JAPAN-EAST ASIA ECONOMIC RELATIONSHIP: THE EVOLVING PATTERN

Ivan Tselichtchev

One of the most important factors, shaping the world economic scene in the era of globalization, is the relationship between economic power centers (US, Japan, leading European counties) and neighboring emerging market countries (hereafter we'll refer to them as adjacent countries, or adjacent area). This relationship is vital for both sides.

For the power centers closer economic integration with their adjacent areas, first, provides for the broad access to a cheap and often skilled and well-educated labor force as well as other cheap managerial resource. Second, a predominant position on the markets of an adjacent area makes it easier to take advantage of its dynamic expansion, both in the households consumption and capital investment sectors. These preconditions are crucial to enhance the growth potential and global competitiveness of every power center and are likely to become even more so in the future.

For adjacent countries closer integration means access to advanced technologies, managerial and professional skills, markets and financial resources.

It is only natural that, regardless of all the obstacles standing on the way, power centers are keen on engaging and integrating adjacent countries and within the latter positive attitudes towards integration, at least in the long run, tend to prevail.

It is appropriate to view in this context both the gradual expansion of EC/EU, especially as three South European nations joined and a number of Central and East European states are likely to do so in the foreseeable future, and the establishment of NAFTA followed by moves on the part of the US to push the idea of a wider free trade area including South American countries.

Japan's growing economic interest and involvement in Asia, especially East Asia\(^1\), which, among other things, materialized in rapidly expanding trade links,

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\(^1\) Hereafter the term "East Asia" will refer to the countries and territories of the region other than Japan. Regional statistics include NIEs, ASEAN-and China.
upsurge of the direct investment and expanding "reverse" imports, was a remarkable trend of the late 80's and, with some modifications, continued into the 90's. However, though Japanese-East Asian economic engagement dynamically expanded, the pattern of "power center-adjacent area" relationship in Asia, for a number of reasons, turns to be largely different from that in Europe or America, and it is likely to have important repercussions for both Japan and other East Asian countries.

What is the economic relationship pattern between Japan and East Asia at the intercompany and interstate levels? How is it evolving? What are the consequences for both sides, for other economic power centers, for the world economy as a whole? These are the main issues the paper will address.

1. Power Center versus Adjacent Area: the East Asian Formula.

In Europe adjacent countries are gradually integrated into EC/EU, and in the 90's most of the Eastern and Central Europe rapidly adopted an EU-oriented posture. On the American continent, despite some integration within its southern part, the US is a dominant economic power center.

On the contrary, East Asia, geoeconomically an adjacent area of Japan, is not oriented towards any single economic power house. Rather, it turns out to be a scene for a multipolar game of all the three power centers, where everyone tries to play its own part.

For Japan the importance of economic ties with East Asia has grown significantly within these two decades (Table 1). Roughly about 40 percent of both its exports and imports go to and come from East Asia, by far exceeding the shares for either the US

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<thead>
<tr>
<th></th>
<th>Composition of Japan's Exports</th>
<th>%</th>
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<tbody>
<tr>
<td>1980</td>
<td>East Asia</td>
<td>25.2</td>
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<tr>
<td></td>
<td>US</td>
<td>24.5</td>
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<td>EU-15</td>
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<table>
<thead>
<tr>
<th></th>
<th>Composition of Japan's Exports</th>
<th>%</th>
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<tbody>
<tr>
<td>1997</td>
<td>East Asia</td>
<td>40.9</td>
</tr>
<tr>
<td></td>
<td>US</td>
<td>28.1</td>
</tr>
<tr>
<td></td>
<td>EU-15</td>
<td>15.6</td>
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</table>

Source: JETRO, Japan Center for Economic Research.
or EU.

As far as Japanese foreign direct investment (FDI) is concerned, East Asia is now the second most important area after the US. However, manufacturing companies (mostly in electronics, auto and chemical industries) since early 90's invest to East Asia more than to any other region.

