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Foreword

The Clinton Administration has pressed for the worldwide reduction of trade barriers and the strengthening of a market-oriented, rules-based international economic system, continuing a strategy pursued by U.S. policymakers since the end of World War II. Yet, trade disputes that were submerged in the security-dominated Cold War era increasingly have become sources of tension. Furthermore, the implementation of a rules-based, market-oriented system faces immense obstacles in countries with a tradition of government involvement in the economy and where government has been based more on personal discretion than rule of law.

The essays in this issue of the *NBR Analysis* explore the rationales, processes, and strains that are accompanying strategies of economic liberalization in East Asia. They examine the effects that openness to world markets has had on regional security, and the difficulties these developments have presented for the United States. In the opening essay, Professor Dwight Perkins of Harvard University argues that numerous factors inhibit smooth and successful Chinese involvement in the world economic system, including state control over enterprise decision-making, the lack of transparent, published laws, and the leadership's concern that China not become dependent on potential adversaries for supplies of strategic goods. Yet several trends counteract these inhibiting forces, such as the development of new, dynamic business organizations that have a substantial degree of autonomy from the national government; the leadership's growing desire to control corruption; and the continued need to import technology and equipment. Perkins concludes by pointing out that Chinese leaders, who are by no means ideological devotees of liberal economic policies, will participate in the international economic system only if they see tangible economic and security benefits from doing so. The challenge for U.S. trade negotiators, in Professor Perkins' view, is to apply consistent pressure to make China's economic practices more liberal and transparent, and to remain cognizant of the historical constraints and security concerns that will make Chinese integration into the world economic system a very gradual process.

In the second essay, Professor Andrew MacIntyre of the University of California-San Diego examines how several Southeast Asian nations have shaped their "grand strategies" to reflect the post-Cold War economic and security challenges they face. He contends that meaningful involvement in the international economy by the Philippines, Malaysia, Indonesia, and Thailand occurred only after these countries underwent a balance-of-payments crisis brought on by the collapse of international commodities prices. Their export-driven economic growth has meant that access to U.S. markets and Japanese capital is essential, and therefore these countries are becoming increasingly invested in a stable and open global economy. As a result, they have sought to minimize economic disputes with the United States and other trade partners. On the security front, Southeast Asian nations have turned their attention from domestic threats to the development of regional multilateral security organizations, and have urged the United States to remain committed to East Asian security.

In the concluding essay, Geza Feketekuty, director of the Center for Trade and Commercial Diplomacy at the Monterey Institute of International Studies, points out that intense global competition and the resulting rapidity of economic change have increased Americans' sense of economic insecurity and led to dissatisfaction with the open trading system developed since the Second World War. He urges U.S. policymakers to develop a trade strategy that rebuilds public confidence in international agreements and contains effective remedies against anticompetitive practices of other countries.

These papers were initially prepared for a conference organized by The National Bureau of Asian Research entitled "National Strategies in the Asia-Pacific: The Effects of Interacting Trade, Industrial, and Defense Policies." Held in Monterey, California on March 28–29, 1996, the conference was generously sponsored and hosted by the Center for Trade and Commercial Diplomacy of the Monterey Institute of International Studies.

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TRADE AND FOREIGN DIRECT INVESTMENT IN CHINA'S DEVELOPMENT STRATEGY

Dwight Perkins

Trade and foreign direct investment have been at the core of China's development strategy since the Communist Party Central Committee's decision in December 1978 to adopt Deng Xiaoping's program of economic reform. The goal of that reform, and hence of trade and investment policy, has been to make China rich and powerful. Maoist dreams of a fundamentally different kind of socialist society are dead, but the goal of reducing inequalities remains, if for no other reason than that it is widely believed that political stability depends on ameliorating gaps in income between rich and poor, and between the coast and the interior. Power, in Chinese eyes, is not synonymous with wealth or the maximization of the rate of growth of gross national product, although they are closely related. In China, as elsewhere, power also involves such issues as food and raw material security. Security in this context is sometimes confused with self-sufficiency.

China's economic reform effort began with limited changes in the industrial sphere. The initial objective was to make the command economy work better, not to replace it with a market-oriented system. Agricultural reforms were more radical, evolving within a few years into the outright abandonment of collective agriculture. In 1984, reform in the industrial sector began in earnest. Although reform was still oriented toward making state-owned enterprises more efficient, the role of market forces in the distribution of industrial inputs and output expanded steadily. Only in the 1990s, however, did the government clearly state that the goal was to move to a market-based system, albeit a "socialist market economy."

Like China's general economic reform efforts, its trade and foreign direct investment strategies have evolved step by step as policymakers gradually have acquired greater understanding of what achievement of their goals requires. The opening up to foreign trade actually began before December 1978 with decisions to encourage the import of foreign equipment and technology. The flood of import orders that followed made it clear that China had to find additional sources of foreign exchange if it were to be able to pay for rapidly rising imports. The export promotion effort followed. The decision to abrogate the prohibition on foreign direct investment came shortly thereafter. Initially foreign direct investment was seen as exclusively a source of new technology and a support to the export drive. A rather general joint venture law was passed and special economic zones were created. But pressure from prospective investors, among other reasons, led Chinese policymakers to draft steadily more laws related to foreign investment activities and commercial practices in general. The exclusive emphasis on exports and technology was modified to allow substantial production for the domestic market, even for such nonstrategic goods as

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Coca-Cola. Foreign exchange controls were reduced and markets for foreign exchange created, making it easier, although not necessarily easy, for foreign investors to repatriate their profits.

Given this history, it should surprise no one that a consensus has not yet developed among Chinese policymakers regarding the details of industrial policy in general or trade and investment policy in particular. Substantial differences of view exist both within the highest levels of the leadership and within the working levels of the bureaucracy. Still, a broad outline of what China's policymakers hope to achieve is possible. What they hope to accomplish, however, is not the sole determinant of how the Chinese system will evolve. Because a key Chinese objective is to expand its role in the international economy, the terms on which that expansion will occur will be determined by the leading industrial economies as much or more than by China's own actions and desires. An analysis of China's trade and investment policy, therefore, requires some discussion of the external constraints on that policy.

China's Industrial Policy

Once China decided to abandon the Soviet-style command economy, the central question for industrial policy was which development model the government would attempt to implement. The issue was to define the continuing role of the government in the management of the economy. Almost no economy today operates at either extreme of the alternative economic systems available—the full command economy at one end and laissez-faire capitalism at the other. All governments, even Hong Kong's, play some role in shaping the economy, and many Asian governments play a bigger role than most in Europe and North America.

The model that appears to have the greatest appeal to many Chinese leaders and bureaucrats is some version of the Japanese approach to industrial development in the 1960s and 1970s, or the South Korean heavy and chemical industry drive of the 1970s. This model has two key elements. The first element is a strong government ministry such as the Ministry of International Trade and Industry (MITI) in Japan or the Economic Planning Board and the president's Blue House staff in South Korea. MITI has broad discretionary powers to support industrial initiatives of the government. In the Korean heavy and chemical industry drive, industrial policymakers could, for example, grant import licenses for the many restricted imports, offer subsidized loans from the state banking system, and provide firms with a temporary monopoly over the domestic market.

The model's second element is the presence of large private conglomerates (*keiretsu* in Japan, *chaebol* in Korea) that carry out the government's desires. The conglomerates' relative strength vis-à-vis the government was weaker in Korea than in Japan, but in both cases they were private corporations with a substantial degree of autonomy from the government. They were allowed to succeed or to fail in carrying out the government's wishes. If they failed because of external forces beyond their control (as in the case of the Korean shipbuilders, who produced their first ships just as the market for ships collapsed), the government would help out. But if failure were the result of corporate mismanagement, no government safety net was provided. Japanese and

Korean firms faced a hard budget constraint: they would not be bailed out with subsidies and soft loans if they ran chronic losses.

This approach to industrialization clearly presents problems for international trading arrangements based broadly on free-trade principles. Direct discretionary authority over imports was one of the major controls manipulated by industrial policymakers. Foreign exchange controls were also important levers of government power. In both Japan and Korea in these earlier decades, foreign ownership of local industry and services was actively discouraged. All of these kinds of discretionary interventions have become unacceptable under rules established by the General Agreement on Tariffs and Trade (GATT) and even more unacceptable after the Uruguay Round and the creation of the World Trade Organization (WTO). For Japan and Korea, these WTO rules and procedures are not a problem. Both countries have moved a long way from the kinds of industrial policy levers used in the 1960s and 1970s. Partly under international pressure, partly for reasons of their own, Japanese and Korean rules now generally comply with WTO requirements. But, as this brief description makes clear, Japan and Korea were able to join GATT at a time when the rules for membership were nowhere near as stringent as they are today.

It is into this changed 1990s arena that the Chinese are trying to enter with a 1970s-style industrial policy. China's effort to promote a modern automobile industry illustrates the basic approach. Unlike the Japanese and Koreans, the Chinese have actively welcomed a number of major foreign producers to help in this process, but that is where the liberal approach ends. There are high tariffs on imported automobiles because domestic producers, whether foreign joint ventures or not, cannot come close to achieving costs attained by producers of duty-free imports. Joint venture firms also face stringent domestic-content requirements. Mandated domestic content in the older version of Volkswagen's Santana, for example, reached 90 percent in 1995. This high level of domestic content did not come about because of the cheaper costs of local supplies. It was a result of the government's dictate, supported by trade and foreign exchange controls. Facing this pressure, Beijing Jeep had to go to the very top of China's leadership to get the foreign exchange needed to pay for the complete preassembly kits that some of its Chinese partners—but not those who controlled foreign exchange—had agreed to purchase.[1]

There is nothing unusual about China's policy; it is standard infant industry protection. In this case, protection is provided to an industry that will probably take more than a decade to become competitive. Almost all developing countries use this approach for some industries. But the Chinese situation is complicated by the fact that nearly half of its industrial output is produced in state-owned enterprises, and a high proportion of these enterprises—the exact percentage is hard to know given the weaknesses of Chinese accounting practices—are running chronic losses even with high levels of protection from foreign competition. China has a bankruptcy law; however, only in the mid-1990s have a few state enterprises been allowed to go bankrupt. The rest have been bailed out with loans from state-owned banks that no one expects them to repay. A reduction in the level of protection for many of these enterprises would simply mean that the state banks would have to increase their loans. To allow a third or more of these enterprises to go bankrupt is deemed politically unacceptable because it would raise unemployment among an influential part of the urban population.

Many of these state-owned enterprises are directly or indirectly related to military security. Those that actually produce weapons are presumably not a major source of problems for China's trade relationships. Weapons are subject to all kinds of restrictions, many of which are not very effective, but which are outside normal WTO rules. Nevertheless, the international community, and the United States in particular, would like to see more limitations, not fewer, in the case of China's weapons exports. The United States has, in fact, threatened trade sanctions against China

[1] For a lively presentation of the Beijing Jeep story, see Jim Mann, *Beijing Jeep: The Short Unhappy Romance of American Business in China*, New York: Simon and Schuster, 1989.

for its export of nuclear equipment to Pakistan. Imports of weapons into China are also subject to numerous, usually not very effective, controls.

The problems for trade arrangements arise more in industries that are only indirectly related to security. The aluminum industry is a good example. China has a highly inefficient aluminum industry. It lacks a large domestic source of bauxite. Production takes place in a number of plants, each far too small to take advantage of the considerable economies of scale that are possible in the industry. Moreover, the aluminum process makes heavy use of electric power, which is in chronically short supply. Any rational economic calculation would lead to a decision to close down the entire industry and pay the workers to do nothing if necessary. But aluminum is probably seen as necessary for China's security. In this particular case, Chinese policymakers might be persuaded that the contribution to security is illusory because there are cheaper and perhaps more effective ways to assure an adequate supply of aluminum in the face of some kind of cutoff in external supplies.

