

OVERVIEW

for

“THE DEEPENING ECONOMIC INTERDEPENDENCE IN THE APEC REGION”

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1. SUBREGIONAL COOPERATION IN THE APEC REGION

1-1. APEC and the Currency Crisis

The East Asian Miracle well-known by the World Bank, seems to have collapsed since the Asian currency crisis came onto the scene in July, 1997. The drop in Thai baht against the US dollar triggered a cross-boundary volatility in the financial market in East Asia and it spread fear of another episode of Black Monday in the world. Faced with unlikely prospects that the monetary crisis would soon end. East Asian economies suffered long term instability and could not for implement effective recovery measures. The depth of the crisis can be seen in the wide spread currency depreciation and stock market plunges, which are the worst experienced since the Second World War. The crisis damaged Asian economy, which had enjoyed economic prosperity for the last three decades. The rapid economic growth of the last decade in the region has strengthened Asia-Pacific economic networks and constructed solid foundation of Asia Pacific Economic Cooperation (APEC). However, APEC activities, which were likely to be backed by ever expanding regional economies, especially in East Asia, now face the first obstacle and must look to reconstruct the damaged market system.

1-2. APEC and IMF Initiatives

In November, 1997 at APEC Leaders meeting in Vancouver, the APEC 's top prioritized theme was figuring out how to overcome Asian monetary crisis and Leaders stressed that the crisis reflected new challenges in the international financial system. The APEC Leaders declaration said that fundamentals for long-term growth and prosperity for the region are exceptionally strong, and while there is deep caution "It is critically important that we move quickly to enhance the capacity of the international system to prevent or, if necessary, to respond to financial crises of this kind" (APEC 97 Leaders declaration, Press release November 25,1997). Though APEC recognized that the IMF role remained central and rescue packages were handed down for solving crises in Asia, the financial turmoil was contagious. It also expanded and endangered more Asian economies. In the most marked example, the exchange rate of Indonesian rupiah to the US dollar devaluated more than eighty percent in the half year after August, 1997, and large part of the rupiah drop came after the IMF aid package was contracted in November. The aid mechanism did not work well because Indonesia seemed reluctant to implement the required measures and lacked of confidence in the governance because of the deterioration of President's health. In January,1998 under strong political pressure, especially from the United States, Indonesia had to surrender again to the IMF to get an additional rescue package. Eve into February, the IMF aid had not clearly affected the financial crisis.

An IMF styled rescue plan, which showed good results during the Mexico crisis in 1994, has not easily solve the contagion of financial crisis in Asia. The reason why IMF aid has not worked well in Asia must be proved so that APEC will be able to reassure the consistent economic growth and realize the target of economic liberalization by 2020. It seems that the present financial turmoil is the first and biggest challenge for APEC and the global economy. The current crisis differ from previous experiences in the following characteristics:

- a. The Mexican crisis in 1994 was contained within boundary. Asian cases in 1997 and thereafter are cross boundary contagion which are difficult to solve county by country because the crisis are caused by rapid globalization of the financial sector.

- b. Short-term capital inflow used ineffectively and speculatively was the main factor of currency depreciation. Some of this short-term capital, 9.6 billion U.S. dollar, had would matured by the end of March, 1998. This means that the recent crises originated from the capital balance sheet volatility rather than the current account deficit, which was the main factor of the crises in Mexico.
- c. Confidence in the state governance deteriorated, and financial systems proved to be vulnerable to bail outs because governments lack creditworthiness. In Indonesia, President Soeharto's illness cause political uncertainty and accelerated the currency plunge into irrecoverable levels. Also, lack of transparency in administrations, ambiguous authority, collusion, nepotism, etc., which are commonly observed in East Asia, blocked the government as well private sector from taking measures toward the stabilization.

The IMF initiative tried to control the financial market, by imposing strict conditions on the destabilizing countries like Thailand, Indonesia and South Korea. Several countries and international institutions followed with more aid packages, but no positive impact toward the stabilization could be seen as of February, 1998. There may not a clear response to why the rescue programs of the consortium organized by IMF were so ineffective. Some may say that assisted countries, pressed by ready-profited groups, were reluctant to accept the conditions imposed by IMF. For instance, Indonesia likely showed obstinacy and partly canceled promises made with the IMF in November, 1997. Then, Indonesia could not help but be compelled to negotiate again and surrender to the IMF after the rupiah plunged further. Nevertheless, the real reason for the IMF's ineffectiveness is not only based on suffering countries, but the system itself was a mismatched to the new characteristics of the Asian monetary crises.

