Japanese Economic Policy in Asia: An Asian Perspective

Teofilo C. Daquila

1 Introduction

There are several ways by which Japan and Asia have been linked to one another. These include trade in goods and services, foreign investments, technology, development assistance, and other forms of economic and technical cooperation. However, these links involve two unequal partners. In terms of gross national product (GNP), Japan ranks second only to the United States, as its GNP reached more than US$ 4 trillion in 1997. The enormous expansion of its output is reflected in its share of the global output rising from 8 per cent in 1975 to about 17 per cent in 1997. Out of total Asia's combined GNP of US$ 6.5 trillion in 1997 (a share of about 25 per cent of the world's GNP), Japan thus accounted for roughly two thirds of Asia's regional output while the other third is divided between China, the Asian NIEs (Newly Industrializing Economies), ASEAN (Association of Southeast Asian Nations) and other parts of Asia (Keizai Koho Center 1998, 17).

Thus, the relationship between Japan and Asia is more of dependence than interdependence, with Asia being very much reliant on Japan's economic and financial resources. These achievements have been realized to a significant degree because Japan's economic policies have had a strong and positive effect on Asian economies. These policies include Japan's trade and foreign investment policy as well as policies dealing with official development assistance (ODA) and other forms of economic and technical cooperation. This paper however, does not intend to provide a detailed analysis of these policies but rather it presents an overview of these policies and analyzes their impact on the Asian economies by examining the trends and patterns of some important economic variables. At the outset, it has to be stated that the economic development experiences of Japan have provided some relevant lessons for Asian economies particularly the NIEs and ASEAN.[1]

[1] For an analysis of the relevance of Japanese economic development experiences in Asia, see studies by Yip (1970), Wong (1988) and Lincoln (1987). See Lincoln (1987, 5–16) for an excellent and comprehensive account of the factors that led to Japan's emergence as an industrial nation.

2 Macro-economic development and policy in Japan

With the economic clout of the Japanese economy arising from its global trade, investments, loans and technology, Japan's macro-economic policy strongly influences the rest of the world. Asian economies are particularly affected as Asia accounts for about 40 per cent of Japan's foreign trade and about a quarter of Japan's foreign direct investments (Keizai Kikakuchō 1998; JETRO 1999). When the Japanese economy goes into recession, its output and hence income falls. This adversely reduces Japan's imports from Asia. As export revenues decline, economic activities automatically slow down in Asian economies. This has to be kept in mind for any discussion of macro-economic policies in Japan and their impact on Asia.

Within Japan, the government has traditionally relied on demand-management policy instruments to stabilize macro-economic disturbances. Various studies have found evidence that the Japanese government has engaged in Keynesian discretionary policies (Minami 1994, 253–85; Ito 1992, 103–76 and Pattanajidvilai 1991). Expansionary fiscal policy instruments through the increase in government spending and/or tax cuts have been adopted to revive the ailing economy. Monetary policy, through lower money supply and hence high interest rates, has been followed to contain inflation. In terms of its exchange rate policy, the revaluation of the yen has been allowed to correct the mounting trade surpluses (Nakamura 1986, 265).

The Japanese economy showed an overall upward trend during the 1975–87 period with the expansion of exports including cars and electrical goods. It is to be noted that Japan was able to recover from the effects of the two oil shocks in the 1970s through austere fiscal and tight monetary policies, combined with massive export expansion (Yamazawa 1992, 122). With the rapid accumulation of foreign exchange reserves due to massive surpluses in the balance of payments, the exchange rate was revalued after the September 1985 agreement of the Group of 5 which consisted of the United Kingdom, France, West Germany, Japan and the United States. They agreed to refrain from propping the US dollar against the yen in order to reduce Japan's trade surplus with the USA. Consequently, the yen surged from about 240 to 140 yen per US dollar (or a 70 per cent increase) over a 3-year period and further appreciated to 122 yen in November 1988. Furthermore, the Bank of Japan lowered its interest rates and hence loans expanded rapidly. The prices of land and other assets rose significantly resulting in a bubble economy during the 1986–90 period. Credit tightening began in 1989 and this was followed by the Bank of Japan's restrictions on real estate lending in 1990. These steps culminated in 1990 with the bursting of the bubble economy. Following the appreciation of the yen, less dependence on exports was expected, consequently, government spending increased. The rising production costs in Japan due to the continuing appreciation of the yen has led to significant increases in its foreign direct investment (FDI) in Asian countries.

During the early 1990s, Japan went through a period of severe output contraction, with the real GDP growth rate dropping from 4.8 per cent in 1990 to 0.3 per cent in 1993. The resulting economic recession was attributed to corporate structuring, the bursting of the bubble, and the rapid appreciation of the yen. Since March 1992, the Japanese government has repeatedly adopted economic measures as seen in Table 1 in order to stimulate the economy through public investment works. In April 1993, a package of expansionary fiscal measures amounting to 13.2 trillion yen was announced and its implementation contributed to the slight improvement of its real GDP increase to 0.6 per cent in 1994. In March 1995, the Japanese government launched its 'Deregulation Action Program' encompassing both deregulation and market-opening measures. It was to be implemented over the period from FY 1995 to FY 1999, but was subsequently reduced to three years. It also aimed to revitalize the Japanese economy and to make it more open to the world and more reliant on the market mechanism. The Japanese economy showed an improvement in 1996 when its real GDP increase reached 3.6 per cent indicating a short-lived effectiveness of the 1995 fiscal programs.

Table 1: **Economic measures of the Japanese government since 1992 (trillion yen)**

	Tax cuts	Social infrastructure investment	Others	Total
August 1992	0	8.6	2.1	10.7
April 1993	0.2	10.6	2.4	13.2
September 1993	0	5.2	0.8	6.0
February 94	5.9	7.2	2.1	15.2
April 1995	0	0	7.0	7.0
September 1995	0	12.8	1.4	14.2
April 1998	4.3	7.7	4.35	16.35

Source: Ministry of Foreign Affairs

In 1997 however, the Japanese economy even started to contract in real terms. In August 1998, the Japanese government announced so far the most comprehensive economic measures amounting to US$ 128 billion (16 trillion yen) or 3.2 per cent of the GDP, with fiscal expenditure approximated at US$ 94 billion (12 trillion yen) or 2.4 per cent of the GDP. This package consisted mainly of tax cuts (26 per cent), social infrastructure investment (48 per cent) and other measures (26 per cent). Besides stimulating domestic demand, these measures indirectly may help the recovery and stabilization of the East Asian economies through a revitalization of the Japanese economy. As Japan's economy picks up, its import demand from and investments into the Asian region are expected to grow.

