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Asia's Regional Integration: Lessons from Eastern Europe

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Even as we explore the possibilities for integrating the economies of Northeast Asia, it is somewhat sobering to consider the fact that other people in other places are meeting to explore how to speed the disintegration of the integrated national economies of Central and Eastern Europe. Over the years, there have been numerous attempts to integrate some or all economic activity carried on within sovereign political entities. Some of these efforts have prospered; others have not—often as much the consequence of political as of economic factors. And, of course, a number of plans for regional integration have remained firmly pinned to the drawing board.

The European Community presents a clearly positive example. The EC is moving with all deliberate speed toward economic integration, and much progress has already been made in drawing together Europe's diverse economies. More recently, integration of trade on a scale that involves the United States, Canada, and Mexico is being actively advanced. The expanding relationships between Southeast Asia's economies and that of Japan have been widely cited as another example of beneficial, if de facto, regional economic integration. On the other side of the coin, the staggering economic difficulties faced by Central and Eastern European nations as they seek to shift from command-based to market-economy systems arise in large part from the integration of their national economies under socialist economic precepts. Central and Eastern Europe's integration is as old as it is flawed: it began in the late 1940s and became increasingly more invasive and pervasive (if not persuasive) for over four decades.

As these brief observations indicate, regional integration does not necessarily yield unalloyed economic benefits. Whether it does or does not depends on a range of interconnected factors including the social and political system within which integration has been predicated, the economic and political criteria on which investment and production decisions are made, and the integrity with which real costs and benefits are calculated and allocated.

Reverting to Central and Eastern Europe, it is increasingly clear that integration of the economies of Poland, Czechoslovakia, Hungary, and Yugoslavia, together with those of Albania, Bulgaria, and Romania, with the USSR economy (within the COMECON's Council for Economic Assistance (CMEA) economic and political framework) was a spectacular and costly failure. Instead of causing the region's economic tide to rise and raising all the region's ships with it, integration produced a strong economic ebb tide, and the ships of the CMEA economies went down with it.

Much of what went wrong in the East and Central European case was not due to economic integration per se. Rather, it was a consequence of faulty economic logic in the underlying model, politically driven decision making, and the downgrading of economic criteria and considerations.

Given the urgency now attached to undoing the economic integration policies, institutions, and practices put in place during the past four decades, Eastern Europe's experience can presumably provide valuable lessons for other nations considering the costs and benefits of increased regional cooperation and integration. A few of the more salient lessons are offered in the following paragraphs. They are based mainly on the experience of Czechoslovakia. The range of disintegration problems that confront Czechoslovakia is representative of those that face the other members of CMEA now trying to disentangle themselves from the strictures bred of an extended period of misguided economic integration.

THE CZECHOSLOVAKIA EXPERIENCE

Economic integration is based on differences among participating political entities in resource endowments, education levels, technical skills, and social and political norms that create different combinations of economic strengths and weaknesses. Through economic integration, these divergent national characteristics can be recombined in a manner that, through the working of complementary and comparative advantage, can optimize benefits and minimize costs. This approach makes sense so long as the fundamental structure and propositions on which integration is based do not jettison basic economic realities. That is, so long as investment, employment, training, production, and related decisions are based on considerations of comparative advantage and real costs, rents and prices, the integration of diverse economic entities can yield positive gains for all participants.

In Czechoslovakia and other CMEA members, however, political dialects took precedence over economic logic and reality. Most significantly, economic decision making was disconnected from the marketplace and the signals provided by comparative prices were replaced by plan-determined physical input and output targets. Comparative advantage, real costs, and market prices were disregarded in this system. In more specific terms, Czechoslovakia's pre-World War II reputation for skilled craftsmen and high-quality engineering led the CMEA's political leaders to decide, in the late 1940s, to make that country the manufacturing, metals, and chemical center for the bloc as a whole. This decision extended the country's industrial base far beyond the limits of its comparative advantage and was heavily influenced by, among other things, Czechoslovakia's protected inland location and the strategic safety it offered.

Under the CMEA system, relative prices played no significant role in the allocation of resources. Production inputs and outputs were decided on and accounted for in physical terms under an all-encompassing central plan. It mattered not at all that Czechoslovakia would have to import most of the raw materials and energy required to meet its CMEA-assigned role, nor that massive investments in railroads, pipelines, and other infrastructure would be needed to move heavy manufactures, metals and chemicals from Czechoslovakia to the USSR and to other East Bloc markets and to transport petroleum from the USSR to Czechoslovakia for refining and processing to feed a new petrochemical industry.

Under the command system, the decreed infrastructure was constructed and the production capacity installed. The result was a wasteful misuse of investment resources, the neglect of social infrastructure and of more productive investments that were not part of the plan, and the beginnings of a badly distorted pattern of investment, production, and employment in the Czechoslovakia economy.

To meet plan-dictated physical production targets in the face of chronic foreign exchange shortages and uncertain supplies of essential inputs, the country's newly created heavy industries found it necessary to set up their own captive intermediate-product suppliers. Most were too small to achieve economic production levels. Real costs and prices did not enter into investment and production decisions, and physical production targets were simply increased by a certain percentage each year. To ensure that their targets would be met, plant managers stockpiled workers and inventories for future need. Since products were exchanged within the regional bloc on a quasi-barter basis and purchasers and markets were assured, the volume of production—rather than quality, innovation, or new technology—was the test of successful performance. As a result, Czechoslovakia's manufactured products became increasingly shoddy and below international standards of quality. Hard currency markets were progressively lost, new technology was seen as a threat to the realization of output targets, and the country's tradition of precision engineering and skilled craftsmanship was lost.

