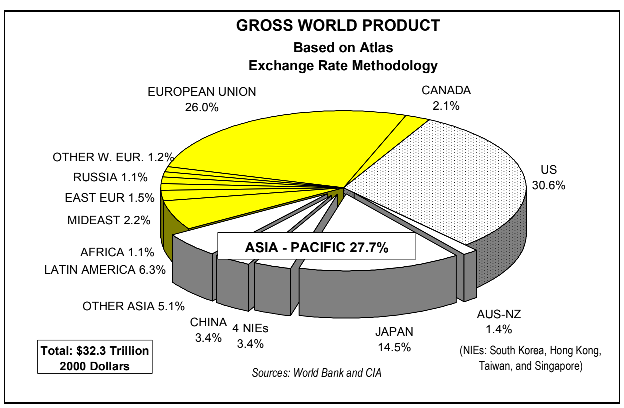
CHAPTER 1
THE GLOBAL ECONOMIC ROLE OF THE ASIA-PACIFIC REGION

In the aftermath of the Vietnam War, many countries of the Asia-Pacific region focused their attention on producing goods to satisfy the economic demand of the United States and Japan. This resourcefulness resulted in some of the fastest economic growth rates that the world has seen. Much of this prodigious growth was due to a reliance on market economics and a security umbrella maintained by the United States. This chapter looks back at Asia's historical dynamism in order to understand the region's current global economic role and its potential for long-term recovery from the Asian economic crisis.

Historic Asian Dynamism

Comparisons. In 1973, Asia accounted for just 15% of the world's economic output.[1] By 2000, the Asia-Pacific region's share was 27% of world output when measured on an exchange rate basis. Today, the total size of the Asia-Pacific region's output rivals those of the United States and the European Union (EU). (See Figure 1-A.) Using exchange rates, the world's second largest economy is Japan (14.7% of total), while China (3.4%) is sixth-largest.

Figure 1-A



However, exchange rates are subject to fluctuations and also force one to evaluate an entire economy based only on international trade and finance sectors. Therefore, technical adjustments are made using a second method, Purchasing Power Parity (PPP), to give weight to non-international, non-industrial markets.[2]

When using the PPP measure, the Asia-Pacific region far exceeds U.S. and EU totals, producing 34% of world output. (See Figure 1-B.) Further, by the PPP measure, China is the world's second largest economy (11.1% of total), followed by Japan (7.3%).

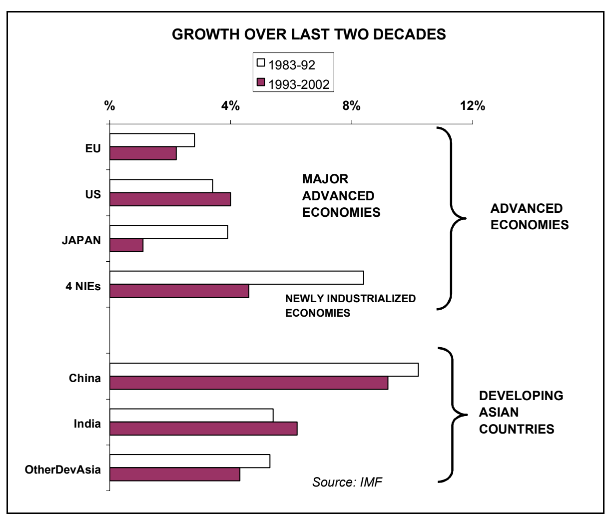
Figure 1-B
Comparison of Regional Output (2000)

	PPP	Exchange rate
Asia-Pacific	\$15.3T (33.9%)	\$8.5T (26.8%)
United States	\$9.6T (21.3%)	\$9.9T (31.0%)
EU	\$9.8T (21.6%)	\$8.4T (26.3%)
World	\$45.2 T	\$31.9T

Sources: World Bank and CIA

Growth. Despite growth fluctuations, Developing Asia has had a higher average economic growth than the industrialized United States, Japan, and the EU over the last two decades.[3] (See Figure 1-C.) The status of the four Newly Industrialized Economies (NIEs) of South Korea, Taiwan, Hong Kong, and Singapore has transitioned from "developing" to "advanced," and they now see slower growth as their economies take on characteristics of industrialized economies. Among the developing economies, China has sustained the world's fastest growing economy over the last two decades, while India also has progressed at a respectable rate despite its high population and incidence of poverty.