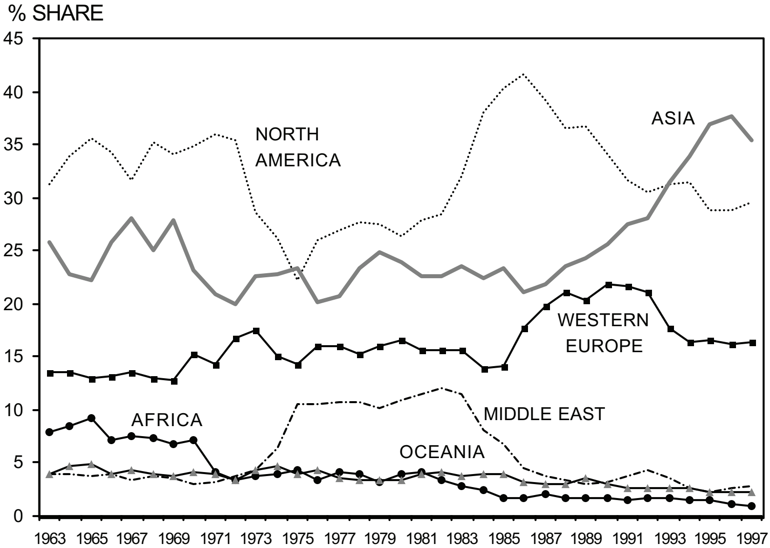
3 Trade policies

Yamazawa and Hirata (1993, 125–26) indicate that Japan's recent trade policies have been geared mainly to the resolution of conflicts with its major trading partners. Various market liberalization measures including reduction and removal of tariffs and non-tariff barriers, improvement of standards and procedures for imports, and deregulation of such sectors of the economy as construction and finance. Voluntary export restraints (VERs) have also been imposed on many machinery exports as an outcome of negotiations with the USA and the European Community. There has been an increasing demand by Japanese manufacturers for the imposition of import restrictions on goods from developing countries including Asian NIEs' exports of knitwear, steel-plate and cement. The Ministry of International Trade and Industry (MITI) has kept VERs at a minimum particularly for knitwear and cotton yarns.

3.1 Exports

Japan's global merchandise exports quadrupled from US$ 5 billion in 1963 to US$ 19 billion in 1970. It rose almost tenfold to US$ 131 billion in 1980 and more than doubled until 1990 at US$ 288 billion. In 1997, it increased further to US$ 421 billion. The remarkable expansion of Japanese exports globally is certainly a result of its successful trade policies. Figure 1 shows the geographical distribution of Japan's merchandise exports. North America, in particular the United States, and Asia are Japan's leading export markets, each accounting for about a third of its global exports during the 1963–97 period. Exports to the U.S. showed a marked expansion during the 1975–1985 period but fell subsequently. Japan's exports to Asia had its ups and downs during the 1963–85 period, but subsequently a significant rising trend was observed. The falling share of the USA and the rising share of Asia in Japan's global exports is an indication of a shift in Japan's exports away from the USA and towards Asia. This is presumably one way of correcting its enormous trade surpluses with the USA at the expense of Asia. Another explanation was the rising per capita income of the Asians, particularly before the economic crisis hit the region.

Figure 1: **Geographical distribution of Japan's exports 1963–1998**



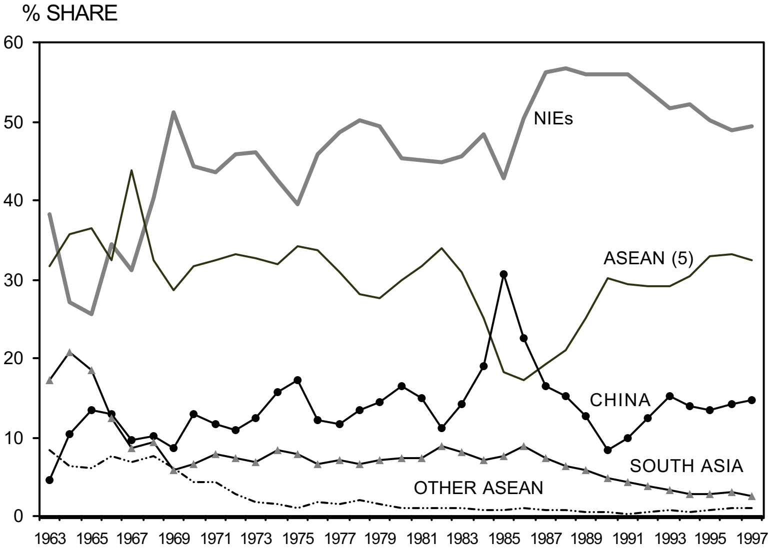
Note: share of Japan's global export

Source: Primark Pte Ltd Datastream 1998

Figure 2 indicates that a large share of exports to Asia has been accounted for by its exports to the NIEs (Hong Kong, Singapore, Taiwan and South Korea) for an average of about 40–50 per cent during the 1963–1997 period. The other 30 per cent is accounted for by ASEAN countries (including Brunei, Indonesia, Malaysia, Philippines and Thailand). Exports to China exhibited a relatively stable trend during the 1963–83 period, rose markedly until 1986, and subsequently fell drastically until 1991. An overall rising trend was observed from 1992 onwards. The share of Japanese exports to South Asia has been declining since 1987.

Japan's export structure shifted away from the exports of primary products towards manufactured goods. The export of manufactured goods shifted away from light industry products (foods and textiles) towards heavy products (metals and machinery) and chemical products. In the case of Japan's exports to ASEAN in 1993, about 96 per cent were in the form of manufactured goods with machinery and transport equipment accounting for a large share (Daquila 1997a, 4). These Japanese exports have certainly provided some of the investment and producer goods which are essential for industrial development in the Asian economies.

