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DE-FACTO INTEGRATION OF EAST ASIA COMPARED WITH DE-JURE INTEGRATION OF THE EU

Abstract

Despite many barriers, there has been a rise of intra-East-Asia trade. Japanese multinational companies are significant promoters of the de-facto integration, enhancing local procurements and orchestrating the mutual-supply network throughout East Asia. All that a Southeast Asian country needs to do is to plug in the intricate

production network led by the MNC. Market dynamics functions well in East Asia, whereas political decisions prevail in the EU. When Japanese MNCs relocate, so does their vertical relationship. Many informal business relationships are active and interwoven in East Asia unlike the EU.

Key words

Economic integration, Japanese MNCs, SMEs, FDI, East Asian Economy, Southeast

Asian Economy, ASEAN, Japanese companies in Germany and the USA, EU.

1. Introduction

There is recently a rise of intra-regional trade in East Asia. Since the late 1980s, the rise is increasingly noticeable. Although set back by the 1997 crisis, the rising trend appears to stay on. What accounts for it? How different is it from

EU-type integration? How important are Japanese companies in East Asia? The purpose of the paper is to answer these questions with new data.

2. Fred Bergsten's comparison

Fred Bergsten (March 2000) points out various barriers to Asian integration. Let me quote partly from his long paper on the Asian Challenge. He says,

«Per capita income in Japan, even with its stagnation in the 1990s, is more than 30 times greater than in Indonesia. Even Japanese who

favor new regional initiatives thus tend toward financial rather than trade links, which they would limit to «horizontal integration» with countries that at least approach Japan's own living standards (to date, only Singapore and perhaps Korea). Moreover, most of the East Asian countries continue to view each other as

economic rivals more than potential partners. Political rivalries pose an even more daunting barrier to effective cooperation. At the highest level of geopolitics, China and Japan are now clearly competing for the leadership of Asia.

At a more microeconomic level, Hong Kong and Singapore are vying to become the financial hub of East Asia. Korea and Taiwan and other country pairs compete vigorously in global markets. Moreover, huge differences in political systems underlie these rivalries. Most importantly China, but also Vietnam and Myanmar, are trying to maintain highly authoritarian regimes even while they embrace market economy. By contrast, Japan has been a practicing democracy for 50 years. Most of the other East Asians come somewhere in between.

These systemic political differences would complicate any Asian integration effort. These contemporary differences of course reflect deep historical and cultural roots. The rest of Asia has yet to accept Japan as a true partner.

Relations with countries outside the region add further complications to regional integration efforts. Some Asian countries, such as Korea and Singapore (and perhaps Japan), would not want such initiatives to undermine their relations with the United States. China, for all its skirmishing with the United States, might again come to take a more global perspective than Japan or its other Asian neighbors and thus resist excessive «Asianization.» Some, particularly in ASEAN but also Japan due to extensive trade ties, might not want to exclude Australia and New Zealand or even Canada and Mexico. Some might even be reluctant to discriminate against Europe, in light of the new series of summit-level Asia-Europe Meetings (ASEM) and the desire in some Asian quarters to «lengthen the short leg» of the Asia-Europe-United States triangle by developing ties in that direction.

The European model is increasingly referenced by East Asians as a possible point of departure. This is a striking change. Until quite recently, the whole concept of «community» as embraced in Europe has been widely suspect in East Asia and the institutionalized bureaucracy of the European Commission in Brussels has been unanimously viewed as the worst possible nightmare that could befall that region. Even more fundamentally, Asians have never viewed themselves as «a region» in the way that Europeans have done since the Holy Roman Empire.

There are of course both objective parallels and differences between the European and East Asian regional situations. Europe's overriding objective, brilliantly achieved, was political and

military. A similar process that could forever preclude conflict between China and Japan would be equally worthwhile. But there is no evidence that East Asia's new push for regional institutions is driven by such far-reaching political goals, and there is a serious question of whether the perceived risk of future confrontation is great enough to convert the wariness between the top Asian powers from a barrier to integration into a motivation for achieving it. A second driving force in Europe was the common enemy embodied by the Soviet Union. There is no comparable threat to East Asia today. Russia could conceivably play such a role again, at least for Northeast Asia in some distant future, but would hardly motivate Asia-wide coalescence now.

An associated element in Europe's integration was the strong support from its main non-regional ally. The United States, driven by its own strategic priorities of deterring the Soviet Union and avoiding another fratricidal war in Europe itself, was willing to accept some negative economic effects from the European process and even the buildup of a potential future rival. No «outside cheerleader» is likely to support Asian regionalism now, however.

Despite US support for European integration, a subtext of the latter has been Europe's own quest for independence from the pervasive influence of the United States. Concerns over excessive reliance on the United States and «its» international institutions represent one of East Asia's motivations today. Such concerns, and the likelihood of countervailing action by the East Asians, would be intensified if a future US recession provoked a surge of protectionism against Asian exports or if a new foreign policy configuration in Washington led to a reduction in the American security presence in the Pacific.

Another key factor in Europe was the prospect of large economic benefits from closer, eventually full, integration among countries that were already each other's main partners. The potential for large economic gains from freer trade, and especially deep integration, exists in Asia today as well.

Finally, all participants in the European integration process have been democracies. Indeed, several countries in the region – notably Spain and Portugal – were deliberately shunned until they shed their dictatorial regimes. Hence the politics of Asian integration, at least to any depth, would be extremely difficult at this point in time.

In sum, there is clearly a case for East Asian integration today. Equally clearly, that case is less compelling than the case for European

integration 50 years ago. Moreover, the hurdles to full emulation of the European Union seem sufficiently large to deter a comparable effort.» (End of quotation)

Bergsten, despite large potential gains from freer trade, is so skeptical of progress of Asian

economic integration due to so many barriers. These negative views on East Asia make it difficult to understand a recent rise of intra-regional trade in East Asia. This paper tries to reveal what is behind.

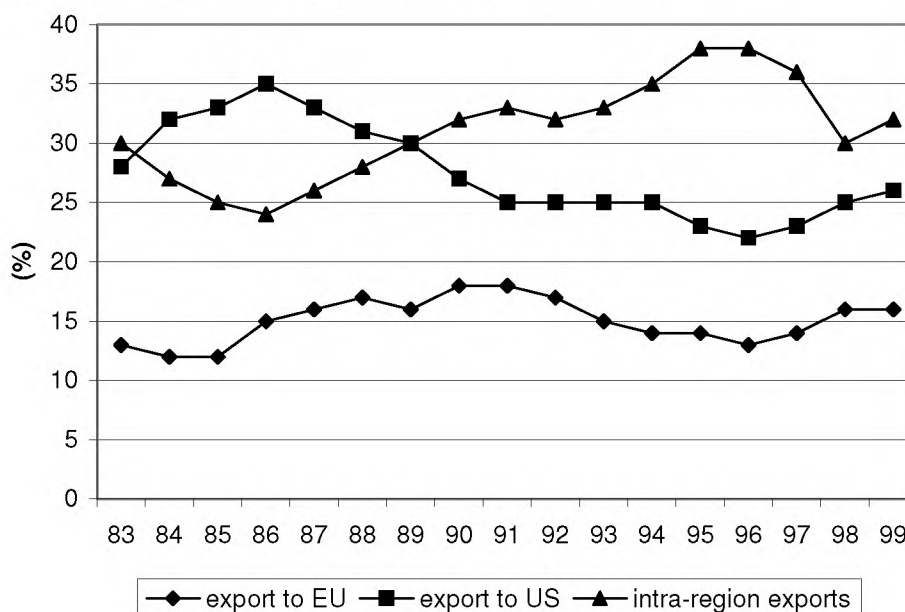
3. Increasing intra-regional trade in East Asia

Diagram 1 shows East Asia's exports to East Asia have surpassed East Asia's exports to the US since 1990. More than 35% of East Asia's exports go to the same region. Diagram 2 manifests most clearly the rising trend of the intra-regional trade in East Asia. Diagrams 3 and 4 indicate the importance of Singapore as regional hub of ASEAN's trade. Intra-ASEAN trade is increasingly promoted by Singapore. Korean and Japanese firms increasingly use Singapore as hub.

