Sub-Saharan Africa	41	78	75	4	14	27		1	-
Europe									
Arab countries	61	87	97	17	42	64	3	11	15
Latin American and Caribbean	99	106	111	20	42	53	4	14	15

Source: World Bank, World Development Report, 1992; World Bank, World Development Indicators, 1998.

External Environment

East Asia's fast growth occurred in favourable international circumstances, at least until the late 1980s. First, the international movement towards freer trade under the GATT enabled East Asian countries to effectively pursue an export-oriented growth strategy. Following a number of multilateral trade talks under the auspices of the GATT, the developed countries moved toward the opening of their domestic markets, yet most East Asian countries, as developing countries, were allowed to keep their domestic markets effectively closed until the end of the 1980s.

Second, the free trade approach on the part of the U.S, which provided the largest market for East Asia's exports, assisted the export-oriented industrialisation strategy of these countries. Also, most East Asian countries received a considerable amount of explicit and implicit economic assistance from the United States during the cold war era, and this provided seed money at the initial stage of economic development.

Third, like flocks of geese flying in a "V" formation to make their flying easier, the East Asian countries followed the export oriented development model of Japan – the lead goose. Japan successfully developed globally competitive high-technology products that it was able to export successfully, including to the economies of East Asia, while its domestic market remained almost effectively closed to foreign competition. After the Plaza Accord in 1985, however, the yen began to increase in value relative to the US dollar. The strong yen encouraged many Japanese companies, particularly in the automotive and electronics industries, to establish overseas plants in order to maintain their international competitiveness (Sato and Rizzo (1986)). The stronger yen also increased the cost of employing labour, relative to that of its regional competitors such as Korea, and resulted in many of Japan's labour intensive industries moving offshore to production units in the lower labour cost countries of East Asia[8]. Instead of Japan exporting these products to East Asia, these countries now started to export to Japan. In the process Japan, through its foreign direct investment (FDI), had passed on its production technologies to the East Asian nations. Specifically Korea and Taiwan followed Japan with a certain time lag, and later, as their labour costs increased, the economies of Southeast Asia followed during the period of the 1980s, and increasingly so into the 1990s as they adopted a more export oriented policy and increasingly opened their financial sectors to further inflows of short and long term capital flows.

Fourth, it is also important to bear in mind that the economies of East Asia, particularly from the period after the breakdown of the Bretton Woods agreement, began to benefit from the rapid development of international financial markets and the globalisation of capital flows. This assisted in the accumulation of FDI and the expansion of regional growth of output and exports. However, such flows of capital increased dramatically, enabling these economies to sustain very high rates of investment, but also contributed to problems on current account and in the accumulation of foreign debt.

Policy Factors

First, the economies of East Asia operated within an environment of primarily market based mechanisms of competitive discipline. This contributed to the development of competitive enterprises subject to hard budget constraints, and, by limiting price distortions, the system contributed to a more efficient and productive allocation of scarce resources.

---

[8] Resulting in the so-called hollowing out of Japan's manufacturing industries.

Second, with the exception of Hong Kong, there was a strong leadership role by regional governments in creating and developing the "market", and their credible commitment to its long-run development. This is a somewhat controversial argument, as there is plenty of evidence that East Asia's industrial policies did not contribute to the growth of industries' productivity.[9] But at least until the early 1980s a strong government leadership was rather necessary and desirable, because the domestic markets were incomplete or missing and the structure of domestic industry was rather simple. Even if the net benefits of government intervention policies are still controversial, they clearly allowed some Asian firms to establish themselves in industries, such as steel, chemical engineering, shipbuilding, electronics and automobiles, where the costs of entry were high.

Third, an outward-looking development strategy, particularly a dynamic export sector, has been a crucial ingredient of the miracle (FRBSF, 1997). The East Asian economies started from a very low level of national income and income per capita. Consequently, domestic producers faced a very limited domestic market, suggesting that developing an industrial base through import substitution had severe limitations. The only way forward was an export oriented industrialisation growth and development policy, requiring the development of globally competitive enterprises. Most East Asian governments set firm- and industry-specific export targets and developed export-marketing institutions. They also made selective use of tariff protection, export incentives ranging from moral suasion to subsidies, and provided industry with financing at lower cost.

The outward-oriented development forced domestic firms to become more efficient and absorb foreign technology and managerial know-how in order to compete in world markets. It also promoted growth by providing access to larger markets and generating increasing returns to scale in production. The export-oriented development was a means of achieving viable external balances, generating foreign exchange to purchase essential technology and imported inputs, and generating the demand needed to accelerate GDP growth.

