

PRELIMINARY : NOT TO BE QUOTED: COMMENTS/CRITIQUES WELCOME.

**THE EURO REVOLUTION AND EUROPEAN UNION:
MONETARY AND ECONOMIC COOPERATION IN THE ASIA-PACIFIC**

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The Rationale

The inauguration of EURO on January 1, 1999, under the management of European Central Bank (ECB) in Frankfurt, is an epochal economic event, warranting a revisit with the general theory of employment, interest and money.

A study of a coordinated monetary and economic policy for the Asia-Pacific region has long been debated. Institutionalization of Asia-Pacific Economic Cooperation (APEC) occurred in 1989. In 1999, APEC membership has risen to twenty-one sovereign-nation-state-based member-economies. Annual meetings of Finance Ministers and Heads of Central Banks of APEC- member economies have been a regular feature, pointing to the fact that a supra-national macroeconomic core, well-defined by monetary/fiscal policy guidelines alone could contribute to the success of APEC agenda of intra-regional free trade, free flow of investment, and then by free flow of human capital.

Inauguration of EURO and ECB on January 1, 1999 presents a learning model to the movement toward economic regionalization in the Asia-Pacific. Hence, we propose to study the economic rationale of institutionalization of Asia-Pacific Monetary Union (AMU) with *an optimal and transparent agenda for intra-regional monetary policy coordination in terms of both supply of aggregate stock of money and the determination*

of the intra-regional core rate of interest, supplemented by intra-regional fiscal policy coordination, which can and will provide the necessary and sufficient conditions for intra-regional free market with free flow of trade/investment/human capital, contributing to the maximization of economic gains for all micro-economic actors – households as well as business corporations – belonging to all intra-regional sovereign nation-state based macro-economies (Dutta 1999). This regional arrangement in the Asia-Pacific will, of course, work within the framework of global institutions, thus optimally harmonizing regionalism with globalism. To paraphrase Saburo Okita - No concept of fortress economic regionalization either in Western Europe or in the Asia-Pacific will maximize global economic gains. (see also Bergsten 1995; Dutta 1998, 1996; 1995a, 1995b, 1995c, 1987, and 1985; Fry 1996; Harberger 1996; Klein 1998, 1994 and 1990; Krugman 1994; Lau and Kim 1994; Letiche 1993 and 1998; Lloyd 1996; Maehara 1998; Petri 1993; Yamazawa 1994; Yoo 1996 and 1996).

The present research is a natural progression of my earlier research, recently published (*Economic Regionalization in the Asia-Pacific: Challenges to Economic Cooperation* (January 1999) Edward Elgar, UK 319pp. I have argued that the core of newly emerging economic regionalization relates to

- (a) a map-of-the-world view of the region, and
- (a) an intra-regional, multilateral cooperative effort to map an economic region with well-specified micro-and-macro economic parameters on to a specific geographic region.

Of course, experiments in Western Europe will be a learning model. Progression of economic regionalization in Western Europe, since its inception in 1958, reached its

membership of fifteen at successive stages over the years. And in January 1999 , eleven of the fifteen signed for EURO, a common currency, managed by an intra-EURO-zone central bank, the European Central Bank (ECB). The remaining four members – the U.K., Denmark, Sweden and Greece are expected to adopt the common currency. Indeed, the U.K. has recently announced a specific time-table in this regard. Greece is working hard to manage its macroeconomic agenda to qualify for the membership of the EURO club. The principle of *inclusion, not exclusion*, remains the policy.

The objective function of EU is to maximize economic gains for micro-actors – households and businesses – in all 15 member–economies within a framework of a shared commitment to a macroeconomic agenda, well-defined by monetary and fiscal guidelines. The micro-economic agenda included (a) free flow of trade in goods and service, (b) free flow of investment, plus (c) free movement of labor. The Maastricht Treaty in 1992 defined the macro guidelines in terms of a multi-lateral management of a set of monetary and fiscal policies. Indeed, the micro and macro facets of the member-economies of EU were duly recognized to be intertwined. In addition, provisions in the Maastricht Treaty adequately took note of structural divergences of the sovereign member-economies and made provisions for **Structural Adjustment Fund and European Investment Fund**.

With EURO, managed by ECB in Frankfurt, the EU now has the institutional framework in place for managing the intra-EURO-zone monetary policy, especially relative to the quantity of aggregate stock of money to be supplied and the core intra-regional rate of interest . The 17-member Board of Governors – 11 Heads of 11 central banks of 11 member-economies and 6 elected is charged with the responsibility of

management of the intra-EURO-zone monetary policy. Be it noted that the ECB replaces European Monetary Institute (EMI) which has been in function for some years, following the prolonged European debates regarding European Monetary Union (EMU) and European Monetary System (EMS) through the 1970s (see also European Commission 1989; Issing 1996: Study Group of EMU 1973; Vanthoor 1998; Werner Report 1970; plus the two working papers of Jerome Levy Economic Institute of Bard College - # 263 by Arestis, McCauley & Sawyer and # 266 by Sawyer).

The issue of sovereignty has been hotly contested in two highest courts of law – one in the U.K. and another in Germany. It has been settled that membership of EU will constitute no threat to the sovereign authority of a nation-state based member- economy. Research shows that EU member economies have achieved their micro-economic goals insofar as maximization of economic gains of consumers by way of delivery of cost-and-quality competitive goods and services is concerned as well as maximization of economic gains of business units by way of improved corporate earnings. Management of intra-EU monetary policy by one common currency, EURO, under one common central bank (ECB), will be EU's way of further accelerating the process, assuming the intra-EU fiscal policy will remain so coordinated.

The Research Framework

EURO and EU must be viewed at once as a learning model and a challenge to the concept of economic regionalization in the Asia-Pacific. Economic regionalization in the Asia-Pacific was institutionalized in 1989 with the Foreign Ministers of APEC- member countries leading the program. In 1993, APEC Summit was hosted by the United States

with the participation of Presidents and Prime Ministers of member-economies, which naturally became an international economic event – a much publicized media event. Since then annual APEC Summits have been a regular feature. APEC agenda has been in the process of evolution; its principal focus being trade liberalization with free trade by 2010/2020. Intra-APEC free trade in services remains to be further reviewed. Discussions on free flow of investment have been limited. Freedom of movement of labor has not been on the agenda. As of 1998, APEC membership includes 21 sovereign-nation-state based macro-economies on the two shores of the Pacific and in the South Pacific (Begsten 1995; Dutta 1999)..

The map-of-the-world view of the APEC region, I have suggested, must be anchored to the concept of the Lake Pacific. An intra-APEC multilateral, cooperative effort to map an economic region on to the geographic Lake Pacific region is very much in order. An important point to be noted in this regard is the annual meetings of the Heads of Finance Ministries/Treasury Departments and Heads of Central Banks, pointing to the recognition that intra-APEC monetary and fiscal policies warrant coordination. In its absence the proposed regime of free trade will be open to disturbances. An intra-APEC macroeconomic core with well-structured monetary-and-fiscal guidelines alone can provide a necessary and sufficient condition for the intra-APEC free-trade regime.

Recent meltdown of financial markets in several Asian economies became an occasion for a re-examination of the macroeconomic issues. One view is to seek the global institutions, such as the International Monetary Fund and the World Bank – to do the needful. Others argue that global institutions must have responsibilities limited to truly global issues. Management of regional economic issues must be an assignment for

a regional economic institution, as is the case in Western Europe with EURO and EU. The global institutions have not been able to make prompt and firm decisions in its efforts to address to a specific regional economic crisis. Indeed, none of the global institutions foresaw the meltdown of the financial markets in Asia and forewarned the economies concerned and the rest of the world. Be it noted that ever since the US dollar became delinked from its fixed gold value on August 15, 1971, the post-WWII international financial institutions became exposed to destabilizing economic factors. The Group of Leading industrial economies (G-7, earlier G-5, now G-7 plus Russia) continue to struggle with the issue international exchange rate stabilization.. On the other hand, the Western European experiments in economic regionalization have been a success story.

On December 5-8, 1999, The World Bank at its conference in Bonn, Germany on Global Development Network (GDN) added a substantive input to the *concept of economic regionalization* based on what I have called a *map-of-the world view of a region* with concurrent emphasis on both micro-and-macro economic paramters of each region. An attempt has been made to group the developing economeis in seven regional areas- (a) East Asia, (b) South Asia, (c) Central and South America, (d) Africa, (e) Middle East, (f) Southeast Europe and (g) Russia with the independent republics on the map of former Soviet Union. *This program for economic regionalization leaves the richer industrialized economies of each region in a global group of donor economies.*

The institutional forum of APEC is in existence and can be made use of toward providing a macroeconomic core of monetary and fiscal discipline for its member

economies. This will involve a departure from the traditional textbook model of international economics wherein some 200 sovereign-nation-state based economies would compete in perfectly competitive market order, given their uniquely competitive production functions and consumption functions. That idealized global market economy continues to elude us. We must accept the real economic conditions, as they are.

It is instructive to note that in his recent Congressional testimony, Chairman Alan Greenspan of the U.S. FED has suggested that the new text books dealing with the emerging new realities are yet to be written. It has recently been reported that one Latin American sovereign-nation-state-based economy has volunteered to accept the U.S. dollar as a common currency, managed by a common central bank, led by the U.S. Federal Reserve System.

EURO and EU must have lessons for APEC promoting the success of economic regionalization in the Asia-Pacific. Let there be no assumption that economic regionalization in the Asia-Pacific will replicate the EURO and EU model. The core issue for the study will be to develop and define a macroeconomic framework, with specific emphasis on intra-APEC monetary policy cooperation.

I may define the structural divergences of the APEC member- economies may be quantified by an individual economy's shares (a) of gross domestic product of the world (GDP_i/GDP_w), and (b) of aggregate level of world export. (X_i/X_w). .

Individual economies with relatively small, often significantly small, shares of world output and world trade will be unable to competitively maximize economic gains for its constituent micro-economic actors – households as well as business corporation – in any form of intra-regional regime of free flow of trade and free flow of investment

capital in the Asia-Pacific unless the regime is anchored into a macroeconomic core of a shared monetary/fiscal agenda..