On the contrary for East Asia the weights of Japan in both its imports and exports are declining (Table 2).

| Table 2 |
| Composition of East Asia’s Exports |
| (by country/region) |
| 1980 | 1997 |
| Japan | 19.8 | 11.7 |
| US | 20.3 | 19.9 |
| EU-15 | 15.8 | 13.8 |
| East Asia | 22.1 | 38.7 |

Source: JETRO, Japan Center for Economic Research

| Composition of East Asia’s Imports |
| (by country/region) |
| 1980 | 1997 |
| Japan | 23.3 | 18.5 |
| US | 16.8 | 13.4 |
| EU | 12.2 | 13.3 |
| East Asia | 22.2 | 40.2 |

Source: Ibid

The main reason for the decline is a remarkable growth of intraregional trade. However, in case of exports, despite the rapidly expanding intraregional trade, the share of the US remains practically unchanged and the share of EU-15 dropped only two points, while Japan’s share went down more than eight.

As a result, while in 1980 the Japanese market was nearly as important for East Asian economies as the US and significantly more important than the EU-15, in 1997 the Japanese and EU-15 markets reversed their positions and the US market became almost twice as big as Japanese.

Though these changes are not unrelated to a prolonged recession in the Japanese economy, it seems quite reasonable to suggest that the problem lies also with Japan’s relatively low import capacity, deeply routed in its structural trade barriers.

Regarding East Asia’s imports, Japan remains a bigger exporter than the US and
EU-15, but the gap is narrowing. While Japan's share between 1980 and 1997 declined, the share of EU-15 increased.

As for FDI, (Table 3) Japan maintained its position as a bigger investor than the US and EU, but again the share is going down because of the dynamic growth of intraregional investment.

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<th>1980</th>
<th>1994</th>
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<tbody>
<tr>
<td>Japan</td>
<td>24.5</td>
<td>19.4</td>
</tr>
<tr>
<td>US</td>
<td>20.1</td>
<td>13.3</td>
</tr>
<tr>
<td>EU</td>
<td>19.7</td>
<td>12.5</td>
</tr>
<tr>
<td>East Asia</td>
<td>19.7</td>
<td>38.3</td>
</tr>
</tbody>
</table>

Source: Industry Canada, Japan Center For Economic Research.

To summarize, unlike Central or East European and Latin American countries, for East Asia no one of the three main economic power houses is predominantly important. The share of the intraregional trade and investment is rapidly increasing, exceeding that for trade with or investment from any of the three centers.²

At present the answer to the question of whether the economic integration area (regardless of its formalization) with Japan as its center is emerging or can emerge in East Asia is definitely “no”. Our preposition is that at this moment Japan itself is economically, politically and psychologically unprepared for a far-reaching regional integration under its leadership. Such kind of integration is hardly possible without an active role of the core country as a major importer, a promoter of the free movement of people (including acceptance of large scale inflows of foreign labor force) and a breaker of legal, institutional or cultural barriers. Sufficiently high level of mutual trust between the economic power center and adjacent countries, cultural commonalities, strong willingness to solve problems together, internationally oriented set of mind of policy-makers as well as in the business community and in the society in general could also be named as major preconditions.

² However, the share of intraregional trade and investment is visibly lower than in the EU. East Asia is critically dependent on the external trade and investment links and is destined to maintain an outward-looking posture.
This set of preconditions, probably, is not yet there in Japan. Both its political leaders and business community do not, as their US or European counterparts, actively push, promote or propose regional integration.

Global competitiveness of any of the three economic power houses will largely depend on its ability to take advantage of the potential of the adjacent area:in terms of labor and other resources as well as markets. It can be achieved only through growing interdependence and integration. Unlike the US and EU, having a strong edge in their adjacent areas, Japan doesn't have one in East Asia. It probably means that in this respect the balance of economic power is unfavorable for Japan and it may further complicate the problem of enhancing global competitiveness in the vast range of its industries.

Progress towards liberalization of trade and investment in East Asia and, respectively, the formation of economic integration structures including East Asia states, is likely to be a multi-dimensional process. A major impetus is to come from AFTA (ASEAN Free Trade Agreement). One more dimension is the gradual and voluntary liberalization within the APEC framework. Is there any room left for Japan's initiatives?

One of the most obvious and realistic options for Japan might be the promotion of the free trade zone with Korea (in the long run it is possible to imagine scenarios of its expansion to Hong Kong, China, Taiwan, ASEAN countries). The two sides are holding official consultations on the issue, but at this point the Korean side seems to be more positive and interested than the Japanese. For Japan overcoming recession is now much higher on the priority list. Besides, both parties still have to tackle complicated political and psychological problems, including the problem of mutual trust.