Fourth was the adherence to stable macroeconomic management. This contributed to vigorous accumulation through higher rates of investment and to improved allocation by

[9] For instance, Beason and Weinstein (1996) find that industrial policies in Japan were not directed towards the higher-growth industries, and Lee (1996) finds a similar result for Korea.

reducing inflation and instability in relative prices (World Bank, 1993). The maintenance of competitive exchange rates was also seen as being important. During the period of the 1990s, however, and before the financial crisis of 1997, the East Asian economies adopted varying nominal exchange rate policies *vis a vis* the US dollar. Some countries pursued relatively fixed rates while others pursued more flexible exchange rates.

While developments in nominal exchange rates over the period 1990-97 suggested, in general, improved competitiveness for these economies, developments in their real exchange rates suggested otherwise. With the exception of Korea and Taiwan the East Asian economies by the end of 1996 experienced a considerable appreciation of their real exchange rates and loss of international competitiveness. The countries with the more rigid exchange rate policy rules experienced a larger real exchange rate appreciation (see Corsetti, Pesenti and Roubini (1998), p.20).

Fifth, education policies that focused on primary and secondary schools generated rapid increases in labour force skills and enhanced the productivity and employability of the workforce. Governments in these countries successfully addressed the market failures of missing information and positive externalities in the educational field, by focusing education spending on universal primary and secondary education. The share of expenditure allocated to tertiary education tended to be low, and this was more focused upon the acquisition of technical skills, vocational training and technically sophisticated disciplines. Consequently, in the context of the New Economy, with its emphasis on technology and knowledge intensive industries, this latter situation is likely to present a major future problem for the region.

Advocates of free markets saw the triumph of the East Asian economies as being in their small governments, the market mechanism and unfettered private initiative. On the other hand interventionists saw the East Asian miracle as being the triumph of selective interventionist policies by East Asian governments. Trade economists viewed it as a miracle based on outward orientation, labour economists stressed the early emphasis on education, and macroeconomists pointed to the region's fiscal conservatism (Rodrik, 1999). But the truth is in between: to varying degrees, all of these policy factors contributed to the fast growth performance of East Asia.

Interim Outcome

The EADM produced impressive results by any standard. These included: high levels of domestic financial savings and private domestic investment; rapidly growing human capital; rapid growth of exports; and rapid catching-up of foreign technologies. These we describe here as being major interim outcomes which became the principal engines of growth. For example, the World Bank (1993) report asserts that investment, exceeding 20 percent of GDP on average between 1960 and 1990, combined with rising endowments of human capital "account" for roughly two-thirds of the growth in the HPAEs.

The HPAE governments encouraged private investment with a wide array of mechanisms such as low capital goods prices, subsidised interest rates for corporate investment, and limited risk for private investors (World Bank 1993). A stable business environment with relatively low inflation also encouraged investment in long gestation fixed assets. High rates of investment were financed by domestic saving, as well as through increasing flows of FDI. High human capital, rapid growth of exports, and rapid technological change further laid the foundations of rapid growth and development. Rapid demographic change was also a key characteristic outcome from this rapid development.

Final Outcome

The interim outcomes contributed to rapid industrialisation, rapid and sustained economic growth, and considerably improved social indicators. Poverty declined significantly and other social indicators, such as equality of income, life expectancy and fertility rates, compared favourably with other countries at a similar level of income before and during the period of rapid growth. Table 4 indicates, for example, that the East Asian economies compared favourably with the economies of Sub-Saharan Africa, the Middle East, and Latin America and the Caribbean in terms of income

Table 4 Social indicators – an international regional comparison

	Life expectancy					Infant mortality rate per 1000 live births					Income inequality - average Gini coefficient		Total fertility rate, births per woman				
	1970-75	1980	1990	1996	1995-2000	1965	1970	1980	1990	1999	1980s	1990s	1965	1970-75	1980	1990	1995-2000
East Asia and Pacific	**60.4**	**65**	**68**	**68**	**68.8**	**95**	**87**	**56**	**34**	**34**	**38.7**	**38.1**	**6.2**	**5.0**	**3.1**	**2.7**	**2.1**
High income countries	72.0	74	77	77	77.8	24	21	13	8	6	33.2	33.8	2.8	2.1	1.9	1.7	1.7
South Asia	49.9	54	58	62	61.9	147	128	120	93	69	35.0	31.9	6.3	5.6	5.3	4.2	3.6
Sub Saharan Africa	45.3	48	51	52	48.8	157	138	115	107	107	43.7	47.0	6.6	6.8	6.6	6.5	5.8
Eastern Europe and CIS	69.2	-	-	-	68.4	-	37	-	-	25	25.0	28.9	-	2.5	-	-	1.5
Arab States	51.9	59	61	67	65.9	151	129	96	79	44	40.5	38.0	7.1	6.5	6.1	5.7	4.1
Latin America and the Caribbean	60.8	65	68	70	69.3	94	87	59	48	32	49.8	49.3	5.8	5.1	4.1	3.3	2.7