Figure 2: **Geographical distribution of Japan's exports to Asia 1963–1998**



Note: share of Japan's export to Asia

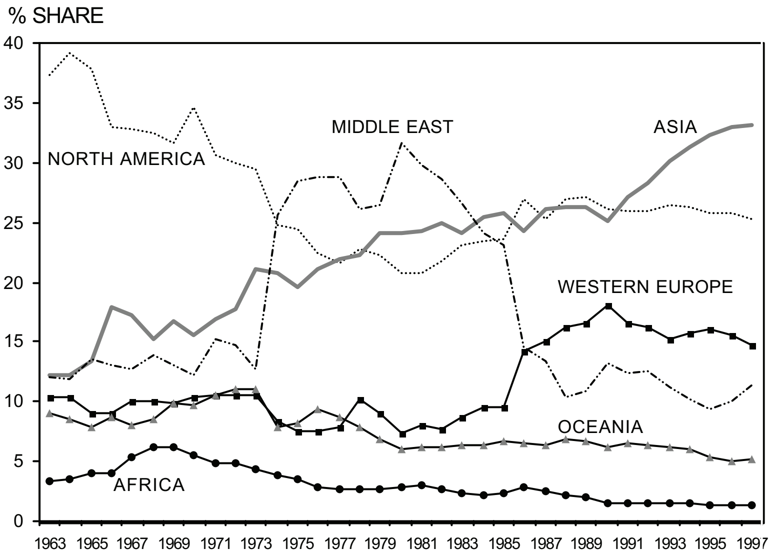
Source: Primark Pte Ltd Datastream 1998

3.2 Imports

Japan's global merchandise imports stood at US$ 6 billion in 1963. It tripled to US$ 19 billion in 1970 and increased about tenfold to US$ 141 billion in 1980. The import bill continued to expand significantly and reached US$ 235 billion in 1990. In 1997, Japan paid the amount of US$ 339 billion for its merchandise imports. Figure 3 shows the geographical distribution of Japan's imports. North America (mainly the USA) and Asia are Japan's leading sources of its imports. The share of the imports from the USA however, declined from a maximum of 39 per cent in 1964 to a minimum share of 20 per cent in 1981. Subsequently, the US share rose steadily to an average of about 25 per cent during the 1982–97 period. Japan's share of imports from Asia showed a steadily rising trend from 12 per cent in 1963 to 20 per cent in 1975. Subsequently, however, Asia's share expanded to an average share of 25 per cent during the 1980s and about 30–35 per cent during the 1990s.

Figure 4 shows that a large share of Japan's imports from Asia can be accounted for by its imports from ASEAN for an average share of about 60 per cent of Asian imports during the 1963–81 period. Subsequently,

Figure 3: **Geographical distribution of Japan's imports 1963–1998**



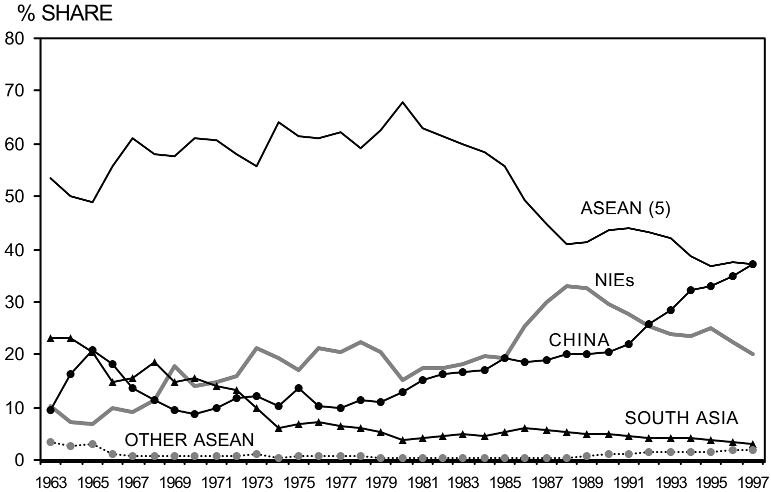
Note: share of Japan's global imports

Source: Primark Pte Ltd Datastream 1998

ASEAN's share showed a declining trend until 1997. Imports from the NIEs have shown an overall rising trend from 10 per cent in 1963 to 33 per cent in 1988, but fell subsequently to 20 per cent in 1997. The declining shares of ASEAN and the NIEs have been due to the rising share of Japan's imports from China.

This trend indicates that an import diversion process is taking place away from ASEAN-5 and the NIEs and towards China. This has to be attributed to the fact that China can provide Japan's import needs particularly raw materials at much lower prices than other Asian countries. Lincoln (1987, xviii–xix) made the following observations with regard to Japan's economic relation with China. First, he stated that Japan has forged a strong economic relationship with China including trade since the major reforms in China began in 1978. Second, the strength and relative smoothness of the Japan-China relationship, however, does not imply the coming of a China-Japan economic combination that will dominate regional or world markets. Rather, Japanese enthusiasm for China is tempered by caution due to the incomplete institutional framework for international business in China, the unpredictability of Chinese policy and concern that China could become a future competitor. Third, the Chinese,

Figure 4: **Geographical distribution of Japan's imports from Asia 1963–1998**



Note: share of Japan's imports from Asia

Source: Primark Pte Ltd Datastream 1998

on the other hand, appear to desire a balance among their foreign economic partners and to use strong control over trade and investment to prevent Japan from becoming too dominant.

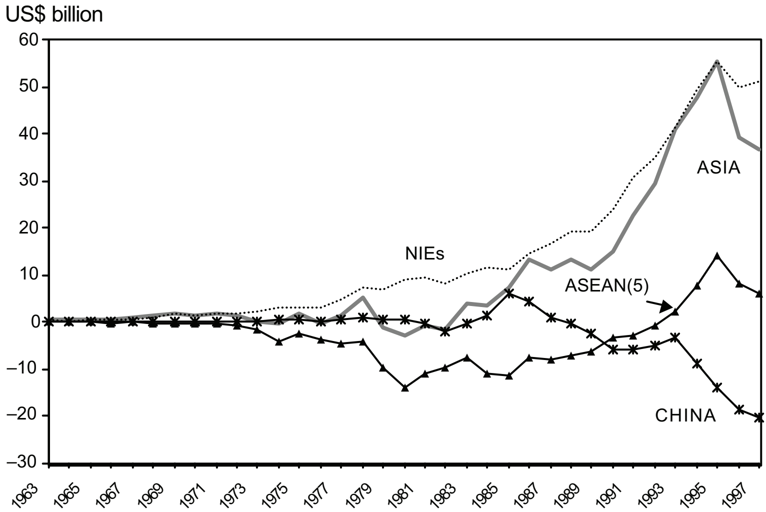
Japan's import structure changed away from primary products (non-processed foodstuffs, raw materials and fuels) towards manufactured goods (Daquila 1997a, 4). Japan's imports from ASEAN were mainly in the form of primary commodities, with its share falling from 75 per cent in 1989 to 61 per cent in 1993. Japan's imports of manufactured goods (especially machinery and transport equipment) rose from 6 per cent in 1989 to 16 per cent in 1993. Japanese affiliates in ASEAN produce manufactured goods, mostly intermediate parts and components which are then exported to parent companies in Japan for the final assembly of high value products and hence generates what is known as the 'boomerang effect.'[2] Thus, the ASEAN region has become a production and export base of Japanese manufacturers.