Indeed, free flow of foreign investment – direct and/or joint ventures – as may be crucially necessary for these low-income, savings-scarce traditional economies, will expose an individual economy with small or marginal shares of world output and world trade to volatility due to exogenous shocks much beyond its control. Financial meltdown in several Asian economies in the recent years may point to this development. *Indeed, economies with marginal shares of world output and world trade, even with their best of intentions to manage their monetary and fiscal policies optimally, will hardly be able to contain exposures to external shocks.*

An intra-regional cooperation will make a difference because the intra-regional shares of world output and world trade will be competitively larger. The situation will be further strengthened if an intra-regional monetary cooperation, based on both aggregate stock of money supply and the core rate of interest, will have been institutionalized. Of course, intra-regional monetary cooperation will have to be supported by an intra-regional fiscal cooperation.. Budget deficits by individual member-economies will have impact on both the supply of aggregate stock of money and the intra-regional core rate of interest. Alternative modes of financing budget deficits either by issuance of government bonds through open market operations or by government borrowing from the market – national and/or international – will have varying impacts.

The study will further examine the critique that an intra-regional, supra-national monetary cooperation will limit *the traditional role of a central bank in a sovereign nation-state-based macro-economy to function as a lender of the last resort.*

Let it be stated that EURO/ECB model , consisting of 11 of the 15 EU member-economies as of January 1999, presents an additional learning experience for any effort in this regard in the Asia-Pacific. Intra-regional monetary cooperation in the Asia-Pacific may encompass all 21 APEC member-economies or any subset thereof. The principle of inclusion must remain the guideline. This study will examine alternative case models – all 21 APEC members, APEC sub-regional groups in Northeast Asia, in Southeast Asia, in South Pacific. An individual member economy of APEC region or of an intra- APEC-subregion will have the freedom to remain outside the institutionalized arrangement for regional/sub-regional monetary cooperation in the APEC regime.

IS THIS A MIRACLE?

Before I turn to many recent economic news stories 1970-1998, first of the Asian miracle and then of the Asian debacle and/or depression, I am tempted to remind you that the term European miracle has very recently been introduced in news literature on economics.

In 1992 at an international economic conference in Bangkok, I referred to the emerging phenomenon of one currency based European Union (EU). As we met at yet another conference in Bangkok in December 1998, EU of 15 member economies in Western Europe became an eventful fact of the paradigm of economic regionalization. I was happy to add that EU's one currency - EURO – was to become a reality in eighteen days on January 1, 1999 for the eleven EU member-economies who signed for it. May

EU's remaining four members follow the lead and may the rest of the world accept the challenge of the emerging paradigm of economic regionalization.

Many of our fellow economists have found no word other than European Miracle to describe the event. Our preconceived notion of sovereign nation-state based macroeconomic systems with its respective sovereign currencies therefore warrants a careful review. The concept of sovereign nation-state based macroeconomies with their respective independent sovereign currencies may be outdated (Dutta 1995). The concept of a sovereign state, to paraphrase a noted historian, owes its origin to accidents of history. An intra-regional macroeconomic core of member-economies of the region with well-structured multilateral monetary and fiscal policy coordination may be the new order (Dutta 1998) in the new millennium.

It is no European *miracle*. It is a rational economic decision by 15 member-nations of EU toward the objective of optimization of real economic gains for microeconomic units – households as well as business organization – in all member-economies of the Union. All available evidences point to that achievement. The region providing the base for EU is not defined by the old-fashioned imperial order, but by a map-of-the-world view of it. The member-economies' belonging to the map of the region is the core issue. In the absence of the ideal of a global UNION of all sovereign member nations of the world, a regional economic UNION is the second best, satisfying the Pareto Optimality condition (Dutta 1998). To quote Saburo Okita, regionalism and globalism will be the core of the new framework of international economic relations.

I now return to the Asian miracle about which so much we read in the last quarter of the century. As of 1997, the story is about Asian debacle/ depression/bust /crisis. In either case there has been insufficient rational economic discourse. Happenings in Asia in the recent decades, I argue, can and must be explained by laws of economics, no *miracle*, nor by reference to terms, such as, “giants”, “dragons”, or “ tigers” of Asia.

By late 1960s and through 1970s, Asia’s agriculture-based, traditional economies recognized that they could not achieve economic advancement without **accelerated industrialization** of their respective economies. They had relative abundance of labor (N)— not only ordinary unskilled labor (N.1) but also skilled (N.2) labor, often with comfortable endowments of natural resources. They had very limited indigenous supply of physical capital goods – equipment and technology (K).. They elected to import physical capital goods (K) from relatively capital-abundant economies. The Asian economies progressively elected to move away from their erst-while economic policy of import substitution and opted for open economic policy regimes.. An obvious experiment in the theory of comparative advantage in its many and varied forms a la Ricardo, Hecksher-Ohlin. They offered to import capital goods (K) from the advanced industrialized economies and pay for it by way of exporting some of the new manufactured products they were able to make with the imported capital goods. The straightforward Cobb-Douglas Production function was their immediate choice. Aggregate level of output (Q) is a non-linear (or log-linear) function of aggregate stock of labor (N) and aggregate stock of capital goods (K). They seemed to be not too anxious to include the role of socially owned inputs, environment and issues relative to non-homogenous labor market.

To begin with these economies in Asia were low income and had limited supply of savings (S) at home. Hence the choice was to import (K) with the inflow of foreign savings from relatively savings-surplus economies and augment the availability of indigenous and inflow of foreign savings to match the accelerated investment (I). These inflows of foreign investment were to be paid for by sharing the revenues from the export earnings which generated a pool of hard currency. The profit repatriation home by foreign investors thus became a way of operation, which in turn induced additional inflow of foreign investments. To optimize a newly industrializing Asian economy's export-earning ability, their export products needed to be competitive in the world market in terms of both cost and quality parameters. An appropriate adaptation of the imported capital goods to their respective indigenous economies rich in labor, both skilled and unskilled, and/or resources must have met this competitiveness of their export products in the world market, which we called **“an adaptive innovation paradigm”** (Dutta and Tatum 1988).

Some economists in advanced industrialized countries referred to it as export-led economic development model and ignored the role of exports of capital goods from the advanced industrialized economies to these newly industrializing economies. Some economists in Asia argued against the import of capital goods from advanced economies as they argued such imports would facilitate exploitation of the under-developed economies. However, many economists at both ends noted it to be a two-way process contributing to the mutual economic gain of all participating economies. It has indeed been *an import-export-led economic growth paradigm* (Klein 1990), a rational two-way, buy-and-sale market. It was by no means an economic *miracle*. The story of newly

industrialized/ industrializing economies in Asia successfully progressed until late 1990s. In 1997-98 came the financial meltdown in several Asian economies. Some economists called it the Asian bust or Asia's Great Depression and the end of the story of industrialization of Asian economies.. Others hypothesized that industrialization in Asia beyond Japan was not to be a rational expectation ((Krugman 1994, Lau & Kim 1994). Again there has been a failure to appreciate the operation of the free market economy (Harberger 1996; Dutta 1996).. Following several decades of economic growth, growth of gross domestic product (GDP) at an average annual rate of 9-10 percent in Northeast and 7-9 percent in Southeast Asia, a business cycle should have been anticipated. Indeed, business cycles in a cyclical economic growth path have been a part of economic experience in advanced industrialized economies.

In addition, periods of high rate of economic growth have been known to encourage "**irrational exuberance**" for investors at both ends – some in receiving economies and some in contributing economies - who engage in highly speculative financial investments, contributing to the de-linking of the basic economic relationship between the two markets, let us call them – the Wall Street and the Main Street. *Short term capital movements with a goodly number of innovative products in the financial market, such as, hedge funds, junk bonds, derivatives and the like add to the game of speculation. Much of the 1997-98 economic happenings in Korea, Thailand, Indonesia may be explained as such.* The financial meltdown in the United states in October 1987 witnessed all of this – a high rate of economic growth from December 1982 through August 1987 encouraged what we now may call “irrational exuberance” of the financial world in the form of junk bonds and Savings and Loan Association debacle, hostile

mergers and takeovers, swallowing of poison pills. The meltdown was followed by years of low growth and then a brief but painful recession in the third quarter of 1990. Only in 1992 economic recovery became real.

Will Korea and Thailand experience recovery relatively sooner? As of December 9, The New York Times Dec 10 reports, Korea is immediately paying back some US\$ 3 billion she received in emergency loans from the IMF. The IMF loan was of US\$ 58 billion of which Korea used only a part of it. Michel Camdessus, Fund's Managing Director, called the repayment an "important watershed in the process of Korea's emergence from last year's foreign exchange crisis." The situation in Indonesia merits more careful scrutiny. Malaysia has adopted her own game plan. Taiwan has been immune from the financial meltdown in Asia. Singapore and Hong Kong are very special economies as they continue to remain too open to the rest of the world. Be it further noted that People's Republic of China which adopted the open economic policy in late 1970s with an economic game plan of accelerated industrialization has been able to successfully manage its exposure to financial meltdown in her neighboring economies. Economies of Russia, now an APEC member, of India and other South Asian economies who are not members of APEC, have very limited trade exposure to the rest of the world, and their economic problems can hardly be related to the meltdown of financial markets in their neighboring Asian economies. They merit independent analyses.

The economic happenings in the process of industrialization of Asian economies are certainly *neither miracles nor debacles/depressions*. **They must be understood in the broader context of experiences of advanced industrialized economies. Other economists who have been known to question the essential logic of the paradigm of**

open market economy - industrialization and internationalization – will, of course, elect not to join the discourse..