Sources: UNDP, Human Development Report, 2001,

World Bank, World Development Reports (various),

World Bank, World Development Indicators (various),

Deininger and Squire (1996),

inequality throughout the period of the 1980s and 1990s, although lagged behind the performance of the economies of South Asia. The gini coefficient, however, improved only slightly in East Asia during the period of the 1990s in comparison to that of the 1980s. East Asia compared very favourably against economies in South Asia, Sub-Saharan Africa, the Middle Eastern economies, and Latin America in terms of life expectancy, infant mortality, and particularly well in terms of fertility rates throughout its period of rapid economic development and growth.

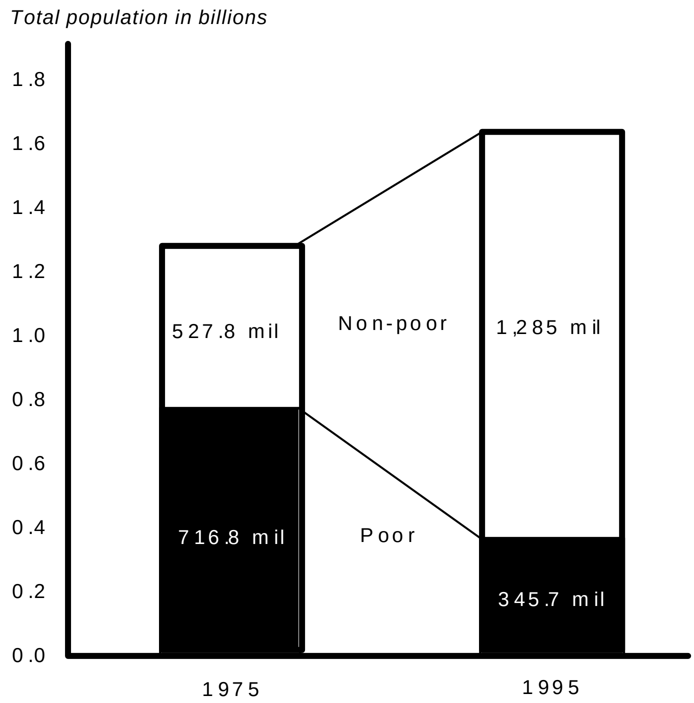
East Asia's performance in regard to poverty alleviation has also been truly remarkable. Poverty has declined not only in breadth (the number of poor) but also in depth (severity of poverty). The period of rapid economic growth was transmitted into improvements in welfare by generating employment growth and an expansion in productivity (World Bank (1993), p.2). Over a period of some 20 years the region reduced the number of people living in poverty by half. As indicated by Figure 1, people living below the international poverty line of US$1 a day fell from 720 million in the mid 1970s to 350 million in the mid 1990s. The rate of decline over the period 1985-95 was 34 percent while it was 27 percent over the period 1975-85. This pace of poverty reduction was faster than for any other region in the world, resulting in a decline of the share of the world's poor living in East Asia:

"Six out of ten East Asians lived in absolute poverty in 1975, roughly two in ten did in 1995" (World Bank, 1998, p.2)

3.2. Towards a New East Asian Development Model

The events of 1997-98 induced academics, policy makers, and journalists alike to re-evaluate the EADM, and to identify whether this required a fundamentally different economic growth paradigm, or model, or whether the old model was still applicable but just required some fine-tuning. Different views on the EADM model stemmed from different explanations for the causes of the crisis. While a number of explanations have been offered for East Asia's financial crisis, they can be broadly divided into three groups. The first group argues that the Asian crisis erupted because, even though there was no serious problem, self-fulfilling investors suddenly panicked and ran away in a herd from the region (Radelet and Sachs, 1998). The second group takes the opposite position and claims that the fundamental problems of these countries had accumulated and finally erupted at once when they reached breaking point (Krugman, 1998; Corsetti, Pesenti and Roubini, 1998). A third group argued that the crisis erupted mainly because of external factors like abrupt changes in international market conditions. Unlike the first and second groups, which included mostly economists, the third group seemed to include mostly politicians and journalists. Some people even claimed that the Asian financial crisis was the result of hegemonic conflict between the East and the West.

