



Occasional Paper 1

JAPAN AND EAST ASIA: TOWARDS A NEW DIVISION OF LABOR

A View from Japan

Susumu Awanohara



East-West Center
Honolulu, Hawaii

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PREFACE

The International Relations Program is pleased to publish Dr. Susumu Awanohara's paper, *Japan and East Asia: Towards a New Division of Labor: A View from Japan*, as the first in a series of occasional papers reflecting the work of the research staff or fellows associated with the program.

This paper, which reflects Dr. Awanohara's special interest in Japan's international outlook, its regional role, and its relationship with the United States, was written in 1988 while he was a senior fellow with the International Relations Program. In this paper, Dr. Awanohara explores the views of Japan's Pacific era enthusiasts, who generally optimistically predict a continuing dynamic process of economic development centered upon Japan as a model and motor. The "flying geese" model, for example, foresees a positive pattern of growth in which the newly industrializing economies and later China and the larger ASEAN economies emulate the earlier growth process in Japan.

Despite the overall optimism of Japanese views regarding the economic future of the Pacific basin and Japan's central role in it, there are some problem areas, and many questions remain unanswered. The most important of these are U.S.-Japan economic friction and the rise of economic regionalism elsewhere. Other concerns focus on the possibility of Japan's becoming protectionist as a result of the appreciation of the yen and the increased competitiveness of Japan's Asian neighbors. One important future issue concerns how well Japan manages the domestic political tensions associated with the economic adjustment processes. As imports of manufactured goods from the region increase, will Japan promote a more horizontal trade relationship with other Asian countries or will it attempt to slow down imports?

Comments by readers on the substance of the paper are welcome.

Charles E. Morrison
Coordinator,
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INTRODUCTION

Some years ago the advent of the Pacific Era was heralded by many. Judging from all the recent talk in Japan, that era has finally arrived, at least in the minds of its Japanese proponents. In contrast with dire predictions—prevalent at times of intense “Japan bashing”—about continued U.S.-Japan economic friction or Japan’s ostracism from an inefficient and jealous world economy, the notion of the Pacific Era is profoundly optimistic.

Essentially, the proponents of the Pacific Era believe that a “Pacific economy” will emerge as the most dynamic growth pole in an otherwise slow-moving world economy; that Japan will be a driving force in this process but at the same time Asia’s newly industrializing economies (NIEs), members of the Association of Southeast Asian Nations (ASEAN),* and probably China, too, will play positive roles and profit from it; and that the division of labor among these economies, already beneficial to the poorer as well as richer players alike, will become progressively more horizontal and equitable in nature. Furthermore, the theory goes, the intractable U.S.-Japan economic problems can be resolved in the broader context of the Pacific economy.

Growing recognition in the NIEs, ASEAN, and even parts of China and the Soviet Union that a benign division of labor seems to be in the making licenses the Japanese to indulge in some self-congratulation. This, however, is dampened by reminders also coming from the region, that Japan’s disastrous attempt to create a Greater East Asia Co-prosperity Sphere half a century ago has not yet been written off.

*ASEAN is made up of Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Singapore, however, is normally treated as one of the NIEs.

This paper is an attempt to explain what the Japanese mean when they speak of the Pacific economy, and why they think the region and the individual countries within it have so far succeeded, and will continue to succeed in the future, in their development efforts. Problems that the Japanese foresee for the Pacific economy are also discussed, followed by an exposition of a set of comprehensive economic policy recommendations for the region that a group of Japanese opinion leaders recently put together. At the end is a list of questions that the theory of the Pacific economy raises for future consideration.

THE NATURE OF SUCCESS

Regarding the Pacific economy, Japanese proponents often point to statistics showing that trade among the Pacific rim nations has surpassed cross-Atlantic trade or that of the United States, whose west coast Asia trade has surpassed trade on the east coast.¹ A graphic presentation of such statistics was made recently by Japan's Ministry of International Trade and Industry (MITI).² The MITI figure shows trade between North America and the European community (EC) growing a relatively modest 6.1-fold (in terms of yen, not U.S. dollars) between 1970 and 1987, compared with the 9.9-fold increase in North America-Japan trade and the 14.5-fold increase in Japan-European Community (EC) trade during the same period. More dramatically, the Asian NIEs increased their trade with North America and Japan 48.4-fold and 17.8-fold, respectively. The inference is that the center stage of world trade has moved from the Atlantic to the Pacific.