The meltdown of financial markets in selected Asian economies must be viewed not in the exclusive context of Asia but in its regional context. On September 5, 1983, *The New York Times* reported the passing of “a milestone” in 1982 when the United States for the first time in its history did more trade on the trans-Pacific routes than on the trans-Atlantic routes. Indeed, the crossing of the “milestone”, occurred one year sooner in 1981 (Dutta 1987, also 1985). The sustained growth in the trans-Pacific trade - a two-way economic relationship - eventually led to the institutionalization of Asia-Pacific Economic Cooperation (APEC) in 1989 with eighteen Asia-Pacific member-economies. [As of November 1997, APEC membership has been increased to twenty-one.] The United States, Canada, Japan, Australia and New Zealand, as five members of the OPTAD, led the APEC movement (Dutta 1998,) Thanks to the pioneering works of Kiyoshi Kojima, and of Kojima and Drysdale)) . The Asia-Pacific intra-regional economic cooperation remains a fact.. The success of the latest APEC Summits in Kuala Lumpur in 1998 and in Auckland in 1999 must be noted. An intra-regional approach to correct the meltdown of financial markets in several Asian economies is in order.

Chairman Alan Greenspan of Federal Reserve System, very rightly emphasized that no single national economy can remain a “mosaic” of economic prosperity when Asian economies collapse. Many of us recall reading Joan Robinson’s celebrated critique of the “beggar thy neighbor” theory.

The Industrial Revolution in Asia Beyond Japan ?

Krugman (1994), reviewing the works of Lau and Kim (1994), has questioned if the industrial revolution in Asia beyond Japan is at all feasible. Did this prompt speculative investors in Asia-Pacific move their hedge funds elsewhere? One will never be able to answer the question. Harberger (1996) has used a two-deflator approach, yielding results easier to interpret and has presented results against the Krugman hypothesis. I have argued that “estimates of residuals” by a specification of any variation of the Cobb-Douglas-family, a single equation specification of a production function, appropriately homogenous of degree, is very likely to be biased and inconsistent, especially in economies with targeted economic plans for accelerated industrialization. I have argued for a multi-variate unit cost analysis with special emphasis on skill-based disaggregation of labor (Dutta 1996, see p. 361). Leontief’s pioneering effort with an exposition of skill-based disaggregation of labor input in the Input-Output Table framework has forcefully articulated the debate. Using the U.S. data, Dale Jorgenson has done extensive research by further gender-race-education-age specific disaggregation of labor input in industry-specific production functions. I have earlier referred to the fact of availability of skilled and professional labor in most Asian economies. I have suggested that these Asian economies successfully completed the important first step of the new industrial revolution by an interface of import-export-led growth paradigm and that Asia’s new industrial revolution is expected to initiate phases of progressive “deepening” by reaching out to higher technological frontiers. [In personal communications Professors Klein and Herberger approved of this proposition.] Concurrently, the process of “deepening” will be reinforced by the “widening” of these

economies to other labor/resource-abundant, yet-to-be-industrialized economies on the Asian map.

Let it be further noted that with the rate of unemployment at an all-time low level in many industrially advanced economies, especially in the United States, the skilled labor has become a scarce input in the global market. The inflow of capital goods from these economies to the skill-labor abundant Asian economies will continue to be a rational economic proposition. The paradigm of import-export-led growth that was successful in the 1970s and 1980s will come to play its role in the new millennium. The sooner an intra-regional approach will be able to fix the present meltdown of the financial markets in several Asian economies, the better will be the prospect for the shared trans-Pacific economic prosperity.

This paradigm has been responsible for accelerated industrialization and rapid rate of growth of GDP in several Asian economies. At the other end, exports of the new manufactured products from these newly industrialized/industrializing countries to the advanced industrialized countries not only facilitated their payments for the imported capital, but also contributed to the high growth and employment, concurrently holding the rate of inflation very low in the advanced industrialized countries. The question often has been raised if the latest rate of unemployment in the U.S. has been as low as 4.1 percent in 1999, will the rate of inflation remain as low as two plus percent? Indeed the open economic policy of the U.S., call it globalization, has made its contributions to this rare economic experience - high growth, low unemployment rate - low rate of inflation.. Contributions of the trans-Pacific trade in this regard must be emphasized and estimated.

The Case for an Intra-Regional Approach : Specification of the Model

The post-financial crisis challenges for progressive industrialization of Asian economies warrants immediate attention and a recent international conference on the above theme in Seoul December 15-17, 1999 addressed the issues. Any newly industrialized/industrializing individual economy in Asia, given its economic magnitude, as we have defined earlier, can hardly be expected to cope with the situation. Each member economy's competitive ability is limited. The two parameters we use are: **(a) the share of its GDP of the world GDP (GDP_i/GDP_w) and (b) the share of its exports of the world export (X_i/X_w).**

For the U.S., the challenge of the financial meltdown of 1987 became no less overwhelming. Given its very large economic base with its shares of world GDP roughly at 20 percent, and its share of world trade at about the same magnitude, the institution of a special restitution fund became a solution as it struggled to work over the years.

Let us consider a simple model: The i th country's exports (X_i) are functionally dependent on the level of world GDP (GDP_w), the price level at home in the i th country (P_h), the price level in the world market (P_w) and the level of export in the world market (X_w). Similarly, the i th country's imports (M_i) will be functionally dependent on the level of GDP in the i th country (GDP_i), the level of exports of the i th country (X_i), the price level at home market of the i th country (P_h) and the price level in the world market (P_w) (Dutta 1998).

We rewrite the two equations,

$$X_i = f (GDP_w, X_w, P_h, P_w) \quad (1)$$

$$M_i = g (GDP_i, X_i, P_h, P_w) \quad (2)$$

In equilibrium, and taking P_h/P_w on the left hand side, the P_h/P_w will be functionally dependent on

$$P_h/P_w = k (GDP_w, X_w, GDP_i, X_i) \quad (3)$$

It follows that if the two variables, GDP_i and X_i were competitive shares of GDP_w and X_w , respectively, the i th country would have a competitive advantage. The relative stability of the home and world price ratio would be a comfortable base for a stable exchange rate for its currency. Foreign investors, exporting capital goods to this economy and/or importing manufactured products from the i th economy would have comfortably less exposure to exchange rate fluctuation risk. We limit our exercise to 18 member economies of APEC.

We present (Table 1) the shares GDP_{APEC} and of X_{APEC} of each member country, i.e., GDP_i/GDP_{APEC} and X_i/X_{APEC} . The U.S. has a dominant position on both counts. Japan is the second richest economy in the world, its shares, GDP_j/GDP_{APEC} and X_j/X_{APEC} must be taken of. We may note that globally, the EU with its 15 members (11 of the 15 joining EURO as of January 1, 1999) will have competitive shares of GDP_w and X_w . The US dollar and the EURO may emerge as the two competing global currencies. As we review the 18 APEC member-countries the picture points to the non-competitive position of most of them. Hence the choice for a regional economic game plan is pronounced. Given the fact that most of these country's have their major trade in the Asia-Pacific region, the use of GDP_{APEC} and X_{APEC} for GDP_w and X_w , respectively, may substantively relate to the competitive positions of these economies.

Limiting our analyses to the APEC membership of 18 sovereign-nation state based economies (excluding Peru, Vietnam and Russia who became members in 1998),

over the time period of 1970-1996, APEC shares of world GDP and world Exports have ranged between 35 - 30 percent , and 40-50 percent, respectively. APEC , of course, includes both USA and Japan. Over the given time period, the group consisting of Canada-Mexico-US-Chile-Australia-New Zealand have shares of world GDP and of world Export larger than the respective shares of East Asian APEC members on the far shore of the Pacific inclusive of Japan.. Exclusion of Japan reduces East Asia's shares for the same period very substantively – shares of world GDP 2-5 percent and of world Export 2-11 percent. We have further examined shares of world GDP and world Export for the same time period for the three other sub-regional groups – ASEAN, Australia-New Zealand (ANZ), and South Korea-Taiwan-Hong Kong (Northeast Asia). Leaving USA and Japan, aside, as we review the respective shares of each individual APEC member economies – both in terms of world GDP and world Exports, the shares range between 3-4 percent.

Based on the concept of Lake Pacific as a map-of-the-world view of a region, intra-regional APEC grouping will be a competitive paradigm. Alternatively, the two continental map-of-the-world view of regions - intra-Asian grouping and intra-American grouping will be an option (Dutta 1999).

The Western European Experiments: EU and The MODEL

I may present here the interesting findings relative to the experiments in economic regionalization in Western Europe in the context of the simple model I have elected to work with. Ten graphical presentations are attached to that end.

Graph 1 presents the share of EU's GDP – 15 sovereign nation-state based macroeconomies for the period 1970-1997 and it ranges around 30 percent. For the same period EURO –11 share ranges between 20-25 percent; with individual shares of Germany, UK, France and Italy being above average. Non-EURO EU-4's share remains between 5 and 10 percent (approximately). Graph 2 refers to EU's share of world Export for the same time period. The EU share ranges between 45-35 percent, the EURO-11 share being around 30 percent and the non-EURO EU-4's between 10-7 percent. The four leading economies present above average profiles for both their respective GDP shares and shares of World Export. The individual shares of the remaining EU-11 both for world GDP and world Export remain rather marginal. Graphs 3 focus on France, Germany and Italy in terms of their respective shares of world GDP and Graph 4 relates to the three economies individual shares of world Exports.

Describing their respective individual shares, Graphs 5 and 6 relate to Austria, Belgium, Netherlands, Spain in terms of both world GDP and world Exports. In Graphs 7 and 8, we present the profiles of Finland, Ireland, Luxembourg and Portugal for their individual shares of world GDP and world Export. Respectively over the same time period. Graphs 9 and 10 relate to non-EURO EU-4 economies – Denmark, Greece, Sweden and UK.

The economic regionalization of EU is thus described by the two select parameters. The EU plans to elect six more Southeast European neighbors to its membership and extend it further over the years to seven more neighboring economies, including Turkey. In course of the first decade of the new millennium, the EU membership may include 28 sovereign nation-state based macroeconomies, conforming

to the concept of a map-of- the- world view of the region – the map of Europe and a shared commitment to an intra-regional macro-and-micro economic agenda. The EURO has already emerged as a competing currency in the world market. The performance of EURO since its inauguration on January 1, 1999 has been a subject of much research and I shall come back to it on another occasion.

