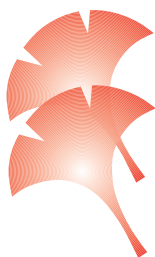


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Facing Asia – Japan's Role in the Political and Economic Dynamism of Regional Cooperation

Edited by
Verena Blechinger
and Jochen Legewie



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FOREWORD

Facing Asia – what better way is there of thinking about Japan's position in the world on the threshold of the 21st century? When Japan was *Facing Asia* for much of the 1990s, was it seeing itself as somehow apart? When Japan is *Facing Asia*, does it express new directions for the future or reaffirm existing boundaries? How does *Facing Asia* connect Japan and its main actors to broader political, socio-economical and cultural networks that set it on a grander stage?

This book addresses these questions as part of *Japan in Asia*, a multidisciplinary research project of the German Institute for Japanese Studies (DIJ). The establishment of the DIJ in 1988 by a decision of the Federal Ministry of Research and Technology – the present Federal Ministry for Education and Research – reflects a new awareness in Germany of the need for a better understanding of East Asia and Japan in particular. To this end, the DIJ conducts research in the fields of the humanities, the social sciences, and the economy of modern Japan. As a research institute located in Tōkyō, the DIJ benefits from close contacts with Japanese institutions and scholars, while also capitalizing on its growing worldwide networks in Japan-related research.

In its endeavor to identify issues of special relevance from a European perspective, the DIJ launched its project on *Japan in Asia* in 1997. Given the geopolitical developments of the 1990s, Japan's locus in the global context and the re-definition of its relations with Asia are of considerable interest. At the same time, the question of *Japan in Asia*, a question that is equally acute in the political, social, economic and cultural spheres, also implies changes in Japan's relationship to Europe or the 'West'.

In the closely interrelated areas of politics and economics, we focus on the process of political and economic integration in Asia and Japan's role within it. From the perspective of political science, we scrutinize the domestic debate concerning Japan's future role in Asia and the influence of business and interest groups on Japanese foreign policy decision making. Economic relations between Japan and Asia in general, and on current changes regarding Japanese business networks within the Asian region in particular, are another important focus within this framework.

Several conferences of the DIJ have highlighted aspects of our *Japan in Asia* research focus. A 1997 conference on the historical background of Japan's relations with its Asian neighbors examined the political, econom-

ical, social, and cultural dimension of the interactions of Japan and the Japanese with Asia, and the Asians. The conference was called 'The Japanese Empire in East Asia and its Postwar Legacy', as was the publication that followed the conference, Volume 22 in the DIJ monograph series edited by Harald Fuess. In 1999, a DIJ conference brought together experts dealing with the strategic responses by Japanese and European firms to a changing business environment in Southeast Asia in the wake of the Asian economic crisis. Jochen Legewie and Hendrik Meyer-Ohle edited the results of this conference under the title *Corporate Strategies for South-east Asia after the Crisis: A Comparison of Multinational Firms from Japan and Europe* (London: Macmillan, 2000). In 1998, the DIJ dedicated the tenth volume of its yearbook *Japanstudien* to 'Japan's new role in Asia'. Verena Blechinger and Jochen Legewie edited this volume which was one of the many other initiatives within this research frame. The DIJ has also been the site of a number of workshops and numerous individual publications by DIJ research fellows on the question of *Japan in Asia*. The most recent venture that focuses on *Japan in Asia* is a conference in April 2000 on 'Contested Historiography', the project of rewriting the history of World War II in Asia from feminist perspectives. Nicola Liscutin organized this conference and she will also edit a volume under the same rubric.

The volume at hand grew out of an October 1998 DIJ conference that took place over two days in Tōkyō titled, 'Regional Cooperation in Asia: Will Japan Stand Up to a Leadership Role?'. The DIJ gratefully acknowledges the cooperation of the Friedrich Ebert Foundation. Our thanks also go to the German Embassy for supporting the conference.

Special thanks are due to Verena Blechinger, head of the DIJ Social Science section, and Jochen Legewie, head of the Economics section, for organizing an exciting conference and putting together a well-rounded volume. They are to be congratulated for the many successes of this volume. Most of all, they have shown that the much-belabored and often-invoked notion of interdisciplinarity is not a chimera. Rather, one can see here that it unfolds its synergetic energies from within a well-defined framework and agenda.

Tōkyō, April 2000

Irmela Hijiya-Kirschnerreit
Director, DIJ

PREFACE BY THE EDITORS

In the 1990s, there is clear evidence of increasing political and economic cooperation in Asia. The end of the Cold War and economic globalization have accelerated regionalization in Asia. Increasing economic interdependence and intense lobbying efforts by multinational corporations operating on a regional scale have made Asian governments realize the need to take political steps to increase cooperation and dialogue in order to preserve stability in the region. These developments have been stimulated by trends of regional integration in other parts of the world, *i.e.* Europe and North America. The 1997/98 Asian economic crisis further added to the dynamics of this process. It painfully illustrated the high degree of mutual dependence of Asian economies and hence the need for a closer regional cooperation in the future. The crisis also reinforced calls from inside and outside of Asia for Japan to take on a stronger leadership role in the process of regional cooperation.

The articles in this book – all written in 1999 – take a closer look at the topic of cooperation at the institutional level of policy formation and coordination within a region. Addressing the various driving forces of regionalism and regionalization, the authors analyze attitudes and expectations of Asian political leaders and civil society and, examine the measures taken by state and non-state actors, *i.e.* by bureaucrats, politicians, and business to bring about closer political and economic cooperation in Asia. Rather than discussing this topic in general terms, the articles in this volume focus on the many facets of Japan's role within this process. By doing so, the Japanese position toward regional cooperation in Asia is analyzed from political, economic and sociological points of view before being summarized in the final chapter.

Throughout this volume, we understand Asia as the region made up by Northeast and Southeast Asian countries. We thus deliberately exclude countries like India or Russia, and do not take into account countries such as Australia, Canada or the United States that belong to the wider Asia-Pacific region. Choosing this definition of Asia, we do not only follow the general understanding of the term 'Asia' that is held in Japan, but also focus on the region that lies at the core of the ongoing process of regional cooperation – a fact that has become especially obvious with the gradual decline of APEC in the aftermath of the Asian crisis.

Many people have contributed to the completion of this book. First, we thank our authors for their contributions that consist of either updated and revised versions of their presentations at the conference ‘Regional Cooperation in Asia: Will Japan Stand up to a Leadership Role?’ that we organized in Tōkyō in October 1998 or of papers written originally and exclusively for this volume. We also thank three anonymous referees for sharing their precious time and insightful comments on the papers with us and the authors. Peter von Staden, Darryl Flaherty, David Leheny and Paul Talcott aided in the important task of proofreading the manuscripts while our colleagues at the DIJ supported us in the final editing process of this book. We would like to thank all of them and apologize to all the others who supported us in many ways that we can not mention them individually. The responsibility for any mistakes that may remain lies of course with the editors. Finally, we express our gratitude to Iudicium Verlag for a fast and efficient publishing process.

Tōkyō, March 2000

Verena Blechinger and Jochen Legewie

WILL JAPAN PLAY A LEADERSHIP ROLE IN EAST ASIAN REGIONAL POLITICAL AND ECONOMIC INTEGRATION?

Kent E. CALDER

In examining Japan's leadership role in the Asia-Pacific region, a political-economic approach is absolutely crucial. There are many things that are not clear from a purely political perspective, or for that matter, an economic standpoint. Ultimately, the interaction of those two areas will shape the distinctive, coordinative role that Japan is coming to play in the East Asian region.

The answers to three questions are crucial in understanding Japan's leadership role, or the lack thereof, in Asia:

- First, does Japan really want to lead?
- Second, do others in the region want to follow Japan?
- And third, what is leadership?

Obviously, the third question is, in some sense, the most fundamental. Yet to highlight the paradoxical and distinctive character of Japan's regional role, it is worthwhile to proceed from the question of whether or not Japan really wants to lead.

1 HISTORICAL PARADIGMS OF JAPANESE LEADERSHIP

Does Japan really want to lead? To fully answer this question, one must first consider the heritage of history in Japan's relations with the region. Historically, one can distinguish four paradigms of Japanese involvement in the region that prefigure the kind of leadership role Japan can potentially play in the future.

First, there is the legacy of what one might call the Meiji paradigm: Japan as liberator or educator. The role of Japan as educator was especially salient for the period from the early 1880s, as the profile of Meiji modernization began to shape, until after the Japanese defeat of czarist Russia in 1905. Chou En-Lai's experience as a student at Waseda University symbolizes Japan's role as educator. Following Chou, a number of other future leaders of the Chinese liberation movement in the first half of the 20th century also studied at Waseda during the Meiji period. This Meiji paradigm of Japan as an educator or as a potential liberator of the region

evolved, as Japan also became a model of industrial progress for Third World nations across many parts of Asia.

India, and a range of Indian leaders up to Chandra Bose and the Indian Liberation Army of the Second World War were much impressed with the Meiji pattern of modernization. Thus, in a symbolic and sometimes educational sense, there was clearly a Japanese leadership role in Asia during the early part of this century. Of course, the events of the 1930s and early 1940s discredited that role in many ways, but the legacy remains a potential element of Japan's relationship to the region. Japan continues to stand as the most economically and technically advanced member of the Asian, non-Western world.

The second paradigm I would like to draw from history is that of Japan as an industrial organizer. The symbolic image is Manchukuo in the 1930s, following the Japanese invasion of Manchuria in 1931. A number of people that later became political leaders and key mediators in Japan's relationship with Asia played major roles in the development of Manchukuo under Japanese occupation. The most conspicuous was Kishi Nobusuke, who later served as prime minister from 1957 to 1960. During the occupation of China, Kishi advised the leaders of Manchukuo on assignment from the Ministry of Commerce and Industry (Shōkōshō). He also acted as the Japanese Imperial Government's representative in Harbin for nearly four years during the 1930s. Shiina Motoo served in Manchukuo with Kishi, helping to direct industrial development. Shiina later became a major mediator of Japan's relationship with Asia, serving as the foreign minister who normalized relations with Korea in 1965.

Japanese industrial policy during the 1930s, as expressed in the Kishi-Shiina efforts in Manchukuo, re-emerged in the 1950s and 1960s to become a paradigm influential across Asia as a whole. From the 1950s to the 1960s, Japan began to think systematically about how it might organize Asia economically. Indeed, Japan developed a concept of leading Asia that was not unrelated to earlier failed ambitions. These ambitions were embodied in the failed concept of Japanese-led Pan Asianism. Ishihara Kanji, for example, who was special advisor to the Kwantung Army in Manchuria, was a major proponent of coordinated development of Asia under Japanese leadership. The idea of an Asia organized under Japan provided the intellectual origins of the wartime Co-Prosperity Sphere, developed during the 1930s. The idealistic aspects of Pan Asianism resurfaced in the 1950s and 1960s.

That leads to a third paradigm: Japan as imperialist organizer. Its expression began earliest and most harshly in Korea. It was applied later in attempts to organize North China, which Japan almost totally occupied,

and then more broadly, as Japan occupied virtually all of Southeast Asia during the Second World War.

The fourth historical paradigm of Japanese leadership is that of Japan as lender and penitent. Kishi promoted this pattern during his years as prime minister. Kishi transformed himself first from occupier of Manchuria and minister of munitions under General Tōjō Hideki in the 1940s to prime minister and then president of the Japan-America Society during the 1960s. Under Kishi's leadership, Japan during the 1950s came to play an influential role in Asia through assistance and reparation programs that promoted the economic recovery of Asia. In some countries, these programs had an enduring impact and played a role that continued into the future. They created networks that have been important in giving Japan a behind-the-scenes, characteristically Japanese-style leadership role in some key nations, such as Indonesia.

History, in sum, leaves Japan a richer legacy in Asia than much of the West often realizes. Particularly in Malaysia, Thailand, Burma, and Indonesia – nations that were either not occupied during the war or where Japan played an important role in their liberation movement – this positive image is quite powerful. Burma has repudiated the Japanese role in its independence movement, but even so, both Ne Win, the military leader for many years, and also Aung San, Aung Su-Chi's father and the father of Burmese independence, were trained by the Japanese army. Both figures had quite close ties with Japan in the early 1940s as founding members of the Thirty Comrades Group. Out of historical experience came personal networks that fused Japan and Asia. In certain countries, such as Burma and Indonesia, Japan's ties to independence movements created a positive heritage from history.

In relation to Northeast Asia, however, Japan has had a converse heritage that certainly should not be forgotten, particularly with respect to Korea, China, and Taiwan. The World War II experience, which was generally much longer and more bitter than in Southeast Asia, continues to constrain Japan's relations with the nations of Northeast Asia. The wartime residue can be seen, for example, in Asian resistance to Japanese prime ministers visiting the Yasukuni Shrine, and in the complexities of diplomatic activities, such as those surrounding the initial visit of Korean President Kim Dae Jung to Japan in 1998. That visit's enormous success, based on Kim's eloquent acceptance of Japanese apologies regarding the past, offers hope that history's dark shadow is becoming less salient in Japan-Korea relations. Yet strong and clear historical memories continue to trouble Sino-Japanese relations, as the 1998 visit by Jiang Zemin to Tōkyō demonstrated.

2 RISING JAPANESE ECONOMIC INTERDEPENDENCE WITH ASIA

The editors of this volume on Japan in East Asia, political scientist Verena Blechinger and economist Jochen Legewie have stressed the importance of integrating various disciplines in the study of Japan. Clearly, economic trends, including the degree of economic interdependence, will influence Japan's future leadership role in Asia. Japan's prospective role, however, is also a function of creating broader regional frameworks that are stable.

One needs to start with underlying economic patterns. In terms of trade interdependence, the relationship of Japan and Asia, in spite of the Asian financial crisis, is deep, and much deeper and larger in scale than it was a decade ago. Seven of Japan's ten top markets are in Asia. From 1991 to 1997, Japan had constantly more trade with Asia each year than it did with the United States, traditionally its largest trading partner. As an individual unit, the United States remains such, but Asia became rapidly more important during the 1990s than it had been previously.

The Asian financial crisis of 1997–1998 shifted that pattern, but in a temporary way. By August 1999, Japanese exports to Southeast Asia were rising at an 11% annualized rate year on year, and by nearly 40% annualized to South Korea. Asia as a market for Japan has become much more important since the mid-1980s. Asia is also traditionally important as a supplier. Indonesia, for example, has been the largest supplier of oil to Japan since the late 1930s.

Since the 1980s, Asia has become a supplier of such manufactures to Japan as electric fans and pocket calculators. More recently, Asia as a whole supplies about 60–70% of Japanese consumption of those products. Taiwan and Malaysia number among the most important suppliers. In general, about two thirds of Japan's imports come from APEC and 74% of its exports go to APEC. The share of the United States within that total has been declining. Clearly, Japan has forged a deep economic relationship with Asia over the past 15 years.

In a political sense, direct investment may be a more important indicator of the depth of a relationship than even trade. Japanese investment in Asia has been expanding very rapidly since the latter half of the 1980s. In 1982, the book value of Japanese investment in Asia was nearly US\$ 20 billion. Today it is close to US\$ 100 billion. During 1997 and 1998, the financial crisis slowed Japanese investment in Asia, but it still remains, by orders of magnitude, much larger than before the watershed of the Plaza Accords in 1985 and the subsequent yen revaluation in the years from 1985 to 1987.

A final element of economic interdependence between Japan and Asia is overseas development assistance (ODA). ODA represents both Japan's

stake in the region, an equity investment of sorts, and a resource for influencing Asia's future. Japan provides over 50% of Asia's total overseas development assistance, or more than US\$ 4 billion annually to Asia. The second largest supplier of ODA to Asia is Germany at around 11%. The United States is typically fifth or sixth, playing a much more managerial role in developmental assistance to Asia than most Americans believe.

3 INSTITUTIONAL CONSTRAINTS ON JAPAN'S ROLE

Moving to the central question more directly: does Japan really want to be a leader in Asia? Can it sustain any aspirations it may have along these lines? In 1988, I published an article in *World Politics*, called 'Japanese Foreign Economic Policy Formation: Explaining the Reactive State' that relates to this issue (Calder 1988). Despite the dramatic expansion in Japan's global economic role over the past decade, Japan does not appear to want to be a leader in the classical sense of a pro-active initiator. Why? To be sure, many Japanese feel profoundly that Japan 'should' have a larger role. Yet structurally, there are major constraints on pro-active leadership. Japan has no strong chief executive on the pattern of the French or the American presidential system. Prime Minister Nakasone talked about a 'presidential prime-ministership' during the 1980s, but he was heavily constrained by a system that included Diet processes that were, and that remain, slow and complex.

Japanese Diet sessions are very short, internationally speaking. Legislation terminates at the end of a session, and it has to be re-introduced in each session, until passed. In the American system, for example, if legislation is introduced in Congress, it continues under deliberation for the full two years of a legislative session. In Japan, it continues until the end of only one of a number of short sessions, at the longest six to eight months, and then has to be re-introduced.

In any complex industrial society, such a discontinuous legislative progress inevitably means a tremendous amount of complexity and indirect veto power on legislation by special interests. That situation compounds Japan's problem of being a reactive state.

A factionalized ruling Liberal Democratic Party contributes further to the structural difficulty of pursuing a pro-active foreign policy. As Joseph LaPalombara has pointed out, there are striking parallels in the domestic politics of Italian foreign policy to those of Japan. These parallels share some similar origins, such as the reactive character of the ruling party in a parliamentary system that does not allow for strong executive leadership (LaPalombara 1974; LaPalombara 1976). Cross-cutting interest-

group behavior also compounds Japan's problems. There is, for example, one individual federation of industry in Germany. In contrast, the Japanese have the Japan Federation of Economic Associations (Keidanren), the Japan Federation of Employers' Associations (Nikkeiren), the Japan Association of Corporate Executives (Keizai Dōyūkai), and the Japan Chamber of Commerce and Industry as well as active industry-level federations, often operating at cross purposes. Cross-cutting private sector interests and organizations thus make pro-active policy making difficult.

Does structural fragmentation simply create an autistic state that can not act? That is the contention of Karl van Wolferen in *The Enigma of Japanese Power* (van Wolferen 1988). He argues that Japan comprehends external stimuli, but is structurally incapable of acting upon that stimuli. I disagree. My reactive state argument suggests that Japan 'can' act in response to strong pressure from the outside. For example, the media and business worlds can be powerful catalysts for policy change, more than van Wolferen recognizes. Historically, business has been very important as a policy initiator in Japan. That leads one beyond the political system for an understanding about whether Japan doesn't want to be a leader in the classical pro-active sense or whether it is incapable of being a leader.

An important question is which of those alternatives one wants to pick. If one introduces the role of the business community, then one has to look at networks, especially at the pro-active Japanese private sector. Business has played a very important role in diplomacy with Asia, beginning with Indonesia, and building on some of the positive war-time ties mentioned above. Peter Katzenstein, among others, has seen the importance of such networks in his recent work (Katzenstein and Shiraishi 1997).

4 THE KEY ROLE OF CORPORATE INCENTIVES

The stakes are clearly high enough in Asia for the Japanese private sector to want some outside power to play a stabilizing role in the region. This is particularly true of the major trading companies like Mitsubishi, or major auto firms like Toyota and Mitsubishi Motors. Supporting the US-Japan security framework, for example, or in an economic sense, supporting efforts at stabilizing the economic parameters of the region are tasks that the Japanese private sector backs strongly. It has been quite pro-active in promoting broad regional stability, while remaining inconspicuous in this role. Given their strength in networks and the relationship of those networks to Asia, Japanese multinational corporations, unlike Western firms, are not concerned with transparent, multilateral frameworks. They hold a

rather different conception of regional organization from that of major multinationals in the West.

Japanese firms generally, and to a lesser degree Japanese politicians as well, have more sophisticated and deeper interpersonal networks in Asia than do many Western firms. Their business operating style has been correspondingly less transparent and more personalistic. The creation of a legal framework, the zero tariff, the Bogor declaration of 1994, and Early Voluntary Sectoral Liberalization (EVSL) do not affect the business community or the political world of Japan in the way that they affect the United States and other major countries in the region. Many Japanese have no need for a comprehensive legally-based, transparent framework of organization, although some important exceptions exist. This is not to deny a deep desire in Japan to deepen and stabilize relationships in the Pacific. Yet there is a qualitative difference in the political-economic nature of Japanese relations and Western political-economic relations with Asia.

5 JAPANESE-STYLE LEADERSHIP

Does Asia want to be led? Asians themselves are best equipped to answer this question. A distinction between the Malay nations in the region and the Sinic nations is useful in clarifying this issue. That was the fundamental line of cleavage during World War II. The Malay nations of the region, very broadly, tend to find a pro-active Japanese leadership role more congenial than do the Sinic nations of the region.

That finally leads, in conclusion, to the issue of leadership style. What exactly is leadership? In a pro-active, classic, Western sense, it is difficult, in many ways, for Japan to lead in Asia, except on relatively technical subjects. For example, there is a domestic consensus within Japan for pro-active leadership on three issues: the environment, energy, and food-related concerns. At the same time, there exists a low-profile Japanese leadership role in Asia that should not be ignored. Sometimes it is called 'leading from behind'. The Japanese ambassador to Cambodia described it as the role of faithful mediator. This kind of leadership has been substantive in some interesting and subtle ways.

An article in the October 1998 issue of *Chūō Kōron* (Tomoda 1998) outlines Japan's role in mediating – and in a sense leading – toward a settlement in Cambodia in 1996. That role dated from 1990, when the Japanese Peace-Keeping Forces went to Cambodia in the first overseas deployment of Japanese troops since World War II. Japan began brokering Cambodian issues in 1990 with the Tōkyō Peace Conference. Subsequently, Japanese ODA took a leading financial role in stabilizing Cambodia. Then, Japan's

Self Defense Forces (SDF) contributed an engineering battalion in Cambodia. After the original peacekeeping agreement broke down, Hun Sen's forces attacked Prince Rannarith, the son of Prince Sihanouk, in July of 1997. The Prince fled the country, and the Hun Sen group prevented his return. Ultimately, Japan brokered an arrangement by which Rannarith was able to return to Cambodia, elections were held, and the situation was significantly stabilized. Tomoda (1998) points out that even though Japan was not in the Security Council leadership group involved in this issue, it took the lead. Japan acted bilaterally, using economic aid as a major lever. Networks were quite crucial, and the business community in Japan supported government action in the interest of stability. The business community invited Hun Sen to Tōkyō and persuaded him to accept the agreement. Essentially, Rannarith was tried in absentia, then was pardoned by Sihanouk. These formalities, to which Japan paid exquisite attention in its mediation, ultimately stabilized the situation in Cambodia.

Two other examples follow a similar pattern. One is the expansion of APEC in 1980–1981. The Australians started out with a proposal to include the nations of the region. Japanese Prime Minister Masayoshi Ōhira played a role in broadening that initiative to include the United States and to expand the framework of APEC generally. In 1997, the Deputy Foreign Minister of Japan, Tanba Minoru, played a key role under the leadership of Prime Minister Hashimoto Ryūtarō in bringing Russia into APEC. Japan again played an important, but low-profile mediating role between various factions. It played off other nations' diplomacy, but nevertheless took an initiative that other nations could not, and did not, readily take. And in general, on issues concerning Russia and the Pacific, Japan has played a subtle but significant leadership role over the past five years.

One major issue for the future remains: does Japan need broad external military or geo-strategic presence in order to give itself leverage for a leadership role? The Cambodian case suggests the importance of some willingness to commit human and material resources. Credibility comes from a willingness to involve oneself directly on the ground in stabilizing the political situation of the region. By sending SDF forces to Cambodia in 1990, Japan added credibility. Of course, Japan's role remains a limited one, subject to constitutional constraints. Whether this will change is an internal matter for Japan to decide. Japan can take more leadership on subjects purely economic than in political-military areas. Supplying 50% of the ODA of the whole region, in economies that are relatively small, creates rather powerful potential leverage, even absent an overseas military role. This mediator-based foreign policy will probably grow stronger in the future.

6 CONCLUSION

It would most likely be hard for Japan to be a leader in the classical proactive Western sense within the current structure of Pacific relations, at least for the coming three to five years. Domestic constraints make it hard for Japan to make rapid, decisive pro-active decisions without a geo-political presence. Yet, the Japanese conception of leadership is distinctive. It is a paradigm of leader as conciliator, broker, and behind-the-scenes mediator. In that respect, as demonstrated in the Cambodian case, there is substantial scope for Japan to take a larger role in the future.

There are many forces that propel Japan, ultimately, towards some leadership role in Asia; especially its substantial political-economic stakes, such as high levels of direct foreign investment. Being a trading nation or exporting to Asia and being an investor on the ground are very different propositions. Being an investor on the ground means deep political-economic stakes in the regulatory policy, the taxation, and the evolution of political frameworks in Asian nations. External relationships, including US–Japan ties, and the relationship with the European Union also encourage a more activist Japanese role in Asia.

These external relationships, especially those between Japan and the West, could powerfully affect what future leadership role Japan will play in Asia. Ultimately, Japan's role will flow from an integrated set of political and economic incentives, particularly economic incentives that are deeply related to the stability of the regional system. To the extent that others provide a political security framework or a broad economic framework to stabilize Asia, activist Japanese leadership will appear less important to Japanese. Conversely, in a volatile, turbulent world, particularly one in which other key actors are not responsive to Japanese concerns, a Japan with close to 15% of the global GNP would be driven by very different, and more ambitious, incentives.

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ASIAN EXPECTATIONS TOWARD JAPAN'S ROLE IN THE CONSENSUAL PROCESS OF REGIONAL INTEGRATION: THE CASE OF THE EAST ASIAN ECONOMIC CAUCUS

Michio KIMURA

1 INTRODUCTION

In December 1990, the East Asian Economic Caucus (EAEC) was first proposed by the Prime Minister of Malaysia, Dr. Mahathir bin Mohamad, as a 'trade bloc' in order to promote a global free trade regime, which sounds paradoxical at first glance. The realization of the EAEC proposal has been pursued by the Association of Southeast Asian Nations (ASEAN) under the name of the East Asian Economic Grouping since 1991, and was renamed EAEC in 1993. At present, it is conceived to be a regional economic cooperation forum, or caucus, within the Asia Pacific Economic Cooperation (APEC) to discuss and seek consensus about a wide range of problems of common concern to the East Asian member economies of APEC. The forum is to be exclusively composed of the East Asian economies. While other regional cooperation arrangements existing in East Asia cover only a part of the region, the EAEC is aimed at representing all major countries within the region. The potential members of the EAEC are Brunei, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam – 6 of the so-called ASEAN 9 –, plus China, Japan and South Korea. Although the EAEC has yet to be officially launched as a caucus within APEC, it has reached the stage where its potential members hold informal talks at various levels. Meetings so far include meetings of heads of states which have been held three times, starting with the inaugural meeting of the Asia Europe Meeting (ASEM) in 1996.

Thus, it can be assumed that the story of EAEC will not only tell the nature and problems of economic and political integration in Asia. It will also shed light on the expected role of Japan in the region, since her membership and leadership is regarded as a major prerequisite for establishing this arrangement. This paper looks at the role that is expected of Japan by Asian countries in this process of regional integration, through examining the process of conceptualization and institutionalization of the EAEC. The EAEC concept is most relevant during times of sustained and rapid growth when strong fundamentals of East Asian economies lead their de-

velopment. Therefore, the pendulum of regionalism will swing to it again when the East Asian countries regain their growth momentum through the revitalization of its networks of production blocs.

This paper is structured as follows: first, the concepts of region, sub-region, and regionalism will be examined. Secondly, the economic background of the proliferation of sub-regional cooperation arrangements since the mid-1980s will be discussed. The focus of analysis will be the relationship between open regionalism and the networking of 'production blocs' among the East Asian economies. Thirdly, the evolution of the EAEC concept will be examined along with the formation of the development strategy of Malaysia. Fourthly, the transformation of the EAEC concept into a regional cooperation scheme promoted by ASEAN will be analyzed. Fifthly, the expected role of Japan as an essential member of EAEC will be discussed and statements of Malaysian and other ASEAN leaders will be examined. Finally, the prospects of further institution-building of the EAEC will be examined. Special emphasis will be given to the impact of the Asian financial crisis on this arrangement for regional cooperation.

2 CONCEPTS OF 'REGION'

One of the critical issues raised by the EAEC concept poses a constraining effect on the openness or non self-contained nature of East Asian economies and runs contrary to any efforts to build regional cooperation arrangements with East Asian only membership. The question is whether East Asia can be, in spite of its openness in terms of economic regimes, a true region, defined here as a group of three or more adjacent countries where political and/or economic integration can be attained. Scholarly literature by trade economists claims that – as the economic dynamism of East Asia relies highly on that of the wider Asia-Pacific Region – the benefit of economic interdependence will be maximized through unilateral and voluntary liberalization of trade and investment by APEC member economies (Ariff 1994; Ariff 1995).¹ While Ariff (1994, 115) emphasized the role of EAEC as a 'safety net' against possible Western domination at the APEC level, he did not answer the question of why the membership of the EAEC should exclude the non-Asian countries in the APEC region.

The issue seems to be better addressed from a wider perspective such as the one offered by international political economists. In attempting to define the term 'region', Mack and Ravenhill argued that 'the concept of

¹ Unilateral measures are defined as actions of a country that are directed towards another country, a group of countries or the world as a whole (Krueger 1995, 87).

“region” is a fluid one, ... and it tends to change according to the issue area in question and is perhaps most usefully self-determined by the participants in “regional” organizations’ (Mack and Ravenhill 1994, 7). From a similar point of view, Alagappa (1994, 158) defined regionalism ‘as sustained cooperation, formal or informal, among government, non-government organizations or the private sector in three or more contiguous countries for mutual gain’. Based on these definitions, they not only introduced the issues of regional political relations and security to their arguments, but also highlighted the primary roles of actors, especially those of states, in the process of regional integration.

International political economists deny categorically the existence of ‘natural regions’ based on political, cultural, and historical commonalities which will bring about regional integration (Mack and Ravenhill 1994, 6).² However, some political economists admit that there can be a type of regional integration driven by the sustained political will of states toward regional identity building. Higgott and Stubbs (1995), observing the fact that two very different understandings of ‘region’ are emerging through enhanced economic dialogue in Asia-Pacific, examined APEC and EAEC as two competing conceptions of regional economic cooperation. While the former regime advances market-led regional integration aiming at rational maximization of economic utility, the latter represents the state interventionist approach seeking identity building not merely through economic regionalization but also through the conceptualization of political, historical and cultural commonalities of the region.

Taking into account these academic arguments over the subject, East Asia in this paper is defined as the region composed of those states which the EAEC concept assumes as its potential members. Geographically it is composed of Northeast Asia and Southeast Asia. An analysis of the EAEC issues will require the examination of several factors related to economics as well as politics in East Asia. The economic factors include the following: the open rather than self-contained structure of regional economies; the vigorous cross border production activities of multinational corporations which has propelled globalization in the region; and the transition of the Chinese economy toward marketization. The political factors are: ASEAN’s approach to regional cooperation through consensus building; the rapidly-progressing regional integration process initiated and driven by the developed West, such as the establishment of the European Union (EU), the North American Free Trade Area (NAFTA), and the restructur-

² What they reject about the concept of ‘natural regions’ is the idea that such regions are destined to integrate spontaneously because of the given commonalities in ethnicity, culture and history.

ing of APEC into a free-trade regime; the changing pattern of power distribution in the region among Japan emerging as an economic big power; China as a potential big power in the 21st century; the US as the sole hegemon in the post-Cold War era; and the strategies of the states in the region incorporating the above-mentioned factors.

The discussion above suggests that the term 'region' can designate APEC, EAEC, ASEAN, or SIJORI (Singapore-Johore-Riau Growth Triangle) respectively in different parts of this paper. In a place where ASEAN is described as a region, APEC or EAEC will be described as 'wider region' or 'supra-region', and SIJORI as 'sub-region'. However, it is worth noticing that the concepts of 'subregionalism' or 'subregional cooperation' differ from 'regionalism' because of specific characteristics that go beyond the mere size of the areas in question. Subregional cooperation is understood in this article as an arrangement by the governments of several neighboring countries through which they partially lift their respective sovereignty over certain parts of their territories to expand mutual interchange to an extent that regional arrangements between the governments concerned could not attain.

3 OPEN REGIONALISM IN EAST ASIA

In East Asia, there has been a proliferation of regional economic cooperation arrangements since the mid-1980s and especially in the early part of the 1990s. They include for example the Greater South China Economic Zone, the Yellow Sea Economic Zone, the Singapore-Johore-Riau Growth Triangle (SIJORI), the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT), the East ASEAN Growth Area (EAGA), and the Golden Quadrangle (Northern Thailand, Yunnan province of China, West Laos, and East Myanmar). The following paragraph will show that the proliferation of these arrangements was led by open regionalism and supported by the expanding networks of 'production blocs' in the region.

The surge of sub-regional economic cooperation arrangements among the developing countries of East Asia is in response to the economic globalization caused by liberalization of trade and investment since the mid-1980s. These arrangements have a strong inclination toward 'open' regionalism in contrast to the discriminatory regionalism represented by the European Union and the North America Free Trade Agreement (NAFTA). Open regionalism is defined as a sustained cooperation among contiguous countries 'that would strengthen rather [than] weaken the members' extra-regional linkages' (Ariff 1994, 99).

The openness of the East Asian economies was a function of their deepening dependence on manufactured exports to external markets that became the basis of their robust economic growth. The list of these countries includes Japan since the mid-1950s, the Asian NIEs (Newly Industrializing Economies) since the early years of the 1970s, the ASEAN countries since the early 1980s, and China since the mid-1980s. The external dependency measured by the ratio of total trade to GNP of East Asian developing economies (excluding China) was quite high. This ratio ranged widely from 43.7% for the Philippines to 383.6% for Singapore in 1980. Since, it has increased in Malaysia, the Philippines, and Thailand. For the rest of the regional economies, it has slightly decreased or remained at a relatively high level (see Table 1). The ratio of China's external dependency almost tripled from 12.6% in 1980 to 35.7% in 1997.

Table 1: East Asian Economies – Ratio of Foreign Trade to GNP

Country	1980	1990	1997
Asian NIEs 3			
Korea	66,1	53,5	64,2
Hong Kong ^a	149, 5	217,7	231,4
Taiwan	95,6	74,2	82,6
ASEAN			
Singapore	383,6	300,9	260,2
Indonesia	50,2	43,5	45,7
Malaysia	100,5	143,5	168,2
Philippines	43,7	48,2	73,3
Thailand	49	66,5	79,7
China	12,6	29,7	35,7 ^b

^a Calculation is based on the GDP at current market prices.

^b This number refers to 1996.

Source: ADB (1998, Table 32).

While exports from East Asian economies have been increasingly directed toward the markets in the region since the mid-1980s, the intra-regional proportion to their total exports is still limited (see Table 2). In 1996, the intra-regional export of the ASEAN 4 countries (Indonesia, Malaysia, the Philippines and Thailand)³ accounted for just 6.5% of its total exports, that

³ In the aggregation of intra-ASEAN exports, the exports from Singapore are not included because of the lack of statistical data regarding exports from Singapore to Indonesia, and because of the substantial share of the entrepot portion in the total trade of Singapore. Accounting for these problems, Legewie estimates the real intra-ASEAN trade ratio including Singapore at 15% (Legewie 1998, 218).

of the potential EAEC member states accounted for 48.4%, and that of APEC member economies for 72.5%. This high rate can be explained by the fact that the absorption of Asian manufactured goods by the US market has remained at a substantial level. At the same time, US exports to East Asia as well as to other APEC economies have been expanding.

Table 2: Intra-regional and Extra-regional Trade of East Asian Economies

Export from - to	ASEAN 4	ASEAN 5	3 Asian NIEs	China	Japan	EAEC	APEC	USA	Total	Share of world export
ASEAN 4										
1980	3,2	15,0	7,1	0,8	34,4	57,4	78,4	18,7	100,0	2,5
1988	3,7	15,0	9,8	2,3	24,6	51,7	74,6	19,7	100,0	2,4
1996	6,5	18,6	11,9	3,0	17,8	51,2	72,8	18,6	100,0	3,9
EAEC										
1980	6,9	11,1	10,3	2,6	10,3	34,3	61,4	22,3	100,0	14,4
1988	5,1	12,2	14,2	4,9	8,6	39,9	74,0	29,4	100,0	22,3
1996	9,8	14,8	16,7	7,9	9,0	48,4	73,7	21,8	100,0	24,9
APEC										
1980	4,4	8,8	6,9	2,1	9,9	25,9	56,9	19,1	100,0	31,8
1988	3,7	8,2	11,1	3,4	10,8	33,6	70,8	25,2	100,0	40,8
1996	7,1	10,8	12,8	5,3	9,1	37,9	72,5	23,3	100,0	43,7
3 Asian NIEs										
1980	5,7	8,6	5,8	2,2	10,7	27,3	60,9	29,0	100,0	3,0
1988	3,3	9,3	8,1	9,2	13,3	39,9	77,4	32,9	100,0	6,9
1996	6,7	10,4	12,2	17,4	9,7	49,5	72,9	20,4	100,0	8,1
China										
1980	4,3	6,6	24,0	0,0	22,2	52,8	60,5	5,4	100,0	1,0
1988	2,8	8,7	38,3	0,0	16,9	63,8	72,7	7,1	100,0	1,8
1996	3,4	5,8	28,6	0,0	20,4	54,9	75,1	17,7	100,0	2,9
Japan										
1980	7,0	10,0	11,5	3,9	0,0	25,4	55,9	24,5	100,0	6,9
1988	4,9	13,0	15,7	3,6	0,0	32,2	72,3	34,1	100,0	9,8
1996	12,4	17,5	19,6	5,3	0,0	42,4	74,3	27,5	100,0	7,8
USA										
1980	2,8	4,2	5,2	1,7	9,4	20,5	45,5	0,0	100,0	11,6
1988	2,2	4,0	9,1	1,6	11,8	26,4	57,1	0,0	100,0	11,9
1996	4,1	6,8	9,5	1,9	10,8	29,1	61,6	0,0	100,0	11,8

Sources: IMF (1980); IMF (1988); IMF (1996).

Notwithstanding the fact that economic interdependence measured by intra-regional export concentration in ASEAN and in the proposed EAEC grouping has been increasing rapidly since the mid-1980s, it justifies the establishment of a trade bloc or even a free trade area arrangement between these countries far less than in the Asia-Pacific region (Mack and Ravenhill 1994, 6–7). An inward looking and discriminatory trade regime

in East Asia would have resulted in a marginal increase of its intra-regional trade at the expense of the stagnation or the decrease of its extra-regional trade. This is especially the case when the retaliatory trade measures of the United States in the 1980s are taken into account. Thus, economic regionalism in East Asia has been conditioned by its openness. It has preferred to orient itself toward the supra-regional trade regime and eventually toward globalization.

But what does East Asian open regionalism aim for? The question is closely related to what has brought about increasing economic interdependence not only in East Asia but also in the Asia-Pacific region. The prime mover of economic interdependence is the rapidly increasing flow of foreign direct investment into China and the ASEAN region since 1985 (Table 3). Noticeable factors of this flow of foreign direct investment on an unprecedented scale will be summarized in four points as follows.

Table 3: Inflows of Foreign Direct Investment by Region or Economic Grouping, 1981–1998

	Annual average inflows (billion US\$)				Share of the world total (percentage)			
	1981– 1985	1986– 1990	1991– 1994	1995– 1998	1981– 1985	1986– 1990	1991– 1994	1995– 1998
World	54,5	149,9	180,4	449,0	100,0	100,0	100,0	100,0
Industrialized countries	36,7	126,9	109,1	288,3	67,3	84,7	60,5	64,2
Central and Eastern Europe including the former Soviet Union	--	0,1	6,1	15,7	--	0,1	3,4	3,5
Developing Countries	17,8	22,8	65,2	145,0	32,7	15,2	36,1	32,3
Africa and Western Asia	7,6	3,6	4,7	6,4	14,0	2,4	2,6	1,4
Asia	4,2	12,1	39,6	82,8	7,8	8,0	20,0	18,4
China	0,8	3,0	19,3	41,5	1,5	2,0	10,7	9,2
East and Southeast Asia	3,3	8,8	19,3	38,4	6,0	5,8	10,7	8,6
South Asia	0,1	0,3	1,0	2,9	0,3	0,2	0,6	0,6
Latin America and the Caribbean	6,0	7,3	17,8	54,8	11,0	4,8	9,9	12,2

Sources: UNIDO (1996, 49); United Nations (1999, 477–80).

First, the increase in foreign direct investment was triggered by the substantial appreciation of the yen resulting from the 1985 Plaza Accord and the following revaluation of Asian NIEs currencies. Japanese and Asian NIEs manufacturing export firms were facing a severe loss of internation-

al competitiveness due to the rise of business costs, especially that of labor and land at home in addition to the appreciation of their currencies. Therefore, they vied with each other to relocate their production activities in China and Southeast Asian countries where they could utilize cheap and abundant production factors, hence the rapid increase of intra-regional exports in East Asia as well as exports from East Asia to Asia Pacific (Table 2). '[The] synergy between trade and investment, one reinforcing the other' (Ariff 1994, 106) is clear, and the circle in which one investment induces another through manufacturing export expansion has supported the rapid economic growth in the region.

Secondly, unlike the former influx of foreign direct investment by Japanese big companies into Southeast Asian countries in the 1970s, those who advanced into China and Southeast Asia this time were mainly small and medium-sized firms from supporting industries. They were accompanied by cost-sensitive parts of the production process of bigger multinational manufacturers not only from Japan, but also from Asian NIEs and later ASEAN countries. Thus, intra-industry and intra-firm trade of parts and components among East Asian economies have increased rapidly through the expanding networks of parent companies and supporting industries (Ariff 1994, 110; Jomo *et al.* 1997, 32), as well as through the production and distribution networks of overseas Chinese (Higgott and Stubbs 1995, 524).

The third factor is the robust and sustained economic growth of China that was accompanied by a transitional process from a central commanding system toward an outward-looking market economy since the mid-1980s. The marketization and export-oriented industrialization policies of the Chinese government induced mass relocation from neighboring economies into the coastal area of China's labor intensive industries, first from Hong Kong, Taiwan, and Japan, and later from South Korea and even ASEAN countries mainly through overseas Chinese networks.

The Shenzhen Special Economic Zone and the Pearl River Delta Area attracted manufacturing export operations from Hong Kong and later from Taiwan and South Korea, combining their capital and technology with an enormous and cheap supply of labor from the surrounding rural areas. These two Special Economic Zones evolved into a sub-regional economic cooperation arrangement consisting of the coastal areas of South China, Hong Kong and Taiwan. Their success was not only followed by the development of many industrial areas along the coast such as Amoy, Shanghai, Tianjing, Dalian, to name a few, but also induced more foreign direct investment into inland areas to produce goods and services for the domestic consumption of China. In this way these Special Economic

Zones provided Southeast Asian countries with a model of sub-regional economic cooperation arrangements.

The fourth factor to be mentioned here is the pulling factor that was especially strong among the ASEAN countries. The expansion of the above-mentioned networks has changed the structure of the international division of labor in the region, from the traditional vertical one between primary industries in the developing countries and secondary industries in the developed countries to a more horizontal one among expanding manufacturing industries. It has provided the developing countries in the region with the chance of rapid economic growth through increasing technological sophistication and capital intensification in their manufacturing sector, which have been readily adopted by ASEAN countries.

Their readiness to host foreign direct investment was demonstrated by the market-friendly policy reforms adopted by individual member countries.⁴ As Ariff (1994, 106) put it, each of the member countries has implemented such policies outside the regional cooperation framework of ASEAN since the mid-1980s. They included the devaluation or depreciation of the currencies of Indonesia, Malaysia and Thailand; the introduction of a value-added tax in Indonesia; a substantial reduction in company and income tax rates in Singapore, Indonesia and Malaysia; fiscal austerity in Malaysia; financial deregulation in all ASEAN countries; liberalization of foreign investment rules, especially with regard to ownership and permissible investment area restrictions; the privatization of public enterprises in Malaysia, Singapore, and the Philippines or the management reform of state-owned corporations in Indonesia. One of the major policy reforms was the unilateral liberalization of trade through streamlining custom procedures and the relaxing of both tariff and non-tariff barriers in all ASEAN countries.

These market-friendly reform measures varied from country to country in their intensity, and in the focus and pace of their implementation. However, they had the common objective to allow the private sector, especially foreign companies, to expand their production activities. These activities were mainly directed to manufacturing goods for export to the markets in developed countries and, later, in the region. In this sense, policy reforms, especially unilateral liberalization measures, were primarily aimed at expanding the production capacity of each ASEAN country rather than to increase intra-regional trade itself.

These liberalization measures represented one of the two prongs of industrialization policies adopted by almost all ASEAN member states but that were implemented independently and individually by each state in

⁴ See for example Masuyama, Vandenbrink, and Chia (1997).

the latter half of the 1980s. The first prong was pointed to the incorporation of their economies into the horizontally oriented international division of labor propelled by the private sector in East Asia. The second was directed at nurturing infant industries to become the local counterpart of newly arriving foreign manufactures, or to act as a means to deepen and expand domestic industrial structures by creating linkages among existing local industries. It required protective trade and industrial policies to be applied to the targeted industries. Hence, liberalization measures were implemented by each ASEAN country as its own policy initiatives and independent from the regional cooperation of ASEAN.

It is worth noting that the implementation of unilateral liberalization measures by ASEAN member states was made possible because of the loose and non-binding nature of regional cooperation within the ASEAN. ASEAN has allowed each member to pursue its own development strategy with minimum constraints or intervention from the developed countries outside and even from the regional association itself. The 1975 ASEAN Summit in Bali established a consensus to create regional resilience through strengthening the national resilience of each member country. This is the framework of regional cooperation within ASEAN, which assures the full sovereignty of its respective member states over their planning and implementation of their respective socio-economic development policies.

The question is now, why these unilateral liberalization measures that were adopted independently by each of the ASEAN member states were finally regionalized. First, intra-regional causes will be analyzed.

In the latter part of the 1980s, many multinational companies, including Japanese companies, mainly from the automotive and electric and electronics industries, tried to expand and reorganize their production networks in the region. These corporations started to demand from ASEAN countries to lower tariff and non-tariff barriers that hindered the free movement of their parts and components. They claimed that a free-trade regime in the region would enable them to reorganize their production process in such a manner that they could enjoy scale merits deriving from concentrating the production of parts and components in one ASEAN country, while at the same time profit from the lower price of specific production elements abundantly available in other member countries. Such a scheme, it was argued, would also contribute to economic growth in the region as a whole.

Even before the late 1980s emergence of production networks, ASEAN responded to manufacturer demands by introducing various schemes like the ASEAN Industrial Project (AIP) in 1976, the ASEAN Industrial Complementation (AIC) in 1981, the ASEAN Industrial Joint Venture

(AIJV) in 1983, and the Brand-to-Brand Complementation (BBC) scheme in 1988. Some ASEAN member countries also launched sub-regional economic cooperation schemes. Through these measures, ASEAN started its regionalization of unilateral liberalization schemes that had so far been independent from its cooperation framework. The BBC scheme, for example, was implemented on an individual automotive maker basis to allow for the procurement of parts and components with preferential tariffs from its subsidiaries located in other ASEAN countries. Naturally, all four major Japanese automobile producers participated in the scheme (Ariff 1994, 110; see also Legewie in this volume). The development of sub-regional economic cooperation schemes within the ASEAN was further stimulated by the Greater South China Economic Zone. Among the several sub-regional cooperation schemes of ASEAN, the SIJORI (Growth Triangle, comprising of Singapore, Johore State of Malaysia, and the Riau Provinces of Indonesia) has been the most successful case. It was proposed by Singapore in 1989.