One more economic integration scenario may emerge in Northeast Asia, on the basis of the Sea of Japan Economic Rim concept. The idea is to combine Japanese and Korean capital and technologies with Chinese (and may be North Korean) labor force, Russia's and Mongolia's natural resources. The organizational framework has been set up for the development of the Tumangkan River delta, which includes the border areas of North Korea, Northeastern provinces of China and the southern part of the Russian Far East. Liberalization of trade and investment in the area is on the agenda. The project, which has already entered the implementation stage, is the development
of the transportation link (the road and the railroad) between the Chinese city of Hunchun in the Jilin Province and the Russian port of Zarubino. Now that construction works are over China has a direct access to the Sea of Japan which means cutting by half the distance for goods delivered to Japanese and Korean sea ports in the coastal provinces.

Japan is likely to participate in the modernization and expansion of the Zarubino port. The realization of the project is expected to boost trade links between rapidly developing Northeastern provinces of China and coastal provinces of Japan. This, in turn, could speed up cooperation and liberalization in the whole area.

However it has to be mentioned that China, not Japan, is taking the initiative in the realization of the Sea of Japan Economic Rim concept, while Japan hasn’t yet even joined the Consultative committee on the Tumangan River area development, which brings together all other parties involved. Development projects in Northeast Asia require huge funds, which are not that easy to mobilize. Besides, the Northeastern part of Asia includes politically and economically troubled countries and regions (such as the Russian Far East) which are underdeveloped by their own countries’ standards.

Yet liberalization and intergration is the Northeast Asia is one of the options Japan’s business community and policy-makers are keeping in mind.

There is really no big opportunity for Japan to consolidate and strengthen its position in the adjacent area in the near future. However, though on an average Japan appears to be lagging behind in this respect, companies in the most internationalized industries, such as autos and electronics, are expanding their networks in East Asia persistently and at a high pace.

The peculiarity of Japan’s EDI is its high concentration in a small group of industries. In manufacturing only two of them, electric and transportation machinery, are taking the lead (65% of the total FDI in 1995). So, it is not surprising that companies in these industries, playing internationally on a full scale, are most active in consolidating their position in the adjacent area. For others it may be a task for the future.

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3 Tsusho Hakusho, (White Paper on International Trade), 1998, p.21

Initially Japanese companies expanded their FDI to East Asia in order to cut production, especially labor, costs. This trend grew stronger after the first oil shock in early 70's and especially in the second half of the 80's after the Plaza Accord. At first Japanese companies sought to transfer labor-intensive operations, such as electronic assembling, though capital-intensive operations, like production of key electronic parts (ICs, printing plates, etc.) were quick to follow under the pressure of cost differentials.

As East Asian countries initially had no supporting industries developed enough to meet Japanese quality standards, parts, components and materials were either imported from Japan or produced locally at daughter companies or joint ventures tightly controlled by Japanese Headquarters.

This centralized management pattern, however, was gradually evolving together with the dissemination of technological and managerial skills. Local affiliates were growing more autonomous, and, at the same time, more capable of playing their own part within the across-the-border intragroup division of labor.

Thus, as time went by, together with the networks economizing on cost simply due to cheaper labor and other resources, there emerged specialization networks where Japanese companies coordinate production at the regional level, with their venture in every particular East Asian country specializing on a certain kind of product. As a result costs are further reduced because of the economy of scale as well as accumulation and upgrading of special skills at every single venture.

For example, in the auto industry Japanese-affiliated local parts makers started with supplying various parts for Japanese-affiliated makers of final products within the same country. Now the situation is changing: makers in one East Asian country, specializing on particular items are supplying factories in other Asian (and sometimes not only Asian) countries as well.

One of the leading Japanese parts makers Denso is to invest 200 mln yen to concentrate production of starters in Thailand and electronic parts in Malaysia. Parts are to be sold not only in East Asia, but also in Europe and the US.

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Production of autoparts in East Asia is changing from a support industry for producers operating "nearby" into a globally oriented scheme.

Specialization networks develop into ones that can be called innovation-disseminating.

