Northeast Asia in the 21st Century: Prospects for Cooperation and Implications for the Philippines

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INTRODUCTION

When speculating upon the future configuration of political and economic forces in Northeast Asia, observers tend to be confronted with the same problem that baffled them 40 years ago: not only is it rather difficult to say with any great degree of certainty where the region is headed, it is also unclear as to how stable the existing institutional conditions within the key countries are. In the midst of clear indications of rising prosperity in places such as China's southern coastal provinces are found leaders primarily concerned with surviving the erosion of their political legitimacy as well as over a billion people overwhelmed by the daily need to make ends meet. In such circumstances, there is precious little energy left to consider global trends, let alone adjust to new domestic and international challenges.

This paper represents a modest effort to forward several conjectures about the changing regional division of labor—i.e., the spatial pattern of industrial and economic activity—relative to the Philippines brought about by a number of crucial developments in China, Japan and South Korea (hereinafter referred to as "Northeast Asia"). The first section identifies various political,
economic and demographic forces which, given their growing momentum, are likely to play a significant role in defining the future of the region. The paper shall then engage in scenario-building and attempt to map out changes in the regional division of labor which are likely to occur over the next decade. Finally, the implications for the Philippines shall be discussed with an aim toward preparing policymakers to respond to these 21st-century challenges.

INTERESTING TIMES: CHINA, JAPAN AND KOREA ON THE EVE OF THE MILLENNIUM

The persistent worldwide flow-on effects from Asia's year-and-a-half old financial troubles have clearly demonstrated two things: first, the formidable and growing economic clout that Northeast Asia already possesses despite its considerable structural difficulties; and second, the growing need to examine the internal economic, political and demographic forces whose resulting tensions and contradictions look to shape the future contours of the region. In an exploratory paper such as this, only the most significant of these domestic phenomena may be considered. The authors argue that they are the following: for China, the widening social fractures that increased liberalization and material progress over the last 20 years have produced; for Japan, the changing demographic profile of the country in the midst of an uncertain economic future; and for South Korea, the prospect of a reunification process that is not only massively complex but strategically important for the region.

CHINA

We begin with China and the premise that macro-oriented indicators of its importance—as one of the fastest-growing economies in the world, as the 8th largest exporter, as one whose trade surplus with the United States rivals Japan's—are insufficient as means of discerning the country's trajectory. What we argue instead is that one must look more closely at the growing social divides that have emerged as a result of China's move toward a more liberalized and globally integrated economy.

Theory suggests that such dislocations and inequities are a necessary outcome of the liberalization process. The specific
factors model in international trade (Jones in Salvatore 1996), for instance, points out that in the face of changing relative prices—such as those that arise from trading in world markets—owners of immobile factors of production are likely to see the returns to these factors diminish and thus their relative income positions deteriorate. Economists, of course, have often been less than attentive to these developments partly because of a long-standing belief in the eventual efficacy of a market-oriented approach but also because it may be argued that other mechanisms to aid marginalized groups may be put in place without reversing the liberalization process. Additionally, there is the point that Krugman and Obstfeld (1996) make regarding the democratization of economic activity, which liberalization encourages. The argument is that in a protectionist or planned economy, favors are inevitably given out to privileged groups often on grounds other than efficiency. This results in a patently inequitable set-up whereby a few influential industrialists are disproportionally represented at the expense of the vast majority of consumers who have neither the voice nor the organizational resources to combat the democratic deficit. Liberalization, it is said, may be viewed as a potent means not only of eroding the economic base of entrenched interests, but also of transferring power to consumers through the more widespread exercise of choice.

Those of us interested in the process of liberalization and market reform rather than merely the outcome, however, do not rest easy on such claims. If the decade-old transition difficulties of Russia are any indication, there are three reasons to pay extra attention to the equity and distributive aspects of the liberalization process: first, because market reforms are often undertaken piecemeal and are thus dependent upon the degree of political support that exist in favor of further opening up. Yawning disparities in income wear away at this capital and have been known to create a powerful backlash toward even more intensified protection, as evidenced by the return to favor of hardline communists such as Zhirinovsky in Russia during the lowest points of its transition.