But in [certain] sectors—such as petroleum, uranium, or grain—there may be a real security element, not just one based on primitive notions of self-sufficiency. If China were to become dependent on the international market in these sectors, policymakers would have to trust that the international market would be available to China when needed.

But in other sectors—such as petroleum, uranium, or grain—there may be a real security element, not just one based on primitive notions of self-sufficiency. If China were to become dependent on the international market in these sectors, policymakers would have to trust that the international market would be available to China when needed. Would key natural resources always be available to China at less-than-exorbitant prices? Or would China, for whatever reason, be subject to sudden embargoes on its supply? We shall return to this subject later when the issue of food security is discussed.

Another issue regarding state-owned enterprises concerns the scope of enterprise management authority. In a true market system, enterprises are usually private, and management is picked by a board of directors representing the owners. Except in time of war, government officials have no authority to give direct orders to management or to play any role in the hiring and firing of that management. Although this is not the case in China, the Chinese government has tried all kinds of ways to make state enterprises more autonomous under the rubric of the enterprise responsibility system. Many enterprises, while not formally privatized, sell ownership shares to other enterprises, their workers, and the public.

However, Chinese shareholders have not been given the power to appoint enterprise senior management. That power is jealously guarded by the various ministries, not to mention the Chinese Communist Party (CCP). As long as the government retains the power to appoint management, true enterprise autonomy will be difficult or impossible to achieve. And without enterprise autonomy, China will not really need tariffs, quotas, and exchange controls to manage foreign trade and investment. The ministries can simply transmit their wishes to management by telephone. Formally the enterprise might have the right to refuse a ministry or party request, but if the price of refusal is transfer to a less desirable post, how many managers will exercise their formal right to autonomy? This problem arises in the area of taxation every day in China. In theory, state enterprises are subject to carefully drafted tax codes. In practice, local governments regularly pressure enterprises in their jurisdiction to make additional, often quite large, contributions to the government's coffers. Only managers confident of their ties to higher officials are in a position to refuse such raids on their profits.

Some Chinese officials find the Japanese *keiretsu* or Korean *chaebol* form of business organization to be attractive because they see this structure as creating the kind of dynamic state enterprises that they seek. But a closer look reveals that these new Chinese conglomerates look suspiciously like government bureaus under a new name. With the demise of central planning, it is not surprising that large parts of the government bureaucracy are looking for new ways to justify their continued employment and perquisites.

Pressure for Unfettered Markets

If the above discussion were the whole story of what is happening in China, there would be few grounds for optimism about China's ability to become integrated into the international economic system on terms that would be consistent with China's full participation in the WTO. Fortunately, there is another side to the story.

The other side involves forces at work outside the state sector, as well as elements within the government and the party. The major force outside the government is the rise of new, more dynamic forms of business organization. The township and village enterprises are the best known of these newer forms. But there are also joint ventures with foreign firms, and their share of goods and services is rising rapidly. And many of the smaller state enterprises are under local governments that themselves have become business- and profit-oriented.

These new organizations now account for more than half of all industrial output and an unknown but very large share of services. These enterprises are not bailed out with state bank loans. For the most part, management is not selected by the central ministries. Enterprises occasionally receive local government support. These governments, however, have limited ability and no incentive to restrict access to foreign imports or foreign exchange. Because the majority of these enterprises are relatively small, their bankruptcy is only a local concern, not a national political problem. Few of these firms are formally private, but they behave enough like autonomous private enterprises to meet the needs of an economy governed by market forces.

Because these newer forms of organization have been so dynamic and successful, they have put great pressures on large parts of the state-owned sector. In some cases the state sector has joined forces with these new firms. The larger joint ventures are mainly with divisions of large state firms and constitute a kind of back-door privatization. The state has generally abandoned the distribution of goods to the non-state sector. And many components required by state industrial enterprises are subcontracted out to township and village enterprises rather than produced in-house, as would have been the case in the past.

The Chinese government now talks openly of retaining ownership of only two thousand of the largest and most strategic industrial enterprises. This number is well below the current 3,800 large state enterprises and 10,400 medium-scale state enterprises.[2] Whether this long-run objective will ever be accomplished, and how much will be achieved by mergers of state firms rather than state divestiture or bankruptcy, remains to be seen. But the active consideration of this goal is a powerful indicator of the intentions of China's top leadership. Far from supporting the large state-owned sector at any price for political or ideological reasons, Chinese leaders are looking for ways to reduce substantially the burden of this sector on such truly important state economic objectives as finding the resources to strengthen the transport infrastructure or controlling inflation.

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[2] State Statistical Bureau, *China Statistical Yearbook*, 1994, Beijing: China Statistical Publishers, 1994, p. 378.

A second pressure for decreasing the discretionary authority of the government economic bureaucracy arises from the desire to control corruption. It is difficult to gauge the strength of this pressure. Certainly the bureaucrats who use their discretionary powers to extract payments of various kinds are not a source of pressure for change. But there is widespread public discontent with what is perceived as pervasive corruption in the government bureaucracy, a perception supported by international polls of businessmen about their impressions of the levels of corruption in various countries. These polls identify China as among the most corrupt, although impressions of this sort are highly subjective.

When goods, services, capital, and land can be readily obtained on the market at the established market price, bribery has no role. When access to land, foreign exchange, or the right to open a business is controlled by licenses, often several different licenses, corruption is virtually inevitable.

Many in the Chinese leadership see this widespread corruption as ultimately a threat to the party's role in Chinese society. What is less clear is how aware the leadership is of the close connection between corruption and an economic system riddled with discretionary government authority. When goods, services, capital, and land can be readily obtained on the market at the established market price, bribery has no role. When access to land, foreign exchange, or the right to open a business is controlled by licenses, often several different licenses, corruption is virtually inevitable. Certainly some Chinese in positions of influence see this connection; however, the emphasis on anticorruption campaigns and long jail sentences as the primary solution to the problem indicates that there are many who do not understand well the issues they are trying to resolve.

Pressure for a market system in China also comes from much of the rural population. More than half of China's population lives in rural areas. Moreover, many in the party and the army have rural backgrounds or rural ties, and are influenced by what goes on there. One of the most unpopular measures implemented by Beijing in recent years was the use of IOUs rather than cash to pay farmers for their crops. These IOUs arose because funds in the banking system were diverted to uses that local bureaucrats considered to be more important. Farmers are also being regularly pressured by officials to pay all kinds of special fees or to provide services in kind without compensation.

A highly centralized industrial policy along Japanese or South Korean lines simply will not solve the problems facing the great majority of the Chinese people. Japan and South Korea had economic bureaucracies that were largely insulated from political pressures and were relatively free of corruption. Decisions were made mainly on technical grounds. And the enterprises that carried out these decisions were private firms operating in a highly competitive environment. None of these conditions applies to China today. The dynamic sectors in China lie outside the central planning bureaucracy and the large state enterprises, which are too politicized and too corrupt to carry out a policy of sustained, broad-based, and rapid growth. In the absence of such growth, the social tensions that are very much present in China today could well explode. Most of China's leaders are aware of the political pressures that surround them. They also see the connection between sustaining a high growth in employment and the standard of living and the containment of these political pressures. What is not clear is how many in the leadership understand that these economic goals depend on an economic system substantially more market-oriented and rule-governed than the one they have today.

International Trade Pressures

The Chinese leadership does not make industrial and trade policy decisions in isolation. The open economy policy was made independently, but implementation of that policy requires cooperation from trading partners and foreign investors.

If any Chinese leader strongly opposes the open economy policy, that person has kept silent. While there is considerable concern about the social consequences of the open policy (e.g. concerns about "bourgeois liberalization"), such concerns have not led any major Chinese leader to oppose the expansion of foreign trade or even the promotion of foreign direct investment. Conservative Chinese leaders have attacked what they perceive to be the excesses of the Special Economic Zones (the zones in Southern China that practice free-trade policies), but not the core of the open policy.

The original motivation for the open economy policy was the desire to import technology and equipment not available at an acceptable cost in China. To pay for these imports, China needed foreign exchange, and that led to the export-promotion drive. In the late 1970s there were grounds for pessimism about China's export development prospects, largely because of the nature of the country's Soviet-style economic system. How could a system geared to producing low-quality goods for a captive market suddenly compete in markets where quality, style, and timeliness were essential? The concept of marketing was virtually unknown within the Chinese manufacturing sector.

But China did solve the marketing problem, largely by relying on business in Hong Kong. Initially Hong Kong was essential because few in China knew how to penetrate Western markets for manufactures. As knowledge about what was required increased in China, so did an appreciation of Hong Kong's contribution. By 1995, with China's total exports reaching $148 billion, a large share of those products that require marketing skill were still exported through Hong Kong.[3] By turning to Hong Kong, China solved the problem of how to produce and market goods appealing to North American, Japanese, and European consumers.

The array of forces in the industrial world that had been mobilized to fight imports from Japan and the four "Asian tigers" (South Korea, Taiwan, Hong Kong, and Singapore) were still very much in place and more than ready to fight this potentially huge new tiger. China, for example, became a major target of antidumping complaints that were often little more than thinly veiled efforts to restrict China's exports.

This solution did not, however, address the other half of the problem of raising export sales, namely the efforts of America and other industrial countries to restrict Chinese exports to their markets. Initially industrial country trade restrictions were not a major problem. Chinese exports of manufactures were small, and Japan, the United States, and Western Europe were all disposed toward helping China's development effort. But China's exports soon ceased to be small, and they tended to be concentrated in areas, notably textiles, where the world market

[3] For a careful analysis of the role of Hong Kong in China's trade, see Yun-Wing Sung, *The China-Hong Kong Connection: The Key to China's Open Door Policy*, Cambridge: Cambridge University Press, 1994.

was marked by trade restrictions of various sorts. The array of forces in the industrial world that had been mobilized to fight imports from Japan and the four "Asian tigers" (South Korea, Taiwan, Hong Kong, and Singapore) were still very much in place and more than ready to fight this potentially huge new tiger. China, for example, became a major target of antidumping complaints that were often little more than thinly veiled efforts to restrict China's exports.

It was not just protectionist forces per se that created a problem for China. Industrial country trade negotiators, notably the United States Trade Representative (USTR), were also an obstacle. The long-term goal of these negotiators was often to promote freer trade; however, promotion of free trade frequently took the immediate form of threatened sanctions against Chinese exports in retaliation for China's open deviations from free-trade principles on both the export and import side.

The leeway given China to use restrictive trade practices was substantially less than that given to several of China's neighbors. Japan, in a sense, had pioneered all of the techniques of promoting exports while keeping one's own domestic market closed to competitive manufactured imports. South Korea and Taiwan followed Japan, but were put under considerably more pressure than Japan by the USTR to liberalize trade more quickly. After the USTR and other trade negotiators had honed their skills on South Korea and Taiwan, China came along as a major trading nation.

As a result of these developments, the trade negotiation agenda of the 1990s was very different from that of the 1960s and 1970s.[4] Intellectual property rights became a major source of contention between a variety of Asian nations and the United States; whereas in earlier years copyright piracy in Asia was almost taken for granted. By the 1990s the trade in services such as insurance was seen to be as important as the trade in goods; such had not been the case two decades earlier. Any real opening to services in Asia also required an open policy toward foreign direct investment because it is difficult for a company to run a broad-based insurance business or a chain of retail outlets if it cannot invest in land and other local facilities. Japan's and South Korea's vigorous and successful efforts to limit severely foreign direct investment in the 1960s and 1970s were criticized by private-sector interests, but were not a major item for official trade negotiators. By the 1990s, however, it was no longer considered entirely acceptable for a government to reserve major public or private infrastructure projects, from airports to electric power facilities, for domestic designers and construction firms.