The Pacific economy proponents go on to marvel at the feats of individual economies in East Asia. The sharp appreciation of the yen from yen 240 to the U.S. dollar in 1985 to roughly yen 130 to the U.S. dollar in 1987 has nearly doubled Japan's gross national product (GNP) in dollar terms to US\$2.4 trillion, more than half of the U.S. GNP. In per capita income and in tangible fixed assets, Japan has now surpassed the United States. Also Japan today is the world's biggest net creditor nation and reflecting this, Japanese institutions have come to dominate the world financial market. A large element of exchange rate illusion is acknowledged in all of this, but still some Japanese like to cite these numbers indicating their strength. The "decline of U.S. hegemony" is often taken as fact, although the arguments are borrowed from discussions in the United States and no one seriously argues that Pax Japonica has arrived, or is on its way, to take the place of Pax Americana.³

Similarly impressive figures are cited from the Asian NIEs (South Korea, Taiwan, Hong Kong, and Singapore). It is pointed out, for example, that by 1985, their respective manufacturing sectors accounted for 24-36 percent of the NIEs' domestic outputs, which is substantially higher than

the average for developed economies. The combined exports of the NIEs jumped from 1.6 percent of total world exports in 1965 to 6.5 percent in 1986, while on the import side, the NIEs' share grew from 2.1 percent to 5.6 percent of world imports during the same period. The NIEs' exports of machinery grew to account for 24–36 percent of their total exports by 1985, fast approaching the developed countries' average of about 40 percent.⁴

Most of ASEAN is still “developing” rather than “newly industrialized” and is grappling with such typical development challenges as industrialization, rural reform, employment creation, and manpower development. The ASEAN economies exposed their vulnerability and fell decisively behind the NIEs in the mid-1980s when prices of oil and commodities collapsed and threatened the Southeast Asian countries' external financial positions.

Yet the Japanese proponents of the Pacific economy have remained bullish about ASEAN. They feel that ASEAN countries are going in the right direction, following the footsteps of the NIEs, which have of course followed those of Japan in their turn. There is frequent discussion as to whether Thailand or Malaysia will become the next NIE, the underlying assumption being that NIEs and ASEAN are emulating Japan. The Pacific economy enthusiasts in Japan feel vindicated by recent records. Thailand has repeatedly revised its gross domestic product (GDP) growth projection upward to the current 10.6 percent for the year 1988, while GDP growth has topped 10 percent also in Singapore in the first two quarters and in Malaysia in the second quarter of 1988. At the same time, the Japanese are particularly encouraged by the growing economic links between the NIEs and ASEAN which, among other things, dilutes the image of Japan's dominance in the Pacific economy—an image which on balance is considered more a liability than an asset.

Despite its socialist economy and uncertainties over its future course, China is usually considered an integral part of the Pacific economy by the Japanese. After 10 years of rapid growth, China's economic reform and open door policies appear resilient even after brakes were applied by the government in September 1988—perhaps a reflection of the fact that enough Chinese have come to prefer uneven development to sharing of penury. The Chinese leadership is apparently sticking to the plan to quadruple the size of the Chinese economy between 1980 and the year 2000 and seems particularly eager to learn from the NIEs' experience.

The collective performance of these individual economies is often also highlighted in Japanese discussions on the Pacific economy. The region's growth rates are among the highest in the world, and according to the proponents, will remain so in the future. It is projected, for example, that by the year 2000, the per capita real GDP of developing ASEAN coun-

tries will reach those of South Korea and Taiwan in 1980, the figures for South Korea and Taiwan in 2000 will reach those of the higher-income Hong Kong and Singapore in 1980, which in turn will surpass the per capita real GDP of Japan in 1980. Even China will close the gap with its per capita GDP in 2000 approaching the 1970 South Korean level.' Together the Pacific economies will become one gigantic engine of growth, and, it is argued, this will make it easier for the community of nations to find solutions to global economic problems of trade imbalances, financial instability, and third world debt.

REASONS FOR SUCCESS

Naturally, attempts are made to account for the remarkable achievements of the Pacific region's economies. Former foreign minister Saburo Okita has identified effective government policies "buttressed by close cooperative efforts by government, industry and academia" as one major reason for their success. More specifically, such government policies, observed in many countries in the region, include export-oriented growth policies, maintaining high investment rates, allowing an active and aggressive private sector to operate within what are essentially market economies, improving the agricultural sector, and making structural adjustments to avoid excessive indebtedness and to stem inflation.⁶

Elaborating, Okita stresses that, aside from bringing in vital foreign exchange, the export-oriented policies have had the effect of exposing domestic industry to world-class competition and thus fostering efficient industries. High investment was crucial in pushing the export-oriented policies, whether it was largely financed through domestic savings as in Taiwan and Thailand, or through foreign capital as in South Korea and the Philippines. The prevailing price mechanism spared many East Asian economies uneconomical investments and inefficient management. Increasing per capita food production in East Asia—which is striking compared to records in Africa where that index has declined—underpinned the growth of many of the region's economies. An examination of the Latin American example should bring into relief the generally prudent management of the Pacific economies.

