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Part One: The Present State of the World Economy

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Chapter I : The Present State of the World Economy

1. An Integrating World Economy

The world economy has become increasingly integrated through transactions in goods, services and capitals. Since 1980, these overseas transactions have outgrown nominal GDP. Particularly noteworthy is that transactions in services have outperformed those in goods and those in capital have outpaced those in services. In the capital sector, investments in securities have outrun direct investments (Figure 1).

Chapter II : Trends in the World Economy

2. Growing Globalization of Corporate Activity

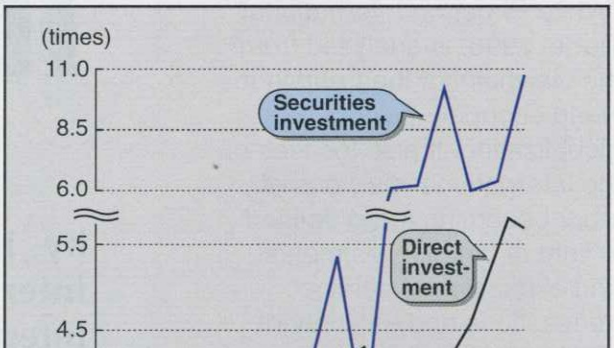
With the activation of direct investment, corporate production overseas has been growing and catching up with product exports. As of 1988, Japanese product exports to various regions exceeded overseas production in the regions concerned. In 1995, however, overseas production overtook product exports in the U.S., EU and ASEAN 4. The progress of overseas production brought about a major change in the structure of foreign trade. Exports to overseas affiliates (manufacturing) account for about 25 % of Japan's total trade and about 18 % in the U.S. while imports from overseas affiliates represent about 10 % in Japan and about 14 % in the U.S. International transactions are increasing not only in goods but also in services. The growth of service exports by the U.S. is, in large measure, a result of expertise, technical services and royalties and other fees, while computer related services contribute much to the growth of activity by U.S. affiliates abroad.

Competition among companies in the forefront of globalization is intensifying, and strategic tie-ups are gaining momentum, stimulating industrial realignments. The competition targets international standards. Electronic trading has become possible through the Internet, a sign that advanced telecommunications is providing further spurs to trade globalization.

3.Growth Potential of Developing Countries

Many developing nations have achieved economic development on the strength of direct investment and expanded exports. In East Asia, NIEs attained economic growth by attracting direct investment from Japan and other advanced countries from the 1960s through the 1970s. After the mid-1980s, the dollar's excessive appreciation was corrected and NIEs lost their export competitiveness under the Plaza Accord. As a result, the ASEAN countries achieved economic growth by attracting direct investment from Japan, other advanced nations and NIEs and expanded exports. In the 1990s, China gained strength under its open-door policy, and Russia, in its continued move toward a market econ-

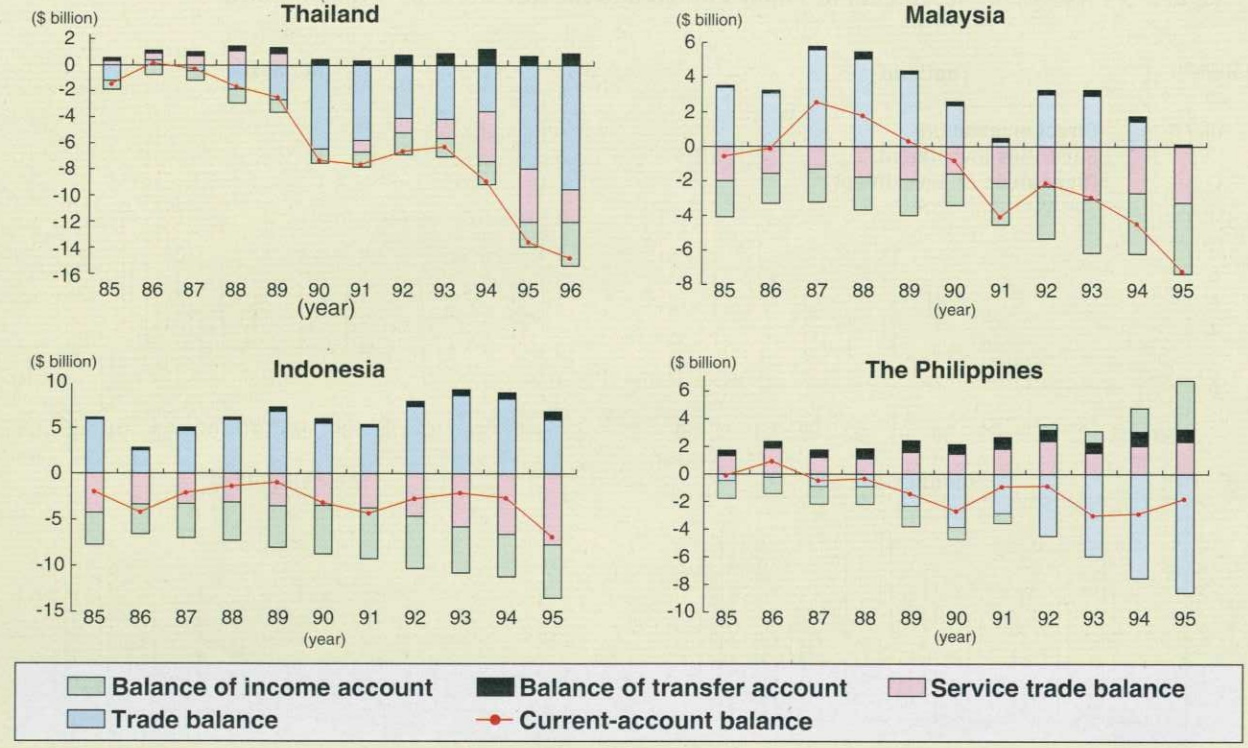
Figure 1: Changes in the Growth Rates of Nominal GDP, Merchandise and Services Trade, Direct and Securities Investment of the World (dollar base)