Initially operations transferred to Asia did not require high skills and technological sophistication, and items produced there were closer to the lower end of the product spectrum. Inside Japan, on the contrary, production is shifting towards top-end items with a high value added ratio. However, as the skills disseminate and demand in East Asian countries grows more sophisticated, it becomes easier also to transfer the production of "medium-level" and even top-end items.

Thus, the main division line between Japanese domestic factories and East Asian ventures starts to move from that between "high-tech" and "low-tech" to the one between new and established products and operations.

Right after a new product has been developed, producer's close interaction with parts or other intermediate product makers inside Japan is often very important. The design-in relationship continues through various modifications and improvements in quality, design, production technology or equipment. Then, at a certain point a product establishes itself. Its design, quality, production technology become a standard. The need for close interaction becomes less urgent. The most important goal shifts to the increase in the volume of production, or "conquering the market". At this stage production often moves to East Asia.

In this respect the issue of a particular importance is the shortening of a period when a new product is produced exclusively in Japan. For example in case of TV sets formerly it took about 20 years to start production of a model in East Asia. At present, however, the gap narrowed to several years or even months. Sony transferred its production of Braun tubes for "yokonaga" (long and thin) TVs to Singapore only 7 months after those TVs went on sale in Japan.5

Under this kind of the division of labor, establishments in Japan are to play the role of innovation (R&D, testing, production of pioneer models) centers, while Asian ventures turn into large-scale production bases, absorbing one innovation after another. Japanese-East Asian networks start to work as a bridge linking a product

newly developed in Japan to global markets.

Along with innovation-disseminating, there emerge product-differentiating networks. Expansion and sophistication of consumers' demand makes it more and more attractive to develop products specifically for East Asia, finding a relevant cost-quality mix.

Japanese automakers came out with plans to develop and produce "Asian cars"—relatively cheap vehicles adapted to local needs.6

An important new trend is the development and production of "high-tech home electronics" targeting East Asian consumers (new, sophisticated models of TV sets, washing machines, etc.).7

Numerous high-grade home electronic items available in Japan are still difficult to find in East Asia. Consequently, a big and lucrative market is emerging. This new demand is likely to be satisfied largely through local production.

For example, Matsushita is starting to produce flat TV sets at "Thai Matsushita AVC" and "Malaysia Matsushita" (production of flat Braun tubes will also start in Malaysia soon). The former is oriented at the Thai market, the latter is targeting both Malaysia and neighboring countries.

Toshiba has started assembling flat TVs in Dailiang, China, and they will be exported to all major East Asian countries.

"JVC Manufacturing Thailand" is to assemble 21, 25 and 29-inch TVs to be sold in a number of Asian countries including Japan itself. Production cost for these items in Thailand is estimated to be 10-15 percent lower than in Japan.

It is important that in some cases Japanese companies begin to transfer not only production, but also R&D. Matsushita established in Malaysia the R&D center specializing on air-conditioners. In spring 1999 Sharp transferred to Malaysia, together with export-oriented production of mini-disks, the R&D on VTRs and announced plants to double (from about 100 to 200 employees) the number of local R&D staff within two years.

In Singapore TDK established an R&D facility for telecommunication electronic

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7 For instance, liquid crystal TVs, up till now sold only in Japan, recently went on sale in Hong Kong, Taiwan and Singapore and centrifugal washing machines in Hong Kong, Singapore and China.
devices and "Nihon Densan"-for motors.

The reasoning for the transfer is that products sold in East Asia can and should be developed locally in order to better grasp needs and opportunities. Yet, the most important factor is probably cost. Under the growing pressure of global competition it is vital to reduce costs not only in production, but also in R&D.

This development paves the way for a new type of Japanese-East Asian networks that can be defined as creative. In the creative networks products may be developed and produced in East Asia and then sold in the different parts of the world, Japan included.

Besides cost sharing, these networks seek to utilize East Asian countries' own R&D potential.

According to the results of the opinion poll conducted by Nikkei Shimbun among Japanese managers in 1997, in their view in certain areas Asian countries already have some technological edges versus Japan. The respondents named such areas as memory chips and LCDs for Korea, PCs for Taiwan, cosmetics for Singapore, Thailand, the Philippines and Vietnam, defense-related technologies for China, computer software for India.8

In the creative networks East Asian counterparts (including "purely" local firms) are equal partners in developing and producing new products.