Firstly, ordinary IMF packages aim to recover a country's market by containing its problem within the boundary so the ill effect do not spill over, but it has not yet stop the cross-boundary crises. And it had not developed a system to adapt to the new situation. Secondly, the crises are now owed to the volatility of short-term capital transactions, which were excessive for the size of each economy, and the rapid deterioration of the balance of current accounts also caused volatility though it was not primary factor. Is the IMF package effective in rescuing the banking system through financial assistance to the government, when

cross-boundary transactions are not controlled by the government under the present situation where monetary transactions realize complicatedly among private banks, enterprises, semi-governmental institutions ,etc. ?. In this case, international rescue packages under the IMF' initiatives are so weak that a new approach for rebuilding the rocked markets must be explored. Thirdly, distrust often exist between the IMF and governments regarding policy implementation for economic adjustments. In order to eliminate this distrust, each side must remain open-mind and present free-flowing and detailed information which will lead to a better understanding of each other through sincere dialogues. Ignoring each other's rules, negative aspects like corruption, over-protection for well connected groups and so on, which obstruct quick economic recovery, may be eliminated. To raise effectiveness of the IMF aid package to a maximum level, each concerned body must promise and implement clear policy withstanding on rational standards. Fourthly, the another way for IMF initiatives to solve crises must be searched. For instance, to assist Indonesia recover its currency market, the G-7 of industrial countries support the idea of private banks for sustaining the rupiah rate at proper level by establishing the financial fund, and they agree to earmark 10 billion US dollar of the export insurance fund for Asia. This action indicates a new direction for stabilizing the monetary market in the region, but it still supplements and remains within the framework of the IMF. Lastly, it is worried that negative reactions to liberalization guided by economic globalization may return again. Indonesia suddenly expressed that it will change from the free float currency system to the key currency pegged rate system and the Currency Board System (CBS) will manage it independently from the Central Bank. The IMF apparently rejected the change because of its uncertain effect and the World Bank rejected the change because it deviates from the agreement made in January, 1998 between Indonesia and the IMF in January 1998. Considering that the rupiah crisis is not separate from the East Asian financial problems, Indonesia cannot solve the crisis by itself. To stabilize the currency market and recover strong fundamentals, discussion will have to begin on creating a new financial cooperation institution. The new cooperation institution would not have to concern itself with operating within the framework of the IMF. At the APEC Leaders meeting 1997, the Asian Monetary Fund (AMF) concept was rejected, but it and other

regional and global schemes are challenging current schemes and trying to combat region-wide contagion that create financial disasters simultaneously.

1-3. Interdependence among Sub-Regions

With regard to the issue of region-wide contagion, APEC is already aware of it, but APEC did not explicitly discuss the topic at the Manila meeting in 1996. At that time, APEC, but not all member economies, agreed to strengthen the trade and investment insurance system in the region. The idea of creating the AMF bases on the same consciousness with APEC. However, APEC worried that the crisis came too quicker than expected and market volatility spread widely over the region. APEC's start to counter the crisis was late, although APEC propelled the regional cooperation that may have worsen the regional market crash by reacting to liberalization. APEC could not adapt to the market turmoil promptly because APEC has not equipped any facility to promote, and APEC is a forum with diversity, voluntary contributing actions, and weak legal compulsion. APEC was also slow to adapt because the mechanism of sub- regional financial linkage, which triggered the contagion, was not unveiled because the economic ties in the sub-region were very difficult to unite- like entangled strings. Therefore, it is valuable to review that the role of sub-regional economic transactions in APEC. Each economy combines its transactions with other economies' transactions, and they are all linked together so that all of the economies suffer from common troubles.

Within APEC, three sub-regional cooperation, NAFTA, AFTA and CER are running. NAFTA includes the United States, Canada and Mexico and it aims to promote economic liberalization to expand trade and investment in the sub-region without any outside discriminatory measures. AFTA is composed of ASEAN member and it targets to level-up ASEAN countries' economic growth through close cooperation and sub-regional liberalization. AFTA aims to open ASEAN markets to others. Only Japan, China, Korea, Chinese Taipei, Hong Kong do not participate in any other sub-regional cooperation forum other than APEC. However, the United States, Japan and China are very influential economies because of their large economic powers and their relations with sub-regions. They also promote economic cooperation and rapid liberalization for many economies in the APEC region. As shown since

July of 1997, large economies and sub-regions faced with regional financial crisis are expected to respond significantly to help solve the instability. Large economies are also quite responsible for the economic soundness of APEC countries because their excess economic power intensifies the region's suffering, while the mechanism of region-wide contagion of economic troubles has not clearly been studied by anyone.

