

● REGIONAL DYNAMICS

A Flight of Wild Geese: Regional Integration and Emergence of Asian Economies

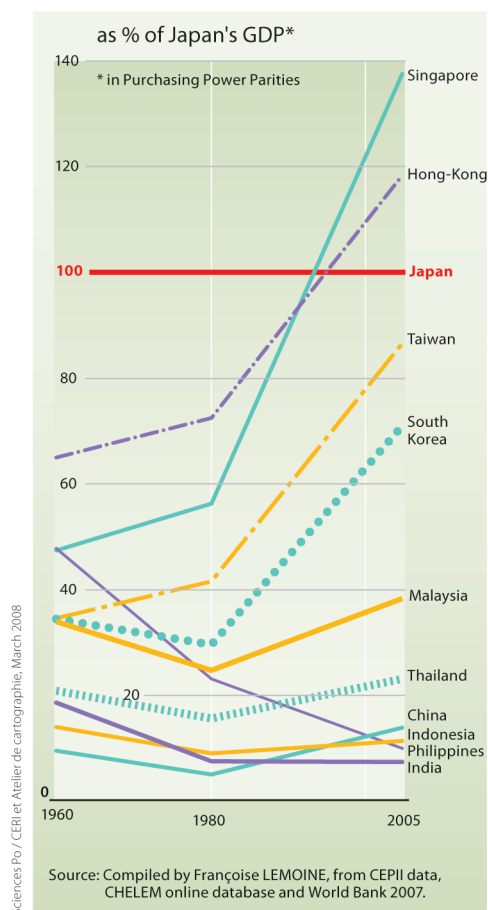
Françoise Lemoine

Many Asian countries have followed a path to catch up with rich countries. In the past 20 years the emergence process has spread to the demographic giants, for which globalization provides a powerful growth accelerator. Their dynamism takes root in internal reforms that aim to liberalize the economy and build a modern state, as well as in their increased opening up to and participation in international exchanges. Emerging economies thus differ from “rentier” economies whose growth depends mainly on the rise in raw material prices.

Dragons, tigers and giants

Meteoric growth brought Japan to the rank of second largest economic power in the late 1960s. When it surpassed Germany in terms of GDP, it already had a per capita income that placed it among the club of rich countries. Subsequently, cases of rapid growth multiplied throughout Asia. Hong Kong, Taiwan, South Korea and Singapore formed the first generation of “newly industrialized countries” (NICs) or so-called Dragons. The per capita income rose sixfold in three decades (from 1960 to 1990) and they, too, entered the club of high-income countries. Since then, the city-states Singapore and Hong Kong have even surpassed Japan in terms of per capita income. Even if their belated industrialization sometimes still

figure 47: **Per capita GDP compared to Japan, 1960-2005**



places them in the emerging economy category, they have clearly emerged. A second generation of NICs—Malaysia, Thailand, the Philippines and Indonesia—appeared in the 1980s. These tigers are on a catching-up trajectory, but they still have a much lower income level than rich countries. The growth of these economies, although brutally disrupted by the 1997-98 financial crisis, now stands above the world average. China started to emerge in the early 1980s, and its income level now exceeds that of the Philippines and Indonesia. Ten years later, India entered the race.

From the early 1960s to the end of the 1980s, South Korea and Taiwan recorded growth in per capita GDP (around 7% and 8%) that was comparable to China's since 1980. But these Dragons were not large enough to destabilize the world economy for long and were easily "absorbed" by it. The case of China and India differs both from that of Japan and the dragons, because these two demographic giants rose to become major economic powers well before becoming rich. In 2005, China, with 5.5% of the world's GDP, and India, with nearly 2%, ranked respectively 4th and 12th in the world's economies, but with a per capita income that was respectively 10% and 5% of that of the United States.

An Asian model

A World Bank report in 1993 (World Bank 1993) analyzing the reasons for the success of Tigers and Dragons underscored the crucial role played by the state, which first ensured the fundamental conditions for takeoff (competitive markets, macroeconomic balances, legal and institutional framework), and secondly intervened selectively to promote high-growth industrial sectors. Already, then, its analysis implicitly recognized that economists had learned more from Asia than the continent had learned from them and that the pragmatism of Asian economic strategies had caught the conventional wisdom of various schools of thought off guard, a conclusion found again in a 2006 report from the same institution.

