Japan's Role in East Asia: Role Model or Bystander?

by James C. Abegglen

As doubts about the durability of the "East Asian Miracle" become more widespread, the series of exchange rate crises throughout the region in mid-1997 raises again the question of the role of Japan in the politics and economics of the region. A massive holder of foreign exchange reserves and much the largest net creditor nation, an expectation of Japanese initiatives in support of the currencies of East Asia might well be expected. In the event, the government of Japan fell far short of playing the leadership role that might reasonably be expected of it.

This situation serves to illustrate a continuing paradox in Japan's role in East Asia. The Japanese economy is a powerful factor in East Asia's extraordinary economic growth over the past three decades, both as model for and as engine in the growth process. Yet in political and strategic terms, Japan has been largely irrelevant, a bystander in much of East Asia's political development. As the region consolidates its economic gains, political issues will become more central in the region's agenda, especially as the role of China must be addressed.

Japan's position in the economics of the region is clear enough; Japan's political and strategic position has not even been articulated. This paradoxical contrast between competent and aggressive business/economics on one hand and ineffectual and passive politics/strategy on the other has been all too characteristic of post-war Japan. "First rate economics; second rate politics" as the cliché has it. Yet for Japan's future well-being, time is running out; Japan risks being isolated both from the West and from East Asia, marginal and irrelevant as the United States and China play out the strategic game. Political leadership must come to match economic influence.

Japan as economic role model

Of Japan's economic role in the region's success there can be no doubt. In scale, Japan makes up about 70% of the total combined economies of all of East Asia. The scale point is well-made in the recent Australian government report on Japan: "Compared with the rest of East Asia, Japan's regional markets are huge and extremely significant. Kanto, Kansai and Chubu are the three largest economies in Asia after Japan itself. Kyushu's economy is nearly the size of China's; ... Hokkaido's economy is larger than Indonesia's and Thailand's; and even in the case of the smallest region, Shikoku, the economy is larger than those of Hong Kong, Malaysia or Singapore." [1]

As the first non-Western culture to successfully industrialize, the sheer role model impact of Japan has been critical. It was the Japanese fleet at the Straits of Tsushima that put paid to Russia's military adventure, and that marked the end of Western military imperialism in Asia. The psychological impact of this event has been remarked on frequently by non-Japanese Asians as putting an end to the view that Asians could not meet the West on its terms successfully. And it was post-war Japan that put an end to the two centuries of Western economic hegemony in Asia.

Curiously, one does not think of Japan, a most conservative nation, as having had revolutionary influence. Yet in breaking down the barricades and freeing East Asia, the role of Japan has been in fact that of a revolutionary. Less spectacularly, Japan's own economic success has been the model for the development plans of East Asia's economies. Witness the care with which South Korean government planners have followed the good points, and have sought to avoid the errors, of Japan's planners. East Asian leaders like Malaysia's Mahathir bin Mohamad, with his famous "Look East" phrase, exhorted their countrymen to emulate the Japanese economic model.

Japanese investment as driver of growth

In the economic growth of East Asia, foreign investment plays a critical role. The need in the region has not been for foreign capital as such. Savings rates throughout the region are quite exceptionally high. Foreign capital is a welcome addition, but not in itself critical to the region's growth. Of real importance is the technology that foreign investment brings. Earlier, in Japan and in South Korea as well, it was possible for local firms to acquire through license the technology needed for growth. Indeed, Japanese firms did this so well, so thoroughly, and so cost effectively, that licensing has become very difficult with would-be sellers reluctant to license without equity position. Thus, throughout the region, foreign investment is made welcome for the management and product technology it provides.

Japan's companies are major investors, and as such are major suppliers of the needed technology. In Malaysia, a single Japanese company, Matsushita Electric, accounts for about 4% of the nation's GDP. Matsushita has moved its air conditioning division to Malaysia nearly entirely, and most significantly has moved its R&D for air conditioning to Malaysia as well.

In total investment, Japanese and U.S. companies have each supplied about 15% of the foreign investment flows to East Asia's NIES, and each about 10% of the flows to mainland China. (Or at least so it appears; these investment statistics are at best approximate.) The major differences between the U.S. and Japanese companies in investment flows are 2-fold. One, Japanese companies are much more heavily invested in the ASEAN economies than are U.S. companies, notably in Thailand and in Indonesia. One estimate is that about 7% of Thailand's labor force is employed in Japanese-owned companies.

The second difference in investment

pattern is the greater Japanese company focus on manufacturing investment, with U.S. involvement greater in raw material sourcing, and in finance and distribution. The shift of Japanese manufacturing investment into East Asia in the past few years has been dramatic. From 1990 to 1995 Japanese manufacturing investment into East Asia tripled, while manufacturing investment by Japanese companies into the U.S. dropped by half, and that into Western Europe largely stagnated. There is now more Japanese manufacturing investment in East Asia than in North America. Some will recall the era of the Tanaka riots and the Japanese as "economic animals." That era is well and truly past.