I have been asked a question all too frequently. Will I suggest numerical shares of world GDP and world Exports for a region to be a rationally competitive region? We must do more research to find an answer.

The Case for Direct Foreign Investment (DFI):

I have argued that DFI, direct foreign investment with 100 percent foreign ownership, “wholly foreign owned” as it is referred to in the People’s Republic of China, is a preferred mode vis-à-vis the financial capital inflows (see also Fry 1996, Lloyd 1996, Petri 1993). DFI has also been in operation with joint ventures with indigenous entrepreneurs in several Asian countries. The terms of agreement between the foreign and domestic investors have, of course, been varied

My arguments in support of DFI, wholly foreign owned, are:

- (a) Assumption of risk – profit or loss – one hundred percent as is the case when it is wholly foreign owned.;
- (b) Optimum technology import enabling the foreign investors to manufacture cost and quality competitive products for the world market, generating export earnings in hard currency - a potential base for repatriation of profit home on terms as per agreement;

- (c) Optimum human capital convergence (superior skill labor, engineers, scientists, managers) enabling the foreign investor to minimize cost of importing them from the home market, and assuring , first creation and then progressive expansion of the market in the country of investment;
- (d) Optimum access to the world market based on his expertise and operation in the multinational program (brand name, marketing know-how, advertisement budget on a global scale), thus ensuring exports of a share of the products from foreign investment;
- (e) Optimization of the time-horizon for investment, as is natural for direct investment, and minimization of volatility attributable to easy-in and easy-out of the movement of financial capital.

In addition, three indirect points merit attention:

Firstly, DFI will introduce a framework of competition in the economy prompting the indigenous entrepreneurs, who will be prompted to be competitively cost effective by way of introduction of necessary innovative measures.

Secondly, the broadening of access to the hard currency earning world market of products manufactured by DFI in the economy will earn a good-will for the country and eventually help expand its share of the world trade.

Third, and finally, to the extent DFI will help expand the economy's export earnings, its current account balance will be balanced and the pressure on its foreign exchange rate will be eased.

In 1998, China's foreign exchange reserve has risen to US\$ 144 billion. This fact adds to the confidence of international investors' in the Chinese economy, thus is Asian

economies. With all that hefty foreign exchange reserve, China recently (December 9) offered to raise funds in the Wall Street with a bond offering which was oversubscribed, helping China to raise twice as much funds as had been expected. “When the offering was priced, China had to pay investors an interest rate only 2.8 percent higher than the United States Treasury pays on its 10-year Treasury securities,” reports David E. Sanger, The New York Times December 10, 1998..

An Open Economy and Free Flow of Financial Capital

With all that has been said about DFI, free flow of financial capital must constitute a part, an integral part, of an open economic regime. The inflow of funds from foreign investors –individuals as well as financial institutions must be allowed. If the funds are allowed to come in, it must have the freedom to move out. The rules of free market must be allowed to work. This is where the issue of a macroeconomic core of an open economy merits careful evaluation.

Asia’s newly industrialized/industrializing economies have been known to lack a well-structured macroeconomic core which must be defined by monetary and fiscal guidelines which must be *transparent* to all concerned at home and abroad. Investors, .foreign as well as indigenous, must be able to comprehend and abide by it. Let us focus on the monetary guidelines. With the notable exception of Taiwan, recent meltdown in financial markets in several Asian economies very much point to the absence of an organized monetary guidelines in the ith economy.

Independence and accountability of the central bank in the ith economy is crucial. It must command optimum independence with sufficient freedom from interference by

the leaders of political establishment. However, the head of the central bank individually can and must be allowed to be a member of a political party. The degree of freedom of the office can be optimized if the tenure of the office is defined by law. Accountability of the office can and must be manifest in the periodic reports on the economic status of the ith economy, prepared and presented by the Head of the central bank.

Should there be regional central banks in a given economy? It is increasingly becoming evident that such an arrangement helps the formulation of the economic agenda of the economy and may be helpful for investors, domestic and foreign. I argued both the above points (Dutta 1995) in the context of China's economy..The U.S. Central Banking Act of 1913 set up such a structure. In January 1998 China acted to reform her central banking system by setting up regional central banks. In January 1998 a detailed plan to that end is expected to be announced. However, China's central bank continues to lack independence and accountability in the strict term we have stated above. I venture to suggest that the when European Monetary Institute (EMI) evolves to the European Central Bank, the central banks of its 15 or 11 member-economies will effectively play the role of regional central banks. The central bank will draw upon the inputs of the central banks of each member-economy, who in turn will relate their activities to the guidelines set by the European Central Bank. Even if the ith country in Asia is relatively small in magnitude the case for regional central banks merit consideration. They relate to the various regions of the economy and collate inputs toward developing a successful national monetary policy.

An effective central bank can function effectively only when the structure of commercial banks and related financial institutions are well-structured. In the 1970s and

1980s, too much of cooperation amongst the leaders of political, industrial and money-markets have been observed by many scholars and often hailed as “a happy marriage” between private capitalism in free market and government-led socially planned economies. Such an economic game plan was certainly politically correct. Were they economically vulnerable? The question remains to be answered.

Free movement of financial capital – inflow into and outflow from - the ith economy can prove too costly an experience for it in the absence of a well-organized money market, led by a properly institutionalized central bank. The recent experience of a giant-size long-term capital management fund in the U.S. with two Nobel Laureates on its Board points to the gravity of the situation. Thanks to the effective leadership of the U.S. central bank which helped minimize the potential adverse economic effects.

Asian economies, caught in recent financial crisis, have experienced the truth with much distress. An effort to restructure their respective money markets under proper leadership of central banks must be in order. Asian economies must be institutionally ready to enable their respective economies permit free flow of financial capital.

A Global Institutional Arrangement:

Familiarity of scholars in economics with the post-World-War II global institutions - the International Monetary Fund (IMF), The World Bank, and the World Trade Organization (WTO) must be taken for granted. Of course, these institutions have a specific role to play in a financial crisis anywhere in the world. They have been engaged in the Asian financial crisis and they have helped ease the situation to a given

extent. The IMF in particular has provided rescue funds to several economies in Asia and also in the Americas. We focus our attention to Asia

In a crisis availability of rescue funds has been known to be an important economic action. On occasions in a given economic crisis, such rescue operations have been undertaken by effective mobilization of monetary and fiscal policies from within the nation. In the U.S. such arrangements in recent times will include special loans to an automobile corporation, a hefty rescue fund for the Savings and Loan Association Debacle and so forth. Asia's need for a rescue fund is no exception. However, Asia's problem is that no rescue fund for an economic crisis from within the economy is absent. Hence the need for the availability of a rescue fund from outside. The IMF is a world institution to deliver the necessary rescue funds to any of its member-economy.

Arguments against this institutional arrangement warrants serious consideration. Firstly, these large global institutions are too large and thus unable to move with promptness. A financial crisis in Thailand or Korea or Indonesia calls for a prompt action.. The 182-member IMF can hardly be expected to deliver the necessary funds to any of these individual economy in crisis so promptly. Secondly, whatever rescue funds are made available by the IMF, it comes after the fact. Indeed, in the 1970s and 1980s, the IMF and also the WB joined the chorus of Asian miracle and continued to publish eloquent reports of dynamic growth of many of these Asian economies, supported by a relevant data bank. Third and finally, the IMF prescription to the economies in financial crisis fail to note that the real sectors of these economies merit support toward the core agenda of accelerated industrialization to which they made a commitment. To persuade these economies to undertake steps to cut down and limit their investment schedules is a

prescription to reverse their growth paradigm. Thus, the IMF prescription which is anti-growth contributes to the growth of unemployment rate and sub-optimal utilization of capital goods in these economies. The parental discipline code of “TIME OUT” is all too familiar. But will it be optimum economic game plan? Many of my fellow students of economics have raised the question.

We have argued above that economic inter-dependence of the Asia-Pacific economies and the rest of the world economies has grown to be much too significant. Indeed, these fastest growing economies in Asia have been contributors to the economic dynamism of the rest of the world. We suggest that the global institutional arrangements under the IMF and the WB must be allowed to do their chores under their respective charters. We argue for supplementing the global arrangements by a regional Asia-Pacific institutional arrangement. The rest of the world must be ready to learn from the regional institutional arrangements in Western Europe (Hesse 1993, Letiche 1993). We do not propose to replicate EU with its EURO. We do propose that Asia-Pacific regionalism in the context of globalism must be the new order..

Asia-Pacific Regional Approach

Indeed, Asia-Pacific economic regionalization of eighteen Asia-Pacific economies (twenty-one as of November 1997) in the form of APEC in 1989 remains a fact. Annual APEC Summits since 1993 have been eventful occasions. Heads of Treasury or Finance Ministries, and of Central Banks of APEC member-economies, joined by their Respective Deputy Heads, have been regularly convening at annual meetings of their own. They last met in Hong Kong October 1997. Indeed, here is a core platform of an

Asia-Pacific regional monetary institute. They perhaps elected not to give any warning to their membership, or to the rest of the world, about the financial meltdown that overtook several of their member-economies immediately after their Hong Kong meeting. Of course, they had a good deal to focus on the Thai financial crisis.

The above forum could indeed function effectively as a regional central banking institution for the coordination of monetary policies of the region. They could jointly study and produce the annual report of the member-economies with respect to monetary policy management and ensure their joint accountability by way of pointing out to the phenomenon of “irrational exuberance” for any member-economy. They could play the role of a regional central bank by way of initiating regional market control game. Indeed, the central bank in a given sovereign economy has the responsibility to manage its free market economy by initiating counter-speculative, anti-inflationary monetary policies and/or pro-growth game plans based on rational investment decisions.

Are the APEC member-economies ready to accept the challenge? In 1996-98 I had a series of personal conferences with members of APEC’s Eminent Persons Group (EPG), and with several academic economists engaged in long-term research on APEC in Australia and Malaysia plus the President of Asian development Bank. I reviewed the issue of a possible/feasible APEC macro-economic core, especially the case for an APEC regional monetary institute (Dutta 1998, Dutta 1995, Klein 1994, Yamazawa 1994, Yoo 1996). I have reported that there is a sense of awareness of the importance of the issues involved but there is a pragmatic judgement to wait for the things to evolve in its due course. Maybe, the financial meltdown in several Asia-Pacific economies will be an occasion to prompt a sense of immediacy. Maybe, the inauguration of EURO by the

EU January 1999 will be an occasion to focus on the issue. Or, there will be an organized effort not to learn the lessons of the experiment in Western Europe and advocate a moratorium on economic regionalization elsewhere in the world - a poor counter-economic argument.