The evolution of the Chinese economy provided another example. China's reform and opening-up policy followed a specific rationale due to the country's

size, its history and the international context. But the country also borrowed elements from successful experiments in the region. Its economic opening-up policy in particular drew on that of East Asian economies that combined promotion of export-oriented industries and protection of local industries (South Korea, Taiwan). Trade policies that protect the domestic market usually end up putting a damper on export: protection drives up the cost of facilities and imported semi-finished goods needed to develop competitive export-oriented industries. They also drive domestic prices up above world market prices, which makes producers steer away from export. To overcome this handicap, Asian countries established special export zones where companies can import duty free. China significantly expanded this selective policy: starting in the mid-1980s, it exempted from customs duties imported goods to be processed or assembled for export as well as capital goods imported by foreign-owned companies. This preferential system was remarkably successful. Over half of Chinese exports are related to international assembly and subcontracting activities, mainly conducted by foreign affiliates. The advantage given to these exporting companies was all the more substantial in that tariffs were relatively high before China joined the WTO in December 2001 (the average tariff of 37.6% in 1994 dropped to 16.2% in 2001) (Lemoine 2006).

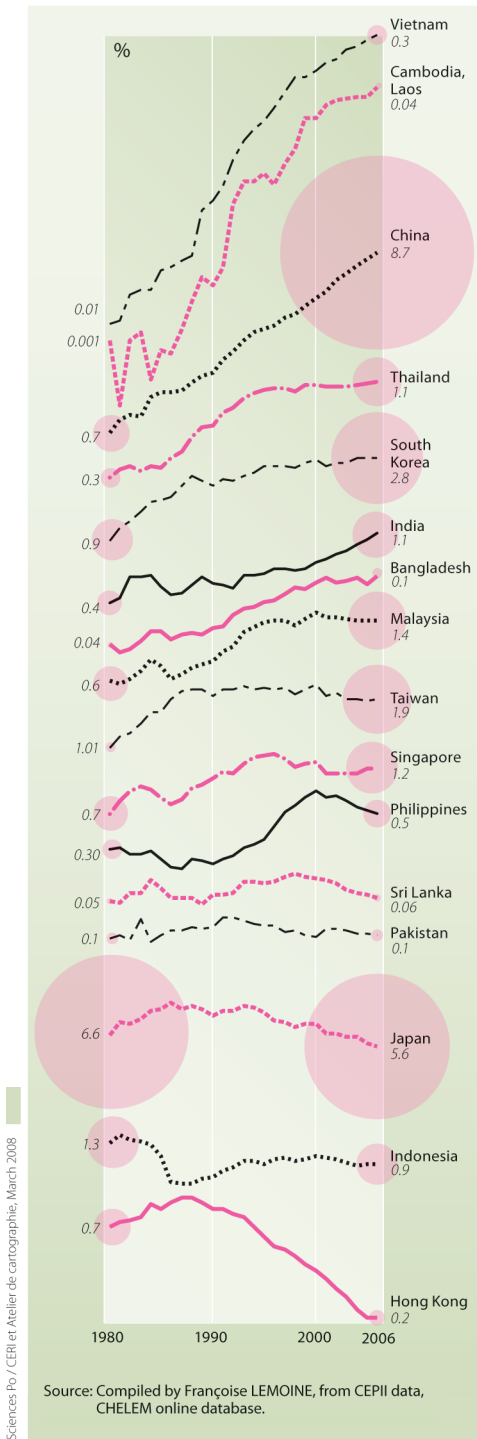
‘Wild-geese-flying pattern’

“A wild-geese-flying pattern” is the image that the Japanese economist Akamatsu (1961) used to describe the model by which development propagated throughout Asia, in which new techniques spread quickly to industrializing countries that follow in the wake of more advanced countries to catch up gradually to them. The leading countries, in this case Japan, first brought in tow the Asian Dragons, then the Tigers. In many respects the emergence of China, and later Vietnam, fitted this pattern.