To the advantage both of East Asia and of Japan, this high level of investment into East Asia seems likely to continue. East Asia's economies continue to offer cost advantages in labor and land. At least as important now, these economies offer large and fast-increasing markets. The push of costs is now mightily reinforced by the pull of regional demand for such goods as autos and air conditioners, for which there is little if any demand growth in Japan or in the West.

Moreover, these are mature industries as well in the sense of being largely technologically mature. It is very much in Japan's economic interest that these mature industries migrate, freeing Japanese capital and labor for application in higher value added, higher technology sectors such as telecommunications and the other emerging electronic/information intensive sectors and in services.

Hollowing out?

In a dangerously misleading way, this process of off-shore manufacturing investment is sometimes referred to as a "hollowing out" of Japan's manufacturing base. It might better be termed a natural process of economic development. Japanese workers incomes increased because coal mines and cotton textile mills, once the main source of employment, were closed down in favor of imports. No one became wealthy digging coal or spinning cotton. Increased incomes require a steady shift to higher levels of skills and output values.

Indeed, arguably Japanese industry remains under-invested abroad, rather than over-invested. About 25% of total U.S. production is abroad, and the figure for Germany is now a bit over 20%. That is, compared to economies at similar levels of income and sophistication, Japan's economy is underinvested off-shore, and it is in the interest of the Japanese work force that more factories go abroad from Japan. This is the more true given the inexorable aging of Japan's population and the impending labor shortages that this aging phenomenon implies.

In fact, a true "hollowing out," as the term was initially used and still should be used, occurs when high technology, high value added components and products have their production off-shore. Japan's companies, especially with relatively low costs of capital at home, show little inclination to move production of key components abroad. Rather, final assembly is moved aboard, along with the more labor-intensive component production. This is not, in fact, a "hollowing out."

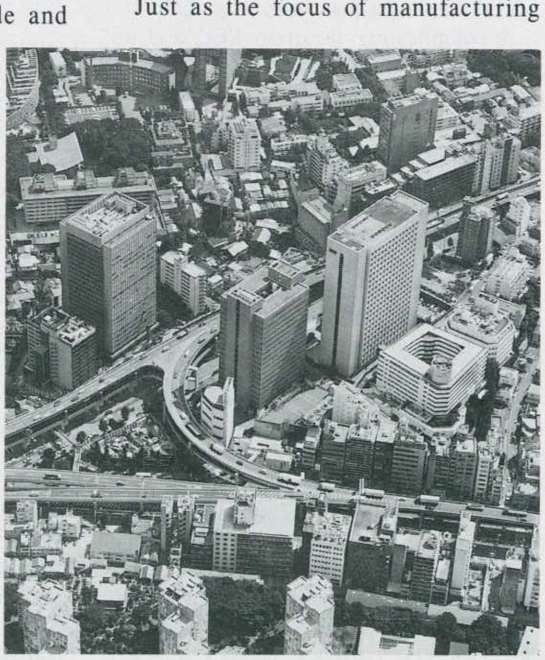
Curiously, the importance and value of shifting industries abroad has long been an explicit part of Japan's industrial policy. In a memorable speech in 1970, Mr. Ojimi Yoshihisa, then Administrative Vice Minister for International Trade and Industry, stated, "We must press with a will and with reason for adjustments in the international industrial structure...(by) progressively giving away industries by way of sophisticating the industrial structure in one's own country, much as a big brother gives the suit which he has outgrown to his younger brother... It is important that the advanced nations should plan for sophistication of their industrial structures and for opening up their market for unsophisticated merchandise, as well as that they should offer aid in the form of funds and technology." [2]

It is in the interests of all, as Vice Minister Ojimi stated, that the process of transfer of industries through foreign investment continue actively. At this critical juncture in Japan's own economic history, further advances up the value added chain are critical and will be facilitated by providing capital and technology to East Asia's attractive markets. Muttering about " hollowing out" is simply counter-productive.

It needs be noted too that with the economic success of East Asia, investment flows are not one-way. East Asian investments in Japan begin to provide a partial offset to Japanese investments in East Asia. Led by South Korea's *chaebol*, a number of Asian companies are building major positions in the Japanese market. In the most recent survey by Gemini Consulting of the 100 largest foreign firms in Japan, 13 are Asian, with Samsung Co. 14th on the list of the largest, followed by Samsung Electronics, Daewoo, LG International and Sunkyong all in the top 50. In addition, recent news reports on major land sales in Tokyo featured Singapore, Hong Kong and South Korean interests among major investors. Japan's ties to Asia continue to broaden as Asian company investments in Japan grow along with Japanese investments in East Asia.

Japan's market shift away from the U.S.