See Figure 1-C



Fundamental Growth Factors

The region's growth reflects a combination of quantitative and qualitative factors. (See Figure 1-D.) When growth falters, their mismanagement is clearly identifiable.

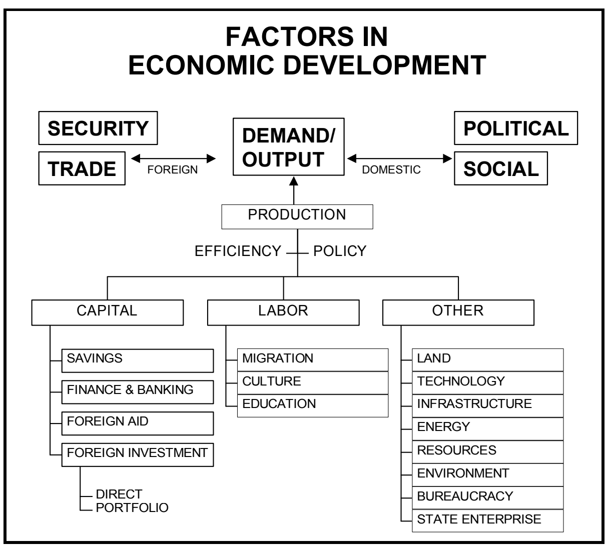
Quantitative Factors.

- Relatively open economies characterized by vigorous trade and investment ties with the United States, Japan, and Europe.
- High inflows of capital and labor to modern, internationally-oriented economic sectors
- High rates of national saving and aggressive investment in physical and human capital.

Qualitative Factors.

- Stable macroeconomic policies conducive to investment and commercial activity.
- Pro-market government interventions intended to steer resources into more productive activities.
- Reliance on cultural factors that value education and a strong work ethic.

Figure 1-D

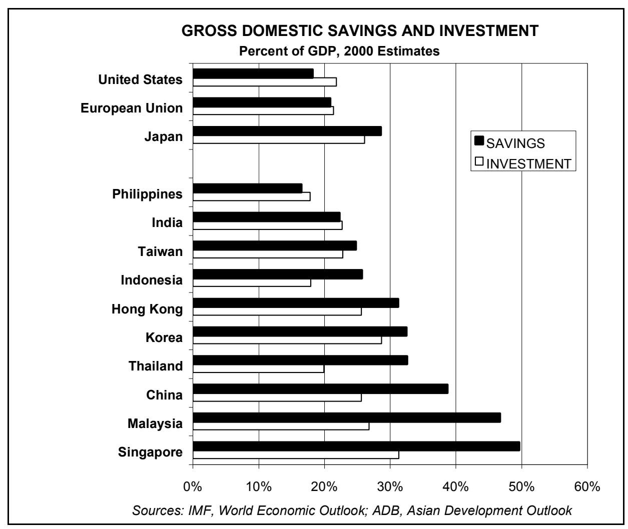


The Producer-Oriented Model. Huge demand from industrialized countries has been a key engine of growth for Asian exports.

- To satisfy demand, Asian producers blended a large inflow of cheap labor with large quantities of capital.
- This capital was obtained from domestic savings and foreign investment sources. (See Figure 1-E.)
- Asia's historic economic policies have promoted domestic investment—rather than consumption—by harnessing domestic savings and investment, profits from exports, and foreign investment.
- Japanese industrial policy typically followed this producer-oriented model, which promotes value-added industries supported by cheap, intermediate inputs from other Asian producers.
- However, this over-reliance on directing industrial output overlooked the benefits of competitive markets and the need for sound financial institutions.