Thus Japan in the 1970s, and then in the 1980s the first NICs (dragons), in general deserted labour-intensive traditional industries (textiles) to specialize in new technologies. The rise in wages pursuant to the reevaluation of Asian currencies (after the Plaza Accord in 1985) prompted many companies to shift low added-value production to second-generation NICs (tigers) and to China, by finding subcontractors or setting up affiliate companies. These newcomers developed their specialization in traditional industries and later moved to the new technology sector, the tigers in the 1980s and China in the 1990s.

The wild-geese-flying model explains the considerable interdependence in Asia between emerging economies and emerged economies. The two are linked by strong intersectoral complementarities, trade and investment flows and technology transfers.

figure 48: **Share of Asian countries in world exports, 1980-2006**



The pattern also implies a hierarchy among the most advanced economies, which must renew their comparative advantages and innovate to maintain their leadership, and the others. The globalization process that gained speed in the 1990s gave a new twist to the Asian dynamics. A deeper division of labour has taken place, strengthening the interdependences, accelerating China's rise and finally challenging the existing hierarchy among countries.

Globalization accelerates reconfigurations

Since the 1990s industries have been organized on a global scale because of the international fragmentation of production processes. Different countries are increasingly involved in the various stages of manufacturing one and the same product. This is true of Nike sports shoes, Barbie dolls and the iPod. Multinational companies choose to locate successive production stages according to the advantages offered by the various countries. Production stages that require skilled labour and investments in R&D (product design, component manufacturing, marketing and sales) are usually handled by the most advanced countries. The newcomers specialize in activities requiring large amounts of low-skilled labour (assembly). The value created in China represents about 10% of the price of an iPod assembled and exported by China; and the product was designed in India.

The electronics sector lends itself particularly well to this type of organization, because manufacturing processes can easily be fragmented, transport costs are relatively low compared to the product price, and economies of scale are particularly high. Companies in advanced Asian countries (especially Taiwan) that often act as suppliers for US companies organize production

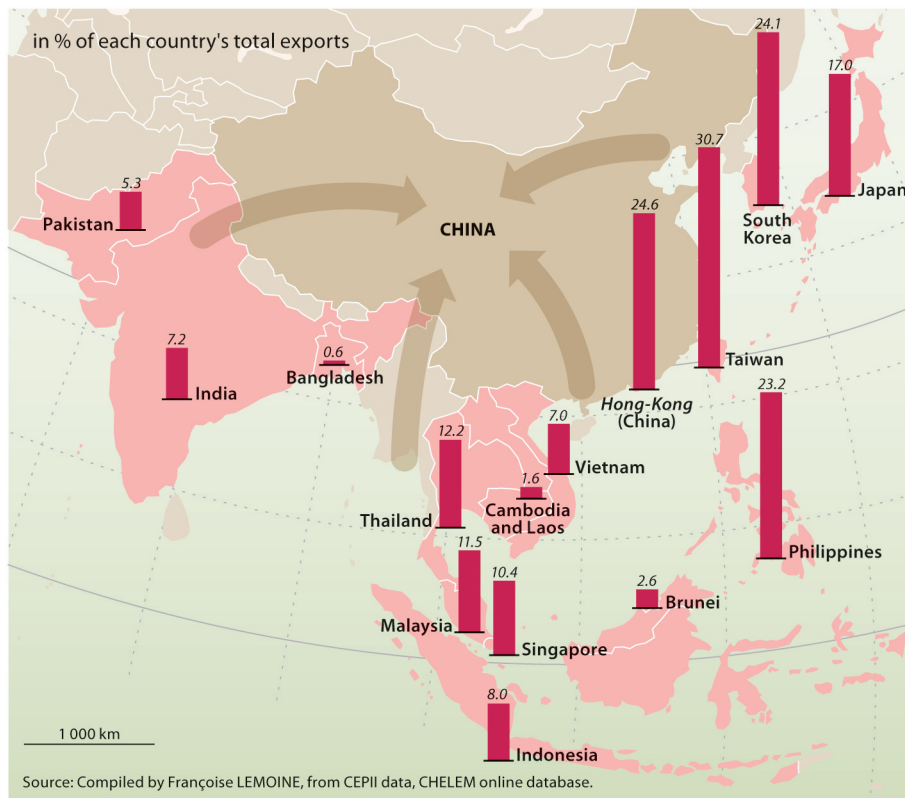
through a network of affiliates and subcontractors scattered over several countries in the region.