Permit me to add that given the relatively small magnitude of most the APEC member-economies, as measured by their respective shares of world GDP and world export (see Table 1), the Asia-Pacific economy, even if it has been successful in restructuring its indigenous macroeconomic core with well-defined monetary and fiscal parameters, will still remain too small and too weak to be exposed to the dynamics of accelerated industrialization and economic development. An intra-regional group macroeconomic core is in order. Or, the wisdom of the economic traditionalists will be that the Asia-Pacific economies may give up the accelerated economic growth agenda. Let their choice be sustainable growth defined by predetermined parameters of the global institutions. An optimal option will be a regional Asia-Pacific macroeconomic institutionalization within the overall global framework.

The New Millennium and the New International Economic Order

The challenges of the new millennium will, of course, be real. Our process of learning what we have not yet learned must continue to progress. However, the real challenge, I believe, will be to unlearn a great deal of what we had learned in the past. I have argued that absence of a well-structured intra-regional macroeconomic core will not help an individual sovereign nation-state based economy to optimize economic gains for its micro-actors – households as well as business units, since most of these

individual economies are limited by marginal values of the two parameters – its shares of world GDP and of world trade. Its competitive functioning as an open economy will face a serious bottleneck.. The macroeconomic core refers to a system of monetary and fiscal agenda. Exclusive focus on a monetary agenda may be self defeating since fiscal indiscipline will be counterproductive. I have further argued that an intra-regional macroeconomic core within a global macroeconomic system is in order.

The proposal for a global convention of the Heads of the Central Banks of the world is receiving serious consideration. May the IMF be restructured as the new World Central Bank. May the World Bank and the IMF be merged into a new institution to serve as the World Central Bank. Recently, a leader of one of the largest international hedge fund has authored a monograph advocating the institution of the World Central Bank. If the 182-member IMF is reconstituted as the new World Bank, it will continue to suffer from its present limitation, inability to take prompt , *preemptive* decision and action.

Economic regionalization in its many and varied form within the global order has indeed been a part of our economic history. The imperial order became outdated. The post-WWII order of globalization based on the concept of one world , reinforced by institutions, (IMF and WB) struggled to do its job, until disintegration came following severance of the fixed gold value of the US dollar in August 1971. Another form of polarization we witnessed when the national economies broke into two groups - the North of the rich nations and the South of the poor nations. Our continued reference to the three worlds - the first world and the third world even when the second world experienced its liquidation. A global economic order continues to elude us.

A map-of-the world view of a region has become the focus of the new economic regionalization. The EU illustrates this. The EU has developed its own independent macroeconomic core, allowing each member-economy of a sovereign nation state maintain its own macroeconomic core. On the other hand, EU is consistent with global institutions – IMF, WB and WTO. The challenge of the new millennium may be to accept a new international economic macroeconomic core with regional macroeconomic institutionalization. Let the sovereign nation -state based individual economies in any and all regions of the world welcome this new international economic order.

Much has been written about the gravity model. Some scholars argue that the core of the gravity model must be sought in extra-economic factors, such as language, religion, life-style and culture and so forth. Many of us in economics sought to relate the gravity model by geographical distance between market points and the cost of transportation. To define such distance between any two points proved to be a challenging problem as modes of transportation progressively underwent revolutionary changes - water ways, railroad, road transportation, airways, and then tunnels. One would venture to suggest that Gravity.com is the latest to challenge the old fashioned gravity model. *Let us recall that in respective imperial models, physical distances between London and Sydney, Paris and Hanoi and Jakarta and the Hague were observed to be shortest.* Indeed, the cost effectiveness of distances between any such two points were secured by the imposition of monetary –and-fiscal policy parameters by the respective HOME governments *The imperial models proved cost-ineffective as and when satellite economies or colonies revolted.*

I argue here that macroeconomic core is the core of the gravity model of economic regionalization, given the concept of a map-of-the-world view of region within the context of globalization.

Note: The views expressed are exclusively mine and in no way represent views of the American Committee on Asian Economic Studies (ACAES), an inter-university program I serve as President and Chief Executive Officer. My special thanks are due to Lawrence R. Klein (University of Pennsylvania) and Robert J. Alexander (Rutgers University) to both of whom I owe a great deal for my sustained research activities. I also wish to thank Kiseok LEE, Daniel Tatum and Amiya Sharma for their helpful cooperation over the years I pursued my research on this project. For assistance in statistical work for the present paper I must thank Dongbo Pei.

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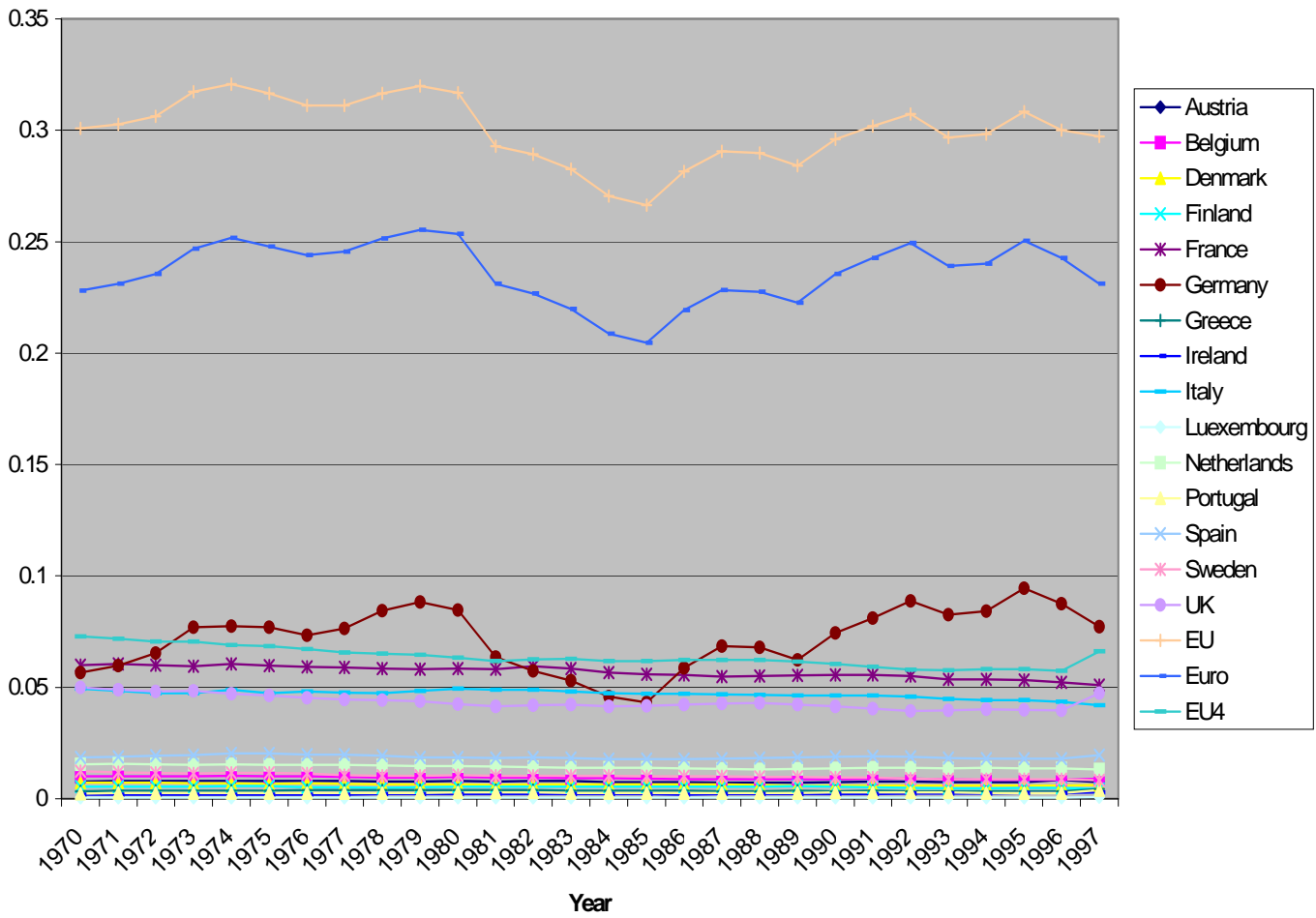
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Table 1: Estimates of GDPi/GDPapec and Xi/Xapec - 1995