These diagrams tell us about rising trends of intra-regional trade of East Asia. The region here includes Korea and Japan. Behind the four diagrams lie the massive inflow of FDIs from Japan, rising local production by Japanese transplants, the yen appreciation since 1985, the shift in Japan's comparative advantages, pressures from the rest of the world to reduce Japan's huge trade surplus, Asian own efforts and local incentives, etc. Intra-ASEAN trade jumped from 43 billion US dollars in 1993 to 71 billion US dollars in 1998.

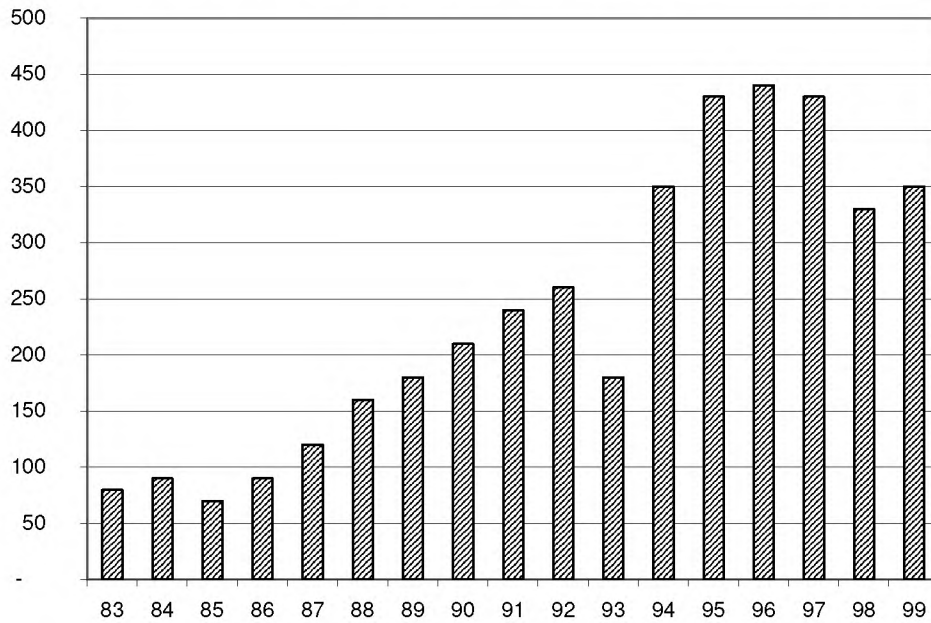
Diagram 1: Exports of East-Asia

(% of East Asian Nine Countries' Exports to East Asia, US and EU)
(Region=Nine Countries=Japan, NIEs, ASEAN4)(Unit=%)



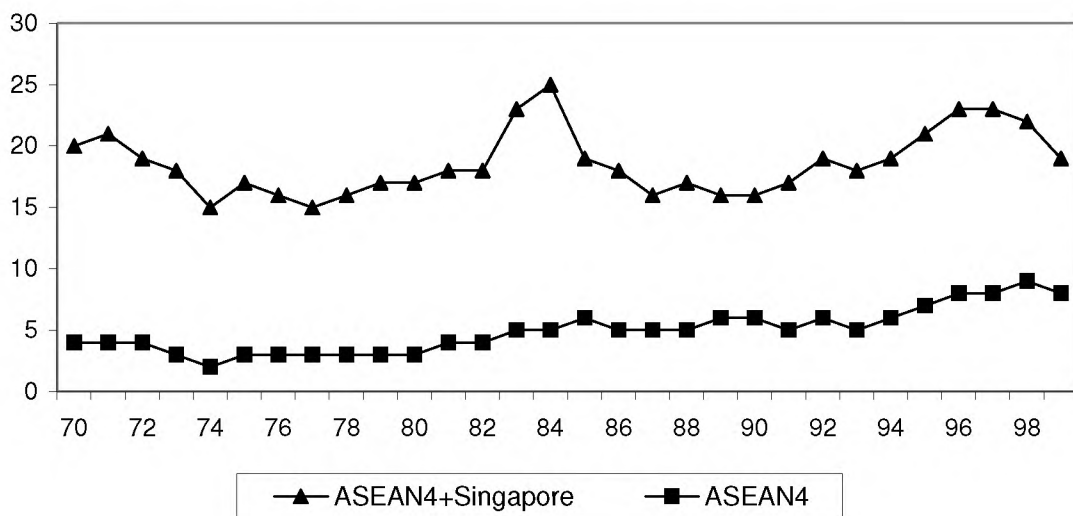
Source: IMF, DOT; MITI, White Book of International Trade 2000

Diagram 2: Intra-regional exports (unit = \$ billion) (Region = East Asia's nine countries)



Source: the same as that of Diagram 1

Diagram 3: Intra-Asean exports in % with and Without Singapore
(Percentage of intra-ASEAN exports in total ASEAN exports)(Unit=%)

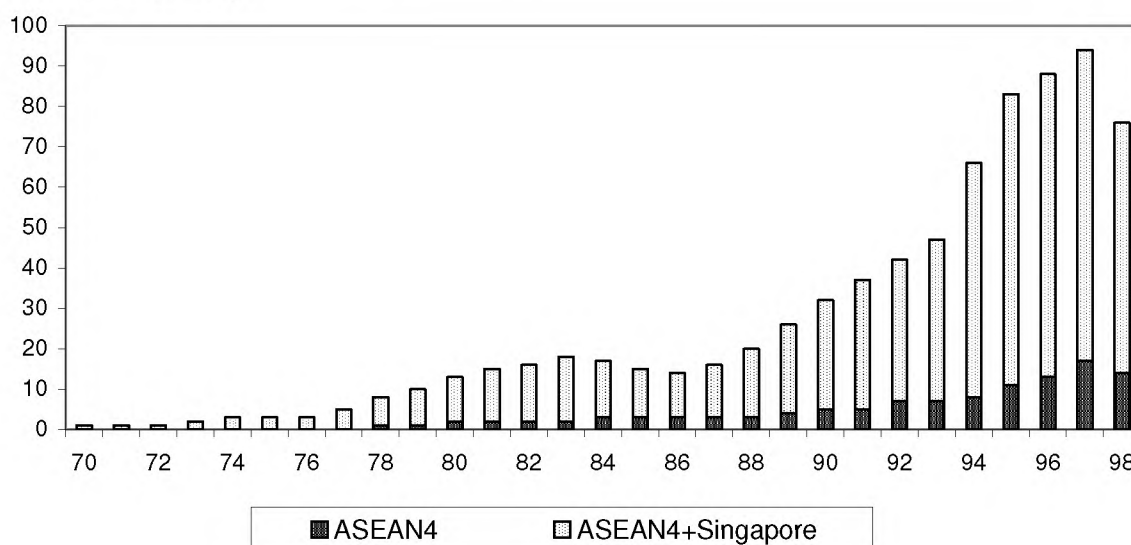


Source: the same as that of Diagram 1

Diagram 4: Intra-Asean export values with and Without Singapore

(Unit: billion US dollars)