Yokokawa Electric found a new supplier of electric circuit control boards, a key component for a new generation precision device not in Japan within its keiretsu, but in Taiwan.

Sony has announced the merger of two Malaysian affiliates into "Sony Technology Malaysia"-a big company capitalized at more than 800 mln yen.9 It will produce DVDs, big screen TVs and other technologically advanced products and expand R&D.

In October 1998 Sony already merged three daughter companies on the Penang island to step up production of digital electronic items.

To summarize, in the industries where Japanese companies are playing globally,

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8 Nihon Keizai Shimbun, November 25, 1997. In this respect an important new option for Japanese companies may also be an active strategy to utilize the huge and largely "idle" P&D potential of Russia.

9 Nihon Keizai Shimbun, July 10, 1999
their networks in East Asia are dynamically evolving. East Asia is becoming a critically important production and, in perspective, R&D base, necessary to enhance their global competitiveness as well as the most important market, opening new opportunities in terms of both scale and sophistication.

At the same time a drive to East Asia and the expansion of regional networks pose big challenges for Japanese economy. They may be summarized as follows.

First, establishments in Japan face the growing pressure to innovate. As the time span between the emergence of a new product in Japan and the start of its production in East Asia shortens, the pace of innovation has to be accelerated and its scale increased. Establishments in Japan have got to turn more and more into innovation, especially product innovation, centers, which means tremendous challenge for people, for education and training systems, for corporate management and culture. The latter includes such basic things as the need to accept individualism, promote leaders and innovators, differentiate wages and working conditions, actively employ high-qualified foreigners, etc.

Second, the pressure is growing to drastically reduce cost, so to say “across the board”, for the whole spectrum of goods and services. M. Porter’s paradigm of commanding high selling prices on the basis of product sophistication and differentiation is unlikely to work properly, at least for today’s Japan. Japanese-East Asian networks will increasingly demonstrate that by international standards goods and services in Japan are overpriced. High-grade items will also have to be produced at a lower cost.

Third, a growing number of Japanese companies in various industries will face the task of finding a place in the Japanese-East Asian division of labor. This may be the shortest way to discover markets, cut costs, promote innovation and, respectively, to survive and expand in the coming years of structural reforms.

3. Impact of the Asian Crisis.

On an average Japanese companies were more sensitive to East Asian countries’ economic turmoil and less prepared to exploit new opportunities than their American and European counterparts (Table 4). In 1998 in Thailand Japan lost to EU its position of the biggest direct investor. In Malaysia its FDI curtailed, while US
investment substantially increased. In Indonesia the Japanese investment declined more than the US and EU, in Singapore-more than the US.

Table 4 Foreign Direct Investment into East Asian Countries.
(amount, annual change, %)

<table>
<thead>
<tr>
<th>Investment to:</th>
<th>Investment from</th>
<th>1997</th>
<th>1998</th>
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<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Japan</td>
<td>US</td>
</tr>
<tr>
<td>Thailand (mln bht)</td>
<td>332,957</td>
<td>163,389</td>
<td>100,290</td>
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<tr>
<td></td>
<td>0.1</td>
<td>4.1</td>
<td>43.1</td>
</tr>
<tr>
<td>Malaysia (mln RM)</td>
<td>11,473</td>
<td>2,164</td>
<td>2,397</td>
</tr>
<tr>
<td></td>
<td>-32.7</td>
<td>-53.0</td>
<td>-17.1</td>
</tr>
<tr>
<td>Indonesia (mln doll)</td>
<td>33,833</td>
<td>5,421</td>
<td>1,017</td>
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<tr>
<td></td>
<td>13.0</td>
<td>-29.2</td>
<td>58.4</td>
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<tr>
<td>Philippines (mln peso)</td>
<td>58,737</td>
<td>3,721</td>
<td>10,522</td>
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<tr>
<td></td>
<td>131.6</td>
<td>145.4</td>
<td>112.2</td>
</tr>
<tr>
<td>Singapore (SD)</td>
<td>5,964</td>
<td>2,032</td>
<td>2,423</td>
</tr>
<tr>
<td></td>
<td>3.0</td>
<td>3.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Korea (mln doll)</td>
<td>6,971</td>
<td>266</td>
<td>3,190</td>
</tr>
<tr>
<td></td>
<td>117.6</td>
<td>4.3</td>
<td>264.2</td>
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Source: JETRO, Japan Center for Economic Research

In contrast, in the Philippines the reduction was insignificant and Japan became the biggest investor among the three. In Korea Japan invests much less than the US and EU, but in 1998 its investment increased and the gap narrowed.