The Uruguay Round was the culmination of this process. If the Uruguay Round had failed, one can assume that developing countries such as China would have faced more ad hoc and less well-defined positions from its principal industrialized trading partners. With the success of the Uruguay Round, the standards expected of major trading countries were clearly spelled out and very liberal. In Asia, the growing role of the Asia-Pacific Economic Cooperation (APEC) forum further reinforced this emphasis on liberal trade policies. The APEC leaders' decision to eliminate all barriers to free trade by the year 2010 for industrialized countries and 2020 for developing countries, while lacking an enforcement mechanism, further reinforced the pressure on each member country to move quickly toward a liberal trading system.

China, therefore, was under enormous pressure to move rapidly toward a broad-based liberal trading regime or face the prospect of not being a fully accepted member of the international economic system. This pressure took its most concrete form in the negotiations over China's attempt to become a charter member of the new WTO.

The WTO negotiations would have been more difficult for China if the United States, Europe, and other leading countries in the WTO were exclusively concerned with the integrity of

[4] The most complete discussion of this agenda as of the end of 1993 is in Nicholas Lardy, *China in the World Economy*, Washington: Institute for International Economics, 1994.

the international trading system and had been otherwise indifferent to what was happening in China. The central issue remains whether China will be allowed developing country status and, if so, for how long. China has argued plausibly that it is still a developing country and should be allowed the same kind of flexibility in applying WTO rules as other developing countries. The United States, supported by Europe, has argued that China is already too large a trading country to be admitted on developing-country terms. The middle ground mainly involves the speed at which China would be expected to approach full compliance.

Full compliance means that China would have to abolish most nontariff barriers such as quotas or domestic content requirements for foreign investment. Tariffs would have to be brought down sharply from their current high levels (China has nominal average tariff rates of 36 percent as contrasted with an average of under five percent for members of the Organization for Economic Cooperation and Development). Intellectual property rights would have to be enforced rigorously and foreign investors would have to receive something approaching treatment of domestic investors.

It is testimony to how much both China and the world at large have changed that these kinds of goals are not wholly unrealistic. China has eliminated many nontariff barriers. At the APEC summit meeting in Osaka in November 1995, President Jiang Zemin announced a sweeping downward revision in tariff rates, although the announcement was short on specifics.[5] An intellectual property rights agreement with the United States has been negotiated. From the point of view of foreign investors, national status would be a mixed blessing, mainly because many enjoyed better-than-national treatment in certain areas. Foreign investors are complaining, for example, about China's recent attempts to impose the same tax rates on them as it exacts on domestic firms. China unified its exchange rate in January 1994, and is very close to legalizing full convertibility of the Chinese currency for trade purposes. Foreign exchange reserves of over $80 billion would make currency convertibility achievable with almost no threat of capital flight. Large amounts of capital already move in and out of China illegally with relative ease.

. . . China's domestic economic system remains in the twilight zone between plan and market, between socialist discretionary commands and the impersonal direction of prices. And therein lies a major part of the problem.

All of these changes have occurred while China's domestic economic system remains in the twilight zone between plan and market, between socialist discretionary commands and the impersonal direction of prices. And therein lies a major part of the problem. How does a country introduce free-trade principles into the international side of its economy when the domestic economy is governed by discretionary administrative commands from party and government officials? The WTO rules do not just involve a few technical changes in the way trade is conducted. They go to the very heart of the way the whole economic system operates. China has accepted in principle a domestic system governed by world market prices and the free exchange of goods, but it is still a long way from achieving it in practice. To take one simple example, must China, in order to comply with WTO rules, eliminate subsidies to loss-making state-owned enterprises that participate in foreign trade, as many do? It might well be good for the Chinese economy if these loss-making enterprises were eliminated, but the decision involves much more than trade issues. In the eyes of some, perhaps most, Chinese leaders, the elimination of loss-making state enterprises

[5] "China Undecided on Tariff Cut List," *Korea Times*, November 28, 1995, p. 7.

would be extremely risky for the prospects for political stability. But if the government continues to provide subsidies for loss-making state enterprises to keep them from going bankrupt, what is to prevent subsidies for other enterprises to help them increase their exports?

Similarly, as suggested earlier in this essay, if state planners can "guide" enterprises to carry out certain domestic goals, how can they be kept from guiding these enterprises in the international trade and investment sphere? Discretionary licensing authority used to promote one goal can easily be used to achieve some other goal. Does it follow that to be accepted fully into the international economic community, China would have to abandon most forms of state intervention in its own economy? The literal answer to this question is "no." China's government can still intervene in the economy in many ways as long as it does so in a transparent manner that does not discriminate against foreign imports and foreign investors. The government's actions must be guided by, among other things, published rules and laws.

But no Chinese government in history has been governed primarily by transparent, published rules and laws. Good government in the Confucian tradition meant government by good people, not by good laws. Good government in the communist period since 1949 has meant rule by party and government officials steeped in the values of Marxist-Leninist-Mao Zedong thought. At the height of the Cultural Revolution, in what admittedly was a caricature of this mode of governance, most laws and the legal profession itself were abolished. China by the mid-1990s, in contrast, has many laws and an increasing number of lawyers. Many of these laws are on the books precisely because they are necessary to attract foreign investment or to operate in the international market economy in some other way. But there is also acceptance by many Chinese, including those in the leadership, that China needs law for its own sake in order to reduce the arbitrary actions of sometimes predatory officials.

Accepting in principle the need for more rule by law does not lead easily to a society that is actually governed by law. Investors in China have always relied primarily on personal relationships (guanxi) with officials and others to provide security for their investment. Contracts play a role, but a distinctly subordinate one. Many foreign investors in China operate in the same manner. The great majority of foreign investors are overseas Chinese. Some come from countries in which the rule of law is more important than it is in China. However, the colonial laws under which overseas Chinese lived in the period prior to the 1950s were often applied in an indifferent way to the local Chinese community. These individuals relied heavily on *guanxi* and did not fundamentally change their way of doing business when they began to invest in China.

If China faces realistic and consistent pressures to transform its international economic practices into ones that are liberal and transparent, there is a reasonable prospect that China will gradually adopt and actually enforce the rules and laws required. It will do so primarily because it will be in China's own interests to do so.

Introduction of the rule of law into China, therefore, is going to be a long-term process even with active support from Chinese leaders. Basic patterns of behavior will have to change at all levels, and that will take time. If the commitment of the Chinese leadership to this effort is often weak and ambivalent, as seems to be the case, the process will take even longer. The pattern where Chinese negotiators agree to end some practice (the pirating of computer software, for example), followed by failure to achieve compliance, will be repeated many times. In some cases the Chinese negotiators will be sincere in their willingness to abolish a particular activity, but will be unable to make the new rules stick in practice. In other cases the negotiations will be a charade, but it will not always be easy to tell which is which. Sanctions and other external pressures may eventually compel compliance, but sanctions and external pressures are not the rule of law.

Other Sources of External Pressure

If China faces realistic and consistent pressures to transform its international economic practices into ones that are liberal and transparent, there is a reasonable prospect that China will gradually adopt and actually enforce the rules and laws required. It will do so primarily because it will be in China's own interests to do so. Compliance with international economic rules will greatly facilitate China's export drive, which could see annual exports passing $300 billion in one decade and possibly doubling again in two. Certainly figures of that magnitude are not very likely if China tries to operate its economy outside of international rules. As the rules and laws take hold, Chinese businesses will become supporters of further application of the rule of law for reasons unrelated to international requirements. Chinese businesses, legitimate ones at least, also fare much better in a predictable and transparent environment.

But will the external pressures on China be realistic and consistent? Or will China face an ever-changing kaleidoscope of demands that will encourage nationalistic Chinese officials to go their own way in designing their economic system, even if their own way involves a partial turn back inward? To begin with, the United States and Europe have goals vis-à-vis China that go well beyond simply ensuring compliance with standard trade and investment practices. It is currently an explicit goal of American foreign policy to promote the spread of market economics. The WTO negotiations with China are seen by some as a vehicle for furthering this goal. Trade is often seen as being useful for achieving many other kinds of goals, both international and domestic.[6] It is not difficult to conceive of a trade negotiation strategy with China that is consistent with achieving Chinese compliance with specific trading rules and the broader goal of encouraging the development of a full market system and the rule of law in China. It is also not difficult to conceive of a strategy in which those negotiating with China overplay their hands, leading China to back away from the whole process.

Domestic politics plays a large role in most U.S. trade positions. The U.S. Congress in particular is largely driven by domestic, often protectionist, concerns. The American labor union movement has become steadily more protectionist over time, and that attitude is fully reflected in Congress. Many specific industries, fearful of Chinese competition, have representatives in Congress that support their positions. And Congress's power vis-à-vis the executive branch is clearly on the rise. For many in Congress, for some presidential candidates, and even for a few officials in the executive branch, China is a convenient whipping boy. China has no natural domestic constituency in the United States or Europe—except for companies that export a large share of their output to China—and so there is very little political cost to using China as a target.

Added to this situation is the human rights issue, which is much more than an American (and European) domestic political issue. Any country like China that throughout its existence has been ruled by "men" and not by "law," and has only recently emerged from the terror of the Cultural Revolution, is going to have a large number of human rights abuses. Given China's recent history of political turbulence, Chinese political leaders commonly see any open challenge to their authority as a challenge to order and stability, and therefore something to be vigorously suppressed.

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[6] For a fuller discussion of the political influences on U.S. trade policy toward China, see James R. Lilley and Wendell L. Wilkie II, eds., *Beyond MFN: Trade with China and America's Interests*, Washington: AEI Press, 1994.

With time, the rise of a more educated and prosperous middle class, and increasing experience with the rule of law, it is reasonable to assume that human rights abuses in China will decline gradually. But there are many in the West, and many in China as well, who are not willing to wait. By publicizing abuses they hope, with some reason, to bring them to an end more quickly. Yet few among those active in the human rights field are satisfied with simply publicizing abuses. They want to bring direct pressure on China to change its ways. Since military pressure is out of the question—it is hardly an instrument for promoting human rights—trade sanctions are the most viable means. So human rights becomes part of the trade negotiation agenda.

The annual American debate over most-favored-nation (MFN) status for China is the most obvious manifestation of the connection between human rights and trade issues. The Clinton Administration's narrow escape from actually having to deny MFN treatment for China, and hence undermine the open economy policies that are doing so much to change China, probably precludes the use of such a sweeping sanction in the immediate future. But narrower sanctions remain on the agenda, with goods made by Chinese prison labor as the most common issue. Chinese prisoners do produce goods that are exported, and some of those inmates are political prisoners. That said, the percentage of Chinese exports made by prisoners of any kind is almost certainly very small. Sanctions might encourage the Chinese authorities to enforce more vigorously the ban of such exports to the United States. Will this, however, actually make life better for China's prison population, political or otherwise? And what if Chinese trade managers actually agree in the course of negotiations to comply with the ban on the use of prison labor in exports, but try to exchange compliance in that area for something more fundamental to the achievement of a transparent and predictable trading system? Will the rule of law and human rights gain by that maneuver?

What happens in Hong Kong after 1997 or in Beijing's relations with Taiwan will also play a role in trade negotiations. The fact that Hong Kong would have been hard hit by a cutoff of MFN status for China influenced the debate. If the political and human rights situation in Hong Kong were to deteriorate markedly after 1997, there is little doubt that China's trade relations with the United States, Europe, and Japan would sour in unpredictable but possibly profound ways. A military confrontation across the Taiwan Strait would have an even bigger impact. No one knows how the United States would respond militarily if such a confrontation involving casualties were to occur, but those Americans supporting continued normal trade relations with China would find themselves in a small minority.

If [China] concedes on major trade issues such as the speed of the transition to developed country status, it still might not secure growing export markets for a decade or more. The United States, for example, has made it clear that no matter what the Chinese agree to in the trade area, its MFN status will still be subject to annual review pursuant to the Jackson-Vanik Amendment.

The Chinese government, therefore, does not always face a straightforward set of issues when deciding how to proceed in trade negotiations. If it concedes on major trade issues such as the speed of the transition to developed country status, it still might not secure growing export markets for a decade or more. The United States, for example, has made it clear that no matter what the Chinese agree to in the trade area, its MFN status will still be subject to annual review pursuant to the Jackson-Vanik Amendment. Even if a current American president promises not to cut off MFN, such a pledge cannot bind Congress or the president's successor.