(Unit=\$billion)



Source: the same as that of Diagram 1

4. Various levels of integration

In general, there are two kinds of economic integration:

- (1) unofficial integration (de-facto, functional, firm-led and market-driven)
- (2) official integration (de-jure, rules-based and government-led)
 - (1) is more effective than (2) in the context of East Asia.
 - (2) is subdivided into three levels in East Asia:
 - (2-1) sub-regional level (bilateral agreements)
 - (2-2) regional level (AFTA, ASEAN)
 - (2-3) supra-regional level (APEC)

(2-1) sub-regional level (bilateral agreements)

Most effective among the three is (2-1), which produces significant impact on the regional division of labor and on increasing the competitiveness of Asian companies. The Singapore-Johor tie is a good example. Singapore-based companies have been investing in Johor Bahru, Malaysia, since the early 1980s, as wages in Singapore rise. The Singapore/Johor/Riau (SIJORI) growth triangle only assumed an official identity in 1989 when Indonesia announced a package of measures liberalizing procedures for foreign investment in

the Batam island of Riau, following a meeting between the heads of states of Indonesia and Singapore. The triangular growth area is driven by economic complementarities. Governments play a largely facilitatory role, but in Europe governments play leading roles. Of particular importance is a governmental guarantee offered to foreign investors. Main players are clever managers of Asian companies.

Thus, the most successful of the trans-border arrangements are largely driven by private sectors. The most recent agreements, such as the Singapore-Japan Trade Accord and the Korea-Japan Trade Accord, are also good examples of (2-1).

(2-2) regional level (AFTA, ASEAN)

Mr. Rodolfo S. Severino, Secretary General of ASEAN, stated in Tokyo on October 25, 2000, «ASEAN is an open and outward-looking region that strongly supports the multinational trading system, being governed by rules-based arrangements consistent with WTO principles. Strong regional integration of ASEAN is supported by trade liberalization and facilitation (AFTA ASEAN Free Trade Area), industrial integration (AICO ASEAN Industrial Cooperation Scheme), services liberalization and facilitation

(AFAS ASEAN Framework Agreement on Services), investment liberalization and facilitation (AIA ASEAN Investment Area), and infrastructure linkages and networks.»

Despite this kind of official statement, however, the officially decided regional integration efforts have had negligible impact. The ASEAN Free Trade Area (AFTA) still remains largely more a statement of intent than a reality. The Singapore Declaration of 1992 which established the AFTA consists of dozen or so pages. The length and density of the NAFTA agreement makes a sharp contrast. The AFTA was initiated primarily in response to the fear that ASEAN's voice would be neglected in a world increasingly dominated by such regional trading blocks as the NAFTA and the EU, and to the fear that foreign investments would shy away from East Asia.

Mr. Jose S. Concepcion, President of ASEAN-CCI, said at the ASEAN-Japan 2000 Joint Investment Promotion Seminar in October 2000, «ASEAN consists of 10 countries and constitutes open regional market of 500 million consumers. Intra-ASEAN trade jumped from 43 billion US dollars in 1993 to 71 billion US dollars in 1998.»

The Intra-regional trade has thus grown. The intra-ASEAN trade almost doubled in five years. Diagram 2 suggests that the intra-NINE exports did not increase so much in the five years between 1993 and 1998. 1998 was the year right after the Asian Crisis. Diagram 4 shows that the intra-ASEAN exports more than doubled between 1992 and 1997. The rate of

increase of imports was higher in the ASEAN plus Singapore region (Diagram 4) than in the NINE region (Diagram 2).

The ASEAN is said to have made progress in moderating internal conflicts and harmonizing external tariffs. Regional organizations like ASEAN (e.g., AFTA) facilitate the already functioning market-led networks. The role of its governments remains largely that of a facilitator rather than a leader.

ASEAN's facilitatory efforts are indeed considerable. The BBC (Brand-to-Brand Complementation) of the ASEAN promotes intra-regional mutual supply of parts and components, which Japanese companies use in order to grasp scale merits and share in profits of enlarged (cross-border) production. Specific countries focus on large-scale production of specific parts and components, which necessitate the intra-regional trade.

The ASEAN, however, still remains loose in organization as compared with the EU. Political statements are minor in actual influence, being different from far-reaching EU-type political grand designs and achievements of integration.

(2-3) supra-regional level (APEC)

The APEC has worthy objectives. Its working parties may through promotion of standardization help reduce the transaction costs among its member states. The APEC has its uses as a vehicle to maintain pressure for non-discriminatory trade liberalization. Beyond these functions, it is difficult to see APEC playing a major role in integration.

5. Various asian production networks conducive to de-facto integration

5-1. Theoretical implications: «Plug-in» model

A focus on the cross-national feature of production networks reflects a market dynamics or a market-based de-facto integration, obscuring EU-type rules-based politically-imposed integration efforts. The expansion of FDIs by MNCs throughout Asia leads to the emergence of multiple, uniquely-organized cross-national production networks, which are not existent in the EU.

South-east Asian countries have encouraged MNCs to locate operations within their borders, and by doing so, have INSERTED themselves into regionally-based cross-national

production networks. They have embraced a «regionalized» development strategy that hinges on joining the cross-national division of labor established by MNCs in Asia. The cross-national production networks do NOT simply consist of expanding quantities of FDI. Rather, these are increasingly integrated complex networks that organize R&D, procurement, distribution, product design, manufacturing and support services. South-east Asian countries have thus PLUGGED IN the MNC production network. Many Japanese MNCs (e.g., SONY, JVC, Matsushita) are engaged in R&D, product design and development locally rather than in Japan.

The network is so complex that no single theory on FDI would suffice to explain it all. The deriving force behind it is more complex than is assumed by conventional economic theory. Dunning's OLI paradigm is relevant but not sufficient. The trade creation-trade diversion framework is not sufficient, as shown by Sander (1995). Vernon's product life cycle theory and Akamatsu's flying-geese theory lack relevance. What is suggested here is what I call «Plug-in Model». Once plugged in, a chain reaction of the system starts, benefiting a Southeast Asian developing country. All that a developing country needs is to plug in an MNC-led network. Then it will be elevated, attaining economic growth and export surge. It looks as if the country were going up in an elevator.

This would be similar to what Edward Chen (1993) calls «aerobatics pattern». Airplanes participating in an air display, with each plane

having a specific role, form one pattern after another. When the commander signals, the planes change roles and form a different pattern. Likewise, different patterns of industrial specialization are generated by different newly developed technologies. Different countries find different production niches in accordance with their competitive edges, local incentives and locational advantages, and specialize in different subsectors of a particular industry, under the signal of the MNC or Network Commander. A particular formation of airplanes corresponds to a particular network of production (or a particular chain of producers) in or around a host country. The area of specialization is not necessarily related to a particular country's level of technology but to a type of technology of the MNC. An aerobatics hypothesis of industrial development can thus coexist with the flying-geese hypothesis which concerns the level of technology.

5-1-1. MNC-based integration of host countries in electronics

Here we focus on electronics. Electronics firms have established increasingly complex international production networks that extend not only beyond national boundaries, but also beyond the boundaries of firms. Competitive success depends on an MNC's capacity to orchestrate such complex cross-national networks and to integrate them into the firm's total organization. Such orchestration promotes MNC-based integration of host countries.