In order to understand the contagious effect of currency devaluation in APEC region, we need to begin by unfastening the complicated entanglement of transactions in APEC. From the beginning of APEC, sub-regional cooperation organizations like the North American Free Trade Agreement (NAFTA), U.S-Canada Free Trade Agreement (UCFTA), ASEAN Free Trade Area (AFTA) and Australia-New Zealand Closer Economic Cooperation (CER) were given roles of promoting APEC liberalization process, even though they are suspected to discriminate other areas' economies. The world was concerned about whether sub-regions were excluding each other. The 1994 Report on Unfair Trade Policies by Major Trading Partners' Trade Policies and WTO by the Industrial Structural Council Japan wrote that, "Tariff reductions applying exclusively to specific countries are prohibited in principle under GATT Article I, which requires the most-favored-Nation treatment as a basic rule. The GATT, however, authorizes establishing free trade areas, custom unions, and interim agreements as long as their purpose is to facilitate trade within the region and not to raise trade barriers against countries from outside." Though its members promise openness, they are not bound tightly by a legal framework. APEC may be violating the WTO free trade principal by using sub-regional cooperation with exclusiveness.

Four questions are raised when considering the GATT arrangement of regional cooperation.

- a. Does the regional cooperation really violate the free trade agreement by creating unfairness to others?
- b. Are the regional cooperation of developing economies, like AFTA, treated the same as the developed economies' cooperation, like NAFTA?
- c. Does a loose contract based on a coordinated forum like APEC help the GATT/ WTO's free trade system? And,

- d. Are the regional cooperation being consolidating under global and free markets exposed and suffering from spontaneous contagion of a financial crisis triggered by global liberalization? The financial markets are quite deviated from the real economic markets that are not yet unexposed to the heavy competition like the financial markets.

The last question (d) is very important to understand the recent monetary crisis in Asia, which saw an 80% plunge in Indonesian rupiah and a 50% of Thai baht to the US dollar within a half year after the summer of 1997.

In Responding to the above three questions from (a.) to (c.), we can not find any inconsistency with the NAFTA or with WTO system. The agreement signed on December 17,1992 wrote its main objectives as follows:

- a. eliminate trade barriers in the region covered by the agreement;
- b. promote fair competition within the region;
- c. expand investment opportunities in the region;
- d. ensure the proper protection and exercise of intellectual property rights within the region;
- e. establish effective procedures for the execution of the agreement and the settlement of disputes; and
- f. create a framework for diversified regional cooperation among the countries, so as to increase the benefits produced by the agreement.

Nonetheless, this could possibly create a disadvantage for outsiders. Even if the trade barriers were not so high, some members may trigger economic blocs, while each regional cooperation proclaims itself an open market. So, it is necessary to continuously monitor regional integration for compliance with the concept of the free trade system that WTO charters.

After receiving notification of the NAFTA's formation, GATT decided in March, 1994 to establish a working party to examine the agreement. The examination aims to strengthen the Rule of Origin, Coverage of the Agreement (relating import restriction caused by three bilateral agreement in North America), Selective Non-Application of Safeguards, and Protection of Intellectual Property Rights. All of which may have contents possibly violating the free trade system. And in February, 1994, the U.S. labor unions filed the first complaints against the supplemental agreement (North American Agreement on Environment and Labor Cooperation,

August 12, 1993) charging that U.S. corporations operating in Mexico had violated the rights of Mexican workers. Indeed, the NAFTA operation must be observed carefully because of its influential power to the outside, and it may undermine the WTO charters.