The Chinese government does not have a unified view of its trade negotiations strategy. There are substantial differences of opinion, for example, over how far it should go in order to obtain membership in the World Trade Organization. More importantly, there are even larger differences over who should hold power in China, differences that may not be resolved until Deng Xiaoping is long gone. Given China's historical experience with the imperial powers of the West and Japan, concessions to foreigners are not popular. Leaders maneuvering for power will be tempted to play the nationalist card in trade negotiations or in relations with Taiwan no matter how damaging such an action might be to China's long-term economic interests.

In summary, there is no simple way to describe China's overall economic strategy. In purely economic terms, the desire for rapidly expanding exports and a willingness to consider substantial changes in the way China manages its international economic relations are not entirely compatible with how China presently manages its domestic economy and how it hopes to manage that economy in the future. Moreover, purely economic terms are not the sole determinants of economic policy. Chinese trade issues are caught up in a broader set of domestic and international pressures that have an important bearing on the outcome of what on the surface appear to be narrow technical issues of trade and finance.

Special Trade Issues

Not all products or commodities are equal when it comes to international economic policy. In China, as in many other countries, food supply is of particular importance. For nations in Europe and North America, grain and other agricultural crops are of special political significance because farmers represent, or used to represent, a large bloc of voters with a special set of interests. Politicians in these countries curried farmers' support with price subsidies, special food export promotion policies, and the like. As the number of farmers has dwindled, these same politicians have been more inclined to eliminate these subsidies and let farmers fend for themselves on the market. The Uruguay Round of the GATT codified this view at the international level, albeit only after overcoming considerable resistance from a number of industrialized nations.

For most low-income countries, including China, food production and consumption play a fundamental economic and political role far greater than in industrialized nations. Over half of the income of the typical consumer goes to buy food. A 30-percent rise in the price of food results in a 15 to 20 percent drop in a family's standard of living. Not surprisingly, large food price increases in urban areas often lead to riots that are sometimes big enough to bring down a government. In rural areas, a major drop in food production can be even more catastrophic. A fall in food output of 20 to 30 percent can lead to widespread famine among farmers who are close to subsistence levels in the best of times.

For China, changes in food output and prices of this magnitude are not just a theoretical possibility. Historically, Chinese emperors, at least the more conscientious among them, received regular reports on grain prices from every part of the country. These price reports were the emperors' main way of monitoring economic conditions that could threaten local prosperity and ultimately the stability of the dynasty. Government granaries were kept full throughout the country to protect against just such a contingency.

More recently, the mishandling of the crop failures of 1959–61 led to the premature death of some 30 million people. In the aftermath of this disaster, the Chinese Communist Party became deeply split over how to interpret what had happened. That split led directly a few years later to the Cultural Revolution, which further undermined the strength and reputation of the CCP and the government it controlled. Therefore, many Chinese political leaders in the post-1978 reform period saw a guaranteed adequate supply of grain not just as an economic benefit, but as an essential condition for the survival of the Communist Party. To these leaders, most of whom were central planners who distrusted markets, a guaranteed adequate supply of grain meant a guaranteed domestic supply. For men like Chen Yun, the second-most-powerful figure in the reform period until his death in the early 1990s, the goal was grain self-sufficiency. Increasing reliance on the import of grain was a cause for alarm.

There was and is, however, a different view in China of the nature of the food supply that starts from the proposition that China today produces substantially more grain per capita than what is required for survival. Rising grain imports result not from a need to keep consumption above starvation levels, but from rising incomes that lead to more consumption of meat, which in turn requires more grain for animal feed. Reliance on imports for this purpose, as long as China has sufficient foreign exchange to pay for them, presents no danger to the system. As one leading rural reformer in China once put it, the answer to China's grain requirements is to export more television sets.

But reliance on imports to supply a portion (less than ten percent by the year 2000) of the nation's food requirements is a politically safe strategy only if grain imports are readily available on a timely basis and at a reasonable price. The relevant concept for China is not food self-sufficiency, but food security. Self-sufficiency involves producing everything you need yourself. Food security simply means that you can get the food you need, from whatever source, when you need it.

Would China have adequate food security if the country regularly relied on fairly large imports of grain and meat? Certainly the world grain market has more than adequate supplies to meet Chinese requirements of 50 million tons a year. Worldwide crop failures, as occurred in 1972 for example, could lead prices to jump substantially. It is hard to imagine, however, grain imports of 50 million tons costing China more than $20 to 30 billion (out of total Chinese foreign exchange earnings in the year 2000 approaching $300 billion), and costs of that magnitude would not last long.[7] Moreover, if China built up large reserves of grain when prices were lower, it could avoid even a temporary boost in the cost of grain imports. Whether large reserves are, in fact, a good idea depends on how much it costs to maintain them.

This analysis of China's food security problem is unassailable as long as one assumes that China will have unfettered access to world grain markets. Is this a reasonable assumption? Certainly in normal times there should be no problem. It is unlikely that the human rights community would call for a grain embargo against China even if hundreds of dissidents were suddenly thrown in jail. But what if war were to break out in the Taiwan Strait, or if China were to try to impose an embargo on a Taiwan that had just declared its independence? The United States did embargo grain sales to the Soviet Union after the invasion of Afghanistan. A U.S. embargo alone might not mean much for Chinese food security, but would other major grain exporters follow suit?

For Chinese political leaders who have been exposed to the kinds of analysis presented above, the answer to the question is likely to be "no." Other countries are not likely to follow suit, and only ten percent of China's grain requirements are involved in any case. But most Chinese leaders are not economists and have not fully grasped such arguments if they have been exposed to them at all. These leaders see the penchant in some American and other circles to link trade with other foreign policy goals as a threat to China's food security. These leaders are likely to think in traditional Chinese terms about the need for something approaching food self-sufficiency.

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[7] Lester Brown argues that Chinese imports will be much larger than this, and that the world grain market will not be able to accommodate such large purchases at anything like current prices. Brown's view, however, is not shared by many other analysts of China's grain situation, mainly because of different assumptions about both China's likely import needs and the capacity of the world to respond. Lester Brown and Hal Kane, *Full House: Reassessing the Earth's Population Carrying Capacity*, New York: W.W. Norton, 1994.

Food, of course, is not the only commodity where security considerations are raised, although it is undoubtedly the most important commodity in this regard. At the height of Mao Zedong's influence over the economy in the late 1960s and early 1970s, almost every commodity was considered of strategic importance. The goal was not only self-sufficiency for China as a whole, but for each Chinese region and even each small locality. That extreme view of Chinese security no longer exists, but a distrust of becoming dependent on the outside world does continue to play an important role in decisions.

This attitude is most apparent with respect to military weapons. The Chinese have purchased a number of military aircraft and submarines from Russia, but the numbers involved are modest both with respect to China's perception of its military needs and with respect to the country's ability to pay. With nearly $200 billion a year in foreign exchange inflows, China could buy a great many modern fighter aircraft, for example, without seriously jeopardizing its economic development program. Given the dire straits of much of the defense industry of the former Soviet Union, these industries presumably would be happy to sell to China.

China has not gone far down the weapons purchase route because it does not see its security being greatly enhanced by becoming dependent on the weapons manufacturers of either Russia or the United States. China's interest since the 1950s has been to develop the capacity to build modern weapons systems within China. Most Chinese purchases (including the recent purchases from Russia) therefore involve broader agreements that include transfer of the technology and important parts of the production process. Where that kind of transfer is not possible, China has invested in research and development to build its own capacity independently.

This attitude on the part of the Chinese leadership (including the military) is not likely to change because it is a rational response, perhaps the only rational response, to the international environment in which China finds itself. China does not need modern weapons to defend itself against attacks from some Southeast Asian nation or even India. Right now, and for the next few years, China does not really face any adversaries that could or would be likely to threaten its fundamental security. But beyond the immediate horizon, the two most important potential adversaries would be Russia and the United States. Japan would presumably be the third if it were to rearm. Since relying on potential adversaries to be a reliable source of weapons is not a very realistic strategy, China has preferred to sacrifice some military capacity now in exchange for a more secure source of critical weapons in the future.

China is led by people who were educated to run a system based on central planning and who live in a country that has been threatened and even occupied for a time by one or more of the world's major powers going back a century and a half. China's willingness to participate in the international economic system is thus not based on deeply held beliefs about the benefits of liberal trading relationships rooted in a liberal society on the Western model. It is based on the calculation that China will be richer and more powerful if it does participate.

A country at war, of course, needs more than weapons. There are industries that produce parts critical for a war effort, and there are strategic materials that are also important. The military security argument is often used by protectionists in many countries to justify support for all manner of industries from sugar to textiles. Most of the arguments are specious; even when the commodity is critical, there are other ways of achieving adequate security—by establishing stockpiles, for example.

Beyond defense, not many industries are really essential for security. While that may be the reality, it does not necessarily follow that Chinese military planners or the leadership in general see the issue that way. It is reasonable to assume that the strategic independence cum security issue will remain a powerful one in Chinese discussions of industry and trade policy. For the most part, it is an issue that weighs in on the side of trade restrictions, not further trade liberalization.

Conclusion

China's policies regarding international trade and investment are, therefore, an integral component of the way China's leaders approach the development of their economy and the maintenance of the nation's security. China is led by people who were educated to run a system based on central planning and who live in a country that has been threatened and even occupied for a time by one or more of the world's major powers going back a century and a half. China's willingness to participate in the international economic system is thus not based on deeply held beliefs about the benefits of liberal trading relationships rooted in a liberal society on the Western model. It is based on the calculation that China will be richer and more powerful if it does participate. If China is to continue to play increasingly by international rules, the benefits from doing so must be tangible in both the economic and security realms.

Trade, Security, and the Internationalization of Grand Strategy in Southeast Asia

Andrew MacIntyre

For some years now there has been intense debate over the significance of national strategy to the economic rise of East Asia. At the crux of the argument are theoretical disputes between mercantilist and liberal schools over the appropriate role of the state in promoting national economic welfare and security, as well as empirical disputes regarding the critical causal factors in the rapid economic growth of particular Asian countries. Initially focused on Japan and the first wave of Asian newly industrializing economies (NIEs), the debate has been broadened as extraordinary rates of sustained economic growth have come to prominence in other parts of East Asia.

This essay explores the experiences of a number of key Southeast Asian countries, focusing on their industrial and defense priorities and the extent to which these are integrated into broad overarching strategies for national advancement. The member countries of the Association of Southeast Asian Nations (ASEAN) are quite diverse. Rather than attempt to examine the trade and security orientations of all seven ASEAN countries—a rather laborious empirical exercise in contrasts—this essay will focus on the four most comparable of these countries: Indonesia, Thailand, Malaysia, and the Philippines. Economically, all four have swung in the last decade or so from relying on a strategy of import-substitution-based industrialization supported by natural resource exports to adopt much more outward-looking and export-driven patterns of industrial growth. On the defense front a comparable trend has emerged: defense planners in all four countries no longer focus so heavily on internal security issues and have begun to pay serious attention to the external security environment. Furthermore, although their political systems vary in design, all four countries suffer (in varying degrees) from comparable institutional weaknesses.

From being a region characterized by poverty and turmoil, Southeast Asia has emerged as an economically dynamic, politically stable, and diplomatically energetic region.

Following the U.S. withdrawal from Vietnam in the 1970s, Southeast Asia disappeared from American radar. With the partial exception of the fall of Ferdinand Marcos and the withdrawal of U.S. bases from the Philippines, developments in Southeast Asia have gone largely unnoticed here.

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And yet much that is of importance to the United States has been unfolding in the region over the past two decades. From being a region characterized by poverty and turmoil, Southeast Asia has emerged as an economically dynamic, politically stable, and diplomatically energetic region.