[2] The boomerang effect is a term to describe the impact on the Japanese economy of increased imports of goods resulting from Japanese overseas investment in manufacturing.

3.3 Trade Balance

Figure 5 shows that Japan had relatively small trade surpluses with Asia during the period from 1963 to 1979. This was followed by small trade deficits until 1982. Until 1995, the surpluses have grown tremendously and this has created a lot of pressure for Japan to open up its economy. To reduce part of the trade surplus, Japan allowed the yen/dollar exchange rate to appreciate.

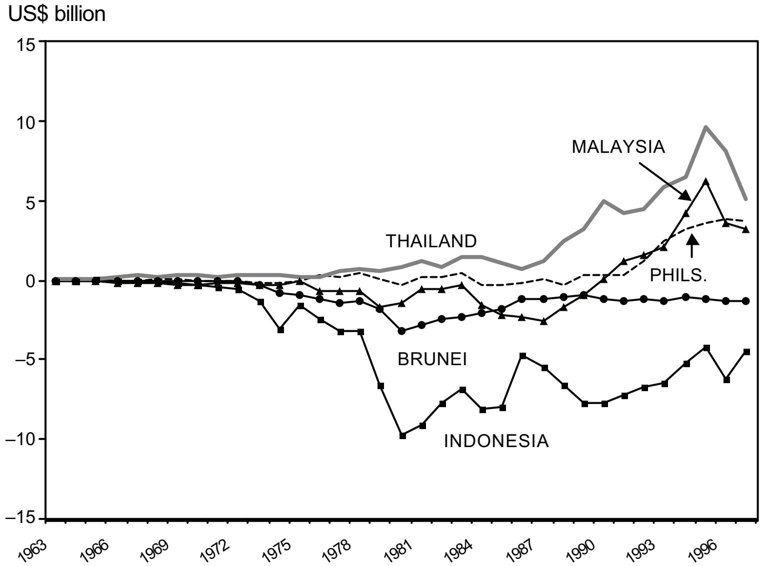
Figure 5: **Japan's trade balance with Asia 1963–1998**



Source: Primark Pte Ltd Datastream 1998

A large proportion of Japan's trade surpluses with Asia is with the Asian NIEs as Figure 5 reveals. Japan's trade balance with ASEAN is relatively better than those of the NIEs. Among ASEAN countries, Figure 6 shows that Japan had trade surpluses with Thailand since the 1960s. Japan's surpluses with Malaysia and the Philippines increased during the 1990s. On the other hand, Japan has had persistent trade deficits with Brunei and Indonesia as these countries provide raw materials needed by Japan. For Indonesia, Japan is the largest trading partner in the non-oil, non-gas product sector. In addition, Indonesia provides the natural gas which accounts for more than 40 per cent of total Japanese imports.

Figure 6: **Japan's trade balance with ASEAN countries 1963–1998**



Source: Primark Pte Ltd Datastream 1998

4 FOREIGN INVESTMENT POLICIES

Japan's per capita income has increased significantly which has contributed to the remarkable expansion of domestic savings. Some portion of the savings has been used to finance government deficits, and some has been used as investments overseas following Japan's globalization strategy in order to generate higher rates of return. In Singapore, for example, Japanese investors generated good returns on their equity investments from 10.3 per cent in 1980–84 to 14.6 per cent in 1985–89 and to 17 per cent in 1990–92, or an average of 14 per cent during the 1980–92 period (Daquila 1997a, 33).

Japan's total international investment consists of direct investment, portfolio investment, loans, trade credits, foreign currencies, foreign deposits and other assets. Japan's aggregate international investment has been relatively stable during the 1986-91 period. Subsequently, however, there was a sharp increase, particularly in 1992 and during the period since 1995. Total investment increased from a net asset position of 29 trillion yen in 1986 to 124 trillion yen in 1997, of which 75 per cent was accounted for by the private sector (banking and other sectors) and the balance by the public sector. The enormous amount of Japan's foreign investments without doubt benefits the Asian economies. These investments have provided the needed financial means for the private, government and banking sectors in Asia, particularly, in the NIEs and ASEAN economies.

4.1 Portfolio Investments

Portfolio investments consist of equity securities, debt securities, money market instruments and financial derivatives. On the asset side, portfolio investments stood at 118 billion yen in 1997, with equity securities accounting for 18 per cent and debt securities for 82 per cent. On the liability side, portfolio investments reached a total of 76 billion yen, with equity securities accounting for 48 per cent and debt securities for 52 per cent.

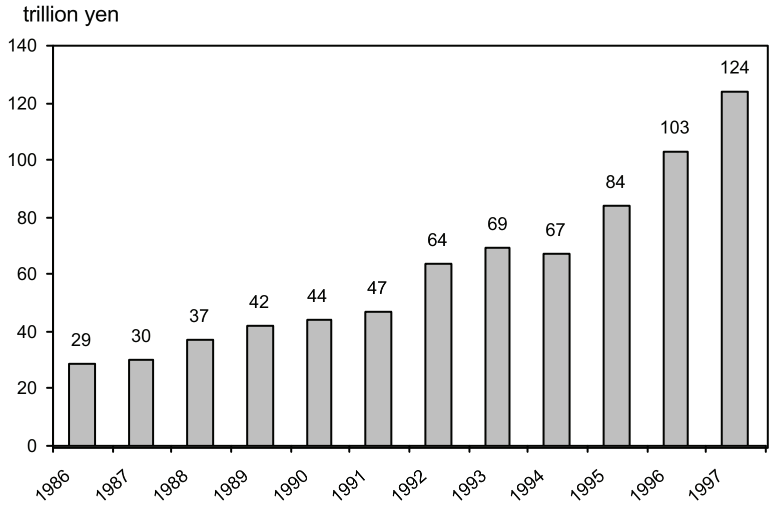
4.2 Foreign Direct Investments[3]

Japanese global FDI (net assets inclusive of all types of investment) remained stable during the 1977 to 1985 period. Following the 1985 Plaza Agreement which resulted in the strong appreciation of the yen, Japan's global FDI increased sharply and reached a maximum of US$ 68 billion in 1989. It declined sharply in the subsequent years to reach US$ 34 billion in 1992 (see also Figure 7). On a cumulative basis, Japanese FDI registered a four-fold increase from US$ 106 billion during the 1951–86 period to US$ 616 billion during the 1951–97 period (JETRO 1999, 528). This represents a remarkable expansion of Japanese FDI by about US$ 500 billion just over a decade. Since the second half of 1997 however, both the value and the number of investment cases abroad declined. This holds true for total FDI but also for manufacturing overseas investment and is mainly due to the economic crisis in Southeast Asia and other parts of Asia as well as to the recession in Japan itself (JETRO 1999).