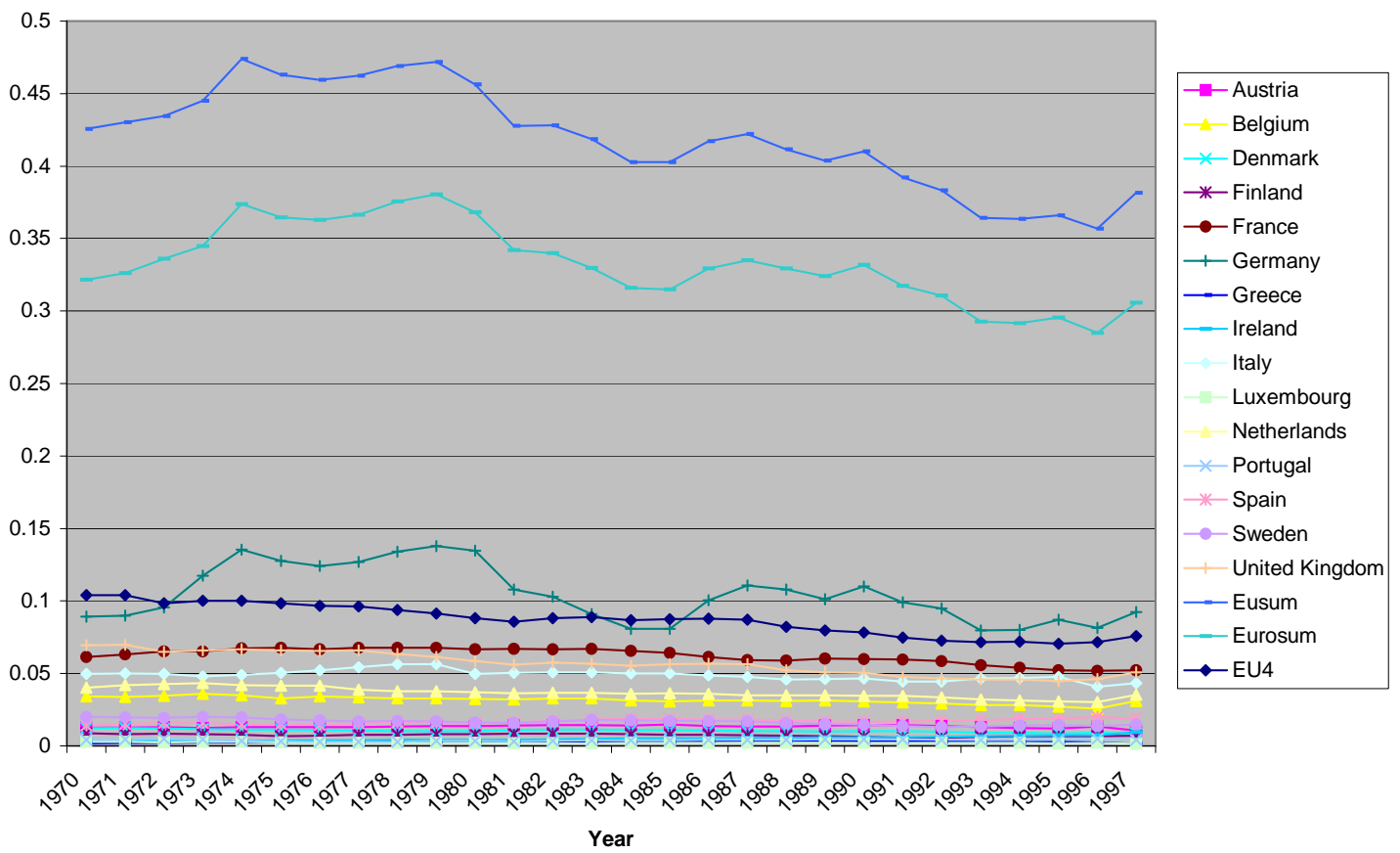
Member-Economies	GNPi / GDPapec	Xi / Xapec
Australia	0.022	0.0235
Brunei Darussalam	0.0003	0.0011
Canada	0.037	0.0085
Chile	0.0004	0.0071
PRC	0.048	0.0660
Hong Kong	0.009	0.0770
Indonesia	0.012	0.0201
Japan	0.319	0.1962
Korea	0.028	0.0554
Malaysia	0.005	0.0328
Mexico	0.021	0.0353
New Zealand	0.0033	0.0061
Papua New Guinea	0.0003	0.0012
Philippines	0.0046	0.0078
Singapore	0.0051	0.0524
Taipei	0.017	0.0495
Thailand	0.0126	0.0250
U.S.A.	0.4563	0,2586

Source: Data on GDPi and Xi from APEC Secretariat Compilations: World Development Report 1996; Brunei Darussalam Key Indicators 1995/1996; Statistical Data Book 1996, Chinese Taipei. Note: Hong Kong and Brunei GDP, and GNP for all others. See also Dutta 1998.

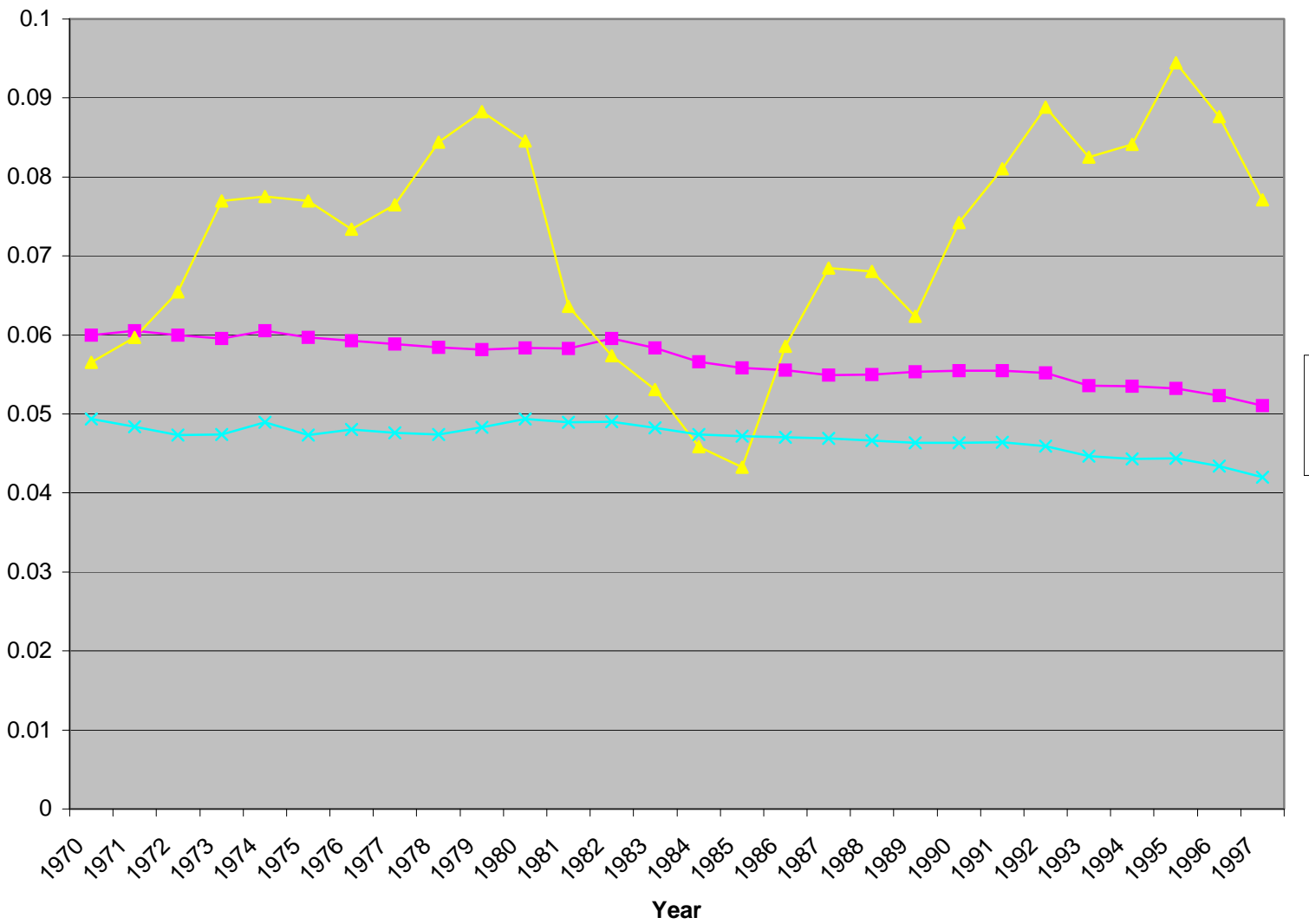
Graph 1: GDP of EU as per cent of World GDP



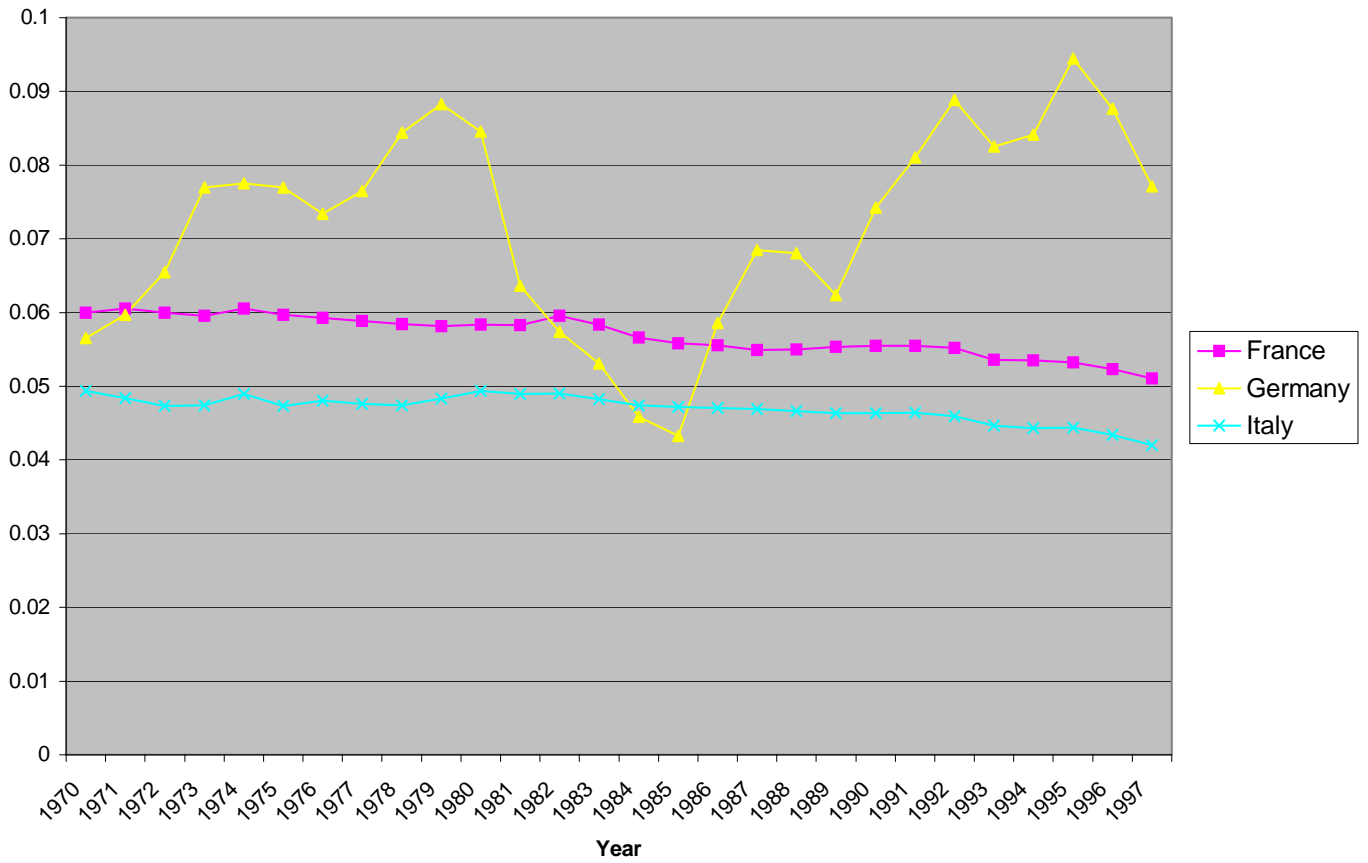
Graph 2: EU 15 Export as per cent of World Export