The international segmentation of production processes is at the heart of productivity and efficiency gains made in Asian industries. It has profoundly reshaped the pattern of Asian trade in the course of the past decade. The most advanced countries (Japan and NIC1s) now share their industrial production capacities with China, whose position is rapidly expanding. The growing wave of trade in parts and components (which has risen from 20% to 31% of intra-Asian trade in manufactured products) is a perfect reflection of this division of labour (Gaulier, Lemoine and Unal-Kesenci 2007).

China at the heart of the division of labour

Thanks to its infrastructure and the quality and quantity of its workforce, China has become the world's largest hub for export-oriented production. Chinese factories are now an essential link in the world added-value chain. The assembly trade accounts for the huge trade surplus (\$250 billion in 2007) of the world's workshop.

figure 49: **China's share of exports from other Asian countries, 2006**





China mainly exports finished goods, most of which are consumer goods. Chinese electronic products, which have made a particularly remarkable breakthrough on the world market, are now the main export item. In 2007, China produced 600 million mobile phones (half the world production) and exported more than 400 million of these products (almost all of which are foreign brands: Nokia, Motorola, Samsung, Ericsson, etc.). Most Chinese imports of semi-finished goods, especially electronic components, come from Asia. China has become the fulcrum of the division of labour on the continent. Its integration in the region has made it a world trade power and the largest in Asia (one-fifth of all the region's exports). It has far surpassed Japan as the main market for Asian manufacturing industries and has almost caught up with it as a regional supplier of manufactured goods.

The demand for agricultural and industrial raw materials and for energy has risen sharply, reinforcing complementarity with Asian producer countries. Indian exports to China multiplied eight times between 2000 and 2005, iron ore deliveries accounting for half of this increase.

India, the other giant in the international division of labor in Asia

Lagging behind China by about 10 years, India adopted a new economic liberalization and international opening-up strategy in the early 1990s.

Its development model is very different from the industry-based development of East Asian countries. In India, services drive economic growth and exports. Industrial development was hindered by domestic regulations, a lack of sufficient transport infrastructure and an electricity shortage. Indian industry remains a relatively underdeveloped sector (it contributed about 20% of the GDP in 2006), still dominated by the main traditional areas (textile, steelmaking, petrochemicals, mechanics). The pharmaceutical industry is the exception. The sector has developed a first-rate world production of generic drugs, taking advantage of specific Indian legislation on intellectual property that existed until 2005. India is not very integrated into the Asian division of labour but is attracted to the region's economic dynamism, and its external exchanges are increasingly turning towards Asia.

Services suffer less from the hindrances that affect Indian industry. This is the most powerful and most dynamic sector of India's economy, making up 54% of GDP and employing a quarter of the country's labour force. High-productivity activities (finance, telecoms, computing) play a key role (Boillot 2006).

New technologies at the heart of Asian emergence

India and China have made the most remarkable breakthroughs in activities that grew out of the technological revolution of the late 20th century. This, com-



bined with globalization (increased capital mobility and opening of markets), has prompted companies to relocate (through affiliates) and/or outsource (by using subcontractors) segments of their activities beyond borders, especially in emerging countries. Globalization—understood as a worldwide reorganization of the production of goods and services—has offered China and India the possibility of short-circuiting certain stages of modernization by adopting cutting-edge technologies. China has become a world production hub for electronics products and the world's foremost exporter of them, with 17% of the world's exports in 2005 (televisions, DVD players, cell phones, iPods, etc.). India is an international centre for computer and information services and the world's largest exporter with 21% of the world's exports. China and India, both major economic powers until the early 19th century when they missed out on the first industrial revolution, have mastered the new information and communication technologies (ICT) and managed to position themselves in very dynamic sectors of world demand (Gaulier, Lemoine and Unal-Kesenci 2006). They have developed competitive production capacities in new sectors much faster than they have been able to renovate obsolete facilities and management methods in the traditional sectors of their economies. In both countries, the boom in new sectors relies on quality labour that is highly productive and paid at a low rate. The efficiency in implementing new technologies explains the strengths of India's and China's comparative advantages in these sectors and the appeal these two countries have for multinational corporations and foreign capital.

