Globalization & Economic Crisis

By Naoyuki HARAOKA

It was a worldwide plunge in exports that prompted the financial crisis originating from the US subprime loan fiasco-induced credit collapse to develop into the global economic tailspin. Today, national economies are closely linked with one another through foreign trade. Accordingly, once demand in one country rapidly shrinks, its effect spreads fast across the globe by way of trade. This is a key feature of the global economic recession in an era of globalization. This kind of analysis is generally made in discussing the current economic crisis.

In particular, Japan was hit hard by the US economic downturn because it used to depend heavily on exports to the United States – its main trading partner – for growth of its gross domestic product (GDP). Further, automobiles and consumer electronics make up the bulk of Japan's exports, with the income elasticity of demand for these products being high. These factors combine to make Japan liable to suffer great damage from a downturn in final demand in the United States and other major trading partners. For these reasons, Japan marked the biggest fall in the rate of economic growth in the world.

Globalization Promoted by FDT

Against this backdrop, calls are rising for Japan to rectify its heavy dependence on exports and the export composition lopsidedly reliant on particular items in order to overcome the fragile aspect of its economy. Specifically, Japan is being urged to push forward a transition to domestic demand-led economic growth and strive to diversify products for export into clothes and other daily necessities in addition to autos and electronics.

For other Asian countries as well, there is an argument that their economies should "decouple" themselves from the US economy to lessen their dependence on the US market and pursue self-sustained economic growth. Indeed, it is significant to make efforts to promote a shift to domestic demand-driven growth and reinforce competitiveness in daily necessaries and other products that are less susceptible to ups and downs of economic activity. But it should be kept in mind that in this era of globalization, any national economy is affected not only by merchandise trade but by investment trends as well.

TABLE 1
Sales by region of Japanese subsidiaries abroad

(in millions of dollars, %)

Region	Sales	2007		2008	
		Value	Share	Value	Share
North America	**Total sales**	251,767	100.0	228,208	100.0
	Local sales	228,074	90.6	205,687	90.0
	Sales to Japan	3,957	1.6	4,041	1.8
	Sales to countries other than Japan	19,735	7.8	18,481	8.1
Asia	**Total sales**	312,179	100.0	332,971	100.0
	Local sales	169,330	54.2	191,210	57.4
	Sales to Japan	67,080	21.5	65,456	19.7
	Sales to countries other than Japan	75,770	24.3	76,305	22.9
Europe	**Total sales**	155,593	100.0	136,719	100.0
	Local sales	93,238	59.9	80,653	59.0
	Sales to Japan	1,856	1.2	1,605	1.2
	Sales to countries other than Japan	60,500	38.9	54,461	39.8

Source : "Trends in Overseas Subsidiaries," METI

Japanese businesses are boosting foreign investment by setting up affiliates and subsidiaries abroad in tandem with the progress of globalization. With this in mind, the Ministry of Economy, Trade and Industry (METI) releases a report titled *Trends in Overseas Subsidiaries* on a quarterly basis. The data are meant to statistically grasp sales and other managerial indices at overseas subsidiaries of Japanese corporations.

Intra-firm Trade Significant in Asia

The statistics show that while sales by Japanese subsidiaries in North America largely comprise those in the North American market, 20% of total sales in Asia are export sales to Japan. On top of this, sales to countries other than Japan account for about a quarter of the total sales in Asia. In Europe, the ratio of exports to countries other than Japan to the total sales is nearly 40%, higher than that of sales in North America, although approximately 60% of sales by Japanese subsidiaries are those in the European market. The ratio of export sales to Japan to the total sales in Europe is extremely low, compared with that for Asia *(Table 1)*. In this way, Japanese subsidiaries seem to have different roles to play by region, depending on management strategies of their parent companies in Japan.

As shown in the statistical data, Japanese subsidiaries in North America are expected by their parents in Japan to act as sales bases for the North American market. By contrast, those in Asia are expected to serve as hubs for export to Japan and to countries other than Japan. As for subsidiaries in Europe, they are expected to play the role of sales bases for the European market and at the same time act as those for countries other than Japan such as in the Middle East and Africa. Particularly notable in Asia is that the ratio of exports to Japan by Japanese subsidiaries is high relative to those in the United States and Europe. This indicates that subsidiaries in Asia import intermediate goods and raw materials from Japan, process them and then export finished goods back to Japan in a practice called intra-firm trade.

As shown in *Table 2*, the latest economic crisis has led to a tumble in sales by Japanese subsidiaries in all regions. Especially in Asia, a fall in sales to Japan in intra-firm trade is conceived to have had a greater impact on the overall sales by Japanese subsidiaries because the weight of export sales to Japan in their total sales in Asia is higher than in other regions. As globalization evolves, a greater number of businesses are prompted to set up operations abroad and engage in sales and production there, ending up launching intra-firm trade between local subsidiaries and parent companies. Intra-firm trade is set to carry greater weight in the value of trade between two regions such as Japan-Asia trade in which a system of division of production has already been established, with Japan turning out component parts and Asia producing finished goods.

Hence, when final demand shrinks precipitously as it has in the latest economic crisis, exports of parts and raw materials from Japan decrease sharply due in part to reduced local sales stemming from a fall in local final demand and in part to a downturn in sales to Japan caused by stagnant economic activity. Therefore, the closer economic relations with Japan, the greater the fall Asian countries could see in their trade with Japan in proportion to declines in intra-firm trade. Japan has concluded free trade agreements (FTAs) with those Asian countries which have close economic relations with Japan. Such a substantial downturn in trade with Japan is highly likely to take place in relation to Asian FTA partners.