Figure 1 Poverty development in East Asia



Source: World Bank, 1998, p.3

Blaming only one factor for the crisis, however, does not seem to be appealing. For example, attributing it exclusively to irrational (or rational) speculative attacks and contagion does not seem to make sense, because the contagion varied widely across the East Asian countries. Blaming it solely on an economic system once praised as a successful model for development is also inconsistent. It seems that there is some truth in each of these explanations. In other words, the East Asian financial crisis occurred not due to one single reason, but due to elements from all of the three explanatory categories.[10]

[10] Using the 'stroke' hypothesis, Harvie and H. H. Lee (2002) synthesise most of the appealing explanations and theories of the financial crisis, and show how the numerous factors were coherently

If this is true, the old EADM, which was adequate throughout most of the period of high growth until the early 1990s, will need to be overhauled in order to give the region a new dynamism and enable it to return to its earlier strong growth path. Even if the main cause of the recent crisis was largely due to volatile international financial markets, the crisis exposed several structural problems that need to be overcome if East Asia is to revive its sustained rapid growth. In any case, the Asian crisis has irrevocably altered the economic landscape of the region.

We construct a new development model, the core ingredients of which are summarised in Table 7. As in Table 1 we begin with reviewing the initial conditions and external international environment, and attempt to suggest plausible policy factors and desired, or targeted, outcomes.

Initial Conditions

It is worth noting that most East Asian economies can no longer be described as less developed, but more accurately as maturing economies. However, there may still remain a good deal of scope for rapid catch-up growth before diminishing returns to heavy capital accumulation bite severely (Crafts, 1998). But the growth bonus due to change in age structure in East Asia, which was inherently temporary, may now be over. This implies that the fast growth rates the East Asian economies enjoyed before are no longer attainable. The region still possesses a sound work ethic amongst its people, which still remains as a valuable asset. But as these economies mature further, their workers will increasingly expect to be compensated in terms of higher wages and by improved social safety net coverage. Hence their traditional advantage in labour intensive production will be steadily eroded.

A high sprit of education also remains valid, but as these countries develop into advanced economies, and with the technology and skill intensive demands of the "new economy", they will increasingly require a highly skilled and creative labour force. But deficiencies in the current education system in most East Asian countries means an inadequate provision for these economies of the kind of labour force they need most.

---

intertwined in causing the financial crisis in Korea in 1997. The same approach could be applied to the crisis elsewhere in East Asia.

Table 7. New Paradigm of the East Asian Development Model

Initial Conditions:

. Maturing economies

. Sound work ethic

. High sprit of education, and good primary and intermediary education system

External Environment:

. WTO, trade and investment liberalisation (Globalisation)

. Proliferation of global regionalism

. Intensification of domestic and foreign market competition (including China, and Indo-China)

. Fair trade approach by the U.S.

. No more flying geese pattern, due to Japan's loss of economic momentum

. Rapid growth of international financial markets

. Worldwide knowledge revolution

Policy Factors:

. Primarily market based mechanisms of competitive discipline

. Improved Governance (corporate, banking and public sectors)

. Encouragement of small and medium enterprises

. Trade and domestic economy orientation (balanced growth)

. Stable macroeconomic management

. Emphasis on high quality education

. Stronger cooperation within the region in both trade and finance

"Targeted" Interim Outcome:

. High savings

. High investment with prudence

. Increasing human capital

. Rapid growth of trade (intra-regional in particular)

. Rapid catching-up and pioneering technology in some areas

"Targeted" Final Outcome:

. Rapid growth of the "new" economy (technology and skill intensive industries), and in the service sector

. Rapid and sustained economic growth

. Reduced poverty

. Improving social indicators

External Environment

The global economic environment continues to change at a rapid pace, and those economies best able to adapt to these changes will be the big winners in the new millennium. First, with the conclusion of the Uruguay Round and the establishment of the World Trade Organisation (WTO), the East Asian economies will face a more rapid opening of their domestic markets to both trade and investment flows. Many of these countries, such as Korea, are no longer considered to be developing economies by the WTO, and hence cannot expect to be able to have access to global markets without at the same time opening their own markets to foreign competition.

Second, unlike in the earlier period of rapid growth, the economies of East Asia are now facing a proliferation of regionalism in both Europe and in the Americas, making the task of further expanding exports to these key markets increasingly difficult. Hence maintaining an export growth momentum in these markets appears to be increasingly unlikely.

Third, within East Asia itself the next wave of rapidly developing economies is coming through. In particular China, the economies of Indo-China, and, more specifically, Vietnam. This will further intensify competition in both regional and global markets. China's recent accession to the WTO will represent a major threat to other regional economies that compete in labour intensive and low value added products.