Second, disparities in income tend not only to be selfperpetuating but also create powerful incentives which, in the end, exact a considerable toll on social service budgets. In the absence of a strong welfare state, for instance, poverty tends to be an inter-generational phenomenon, the result of which is either the drift of millions from the countryside to already overcrowded urban
centers or the migration of similar millions to more affluent nations elsewhere (Barnet & Cavanagh 1993).

Lastly, and perhaps most importantly, the market itself is an institution that relies upon what authors such as Putnam (1993) have referred to as "social capital"—i.e. levels of trust that exist within a community which lower the costs of transacting. Strange (1986) has argued that in a society where the prevailing perception is that wealth comes as a result of sheer luck rather than hard work (such as through stock market or privatization windfalls), then faith in the social and political system, upon which smooth market functioning depends, quickly fades. What replaces it is often an individualistic and amoral society in which public goods are overexploited, contracts are systematically reneged upon and property rights are difficult to protect (Italy's Mezzogiornio region is often cited as an example).

The cleavages in China are unmistakable. Khan and Riskin's (1998) recently-published estimates of income distribution within China have confirmed what a good number of observers have felt all along—that between the years 1988 and 1995, income inequality within China increased sharply, making it one of the more unequal developing nations in Asia. The 1995 Gini ratio for China is 0.452—higher than that of India, Pakistan and Indonesia and about the same for the Philippines. The great urban-rural income gap appears to be the primary contributor to this inequality, although it was found that the Chinese government's tolerance of regressive tax structures, uniform housing subsidies and similar policies played their part in exacerbating an already undesirable situation. While the authors were careful to use examples of poor public sector management as evidence that not all the blame for such disparities may be laid at the door of liberalization, one may safely dismiss the point. Their own findings indicating that the shift from public to private ownership of real estate has done much to increase rural-urban inequality on account of faster-rising house prices in the cities prove otherwise. Apart from this, the social context of such wealth accumulation must not be ignored. After all, the people who first benefited from Deng's change of heart were high-profile Party cadres, not anonymous and atomistic Smith-type entrepreneurs (Zeng 1998). It has been asserted that when these resale tycoons (there are over a million of them in Shanghai and Guangzhou alone) used their special privileges to obtain wholesale vouchers, allowing them to purchase goods
below the market price and reap windfalls selling them in the open market, the discontent was much higher. Zeng (1998) contends, in fact, that the 1989 Tiananmen Incident was intimately related to this widespread economic practice.

The economic marketization of China which has been promoted over the last 20 years, is actually a process of the capitalization of power, that is to say, a process of converting social wealth into private capital (Kong 1998). As such, a considerable degree of decay in the social atmosphere is being observed, partly because of the increasing irrelevance of the old legal system in which "judicial autonomy under the leadership of the Party" prevailed, but also because of the backlash against organizational streamlining. Perhaps the best evidence of this is the reported increase in the ratio of government officials to private citizens (now 1:30), with such officials refusing to relinquish their privileges.

If such trends continue, one should expect an interesting next decade from mainland China. The contradiction between the desire of higher-level Party officials to use liberalization as a bargaining chip to acquire WTO membership and strengthen China’s regional presence set against the need of these same officials to maintain their own power as a means of dealing with the discontent arising from growing inequalities is not an easy one to resolve. It has far-ranging implications for China’s economic development (as investor confidence absolutely depends on the stability of the political system) and the pace of reform—for although the 15th Congress has put capital market reforms high up on its list of priorities, the state still owns all but a handful of the 843 listed companies (Neoh 1999).