The basic structure of sub-regional cooperation schemes calls for the governments of two or more neighboring countries to designate certain parts of their territories and to lift or ease restrictions regarding the movement of production factors such as capital, labor and technology, as well as to establish an industrial infrastructure. Further, it calls for leaving the combination of these production factors and the selection of industries to be promoted to the private sector which mainly consists of multinational manufacturing exporters, in order to achieve a more efficient allocation of resources through market mechanisms (Kimura 1994, 4). Thus, 'the SIJORI triangle acts as a "production bloc" that would render its products internationally competitive' (Ariff 1994, 114).

The analysis of the intra-regional causes of the proliferation of sub-regional cooperation arrangements in East Asia since the mid-1980s confirmed that unilateral and independent liberalization measures of the East Asian economies were cumulated into region-wide measures (or 'open regionalism') in order to expand the networks of 'production blocs' as well as to address the horizontally oriented international division of labor brought about by foreign direct investment from Japan and Asian NIEs. The EAEC was proposed to promote open regionalism in East Asia. In the following section, the conceptualization process of the EAEC will be analyzed. The grouping will be examined as a part of the Malaysian development strategy and as a regional cooperation arrangement of ASEAN.⁵

⁵ Since the intra-regional discussion of the EAEC has not yet been examined in detail, and also with regard to the focus of this volume, the role of US firms and contractors will not be discussed here.

4 THE EAEC AND THE 'VISION 2020'

When the original idea of the EAEC was proposed by Malaysian Prime Minister Dr. Mahathir Mohamad at the occasion of a visit by Chinese Premier Li Peng to Malaysia in December 1990, it was presented in a somewhat misleading and paradoxical way. Its aim was reported to establish 'a bloc to countervail the others [which were already formed by the developed West with an inclination toward protectionism]' (*New Straits Times* 11 December 1990).

The concept later became clearer when the grouping was re-named the East Asian Economic Group (EAEG) after the Malaysian government had sounded out the responses from ASEAN member countries for about one month. The EAEG was defined, as Noordin Sopiee, a brain truster of Prime Minister Mahathir, put it in January 1991 as a group of East Asian economies to function as 'a pressure group ... that can act as a megaphone to magnify our voice in the current Uruguay Round, and in future arenas of multilateral economic diplomacy, ... in order to try counter the severe erosion of multilateralism ... and to head off, if possible, the creation of full-blooded trade blocs. It is consistent with GATT, enhances ASEAN's role, and is compatible with APEC. Its potential members assumed by Malaysia at that time were ASEAN 6, Japan, China, Taiwan, Hong Kong, South Korea and Vietnam' (Sopiee 1991). Sopiee continued: 'If we [the East Asian nations] wish to enrich ourselves with each other, ... [and] if there are already three groupings within APEC, ... in the East Pacific [an emerging NAFTA], in the South Pacific [Closer Economic Relation between Australia and New Zealand; CER] and in the West Pacific (ASEAN) – and we see nothing wrong in this, what is wrong with an East Asian grouping?' (Sopiee 1991).

His argument suggests that the proposal to form the EAEG, or, as it was later called, the EAEC, was derived from a common wish for economic development through rapidly deepening mutual interdependence among the East Asian countries. As for Malaysia, its ardent wish and strategy to achieve it were best demonstrated in the concept 'Vision 2020' that was explained in a policy speech by Prime Minister Mahathir in February 1991. This speech was prior to the publication of the Second Outline Perspective Plan 1991–2000 (which detailed the National Development Policy, the successor of the New Economic Policy (NEP) 1971–1990) in June 1991, and the Sixth Malaysia Plan 1991–1995 in July 1991.

In 'Vision 2020', Mahathir claims that Malaysia should be and can be a fully developed and united country in its own mold by the year 2020 (Mahathir 1991). This goal would be attained through achieving a real term economic growth rate of about seven percent per annum for the com-

ing 30 years, implementing a set of market friendly and outward looking policies,⁶ and through overcoming nine central strategic challenges⁷ in the realm of society. Mahathir claimed that the diversity unique to Malaysia in terms of ethnicity, culture and society, and the economic disparities among major ethnic groups (Malays, Chinese and Indians) required these societal challenges to be incorporated in this Vision. Mahathir declared these demands to be the outcome of his long political experience that led up to the establishment of a long-run supreme leadership over the United Malay National Organization (UMNO), the dominant party within the ruling coalition, the National Front. The UMNO was expected to serve the interests of a specific ethnic group, the *bumiputera* (Malay and other indigenous peoples), and the interests of the fellow ruling parties, many of which were organized along their respective ethnic lines.

The critical task of the Mahathir government in the latter half of the 1980s was to establish a new longterm development policy that could overcome the issues deriving from the implementation of the New Economic Policy (NEP, 1971–1990). While a consensus was established among the ruling coalition parties that achieving national unity as the ultimate aim of the NEP should be carried over to a new development pol-

⁶ These economic policies include privatization, deregulation, accelerated industrialization, diversification of exports, liberalization of the economy, fostering the inflow of foreign investment and domestic investment, massive provision of infrastructure, human resources development, research and development (R&D), modernization of agriculture and the service sector, creation of information society (Mahathir 1991, 10–21). All the policies had been tested by the Malaysian government since the mid-1980s and were recommended by the National Economic Consultative Council (NECC).

⁷ These challenges are as follows: a) establishing a united Malaysian nation, made up of the 'Bangsa Malaysia (Malaysian Race)' with political loyalty and dedication to the nation; b) creating a psychologically liberated, secure, and developed Malaysian society with faith and confidence in itself; c) fostering and developing a mature democratic society, practicing a form of mature consensual, community-oriented Malaysian democracy; d) establishing a fully moral and ethical society; e) establishing a mature liberal and tolerant society in which Malaysians of all colors and creeds are free to practice and profess their customs and religious beliefs, while yet feeling that they belong to one nation; f) establishing a scientific and progressive society; g) establishing a fully caring society in which society will come before self, in which the welfare of the people will revolve around a strong and resilient family system; h) ensuring an economically just society that ends all identifications of race with economic function and economic backwardness with race; i) establishing a prosperous society with an economy that is fully competitive, dynamic, robust and resilient (Mahathir 1991, 2–4).

icy, there were differences of opinion about the policy measures needed to bring about national unity.

Not only the multi-ethnic opposition parties, but also the Chinese and multi-ethnic parties in the ruling coalition demanded that the Malaysian people regardless of ethnicity should be dealt with equally in the post-NEP development policy. Under the NEP, state intervention with regards to the distribution of wealth or to employment and education opportunities was based on quota systems and discriminated in favor of *bumiputera*. This policy brought about the broad resistance of non-*bumiputera* (including Chinese and Indians) to the extent that it has resulted in a huge amount of capital flight overseas since the mid-1970s.⁸

Around the mid-1980s, the deepening frustration of non-*bumiputera* groups, especially among Chinese people, was demonstrated in a series of political gatherings that especially focused on national policies against Chinese education. These activities were joined even by the Chinese ruling party and were retaliated by counter-gatherings of the youth wing of UMNO. These intensified ethnic tensions were eventually silenced by the so-called 'Operation Lallang' in October 1987. More than one hundred political leaders, both of ruling and opposition parties, who were involved in the Chinese education movement or in other social reform movements, were alleged to stir up 'racial sentiment' and were detained without trial under the Internal Security Act.

It was not only through such political suppression and government maneuvers⁹, that the Mahathir government maintained its basic aim of raising the economic status of *bumiputera* to a level on par with that of the Chinese. The Malaysian government also had to introduce considerable modifications to its traditional policy. In the latter half of the 1980s, the Mahathir government had to a certain degree already assisted Chinese business groups to attain 'a fair balance'. On the one hand, it was allowing them to make overseas direct investments in China and later in Indochina through their own networks established since the mid-1970s. On the other

⁸ The Morgan Guarantee Trust Company estimated that capital flight from Malaysia totaled US\$ 12 billion between 1976–1985 (Jomo 1989, 82).

⁹ Mahathir withdrew the terms of reference for the National Economic Consultative Council which he had set up in 1988 to bring about a consensus about a new development in the post-NEP era and received a national mandate for his government to formulate its own post-NEP policy after winning a landslide victory in the 1990 general election. Finally, the government incorporated all the NECC recommendations into the 'Vision 2020', the National Development Policy and the Sixth Malaysia Plan 1991–1995. Only the suggestions to set up a Royal Commission to monitor policy implementation and critical discussions about the quota system was not included in any of these programs (Kimura 1993, 52).

hand, it acquired, in return of favor, their collaboration in fostering a *bumiputera* entrepreneur community as their business partners in Malaysia.¹⁰ Based on the experience of establishing a synergistic relationship among small factions (*i.e.* the entrepreneurs) of the respective ethnic groups, the Vision justifies affirmative action to ensure the development of a viable and competitive *bumiputera* commercial and industrial community. At the same time, it also tries to ensure equal opportunities of participation and contribution for all ethnic groups in Malaysia.

The longterm development strategy of Malaysia did not only address the country's domestic ethnic issues, but it was also related closely with its regional and international policy. The Vision included two factors that necessitated devising the EAEC.

First, when the Vision sought to build a new national identity, 'Bangsa Malaysia' (the Malaysian Race), it claimed to create this identity through the fostering of so-called 'Asian values' such as the predominance of society and community over individuals, the family system as a basis of society, and esteem to elders. It also adopted an 'Asian approach' to democracy based on consensus building. These 'Asian values' were increasingly promoted by Prime Minister Mahathir in his 'Look East Policy' that he pursued since the end of 1981. 'Asian values' had to be seen, according to Mahathir, as the cultural basis supporting rapid economic growth and political and social stability not merely in Japan but also in other East Asia countries. In this sense 'the "Look East Policy" and "Vision 2020" [were] essentially comprised of national objectives as defined by Mahathir's government and were used as the cutting edge of foreign relations and ventures' (Saravanamuttu 1996, 8). Consensual democracy has been the principle of decision making of the ASEAN, an organization that is composed of countries which have more diversity in culture, ethnicity, political regimes and levels of economic development than common elements which serve to unite them.

The concept of the EAEC is linked to the 'Vision 2020' in two ways. First, the EAEC is the materialization of the 'Vision' in the area of regional cooperation, and it also balances some of the shortcomings of the 'Vision'. Second, both concepts were drafted with the intention that they should play an active role in the promotion of 'Asian values'. The 'Vision' claims that the identity of the Malaysian people should be based on 'Asian values'. The definition the Malaysian government uses to explain 'Asian val-

¹⁰ The Malaysian government reversed its policy of capital movement from the traditional suppression of capital flight to the encouragement of overseas direct investment (the so-called 'reverse investment') with a series of tax incentives since 1991 (Malaysia 1995, 128).

ues', however, is a rather abstract one. The idea behind the concept of 'Asian values' is to promote the particular values of the various ethnic groups within the Malaysian population among all peoples in East Asia. The link between the EAEC concept and the 'Vision 2020' can be seen in its aim in achieving a regional identity in East Asia that is based on 'Asian values' and a consensual approach claimed to be common to the countries that constitute this region, despite their political, cultural and racial diversities. As Higgott and Stubbs claim, 'the search for some kind of "Asian" identity is becoming an increasingly forceful aspect of Malaysian policy [of advocating the EAEC]. This quest is replicated in other neighboring countries' (Higgott and Stubbs 1995, 530).

Secondly, the 'Vision 2020' required Malaysia to form coalitions in international economy and politics. The objective behind this is explained in the following statement by Malaysian Prime Minister Mahathir: '... In international relations, the emphasis should be less on politics but more on economic imperatives. Small though we may be, we must strive to influence the course of international trade. To grow we have to export ... The trend towards the formation of trading blocs will damage our progress and we must oppose it ... A country without adequate economic defense capabilities and the ability to marshal influence and create coalitions in the international economic arena is economically defenseless ... This Malaysia cannot afford to be' (Mahathir 1991, 21).

It can be argued that the EAEC is one of these coalitions mentioned above.¹¹ For Malaysia, it was very important to build such coalitions, partly because of the small scale and open nature of its economy in the days of globalization, and partly because of its cautious perception of the changing American position in international relations after the end of the Cold War. In his keynote address at an international conference on ASEAN and world economy that was held in Bali in March 1991, Mahathir advanced his perception as follows: 'We see a situation today of a dramatic rise in the political, diplomatic and military clout of the US and a severe erosion in its economic position and welfare ... We can expect the application of that enhanced political, diplomatic and military clout to

¹¹ Other than the EAEC, Mahathir's efforts to create coalitions include, among others, the setting up of the South-South Commission in 1985, the establishing of the so-called Group of Fifteen developing countries to counterbalance the G 7 in 1989, Malaysia's advocacy of the interests of Third World countries with regard to environmental issues at the Earth Summit in Rio de Janeiro in 1992, and the Malaysian return to the meeting of the Commonwealth Heads of Government in 1987 (Saravanamuttu 1996, 2–9).

shore up the economic position and to enhance the US economic welfare' (*The Straits Times* 5 March 1991).

While this perception was not unique to Mahathir but rather common to other ASEAN leaders, they differed in their responses to the changed position of the US. These differences have been reflected in the ambivalent acceptance by the other ASEAN countries of the Malaysian proposal to build the EAEC.

5 ASEAN RESPONSES TO THE EAEC CONCEPT

Responses to the EAEC concept among other ASEAN member states swung from a cautious and ambivalent attitude at the initial stage to a positive one in having an East Asian regional cooperation arrangement based on an Asian approach. The momentum of the swing was given by their common experiences of success in dealing with the American version of regionalism in Asia-Pacific, the Asia-Pacific Economic Cooperation (APEC). Another factor that contributed to the rather positive reaction of ASEAN toward the EAEC proposal was the rising self-confidence of ASEAN member states as a prime mover in East Asia's role in the an emerging tripolar order in the global economy.

The original proposal by Malaysia's Prime Minister Mahathir of what would later become the EAEC concept was aiming at a regional trade bloc and thus was met with a cautious response from China¹² and blunt rejection by Singapore and Indonesia. At the same time, leading government officials of these countries also were indignant about the lack of consultation prior to Mahathir's announcement (Saravanamuttu 1996, 10–11). The government of Singapore soon changed its stance to supporting the proposal on the condition that the grouping should be consistent with GATT, compatible with APEC and should also enhance ASEAN's role. Moreover, to avoid further misunderstandings and to dissolve all resemblances to a trade bloc, Singapore proposed to name the grouping the East Asian Economic Group (EAEG). Indonesia, however, remained doubtful about the idea. This was partly caused by suspicions about ambitions by Malaysian Prime Minister Mahathir to take on a leadership role in ASEAN (Shima 1993, 36). However, the main reason for the negative reaction of the In-

¹² Chinese Prime Minister Li Peng, who was present when Mahathir first proposed the grouping, commented at the end of his official visit to Malaysia in December 1990 that 'such an economic cooperation would be useful, [however] it should be developed in a looser form (than a trade bloc)' (*New Straits Times* 14 December 1990).

donesian government was its preference for a global free trade regime, or for regional liberalization in Asia-Pacific as the second best alternative to closer cooperation in Southeast Asia or East Asia (Ariff 1994, 114).

After strenuous diplomatic efforts by Malaysia, the 23rd ASEAN Economic Ministers Meeting in October 1991 agreed to accept the EAEC as an ASEAN scheme after changing its name again from 'East Asian Economic Group' to 'East Asian Economic Caucus'. The ministers also agreed to establish the EAEC as a forum to discuss issues of common concerns to East Asia. However in January 1992, the Fourth ASEAN Summit, the highest decision making apparatus of the regional cooperation organization, shelved up the EAEC's official launch. While principally approving to the EAEC concept, the delegates referred the proposal to a Joint Consultative Meeting for further discussion. The ASEAN Ministerial Meeting in July 1992 followed suit by referring the proposal for further study to the ASEAN Secretary General, hence the prolonged process of institution-building of the EAEC.¹³

More serious reasons for the ambivalent attitude of ASEAN toward the EAEC concept than competition for regional leadership or strong preferences for an open trade regime in a wider region was the persistent opposition of the United States against the idea and the resulting undecided stance of the Japanese government over the issue.

In order to break deadlock in the protracted Uruguay Round negotiation of the GATT, the United States under President Bush tried to convert its trade policy from a policy line solely based on bilateral arrangements¹⁴ to a policy line based on both bilateral and regional arrangements. In North America, the US engaged in the establishment of the North America Free Trade Agreement (NAFTA) to broaden the free trade area from what was covered by the US-Canada Free Trade Agreement to a wider area including Mexico. With regard to Asia-Pacific, in 1989, the US government suggested an initiative to build a new mechanism for multilateral cooperation among the Pacific Rim nations (Asano 1994, 108). Because of these regional cooperation initiatives, America bluntly rejected the EAEC proposal in March 1991, denouncing the EAEC concept as intended to exclude the United States and to divide the

¹³ The principal approval of the EAEC at the 1992 ASEAN Summit was widely believed to be a 'face-saving' compromise for Malaysian Prime Minister Mahathir (Shima 1993, 45; MacIntyre 1997, 226). The study by the ASEAN Secretary General about appropriate modalities for setting up the EAEC has not been officially submitted to ASEAN (Ghazali 1994, 328).

¹⁴ In this context, bilateral measures denote the trade policies or trading practices implemented by the US on a country-by-country basis (Krueger 1996, 85).

Pacific into two parts¹⁵. Then Secretary of State James Baker sent a letter prior to the APEC Ministerial Meeting in Seoul in November 1991 in which he requested that the Japanese government opposed the proposal.

Faced with strong opposition from the United States, the Japanese government, demonstrating an acceptance of a Post Cold War regional order in Asia-Pacific under the sole hegemony of the United States, deferred making a decision whether it should commit itself to the EAEC or not. Official Japanese government statements at that time only requested that ASEAN kept the membership of the EAEC open to other member economies of APEC, or asked for more clarification about the concept from ASEAN. These actions can be seen as intended earn time for Japan and ASEAN to transform the EAEC concept into a more accommodating one for an emerging hegemonic order fostering stability in the Asia-Pacific region. Thus, Indonesia led discussions at the Fourth ASEAN Summit in 1992 to shelve the EAEC concept (Shima 1993, 42). It was said that Indonesian President Suharto attempted to exclude the EAEC proposal from the Summit agenda, claiming that it did not make sense to discuss the security and political issues of ASEAN without the presence of the United States in the region (Kitamura 1992, 7).

At its Fourth Summit in Singapore in January 1992, ASEAN responded to the prospect of rising discriminatory regionalism in the West by launching the ASEAN Free Trade Area scheme. This scheme originally aimed at establishing a free trade area covering the ASEAN region. It was set into effect with the introduction of the so-called Common Effective Preferential Tariff (CEPT) system which was intended to bring down tariffs for manufactured goods produced in the region to 0–5% within 15 years, starting from 1 January 1993. The completion date of the scheme was moved up five years in 1994. Further, the scope of intra-regional trade that was to be liberalized was expanded to agricultural products in 1994 and to services in 1996.¹⁶ The emerging EU and NAFTA, together with the strong absorption capacity of China, were likely to steer away the flow of

¹⁵ At the above mentioned international seminar in Bali in March 1991, the US ambassador to Japan gave a comment in which he officially rejected the idea. This was the first official statement by the US government about the EAEC since Malaysian Prime Minister Mahathir proposed the grouping four months earlier (*Asahi Shinbun* 6 March 1991).

¹⁶ For more detailed information about the AFTA scheme, see for example Menon (1996). The ASEAN Secretariat also published a series of so-called 'AFTA Readers' (see for example ASEAN Secretariat 1996) that address current issues related with the AFTA scheme. Among the 15 product groups included in the fast track of the AFTA scheme, copper cathodes, for example, ended up to be included in one group with products such as vegetable oil or cement. This suggests that the

foreign direct investment from the ASEAN countries. The AFTA scheme was thus conceived to provide foreign direct investment with common incentives for the region such as scale merits of their production. As Ariff (1994, 113) put it, 'AFTA should not be seen as an instrument that will increase intra-regional trade but as a catalyst ... that would render the ASEAN region attractive for foreign investments'. The AFTA scheme can therefore be seen as a representation of the 'open regionalism' of the ASEAN. It was aiming at expanding production capacity, but it did not serve as an instrument to strengthen their voice in multilateral fora or within discussions about the global trade regime.

ASEAN member countries became concerned with the fact that the developed West was monopolizing the rule-making power in the prolonged Uruguay Round while at the same time the voices of developing countries were disregarded. Another matter of ASEAN concern was that ASEAN was too small in size to exert influence in matters of global trade and that its economic dynamism highly relied on the wider Asia-Pacific region (Ariff 1994, 114). In the eyes of at least some of the political leaders of ASEAN, a realization of the EAEC proposal would secure ASEAN a greater voice in international consultations¹⁷ and also provide it with 'a "safety net" in the event of any Western domination at the APEC level' (Ariff 1994, 114). Hence, the 1992 ASEAN Summit kept the EAEC concept alive (Shima 1993, 45–6) although it was overshadowed by the high profile of APEC (Higgott and Stubbs 1995, 522).

International attention was drawn again to the EAEC in July 1993, when the newly elected president of the United States, Bill Clinton, initiated the transformation of APEC from a loosely binding organization to a forum for regional trade negotiations. He called the first informal meeting of APEC economic leaders in Seattle in November 1993 and requested the preceding Ministerial Meeting to adopt a framework agreement on trade and investment within the region. Not only the governments of the ASEAN member states, but also political leaders of East Asian developing countries reacted with concern to the American version of 'open regionalism' brought forward in these meetings. The US claimed the same level

implementation of the scheme was decided without sufficient discussion among the ASEAN member countries (Azahari 1993, 52).

¹⁷ The Prime Minister of Singapore, Goh Chok Tong, said that 'by being part of a big team like the EAEC and APEC, ASEAN can play with other world class teams in the same league' (*New Straits Times* 5 March 1991). Malaysian Prime Minister Mahathir made a similar remark: 'If ASEAN is to have a bigger say in the trade negotiations internationally, then it must work together with the East Asian countries' (*The Straits Times* 8 October 1991).

of openness of markets and the same 'fairness' in terms of industrial policies, human rights, labor policies and environmental standards for APEC member states as those in the United States, but at the same time disregarded the disparities in the levels of development.

In response to the diplomatic offensive of the US to promote APEC, the ASEAN Ministerial Meeting in July 1993 agreed, on the one hand, to take the EAEC concept out of its stock of reserved schemes and to establish it as a caucus within APEC that should receive support and direction from ASEAN Economic Ministerial Meetings. It can be argued that taking this decision, the ASEAN member states had taken the potential role of the EAEC as a safety net within APEC in to account. On the other hand, the ASEAN Ministerial Meeting also decided to accelerate the AFTA scheme. In October 1993, the ASEAN Economic Ministerial Meeting agreed to establish the EAEC as a forum to be held when the need arises. It should discuss problems of common concern to all ASEAN member states, and its membership should consist only of the East Asian member countries of APEC, namely the ASEAN member states¹⁸ plus China, Japan and South Korea.

The efforts of ASEAN to create the EAEC as a caucus within the supra-regional regime for trade negotiation, APEC, brought about the so-called working lunch attended by the foreign ministers of the potential EAEC members. It was introduced in 1994 and has been held annually since 1994, when it started as an interlude between the ASEAN Regional Forum and the Post Ministerial Conference. However, even given such regular meetings, the institution-building of the EAEC was far behind that of APEC. Even after a decision about trade liberalization by the year 2010 (by the year 2020 for developing members) was reached at the 1994 APEC Summit in Jakarta, the ASEAN Economic Ministers failed to invite their counterparts from their potential EAEC colleagues China, Korea, and Japan to their following retreat meeting in Pattaya in April 1995.¹⁹ The ASEAN Economic Ministers Meeting only agreed that ASEAN should assume its role as the core of APEC in the preparatory process of the Action Agenda of the Ōsaka Summit in 1995.

¹⁸ At that time, ASEAN consisted of six member states, namely Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

¹⁹ The Japanese government had made the presence of the economic ministers from Australia and New Zealand a pre-condition for its participation in the meeting. This conditionality of Japan's presence at the ASEAN Economic Ministers Meeting (AEM) was protested by Malaysian Prime Minister Mahathir who criticized the Japanese position as giving an impression of great-power chauvinism (*Yomiuri Shinbun* 1 April 1995). As a consequence, Japan, China and South Korea were not invited to the AEM in Pattaya.

Since the very beginning of the APEC process, ASEAN had insisted on 'an Asian approach to regional cooperation built on consensus building and "hearts and minds" elite bonding at the expense of ... legalism, form and contractual obligation' (Higgott and Stubbs 1995, 522). Their approach was justified, as Ariff (1995, 185) put it after examining the ASEAN and NAFTA experiments; 'informal arrangements work better than formal ones ... institutionalization can cause rigidities of sorts, raise transaction costs, and entail increased budgetary allocations'. In this way ASEAN, together with other East Asian developing members of APEC, demanded that a unilateral and voluntary approach should be adopted in the trade and investment liberalization of APEC.²⁰ In response to their demand, Japan as the host country of the 1995 APEC Summit Meeting in Ōsaka, contrived a so-called 'concerted unilateral approach' that was supposed to persuade the United States which insisted on a more rigid and legally binding approach towards trade liberalization.

It might not be an exaggeration to say that the sustained efforts inside and outside of APEC that were taken by the East Asian APEC members produced substantial results at the APEC Summit in Ōsaka. Concerted unilateral actions as proposed by Japan were introduced in the APEC Ōsaka Action Agenda in line with collective actions (APEC 1995). The principles of 'flexibility' and 'non-discrimination' (not only among APEC economies, but also against non-APEC economies) were adopted as part of the nine general principles to guide the action plans for liberalization and facilitation. Among them, the principle of flexibility is intended to ensure that enough consideration will be given to issues arising from different levels of development and from practices unique to the respective developing member economies. The recognition of such uniqueness shall further lead to non-intervention by other APEC member economies, whether developed or developing, into the development management and practices of the respective members.

Based on these common experiences and achievements in the APEC process and further stimulated by the first, though informal, meeting of the ASEAN Economic Ministers with their counterparts of other potential EAEC members on the occasion of the 1995 APEC Ōsaka Summit, the institution-building of the EAEC gained momentum. The fifth ASEAN Summit in January 1995 agreed to hold the first informal ASEAN summit in 1996 and to discuss the ASEAN Mekong River Basin Development Co-

²⁰ Noordin Sopiee, the then representative of Malaysia in the APEC Eminent Persons' Group, claimed that trade liberalization within the region should be based on 'peer pressure' and should proceed on an open time table (*Far Eastern Economic Review* 15 September 1994).

operation scheme (AMDC) as one of the topics on its agenda. After the meeting, the Prime Minister of Singapore, Goh Chok Tong, who had proposed the scheme, suggested that the leaders of the non-ASEAN potential EAEC members should also be invited to exchange views about the AMDC at the following Non-Official Summit to be held December 1996.

Another important development that further helped realizing the EAEC was the make-up of the Asian delegation for the first Asia-Europe Meeting (ASEM) held in Bangkok in March 1996. The countries that represented Asia at this forum were identical to the potential EAEC members. For the purpose of this article, four implications of the ASEM meeting for the development of regionalism in East Asia have to be noted:

First, at the ASEM meeting, the heads of state of all potential EAEC members 'met together in the absence of the USA' for the first time (MacIntyre 1997, 233). It was not the United States, but the European Union that thus recognized East Asia as a regional entity. At that time, there did not exist any other relevant configuration of Asian states than the potential members of the EAEC that could represent an Asian voice in the inter-regional dialogue. The recognition of this fact by the EU provided the impetus for the launch of the EAEC or another regional grouping formed by the same member countries. Such an EAEC-like arrangement could be established under the guidance of ASEAN, outside of APEC, and did not need the recognition of the United States.

Second, the ASEM summit was held under the condition that politically sensitive issues like the situation in East Timor or the respect of human rights in Myanmar were excluded from its agenda. Referring to this strategy in his closing remarks as the Chairman of the meeting, Thai Prime Minister Banhan emphasized that the dialogue among the participating countries should be conducted on the basis of non-intervention, whether direct or indirect, in each other's internal affairs. The delegations present at the ASEM meeting also declared that follow up actions would have to be consensual. Thus, the Asian approach to regional cooperation that is based on utmost respect for the sovereignty of the member countries and on consensus building was recognized as a working principle of the inter-regional cooperation between Europe and Asia.

Third, Thai Premier Banhan referred in his opening address and again in his closing remarks to the emergence of a new tripolar order, including Europe, the US and Asia. He stated that 'we will create the linkage of the tripartite economic centers of Europe, America, and Asia so as to help promote economic development, peace, and stability in the world' (*Foreign Broadcast Information Service Daily Report: East Asia* 4 March 1996). These remarks and the success of the ASEM meeting generated a new feeling of self-confidence among ASEAN members. This new self-confidence was,

for example, expressed in the Seventh Malaysia Plan (1996–2000) which stated that ‘as a result of recent rapid growth of the East Asian countries of between 6.5 to 7.5% compared with the 2.5 to 3.0% growth in Europe and the US, the East Asian region has now reached parity with Western Europe and North America, leading to the emergence of a tripolar world’ (Malaysia 1996, 49). Although such statements had a strong bias toward the creation of a production bloc aimed at the world market,²¹ they led to further political integration in pursuing the enlargement of ASEAN to now ten member states (ASEAN 10).

Fourth, despite the fact that the above mentioned factors suggested the de facto establishment of an EAEC-like regional cooperation arrangement, the EAEC concept was never officially mentioned throughout the first ASEM meeting. As Malaysian Prime Minister Mahathir stated prior to the meeting, ‘although it is not an EAEC yet, we will be working closely with East Asian countries in the EU meeting’ (*The Star* 16 December 1995). It seemed that the lack of a positive labeling of the EAEC at the ASEM meeting was not only caused by the refusal of other APEC members to recognize the caucus. Another reason was certainly the lack of consensus among the member states of ASEAN over the prospect and direction of regional integration based on the EAEC concept.

While the pendulum of regionalism in East Asia swung from APEC to EAEC as a consequence of the ASEM meeting, the ASEAN members with the exception of Malaysia also became rather complacent about a regional cooperation arrangement that would lead to another kind of EAEC. They were aiming at a grouping through which they could not only ensure the consensual process of regional integration, but also accommodate diplomatic concerns of Japan and guarantee a future military presence of the United States.

6 THE EXPECTED ROLE OF JAPAN

The EAEC concept was not defined any better than the expected role of Japan contained therein. According to Noordin Sopiee (1991), and advisor to Malaysian Prime Minister Mahathir and former representative of Malaysia within the APEC Eminent Persons’ Group, the EAEC has three aims. These are to enhance the prospects of the successful conclusion of the Uruguay Round of the GATT, to marshal and magnify the voice of the intensely trade-dependent East Asian nations in international trade negotiations, and to promote a greater East Asian economic cooperation. As Ja-

²¹ See also section 3 of this paper.

pan has a critical interest in these three objectives as well, Sophe seemed to suggest that it was only natural for Japan to play a leading role in EAEC. In 1994, Malaysian Prime Minister Mahathir further defined the objective of the EAEC as an enterprise to build an East Asian community of cooperative peace and prosperity 'in which the giants of our region – China, Japan, and Indonesia – shall have their rightful place, discharging their rightful responsibilities' (cited in Sophe 1997).

The very idea of having Japan as an essential leader in initiating the EAEC process immediately aroused fear of Japanese economic dominance in East Asia not only among ASEAN member states, but also in the US. In order to dismiss such concerns, Malaysian Prime Minister Mahathir pointed out in 1992 that mutual checks among Japan, China, South Korea, and ASEAN would effectively reduce such a risk (Saravanamuttu 1996, 6). The politico-economic balance of power in East Asia required both Japan and China to participate in the EAEC. The promoters of the EAEC concept intended that Japan's role in the EAEC would be determined by a concentration on economic activities and that it would also counter-balance China which still keeps the option of both economic and military leadership in the region. In this sense, the Singapore Prime Minister Goh Chok Tong stated that an EAEC without Japan would be meaningless (*New Straits Times* 17 February 1995).

A more serious concern that was raised with regard to the EAEC proposal was the possibility that the EAEC might cause a political separation of East Asia from the United States and might result in the fact that the East Asian countries lose their sole guarantor and arbiter of peace, security and stability. Both Singapore and Indonesia seemingly held the perception that an American presence in the region is essential for the continuation of the international order in East Asia. Therefore, they claimed that the EAEC should be compatible with APEC. The above concerns also led to a view that 'the idea of an EAEC can only make sense if it is considered as part of the whole, namely as a caucus within the APEC' (Wanandi 1997, 47–8). Singapore and Indonesia thus expected that Japan would have remained a sub-leader under the sole hegemony of the United States in the region.

While Malaysia accepted the general idea that the EAEC should be compatible with and should be established as a caucus within APEC, Malaysian Prime Minister Mahathir expressed his doubts about whether US military presence in Asia would efficiently guarantee regional security. His view struck a rare sympathetic cord in his long-time critic, academic-cum-social activist Chandra Muzaffar (1992, 8–12) who commented in the following way: 'The US is after territorial, economic, political and cultural hegemony ... the US has relentlessly opposed the EAEC, arrogantly not

allowing East Asians even to call themselves East Asian ... the security of East Asia should be looked after by East Asians, not by the American god-father ... The time has come to turn swords into plough shares by East Asians for East Asians ... [Mahathir's] EAEC proposal is worthy and timely of support by all East Asians'.

It is significant to note that a Japanese participation in the EAEC, if it materialized, could bring about a substantial change in its security alliance with the United States and make the American military presence in the region meaningless.²² This situation, however, could only develop if the governments of Malaysia's East Asian neighbors accepted Mahathir's repeated claim that economic cooperation alone was the best way to attain stability through prosperity in the region. In Mahathir's opinion, the costs to prevent war by building up military forces are so high that it was much more economical for East Asian nations to concentrate their resources on economic activities and to accumulate enough wealth to convince any militarist country to follow suit. This is especially true in the post-Cold War era (Mahathir 1996, 3–4).

In the scenario preferred by Mahathir, Japan is not expected to play the role of a full-fledged hegemon in the region. As an economic power, it is rather supposed to promote symmetric economic interdependence in the region²³ and to provide international public goods. The role of a leading economic power also involves that Japan takes the risks and burdens the costs arising from its leadership.

In doing so, as an economic power without the military clout to impose its will, Japan will have to rely on consensus building among the fellow states in the region. Hence the nature of Japanese leadership as it is defined in the EAEC proposal is best described as 'first among equals'. This type of leadership stands in sharp contrast to the sub-leadership role as a dependent on the hegemony of the United States that is expected from Japan by at least two ASEAN countries, *i.e.* Singapore and Indonesia. It also is the reason why China and Korea reacted warily to the EAEC concept (Heng 1995). These differences among East Asian states over the ex-

²² Malaysian Prime Minister Mahathir clearly expressed his doubts about the efficiency of US guarantees for regional and Malaysian security (*Yomiuri Shinbun* 1 April 1995). On the other hand, however, he also pointed out that Japan's special relationship with the US did not at all contradict the EAEC concept (*Yomiuri Shinbun* 5 April 1995).

²³ Given the disparity of economic development among Asian countries, the benefits from economic interdependence are spread asymmetrically and aggravate inequalities among them. The leading economic power in the region is thus expected to provide international public goods that help to make interdependence symmetrical (Kimura 1995).

pected role of Japan certainly hindered them from accepting the EAEC concept and from building a corresponding regional identity.

As analyzed in section four of this chapter, the EAEC concept was based on the political will of Malaysian Prime Minister Mahathir to establish a cooperative regional development path unique to East Asian societies. It was his intention to use evolving networks of Asian multinational corporations and also overseas Chinese networks, while at the same time providing a stable framework of politics and society that was based on Asian values and a consensual decision-making approach. In Mahathir's view, the predominance of society over individuals and consensus building are, among others, the core of so-called 'Asian values' and of a particular 'Asian way' of politics. Using these uniquely 'Asian' ways, his intention was to promote a specific Asian way of development that drew on his concept of a 'Look East Policy' and, in a wider perspective, on common historical experiences of the East Asian countries. Higgott and Stubbs (1995, 525) claim that the 'colonial aspirations of Japan' provided East Asian states with a model for 'state-directed development', and that the exercise of American hegemony and the imperatives of the Cold War created strong, centralized states. In their view, the dynamism of the Japanese economy brought about the economic success of the East Asian countries, and the Plaza Accord was accompanied with the benefit of Japanese foreign direct investment to them. Hence, they state that 'this common experience has tended to reinforce a perception of shared attitudes and values across these countries'. However, it has to be said that the argument of common experiences does not necessarily entail the demand for a Japanese leadership role in Asia.

At the time when the EAEC was proposed, the memory of Japanese war atrocities committed during the days of the so-called 'Greater East Asia Co-Prosperty Sphere' rather aroused suspicions about Japan's intentions. In December 1991, for example, Singaporean Senior Minister Lee Kuan Yew quipped in an interview that 'allowing Japan to once again send its force abroad is like giving chocolate liqueur to an alcoholic' (*New Straits Times* 15 December 1991). Lee further said that these concerns were the reason why the United States should keep their military presence in Asia. In his view, it was the role of the US to hold Japan within a security framework that let it concentrate on economic activities. This was the only way to ensure open global economic integration. Regarding his cautious view of Japanese leadership, it is worth noting that it was Lee who at the end of the 1970s, when he was still the Prime Minister of Singapore, initiated a campaign to 'learn from Japanese experiences' in order to utilize Japanese business practices and patterns of industrial relations for the economic development of Singapore. Through this campaign, Lee seems

to attribute both Japanese military failure and its economic success to a common root: its somewhat conformist value system.

The above mentioned cautious view about potential Japanese military ambitions over the region is still held by many political leaders in Asia, not only from Singapore, but from almost all potential EAEC members except Malaysia. Most regional political leaders rather prefer a Japanese sub-leadership role in the region that is checked by the United States. In other words, they are rather interested in preserving the current system of Japan-US security relations that has been built up since the 1960s and that was carried over into the post-Cold War era. The Japanese position within this system is best characterized with the term 'leadership from behind' (Rix 1995). It has best become visible in Japanese official development aid (ODA) policy which is subject to requests from recipients and emphasizes the need for them to take the initiative in solving their own problems. Based on this principle of request and assistance provided on a bilateral basis, Japans Ministry of International Trade and Industry (MITI) began in the mid-1980s to provide ASEAN countries with advice for their export orientated industrialization plans. In this context, the Japanese role as a moderator and consensus builder as it was shown in its self-presentation as host of the 1995 APEC Summit in Ōsaka was very important. It was this self-presentation that finally made the government of Singapore propose the EAEC-like arrangement that was examined in the preceding section.

Since the end of the 1980s, the expectations ASEAN member countries had towards the Japanese role in the region changed significantly. ASEAN countries closely watched the 1989-1990 Structural Impediments Initiative (SII) talks between Japan and the US. For ASEAN governments, but also for many Japanese observers, these talks constituted a hegemonic intervention from the United States into internal economic practices of Japan such as its high propensity for savings, the expensive land prices in Japan, its complex distribution system and so on. At the same time, the establishment of a discriminatory regional trade regime in the North American Free Trade Agreement (NAFTA), did not only cause cautious responses among ASEAN countries (as was shown in the preceding sections), but let to a rise of 'neo-Asianism' in Japan.²⁴ Given this background, the EAEC idea was met with a more positive echo in East Asia as a whole. Since this resonance to the EAEC concept is basically emotional in nature, to pursue the ideas of 'neo-Asianism', Japan would be required to clearly define its identity as an Asian state and to make the decision whether and how it would reduce its dependence on the security frame-

²⁴ See also the chapter by Blechinger in this volume.

work provided by the United States. In this sense, the EAEC idea is closely linked to the expectation that Japan, as an economic power, changes its leadership style from a 'leadership from behind' to a 'leadership from the front'.

In conclusion to this section, it has to be noted that there exist two types of roles expected from Japan. It can be said that the expectations of the Asian countries have swung between them. One is the role of Japan as a regional sub-leader under the sole hegemony of the United States. This role includes the strong possibility of US intervention into the internal affairs of the various Asian countries. On the other hand, there also is the role of Japan as an economic power in the region without military clout. The demands towards a possible leadership role for Japan in this scenario are based on a consensus building approach and on emotional resonance to Asian identity building. Fundamental to both, however, is the base line that Japan should concentrate on economic activities in order to promote regional integration.

7 CONCLUSION: WAS THE EAEC CONCEPT INEFFECTIVE IN THE ASIAN FINANCIAL CRISIS?

In December 1995, Malaysian Minister for International Trade and Industry Rafidah Aziz reportedly stated that while the EAEC had already started on an informal basis and could be launched without Japan, ASEAN would delay this launch out of a preference for a more formalized ministerial level that guaranteed an overall view (*The Star* 13 December 1995). In May 1996, two months after the first ASEM meeting, Malaysian Prime Minister Mahathir, in looking back at the history of the EAEC proposal, quoted Shakespeare's 'Romeo and Juliet': 'What's in a name? That which we call a rose/By any other name would smell as sweet.' With these words, Mahathir alluded to the fact that the EAEC or an EAEC-like regional arrangement was already in place, however, it did not explicitly refer to the original EAEC concept proposed by Mahathir in 1990.

In this context, it is worth noting that, over the last years, the way ASEAN member governments perceived the process of institutionalization of the EAEC has changed. The press statements of the annual ASEAN Ministerial Meetings between 1991 and 1997 show, in one small clause, that the EAEC concept came nearer to its realization year by year. In December 1997, the first de facto informal summit meeting of EAEC member states was held in the context of the second ASEAN Informal Summit Meeting hosted by Malaysia. However, the press statement about the meeting never mentioned the EAEC by name. Even the clause about the

ASEAN Mekong Basin Development Cooperation scheme, which seemed to imply that the EAEC was expected to play a critical role only referred to the fact that the nine heads of government present at the meeting discussed the status of the project. Finally, the press statement of the ASEAN Ministerial Meeting in July 1998 did not even in one clause refer to the EAEC concept. Henceforth, it is argued here that the EAEC has reached a stage of institutionalization that allowed *de facto* EAEC summit meetings to be held. However, the grouping is far away from achieving its objective of becoming a forum within APEC that discusses and seeks consensus about problems of common concern and that is called whenever the need arises. Before ASEAN could move to this next step, the Asian financial crisis forced a standstill in the institutionalization of the EAEC.

The Asian financial crisis could have provided an opportunity for the EAEC to become more legitimate and to address an urgent and most relevant task: solving the crisis that started in Thailand in May 1997 and spread all over East Asia in the following few months. But the EAEC never surfaced to play its role as a trouble shooter. Why did this standstill in the EAEC process take place? The reason might be related to the aborted Japanese plan to establish an Asian Monetary Fund (AMF). The proposal to set up the Asian Monetary Fund was made during a meeting of the finance ministers of the ASEAN 7 and Japan at the occasion of the first Finance Ministers Meeting of ASEM that took place on 18–19 September 1997.²⁵ Then Japanese Minister of Finance, Mitsuoka Hiroshi, presented it to the Finance Ministers' Meeting of the G7 (involving the minister of finance and the heads of the central banks of all seven member countries) on 20 September 1997. The proposal aimed at the institutionalization of a currency stabilization fund directed only at Asian countries and financed by, among others, ASEAN, Japan, the US and Australia. Under conditions different from those of the IMF, the fund would have provided immediate financial relief to the East Asian economies perceived by Asian leaders as having fallen victim, through no fault of their own, to attacks by speculators. In addition to setting up a relief fund, it was intended to create a regional financial monitoring system on a mutual basis that was intended to prevent further financial crises. Looking at the countries mentioned in the proposal, and also at the character of the AMF as a fund that should work independently from the IMF and only give financial relief to Asian countries, one can say that the AMF proposal was conceived within the framework of a *de facto* EAEC, even if it was never explicitly stated.

²⁵ Laos and Myanmar were excluded from ASEM although they were admitted as new ASEAN members in 1997.

After a debate in which the Japanese government presented itself in a rather ambivalent way, the US and the IMF showed strong opposition while the ASEAN countries lingered and could not find a common path of action, the AMF proposal was finally aborted at high-level political and financial talks between the US, Southeast Asian countries and Japan in Manila on 18 November 1997. It is important to note that the Japanese Minister of Finance, Mitsuoka, had changed his position after the G7 Meeting on 20 September. While he had acted as a leading promoter of the AMF idea until then, he abandoned this position after the G7 meeting and resolved to non-committal statements. The Japanese government was torn between the questions of whether to follow the leadership of the IMF or whether to give priority to a prompt relief for the East Asian countries hit by the crisis. Internally split, it could not come to a unanimous decision and thus failed to show the leadership that the countries of Southeast Asia had expected (*The Asian Wall Street Journal* 6 November 1997).

After solving the 1995 Mexican financial crisis, a US Senate resolution on financial relief measures imposed severe restrictions on the US administration which had unilaterally intervened. Therefore, the US government feared that in a situation where it could not provide financial assistance itself, a realization of the AMF would lead to a decrease of its leadership in Asia while at the same time an economic bloc in Asia under Japanese leadership could develop. Moreover, from the perspective of the US government that was interested in the promotion of international financial liberalization, there also was the strong suspicion that the financial relief that the AMF was aiming to provide and that was based on looser standards than the IMF loans would increase the moral hazard on the side of the borrower. This could lead to a delay in the recovery from financial crises and at the same time weaken the international financial system under the control of the IMF (*Far Eastern Economic Review* 6 November 1997). Consequently, the US, represented by Finance Minister Robert Rubin and his deputy Lawrence Summers increased their persuasive efforts towards Japan and the Southeast Asian countries in late October 1997. They finally succeeded when an agreement was reached at the Manila meeting to abort the AMF proposal. The Manila Framework aimed at the creation of a mutual regional monitoring body under the leadership of the IMF that should prevent future financial crises. The AMF idea of a monetary fund for crisis relief was aborted, and instead, an agreement was reached to initiate talks about a credit mechanism that should be set up by the IMF in times of crisis.²⁶ This mechanism was accepted at the

²⁶ This mechanism should be a drawdown credit mechanism instead of a standing credit facility which required advance collection of funds from members.

APEC Summit in Vancouver on 24–25 November 1997 as an APEC framework for the recovery from financial crises.

On the other hand, among ASEAN member states, there was initially active support for the AMF idea. This support came from Thailand which distrusted the US government after it did not take part in the August 1997 relief measures of the IMF for Thailand. Support also came from the Philippines which asked for immediate financial relief, and from Malaysia that called for a prohibition of international currency speculation. However, Thailand and the Philippines gave in to US and IMF persuasion and took a position that opposed the AMF as an institution largely independent from the IMF. Moreover, from the beginning of the crisis, Malaysian Prime Minister Mahathir repeatedly criticized international currency speculation and demanded its prohibition. With these statements, he did not only invite criticism from the markets, but it could also be said that his provocations did not only threaten the Malaysian currency, but were also one factor that led directly to the depreciation of the currencies of Thailand, the Philippines, Singapore, and Indonesia. As a consequence, the majority of ASEAN countries decided to follow the Singaporean position to search recovery from the financial crisis through a thorough liberalization of their financial markets under the guidance of the IMF, and Malaysian Prime Minister Mahathir lost a lot of his influence within ASEAN.

Malaysia took part in the relief efforts for Thailand in August 1997 and for Indonesia in October 1997. By doing so, it intended to show that Asia had the power to recover from the Asian financial crisis on its own merits and with the help of regional cooperation. However, one can also argue that this was another strategy to get over the isolation resulting from the weak Japanese leadership role on the one hand and the criticism from fellow ASEAN countries about the public statements Mahathir had made. On the occasion of the G 15 meeting²⁷ that was hosted by Malaysia in November 1997, Prime Minister Mahathir reiterated his demand that regulation about speculation and a new mechanism for international currency stability should be introduced in international financial systems. Mahathir also made a similar proposal at the informal ASEAN Summit Meeting in Kuala Lumpur in December 1997 that was de facto an EAEC Summit. There, he proposed a regional trade plan that should not be settled in US dollars, but in Asian currencies. However, this plan failed to make

²⁷ The G 15 meeting is a brainchild of Malaysian Prime Minister Mahathir. It was established in 1989 as a group of developing countries to counterbalance the G 7. The members of the G 15 are Algeria, Argentina, Brazil, Chile, Egypt, Indonesia, India, Jamaica, Mexico, Nigeria, Peru, Senegal, Venezuela, Zimbabwe, and Kenya that was admitted in November 1997.

enough impact within ASEAN and could not receive active support from the organization.