Since Czechoslovakia had manufactured and exported armaments in earlier years, the central planners decided that a major part of the country's new investment would be devoted to expanding the region's armaments industry. For political reasons, the expansion was concentrated in the Slovakia region, a decision that was to engender social ethnic pressures within the country when, post-CMEA, the time came to close these plants. Once again, the result was a cycle of investment, employment and production patterns unrelated to real costs and prices, as well as the continued erosion of Czechoslovakia's work ethic and skilled craftsmanship. Over the years, Czechoslovakia's economy grew

EASTERN EUROPE'S EXPERIENCE

Asian nations considering enhanced economic cooperation or regional integration would obviously not adopt a political-economic framework similar to the now-discredited COMECON/CMEA type. Nevertheless, the experience of the Eastern European nations under that system holds some useful lessons for Asia.

The Discipline of International Prices and Markets

The most fundamental flaw in the CMEA approach to regional integration was the separation of investment, production, and related economic decisions from the discipline of the international marketplace. This separation in turn produced a cascade of decisions that insulated member countries' economies further from the bracing effects of international prices and made them less and less competitive.

While new regional groups may decide that it is essential to provide fiscal incentives and import protection to their infant industries, any such incentives and protection should be framed in a way that will prevent the long-term institutionalizing of production inefficiencies. Border prices should be the standard of measurement for investment and production decisions, and deviations should be limited, short-term, and economically justifiable. Incentives and protection legislation should contain automatic "sunset" provisions to ensure that they do not become impediments to international competitiveness.

Open markets and international competitiveness are essential for ensuring that regional products and service incorporate the latest product and process technology. Open markets are similarly necessary to ensure that quality standards are maintained. These considerations warrant specific attention in efforts to explore integration prospects in North Asia.

Specialization and Economic Balance

Specialization is typically a key objective of regional integration. It should, however, be based on market-determined comparative advantage. Specialization should not be pushed beyond related efficiencies of scale, an error repeatedly committed in East Europe.

Comparative advantage and specialization should not obscure the need for participating countries to maintain a reasonable balance and diversity in the structure of employment, investment, and production. A major dilemma for Czechoslovakia stems from the fact that its economic base became increasingly narrow and overspecialized under the CMEA regime. For this reason, the recent sharp decline in demand for manufactured products from former CMEA countries has had a particularly strong impact on the country's production and employment that cannot be readily absorbed by other sectors.

Balance Among Member Countries

In the now defunct CMEA system, the USSR was by far the dominant player. The USSR provided the petroleum and other raw materials on which other members' industries were based; it was also the main market for these nations' agricultural and industrial output. Because of this unbalanced relationship, the recent sharp decline in the USSR economy has had a devastating economic effect on other CMEA countries. This experience suggests the desirability of avoiding an economic association in which one member's economy is significantly larger than the others', more developed, and able to dominate.

Assigning Environmental Costs

One of the most egregious and costly mistakes committed in the name of regional integration in East Europe involved the environment. The massive scale of ecological destruction condoned in the name of increased employment and output is only now becoming clear. In essence, the system failed to recognize—and to assign to those responsible—the costs of environmentally destructive processes and practices in industry and agriculture.

Measures to prevent environmental degradation most frequently involve actions that must be taken on a regional basis. Thus economic integration offers unique opportunities for combined and effective efforts in the environmental field. The first step required to set this process in motion is ensuring that the costs of environmental degradation are recognized, fully accounted for, and assigned to the responsible individuals, firms, and industries. This matter should be high on the agenda of any discussion of future Asian regional integration.

Review Mechanism

In retrospect, it is clear that the Central and Eastern European economic group lacked the mandate, political will, and implementing machinery required to undertake a candid and objective review of the progress, costs, benefits, successes, and failures of the region's economic integration program. Such a requirement might have attempted to bring about needed reforms before the system collapsed under the weight of its own mistakes. A regularly scheduled systematic review of integration progress and problems would therefore be a useful feature of any new economic integration initiatives in the Asian context.

FINAL OBSERVATIONS

All these points are intended to illustrate a simple fact: Regional integration is a complex and multifaceted political, social, and economic institution. It is inherently neither good nor bad; rather, it presents both economic opportunities and risks. The trick is to be able to distinguish one from the other.

Opportunities arise from the relatively unfettered interplay of economies of scale, complementarity, and comparative advantage. Risks arise from pushing these positive factors beyond their economic limits, from ignoring real costs and prices, and from sheltering domestic markets for too long from the invigorating effects of international competition.

To sum up, the prospects for successful regional integration appear to be most favorable when the marketplace and competitive pricing provide the basic policy and decision framework. Conversely, regional economic integration can become an economic nightmare when its authors ignore or attempt to outsmart the market. Presumably, any efforts toward greater cooperation or integration would, in the Asian environment, follow the first rather than the second approach.