In exploring these themes, this essay is organized in four parts. The first looks at the relationship between national strategies, domestic political institutions, and the security environment. The second and third divide the recent history of Indonesia, Thailand, Malaysia, and the Philippines into two rough periods—the mid-1960s to the mid-1980s, and the mid-1980s to the present—for the purposes of highlighting the reorientation of their economic and defense policies. The final section offers some thoughts on the likely evolution of Southeast Asian national strategies over the next five to ten years.

National Strategies, Institutional Capabilities, and the Security Environment

National strategy (or, in the language of international relations, grand strategy) refers to the overall mix of economic and defense policies that shape the terms on which a country deals with the rest of the world. Quite apart from the theoretical debate about whether state activism and interventionism tend to promote national advantage, there is the more applied question of whether the institutional frameworks of all states (or even most states) are conducive to an activist and interventionist role. Understandably, given their system-wide focus, international relations theorists tend to pay relatively little attention to the institutional characteristics of states (the bread and butter of comparative politics theorists). But as the experiences of these Southeast Asian countries highlight, activist and interventionist national strategies are dependent upon the institutional capabilities of the state. Theodore Moran cleverly deflates much abstract argumentation when he points out that real-world experience in public administration:

> . . . is likely to pull would-be grand strategists in two conflicting directions on the issue of government intervention. On the one hand, it is axiomatic that anyone who has had to negotiate with the Japanese on market access for more than six months will feel the urge to advocate policies, no matter how unwise, that "show them a thing or two." On the other hand, anyone who has witnessed the mills of the U.S. government grind out economic policy (say, on antidumping) for more than six months will, I predict, begin to recommend the reading of Milton and Rose Friedman's *Free to Choose* to friends.[1]

Although perhaps not subject to the same degree of executive gridlock as the United States, the four Southeast Asian countries under examination here should not be thought of as possessing the super-bureaucracies of Japan and the first generation of NIEs (the so-called "tigers," South Korea, Taiwan, Singapore, and Hong Kong).[2] Three of them (Indonesia, Thailand, and Malaysia) have enjoyed sustained rapid economic growth for approximately three decades; the fourth (the Philippines) has begun to notch up quite impressive rates of economic growth in the last few years after being the laggard of the region for more than a decade. Not surprisingly in the context of widespread rapid economic growth in East Asia, the economic trajectories of these countries have been compared and linked with those of Japan and the first generation of Asian NIEs. However, closer examination reveals key differences in the overall national strategies between this new generation of industrializing countries and Japan and the first generation of NIEs.

I do not wish to suggest that the experiences and strategies of Malaysia, Indonesia, Thailand, and the Philippines have been completely different from those of Japan and the earlier NIEs, for

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[1] Theodore Moran, "Grand Strategy: The Pursuit of Power and the Pursuit of Plenty," *International Organization*, vol. 50, no. 1 (1996), p. 196.

[2] Andrew MacIntyre, "Business, Government and Development: Northeast and Southeast Asian Comparisons," in Andrew MacIntyre, ed., *Business and Government in Industrialising Asia*, Ithaca, NY: Cornell University Press, 1994.

there have indeed been some important similarities. As the World Bank in particular has emphasized, in all of these countries the core elements of macroeconomic policy have been generally sound (reasonably stable exchange rate management without a heavy anti-export bias, reasonable levels of inflation, good savings records, and reasonable fiscal behavior), and there has been generally strong investment in education and human resource development.[3]

In short, interventionist trade and industrial policies have been a significant component of national economic strategy in Southeast Asia. Nonetheless, it would be a serious—if common—mistake to conclude that these countries are somehow following in the footsteps of Japan, South Korea, Singapore, or Taiwan by adopting carefully planned and implemented industrial master plans for national advancement.

It is also certainly the case that these four countries have adopted markedly more interventionist trade and industrial policies than the United States. All have employed various tools and strategies, including detailed national economic planning; tariff and nontariff trade barriers; fiscal incentives; investment restrictions; and state-owned enterprises.[4] In short, interventionist trade and industrial policies have been a significant component of national economic strategy in Southeast Asia. Nonetheless, it would be a serious—if common—mistake to conclude that these countries are somehow following in the footsteps of Japan, South Korea, Singapore, or Taiwan by adopting carefully planned and implemented industrial master plans for national advancement. Put simply, the patterns of intervention in these Southeast Asian countries have been markedly different from those of Japan and the first NIEs.[5]

The key differences may be summarized as follows:

- The vastly greater natural resource endowments of Thailand, Malaysia, Indonesia, and the Philippines have had important implications for trade and industrial policy. The luxury of easy foreign exchange earnings from natural resource exports enabled import-substitution arrangements to continue for much longer. Moreover, the two countries that happened to have major resource booms—oil exporters Indonesia and Malaysia—enjoyed fiscal bonanzas that enabled them to invest even more heavily in the public sector and subsidize sundry private-sector activities.
- The nature of trade and industrial policies has been quite different than those of Japan, South Korea, Taiwan, or Singapore. In the four Southeast Asian countries, protection and subsidies have generally not been counterbalanced by fierce competition in local markets or the enforcement of performance criteria. There has

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

[4] Mohamed Ariff and Hal Hill, "Industrial Policies and Performance in ASEAN's 'Big Four'," in Hiromichi Muto, et al., eds., *Industrial Policies for Pacific Economic Growth*, Sydney, Australia: Allen and Unwin, 1986.

[5] Chalmers Johnson, Laura D. Tyson, and John Zysman, *The Real Story of Why Japan Works*, Cambridge, MA: Ballinger, 1989; Richard Samuels, *"Rich Nation, Strong Army": National Strategy and the Technological Transformation of Japan*, Ithaca, NY: Cornell University Press, 1994; Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries*, Ithaca, NY: Cornell University Press, 1990; Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, New York: Oxford University Press, 1990; and Garry Rodan, *The Political Economy of Singapore's Industrialisation: National State and International Capital*, London: MacMillan, 1989.

been little effort to ensure that subsidies were used in a productive fashion consistent with national objectives. To use Alice Amsden's useful terminology, subsidies have been allocated on a "giveaway" rather than "reciprocity" basis.[6]

- The principal reason for the "giveaway" character of subsidies in Southeast Asia has been the institutional weakness, or poor bureaucratic capacity, of the state. Simply put, bureaucratic agencies have generally been less technocratic and meritocratic, less well-coordinated, less well-insulated from diversionary political pressures, and much more prone to capture and corruption.[7]
- The prevailing security environment of the four Southeast Asian nations has been quite different. Meredith Woo-Cummings has made the compelling argument that the highly threatening security environment faced by South Korea imposed strong discipline on the polity—providing a powerful incentive to establish effective state institutions, relatively free from diversionary pressures.[8] Borrowing from Woo-Cummings, Jeffrey Winters has suggested that the opposite was the case for Indonesia; that is, the absence of a seriously threatening security environment reduced the incentive for Indonesian leaders to run a tight administrative ship.[9] It seems evident that Taiwan and Singapore were in situations comparable to that of South Korea, whereas Thailand, Malaysia, and the Philippines, like Indonesia, faced no powerful external security threat from the late 1960s onwards.
- Consistent with these institutional limitations and the comparatively unthreatening external security environment, there has been relatively little effort to coordinate the economic and defense arms of national strategy in the four Southeast Asian countries. The institutional mechanisms to do so in any practical sense have either not existed or been very weak. While these countries have developed quite detailed national plans, the plans typically have been very poor predictors of outcomes, and often have been accorded little serious attention after publication.

The Early Years: Domestic Priorities

During the first two decades of ASEAN's existence—roughly the mid-1960s to the mid-1980s—the national strategies of Thailand, Indonesia, the Philippines, and Malaysia were for the most part inwardly oriented. Both economic and defense policies were focused on domestic priorities.

Protected Industrial Development

Agriculture dominated all four economies in the early years. Cushioned by strong natural resource exports, the priority of governments during this period was to support the development of new national industrial capabilities in order to raise living standards and promote na-

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[6] Alice Amsden, *"Post-Industrial" Policy in East Asia*, Asia Project Working Paper, Council on Foreign Relations, New York, 1995, p. 32. Interestingly, Amsden argues that trade and industrial policy initiatives in Southeast Asia *have* been quite comparable with those of South Korea. In my view, her argument rests on a very uncertain evidentiary basis. See also A. Amsden, *Structural Macroeconomic Underpinnings of Effective Industrial Policy: Fast Growth in the 1980s in Five Asian Countries*, Discussion Papers, United Nations Conference on Trade and Development, Geneva, 1993.

[7] Andrew MacIntyre, "The Politics of Finance in Indonesia: Command, Confusion and Competition," in Stephan Haggard, Chung Lee, and Sylvia Maxfield, eds., *The Politics of Finance in Developing Countries*, Ithaca, NY: Cornell University Press, 1993; Andrew MacIntyre, "Business, Government, and Development," *op. cit.*; and Donald Crone, "ASEAN Industrial Policies," in Gunnar Sletmo and Gavin Boyd, eds., *Industrial Policies in the Pacific*, Boulder, CO: Westview Press, 1994.

[8] Meredith Woo-Cummings, *Race to the Swift: State and Finance in Korean Industrialization*, New York: Columbia University Press, 1991.

[9] Jeffrey Winters, *Indonesian Development: A Missed Opportunity*, unpublished paper, 1994.

tional stability. There was not much attention to questions of international competitiveness, since the domestic challenges of poverty reduction and basic industrialization were more elementary. As might be expected, import-substitution was an important element in the trade and industrial policy frameworks of these countries.

The Philippines had one of the most inward-looking economies in Southeast Asia during this period. At the end of the 1970s the manufacturing sector enjoyed the highest rate of nominal protection in ASEAN.[10] However, rather than reflecting any considered economic logic on the part of state planners, the pattern of industrial protection and assistance in the Philippines was overwhelmingly a function of cronyism and corruption. For instance, preferential lending by the central bank was systematically plundered under a pattern of business-government relations that has been given the evocative term "booty capitalism."[11] Although government intervention was extensive in the Philippines, it typically reflected the monopolistic preferences of politically well-connected business groups rather than those of government planners seeking to pursue a national industrial master plan.

The story in Thailand was somewhat different. Although by no means an exemplar of laissez-faire economics, by comparison with many other developing countries (and certainly by comparison with Japan or South Korea at corresponding stages of development) the extent of state involvement in resource allocation has been modest. The Thai economy has long been fairly open to foreign investors. Direct state intervention through state ownership has been limited mostly to public utilities and a number of state enterprises used by the military as sources of easy revenue. Tariff barriers have been extensive but not particularly high, and there has been little use of preferential credit to target specific industries. Although the problems of cronyism and corruption during this period were apparently not as extreme as in the Philippines, it was generally the case that trade and industrial policy initiatives were subject to extensive manipulation by industry groups.[12] As with the Philippines, it is difficult to portray Thailand as determinedly pursuing an activist national strategy for industrialization that bears close comparison with the experiences of Japan or the Asian NIEs.

The two countries in our sample that bear the most resemblance to Japan and the earlier NIEs are Indonesia and Malaysia. During the 1970s and early 1980s they both pursued intensive state-led drives to develop heavy industries and more advanced technological capabilities. Of the two, Indonesia has without question featured far more extensive state intervention in the marketplace and has a lengthy history of economic nationalism. Heavy use of tariff and nontariff barriers, restrictions on foreign investment, the injection of very large amounts of capital into state enterprises, and directed preferential lending from a state-dominated banking sector are among the instruments that have been used to support a drive to heavy and strategic industries (such as steel and petrochemicals) in the 1970s and aircraft building in the 1980s and 1990s.[13]

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[10] Sisira Jayasuriya, "Structural Adjustment and Economic Performance in the Philippines," in Andrew MacIntyre and Sisira Jayasuriya, eds., *The Dynamics of Economic Policy Reform in South-East Asia and the South-West Pacific*, Singapore: Oxford University Press, 1992.