If we assume that there was an EAEC scenario behind the AMF proposal, the failure of the AMF means that regionalism in East Asia swung again from an East Asian identity as it was contained in the EAEC proposal to an Asia-Pacific identity as promoted by the US and as represented by APEC. Interestingly, Malaysian Prime Minister Mahathir replied to a reporter's question in an interview that he preferred ASEAN cooperation for the solution of the Asian financial crisis to an EAEC framework, because it would not be easy to achieve an understanding among EAEC members as each country had its own stance (*The Star* 14 January 1998). The reality is that any consensus even among ASEAN member countries became difficult to attain. Most ASEAN governments were preoccupied with domestic affairs, and thus the organization was far from considering an Asian solution for the financial crisis or for the prevention of future similar scenarios.

In conclusion, the concept of the EAEC seems to have been most relevant for days of sustained and rapid economic growth in the region. The pendulum of regionalism in Asia is therefore likely to swing back to this idea and to the building of an Asia-only regional identity only when East Asian economies regain their growth momentum which is in turn likely to derive from the ever transforming networks of production blocs. For now, realization of the EAEC is difficult to develop further, and complicated by the continuation of the regional hegemony of the United States and persistent Japanese 'followership' in the region.

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FLIRTING WITH REGIONALISM: JAPAN'S FOREIGN POLICY ELITES AND THE EAST ASIAN ECONOMIC CAUCUS

Verena BLECHINGER

1 INTRODUCTION

Japanese foreign policy decision makers in the 1990s find themselves caught in a dilemma. The question they are struggling with is whether Japan's international relations in the future should continue its postwar foreign policy line and focus on the Japan-US alliance, or whether Japan should re-orient itself toward East Asia and take on a more regionalist perspective.

During the Cold War period, bilateralism characterized Japan's international relations. Primary importance was attributed to the US-Japan alliance, which many considered to be 'the most important relationship in the world' (see for example Tanaka 1999, 6). After the Second World War, Japanese diplomacy oriented itself on the policy line given by the US and rarely stood out with diplomatic initiatives. Blaker (1993) thus suggested that Japanese foreign policy was merely 'coping' with international problems and issues that were created by other countries. Others criticized Japan for being a 'reactive' state in international relations (Calder 1988). Such interpretations, however, are based on a state-centered perspective that tends to neglect the importance of the domestic foundations of foreign policy decision making.

In fact, any understanding of 'regionalism' that goes beyond merely geographic questions must grapple with the question of how actors within states see and view the region in question. It thus makes little sense to examine Japan's shifting regional orientation without taking into account social, economic, and political actors within countries. This is especially true for the post-Cold War period. While domestic interests were previously controlled and often submerged by Cold War policy constraints, today, in an international system no longer shaped by Cold War bipolarity, domestic players are free to pursue their own international agendas, sometimes different from official government policy lines. This paper argues that in evaluating Japanese foreign engagement with East Asia, especially in the highly public debate about the East Asian Economic Cau-

cus (EAEC) in the 1990s, one must pay attention to the domestic politics behind the government's hesitant flirtation with the idea of Asian regionalism.

Two factors can be considered driving forces for a redefinition of Japan's international role. First, with the end of the Cold War, the quality of the Japan-US alliance has changed. Economic tensions between the two countries are no longer buffered by Cold War security concerns, but can be considered a constant and widely discussed feature of Japan's relations with its main ally. On the other hand, regionalism in Asia has expanded and dispersed. This trend was stimulated by European political and economic integration, and by the emergence of other regional (economic) groupings, such as the European Union (EU) or the North American Free Trade Area (NAFTA). It was further energized by longterm high rates of economic growth in East Asia. Continuing from the early 1980s to the late 1990s, the 'economic miracle' in the region consisting of North- and Southeast Asia made many observers proclaim an upcoming 'Asian century'. Even after such enthusiasm died down in the wake of the economic crises that hit East Asia from 1997-99, the idea of regionalism in Asia is still alive and might even have gained in appeal as a possible way to prevent similar events in the future.

Against this background, Japanese politicians, top bureaucrats, business executives, journalists and intellectuals have engaged in a discourse about the future Japanese role in the region. The debate about the East Asian Economic Caucus (EAEC) can be seen as symbolic of this discourse. Originally intended by its initiator, Malaysian Prime Minister Mahathir Mohamad, as the foundation of an East Asian economic bloc, the Caucus is now promoted as an Asian consultative grouping within the Asia-Pacific Cooperation forum (APEC). Although the list of countries named as putative members of the EAEC has changed several times since the proposal was first made, the core members of the grouping remain the same: the ASEAN member states¹, China, South Korea, and Japan. Due to the limitation of EAEC membership to East Asian countries only, the US and other countries in the Asia-Pacific region like Australia and New Zealand vehemently opposed the concept from the beginning (see Hook 1997). With efforts of EAEC supporters to place the grouping into the broader context of APEC and thus to include or at

¹ The Association of Southeast Asian Nations (ASEAN) was formed in 1967 by Singapore, Malaysia, Thailand, Indonesia, and the Philippines. Brunei has been a member of ASEAN since 1984. Vietnam joined in 1995; Myanmar and Laos in 1997, and Cambodia in 1999.

least consider the interests of the non-Asian states in the Asia-Pacific region, such opposition has weakened over the last few years. As a consequence, the grouping gradually emerged and a number of meetings have been held. However, the participating states carefully avoided mentioning the EAEC by name; rather, they referred to their meetings as gatherings of 'ASEAN plus-three' (ASEAN plus China, Japan, and South Korea). Japan, the most advanced economy in East Asia, was asked to join the EAEC and to play a leading role. Japanese government representatives also participated in the *de facto* EAEC meetings mentioned above. However, the official Japanese position on the EAEC did not change much from the cautious and unresolved stance the government took when the proposal was first made. In contrast, the complete spectrum of opinions in Japanese public debate differs considerably from the official policy line of the Japanese government. Individual statements by high-ranking members of the Japanese government bureaucracy and politicians, by researchers, policy consultants, and representatives of the private sector range from outspoken hostility to enthusiastic support.

This paper analyzes the domestic Japanese debate about the EAEC and presents the main positions taken by members of the Japanese foreign policy elite. It will be argued that although official statements about the EAEC have been rather negative or non-committal from the beginning, there are strong tendencies among Japanese political elites that favor a more active role for Japan in Asia and therefore support the EAEC concept. In particular, multinational corporations and associations representing big business, for whom Asian countries are important both as markets and production sites, exert pressure on the Japanese government to pursue a policy of economic integration and regionalism in Asia. Additionally, traditional foreign policy elites are not as united in their positions toward the EAEC as the official Japanese government position might suggest. Many politicians, government bureaucrats and diplomats are attracted by the proposal and support or at least consider a more regionalist approach to Japan's international relations. Although it can not be expected that regionalism will become the prevailing strategy in Japanese foreign policy in the immediate future due to lingering bilateral considerations, some Japanese foreign policy decision makers are now willing to engage in an extended flirt with regionalist ideas and concepts.

2 CLARIFYING REGIONALISM

Before turning to the domestic Japanese debate about the EAEC and the question of how Japanese foreign policy elites address regionalism, it is important to define what is understood by 'region' and 'regionalism' in the context of this paper. The necessity to clarify these core terms for the argument of this paper stems from the fact that there is no common definition of the concept of region in the study of international relations. Most authors describe regions in the context of geographic proximity. However, the reference to the location of a country in a geographically specified area does not yet provide a sufficient means to identify it as being part of a region. Neither are high degrees of political, economic, military or social relations, policy convergence or trade adequate conditions to call a group of countries a region. Those factors can certainly be seen as influences that promote the emergence of a region, however, as long as there is no common perception of 'region', a feeling of 'regional identity', among the people(s) living in an area of geographic proximity, the existence of a region can not be confirmed.

To form a region and to create such a 'regional identity', a conscious decision by the political elites of the countries involved is necessary. In the same way as nations are, according to Benedict Anderson (1991), 'imagined communities', *i.e.* the products of policy choices by national policy decision makers, regions are socially and politically constructed. Higgott (1998, 338) states that 'the yardsticks of "regionness" vary according to the policy issues or questions present and above all by what the dominant actors in a given group of countries at a given time see as their political priorities'. Clearly, political action and also support from all spheres of a society are needed to build a region. Political action in this context firstly means the creation and maintenance of a sense of unity – 'regionness' – between the member states of the region.

The complex of ideas, attitudes, and loyalties that are meant to produce a feeling of shared communality among the people(s) of a putative region is usually referred to as 'regionalism' (see, for example, Evans and Newnham, 1998, 474). Political elites use their public role to create and disseminate conceptions of regionalism in order to influence public perceptions of 'regional affairs' and to increase support for closer cooperation and policy convergence between and among the 'member' states of a region. In this paper, 'political elites' refer not only to politicians and high-ranking bureaucrats, but to all 'holders of strategic positions in powerful organizations and movements, including dissident ones, who are able to affect national political outcomes regularly and significantly' (Dogan and Higley 1998, 15).

While regionalism thus has to be seen as a political concept brought about by political elites with the intention to form a regional identity in the countries involved², this paper uses 'regionalization' to refer to an un-directed economic process driven by actors from the private sector, *e.g.* multinational corporations. This process is rather an accumulation of economic networks, such as in the fields of production or distribution, within or across geographical regions (Higgott 1998, 339), and it is not based upon ideological or strategic motivations. Regionalization is not necessarily linked to government policy, but it can be argued that private sector economic power and regional economic integration can act as driving forces and incentives for governments to take on a more active regional political role. Studies of the European Community (EC), for example, have shown that high economic activity can stimulate further cooperation between the participating states, first on the economic level, but later also in a broader political context. At the same time, regionalization also can affect the policy preferences of domestic actors and thus generate support for further integration (see for example Haas 1958). Milner (1997) has pointed out that pressure from the private sector can influence political leaders who are interested in improving their chances for re-election by serving special interests, *e.g.* of firms and private companies, to favor regionalist projects.

The degree of economic integration in East Asia is, although impeded by national policy considerations and different stages of economic development, already quite high (see, for example, Dobson and Chia 1997; Legewie 1998). At the same time, however, political cooperation on the state level still has yet to gain momentum. This paper addresses the dynamics between political and economic actors on the domestic level in Japan. It is argued that there is a high chance of spillover of regional activity from the economic to the political sector. After a brief overview of the development of the EAEC proposal and the official Japanese government position toward it, we will examine the main positions among Japanese opinion leaders.

² After the end of the Cold War, levels of governance broke down and brought more freedom for domestic players to pursue their own international agendas. Regionalism thus can also involve subnational parts of different states that create a transborder identity not embracing whole countries, but only parts thereof (see, for example, the chapter by Hook in this volume).

3 LET'S GET REGIONAL – THE EAST ASIAN ECONOMIC CAUCUS (EAEC)

The proposal to create a regional economic forum only for East Asian nations was first made by Malaysian Prime Minister Mahathir Mohamad at a dinner in honor of Chinese Prime Minister Li Peng during Li's official visit to Malaysia in December 1990. Originally named the East Asian Economic Group (EAEG), Mahathir intended it to become a regional trade bloc, formed by the member states of the Association of Southeast Asian Nations (ASEAN), the three Indochinese states (and later ASEAN members) Cambodia, Laos and Vietnam, as well as Japan, China, Hong Kong, Taiwan, and South Korea. After concern rose within the Malaysian government that the proposal of a trade bloc might not find support in Asia and could cause international problems, Mahathir restated his plan and proposed the formation of the EAEG as a consultative group (Okita 1993, 56; McDougall 1997, 222). The EAEC concept was then formally proposed at an international conference in Bali in March 1991.

Mahathir's proposal of an exclusively Asian consultative forum stems from both international and domestic motives. First, the EAEG concept can be interpreted as a reaction to economic integration in Europe and North America (*i.e.* the European Community, EC, and the North American Free Trade Agreement, NAFTA). Claiming that these two regions were gaining more influence due to economic integration and the coordination of international trade policies, Mahathir stated that increased cooperation within East Asia would be necessary for the improvement of the region's bargaining position in international trade negotiations. It would furthermore counter the possibility of protectionist actions by European or North American states. At the same time, a regional grouping like the EAEG could serve as a means for Asian countries to jointly address economic and political problems in the region, to enhance trade, and to thus further increase the efficiency of East Asian economies (Okita 1993, 57). Second, the Malaysian government clearly evinced concerns about the APEC process. As it became clear in a 1990 statement by Prime Minister Mahathir, the Malaysian government considered APEC a grouping that was designed to ensure US domination of the region. There were fears in Malaysia, but also in other Asian countries, that APEC might turn into a trade bloc helping the US and Japan to counterbalance the European Union, and that it might overshadow ASEAN (*Far Eastern Economic Review* 18 November 1993, 16–17; *Far Eastern Economic Review* 10 November 1994, 29). Third, the EAEG proposal has to be seen in the context of Mahathir's general criticism of US influence in the region and his calls for a re-orientation toward Asian values and traditions. Since the early 1980s, Mahathir had promoted his concept

of a 'Look East policy' that was oriented on the Japanese model of economic development rather than the West (see also the article by Kimura in this volume). This is also the reason why Mahathir called on Japan to take on a leadership role in the grouping. Finally, a successful initiative for a regional organization in Asia would have raised Mahathir's personal profile as a statesman, thus becoming a valuable asset for the maintenance of domestic support and also for enhancing Malaysia's international position (Hook 1997, 22; *Far Eastern Economic Review* 8 December 1994, 22).

As noted above, the EAEG proposal was part of an ideological concept, pushed forward by Malaysia, to promote an 'East Asian' regional identity in contrast to the 'Asia-Pacific' regional identity favored by the US, for which APEC is the vehicle. Therefore, the US, but also other non-Asian members of APEC, especially Australia, vehemently opposed the EAEG plan. The reasons for this strong resentment on the side of non-Asian APEC members have to be seen as more than the fear of a trade bloc in East Asia that would limit access to Asian economies. Much more important were concerns that such a grouping might undercut efforts, especially by the US and Australia, to enlarge and solidify APEC. The US were also concerned that the EAEG might engage in discussions on regional political or security issues without the US and thus might undermine US claims for a leadership role in the Asia-Pacific region.

EAEG supporters were also confronted with negative reactions from within Asia. In particular the political leadership of Indonesia, traditionally suspicious about policy ideas promoted by erstwhile rival Malaysia, reacted adversely to Mahathir's proposal. There also was a lively debate among Asian countries about the membership in the grouping, with the Chinese government opposing the inclusion of Hong Kong and Taiwan, although it supported the EAEG proposal from the start (*Far Eastern Economic Review* 30 January 1992, 15). To overcome such problems, the ASEAN economic ministers proposed at a meeting in Kuala Lumpur in October 1991 to create an informal East Asian forum within the context of APEC. To stress the consultative and open nature of this organization, the name of this grouping was changed into East Asian Economic Caucus (EAEC). The discussants also postponed an agreement about the membership of the EAEC, to avoid a further delay in the process (*Far Eastern Economic Review* 17 October 1991, 121).

Even after the name change and ASEAN diplomatic efforts to ease US suspicions, US opposition to the plan remained as strong as before. Although not part of the official agenda, the EAEC proposal became a dominant topic at the APEC summit in Seoul in November 1991. Prior to the summit, the US government exerted considerable pressure on both Japan

and South Korea not to join the EAEC. In a letter to then Japanese Minister of Foreign Affairs, Watanabe Michio, US Secretary of State James Baker expressed his concerns that the EAEC could develop into a trade bloc. Baker also pointed out that with the exclusion of the US and Canada, the EAEC 'would divide the Pacific region in half' (*Far Eastern Economic Review* 28 November 1991, 11). He thus made it clear that in the competition between the two concepts of regional integration, the US model of an Asia-Pacific region with APEC at its center, and the Malaysian model of an exclusively East Asian region symbolized by the EAEC, a positive stance toward the EAEC would be considered a choice of sides and have a negative impact on the relationship with the US. To avoid difficulties with its main ally, the Japanese government quickly distanced itself from the EAEC proposal.³ The government of South Korea, which had shown some sympathy for the proposal, also backed down as a consequence of US pressure and expressed its intention not to join the EAEC.

Vehement resistance by the US and Australia, but also the hesitant and sometimes hostile reactions from ASEAN members such as Indonesia stalled the discussions about the EAEC, and the proposal ran the risk of losing momentum. EAEC supporters, especially the government of Malaysia therefore engaged in consensus-building measures in Asia and on the international level. They repeatedly stressed that the council should be created as a conference, not an institutionalized entity, and focused on the informal character of the group (*Japan Times* 23 November 1991; Korhonen 1997, 180). These activities reached their goal in July 1992 when ASEAN heads of state reached a consensus to form a trade caucus with an all-Asian membership.⁴ The question of how this caucus should work in practice, however, was only settled one year later. While Malaysia favored organizing the EAEC as an independent grouping outside of APEC in order to avoid influence from non-Asian APEC members such as the US, Indonesia opposed this concept and insisted on situating the EAEC within the APEC framework. Singapore's Foreign Minister Wong Kan Seng final-

³ For a detailed analysis of the official Japanese government position toward the EAEC, see section 4 of this article.

⁴ One example for the strategies used by EAEC promoters to win ASEAN support for the EAEC proposal can be seen in the references to Laos, Cambodia, Vietnam, and Burma. The strained economic and political situation in these four countries caused a wave of illegal immigrants into ASEAN states and thus created considerable political, social and economic difficulties for ASEAN member states. Malaysian Foreign Minister Abdullah Badawi took advantage of this situation and promoted the EAEC as one possible vehicle for Asian countries to coordinate efforts for economic development in Indochina (*Far Eastern Economic Review* 15 September 1994, 20).

ly proposed a compromise: the ASEAN member states agreed that the EAEC should operate within APEC, but would be driven by the ASEAN economic ministers' meeting (*Far Eastern Economic Review* 5 August 1993, 11).

This new formula made it easier for reluctant putative EAEC members like Japan and South Korea to consider the proposal in more favorable, if still non-committal and cautious, terms. In particular, the agreement to meet informally as an ASEAN plus-three group consisting of the ASEAN member states, China, South Korea, and Japan, helped to finally realize the grouping. Since 1994, delegations of the prospective EAEC members have met annually to hold informal consultations on economic issues, while at the same time evading any references to the EAEC proposal. This twofold strategy of showing loyalty to the APEC process, while at the same time building dialogue and trust in East Asia through informal meetings, helped to ease the concerns of the US and Australia. In May 1995 and March 1996, the two countries, though still critical of the EAEC concept, dropped their opposition toward an East Asian grouping as one of several layers of regional organizations in the Asia-Pacific region (*Japan Times* 22 March 1999).

The EAEC structure was given legitimacy in Bangkok in March 1996 when the heads of state of the ASEAN plus-three countries met the political leaders of the European Union for the first summit level Asia-Europe Meeting (ASEM) (Higgott 1998, 346). Although the participants carefully avoided or even denied parallels between the Asian representatives and the membership of the EAEC, it can be said that at this meeting, the Council was *de facto* installed as an internationally acknowledged East Asian regional grouping. In December 1997, the political leaders of the ASEAN plus-three states met for the first East Asia summit meeting in Kuala Lumpur. Again, all participants took care not to make any statements that could be used to construct a connection to the EAEC (Chongkittavorn 1998, 46; Pempel 1999, 76). Since then, two more summit meetings followed in Hanoi in December 1998 and in Manila in November 1999. While economic issues and especially trade were in the center of the first meetings, for the future, talks on cooperation in the fields of science, technology and culture are also planned (*Japan Times* 22 March 1999).

The compromise to create the EAEC *de facto* without making a commitment to the ideological framework of the grouping certainly has helped to overcome both Asian and Western concerns, especially US opposition, and to get the grouping off the ground. However, if the EAEC is to develop further, this cannot be seen as a permanent solution. Enhanced dialogue and increased cooperation of East Asian countries in economic and other fields, which was agreed upon at the East Asian summit meet-

ing in Hanoi in 1998 and stressed in Manila in 1999, will confront East Asian governments with the necessity to generate domestic support for further grouping. In other words, if these efforts are to be successful, leaders will need to build an ideological basis among their citizens for their political redefinition as 'Asians' rather than as simply 'Japanese', 'Indonesians', 'Malaysians', or 'Chinese'. It will thus be unavoidable for East Asian governments to address regionalism. The 1999 Leaders' Statement of the East Asian Summit Meeting in Manila points to the general direction regionalism in East Asia might take. The statement stresses the intention to promote dialogue and to deepen and consolidate relations between the countries of the region. At the same time, the statement points to the willingness to use increased regional cooperation to 'support and complement' other multilateral fora, such as the UN, APEC, and ASEM. This statement implies, together with references to the 'diversity' of the region, that East Asian regionalism will not take on the exclusive nature of the original EAEG concept. The leaders, however, also paid tribute to an Asian regional identity when they agreed 'to strengthen regional cooperation in projecting an Asian point of view to the rest of the world ... focusing on the strength and virtues of East Asian cultures' (*Japan Times* 29 November 1999).

4 'DELIBERATE AMBIVALENCE' – THE JAPANESE GOVERNMENT AND THE EAEC

The Japanese government's initial reaction to the EAEG proposal by Malaysian Prime Minister Mahathir was unsympathetic. Both Japanese postwar economic development and later economic growth were only possible because of global free trade and access for Japanese products to European and US markets. Therefore, Japanese governments have traditionally been advocates of free trade and opposed to trade blocs in general (see Kōno Yōhei in *Japan Times* 1 January 1992). As the original EAEG concept was aimed at the creation of a trade bloc in Asia, it instantly provoked negative reactions in Japan and was countered by government representatives with strong rhetoric in the defense of free trade.

The Japanese government's initial objection to the proposal was also caused by the awareness of opposition against the EAEC from both the West, especially the US, and ASEAN member states. A statement by Japanese Prime Minister Kaifu to Malaysian Prime Minister Mahathir that Japan would not commit itself before ASEAN had reached a consensus also points to the low chances Japanese government leaders gave the EAEC

proposal (McDougall 1997, 222; *Far Eastern Economic Review* 1 October 1992, 20). Instead of risking a strain to the relationship with Japan's main ally, which was already tense due to trade conflicts at the end of the 1980s, Japanese government representatives continued to speak out in support for APEC. They also clearly signaled to the US and Asian countries that East Asian regionalism was not on the official Japanese government agenda. This could be seen from public statements by MITI officials that Japan had 'a regional policy for Asia but not a policy on regionalism' (*Far Eastern Economic Review* 18 June 1992, 44–8).

The negative position of the Japanese government toward the EAEC seemed to soften a bit after the ASEAN economic ministers agreed to create the East Asian Economic Caucus (EAEC) as an informal East Asian forum within the framework of APEC. Instead of outright opposition, the official Japanese reaction to the EAEC proposal was rather non-committal. This lack of a clear response by the Japanese government was interpreted by some observers as an indicator that Japan, although not in favor of the concept, at least welcomed some of the effects of the EAEC proposal. Especially with regard to international trade and the formation of regional organizations such as the EU and NAFTA; the EAEC concept created 'new leverage vis-a-vis Europe and North America by making the threat of a retaliatory East Asian trade bloc more credible' (*Far Eastern Economic Review* 28 November 1991, 11).

However, even if this interpretation is correct, Japanese government officials were careful to avoid any kind of confrontation with the US, which vehemently opposed the creation of the EAEC and made its adverse feelings clear to its allies. US pressure on Japan not to join the EAEC was intense, as can be seen from Baker's 1991 letter to Watanabe. Japanese government concerns about US opposition to the EAEC proposal and a possible Japanese participation did not stem from simple loyalty to Japan's main ally. The Japanese Ministry of Foreign Affairs (MOFA) also avoided controversial moves in Asia out of strategic considerations. First, Japanese foreign ministry officials were eager to keep the US, where the new Clinton government had displayed a decreasing commitment to the region after the end of the Cold War, politically and militarily involved in East Asia. The reasons for this can be seen both in worries about China's ambitions to become a regional power in Asia and in Japanese hopes that US presence in the region might counterbalance this development. On the other hand, Japanese government officials also were convinced that a continuation of the Japan-US security alliance would ease historically motivated Asian concerns about a resurgence of Japanese power in Asia. It would, in this analysis, be easier for Japan to play an active role with, rather than without, US support. Second, also economic reasons kept Japanese

government officials from actively supporting East Asian regionalism. The US was and still is the most important market for Japan. Although the Japanese trade volume with Asia surpassed trade with the US in the early 1990s, part of the increase in trade between Japan and Asia was caused by the relocation of production facilities from Japan to Asian countries and the related flow of equipment and parts from Japan. A high share of the products made by Japanese companies in Asia, however, is later exported to the US, thus pointing out the continuing importance of the US market for Japan (*Far Eastern Economic Review* 14 January 1993, 11–12; *Far Eastern Economic Review* 16 December 1993, 24; *Far Eastern Economic Review* 9 June 1994, 47).

Japanese Prime Minister Miyazawa therefore avoided the topic of the EAEC during Malaysian Prime Minister Mahathir's visit to Tōkyō in December 1991. He also stressed continuity in Japanese foreign policy rather than change during his official trip to Malaysia in January 1993, implying that no change in the Japanese position toward the EAEC was imminent (*Japan Times* 25 December 1991; *Far Eastern Economic Review* 28 January 1993, 11). After ASEAN agreed to support the creation of the EAEC in 1992 and decided to establish it as a council within APEC in 1993, however, the Japanese government took on a more open stance toward the proposal. In August 1993, Japanese government officials explicitly welcomed the Japanese decision to place the EAEC within the APEC framework (*Far Eastern Economic Review* 5 August 1993, 11). In July 1994, then Minister of Foreign Affairs Kōno stated in an official meeting with the Foreign Ministers of Malaysia, Thailand and the Philippines that Japan was 'not against the EAEC', but that it favored a solution which was acceptable for both ASEAN and the US. He further stressed that Japan would not support any development that could split the Asia-Pacific region, thus alluding to the two competing concepts of regionalism in Asia brought forward by the US and Malaysia, and also to US concerns about the EAEC (*Asahi Shinbun* 27 July 1994).

In late 1993, ASEAN formally approached Japan to join the EAEC. Since then, the Japanese government has postponed a final decision while regularly stating that the proposal was under deliberation. Japanese politicians and government officials have avoided occasions where a commitment to the EAEC might have been demanded. In March 1995, for example, a senior MITI official declared that Japan would not attend a meeting of ASEAN economic ministers if the EAEC was on the agenda (*Daily Yomiuri* 1 April 1995). The extremely careful position of the Japanese government toward the EAEC also became visible when the Ministry of Foreign Affairs made the Japan–Malaysia Association delete the words 'World-Shaking Quiet Revolution EAEC' from the cover page of a

booklet for a symposium about the EAEC organized by the association (*Japan Times* 18 January 1995). Even as late as February 1996, a Ministry of Foreign Affairs (MOFA) spokesman declared at a press conference about the ASEM meeting that it was a mere coincidence that the group's membership was more or less identical to the EAEC conception. He further pointed out that the issue of the EAEC was still 'under study' at the Japanese government and did not provide further comment.⁵ At the same time, Japan has participated in all three informal East Asian summit meetings since 1997 and has even played a major role at these meetings. Japan has also presented several initiatives to promote cooperation and economic growth in the region, including the 1997 initiative to create an Asian Monetary Fund (AMF) to help Asian economies overcome the East Asian economic crisis. This proposal was later aborted due to US opposition. Another example is the so-called 'Obuchi Plan' under which US\$ 500 million shall be extended for the development of human resources and the promotion of exchange programs in the region. It was presented at the informal summit in Manila in November 1999 and was part of a newly declared Japanese policy to play an active role in furthering regional cooperation (*Daily Yomiuri* 29 November 1999).

In sum, the official Japanese position toward the EAEC can be characterized as 'deliberate ambivalence': The Japanese government carefully avoided making ideological commitments to East Asian regionalism out of concerns about possible strains to Japan-US relations. This cautious and non-committal approach certainly delayed the EAEC process. At the same time, however, Japanese government representatives also took part in the *de facto* installation of a regional consultative grouping as a supplement to the APEC process, but without any explicit references to the original proposal. By doing so, the Japanese government showed an interest in cooperation and further integration in East Asia, and it also signaled its willingness to take on an active role in this process. Thus, the Japanese government has managed to practically implement East Asian regionalist concepts without their ideological framework.

The official Japanese government position toward the EAEC and East Asian regionalism is, although important, only one facet of the multi-layered discourse about the future role Japan should play in the region. As noted above, regionalism has to be seen as the result of a process involving not only the state, but all spheres of society. To create a regional identity shared by the people(s) of all member states of a region, support has

⁵ The minutes of this press conference by the Press Secretary of the Ministry of Foreign Affairs on 23 February 1996 were downloaded from www.mofa.go.jp/announce/press/1996/2/223.html.

to be developed at all levels of society and in all member states in the region. The next section of this paper will show that although the official Japanese foreign policy establishment is reluctant to display any sympathy for regionalist ideas, large groups within the political elite are ready to engage in East Asian regionalism or at least to flirt with such concepts. It will become clear from unofficial public statements by bureaucrats, politicians, business representatives and other opinion leaders that Japanese political elites are not as unified in their attitudes as the official government policy line might suggest.

5 DEBATING REGIONALISM: THE DOMESTIC DISCOURSE IN JAPAN ABOUT THE EAEC

After analyzing the official Japanese government approach toward the EAEC proposal and East Asian regionalism, this section will address the positions of Japanese opinion leaders as presented in the public debate in the Japanese media. Statements by politicians, bureaucrats, journalists, intellectuals and business leaders influence public opinion and can thereby take on an important role not only in domestic politics, but also in the setting of new foreign policy agendas.⁶ This argument is based on the assumption that the views presented in public debate are basically consistent with opinions and policy lines proposed by interest groups in informal consultations with the foreign policy establishment.⁷ Political elites use the media to build up public support for their policy goals and to thus strengthen their position in the policy making process. An analysis of public discourse therefore contributes to an understanding of political decision making also in the field of international relations.

With regard to the EAEC and a future role for Japan in Asia, three main opinion groups can be distinguished in Japanese newspapers and journals. In this paper, they are referred to as

- ardent Asianists
- traditional bilateralists
- globalists and ‘honest brokers’

⁶ For details on the role of media in Japanese politics, see for example Krauss (1996).

⁷ For private sector influence on Japanese foreign policy decision making, see also Blechinger (1998).

5.1 Embracing Asia: the ardent Asianists

The most outspoken, widely published and possibly also most noticed group both on the domestic and international level are the 'ardent Asianists'. Their main argument is that Japan is first and foremost an Asian country. The universalism of so-called 'Asian values', which are considered common to all East Asian countries, is stressed, and it is claimed that Japan should re-orient its attention toward Asia and become a true member of an Asian community of nations. Inspired by the 'Look East' policy of Malaysian Prime Minister Mahathir, which promotes the Japanese model of development as an alternative to Western models, opinion leaders sympathetic to this view claim that Japan should be proud of the country's position as a global economic superpower. As a consequence of Japanese success, Japan should take a leading role in Asia and should offer cooperation and support to fellow Asian nations, while at the same time reducing its ties with the US and other Western countries.

In the mid-1990s, the EAEC proposal and its initiator, Malaysian Prime Minister Mahathir Mohamad, received a generous amount of favorable media coverage in Japan. This high level of media attention was caused by the publication of two co-authored books by Mahathir and Japanese writers. One of Mahathir's joint authors was former Member of the Lower House and now Governor of Tōkyō, Ishihara Shintarō, who also is a key representative of the Asianist view in Japan. In the 1980s and early 1990s, he made domestic and international headlines when he published, together with the founder and former chairman of Sony, Morita Akio, a volume entitled 'The Japan that can say NO' (*NO to ieru Nihon*) (Ishihara 1991), which demanded a more assertive Japanese position in trade conflicts between Japan and the US. In an allusion to this publication, the volume he wrote together with Mahathir was entitled *NO to ieru Ajia*, literally translated 'The Asia that can say NO'. The Japanese version was published in 1994 (Mahathir and Ishihara 1994), and the English edition 'The Voice of Asia' came on the market in 1995 (Mahathir and Ishihara 1995). In the volume, both authors engage in harsh criticism toward the West. While the West is described as decadent, aggressive and selfish, Asian societies are portrayed as the exact opposite. For Japan, Ishihara proposes the introduction of a 'New Asian Co-Prosperity Sphere', taking up a concept which Japanese militarist regimes were striving to implement during the Second World War and which should justify Japanese imperialist ambitions in Asia. In contrast, the 'New Asian Co-Prosperity Sphere', according to Ishihara (Mahathir and Ishihara 1995, 141), shall be characterized by Japanese economic leadership and investment, with the Japanese as 'solidary colleagues' of their fellow Asian nations. It can be argued that the author in-

tended the EAEC to become the vehicle for such a new relationship between Japan and East Asia.⁸

Only several weeks after the publication of *NO to ieru Ajia*, another co-authored volume by Mahathir was published. This time, his partner was economist Ohmae Ken'ichi, an author who is well-known in Japan for his works on business strategies as well as on globalization and its effects on politics and the state (see for example Ohmae 1994; Ohmae 1995). In the volume *Ajiajin to Nihonjin* ('The Asians and the Japanese') (Mahathir and Ohmae 1994), both authors argue that Japan should focus on contributing to development in Asia, again appealing to Japan to play a more active role in Asia and to be the leader in East Asian economic development.

One may argue that the publications Malaysian Prime Minister Mahathir launched in Japan at this time were part of his strategy to promote the EAEC and to gain support in the Japanese public. To achieve this aim, he chose two co-authors who were well-known to the Japanese public and who had a reputation of bringing forward unorthodox and often highly disputed arguments. At least in terms of media echo, this strategy worked out well, and one could almost speak of a 'Mahathir boom' in Japan in the mid-1990s (*Far Eastern Economic Review* 24 November 1994, 18). The sympathetic coverage of Mahathir in Japan can be seen, for example, in a very favorable cover story in the well-established weekly magazine *AERA*, which characterized the Malaysian Prime Minister as a pure realist and emphasized his leadership capabilities. This article also presented the EAEC as a pragmatic concept and stressed that it only had a chance to be realized if Japan participated in the Caucus (Mimatsu 1994, 21).

The popularity Mahathir enjoyed in Japan in the mid-1990s also spilled over to the newspaper debate on the EAEC. The prestigious daily *Asahi Shinbun*, for example, printed a number of positive statements about the EAEC proposal in the wake of public attention for Mahathir. Two comments may serve as an illustration. Furukawa Eiichi, a former MOFA bureaucrat with a specialization on Southeast Asia, who is now Director of the Japan International Strategic Center (Nihon Kokusai Senryaku Sentā) was one writer in support of the EAEC. After stressing that the reluctant position of the Japanese government toward the EAEC raised critical voices all over Asia, Furukawa stated that in his eyes, the majority of the

⁸ The same concept was also promoted by his co-author Mahathir. In a speech he delivered in Oita at the 'Kyushu-Asia Local Authority Summit' in October 1994, he stated that in his view, Japan 'owed it' to Asia to join the EAEC. He further suggested that active participation in the EAEC might be a means for Japan to 'make amends' for Japanese wartime atrocities (*Far Eastern Economic Review* 24 November 1994, 18).

Japanese people was in favor of the EAEC. US pressure had to be seen as the only reason for Japan's ambivalent position to the proposal. Furukawa also pointed out that a Japanese 'No' to US pressure about the EAEC would not necessarily bring about friction in Japan-US relations. It would rather help to put Japan-US relations on a 'healthier' basis. US opposition to the EAEC was, in his eyes, merely based on unrealistic assumptions. He appealed to Japan to actively support the EAEC (*Asahi Shinbun* 2 December 1994).

A similar point was made by the political commentator Miyake Watsuke (*Asahi Shinbun* 10 December 1994). He stressed that the passive Japanese official stance toward the EAEC proposal caused disappointment and criticism among Asian countries. Later he pointed out that there was more potential for Japan in stronger ties with Asia than in the continuation of the close relationship with the US. In his opinion, the 21st century would certainly become an 'Asian century'. Therefore, it was high time for Japan to shift the focus of its foreign policy toward Asia. At the same time, he was also advocating a leadership role for Japan in the region and demanded that Japan should, together with China and the US, become one of the main pillars of Asian security in the future. The EAEC would be one vehicle for such a leadership role.

While the positions stated above present a rather exclusivist perspective on Japan-Asia relations, there also are voices in the Asianist camp in Japan that take a more moderate position. While authors like Ishihara call for turning away from the US and 'the West' and emphasize Asia as the core basis for Japan's international relations, the more moderate Asianists rather speak of a shift in attention. They stress the extraordinary position of Japan as the most advanced economy in East Asia and the only Asian member of the G8. Due to this background, Japan is, in their eyes, in an excellent position to bridge the gap between East Asia and 'the West'. This group favors the EAEC and other regional organizations with exclusive East Asian membership as an expression of a new focus in Japan's foreign relations: Asia.

One representative of this approach was also an advisor to Malaysian Prime Minister Mahathir about the EAEC. The late Okita Saburō, former minister of foreign affairs and chairman of the Institute for Domestic and International Policy Studies in Tōkyō defended the EAEC proposal in numerous public statements and stressed the consultative nature of the Caucus (see for example Okita 1993). He also pointed out that the EAEC was meant to counterbalance regional organizations in other areas of the world and was therefore in Asia's (and Japan's) best interest. Okita called on the US to refrain from putting pressure on Japan about the EAEC because the incremental development of the Caucus was in many ways a re-

sponse to concurrent developments in Europe and North America (*Japan Times* 13 November 1991). By arguing in this direction, Okita promoted the EAEC as a purely pragmatic concept and neglected the ideological part of the EAEC proposal. As a friend and advisor to Mahathir, Okita was also named chair of an advisory committee for Mahathir in Japan that was designed to promote the EAEC within the Japanese business community (*Far Eastern Economic Review* 28 November 1991, 11).⁹

Asianist positions can also be found in the Ministry of Foreign Affairs (MOFA). One example is Ogura Kazuo, the former Japanese Ambassador to Vietnam (1994) and Deputy Minister of Foreign Affairs (1995) who currently serves as Japanese Ambassador to South Korea. In a 1993 article for the leading opinion magazine *Chūō Kōron*, entitled 'For the Sake of Reinstating Asia' (*Ajia no fukken no tame ni*) (Ogura 1993), he advocated the adoption of Asian values as a concept not only for Asian countries, but also for the 'West', to solve problems like environmental pollution, the impact of aging societies and human rights violations. This article was not the only publication by Ogura with an Asianist emphasis. He also published a book about cultural friction between East and West (*Tōzai bunka masatsu*) (Ogura 1990), in which he called for more distance in Japan-US relations. MOFA officials up to that time had the reputation domestically and internationally as the pro-US faction in the bureaucracy. Therefore, Ogura's Asianist arguments were met with considerable public interest. He is well known in Japan for his opinion that Japan should depart from its postwar 'America first' policy and redefine itself as an Asian nation. The fact that he made such an impressive career can be interpreted as a signal that there are tendencies within MOFA to strengthen the Ministries' Asian Bureau and to redefine the weight of Asia in Japan's foreign politics.

With the Asian economic crisis of 1997/98, Asianist declarations in Japan decreased considerably in volume and also subtly changed in tone. The idea of a superior value system that guaranteed economic growth had been dealt a severe blow, losing its appeal to the public. But the shock of the crisis, combined with Asian disappointment and dissatisfaction with the efforts of such 'Western' bodies as the International Monetary Fund (IMF), inspired a defensive stance, highlighting the need for Asian nations to circle their wagons and protect themselves from the unfettered liberalism espoused by US and European-led institutions. Ogura Kazuo's pub-

⁹ Further members of this committee were Kurosawa Yoh, President of the Industrial Bank of Japan, Ijiri Kōichirō, Chairman of Mitsui & Co., Anzai Kunio, President of Tōkyō Gas Co., and Saitō Hiroshi of Nippon Steel Corp. For background information about Okita, see also Korhonen (1997, 177–9).

lished opinion once again reflects this new post-recession Asianism. In an article entitled 'Creating a New Asia' (*Atarashii Ajia no sōzō*) (Ogura 1999), he argues that in the wake of the crisis, there is an even stronger need for an Asian identity. The lack of a strong Asian voice in international institutions, the need to check US leadership in the region, and the collapse of Asian self-confidence in the late 1990s become central ideas in his analysis, as Ogura pushes strongly for a reasserted Asian identity. Alluding to the EAEC, he claims that the US should 'stop obstructing Asian attempts to get together and exchange views among themselves' (Ogura 1999, 12). He points out that in the aftermath of the crisis, Asian countries had a responsibility to coordinate their efforts to overcome the problems caused by the crisis and to fight nationalist tendencies that might destabilize the region. The crisis had raised the necessity to invigorate the concept of Asia so that the region would no longer be 'the plaything of Americans, Europeans, and other outsiders' (Ogura 1999, 12). In his view, Japan as the most advanced economy in the region plays a key role in the process of restructuring and reviving Asia. Ogura therefore calls for a re-orientation of Japanese diplomacy to strengthen its Asian strategy.

5.2 *Stand by your ally: The traditional bilateralists*

Where the Asianists demand a complete departure from 'traditional' Japanese foreign policy orientations and the central importance of Japan-US relations, another group of Japanese opinion leaders strongly insists on the continuation of this policy line. This group is represented by MOFA officials like the former Head of the Asia Bureau in the Ministry of Foreign Affairs and Deputy Administrative Vice Minister Ikeda Tadashi and influential academics like the Head of Tōkyō Gaikokugo Daigaku, Nakajima Mineo. With articles and opinion columns in conservative magazines like *Bungei Shunjū* or *This is Yomiuri*, in which they stress the risks of Asianism and the dangers inherent to a departure from established structures of Japanese international relations, the supporters of this view do not make headlines. However, it can be argued that their position is representative of an important faction within the official foreign policy establishment and does still represent the mainstream opinion among MOFA bureaucrats. Their views might also be shared by more decision makers and leading figures in Japanese business and politics than the provocative, but also often unrealistic proposals of the Asianists.

The main line of argument of the opinion leaders who support this position is that Asia as a region is far too diverse for regionalist ideas to work. For these observers, the Asianists' claims are illogical at best, and dangerously specious at worst. The traditional bilateralists thus empha-

size the cultural, ethnic, and religious differences between the various nations in the region, and underline the different levels of economic success and divergent political systems in such countries as China, Japan, and Indonesia. Moreover, they argue, the region is itself embroiled in several territorial disputes, and the uncertain future of China might produce a regional hegemon or a complete internal collapse, with nasty consequences for the region and for world security more generally (Nakajima 1995, Noda 1996).

With these arguments in mind, the traditional bilateralists recommend a continuation of Japanese foreign policy strategies, especially the preservation of the Japan-US alliance and Japanese involvement in multilateral international institutions. Even if these observers suggest that Japan should develop a leadership role within Asia, they strongly reject the notion of 'Asia' as a coherent region with political meaning other than geographical. These authors also reject globalist approaches, because they argue that globalism does not take cultural differences into account. To take on a proactive position in the region and internationally, Japan has to cooperate with and rely on the support of the US (Noda 1995). With relation to the EAEC, the main line of argument is that Japan-US relations are the stabilizing factor in Japan's relations with other countries in Asia-Pacific. The region's economic development is considered largely dependent on US and European markets, and it is stated that Asian nations alone cannot establish a self-sufficient regional framework. In 1992, an advisory committee to then Prime Minister Miyazawa presented a report that was highly critical of the Asianist conception. Chaired by Ishikawa Tadao, then president of Keiō University and a vociferous opponent of the EAEC, the committee argued that any regional economic framework with Japanese cooperation must be open, non-discriminatory, and consistent with the GATT system. It also must not damage the interests of outsiders like the US and Europe. While APEC was therefore considered a valid option for Japanese activities, the EAEC proposal was rejected (*Japan Times* 26 December 1992). A further claim of this group of opinion leaders is that Japan should avoid exclusive regionalism in its economic relations with other Asia-Pacific nations and should therefore refuse to endorse the EAEC. Such an action would only trigger protectionism in North America and Europe (*Japan Times* 1 October 1992). A similar argument was made by Ogawa Gōtarō, then Deputy Director of MOFA's Intelligence and Analysis Bureau. Reflecting US criticism to the EAEC proposal, he stated that his agency was worried that the EAEC could divide APEC: 'Since APEC has become increasingly important for us, we can not make hasty decisions when various views exist among other major members of APEC' (*Japan Times* 18 January 1995).

5.3 Searching for the best of both worlds: globalists and 'honest brokers'

While the two groups presented above represent two clearly defined and contradicting positions in the discourse on the EAEC and the Japanese position toward regionalism in East Asia, the next group to be analyzed here looks for a middle way between the two extremes described above. It represents the mainstream of Japanese opinion leaders from the private sector and also includes bureaucrats both from the diplomatic service and the economic bureaucracy. The prevailing view of the 'globalists and honest brokers', as they are labeled in this paper, is that because of its economic position and related power, it is indispensable for Japan to take on a stronger role in the region. At the same time, it is also important to keep the US interested in Asia. Supporters of this perspective on Japan's international relations claim that a US retreat from Asia would cause considerable political, economic and security problems both for Japan and for the region. The main interest for Japanese diplomacy should therefore be to integrate East Asian regionalism into the existing Japanese foreign policy line. The representatives of this view are close to the traditional bilateralists in their conservative interpretation of the present Japanese foreign policy and also agree with them in their critical view of the risks that the cultural, ethnic, political and economic diversity in Asia may bring about for Japan. Moreover, they stress the special position of Japan between Asia and the West and define a future role of Japan as a mediator or 'honest broker' both within Asia and between Asian nations and other parts of the world. By doing this, from the perspective of this approach, Japan will not only be able to make the best use of its advantageous position of belonging purely neither to the West nor to Asia. By offering itself as a broker, these observers argue, Japan can not only secure its position in the center of future integration processes in Asia and Asia-Pacific, but also influence future developments in a way favorable to Japanese business interests. The EAEC is considered a generally benign concept but in this view, it should only be created in the context of APEC.

It is perhaps no surprise that the basic position of organized Japanese business would be stated most publicly and succinctly by the head of Keidanren (Japan Federation of Economic Organizations), Japan's major business and employer organization. The Chairman of Toyota Motor Corp., Toyoda Shōichirō, served as the Chairman of Keidanren in the mid-1990s, and repeatedly argued that Japanese foreign policy required a balance between the country's relationship with the US, which had to remain its top priority, and a strong and increasing involvement in the economic and political development in Asia. As Toyoda pointed out in an interview with the *Japan Times* on 6 January 1995, he considers it of key importance to

cooperate with the US to further the economic development of the Asia-Pacific region. With regard to the EAEC, Toyoda was keen to remove all suspicions Keidanren would support regional integration excluding the US: 'The US should not worry about such a scheme because it is only a small caucus in APEC and has no decision making power. We have no plans to join forces with other Asian countries to oppose the US in this region'. The key objectives for Japanese foreign policy in Asia, besides a close cooperation with the US, should be Japanese support for the improvement of East Asian economies and the establishment of a horizontal division of labor with Japan. With this in mind, in 1995, Toyoda announced Keidanren missions to various countries in East and Southeast Asia (*Japan Times* 6 January 1995). These missions, together with a series of international conferences organized by Keidanren in Japan, played an important role in Keidanren economic diplomacy in the region in the late 1990s.