GATT's "Enabling Clause" recognizes that developing countries may want to form their own free trade area to promote their trade on the conditions that the trade areas will not raise trade barriers and create undue difficulties for countries outside the trade area. A typical and successful example of a free trade area of developing countries is the ASEAN Free Trade Area (AFTA), which was signed at an ASEAN summit meeting in January, 1992. The agreement introduces Common Effective Preferential Tariffs (CEPTs) and stipulate that duties on industrial goods and processed agricultural products traded within the area need to be reduced to a range of 0 to 5 percent within a period of 15 years. The period was later shortened to 10 years by 2003. However, the U.S. and EU were skeptical about the CEPTs which aim to form a unified market at some point in the future and go beyond the scope of the "Enabling Clause." The EU, Scandinavia, and others supported the U.S. stance against AFTA, while Brazil, India, and others developing countries supported AFTA. Malaysia, a member of AFTA, stated on behalf of ASEAN that the Committee on Trade development (CTD) already notified CEPTs, as a *fait accompli*. Malaysians aim was to counter the critics from the U.S., Europe, and others. The question here is whether AFTA should be treated as a free trade area with the same status as the NAFTA or the EU. ASEAN insists that AFTA is a free trade area of developing countries. The U.S. position on free trade areas seems to be leading others to follow the rule of law realized in NAFTA to and restrict developing countries from going beyond the accepted scope based on the U.S. concept. The U.S. position cannot be separated from efforts to consolidate regional cooperation schemes. On the contrary, AFTA basing on the principle of unilateralism and voluntarism and characterizing with mixed and different approaching types cannot follow the U.S. demand.

The last question (d.) of sub-regional cooperation relating to the contagion is a result of APEC liberalization pushing free capital transactions without effective development of the real economy in the ASEAN countries, while they were praised for a miracle growth. The currency transactions became entangled when international capital flows from super economies like Japan

and the United States to the regions and the entanglement is not easily untied. Monetary investments in the form of regional package schemes has combined markets in the area, and capital inflows or outflows emerged at same time with ignoring proper condition of individual economy. If some influential speculators draw money from a market, it means that every packaged bond spontaneously run out of the regional markets. Capital flights happen so fast because short-term banking sources seek immediate profits, and they are always coward of a down-swing fluctuation. Although macro-economic performances of each economy were not so weak, the monetary market swings overly dragged down the real economic activity. The contagion currency plunges is a new phenomenon of Asian currency markets that still continues nearly a full year. Contrastingly, after Mexico's crisis began in 1994, its currency stabilized within a few months, and macro economy began to recover positively after just a year.

2. SUMMARY OF THE PAPERS: THE DEEPENING OF INTERDEPENDENCE IN APEC

In order to understand the new economic conditions in APEC, we first need to prove that developed countries play a role in the sub-regional cooperation and affect real conditions the relation between sub-regional organizations, and the relation between sub-region and a large economy. It is not clear where the contagion comes from in Asia, but studying issues about sub-regional cooperation is quite meaningful. Members of the study group organized by IDE's APEC Study Center share several quests summarized bellow

2-1. In **Chapter I**, Prof. Hiroshi Osada writes "Boom and Vulnerability through Linkage."

- a. He points out firstly that "The growth of the East Asian developing economies between 1985 and 1995 was often characterized by increases in both of trade and investment. As a result, the region's producers have come to be woven into the international production network," and "In addition to the liberalization in the age of globalization, the policy move in

the 1990's was to strengthen regional schemes, hoping to maintain the so called Asian growth dynamism. APEC and AFTA increased their impetus.”

- b. Secondly, he describes how increase in the export dependency ratio is closely related to the increase in FDI. However, he also points out that the rapid growth of the East Asian economies has suddenly come to a halt in 1997 without any prior signs of disruption to the growth. He says that, “We come to realize that the financial interdependence in the region had proceeded more deeply than we noticed. The rapid growth was financed not only through FDI but also through portfolio investments and bank loans.” and “It is not a coincidence that countries severely hit by the currency crisis have higher shares of cumulative portfolio investment.”
- c. Thirdly, he analyzed, where the data is relatively abundant like Japan, USA, China, Asian NIEs and ASEAN by outside countries affected area. The period of estimation was divided into 1985-90 and 1991-96 to see the change in the degree of fluctuations between the periods, and the Keynesian multiplier under the open system was used as an analyzing tool. He concludes that “Japan's export fluctuation was the largest in the earlier period, but it became quite stable in the latter period. China's exports and Hong Kong's domestic exports had high fluctuations. Indonesia, Taiwan and Korea had more stable exports after 1991 compared to the period before, while China, Singapore, and Malaysia showed the opposite tendency.”
- d. Fourthly, he unveils the degree of external shock to an economy and break down the factors affecting the degree of fluctuation into export instability and the degree of sensitivity represented by the open Keynesian multiplier. He also summarizes that, “The increasing interdependence made the multiplier of each developing country smaller. The more liberalized the economy is, the lower the multiplier is. The figures for Indonesia, Thailand, and Malaysia are a good example. This implies that macro control of an economy becomes an ever more difficult job in the days of economic interdependence if there is no policy coordination among countries.
- e. Fifthly, the total of both direct and indirect effects generated by an independent increase of investment was shown by measuring the interregional income multiplier. While the growth