Forty-four years after the end of World War II, Japanese memories of their war and aggression, and along with them, guilt and contrition, are fading. It is no longer taboo for the Japanese to argue that they may have provided the inspiration, as well as the model, for the Pacific economies. Some of the essential government policies mentioned by Okita and above all the notion of putting top priority on economics are considered to have been pioneered in Japan.⁷ Perhaps more importantly, the fact that Japan, a non-Western country, was able to develop inspired the NIEs in

Japan's geographical proximity, and, it is maintained, the fact that the NIEs have achieved success has become an inspiration for ASEAN, China, and even the region's other communist countries.⁸ A few get carried away and claim that postwar demilitarization and democratization have created a new Japanese civilization, in which economic logic reigns supreme and prosperity is universal. The Japanese way of life, emphasizing freedom of production and material well-being for all citizens, is now permeating the Asia-Pacific region—"the sphere of the Japanese civilization."⁹

There are also noneconomic explanations for the success of the region's economies. In particular, the phenomenal advance of the Asian NIEs has rekindled interest in Confucianism as a possible factor. Until recently, Japan was the only really successful industrial economy outside areas touched by the "Protestant ethic," but now several other economies in Northeast Asia, all sharing a vaguely defined Confucian tradition, have joined the ranks. No one seems quite comfortable with the theory that Confucianism, to a significant extent, explains East Asian economic growth. For one thing, China, the motherland of Confucius, has so far not succeeded in development and Confucianism has indeed been blamed for this. For another, the theory will have difficulty as soon as the Malaysian or Philippine economy takes off to join the NIEs. (The theory's adherents will no doubt argue that Thailand, with a strong and well-assimilated ethnic Chinese community, is within the Confucianist tradition.) The implication that countries without a Chinese tradition cannot hope to develop will hardly be popular in those countries.

Yet the Confucianist theme attracts great interest. There is no obvious reason to assume that all countries will eventually go the NIEs' way (that is, the Japanese way) towards industrialization or that the NIEs will not remain a small minority of success cases, as some argue.¹⁰ The link between Confucianism and East Asian economic development is one of several topics to be studied by the East Asia Comparative Study Project, a grandiose program financed by the Ministry of Education involving about 100 top Japanese scholars. Mineo Nakajima of Tokyo University of Foreign Studies, who heads the overall project, is obviously attracted by the Confucianist theory and speaks of a "Confucianist economic sphere."¹¹

The Flying Geese Postulate, Old and New

International reasons for economic success are also sought, along with the domestic ones, and particular significance is attached to one. This is the division of labor among the region's economies, which the Japanese believe has been uniquely benign. According to Japanese thought, without such a system of interdependence the individual national economies could not have done as well as they have.

The Japanese have long identified in the region a flying geese pattern of development that they were convinced was quite different from two other more common patterns, namely, the vertical and horizontal divisions of labor. The former prevailed in the 19th century between industrialized suzerain states and their resource-supplying colonies, while the latter is seen typically in the EC with its trade in manufactures among industrialized countries.

With diverse stages of economic development, horizontal division of labor has so far not been possible in East Asia. The flying geese pattern represents a vertical relationship, in which there is both competition and complementarity and which is more dynamic than a typical vertical division of labor. In this vertical relationship, Japan follows the United States and Western Europe and tries to catch up, in stages, in the production of nondurable consumer goods, then consumer durables, and, eventually, capital goods. At each stage, Japan starts production for the domestic market, already created through imports, increasingly replacing these imports and eventually moving on to exports. Each stage thus creates new imports of raw materials and more advanced capital goods, as well as the exports of the goods now being produced domestically. The NIEs likewise follow Japan, while ASEAN economies follow the NIEs. The great advantage of the flying geese pattern is that in it the vertical relationships are never rigid or permanent.¹²

Obviously, this is a convenient theory for the Japanese and its earlier incarnations were indeed enlisted during the war years to rationalize the idea of a Greater East Asia Co-prosperity Sphere.¹³ But the theory has had enduring appeal in Japan, not just because it puts the Japanese in a good light, but no doubt also because it seems to fit aspects of the region's reality rather well.

In a more recent rendition of the flying geese theory, Toshio Watanabe of Tokyo Institute of Technology has identified a "multi-layered chase process," in which the NIEs chase Japan and the ASEAN economies chase the NIEs. Watanabe stresses that the gaps between Japan and the NIEs and between the NIEs and ASEAN are being narrowed progressively so that the three groups are now linked in one continuous order. This is in sharp contrast with the still discontinuous relationships that obtain between the United States and Latin America, or between Western Europe and Africa.

To support his thesis, Watanabe has devised a two-dimensional diagram where industries, starting with the lowest-value-added industries and moving to the higher-value-added ones, are lined up along the horizontal axis, and the initial level and change over time in the international competitiveness of each industry is indicated along the vertical axis. A comparison of diagrams, one for South Korea and another for Thailand, for

example, demonstrates how South Korea has been losing (or only moderately gaining) competitiveness in the lower-value-added industries and making great gains in higher-value-added sectors, while Thailand has been making great strides in lower-value-added items and small or no gains in higher-value-added areas.¹⁴

Criticisms have been voiced that the unequal economic relationship between Japan and the NIEs is unjust and unalterable. The NIEs are compelled to buy capital and intermediate goods from Japan and chronically suffer large trade deficits with Japan, because Japan produces just about everything and does not import enough from the NIEs. To Watanabe, this trade pattern represents a short and necessary phase in the progress towards industrial sophistication in the NIEs and a more horizontal division of labor between them and Japan.