Note: 1980=1. "Trade" means exports, and "investment" means out-bound investment.

Sources: IMF's"BOP," The World Bank's "World Table," and The central bank of China's "Balance of Payments"

Figure: 2 Changes in the Current-Account Balance of the ASEAN 4



Source: IMF's "IFS"

omy, received direct investment from Europe and the U.S. and enlarged its exports. Russia's GDP growth in real terms turned to the plus side for the first time in 1997. Central and South American countries received direct investment mainly from Europe and the U.S., as Central and Eastern European countries relied on Germany and other European countries for direct investment. Their exports are expanding, placing their economies on a slow but steady growth path.

4. Globalization of Economies, and Realignment of Currencies

Meanwhile, close ties between various countries and regions through capital transactions means that the world economy is vulnerable to risks like precipitous capital transfers. In the wake of such capital transfers, a currency crisis started in Europe in 1992. The yen also surged when the Chinese yuan plunged in value. Mexico faced a currency crisis, followed by the yen's slide and the dollar's spirited rally. And in 1997, a currency crisis battered Asia. These exchange rate adjustments have had a heavy impact on the economies of the countries involved through contagion and fluctuations in their export competitiveness.

5. Asia's Currency Crisis

The Asian currency crisis of 1997 originated in Thailand. Concern about the future growth of the Thai economy surfaced when exports, the dynamo of the country's economic growth, began to slow down. Its trade and current account deficits, until then little heeded, became a big issue (Figure 2). Behind the currency chaos was the fact that Thailand depended on securities investment and other relatively unstable funds for redressing trade and current account balances (Figure 3).