Fourth, the US market, the single biggest market for East Asian products, that previously emphasised a free trade approach, has changed its attitude toward a fair trade approach. Export-oriented industrial development has increasingly been constrained by protectionist policies in the U.S. and other industrial countries.

Fifth, the foundation of the flying geese process, whereby countries at different levels of industrialisation and development move together on the basis of a progressive upgrading of their industries, has recently been shaken by the economic difficulties faced by Japan. For instance, Japan, which had invested nearly US$50 billion in developing East Asia from the mid 1980s onward, lost its bearings in the early 1990s. Japan's foreign direct investment, which totalled 35.3 trillion yen at the end of 1997, dropped to 31.2 trillion yen at the end of 1998 and to 25.5 trillion yen at the end of 1999. No new lead goose has come forward to replace Japan. China, perhaps, can assume the lead role in the future. But thus far, competing across the technology/production value chain with other countries in East Asia, China has broken the flying geese pattern. Thereby posing a serious threat to the existing EADM.

Sixth, there has been a phenomenal growth of international financial markets and a rapid opening of domestic financial markets in East Asia during the period of the 1990s. The crisis of 1997-98 was triggered by a rapid withdrawal of short-term capital from the crisis-afflicted economies. The rapid growth of short-term capital flows has the potential to result in greater financial market volatility and indeed, as seen in East Asia, to wreak havoc if there is a rapid reversal of such flows.

Finally, the world is today experiencing a knowledge revolution. In other words the world is currently experiencing a major transition from an industrial society to a new economic paradigm, where information and knowledge are the principal drivers of competitiveness. The driving force behind this has been rapid advances in information and communications technology (ICT). Rapid advances in ICT have brought fundamental changes to the economic transaction modes of business, government, and lifestyles. Indeed, the access to ICT-related tools and skills are becoming crucial components in economic development worldwide.

Policy Factors

Given the changed economic circumstances in the wake of the financial crisis as well as developments in the external environment previously identified, a re-appraisal of the conduct of certain aspects of policy becomes essential. First, the primarily market based mechanisms of competitive discipline will remain and intensify. It is no longer possible to protect certain sectors of the economy behind trade and non-trade barriers. Consequently, the development of domestic enterprises capable of competing domestically and internationally will be essential. Second, East Asian governments need to play a new role in the economy that focuses upon establishing the necessary institutional framework that supports competitive and open markets, and contributes towards capacity building. Key to this will be policy that focuses upon good governance both in the private and public sectors. In the private sector the development of stock markets and financial institutions with the capacity to monitor the performance of private sector enterprises will be essential to ensure a more efficient and productive usage of financial resources.

Third, more policy emphasis also needs to be devoted to the development of small and medium sized enterprises (SMEs). In the wake of the crisis a re-appraisal of the role of SMEs has taken place. The Korean and Taiwanese experience is of relevance here. Korea has traditionally emphasised the role and importance of large enterprises, the *chaebol*, and suffered severely during the period of the crisis, while Taiwan, dominated by SMEs, came through the crisis relatively unscathed (see for example Harvie and B. C. Lee (2002)). The development of the SME sector has the potential to expand growth, employment, exports, reduce poverty, enhance regional development, empower groups such as women, and contribute to a more crisis resilient economy. The issue of whether industry policy should give more focus to the development of large or small enterprises remains a contentious issue in the literature, see for example Hallberg (2000), however the contribution of SMEs to the future development of the region remains of paramount importance and particularly so for the developing economies.

Fourth, the East Asian governments should continue to pursue an outward-looking development strategy as the relationship between openness and growth appears to be fairly robust. But in the new framework, trade should be promoted not only by promoting exports but also imports. This is not just because of the increasing pressure from the industrialising countries elsewhere in the world. Rather this is because by embodying technologies of the country of origin, and other countries contributing to the product, imports are an effective vehicle for assimilating new technology (Bayoumi, Coe, and Helpman, 1996). In addition, higher priority should be given to greater integration between the domestic and external sectors of the economy, as well as giving more emphasis to the development of sectors that serve primarily the domestic market. The former, in particular, implies the need to increasingly incorporate domestic enterprises in the supply chain of multinational enterprises located domestically but also those located overseas. Hence an important change of emphasis would be to move towards a more balanced approach to growth of the economy, in which domestic and foreign market oriented enterprises are given more equal treatment.