The NIEs were able to gain developmental momentum, initially exporting low-value-added consumer products and investing in machinery (with embodied technology) and intermediate goods from Japan to upgrade their exports. The next round started with the NIEs exporting higher-grade products and importing still more advanced Japanese equipment and inputs. Thus the NIEs' imports and investment have increased along with their exports. Watanabe stresses that the NIEs were not going in circles just to survive, they were moving up the ladder of industrial sophistication. The Japan-NIEs trade pattern is far from self-perpetuating. The NIEs are now able to produce by themselves many of the hitherto imported capital and intermediate goods. Watanabe sees an impending reversal of the Japan-South Korea trade balance and goes on to predict that an EC-style horizontal relationship will increasingly become the norm in East Asia, particularly in Northeast Asia.¹⁵

The Postulate is Vindicated

There is a general feeling that the latest developments in East Asian economies, including the sharp appreciation of the yen and its effects on Japanese consumption and investment behavior and the NIEs' rapid emergence as major investors in the region, have vindicated the flying geese postulate. In particular, appreciation of the yen after the Plaza Accord of September 1985 of industrial powers to reduce the value of the dollar seems in fact to have speeded up structural changes towards a more horizontal division of labor among East Asian economies.

The higher yen has finally blunted Japan's export growth. Exports in yen terms began to decrease in 1986, though in dollar terms it has continued to grow. Imports in dollar terms declined slightly, but that was to a considerable extent because of the fall in oil prices. The volume of imports has increased, particularly in manufactures. The NIEs, ASEAN, and China have been the principal beneficiaries of increased Japanese purchases of manufactured products.

Behind these statistics, experts see changed Japanese consumer behavior. Whereas in the past, the Japanese tended to import only small quantities of upmarket or top-brand items, more recently supermarkets and retail chains have started importing and marketing standard-quality consumer items in large quantities. The range of products being offered to the consumers through these channels has widened drastically to include electric and electronic goods and other consumer durables.

The high yen has also prompted Japanese companies to procure intermediate goods outside Japan. Heavy engineering companies, for example, very quickly changed their policy after the Plaza Accord, replacing Japan-made inputs with those manufactured outside Japan.¹⁶ The high yen has made domestic production of many items untenable and resulted in a sharp increase in Japanese investment overseas. In 1986, Japanese direct foreign investment (on an approval basis) jumped more than 80 percent, the bulk of it going to the United States and the Asian NIEs. Japanese investment in South Korea and Taiwan in that year increased 117 and 74 percent, respectively, over the previous year, and Japan became the biggest investor on a cumulative basis in all the NIEs and ASEAN countries except the Philippines.

The trend has continued into 1987 and 1988, only with ASEAN making the greatest gains. The number of Japanese manufacturing investments in ASEAN has grown steadily over the past several years, surpassing that in the NIEs by the first half of 1988. The number of such investments in the NIEs peaked during the first half of 1987 and that in North America peaked during the second half of 1987.¹⁷

A few points stand out about the current Japanese investment boom, compared with the earlier booms of 1972-73 and 1978-81. First, the concentration of investment in the United States and East Asia, already evident in the past, is now more marked. Second, this time the major investors are either procuring more parts, components, and other inputs locally, or bringing along a whole host of input suppliers from Japan to invest in the same host country for local production. Third, and related to the second point, more medium- and small-scale Japanese companies are investing abroad this time, which will presumably result in more broadly based industrialization and greater overall value added in the host countries.¹⁸

Fourth, whereas previously many Japanese investors set up operations aimed at local markets (which were usually heavily protected under import substitution policies), there is now more emphasis on exporting, not just to the United States but to Japan itself. This is significant. Having production units elsewhere to satisfy demand in domestic and developed country markets, major Japanese companies were often uninterested in their East Asian subsidiaries upgrading quality for the world market. Now many of these companies have no other choice.

These Japanese investment trends should bring greater foreign exchange earnings and technology transfer for the host countries, supporting their shift to an export orientation. Some Japanese experts regard foreign investment as the most important channel for transferring the dynamism of the Japanese economy to the rest of the Pacific region.

Also contributing to the emergence of a new regional division of labor is the NIEs' budding role as investors. According to one Japanese count, Taiwan's investments in Southeast Asia doubled from US\$8.1 million in 1986 to US\$16.1 million in 1987. Another set of figures shows Taiwan investments in Thailand rising from 33 cases in 1986 to 160 cases in 1987. In the first half of 1988, the Thai Board of Investment approved 186 investment projects involving Taiwan, as against 171 from Japan. Taiwan also became the main investor in the Philippines (during the first quarter of 1988) and the second largest in Malaysia in 1987. The presence in Southeast Asia of ethnic Chinese (whether naturalized in the countries of residence or otherwise) facilitates—and many assume, understates—Taiwanese investment activities in the region. There are varying figures on South Korean investment in ASEAN. One source says it grew more than 70-fold in 1987 to \$129 million, while another shows investment doubling from \$172 million in 1986 to \$359 million during January–September 1987.¹⁹

Thus Japan has begun to depend less on exports and more on the domestic market for growth. It is moving production facilities offshore and importing more. The NIEs have had successes in reducing dependence on imports from Japan and exports to the United States. South Korea has dramatically improved relations with China and the Eastern Bloc countries, while Taiwan is getting closer to the communists on the Chinese mainland, in all cases against great political odds. ASEAN is attempting, with varying results, to reduce dependence on primary product exports. Japan is shifting investment from the NIEs to ASEAN and China, while the NIEs are themselves investing in ASEAN and to some extent China.²⁰ The restructuring has become region-wide, with trade and investment serving as key vehicles.

