

---

## BOOK REVIEWS

---

***The Pacific Economy: Growth and External Stability.* Edited by Mohamed Ariff.** North Sydney, Australia: Allen & Unwin in association with The Pacific Trade and Development Conference Secretariat, The Australian National University and The Institute of Strategic and International Studies (ISIS), Malaysia, 1991.

---

This volume of collected papers represents the output of the eighteenth Pacific Trade and Development Conference held in Kuala Lumpur in December 1989. Nineteen authors from eight countries (Australia, Canada, Indonesia, Japan, Korea, Malaysia, the Philippines, and the United States) have, under the editorial direction of Professor Ariff, produced an exceptional volume on current economic problems and opportunities that confront the nations of the Pacific Rim. This work is remarkable in at least two respects: first, no more convincing proof can be evinced of the progressive integration of the international economy than by a book which ostensibly focuses on one global region but, in the process of so doing, provides a comprehensive analysis of the most critical issues facing the entire global economic community today. Second, the cogent analysis in this volume is refreshingly agnostic, demonstrating on numerous occasions a willingness to re-examine critically preconceived economic theory in light of empirical evidence.

The principal thrust of this volume is an assessment of major macroeconomic factors that have

influenced the dynamic growth of the Pacific Basin for the past several decades, and how such factors and related economic policy decisions may affect the future of this remarkably diverse region. At least three major themes emerge from this work: first, and foremost, that national macroeconomic policy in the highly fluid and interdependent international economy of the present can no longer be confined to narrowly construed domestic monetary and fiscal issues; as Krueger states, effective macroeconomic management must also include among its most important components, exchange rate policy, trade policy, financial policy, and wages policy; second, that a vital ingredient in the continued economic growth and development of all global regions is a strong export orientation facilitated by adequate infrastructure, minimal price distortions, and a low level of government intervention in market-driven decisions; and third, that serious although not insurmountable problems threaten the longer-run stability of the Pacific Rim as they do the international economic system. These problems include the continuing imbalance in the United States budget and current account, growing protectionist sentiment in many nations, a parochial European preoccupation with internal political and economic union, and the festering issues before GATT including agricultural subsidies, intellectual property rights, and trade in services.

This review continues with brief commentary on several of the major questions addressed by

---

this volume, and concludes with a number of summary observations.

1. What are the explanatory variables for the dynamic growth of the Pacific Rim economy?

Anne Krueger analyses Pacific region development in the context of several growth and development models. She concludes that there is an unambiguous nexus between growth and an outer-oriented trade strategy, and a looser but none-the-less compelling relationship between growth and a transformation in the role of government, involving a loosening of regulatory regimes and increased reliance upon market mechanisms, but coupled with a significant commitment to infrastructure development, education and social services.

Ippei Yamazawa, Akira Hirata and Kazuhiko Yokota track the changing patterns of comparative advantage within the Pacific Basin, suggesting the now familiar "flying geese" metaphor for the process of successive industrialization among country subgroupings. The authors conclude that "the underlying forces of the evolving comparative advantage were the catch-up industrialization of the NIEs and ASEAN countries and FDI by American and Japanese firms".

Manuel F. Montes re-examines the apparent paradox of how the developing countries of Asia (with the exception of the Philippines) fared much better than their Latin American counterparts in the turbulent 1980s despite similar debt/GNP ratios in the early part of the decade. In effect, Montes attributes the success of these Asian nations in attracting external credit for financing their savings/investment imbalance to "getting the prices right" and creating a responsive climate for foreign investment, particularly private capital flows from within as well as outside the Pacific bloc.

Yung Chul Park describes the evolution in Japan, Taiwan and Korea from a macroeconomic focus on export-led growth to a complementary policy of internal demand-oriented economic expansion. To Park, this increased attention to domestic consumption and investment in the three

strongest economies of the Western Pacific is essential to defusing the growing trade tensions between Pacific Asia and the rest of the world, especially the United States, and staving off a potentially major disruption in the global system of trade and payments.

Finally, Mari Pangestu describes how the ASEAN nations have been successful in utilizing macroeconomic adjustment and structural micro policies to respond to external and internal shocks of the 1980s that could have caused significant problems with inflation, current account and fiscal balances, and real GDP growth. Important policy initiatives undertaken by most of the ASEAN nations involved tax and fiscal reforms, trade and investment deregulation, removal of government control over interest rates, a greater focus on increased efficiency and competitiveness, and maintaining an appropriate exchange rate. The author cautions, however, that policies assuring the soundness of evolving financial institutions must accompany deregulation in the financial sector. Parenthetically, this suggests that those trained in the current era of deregulation must be reminded occasionally that the originally motives for regulatory activity were numerous and disparate, and that some initiatives designed to protect the economy from the failure or conscious subversion of market forces remain valid today.

2. What are the roles of the United States, Japan, and the European Community in the continuing process of Pacific Rim development?

The chapter by Barry Bosworth is the first of several which address the central role of U.S. economic policy (especially its current account and budget deficits) as the key to the continued viability, if not survival, of the current world economic order. Two of Bosworth's more compelling observations are: first, that the issue of the U.S. budget deficit has become mired in an intractable ideological debate, and that this deficit has placed an enormous burden on monetary policy to serve the dual goals of domestic and external economic balance. Yet, "the current account imbalance has

---

become an integral part of the world economy, critical to continued expansion. A U.S. deficit allows a large number of other countries to follow a policy of export-led growth". Second, a disturbing, and indeed dangerous, pattern has emerged in the United States of blaming foreign trade restrictions, as opposed to inadequate domestic savings, for the current account deficit. Bosworth sees a much greater threat from emerging American protectionism than from a continuing reliance on foreign borrowing to correct the domestic savings-investment imbalance.