Fifth, stable macroeconomic management should continue to be maintained. In the wake of the crisis in 1997-98, many crisis-hit East Asian countries built up a considerable amount of government debt to finance the restructuring of their financial institutions and corporations. Therefore special efforts to maintain stable macroeconomic policies are required which will entail: the maintenance of low budget deficits, or surpluses, and the reduction of public debt to a sustainable level; monetary policy aimed at price stability; ensuring that the real exchange rate remains competitive; ensure a reduction of foreign debt, particularly short term debt; and encourage the rapid repayment of any international loans arising from assistance given during then period of the financial and economic crisis of 1997-98. This, in collaboration with reform of the financial and corporate sectors, will be essential for the establishment of a platform for the long-term sustainable recovery of regional economies

Sixth, the East Asian countries will need to improve their current education systems so as to provide the economy with a high skilled and creative labour force, which is in most need, as the economies advance to the stage of being developed economies. In addition, as noted previously, the world is moving toward the stage where knowledge and information are key to economic growth. But the current education system in most economies – except perhaps Hong Kong and Singapore – has not provided adequately these economies with the kind of labour force that is increasingly required. Therefore developing an appropriate education system to produce a creative, skilled and adaptable workforce will be fundamental for the East Asian countries to embrace the new economy for the 21st century.

Finally, stronger cooperation within the region in both trade and finance is desperately needed. More detailed discussion of this is conducted in the following section, as the theme of this paper is the relationship between East Asia's regionalism and the region's development model.

"Targeted" Interim and final outcomes

As with the original EADM it is essential that the fundamentals for achieving high and sustainable growth are put in place. Targeted interim outcomes must aim at the maintenance of high rates of domestic saving to reduce the reliance on foreign funds, foreign borrowing in particular, as much as possible. A second objective, and a key lesson from the crisis, is the need for such funds to be put to productive usage with prudence. Excessive investment in non-productive assets, such as real estate and property development, resulted in excessive borrowing for this purpose both from domestic and external sources. Third, attaining a high level of human capital to meet the demands of the new economy for a technologically literate and skilled workforce. Fourth, maintaining export growth while ensuring the development of domestic market opportunities. The expansion of export growth is likely to increasingly focus upon intra regional trade, as discussed in the following section. Finally, in order to maintain its international competitiveness, it will be essential for the region to continue the process of technological catch-up in key sectors, as well as to engage in pioneering technology development of its own.

If these key building blocks can be put in place then the region, in this new global environment of intensive competition, improved information and communications technology, and openness of markets, can flourish. It can be at the forefront of the rapid growth of the new economy as well as of the service sector, return to relatively high and sustainable growth rates, achieve further major progress in alleviating poverty, despite the set backs arising from the recent crisis, and once again be at the forefront of developing economies in terms of their improving social indicators.

3.3. East Asian Regionalism and the East Asian Development Model

As discussed in Section 2, there has been an increasing trend towards regionalism in East Asia. The driving forces behind this have been: the slowing liberalisation process under the WTO; proliferation of regionalism else where in the world; and the 1997-98 financial crisis which demonstrated the risk of contagion and investors perception of the region as a "single market."

If the world is a free market as a whole at the multilateral level, or keeps moving toward it, the policies of free trade on the part of East Asian countries may be superior to one that relies on regionalism. However, more efforts to build regional cooperative frameworks within East Asia can be justified with the current worldwide trend of regionalism. This suggests that the East Asian countries should pursue an outward-looking development strategy that relies on both worldwide globalisation and the Asian-wide "regionalisation" by forming FTAs among themselves. The implications of this for the EADM is now briefly discussed.

First, it is clear that exports will remain important if the economies of East Asia are going to return to high and sustainable growth. However with the growth of regional trading blocs (for example NAFTA and the EU) access by the East Asian economies to these is likely to be fraught with increasing uncertainty. Instead, East Asia should give more weight to expanding trade within the region itself. There is likely, therefore, to be increased importance placed upon an intra regional trade emphasis rather than, as in the past, an inter-regional trade emphasis[11]. Given the current WTO difficulties in producing another round of tariff reductions, the East Asian economies can initiate this process through greater economic integration between themselves, over which they have more control, and where they have a vested interest in making it succeed. This is particularly relevant given the complementarity of many of the regional economies.

Second, with greater regional integration comes the prospect of expanded competition in domestic markets. Hence there is the need to develop globally competitive indigenous enterprises that can compete both in domestic and international markets. This would eventually help increase the productivity of East Asian countries and help revitalise their economies. Enhancing corporate sector restructuring and transparency is of particular importance here as is the expanded role of the SME sector.