ROADBLOCKS AHEAD

The Japanese believers of the Pacific economy are not without worries, in spite of the encouraging trends. First and foremost, U.S.-Japan economic friction remains a major concern. An apparent rise of economic regionalism is another. U.S. bilateralism coupled with the probable rise of American protectionism could spoil the prospects of the Pacific economy. Some Japanese question what will happen if the EC becomes a closed economic

bloc in 1992 and the United States creates its own bloc. Further, the Pacific economy proponents do not rule out the possibilities of Japan's losing steam in innovation and restructuring and becoming protectionist, if the impact of the NIEs' assault on the domestic market proves too great. Finally, whether or not and how China will fit into the Pacific economy preoccupies some Japanese experts.

U.S.-Japan Frictions

Until Black Monday, or the collapse of the New York stock exchange in October 1987 which led to a worldwide stockmarket crisis, there was much debate between those Japanese who advocated accommodating U.S. pressures to correct bilateral trade imbalances and those who, blaming the United States for the huge imbalances, argued that only the United States could rectify the situation. After Black Monday, the Japanese are more convinced that whatever contribution they themselves may decide to make towards global adjustment, they must firmly demand that the United States puts its house in order by reducing its bulging twin deficits. The U.S.-Japan imbalance is seen as arising largely from Washington's macro-economic policies—a combination of a massive military buildup, a major tax cut, tight monetary policy, and a deliberately overvalued dollar—and not primarily from “unfair Japanese trade practices.” The Japanese who follow such topics are more convinced than their American counterparts that the United States must now reduce its current account deficit (or net foreign borrowing) by either reducing aggregate (private sector and government) investment, increasing aggregate saving, or both. That means, among other things, restrained spending—by the public and by the Pentagon—or tax increases, or a combination of the two.

Two implications of such a U.S. adjustment are particularly troubling to the Japanese. One is its global deflationary effect. The Japanese are well aware that the boom of the Pacific economy in the 1980s was export-led and half the increase in world exports went to the United States. The great American profligacy had its good points, but there is no way the U.S. market can keep growing as a limitless “absorber” of East Asian products.

The recent U.S. imposition of an import tariff surcharge on a Thai ball-bearing manufacturer, a Japanese joint venture, was a rude shock that the Japanese may have simply exported the “Japan problem” to the NIEs and ASEAN. The United States may, of course, choose more general and less industry- or firm-specific measures to reduce its twin deficits. Either way, the Pacific economy will be affected. Tokyo's Economic Planning Agency has recently conducted an elaborate simulation of U.S. efforts to reduce the budget deficit, showing that such efforts will have a rapidly growing, cumulative negative effect on Pacific economic growth.²¹

The other unpleasant implication of U.S. adjustment is greater pressure on Japan to share the burden of maintaining security in the Asia-Pacific region. U.S. pressure on allies, including Japan, to take on greater burdens is not new, and the Japanese have in fact accelerated their defense buildup in recent years. But the festering "Japan problem" prompts many Americans, including Congressmen, to make extreme demands. The Japanese feel uncomfortable about responding to these not only because of the costs entailed, but also because of the region's inevitable reaction to any Japanese military role.

Rise of Regionalism

A second Japanese concern is the possible rise of U.S. bilateralism, at the expense of its vaunted multilateralism. The increasingly shrill U.S. demands and actions to restore a bilateral trade balance has been disquieting enough. The fear of U.S. bilateralism intensified when the U.S.-Canada free trade agreement was being finalized at one trough of the U.S.-Japan relationship. Talk that Europe may become a self-contained and self-centered economic bloc in 1992 fed the fear. It is not just a fear of exclusion. Understandably, the Japanese at this stage rather sincerely believe that multilateralism is best for them and for the world. Thus, they have been reacting negatively to U.S. overtures for a U.S.-Japan free trade arrangement, saying that any arrangement they might consider must be wide open for Japan's trading partners in East Asia to join.

The recent interest among some of Japan's Pacific economy proponents in creating an organization like the Organisation for Economic Cooperation and Development (OECD) in the region is related to the multilateralism versus bilateralism discussion. Not surprisingly, the Foreign Ministry and MITI have rival concepts of such an OECD-like framework, and former prime minister Yasuhiro Nakasone evidently has his own. Those who belong to the Japanese committee of the Pacific Economic Cooperation Conference (PECC) and who are, incidentally, close to the Foreign Ministry, floated (at last year's general meeting in Osaka) the idea of gradually transforming the PECC, essentially a private organization, into an official one resembling the OECD.