Although Asia's economies were steeped in fairly immature business practices, their growth was sustained by an environment that was politically and socially stable.

Figure 1-E



Laborers, Consumers and Quality. From the mid-1990s, the countries of the Asia-Pacific have been emerging as lucrative consumer-oriented markets. This trend towards consumption is due to the promotion of qualitative factors that develop a middle-class base of well-paid workers.

Other Factors. Today, additional factors such as energy, population, the environment, transport, defense spending, infrastructure, and technology are crucial elements of the growth equation. (See Section II.) The future path these elements take will be largely determined by the quality of governance of the institutions in each country. (See Section III.)

Globalism and Growth[4]

The globalist prescription of these fundamental growth factors includes:

- Openness to international trade
- Macroeconomic stability
- Moderate size of government
- Developed financial markets
- Strong property rights, and
- Good rule of law.

Globalism, Growth, and Inequality. Contrary to claims by anti-globalists, participating in the global trading system helps increase average income and reduce poverty among the poorest segments.

- Non-participants lose-out and do not see economic growth. (See Figure 1-F.)
- Globalization benefits the poorest fifth of a country's society as much as it does to other segments. The poor are not left behind, but see a proportionate rise in income. (See Figure 1-G.)
- The income of the world's poor has risen dramatically, and the level of absolute poverty has dropped sharply, from 75% of the population in 1988 to 37% in 1998. Poverty was cut in half in only 10 years.[5] (See Figure 1-H.)
- The per capita incomes of populous Asia-Pacific countries like China, India, and Bangladesh are much higher than two decades ago. On a worldwide basis, therefore, the distribution of individual wealth is now weighted closer to the average than to the lowest-income group.

Implications for Non-Participants. Less globalized countries do not attain healthy growth for a variety of reasons often related to domestic turmoil. In cases such as North Korea and Burma, the rulers of these countries feel threatened by globalization principles and attribute their isolationism to their historic culture—despite the prosperous counter-examples established by their predecessors. This reclusive behavior lies in contrast to behaviors of other non-participating countries, such as Africa's post-colonial avarice or the Middle East's pre-occupation with the past.

Figure 1-F

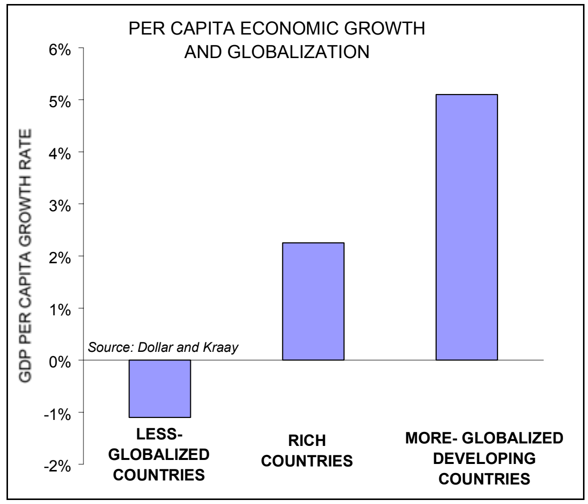
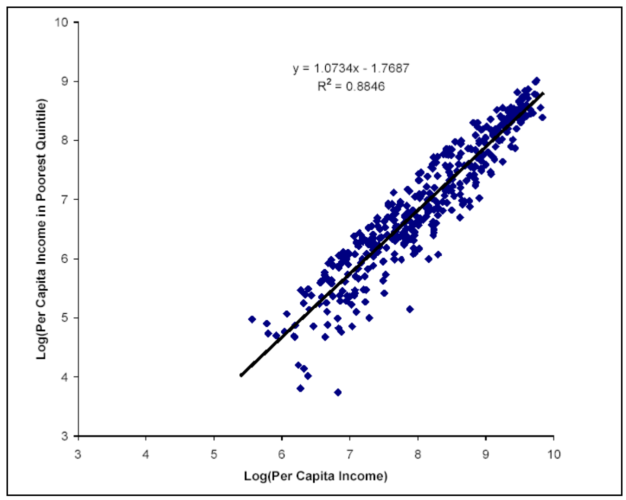