The accent on an equally strong Japanese involvement in Asia and other parts of the world as the US and Europe has been stressed repeatedly by Keidanren officials throughout the 1990s. Considering the fact that Keidanren is the largest business organization in Japan and that it represents companies and sectoral business networks of all spheres of the Japanese economy, its even-handedness is unsurprising. Both Toyoda and his predecessor Hiraiwa Gaishi, now Honorary Chairman of Keidanren, frequently pointed out that there was either a tendency in the US to lose its interest in Japan and to turn its activities toward Europe, expressed as 'Japan passing' (Toyoda, *Japan Times* 9 February 1996), or that Japan might be losing its influence in Asia and there might be complaints of Asian countries that 'Japan is no longer part of Asia' (Hiraiwa at the 'Tōkyō Colloquium' on 6 June 1998, *Daily Yomiuri* 10 June 1998). The tentative position Keidanren took – between a focus on the US and Asia – also characterizes the organization's stance vis-a-vis the EAEC. Keidanren officials never spoke out clearly in favor of the Caucus or openly expressed their opposition to the proposal, but always adopted a cautious position. A statement by Katsuhiko Utada, then Vice Chairman of Keidanren, following the policy line of the Japanese government, may serve as an example: 'We have to find out whether creating something other than APEC will offer any favorable effects' (*Japan Times* 18 January 1995).

While Keidanren officials thus reacted rather ambivalently to the EAEC, a large number of its member businesses were clearly in favor of the proposal. This became clear at a luncheon for Japanese top business representatives and former US secretary of state James Baker, hosted by the organization in January 1995. While Baker (author of the angry 1991 letter) explained why the US was opposed to the EAEC, the present business representatives pointed out that in their view, the EAEC in general

was a positive idea and there was no intention to build up an exclusive Asian trade bloc (*Asahi Shinbun* 8 January 1995). The positive attitude of individual businesses became also clear from statements by Keizai Dōyūkai, the Japan Committee for Economic Development. This organization only allows individual membership and thus can act more flexibly than Keidanren which has to consider the diverse interests of all its member associations. It took a more open position toward the EAEC. In a press release in November 1994, the organization stated that it was principally in favor of the EAEC. Even so, as US opposition against the Caucus was so strong, a consensus of all countries in the Asia-Pacific area was a necessary precondition for the realization of the forum (*Asahi Shinbun* 2 November 1994).

The strong support for the EAEC from the Japanese private sector, and especially from big business and the Japanese industry, became obvious from public statements by individual business leaders. Kobayashi Yōtarō, President of Fuji Xerox and Co-Chairman of the US–Japan Business Council until July 1997, for example, proposed the re-Asianization of Japan (as quoted in Kimura 1997, 62). At a seminar sponsored by Keizai Dōyūkai in July 1989 under the motto ‘establishing a national identity and winning the trust and respect of Japan’s Asian neighbors will be the top goals of Japanese business in the next century’ (*Japan Times* 22 July 1989), Kobayashi said that before talking about internationalization, Japan should first clearly identify itself as a member of Asia. At various occasions over the last 10 years, he has repeatedly stressed the need for Japan to engage itself in Asia. He has warned Japanese business representatives not to take on an arrogant stance toward other Asian nations (*Japan Times* 25 March 1997) and advocated the creation of market conditions which facilitate access for Asian companies to the Japanese market (*Japan Times* 25 October 1995). With regard to the EAEC, he pointed out that ‘Japanese business leaders are basically in favor of the Caucus’ (*Japan Times* 15 February 1995) and that this broad stance made it difficult to reach consensus in recent Japan–US business consultations. Interestingly, as Chairmen of the US–Japan Business Council, Kobayashi was busy emphasizing the importance of Japanese–US cooperation in the future. Yet he also made clear that within this cooperation and all talks about future Japan–US relations, Asia had to be a major focus (*Japan Times* 31 July 1997).

Given Kobayashi’s background as a leading figure in the US–Japan Business Council with educational and business experience in the US (Kimura 1997, 63), his rather Asianist perspective seems surprising at first glance. It can be plausibly argued, however, that many Japanese business representatives consider regionalist concepts and ideas as useful tools to counterbalance the US in international trade negotiations.

Such an attitude can be detected in the statement of then Chairman of JETRO (Japan External Trade Organization) and Chairman of Mitsui Bussan Ikegami Kōichirō in 1994. In a press conference on APEC and regional cooperation in Asia, he stated that the EAEC was 'not necessarily what Japan should support', and that Japan should make sure that the US did not get too self-assertive. To give the Japanese position vis-à-vis the US some more leverage, the EAEC might be a good vehicle (*Asahi Shinbun* 9 December 1994).

Representatives of the 'globalists and honest brokers' can be found not only in business. There are also numerous unofficial statements by high ranking bureaucrats that favor an integrated approach for Japanese foreign policy between Asia and the US. One example is Okamoto Yukio, the former head of the first US division in MOFA. In an article in the *Asahi Shinbun* (23 December 1994), he stressed that after the end of the Cold War, it was time for Japan to think about an independent foreign policy line. While cooperation with the US, especially in terms of the Japan-US security cooperation, was still vital for Japan, in relations with Asia, a more independent policy line should be created. As long as there was a basic common understanding with the US, Okamoto supported the creation of the EAEC and an active role for Japan within it.

Another supporter of the EAEC concept who at the same time called for a continued close cooperation with the US is former senior financial bureaucrat Oba Tomomitsu. Facing regionalism in other world regions, he perceived an 'urgent need' for strengthened economic cooperation in Asia, especially with regard to capital markets. At the same time, however, he pointed out the importance of the APEC process which should be continued. Oba made this statement at the 1991 annual meeting of the Japan Bankers' Association, in which Japanese bankers have considerable influence (*Far Eastern Economic Review* 19 December 1991, 15).

6 CONCLUSION

What conclusions can be drawn from the public debate about the EAEC and the Japanese position toward regionalism in Asia? First, it has become clear that there is considerable support from Japanese opinion leaders for a 'middle way' for Japan that includes both the continuation of the close relationship with the US and a stronger integration of the country with Asia. Both government officials and Japanese business representatives are keen to preserve close relations and trust both with Asia and the US. Given the fact that the Japanese economy strongly relies on exports and has important interests in Asia and the US, it may be argued that the main-

stream opinion in the Japanese domestic discourse rather supports an Asia-Pacific identity as compared to an Asian identity. Considering the current state of regional integration and security cooperation in Asia, there are no dramatic changes to expect in the near future.

Second, however, we also see a growing interest among Japanese foreign policy decision makers in Asia and there is a readiness to take on a leadership role in the region. This is especially true for business representatives. While many MOFA bureaucrats and veteran LDP politicians like former Prime Minister Miyazawa emphasize the importance of Japan-US relations and the need for continuity in Japanese foreign politics, business representatives and a considerable number of bureaucrats are willing to bring Asia more into focus. This development could bring about a reassessment of priorities in Japanese international relations.

Third, with the end of the Cold War and the relative clarity of its attendant security issues, Japanese foreign policy decision making is becoming more pluralistic, with an increasing number of actors taking the opportunity to pursue their own foreign policy agendas and to influence government decision making on Japan's appropriate strategies (Blechninger 1998). Japanese big business has to be expected to be more active in Japan's international relations in the future. Multinational corporations have long been playing an important role in Asia. One may argue that these interest groups will engage in the promotion of a stronger political role of Japan in the region as well. The Japanese business community has already created a wide network of contacts and information gathering facilities all over Asia, for example think tanks run by private companies or business associations, which help developing policy ideas and initiatives. Japanese multinational corporations do not only have longterm experience in relations with governments in Asia, they also dispose of enough economic potential to make their interests count in political decision making processes.

Fourth, the East Asian economic crisis has not terminated East Asian regionalism. Rather, the impact of economic turbulence on individual economies and the awareness how intertwined Asian economies have become, have changed the wish for further integration into a necessity to prevent similar events in the future. Programs like the ASEAN Vision 2000 of 1998, but also declarations like the Leaders' Statement of the 3rd ASEAN Informal Summit of 1999 point to a common aim to deepen East Asian economic and political integration. With the *de facto* creation of the EAEC as 'ASEAN plus-three', at a very informal level, the first organizational efforts have been made. It can be argued that further cooperation and integration also will contribute to the formation of a regional identity and thus invigorate East Asian regionalism.

Fifth, Japan will actively participate and play a leading role in this process. One example for the willingness to assist East Asian recovery is the 1997 Japanese proposal to create an Asian Monetary Fund (AMF) to offer immediate financial support to crisis-hit East Asian economies and to stabilize regional financial systems in the long run. Although this concept was aborted due to US objections, the idea still lives on in the Miyazawa Plan of 1998 and in the creation of local funds to help restart private capital flows into Southeast Asian countries as for example the 1999 Thailand Recovery Fund (TRF). Such initiatives will bring about a stronger Japanese commitment to the region. Japanese companies that have invested in the region will also profit from such programs. Business pressure to continue this kind of assistance and support is likely to persist. With increasing economic involvement in East Asia and the need to preserve and improve existing structures, a spillover from the economic to the political level has to be expected. East Asian regionalism and Japanese leadership will spread faster than standard state-centered analyses of international relations would lead us to expect.

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THE JAPANESE ROLE IN THE EMERGING ASIA-PACIFIC ORDER: A ROLE FOR STATE AND NON-STATE ACTORS?

Glenn D. Hook

1 INTRODUCTION¹

A striking feature of the nascent post-Cold War order in Asia-Pacific is the emergence of new regionalist, subregionalist and microregionalist projects in the context of ongoing globalization and regionalization processes. In this paper, we will address the ways in which, in the wake of the Cold War's ending, the Japanese state and non-state actors are giving shape to the emerging order in Asia-Pacific on different spatial scales. Whether we take the regional scale of Asia-Pacific, the subregional scale of East Asia, or the microregional scale of the Japan Sea Rim Zone, we find the state and a range of non-state actors playing a role in reconfiguring these spatial orders through their political, economic, security and cultural activities. This is evidenced by the government's promotion of dialogue on regional security through the Association of Southeast Asian Nations (ASEAN) Regional Forum (ARF) and dialogue on the regional economy through the Asia-Pacific Economic Cooperation (APEC); in responding to the Malaysian proposal to establish the subregional grouping of East Asian states, the East Asian Economic Caucus (EAEC); and in the initiatives taken by prefectures and cities to establish microregional, cross-border zones of cooperation, as in the case of the Japan Sea Rim Zone. In this way, post-Cold War regionalist projects are being pursued on different spatial scales, embrace a wide range of issue areas, involve an array of actors, and vary greatly in their degree of institutionalization (Hook and Kearns 1999). What is more, post-Cold War regionalism is often contested, as with APEC and EAEC, which represent quintessentially an ideological struggle to construct a regional versus a subregional identity as the core of the emerging order, with the United States now taking the lead in promoting an 'Asia-Pacific' order, and Malaysia seeking to promote an 'East Asian' order (Hook 1999). In terms of identity, these states can be said to be seeking to reproduce the 'imagined community' (Anderson 1991) at the heart of the nation-state at the regional and subregional lev-

¹ In carrying out this research the author is grateful for the award of a Research Fellowship from the Leverhulme Trust.

els, which is thereby generating overlapping, patchwork regionalisms on different spatial scales.

The difference between regionalism and regionalization is here crucial. We draw a distinction between regionalism and subregionalism as ideological projects, on the one hand, and regionalization and subregionalization as processes, on the other. The former are driven forward by actors, such as states, which are strategically motivated to construct a 'region' or 'subregion'. These regionalist projects differ from regionalization processes, which are driven forward by actors, such as corporations, which do not necessarily harbour such strategic motivations. More specifically, regionalism is rooted in strategic motivations to promote a regional identity, ideology, and order, whereas regionalization is a non-motivational process emerging out of economic and social activities. The link between the two is political: regionalization processes provide the economic and cultural ingredients for the ideological construction of regional and subregional identities. The complex overlapping of regionalist projects and regionalization processes is central to the statist attempts to construct 'Asia-Pacific' and 'East Asian' identities and orders. For these are two rival projects seeking to impute space with different identities in the wake of the ending of the Cold War and the search for new regional and subregional orders. However, it has been the activities of corporations in particular that have created the regionalization processes at the heart of the attempt to impute space with trade and investment data as sources for a new 'Asia-Pacific' identity, linking the Pacific with Asia, contrasted with a more circumscribed 'East Asian' identity rooted in both economics and culture. In this we can see the need to examine the role of the state as well as the market in shaping the emerging regional and subregional orders.

By paying attention to both the state and the market we are drawing on certain insights from two of the dominant approaches to the study of international relations, namely realism or the more contemporary variant, neo-realism (e.g. Morgenthau 1978; Waltz 1979), and liberal or neo-liberal institutionalism (e.g. Keohane 1984; Baldwin 1993). The realist's focus on the state and its material capabilities alerts us to the continuing importance of these features of international relations, whereas the institutionalist's interest in the way economic actors strengthen the potential for regional cooperation highlights the need to analyze actors other than the state in our examination of the Japanese role in the emerging Asia-Pacific order. At the same time, however, our reference above to the role of the soft aspects of power, such as ideology and identity, and the emergence of multi-layered regionalism on different spatial scales, involving a plurality of actors going beyond the state and the market to include sub-state po-

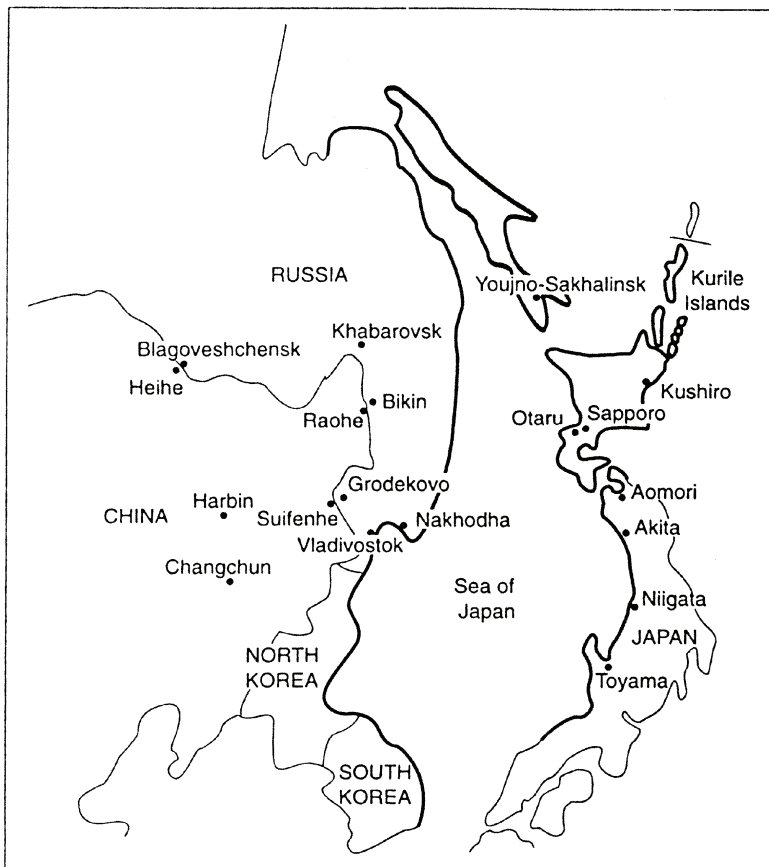
litical authorities, suggests we should not be restricted solely to drawing on the insights of these two approaches.

Thus, in order to illuminate the complex and overlapping layers of activities carried out on different spatial scales by a range of Japanese actors, we will also pay attention to the role of 'soft power', ideology and identity (see Cox 1996; Checkel 1998), as well as to the international role of sub-state political authorities (see Alger 1990). In particular, in the final section we will turn our attention to the least studied scale of regional activity, microregionalism, in order to elucidate how the Japan Sea coastal prefectures and cities of the archipelago are seeking to give life to a microregional project by linking together sub-national parts of North East Asia, with the microregion embracing areas of Japan, the Russian Far East, North East China, South Korea, and North Korea (see map below). Although the idea for this project dates back to the 1960s, as during the Cold War the bilateralism at the heart of Japanese security policy directed attention towards the Pacific, links across the Japan Sea were severely constrained, for any attempt to cross the sea, either physically or ideologically, could have been tarred with the red brush of communism. With the ending of the Cold War the 'frozen sea' now is being transformed into a pacific link between Japan and other parts of North East Asia, with sister-city agreements, business activities, and cultural exchange centring on the Japan Sea helping to give shape to the new regional order. In this respect, sub-state political authorities, non-governmental organizations (NGOs) and other actors in civil society, not just the state and corporations, can be seen to be playing a role in the emerging Asia-Pacific order, further 'de-statizing' international activities.

2 THE BILATERAL COLD WAR SECURITY ORDER

These regional, subregional and microregional projects nevertheless are taking shape within the constraints imposed by the structural and ideological legacies of the Asia-Pacific security order established by the United States during the Cold War. It is true that, in comparison with Europe, the structural legacies of the Cold War can still be identified in East Asia, as in the division of the Korean peninsula and in the survival of the communist political regimes in China and Vietnam. Still, the military confrontation on the peninsula is not now so much a part of the Cold War regional confrontation as a reflection of North Korea's military isolation, and both the Chinese and Vietnamese regimes are pressing forward with economic liberalization and the introduction of the market economy. While this legacy continues to influence the shape of the Asia-Pacific order, the legacy of the

The Sea of Japan Zone



Source: Postel-Vinay (1996, p. 491).

military confrontation between the East and West, which centred on the anti-communist bilateral security treaty system set in place by the US in the early post-war years, exerts a more profound structural and ideological constraint on Japan's role in the emerging Asia-Pacific order. This 'hubs and spokes' security system, which firmly ties East Asian allies to the United States, served structurally to divide the region along the Pacific fault line. What this means is that, in contrast to Europe, security issues in East Asia have been understood primarily through the ideological prism of bilateralism centring on the United States, rather than regionalism (on bilateralism,

see Hook 1996a). Thus no multilateral alliance system along the lines of the North Atlantic Treaty Organization (NATO) sank firm roots in East Asia. The most well-known attempt to embrace some of the East Asian nations in a regionally based multilateral security framework, the Southeast Asia Treaty Organization (SEATO), ended in failure (on SEATO, see Buszynski 1983).² In essence, until the end of the Cold War, regionalism was suffocated under the overpowering ideological weight of bilateralism.

For the Japanese government, at the heart of bilateralism was a conception of security drawn from both the regional and global strategies of the United States. More specifically, the Cold War division of the world into 'two worlds', capitalism and communism, entangled Japan in a definition of the regional security order emanating from outside of the East Asian subregion. The role of Japan in shaping the Asia-Pacific order was thus as a supporter of the US's global and regional strategies through commitments under the US–Japan security treaty system as an 'Asia-Pacific', rather than an 'East Asian', power (on US–Japan security relations, see Funabashi 1997; Fujimoto and Akiyama 1998). This commitment was evidenced ideologically in the promotion of an 'Asia-Pacific' identity and functionally in the dual role of the archipelago as a global as well as a regional launch platform for the United States in the event of nuclear or conventional confrontations. It was essential in the emerging Cold War confrontation with the Soviet Union for the United States to secure bases in Japan in order to prosecute and prepare for both these kinds of wars. This was achieved by the signing of the US–Japan Security Treaty in 1951, its renewal in 1960, and the location of the vast majority of US bases outside the main Japanese islands in Okinawa (on Okinawa's role, see THMSK 1997). The return of Okinawa to Japan in 1972 probably means that nuclear weapons no longer are stored in the archipelago, but part of the government's three non-nuclear principles of not to produce, possess or introduce nuclear weapons into Japan has been broken as a consequence of port calls made by nuclear-loaded US naval vessels (for details, see Hook 1996b, 45–73). At the same time, the use of these bases during the Korean War, the Vietnam War and the Gulf War highlights the pivotal role of Japan in conventional wars fought by the United States both inside and outside of the region. In this way, the security treaty with Japan has been at the heart of the US's pursuit of both its regional and global interests.

² The Southeast Asian Treaty Organization (SEATO) was a 1954 US attempt to graft Pakistan onto a pro-American 'Southeast' Asian military organization composed additionally of Cambodia, Laos, the Philippines, Thailand, and South Vietnam.

In the Cold-War environment, regional security regimes, regional security initiatives, and even regional security dialogue were unable to emerge from beneath the shadow of bilateralism. Regionalism implies multilateralism, which was interpreted both inside as well as outside of the region as a challenge to the bilateralism at the heart of the alliance structure linking Japan to the Pacific, both structurally and ideologically. Thus, attempts to promote regional or multilateral dialogue on security, as seen in President Mikhail Gorbachev's 1986 Vladivostok proposal, were interpreted by the Japanese policy-making elite as a means for the Soviets to erode the bilateral alliance structure, rather than as a genuine way to promote a multilateral security framework, nuclear-free zones, or security dialogue across the ideological divide (for Gorbachev's speech, see Gorbachev 1986). Even attempts by the capitalist authoritarian regimes of East Asia to promote multilateral initiatives on security, as in ASEAN's proposal to create a nuclear-weapons free zone, were resisted by Japan. The realization of this initiative had to wait until after the end of the Cold War, in December 1995, when the ASEAN heads of government and others signed a treaty to prohibit the production, storage, and testing of nuclear weapons.³

These structural and ideological constraints on regional security cooperation were reinforced by the legacy of the earlier attempt of the Empire of Japan to restructure the regional order through imperial expansion and violence. For East Asian policy-makers, the reluctance of post-war governments to accept squarely responsibility for the war, not to mention the predilection of leading members of the Liberal-Democratic Party (LDP) to legitimize the empire's aggression and imperialism (for details, see Wakamiya 1995; Habōhō Kenkyūkai 1995), raised fears over the possible recrudescence of militarism and a new drive to create a contemporary version of the Greater East Asia Co-Prosperty Sphere. In this context, 'security cooperation' in East Asia could possibly provide the former empire with the opportunity to dominate the subregion again. Finally, Japanese policy makers would often trot out the sheer 'diversity' of East Asia, as seen in the differences in political systems, level of economic development, culture, civilization, and so on, as an impediment to the promotion of even

³ The Southeast Asian Nuclear Weapon-free Zone (SEANWFZ or Bangkok Treaty) has been promoted by the Association of Southeast Asian Nations (ASEAN) since the 1970s, as a part of ASEAN's proposal to establish a Zone of Peace, Freedom and Neutrality (ZOPFAN). The Bangkok Treaty was signed in December 1995 by the ten countries making up the zone – Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam – and came into force in March 1997. For further details, see www.ask.or.jp/~hankaku/english/McCoy.html.

dialogue on regional security. Whatever the constraining influence of 'diversity' may have been, however, it is precisely in this 'diverse' East Asia that security dialogue has come to life in the post-Cold War years.

3 POST-COLD WAR REGIONAL SECURITY

The reason is related to the Japanese response to the ending of the Cold War. It emerged gradually as a rethinking of security policy, despite an ideological resistance to the new thinking required by the Cold War's end. By 1993–94 policy makers had gradually come to accept that the global Cold War had indeed ended and that this called for the replacement of the 1976 Defence Outline with a new Outline (for details of the Outlines, see *Bōei Handobukku* 1997, 17–36). What is important to note about the new 1995 Outline, however, is the way the old Cold War structures and ideology continue to constrain thinking. For although the likelihood of war is seen to have been lessened as a result of the Cold War's ending, the Outline also recognizes the need to maintain the US–Japan security treaty system as regional instability can still pose a threat to Japan. In other words, although the US–Japan Security Treaty is rooted firmly in the Cold War confrontation between the 'two worlds' and the perceived threat from the Soviet Union, the Cold War's ending and the fading of the Soviet threat did not lead to the abandonment of the treaty; in fact, the security treaty system has been strengthened. In this we can see the continuing ideological influence of bilateralism on the policy-making elite in Japan.

What this means is that, instead of the rethinking of Japanese security policy taking place outside of the constraints imposed by the structural and ideological straightjacket of bilateralism, the security treaty system at its heart was accepted as the premise of, not a part of, that rethinking (for an attempt at 'new thinking' on Japanese security, see Kyōdō Teigen 1994). Given that, it is hardly surprising to now find the 'Chinese threat' appearing as a replacement for the 'Soviet threat', as an external threat serves forcefully to legitimize the continuation of the security treaty (on China as a threat, see Hasegawa and Nakajima 1997; *Far Eastern Economic Review* 1 July 1999, 21). Still, given the Chinese concern over the possible recrudescence of Japanese militarism, as surfaced during the 1998 visit to Tōkyō by President Jiang Zemin, the government has been reluctant to openly target China and has issued denials of regarding its giant neighbour as a threat (*Far Eastern Economic Review* 10 December 1998, 21). In this situation, China's decision to lob missiles across the straits just before the March 1996 presidential election in Taiwan, the testing of nuclear weapons, and the recent deployment of missiles targeting Taiwan (*Financial*

Times 11 February 1999), have provided needed ammunition for those in Japan seeking to promote the 'Chinese threat'. In this way, Japan's giant neighbour has begun to appear as the threat at the base of the US-Japan security treaty system, with the 'North Korean nuclear threat' and 'regional instability' providing additional grist for the bilateralist's mill.

The strengthening of the US-Japan security treaty system has been pushed forward through the April 1996 'reaffirmation' (redefinition) of the treaty and the September 1997 revision of the US-Japan Guidelines for Defence Cooperation. The security architecture being put in place is part and parcel of the US's attempt to play a pivotal role in shaping the emerging Asia-Pacific order. The US-Japan joint declaration redefining the treaty sought to ensure Japan remained firmly tied to bilateralism centring on the Pacific by expanding the scope of the treaty beyond the 'Far East' (Article IV of 1960 treaty), thereby redefining the treaty as an 'Asia-Pacific' security treaty. For instance, the joint declaration makes no reference to the 'Far East', but refers instead to 'Asia-Pacific' a dozen times (Japan-US Joint Declaration on Security 1996). Of course, the geographical extent of 'Asia-Pacific' is more to do with politics than geography, as became clear over the years through the government's flexible and expanding interpretation of the scope of the original 'Far East', but the treaty can now be said to cover as far as the Middle East, the Malacca Straits, and other areas of significance to Japanese security (*Yomiuri Shinbun* 18 May 1996). In this way, even after the end of the Cold War, the US-Japan security treaty system and the ideology of bilateralism remain central to Japan's own role in the emerging Asia-Pacific order.

The redefinition of the security treaty is taking on particular significance in the context of the agreement between Japan and the United States to revise the Guidelines on Defence Cooperation adopted in 1978 (on the revision, see *Gunshuku Mondai Shiryō* 1996, Yamauchi 1999). The various legislative measures required in order to implement the new Guidelines were brought before the Diet in early 1999. In general, the new Guidelines aim to bolster the alliance relationship between the two Pacific powers by integrating Japan more fully into America's war preparations and possible war fighting in Asia-Pacific (For a discussion, see Yamauchi 1999). Despite denials by then Prime Minister Hashimoto Ryūtarō, the reference made to US-Japan cooperation in meeting 'situations in areas surrounding Japan' has fueled Chinese suspicions of Japanese cooperation with the United States in any conflict over the Taiwan problem (on this expression, see Maeda and Henmi 1998). In this way, the 'Chinese threat', on the one hand, and the 'security treaty threat', on the other, are surfacing at the centre of the competitive attempts to reshape the Asia-Pacific security order in the post-Cold War era.

At the same time, however, Japanese policy makers are supplementing bilateralism with a multilateral approach to security, as seen in the promotion of multilateral dialogue on regional security through the ASEAN Regional Forum, and the promotion of economic dialogue through APEC. This highlights the complex and overlapping nature of the emerging order in Asia-Pacific, where traditional statist concerns with security through military might, alliances, and the balance of power are being complemented by multilateral initiatives involving politics, economics as well as security.

3.1 The ASEAN Regional Forum

The ARF came into being following Foreign Minister Nakayama Tarō's proposal to create a forum to discuss regional security at the ASEAN Post Ministerial Conference in 1991 (for details on Japan's role, see Kawasaki 1997). This took on life in 1993 when the ASEAN Ministerial Meeting and the ASEAN Post Ministerial Conference agreed to set up the ARF, which held its inaugural working session in Bangkok in July 1994. The Japanese government has played a key role in both establishing and promoting the ARF but, as the name implies, even though Japan pushed the initiative at the outset, ASEAN now plays the central role in setting the framework for security dialogue, with one of the ASEAN nations hosting the annual meeting of the ARF. The initial meeting in July 1994 was the first region-wide dialogue on security to be held including the nuclear powers, USA, China, Russia, as well as Japan and the European Union (EU), with a total of eighteen participants at the first meeting.⁴ In 1995 Cambodia, and in 1996 Myanmar and India, joined, bringing the membership to twenty-one. The fifth meeting of the ARF held in Manila in July 1998 was dominated by discussions of the India and Pakistan nuclear tests and the 1997 East Asian financial crisis. In this way, the ARF confirmed the importance of both financial and military security for peace and order in Asia-Pacific.

During the past five years the ARF has emerged as the major forum for multilateral security dialogue in the region. In order to clarify the ARF's regional boundaries, the 1996 meeting introduced the idea of the ARF's 'geographical footprint' of the region, although this does not preclude

⁴ The eighteen members at the first meeting in 1994 were the six ASEAN members (Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand); ASEAN's seven dialogue partners (Australia, Canada, the European Union, Japan, New Zealand, South Korea, and the United States); two consultative partners (China and Russia); and three observers (Vietnam, Laos, and Papua New Guinea). New ASEAN members automatically become members of the ARF.

membership from states outside of this 'footprint'. As the Chairman's Statement declares, the ARF's "geographical footprint" will cover all of East Asia, both Northeast and Southeast Asia, as well as Oceania', with the key criterion for membership being that only participants 'that directly affect the peace and security of the region are admitted' (Chairman's Statement Third ARF, Jakarta 23 July 1996). In other words, although the 'geographical footprint' of the region is East Asia and Oceania, the Pacific power, the US, the South Asian power, India, and the EU are accepted as members due to their impact on Asia-Pacific security.

Thus, as the United States is a member of the ARF, the bilateralism at the core of Japanese security policy during the Cold War era can be sustained within a multilateral, regional forum in the post-Cold War era. From this perspective, the Japanese concern over East Asian regionalism splitting the two wings of the Pacific, as evidenced in the government's resistance to fully supporting Malaysia's proposal to establish the EAEC (Hook 1999), has not arisen in the 'Asia-Pacific' context of the ARF. Rather, the forum functions as a supplement to the bilateralism at the heart of Japanese security policy (Hook 1998). From this perspective, the ARF can be regarded as a platform from which Japanese policy makers are able to launch an attack on any East Asian concerns that taking on a greater security burden under the revised Guidelines will lead to a revival of militarism.

At the same time, the ARF can serve as a platform for promoting a range of Confidence-Building Measures (CBMs) in the region, which can work to reduce the distrust of Japan as well as to promote the nation's security interests. For instance, the ARF seeks to promote transparency amongst the members, with Japan pushing for them to make available information on defence and security policies, albeit on a voluntary basis, and to participate in the UN Conventional Arms Register, again on a voluntary basis. In line with the ARF's agreement in 1995 to take a gradualist approach to security issues, moreover, the forum aims to move gradually from CBMs to preventive diplomacy to conflict resolution. Security dialogue is seen as part of confidence building, with the 1995 meeting taking up concrete security issues, such as the question of sovereignty over territory in the South China Sea. Finally, Japan has played the lead role in calling for a ban on anti-personnel mines, the clearing of laid mines, and cooperation amongst ARF members to train personnel in mine-clearing.

In addition to the annual meetings of the ARF, from 1995 onwards a number of intersessional meetings have been organized in order to deal concretely with a variety of regional security issues. The Workshop Series on Managing Potential Conflicts in the South China Sea, the Intersessional Support Group on Confidence Building Measures, the Intersessional

Meeting on Peace-Keeping Operations, and the Intersessional meeting on Search and Rescue Cooperation and Coordination were all held during 1996. These meetings are co-chaired by one non-ASEAN member as well as an ASEAN member and are not necessarily convened in an ASEAN country. In the case of CBMs, for instance, the intersessional meeting was held in Tōkyō in January 1996 under the co-chair of Japan and Indonesia. This was the first time for officials from both the Ministry of Foreign Affairs and the Defence Agency to take part in such a meeting. In line with the co-sponsorship of the meeting on CBMs, the second meeting was held in Jakarta in April 1996.

The third 1996 ARF meeting in Jakarta is important in pointing to the way the 'Pacific' side of the security equation is being addressed through the ARF process, as issues taken up are not limited to the military definition of security at the heart of Cold War security concerns. As the Chairman's Statement proposes, the 1997 meeting will take up 'drug trafficking and other related transnational issues such as economic crimes, including money laundering, which could constitute threats to the countries of the region' (Chairman's Statement 1996, 9). The role of Myanmar and other states in the region as the source of drugs to the US market links the American concern with the supply-side of the drug problem, as seen in the case of Latin America, with the widening conception of security in the post-Cold War era. With Myanmar accepted as a member of the ARF in 1996, and the East Asian states less concerned with the drugs problem than the United States, which has maintained a 'war on drugs' from the early 1980s, the security agenda in East Asia is clearly being influenced by the security agenda of the United States. In this sense, the link between the Pacific and East Asian security agendas, which during the Cold War era focused on the communist threat, is being reestablished by the addition of the drug and economic crime issues of growing concern to the United States in the post-Cold War era.

3.2 APEC and the East Asian financial crisis

The ARF as a multilateral forum for addressing security issues in Asia-Pacific is playing a complementary role to APEC as the main forum for addressing economic issues, with both playing a role in shaping the emerging Asia-Pacific order (on APEC's wider role in the emerging Asia-Pacific order, see Kikuchi 1995). In comparison with the ARF, the APEC has established a greater institutional presence, especially after the upgrading of the APEC meetings to involve the political leaders of the members (despite problems over Taiwan's representation), as seen from the 1993 APEC meeting in Blake Island, USA. Despite resistance, the APEC has

emerged gradually as a tool for the US to promote the neo-liberal, free-market ideology at the economic heart of its conception of the Asia-Pacific regional and global orders. This is manifest in the attempts being made to liberalize the multilateral trading system, as seen in the proposals to bring down barriers to trade and investment in East Asia, and the promotion of the free flow of capital. The 1995 Ōsaka Action Agenda, for instance, seeks to address 'all impediments to achieving the long-term goal of free and open trade and investment' (Ōsaka Action Agenda 1995, 1). At times, this neo-liberal, globalist project promoted by the United States has met resistance in East Asia. At the 1998 APEC meeting in Kuala Lumpur, for instance, Japan refused to bow to calls to liberalize forest products and fisheries. Of course, domestic political factors help to explain this resistance, as the LDP is reluctant to erode its political base of support by opening these markets. In the wake of the 1997 East Asian financial crisis, however, the deep-rooted nature of the resistance to the neo-liberalist project has become much more salient.

Indeed, the divergent responses of Japan and the United States to the crisis are central to understanding the inchoate, yet emerging contest over reshaping the Asia-Pacific order at the heart of the powerful neo-liberal, APEC project and the much weaker developmental state, EAEC project. It is illustrated specifically by the Japanese response to the crisis, the contrastive views of Japan and the United States over the International Monetary Fund's (IMF) role in the crisis, the evaluation of Malaysia's imposition of capital controls, and the role of IMF conditionalities. Starkly put, whereas the US sought to orchestrate all rescue efforts internationally through the IMF without putting much of its own money up front, Japan sought to orchestrate them regionally by establishing an Asian Monetary Fund (AMF) and contributing both internationally to the IMF and bilaterally to the affected countries, the latter most lately as part of a 30-billion-dollars package under the Miyazawa Plan (on the Miyazawa Plan, see Montagu-Pollock 1999). Whereas US Treasury secretary, Robert Rubin, has praised the role of the IMF (*International Herald Tribune*, 6–7 February 1999), Japanese Minister of Finance, Miyazawa Ki-ichi, has criticized it (see Miyazawa 1998). Whereas Vice-President Al Gore lambasted Prime Minister Mahathir of Malaysia for his betrayal of the neo-liberal cause at the November 1998 APEC meeting (Gore 1998), Prime Minister Ōbuchi Keizō in December 1998 offered him 1.5 billion dollars of financial assistance as part of the Miyazawa Plan, despite the imposition of capital controls. Whereas the neo-liberal conditionalities imposed on the financial assistance offered to Thailand, Indonesia, and South Korea, to which Malaysia balked, were supported by the US (on the ideological role of IMF conditionalities, see Feldstein 1998), the bi-

lateral financial assistance offered by Japan has not been premised on such conditionalities.

These differences are symptomatic of the more general resistance to the neo-liberal project in East Asia and the widening gap between the American and Japanese conceptions of the role of APEC in the emerging Asia-Pacific order. Quintessentially, they arise from the different models of capitalism promoted by Japan and the US. As is indicated by their respective responses to the financial crisis, the American role in promoting the neo-liberal project of the free-market economy and the free flow of capital at the heart of the Anglo-American model of capitalism is increasingly being challenged, albeit often in a low-key manner, by Japanese policy makers seeking to establish a stable financial and economic order in Asia-Pacific based on the continuing viability of the East Asian developmental state model of capitalism (on the latter in the context of the crisis, see Hughes 1999). For the Japanese policy-making elite, APEC is not a tool for realizing its own interests by promoting the neo-liberal, globalist project in East Asia, as with the United States, but a tool for realizing its own interests by promoting East Asian economic development and a stable regional order. The East Asian financial crisis revealed starkly and really for the first time the crucial need for Japan to play a role in establishing financial stability in order to achieve a viable order in Asia-Pacific. This perception of the role of economics and finance in shaping that order means that, in addition to the APEC being viewed as a way for Japan to promote or protect its own narrow economic interests, it also is seen to play a role in promoting the wider security interests of Japan. In this way, security is perceived as being much broader than the military security at the heart of the US-Japan security treaty system.

As part of the Ōsaka Action Agenda, for instance, the APEC economies are committed to 'pursue economic and technical cooperation in order to attain sustainable growth and equitable development in the Asia-Pacific region, while reducing economic disparities among APEC economies and improving economic and social well being' (Ōsaka Action Agenda 1995, 21). This aim of seeking to address economic disparities within the APEC framework is being promoted by Japan through the continuation of Official Development Assistance (ODA) and other forms of economic cooperation. At the same time, the government has offered for the next several years a maximum of 10 billion yen per annum for APEC-approved projects serving to liberalize and facilitate trade and investment in the region. This includes Japanese financial support for holding seminars on such topics as customs duties and industrial ownership as well as for carrying out research and surveys.

The view amongst the policy-making elite that the 'flying geese' model of development has proven successful in East Asia is at the heart of the link between the East Asian model of capitalism and regional order. Despite the lack of empirical support for the 'flying geese model' (Bernard and Ravenhill 1995; Korhonen 1994), the ODA, trade, investment and other links between Japan and the East Asian economies have given rise to disparities as well as helped reduce them. For Japanese policy makers, the efficacy of economic development in reducing if not eliminating the possibility of war in the region seems to be substantiated by the Japanese contribution to East Asian development in the post-war period, but the call in the APEC Leaders' Declaration 'to enrich the lives and improve the standards of living of all citizens' (*Japan Times* 26 November 1996), can be seen as a recognition that the question of economic disparities still needs to be resolved. This is even more the case in terms of the 'human crisis' at the heart of the East Asian crisis and the Japanese attempt to revive the economies through the Miyazawa Plan (on the crisis as a human crisis, see Bullard *et al* 1998). Given the history of many East Asian nations following the decolonization process, maintaining domestic order and peace is as much of a concern as is maintaining regional order and peace. The role of ODA, investment, trade and financial support in reducing the domestic sources of instability is an important motivation for the Japanese government to play a prominent role in APEC. In this respect, the Japanese support for the economic development of these states has tended to take precedence over the promotion of democracy and human rights in East Asia, with political voices inside Japan coming out in support of 'Asian values' (Ishihara and Mahathir 1996), on the one hand, and concern by government critics over the willingness of Japanese policy makers to promote human rights, on the other (Mushakōji 1997). As seen in the recent distribution of financial assistance to Malaysia, authoritarian developmental regimes charged with the suppression of democratic and human rights are as much a target of Japanese financial assistance as are those East Asian states making the transition to democracy and respect for human rights, as in the case of South Korea, which benefit from Japanese investments.

4 THE GROWING ROLE OF NON-STATE ACTORS

As we have seen above, the primary actor involved in shaping the emerging regional and subregional orders through the ARF and the APEC as well as in response to the East Asian financial crisis has been the Japanese state. By focusing only on the role of the state at the regional and subre-

gional levels, however, we miss the undercurrent of activities carried out by a variety of non-state actors on the microregional scale. By lowering our sights to the sub-state level we thus are able to discern more clearly how complex international relations in East Asia have become after the end of the Cold War. They refuse to fit neatly into either the realist's or the institutionalist's paradigm, involving as they do multiple actors, levels, dimensions, and scales. In other words, a range of actors at the state and sub-state levels can be said to be carrying out a variety of activities in the political, security, economic and cultural dimensions on the regional, sub-regional and microregional scales. Here we will limit our discussion to the role sub-state political authorities, prefectures and cities, are playing on the microregional scale, although this is not to deny the important role other sub-state actors, such as NGOs, are playing, too (see Yamamoto 1996). For over the years these authorities have played a crucial role both in challenging the bilateralism at the heart of Japan's state-centred international relations and in expanding the scope of international activities carried out at the sub-state level. The ending of the Cold War has created an even wider space for such sub-state actors to play a role in shaping the emerging regional order, as the ideological and other barriers dividing the 'two worlds' in East Asia have in the intervening years been largely removed.

The role sub-state political authorities have played in challenging the bilateralism at the heart of state-centred Japanese international relations already had emerged in the 1950s, when local, city and prefectural assemblies adopted a variety of anti-nuclear policies at odds with the central government. At different times during the Cold War era, cities as diverse as Nagasaki and Nagoya and prefectures as diverse as Hiroshima and Hyōgō passed resolutions calling for a ban on nuclear testing, the end to port calls by nuclear-armed US naval vessels, the promotion of disarmament, and carried out other activities opposed to American nuclear testing and the US-Japan security treaty. Later during the Cold War years, a nation-wide movement to promote nuclear-free zones emerged, when in the early 1980s one after another town, city and prefecture resisted central government pressure and declared themselves 'nuclear free' (for details, see Nishida 1985). These anti-nuclear activities demonstrate how, despite the overwhelming structural and ideological power of the bilateralism at the heart of the state's security policy, sub-state actors could still mount a challenge to the role Japan was playing in the US-Japan security treaty system.

In expanding the scope of international activities at the sub-state level, moreover, political authorities have taken the lead in legitimizing sub-state diplomacy. Through these activities the power of the state to totally control foreign policy and international activity has been gradually erod-

ed. Kanagawa prefecture's 'people-to-people' diplomacy, in particular, can be said to illustrate the erosion of the Japanese state's monopoly in this respect (Nagasu and Sakamoto 1983). Still, as with the state, the bilateral prism of international relations meant that, in forging sub-state links across national boundaries, Japanese sub-state political authorities mostly chose cities and other political authorities in the western half of the 'two worlds'. This is evident from the sister-city agreements signed, which overwhelmingly established links between Japan and the United States and Western Europe, rather than across the ideological divide with China and the Soviet Union (Nihon Toshi Sentā 1995).

Nevertheless, despite the structural and ideological constraints imposed by the Cold War, sub-state political authorities were able to play some role in forging links across this divide. For instance, the Hokkaidō city of Otaru signed a sister-city agreement with Nakhodka in Russia in 1966, and biennial meetings of Russian and Japanese mayors were inaugurated in 1970. It was not until the 1980s, and especially the 1990s, however, before China and Russia came to prominence in the sister and other relationships established by sub-state political authorities, suggesting how the ending of the Cold War enabled microregional cooperation to forge ahead. The break-up of the Soviet Union, in particular, gave the counterparts for Japanese sub-state political authorities greater flexibility in developing their own links with Japan, despite the continuing problems between Japan and Russia at the national level arising out of the conflict over the sovereignty of the Northern Territories and the absence of a peace treaty (on this outstanding issue, see Wada 1990; Wada 1999). In particular, the growing links between Japan and Russia can be seen from the increase in contact between the Russian Far East and the coastal prefectures and cities of Japan bordering the Japan Sea (Hokuriku Kokusai Mondai Gakkai 1993).

In this way, sub-state political authorities have adopted policies at odds with those of the central government as well as policies to complement them. Even though their degree of flexibility is limited by the financial control the state can exert over prefectural and city political authorities (Shindō 1994, 35–52), the policies and activities these authorities promote, despite being at odds with the state's policy, can help to shape the short-term as well as the long-term direction the Japanese state takes. Even during the Cold War, their opposition to nuclear weapons and testing can be regarded as one of the factors leading to the eventual ban on atmospheric testing and the Japanese government's adoption of the previously stated three non-nuclear principles. Although, as mentioned above, the last of these principles has been violated as a result of the Japanese government's commitment to the US–Japan security treaty system at the

heart of bilateralism, sub-state political authorities have continued to play a role in restricting its full operation. For instance, during the Vietnam War local ordinances were used in order to prevent the transport of US tanks for the war passing along city roads. More recently, in 1996 Ōta Masahide, the then governor of Okinawa, put pressure on the central government over the renewal of land leases for US bases, which forced a commitment from both the governments of the US and Japan to close Futenma Air Station (for details, see Takamine 1998). Even though Ōta was defeated in the 1998 prefectural election by Inamine Keiichi, the new governor also opposes the construction of an offshore heliport to replace Futenma, although he remains supportive of building a new airport for joint use by military and civilian aircraft.

At the same time, sub-state political authorities can provide the central government with a degree of flexibility in dealing with complex problems between states. In the case of Russo–Japanese relations, for instance, in spite of the outstanding problem of the Northern Territories, sub-state political authorities have been able to play a role in promoting closer relations with Russia, as we will see below in the case of Niigata prefecture.

4.1 The case of the Japan Sea Rim Zone

During the Cold War, the Japan Sea coastal region of the nation was constrained in seeking to promote links across the sea, as it faced the perceived ‘communist threat’. With the Japanese state’s conception of regional order rooted firmly in bilateralism centring on the US–Japan security treaty system, any attempt to promote links with communist neighbours across the Japan Sea were interpreted in the Cold War ideological mind set as a challenge to the bilateralism at the heart of the government’s security policy. The Japan Sea was seen through an ideological kaleidoscope which, when rotated, highlighted the sea as the possible site for naval warfare with the Soviet Union and obfuscated the sea as a historical trade route or as a possible link to business opportunities in the Russian Far East.

With the ending of the Cold War, the cities and prefectures of the Japan Sea coast have taken the lead in establishing links with their counterparts across the sea. This can be seen, for instance, in the opening of an air route between Niigata and Vladivostok in 1993, the growth in trade, and the strengthening of political and cultural links. These efforts reflect the change in both the global and the Japanese national political economies: on the one hand, the entry of the former socialist economies into the global market place offers Japanese enterprises, particularly small- and medium-sized enterprises, the opportunity to develop business on the other side of the Japan Sea (NKKKK 1992, 86–90). Now, instead of the sea being

viewed as a barrier to economic interaction, as in the Cold War era, the sea is regarded as a transportation link between these prefectures and a variety of economic opportunities on the other side of the sea (Economic Research Institute for Northeast Asia, 1996). The potential benefits of economic complementarity are seen in tying together Japanese and South Korean capital and technology, Chinese labour, and the natural resources of the Russian Far East.

On the other hand, the domestic political economy is undergoing drastic change in the face of the worst economic downturn in the postwar era and the strident calls to push forward with decentralization (Matsushita 1996). From the Meiji period onwards, the economic development of Japan has centred on the Pacific coast, with the resultant over-development of the Pacific coastal region and the underdevelopment of the Japan Sea coastal region of Japan, the 'back' ('backward') part of Japan, or *ura Nihon* (Furumaya 1997). The proposal to develop the Japan Sea Rim Zone is thus emerging as part of a domestic reorientation away from the Pacific, not just as a response to the new international opportunities brought about by the end of the Cold War.