The idea was generally unpopular among non-Japanese members of the PECC who feared Japanese domination, among other things, and the Japanese withdrew it for the time being. But many Japanese are still convinced that there is a growing need not only for exchange of economic information but also for coordination of policy in the region as interdependence increases. Kumao Kaneko, a Foreign Ministry official seconded to the PECC and who was instrumental in organizing the Osaka meeting, wrote after the event that "although it may not be possible to turn the PECC formally into an OECD-like organization, whether or not the PECC

ought to fulfill specialized functions similar to those of the OECD is a separate question."²² Clearly Kaneko wants the PECC to become an OECD, if not in form, then in substance.

Less obviously, those who advocate setting up a Pacific equivalent of the OECD seem to split into two groups, the first aiming to check the U.S. impulse towards bilateralism by using collective pressure against it, and the second wanting to see the "Pacific OECD" develop into a Japanese bloc, in case the world is indeed divided up into groups and Japan is excluded from major blocs formed around the United States and the EC. The first group is mainstream and easy to identify. Okita, who chaired the PECC Osaka meeting, is among its proponents.²³ Some Japanese are working out the position that the trend toward regionalism is not against GATT but that it can strengthen the faltering multilateral trading system. They advocate establishing a Pacific free trade area in the name of (an eventual) free world trade.²⁴ The group who favors setting up an exclusive Japanese-centered economic region in the Pacific is more difficult to pinpoint. One only reads vague references to those in "Kasumigaseki" (a district of Tokyo where the ministries, including the MITI and the Foreign Ministry are concentrated) who want to establish a Pacific economic sphere as Japan's answer to fortress Europe and other economic blocs.²⁵

A Protectionist Japan?

A third concern among the Pacific economy proponents is the possibility that the Japanese will adopt protectionist attitudes themselves. Until now, accommodating U.S. pressures on the Japanese to open up the domestic market, save less and spend more, or even to work fewer hours were more or less congruent with the interests of the long-suffering Japanese salaried men and housewives. Fortunately, striving towards "international harmony" tended at the same time to raise the domestic quality of life. This may explain why U.S. attacks on Japan have provoked as little nationalistic reaction as they have. The high yen and minor improvements in the distribution system have made imports more attractive, and products from the NIEs in particular have visibly contributed to increased consumer welfare.

It could be a different story when Japanese companies feel more and more threatened by the NIEs' competitors in the U.S. and even home markets. A while ago, before the sharp yen appreciation and the current rush of outward investment, the Japanese used the fear of a "boomerang effect" to explain their reluctance to invest abroad. Now many Japanese companies have no choice other than to relocate production facilities overseas. This has raised new fears of a "hollowing out" of Japanese industry. While the labor unions have not yet taken up the cause of keeping industries inside Japan (resource-poor Japan could never afford to isolate itself), isolationist impulses do exist and could affect the course of events.

The China Worry

A fourth Japanese concern is whether and in what way China will fit into the Pacific scheme of things. The 13th Party Congress in 1987 reconfirmed that the reform and open door policies were still very much effective. But obviously domestic resistance to these policies has been building up, as was evidenced more recently. The Japanese have wondered how China would cope with the new, and often unanticipated, problems created by the reform and open door policies, including the bifurcation of rich and poor particularly in the countryside, price increases (resulting from price reform as well as inflation), and unabashed materialism among the populace. Shortage of capital is an abiding condition that can only be overcome through changed attitudes towards foreign funds. Some China experts sensed that a clash of ideologies, or at least a competition for political ascendancy, was intensifying between the reformists led by General Secretary Zhao Ziyang and what they feel constitutes a group of Soviet-influenced orthodox Marxists, notably Premier Li Peng and Deputy Premier Yao Yilin.²⁶ Such a view seems to have been justified by the political upheaval triggered by the death of former general secretary and reformist leader Hu Yaobang in April 1989. The Japanese have also been made aware of the rise of economic regionalism inside China, reaction to which can further complicate China's basic economic policies.

THE JAPANESE CONSENSUS

In March 1988, the Japan Forum on International Relations, a recently formed private research council, completed its first major study. It was entitled "The Structural Adjustment of Economies of Japan, the United States and Asian NICs" (newly industrializing countries) and was accompanied by a set of policy recommendations. The forum, made up of representative "internationalists" from academia, business, the press, and influential ex-bureaucrats, is chaired by Okita and the task force for this specific study was led by Watanabe.

The study's premise is that "[the] world economic system is not a given condition for the growth of Japan anymore. Japan is now in a position where she should devote herself to the reformation and evolution of the world economy."²⁷

There are 13 policy recommendations in all. Not surprisingly, the first recommendation calls for macroeconomic adjustments between the United States and Japan. The former must curtail its fiscal deficit, while the latter should continue efforts to stimulate domestic demand. In a separate recommendation, the forum calls for Tokyo's hasty implementation of emergency measures promised in mid-1987 with a view to boosting domestic demand.

The second recommendation is for "maintaining a trade regime which is free, multilateral and indiscriminatory." In the background elaboration, the forum says, "there would be a cause for concern if the United States conducts bilateral trade negotiations, stressing too much on the 'reciprocity principle'." Instead of taking retaliatory measures, the United States should invest in new plant and equipment to regain international competitiveness.