Third, to benefit from further expansion in trade and investment in the region will require stable financial markets, including that of regional currencies. The example of the EU is of interest here. Perhaps the ultimate movement towards economic and monetary union should be attempted in stages: movement towards free trade and a single market; closer coordination of monetary, fiscal and exchange rate policies; convergence criteria; movement towards fixed exchange rates, and movement towards a single currency and a single central bank for East Asia (see for example Oh and Harvie (2001)).

Fourth, while export growth will remain important, more emphasis should also be given to the development of the domestic sector and the growth opportunities this provides. Hence there should be more emphasis on balanced growth for the economies of East Asia. This should include a greater focus upon building relationships between the domestic sector and the external sector. In the past these were highly segregated in many countries.

Finally, in addition to these economic gains, the East Asian countries would be able to make the overall ties among themselves stronger and more stable through increased

[11] About 50 percent of trade for the East Asian economies is already accounted for by trade with other East Asian economies

interdependence, and thereby increase their influence in the international trade and investment arena. Increasing the likelihood that issues of prime concern to these countries can be more directly addressed in international forums. Most East Asian countries also seem to agree that they need not only intra-trade liberalisation, but also intra-regional cooperation in the political, security, social and culture arenas to create a regional community.

While regionalism in East Asia is still at an early stage and its precise shape still remains vague, in the foreseeable future, however, the ASEAN+3 might be converted to a sort of East Asian Community and a full-fledged East Asia free trade area. If formed, this entity would immediately rank alongside the EU and NAFTA in size, transforming the world into a tripolar economy (Bergsten, 2000). The creation of such an East Asian economic bloc could have many implications for the global system. On the positive side, East Asian economic integration could be a catalyst for the global trading system in the same way as the successive process of economic integration has been during the post-war period. Thus, a unified East Asia could accelerate the momentum of overall trade liberalisation, boost global economic growth, and contribute to international peace. On the negative side, a process of new regionalism in East Asia would discriminate against outsiders. This in turn could act as a disruptive force in the world trading system, and undermine the multilateralism of the WTO.

The overall outcome will be determined mostly by the policies of the East Asian countries themselves. The East Asian countries, however, should not reject the multilateral institutions. That is, they should continue to work with, and within, the framework of the WTO and cooperate with the rest of the world in both economic and security terms. But, as with the case of the EU, East Asia should raise its voice in the global world and attempt to seek its own "made-in Asia" solutions and independent actions in certain cases.

4. Concluding Remarks

This paper has reviewed recent developments in regionalism in East Asia, and discussed how this relates to the region's old economic development paradigm, and how it fits into the new growth and development paradigm. As in the past the growth of exports will remain a key ingredient behind the recovery of the region in the aftermath of the events of 1997-98, but more emphasis will be placed upon the growth of intra regional trade rather than inter regional trade. Movement towards closer economic integration for the regional economies has the potential to produce substantial trade and finance benefits. In particular the establishment of an expanded regional trade bloc, such as ASEAN+3, should be actively encouraged, as well as the movement towards an Asian Currency Union.

The original EADM model has now run its course, but in the process has produced remarkable social and economic outcomes. Many of the economies of East Asia have now matured and face a different global trade and financial environment, with the need to develop their "new economies" based upon technology and knowledge intensive sectors. A more balanced approach to economic development, emphasising the development of both the domestic and external sectors, will also be required, as will the need to put in place the necessary restructuring of their financial and corporate sectors to overcome the problems that lay at the heart of the events of 1997-98. The need to develop a globally competitive enterprise sector, giving more focus to the development of the SME sector, will be crucial. Those economies most able to adapt to rapidly changing regional and global conditions will be the new East Asian miracle economies of the twenty first century.

References

Ando, A. and F. Modigliani (1963), "The Life Cycle Hypothesis of Savings: Aggregate Implications and Tests", American Economic Review, 53(1).

Bayoumi, T., D. T. Coe, and E. Helpman, "R&D Spillovers and Global Growth, *National Bureau of Economic Research*, No. 5628, 1996.

Beason, R., and D. E. Weinstein, "Growth, Economies of Scale, and Targeting in Japan (1955-1990), *The Review of Economics and Statistics*, Vol. 78, 1996, pp.286-295.

Bergsten, C. F., "Towards a Tripartite World," *The Economist*, 13 July 2000.

Bloom, D. E. and Williamson, J.G., "Demographic Transitions and Economic Miracles in Emerging Asia," NBER Working Paper No.6268, 1997.

Carroll, C., D. Weil and L.H. Summers (1993), "Savings and Growth: a Reinterpretation", Paper presented at the Carnegie-Rochester Public Policy Conference, Bradley Policy Research Centre, April 23-24.