[11] Paul Hutchcroft, "Selective Squander: The Politics of Preferential Credit Allocation in the Philippines," in Stephan Haggard, Chung Lee, and Sylvia Maxfield, eds., *The Politics of Finance in Developing Countries*, Ithaca, NY: Cornell University Press, 1993; and "Booty Capitalism: Business-Government Relations in the Philippines," in Andrew MacIntyre, ed., *Business and Government in Industrialising Asia*, Ithaca, NY: Cornell University Press, 1994.

[12] Peter Warr, ed., *The Thai Economy in Transition*, Melbourne, Australia: Cambridge University Press, 1993; Robert Muscat, *The Fifth Tiger: A Study of Thai Development Policy*, Armonk, NY: M.E. Sharpe, 1994; Daniel Unger, *Japan, the Overseas Chinese, and Industrialization in Thailand*, Berkeley, CA: University of California, 1989; Richard Doner and Anek Laothamatas, "Thailand: Economic and Political Gradualism," in Stephan Haggard and S. Webb, eds., *Voting for Reform: Democracy, Political Liberalization, and Economic Adjustment*, New York: Oxford University Press, 1994; and Mohamed Ariff and Hal Hill, *op. cit.*

[13] Hal Hill, *The Indonesian Economy Since 1966: Southeast Asia's Emerging Giant*, Melbourne, Australia: Cambridge University Press, 1996.

In Indonesia, the so-called strategic industries have been beset with deep and chronic fiscal problems, have shown little sign of producing goods that will be competitive on world markets, and have generated few appreciable spinoff advantages. . . . In Malaysia too the drive to develop strategic industries has been beset with major problems.

Malaysia generally has had less interventionist trade and industrial policies than Indonesia (trade barriers have been markedly fewer, lower, and more often have taken the form of tariffs; and the attitude toward foreign investment has been much more welcoming). However, in the 1980s it also pursued a determined heavy industry drive under the auspices of the state-owned Heavy Industry Corporation, which entered into joint ventures with foreign investors in industries such as automobiles, steel, and cement.[14] Not only did Malaysia look to Northeast Asia for capital and technology in this heavy industry drive, the government explicitly pursued a strategy based on South Korean experiences.

While both Indonesia and Malaysia pursued vigorous industrial policies, in neither case have the results been particularly impressive. In Indonesia, the so-called strategic industries have been beset with deep and chronic fiscal problems, have shown little sign of producing goods that will be competitive on world markets, and have generated few appreciable spinoff advantages.[15] Furthermore, there has been little sign of serious coordination between defense-related industries and the armed forces. Indeed, military leaders have generally been quite critical of requirements that they accept the output of these industries.[16] In Malaysia too the drive to develop strategic industries has been beset with major problems. In the face of massive debt, inefficiency, and corruption, the Malaysian government in the late 1980s reconsidered its interventionist policies and undertook a major restructuring program of these industries, including considerable privatization.[17]

Internal Security Preoccupations

Turning from economic priorities to defense, it was quite clear until the mid-1980s that the principal security concerns of Indonesia, Malaysia, Thailand, and the Philippines were fundamentally domestic in nature: insurgencies, ethnic divisions, secessionist movements, and gen-

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[14] K.S. Jomo, ed., *Industrialising Malaysia: Policy, Performance, Prospects*, London: Routledge, 1993; Alisdair Bowie, "The Dynamics of Business-Government Relations in Industrialising Malaysia," in Andrew MacIntyre, ed., *Business and Government in Industrialising Asia*, Ithaca, NY: Cornell University Press, 1994; and Mohamed Ariff and Hal Hill, *op. cit.*

[15] Hal Hill, *Southeast Asian Economic Development: An Analytical Survey*, Canberra: Economics Division Working Papers, Research School of Pacific Studies, Australian National University, 1993; and David McKendrick, "Obstacles to 'Catch Up': The Case of the Indonesian Aircraft Industry," *Bulletin of Indonesian Economic Studies*, vol. 28, no. 1 (1992), pp. 39–66.

[16] A number of explanations for the military's hostility to these industries suggest themselves: military irritation at being compelled to purchase inferior equipment, military irritation at the loss of opportunity for significant kickbacks from the international arms suppliers, or political irritation with the champion of these industries, Technology Minister B.J. Habibie.

[17] Alisdair Bowie, *op. cit.* There are two outstanding reasons why Malaysia and Indonesia had more activist trade and industrial policies than Thailand or the Philippines: the politics of ethnicity, and the fiscal bonanza created by the oil boom of the 1970s and early 1980s. Governments in both countries have been acutely conscious of the political resentment of the majority indigenous population toward the dominance in the modern sector of the economy by people of Chinese descent. This ethnic sensitivity has been a source of underlying political tension in both countries. In addition to any economic arguments about the importance of developing national industrial and technological capabilities, the idea of a state-led heavy industrialization strategy had strong political appeal as state-ownership was equated with a reduction in the economic dominance of Chinese-owned firms. If ethnic sensitivities created a demand for interventionist industrial policies, the boom in oil prices during the 1970s and early 1980s brought enormous windfall gains to Malaysia and particularly Indonesia—thus enabling the investment of large sums in the state enterprise sector.

eral political instability. It is scarcely surprising that the focus of defense planning was domestic—these countries were wrestling with very real problems of nation-building and poverty. National security was seen as dependent on political cohesion and stability, which, in turn, depended crucially on sustained economic development. To use the language of Indonesian defense doctrine (which was subsequently loosely adopted for all of ASEAN), national security depended upon national resilience.

This focus on internal security was reflected in the organizational structures of the armed forces, weapons procurement priorities, and ultimately the political standing of the various bureaucratic agencies (i.e., the importance of domestic intelligence agencies). With this heavy domestic orientation, relatively little attention was paid to external security threats or, correspondingly, the building of multilateral security arrangements in the region. Indeed, ASEAN as an institution studiously avoided doing anything of real significance in the area of security cooperation. Proposals for the establishment of a Southeast Asian Nuclear Weapons-Free Zone were floated but never pursued with any determination. The other key factor in the failure of ASEAN countries to pursue actively multilateral security cooperation was that there remained very real, if unstated, mutual suspicions and rivalries among members. The one striking case where ASEAN countries did cooperate in a significant way on an external security issue was the effort to help broker a settlement to the Cambodia conflict.[18]

Internationalizing Grand Strategy

Over the course of the last ten years or so, and particularly during the 1990s, the well-established pattern of domestically focused national strategies has begun to change. Moreover, to the surprise of many people, the change has been quite rapid. Put simply, on both the economic and security fronts these four countries—and ASEAN as a whole—have become markedly more outward in orientation. Loose as they are, the national strategies of all four countries have shifted away from their previous domestic preoccupations to engage the wider regional and global environments. Accompanying this shift in orientation has been the emergence of a much more enthusiastic approach toward multilateral economic and security cooperation. Although diverse forces lie behind the reorientation of policy in these countries, the changes in economic and security strategies have been interactive and on the whole mutually reinforcing.

Economic Liberalization

On the economic front, the changes have been quite dramatic. Malaysia, the Philippines, Thailand, and Indonesia each underwent a period of serious economic downturn or even crisis and emerged with increasingly liberal and outward-looking economic strategies. All four countries have shifted to export-oriented industrialization strategies.[19] The precise sequence and speed of the policy reorientation varied, reflecting differing economic circumstances and political institutions, but all were gripped by serious balance-of-payments problems stemming from the collapse of international commodity prices. As the value of commodity exports fell, governments sought to service mounting debt levels by encouraging manufactured exports as alternative sources of foreign exchange. This entailed reducing trade barriers that protected industrial inputs needed for new export sectors and, because of severe fiscal constraints, winding back previously generous subsidies channeled to protected industries. Protectionism was certainly not abandoned altogether—a range of capital-intensive industries (such as automobiles, steel, petro-

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[18] For useful overviews of ASEAN's early development, see Alison Broinowski, ed., *Understanding ASEAN*, London: MacMillan, 1982; and Michael Leifer, *ASEAN and the Security of South-East Asia*, London: Routledge, 1989.

[19] For details, see David Timberman, ed., *The Politics of Economic Reform in Southeast Asia*, Manila, Philippines: Asian Institute of Management, 1992; Andrew MacIntyre and Kanishka Jayasuriya, *op. cit.*; and Hal Hill, *Southeast Asian Economic Development, op. cit.*

chemicals, and aircraft) together with a number of lucrative markets controlled by the politically well-connected continue to enjoy major assistance. Nonetheless, industries such as textiles, footwear, consumer electronics, and agricultural processing, which have lost both protection and subsidies, have thrived in the more open policy environment and emerged as the star export performers of the late 1980s and 1990s.

In sum, the swing to export-led industrialization in these Southeast Asian countries has been accompanied by the "strategic retreat" of the state.[20] Nationalist economic sentiments have certainly not been abandoned—particularly in Malaysia and Indonesia—but there is fairly widespread recognition that industrial targeting has generally produced disappointing results.

. . . as these [Southeast Asian] countries have internationalized their economies it has become increasingly important to them that global economic conditions remain stable and conducive to the reasonably free movement of goods and capital.

The changes unleashed by these reforms have in turn had ramifications for trade diplomacy. The liberal economic reforms in Thailand, Malaysia, Indonesia and, most recently, the Philippines have resulted in a rapid influx of foreign goods and capital. Along with renewed economic growth, driven by the success of the new export industries, has come an increased dependence on access to foreign markets in the industrial economies (especially the United States) and an increased dependence on foreign capital and technology (especially from Japan) to fuel further growth. Consequently, the possibilities of reduced access to the massive U.S. market for consumer exports and reduced investment inflows from Japan (as China and other lower-labor-cost economies compete for capital inflows) have become something to be feared. In other words, as these countries have internationalized their economies it has become increasingly important to them that global economic conditions remain stable and conducive to the reasonably free movement of goods and capital. More specifically, they have acquired a large and direct interest in the outcome of negotiations under the General Agreement on Tariffs and Trade (GATT) and its successor organization, the World Trade Organization (WTO).

Beyond a general interest in seeing global trade and investment regimes become more open, the ASEAN countries have also acquired a particular interest in minimizing bilateral trade tensions that might threaten their access to the U.S. market. All of these countries have been involved in bilateral trade disputes with the United States on specific issues such as market access and intellectual property rights.[21] Although acceding to U.S. demands has rankled officials, preserving the flow of exports to North America has become of vital strategic importance. Similarly, the ASEAN countries have acquired a direct interest in ensuring that bilateral disputes between the United States and Japan not disrupt the wider web of economic relationships spanning the Pacific.

The emergence of these new foreign economic policy priorities for Malaysia, Thailand, Indonesia, and the Philippines has led to a sudden upsurge of interest in multilateral forums for international economic cooperation. All four countries have become members of the GATT, but recognizing their lack of impact in that forum—both individually and as the ASEAN collec-

[20] Andrew MacIntyre, "Business, Government and Development," *op. cit.*

[21] United States Trade Representative, *1994 National Trade Estimate Report on Foreign Trade Barriers*, Washington, DC, 1994; and *1995 National Trade Estimate Report on Foreign Trade Barriers*, Washington, DC, 1995.

tive—they have looked for other multilateral groupings that could be employed to influence GATT negotiations. A number of new such opportunities emerged in the late 1980s and early 1990s. The first was the Cairns Group—an informal group of industrializing and industrialized countries launched by Australia in 1986 to advance the interests of agricultural producers in GATT negotiations. Indonesia, Malaysia, Thailand, and the Philippines all joined the Cairns Group and became active supporters of its programs. A much more contentious undertaking began in 1989 when, with some hesitation, they joined with nine other industrialized and industrializing countries around the Pacific Rim to launch the Asia-Pacific Economic Cooperation (APEC) forum.