The following several recommendations are about "strengthening support for the Western Pacific developing countries." Japan must help "release the dynamism" of the NIEs, ASEAN, and Chinese economies, the forum exhorts. One way to achieve this is to "normalize" the flow of Japanese funds. Too much is now going to the United States for dollar assets. More funds, both private and official, should flow to developing countries in East Asia and elsewhere. Another way is for Japan to become an "absorber" of developing country exports to supplant the United States in this role, in addition to being a supplier of capital and intermediate goods. Crucial in this process is "outsourcing," or offshore procurement by Japanese manufacturers. Interindustry and intraindustry division of labor in the Western Pacific, particularly in the machinery industries, is also desired, which amounts to abandoning the "full-set principle" in Japan's industrial policy, that is, maintaining a closed integral structure and producing just about everything from start to finish. Incidentally, this full-set principle has been identified as the culprit behind Japan's "wrong elasticities"; even when incomes and prices move in the right direction, Japanese imports do not grow as much as is hoped for. But already elasticities of imports from the NIEs are growing considerably.²⁴

"Acceleration of the acceptance of foreign nationals into the Japanese labor market" is the single controversial recommendation that helped the study to get the little press coverage it got.

The forum's recommendation to the NIEs is to become "a new growth axis comparable to Japan" through trade liberalization and currency revaluations, and to enhance the growth of ASEAN countries and China. NIEs are thus expected to become absorbers and investors in their own right. ASEAN countries are asked to develop export-oriented and support industries, making it easier for foreign funds to contribute to that process. Inclusion of China into the Asia-Pacific sphere is strongly recommended by the forum, which asks China, for its part, to "clearly state that the open door policy would not be subject to shortsighted manipulation" and to "ease state control of foreign trade and investment."

TASKS FOR THE FUTURE

Compared to the celebrated Maekawa report on "economic structural adjustment for international harmony," which was published in 1986 and

became the guidepost for Japanese economic reform, the forum study was longer and more specific, but was not much noticed by the press, in Japan or abroad, and did not become a subject of heated debate. The study did not have obvious influence on policy, as the Maekawa report did. But there are similarities between the two documents.

Neither is brimming with revelations or radical recommendations. They do integrate, however, pulling fragmented pieces of knowledge together to offer a coherent view on how these are interrelated, and both contain recommendations that, if actually implemented, would make a difference. Each document involved a large number of Japanese elites in its preparation. In fact elite consensus building was as important an objective as the uncovering of new truths in both cases. The two documents represent more or less reasonable internationalist approaches to challenges facing Japan.

That said, the theory of the Pacific economy is still largely a happy hypothesis. It remains for its proponents (or opponents) to become more quantitative. Several crucial questions could usefully be asked. How much will U.S. imports have to slow down or decline to reduce the twin deficits by significant amounts in a given period? How much of the slack in world export can Japan absorb without creating undue pressure on domestic interests? How much can South Korea and Taiwan absorb? Will absorption of exports by Japan, South Korea and Taiwan be enough to allow the Pacific economy to keep growing, despite the slower growth (or contraction) of the U.S. market? What will be the scenario if the United States depends more on expanded exports?

Perhaps another task of the Pacific economy theorists is to bring some politics into the picture. South Korea averted a post-Olympic Games upheaval that some had foreseen, but can its political stability be taken for granted now? How will the economies of Taiwan, Hong Kong, and China fare, if China gets too tough or otherwise blunders on the reunification issue with the two NIEs? The question of China per se—whether its reform and open door policies will stick—has already been posed. In ASEAN, will President Corazon Aquino's regime in Manila succeed in its land reform efforts, or survive attacks from the Left and the Right? How will deteriorating race relations affect Malaysia's economic performance?

U.S.-Japan friction has both political and economic dimensions and the two are linked. Though dissatisfied with the meager political and security roles Japan currently plays in the region, the Americans may in the end acquiesce in Japan's contributing towards security in its own way—economically rather than politically or militarily.

One dilemma for Washington is that economic contributions may bring returns to the donor; the Japanese may gain influence and popularity in the third world, possibly at the expense of the United States. The more U.S. misgivings about Japan's economic contribution grow, the more

strained U.S.-Japan economic relations will be. Another problem for some Americans is that Japan may start wanting to share the power as well as the burden, whereas what these Americans really want is for Japan to bankroll their traditional activities without interfering in the decision making. The gap is already evident in multilateral organizations like the International Monetary Fund (IMF) and the World Bank, to which Japan would like to contribute more capital and thereby gain greater voting power. Apparently, the United States wants the capital, but not a greater Japanese say.

Introducing political factors will no doubt complicate the analysis. Yet abstracting from politics is not realistic. On the other hand, after some politics have been taken into consideration, the Pacific economy proponents may turn out to have been correct in their optimism for the region.