Figure 8 shows that North America (in particular the United States) is Japan's major destination of its FDI, accounting for an average share of about 35 per cent until the mid-1980s. Then there was a marked jump in Japan's FDI in North America to a share of 44 per cent in 1985. This trend continued and peaked at 1989 at about a 50 per cent share. Subsequently, it fell steeply to 40 per cent in 1992 but, eventually improved to 45 per cent in 1995. In Asia, FDI was about 30 per cent in the late 1970s and early

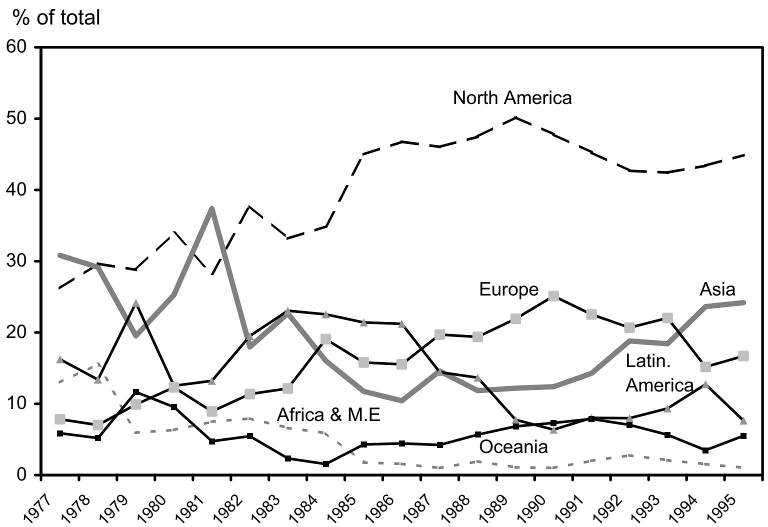
[3] For a detailed analysis of Japanese investments in Asia, see among others Doherty (1995), Daquila and Nguyen (1994), Chng and Hirono (1987), Hook (1992), Lim (1994), Pattanajidvilai (1991) and Yamazawa (1992).

Figure 7: **International investment (net assets) of Japan 1986–1997**



Source: Ministry of Finance

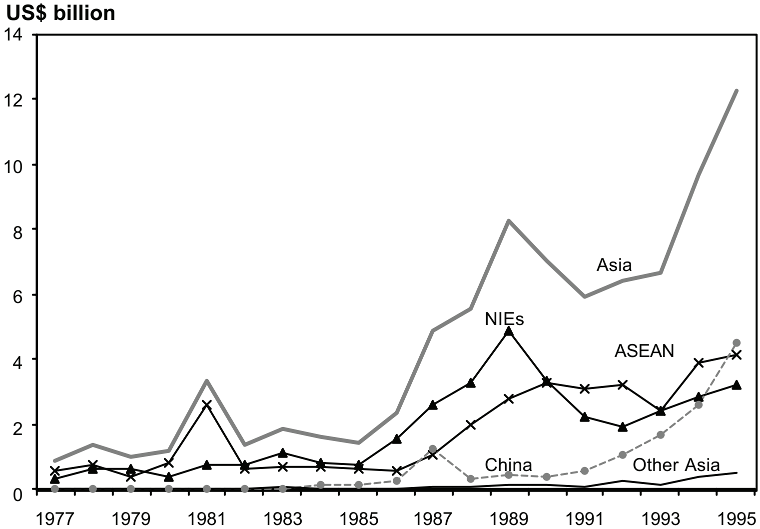
Figure 8: **Geographical distribution of Japanese FDI 1977–1996**



Source: JETRO

1980s, mainly due to investments in ASEAN and NIEs. Japanese direct investments rose significantly in both these groups from 1986 until 1989.

Figure 9: **Japanese FDI in Asia 1977–1995**



Source: JETRO

Subsequently until 1992, investments in the NIEs fell drastically due to the erosion of their comparative advantage in labor-intensive manufacturing industries in these countries. However, investments in Malaysia, Thailand and Indonesia increased markedly until 1990 and remained constant until 1992.

After a drop in 1993, investments in ASEAN expanded to about US$ 4 billion in 1995 (see Figure 9). Since the mid-1980s, Japan has been the major source of foreign investments in Indonesia. It has accounted for more than 70 per cent of total investment in the manufacturing sectors. The Japanese share in some industries exceeded 80 per cent such as in the basic metal industry. The Industrial Bank of Japan (1998, 3) reported that the cumulative totals for the 1951–96 period covering the manufacturing industries in ASEAN 4 (Indonesia, Malaysia, Philippines and Thailand) were distributed as follows: electric (20 per cent); ferrous and nonferrous metals (20); chemical (16); textile (11); transportation equipment (9); foodstuffs (3); and others (21). It is also noted that the Chinese share has risen significantly since 1990 because of its cost-competitiveness and the improved relations between Japan and China.

On the one hand, there are push factors which triggered a marked expansion of Japanese investments in Asia including the strong appreciation of the yen and Japan's ownership advantages. On the other hand, there are factors which have pulled these investments from Japan including locational advantages such as the abundance of high quality, low wage labor, low transportation costs, generous investment incentives and political regional stability (Daquila 1997b, 7–10).

The 27th survey of overseas business activities of Japanese companies conducted by the MITI (see MITI's homepage) in 1997 reported that the amount of sales achieved by foreign affiliates of Japanese companies increased considerably in both manufacturing and non-manufacturing sectors. For the first time, the sales by those affiliates in the manufacturing ratio have surpassed the total amount of exports from Japan. The ratio of overseas production to domestic production rose to 11.6 per cent. By region, the affiliates sales and profits in North America were at a high level because of the economic prosperity in the USA.