was supported by both the price effects and the income effects, here, only the degree of the income effects was estimated because the size of income multiplier is of great interest especially at the time of the dampened Asian economy caused by the currency crisis. The conclusion is that, “The USA has a larger total interregional income multiplier, 2.63 compared to Japan’s 1.71. This implies that the expansionary fiscal policy in Japan does not have as much impact on the region as the USA does. Impacts from Japan mainly go to the USA, and some to China, and Korea. Impacts to other East Asian countries are small. In Contrast, the impacts of the USA too the other East Asian countries are relatively large. This means that the ASEAN countries are more dependent on the US market than on the Japanese market.” And “Among the ASEAN countries, the impacts to Japan are clearly larger than to the USA in the case of Thailand and Malaysia. On average, the impacts to the neighboring ASEAN countries are not so small.”

- f. Lastly, he concludes that the deepening economic linkages will become a source of economic vulnerability if international policy coordination is not made.

2-2. In **Chapter II**, Mr. Satoru Okuda studied about the trade creation effect of a sub-regional group, with a special emphasis on East Asia. He tries to investigate whether or not sub-regional groups in APEC has a trade creation effect, and whether or not the magnitude of the effect differs between formerly established sub-regional trade agreements (SRTAs, such as NAFTA, AFTA, and ANZCERTA) and informal regional groups such as East Asia, characterized mainly by geographical closeness. In his definition, East Asia refers to five economies, namely, Japan, Korea, Taiwan, China, and Hong Kong.

- a. Firstly, he points out that the other SRTAs in APEC and East Asia looks similar, in terms of trade concentration to APEC and concentration to intra-regional trade. Also, an analysis using the trade intensity index shows that the trade structures resemble between East Asia and other SRTAs: all sub-regional groups tend to intensively trade within their own area.
- b. Secondly, in order to distinguish the difference between the formal SRTAs and informal East Asian group, Mr. Okuda performs a further analysis using the gravity model of international trade. The gravity model enables to isolate a group-specific factor (such as

belonging to a certain trade agreement or being a member of sub-regional group) from other substantial factors, such as GDPs of the trade partners and the distance between the trade partners. As a result of regression, the trade creation effect of each sub-regional groups increased over time, but the effect was weaker for East Asia than other formal SRTAs. As for the trade diversion effect of sub-regional groups, with the exception of NAFTA, no major adverse effects on non-group economies were detected. NAFTA's formation in 1994, though, did not result in an increased trade diversion effect against non-NAFTA economies. As a corollary, it was shown, the enhancement of sub-regional trade agreements in APEC proceeded quite well, in light of the "Principle of Open Sub-Regionalism."

- c. Thirdly, Mr. Okuda points out negative and positive factors affecting the projection of a future intra-East Asian trade. The negative factors include (1) lack of a formal trade agreement, (2) critical diplomatic climate surrounding China and Taiwan, (3) the peculiarity of China-Hong Kong trade, and (4) high self-sufficiency in Japan and China. However, Mr. Okuda foresees that the positive factors will marginally dominate the negative factors. The positive factors include, (1) further enhancement of the China-Taiwan trade, (2) China's further involvement in the world economy, (3) increased division of labor in the region due to ongoing re-structuring in Japan and Korea, and (4) repercussion of the above-mentioned factors back into the region.
- d. Lastly, under an optimistic prospect, Mr. Okuda measures the impact of improved trade environment in East Asia. Assuming that the East Asian dummy increased to half the level of the current AFTA dummy, the intra-regional trade was forecast to grow by 42.8 billion dollars, or 12.5% of the total intra-East Asian trade. Korea was forecast to be the main beneficiary under the author's assumption, with an additional economic growth rate of 1.52%. This would be a significant allowance for Korea, which is supposed to experience great pains of negative economic growth in 1998 due to the fulfillment of the IMF policy agreement.

2-3. In **Chapter III** titled “The Background and Causes of the Current Financial Crisis in Indonesia,” Prof. Masaaki Komatsu elaborates on the background and causes of the current financial crisis in Indonesia. This is similar to the report by Prof. Osada because it shows the financial market’s vulnerability from a country case. Prof. Komatsu asks three questions;

- i. Why massive capital inflows have continued for more than 10 years?
- ii. Do all players in the LDC’s financial markets play consistently with the modern market discipline?
- iii. Are the macro economic policies, i.e. orthodox monetary and fiscal policies effective in managing Indonesian economic problems in the 1990s?