Above all, however, what must be remembered is that whatever benefits in capital accumulation and efficiency China receives as a result of its liberalization efforts must be weighed against the destabilizing consequences of this very same process. The stakes are high: not only is China a country of 1.2 billion people, the vast majority of whom is poor, it is also a country riven by deep inequalities between northwest and southeast. It is a country bent on making a play for regional leadership but also one hard-pressed to settle territorial disputes on all sides and contain its own internal discontent. Finally, it is a country in which are found some of the fastest-growing provinces in the world, but also one which has had to use state legislation to forcibly prevent...
the inward drift of hundreds of millions of people in search of better fortunes.

JAPAN

"Guarded optimism" is Paul Kennedy's (1993) rather well-known view regarding Japan's ability to meet the challenges of the next decade. Claims about Japan's technological and economic superiority are, on the whole, well-founded. However, they must be assessed against a number of serious challenges that appear over the horizon. Some of these challenges are political. Clearly the most long-standing one is the perception that Japan continues to maintain a disproportionately low profile even in this multi-polar world, which gives rise to resentment and accusations of its free-riding on the security provided by countries such as the United States. Another is Japan's continuing inability to create the sort of high-caliber political leadership to which, ironically, most advanced nations seem to attribute their successes. In Kennedy's words, Japan seems to have "constructed a machine that can go by itself" through the use of rigorous standards, social codes and a team-spirit ethos. While some may view this as a kind of national triumph, it is doubtful whether the formidable nonmaterial and moral challenges of the 21st century which require strong political vision can successfully be dealt with using this approach.

What we would argue, however, is that the key phenomenon that will determine Japan's direction in the next decade is the "greying," if you will, of its population. We would argue that the dramatic change in the demographic profile of the country has produced and will continue to produce spillovers in both the economic and political spheres. On the economic front, the analysis is straightforward. Many authors such as Krugman (1994) have been at pains to point out that the tremendous and persistent trade surpluses that Japan maintains with many industrialized countries stems primarily from its historically high savings rates—whether public, household or corporate. But while there are many reasons for the high savings ratio, one thing is sure: the rapid ageing of the population will be sufficient to cause private savings to decline precipitously, possibly becoming negative in the next ten years (Schoppa 1998).
The pressure is great: in the next generation, Japan will have the highest proportion of elderly in any OECD country. Its over-65 segment has been growing at 5.03% since 1950, while its under-14 group has declined by 0.84% over the same period (UN 1994). Apart from the anticipated steep drop in the savings rate which will come as a result of reduced earnings alongside greater health and consumption expenditures, there are reasons which might lead one to expect a drop in Japan’s current account surplus, a weakening of the yen, as well as labor shortages, new career paths for women and a shift away from the lifetime employment system (Schoppa 1998). Andrew Mason (1997) has studied the population characteristics of most East Asian states and has concluded that demographic changes influence aggregate saving in ways which are often overlooked. Since aggregate saving depends not just on the life cycle pattern of household saving but also on the relative numbers of households at different stages of the life cycle, then two scenarios may be obtained. If a relatively large portion of the population consists of “empty nesters” whose children are at their earning peaks, then aggregate saving will be higher. On the other hand, if a large part of the population consists of retirees who are no longer saving but instead drawing down on their wealth to finance retirement, then aggregate saving will be low.

As a result of these wide-ranging developments, sweeping changes have been observed in Japanese lifestyles. Between 1990 and 1995, for instance, Mason documents an actual increase in elderly participation in the labor force, although he is quick to point out that because of the small sample size, this is rather a tentative finding. What is clear, however, is that the elderly in Japan—as well as all over East Asia—are increasingly likely to live independently. The proportion of Japanese elderly living with children has declined from 80% in 1950 to about 70% in 1970 to 50% in 1990. The impact of this on saving is substantial since it has long been established that the family support system is a key contributor to the high savings rate (Ogawa and Rutherford 1997).