The increased price competition needs to be combined with product differentiation. Of equal importance is speed-to-market. Competition centers around a firm's ability to build capabilities quicker and at less cost than its competitors. This is especially true in a knowledge-intensive industry like electronics. No firm can internally generate all the different capabilities that are needed. This requires a shift from individual to collective forms of competition or contractual network of firms. Electronics firms search for new ways to improve their specialization and INTEGRATE their erstwhile stand-alone

operations in host countries into increasingly complex across-border production networks.

In essence, electronics firms now break down the value chain activity into discrete function and locate these different functions wherever they can be carried out most effectively. Locations can be neighboring countries. Systemic rather than partial rationalization now cuts across national borders, and covers a variety of cross-border linkages conducive to intra-regional transactions. It is systemic rather partial globalization that now matters. Once locations are fixed, certain aerobatics will follow.

Multinational companies become much more demanding in their choice of locations and supply sources. Low labor costs are taken for granted. Alternative locations are judged by the quality of specialized capabilities available. Local advantages are decisively important in combination with ownership advantages a la OLI approach of Dunning. And this applies typically to electronics.

5-2. Chinese overseas companies and networks

5-2-1. Chinese overseas companies: lean, fast and flexible

Overseas Chinese plug into the MULTINATIONAL production networks. The result, according to Borrus (1997, p. 8), is burgeoning indigenous electronics production

through Asia under the control of Overseas Chinese capital. Resident ethnic Chinese investors have been playing the private

entrepreneurial role in the China Circle, Singapore, Malaysia, Indonesia, and Thailand.

The OC (Overseas Chinese) network is focused on intricate division of production tasks (e.g., components and subassembly steps) that can be farmed out all the way down to family job shops and individual home workers. Individual units operate at small scale with minimal capital investments and link on the informal bases of *guanxi*, namely, kinship and friendship ties. The flexibility that results makes it possible to decrease or increase production scale on short notice, and enter niche markets at minimal cost.

The best OC networks run extremely lean. The OC networks appear to be insular, fast, flexible, *guanxi*-mediated, and fluid.

Like the American networks, the OC networks exploit highly competitive supply bases in Asia and concentrate on industrial electronics. Much like the Japanese dual production system, the OC networks retain in the home base the high value-added products assembled with more advanced processes, and in off-shore production locations the lower value-added products assembled with simpler processes.

Table 1 Dual production system in Japan

	Sophisticated Products	Unsophisticated Products
Production Base	Home (Japan)	Off-shore (other East Asia)

The dual production system in Table 1 implies differentiation of production sites of sophisticated products from those of unsophisticated products. Sophisticated products are produced in Japan with sophisticated processes to serve advanced country markets, while lower-end unsophisticated products are produced with simple processes in regional Japanese affiliates to serve local Asian markets. Similar system exists in Korea, Overseas China, etc. When Japanese companies respond to government pressures to localize, they do so from within their established supply base (by transplanting operations of affiliated domestic Japanese suppliers), not necessarily sourcing from Asian supply bases already available locally. US companies, by contrast, source locally and are entwined with local OC

producers. The lag reflects Japan-centered corporate strategy, lack of international business experiences, etc.

Unlike the Japanese, however, the OC networks also self-consciously leverage increasing technical specialization through Asian local relationships wherever possible. And unlike both, the OC networks are increasingly China-centered. The OC networks may end up with a China base as their global center in the future, using technical know-how in Mainland China to achieve world-class scale, costs and innovation. Borrus (1997) discusses Taiwanese production network as part of the OC production network, while Zysman and Doherty (1995) try to separate both recognizing some difference between them, as discussed later.

5-2-2. Bamboo network of overseas chinese throughout Asia

Since the 1500s, southern China has served as a springboard for emigrants to Vietnam, Thailand, Indonesia, and elsewhere in Southeast Asia. These Overseas Chinese have developed a «bamboo network» that transcends national boundaries. This is an informal array of complementary business relationships that extends throughout the region, where entrepreneurs, business executives, traders and

financiers of Chinese background are major players in local economies. It is now said that Overseas Chinese run 160 out of 200 largest businesses in Indonesia. Overseas Chinese control 80% of Indonesia's corporate assets, 50% of Malaysia's corporate assets, and 90% of Thailand's manufacturing. Let me here summarize features of the bamboo network in Table 2:

Table 2: Features of overseas Chinese (bamboo) network

	Overseas Chinese network
Features	China-centered, lean, fast, flexible, <i>guanxi</i> -based, bamboo-network
Similarity to American Network	Use of specialized local suppliers
Similarity to Japanese Network	Dual production system

Overseas Chinese are very active in East Asian countries. Their mutual support is so strong that no governments can ignore them. The bamboo network seems to support some part of the already-mentioned intra-regional trade in East Asia, but nothing detailed is known yet.

Japanese, US, Taiwanese, Hong Kong, Korean, and Overseas Chinese firms establish the multiple intricate cross-border networks that are partially overlapping and partially competing with one another, defying simple theoretical approach. There are differences. US networks are open, but Japanese and Korean networks are closed. Overseas Chinese networks are closed but horizontally integrated, while Japanese and Korean networks are vertically linked. Taiwanese networks are open and horizontally integrated.

6. My own questionnaire surveys for Malaysia and Thailand

I conducted a questionnaire survey of 40 Japanese-affiliated manufacturing companies in Malaysia in November 2000, and the one of 60 Japanese-affiliated manufacturing companies in Thailand in November 1999. Each questionnaire consists of 30 statements, which I ask the top manager to evaluate. The ranking consists of five: 1 strongly disagree, 2 disagree, 3 undecided, 4 agree, 5 strongly agree. The higher is the rating, the more positive evaluation of a statement in question results. Here we focus on two statements.

Statement No.5 in my questionnaire is «Local technology is well developed», and statement No.6 is «Good supporting industries are located nearby». It is very important that, if negative responses prevail in statement 5 and

positive responses prevail in statement 6, we can conclude that good foreign-affiliated supporting industries are located nearby. The supporting industries which Japanese manufacturing companies utilize are localized but often are of foreign origin. Many Japanese companies have failed to find competent domestic suppliers whom they can trust, ending up with Japanese-affiliated subsidiaries, related Korean companies, and the like.

Diagram 5 shows a frequency distribution of the 40 Japanese-affiliated companies in Malaysia in October 2000. More than half of the respondents show negative response to the statement that local technology is well developed. 20 out of the 40, or half, of the respondents «disagree» (rating 2) with the statement.