Motives for joining APEC and supporting its development varied, but common to all four of these ASEAN countries were the hopes that APEC would help bring pressure to bear on the Europeans in GATT deliberations, help "manage" the increasingly difficult bilateral economic relationship between the United States and Japan by bringing them together in a reform-oriented regional grouping, and provide ASEAN with a forum for more effectively asserting its foreign economic interests.

Precisely because ASEAN was the only regional association in the Pacific, Southeast Asian countries have enjoyed an enhanced bargaining position in APEC deliberations. For instance, Southeast Asian concerns that APEC might become a strict rules-based organization dominated by the advanced industrial economies were reflected strongly in the original agreement reached in Canberra in 1989 and were codified in early 1990 with the adoption of a formal ASEAN policy document, the so-called Kuching Consensus.[22]

The principal concern these countries have had about APEC is that it might overshadow ASEAN, and that the interests of Japan and particularly the United States would predominate. While these concerns were shared to some degree by all ASEAN states, it is clear that Malaysia had much deeper reservations about APEC than the others. The 1990 proposal of Prime Minister Mahathir Mohamed of Malaysia for an "Asians-only" economic grouping generated considerable controversy. Much attention has been given to Washington's hostility and Japan's unenthusiastic response to the idea. Less well-noted was Indonesia's unusually blunt and public rejection of an Asians-only forum in 1990, together with the opposition of Singapore. The compromise ultimately brokered within ASEAN provided for a much diluted form of Mahathir's original idea, wherein an East Asian Economic Caucus (EAEC) was established as a discussion forum for Asian economies *within* APEC.

But it would be a mistake to conclude that Dr. Mahathir's proposal enjoyed little support in Southeast Asia (and East Asia more generally), or that the idea of an Asian-based grouping has disappeared. Perhaps the clearest evidence that the ASEAN countries' commitment to APEC is not exclusive and that they are now willing to explore vigorously all multilateral options as part of their national economic strategies is provided by the inaugural Asia-Europe Meeting (ASEM) in Bangkok in March 1996.[23] Expectations for the meeting were low, but it in fact produced a surprisingly full agenda for action, including coordination in the lead-up to WTO negotiations, negotiation on the reduction of bilateral trade and investment barriers, and various initiatives for interregional economic and security cooperation.[24] While there appears to be little potential for ASEM to become a coherent economic grouping—not least because it lacks any geographical logic—it does seem to have a clear strategic purpose: to put pressure on the United States in international trade negotiations and, from the point of view of most East Asian countries, to signal their unwillingness to sit

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[22] *Joint Statement of ASEAN Foreign and Economic Ministers*, Kuching, Malaysia: February 1990. The Kuching Consensus called for a very loose organizational framework for APEC and consensus-style government for the forum.

[23] The ASEM meeting was organized by ASEAN. In addition to the ASEAN countries, it brought together the other major East Asian countries (Japan, China, and South Korea) and the members of the European Union.

[24] Jusuf Wanandi, "Continuity of ASEM Assured," *Jakarta Post*, March 8, 1996, p. 4.

passively as Washington targets them individually on bilateral trade disputes. Viewed from this perspective, ASEM brings Dr. Mahathir's vision of an East Asian grouping a step closer.

The final front on which these four Southeast Asian countries have been pursuing foreign economic policy goals on a multilateral basis has been within ASEAN itself. In 1992 ASEAN leaders agreed on the establishment of an ASEAN Free Trade Area (AFTA) built around a common effective preferential tariff system which would lower tariffs on most manufactured goods and processed agricultural products below five percent within fifteen years (subsequently shortened to ten years). Compared with ASEAN's record of economic cooperation in the preceding two decades, the creation of AFTA was a truly remarkable achievement. Nonetheless AFTA is likely to be of only modest economic significance. Not only is it weakened by a range of exemptions to certain industries, but the whole initiative runs the risk of being overtaken by wider international developments. Indeed, the principal reason for shortening the timetable for implementation from fifteen to ten years was that ASEAN countries would have been implementing most of the trade reforms sooner under their GATT obligations. Perhaps the most significant economic benefit likely to flow from the establishment of AFTA is the increased attractiveness of Southeast Asia to foreign investors by offering them easy access to all ASEAN economies (a market of over 400 million consumers).

Paralleling this more outward-looking and multilateral approach to industrial development has been a comparable reorientation of security strategies by these four countries. A range of domestic and international changes have caused these Southeast Asian countries to take a much keener interest in their external security environments. . . .

The Regionalization of Security

Paralleling this more outward-looking and multilateral approach to industrial development has been a comparable reorientation of security strategies by these four countries. A range of domestic and international changes have caused these Southeast Asian countries to take a much keener interest in their external security environments, both on the basis of increasing cooperation among themselves and especially in conjunction with other countries in the wider Asia-Pacific region.

A number of factors have been at work here. Perhaps the most fundamental is that a quarter of a century of sustained rapid economic growth (at least in the cases of Indonesia, Malaysia, and Thailand) has wrought major social and political changes domestically. A sizable new middle class and urban working class have been created, poverty has been dramatically reduced, and income distribution has been equitable in comparison with most other developing countries. While many problems remain, it is clear that nation-building concerns are no longer as pressing as they previously were. Dissident (and in some cases secessionist) groups are still active, but the likelihood of any of these countries again experiencing the fundamental upheavals of past decades seems low.[25] As a consequence, security planners are now more able to adjust their sights from purely domestic problems and contemplate external challenges to national security.

[25] For a useful overview of the range of internal security challenges confronting these countries, see Amitav Acharya, *A New Regional Order in South-East Asia: ASEAN in the Post-Cold War Era,* London: Adelphi Papers, International Institute for Strategic Studies, 1993.

The second critical factor has been the changing nature of the regional and global security environment. The old East-West international cleavages of the Cold War have been replaced by a much less certain environment.[26] There are real doubts in the minds of most Southeast Asian defense planners about the depth and value of the U.S. military commitment to the security of the region. The conclusion drawn by many observers in Southeast Asia in the wake of the Gulf War was that although the United States did indeed maintain very lethal force projection capabilities, a number of conditions would need to be met before Washington would commit itself to decisive intervention. Among these were that military action serve some fundamental U.S. interest, that it be supported by the president and both houses of Congress, that it enjoy at least the tacit consent of the major powers, that the prospects for victory be very good, and that the costs of such action could be defrayed by other countries. Some would say that the peacekeeping exercise in Somalia added a further condition: that there be no grim casualties captured on television.

Coupled with these concerns about the willingness and ability of U.S. leaders to commit to decisive military intervention is the reemergence of China as the proximate great power in Asia. This is clearly the fundamental international challenge with which Southeast Asian defense planners are attempting to grapple. Important territorial disputes with China in the South China Sea provide an immediate focus for these concerns, but the underlying issue is how to deal with an economically resurgent and self-confident China that is once again beginning to take an interest in issues outside its borders commensurate with its size and resources. In this regard, there can be little doubt that one of the attractions of admitting Vietnam to ASEAN was the acquisition of a strongly armed buffer state on China's doorstep.

If the easing of the problems of nation-building has permitted a wider security focus and the changed regional security environment has demanded it, a third factor at work has been the new-found wealth of these Southeast Asian countries. Larger budgets have enabled governments in the region to upgrade their military capabilities.[27] This enhanced military purchasing power, together with the changes in their strategic circumstances, has led these countries to adjust their force structure and to purchase weapons systems that afford greater air and maritime force projection capabilities. For example, ASEAN countries are acquiring combat aircraft, submarines, missiles, and guidance systems.

Paralleling the shifts in their economic strategies, the changes in the defense priorities of these four countries have led them to take a much keener interest in multilateral collaboration within ASEAN itself and, more importantly, with other countries in the region. This has been manifested in several ways. First, although still very modest, the level of defense cooperation among various subsets of the ASEAN membership is increasing.[28] And, after more than a decade of weak and intermittent discussion, the decision was made to establish a Southeast Asian Nuclear Weapons-Free Zone at the ASEAN summit in Bangkok in December 1995. This was in spite of public opposition from the United States and China.

Without doubt, however, the most notable initiative to date has been the creation in 1994 of the ASEAN Regional Forum (ARF), an ASEAN-centered framework for dialogue on security

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[26] As Roger Uren rightly points out though, the impact of the collapse of the Soviet Union should not be exaggerated, as important changes in the East Asian security environment were already under way well before the Cold War ended. Roger Uren, "The Changing Role of External Powers in Southeast Asia," *Australian Journal of International Affairs*, vol. 47, no. 2 (1993), p. 279.

[27] Desmond Ball, "Arms and Affluence—Arms Acquisitions in Southeast Asia," *International Security*, vol. 78, no. 3 (1994), pp. 78–112; and Amitav Acharya, *An Arms Race in Post-Cold War Southeast Asia? Prospects for Control*, Pacific Strategic Papers, Institute for Southeast Asian Studies, Singapore, 1994.

[28] For details, see Amitav Acharya, *A New Regional Order in Southeast Asia, op. cit.*, pp. 53–73.

issues linking most countries in the Asia-Pacific region.[29] Some analysts have been quick to focus on the lack of tangible outcomes from these exercises in multilateral security cooperation. But these skeptics miss three important points. The first is that the very act of establishing the ARF is itself quite remarkable given the long history of inaction and empty rhetoric in Southeast Asia about security cooperation. Secondly, the value of these initiatives as confidence-building measures should not be discounted. Given that the Asia-Pacific region has no history of region-wide dialogue on security issues, any move to promote information exchange and transparency must be welcomed.[30] And finally, from a Southeast Asian viewpoint, even more so than APEC, the ARF has enabled ASEAN to secure a surprising measure of prominence and influence in Pacific affairs. Far from being overshadowed in a larger grouping, ASEAN has (thus far) secured control over the agenda and activities of the ARF—so much so that it has reportedly generated consternation in Washington.[31]

Conclusion: National Strategies and National Futures

If the last decade has seen a reorientation of the economic and defense arms of national strategy in Indonesia, the Philippines, Malaysia, and Thailand, what do the next five to ten years hold? Specifically, are the new, more outward-looking orientations of these countries likely to remain in place? Among the wide range of conceivable challenges confronting these four countries over the next decade, two in particular stand out.

One challenge will be to maintain the impressive rates of economic growth. While there is widespread optimism about Southeast Asia's economic future among most commentators, in my view considerable caution is merited. Perhaps the single most important factor governing future economic performance will be the ability of these governments to maintain an appropriately tuned combination of growth-oriented economic policies. But as emphasized at the outset, this depends heavily on the institutional foundations of the machinery of government, and in these countries the foundations are weak. Indeed, it was only the balance-of-payments crisis that forced them all to begin to revise the cozy market-restricting arrangements enjoyed by the well-connected and which stood in the way of the development of industries capable of competing in world markets. The specific policy challenges these countries face in seeking to foster rapid economic development are clear: overcoming acute infrastructural bottlenecks, strengthening the domestic savings base, winding back crony-driven restrictive market arrangements (especially in export-related industries), upgrading technological capabilities and worker skills (so that they are not trapped in low-wage and low-value-added industries), and invigorating state enterprises.

Listing the problems is not hard: the real issue is the ability of these governments to tackle such problems effectively. Certainly there will be international pressures (the complaints of foreign investors and obligations under the WTO, AFTA, and perhaps APEC) as well as domestic pressures (principally from industry groups that do have to operate in competitive markets), but whether the institutional frameworks of these countries will be able to deliver the needed outcomes remains an open question. I am not suggesting that institutional arrangements are uniformly weak—the Philippines, for instance, seems to have greater problems than Malaysia.

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[29] The ARF is not an entirely new structure, as it was built upon the framework of the earlier ASEAN Post-Ministerial Conference. Nonetheless, it represents a major expansion and upgrading of the region's commitment to institutionalizing multilateral structures for security cooperation. The members of the ASEAN Regional Forum are the members of ASEAN itself (Indonesia, Malaysia, Singapore, Thailand, the Philippines, Brunei, and Vietnam) along with the United States, Japan, Australia, New Zealand, the Republic of Korea, Canada, the European Union, Cambodia, India, Burma (Myanmar), Russia, China, Laos, and Papua New Guinea.