However, with the exception of the Philippines and Korea, in the year of crisis Japanese FDI declined more abruptly than those of at least one of the two other economic power houses. Typical reaction on the part of Japanese companies was to cut new investment and to decrease or freeeze production at the functioning factories.

Japanese banks made even more dramatic retreat as they were fighting "bad loans", streamlining and restructuring their operations. They are selling assets to withdraw funds and curtailing business activities in the region.

Outstanding loans of Japanese banks in Asia at the end of 1998 were estimated at 554 bln dollars (options included), 30 percent less than a year before. Their share in the total amount of bank loans to Asia dropped below 30 percent.¹⁰

On the contrary, there are numerous signs that American and European companies and financial institutions are actively trying to exploit new opportunities opened
amidst Asian crisis. The fall of Asian share prices made it much easier to buy stocks to impose control over Asian companies’ management. Financially such an investment is also promising as the return of East Asian countries to the path of growth will presumably push share prices up again (in summer 1999 in most East Asian countries share prices were already back to the pre-crisis level). Besides, facing severe fund shortages, Asian companies are trying to do their best to mobilize capital at the stock market, and the business and legal environment in the region is becoming more favorable for shareholders.

While Japanese companies act cautiously, European and US firms made some bold steps to strengthen their position in East Asia. For instance, “Philips” acquired the LCD branch of LG group in Korea, British Telecom invested into a mobile phone company in Hong Kong, Britain’s “Standard Chartered” bank acquired “Bank Bali” in Indonesia, etc.

Especially active are US and European telecommunication companies and financial institutions.

The latter are also taking the lead as M&A advisors and in other areas supporting reorganization and restructuring of Asian businesses. For instance, American investment bank was chosen an advisor to Hyundae Electronics for the purchase of LG Semiconductors.

The Asian crisis seems to have resulted in a certain power balance shift in the region not in favor of Japan.

4. New Dimensions at the Interstate Level.

While the US and the IMF tended to stress the importance of a resolute structural adjustment in crisis-impacted East Asian countries and conditionality of loans, Japan seemed to be willing to work out this or that kind of a bail-out arrangement to provide those countries with a substantial amount of money to be used for stabilization of their economies. Though in November 1998 US and Japan came out with a joint initiative to support crisis-hit economies, mainly through debt guarantees and purchases of bad assets, the views of both parties on how to deal with Asian crisis

Nikkei Shimbun, July 25, 1999
differed substantially. Their joint effort could play only a limited role in addressing the emerging issues.

The US strongly opposed the idea of the Asian Monetary Fund largely favored by Japan and other East Asian nations. As for Japan's role, the view prevailing in Washington is that Japan's main contribution to coping with the crisis should be the expansion of its imports.

Under this circumstance Japan put forward a number of initiatives of its own. Probably, in the short term the most important initiative is the New Miyazawa Plan. Its focal point is the 30 bln dollars fund to be used first of all to guarantee debts of East Asian countries' governments and state-owned companies: namely bonds they issue to mobilize funds at the capital markets around the world.

15 bln dollars are allocated to help Asian countries stimulate economic recovery and overcome credit crunch. The other 15 bln are supposed to be used to meet the short-term demand for funds: for trade loans, etc.

The plan has already entered the implementation stage. For example, as of July 1999, Thailand received 1850 mln. dollars mainly used to tackle the credit squeeze.

Miyazawa Plan is instrumental in helping East Asian countries' public sector to borrow more easily and to restore access to capital markets it largely lost as result of the crisis. Yet, its effect is limited as the IMF-prescribed policies accepted by the majority of those countries oblige them to borrow less to put their financial house in order.

One more important step, reflecting Japan's present strategies towards East Asia, was the adoption in July 1999 of the Medium Term ODA Plan (1999-2003).