Figure 1-G

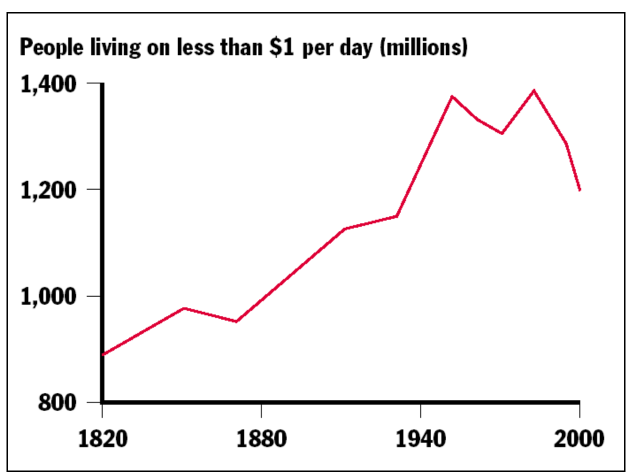
THE POOR'S PROPORTIONATE RISE OF INCOME



Source: Dollar and Kraay

Figure 1-H

WORLD POVERTY

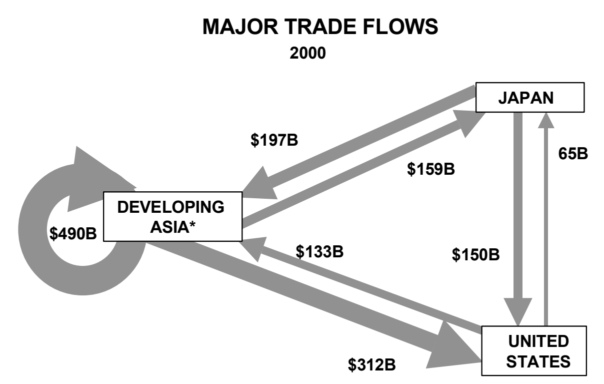


Source: World Bank

Multipolar Trade System

The United States, Japan, and the rest of the Asia-Pacific region are mutually dependent on open trade. All inject significant amounts of goods and services into the global trading system. The United States produced 13% of the world's exports in 2000, while Japan produced 8%, and Developing Asia produced 20%. Asia-Pacific trade is multipolar, with neither the United States nor Japan being the single, dominant trade partner of Developing Asia.[6] (See Figure 1-I.)

Figure 1-I



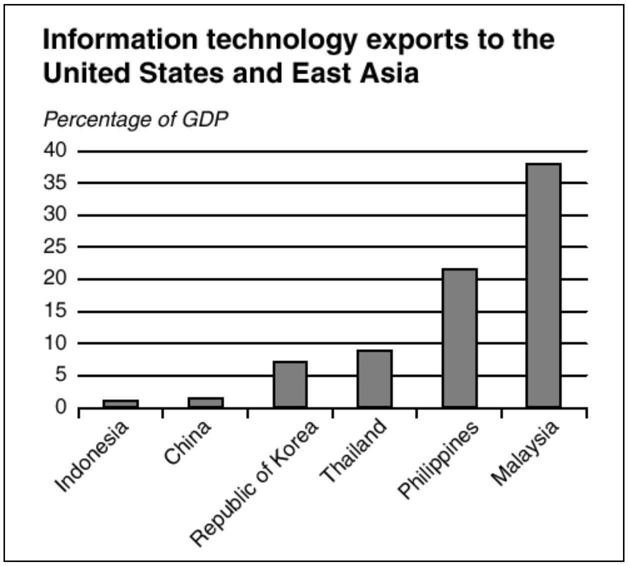
Source: IMF, Direction of Trade Statistics September 2001
** Includes Four Newly Industrialized Economies*

In terms of the volume of their trade with the world, both Japan and the NIEs rival the United States as global trading powers. In 2000, Japan exported $514B to the world and the NIEs an even larger $532B. In contrast, total U.S. merchandise exports were a sizable $859B.