This brings us nicely to the rather more complex implications that demographic change will have on the social and political system in Japan. For even as the country is battered by both economic and financial crises, the political system virtually ensures that enlightened leaders will not emerge (Van Wolferen 1990). Instead, an “old boys’ network” (graduates of Tokyo Law
School etc.) in the bureaucracy, big business, banks will continue to share power, rather than defer it to a "leader" (in the Western democratic sense). The increasing proportion of the elderly as well as their growing economic independence set alongside the value placed on collective wisdom and in authority as a whole, is not likely to produce a new brand of leadership better prepared to face a vastly different 21st century. On the other hand, it is this very same demographic change that is ushering in ever more opportunities for women in employment and social participation as well as forcing change in long-standing economic structures such as permanent-hiring practices and vertically integrated keiretsu monoliths (Naohiro 1996). The outcome of these two tensions should be interesting to observe since the speed at which economic pressures mount clearly outpaces the ability, let alone willingness, of Japanese society as a whole to modify historically-rooted and culturally-entrenched institutional arrangements.

SOUTH KOREA

The new year is off to a promising start in South Korea. Although official full-year GDP figures are not to be released until March, it appears that the country has begun to claw its way out of recession. Some economists now forecast growth of 3 to 4% for 1999 (FEER 1999). Although others are quick to point out that even if the economy expanded by 4%, it would still only be returning to pre-crisis levels, the mood is decidedly one of optimism. It is perhaps because of this that more attention is being paid to the long-term Korean project: the unification of the peninsula.

Kang In-duk, South Korea's Minister of Unification, has sketched the situation: reuniting separated families is the top priority of the South toward the North, even as it has dropped this as a condition for the provision of fertilizer—the sticking point of the 1998 talks-suspending dispute. As both relatively new governments settle into their respective positions, both official and unofficial channels will be encouraged to make contact, bearing in mind, of course, the importance of keeping the talks between Koreans, rather than depending on non-Korean parties.

For the past two years, it has been fashionable to discuss the future of North-South relations in terms of three basic scenarios. One, the most extreme, involves an outbreak of war beginning with the invasion of South Korea by North Korean armed
forces. According to this projection by the former commander of the Combined Korea-US Force General Gary Luck, Pyongyang is likely to start a war by shelling the Seoul area, which lies within artillery range of its approximately 240 howitzer batteries located near the DMZ. Next will come a southward thrust by land and marine forces. But before its offensive capabilities diminish, the North will settle for taking Seoul and suing for peace.

While this outcome is possible, it is certainly implausible given not only the food shortages, but the energy deficit and infrastructural limits of the North Korean military.

A second scenario involves the collapse of North Korea, which would come as a result of food shortage and economic pressures. While this appears to be the conventional wisdom—the question being “when” rather than “if”—there are a number of factors that could head off this collapse. Kim Ki-hwan, chair of the Korea Trade Promotion Corporation names them. For one thing, he says, Kim Jong-il has not lost control over the party or the military. Furthermore, there is no such thing as “widespread consumer resentment” since its population has been isolated from the rest of the world, and is controlled by terror. Finally, its neighbor China is willing to continue giving support to the North since the latter serves as a buffer between their transition economy and capitalist South Korea, a close ally of the United States. Apart from this strategic consideration, there is the very real prospect of being deluged socially and economically by waves of North Korean refugees. This, in large part, is the reason China resumed its food aid program to North Korea in May 1996.

The last scenario is unification via what is currently known in the discourse as a “soft landing.” In this case, the minimum requirement appears to be the willingness of Washington, Seoul and Tokyo to extend substantial food aid to North Korea to halt the further spread of famine. In return, it is hoped that concessions on the renunciation of terrorism and the agreement to refrain from selling missiles to countries in the Middle East may be obtained from Pyongyang. Afterward, South Korean companies may then begin to implement their plans to invest in North Korea, eventually encouraging multilateral lending agencies such as the Asian Development Bank and the World Bank to extend additional credit assistance and continue the unification process.