Since the 1970s, the region has become, not only a production base to serve the domestic markets, but also a distribution base for export-oriented investments from Japan. The Industrial Bank of Japan (1998, 5) identified the relations between the Japanese industry and the ASEAN region as follows: In the case of automobiles and home appliances (audio-visual equipment), ASEAN countries serve as a production base for sales in the local markets. In the semiconductor industry, they serve mainly as assembly bases for exports while in other industries their main function is to maintain production levels at domestic Japanese plants. In his study, Daquila (1997a, 7) noted that, according to sales data, the top 10 foreign affiliates in each of the ASEAN-6 countries were mainly Japanese companies (43 out of the top 60 companies). This is followed by the EU with 8 companies, the USA with 5, Singapore having 2, Malaysia with 1 and USA/Hong Kong with 1 company.

It was also revealed in the same 27th MITI survey that in Asia, sales, profits, plant and equipment investment by Japanese companies were increasing to the level beyond those in the USA. It was also reported that in Asia, the presence of foreign affiliates of Japanese companies had been very high so that there were growing concerns about the impact of the Asian currency crisis which began after the survey was completed.

JETRO also reported that Japan's foreign direct investments have seen an increase in the number of Merger and Acquisitions (M&A) and investments through local procurement of funds. In the USA and Europe, Japanese M&As target large firms while in Asia, these firms are usually small both in terms of average value and average funds invested so that by nature these have been less of 'investments' and more of strengthening relations to secure sources of supply for products and consignment of production. In the case of non-M&As, as soon as Japanese manufacturing operations become firmly entrenched in their host countries, they can procure local funds for investment.

There is no doubt that Japanese foreign direct investments have been beneficial to the Asian economies particularly those in the ASEAN region (Daquila 1994). These investments have helped in the creation of the manufacturing industries which are largely export-oriented; other benefits include job generation, transfer of skills and transfer of technology. Export-oriented foreign direct investment is certainly considered one of the principal determinants of East Asian economic development.

4.3 Other Investments

Japan had an overall net asset position in 1997 at 22 trillion yen, an increase of about 200 per cent relative to that of 1996. On the asset side, other investments rose from 144 trillion in 1996 to 174 trillion yen in 1997. They consisted of loans (72 per cent), trade credits (4 per cent), currency and deposits (10 per cent) and other assets (14 per cent). In 1997, foreign loans from Japan had the following characteristics: (a) about 70 per cent were granted by the banking sector and (b) about 62 per cent had short-term maturity. It will be interesting to see the extent of Japan's exposure to Asia. The loans provided by Japan to Asia have certainly contributed to the development of industry and infrastructure as well as to the financing of trade. On the other hand, as most of the loans are yen-denominated, the appreciation of the yen has created a severe debt burden to Asian borrowers which has resulted in a serious conflict between Japan and other Asian economies.

On the liability side, Japan's other investments increased from 136 trillion yen in 1996 to 151 trillion yen in 1997. They consisted of loans (78 per cent), trade credits (1 per cent), currency deposits (15 per cent) and other liabilities (6 per cent). In 1997, Japan borrowed an aggregate of 117 trillion yen which consisted of loans from the banking sector (56 per cent) and from other sectors (44 per cent). It can be assumed that Japan has also relied on Asian lenders particularly those from the NIEs, however the extent is not exactly known. Overall, considering both sides of the balance sheet, Asia would have depended more on loans and trade credits from Japan than vice-versa.

To conclude this section on Japanese foreign investment policies, the need for Japan to invest overseas is certainly prompted by the need to generate higher returns on their investments following the marked appreciation of the yen. Without Japanese savings flowing into the region, East Asian economies, would have not been able to achieve as fast a pace of industrialization and economic development.

5 Policies dealing with ODA

Japan's ODA aims to contribute to the alleviation of starvation and poverty in developing countries, to assist developing countries in accomplishing economic takeoffs, to share its own development experiences including human resource development, and to assist in solving global problems of environmental degradation and overpopulation (MOFA 1998). The World Bank estimates that from 1995 to 2004, East Asia and the Pacific will generate a demand for capital between US$ 1.3 to US$ 1.5 trillion to finance infrastructure construction. Because of the current economic crisis, these estimates will certainly be adjusted upwards. As for the second task of assisting the takeoff of developing countries, environmental destruction has aggravated the widening gaps in income distribution, industrial pollution and rapid urbanization.

Japan has recently been the major source of ODA for developing countries, except in 1987–88 and in 1990. However, Japan's bilateral ODA declined substantially to US$ 6613 in 1997, with more than the half of this amount directed to Asian countries (Keizai Koho Center 1998, 66–7). Given the current crisis and the current status of the Japanese economy, Japan's ODA will probably further be reduced. This will negatively affect the Asian region, particularly the countries hit by the crisis.

6 Japan's role in the Asian crisis

Numerous studies have been published analysing the causes, effects, policy responses and policy proposals to the Asian economic crisis. This financial crisis began in Thailand in July 1997 and has spread to other parts of the Asian region, with Indonesia, Thailand and South Korea being the most adversely affected. The affected economies have common characteristics as far as the initial causes of the crisis are concerned. These characteristics are mainly demand-determined; namely, the role of rising income expectations, high levels of current account deficits, external debt problems, and rapid domestic credit expansion.

1) Economic agents grew accustomed to and lived with high levels of growth over the past 35 years. Consequently, they expected that the economic miracle would continue and made their economic decisions based on rising income expectations particularly on decisions affecting their consumption and investments including investments in property and capital markets.
2) With higher growth rates and rising income, expectations that growth would continue, total spending (absorption) exceeded income which

resulted in a current account deficit, or equivalently, a national deficit (the sum of public sector and private sector financial balances).[4] In Southeast Asia, Singapore had the strongest net external financial position as it reached a surplus of about 14 per cent of GDP during the 1993–95 period. Singapore's public and private sectors were both in healthy surplus positions. The other ASEAN countries had high levels of current account deficits, with Thailand having the highest at 6.3 per cent of GDP and Indonesia, the lowest at 2.2 per cent of GDP during the 1993–95 period. Since the public sectors in these countries were in surplus positions, the net external deficits were attributed mainly to private sector deficits.

3) External indebtedness rose markedly largely due to short-term and commercial loans, the proceeds of which were mostly in non-performing assets and speculative activities, which in turn generated serious repayment difficulties. It seems that the Philippine external debt crisis in the 1980s did not provide any important lessons for other economies in the region. In the case of the Philippines, the proportion of short-term commercial loans was high, but it was the public sector which was responsible for the crisis.
4) Rapid credit expansion accommodated non-performing loans, a reflection of the banking sector's lack of discipline, lack of effective credit monitoring and inadequate prudent supervision. Moreover, the massive financial capital inflows indicate the central bank's ability (or the lack of it) to neutralize the expansionary monetary effects of these inflows.