Diagram 5 «Local technology is well developed»

Frequency distribution of 40 responses in my questionnaire survey of Japanese-affiliated manufacturing companies in Malaysia, October 2000

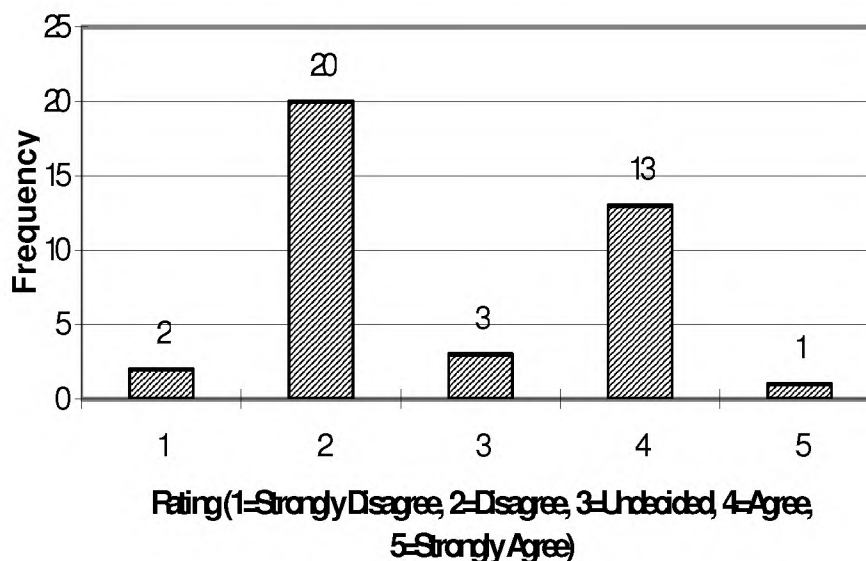


Diagram 6 «Good supporting industries are located nearby»

Frequency distribution of 40 responses in my questionnaire survey of Japanese-affiliated manufacturing companies in Malaysia, October 2000

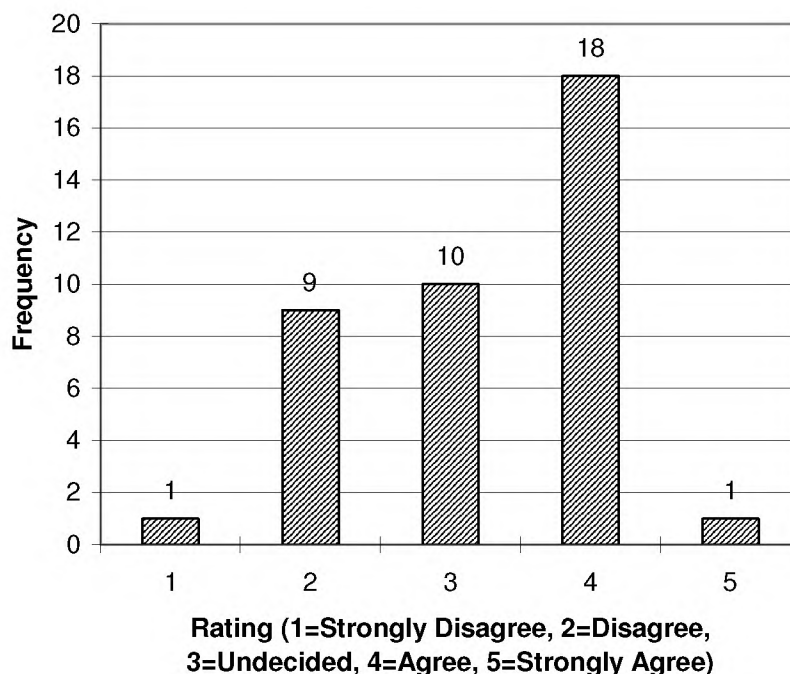


Diagram 6 shows a frequency distribution of the 40 Japanese-affiliated companies in Malaysia in October 2000. About half the respondents show positive response to the statement that good supporting industries are located nearby. 18 out of 40 companies, or 46% of all the respondents, agree with the statement.

Diagram 7 shows a frequency distribution of the 60 Japanese-affiliated companies in Thailand in November 1999. More than half of the respondents show negative response to the statement that local technology is well developed. 25 out of 60 companies, or 42% of all the respondents, disagree.

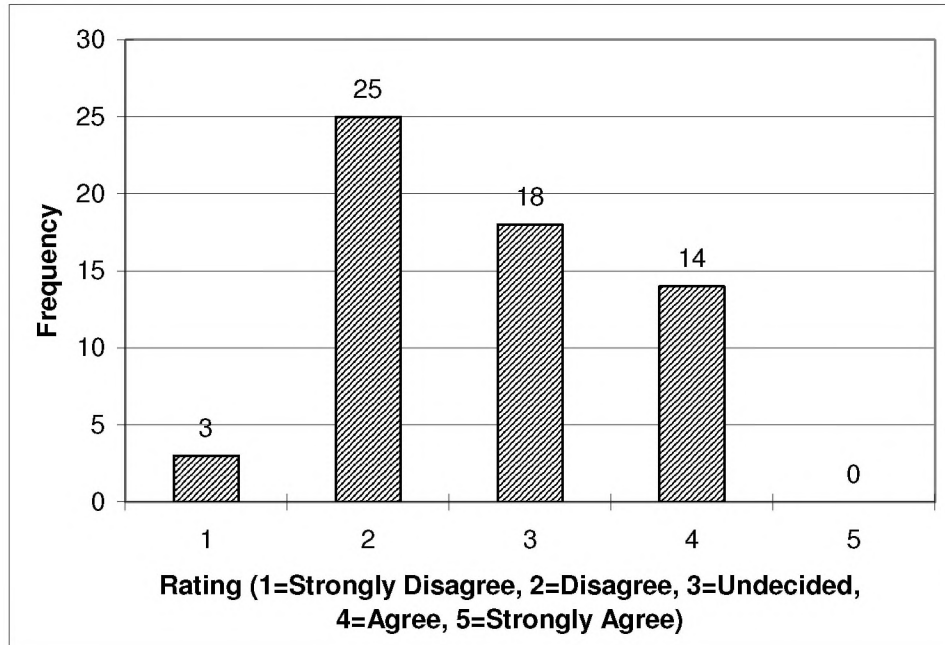
Diagram 8 shows a frequency distribution of the 60 Japanese-affiliated companies in Thailand in November 1999. More than half the respondents show positive response to the statement that good supporting industries are located nearby. 23 out of 60 companies, or about 39% of all the respondents, agree with the statement.

In sum, diagrams 5, 6, 7 and 8 clearly show the dominant view of Japanese managers that good foreign-affiliated supporting industries are

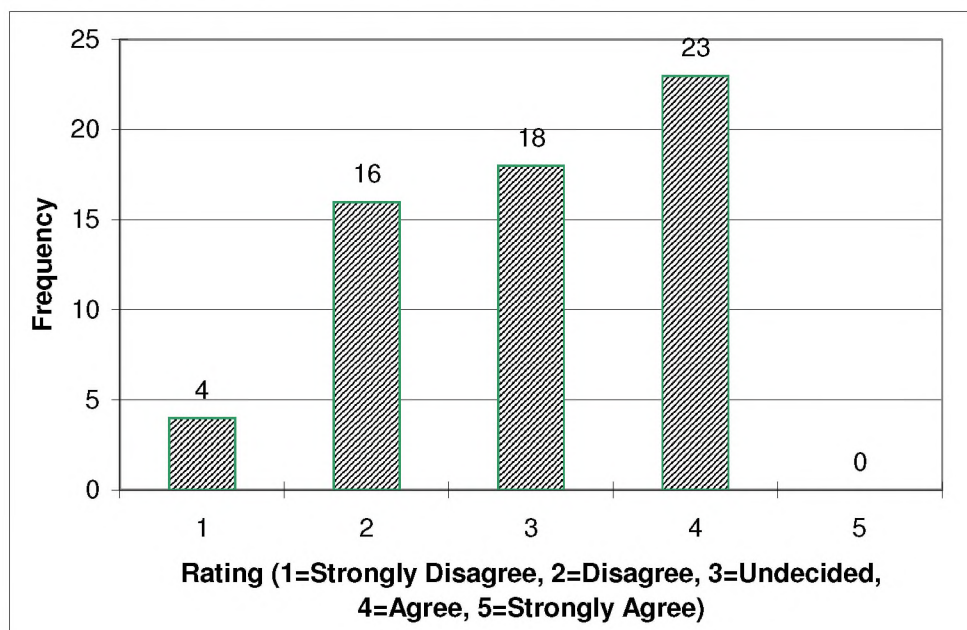
located nearby. They mostly admit that local technology is not well developed. Their assembly work is indeed done locally, but based on high-quality inputs procured in host or neighboring East Asian countries, promoting the intra-ASEAN trade. Most of the supporting industries which Japanese manufacturing companies utilize are of foreign origin. Many Japanese companies which desire to have technology transferred have tried many times to find capable domestic suppliers they can trust, but in vain. They have so far ended up with affiliation with Japanese subsidiaries, related Korean companies, and the like. Some economists may blame their failure to use domestic suppliers, but what matters in the borderless mega competition is very high quality of products, which can only be secured by skilled, experienced, QC-trained and knowledge-intensive companies not easily available indigenously. It takes much time to develop technological levels of indigenous workers sufficiently. Technology transfer is not easy. Manuals are not thick in Japanese companies, although they are thick in US companies.