Just as the focus of manufacturing



Mutual penetration: South Korea's Samsung Group moves into central Tokyo as an investor (center) investment by Japanese companies has shifted to East Asia, so Japanese trade patterns are changing under the impact of East Asia's growth. In the decade since the dramatic shift in exchanges rates in 1985–6, East Asia has taken the place of the U.S. as Japan's most important export market and most important source of imports.

Investment brings with it trade

Japanese investment in East Asia has pulled in Japanese capital equipment and components and sub-assemblies to supply these investment sites. In part owing to this investment effect, by the mid-1990s, East Asia has become by far Japan's largest export market, taking well over 40% of Japan's total exports. In the most recent period, the first half of 1997, Japan's exports to East Asia were up another 11% on a year earlier, despite a slowing of East Asian growth.

This has meant a massive surplus for Japan in trade with East Asia, but with local content in Japanese manufacture in the region increasing, and with a rapid increase in imports to Japan from Japanese plants in the region, the surplus is leveling and can be expected to diminish over the next few years.

A complicating factor in this, and an indication of the special role of Japan in trade, has been the exchange rate issue. The governments throughout the region have, for a range of reasons, keyed their currencies to the U.S. dollar. With the yen strengthening against the dollar, this helped these economies compete with Japan. As the yen weakened, Japanese export competitiveness increased and for countries like South Korea, who compete more directly with Japanese goods, this has posed a real problem. No doubt with declining values of the region's currencies against the dollar, this problem will ease.

The other side of the exchange rate coin however is the indebtedness of these economies to Japan, both in commercial loans where Japanese banks are the dominant lenders and in government loans. Most of East Asia has been holding dollars as reserve currency, and a strong yen puts them under severe repayment pressure, having borrowed in yen and having to pay in depreciating dollars. Thus both in trade and in reserve positions it seems likely that there will need to be a steady increase in the use of the yen as a reserve and trading currency throughout the region over the coming years. This will, like mutual investment patterns, tend to draw the region together.

Infrastructure needs and Japanese aid

Japan has played a key role in the economic success of East Asia in the amounts and nature of its aid programs. Japan has in the past few years been the source of nearly a quarter of official world aid. This very large aid flow has been focussed on East and South Asia, with about half of the total to East Asia, and a fifth to South Asia. By way of contrast, only 5–6% of U.S. aid, lesser in total amount in any case, has been assigned to East Asia.

The aid flows are of special importance because of the fit between East Asia's needs and Japanese aid policy. The bottlenecks to growth throughout the region are infrastructure needs—transport, communications, energy supply and water and sanitation. The World Bank puts infrastructure investment needs at some $1,500 billion over the next decade. Japanese aid is directed very largely at hard, infrastructure investments. In 1994, just over half of Japan's total aid was to infrastructure projects; for the U.S., focussed on softer aid programs, infrastructure's share of aid monies was less than 5%.

Japan as bystander?

The massive role of Japan in the economics and businesses of East Asia makes its passive and marginal role in the region's politics all the more concerning. There is in any case for Japan a risk of isolation. Japan is not of the West, nor yet is it in many regards part of Asia. It is in Asia, but not of Asia. For Japan to become a full member of the East Asian community will require a degree of political will and commitment that is not at all in evidence.

The recent rather feeble proposal by Japan for a regular summit meeting with ASEAN was in any case some years late, and has met with no visible enthusiasm anywhere in the region. Yet the efforts by Mahathir of Malaysia to organize an East Asia Economic Caucus has been put to one side by Japan. Japan's government clings to APEC as a policy instrument for dealing in and with Asia. Yet Japan is the only APEC member not part of some other, more limited and better defined trading arrangement. And APEC can hardly be called Asian. It might better be called a politician's "photo op."

It is difficult to discern meaningful Japanese initiatives in any of the major political or strategic sectors. The re-definition of the Security Treaty with the U.S. was apparently at U.S. initiative, done to U.S. needs and interests. And well designed to cause maximum suspicion in Beijing. Where is the threat to Japan that requires a drawing closer to the U.S. strategically? Is this a deliberate choice, with the consequence of distancing Japan from China? Or is this merely another case of passive compliance with U.S. demands?

The need is clear enough—political policies and initiatives to match in breadth and effectiveness the powerful economic programs Japan's government and businesses have applied to East Asia. The economic turn of Japan to East Asia now needs a comparable political change of direction.

Notes:

[1] *A New Japan? Change in Asia's Megamarket.* East Asia Analytical Unit, Department of Foreign Affairs and Trade, Commonwealth of Australia. Barton, Australia, 1997, p.284.

[2] *The Industrial Policy of Japan.* Organization for Economic Cooperation and Development, Paris, 1972, p.28. JJTI

Dr. James C. Abegglen is currently chairman of Asia Advisory Service K.K.and director of several Japanese and Western companies. He is the author of ten books, including Sea Change: Pacific Asia as the New World Industrial Center (1994) *and* Kaisha: The Japanese Corporation (1985).