The critical factors which will swing the situation either way have been identified (Ki-hwan 1998). The first is, of course, the
looming famine up North. As the North Korean population is now allowed greater mobility to assist in searching for food, this places great strain on the mechanisms needed to keep domestic discipline at a reasonable level. Already, the military has shown not only low morale but strong signs of discontent, leading several observers to suggest that a large-scale food riot is not out of the question.

A second key factor is the choice Kim Jong-il has taken by clearly siding with the military rather than the Party. This approach seems to have caused great tension within the aging ruling elite, so much so that the defection of Hwang Jang-yop has been attributed to this development.

The last factor is the nature of the talks themselves. On the one hand, the South needs US backing as a bargaining chip, since diplomatic recognition from and the lifting of sanctions by the latter are preconditions demanded by the North. However, US participation also increases the chances of direct two-way talks between Pyongyang and Washington, something that has evidently caused discomfort in the South Korean government.

Although the soft landing scenario is easily the most desirable amongst the menu of outcomes presently imaginable, it is not without considerable challenges. It cannot be over-emphasized, for instance, that South Korea's economic strength is not yet anything like that of West Germany at the time of its unification with East Germany, In 1990, West Germany's per capita GDP was $25,000; South Korea's is $10,000 today. Furthermore, the Korean income gap is much larger at 10:1 than the German gap, which stood at 3.6:1.

Not to be forgotten, of course, is the fact that, unlike the Germans, the Koreans fought a grievous fratricidal war. As a result, each side has very little knowledge of the other and suspicions still run high, increasing the cost of transition for both peoples. Of the 616 known defectors since 1953, only half have held steady jobs (Lee 1997). They have also experienced problems relating to social treatment from Southerners, lack of support mechanisms, even the inability to understand the Korean language as it is spoken in the South (which has many more English terms embedded in its vocabulary). All these indictors point to the fact that the reunification of the peninsula is likely to be a gradual and troublesome process, needing much more than just economic aid from the major players.
IMPLICATIONS FOR THE PHILIPPINES

Diverse as all these developments in Northeast Asia may seem, some general changing division of labor in the region as well as a possible Philippine response may be drawn. The first is that given current trade and investment trends in the region and working on the premise that they will continue to increase in a more liberalized environment, attention should now be paid to both the geographical and qualitative characteristics of the Philippines' own industrialization strategy. As always, the picture is mixed. On the one hand, if pessimistic scenario obtains, then efforts at establishing further economic ties with the countries in question may be waylaid. If the Japanese economy experiences much slower growth as a result of its changing demographic profile, for instance, then alternative export markets to our second largest trading partner will have to be found.

On the other hand, the transition in which China, Korea, and Japan find themselves provides the Philippines with a unique opportunity to “buy time” for further reconstruction. As China's exploitation of its huge low-wage labor force is held in check by resources increasingly channeled toward quelling dissent and redistributing the gains from liberalization, the Philippines may choose to more vigorously pursue a strategy that will lessen its dependence upon unskilled labor, as the qualitative nature of regional specialization changes. For the slower and more measured the pace of liberalization in China becomes, the less painful the transition for domestic industries in the Philippines competing with Chinese exports worldwide will be. Increasing the value-added of Philippine exports involves capital deepening, investment in human resources and the encouragement of technology transfer. The latter, however, if we are to follow the true “flying-geese” strategy as elucidated by Intal (1996), requires higher local investment rates rather than multinational-led development.

The evolving geographical arrangements in the region must also be kept in mind. Already in Southeast Asia, “growth triangles”—strategically-located cities bound together by an assortment of investment and export zones—have done their part to spur regional development. So far as the possibilities for carrying out a similar plan with Japan and Korea are concerned, they are considerably smaller, given the high transaction costs and geographical
distance. If pressed to find prospects for regional cooperation in the Northeast, one would have to point to the Tumen River Area development program (Foot 1996) which involves North and South Korea, Japan, China, Russia, and Mongolia. This $30 billion trade and transport project, if it ever materializes, will include 11 harbors and a rail hub. The objective is to transform this backward region, which offers timber, minerals, oil, coal and cheap labor into an area that may someday rival Guangdong and Fujien, Hongkong and Taiwan and thus shift the direction of specialization once more.