Diagram 7 «Local technology is well developed»

Frequency distribution of 60 responses in my questionnaire survey of Japanese-affiliated manufacturing companies in Thailand, November 1999

**Diagram 8 «Good supporting industries are located nearby»**

Frequency distribution of 60 responses in my questionnaire survey of Japanese-affiliated manufacturing companies in Thailand, November 1999



7. Intra-East-Asia trade and Japanese companies

Japanese-affiliated firms in Southeast Asia procure parts and components more and more from Southeast Asian countries than from elsewhere including Japan. They rely increasingly on intra-Southeast-Asia supplies, a strong evidence of the recent rise of the intra-regional trade. The procurements or imports from Southeast Asia is facilitated by some ASEAN moves like the BBC. The suppliers are often second or third subcontractor groups transplanted recently from Japan belatedly following their parent companies. This transplantation is increasingly evident since around 1990. Where Japanese MNCs migrate, so does its vertical and horizontal relationship.

Intra-regional trade is being promoted significantly by Japanese-affiliated firms. Individual markets are so small in East Asia that there is no sense in targeting a small market of one country. It is necessary to target the whole market of East Asia in order to obtain merits of large-scale production which induces cost reduction and profit making. Japanese automakers, for instance, have spread the supply network throughout East Asia. The supplies are well coordinated inside East Asia as shown in Diagram 13. If Thailand, for instance, specializes in producing certain parts for East Asia as a whole, Malaysia in turn specializes in making different parts for East Asia as a whole. Mutual supply or exchange of various parts produced in different countries in East Asia boosts the intra-regional trade, as recorded in Diagrams 1 and 2 and shown in Diagram 13.

Table 3, Diagrams 9 and 10 show procurements of Japanese-affiliated companies in East Asia. Local procurements include domestic procurements of supplies from Japanese and other subsidiaries including Korean or Chinese firms. The Matsushita group of Malaysia, for instance, which produces 5% of Malaysian GDP and exports 2% of Malaysian exports, aims at increase of local procurement, reduction of imports and increase of exports to other East Asia markets.

Japanese-affiliated companies contribute to increasing local procurements and increasing domestic industrial linkages. Imports from Japan are strategically important, because key

products, key technology and key inputs are unavailable locally. PROTON cars in Malaysia, for instance, have to depend on Mitsubishi engines imported from Japan.

The local procurements as well as the imports from Japan constitute at least 80% of the total procurements in Table 3, but the imports from the third countries increase steadily. Among the imports from the third countries, those from Asia rise from 45% in 1986 to 74% in 1996, a jump of 19% in a decade. This shows the intra-regional trade viewed from imports side, supported by the cross-border expansion of Japanese-based supply network.

Table 4, Diagrams 11 and 12 in turn show sales or exports of Japanese-affiliated companies in Asia. Although local sales take biggest share, exports to third countries exceed those to Japan and increase from 1990 to 1996. Among the exports to third countries, those to Asia amount to 59% in 1996, rising from 43% in 1986 in Table 4. The exports to Asia include those to other Asian countries, thus forming an Asia-wide network of supplies. This is the intra-regional trade viewed from exports side.

Imports from Japan in Table 3 exceed exports to Japan in Table 4, with trade balance in favor of Japan. Exports to Japan are less than 20% of total exports, although imports from Japan are at least about 40% of total imports of Japanese-affiliated firms. Southeast Asia exists as typical high exchange economy (=economy typically dependent on import supplies for boosting output and exports). Imports from Japan are indispensable to local production and exports. The imports are exchanged into exports through high-level processing by Japanese-affiliated companies in Southeast Asia.

In essence, Tables 3 to 4 and Diagrams 9 to 12, which are all consistent with Diagrams 1 to 4, clearly show important roles being played by Japanese-affiliated firms in promoting de-facto integration. Intra-regional trades are not based on political rules but on corporate strategy of Japanese-affiliated companies active throughout the world. In conclusion, the de-facto economic integration of East Asia, especially Southeast Asia, is being promoted significantly by the Japanese-affiliated companies.

Table 3: Procurement of Japanese-affiliated firms in East Asia (Unit: %)

		1986	1990	1996
Local Procurement		42	50	40
Imports from Japan		45	39	40
Imports from Third Countries		13	11	19
		1986	1990	1996
Imports from Third Countries	N. America	15	8	7
	S. America	3	6	1
	Asia	45	54	74
	Middle East	1	3	7
	Europe	4	12	4
	Oceania	30	12	2
	Africa	2	5	1

«Third» means «non-local» and «non-Japan».

Source: MITI, Kaigai Tousei Toukei Yourann, various issues.

Table 4: Sales of Japanese-affiliated firms in Asia (Unit: %)

		1986	1990	1996
Local Sales		55	64	58
Exports to Japan		16	16	19
Exports to Third Countries		30	20	23
		1986	1990	1996
Exports to Third Countries	N. America	35	30	16
	S. America	1	1	1
	Asia	43	48	59
	Middle East	3	2	1
	Europe	15	16	8
	Oceania	1	2	1
	Africa	1	1	0

«Third» means «non-local» and «non-Japan».

Source: MITI, Kaigai Tousei Toukei Yourann, various issues.