In the early 1990s, the region's exports drove its economic dynamism. During the ten-year period from 1987 to 1996, the value of exports from Developing Asia grew 16% annually, in contrast to a world average of 11%. But in 1996, Developing Asia's exports grew only 5% —an omen of the Asian financial crisis of 1997.

Information Technology Exports. The declining demand for information technology in 2000 and 2001 had strong repercussions across Asia. Malaysia was the hardest hit, having over 35% of its GDP directed toward technology exports.[7] (See Figure 1-J.)

Figure 1-J



Source: World Bank

Key Organizations.

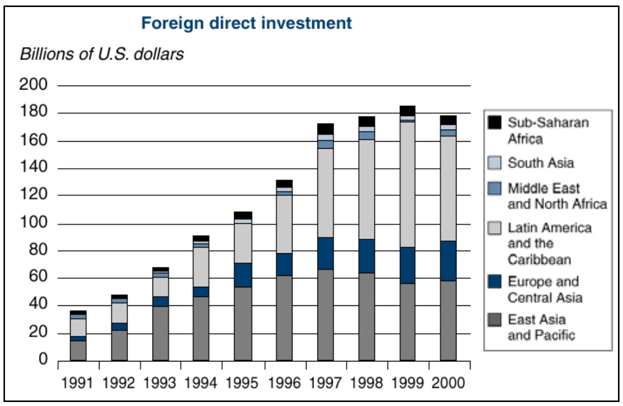
- ***The World Trade Organization (WTO)***. Through tariff reduction, WTO closely connects the global trading system and adds business opportunities in a free, fair, and rule-based international competitive environment. Membership entails the restructuring of protected sectors, such as food and consumer goods, while significant cost savings accrue to consumers through competition. WTO's dispute settlement mechanism provides a forum for dialog and for resolving disputes. In November 2001, China and Taiwan became members.
- ***Asia-Pacific Economic Cooperation (APEC)***. APEC is an organization of 21 economies on both sides of the Pacific whose key goal is sustaining growth through economic openness, especially through free and open trade and investment by the year 2020 for developing countries and by 2010 for industrialized countries. APEC maintains high visibility through annual Ministers Meetings and concomitant APEC Leaders Meetings.
- ***Emergent Organizations.*** Both the Association of Southeast Asian Nations (ASEAN) and the South Asian Association for Regional Cooperation (SAARC) are planning to reduce tariffs through Free Trading Agreements (FTAs).

Foreign Capital Flows in Asia

Private foreign capital flows into the region primarily in two ways: through the traditional route of direct investment—the establishment, acquisition or expansion of a business enterprise by a foreign concern—and through the more recent conduit of portfolio investment—i.e., foreign purchases of Asia Pacific stocks and bonds. In comparison to short-term portfolio investment, direct investment represents a long-term commitment to an economy while providing direct control to the investing company.

Foreign Direct Investment (FDI). Developing Asia is the major destination of world FDI into developing countries. It received $61B in 2000, or 34% of all such flows. The Chinese economy received the largest part in 2000, $42B, or 23% of all FDI flows into the developing world. (See Figure 1-K.)