The share of East Asia in Japan's ODA (which, in a way, has become a politically sensitive issue) will be on the rise again after going down since early 80's. The focus of the ODA to East Asian states is to shift from infrastructure to the support for structural reforms. Namely aid will be granted for restructuring financial institutions, technology transfers, development of support industries, strengthening of social safety nets. Japan has also put forward a program of assistance to developing countries in building stronger markets, which was announced at one of the APEC meetings. Among other things Japan will assist those countries, both financially and by sharing expertise, in developing their policies towards small and medium companies and business startups as well as improving commercial legislation systems.
In its assistance strategy Japan is presumably trying to push its basic view on structural reforms in the developing, especially Asian countries. While the American approach stresses openness, deregulation, free competition and self-responsibility, Japan gives priority to an “orderly evolution”, emphasising the role for the governments in helping private businesses to adjust to a new environment.

For several decades East Asian economies demonstrated high growth rates which symbolized the success of the Asian model. Its essence is the dynamic industrial development under strong government leadership (the so-called “development dictatorship model”).

Asian crisis was the manifestation of the collapse of the Asian model in its traditional sense. Structural reforms, meaning a shift towards economic systems with less government involvement, more freedom for private enterprise, more openness to outside investors (including portfolio investors), more competition, more emphasis on profitability and quality than quantity have become the imperative of the end of the 20th – the beginning of the 21st century. Internationalization and globalization accelerate such kind of transformation. Outside political pressures for the speedy implementation of reforms, after all, only reflect these changes.

Within this set-up Japan’s role will shift from assisting mainly in infrastructure development to helping East Asian countries mitigate shocks and minimize negative effects of the structural transformation. In other words, while the US are likely to put an increasingly strong pressure on East Asian countries to take speedy and radical reforms, Japan will extend support in order to make those reforms less painful. In this role of “a buffer” it will remain East Asia’s most important partner.

Epilogue. Internationalization of the Yen?

The birth of euro gave a new impetus to discussions about the possibility of a three-polar international monetary system, the euro together with the yen playing a role comparable to that of the dollar. At the government level Japan seems to become more positive to and interested in the yen’s internationalization.

It goes without saying that in case visible progress in this direction is achieved, East Asia will become “the launching ground”.

However, present economic realities don’t leave much room for such kind of a
change. The main precondition is not there: as shown above, there is no trend (unlike EU and euro) towards the formation of an economic integration zone centered around Japan and, furthermore, the relative importance of Japan as a partner for East Asian economies is diminishing.

Respectively, there is no sufficient demand for the yen to become a major international currency. In other words, it doesn't have sufficient liquidity.

Basically, a currency with a higher liquidity is preferred for international settlements as holding this currency means minimization of risks. Dollar today has the highest liquidity and unless Japan establishes itself as a core of an intensive economic integration area, actively engaging adjacent countries, it will be difficult to find strong incentives for the shift from dollar to yen (unless there is some unexpected dramatic change concerning the dollar itself-scenario we don't take into consideration here).

It is hardly surprising that Japanese firms themselves, when they sell to Asian or other counterparts, usually prefer to be paid in dollars, not in yen. In case of Japan-ASEAN trade, for example, about 80 percent of the settlements and dollar-based. From the viewpoint of either a Japanese businessman or its overseas counterpart it is often rather difficult to find a benefit from changing those settlements to yen. (For Japanese businessmen even more so after liberalization of foreign currency transactions and settlements since April 1998. Among other things, it opened the way for direct dollar settlements even inside Japan).

At least two more factors have to be added to the list of basic obstacles on the way to the yen's internationalization.

First, as Japan has big structural trade and balance of payments surpluses, recirculation of yen can be only very limited.

Second, in case there is a shift towards the internationalization of the yen, the demand for it will grow, and the possibility is high that its exchange rate will come under a strong upward pressure. However, Japan is very apprehensive towards yen's appreciation not only because of its negative impact on exporters, but also because many of its inward-oriented industries and companies are still not ready to face strong challenges from foreign competitors. In other words, while apprehension towards imports and structural weaknesses in industries not playing internationally remain, Japan itself is likely to have strong reservations about the internationalization of its
currency.

Internationalization of the yen can only follow, not precede, progress towards more internationalization of the Japanese economy, formation of an area of intensive economic ties centered around Japan and far-reaching structural reforms on its domestic front.

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