[30] Desmond Ball, "A New Era in Confidence Building: The Second-Track Process in the Asia / Pacific Region," *Security Dialogue*, vol. 25, no. 2 (1994), pp. 157–176.

[31] *Far Eastern Economic Review*, March 14, 1996, p. 12.

Rather, by contrast with Japan and the first generation of Asian NIEs, all four countries appear to have markedly lower institutional capabilities. Further, economic catastrophe is not imminent. However, there are real questions about the ability of these countries to sustain growth rates of six to eight percent, as distinct from three to four percent.

Southeast Asian concerns focus on the reemergence of China and uncertainty about Washington's commitments to Asian security. In response to the changing security environment, a growing consensus in both scholarly and policy circles has emerged that multilateral cooperation is the most promising approach for promoting security and stability in the Asia-Pacific region.

The second fundamental challenge for national strategy in these countries concerns the regional security environment. Southeast Asian concerns focus on the reemergence of China and uncertainty about Washington's commitments to Asian security. In response to the changing security environment, a growing consensus in both scholarly and policy circles has emerged that multilateral cooperation is the most promising approach for promoting security and stability in the Asia-Pacific region.

While this is of some encouragement, it is unclear whether the multilateral architecture for security cooperation which Southeast Asian countries are striving to put in place will be adequate for the task assigned for it. For instance, while the ARF's contribution to regional confidence-building is real and important (rather like increasing transparency in trade and industrial policy instruments) it is far from clear that the forum will be able to move much beyond confidence building to deal with more substantive forms of security cooperation. In short, building confidence is relatively simple compared to the more difficult task of diffusing disputes.

For the foreseeable future the general approach that the Southeast Asian countries are likely to pursue will be built around several components. First, they will endeavor to increase bilateral defense cooperation among some, if not all, ASEAN members, as well as with others in the immediate region (e.g., the remarkable security agreement signed between Indonesia and Australia in 1995). Second, they will seek to bolster the ARF (as they have done, for example, by bringing in other members such as Burma, Laos, Cambodia, and, very significantly, India). Third, they will continue to urge the United States to remain engaged in Asian security. Finally, without saying as much, they will become more accommodating of China's security goals in Asia.

U.S. Trade Policy and the Public Discourse: A Postscript

Geza Feketekuty

Since World War II, the United States has pursued a trade policy focused on the worldwide reduction of barriers to trade and investment within a framework of global, market-oriented, and enforceable rules. This policy not only aided the growth of the U.S. economy and American consumer welfare, but also advanced U.S. foreign policy and security interests by encouraging peace based on prosperity. Until recently, this policy had broad public support: it was perceived to be in the national interest.

. . . a significant sector of the American public has begun to question the accomplishments and wisdom of postwar American trade policies, and there is growing concern that the United States has not equipped itself with the policy tools needed to remedy the injurious effects of foreign industrial policies on the growth and development of key U.S. industries.

Since the end of the Cold War, however, the emphasis on building peace through prosperity has become less compelling. Americans face increasingly fierce global economic competition, both "fair" and "unfair." At the same time, they are less willing to overlook apparently inequitable policies on the part of trading partners. In the post-Cold War era, peace seems assured: national prosperity and individual economic security do not. As a result, a significant sector of the American public has begun to question the accomplishments and wisdom of postwar American trade policies, and there is growing concern that the United States has not equipped itself with the policy tools needed to remedy the injurious effects of foreign industrial policies on the growth and development of key U.S. industries.

Much of the current concern involves conspicuous trade disputes with the countries of East Asia. The Japanese market is difficult to penetrate, leading to accusations of discrimination against foreign products. Chinese exports, made by low-paid workers and occasionally prison labor, com-

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pete with American products; and Chinese factories illegally reproduce products developed by America's leading entertainment and software companies. Throughout Asia, governments support export-oriented industries to a greater degree than in the United States. These methods include preferential access to credit, authorization for foreign currency transactions, assistance with research and development, and protection of the local market to increase the local price, thereby subsidizing export sales. Of course, the perceived sources of threat to American economic security lie not only in East Asia. In various parts of the country, Canadian softwood, Mexican immigrants, Indian textiles, and European airplanes also contribute to the public's sense of anxiety.

The United States must undertake a critical and comprehensive review of its trade policies, not only because it needs to chart new strategic objectives after having completed major negotiations such as the North American Free Trade Agreement (NAFTA) and the Uruguay Round of negotiations of the General Agreement on Tariffs and Trade (GATT), but also because the American public is no longer sure that U.S. trade policy adequately serves the national interest.

The Post-War Trading System

The architects of the post-World War II trading system were very much aware of the potential for national economic rivalries to create conflict. Indeed, an overriding consideration in establishing the postwar economic institutions was to reduce the potential for armed conflict among nations—conflict that could arise from friction over preferential access to markets and economic spheres of influence.

The GATT was a key component of this postwar system. It established basic rules of the game whereby countries made mutual reductions in barriers to trade. The rules were very cleverly designed. They encouraged global trade liberalization not only by creating the basis for multilateral negotiations, but also by ensuring that the world trading system would benefit from bilateral bargaining. The GATT encouraged the bilateral negotiation of trade agreements whereby each country sought to reduce foreign barriers to its exports by agreeing to cut some of its own barriers and then, by way of the most-favored-nation principle, assured that the global trading system would benefit from these bilateral bargains. GATT members were required to extend the benefits of bilateral bargains to all other GATT members.

By obligating countries to treat all other countries alike, the GATT encouraged trade liberalization and economic efficiencies. In essence, the GATT helped to tie the economic prosperity of individual countries firmly to the preservation and expansion of a global trading system.

The End of the Cold War

In retrospect, the underlying rationale for the postwar economic architecture was proven correct. Even though much of our attention during the past 50 years was riveted on the East-West and North-South ideological conflicts, it was ultimately the superior economic performance of countries pursuing outward-looking, market-oriented economic policies within the ambit of multilateral economic institutions that led to the end of the Cold War. With very few exceptions, countries around the world have initiated market-oriented reforms and are eager to join the multilateral economic institutions created on the basis of American initiative and leadership after the war. This outward approach has encouraged countries like China to play a more constructive role in the international arena and to be more sensitive to diplomatic pressures than would have been possible had they continued on the path of inward-looking, government-controlled economic planning.

The shortcomings of the global trading system have become increasingly apparent, as the principal focus of international relations has shifted to the economic front and trade agreements have become more important for organizing relationships among states. With global economic competition fiercer than ever, these shortcomings are likely to grow in importance.

Despite this success, the end of the Cold War has brought new challenges. The shortcomings of the global trading system have become increasingly apparent, as the principal focus of international relations has shifted to the economic front and trade agreements have become more important for organizing relationships among states. With global economic competition fiercer than ever, these shortcomings are likely to grow in importance. They are already contributing to public unease about the basic direction of U.S. trade policy. One result has been a series of highly publicized trade disputes between the United States and governments in East Asia.

Public Dissatisfaction with Trade Policies

Public polls in the United States and the growing use of protectionist rhetoric by politicians and pundits suggest that a significant part of the American public questions the accomplishments and wisdom of postwar American trade policies. Part of the concern stems from an increased sense of economic insecurity. While many people blame their loss of economic security on increases in trade and foreign investment, in fact trade has caused fewer job losses than structural economic factors such as the increased pace of technological change, the shortening of product life cycles, outsourcing, and corporate downsizing. As a result of the fast pace of economic change and the unrelenting competitive pressure on corporations to pursue every avenue for increasing economic efficiency, lifetime employment is a thing of the past. Typical workers today not only have many different employers in their careers, but more than likely will have to change their occupations along the way.

This economic insecurity stemming from the increased pace of economic change has been reinforced by the budgetary pressures created by the relatively generous social welfare systems put in place in the postwar period. In addition, the globalization of production creates a growing sense among workers that they are in competition with billions of workers around the world, many of them willing to work under poor conditions for minuscule wages. Blame often falls upon multinational corporations that attempt to reduce labor costs by outsourcing work to developing countries such as Indonesia or China; or on Asian governments that do not allow labor to organize and, in the worst of cases, condone forced labor. In short, global economic pressure on individual corporations and the concomitant pressure on social welfare budgets create a feeling among many people that they have lost the political power to shape their economic environment.

Shortcomings of Existing Trade Agreements

As mentioned previously, another source of public unease results from shortcomings in existing trade agreements. There is concern that existing agreements have failed to discipline the aggressive use of trade policy tools by a number of countries, especially in East Asia. Of particular worry is that such countries have achieved a high degree of international competitiveness via these “unfair” strategies while simultaneously benefiting significantly from the openness of other markets.

Another shortcoming of existing agreements is that they do not provide sufficient pressure and incentive for countries that became signatories as developing countries to bring their commitments in line with their level of economic development. This is the case with respect to a number of East Asian countries such as South Korea and the countries of the Association of Southeast Asian Nations (ASEAN).

A third shortcoming of the existing rules is, unfortunately, also one of the real advantages of these rules—namely that they allow countries to give preferential treatment to each other if they remove substantially all barriers to trade between them. This rule is an advantage insofar as it encourages countries to eliminate all barriers to trade with another country or group of countries. However, it holds the risk of becoming a source of global political instability if it were to trigger a race among major powers for the creation of competing spheres of economic influence in the highly competitive post-Cold War era. In short, these shortcomings weaken support for trade policies that have been the major source of postwar growth.

The end of the Cold War creates the risk that countries will use trade policies and agreements to achieve economic, foreign policy, and national security goals at the expense of other countries. In certain bilateral relations, trade disputes can create the perception that one country is using economic policy to weaken or dominate another. Some Americans accuse Japan of this motive (and vice versa), and Russians and Chinese often accuse the United States of using economic policy to undermine their national power. The possibility arises that trade policies could generate increased friction among nations, friction that could degenerate into armed conflict.

A Trade Strategy in the U.S. National Interest

The United States needs a strategy that will address the concerns of the American people about the inadequacy of existing trade rules as well as build on the strategic opportunities opened up by the end of the Cold War. Such a strategy also needs to include new domestic initiatives designed to address concerns that globalization, automation, and budget pressures have increased economic insecurity for many workers.

A new U.S. trade strategy should establish negotiating priorities that: 1) respond to public concerns about the inadequacies of existing international trade agreements and 2) take advantage of new opportunities resulting from the changed geopolitical environment and favorable economic circumstances created by new product and process technologies and the globalization of the world economy. These priorities should be reflected in proposals for future bilateral, regional, and global negotiations, and for changes in U.S. trade laws that will better equip U.S. trade officials to deal with foreign industrial policies. For example, the United States needs more effective remedies in its own laws for dealing with anti-competitive practices of other countries.

This brings us to a fundamental conundrum reflected in the current situation. To regain American public support and to prevent serious conflict in the future will require the negotiation of new trade agreements. Yet the current public ambivalence and discontent with trade policy makes it difficult to mobilize the necessary public support for new trade agreements.

This brings us to a fundamental conundrum reflected in the current situation. To regain American public support and to prevent serious conflict in the future will require the negotiation of new trade agreements. Yet the current public ambivalence and discontent with trade policy makes it difficult to mobilize the necessary public support for new trade agreements. This conundrum will need to be tackled by the Washington trade policy community on a priority basis after the elections this fall.

The Clinton Administration has launched many of the right kind of initiatives, such as the free trade area of the Americas and the proposal for free trade among the countries of the Asia-Pacific Economic Cooperation (APEC) forum that was agreed to at the 1994 APEC ministerial meeting in Bogor, Indonesia. What is needed is a coherent strategy that will persuade the American people. Such a strategy must address the domestic sources of discontent, including concerns that current agreements inadequately curb the beggar-thy-neighbor policies of some countries.