Figure 1-K



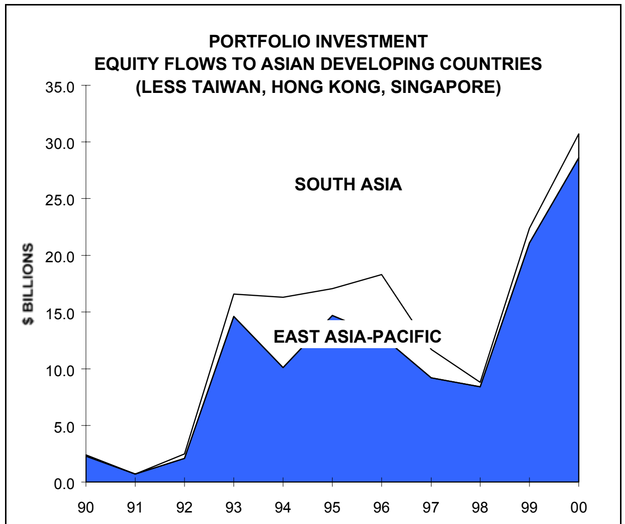
Source: World Bank

Throughout the Asian economic crisis, the region continued to see an inflow of direct investment. U.S. companies in particular have an interest in a prosperous Asia, since U.S. direct investments typically have been used to multiply their access to Asian import markets.

Revised estimates indicate that Japan's direct investment position in Developing Asia (including the 4 NIEs) is $49B, while U.S. holdings are a significantly higher $109B.[8] Historically, Japan has not been a major recipient of FDI, having received a cumulative total of only $50B by 2000. In contrast, Japanese FDI in the United States was approximately $132B.[9]

Portfolio Investment. In 1993 portfolio investment began to expand dramatically in the region, as investors sought to profit from opportunities in the region. Asian governments opened their markets to foreign funds while trying to control the flow through immature domestic banks and fledgling stock markets. The flow to Developing Asia dropped in 1997 with the Asian economic crisis, but has since redoubled, from a previous peak of $17B in 1993 to an aggressive $31B in 2000. (Taiwan, Hong Kong, and Singapore are not included in these figures.) (See Figure 1-L.)

Figure 1-L



Source: World Bank, Global Development Finance 2001
Data on Newly Industrialized Economies (South Korea, Hong Kong, Taiwan, Singapore) not included.

Foreign Aid and Other Official Flows. Foreign aid continues to be important to regional economic development. Many official projects are undertaken where private flows are not immediately profitable and where social benefits are key. Official flows include Official Development Assistance (ODA) that target economic development; export credits and investment insurance that address the risk borne by merchants and investors; project finance loans that increase commercial presence; and military assistance and training that reinforce the donor's strategic interests.

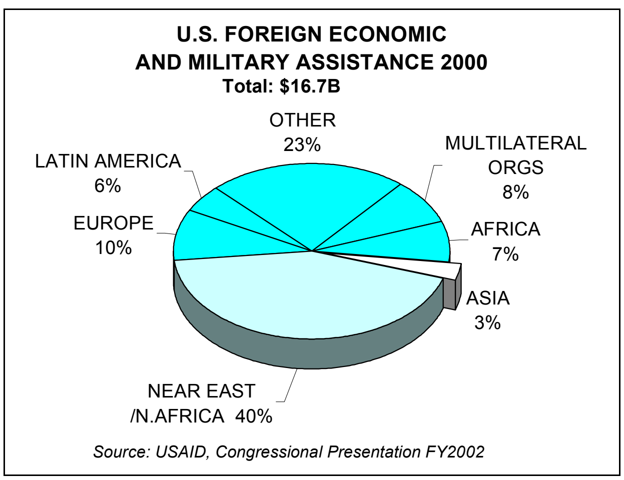
- The world's top four ODA receivers in 2000 were in the Asia-Pacific region: China ($1.7B), Indonesia ($1.7B), Vietnam ($1.7B), and India ($1.5B)—with Bangladesh ($1.2B) ranking sixth.[10]

- Debt relief is receiving increased visibility as a means of restoring financial health to developing countries, although only 4.2% of the world's ODA is devoted to this purpose.
- The United Nations recommends that ODA donors devote 0.7% of gross product to ODA.[11] The average share among donors, however, is about 0.4%. In 2000, about 0.1% of U.S. GDP was for ODA, while the share for Japan was 0.28%.

U.S. Foreign Aid. America's contribution to the volume of foreign aid flowing into Asia is minor at best, and budget cuts are likely to reduce donations further.