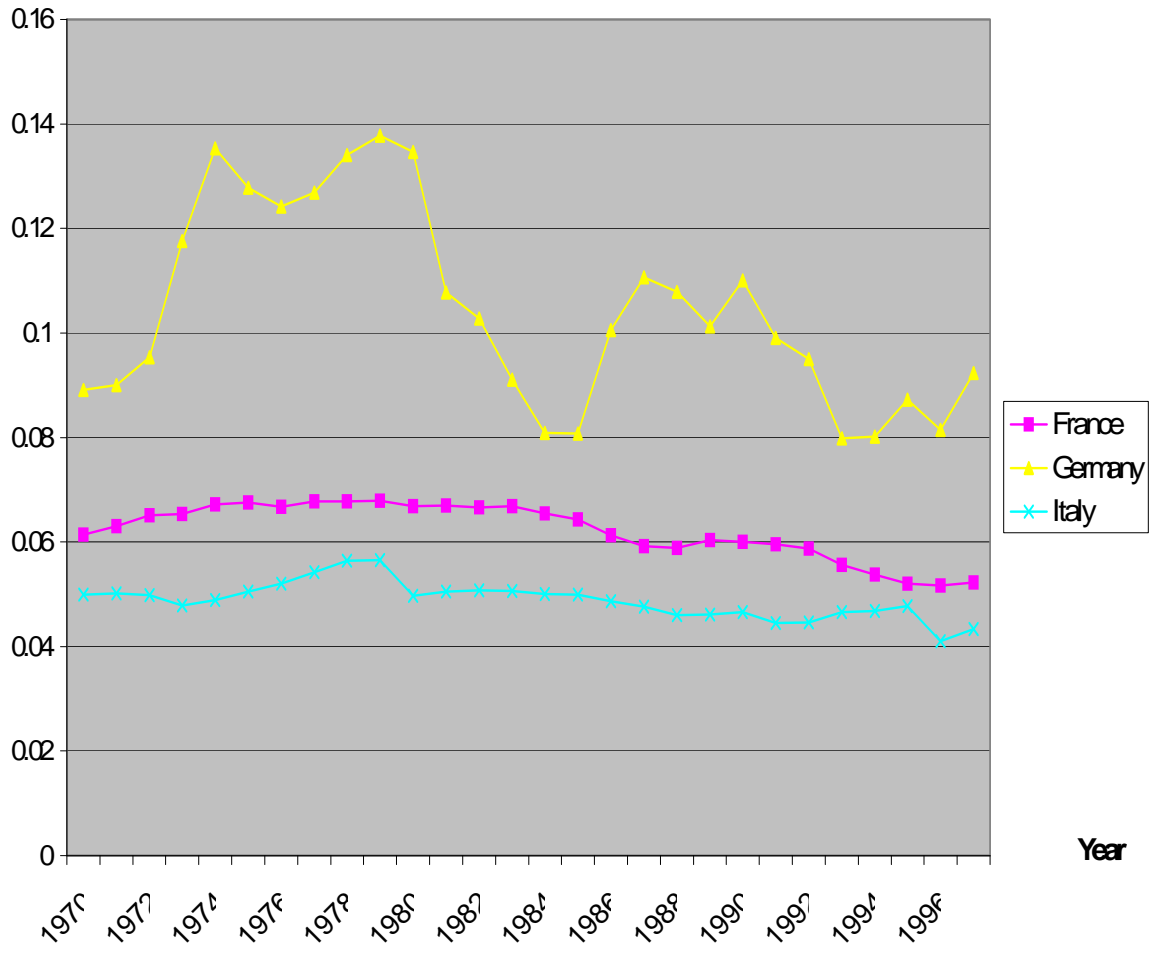
Graph 3: France, Germany and Italy GDP as percent of World GDP



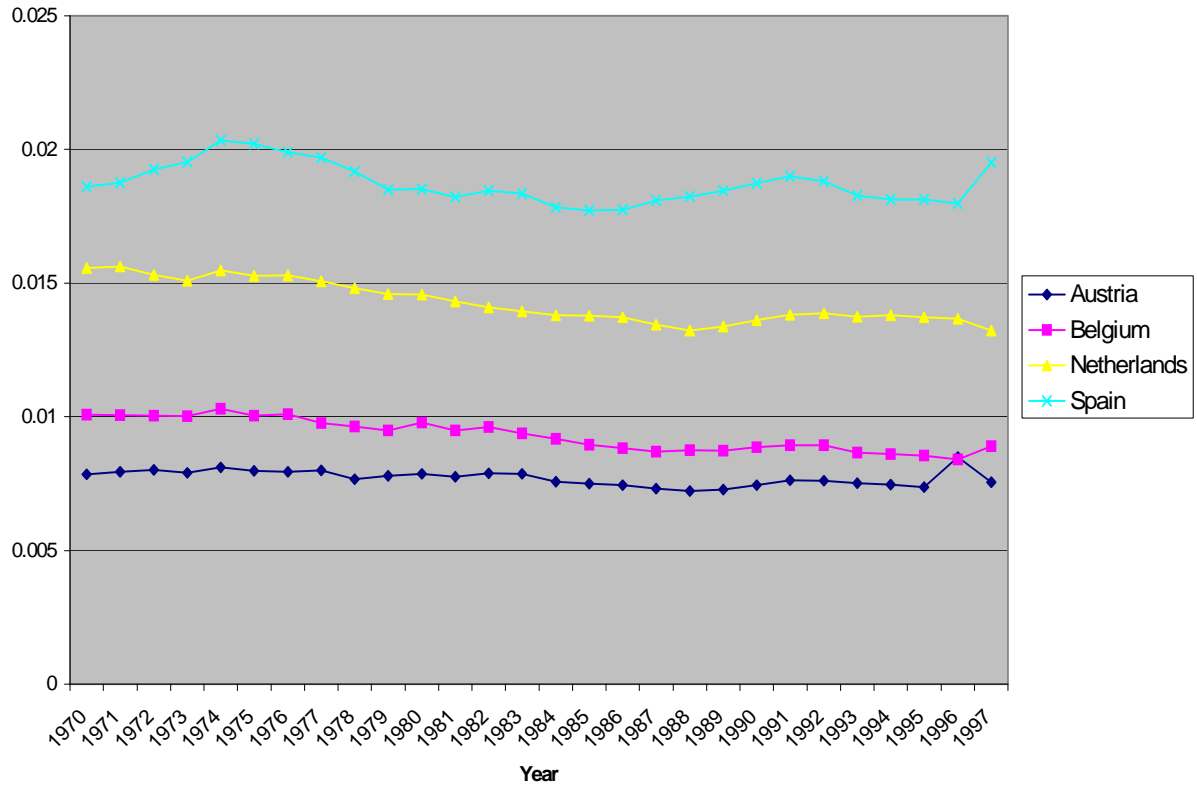
Graph 3: France, Germany and Italy GDP as percent of World GDP



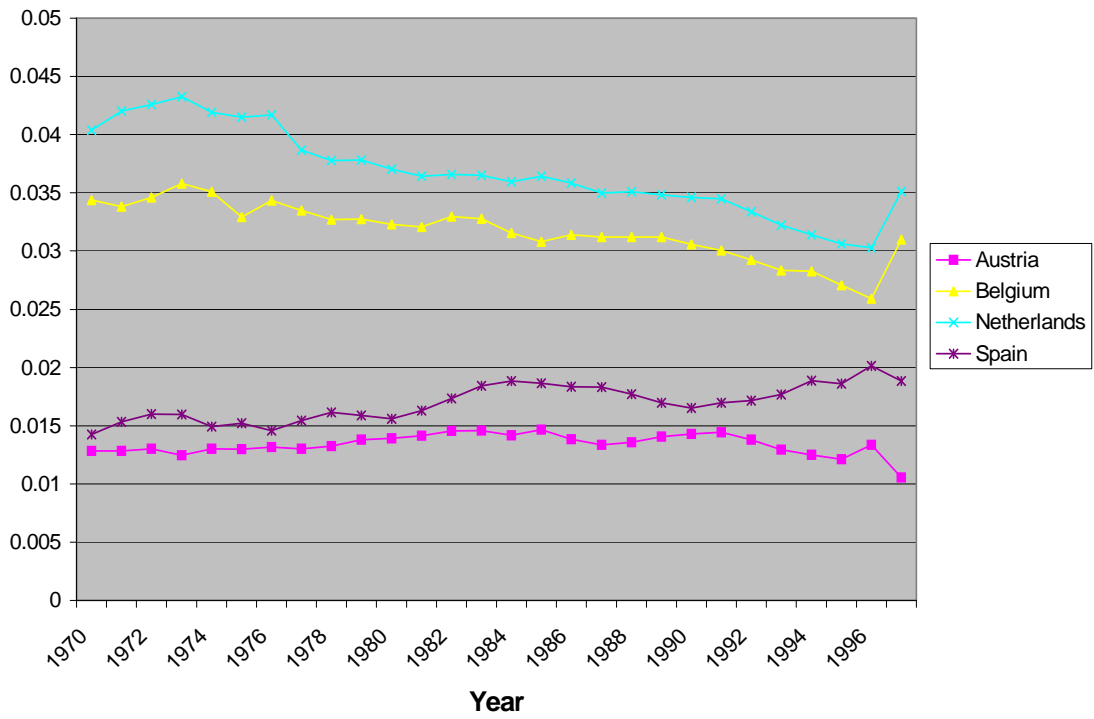
Graph 4: Germany, France, Italy export as per cent of World export