Nevertheless, the ending of the Cold War and the normalization of relations between Russia, China, and South Korea have opened up a greater possibility for sub-state political authorities on the Japan Sea side of the nation to play a role in shaping the emerging Asia-Pacific order (for details, see Hook forthcoming). The developing relations between Niigata and the Russian Far East are illustrative. Although Russia is not a target for Japanese ODA, Niigata in 1994 became the first prefecture to carry out 'local ODA', when it put together a blueprint for the maintenance of port facilities in the Russian Far East. Thereafter, a jointly organized project was carried out, leading to the publication of the results of a feasibility study in 1996 (Economic Research Institute for Northeast Asia 1996, 19–20). This is an example of how, despite the lack of progress in resolving the territorial dispute and in signing a peace treaty at the national level, political authorities can use public funds in order to act in place of or on behalf of the state at the sub-state level. In turn, this can help to promote the microregional integration of sub-national parts of the two economies and help to shape the emerging order in the region.

In this way, sub-state political authorities and other sub-state actors can play a role in linking together the interests of sub-national parts of Japan and Russia in an emerging microregion. From this, shared interests and identities which cross state boundaries may in time evolve. It is the longer-term development of these shared interests and identities which lies at the heart of the link between sub-state actors and the emerging order in Asia-Pacific. For a regional order embracing a multitude of over-

lapping links and interests on different regional scales is fundamentally different to a regional order held in place by the structural and ideological force of bilateralism centring on the US–Japan security treaty system. In this sense, the increasing visits between prefectural and local politicians; the overseas investment by small-and medium-sized enterprises as well as the giants; the increase in the study of each other’s culture; and the promotion of a variety of activities seeking to promote links between civil societies, can in the longer term be seen to contribute to breaking down the centralizing power of the state and giving shape to a much more complex, multifaceted Asia-Pacific order.

5 CONCLUSION

In the Cold-War era, nuclear deterrence and the balance of power were the fount and matrix at the heart of bilateralism. In line with these principles, Japan played a pivotal role on the front line of the conflict between the ‘two worlds’, supporting the global as well as the regional strategy of the United States. Now, in the post-Cold War era, the bilateralism at the heart of Japanese security policy is being supplemented by a role in a multilateral, regional security fora. The ARF is emerging as the key institutional framework for dealing with a wide variety of security issues, including the threat posed to domestic stability by the flow of drugs as well as confidence building measures amongst states with little experience of participating together in dialogue on security issues. Thus, with the end of the Cold War, bilateralism has not been abandoned; instead, as we have seen with the redefinition of the US–Japan Security Treaty and the role of Japan in the ARF, it has been supplemented with a conception of regional security centring on Asia-Pacific. In this sense, the Japanese government is pursuing a twin track approach to security, bilateralism and supplementarism, with the US–Japan security treaty system and the ARF being at the heart of this approach to shaping the emerging Asia-Pacific security order.

Yet to only view the regional order through the prism of the bilateralism at the heart of the security treaty system and the concept of security in the ARF is to miss the importance of economic development and financial stability in contributing to the creation of a new regional order. In its approach to regional peace and order, the Japanese policy-making elite views economic development as crucial, with the APEC seen not simply as a way for the United States to promote the liberalization of trade and investment, but also as a way for Japan to address economic disparities, which can be a source of domestic and regional instability. The Japanese response to the East Asian financial crisis highlights the contested nature

of the regional order being promoted through the US's neo-liberal project. This suggests that the market as well as the state is helping to shape the Asia-Pacific order, with the struggle between the Anglo-American model of capitalism and the East Asian developmental state model of capitalism becoming much more salient in the wake of the East Asian financial crisis. Even if the state is playing a key role in promoting liberalization in the region, market forces are operating largely outside of the control of the state, as the hedge funds' attack on East Asian currencies amply demonstrated to Prime Minister Mahathir (*Far Eastern Economic Review* 11 February 1999, 31). The economic interlinkages in East Asia are tying the subregion together in a complex, overlapping web of investment, trade, and production networks, and these links are playing a central role in shaping the emerging regional order. Indeed, market forces can be said to have engendered a large measure of the incentive to create regional fora and groupings in Asia-Pacific and East Asia. In this sense, the market has given substance to neo-liberal and developmental state projects seeking to shape the emerging regional and subregional orders.

Finally, the pluralization of the actors contributing to the shape of the emerging Asia-Pacific order can be seen in the role played by sub-state political authorities, which are developing microregional links outside of the traditional framework of the state and the market. In this context, the anti-nuclear activities of a range of local authorities, along with the role played by Japanese cities and prefectures in promoting the Japan Sea Rim Zone, demonstrate the international role 'local' actors can play. In the latter case, the Japan Sea Rim Zone is playing a part in embracing the emerging market economy of the Russian Far East and elsewhere in overlapping economic and civic linkages with the Japan Sea coastal cities and prefectures of Japan. The role of these sub-state actors points to how, in addition to states and markets, sub-state political authorities, NGOs and other actors in civil society need to be taken into account in order to elucidate the complex nature of the emerging Asia-Pacific order. What this means is that, as a result of the transformation in the structure of the international system brought about by the end of the Cold War, a much more complex regional order is emerging. At one level, the state continues to be tied to concerns of sovereignty, national interest, national security, and so on, whereas, at another level, sub-state actors in Japan and other states in the region are building cross border links, penetrating each other's societies in the political, economic, security, and cultural dimensions. As a result, the regional order cannot be portrayed simply by reference to the billiard-ball view of international relations; nor can it be portrayed simply by reference to the market; nor, for that matter, can it be portrayed by reference to both the state and the market. It can only be portrayed in a much richer, complex

way by taking account of the role of sub-state actors on the microregional level.

Given these changes in the post-Cold War era, what relationship do we find between regionalism and the emerging regional order? How are we to understand the role of the state, sub-state political authorities, and other non-state actors? In a realist approach, as international relations are viewed as anarchic, with states involved in a struggle for power, regional cooperation has tended to be seen as a by-product of the international system. Thus, the new regional order in Europe to emerge after the end of the Second World War, which took shape in the West as the European Community (EC), has been largely attributed to the bipolarity of the international system. More specifically, as the Cold War was at heart a bipolar confrontation, where the Europeans were under the nuclear protection of the United States, the emergence of the EC has tended to be viewed as a by-product of the West's need to create a military balance of power against the Soviet threat. Yet, if the nature of the international system is the key, then the closer cooperation signified by the Maastricht Treaty and the 1999 launch of the Euro, which are being implemented after the collapse of the bipolar Cold War structure, is difficult to explain in realist terms.

In the case of Asia-Pacific, moreover, the recent emergence of new regional organizations such as APEC and the ARF suggests the growing importance of regionalist projects in the creation of regional order. In these cases, the members are seeking to embrace all the regional powers, rather than create a regional balance of power, as seen by the inclusion of China in these organizations. Indeed, any attempt to try to balance China is resisted in the region, especially by Malaysia (Furukawa 1996, 34). What is more, in both Europe and Asia-Pacific, the strengthening and emergence of regional organizations is occurring in the context of regionalization processes, which are linking the region together in complex ways. Yet these are links not forged by sovereign states, but by non-state actors, especially corporations, which are largely operating on market principles outside of the control of the state. In this sense, these actors are complementing if not eroding the centrality of the state in shaping the emerging regional order in Asia-Pacific.

Thus, the realist attachment to the state as actor and a balance of power premised on nuclear deterrence as a motivation for regional cooperation misses the role of the market in promoting regional cooperation. In this respect, liberal institutionalists do draw our attention to the importance of economic interests as an explanation for the rise of regional cooperation, where the market, rather than the state, takes centre stage. Regionalism, regionalization and regional cooperation are thus understood

with reference to the non-military sphere of international relations, where trade, investment, and production networks functionally link the region together, promoting the potential for a new regional order. True, through the promotion of liberalization the state is facilitating regionalization, but to a large extent the market is beyond the control of the state and seeks to maintain autonomy from the state. As seen at the 1996 meeting of APEC, in this the role of business is central: the leaders 'affirm the central role of the business sector in the APEC process' (Leaders' Declaration, *Japan Times* 26 November 1996).

Other approaches to regionalism do exist (Hurrell 1995), but none of them takes account of the various roles played by sub-state political authorities, NGOs and other actors in civil society. Such sub-state actors tend to be either downplayed or ignored. Although their role should not be exaggerated, with the end of the Cold War sub-state actors do seem to be growing in importance, with our discussion elucidating how prefectural and city governments along the Japan Sea coastal region of the nation have been seeking to link sub-national parts of Japan with other parts of North East Asia. Several other microregional projects exist (e.g. Ogawa 1995). In this sense, in seeking to draw attention to the complex nature of the emerging order in Asia-Pacific, sub-state political authorities, NGOs and other actors in civil society, as well as the state and the market, need to be taken into account. There are at least three reasons.

First, as in the case of Niigata's 'local ODA' to conduct a study in the Russian Far East, sub-state political authorities can carry out bilateral or multilateral activities not possible for the central government. This can serve to promote peaceful relations at a sub-state level, which can filter up to the national, subregional or regional levels. Second, the emergence of microregional as well as subregional and regional groupings suggests that, in the emerging Asia-Pacific order, sub-state actors are in the process of building transnational links which are complementing if not eroding the role of the state. In the case of the Japan Sea Rim Zone, for instance, the long-term result of these sub-state linkages may well be to gradually tie the Japan Sea coastal prefectures more closely to the economies across the Japan Sea than to the Pacific side of Japan. This can play a role in linking together the civil societies in the region, too, which can over time lead to the growth of shared interests and identities. Finally, the break-up of the Soviet Union and liberalization and democratization in Eastern Europe cannot be understood fully without taking into account the role of civil society in this process. The focus on the state by the realist school and the focus on the market by the institutionalist school neglects or fails to pay due attention to the role of civil society in the creation of new orders. In this respect, the development of transnational civil society may help to promote

democratization in East Asia and the creation of a more democratic regional order. Herein lies at least one reason for taking into account NGOs and other actors in civil society, not just the state, corporation and sub-state political authorities in seeking to shed light on the complex role Japan is playing in the emerging Asia-Pacific order.

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NON-GOVERNMENTAL ORGANIZATIONS (NGOs) IN SOUTHEAST ASIA AND JAPAN: ORGANIZING FOR REGIONAL DEMOCRACY?

Motoko SHUTŌ

1 INTRODUCTION

The proliferation of Non-Governmental Organizations (NGOs) in the last decade has become a striking feature in the political landscape of Southeast Asia and, accompanying this development, the amount of related literature on NGOs has also remarkably increased. The primary premise of these studies is that the proliferation of NGOs strengthens civil society and promotes democracy, by fulfilling a role which traditional institutions such as labor unions and political parties are less able to do, and by representing interest articulation more widely than those traditional political actors. Also, NGOs are expected to play a role as an intermediary enabling the voices of those who have no access to the decision-making process of international institutions or multilateral corporations and may possibly become disadvantaged by globalization.

The basis of the arguments put forth for NGOs as an aid to the strengthening of civil society depends from which perspective these organizations are discussed. Due to its ability to act more flexibly than the bureaucracy, liberals expect NGOs to be able to provide an alternative to the rigid state sector and that they will strengthen the weak private sector, in effect becoming a third sector, particularly at present when the trend for deregulation has become strong. More progressive activists see NGOs as a vehicle of social movement to transform the social and political system. Despite these differences, both perspectives share the common premise that civil society can and should exist independently from the state. Moreover, they agree upon the fact that the proliferation of NGOs is a barometer gauging the maturity of civil society, *i.e.* the degree in which a society enables its citizens to freely express their opinions and to carry out social activities independent of the state, while at the same time exerting control to ensure that citizens fulfill their duties such as paying taxes.

This brief essay is not to examine fully the validity of the premised correlation between the proliferation of NGOs and the maturity of civil society in the cases of Asian countries, but to posit that there have emerged

NGOs which play and will continue to play a significant role in the democratization process in Southeast Asia. The emergence of NGOs is both a cause and an effect of social change in the last two decades, a period during which the economic and social situations underwent remarkable transformations and the trends toward peace, stability and prosperity seemed to be resilient and irreversible in the region. This prospect, however, turned to be too optimistic because the financial crises since mid-1997 have triggered economic downturns, social tensions and political uncertainty in the region.

The present economic crises have brought terrible pains and there has been no significant progress since the outset of these problems in the performance of their national economies in the region. Notwithstanding, it is clear, at least, that these crises must become an opportunity to change the financial and political systems to which these nations have been accustomed in the past and to promote transparency, to eliminate corruption, collusion and nepotism, and to enhance the quality of political participation. In other words, the East and Southeast Asian nations which have suffered the present economic crises have come to a turning point at which it is necessary to incorporate more of the plural aspirations of their societies into the national agenda and to create communities based on a shared sense of regional identity and values of caring societies.¹

For this purpose, the proliferation of NGOs in the region is encouraging and important, because it can contribute to the articulation of the interests of the previously muted people and to spread pluralism in the societies, even if it does not immediately mean a growing maturity of civil society that can exist separately from the state. Based on this perception, the prospects of NGOs in Southeast Asia and Japan's possible role and problems will be briefly discussed below.

2 DIMENSIONS OF NGO ACTIVITIES IN SOUTHEAST ASIA

In the last two decades, NGOs working in various fields of society, such as rural development, the environment, legal assistance, and gender, have emerged in Southeast Asia. Among them, Philippine NGOs are by far better developed organizationally compared with those in other ASEAN countries. NGOs have not only increased in number but also developed in

¹ This thought was also stated in the section 'A Community of Caring Societies' in the 'ASEAN Vision 2020', which was adopted at the second informal summit meeting of the Association of Southeast Asian Nations (ASEAN) in Kuala Lumpur on 15 December 1997.

terms of the intensity and geographic scope of their activities over the last decade. Internet communication has greatly facilitated their exchange of information in the 1990s.

The NGO activities in the ASEAN countries may be found in a diversified array of programs. The most common programs are related to poverty and development such as primary education, primary health care in rural areas, child labor, slum dwellers in cities, and environmental degradation, to mention a few. There are many NGOs which are engaged in advocacy activities related to development policies which may cause, or have caused, land disputes or environmental deterioration. Also there are NGOs which are struggling to improve the civil and political rights of the people of countries where these NGOs are based. Though these activities are seemingly different from one another in their issue-based dimensions, the targets of legal assistance groups, development NGOs and environmental NGOs often converge, and they sometimes call for joint action when they are faced with problems related to the abuse or inefficiency of administrative power over the local people.

The leaders of these NGOs² mostly belong to the educated middle class, which has emerged along with the continuing economic growth in the last two decades. It can be said, therefore, that economic growth, both from the positive and negative aspects, encouraged the proliferation of NGOs. These people, however, often hold the view that economic development is not sufficient in itself as this change must be paralleled by the reform of the political and legal system. Otherwise, they say, economic growth without accompanying social justice would produce social instability by deepening economic gaps and social grievances (Lubis 1993, 40–4).

This means that a new group of people has emerged, who have a keen interest in the public interest at large and are capable to show their vision to the society independently from the governments in Southeast Asian countries. Visions pursued by these NGOs are, for example, that of a society that protects individual civil rights, including children's human rights, that opposes the degradation of the natural environment, or that enlarges possibilities for political participation of the local people. This is an essentially new phenomenon in the sense that the rise of 'citizenry' independent of state power did not accompany the political process of nation-building, unlike the cases in the European states, because the nations in Southeast Asia, except for Thailand, had to start state-building after the

² The term 'leaders' as it is used here refers to either the founders of NGOs or, in the case of relatively large NGOs, to elected full-time representatives of these organizations.

end of World War II by fighting against the external powers, especially the former colonial powers, and then by pursuing economic development primarily under the initiatives of governments and state sectors.

Among NGOs fighting for civil rights, it is human rights NGOs that are directly faced with the dilemma between their struggle for public aspiration, *i.e.* basic rights like the freedom of expression and association, the right of property (of indigenous peoples), and the states which often fail to pay attention to it, or even suppress it. Furthermore, human rights NGOs also find themselves under the authoritarian systems in the region where they operate. For these reasons, the impact and spread of activities of human rights NGOs in Southeast Asia are worthy to be mentioned in the context of this paper.

3 HUMAN RIGHTS NGOs IN SOUTHEAST ASIA

Human rights NGOs in a narrow sense are those which supply legal assistance to protect the legal rights of victims, who are often legally-illiterate and vulnerable to decisions of the state or corporations, for example in the case of the seizure of their land or forests for development projects. In this narrow sense, human rights NGOs are generally lawyer-based groups, and most of them in the ASEAN countries started their activities in the early 1970s.

In Indonesia, the Indonesian Legal Aid Foundation³ evolved into a remarkably active nationwide human rights NGO under the leadership of the founder, Dr. Adnan Buyung Nasution, a prominent advocate of human rights. Though this was not the first lawyer-based human rights NGO in Indonesia, LBH has been outstanding in its wide range of activities involving legal aid and political activities to protect human rights since the early period of the New Order regime. From the outset, LBH had a basic plan in both the legal and political dimensions. The legal dimension is to defend the people of the low income bracket free of charge and on an individual basis. The political dimension is to develop a conceptual framework of democratic values, human rights, and rule of law for taking the initiative to improve the legal system. This latter dimension is based on the concept of 'structural legal aid' (Nasution 1996, 23), which focuses on initiatives to improve legal systems instead of taking such systems for

³ The Indonesian name of this organization is Yayasan Lembaga Bantuan Hukum Indonesia (YLBHI). It was originally set up as LBH in 1970 and started its operation in 1971. YLBHI became its formal name in 1981, but hereafter it is abbreviated as LBH.

granted and restricting oneself to just giving legal advice. Under the Soeharto regime in Indonesia, social organizations were under tight control by the government, the society as a whole was sweepingly de-politicized and the basic rights of social groups such as workers, students, youth, and women were strictly limited. LBH, which was supported in its initial stages by the Governor of Jakarta, succeeded in sustaining a considerably independent stance and struggled against the excessive abuse of human rights under the Soeharto government. By representing the voices of the public through legal measures, LBH fulfilled an important role in the Indonesian political system. Since the 1970s, LBH has been committed to defend the human rights of defendants in political trials and has actively supported the establishment of other leading NGOs such as Walhi, the biggest environment NGO in Indonesia, INFID (International NGO Forum on Indonesian Development)⁴, and the Independent Committee for Elections Watch (KIPP) in March 1996. Though some leaders left LBH because of an internal conflict over the new leadership in 1996, they also set up new human rights NGOs and are actively involved in the protection of the human rights of student activists and political prisoners in Indonesia.

It is not LBH alone that has struggled for the empowerment of the common people, *i.e.* the establishment of their civil rights, since the 1970s. By providing a channel for the people to express dissatisfaction with the political system, by stimulating the development of alternative political options and visions, and by establishing an international network of activities, these new NGOs – and their leaders in particular – became a trigger of the recent political dynamism in Indonesia, which led to the fall of former President Soeharto. Social dynamism has emerged in the early 1990s in Indonesia, at first in the form of workers' movements to form independent labor unions, then in the form of pro-democracy organizations along with the revitalization of intellectuals. These new movements were sometimes suppressed ruthlessly but eventually created an environment that led to the outburst of students' revolt in 1998 under the serious economic downturns and the incapability of the government to improve the economic situation.

There are two other factors contributing to the present political dynamism in Indonesia; first, the drastic increase – about tenfold – in the

⁴ It started in 1985, and was known as the International NGO Forum on Indonesia (INGI) from 1988 until 1994. Shortly after its 8th annual meeting in March 1992, the Indonesian government announced its intention to dissolve the Inter-Governmental Group on Indonesia (IGGI) which had been chaired by the Dutch government. As a consequence, INGI lost its main target of advocacy activity, and in 1994 INGI changed its name to INFID.

number of university students including technical schools in the last three decades; and secondly the open minded attitude of some leading political elite like General Wiranto or Lieutenant General S. Bambang Yudhoyono toward a dialogue with the people. Now for the first time since the years of struggle for independence from 1945–1949, with the revitalization of political activities, workers and students have again become dynamic actors. This dynamism is a remarkable social change. In the 1960s and 1970s, only a handful of intellectuals were active advocates in protecting human rights and democracy. They might have raised public awareness about civil rights, but they were too small in number and their abstract political ideas were too detached from the general public to trigger social change at that time.

Compared with the Indonesian cases, the Philippines has been much more experienced in organizing societies or communities, not only in regard to human rights issues but also various welfare activities. Welfare organizations were already set up in the American colonial period, and shortly after its independence, some nationwide pioneer NGOs, such as the Institute of Social Order (ISO), founded in 1947, and the Philippine Rural Reconstruction Movement (PRRM)⁵ in 1952. These NGOs were set up to encourage ‘community development’ incorporating the promotion of primary health and education, and various socio-economic development activities, which were meant to offer a strategic alternative to the perceived imminent spread of communism in rural areas. As a result, they were supported directly or indirectly by businesses, the Catholic Church, and the United States-backed governments.

After the imposition of martial law in 1972, the systematic violation of human rights, such as arbitrary arrests, abduction and the murder of members of opposition groups, became widespread. Human rights NGOs actively supported the estimated 10,000 political detainees, such as the Catholic Church-based Task Force Detainees of the Philippines (TFDP), the Free Legal Assistance Group (FLAG), and the Movement of Attorneys for Brotherhood, Integrity, and Nationalism Inc. (MABINI). These NGOs raised the issue of human rights as their central cause around which the fragmented opposition groups could unite and mobilize political advocacy against the Marcos regime.

⁵ PRRM, at the time when this writer visited its head office in August 1996, had branches in 17 provinces with about 400 staff. It is one of the most well-organized and influential NGOs in the country, which has recovered from a decade-long moribund situation under a new leader, Horacio Morales, who had been detained as a political prisoner and released in March 1986. For a summarized history of PRRM, see Clarke (1998, 138–64).

After the EDSA revolt in February 1986, the wave of democratization brought about an enormous increase in the number of NGOs. Curiously, at the same time, some big human rights NGOs with long records in social activities, such as the TFDP, began to be fragmented by internal rifts over their strategy and had to redefine their role as human rights NGOs. Because the issue of human rights was a major plank of the Aquino administration, they had to engage themselves with, or even shore up, the government which was rapidly weakened after the short euphoria in the post-election period had waned.

In other words, when the state power was ruthlessly authoritarian, the activities of human rights NGOs were aimed at protesting the abuse of power and protecting human rights, but once the state became sympathetic to these issues, their activities changed to focus on the enhancement of human rights by means of electoral participation and participation in local governments. Also, recently there can be found a new change in the Philippine NGOs. They previously had few links with NGOs in the other ASEAN countries, but have begun to join in the regional movements and network in the 1990s. Also, as for the elections in June 1999 in Indonesia, the National Movement for Free Elections (NAMFREL) cooperated with Jaringan Masyarakat Pemantau Pemilu Indonesia (JAMPI), one of the independent organizations in Indonesia, in monitoring the general elections. This in itself was a significant opportunity to gain experience for NGOs in the both countries.

In Thailand, traditionally there have been philanthropic activities by non-state actors, but it was in the 1970s that human rights NGOs became active, and intellectuals and students were the principal actors. The Union for Civil Liberty (UCL), set up in the mid-1970s during the 'democratic period' by the activist lawyer Somchai Homlaor, played a key role in setting up the Coordinating Committee of Human Rights Organizations of Thailand (CCHROT) in 1983. The main activities of this organization are monitoring human rights violations, public education through its radio program and publications, and lobbying for an independent human rights committee at home as well as for a regional human rights mechanism in Southeast Asia that promotes the exchange of information and supports lobbying activities at international organizations.

In Malaysia, proactive human rights NGOs started their activities mostly in the late 1980s or early 1990s. Suaram (Suara Rakyat Malaysia) is a Kuala Lumpur-based human rights NGO which was formed to protect the detainees arrested in the 'Lalang Operation' of 1987. Also, since the former Deputy Prime Minister and Minister of Finance, Anwar Ibrahim, was sacked and later arrested in September 1998, new social movements calling for justice have occurred. NGOs such as Aliran, set up in 1977 in

Penang, Consumers' Association of Penang (CAP), and Just World Trust (JUST)⁶ are actively involved in this campaign for political justice.

The campaign for Anwar Ibrahim is interesting in the sense that it takes a partisan character, but it is not the first such case under the Mahathir administration. So far most of the human rights NGOs in Malaysia were organizations made up of non-Malay people. Malay people, generally speaking, show little interest in participating in human rights activities, because for them to claim 'human rights' was almost equal to challenge their legally protected privileges. In other words, 'for many middle-class Malays, indigenous rights and ethnic privileges are more important than human rights' (Muzaffar 1990, 124). The Anwar case, however, seems to have changed this traditional character of human rights activities in Malaysia.

Besides these lawyer-based human rights NGOs which emerged out of pressing domestic necessities, there are many other pro-active NGOs in Southeast Asia that work regionally for human rights issues. For instance, the Asian Cultural Forum on Development (ACFOD), set up in Bangkok in 1975, has had from the outset a regional network in the Asia-Pacific region, and since 1983 it has drafted and implemented action programs for workers⁷, peasants, fishermen, and women. Each corresponding forum has four sub-regional groups: South Asia, Southeast Asia, East Asia, and the Pacific region. Since 1992, joint action programs of all four forums started focusing on human rights, the environment and the empowerment of the people. Also in 1992, the Asian Regional Resource Center for Human Rights Education (ARRC) was set up in the office of ACFOD. It was ACFOD and other human rights NGOs in Asia which in 1992 created the 'People's Plan for the 21st Century (PP21)'. It presented the platform for pursuing a people-oriented development vision by building the international cooperation of the NGOs in Asia.

Forum Asia (Asian Forum for Human Rights and Development), set up in Bangkok in 1991, consists of about 20 human rights NGOs in Southeast and South Asia.⁸ It has been involved in fact-finding research and advocacy campaigns for the democratization of Indonesia, Myanmar and

⁶ CAP was established in 1970 and helped to establish Friend of Earth Malaysia (SAM) in 1976, and Third World Network in 1984 in Penang. JUST, which was set up in 1992, moved to Petaling Jaya close to Kuala Lumpur in February 1997.

⁷ The Workers' Forum now belongs to the Asia Pacific Workers' Solidarity Links (APWSL) in New Zealand. Personal interview with Mr. Boonthan T. Verawongse, Peace and Human Rights Program of ACFOD on 1 August 1997.

⁸ Representatives of YLBHI, Suaram, Philippines Alliance of Human Rights Advocates and three other NGOs in Sri Lanka, India and Pakistan are members of the Executive Committee of Forum Asia in 1997.

Cambodia. Altsean Burma (Alternative ASEAN Network on Burma) was one of the products of a workshop in 1996, coordinated by Forum Asia and two other Thai-based NGOs.⁹ They have been actively lobbying with regards to Myanmar's problems at ASEAN meetings.

Thai human rights NGOs such as ACFOD, CCHROT and Forum Asia played a key role as coordinators of the 'Asia Pacific NGO Conference on Human Rights' in Bangkok in March 1993, prior to the 'UN World Conference on Human Rights' held in June 1993. In many joint statements of extensive agendas, they have proposed the establishment of a regional human rights mechanism as well as adequate national human rights institutions.¹⁰ They also urged Asian states to repeal internal security laws that conflict with international human rights norms.

The 'Asia Pacific NGO Conference on Human Rights' became a turning point for two reasons. First, the idea of a regional mechanism to protect human rights, which used to be proposed by eminent persons' groups since the 1960s, changed into the program of more action-oriented NGOs trying to catalyze the empowerment in the Asian societies. Second, after this Conference, the regional networking of the participant NGOs began to be institutionalized, and in the first follow-up meeting held in New Delhi in late 1996, the NGOs decided to meet every three years (ACFOD 1997). Such growing NGO cooperation, which can also be seen in the cases of the Altsean Burma based in Bangkok or the APCET (Asia Pacific Conference on East Timor), suggests that the 'Asia Pacific NGO Conference' in Bangkok engendered a regional network for norm-setting activities within the ASEAN societies and this solidarity seems to have given NGOs a sense of confidence in their purpose and action.

While it is too early to evaluate the effect of this regional networking, at least an official response has emerged from the governments. Interestingly, the ASEAN Ministerial Meeting responded to this trend in its 1993 Joint Communique by stating that 'ASEAN should also consider the establishment of an appropriate regional mechanism on human rights' (ASEAN Secretariat 1994, 8). Also in recent years, the human rights NGOs in the ASEAN countries have set forth action plans collectively entitled 'the Initiative for the Establishment of an ASEAN Human Rights Mechanism', and they have now adopted the practice of establishing regular di-

⁹ They were the Thai Action Committee for Democracy in Burma and the Burma Solidarity Group in Malaysia. Personal interview with Ms. Debbie Stothard, Coordinator of Altsean Burma on 31 July 1997.

¹⁰ Joint Statement by NGOs on Regional Human Rights Instruments and Mechanisms in the Asia-Pacific Region and National Institutions (*Our Voice* 1993, 189–92).

alogues with senior officials prior to the ASEAN Ministerial Meeting.¹¹ This contact between human rights NGOs and the governments is very new, and it is significant that the emerging regional network in the ASEAN countries is now going to work regionally for the universal human rights agenda.

4 JAPAN'S APPROACHES TO HUMAN RIGHTS ISSUES IN SOUTHEAST ASIA

This new situation, however, has not yet attracted considerable attention in Japan, except for only a handful of human rights NGOs. Three background factors are to be considered.

First, Japanese NGOs are relatively new and historically less experienced in international joint activities than Western NGOs. Also it is a relatively new phenomenon, especially in the 1990s, that the mass media as well as the public pay attention to NGOs and volunteer activities for certain pressing needs in domestic situations. According to the statistics provided by the Japanese NGO Center for International Cooperation (JANIC), about 48% of Japanese NGOs were set up in the 1990s, 40% in the 1980s, and less than ten NGOs were established in the 1970s, which deserve to be regarded as pioneers (JANIC 1996, 2–3). This partly resulted from the social atmosphere in which ‘non-governmental’ activities were easily regarded as ‘anti-governmental’ during the decades of Liberal Democratic Party single party dominance. Until the early 1970s, there were no civic movements in Japan that were not based on political parties, except for a few cases like women’s organizations and the intellectuals’ peace movement.

Second, the primary motivation of Japanese NGOs is humanitarian. Of the 185 Japanese NGOs involved in overseas activities, 68 NGOs are motivated by a wish to help people in emergencies such as refugees from starvation or natural disasters (JANIC 1996, 5–7). The work of most Japanese NGOs focuses on humanitarian activities. The second most common activity is to supply material such as medical equipment or supplies for schools. Out of these initial motivations, some Japanese NGOs have expanded their operations into direct development assistance such as digging wells, building schools, and planting trees (Kitazawa 1994, 14–15). While these activities can be said to be motivated by human rights prob-

¹¹ Its first contact with the Senior Officials meeting was established in 1996. It also seeks to have regular dialogues with the Senior Officials meeting. A copy of the documents of the workshop which adopted the action plans in June 1997 was given to this writer by courtesy of Forum Asia in Bangkok in July 1997.

lems, considering that poverty hinders the fulfillment of human rights, such operations are reactive in nature and only can help to treat the symptoms of a problem, but not the causes. This characteristic curiously coincides with that of Japan's ODA policies, which has predominantly focused on material development assistance, based on the principle of non-interference in internal affairs, and has taken the legal and political system of the recipient countries for granted.

In the last decade, changes in the ODA budget have encouraged new methods to help the activities of NGOs. These are, for example, subsidies to NGO programs and grants to grassroots organizations in recipient countries.¹² The Ministry of Foreign Affairs established an office to support private foreign assistance activities in 1994, and has instituted regular meetings with representatives of Japanese NGOs since 1996. However, applications have to meet stringent conditions to be eligible to obtain such subsidies, and accordingly only projects requiring large amounts of money such as the construction of schools, medical facilities, or water supply facilities tend to be accepted.

While these new methods may be based on the new perception of the potential role of NGOs to empower the local societies in recipient countries, they appear to be intended to complement the weakness of Japanese ODA policy that makes the recipient NGOs supplementary components of Japan's foreign policy. These methods could thus result in reinforcing the status quo of the aid delivery system. What is needed more than this is to properly focus on, and to have a creative vision to improve, the problems of the present aid delivery system, instead of taking it for granted. To this end, it would be important for Japan's ODA and NGOs to have extensive networks, both directly and indirectly, with the local NGOs. In other words, Japan's ODA policy needs to enhance a more sociological approach both on the domestic and international level: ODA policies that consider and respond more directly to the local needs of the Asian societies, and which provide local people with increased opportunities for participation.

As for Japan's ODA policies in the domestic context, since the Law to Facilitate Activities of Nonprofit Organizations was enacted in March

¹² Subsidies to NGO Programs are financed exclusively to Japanese NGOs operating in developing countries. It started with a budget of 82 million yen in FY 1989, and has increased to 816 million yen by FY 1996. Grants to grassroots organizations financed directly to local NGOs in the recipient countries started by 300 million yen in FY 1989 and has increased by more than 10 times to 5 billion yen in FY 1997. About 55% of both operations participated in activities in the Asian countries (MOFA 1997, 189, 210).

1998, the legal status of NGOs has improved, and the number of NGOs is likely to increase. What really matters is, however, not their number, but the functions that they play. If their major function is to help meet the shortcomings of public policy by providing social service, their relations with administrative agencies would be mostly complementary. This is necessary but perhaps not sufficient for the 'sociological approach' advocated by this writer. The idea is suggested here to create a new policy to financially support activities of human rights NGOs, not by the government directly but by a neutral institution set up by the government, for instance, to facilitate human rights research projects and activities internationally as well as locally. As for its ODA policies to Asian countries, a sociological approach has been employed for the last decade in particular, by focusing on material assistance to the socially disadvantaged or on the training of people. While this approach is on the right track to the empowerment of local societies, the problem seems to be its channel through the central governmental agencies of the recipient countries.

The dramatic rise in the number of NGOs in the Philippines, where the new Local Government Code enacted in 1991 has facilitated, though not always successful, civic participation in local governance,¹³ or the increase in NGO activities in Indonesia, where the new Laws on Intergovernmental Fiscal Relations and on Local Autonomy were approved in April 1999, may promote decentralization and change problematic aspects of local politics such as the interplay of patronage, clan and customary law. The important function of NGOs would become community building in rural areas and network building between rural and metropolitan NGOs. For the regional level, such a development was depicted in the 'ASEAN Vision 2020', adopted at the December 1997 ASEAN Informal Summit Meeting. It envisioned 'a community of caring societies', formed by 'nations being governed with the consent and greater participation of the people' (ASEAN Secretariat 1998, 76-7). In this context as well, Japan's approach needs to help, either indirectly through NGOs or local governmental agencies, local NGOs' activities to empower community building and local governance.

Third, the Japanese public as well as the media had been generally unaware of, or not interested in, the political systems and human rights issues caused by the state powers in Asia until the late 1980s and early 1990s. The causal factors for this considerable lack of interest in human rights issues abroad are not directly relevant to the context of this paper, but it has to be noted that the public atmosphere has obviously changed in the last decade. Much more public attention is still needed, however.

¹³ Four interesting case studies can be found in Silliman and Noble (1998).

Because of the above three factors combined, there has been little discussion on human rights issues between Japan and other Asian societies at the non-profit private sector level. Only recently, however, new developments have emerged. One example is the joint meeting of the Japan Civil Liberty's Union (JCLU) and other human rights NGOs in Asia-Pacific in Jakarta in February 1999. The various NGOs participating in this meeting agreed on regularly holding such meetings and on cooperating to strengthen human rights NGOs in the region. This kind of sociological approach is noteworthy, because it has been missing in Japan's relations with Asia, both on the official and private level.

5 CONCLUSION

As this brief survey shows, NGOs have emerged in Southeast Asia that are engaged in advocacy activities to empower the weak civil societies from within, sometimes in collaboration with international NGOs. They directly confront patronage-based political systems, and have also created an increasingly large regional network in the last decade, though it is still too limited to represent the voices of the muted at the grassroots and regional levels.

The political implication of these emerging NGOs in Southeast Asia is that, firstly, they are changing the nature of political opposition in Southeast Asian countries to a less militant, more issue-based, and more ideologically flexible one. These NGOs are essentially different from traditional political opposition groups in the sense that most of them do not intend to hold political power by themselves. This may imply that traditional political opposition structures in Southeast Asia that were aimed at taking over political power have declined over the last two decades, being replaced by and changed into issue-based NGOs.

Secondly, along with the end of the Cold War, old political movements with revolutionary paradigms have waned. However, this change had already started in Southeast Asia in the 1970s and 1980s, and for political opposition groups demilitarization and negotiation have become a primary means for conflict resolution. This results from the change of stance and attitudes of both governments and NGOs under the continuing economic growth in the last two decades.

Thirdly, however, the nature and scope of NGO activities, particularly the activities of human rights NGOs, are relative to the function of political parties. When political parties are weak to articulate explicit platforms on the core values of the people, such as human rights, NGOs are forced to struggle for these core values in coordination with other NGOs. Thus,

their activities often have partisan nature by expanding membership and in some cases by cooperation with Western NGOs. But, when the human rights situation is improved by the change of government policies, the partisan character of human rights NGOs' activities also tends to change into divergence and fragmentation because of internal debates over leadership and strategy.

From the short-term perspective, this implies the possibility of plural articulation of human rights issues by various human rights NGOs. From the long-term perspective, however, if political parties become more representative and effective, and if they develop independent policy making capacities, the nature of human rights NGOs may also change. There might arise a possibility that either it becomes their primary goal to enhance political participation under a given political party system, or that NGOs themselves choose to become an independent political actor.

Certainly these NGOs have their own problems such as internal conflicts, splits over leadership, or management that often lacks efficiency and transparency. Also the number and capacity of NGOs is still too small to be an effective catalyst for the transformation of societies which are imbued with the distrust of public institutions as well as accustomed to state intervention.

Even impeded by all these problems, however, NGOs can play a significant role in Southeast Asia, or Asia-Pacific in general. This is due to their belief that international civil society in the region must emerge in the years to come, in order to give a regional voice to local people and hopefully to counterbalance states and business sectors where the predominantly principal actors in Asia-Pacific are located. Moreover, governments and international organizations are increasingly aware that NGOs can play an important role in planning and implementing development programs. If these new trends in Southeast Asia are taken into consideration, a creative sociological approach that is beyond the donor-recipients relation is much more necessary than ever in Japan's official policy. Also more active networking based on conceptual, not merely operational, activities on the NGO level between Japan and other Asian societies needs to be created.

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JAPAN'S MULTILATERAL ASSISTANCE LEADERSHIP: MOMENTUM OR MALAISE?

Dennis T. YASUTOMO

1 INTRODUCTION

The 1990s have not been kind to Japan. The glow of the vaunted economic miracle of the 1960s and the economic spurt of the late 1980s have faded, and any discussion of the possibility of Pax Nipponica replacing Pax Americana has disappeared in a cloud of embarrassment. Just as Japan seemed to be leading the way for the economic miracles of its Asian neighbors in the 1980s, Japan's economic slide from the early 1990s seemed to lead the way for the region's sudden economic downturn in 1997. This is not the kind of regional leadership Japan had envisioned.

As the next millennium approaches, Tōkyō's record in dealing with its domestic economy since the bursting of the bubble economy in 1991–92 and its performance in the Asian financial crisis since 1997 shape any discussion of Japan's leadership role in Asia, whether bilateral or multilateral. In both arenas, the verdict has been harsh. From abroad, Japan appears to lack the will to exert leadership or, even worse, Japanese cabinets appear to lack the ability to lead even if the will exists. As a result, Japan has endured harsh criticism not only for its failure to take the helm in the regional financial crisis, but also for its failure to halt the slide of its own economy into an unrelenting, deep recession. From within, Japanese voters have expressed their frustration by forcing the fall of the Hashimoto Ryūtarō Cabinet after the July 1998 House of Councillors election, and the assessment of the succeeding Ōbuchi Keizō Cabinet has, to date, remained equally harsh. All of this has created a concern that if the Japanese can not solve their own problems, how can they possibly solve the Asian financial crisis and assume a long-desired regional leadership role?

In contrast with the image of a passive, stagnant Japan floundering helplessly in the waves of the domestic and Asian financial crises, Japan's Official Development Assistance (ODA) policy has been characterized by activism, diversification, politicization, and greater independence in both bilateral and multilateral arenas over the past 20 years. By the 1990s, Japan assumed the status of the top ODA donor to the developing world and an increasingly prominent presence in the multilateral development banks (MDBs). Japan's ODA reached US\$ 14.5 billion in 1995 and has main-

tained a level of US\$ 9.4 billion in 1996 and 1997 (Gaimushō 1998). Japan provides aid to 162 nations and is the largest donor to over 50 nations, and its independence in bilateral aid policy has often led to clashes with the United States over the restoration of aid to controversial states like Myanmar and Iran. Tōkyō is also the first or second largest contributor to all major international financial agencies and the United Nations. Multilateral aid to international organizations increased 125.5% (US\$ 2.8 billion) from 1996 to 1997. In MDBs, Japan has managed to gain a more visible presence via increased vote shares and management and staff positions. Further, Japan has begun to challenge the current development orthodoxy in MDBs by moving into the area of development philosophy and strategy.

In other words, ODA is one area where Japan claims a leadership role. However, as the 1990s come to a close, caution may be in order in assessing the longterm prospects for Japanese ODA. As Japan enters the new millennium, ODA policy appears to have reached a turning point. ODA has lost its status as a 'sacred cow' of Japanese budget politics, suffering annual budget cuts and enduring attacks on several fronts. The momentum of multilateral aid visible in the 1980s and early 1990s appears in jeopardy at precisely the moment when not only large flows of capital are required from the multilateral institutions that depend heavily on contributions from the Japanese budget but also political leadership from Tōkyō.

This essay will evaluate the apparent malaise in Japan's current multilateral assistance policy, primarily toward the World Bank and Asian Development Bank (ADB), the two multilateral development banks active in Asia. It will focus especially on the exaggerated nature of the harsh assessment and point to the factors that lead to a revitalization of activism and, depending on one's definition, to the exercise of leadership.

2 MOMENTUM TO MALAISE?

Japan's entry into the club of foreign aid donor nations began multilaterally. On 6 October 1954, Japan joined the Colombo Plan, a technical assistance arrangement among the British Commonwealth nations. However, at that time, the World Bank constituted Japan's main MDB policy pillar, with Tōkyō being the second largest borrowing member by 1960, trailing only India. As a major recipient rather than major contributor, Japan was not intimately involved with the rule-making and agenda-setting activities in the Bank, lacking a major share of the vote, its own executive director's seat, management and staff presence, and a development philoso-

phy of its own to advocate (Shiratori 1993). Besides, in the 1950s and 1960s, bilateral aid constituted the pillar of Japan's foreign aid policy, which began in the form of reparations or semi-reparation economic co-operation agreements negotiated throughout the 1950s with Asian nations Japan had occupied during World War II. Non-reparation bilateral loans started with India in 1958.

Both bilateral and multilateral aid shared one basic objective in the early years: the promotion of Japan's economic recovery and growth. But bilateral aid also had a diplomatic political agenda: to restore friendly relations with Asian victims of Japan's wartime aggression and, by the late 1960s, to support American policy in Vietnam and Southeast Asia. While bilateral aid pursued underlying diplomatic objectives, Japan carefully avoided the politicization of MDB policy, in line with explicit restrictions against political considerations in MDB charters. Hence, Japanese ODA policy took on a dual nature, with bilateral aid increasingly susceptible to politicization and multilateral aid relegated to the realm of technical decisions.

In the 1980s, Japan became the world's largest creditor nation, enjoying huge surpluses. Tōkyō used its newly-found financial power to negotiate a new status within MDBs. Prior to the 1980s, in both the World Bank and the ADB, Japan remained fairly quiet and low-key in approach, but throughout the 1980s, a new activism reared its head. In the World Bank, Japan utilized financial contributions to improve its status, including subscriptions, contributions to concessional lending facilities, and the creation of special funds. The result was Japan's leap-frogging to the number two shareholder position, a new vice presidency occupied by a Japanese national, and an increased emphasis on Japanese staff recruitment (Ogata 1989). In the ADB, Japan's institutional weight was already heavy as the largest shareholder because of its contribution to the ordinary, soft loan, and special funds, and because of its hold on the presidency and the presence of management and staff. Japan attempted in the 1980s to convert its *de facto* number one position into a recognized and clear-cut status rather than a shared status with the US (Yasutomo 1995).

This institutional activism, focused primarily on building Japan's administrative power and status foundations, paid dividends in the late 1980s and early 1990s, as bilateral and multilateral aid policies began to converge in the areas of diplomacy and development philosophy. Several global issues triggered diplomatic activism and this convergence. Perhaps among the most important were the international debt problem, the Tiananmen Square incident, the collapse of East Europe and the Soviet Union, and the Gulf War. During this period, multilateral activities gained as much prominence as bilateral diplomacy, especially in MDBs. Japan's

major plunge into multilateral diplomacy in the 1980s was its contribution to the Third World debt crisis, which exploded in 1984. Japan devised three tranches, for a total of US\$ 65 billion, designed to recycle its considerable surplus to debtor nations through MDBs, primarily the World Bank and the ADB. It proposed a debt plan, attributed to then Finance Minister Miyazawa Kiichi, at the Toronto Summit, the core of which constituted the same two MDBs. Japan also focused much of its attention on the G7 process concerning issues such as the restoration of ODA to China after the initiation of international sanctions following the massacre of students and workers in Tiananmen Square in 1989, and the extension of economic assistance to East Europe, Russia, and the Russian Republics, with the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the European Bank for Reconstruction and Development (EBRD) serving as the major conduits.

Perhaps the most striking development in Japan's multilateral diplomacy is the attempt at intellectual leadership. In the first half of the 1990s, Japan began advocating a development philosophy or strategy at odds with the prevailing consensus in the international development community. Observers were asked to absorb the sight of a super-pragmatic Japanese foreign policy propounding an ideology or theology. The core of the ideology involved the Japanese belief in the importance of the state as well as the market for economic development. Japan's conviction of the correctness of this development strategy comes from its own development experience, reinforced in the early 1990s by the economic miracles of other Asian nations, and leading to a focus on the commonalities of regional development strategies and experiences, almost all of which involved a strong activist state. For our purposes, it is important to note that the World Bank became the focal point of Japan's new campaign to proselytize the development community with its ideas, and thus became the core of multilateral activism. The ADB's approach already reflected many of the tenets of Japan's development thinking, requiring less advocacy and more maintenance activities.

The Japanese challenge resulted in the World Bank's formation of a task force to study the Asian development experience, resulting in the well-known, controversial 1993 study of the East Asian miracles (IBRD 1993). The Report was the result of Japanese dissatisfaction with the direction and results of the orthodoxy, which had dismissed the Japanese experience, and it triggered a debate about the efficacy of over-reliance on the market mechanism. In essence, Japan entered the international development debate using the World Bank as a forum to present its alternative answer to the problems of development, and although the Japanese were not fully satisfied with the substance of the Report's analysis and conclu-

sions, its publication did represent a victory of sorts for the Japanese campaign to effect a leadership role by stimulating a re-thinking of international development approaches (Wade 1996; Yasutomo 1995). The East Asian Miracle report succinctly summarizes the tenets of the orthodoxy, and Ohno and Ohno have deftly explained and analyzed the basic tenets of Japan's development approach (Ohno and Ohno 1998).