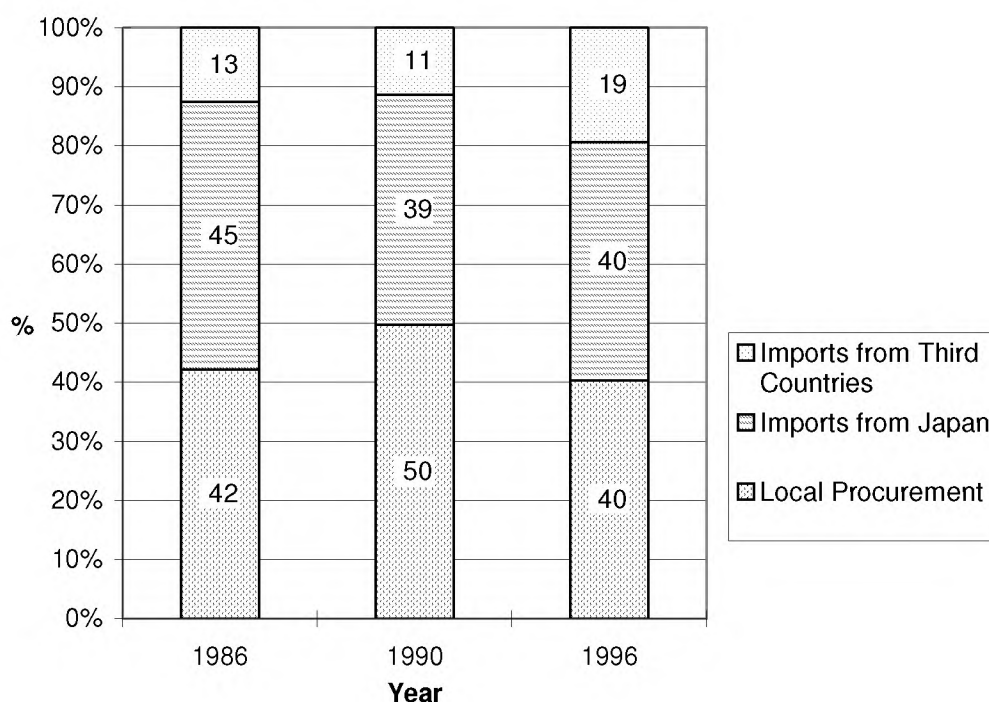
Diagram 9 Procurement of Japanese-affiliated firms in Asia

Diagram 10 Imports from third countries by Japanese firms in Asia

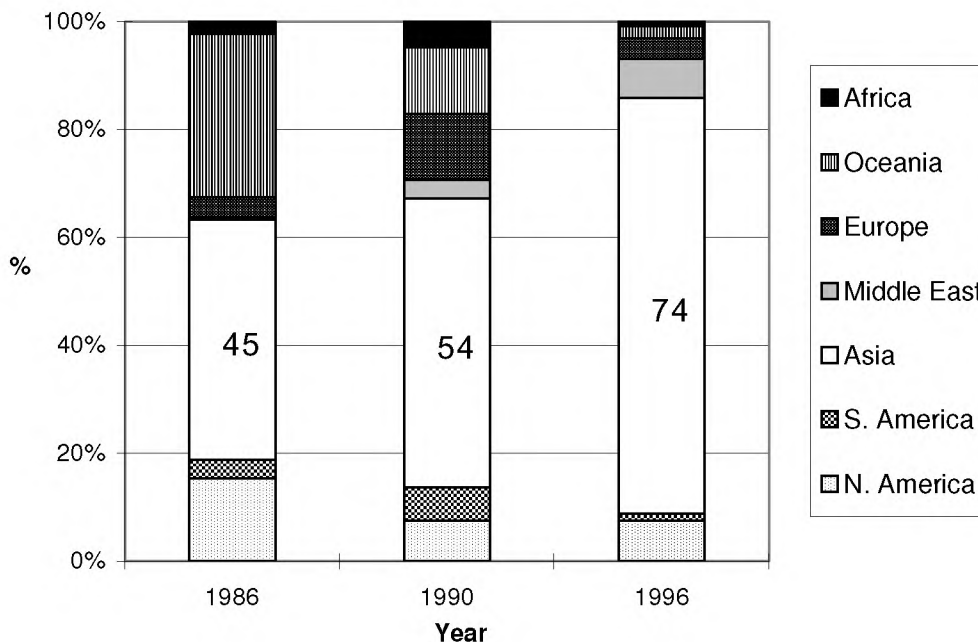


Diagram 11 Sales of Japanese-affiliated firms in Asia

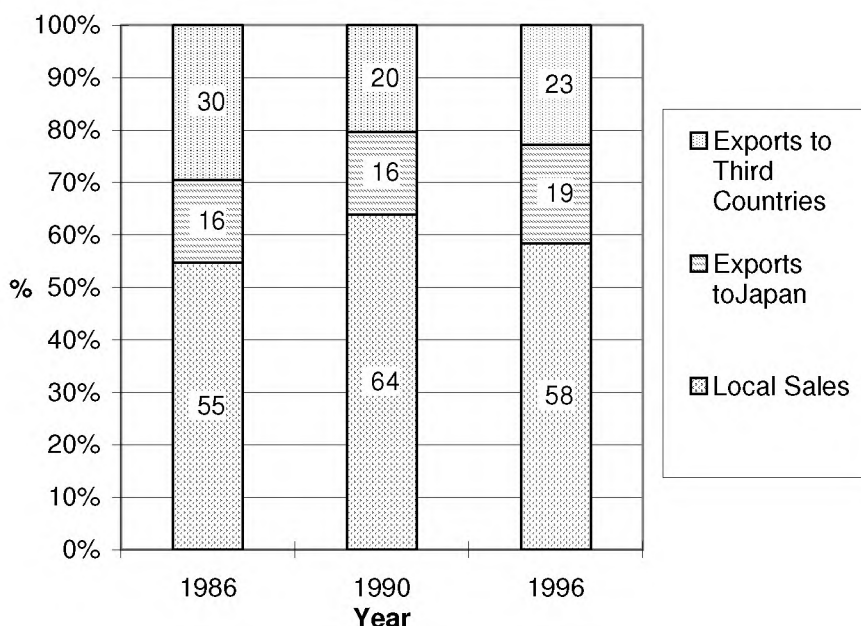


Diagram 13 illustrates the intra-regional trade in automobile parts. What is implied in Tables 3 and 4, and Diagrams 10 and 12, is exemplified in Diagram 13. The mutual supply of parts is done among the ASEAN Four (Malaysia, Thailand, Indonesia and Philippines) under the control of MNCs. Each of the Four specialized in the large-scale production of certain types of parts and components and depends on other countries, especially ASEAN members, for other parts and components, under the orchestration of MNCs.

From the ASEAN Four flow parts and components into Japan, Korea and others to support the car assembly work. Japan's roles are important as market as well as producer. Japan also benefits from the Asia-wide network. Japanese small and medium enterprises are also deeply involved. MNCs orchestrate the increasingly complex multiple network. Market dynamics functions well. Chain responses among localized companies result in the active cross-border transactions, enhancing the de-facto integration in East Asia.