Japan itself has been experiencing economic problems due to its worsening recessionary conditions. In addition to attending to its own domestic economic problems, Japan has been under tremendous obligations and pressure to assist the crisis-hit economies in the region, particularly Indonesia, Thailand and South Korea. In order to address the Asian economic crisis, Japan intends to provide maximum support and work together with the United States and other countries. The Japanese government has provided many support measures to assist Asia including those extended by the Japanese MITI; namely, (a) trade credit insurance to support import finance and general corporate finance of Asian companies, and (b) assistance through the Export-Import Bank of Japan to promote exports from Asia to Japan. In its operations during fiscal 1997, the Export-Import Bank of Japan (JEXIM) made 323 commitments for a total of 2,120 billion yen in

[4] A current account deficit arises when (i) both private and public sectors have deficits, (ii) private sector deficit is greater than the public sector surplus, or (iii) public sector deficit is greater than private sector surplus.

loans, guarantees and equity participation. By region, Asia received the majority of 162 commitments totaling 1,284 billion yen, or 61 per cent of the total value. This is followed by Latin America with 51 commitments totaling 389 billion yen.[5]

Because of the shortage of foreign exchange and a fall in their credit rating, Asian banks, particularly those in Indonesia, have found it extremely difficult to issue letters of credit in order to finance the import of raw material and components which are crucially needed by its export-oriented manufacturing industries. Japan has extended financial assistance to crisis-hit countries as there are many Japanese affiliates and subsidiaries in Asia. In particular, Japan holds the largest share in the flow of direct investment to Indonesia. Having realized the severe impact of the Asian crisis on its economy, Japan announced a total financial assistance package of US$ 73 billion as shown in Table 2. This consists mainly of two packages. The first package (up to 24 April 1998) amounted to US$ 43 billion consisting of (a) Japan's participation in the IMF-led support to Thailand (US$ 4 billion), Indonesia (US$ 5 billion) and to South Korea (US$ 10 billion); (b) assistance through the Japan Special fund (3 billion yen); (c) export credit for trade transactions (US$ 15 billion); (d) import financing, investment financing and two-step loans from the Export-Import Bank of Japan (US$ 2.5 billion); (e) quick-disbursing ODA loans to Indonesia (US$ 580 million); and (f) grant aid to Indonesia (US$ 33 million) and assistance measures for other Asian nations (US$ 5.4 billion). The second package is the US$ 30 billion assistance under the Miyazawa initiative.

This Miyazawa initiative can be seen as a substitution for the US$ 100 billion Asian Monetary Fund which had been proposed by Japan in the fall of 1997 but which had been immediately dismissed by the opposition of the IMF and the U.S. government. As Bullard, Walden and Malhotra (1998) argue, Japan had strong motivations to offer that money. Not only were Japanese banks heavily exposed in Korea and Southeast Asia but its whole economy is deeply integrated with those of its neighbors implying a strong interest in stabilizing volatile currency markets and supporting regional economies.

7 CONCLUDING REMARKS

Can Japan's economic power be sustained? As Karatsu (1998) states, Japan's economic power lies essentially in its technological prowess, particularly in Japan's ability to add value to natural resources and create new

[5] For further details, see JEXIM homepage (www.japanexim.go.jp).

Table 2: **Japan's contributions to resolve the Asian crisis**

I.	**Japan's participation in IMF-led support to Thailand, Indonesia & Korea**		**(US$ billion)**	**19**
(1)	to Thailand			**4**
	IMF	4	**Japan**	**4**
	World Bank	1,5	Australia	
	ADB	1,2	Singapore	
			Malaysia	
			Indonesia	
			Brunei	*7*
			China	
			Hong Kong	
			S. Korea	
(2)	to Indonesia			**5**
	B44 IMF	10	**Japan**	**5**
	World Bank	4,5	Singapore	*5*
	ADB	3,5	US	*3*
	Emergency Reserve	5	Australia	*1*
			Malaysia	*1*
(3)	to South Korea			**10**
	IMF	21	**Japan**	**10**
	World Bank	10	US	*5*
	ADB	4	Australia	*1*
			Canada	*1*
			Others*	*6*
			*UK, France, Germany, Italy, Belgium, Netherlands, Sweden, New Zealand	
II.	**Assistance through Japan Special Fund**			**0.23**
	World Bank		US$ 11.5 million (1.5 billion yen)	
	ADB		US$ 11.5 million (1.5 billion yen)	
III.	**Export credit for trade transactions**			**15**
	$ 13 billion (actual result in 1996, continue provision of short-term insurance)			
	1 billion (untied loan insurance for Thailand)			
	1 billlion (untied loan insurance for Indonesia)			
IV.	**Import & investment financing and 2-step loans from EXIM Bank of Japan**			**2.5**
	$ 2.5 billion (300 billion yen)			
	(0.6 billion two-step loans were extended to Thailand)			
V.	**Quick-disbursing ODA loans to Indonesia**			**0.58**
	$ 580 million (70 billion yen)			
VI.	**Grant aid for pharmaceutical, medical items & powdered milk to Indonesia**			**0.33**
	$ 33 million (4 billion yen)			
VII.	**Assistance measures for Asian nations announced on April 24, 1998**			**5,4**
	(= about 700 billion yen or US$ 5.4 billion) including:			
	$ 1 billion two-step loans for Indonesia announced on April 8,			
	– support for facilitating trade finance utilizing Export-Import Bank of Japan's two-step loans			
	– support for economic structural reforms with an emergency special low interest rate for quickly-disbursed government credits			
	– additional support for human resources development including accepting trainees and dispatching specialists			
	– support for food and medical supplies (500,000 tons rice from government stock pile and about 100,00 tons rice in grant aid)			
	SUBTOTAL (I TO VII)			**43**
VIII.	**Miyazawa Initiative**			**30**
	– US$ 15 billion for swap agreements with Asian banks			
	– US$ 15 billion to purchase Asian sovereign bonds or guarantee sovereign issuers for international fund raising			
	GRAND TOTAL (I TO VIII)		**(US$ billion)**	**73**

Source: Ōkuda (1999), Ministry of Foreign Affairs products out of them.[6] It is this value-added factor (and thus the manufacturing sector) that continues to be an important underpinning force of the Japanese economy.