Heizo Takenaka reaffirms Bosworth's linkage between Asia-Pacific growth and the U.S. trade deficit but is much less sanguine about continued reliance on the United States. To Takenaka, the burden of maintaining the continued expansion of the Pacific Rim economy must perforce fall upon Japan, yet the required "unprecedented and drastic reformation of Japan's domestic economy by means of substantial deregulation" is not guaranteed.

Lawrence Krause and Mark Sendberg examine the impact of five past and potential pivotal factors on the global economic environment: the end of the Cold War, the transformation of Eastern Europe, Western European integration, a marked strategic change in Latin America toward export-led growth, and structural change in the United States that could reduce the budget and current account deficits. While acknowledging the potentially detrimental effect of reduced U.S. demand on developing countries, the authors contend that such undesirable consequences could be avoided through a cautious and integrated policy response between developing and developed nations that seeks and permits the creation of alternative markets for Pacific Rim exports. Of much greater concern to the authors are two possible scenarios: first, what they term "contentious trilateralism" (among Europe, the Americas and Western Pacific); and, second, "one-world anarchy" where the existence of unequal players with divergent interests, coupled with the absence of a hegemon to enforce a stable economic environment, leads to an anarchic global economic system. The authors conclude that the optimal global organizing

system to replace the Cold War antagonists is a bilateral division between Europe, on the one hand, and the rest of the world on the other. There is reason to believe that this conclusion might not be universally shared. In addition, the predicted shift of U.S. priorities from a preoccupation with military hegemony to intensified economic competition may be premature in light of the increasing threat of nuclear proliferation demonstrated by recent events in Iraq.

3. What is the nature of the threat to continued Pacific Rim development from such diverse factors as commodity price instability, increased capital mobility, and emerging regionalism?

Ronald Duncan reviews the threat to developing economies from the volatility of primary commodity prices — a problem that can adversely affect a nation's macroeconomic management policies. While highlighting the failure of price stabilization agreements, the author outlines how risk sharing through financial diversification or activity diversification for hedging prices and production risks can help to alleviate some of the more detrimental effects of commodity price instability.

Lin See Yan's excellent discussion of the Malaysian experience with exchange rate policy reflects similar issues throughout the developing world. The author describes how the increasing integration of the global economy, and capital markets in particular, has forced a critical re-assessment of freely floating exchange rate systems. Exchange rate volatility threatens economic development, yet the relative stability of such rates required for orderly industrialization has been threatened by the high degree of global capital mobility.

In the final contribution of this volume, Edward English and Murray Smith recast the current debate on the relative merits of bilateralism, regionalism and multilateralism. To the authors, much of recent "bilateralism" has been thinly veiled, unilateral pressure from major powers designed to evade provisions of GATT. Such pernicious and *ad hoc* bilateralism must be

---

differentiated from true regionalism entailing systematic institutional arrangements between two or more countries as under Article 24 of GATT. The authors feel strongly that current fears that regionalism is inconsistent with, and antithetical to, global multilateralism are misplaced. Both organizing principles are required to sustain the world economic order. In light of the fact that unencumbered global free trade remains an elusive goal, carefully crafted regional alliances (based on the exchange of information and policy initiatives aimed at international problems) can be the vehicle for carrying GATT principles "further and sooner into practice".

This volume provides irrefutable evidence of the complex interdependency of the global economy — a cause and consequence of the growth in investment, development and trade over the last several decades. Yet, to utilize an ecological analog, the tighter systems linkages forged in this period bring greater risks as well as benefits. The increased threat to system resilience follows from the fact that no system component can insulate itself from the potentially detrimental acts of commission or omission of other major entities.

One message that is clearly articulated by this volume is that the health of the global economic system depends on carefully crafted and coordinated policy responses from the major international players. These actions include continued liberalization of trade and financial systems within the NIEs and other developing countries of the Pacific Rim, substantial deregulation of the Japanese domestic economy and encouragement of domestic demand, a greater degree of engagement by Europe in external economic and political issues, and progress in solving America's budget and current account imbalances. In this respect, there have been at least two disturbing trends in the United States. While the dynamic economies of East Asia have devoted substantial resources to infrastructural development and education of a skilled labour force, the United States prior to the election of President Clinton has followed a divergent path, flirting with the deterioration of many infrastructure components, and a weakened public education system. Accompany-

ing this has been an increasingly politicized and trivialized public debate over the size of the U.S. budget deficit. This debate has abstracted almost completely from such specific issues as the relative productiveness of budgetary components (for example military versus infrastructure expenditure) and the extent to which some government expenditure such as education and infrastructure can be viewed as social investment. The recent economic policy proposals of the new Democratic administration are encouraging, but the renewed calls for a constitutional amendment for a balanced budget could prove disastrous. If such a mandated balance were ignored, it could further shake public confidence in government institutions; if followed, it could eliminate an essential Keynesian remedy for a major economic recession or depression. This latter outcome summons up a draconian scenario of a U.S. Government, faced with a weakened economy, forced into a cycle of mutually reinforcing contractionary budget balancing measures.

In conclusion, despite the emergence of the Pacific Rim as a major player in the international economy, it must be said that now, as in 1929, the United States, through its macroeconomic performance and policy responses, remains the linchpin of global economic stability.

PETER N. NEMETZ

*Associate Professor, Policy Analysis Division  
Faculty of Commerce and  
Business Administration  
University of British Columbia*

---

**"Trade Reform" Lessons from Eight Countries.** Edited by Geoffrey Shepherd and Carlos Geraldo Langoni. An International Centre for Economic Growth Publication. San Francisco, California: ICS PRESS, 1991.

---

Most of the newly independent developing countries of Latin America, Africa and Asia in the