Corsetti, G., P. Pesenti and N. Roubini, "What Caused the Asian Currency and Financial Crisis?", Part 1: A Macroeconomic Overview, September, 1998. Available at http://www.stern.nyu.edu/globalmacro/.

Crafts, N., "East Asian Growth Before and After the Crisis, IMF Working Paper, WP/98/37, 1998.

Deininger, K. and S. Squire, "A New Data Set Measuring Income Inequality", The *World Bank Economic Review*, 10 (3), pp.565-91.

Federal Reserve Bank of San Francisco (FRBSF), "Government Intervention and the East Asian Miracle," FRBSF Economic Letter, 97-20, 1997.

Feinberg, R., "Asians Seek Their 'Made-in Asia' Solutions, " Seoul: Korea Herald, 5 July 2000, (http://www.koreaherald.co.kr).

Gerschenkron, A., *Economic Backwardness in Historical Perspective*, Cambridge, Mass.: Belknap Press, 1962.

Hallberg, K., "A Market Oriented Strategy for Small and Medium Enterprises", IFC Discussion Paper 40, Washington, DC, 2000.

Harvie, C. and B.C. Lee, *The Role of SMEs in National Economies in East Asia*, Cheltenham, Edward Elgar, 2002 (forthcoming).

Harvie, C. and H.H. Lee, *Korea's Economic Miracle: Fading or Reviving?*, Palgrave, Basingstoke, UK, 2002 (forthcoming)

Kim, Tae-Joon, Jai-won Ryou and Yunjong Wang, "Regional Arrangements to Borrow: A Scheme for Preventing Future Asian Liquidity Crisis," *Policy Analysis* 00-01, Korea Institute for International Economic Policy, November 2000.

Krugman, Paul, "What Happened to Asia," *mimeo*, 1998. (http://web.mit.edu/krugman/www/disinter.html)

Lamberte, Mario B., Ma. Melanie S. Milo and Victor Pontines, "NO to YE$? Enhancing Economic Integration in East Asia Through Closer Monetary Cooperation, *Discussion Paper Series* No.2001-16, Philippine Institute for Development Studies, July 2001.

Lee, J. W., "Government Interventions and Productivity Growth, " *Journal of Economic Growth*, 1996, pp.391-414.

Lloyd, P. J. and H. H. Lee, "Subregionalism in East Asia and Its Relation with APEC," *The Journal of the Korean Economy*, Vol. 2, No.2, 2001, pp.211-227.

Modigliani, F., "The Life Cycle Hypothesis of Savings and Intercountry Differences in the Savings Ratio", in W.A. Eltis, M.Fg. Scott and J.N. Wolfe (eds), *Induction Growth and Trade: Essays in Honour of Sir Roy Harrod*, Oxford, Clarendon Press, 1970.

Ogawa, E, "A Regional Monetary Fund and the IMF," paper presented at *Conference on New Regionalism in East Asia*, Seoul, 11-12 May, 2001.

Oh, Junggun and Charles Harvie, “Exchange Rate Coordination in East Asia”, *The Journal of the Korean Economy*, Vol. 2, No. 2, Fall 2001, pp.249 to 296.

Radelet, Steven and Jeffrey Sachs, “The East Asian Financial Crisis: Diagnosis, Remedies, Prospects,” *Brookings Papers in Economic Activity*, 1, 1998, pp.1-74.

Rodrik, D., “King Kong Meets Godzilla: The World Bank and the East Asian Miracle,” in Alter Fishlow, etal eds., *Miracle or Design? Lessons from the Past Experience*, Washington: Overseas Development Council, 1994.

Rodrik, D., “East Asian Mysteries: Past and Present,” NBER Reporter Online, Spring 1999. (http://www.nber.org/reporter/archive.html)

Sato, R. and J. A. Rizzo, “The Other Side of the Trade Imbalance: What will Japan do?”, Working paper, NBER, No. 2111, Cambridge, Mass., 1986.

Wang, Y., “The Asian Financial Crisis and Its Aftermath: Do We Need a Regional Financial Arrangement?” *ASEAN Economic Bulletin*, Vol.17, No.2, 2000 pp.205-217

World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, New York: Oxford University Press, 1993.

World Bank, *East Asia: The Road to Recovery*, World Bank, Washington, DC, 1998.

World Trade Organisation (WTO), “Mapping of Regional Trade Agreements: Background Note to the Secretariat”, WTO, Geneva, 1999. (http://www.itd.org/forums/mapping1.pdf).

World Trade Organisation (WTO)), *Annual Report of the Committee on Regional Trade Agreements*, WTO, Geneva, 2000a.

World Trade Organisation WTO, Focus Newsletter, December, WTO, Geneva, 2000b.