NOTES

1. See, for example, Sakamoto, Masahiro, "Kishimu nichibei hegemonii buntan no kozo [Creaking Japan-U.S. hegemony sharing]," in Special Feature: "Taiheiyo keizaiken to Nippon [Pacific economic sphere and Japan]," *Shukan Toyo Keizai*, 21 August 1988.
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3. Takubo, Tadae, "Amerika suitairon no haikei [The background to the theory of U.S. decline]," *Chuo Koron*, June 1988.
4. Watanabe, Toshio, "'Nishi taiheiyo no jidai' no nichibei-NICs [Japan-US-NICs in the Western Pacific era]," *Shukan Toyo Keizai*, 20 May 1988.
5. Shinohara, Miyohei, "NICs ni takamaru jishin to sekinin no jikaku [Rising confidence and awareness of responsibility among the NICs]," in Special Feature: "Ajian taiheiyo no jidai ga yattekuru [The Asia-Pacific era is coming]," *Ekonomisuto*, 14 June 1988.
6. Okita, Saburo, "Pacific Development and Its Implications for the World Economy." Keynote speech at the Pacific Economic Cooperation Conference (PECC), Seoul, April 1985.
7. See Special Feature: "Ajia taiheiyo keizaiken," *Shukan Toyo Keizai*, 5 November 1988.
8. Takeuchi, Hiroshi, "Senshinkoku ni dappi suru NIEs [NIEs are becoming advanced countries]," *Voice*, January, 1989. See also Sakamoto, Masahiro, "Taiheiyo chiiki no keizai tembo [Economic outlook of the Pacific region]," *Kokusai Mondai*, November 1988.
9. Yano, Toru, "Gunjiryoku yorimo sentan gijutsu ga sekai o ugokasu [Leading-edge technology, not military might, will move the world]," *Shukan Toyo Keizai*, 20 May 1988.
10. Iida, Tsuneo, "Jukyo kasetsu to NICs [The Confucianism hypothesis and the NICs]," in Special Feature: "Ajia taiheiyo keizai no 1988 nen [1988, the year of Asia-Pacific economy]," *Keizai Seminar*, January 1988.
11. Nakajima, Mineo, "Taiheiyo jidai no chugoku [China in the Pacific Era]," in Special Feature: "Taiheiyo keizaiken to Nippon," *Shukan Toyo Keizai*, 21 August 1988.
12. Okita, see note 6.
13. For a classic statement of the flying geese theory, see Akamatsu, Kaname, *Keizai Shin-chitsujo no Keisei Genri* [On the formation of a new economic order], Risosha, Tokyo and Osaka, 1944.
14. Watanabe, Toshio, *Ajia: sono seicho to kuno* [Asia: its growth and pains], Nihon Hoso Shuppan Kyokai, Tokyo, 1988.

15. Watanabe, Toshio, "Ajia shokoku koso nihon no 'furu setto-gata kogyo kozo' o uchiyaburu [Asian countries will defeat Japan's 'full-set industrial structure']," *Economics Today*, Spring 1986.
16. Hirata, Akira, and Nohara, Takashi, "Changing patterns in international division of labor in Asia and the Pacific." Paper presented at "Tokyo conference on global adjustment and the future of Asian-Pacific economy," May 1988.
17. Nakakita, Toru, "Nihon kigyo no takokuseki tenkai to higashi ajia no keizai hatten [Multinationalization of Japanese companies and economic development of East Asia]," *Kokusai Mondai*, November 1988.
18. Aoki, Ken, "Ajia taiheiyo keizai to nihon [Asia-Pacific economy and Japan]," in Special Feature: "Ajia taiheiyo keizai no 1988 nen," *Keizai Seminar*, January 1988.
19. Figures are from Watanabe, Toshio, "Sekai keizai o ken'in suru ajia: Nishi taiheiyo no jidai wa kuruka? [Asia pulls the world economy: will the Western Pacific era arrive?]," *Voice*, October 1988; and Special Feature: "Ajia taiheiyo keizaiken," *Shukan Toyo Keizai*, 5 November 1988.
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21. Economic Planning Agency, *Keizai Bunseki*, No. 111, September 1987.
22. Kaneko, Kumao, "Taiheiyo kyoryoku no soshikika to nihon no yakuwari [Organizing Pacific cooperation and Japan's role]," in *Kokusai Mondai*, November 1988.
23. Okita made this point in reviewing the Osaka PECC meeting in an article in *Shizuoka Shimbun*, 13 August 1988 (cited in Kaneko, Kumao, "Taiheiyo kyoryoku...." in *Kokusai Mondai*, November 1988).
24. See, for example, Eguchi, Yujiro, "Taiheiyo kyoryoku to boeki taisei [Pacific cooperation and trade systems]," *Kokusai Mondai*, November 1988, and Nakatani, Iwao, "Burokku keizai 'akudama' ron no uso [The fallacy of prejudging bloc economies]," *Voice*, January 1989.
25. See, for example, Watanabe, Toshio, "Sekai keizai o ken'in suru ajia," *Voice*, October 1988.
26. Nakajima, see note 11.
27. Japan Forum on International Relations, "The structural adjustment of economies of Japan, U.S., and Asian NICs," March 1988.
28. Kitamura, Yuichi, "Taiheiyo toriainguru boeki no dainamizumu [Dynamism of Pacific triangular trade]," in Special Feature: "Taiheiyo keizaiken to Nippon," *Shukan Toyo Keizai*, 21 August 1988.

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