Diagram 12 Exports to third countries by Japanese-affiliated firms in Asia

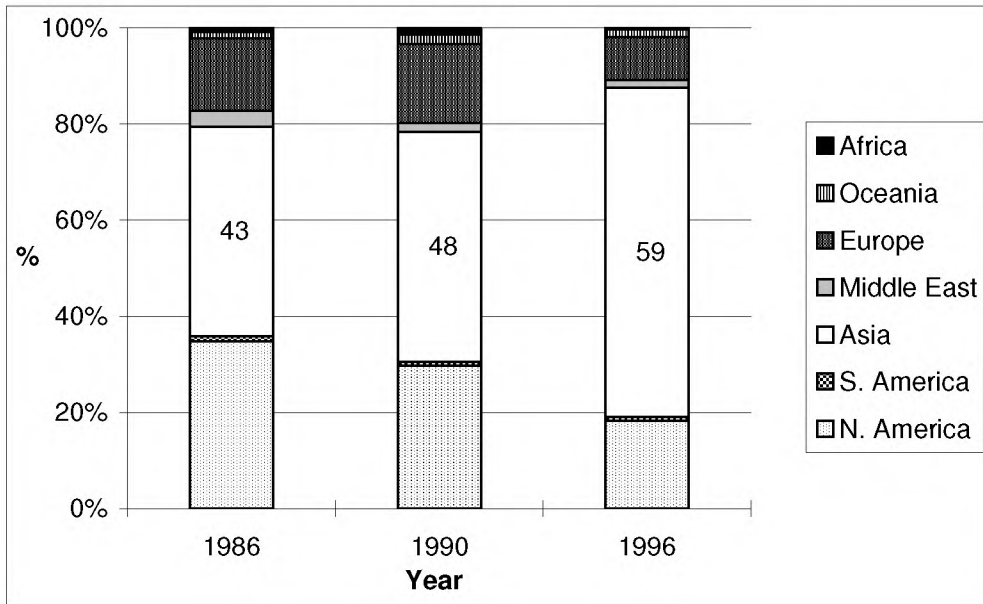
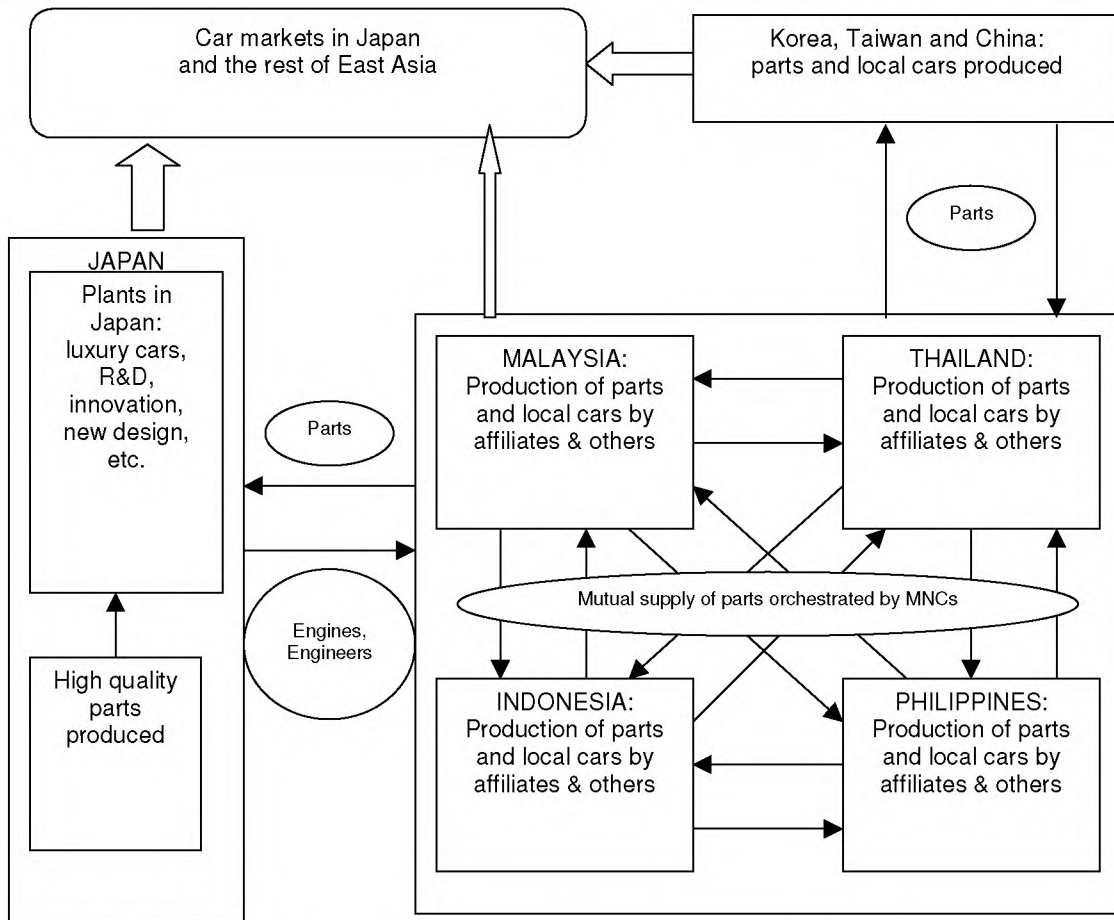


Diagram 13: Production network of automobile parts in East Asia (Involvement of Japanese MNCs and SMEs in cross-country division of labor in East Asia (Plug-in model for Southeast Asia))



Source: My own interviews in Thailand, Malaysia and Indonesia; Small and Medium Enterprise (SME) Agency, «Survey of Internationalization of Small Business», December 1997

8. Conclusion

East Asian (ASEAN-type) integration is different in many aspects from the EU-type

integration. The differences can be summarized as follows:

Europe (EU)	Comparison	East Asia (ASEAN)
De-jure integration	Basic feature	De-facto integration
Tight	Organization	Loose
Politics	Driving force	Market
Leader	Role of government	Facilitator
Inherent, strong	Community concept	Alien, weak
Small	Political system difference	Large
Developed countries	Members	Developing countries
Governments	Promoters of integration	MNCs (esp. Jap. firms)
Increasing	Intra-regional trade	Increasing
Small	Intra-regional income gap	Large
Few	Informal complementary business relationships	Many
Relatively Closed	Regionalism	Relatively Open
Large	Gains from freer trade	Large
Yes	US presence	Yes

Despite the differences or difficulties, there has recently been a rise of intra-regional trade in East Asia. What accounts for it? Various new data in the paper support a view that Japanese multinational companies play significant roles as promoters of the de-facto East Asia, especially Southeast Asia, integration, although Singapore as ASEAN's hub is important in a different sense. Behind it are massive inflows of FDIs from Japan, increasing local productions by Japanese transplants, involvement of Japanese small and medium enterprises (SMEs), the shift in Japan's comparative advantages, Asian local incentives, Asian own efforts, etc. Relevant is also the cooperation with Korean firms. Samsung's Asian networks, for instance, are deeply enmeshed with Japanese multinational companies.

When Japanese MNCs relocate, so does their vertical and horizontal relationship. In management localization, Japan lags behind other advanced countries, as shown by my questionnaires in Malaysia, Thailand, Germany and the USA. Japanese small and medium enterprises (SMEs) are also promoters of the de-facto integration.

South-east Asian countries have encouraged Japanese and other MNCs to locate operations within their borders, and by doing so,

have PLUGGED IN the regionally-based production system of MNCs. The cross-national networks which are not available in Europe become increasingly complex, interwoven and overlapping, making the Asian de-facto integration deep and unique. Market dynamics functions well especially in East Asia. All a developing country in Southeast Asia needs to do is to plug in. The network then starts working under the control of the MNC, just as a formation of airplanes takes off under the control of an aerobatics commander. The developing country is «elevated» by an «elevator», attaining high economic growth and export expansion inside the MNC-led production network. An «elevator» model functions well.

My own questionnaire survey of the managers of Japanese-based companies concludes that good foreign-affiliated supporting industries are located nearby in South-east Asia. Domestic procurement is made possible by the support of foreign-based subsidiaries, which make domestic linkages (clusters) possible. Southeast Asia acts as typical high exchange economy. The key imports from Japan and elsewhere are processed (exchanged) into export-products by localized foreign-affiliated companies. The high exchange economy corresponds to the plug-in model in the MNC production network. Mutual supply of parts

among East Asian countries is promoted mainly by Japanese-affiliated MNCs, a feature not found in the EU.

In conclusion, various new data including my own questionnaire survey data support that

the de-facto economic integration of East Asia, especially Southeast Asia, is being promoted significantly by the Japanese-affiliated companies. De-jure integration of the EU by contrast is being promoted by political initiatives and imposed by governments.

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