To answer the above questions, he explains the changing structure of financing Indonesia’s balance of payments in the 1990s, the mechanism of rapid external debt accumulation, which is a typical bank behavior that has caused accumulation of non performing assets in the Indonesian banking sector, and macro economic policies introduced by the Indonesian government. He also assesses the limitation to their effectiveness.

- a. Firstly, Prof. Komatsu explains that private capital flows have surged rapidly and far exceed official flows in the 1990s, and he explains that the Indonesian Government and international consortia have not developed a system to manage external debt under the new age of globalized and integrated international capital flows.
- b. Secondly, during the last few years, the upward pressures on valuation of the rupiah exchange rate stemmed from other countries’ currency movements, i.e. the appreciation of the US dollar vis-a-vis to the Japanese yen. Pressure has also come from foreign market pressures with massive capital inflows. However, rapid financial development and a sharp increase in commercial banks’ credit resulted in an increase in non performing assets and weakened the banking sector. Prof. Komatsu notes that Indonesia’s banking sector is still in an early stage of development, and the players in the market are also affected by traditions and customs in the community. Then he says that, “Under these circumstances, the financial deregulation and integration into the international financial markets have a tendency to develop financial technology without development in social and institutional factors. These

- inconsistencies among the modern market mechanism, financial institution, and traditional social behavior have caused an increase in non performing assets in the banking sectors.”
- c. Secondly, he mentions that the state banks often make decisions from a political point of view, which may contradict commercial and financial discipline. And he stresses that, “Under this situation, the most important factor affecting the manager’s decision is to know the intentions of the government and the politicians, rather than to develop financial inter-mediation, such as credit analysis, which is a major banking function.” Also, “Political intervention and bureaucratic behavior of the managers caused the accumulation of non performing assets in the state owned banks.”
 - d. Thirdly, he says most Business Group Banks belong to Chinese groups. Their capital and management are not clearly separated in the business group banks. The group banks absorb deposits from the public and lend them mainly to the firms within the group. Also, the information within the group is symmetrical and perfect; however, for the depositors outside of the group, the information is asymmetrical. With regard to accumulation of non performing assets in business group banks, he writes that, “The ratio of loans to group enterprises is excessively high, often higher than the legal lending limit set by the Central Bank.” And, “When the loans to group firms turn into non performing, the banks tend to continue investing in the troubled firm.”
 - e. Fourthly, monetary policy and fiscal policy are touched on for the sake of raising the effectiveness of macro economic policies. The first problem is that the Central Bank’s ability has been weakened because the demand for M2 has grown more rapidly than reserve money. At the same time, economic growth and financial deepening have accelerated. The second, problem, ironically, is that the achievement of the of the long standing development objective has caused difficulties in controlling money supply and credit expansion; therefore, the economy overheated. The third problem is that a substantial portion of the increase in time deposits may not be a result of genuine domestic resource mobilization. However, foreign investing in time deposits at the Indonesian banks would have a similar impact as the bank’s foreign borrowing, which was restricted by Decree 39 introduced in 1991.

- f. Fifthly, as for the fiscal policy, Prof. Komatsu points out problems. The first is that the government budget has been expansionary rather than contractionary as stated by the government fiscal report because, for instance, privatized projects managed and invested in by the private sector should be classified as quasi-budget and should be controlled under the control of the fiscal policy. The second, the government external borrowing was controlled by the unified debt management system which effectively controlled overall external debt of the country until 1988. The private sector did not have access to the international financial markets, and foreign investors had little confidence in Indonesian companies. However, private borrowings have increased in the 1990s much faster than the government expected. The government wanted to control them, but it could not. “Along with the continued economic boom in the Southeast Asian region, external financing has continued to increase, current account deficit has grown, and vulnerability of the Indonesian economy, which relied excessively external financing, has increased substantially.
- g. Lastly, he concludes that, “The prudent management of external borrowing is a key element for sustaining macro economic stability, Enforcement of the foreign borrowing ceilings for public and quasi-public projects under decree 39, in fact, ensures real tightening of the fiscal conditions and controls external borrowing.” And, “It is necessary to improve reporting and information systems to monitor external borrowing and capital flows.

2-4. In **Chapter IV**, “ASEAN ‘s Relationships with America,” Prof. Takeshi Aoki tackles the following concerns.