However, can one argue that the Report's publication represented the peak of Japan's activist multilateral diplomacy? Japan seemed to virtually disappear from the multilateral scene thereafter: the spotlight turned to the US; Japan's visibility lessened in the World Bank; it abandoned its attempt at predominance in the ADB; its bilateral efforts in Sub-Saharan Africa stood out and still do more than its aid to the African Development Bank; it achieved its own Executive Director seat in the Inter-American Development Bank, but the US shadow was more present than ever; the Asian financial crisis seemed to undermine the Japanese development model; and who hears much about Japanese activities in the European Bank for Reconstruction and Development?

We can identify several reasons for the apparent retreat from activism. First, by the end of the 1990s, bilateral ODA once again began to out-pace multilateral aid policy, returning to the parallel but bifurcated nature of Japan's aid policy. Much of this has to do with the dissipation of Japan's aid focus into two broad categories in the era of post-Cold War 'global issues'. On technical issues, ODA has become a less distinct policy arena and more of a component in fields such as the environment, AIDS research, biodiversity, women in development, and global warming. International conferences or organizations shape policies in these areas, but the implementation often takes bilateral forms. For example, Japan's pledges to contribute to international environmental policies are announced at international gatherings, but specific projects are negotiated bilaterally, as with the environmental research centers in China, Indonesia, and Thailand.

On diplomatic issues such as democratization, human rights, terrorism, illegal drugs, nuclear testing, and the transition to market economies, discussion occurs in international fora, but, again, implementation is often handled bilaterally. For example, Japan has engaged in a recent spate of 'sanction diplomacy'. MDBs are used by nations to level sanctions against a country, but the decision is usually made on a bilateral basis. Japan resorted to sanctions through a stoppage of yen loans to China (1995), India (1998), and Pakistan (1998) as a protest against nuclear testing, moving ahead of or parallel to the international reaction. For India and Pakistan, Japan initiated sanctions first, and then called for a Conference on Urgent Actions for Nuclear Non-proliferation and Disarmament in Tōkyō

in August of 1998, outside of MDB auspices (*Japan Times* 31 August 1998). Japan's immediate reaction to the launching over Japanese territory of a missile or satellite by North Korea in 1998 was not to take it to an international body but to reconsider food aid. The reinstitution of ODA is also bilaterally negotiated, as seen in the cases of aid restoration to Myanmar, Vietnam, and Iran, in the face of US opposition. And on aid to Russia, Japan still follows multilateral strictures, especially under G7 and IMF guidance, but both Prime Ministers Hashimoto and Ōbuchi have pursued the bilateral route more vigorously throughout 1998.

The bilateral emphasis is due partly to the new Japanese emphasis on ODA as a diplomatic tool (*gaikō shudan*). To put it another way, the more Japan utilizes ODA as a diplomatic tool, the more important bilateral aid becomes. The Japanese government wants recognition for its aid, reflected in the widely-used slogan *kao ga mieru enjo*, or a more visible aid policy that gains kudos for its positive contributions. Japan's contributions to multilateral banks often disappear in the bowels of an international organization, with individual contributions hidden from sight. Besides, Japan does not have to await for the approval of its policies by a board of directors, nor does implementation depend on an international bureaucracy. Thus, bilateral aid is the more effective means of pursuing the national interest, however defined, for which Japan can take credit. Multilateral aid becomes one policy implementation channel, and not always the most important channel.

A second major change in the multilateral terrain has been the ascendancy of the IMF in the 1990s. Despite the creation of the EBRD in 1991, and with the onset of the Asian financial crisis in 1997, assistance to Russia and the Asian financial recovery are IMF turf. The IMF is the flagship institution for promoting reform in Russia and leading rescue efforts in Thailand, South Korea, and Indonesia. In terms of these two roles, MDBs play a supplementary role. The amount of Japan's contributions to each institution for Asian rescue efforts reveals the order of importance and priority: the IMF, the World Bank, and the ADB. However, the IMF poses some problems for Japanese diplomacy because Japan does not have full confidence in the IMF's policy prescriptions. Tōkyō proposed an Asian Monetary Fund early in the regional financial crisis, but the idea died under strong opposition from the US and the IMF. Without a concerted Japanese-led international bailout effort, the IMF thus remains the main alternative to address the crisis. Japan therefore works through the IMF. But the other problem is that Japan's institutional weight in the IMF is weak. Tōkyō's institutional efforts had focused on the World Bank and not so much on the IMF, which the Japanese view more as American and European turf. Only in the ADB does Japan occupy a predominate status, and

the ADB has contributed to regional rescue efforts, but in a low-key, almost invisible way.

Third, there is the strong impression that Japan has not followed through on perhaps the most notable area of its activism. Japan's challenge to the neo-classical development model culminated in the initiative within the IBRD that resulted in the East Asian Miracle Report. The Japanese dissatisfaction with some of the Report's conclusions led to a cottage industry dedicated to criticizing the Report, but Japan did not challenge the Report openly, directly, or severely. The Japanese seemed to wait for others to challenge the Report and tout the virtues of the Asian development model. Then came the Asian financial crisis, which has called into question the appropriateness of the model. Japan's counter-attack on the Miracle Report and the neo-classical orthodoxy appears side-tracked, and it is not yet clear how Japan will assess the longterm implications of the crisis for the Asian development experience.

Fourth, domestic developments have stymied policy activism. Partisan politics finally hit ODA, long a 'sacred cow' of Japanese budget politics. The Japanese Diet has slashed the annual ODA budget by 10% per annum since 1997. Japan has managed to maintain its hold on first place as the world's largest donor nation, but the amount dropped from a peak of almost US\$ 15 billion in 1995 to the US\$ 9 billion range since. Even though multilateral aid is the most unpredictable item in the ODA budget, fluctuating between around 25–30% of the annual budget because of shifting subscription and contribution requirements (which accounts for the 125% increase in 1997), the budget cuts hit multilateral institutions hard, especially the United Nations but also the MDBs.

Administrative reform politics have also affected multilateral aid policymaking. The primary responsibility for MDB policy rests with the Ministry of Finance (MOF). It was MOF that initiated the process that resulted in the IBRD East Asian Miracle Report. In the first half of the 1990s, a pattern of multilateral decision-making emerged whereby the Finance Ministry and the Ministry of Foreign Affairs (MOFA), despite the traditional rivalry and jurisdictional battles, worked closely on MDB policy. However, a consequence of the targeting of the MOF for administrative reform has been the curtailment of its power and influence. This has tilted the field in favor of MOFA, the longtime proponent of *kao ga mieru* bilateral aid over the MOF, a strong supporter of apolitical multilateral aid. MOFA has also been joined by a rejuvenated ODA policy actor, the Ministry of International Trade and Industry (MITI), a reflection of the new aggressiveness of the private sector on ODA issues in an era of economic slowdown.

In addition to these points, the MOF has received bad press because of two MDB-related scandals in the summer of 1998. Both incidents involved

the World Bank, one concerning the use of a Japanese trust fund within the Bank for supporting the training of Finance Ministry officials, raising questions in the Diet about the appropriateness of utilizing ODA for Japanese government officials for service in the World Bank rather than meeting the needs of recipient countries. The other incident involved two Japanese World Bank officials receiving kickbacks for awarding a procurement project to a Japanese firm, resulting in their dismissal. MOF quickly curtailed the use of the fund for training its own officials and fully supported the IBRD's efforts to investigate the latter allegations, but the MOF, which oversees the uses of the trust funds, had come under the intense scrutiny of the press (*Asahi Evening News* 16 July 1998; *Washington Post* 16 July 1998; *Japan Times* 16 July 1998; *Japan Times* 17 July 1998; *Japan Times* 6 September 1998). The question therefore arises whether or not the MOF, over the long run, can regain some of the policy momentum built in the 1980s and early 1990s.

Finally, most analyses of Japan-US relations in MDBs identify Washington as a major obstacle to Japan's multilateral leadership. The standard view assumes competition and contention between Washington and Tōkyō. In the World Bank, because of the predominant status of the US in setting the agenda and maintaining the rules of the game, any Japanese initiative that challenges the Bank's orthodoxy and standard operating procedures can be considered, almost by definition, a challenge to the United States. But many observers also point to a more active opposition by the US toward Japanese moves. Ogata was among the first to identify the competition and strain in the US-Japan relationship in the World Bank over vote shares in the early 1980s (Ogata 1989). By the end of the decade, Japan had adopted a 'mild challenger' stance, though supportive overall of American policies and position (Yasutomo 1995). Rapkin and Strand provide the most widely-held current assessment of US-Japan relations within the Bank: 'Heretofore, *willingness to share* leadership has been a greater problem for a once hegemonic United States than for a Japan seeking to expand its global role. American rhetoric about sharing global burdens and responsibilities seems to have translated into American expectations that Japan will cover the costs of American initiatives without being factored into agenda-setting and policy-formation activities' (Rapkin and Strand 1997, 270). Awanohara (1995, 162) captured the Japanese (MOF) response: 'There is a sense among Japanese bureaucrats ... that even though the US has claimed to want Japan to take on the greater burden of leadership, it may not actually welcome Japan taking initiatives'.

There is a corollary proposition here – that MDBs themselves block Japanese initiatives. The World Bank is depicted as heavily influenced by management and staff trained in the US and dedicated to the develop-

ment orthodoxy learned in American educational institutions. Two Japanese veterans of the World Bank and IMF assert that 'global propagation of accepted Western norms has become a major *raison d'être* for international organizations during the last half century' (Ohno and Ohno 1998, 12). Wade's narrative of Japan's struggle to get the East Asian miracles study on the agenda provides a vivid example of opposition within the Bank, which viewed Japan's efforts as a clear threat, with part of the reason being that Japan's view on development 'would run against the strategic and diplomatic power of the US, which has used the Bank as an instrument of its own external infrastructural power to a greater degree than any other state' (Wade 1996, 14).

Even in the ADB, despite the large Japanese presence and financial weight, observers feel that the US controls the agenda. According to one assertion, the US basically let the Japanese dominate the ADB in the early years in return for a strong strategic partnership, but in later years, fought hard to counter economic benefits accruing to Japan from ADB activities (Woo-Cumings 1995). Perhaps this assessment exaggerates American policy, but there have been instances where the US strongly opposed Japanese efforts to gain predominance in the Bank (Yasutomo 1995). Another observer notes that Japan actually receives less from the ADB than it contributes, implying that Japan does not take advantage of its weight (Wan 1995). Pascha notes that the ADB is sensitive to American opinions: 'One even gets the impression that a conscious effort is made to blur possible distinctions and to avoid formulating clear statements which could be in contrast with Washington' (Pascha 1999, 22). Also, there have been occasions from the founding years when the ADB, as an institution, and usually in the person of the Japanese president, clashed with Japanese preferences in the Bank irrespective of US activities (Yasutomo 1983; Yasutomo 1995).

The picture by the end of the 1990s is that of a holding pattern. Japan had achieved a certain amount of success in pursuing an activist course in MDBs throughout the 1980s and into the 1990s. Many of its major institutional objectives had been attained, resulting in a sense of relative satisfaction; its diplomatic agenda had incorporated the MDBs, but the scene shifted back to the bilateral dimension; and it had issued its challenge to the development orthodoxy without much visible follow up. In addition, domestic political developments stymied policy movement, and outside Japan, both the US and the MDBs themselves strove to blunt Japanese initiatives and activism, thus limiting Japan's influence and effectiveness. As a result, it appears that Japanese multilateral activism had lost its momentum.

3 MALAISE TO MOMENTUM?

Despite all of the problems Tōkyō encountered in the past decade, it is premature to sound the death-knell for Japan's multilateral aid-related diplomacy. We can identify several factors that point either to continued or revived activism. In essence, Japan will not abandon multilateral activism because of its utility and necessity. It may take a less visible, low-key form in selected technical and diplomatic arenas, and in a wider range of multilateral fora. This may not constitute 'leadership' for many observers, but neither does it qualify as malaise.

First, the evolution of ODA into a diplomatic tool provides one guarantee that multilateral diplomacy will remain in the spotlight. Even if bilateral aid takes center stage, the broad range of multilateral institutions, including MDBs, still have their uses. Japan still assumes that ODA is one of the few means at its disposal to contribute substantively to the world community, especially to the post-Cold War global issues agenda. Multilateral institutions, ranging from international fora such as the United Nations Conference on Environment and Development (UNCED) to traditional agencies such as the International Atomic Energy Agency (IAEA), are at the core of international activities, and Japan's presence has heightened in these arenas. Recent Japanese diplomatic initiatives in brokering the birth of a new Cambodian government, which included pledges of aid, and the dispatch of 80 Self-Defense Forces and 20 Japan International Cooperation Agency (JICA) personnel to aid in disaster relief efforts in Honduras in 1998 may be the harbinger of things to come in multilateral-related aid policy.

The conclusion is that bilateral and multilateral aid have converged once again. For the future, the Japanese do recognize the need to strengthen bilateral and multilateral policy planning. This is reflected in the recommendations of the Council on ODA Reforms for the 21st Century final report, submitted to MOFA in early 1998, which advocated better coordination between domestic policymaking organs and multilateral institutions: 'If it is to pursue a uniform and consistent set of aid policies, Japan will need to strengthen its ties with multilateral institutions and ensure that those ties are effectively echoed by its policy goals. To this end, it will be essential to heighten the policy dialogue with aid recipients and at the same time have all agencies and ministries concerned work more closely together and aim for stronger policy dialogues and personnel exchanges with the headquarters of multilateral institutions' (Council 1998, 36).

Further, the locus of multilateral diplomacy has been expanding beyond multilateral banks, which also accounts, in part, for the lower Japanese profile in MDBs. We see Japanese activism in these other multina-

tional groups, ranging from APEC and the ASEAN Regional Forum to the Red Cross¹. For example, Japan utilized multilateral channels to resume ODA to Myanmar. Japan suspended aid for new projects in 1988 after a military take-over of the government. The first step toward restoration of aid was through the Red Cross and other non-governmental organizations in 1994. Its major push came in 1997, when Japan took the issue to the G8 Denver Summit, after which Japan announced its decision in March of 1998 to resume yen loans for the construction of an airport in Yangon. The Myanmar case is reminiscent of the step-by-step process by which Japan restored ODA to China after Tiananmen Square, in which the World Bank and ADB resumption of lending contributed to the softening of the environment that led to Japan's resumption.

None of these developments should be interpreted as the Japanese abandonment of the existing MDBs. In fact, the World Bank and ADB constitute the pillars of the US\$ 30 billion plan for assistance to Asian nations hit by the financial crisis, unveiled by Finance Minister Miyazawa in October 1998 (*Japan Times* 4 October 1998). According to early reports, the Japan Export-Import Bank and the Overseas Economic Cooperation Fund (OECF) will work with the two banks in the areas of co-financing, corporate debt restructuring, bank loan guarantees, and the establishment of an interest subsidy fund in the ADB. In addition, at the APEC summit in Malaysia in November, Japan and the US agreed to co-sponsor an additional US\$ 5 billion initiative that will work through the ADB and World Bank, with Japan pledging to provide US\$ 3 billion (*Nihon Keizai Shinbun* 25 November 1998; *Yomiuri Shinbun* 18 November 1998; *Asahi Shinbun* 24 November 1998)

Even if one can argue that attention has moved away from the MDBs, in the long run, Japan is bound to return to these fora because of the nature of the issues. Once the Asian financial crisis stabilizes, longterm development needs will take center stage again, and this is the MDBs' turf. Global issues require global efforts, and while not all require multilateral assistance, it is difficult to imagine Japan ignoring the MDBs in areas such as afforestation, disaster prevention, AIDS, biodiversity and other technical areas, especially in fields where Japanese experience is thin and expertise is weak. So the end result may be not the demise of multilateral diplomacy in the future but rather the deepening of involvement in MDBs and the expansion of activities to other international fora.

A second reason to expect continued multilateral activism is the domestic underpinning of policymaking. To cite two factors, we can point to

¹ APEC is the abbreviation for Asia Pacific Economic Cooperation; ASEAN for Association of Southeast Asian Nations.

domestic support for aid and bureaucratic activism. On both fronts, the domestic situation may not be as bad as it may seem. ODA budget slashing is occurring in the broader context of party politics and administrative reform. While the current mood is toward slashing the ODA budget, political leaders recognize and accept the ODA function as a useful diplomatic tool. This will prevent the complete gutting of the ODA budget. And while public opinion supporting ODA has slipped in the area of increased spending, if one combines ODA with specific uses of aid, the approval rate soars. For example, the public strongly supports Japanese efforts in the area of humanitarian assistance, contributions to world peace, and international environment policy, in which ODA constitutes a major pillar (Sōrifu Hokō Shitsu 1998). Hence, specific uses of aid and the absorption of ODA into diverse technical sectors have the effect of maintaining strong support for aid.

Also, ODA is thought to lack politically influential interests groups and 'policy tribes' (*zoku giin*), contributing to the targeting of ODA for budget cuts. However, in recent years, an old constituent has reemerged and new constituents are emerging. The business community, a traditional beneficiary of the commercial uses of ODA, had been grumbling about the efforts of the Japanese government to untie aid and lighten its commercial objectives. However, business, aided by its ally MITI, has staged a 'comeback' in an era of deep recession by waging a partially successful battle to restore some tied aid in the field of environment. In addition, new constituents have emerged. Perhaps the most notable are Non-Governmental Organizations (NGOs). Internationally-oriented NGOs proliferated as part of the NGO boom that emerged in the aftermath of the 1995 Kobe earthquake. MOFA is actively involved in nurturing this constituency, including financial support and inclusion in project-related delegations. NGOs have also established working relationships with politicians, foreign NGOs, and international organizations. And the Diet passed a Non-Profit Organization (NPO) Law in March 1998, giving many of these groups legal status. For the most part, they tend to be supportive of Japan's international development efforts as new ODA constituents, though at this stage, their weaknesses outweigh their strengths and their influence is more potential than actual. However, the expansion of constituents potentially strengthens the support base for such recommendations as that of the Council on ODA Reforms for the 21st Century: 'Given Japan's position as a country highly dependent on the rest of the international community, and in view of the record Japan has set with ODA in terms of building international trust, we must urge that the government do everything in its power in the years ahead to ensure that ODA is available in quantity as well as quality' (Council 1998, 37).

The Council also stresses the importance of ministries and agencies working more closely together in the area of multilateral aid. To some extent, this was the case in the early 1990s, before the current broadside aimed at 'bureaucrats' and especially the Ministry of Finance, the core of MDB policy. In fact, one might argue that the loss of momentum in MDB policy coincides with the onset of the harsh attacks on the power and influence of the MOF. Japan's activism in the early 1990s was centered on the MOF, in a partnership with MOFA, but reform efforts targeted the MOF, shaking its standard operating procedures and side-tracking its policymaking capabilities. However, policymaking in the Ministry on the international finance side seems less affected by the surrounding turmoil than many domestic-oriented bureaus and divisions, and the Ministry seems to be ready to get back on track as the general headquarters for the implementation of the Miyazawa plan.

In the long run, therefore, the ability of the Japanese government to revive activism may depend on the ability of the MOF to adjust to current reform moves, and to hold its own against an increasingly active MOFA and resurgent MITI. The assumption here is that initiative-taking rests in the hands of the bureaucrats more than the politicians, who still lack both the technical expertise in the field of development and international financial policy necessary to fashion an MDB policy. As long as the bureaucracy remains hobbled by political maneuvering, activist policies will be stymied. The hope is that greater transparency in policymaking, closer monitoring of and accountability for aid, and greater effectiveness will strengthen multilateral aid policy. Notably, the main reform issue involves efforts by politicians to oversee and improve, not abandon, ODA through such mechanisms as a foreign aid law.

Recent bureaucratic initiatives provide one reason why the attention has focused away from MDBs. A point made earlier was that Japan had apparently not followed through on its challenge to the development orthodoxy. This may be true within the IBRD, perhaps, but outside the bank, the Japanese have been hyperactive. The Miracles Report spawned numerous studies and discussions about the efficacy of the Japanese or Asian model, especially within OECF and among Japanese scholars. In the policy realm, the government is attempting to propagate the Japanese approach beyond Asia. Just two different types of examples suffice. The convening of the Tōkyō International Conference on African Development (TICAD), launched in the fall of 1993 just as the World Bank report was published, and TICAD II in November of 1998 is an MOFA-led effort to explore the application of the Japanese development experience to Africa. And the many programs and conferences of the MOF's Institute of Fiscal and Monetary Policy invite government officials of developing na-

tions and transitional economies to Tōkyō for briefings and discussion sessions on various aspects of Japan's economic and financial institutions and system.

So while Japanese activities within the World Bank may seem dormant, the 'action' may have shifted back home or to other fora as Japan tries to build upon the initial success in getting the Asian experience recognized. In this sense, the Asian financial crisis has yet to dent the confidence many Japanese have in their own development model. Or to put it another way, even if one argues that Japan has not followed up on the Miracles Report within the IBRD, it is waging a kind of guerrilla warfare internationally outside the bank.

A third reason for expecting Japanese activism to continue is the fact that MDBs themselves actively seek increased Japanese involvement in bank activities. The opposition to Japan's development ideas in the World Bank is instructive, for despite the opposition, Japan did manage to get the Asian experience on the agenda both within and without the bank. The IBRD could not ignore Japanese pressure to study the Asian experience and to publish the Report, however watered down the conclusions, because of Japan's heightened presence. Perhaps the best indication of MDB interest in Japan is the increased activities of the World Bank Tōkyō Office in the past three years, and the opening in 1997 of Tōkyō representative offices by the Inter-American Development Bank, the IMF (the Regional Office for Asia and the Pacific), and by the Asian Development Bank, which also inaugurated a separate ADB Institute in Tōkyō, funded by the Japanese government, in 1998. The presence of these offices in Tōkyō has implications for Japanese access, networking, funding, staff recruitment, and lobbying efforts in the future.

Fourth, much is made of the competition and contention between Japan and the US in MDBs. There are serious differences between those of Tōkyō and Washington, and some of these issues are likely to create considerable friction in the near future. The most recent visible example was the US-led squashing of Japan's 1997 initiative in calling for the creation of a new Asian Monetary Fund to deal with the emerging financial crises in Thailand, South Korea, and Indonesia (Altbach 1997), and the Japanese retort in the form of the 1998 US\$ 30 billion Miyazawa Plan, followed by the US effort to restrain Japan via the US\$ 5 billion additional commitment. Japan remains committed to the idea of the fund and will pursue it in some form despite US opposition.

However, this rivalry is exaggerated, at least as a general description of bilateral relations. In none of these institutions, including the ADB where Japan's position is strongest, is Tōkyō angling to displace Washington. The picture is more complicated. On some occasions, Japan resents

the heavy hand of US influence and ideological fervor, a factor in the Japanese East Asian miracles report campaign and US–Japan relations in the ADB in the 1980s. In these instances, Japan tried to moderate or counter American maneuvers, usually indirectly. Yet on other occasions, Japan feared the withdrawal of American interest in the bank, as was the case in the ADB and Congressional debate on IDA 11² contributions during the first Clinton administration. In this case, Japan attempted to induce the US to restore, maintain, or increase contributions and attention. On the other hand, the US vacillated between demanding Japanese leadership and hesitating when Tōkyō attempted to take the spotlight.

On most occasions, the US and Japan cooperate on the thrust of MDB policies. Despite differences in development philosophy, exchanges on the board of directors between American and Japanese representatives on specific projects do not disintegrate into debates over the Japanese versus neoclassical development models. In fact, Japan's problems have often come from other quarters, for example, from European members over whom Japan leaped to attain number two status in the World Bank (and the IMF). Also, observers have noted the intrusion of extraneous issues in US–Japan relations in MDBs, for example, the US hesitation on increased vote shares because of Japanese intransigence in bilateral negotiations on the financial liberalization of their domestic market.

A key factor in US–Japan relations is the difference in the utility of MDBs. All recent observers of Japanese policy assume that MDBs mean more to Japan than to the US. Thus the level of activism reflects this asymmetry in perceived stakes. All previously cited observers of Japan–World Bank relations contrast the intensity of Japan's policy with America's apparent retreat. Japan's stake in the ADB has always been high, given its particular history and status within the bank, ensuring close attention. When the US does turn its attention to these institutions, sparks may fly, as is usually the case when capital increases are involved, especially for concessional lending facilities. But these are usually not exclusively US–Japan bilateral spats. And when the US does flex its muscles, Japan often gives way, at least initially, as in the case of economic sanctions and the Asian Monetary Fund. Japan, however, usually engages in countermeasures when its national interests are at stake, including the lifting of sanctions after a suitable period of time.

The one divisive issue that captures the attention of most observers is the current debate on development philosophy. There seems to be a feeling that if there is any issue that may occasion bitter US–Japan conflict in

² IDA 11 refers to the 11th replenishment of the International Development Association, the concessional lending facility of the World Bank.

the future, it is this toe-to-toe battle over the role of the state in development (Rapkin and Strand 1997). However, even here, there are mitigating factors at work. The Asian financial crisis has raised questions about the efficacy of the 'Japanese' or 'Asian' approach. Critics assert that the very strengths of the model ultimately led to the current crisis, including the heavy hand of government and culturally-based 'crony capitalism'. Also, the US has not taken the bait. The fervor of the Reagan administration representatives for the market and private sector leadership in development began to cool in the Bush administration. By the Clinton administration, the battle had essentially been won as far as an international consensus on the centrality of the market is concerned. The US does not draw a line in the sand on development policy. Finally, Japan's effort to put an alternative model on the table essentially succeeded. The basic tenets of Japan's development 'ideology' have gained recognition and concessions from the orthodoxy, notably the 1997 IBRD World Development Report on 'The State in a Changing World' (World Bank 1997), and many Japanese have begun to reassess the Asian experience in light of the regional financial crisis. Japanese are still honing the tenets of their model. Hence, compromise and convergence appear to be the state of the 'great debate', thus mitigating US-Japan conflict and preserving Japan's intellectual leadership role.

A point should be made that, on the whole, Japan has achieved its major goals in MDBs regardless of American support or hesitation. Tōkyō can list a series of achievements in MDBs: increased vote shares and number two status (IBRD/IMF), management positions (IBRD), exclusive executive director post (Inter-American Development Bank, IDB), restoration of aid to China (IBRD), emphasis on Central Asian Republics (ADB and EBRD), a task force on East Asian development and the publication of the report (IBRD). Japan's *quid pro quo* is not hegemony but status. The difference with the past is that status encompasses recognition not only of Japan's financial contributions and strength but also its intellectual and policy contributions.

Finally, an 'Asia factor' underlies Japan's multilateral activism. As long as relations with neighboring countries remain a central focus of Japanese diplomacy, activism will reign. Tōkyō's strongest and most decisive actions involve Asia in some way: post-Tiananmen China; Myanmar aid restoration; the Asian Monetary Fund proposal; sanctions against India and Pakistan; the Miyazawa plan; Cambodia peace initiatives, etc. In general, within multilateral institutions, Japan plays the role of spokesperson or advocate for Asian views and interests, and it is in this role that Japan is more likely to stand against the West, as seen in the recent opposition to Ukrainian aid in the IMF because of conditions more lenient than for In-

donesia (*Japan Times* 15 September 1998). The underlying concern for Asia in Japan's MDB policy is remarkable (Yasutomo 1995), and it is at this nexus of Asian-Western interaction that we can expect to see Japanese leadership well into the next century.

4 CONCLUSION

In sum, Japanese multilateral diplomacy in the late 1990s, though low-key, is not stagnant. We can still identify activism. The question is whether this activism constitutes leadership. If we define leadership as setting the international agenda and establishing the rules of the game, Japan has a long way to go. However, it can try to establish footholds in 'niches' such as multilateral institutions, the Asian region, and the environment. But then, too, we live in an era when leadership seems to be in short supply in almost all of the major powers. This puts Japan, a nation striving for 'normal nation' status, in the international mainstream and criticized for acting normally.

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CHANGING JAPANESE ECONOMIC POLICY TOWARD EAST ASIA IN THE POSTWAR PERIOD

Ryōkichi HIRONO

1 INTRODUCTION

Japan's major policy thrusts for the economic development of East Asian countries (North- and Southeast Asia)¹ have made dramatic changes over time since the end of World War II. On the one hand, the Japanese economy has grown from a small, war-torn economy to the world's second largest economy during this period. The Japanese industry has gone through the enormous process of restructuring, moving from labor-intensive to capital- and technology-intensive sectors and from goods- to service-producing sectors. On the other, many economies in East Asia have also expanded remarkably during the same period, growing out of poor, agrarian economies into middle-income, newly industrializing economies (NIEs) and near-NIEs. In this process there has been an enormous expansion in the international trade, investment and aid in East Asia and a remarkable strengthening of the economic relations between Japan and East Asian countries. The vast changes seen in both Japan and the rest of the East Asian economies have thus been both the causes and effects of Japan's changing economic policy thrusts toward East Asia and East Asia's changing economic policies toward Japan.

This paper intends first to present the changing economic relations between Japan and the rest of the East Asian economies during the last half a century, secondly to analyze the major shifts in Japan's economic policy toward East Asia in terms of those factors responsible for such changes both in Japan and East Asia in the global context. Finally, this paper will make several policy recommendations to Japanese and East Asian governments.

¹ Northeast Asia includes such countries as the Democratic People's Republic of Korea, Japan, the People's Republic of China, Mongolia and the Republic of Korea and such territories as Macao and Taiwan. Included in Southeast Asia are Brunei Darussalam, Cambodia, Indonesia, Malaysia, Myanmar, the People's Democratic Republic of Lao, Philippines, Singapore, the Socialist Republic of Vietnam and Thailand.

2 TRENDS IN JAPAN–EAST ASIAN TRADE AND INVESTMENT RELATIONS, 1950–2010

2.1 The decades of rapid trade expansion, 1951–1970

Once the process of the immediate postwar economic reconstruction and reforms of Japan had been completed between 1945 and 1950 and laid down the foundation for the succeeding period of economic expansion, Japan became interested in reaching out for closer trade and economic relations with its neighboring East Asian countries to continue its economic growth and industrial development. Japan's perception of East Asian countries thus emerged first and foremost as its export market and source of raw materials. All the Japanese economic policy measures toward East Asia were to promote Japan's exports to the region and simultaneously enable Japanese industries to secure the continuous supply of the necessary raw materials at a reasonable cost. While this perception varied in strength among different industries, it persisted in many segments of the Japanese industry until the late 1960s when Japan was constantly threatened with trade and payments deficits, thus forcing the Government of Japan (GOJ) to implement tight money and fiscal policies.

Japan underwent a dramatic economic reconstruction during the period 1945–50 and sustained its high rate of economic growth during the succeeding two decades until 1970 (Table 1). In the history of Japanese economic development since the Meiji Restoration of 1868, this period stands out by attaining the highest rate of economic growth ever recorded for a sustained period of time. In the 1950s, Japan's national income doubled and the same was repeated during the 1960s, partly by the Income Doubling Program (1961–70) pursued by the GOJ as its top priority, thus raising Japan's gross domestic product (GDP) from 1.2 percent in 1950 to 3.4 percent of the combined GNP of the industrial countries in 1970 (for a more detailed discussion see Hirono 1980).

Along with the high rate of economic growth between 1950 and 1970, there was a steady restructuring of the Japanese economy shifting from primary to secondary and tertiary sectors and so also with the Japanese manufacturing industry, shifting from labor-intensive and low value added consumer products to capital-intensive and higher value added consumer products and capital goods sectors (see Table 2). This industrial restructuring throughout the two decades reflected a changing competitive position of those different sectors and industries of Japan in the international market.

This was partly a natural outcome of the GOJ's policy shift in favor of trade liberalization announced in 1961 and foreign investment liberaliza-

Table 1: Gross domestic products of major industrial countries, 1950–1997

Country	1950		1970		1990		1997		1997*
	bn US\$	%	bn US\$	%	bn US\$	%	bn US\$	%	
Canada	40	4,2	253	4,2	570	3,6	603	2,7	19.290
France	60	6,4	652	10,9	1.191	7,5	1.397	6,3	26.050
Germany	72	7,6	819	13,7	1.488	9,3	2.100	9,4	28.260
Italy	37	3,9	394	6,6	1.091	6,8	1.145	5,1	20.120
Japan	11	1,2	204	3,4	2.943	18,4	4.202	18,8	37.850
United Kingdom	71	7,6	523	8,7	975	6,1	1.272	5,7	20.710
USA	507	53,7	2.587	43,1	5.392	33,7	7.746	34,7	28.740
Industrial countries	944	85,8	5.993	81,8	15.993	82,7	22.322	79,3	25.700
Developing countries	183	14,2	1.334	18,2	3.334	17,3	5.910	20,7	1.250

Note: The figures for industrial countries include those for high-income developing countries.

* per capita GNP in US dollars

Source: Miyazaki, Okumura and Morita (1981), World Bank (1972, 1992, 1995, 1998), Keizai Kikakuchō (1982)

Table 2: Gross domestic product by kind of economic activity, 1955–1996

Industry	1955	1965	1975	1985	1990	1995	1996
Primary sector	158,7	310	8,141	10,214	10,921	9,351	9,308
Secondary sector	297,3	136,02	598,99	121,013	165,769	170,665	175,395
Manufacturing	235,6	107,47	448,01	946,73	121,219	119,261	121,554
Food & beverage	589	147,9	361,1	654,2	800,1	928,6	919
Textile products	237	708	176,2	301,1	310,9	179,5	173,9
Clothing	49	179	577	170,1	219,1	243,8	229,2
Wood & wood products	79	251	598	137,5	166,4	152,7	153,3
Furniture & fixtures	34	172	472	120,5	175,7	155,6	159,1
Pulp & paper	83	316	124,4	229	308,1	322,7	328
Printing & publishing	120	412	181	455,2	636	673,5	690,3
Leather & leather products	6	102,4	116	382	475	384	368
Rubber & rubber products	31	134	559	119,5	163	153,5	156,7
Chemical products	209	953	405,7	795,6	112,72	119,84	119,02
Coal and petroleum products	67	571	737	396,1	469,3	554,7	535,6
Ceramics & clay products	94	456	181,7	393,6	500,5	496,5	500,5
Iron & steel	158	683	283,3	518,8	620,9	496,9	492,1

Industry	1955	1965	1975	1985	1990	1995	1996
Nonferrous metals	46	148	927	156,6	211	196,7	209,2
Fabricated metal products	78	697	180,9	552,3	805,5	797	811
General machinery	133	112,9	387,6	100,02	136,02	121,31	127,69
Electrical equipment	103	826	424,7	148,63	200,85	196,43	201,65
Transportation machinery	162	108	462,7	977,4	125,82	124,94	133,98
Precision machinery	44	219	703	183,4	202,1	167,3	173,8
Miscellaneous	36	309	136,8	169,8	233,6	228,9	222
Construction	426	247,4	143,22	253,81	434,28	503,32	527,68
Tertiary sector	442,5	171,11	802,87	189,192	253,350	303,204	315,158
Total	898,5	338,13	148,327	320,419	430,040	483,220	499,861

Note: in billions of yen at current prices

Source: Sōmuchō Tōkeikyoku (1971, 1998)

tion announced in 1967. This resulted in the increasing economic integration of Japan into the rest of the world economy through expanding international trade and investment. These policy shifts were in line with, and were promoted under, the Kennedy Round of the multilateral trade negotiation during the 1960s. Thus, there was a rapid expansion in Japan's foreign trade with the rest of the world, accompanied by steady restructuring in terms of commodity composition and destination.

The war in the Korean peninsula starting in mid-1950 saw a dramatic expansion in the Japanese exports of labor-intensive manufactured goods such as processed foods and textiles to the United Nations forces fighting in Korea whose special procurement program alone reached as high as US \$ 300–350 million annually. Throughout the 1950s and 1960s, East Asia and North America remained the major markets for Japanese exports, comprising roughly two-thirds of the total exports. However, the United States by the mid-1960s replaced East Asia as Japan's largest export market (see Table 3). While food and textile products continued to be major items of Japanese exports throughout the 1950s, heavy and chemical industry products replaced them as Japan's largest export item during the 1960s. On the import side, however, foodstuffs, raw materials and fuel remained the major items of interest to Japan in feeding its expanding population and rapidly growing industries.

As most East Asian countries began their industrialization program during the 1960s, synthetic fibres, iron and steel and other industrial materials as well as machinery and equipment became increasingly important in Japanese exports to these countries, exceeding 50 percent of Ja-

Table 3: Japanese exports by destination, 1955–1997

Destinations	1955	1965	1975	1985	1990	1995	1997
Asia & Middle East	40.6%	36.9%	36.7%	32.6%	34.1%	45.5%	44.5%
China	3.0%	0.0%	4.0%	7.1%	2.1%	5.0%	5.2%
East Asia except China	29.0%	n.a.	20.7%	17.4%	27.7%	30.4%	35.9%
Others	9.0%	n.a.	12.0%	8.1%	4.3%	10.1%	3.4%
Western Europe	10.1%	12.8%	18.5%	16.3%	23.4%	17.4%	17.5%
North America	24.7%	28.0%	22.1%	38.0%	33.9%	28.6%	32.5%
Canada	2.2%	2.8%	2.1%	2.6%	2.4%	1.3%	1.4%
United States	22.5%	25.2%	20.0%	35.4%	31.5%	27.3%	27.8%
Latin America	7.8%	6.0%	8.5%	6.5%	3.5%	4.4%	1.8%
Oceania	2.7%	2.4%	4.1%	4.0%	3.1%	2.4%	2.4%
Africa	12.6%	12.0%	9.9%	2.7%	2.0%	1.7%	1.3%
USSR & Eastern Europe	1.5%	1.9%					0.6%
Total (in billion yen)	700,0	3,320,0	16,545,0	41,956,0	41,457,0	41,531,0	50,938,0

Note: The figures for USSR and Eastern Europe for the period 1975–95 are included in those for Europe.

Source: Sōmuchō Tōkeikyoku (1951, 1961, 1971, 1981, 1991, 1997)

pan's manufactured exports by 1965. While East Asia, being Japan's neighbors, was an important market for Japanese manufactured exports, the region fed the rapidly expanding Japanese industries with much of the necessary minerals, agricultural materials and crude oil. But increasingly in the late 1960s, this turned to foodstuffs, textiles and other labor-intensive products that reflected the changing comparative advantages of their economies vis-à-vis Japan. Because of this vertical specialization between Japan and East Asia, Japan's trade balance continued to favor Japan. This sowed in East Asian countries the seeds of discontent and demand for Japan's import expansion both of agricultural and forestry products and light-industry products in which they had a comparative advantage and for which Japan continued to impose either high tariffs and/or quantitative import restrictions to protect domestic industries. As a result, trade tensions began to emerge between Japan and East Asia in the late 1960s. This was on top of a series of trade disputes between Japan and the United States for Japan's major export products such as textiles and iron and steel products (for a more detailed discussion see Chng and Hirono 1984; Chung *et al.* 1985).

2.2 The decades of rapid foreign investment expansion reinforced by increased foreign aid and trade, 1971–1990

By the end of the 1960s, however, we see a changing perception of the East Asian economies in the mind of Japanese industrialists. Having been confronted with the acute shortage of both unskilled and semiskilled labor, their rapidly rising wage pressures and the rising prices of industrial sites, Japanese manufacturers began to look upon East Asian countries as the major source of cheap labor and resources (including land). Also, given the rising 'resource nationalism' emerging in the wake of the rapid industrialization of Japan, Western European countries and some developing regions of the world such as Latin America and East Asia, the prices of some essential natural resources began to rise sharply beginning in the early 1970s. For instance, the Organization of Petroleum Exporting Countries (OPEC) suddenly quadrupled its crude oil prices resulting in the first energy crisis of 1973–74 and once again doubled them producing the second energy crisis of 1979–80.

These critical conditions in labor and petroleum markets encouraged the Japanese industry to innovate labor- and resource-saving technologies in their production processes and, move from labor- and resources-intensive products to capital- and technology-intensive ones. At the same time, they encouraged the Japanese industry to invest in those neighboring East Asian countries where labor was cheap and efficient and which offered abundant resources and an expanding domestic market (see Table 4). There was also a rising concern with the rapid deterioration of the environment, such as air, water, soil and noise pollution throughout the country, particularly in urban areas, which compelled Japanese industries on the one hand to invest heavily in anti-pollution equipment at home and, on the other, to move to East Asian countries where environmental constraints were less severe. The rapid rise in Japanese direct investment overseas also reflected a reduced foreign exchange constraint in Japan arising from its ever increasing current account surplus since the late 1960s which led to the appreciation of the Japanese yen vis-à-vis the US dollar in the 1970s.

Also, the rising trade disputes between Japan and the United States and between Japan and the European Economic Community (EEC), in one product market after another, began to make it increasingly difficult for Japanese industry to expand its export directly to the US and Western Europe. This can be seen in the cases of textiles, steel, automobile and some electrical machinery and precision equipment. Thus, in addition to investing in these industrial countries as a means of circumventing walls of protectionism, Japan began to see East Asian economies as the source of off-

Table 4: Japanese direct investment overseas by region and country, 1951–1996

Region & Country	US\$ million							
	1951–75	1980	1985	1990	1995	1996	1951–96	1951–96
Africa	284	139	172	551	379	184	8.507	1.5%
Asia	1.881	1.186	1.435	7.054	12.264	6.690	100.094	17.8%
China			100	349	4.473	1.158	15.712	2.8%
Asian NIEs			718	3.355	3.179	1.500		
HongKong		156	131	1.785	1.125	394	16.493	2.9%
ROK		35	134	284	445	129	6.129	1.1%
Taiwan			114	446	457	277	4.975	0.9%
Singapore		140	339	840	1.152	700	11.803	2.1%
ASEAN 4			597	3.243	4.110	3.409		
Indonesia		529	408	1.105	1.596	1.677	20.991	3.7%
Thailand			48	1.154	1.224	1.133	9.811	1.7%
Malaysia		146	79	725	573	307	7.501	1.3%
Philippines		78	61	258	718	293	4.094	0.7%
Vietnam					197	143	754	0.1%
India				30	127	171	809	0.1%
Others			20	77	177	306	1.023	0.2%
Europe	971	578	1.930	14.294	8.470	3.248	105.709	18.8%
Middle East	530	158	45	27	148	135	5.123	0.9%
North America	1.817	1.596	5.495	27.192	22.761	9.053	248.473	44.2%
Oceania	463	448	525	4.166	2.795	567	30.942	5.5%
World, total	6.876	4.693	12.217	56.911	50.694	23.501	562.320	100.0%

Note: All figures were published in Japanese yen and converted into US dollar on the basis of the Bank of Japan interbank rate averages. The figures for 1995 and 1996 do not include those direct investments whose total is less than 100 million yen which used to be included prior to 1995.

Source: JETRO (1972, 1982, 1992, 1998)

shore production where Japanese industry would invest their capital and from where they would export their products overseas. The introduction of the Generalized System of Preferences (GSP) by the United Nations Conference on Trade and Development (UNCTAD) in 1968 and its implementation by some major industrial countries such as those of the EEC and Japan beginning in the late 1960s and by the United States in the early 1970s also acted as an inducement to multinational manufacturing corporations. Based in Japan and other industrial countries, these corporations

attempted to locate and relocate their factories in developing countries for exporting to the markets of industrialized countries with or without low-tariff rates (Okuzumi, Calder and Gong 1992).

Above all, however, it was President Nixon's announcement in August 1971 of the New Economic Policy (NEP) measures which had the greatest impact on the Japanese manufacturing industry to accelerate its rate of direct investment overseas. Comprised of four major pillars – namely the delinking of the US dollar from gold, a 10 percent cut in the US foreign aid, a 10 percent import surcharge on all goods coming from overseas, and a tax credit for US corporations' investment at home. Together with other key currencies, the NEP appreciated the Japanese yen against the US dollar from 360 to 308 per dollar, as agreed upon at the Smithsonian Multi Currency Realignment Agreement. The Japanese yen continued to appreciate against the US dollar in the ensuing two decades, finally reaching 168 per dollar at the Plaza Accord in the fall of 1985 and 130 by the end of the 1980s. The stronger and overvalued Japanese yen resulted in the acceleration of overseas investment expansion by Japanese industries particularly in East Asian countries.

It is important to note here that in the interest of promoting industrial development further, developing countries in East Asia began to shift their policies toward foreign multinational corporations based in industrial countries. They shed themselves of their previous suspicion that these multinationals, located formerly in metropolitan countries, would dominate their 'tinier and weaker' economies and emerge as neo-colonialists through the marketplace. Some of these developing countries in the region, in addition to administrative incentives such as the 'no-strike' guarantee, lavishly provided fiscal and financial incentives to those multinationals investing in the manufacturing sector with advanced technology and export potential. These incentives offered by the developing countries worked to increase investment overseas by multinationals based in Japan and other industrial countries.

In order to assist East Asian developing countries to promote outward-oriented industrialization policies, Japan, far more than any other industrial country, concentrated its official development assistance (ODA) in East Asia (Table 5). Furthermore, Japan steadfastly increased its aid programs which were focussed on the development and improvement of the target country's economic infrastructure such as highways, ports, power generation and irrigation facilities as well as the social infrastructure of education, health and sanitation. The Japanese aid programs thus contributed a great deal to the expansion and modernization of productive capacity including physical and human resource development. In fact, it was of vital interest to Japan to see that these East Asian countries

would remain politically stable, economically viable and socially attractive to all investors including the Japanese themselves. This resulted in the creation of a number of Japan's economic policy measures in favor of East Asian development and intra-regional economic cooperation (Scalapino and Kosai 1988), as discussed in more details in Section 3.

Table 5: Geographical distribution of Japanese official development assistance (ODA), 1970–1997

Regions	1970	1975	1980	1985	1990	1995	1997
Asia	90.3%	80.3%	70.5%	67.8%	59.3%	54.5%	46.5%
Northeast Asia	23.3%	10.3%	4.2%	15.3%	12.0%	15.2%	8.0%
Southeast Asia	55.6%	59.0%	44.0%	37.6%	34.3%	24.6%	21.4%
ASEAN	43.6%	36.4%	35.9%	31.3%	33.1%	21.1%	20.5%
Southwest Asia	19.4%	11.0%	22.2%	14.7%	12.9%	13.6%	14.6%
Central Asia	n.a.	n.a.	n.a.	n.a.	n.a.	0.6%	2.2%
Caucasus	n.a.	n.a.	n.a.	n.a.	n.a.	0.0%	0.2%
Other Asia	n.a.	n.a.	0.3%	0.1%	0.1%	0.4%	0.1%
Middle East	3.3%	3.9%	10.4%	7.9%	10.2%	6.8%	7.8%
Africa	2.3%	13.0%	11.4%	9.9%	11.4%	12.6%	12.1%
Latin America	4.0%	5.6%	6.0%	8.8%	8.1%	10.8%	10.8%
Oceania	0.0%	0.6%	0.6%	0.9%	1.6%	1.5%	2.4%
Europe	-0.2%	0.6%	–	0.0%	2.3%	1.5%	2.0%
Eastern Europe	n.a.	n.a.	n.a.	n.a.	2.2%	1.3%	0.8%
Others	0.3%	1.3%	1.2%	4.8%	7.1%	12.3%	18.3%
Total bilateral (million US\$)	372	850.4	1.961	2.557	6.940	10.557	6.613
Total ODA (million US\$)	458	1.148	3.304	3.797	9.069	14.484	9.435

Note: Aid to five Central Asian countries started in 1993, while aid to three Caucasus countries began in 1994.

Source: MOFA (1978, 1988, 1998)

The rapid increase in Japanese direct investment in East Asia was accompanied by an equally rapid trade expansion not only between Japan and these countries in the region, but also among the latter (see Table 6). Essentially, in pursuit of greater competitiveness in the changing world market, multinational corporations of Japan and elsewhere made a conscious effort to promote intra-corporate division of labor among its production facilities in different countries within and outside the East Asian region. It became well known that a fairly high proportion of international trade in manufactured goods was in fact intra-corporate trade, *i.e.*, trade between

headquarters, subsidiaries and joint ventures and among the latter of the same multinational corporation. As a result, the intra-East Asian exports of all the East Asian countries as a percentage of their total exports increased from 35.7 percent to 46.8 percent during the period 1981–92.