Consumption: the weak link in Asian growth

Learning from the 1997-98 financial crisis in several East and South Asian countries (Thailand, Malaysia, South Korea and Indonesia) caused by the sudden withdrawal of international capital, East Asian countries have since conducted cautious policies aimed at sheltering their economic growth from another external shock. For this purpose they have given priority to exports and accumulation of currency reserves. In fact, the Dragons and Tigers have returned to the path of high growth, but household consumption has been the weak link of their economies. Currently, China is an extreme case in this regard. Since the late 1990s, its economic growth has mainly been driven by domestic investment, which has reached new heights (45% of the GDP), and more recently by exports. Since 2005, external demand has accounted for about one-quarter of China's growth. Household consumption has increased less quickly than other components of demand. Chinese households in fact have a strong propensity to save, both out of cautious habit and to make up for the lack of social welfare (health, retirement), and in the face of the increase in schooling costs.

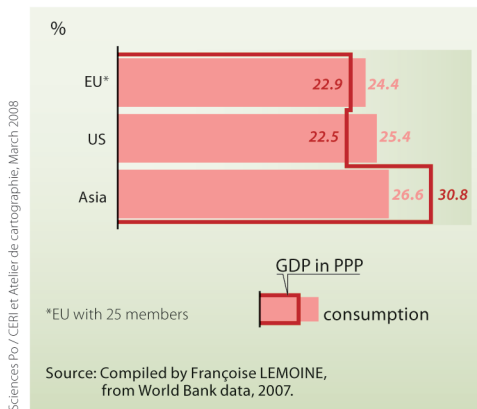
The strong propensity to save and invest is characteristic of the East Asian economic development model, where the priority given to competitiveness keeps

a lid on wages and consumption. On the other hand, South Asia, particularly India, generally devotes more to consumption. For instance, even if India's per capita GDP is half that of China's, per capita consumption is only 30% lower.

Towards autonomous growth?

Asia is the region that has known the greatest economic dynamism in the world since the mid-20th century. It now contains major emerging powers that are contributing more and more to world growth. Does that mean the Asian economy functions in a truly autonomous fashion, or is it still dependent on the rest of the world? China's rise in power has given new impetus to Asian integration and suggests the idea of delinking of Asian activity from Western economies, especially the United States.

figure 50: **Share of EU, US and Asia in GDP and world consumption, 2007**



In 2007, China, which represented 5.4% of the world GDP (in current dollars), recorded an 11.5% growth rate. It thus contributed more than the United States (1.9% growth and 27.5% of the world GDP) to world growth. India, which represented 2% of world GDP and had a 9% growth rate, contributed as much as Japan to world growth. If the economy slows down in developed countries, the emerging economies' contribution to world growth should increase. Does that mean they will be able to drive the rest of the world's growth?

The spillover effect of Chinese growth on the US and the EU economies is fairly limited because China remains for both entities a market of only minor importance. It receives 5% of total US exports and 4% of the EU's extra-community exports. India has even less weight than China. The BRICs taken together (Brazil, Russia, India and China) account for less than 10% of EU and US exports.

Chinese growth has spillover effects on the rest of Asia thanks to gains in efficiency related to an intense international division of labour in the region. Asia thus supplies China with two-thirds of its imports. It is not certain, however, that Asian growth has acquired great autonomy from the American continent on which it is still heavily dependent for much of its finished product exports. The "de-coupling" of Asia from the United States runs up against the importance of the American market for Asia: East Asia exports 30% of its finished products (consumer goods and capital goods) to North America and 20% to the European Union.

Only a more dynamic Asian internal demand based on a rise in household consumption can lead to a real "de-coupling" of the region's growth and give the continent a truly driving role with respect to the rest of the world.

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