- Although the United States is the second largest world ODA donor—at $8.6B in 2001 when military grants are not included—only a small portion of these funds are directed at Asia (about $0.5B).[12] (See Figure 1-M.)
- American military assistance to the region is modest, totaling only $6.4M in 2000 for International Military Education and Training (IMET) and $1M for a Foreign Military Finance (FMF) grant to the Philippines.

Figure 1-M



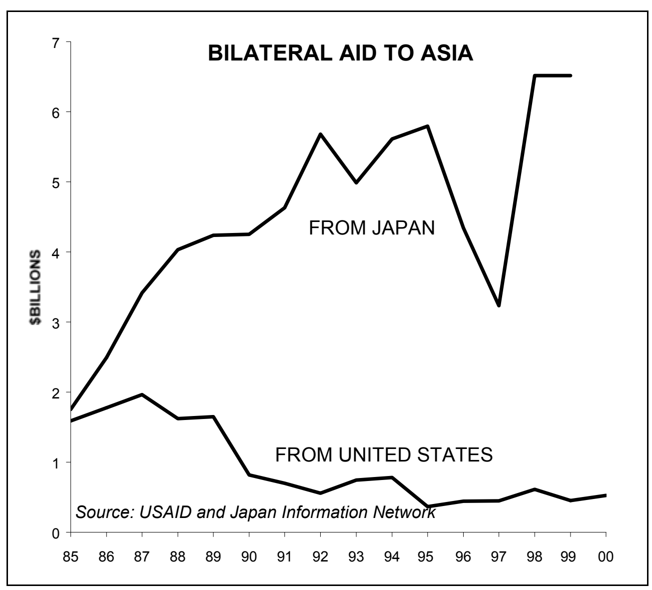
The activities of the U.S. Export-Import Bank and the Overseas Private Investment Corporation in Asia are somewhat more substantial for Asia, but are in the form of loans, guarantees, and insurance for American companies. These activities cover the risks taken by American companies when seeking to sell U.S. goods to customers who might default on their payment.

- During the Asian economic crisis, the U.S. government helped recovery by financing over $5.0B of potential exports in 1998—although some projects in Indonesia and Thailand were canceled, as the risks became untenable.[13]

Japanese Foreign Aid. Japan's ODA is a key element of its sharing of the burden of maintaining Asian security. In particular, Japanese assistance helps to construct significant large-scale infrastructure projects in Asia and promote industrial projects.

- Of Japan's $10.5B of bilateral aid in 1999, 62% was directed towards Asian countries. This heavy ODA component gives Tokyo a high profile in the region. Some 18 Asia-Pacific countries—among them China, India, and Indonesia—rate Japan as their largest single aid donor.[14]
- Due to Japan's faltering economy, assistance has varied greatly over recent years. Japan's total ODA grew 44% in 1999, declined 15% in 2000, saw little change in 2001, and is expected to decline 10% in 2002.
- Japan's flow of assistance to Asia is similarly unsteady. This flow is nevertheless significant—far exceeding U.S. aid. (See Figure 1-N.)

Figure 1-N



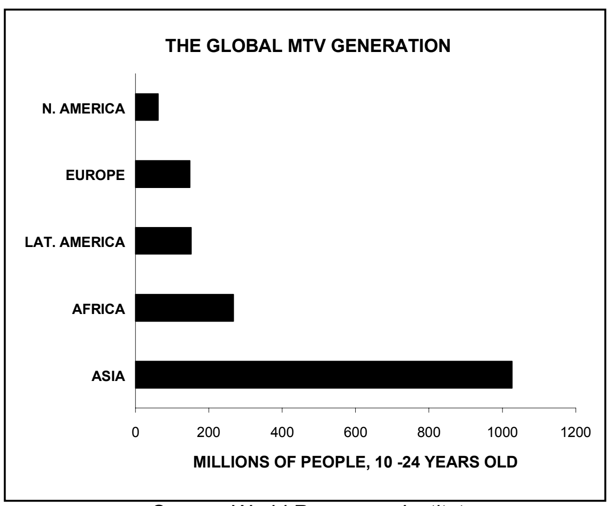
Key Factors for Asia's Future

Energy, Infrastructure, and Environment. As Asia's economies grow, so do their requirements for better infrastructure that creates an international demand for energy, transportation, communications, and environmental projects. Asia's increasing environmental problems are seen as constraints to growth, needing American expertise and equipment. This needed modernization of Asia's infrastructure presents enormous commercial opportunities for American business.