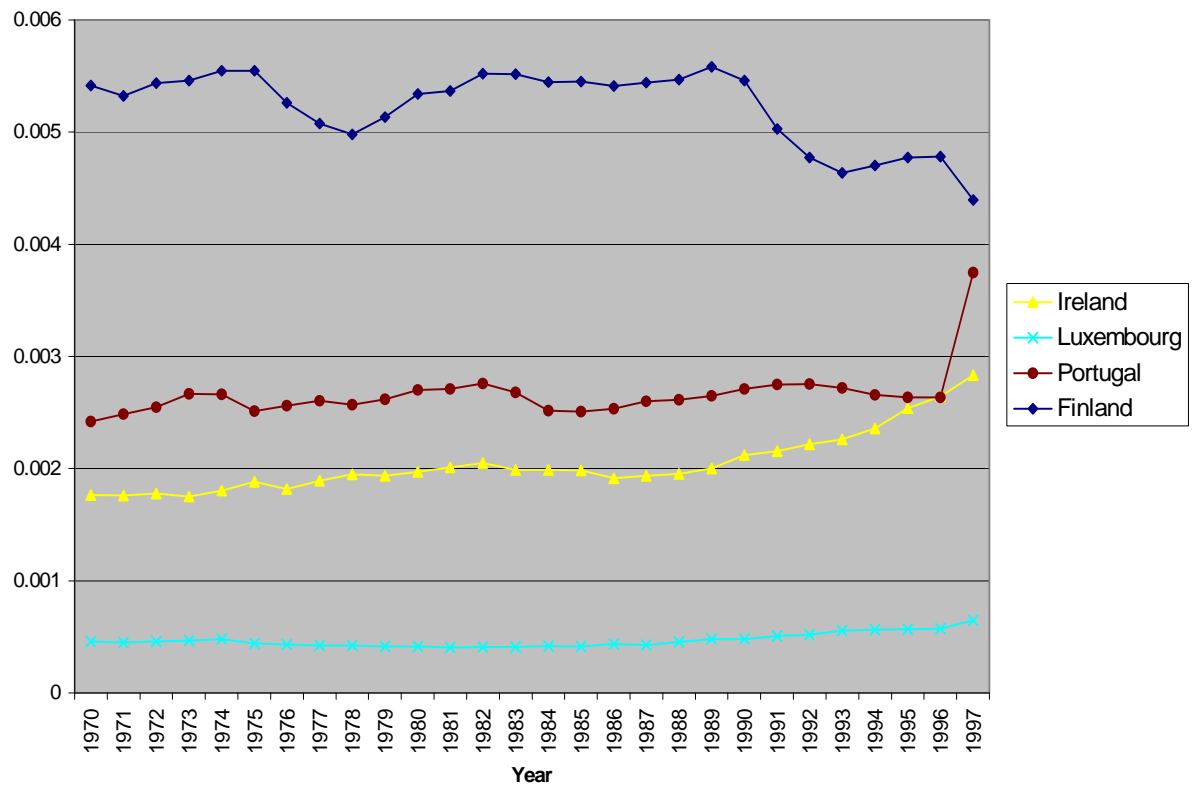
Graph 5: Austria, Belgium, Netherlands, Spain GDP as per cent of World GDP



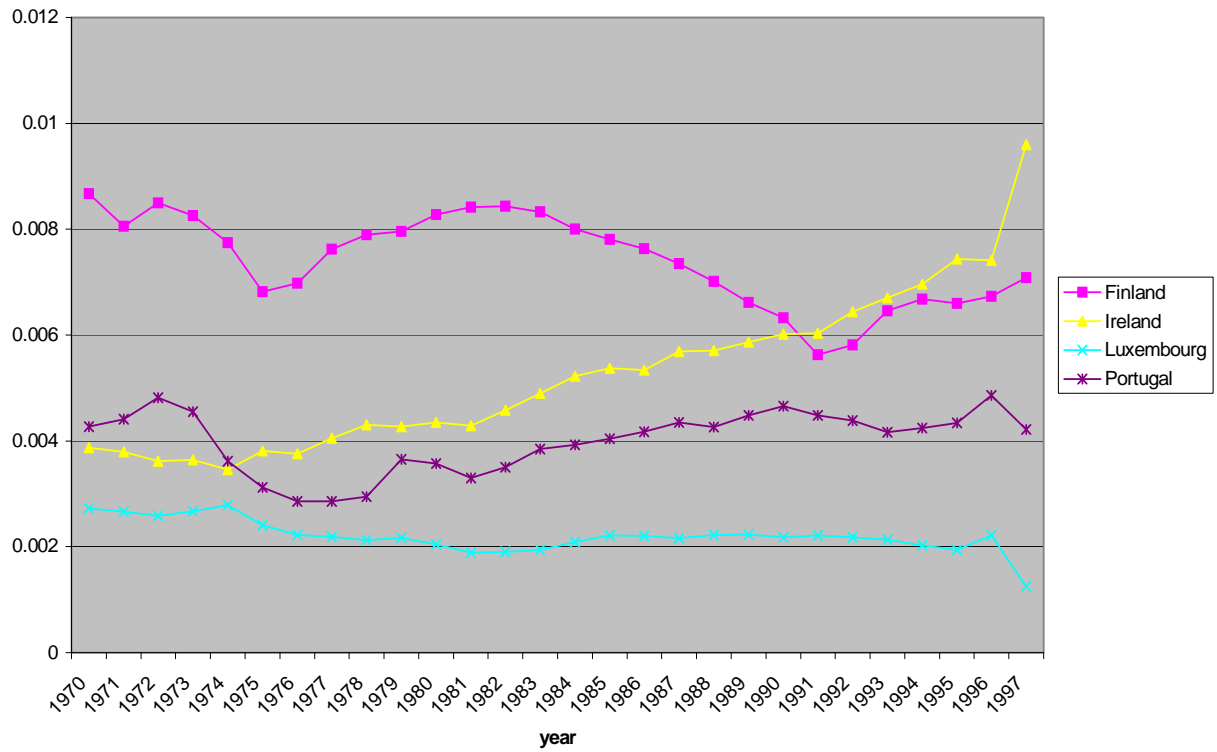
Graph 6: Austria, Belgium, Netherlands, Spain export as per cent of World export



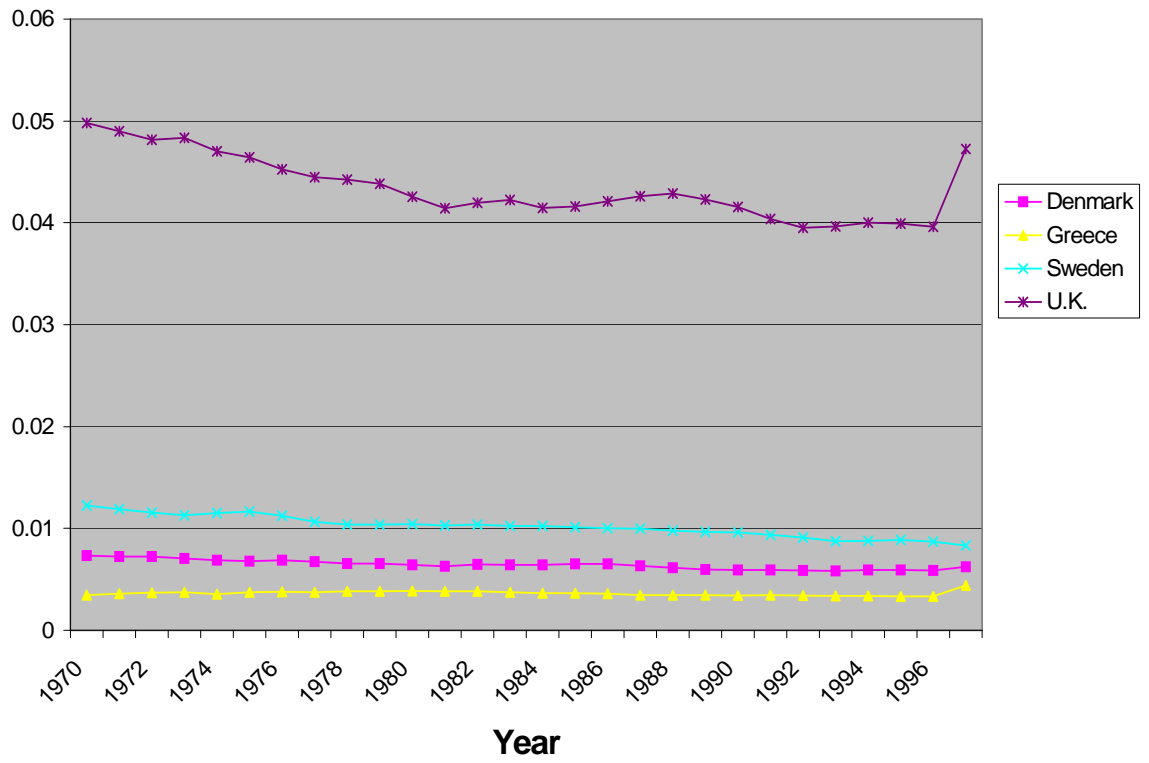
Graph 7: Finland, Ireland, Luxembourg, Portugal GDP as per cent of World GDP



Graph 8: Finland, Ireland, Luxembourg, Portugal export as per cent of World export



Graph 9: Non-euro EU countries GDP as per cent of World GDP



Graph 10: Non-Euro Eu countries export as per cent of World export