- a. Firstly, Prof. Aoki begins with the sentence, “Macro-economic performances of ASEAN countries are excellent particularly in terms of growth rates of GDP, low CPI rate increases and export rate increases over the past 20 years until 1997, when the currency and financial crisis seriously hit ASEAN economies.” He describes the main cause of the growth coming from massive capital outflows from Japan to ASEAN since the Plaza Accord in 1985, which is the so-called “Third Wave.” He continues that “The most important characteristic of the third wave as compared to the last two is relocation, Japanese companies have shifted their production bases partially or totally to outside of Japan. This has been enhanced by the

sharp appreciation of the Japanese yen, particularly in the latter half of the 1980s. ASEAN as a whole realized 17.5% yearly export growth since 1990, which was more than two times higher than the world's average increase during the same period. Although the export growth rate to America was 16.7%, which is a little bit lower than the average rate. America was the largest export destination for a single country. This means that, "The trade between the two (ASEAN and America) has been shifting from vertical to horizontal in the international division of labor, and this characterizes the trade pattern among the developed countries where the dealt goods are almost all industrial goods." America, on the other hand, was attracted to ASEAN as a "Magnetic Place" with high growth. He says that, "As American MNCs have invested more in ASEAN countries after 1990, the more complementary structures have been established through the intra-firm trade of MNCs operating across the Asian region, of course, including ASEAN countries."

- b. Secondly, Prof. Aoki stressed "ASEAN-Centrism" will be strengthened by two approaches. He said that, "The first is to strengthen ASEAN itself. The other is to develop multi-layer relationships through dialogues with countries outside ASEAN who approach ASEAN aiming to introduce her dynamism." ASEAN has been trying to strengthen itself by "Self-Organizing" by using three approaches. "First, increase its members." "Second is to enhance ASEAN Regional Forum" activities, which aim to create a better political environment necessary to maintain favorable economic growth. The third is to promote AFTA, which reflects the economic aspect of ASEAN for accelerating the growth and integration."
- c. Lastly, he describes three different approaches for mitigating relations between ASEAN and America. The first approach is that, "Particularly in APEC, ASEAN was one centripetal force, and America was the other one. But the decision-making process for the time are in a directly opposite position. The American way sets a target first and then implements it by making schedules, codes, rules and functional organizations, and violations carry penalties. The ASEAN Way of consensus is the opposite style to the American's. It respects diversities, communication, and exchanges of opinion until they understand a subject completely and accept things. Second, "Another American movement which

irritates and frustrates ASEAN members are the America's demands for human rights diplomacy and democratization of China and Myanmar's military regime." The third, Asian currency in 1997 converged to a "Confidence Crises." In this case, Prof. Aoki also finds contrast between the American and ASEAN way. "The American way is contradictory to the interests of ASEAN as an exogenous factor. On the other hand, ASEAN needs to internalize the economic dynamics of America as an endogenous factor to sustain its economic growth. That is to say, ASEAN has a feeling of ambivalence toward America." Prof. Aoki continues about this ambivalence, "The first approach is absolutely necessary to internalize America's economic dynamics," and "The second is the one which ASEAN is forced to introduce and internalize to conquer the vulnerabilities of ASEAN economies against their will." Then, he concludes that, "Until the occurrence of the currency crisis in the mid 1997, ASEAN and America were the two centripetal forces in APEC. In spite of the developing countries receiving assistance from the developed countries ASEAN as a whole, exhibited strong bargaining power in the international communities, sometimes as America's rival.

2-5. In **Chapter V**, Mr. Jiro Okamoto focused on the historical development of Australia-ASEAN relations as one of the key subregional relationships within APEC. Mr. Okamoto argues that the development of the relationship with ASEAN was a crucial factor for Australia's foreign policy behaviour from the late 1980s. He also suggests that Australia learned how it should act in multilateral negotiations or consultations to achieve its interests from the experiences it had with ASEAN in previous decades.

- a. First, he states that the Southeast Asia region has been important for Australia since the end of World War II, but for Australia, the importance of the region was historically based on political/security considerations under the Cold War framework. The establishment of ASEAN in 1967 did not change the perception.
- b. Australia-ASEAN relations in the period between the mid 1970s and the early 1980s were filled with economic disputes. By this period, the ASEAN countries had developed their capacity to export labour intensive goods, and kept demanding improved access to the

Australian market. The Australian government at the time was incapable of meeting ASEAN demands because of its failure to understand the political meaning behind such demands. The government also failed to understand the need to dismantle Australia's traditional protectionism to adjust its economy and to diversify the range of goods for export away from a reliance upon primary commodity areas.