Table 6: Inter- and intra-regional trade by destination, 1981–1992

From/To	Japan		NIEs		ASEAN 4		China		East Asia	
	1981	1992	1981	1992	1981	1992	1981	1992	1981	1992
Japan	–	–	13,7	21,4	7,1	8,1	3,4	3,5	24,1	33,0
NIEs	10,6	9,1	10,1	14,6	10,4	7,8	2,5	11,2	33,5	42,8
ASEAN 4	32,7	21,1	17,8	22,7	3,7	4,4	0,8	2,5	54,9	50,6
China	24,4	14,5	28,1	52,1	3,5	2,8	–	–	56,1	69,4
East Asia	10,2	8,4	15,1	24,1	7,8	7,7	2,7	6,6	35,7	46,8

Source: PECC (1994)

Various policy measures adopted by the Association of South East Asian Nations (ASEAN) contributed in no slight measure to the enormous expansion in intra-ASEAN trade and investment hitherto observed. It was surprising to note that toward the end of the 1980s intra-ASEAN trade expanded more rapidly than the ASEAN trade with its external partners. Also, the annual flows of intra-ASEAN investment became larger in volume than those of the Japanese investment in the ASEAN countries. This was a symbolic result of the horizontal division of labor spreading to all ASEAN countries and its neighbors (for a more detailed discussion see Suh and Ro 1990).

2.3 The decades of hopes, crises and uncertainties, 1991–2010

The 1990s began with high hopes in East Asia, as exemplified in the World Bank's 'East Asian Miracle' that the high rates of economic growth and restructuring sustained during the last three decades would continue into the current decade and beyond the year 2000, despite some serious bottlenecks such as the scarcity of skilled manpower and economic infrastructure (World Bank 1994). Even as late as 1996, the Asian Development Bank forecasted rather high growth rates for East Asian countries in its publication, 'Emerging Asia' and the 21st Century was often referred to in various publications as 'the Asian and Pacific Century' (Asian Development Bank 1997). In fact, the period of 1991–97 saw a sustained economic growth for the East Asian region averaging annually at 6.7 percent in real terms (see Table 7). This compared very favorably with the other regions

of the world. As reflected in the sustained high rates of economic growth, both the international trade and investment of Japan and the other East Asian countries continued to expand rapidly even during the first half of the 1990s, further upgrading their trade and investment composition from labor-intensive to capital- and technology-intensive sectors.

The burst of the bubble in the Japanese economy in 1990 and the ensuing economic recession since then, however, has precipitated the Japanese industry to reduce its imports of capital and consumer goods, industrial raw materials, petroleum and other energy resources. At the same time, Japanese companies were expanding their exports to East Asian high-growth countries and North America creating a further rise in their trade and current account surplus. The GOJ's low interest policy has failed to generate additional domestic aggregate demand under prolonged recession and conditions of excess productive capacity. Instead, the soft money policy has also contributed to the increased trade and current account surpluses through the depreciation of the Japanese yen which further increased the price competitiveness of Japanese manufactured exports in the international market.

Moreover, the continued recession of the Japanese economy in the 1990s has precipitated the Japanese industry to invest and expand its production overseas, particularly in neighboring East Asian countries to meet the rising demand for consumer durables and services in those countries. Together with an enormous expansion in the short-term capital movement through portfolio investment and bank loans, the rapid expansion of the Japanese direct investment in East Asia, while providing temporary relief to the further deterioration in their trade and current account deficits and to the downward pressure on their currencies, contributed to further rise in excess productive capacity. Finally this resulted in glutting the product markets, creating a recessionary trend in their economies, accelerating foreign divestment, creating international runs on their foreign currency reserves, and a huge depreciation of their foreign exchange rates culminating in the ensuing financial crisis.

The currency crisis that hit Thailand in July 1997 soon spread to other ASEAN countries and Korea, leading to a financial and economic crisis in most countries of the region and, as in Indonesia, to a political crisis under the onslaught of inflation particularly for food and other basic necessities, rising unemployment and widening disparities between the rich and the poor.

All major East Asian countries, once riding high on the 'Miraculous Growth,' had to face downward growth and eventually negative growth in 1998 with the notable exception of Singapore (+1.5%), Taiwan (+4.8%) and China (+7.4%). In spite of the international rescue packages organized

Table 7: Economic growth performance of East Asia, 1970–1998

	Real GDP (US\$ billion in 1990 prices)					Real GDP (Average annual growth rates in %)				
	1970	1980	1990	1997	1998	Share	1960–70	1970–80	1980–90	1990–98
Hong Kong	15	37	70	171	(167)	0.6%	8.7	9.4	6.9	5.2
ROK	46	100	244	443	298	1.0%	9.1	8.2	9.5	5.5
Singapore	7	18	35	96	85	0.3%	8.7	9.0	6.6	7.8
Taipei, China	29	74	155	303	303	1.0%	9.1	9.7	7.7	6.8
Asian NIEs	97	229	505	1,013	(853)	2.9%	n.a.	8.9	8.2	n.a.
Indonesia	29	63	107	215	96	0.3%	3.0	8.0	6.1	4.6
Malaysia	11	24	42	98	71	0.2%	n.a.	8.0	5.2	7.8
Philippines	21	38	44	83	65	0.2%	4.9	6.1	1.6	5.1
Thailand	20	38	80	157	154	0.5%	8.0	6.8	7.8	-0.4
ASEAN 4	81	162	274	553	386	1.3%	n.a.	7.2	5.4	n.a.
China	93	161	370	825	961	3.3%	n.a.	5.6	8.7	8.8
Vietnam	7	8	14	25	25	0.1%	n.a.	1.4	6.1	8.8
Japan	1,263	1,957	2,940	4,202	3,783	13.0%	11.1	4.5	4.2	0.9
East Asia	278	504	1,163	2,416	2,068	7.1%	n.a.	n.a.	7.1	5.5
South Asia	n.a.	237	190	440	518	1.8%	n.a.	n.a.	5.3	5.1
West Asia	n.a.	n.a.	853	816	849	2.9%	n.a.	n.a.	-2.2	5.9
Africa	n.a.	270	358	484	495	1.7%	n.a.	n.a.	1.9	3.0
Latin America	n.a.	782	1,155	1,617	2,077	7.1%	n.a.	n.a.	1.0	5.4
EU (15)	n.a.	2,514	5,340	7,604	8,036	27.6%	n.a.	n.a.	2.3	2.5
U.S.A.	3,256	4,276	5,522	7,391	8,211	28.2%	3.9	2.8	2.6	3.8
World	12,709	17,711	23,159	28,460	29,157	100.0%	4.9	3.4	2.7	3.3
										1.8
										2.4

Sources: Asian Development Bank (1998, 1999), United Nations (1998), World Bank (1998, 1999), JETRO (1998)

by the International Monetary Fund (IMF) for Thailand, Indonesia and Korea and despite the international assurance by major bilateral donors of their further financial and technical assistance immediately after the crisis, East Asian countries have not been able up to now to make a turnaround and resume their high-growth path, although apparently proceeding steadily to macroeconomic stabilization and recovery. There are some indications that the downward spiral of national output has come to an end with some economic recovery, albeit slowly, beginning in early 1999 in some countries, as shown in Table 7.

Obviously, one of the major factors contributing to this downward spiral in 1997–98 and, in 1999, uncertainty over the fast economic recovery of these East Asian countries has been the prolonged recession of Japan. Standing as impediments to recovery are its problems of a huge and rising volume of non-performing assets (NPAs) held by financial and non-financial institutions, sagging investment, consumption and corporate profits, rising unemployment and growing fiscal deficits at the national and local levels. Basically due to government policy failures and the lack of political leadership, Japan has yet not been able to overcome the aftermath of the burst of its bubble economy since 1991.

3 JAPAN'S MAJOR ECONOMIC POLICY THRUSTS TOWARD EAST ASIA, 1951–2010

3.1 Re-entry of Japan into East Asia by rapid economic growth and vertical trade expansion, 1951–1970

As soon as Japan gained its political independence after World War II with the signing of the San Francisco Peace Treaty in 1951, Japan sought its re-entry into the world economic and political scenes by becoming a member of the United Nations Economic Commission for Asia and the Far East (U.N.ECAFE), the IMF, the World Bank in 1952, GATT and Colombo Plan in 1954 and the United Nations in 1956 (see in more details CED and Keizai Dōyūkai 1963).

To regain a position of respect among its East Asian neighbors, Japan started to pay reparations to those countries that had suffered from human and physical damages during the war period, except China which declined the Japanese reparations payments. For those East Asian countries such as Malaysia, Myanmar, the Republic of Korea, Singapore, Thailand and Vietnam which did not enter into agreement with Japan on reparations payments, Japan provided quasi-reparations payments in the form of 'generous' grants and low-interest yen loans. As just mentioned,

Japan also became a member of the Colombo Plan in 1954 to provide technical assistance to those Asian countries which were developing members of this Colombo Plan.

Both money extended by Japan's reparations payments to these East Asian countries and from the ODA initiated by Japan with its entry into the Colombo Plan in the initial period were also mobilized to expand Japanese manufactured exports to East Asian countries. The Ministry of International Trade and Industry (MITI) of the GOJ made clear the importance to Japanese exports of Japan's reparations payments and official development assistance (ODA) to East Asian countries.

Had these measures not been taken, it would have required the spending of precious foreign exchanges reserves. In fact, these helped to accelerate the recovery and development of the Japanese manufacturing industry by tying overseas assistance to the procurement of goods and services in Japan. Furthermore, both the reparations payments and the ODA to East Asian countries were helpful to Japan in inculcating in these Asian countries a taste for Japanese consumer and capital goods as well as trade and engineering services and contributed further to Japanese manufactured exports since then.

In 1955 Japan announced its economic cooperation policy toward East Asia, reaffirming its commitment to the fulfillment of its reparations programs by the end of the 1960s and its assistance to non-communist countries for their economic and social development. In the same year Japan established Japan External Trade Organization (JETRO), although the Export-Import Bank of Japan (EXIM-Bank) had already been established in 1950 to assist Japanese industry to expand its exports and particularly to cement closer economic cooperation with East Asian neighbors. In 1958 Japan established within the EXIM-Bank a fund for the economic development of Southeast Asia by way of providing long-term development loans (the so-called Yen Loan). Thus, Japan laid down all the institutional mechanisms necessary for re-entry into East Asia as a respectable partner in the postwar world and to assist the newly independent developing East Asian countries to promote their trade, investment and economic expansion.

The GOJ established in 1960 the Overseas Economic Cooperation Fund (OECF) and in 1962 the Overseas Technical Cooperation Agency (OTCA) (reorganized in 1974 into Japan International Cooperation Agency, JICA) as an expression of its readiness to expand its ODA to developing countries to assist in particular its East Asian neighbors. Japan's ODA expanded rapidly during the 1960s when Japan's gross national products (GNP) grew at the annual average rate of 10 percent. To further strengthen its economic cooperation with East Asian neighbors, Japan took initia-

tives for organizing in 1963 the Ministerial Conference for the Economic Development of Southeast Asian Countries whose member countries constituted the core of the Asian Development Bank when established in 1966. Japan also gave strong support to the formation in 1967 of ASEAN among its five member countries of Southeast Asia – Indonesia, Malaysia, the Philippines, Singapore and Thailand – partly to counteract the growing Soviet influences in the Indochina Peninsula, Vietnam, Laos and Cambodia (CED and Keizai Dōyūkai 1970).

By the late 1960s it was quite clear that there was not only a closer economic relationship built up but also a closer political dialogue developing between Japan and Southeast Asian countries. As an ally of the West, Japan gave strong support to non-communist East Asian neighbors in support of the foreign policy of the United States in Asia. Because of its constitutional prohibition Japan did not send its armed forces, unlike Australia and the Republic of Korea, to defend South Vietnam. However, Japan did remain the closest ally of the United States in its fight in the Vietnam War, providing strong economic assistance to South Vietnam during the war. Just as during the Korean War of 1950–52, Japan reaped economic benefits through trade and investment expansion from the Vietnam War, as similarly did its Southeast Asian neighbors.

3.2 From vertical trade expansion to economic partnership, 1971–1990

As Japan began to build up its trade account surplus not only vis-à-vis the United States but with the rest of the world in the late 1960s, there was rising pressure on Japan not only from among industrial but also developing countries particularly in East Asia. This pressure was for Japan to open up its huge domestic market to foreign exporters through the further reduction of tariffs and through the elimination of non-tariff barriers (NTBs) as well as through the appreciation of the Japanese yen. Because of the unwillingness of Japan to appreciate the external value of its yen currency, the United States announced in 1971 its NEP, as discussed earlier. Following the NEP, Japan announced its support to help strengthening the freer international trading regime by calling for the Tokyo Round of Multilateral Trade Negotiation (MTN) in 1971, the successor to the successful Kennedy Round during the 1960s. The Tokyo Round of MTN went beyond negotiation on tariffs and one of the primary focus on NTBs negotiation was the elimination of import quotas, as well as other quantitative restrictions, discriminatory government procurement policies and practices, and restrictive business practices.

The 1970s saw a decided shift in the Japanese economic policy toward Asia on three accounts (CED and Keizai Dōyūkai 1974). First of all, the

GOJ was no longer interested in assisting the Japanese industry to expand its exports. Nearly all its export subsidies that had been prevalent during the past two decades in the form of fiscal and financial incentives to exporters were eliminated in the early 1970s. The Supreme Export Council, chaired by the Prime Minister and held regularly with the participation of the MITI minister and private sector representatives, was abolished. JETRO changed its name from Japan Export Trade Promotion Organization to Japan External Trade Organization, implying that the GOJ was interested in expanding Japan's imports as well as its exports to hitherto untapped markets. Instead of export incentives, government incentive measures were implemented for promoting research and development (R&D) in the private sector to precipitate the process of industrial restructuring from low value added to higher value added industries.

Secondly, to prevent the rising trade deficits of East Asian countries vis-à-vis Japan from further aggravating anti-Japanese sentiments – as shown in the demonstrations against Japan at the time of Prime Minister Tanaka's visits to Indonesia and Thailand – the GOJ relaxed its foreign exchange control over the Japanese industry's direct investment overseas and installed incentive measures for their investment in mineral and energy resources in developing countries and, lowered tariffs and NTBs on manufactured imports particularly from developing countries. Being the closest neighbors to the Japanese industry, East Asian exporters were best able to reap the benefits of freer trade as compared with those exporters elsewhere. The installment of the GSP beginning in 1970, as mentioned earlier, was also mostly beneficial to East Asian neighbors exporting to Japan.

The floating exchange rate regime introduced in February 1973 also proved to have an enormous impact on the growth of the Japanese manufactured imports from Asian neighbors whose currencies were tied to the US dollar. Had it not been for the interventionist policy of the Bank of Japan's (BOJ), the Japanese imports of manufactured goods from the East Asian neighbors would probably have risen much higher through the further appreciation of the Japanese yen vis-à-vis the US dollar. The sudden and dramatic appreciation of the Japanese yen under the Plaza Accord of 1985, however, was a counter-blow to the BOJ's interventionist policy, but it would have been better not only for the Japanese but also for other economies, if the Japanese yen had been appreciated steadily, following the market rather than such a concerted intergovernmental sanction. There was no doubt that the political rapprochement between Japan and China with the signing of the Japan-China Friendship Treaty in 1973 and the Japan-China Peace Treaty in 1975 opened a new avenue of international trade for both countries, increasing the East Asian share of the growing

Japanese exports and imports ever closer to the North American share in the 1980s.

It was also quite obvious that since East Asian countries had all the attractive elements for direct investment operation by Japanese firms, whether in terms of political stability, wage cost, skills or market, East Asian countries received a disproportionately high percentage of Japanese direct investment overseas (see in more details Ng, Hirono and Narongchai 1987). Towards the end of the 1960s and early 1970s most of the East Asian governments also implemented export-oriented policies, replacing their old import-substitution industrialization policies and welcomed private foreign direct investment including Japanese multinationals in order to accelerate their industrialization, improve their industrial technology, management know-how and increase their export earnings. The appreciation of the Japanese yen under the floating exchange rate regime precipitated the Japanese industry to invest overseas particularly in developing East Asian countries, as foreign assets became relatively cheaper as compared with the Japanese. Also, the opening of China in 1978 under the Teng open-door policy became increasingly 'real' to Japanese investors who had been previously rather cautious and timid, in turn heightening their fervor for direct investment in China later in the 1980s. China thus became an important economic partner to Japan both in trade, investment and aid, as will be discussed below.

Thirdly, partly to assist developing East Asian countries in economic and social development and partly to help reduce their rising anti-Japanese sentiments, the GOJ launched its massive assistance program by announcing that its ODA would double every three to five years beginning in 1978. As shown in Table 5, nearly 80–90 percent of the Japanese ODA during the 1970s went to Asian countries, in particular to Southeast Asia. In the 1980s, the East Asian share of the Japanese ODA declined steadily in line with the constant increase in their per capita GDP and the increasing pressure on Japan from its allies to increase its ODA to sub-Saharan Africa and least developed countries elsewhere. With the Japan-China Peace Treaty signed in 1975, however, the GOJ began to provide economic assistance to China, partially offsetting the decline of the East Asian share of the Japanese ODA that would have otherwise been observed more conspicuously (Blaker 1984).

Much of this Japanese ODA went into the expansion and improvement of economic infrastructure such as transport, energy and telecommunications as well as into that of productive sectors such as agriculture and industry, all of which were essential to the target country's faster growth of GNP and its industrialization. This was in line with the GOJ's basic philosophy that ODA whether from Japan or other donors ought to

be only a supplement to the recipient's own efforts for raising its domestic savings and should preferably be given to those sectors of the national economy which would constitute the basic foundation for, and contribute most to, national economic development. While a larger proportion of the Japanese ODA was in the form of the yen loan provided by OECF, its increasing proportion was made available in grant assistance particularly in health, sanitation, education and other social sectors.

The only aberration in Japanese ODA during the 1970s, aside from the policy shift away from Japan's export and own economic development to the assistance of East Asian countries, was triggered by the energy crises of 1973–74 and 1979–80. Having been threatened by OPEC with the oil embargo to Japan and the quadrupling of the price of oil in 1973–74 and its doubling in 1979–80, the GOJ suddenly increased its ODA, in particular grant and technical assistance to the oil-rich Middle Eastern countries and to oil-poor Arab countries. Even here one could argue, however, that the GOJ's readiness to assist the Middle Eastern countries was based on its genuine interest in helping the economic development of the oil-importing Arab countries and economic diversification of the oil-dependent Arab countries. Although, judging from the timing of its offer of increased ODA, it was obviously tied to Japan's keen interest in procuring stable sources of crude oil supply.

By and large, however, Japan's economic cooperation policy toward East Asia made a radical departure in the early 1970s. It moved from the age of Japan's preoccupation with its own trade and economic expansion during the 1950s–60s to the age of Japan-Asian economic partnership in which Japan gave its priority to the acceleration of the economic development of the developing East Asian neighbors during the 1970s and their social development in addition during the 1980s. This was symbolic, and an inevitable consequence, of Japan's attainment of a global power status which compelled Japan, together with the United States and the European Community nations, to realize their joint responsibility to assist developing countries to advance economically and technologically. This awareness of the joint responsibility on the part of Japan to assist the developing countries grew keener and sharper not only in the GOJ but even among the general public as Japan became the largest creditor nation and the largest donor of ODA in the world in 1989. This surpassed for the first time the United States, which had always led the West and, for that matter, the world in helping the developing countries (see for a more detailed discussion Islam 1991).

3.3 Toward the age of Japan-East Asian comprehensive partnership, 1991–2010

Already toward the end of the 1970s and in the 1980s the age of the Japan-East Asian economic partnership began to be steadily transformed and matured into the age of the Japan-East Asian comprehensive partnership of the 1990s in the broader Asia-Pacific partnership. This was achieved by the establishment of the ASEAN/Post-Ministerial Conference (PMC) in 1978, the Pacific Economic Cooperation Conference (PECC) in 1980, the Asian and Pacific Economic Cooperation (APEC) in 1989 and the ASEAN Regional Forum (ARF) in 1990 (Suh and Ro 1990).

The ASEAN/PMC is a forum of the ASEAN foreign ministers meeting with their counterparts from Australia, Canada, Japan, New Zealand and the United States to discuss their foreign policies in the changing international relations at the regional and global level. It was a product of ASEAN countries' keen interest in strongly involving the major Western partners in their accelerated economic development and securing Western support in the face of the communist victory in the Vietnam War and these countries' interest in cementing a fortress ASEAN against the onslaught of the communism. Underlying the establishment of the ASEAN/PMC, therefore, there was a strong interest in building a political partnership between ASEAN and Western countries.

The PECC is a forum for the government and private sector as well as academia of the member countries of the ASEAN/PMC and other East Asian countries that aimed to promote economic cooperation in the Pacific region including trade, investment, technology and aid. The PECC was a natural outcome of the Pacific Businessmen's Congress initiated in 1970 by the private sector in Australia, Canada, Japan, New Zealand and the United States. It was also initiated by the Pacific Economic Conference started in 1976 by the academia in the industrialized countries of the Asia-Pacific region. The PECC proved to be quite useful to its member countries in furthering economic cooperation. Their governments thus went ahead to establish in 1989 APEC, an inter-governmental forum with the same objective as the PECC.

APEC gradually expanded its mandate and membership as it evolved in the 1990s, not only to promote economic cooperation among its member countries but also to engage in setting up nearly a pan-Pacific free trade area, based on the principle of open regionalism, by collectively agreeing to the reduction in tariffs and NTBs in their intra- and extra-regional trade.

Consensus building for the establishment of a freer trading regime in the Asia-Pacific region consistent with the global rules and regulations of the WTO was initiated by the United States under the strong leadership of

President Clinton when APEC met for the first time at the Summit level in Seattle in 1996. Also, the membership of APEC today has been extended not only to the market-oriented economies in Latin America across the Pacific but also to socialist market economies such as China and Vietnam.

The ARF is an inter-governmental forum focussed on the maintenance of peace, stability and security in the East Asian region. ARF membership was drawn from the ASEAN/PMC, China, the Republic of Korea and Vietnam which joined ASEAN in 1995. Japan has been quite active in the ARF from its inception, seeking an institutional mechanism for consolidating regional security along with the Conference for Security Cooperation in Europe (CSCE) which predated the collapse of the Soviet Union's influences in Central and Eastern Europe. Japan has also been quite active in collaborating with ASEAN in setting up the ASEAN-European Meeting (ASEM) in 1996 and participating in its various sessions.

Furthermore, Japan has been seeking a role in South Asia by promoting its bilateral relations with each of the South Asian countries and exploring ways and means by which to accelerate the economic and social development of South Asian countries. Japan has tried to achieve this through their respective domestic deregulation, liberalized trade and investment regimes and through further development of the South Asian Association for Regional Cooperation (SAARC). The increase of Japanese ODA going to South Asia began in the early 1990s with these measures in mind. The GOJ has been hosting Japan-SAARC symposia and conferences in Japan and South Asian countries to promote better understanding, trade, investment and technology cooperation among the SAARC countries and between the SAARC countries and Japan (MOFA 1998).

From the above discussion it is clear that Japanese economic cooperation toward Asia has become much more global oriented, going beyond the traditional confine of East Asia. It has also become much broader in its approach to development, going beyond the traditional confine of trade and investment and promoting good governance and people participation. Moreover, it has developed a much more collaborative approach, going beyond its bilateral relations and involving other major bilateral and multilateral partners in pursuit of regional and global peace, stability and security. Japan has indeed become a responsible global partner in the Asia and Pacific region through a step-by-step enhancement of its economic policy toward Asia.

4 EAST ASIAN ECONOMIC CRISES AND POLICY RECOMMENDATIONS FOR JAPAN'S ECONOMIC COOPERATION TOWARD EAST ASIA

4.1 Major factors responsible for the East Asian economic crisis

Major factors responsible for the current economic crisis of most East Asian countries are found both in- and outside of this region (see among others JDS 1998; World Bank 1998; Griffith-Jones 1999). The most important factors within the crisis hit countries were:

- a) national government policies of pegging their national currencies to the US dollar which appreciated their exchange rates vis-à-vis the currencies of their new competitors such as China and Vietnam. This made their exports less competitive in the international market and their imports more attractive, thus enlarging not only their trade deficits but also the massive short-term capital inflow that had been seeking quick profits from interest differentials and an equally massive and rapid outflow in the face of the imminent foreign exchange crisis,
- b) a weak financial sector engaged in risky investments, together with an inadequate regulatory framework on accounting standards, information disclosure and supervision by central banks,
- c) governments sticking to high-growth policies in spite of rising and persistent current account deficits which encouraged domestic and foreign investors, together with dollar pegging, to resort to heavy foreign borrowing on the basis of an excessive confidence in the continuation of high economic growth and asset appreciation.

One of the major external factors responsible for the East Asian economic crises was the IMF policy of encouraging East Asian countries to implement the non-discriminatory liberalization of their capital accounts, including short-term capital inflows and outflows, regardless of weak financial systems and inadequate supervision by central banks. The IMF should have recommended, not only to Thailand but to any other developing countries with inadequate financial systems to strengthen their financial system first before opening up completely to the short-term movement of foreign capital. As suggested later, the IMF should have also recommended that these developing countries levy tax on short-term capital inflow and outflow, as Chile has been doing successfully for some time. A massive attack by international investors on Asian currencies for fear of imminent collapse of foreign exchange positions also precipitated the crisis.

Another major factor contributing to this downward spiral in 1997–98 and the uncertainty thereafter has been the prolonged recession of Japan with its problem of huge NPAs which is further exacerbated by Japan's

sagging investment, consumption and corporate profits, rising unemployment and growing fiscal deficits at the national and local levels. The essential reforms necessary in the political and economic structures, enterprise management, the financial system, fiscal and administrative system and social security arrangements have been very slow both in policy formulation and implementation.

4.2 Economic consequences of the East Asian economic crises and government policy measures

As a result of the East Asian financial and economic crisis and the prolonged recession of the Japanese economy, East Asian countries have been suffering from negative growth with the exception of China, Singapore and Taiwan. The economic crisis has hit every segment of their populations, but hardest on the poor as a result of the loss of jobs and the inflationary pressures on food and other basic commodities and services. The crisis has enormously increased the amount of non-performing assets of banking and non-banking institutions, often resulting in bankruptcies. Wages have also gone down and at the same time there has been a rising rate of unemployment and underemployment not only in metropolitan areas but also in local municipalities, towns and villages. Trade and investment flows between East Asian countries and Japan have been declining since 1997.

While governments of East Asia have come to deal squarely with their economic crises to bring them under control and regain positive economic growth before the turn of this century through those measures recommended by IMF such as tight money policy, fiscal discipline and financial sector reforms, these measures have not worked as well as intended. However, they are not completely in vain, as some prospect for reversing the recessionary trend is being seen in some countries such as Thailand. It is sincerely hoped that ASEAN's own efforts as declared by the ASEAN Summit on 15 December, 1998 such as the acceleration of the intra-ASEAN tariff reduction to 0–5 percent by the year 2002, the ASEAN financial system reform by the year 2004 and the introduction of the special corporate income tax exemption for foreign manufacturing investment coming during the years 1999–2001 from outside the ASEAN will speed up the economic recovery of the ailing ASEAN economies. It is equally hoped that enhanced economic cooperation among them and with the rest of the world would bring an early reversal of the economic downturns. It would seem, however, quite difficult for these countries to complete the necessary structural reforms and return to the past growth path that had been achieved between 1970 and 1990 and even during the 1990s up to mid-1997.

4.3 Various rescue plans by bilateral and multilateral donors and the role of Japan

Since the crisis began in Thailand in mid-1997, a number of rescue plans and programs have been announced by bilateral and multilateral donors. IMF has led the international community to mobilize financial resources to deal with the immediate adverse impact of the crisis on foreign exchange rate devaluation and the loss of confidence among foreign investors in the economic strength of these East Asian economies. The World Bank and the Asian Development Bank have also committed their assistance to rescue these ailing economies from further financial and economic collapses.

Japan, though in the midst of own financial difficulties and deep recession, has been one of the first bilateral donors to express its commitment of assistance to these crisis-ridden countries (see MOFA 1999). The Japanese commitment to the East Asian countries under crisis is linked to its domestic efforts to revive the Japanese economy from the long-term recession following the burst of the bubble in 1990 and the Japanese direct and indirect (through multilateral institutions) assistance on the short-, medium- and long-term bases to these East Asian countries to rescue them from the on-going hardship.

To deal with the lack of foreign exchange reserves in East Asian countries, Japan has made US \$ 19 billion (US \$ 4 billion for Thailand, US \$ 5 billion for Indonesia and US \$ 10 billion for the Republic of Korea) available as part of the international rescue package initiated by IMF. Part of this was initiated in August, November and December 1997 and has already been disbursed to tackle with the financial instability, the shortage of international liquidity and the accumulated private indebtedness. US \$ 23 million has also been given to the World Bank and the Asian Development Bank to provide technical assistance on financial sector reforms in these countries. To deal with the downward pressures on the national economy and the rising unemployment in these adversely affected countries and to intervene in the inadequacy of export earnings and trade finance, the GOJ has made available US \$ 22.5 billion at the disposal of these governments. All these programs committed by the GOJ to assist the East Asian countries sum up to US \$ 44 billion, by far the largest sum of money ever pledged by any bilateral and multilateral donor.

It is to be noted that the above commitments are in addition to the New Miyazawa Plan which was announced at the time of the joint IMF / World Bank annual meeting in October 1997, making available US \$ 30 billion consisting of US \$ 15 billion for medium- and long-term loans through the EXIM-Bank and the OECF and, another US \$ 15 billion for short-term relief to economic reforms in these adversely affected coun-

tries of East Asia. Furthermore, Japan and the United States came out with a joint Japan-U.S. proposal, as announced at the APEC Summit meeting on 16 November 1998 in Kuala Lumpur, to provide the governments and state enterprises of these countries with an access to US\$ 5 billion in the form of bond purchases, guarantees and loans. These measures are expected to strongly help countries now in crisis. Under this program, Japan will establish a US\$ 3 billion Asian Currency Crisis Support Facility in the Asian Development Bank. Finally to extend during the years 1999–2001 600 billion yen (approximately US\$ 5 billion) for a special yen loan facility to needy East Asian countries.² However, most important of all the, Japanese government policy that aims to support East Asian countries should also bring about the sustained revival of Japan's own economic growth to the level of approximately 1–2 percent as soon as possible. Also, the continuation of the open-door policy to expand Japan's imports is important, not only of primary commodities from the ASEAN countries, but also of manufactured products. In view of the fact that East Asian economies are, and will continue to be, globalized beyond the year 2000, Japan's open-door policy must not be limited to East Asian countries now under economic crisis but to the rest of the APEC countries and the world which are dependent upon East Asia.

Japan must go far beyond what has recently been shown by the Obuchi Administration in its fiscal 1998 second and third supplementary budgets and its fiscal 1999 budget proposal. Japan must continue its serious efforts for expanding Japan's domestic aggregate demand by:

- a) maintaining an appropriate monetary policy, while watching against any creeping inflationary pressures,
- b) continuing on an expansionary spending policy targeted at swift economic recovery and a moderate growth, and focussed on long-term investment in human and environmental capital and industrial restructuring rather than on the traditional public investment programs,
- c) rigorously pushing through a series of enterprise, fiscal, financial sector, social security, educational and administrative reforms already undertaken by the previous Hashimoto Administration to enable Jap-

² Also, to assist East Asian countries in accelerating economic recovery and reforms, the GOJ has made available US\$ 1.98 billion, while food and pharmaceutical drugs worth US\$ 140 million has been disbursed to support the weaker segments of the population in East Asian countries. US\$ 32 million has been earmarked to assist them in human resource development and another US\$ 32 million to help those students now studying in Japan suffering from their home countries' downturn. In addition, US\$ 20 million has been given to the ASEAN Fund to assist their activities in areas of humanitarian and development assistance in the adversely affected ASEAN countries.

- anese firms, institutions, its economy and people to become more competitive in the increasingly globalized markets,
- d) revising and enforcing the Anti-Monopoly Act effectively to encourage domestic competition and eliminate all the cartels now legalized under special provisions,
 - e) making illegal all the built-in barriers and restrictive business practices by the private sector enterprises to restrain competition at home and abroad.

In terms of external relations, Japan must not repeat the wrong policy decision as shown at the recent APEC Summit in Kuala Lumpur in November 1998. There its refusal to lower tariff and non-tariff barriers to forestry and agricultural products according to APEC's Earlier Voluntary Liberalization Program (EVL) has certainly created the worldwide impression Japan is interested in delaying the international efforts for establishing the Liberalized Global Trading System at the advent of the 21st century.³

Japan must accelerate its import and capital liberalization by reducing as soon as possible all its import tariffs and NTBs including quantitative restrictions, and thereby encourage domestic competition to benefit their consumers in Japan, by simplifying all the import documentation and custom clearance procedures and by eliminating all the legal restrictions and administrative guidance over the foreign capital participation and management in Japanese enterprises. Furthermore, with its large amount of foreign exchange reserves, Japan must continue to support the private sector not only to expand its own direct investment overseas but also expand its imports of all types of goods and services including long-term foreign capital inflows for global industrial and trade restructuring. Japan also must continue to enhance its ODA both quantitatively and qualitatively with a view to assisting the developing countries in East Asia and elsewhere in their economic and social development and narrowing the North-South gap which has unfortunately been widening ever since the end of World War II. Japan must continue to consolidate firmly the bridge of sustainable development between the developing and industrial countries and strengthen the bridge of mutual communication and trust between the Eastern and the Western civilization in search for global peace, sustainable development and human security.

³ The APEC Summit in November 1997 and the APEC Trade Ministers' meeting in June 1998 had agreed upon the EVL for reducing simultaneously all the quantitative import restrictions and tariff rates for forestry, fishery, medical equipment, communications apparatus, chemical products, toys, jewels, environmental and energy products, without waiting for item-by-item negotiation in the World Trade Organization (WTO).

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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.

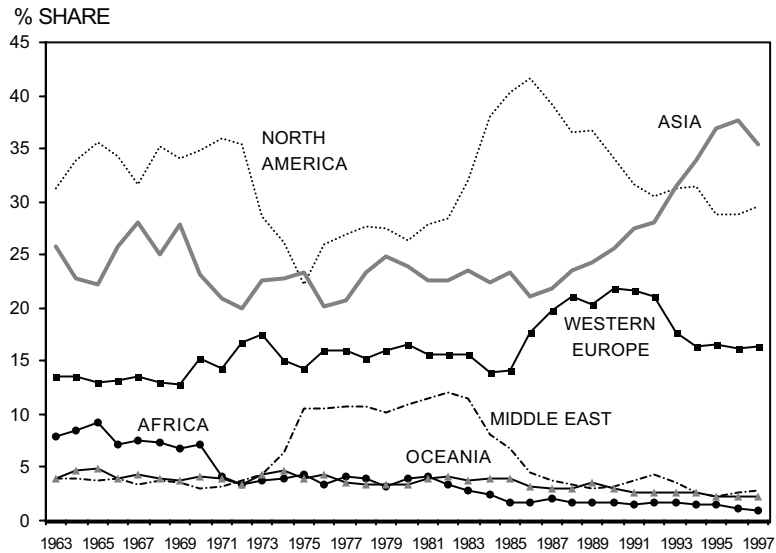
3 TRADE POLICIES

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



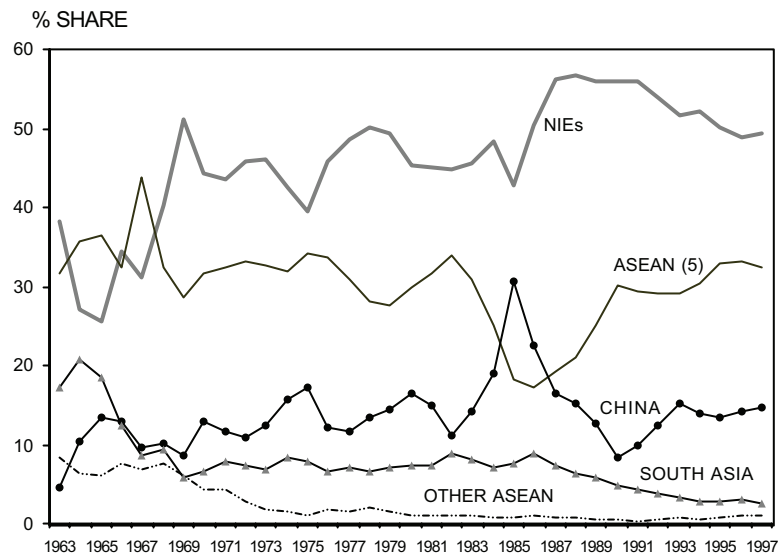
Note: share of Japan's global export

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

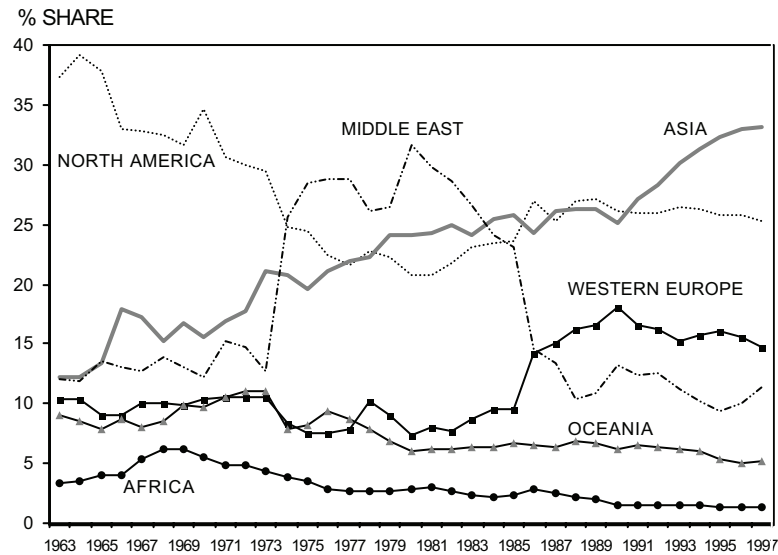
Source: Primark Pte Ltd Datastream 1998

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



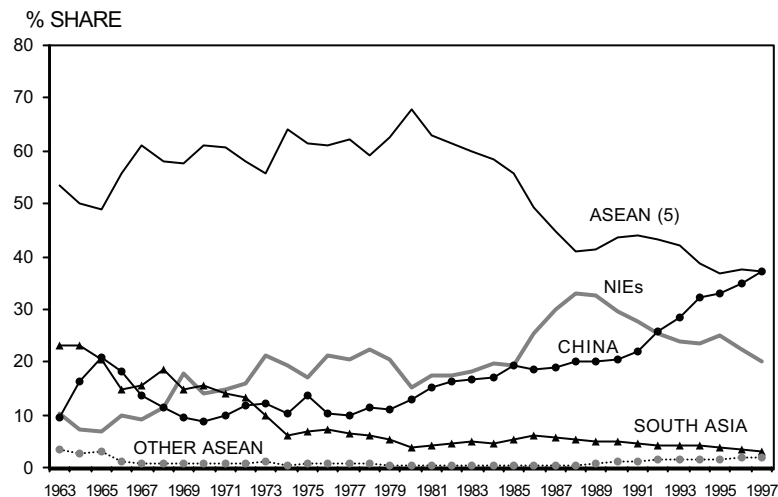
Note: share of Japan's global imports

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.

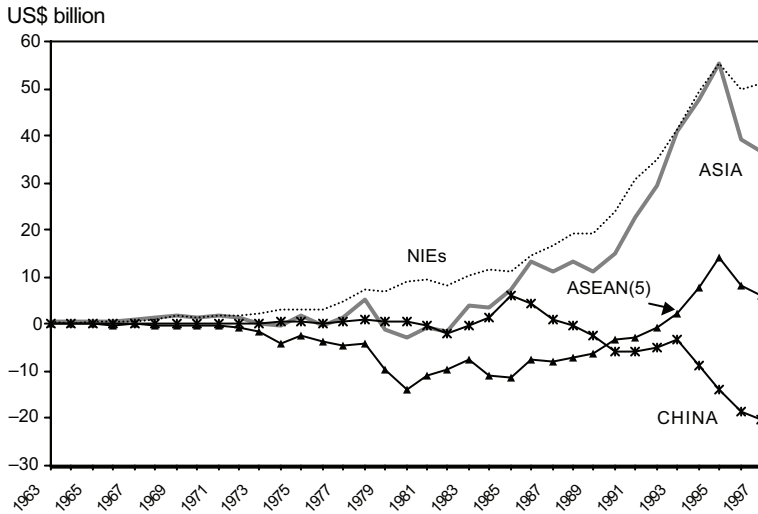
Japan's import structure changed away from primary products (non-processed foodstuffs, raw materials and fuels) towards manufactured goods (Daquila 1997a, 4). Japan's imports from ASEAN were mainly in the form of primary commodities, with its share falling from 75 per cent in 1989 to 61 per cent in 1993. 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.

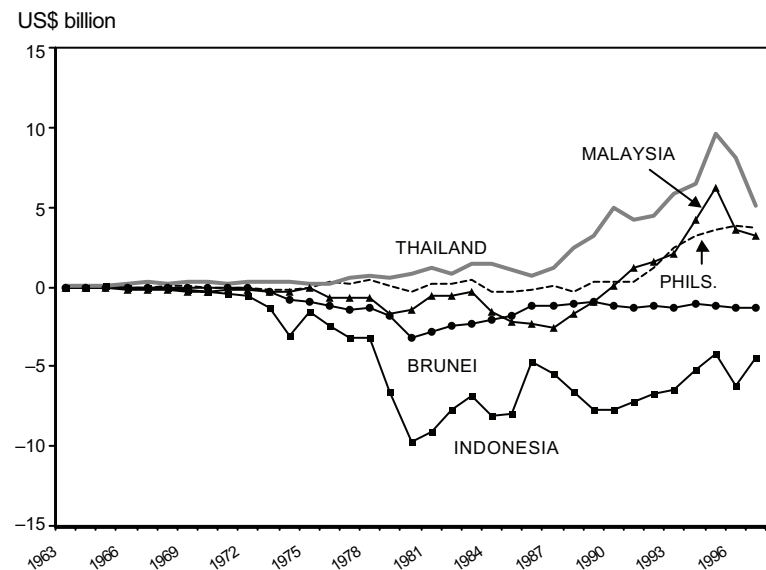
Figure 5: Japan's trade balance with Asia 1963–1998



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 bal-

ance 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.

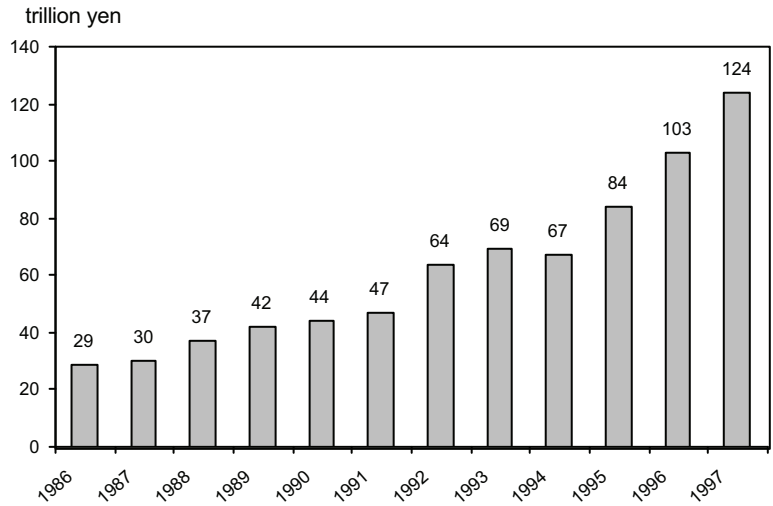
4.2 Foreign Direct Investments³

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

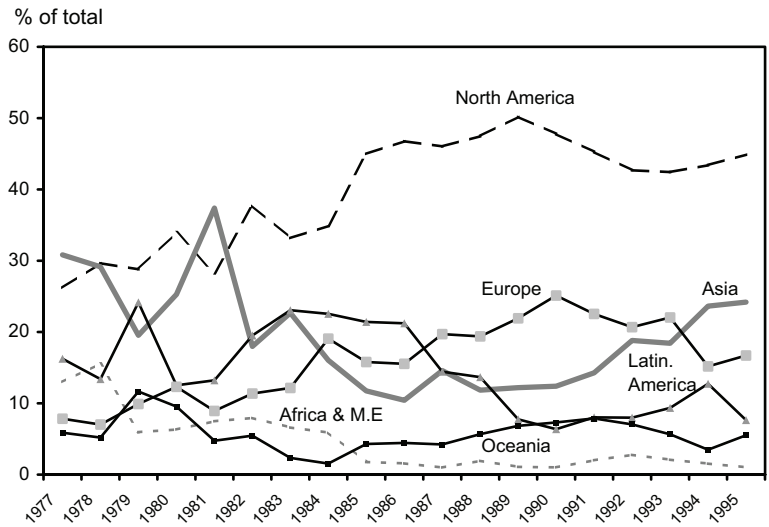
³ For a detailed analysis of Japanese investments in Asia, see among others Doherty (1995), Daquila and Nguyen (1994), Chng and Hirono (1987), Hook (1992), Lim (1994), Pattanajidvilai (1991) and Yamazawa (1992).

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



Source: Ministry of Finance

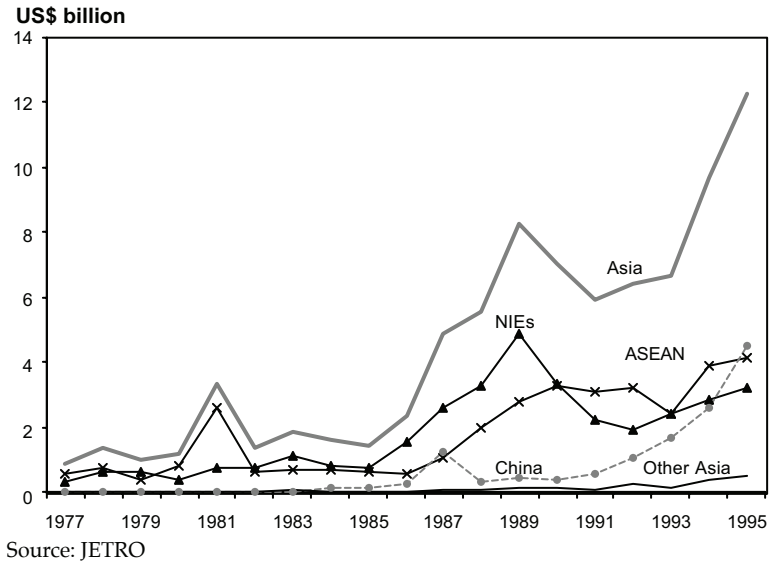
Figure 8: Geographical distribution of Japanese FDI 1977–1996



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



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); food-stuffs (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 Japa-

nese 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		
		China		
		Hong Kong		
		S. Korea		7
(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 billion (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 100,000 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.

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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THE EFFECTS OF THE ASIAN CRISIS ON JAPAN'S MANUFACTURING FOREIGN DIRECT INVESTMENT IN ASIA

Shigeki TEJIMA

1 INTRODUCTION

In the 1980s and the 1990s, there existed a complementary relationship between Asian host countries and Japan's manufacturing firms through foreign direct investment (FDI) and international trade. The Asian crisis since 1997, which was basically a financial phenomenon, prompted the transformation of this complementary relationship. The objective of this article is to analyze the effects of the Asian crisis on Japan's FDI outflow, based on a questionnaire survey conducted by the author which was delivered to Japanese manufacturing firms in May in 1998. The questionnaire was sent to 259 Japanese manufacturing firms of which 157 responded. To clarify the findings, 15 respondents were interviewed in Japan between July and August. Later, 8 manufacturing firms' affiliates, 3 Japanese banks and 2 FDI authorities were interviewed in Thailand, Indonesia and Singapore in September 1998.