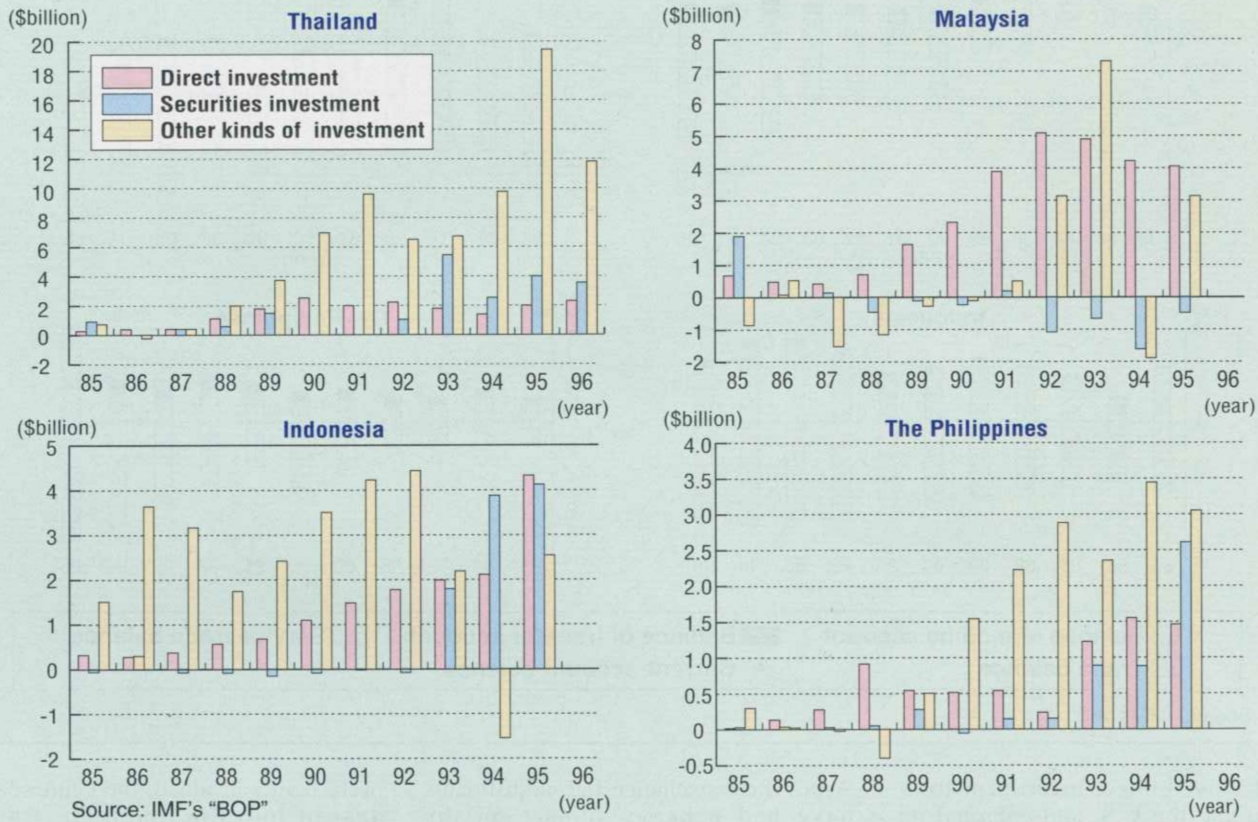
The currency turmoil instantly spread to neighboring countries. Though all these countries did not face the same problems as Thailand, they lost the confidence of markets for similar or other reasons, which led to the contagion of currency falls. While the currencies of neighboring countries were being devalued, the Chinese yuan leaped into the limelight. But the Chinese government has repeatedly denied the possibility that it will devalue its currency.

Incidentally, Mexico, which was hit by a crisis similar to the Asian currency crunch in 1994, recovered its domestic demand under the lead of exports and shifted to positive growth in 1996.

6. Global Environmental Problems

In recent years, there has been mounting concern over global warming and other environmental problems. The amount of CO2 emission, a main culprit for global warming, is larger in advanced countries, and it is forecast that, in the future, developing nations will increase their CO2 emissions against a backdrop of economic growth. In the global warming issue, all parties in the world are "assaulters" and, at the same time, "victims." Therefore, steps to combat global warming must be taken on a global scale. In order to resolve the global warming issue without damaging economic growth, it

Figure: 3 Changes in the Amount of Funds Flowed into the ASEAN 4, by Types of Funds



Source: IMF's "BOP"

is important that efforts be made to reform the energy supply-demand structure by energy saving or other means.

7. The Energy Problem

To review recent trends in energy security, it must be noted that the international oil market has grown remarkably. The development of the international oil market brings about an increase in the weight of economic factors in transactions, a desirable security effect for Japan and other countries highly dependent on oil as an energy source and on the Middle East for its oil supply. If energy security is to be maintained, the oil policy as a whole must undergo an overhaul based on the growth of the international oil market. Furthermore, efforts should be made to address the global environmental problem, as mentioned earlier, and foster a common perception throughout Asia, a region with which Japan has mutually reliant economic relationships.

8. The World Economy and the International Trade System

By soul-searching about the economic chaos that triggered wars, various countries have endeavored to structure free trade and stable currency systems. Against the constant pressure of protectionism and major changes in the world economic environment, they have worked to alter systems, on the trade front, through multilateral negotiations at GATT and, on the currency front, through close policy coordination and stepped-up multilateral cooperation under the IMF and other systems.

These countries are now going ahead with the formation of new trading systems within multilateral, inter-regional and bilateral frameworks in an effort to address new problems arising from the globalization of the world economy. First, rules are being worked out and systems in various countries reconciled in the investment and service fields to cope with the diversity of economic transactions. Second, expanding international capital transfers, as symbolized by the currency crisis in East Asia, are rapidly adding to the fragility of developing economies. Thus, avenues for cooperation are now being explored to prevent the weakening of developing economies from seriously affecting other countries through trade, investment, overseas assets and other channels.