- c. After a massive deterioration of the terms of trade in the early 1980s, Australia finally initiated the reform of the domestic economy. Along with the liberalisation and deregulation of the financial market, protective measures for domestic manufacturing and services were removed. To underpin the efforts made on the domestic front, the government actively committed itself to multilateral negotiations to pursue global freer trade and investment.
- d. In the same period, the ASEAN economies started to grow rapidly and became increasingly enmeshed in the regional and world economy. For ASEAN, too, the maintenance and promotion of liberal trade and investment regimes became crucial.
- e. Common interests between Australia and ASEAN emerged from the late 1980s. Australia and ASEAN worked together in multilateral trade fora. To do so, Australia advocated "middle power diplomacy" which was similar to the ASEAN way of regional cooperation and policy coordination.
- f. If current economic recession in East Asia is prolonged, Mr. Okamoto argues, Australia may be forced to face the difficult situation of relying on the US and EU markets for its exports. These markets do not, however, offer the same growth prospects as those achieved in East Asia in recent years. Thus, it is likely that Australia will keep trying to maintain and promote a favourable economic environment for ASEAN and the Asia Pacific region. So far, according to him, APEC has emerged as the most suited vehicle to pursue this objective. It is therefore likely that Australia's commitment to the APEC process will continue. It is important to note that Australia's seeking of "Asian engagement" would continue even if the APEC process were deteriorated. Economic interdependence between Australia and its northern neighbours has already grown to such a level that it cannot easily be abandoned.

2-6. In **Chapter VI**, “Industrial Policies and Trade Liberalization: The Automotive Industry in Thailand and Malaysia,” Ms. Mai Fujita compares Thailand and Malaysia’s automotive industrial policies, and discusses how they have affected the capabilities of the two countries to cope with the liberalization progress and the currency crisis.

- a. Firstly, Ms. Fujita compares the policies followed by Thailand and Malaysia to develop the automotive industry. While both countries started with the import substitution strategy, their subsequent approaches differed in the following aspects: (1) while the Thailand has basically let the private sector take the lead and made substantial progress in liberalization in the 1990s, Malaysia has focused solely on the national car project supported by extensive protection by the state; and (2) Thailand has tried to attract foreign multinationals to establish joint ventures with local firms, while Malaysia emphasized producing cars of national brands by national firms.
- b. Secondly, Ms. Fujita argues that the above difference in approaches has resulted in diverging performance and difference in directions and capabilities to deal with the liberalization progress. Thailand has experienced a surge of FDI inflows and rapid growth of production, and has been eager to take advantage of the globalization and liberalization, whereas Malaysia, concerned about the lack of competitiveness of national car firms, has been reluctant to reduce protection.
- c. Thirdly, Ms. Fujita describes the impact of the currency crisis, and predicts that the automotive industry in both countries will have to go through a difficult period of adjustment and restructuring. She shows that the crisis will likely impact disproportionately on the less competitive firms which have depended on protection, particularly Malaysia’s national car firms and Thailand’s local suppliers.
- d. Lastly, placing the case studies in a broader perspective, Ms. Fujita points out that globalization and liberalization have become irreversible trends even in the automotive industry, which is generally recognized by governments as an economically strategic sector, and that developing countries need to prepare for intensified competition with foreign firms by gradually exposing local firms to competitive pressure. In this regard, the concrete liberalization programs under AFTA and WTO might encounter oppositions and delays in

implementation. The most important contribution of APEC, the author concludes, is to mediate and reconcile conflicts of interests of concerned parties including the member governments, local firms, and foreign investors.

2-7. The last part is **Appendix**, contributed by Mr. Daisuke Takoh. He summarized China's liberalization policies surrounding APEC and WTO in 1997, under the title "China's Policy for the Liberalization of Trade and Investment through the APEC /IAP and Negotiations for the Accession to the WTO, in 1997." He tries to suggest, using detailed materials, that China weighs more on World Trade Organization (WTO) in its international cooperation strategy.

- a. He points out two objectives of China regarding its APEC policies. One is the promotion of domestic economic reforms geared to the marketization of the national economy, through involvement in the APEC activities. The other is to utilize APEC as the preparation step for the accession to WTO membership, which China has longed for. For China, he suggests, faithful implementation of APEC-related liberalization measures has been the key for the WTO membership. Next, he mentions that the negotiation for China's accession to the WTO developed greatly in 1997. By showing this fact, he tries to allude that China started to emphasize more on WTO talks. However, he foresees that it will be difficult for China to become a WTO member by the GATT/WTO's 50th anniversary, mainly because of the deadlocked bilateral negotiation with the US.