In terms of its macro-economic policies, Japan has relied on the traditional demand-management policies to stabilize economic disturbances. It is important that the Japanese economy recovers and remain in good shape as this would have an important effect for the rest of the world and in particular Asia. It was estimated that the total tax cuts and public investment announced in April 1998 would generate an overall impact equivalent to 2.1 per cent of the GDP. For public investment, the estimated expenditure is 7 trillion yen and the multiplier is 1.32, so that the estimated impact is approximately equal to 10 trillion yen or 1.9 per cent of GDP. For special tax cuts amounting to 2 trillion yen, the estimated impact with a multiplier equal to 0.46 per cent is approximately equal to 1 trillion yen or 0.2 per cent of GDP. Thus, the total impact is equal to approximately 11 trillion yen or 2.1 per cent of the nominal GDP one year later – as estimated by Japan's Economic Planning Agency based on its projection using the multiplier of the 'Fifth World Economic Model'.

Japan has also introduced reforms, commonly known as 'Big Bang', to stabilize and liberalize its financial sector. The rate of increase in its total GDP due to implementing these reforms was estimated to rise by approximately 0.3 per cent. The major elements of these reforms include a) liberalization of cross-border capital transactions; b) widening the scope of financial instruments; c) providing attractive services; d) improving the efficiency and diversity of markets; and e) a fair and safe framework for users.

Japan has also allowed its yen to appreciate in order to lessen its trade imbalances with the rest of the world particularly with Asia but certainly this policy is not enough. With enormous pressures from its major trading partners, Japan has liberalized some of its import restrictions. It has also been pressured to open up its markets to Asian goods. Despite all these measures, Japan's trade imbalances with Asia has continued to increase.

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[6] All of Japan's raw materials are imported, which is an important point when you consider, for example, that the Japanese steel industry produced a record 100 million tons output of crude steel in 1997 (Keizai Koho Center 1998, 24). When iron ore reaches Japan, one ton is worth about 2000 yen. When it is turned into steel plates, a ton is worth 50,000 yen which, in terms of value added, is an increase of approximately 25 times. If these steel plates are used by the automotive industry, one ton of plates can be turned into about one to two million yen worth of automobiles.

This calls for more import liberalization measures and more Japanese investment in Asia.

Japan has adopted a global investment strategy following the appreciation of the yen in order to generate higher returns on its investments overseas in the form of portfolio and direct investments, loans, trade credits, foreign currencies and deposits. The Japanese acquisition of Asian private equities and bonds has certainly helped in the creation and expansion of industries and businesses in the Asian region. Japanese direct investments in Asia have contributed to the creation and expansion of export-oriented industries, to employment generation and to the transfer of technology and management expertise. Japan's trade credits to Asian economies have provided the financing requirements of exporters and importers in the region. Overall, Japanese investments in Asia have generated substantial additional sources of investment income which in turn have increased its level of national wealth. Thus, Japanese economic policies through trade, investment, ODA, and technology have indeed contributed to the economic growth and development of the Asian countries. The transfer of Japanese savings (through foreign investments) to Asian countries (NIEs, ASEAN, China, and other Asian countries) have stimulated capital formation and increased the export capacities of these countries.

Japan itself is in recession. Its crisis has gone from bad to worse – an economic situation which is said to be 'extremely serious'. It plunged deeper into recession as the economy continued to shrink also for the fiscal year 1998 and thus a second year in continuation.

The Asian region also continues to suffer from the onslaught of the economic crisis. Furthermore, it is facing a serious threat from developments in other regions like the deepening and widening of the European Union and of the American continents. The Straits Times (31 August 1998) reported that representatives from 34 countries began the process of negotiating a massive Free Trade Area (FTA) of the Americas to be implemented by the year 2005. It would be the world's largest FTA stretching from the Arctic Circle to the southern tip of South America, with 800 million consumers and a regional annual output of some US$ 10 trillion.

As Asians cannot control these developments in the E.U. and America, what measures can be taken in Asia? There is the need to promote and develop the Asian region, with Japan and other Asian NIEs investing in the region. There is a need to determine ways and means by which the Asian countries can complement one another. There is a need to increase intra-Asian trade and investment activities with the aim of the possible creation of an Asian Free Trade Area (ASFTA). Above all, Asians should strive for a borderless region including the EU and FTAA, as all Asian economies are highly interdependent. Asian economies increasingly need one another as their economies become more and more integrated due to the rapidly growing pace of globalization.

Another area of intra-Asian cooperation is the use of the regional currencies in settling trade transactions in order to reduce dependence on US dollars. In the case of Japan's trade transactions, the share of the yen as payment has grown over the years. MITI reported that for Japan's exports to the world, the proportion of yen settlements rose from 33.4 per cent in 1987 to 43 per cent in 1993. For its exports to Southeast Asia, the proportion rose from 41 per cent to 53 per cent during the same period. For Japan's imports from the world, the proportion of yen settlements increased from 10.6 per cent in 1987 to 21 per cent in 1993, and from 11.5 per cent to 26 per cent for imports from Southeast Asia.[7] Since then however, the use of yen in trade transactions shows a less clear pattern indicating that the regionalization of the yen has still a long way to go.

There are also various ways by which Japan and Asia can continue to enhance their partnership and work towards lessening the imbalance in their economic relations as discussed in Daquila (1997a, 9–17):

1) Both Asia and Japan should continue to adopt trade and investment liberalization measures.
2) Japan and Asia should continue with presidential and diplomatic visits, as well as bilateral and multilateral dialogues including institutional co-operation, active participation in and support for the activities of APEC (Asia-Pacific Economic Cooperation), WTO (World Trade Organization), ASEM (Asia-Europe Meeting) and other similar organizations. In his visit to Southeast Asia in May 1998, the Japanese premier Obuchi explained Japan's assistance measures and expressed Japan's firm resolution to restore its own economy through the 'Comprehensive Economic Measures' which will also help the Asian economy to recover.
3) There is also a need for Japan to set up more technical institutes in Asia to provide training and re-training programs for Asian workers in order to meet the skill requirements of Japanese manufacturing industries.
4) Japan should also be able to increase its intake of Asians through generous training and scholarship programs.
5) As Asia is essentially an agricultural-based economy, the agricultural sector needs to be promoted and developed with investments from Japanese investors given their technical knowledge on production, crop processing, storage and marketing of the agricultural products.

[7] See MOFA homepage (www.mofa.go.jp).

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Note: All internet files were downloaded between August 1998 and October 1999.