Urbanization. Urban issues have taken on increasing importance as populations move to the cities, placing stress on physical and social infrastructures. At present, 33% of Developing Asia's population reside in urban areas.

Asia's Demographic Potential. The magnitude and youth of Asia's population have led many American businessmen to conclude that huge untapped resources for trade and investment exist in Asia. The Asia-Pacific region's 3.4B people comprise 56% of the world's population. About 1B of Asia's people are between 10 and 24 years old. This "MTV Generation" has been characterized as urban, educated and consumption–oriented, with production consequently being redirected to Asia's younger generation. (See Figure 1-O.)

Figure 1-O



Source: World Resources Institute

Endnotes

1 Maddison, Angus, *The World Economy in the Twentieth Century*, 1989 and *Monitoring the World Economy 1820- 1992,* 1995.

2 World Bank, *World Development Report 2001-2002* and *2001 World Development Indicators database,* 7/16/01 (www.worldbank.org); and CIA, *The World Factbook* . The exchange rate method converts foreign currency to U.S. dollars using market exchange rates, and is fairly straightforward to calculate; however, it does not account for the buying power of a country's currency for those goods and services that are not transacted in the international trading system, but only trade in domestic markets. The PPP method of estimation is more cumbersome, but accounts for domestic purchasing vitality.

3 International Monetary Fund (IMF*), World Economic Outlook (series)* (www.imf.org/). In 1997 the Newly Industrialized Economies were given "Advanced Economy" status. See also ADB, *Asian Development Outlook (series)* (www.adb.org).

4 Dollar, David and Aart Kraay, *Growth is Good for the Poor*, 2001 (www.worldbank.org/research/growth)

5 World Bank, *Globalization, Growth, and Poverty*, 2002.

6 IMF, *Direction of Trade Statistics (series)*.

7 World Bank, *Global Development Finance 2001*, (www.worldbank.org/prospects/gdf2001/).

8 Japan Ministry of Finance, *Regional Direct Investment Position (assets)* (www.mof.go.jp/english/fdi/); Bureau of the Census, *U.S. Direct Investment Position Abroad* (www.bea.doc.gov/dea/di1.htm). Previously Japan published only annual flow data, and position estimates were calculated as sum of the flow. Newer, more accurate, data show direct investment holdings to be about half of what was previously estimated.

9 Japanese Ministry of Finance, 2001 (www.mof.go.jp/). U.S. Commerce data for Japanese investment in the United States indicate a larger $163B stock through 2000; *Foreign Direct Investment in the United States* (www.bea.doc.gov/bea/di1.htm).

10 OECD, *Development Co-operation 2000*, (www.oecd.org/dac/xls/TAB25E.XLS).

11 Employing a policy goal that is fixed at a constant, linear share of production may not have a strong theoretical basis—especially among very-large or very-small economies. Empirically, there is only a 70% statistical correlation for a linear relationship between ODA and GDP for OECD donors in 2000, i.e., factors other than GDP explain 30% of ODA.

12 Agency for International Development (USAID), *Congressional Presentation, Summary Tables, FY 2002*. Note: In contrast to OECD foreign aid figures, U.S. government statistics also include military and other forms of assistance. U.S. aid includes foreign military financing (FMF) grants, primarily with Israel ($3.1B) and Egypt ($1.3B).

13 U.S. Export-Import Bank, *1998 Annual Report*, (www.exim.gov/newslett/98-anrpt/); Overseas Private Investment Corporation, *1998 Annual Report* (www.opic.gov/subdocs/public/).

14 Ministry of Foreign Affairs of Japan, *Japan ODA Summary* (www.mofa.go.jp/policy/oda/index.html).