In the era of globalization, it is only natural from the viewpoint of management strategy that businesses select what they regard as the most advantageous production/sales bases in terms of price competitiveness on a global scale. Otherwise, it cannot be said that they have fully benefited from globalization. Assuming that capital flow should basically be free, therefore, it seems unavoidable that merchandise trade, including intra-firm commerce, suffers a sharp decline should an economic crisis like the latest one occur. The view that the effect of the economic crisis is so grave that a country should make its market free from the effect of other countries' economies as much as possible overlooks the aspect of globalization-driven evolution in international investment.

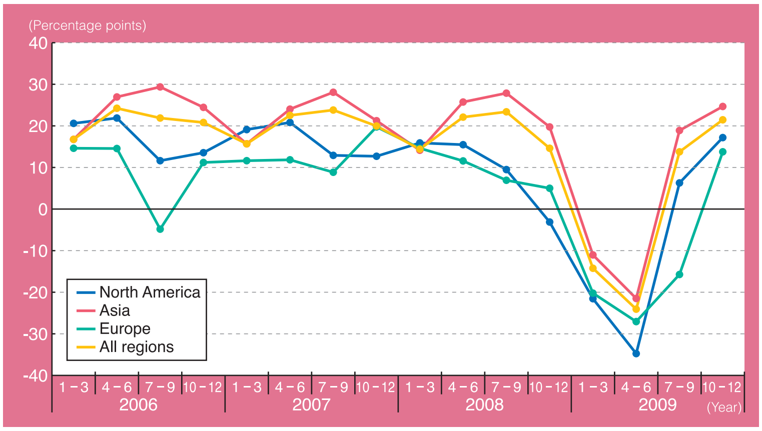
TABLE 2
Changes in post-crisis sales by region of Japanese subsidiaries abroad

(%)

Region	Sales	2008 Jul-Sep (3rd qtr)	2008 Oct-Dec (4th qtr)	2009 Jan-Mar (1st qtr)	2009 Apr-Jun (2nd qtr)
North America	**Total sales**	▲2.6	▲16.4	▲38.3	▲33.0
	Local sales	▲3.3	▲16.8	▲38.4	▲33.5
	Sales to Japan	12.8	▲1.1	▲17.8	▲24.8
	Sales to countries other than Japan	2.1	▲15.5	▲41.2	▲28.4
Asia	**Total sales**	13.1	▲5.3	▲26.6	▲23.4
	Local sales	22.5	1.2	▲20.1	▲20.6
	Sales to Japan	7.5	▲6.8	▲30.8	▲21.4
	Sales to countries other than Japan	▲1.2	▲18.1	▲38.3	▲31.4
Europe	**Total sales**	3.7	▲24.3	▲40.4	▲40.1
	Local sales	2.6	▲25.1	▲41.0	▲40.7
	Sales to Japan	▲4.0	▲26.4	▲44.7	▲21.3
	Sales to countries other than Japan	5.6	▲23.1	▲39.2	▲39.7

Note: The figures represent percentage changes from the same quarter a year before. ▲denotes minus.
Source : "Trends in Overseas Subsidiaries," METI

CHART
Projections on sales DI by region



Note: The diffusion index (DI) represents the percentage of companies reporting higher sales minus that of those reporting lower sales.
Source : "Trends in Overseas Subsidiaries," METI

Policy Assignment at the Crisis

With the exception of emergencies such as the latest crisis, businesses have benefited from positive aspects of globalization through the free flow of capital, and globalization-based corporate strategies were established as early as the 1980s. Businesses will lose a variety of benefits they have so far enjoyed if restrictions are imposed on capital flow to maintain independence of a country's market so as to brace for the likelihood of a once-in-a-century economic crisis. Just like protectionism, giving a country's economy greater independence and making its market decoupled from those of other countries is not construed as an appropriate response to the economic crisis.

An economic crisis such as the latest one should absolutely be addressed by macroeconomic policy. In other words, it should be dealt with not by trade policy but by fiscal and monetary policies. One of the theories in economics is that when there are multiple policy goals, the most effective policy measure should be applied to each target to achieve those goals. This theory should be used in coping with the current economic crisis. Assume there are two policy challenges – economic stability and trade development. Economic stability should be pursued only with fiscal policy aimed at expanding domestic demand and monetary policy designed to stabilize financial markets. It should not be sought with trade policy. Trade policy should absolutely be dedicated to enhancing the positive aspects of globalization while rejecting protectionism and firmly upholding the principle of free trade.

According to a *Trends in Overseas Subsidiaries* survey for the second quarter of 2009, the diffusion index that indicates economic activity ahead in regions where Japanese subsidiaries are located showed signs of recovery in North America, Asia and Europe, across the board as shown in *Chart*. The outcome of the quarterly survey indicates not just economic recovery in each region but improvement in intra-firm trade and exports to countries other than Japan by Japanese subsidiaries as well. These statistical data point to a recovery trend in the global economy. At long last, we have now entered the phase of enjoying much benefit from the positive aspect of globalization. JS

Naoyuki Haraoka is editor-in-chief, Japan SPOTLIGHT, and executive managing director, Japan Economic Foundation.