With China, however, there is much more room for Philippine involvement. For not only are its booming provinces auspiciously close to the northern corridor of Luzon, a key factor in lowering transaction costs between these sub-regions is the overseas Chinese in the Philippines, most of whom come from Guangdong and Fujian. All over Southeast Asia, their economic power is unmatched by any other racial group. It is estimated that the private wealth of the region’s 20 million ethnic Chinese exceeds $200 billion. Of the 1,000 leading companies listed in the region, over half—some 517—are owned by the ethnic Chinese who represent a mere 5% of the population. They own nearly 80% of Indonesia’s private wealth and about 50% of Malaysia’s corporate assets, and although figures for the Philippines are sketchy, they cannot be too far off these estimates given the country’s decidedly tolerant population (Kao 1995).

Apart from the commonalities of language and culture which they are more likely to share than, say, the Taiwanese, the overseas Chinese in the Philippines themselves have actively made efforts, through their various cultural and civic organizations, to establish stronger links with the mainland. Indicative of the PRC government’s encouraging attitude, in fact, the Chinese Embassy in Manila exempted visa fees for delegates to the First Convention of the World Jinjiang Federation in May 1997 (Hong 1998). An increasing number of them are sending sons and daughters to places like the Beijing Language and Culture University to study Mandarin, in anticipation of business opportunities arising from greater ties between the two countries.

Mittleman (1995) stresses that the formula in establishing these sub-regional groupings, as they have been formed in Southeast Asia, is to utilize small-scale, decentralized negotiations amongst fewer parties committed to locally-based and relatively
informal arrangements, rather than the cumbersome bureaucracies of full-blown institutions. As such, the PRC appears to have the advantage, particularly over Taiwan, in offering the locations of these non-governmental international conventions and networking partnerships, being the site of both tremendous economic activities and the ancestral hometowns of the overseas Chinese. Local governments in South China regard the resumption of local traditions and worship as a means to reconnect with overseas compatriots as well as attract investment, adding a cultural incentive, if you will, to the diaspora (Hong 1998). This is particularly significant given that the one enduring feature of Chinese business practice is trust (xinyong), which helps reduce transactions costs and obtain reliable information about the reputation of potential business partners (Mackie 1992).

Finally, the trends discussed above seem to suggest that the Philippines' comparative advantage is shifting away from commodities associated with its traditional export base, toward those goods and services which are "tradeable but not traded" (e.g. tourism, health services, education). The prospects for specializing in these industries will depend ultimately on the willingness of Philippine policymakers to make the necessary one-off investments as well as correct distortions in these areas. However, the potential is great. If China achieves its aim of a convertible currency within five years, then tourism and related activities are almost sure to experience unprecedented growth and encourage the shift in sectoral activities. The need of Japan's geriatric population for health care may be met quite handily by the fact that the Philippines is the world's largest producer of nurses (Barnet & Cavanagh 1994). And finally, the increasing number of Koreans enrolling in Philippine graduate, language and distance-learning schools over the years has shown the country's comparative advantage in this highly-specialized service.

All in all, it may be said that the transition-related phenomena that states in Northeast Asia are experiencing provide significant opportunities for the Philippines to consolidate its efforts and accelerate its own unique process of development. By taking advantage of the current uncertainties within the region, the country may almost ironically, place itself in a clear position to provide neighboring countries with goods and services whose demand will undoubtedly increase over the next few years. If it succeeds in this, not only will it be able to hasten the pace of its
own stalled development, but it may manage to convince a few other pundits to rethink their notion of what it means to live in interesting times.

BIBLIOGRAPHY