The Asian crisis has had and will continue to have a negative impact on Japanese affiliates' sales and profit performances in Asia and, in turn, discourage to some extent, Japanese FDI flows into Asia. It may take 3 to 5 years for these firms to return to the level of sales and profits achieved before the Asian crisis and 10 years to recover to the level of 1997 in yearly FDI flows.

The contents of this article are as follows: in Section 2, the complementary relationship between Asia and Japan is briefly described; in Section 3, the effects of the Asian crisis on Japan's FDI are examined based on the results of the survey; Section 4 presents a theoretical argument to clarify the characteristics of Japan's FDI, which originated from specific advantages of Japanese firms, and the effects of the Asian crisis on those characteristics are discussed. Finally Section 5 presents the conclusion and comments on the prospects for Japanese FDI in Asia.

2 THE COMPLEMENTARY RELATIONSHIP BETWEEN ASIA AND JAPAN

The FDI of Japanese manufacturing firms has strongly promoted the economic development of host Asian countries while Japan's FDI has also preserved the international competitiveness of Japanese manufacturers. Japanese firms have enjoyed low-wages and qualified human resources, growing local markets, local currencies linked to the US dollar, and stabilized macro-economies and politics in Asia. From the perspective of the host Asian countries, they received large-scale FDI inflows, which provided them with financial resources of a non-debt nature, sophisticated managerial resources, advanced technologies and easy access to the international sales networks of Japanese firms. This relationship between Asia and Japan was based on six factors:

- 1) The advantage of export bases whose target markets were located in the USA, Canada and Europe was important. FDI specified for constructing export bases in Asia was accelerated by the trade frictions between Japan and Western countries and the appreciation of the yen. The Asian currency regime, which was in practice linked to the US dollar before the Asian crisis, prompted this type of FDI in Asia.
- 2) The role of export bases in Asia serving Japan was mutually beneficial. In order to decrease production costs in Japan, Asian-made parts produced by Japanese affiliates, which were of high quality and low price by Japanese affiliates, were increasingly imported by parent companies during the period of the yen appreciation from 1993 to 1995 (Tejima 1995, 1996 and 1997).
- 3) The divergence of the profitability of Japanese affiliates in major regions was advantageous. The annual surveys of the Export-Import Bank of Japan (JEXIM annual survey) and the Ministry of International Trade and Industry (MITI) showed higher profitability in Asia than in other regions in the 1980s and early 1990s (Table 1).¹ This profit divergence encouraged Japanese firms to invest more in Asia than in non-Asian regions.
- 4) The pro-FDI strategy of Southeast Asian countries was of additional critical importance to the region.
- 5) The advantages of Asian low wage cost significantly aided in maintaining low production costs.

¹ JEXIM annual surveys have been conducted annually for 500–700 major Japanese manufacturing firms. The response rate for the survey is 50–60% in average. The MITI survey is also periodically conducted. The sample size is about 2000–3000 firms, including small and medium firms. Both surveys show almost similar results.

6) The growth of markets in Asia finally facilitated expansion.

Table 1a: Profit/sales ratio (%) of Japanese overseas manufacturing affiliates

FY	Latin America	USA/Canada	Europe	Asia	World
1983	n.a.	1.9	4.2	3.9	3.0
1984	n.a.	0.9	2.8	4.7	1.9
1985	n.a.	-0.5	1.7	2.9	1.3
1986	n.a.	0.7	1.2	2.3	1.4
1987	n.a.	0.4	2.0	4.0	2.2
1988	n.a.	0.7	2.3	4.4	2.9
1989	n.a.	0.2	2.3	3.8	1.8
1990	n.a.	-0.9	3.2	5	1.8
1991	-2.4	-1.9	-0.6	4.8	0.9
1992	n.a.	-0.3	-2.5	5.1	1.1
1993	3.0	0.1	-1.0	3.8	1.4
1994	7.6	1.9	1.2	4.1	2.9
1995	11.8	2.0	1.3	4.1	3.1

Source: MITI

Table 1b: Profit evaluation of Japanese manufacturing affiliates by region/country

FY	NIEs	ASEAN	China	Other Asia	USA/Canada	E.U.	Latin America
1991	3.12	3.15	n.a.	2.81	2.27	2.93	n.a.
1992	3.34	3.19	n.a.	2.97	2.26	2.55	n.a.
1993	3.31	3.15	2.88	2.97	2.26	2.29	2.61
1994	3.04	3.20	2.83	2.97	2.46	2.35	2.65
1995	3.17	3.15	2.75	2.63	2.72	2.52	2.91
1996	3.24	3.20	2.55	2.91	2.88	2.81	2.89
1997	3.31	3.21	2.65	2.26	3.07	2.99	3.16
1998	3.29	2.76	2.67	2.51	3.14	2.99	3.05

Note: 5 stages evaluation: 1 unsatisfied, 2 rather unsatisfied, 3 average, 4 rather satisfied, 5 satisfied

Source: Japan Export-Import Bank

However, most of the above six factors have changed in recent years.

- 1) Japanese firms' large-scale production in Western countries have softened trade frictions while growing markets in Asia have strengthened Japanese supply bases to Asian markets.

- 2) Since the depreciation of the yen starting in 1995, Japanese domestic production for the home market has recovered substantially in comparison to the affiliates' production in Asia.
- 3) Global divergence of profitability has weakened since approximately 1993 because the profitability in Western countries and Latin America has improved (Table 1). This change from profit divergence to convergence prompted more FDI into non-Asian countries in the fiscal years 1996 and 1997.
- 4) Asian countries' unilateral liberalization of FDI resulted in a delay of the development of region-wide markets in Asia.
- 5) The Asian advantage of low labor costs has been gradually lost in recent years. Past successes of high economic growth have reduced the advantages in labor-intensive industries.
- 6) The Asian crisis has dampened the Japanese motivation for increasing FDI in Asia.

3 THE EFFECTS OF THE ASIAN CRISIS ON JAPAN'S FDI IN ASIA SHOWN BY THE SURVEY

3.1 Outline of the survey

The Asian crisis since 1997 as a financial phenomenon had a major impact on the FDI strategies of Japanese firms. In order to evaluate the concrete effects, a questionnaire was submitted to 259 Japanese manufacturing firms, which include major electric/electronic, automobile and chemical firms.

3.2 Profile of respondents

In total, 157 firms answered the questionnaire providing a response rate of 60.6%. The majority (60.5%) of the respondents were large-scale firms, which have paid-in capital equal to or more than 10 billion yen (about 80 million US dollars). The small-scale firms, with paid-in capital of less than 1 billion yen (about 8 million US dollars), represented only 8.9% of the total.

3.3 Overseas affiliates owned by respondents in Asia

A total of 157 respondents in this survey own 1,611 affiliates in Asia and 3,176 affiliates throughout the world. The definition of 'affiliate' in this article is a Japanese firm that owns 10% or more of the paid-in capital of the overseas firm. In addition, if a respondent owns more than 50% of the

paid-in capital of the overseas affiliate and if the same affiliate owns more than 50% of the paid-in capital of other overseas firms, they are also regarded as overseas affiliates of the parent company.

3.4 FDI plans over the short-, medium- and long-term period

3.4.1 FDI plan over the short term period

The basic purpose of this research is to find out about the respondents' FDI plans for the future. At first, 10 Asian countries / regions were selected representing the main destination for Japan's FDI in Asia. These are Thailand, Indonesia, Malaysia, the Philippines, Singapore, Korea, China, Taiwan, Hong Kong and Vietnam. The basic method of the survey was to ask whether or not the firm has positive FDI plans (in terms of yearly flows) in the future limiting responses to a selection of five scaled choices: at the one end of the range, the first choice was 'to reduce the annual FDI flow dramatically (by 50% or more) below the FDI flow of 1997'. The next was 'to reduce the FDI flow slightly (by 25%) below the 1997 FDI level', the third was 'to preserve the same FDI flow level as 1997', the fourth was 'to increase the FDI flow slightly (by 25%) above the level of 1997', and, finally, the fifth was 'to increase the FDI flow dramatically (by 50% or more) above the level of 1997'.

To clarify the trends of the future FDI flows, two indexes were introduced namely, the 'simple average index (SAI)' and the 'weighted average index (WAI)'. The former is to measure the average FDI in the future, assuming the answer of each respondent has the same weight. The latter is to measure FDI, assuming the answer of each respondent is weighted by the size of its domestic sale. The main objective of such a double-layered analysis is to identify the differences in the respondents grouped according to their company-size. Generally speaking, large-scale firms forecasted large-scale FDI and large-scale overseas business. On the other hand, small-scale firms planned for small-scale FDI. The difference between SAI and WAI is assumed to show roughly the difference in sales/profit performances and FDI strategies of the respondents by company-size. The formula of SAI and WAI are as follows:

$$\begin{aligned} \text{SAI of FDI} &= [(50\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) \\ &+ (75\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) \\ &+ (100\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) \\ &+ (125\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) \\ &+ (150\% \text{ (of FDI 97)}) * (\text{Number of Respondents})] \\ &/ (\text{Number of all respondents}) \quad (1) \end{aligned}$$

FDI 97 refers to the FDI achieved by our respondents in 1997.

$$\begin{aligned}
 \text{WAI of FDI} = & [(50\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) * W \\
 & + (75\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) * W \\
 & + (100\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) * W \\
 & + (125\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) * W \\
 & + (150\% \text{ (of FDI 97)}) * (\text{Number of Respondents}) * W] \\
 & / (\text{Numbers of all respondents}) \quad (2)
 \end{aligned}$$

‘W’ refers to the ratio of the domestic sales value of each respondent divided by the total domestic sales value of all respondents. Table 2 and 3 show future FDI flows over the short-, medium- and long-term in SAI and WAI by country and by industry. The SAI for the 10 Asian countries is 94.1 over the short-term period when we assume 100 for the FDI flow in 1997. In other words, as an effect of the Asian crisis FDI will decrease slightly (0–25%) in the next three years. Taking into account that WAI is lower than SAI (88.4 as opposed to 94.1), it can be concluded that larger are more cautious than smaller ones over the short-term period.

Table 2: Expectations on FDI flows by country

		Short-term	Medium-term	Long-term
10 countries	SAI	94.1	97.8	101.9
	WAI	88.4	95.4	102.9
Thailand	SAI	88.9	94.4	100.8
	WAI	78.0	88.6	101.0
Indonesia	SAI	83.8	96.1	102.5
	WAI	71.7	86.1	100.0
Malaysia	SAI	96.2	97.3	100.7
	WAI	84.7	91.5	101.1
Philippines	SAI	101.0	102.2	107.2
	WAI	90.9	94.5	108.3
Singapore	SAI	94.8	95.8	96.0
	WAI	93.2	97.3	97.6
Korea	SAI	91.9	92.8	98.1
	WAI	91.0	95.6	100.4
China	SAI	99.7	103.4	107.8
	WAI	100.3	100.5	105.6
Taiwan	SAI	96.2	98.6	100.3
	WAI	93.9	104.6	106.1
Hong Kong	SAI	93.6	95.8	100.0
	WAI	96.0	100.0	102.2
Vietnam	SAI	100.0	104.8	108.3
	WAI	93.1	103.6	106.1

Table 3: Expectations on FDI flows by industry

		Short-term	Medium-term	Long-term
Chemicals	SAI	95.5	98.7	105.5
	WAI	93.9	95.9	104.8
Electric/electronic assembling	SAI	97.3	102.0	105.4
	WAI	89.6	96.8	100.7
Electric/electronic parts	SAI	101.1	102.1	102.1
	WAI	101.3	107.6	106.9
Automobile assembling	SAI	89.5	96.5	101.2
	WAI	83.8	98.3	108.8
Automobile parts	SAI	80.1	88.1	96.0
	WAI	77.0	79.8	104.7

The FDI attitude varied according to country and industry. Indonesia, Thailand and Korea, being the most severely affected by the crisis of all Asian countries, show the least positive FDI indexes in both SAI and WAI in Table 2. On the other hand, China will receive approximately the same amount of future FDI flows as in 1997. Singapore, Hong Kong, the Philippines, Malaysia and Vietnam and Taiwan are in between the first and the second group. In Section 3.5, it will be shown that good and bad sales and the profit performances of Japanese affiliates in host countries are closely related to the investment attitude of Japanese firms. In Indonesia, Malaysia, Philippines and Thailand, WAI is smaller than SAI by more than 10% percentage points. In these ASEAN countries the larger the size of the respondent gets the more cautious the FDI plans become.

By industry, the electric/electronic parts industry shows the most positive FDI over the short-term period both in SAI (101.1) and WAI (101.3) in Table 3. On the other hand, the automobile parts industry shows the most cautious FDI over the short-term period both in SAI (80.1) and WAI (77.0) in the same table. Again, the difference in attitude with regards to FDI is related to the sales and profit performances of their affiliates in Asia. By industry, we find some difference between SAI and WAI in the electric assembling industry but no significant differences in other industries. Larger electric assembling firms are more cautious in FDI over the short-term period than smaller ones. In other industries, the characteristic of company size is not so pronounced.

3.4.2 FDI over the medium- and long-term period by country

Generally speaking, Japanese firms' FDI plans over the medium-term period are be more positive than over the short-term (Table 2 and 3). If we

look at the SAI and WAI for 10 countries, both indexes increase from 94.1 to 101.9 and from 88.4 to 102.9, respectively. Moreover, all respondents plan to recover, on average, their FDI flow level of 1997 within 10 years.

When we focus on the host countries, we find some changes in medium-term FDI plans. Even in the most severely damaged countries (Thailand, Indonesia and Korea), our respondents' medium-term FDI plans become more positive over the short-term. Over the long-term period, Japanese firms will exceed the FDI level of 1997 in 8 Asian countries. The respondents' positive FDI attitude is prominent in China, Vietnam, the Philippines and Taiwan. Even in Thailand, Indonesia, Malaysia and Hong Kong, SAI and WAI exceed 100 over the long-term period. But, we should take into account that long-term FDI plans are less concrete than those over the short- and medium-term period.

3.4.3 FDI over the medium- and long-term period by industry

If we compare the most optimistic electric/electronic parts industry with the most cautious automobile parts industry (Table 3), one prominent characteristic is that even the electric/electronic parts industry is moderate in its FDI over the medium- and long-term period. Another point is that the automobile parts industry does not recover its FDI flow level of 1997 for the next ten years. However, WAI shows that the larger our respondents are, the more positive with regard to their future FDI they are even in the auto-parts industry because of their larger managerial resources.

3.5 Effects of the crisis on sales and profits of Japanese affiliates

3.5.1 Effects of the crisis at present

One main objective of this survey is to show the effects of the Asian crisis on sales and profit performances of the respondents' affiliates (Table 4 and 5). If we calculate the SAI and WAI of sales in Table 4 by substituting 'sales value' for 'FDI' in the equation (1) and (2) of Section 3.4.1, the value decreases to 88.5 for SAI and 73.9 for WAI for nine countries at the end of this fiscal year. Vietnam was omitted because of insufficient sample size.

The calculation of SAI by country reveals that Thailand, Indonesia and Korea are most severely effected by the crisis. When employing WAI, Thailand, Indonesia and the Philippines are shown as the hardest hit. In contrast though, the sales of affiliates located in China and Taiwan are higher than before the crisis. The remaining countries are in between the above two groups.

Table 4: Expectations on sales performance by country

		At present	Short-term	Medium-term
9 countries	SAI	88.5	100.0	112.1
	WAI	73.9	92.2	109.4
Thailand	SAI	81.3	96.8	109.6
	WAI	76.5	102.4	118.7
Indonesia	SAI	81.6	93.1	108.5
	WAI	58.3	67.1	89.2
Malaysia	SAI	94.8	104.8	111.7
	WAI	101.6	109.1	110.4
Philippines	SAI	90.3	104.4	122.1
	WAI	79.1	105.0	127.0
Singapore	SAI	91.7	104.0	116.7
	WAI	95.7	103.6	107.6
Korea	SAI	88.8	97.2	107.7
	WAI	100.6	107.8	110.9
China	SAI	111.7	116.7	126.7
	WAI	113.6	114.4	115.8
Taiwan	SAI	103.6	105.4	115.4
	WAI	117.5	116.4	129.6
Hong Kong	SAI	90.4	98.1	109.6
	WAI	94.1	98.6	114.2

Regarding current profit performances, we find similar results to those of sales (Table 5). The SAI is 81.7 and WAI is 64.1 at present. This means that the decline of current profits is larger than the decrease of current sales.

The decline in profits is most striking in Indonesia, Thailand and Korea. On the other hand, China and Taiwan are exceptions to this observation. In the remaining four countries, Malaysia, the Philippines, Singapore and Hong Kong, the fall in profits ranges between these two groups. It is noteworthy that Indonesia and Thailand, which were severely effected in terms of sales and profits, are host countries where the majority of our respondents are planning to decrease their FDI flows over the short-term period. In contrast, China, which has been little touched by the crisis, will receive a rather positive FDI inflow over the short-term period (see Section 3.4). Other countries in between these groups in terms of sales and profit performances also range in between these groups in terms of their

Table 5: Expectations on profit performance by country

		At present	Short-term	Medium-term
9 countries	SAI	81.7	95.3	109.7
	WAI	64.1	78.7	103.0
Thailand	SAI	76.3	91.6	107.3
	WAI	63.3	82.0	109.6
Indonesia	SAI	74.2	89.5	107.3
	WAI	54.9	62.0	88.2
Malaysia	SAI	84.2	95.2	105.9
	WAI	87.2	99.4	109.4
Philippines	SAI	82.4	100.0	120.6
	WAI	78.6	104.7	106.3
Singapore	SAI	87.1	101.6	113.3
	WAI	95.0	102.2	107.5
Korea	SAI	75.9	92.6	106.7
	WAI	71.3	90.1	110.3
China	SAI	108.3	116.7	123.3
	WAI	103.7	115.2	115.8
Taiwan	SAI	98.2	101.8	113.5
	WAI	115.8	116.4	131.2
Hong Kong	SAI	92.3	98.1	113.5
	WAI	90.5	99.8	116.6

future FDI plans. As an exception to this pattern, in the Philippines, firms are rather positive toward future FDI flows as measured by SAI in spite of insufficient sales and profits.

If we focus on the difference between SAI and WAI, the decline of larger firms' sales and profits is very significant in Indonesia while that of larger firms is relatively slight in other ASEAN countries. This situation led large firms respondents to have a more cautious FDI attitude in regards to Indonesia.

Another aspect is sales and profit performances by industry (Table 6 and 7). The electric/electronic industry, which is more strongly oriented toward global markets than the automobile industry, was less effected by the Asian crisis than the automobile industry. The SAI of current sales performances of the electric/electronic parts industry is 96.2 and the WAI is 104.2, which means the affiliates of large firms will expand their sales beyond the level that existed prior to the Asian crisis. In contrast, the auto-

mobile parts industry suffered severely because of the crisis as most of the customers in Southeast Asia, including many Japanese affiliates, drastically decreased their demand for parts.

Table 6: Expectations on sales performance by industry

		At present	Short-term	Medium-term
Chemicals	SAI	98.4	110.2	122.8
	WAI	91.8	101.9	124.3
Electric/electronic assembling	SAI	89.2	99.0	111.5
	WAI	68.3	78.7	94.1
Electric/electronic parts	SAI	96.2	103.0	113.1
	WAI	104.2	99.7	105.5
Automobile assembling	SAI	61.8	87.5	107.5
	WAI	65.4	106.5	125.5
Automobile parts	SAI	76.7	88.3	100.4
	WAI	58.0	73.0	90.3

Table 7: Expectations on profit performance by industry

		At present	Short-term	Medium-term
Chemicals	SAI	86.7	105.4	123.7
	WAI	75.8	89.1	122.2
Electric/electronic assembling	SAI	83.0	93.1	111.0
	WAI	59.1	71.4	96.8
Electric/electronic parts	SAI	89.3	101.8	111.3
	WAI	82.8	99.9	110.4
Automobile assembling	SAI	51.5	73.8	100.0
	WAI	50.0	71.3	105.6
Automobile parts	SAI	72.5	84.6	98.8
	WAI	56.8	64.4	82.6

The difference between SAI and WAI is very large in the automobile parts industry, which means that the effect on large parts makers is greater than that on smaller makers. In fact, some auto-parts firms and their affiliates answered in interviews that demand by assemblers in Asia has shrunk dramatically. Presently, auto-parts affiliates have to export their products to Japan and third countries. Naturally, they are cautious in their FDI plans over the short-term. Several firms in the electric/electronic parts industry answered during interviews that they were only slightly effected

by the crisis because their customers' demand for their parts is globally strong and their Asian procurement ratio of parts is substantially high. High ratio of local parts procurement in Asia means that the electric/electronic parts firms do not suffer much from increasing import expenditure caused by the depreciation of Asian currencies. Rather, they gain benefit from expanding exports benefiting from the depreciated currencies. It is natural that the electric/electronic parts industry, which has performed better than other industries, is more positive in short-term FDI plans than other industries.

3.5.2 Effects of the crisis over the short- and medium-term period

Our respondents forecast a substantial improvement in sales and profit performance (Table 4 and 5) over the short- and medium-term. In sales performance, SAI increases to 112.1 over the medium-term from 88.5 at present and WAI increases to 109.4 from 73.9. In profit performance, SAI increases from 81.7 to 109.7 and WAI increases from 64.1 to 103.0.

Grouping respondents by country, in terms of the SAI and WAI of sales and profits over the short-term, the recovery foreseen for Thailand and Korea is prominent. Over the medium-term, sales and profits of Japanese firms' affiliates substantially exceed the level achieved before the Asian crisis in most of the countries. In terms of the WAI, the only exception to this observation is Indonesia, which means that large-scale firms are cautious about their prospects. This prediction of improved sales and profit over the short- and medium-term suggests more positive FDI plans over the medium- and long-term.

As measured by industry, all including the automobile parts industry, have turned to a more positive FDI over the short- and medium-term (Table 6 and 7). However, in the automobile parts industry, even over the medium-term, larger firms cannot recover the sales and profits level of those before the Asian crisis.

3.6 Export ratio of local affiliates by industry

Sales and profit performances of Japanese affiliates in Asia are strongly related to the export ratio of the affiliates. By industry (Table 8), the electric/electronic parts industry has the highest export ratio of local affiliates in Asian host countries. This is followed by the electric/electronic assembling, the chemical, the automobile parts and the automobile assembling industries.

Table 8: Expectations on export performance by industry

		At present	Short-term	Medium-term
Chemicals	SAI	32.6	33.6	32.8
	WAI	42.5	41.4	38.3
Electric/electronic assembling	SAI	42.8	47.7	49.8
	WAI	42.5	47.7	51.5
Electric/electronic parts	SAI	62.1	61.7	62.1
	WAI	50.7	57.4	58.4
Automobile assembling	SAI	12.5	14.5	14.5
	WAI	12.7	16.6	18.5
Automobile parts	SAI	18.0	22.6	23.8
	WAI	17.2	23.9	27.0

This result was predictable because the automobile industry is more oriented toward local markets than the electric/electronic industry. However, it is noteworthy that the electric/electronic parts industry is more export-oriented than the electric/electronic assembling industry probably because of a greater concentration of the latter in local markets. The results of this Section and Section 3.5 suggest that satisfied sales and profits are based on a high export ratio. The simple correlation coefficients between the export ratio and sales and between the export ratio and profits as measured by WAI for major industries are as illustrated by Table 9.

Table 9: Export ratios to sales and profits

	export ratio to sales	export ratio to profits
All industries	0.848	0.780
Chemicals	0.889	0.797
Electric/electronic assembling	0.758	0.646
Electric/electronic parts	0.800	0.738
Automobile assembling	n.a.	n.a.
Automobile parts	0.390	0.386

Observing the trend of WAI, we see that the increase of sales and profits in the electric/electronic parts and the automobile parts industries is prominent both over the short- and medium-term. In both parts industries, affiliates of large firms' affiliates seem more eager to develop further export markets than small firms' affiliates. Large firms seem to have more managerial resources to develop new export markets than smaller ones.

3.7 Local procurement of parts by Japanese affiliates in Asia

The local procurement ratio of Japanese affiliates in Asia is generally predicted to increase from the current ratio to a higher ratio over the short- and medium-term. Viewed on the basis of industry, the automobile assembling, the automobile parts and the electric/electronic assembling industries show a higher local procurement ratio than the electric/electronic parts industry. The result is noteworthy as the sales and profits of the former industries have deteriorated more than the latter. A high local procurement ratio obviously does not improve much the sales and profit performance.

3.8 Mergers & Acquisitions (M&A) in FDI strategies by Japanese manufacturing firms

One of the most prominent characteristics of Japanese firms' FDI is that they use M&A very rarely (only 7.9%) as a FDI measure. This attitude toward M&A is quite different from that of Western firms. Furthermore, most of our respondents do not wish to be involved in M&A after the Asian crisis. This Japanese attitude is again quite opposite from that of Western firms, which want to expand their Asian business through more frequent M&A, utilizing the lowered prices of Asian companies after the crisis.

The reasons for this difference seem to be the following: first, Japanese manufacturing firms always prefer to establish new companies owned completely by themselves in foreign countries, and secondly, they have already invested in Asia far more than Western firms. Therefore, they are more interested in supporting existing affiliates with additional capital injections than to conduct M&A.

3.9 The determinants of future FDI

As the most important FDI determinant among the 17 given to decide whether to increase or decrease future FDI over the medium term evolved the determinant 'future potential of the local markets of host countries', which was selected by 236 respondents (on a cumulative basis). Of the respondents, 62.4% said that 'the future of the local market is promising', while 37.6% of respondents said 'the future is gloomy'. As the second most popular reason in deciding on future FDI turned out to be 'the future development of regional integration of Asia over the medium term', which was chosen by 192 respondents. 63.3% of all respondents feel positive about the future expansion of Asian regional markets through re-

gional integration while 36.7% are pessimistic about it. The third most noted reason is 'the political stability of the host country', which was given as an answer by 178 respondents. From the respondents who gave this answer, 67.7% estimated that 'political stability will be achieved' over the next five years. The fourth reason is 'the infrastructure in the host country', which was the answer of 148 respondents. More than three quarters of our respondents, who chose this answer, believe that the 10 Asian countries will further develop their infrastructure. The fifth reason provided is 'the potential for export bases', which was the answer given by 144 respondents, 68.2% of the respondents believe that the 10 Asian countries have much potential as export bases. The sixth reason is 'the local finance procurement for capital formation in host countries', which was selected by 134 respondents of whom 45.7% expected to have a higher availability of local finance in host countries while 54.3% of them predicted to have in the future lower availability of local finance. Certainly, local finance procurement in host countries is one important negative FDI determinant. The seventh and final reason is 'labor costs in host countries', which was selected by 128 respondents of whom 69.1% of our respondents said 'labor costs of the host country will increase in the next five years', while 30.9% of them expected a decrease.

In summary, five of the seven major determinants bode well for future FDI. Only the sixth and seventh ones portend to have a negative impact on future FDI. The difficulty in local financing is especially serious to relatively small-sized affiliates in Asia. The increase in labor cost will diminish one important source of Asia's former advantages.

4 THE FIRM-SPECIFIC CHARACTERISTICS OF JAPAN'S FDI

4.1 The accelerated change of the complementary relationship

Section 3 showed that the sales and profit performances of Japanese affiliates in Asia were substantially damaged strongly affecting profitability in Asia. Worsened performances will accelerate the convergence of profitability of Japanese affiliates in Asia, Western countries and Latin America. Moreover, the advantage of low labor costs in Asia is predicted to diminish over the medium-term. Japanese affiliates are very eager to increase exports but the export increase is predicted to be rather moderate, in particular for the firms in the automobile industry that are facing serious difficulty in expanding exports because of the nature of their products.

4.2. Firm-specific characteristics of Japan's FDI

The Asian crisis has had a serious impact on Japanese affiliates, which rely on local markets. If assembling firms depend on local markets, the shrinking local demand for them is disastrous for parts suppliers, too. The Asian crisis is so serious that the recent FDI strategy of the automobile industry does not work well in this situation. This strategy was based on transplanting the concept of strong, long-term vertical supplier networks to Asian countries, in order to exploit the Japanese competitive advantages which result from lower transaction costs through networks (see Tejima 1996, 1998b). The basic assumption is that assemblers and parts suppliers have achieved economies of scale in parts production and that assemblers and parts suppliers prefer to preserve long-term transactions rather than to seek opportunist's profit. In addition to that, employers and employees in a company are also assumed to choose long-term transactions rather than short-term transactions (life-time employment system).

When Japanese firms engage in overseas production, they try to reconstruct these competitive internationalization advantages in their international production networks. One important way to do this is to persuade Japanese parts suppliers to invest in foreign countries to supply locally to their assemblers. Another measure is to persuade local parts suppliers and employees to change their habits to switch to long-term transactions. In Western countries, especially in the USA, Japanese affiliates have gradually succeeded to reconstruct their advantages after a struggle of more than 10 years in cooperation with affiliates of Japanese parts suppliers (also see Oman 1994). On the other hand, the Asian crisis has severely damaged Japanese firms' efforts in their Asian networks, especially in the automobile industry. Reconstructing assemblers and parts suppliers networks in Asia is not enough to reconstruct the advantages once held by the Japanese automobile industry in Asia, because the shrinking local demand is eroding the advantage of economies of scale. For that industry, an enlarged Asian-wide market is necessary in addition to the strategy of reconstructing their production networks in Asia.

5 CONCLUSION

Recent experience suggests that the complementary relationship between Japanese firms and Asia might be approaching a turning point at an accelerated pace. In the late 1980s and early 1990s, Japan's FDI in Asia stimulated high economic growth in that region and growing trade between Asia and Japan. But, the past Asian success has, ironically, weakened the

former advantage of low production cost. The recovery of the business performance of Japanese affiliates in non-Asian regions relatively weakens the position of Asia as a major destination of Japan's FDI.

The Asian crisis has accelerated this transformation of the complementary relationship. Deteriorated sales and profit performances in Japanese affiliates in Asia accelerate the diversification of Japan's FDI from Asia to non-Asian regions. Asian countries, which have gradually lost their advantages in labor-intensive industries, have to seek higher value-added industries to support the higher per-capita income of these countries.

The future success of Japanese industries in Asia will greatly depend on whether they can make the FDI of parts suppliers successful or not. Parts suppliers are now eager to expand exports from their Asian affiliates to non-Asian regions. They have to cooperate with newly constructed higher value-added industries in Asia. However, further liberalization of trade and FDI in the Asian region including developed countries is most important and indispensable into stimulating more of Japan's FDI flow to Asia and to foster the growth of region-wide markets and competitive large-scale industries.

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DRIVING REGIONAL INTEGRATION: JAPANESE FIRMS AND THE DEVELOPMENT OF THE ASEAN AUTOMOBILE INDUSTRY

Jochen LEGEWIE

1 INTRODUCTION

‘Size does matter.’ In the summer of 1998, this slogan was used as the main catch-phrase to advertise the US movie *Godzilla* in Japan. Despite its size of 70 meters however, the Hollywood remake of the original Japanese monster failed to impress the audience in Japan due to its total obsession with destruction. By not allowing for some of the more redeeming characteristics of its Japanese predecessor, in particular helping and protecting mankind, the US *Godzilla* failed to fulfill the role attributed to it and thus to live up to the expectations of the Japanese audience. Here we see as a case in point that size alone does not necessarily matter.

Looking at the automobile industry in the countries of the Association of Southeast Asian Nations (ASEAN), maybe its most striking feature is the dominant position of Japanese car manufacturers. Japanese companies have been holding market shares of about 80–90% for both sales and production, within this region, since the start of the Southeast Asian automobile industry in the late 1960s. Here again we face the question of size and whether it matters. Has Japanese dominance helped or hindered the development of the Southeast Asian automobile industry until now, and how will this dominance affect its further development? Attempts to find an answer to this question directly lead to the problem of regional integration and disintegration that have been at the core of the development of the ASEAN automobile industry since its start.

Hence, this paper focuses on regional integration attempts and achievements within the Southeast Asian automobile industry in the past and present. It describes and analyzes various industrial cooperation schemes and the reasons for the partial or total failure of their implementation. It identifies ASEAN governments and Japanese automakers as the two important players within the regional integration process and it shows that the latter ones have become the decisive actors over time by partly taking over the formulation of industrial policies at the ASEAN level.

With regard to this dual role of Japanese companies, this paper complements two kinds of scholarly works. The first group is comprised by those that have analyzed the development of the ASEAN automobile industry by merely pointing to the dominance of Japanese companies without sufficient attention given to the delicate power play in industrial policy formulation and implementation (see *e.g.* EIU 1985; Payne 1993; Funke 1997; Fujita and Hill 1997). The other group of articles and books has analyzed the general political economy of economic integration within ASEAN with too much emphasis on ASEAN governments as the main actors within this process (see *e.g.* UNIDO 1986; Chatterjee 1990; Rieger 1991; ASEAN-Secretariat 1997).

This paper closer follows the work of Doner (1987, 1991) whose analysis on the automobile industrialization of Southeast Asia and the political bargaining process between ASEAN governments on the one hand and Japanese firms on the other presents the most encompassing approach of developments until the late 1980s. This paper enlarges Doner's work by including an analysis of the development in the 1990s and showing why Japanese companies have become the driving force in shaping and utilizing regional cooperation schemes as well as in building up a region-wide industrial structure including supporting industries. By examining the position of Japanese automakers in contrast to their Western competitors and simultaneously highlighting the obstacles within and between single ASEAN countries toward a deeper industrial integration, this paper argues that there has been no viable alternative to this Japanese led approach toward regional integration and the development of the Southeast Asian automobile industry and that there will be none in the near future.¹

¹ Thus this paper concentrates on the role of Japanese companies within the important integration process of the ASEAN automobile industry. By contrast, it does not attempt to answer the more general question whether the regional dominance of Japanese manufacturers over Western companies has been advantageous or disadvantageous for the development of the local industry in terms of technology transfer or the nurturing of local companies.

However, the author strongly opposes the often heard and negatively connoted argument that Japanese dominance has come with a lack of competition. Undoubtedly there has been and there continues to be fierce competition between single Japanese manufacturers in ASEAN. The very existence of Proton, the Malaysian national car manufacturer, is the best proof for this view as Proton could be only established in 1983 by the help of Mitsubishi Motors. While no Western company was willing to engage itself in the Malaysian national car project at that time, Mitsubishi did so out of the motivation to gain a stronger foothold in Southeast Asia and thus a leading edge over its Japanese competitors.

2 CHARACTERIZATION OF THE ASEAN AUTOMOBILE INDUSTRY: THE PROBLEM OF FRAGMENTATION AND MISSING ECONOMIES OF SCALE

Although the volume of automobile production in ASEAN has risen enormously until recently (Table 1), the industry in general is still characterized by a high degree of production fragmentation. This fragmentation separates the four most important markets of Thailand, Malaysia, Indonesia and the Philippines from each other and thus limits the size of their automobile industries mainly to their respective domestic markets. This is the direct outcome of the import substitution strategies that have been pursued by these four countries since the 1970s. Even today import tariffs, local content regulations and other trade and investment barriers continue to dominate automobile industrial policies separating Southeast Asian markets from each other and preventing car manufacturers from enjoying the benefits afforded by regional production specialization and economies of scale.

Table 1: Automobile production figures (including knock-down) in ASEAN countries 1970–1998

	Thailand	Indonesia	Malaysia	Philippines	ASEAN 4	Japanese Share ¹
1970	22,000	10,000	28,000	19,000	79,000	90%–95%
1980	72,000	174,000	101,000	93,000	440,000	90%–95%
1985	82,000	139,000	124,000	20,000	365,000	90%–95%
1990	305,000	272,000	205,000	40,000	822,000	79.2% (92.3%)
1995	483,000	388,000	308,000	123,000	1,302,000	80.3% (95.3%)
1996	559,000	325,000	396,000	137,000	1,417,000	74.0% (91.6%)
1997	360,000	389,000	457,000	111,000	1,317,000	67.6% (91.0%)
1998	169,000	58,000	164,000	47,000	438,000	n.a. (91.4%)

1) The figures in brackets indicate the share of Japanese manufacturers including the production of the Proton and Perodua in Malaysia in which Mitsubishi and Daihatsu are highly involved.

Source: Nikkan Jidōsha Shinbunsha (1996), Fourin (1998a), Fourin (1999)

Even worse, the problem of small-scale production does not end here as there is a second layer of fragmentation at each national level where the limited production has to be divided among a large number of automakers.² In each of the four countries, 15 to 20 assemblers (of which at least 10

² For a detailed description and explanation of the failure of ASEAN governments to effectively limit the number of assemblers in their respective countries, see Doner (1991, 96–218).

involve Japanese manufacturers) plus numerous original equipment manufacturers compete against each other reducing the output of single factories to below 10,000 vehicles in most cases. In addition, most companies split these low numbers not only between passenger cars and commercial vehicles but also among a wide range of different models further reducing the potential for any scale economies. Even among the bigger Japanese manufacturers, the average plant output per year did not exceed 20,000 in 1996 with 32 out of 54 plants producing less than 10,000 vehicles (IRC 1997). The only company that stood out with a per year production of more than 100,000 is Proton in Malaysia, but even Proton could not reach the production level of 200,000 units which is regarded as the minimum number required for mass production (Ishizaki 1994, 18; Fourin 1998a).

As a result of this production fragmentation at the regional and national level, the ASEAN automobile industries have mainly remained at the knock-down assembly stage so far, unable to move on to the next stage of automobile industrialization – mass production. Thus, the problem of small-scale production lies at the heart of the problem of the development of the Southeast Asian automobile industry. This holds especially true as this problem affects the equally important supporting industries (material and parts suppliers) in the same way. It restricts all efforts to improve international competitiveness by reducing costs or raising quality without stronger cooperation between companies in different countries of this region. The first successful steps toward such a regional integration have been taken by Japanese companies in recent years as we will see below; though, the extent has been quite limited so far.

3 DEVELOPMENT UNTIL THE LATE 1980s: JAPANESE DOMINANCE AND THE FAILURE OF REGIONAL INTEGRATION EFFORTS

Japanese manufacturers have dominated automobile production in Southeast Asia since its start in the late 1960s as they had dominated the import markets of the same countries before. After the introduction of import substitution policies had forced foreign companies to tie up in terms of capital or technology with local companies to replace imports by local assembly, Japanese manufacturers showed much more enthusiasm and commitment to follow this path than did their European or US competitors. This strong interest of Japanese automobile companies in the ASEAN markets in the 1970s and 1980s can be explained by a number of factors (Doner 1991, 76–8):

- 1) geographical – and partially cultural – proximity;
- 2) product compatibility between the market needs in Southeast Asia and the focus of production on commercial vehicles and small, durable passenger cars in Japan in the 1960s and 1970s;
- 3) the importance of ASEAN countries as an export destination for Japanese car producers (switching from the export of complete vehicles to the export of knock-down parts for local assembly);
- 4) the fear that the Japanese market itself would be endangered if European and US automakers gained a strong foothold in neighboring Asian markets.³

Beside this strong interest, Japan's dominance of the ASEAN automobile industries during these years has equally been a function of Japanese companies' specific advantages over its Western competitors in the region. The reasons are threefold: Firstly, Japanese business strategies were not based only on a long term perspective as opposed to the more short term cost-benefit oriented approach of their Western counterparts. They also included the ability to adapt flexibly to local needs like equity restrictions in joint ventures or the extensive use of informal networks including the sometimes extra-legal accommodation of the interests of key persons within the host countries. Secondly, the excellent financial health of Japanese companies throughout the 1970s helped expansion in Southeast Asia especially during the initial market penetration phase that offered only low profits. The financial strength of the Japanese assemblers may have been even more important during the 1980s when it facilitated the expansion of Japanese material and parts suppliers in Southeast Asia – a point we will refer to in more detail later. Finally, the well known ability of Japanese firms to efficiently manufacture small numbers of different vehicles and models has greatly supported their move into the small and fragmented markets in the ASEAN region and helped their success over other foreign companies there (EIU 1985, 7–16; Doner 1991, 79–83).

Despite this 'Japanese success story' the subsequent move of all 11 Japanese assemblers into ASEAN auto production simultaneously contributed to the fragmentation of the single national markets and the entire region as described above. This problem of an uneconomic fragmentation of manufacturing activities was foreseen from the start of ASEAN auto-

³ As a fifth factor that raised Japanese interest in achieving a strong position in Southeast Asia, some authors mention geopolitical interests like securing raw material supplies for Japan (EIU 1985; Doner 1991; Hatch and Yamamura 1996). However, as related to corporate strategies, this argument holds true only for a company like Mitsubishi Motors with the interests of the broader Mitsubishi Group encouraging aggressive strategies by its automobile arm.

mobile industrialization as shown by the early proposal for regional automotive complementation by a United Nations Report on ASEAN in 1969 (Solidum and Meow 1987, 1). For the following 20 years, different concepts and schemes of regional complementation within the ASEAN automobile industry were to be pursued by the Southeast Asian countries generating, however, only negligible success. A closer examination of the main actors and approaches within this phase of regional integration efforts will help to identify the main problems and reasons for that failure and to understand why Japanese companies were later given the power to become the leading force within the integration process (see also Legewie 1998, 223–30).

Subsequent to the UN report, the first regional meeting of private ASEAN automotive representatives took place in Bangkok in 1971. It ended in a joint call for a region-wide complementation program to be supported by the ASEAN governments that were requested to provide special tariffs and local content privileges. In 1976, the private automotive business formally organized the *ASEAN Automotive Federation* (AAF) which immediately set up the concept of *ASEAN Automotive Complementation*. This concept was presented to the ASEAN governments and eventually became the basis for the *ASEAN Industrial Complementation* (AIC) scheme adopted in 1981. This scheme aimed at facilitation of regional production specialization by offering local content accreditation and tariff privileges to certain part productions in different countries. The allocation of these selected part productions was to be decided jointly among the ASEAN governments and supposed to be based on reciprocity. Thus the AIC scheme required one big package deal with a ‘fair’ and reciprocal allocation of benefits among the participating ASEAN countries (UNIDO 1986, 29–33; Solidum and Meow 1987, 1–5; Kamo 1997, 66–8).

The need for such a consensus among the ASEAN countries however proved to be an insuperable obstacle for the successful implementation of the AIC scheme. Although all countries acknowledged the need for production rationalization and specialization on a regional scale, they simultaneously tried to pursue their national strategies of establishing their own integrated automobile industries. This held true despite the official pledge of aiming at the production of an *ASEAN car*⁴. Thus, all attempts at allocating the production of a specific component to one country faced stiff opposition by other countries fearing to lose out in that specific production area.

⁴ This vague idea that had been formulated for the first time at the Bangkok meeting in 1971 resembles the concept of the Airbus production in Europe.

This coordination problem had already become visible during earlier discussions within the AAF between 1976 and 1978. Within the subsequent negotiation process at the ASEAN government level, the number of items for possible industrial complementation under the AIC scheme was reduced from 121 to 17 at which point the first AIC package was finally approved in 1981, followed by a second (and last) package of just 5 more items in 1983 (see Table 2). As a result, the overall impact on regional complementation with these agreements was only minimal, covering less than 1% of the total intra-ASEAN trade (UNIDO 1986, 32–3; EIU 1985, 66–7).⁵

Table 2: AIC packages for preferential trade treatment 1981 and 1983

First Package 1981	
Indonesia:	diesel engines, axes (motorcycles), wheel rims
Malaysia:	spokes/nipples, drive chains, timing chains, crown wheels and pinions, seat belts
Philippines:	body panels (pass. cars), transmissions, rear axes (light comm. vehicles)
Thailand:	body panels (commercial vehicles), brake drums, shock absorbers
Singapore:	universal joints, oil seals, V-belts

Second Package 1983	
Indonesia:	steering systems
Malaysia:	headlights
Philippines:	heavy duty rear axles
Thailand:	carburetors
Singapore:	fuel injection pumps

Source: EIU (1985, 66)

The rivalry between the single states competing for the same industry has already been given as the main reason for the failure of this government-led attempt at industrial integration in ASEAN. Other factors contributed as well to the failure of the AIC scheme. Among them was the absence of common objectives with ASEAN countries simultaneously aiming at industrial integration, the creation of employment, export promotion, the facilitation of technology transfer and the earning of foreign exchanges. In

⁵ In other industries, the ASEAN countries even failed to finalize any AIC package despite wide interest and some 30 proposals ranging from industries like iron & steel and textiles to chemicals, electronics and food processing (UNIDO 1986, 29–34).

addition, the insistence on reciprocity in every single preferential agreement necessitated long negotiations at the bilateral and multilateral levels further restricting the opportunities for production rationalization.⁶ In 1982 the announcement of the Malaysian national car project finally destroyed all plans of a regional car project and the probability of enforcing part-to-part complementation as called for in the AIC (Meow 1987, 81–3; Shimizu 1994, 53).

Within this discussion of the reasons for the failure of the AIC scheme, we still have not referred to the attitude of foreign companies toward complementation schemes, especially that of the Japanese automakers. Doner describes their behavior through the mid 1980s as that of ‘reluctant multinationals’ and correctly identifies their reservations as being less against regional complementation schemes in particular but more against a change of the status quo that would require new big investments in the ASEAN region in general (1991, 83). This reluctance can be attributed to three characteristics of the Japanese automakers and distinctive features of their production system, (1) a capital-intensive production; (2) tight links to supplier firms; and (3) a strong interfirm rivalry. The rapidly falling labor intensity in the automobile industry since the 1970s reduced the attractiveness of cheap labor and thus that of developing countries as production sites for all automakers. For Japanese manufacturers this held true even more so than for their Western competitors due to the highly capital-intensive character of the Japanese production system. In addition, their strong reliance on parts suppliers in terms of quality, cost and delivery (just-in-time) further complicated a production process that went beyond the mere assembly of knock-down parts in ASEAN countries characterized by a weak supplier base. Both factors were exacerbated by the strong interfirm rivalry of Japanese companies that impeded cooperative production arrangements required to achieve the necessary economies of scale.

It becomes obvious that from the Japanese manufacturers’ perspective any expansion of auto manufacturing in ASEAN only threatened to reduce their quality, efficiency and competitiveness while raising production costs at the same time. Maintaining the status quo and sticking with the simple assembly of imported knock-down parts thus was the preferred strategy for Japanese companies through the mid 1980s and ex-

⁶ The notion of a 50% cut in tariff rates itself proved to be an obstacle to harmony. As each member nation used to charge different rates, it meant that the country with the highest initial rates (Thailand) had to concede more percentage points which was seen by this country as a special sacrifice (EIU 1985, 65).

plains their reluctance toward any changes including those associated with the new complementation programs.

However, by the end of 1982 their role within the integration process suddenly was set to gain in importance. Frustrated with the slow progress and the obvious failure of the AIC after the announcement of the Malaysian national car project, ASEAN officials for the first time addressed Japanese car manufacturers directly and asked them to present their ideas of a realistic development program for the automobile industry in Southeast Asia. Although their first response still reflected reluctance, Mitsubishi Motors, with some enthusiasm, took up that chance to strongly promote the old idea of brand-to-brand complementation (Shimizu 1994, 53–4).⁷

This concept had already been suggested by Japanese automakers in 1976, but had been strongly rejected within the AAF by the majority of non-Japanese member companies at that time (Solidum 1987, 45). Compared to the idea of part-to-part complementation that aimed at a consensual allocation of complete part productions to single ASEAN countries, the brand-to-brand concept was built on more flexibility and a stronger involvement. This was to be achieved by allowing – at least in theory – private companies to decide how and where to execute complementation within the production of their respective brands. But even after the obvious failure of the AIC scheme, the implementation of the brand-to-brand idea took another six years until 1988. Until then, several obstacles had to be overcome, especially the opposition within the region against a growing Japanese dominance, the prevailing reluctance among Japanese automakers other than Mitsubishi Motors and the economic depression of 1985/86. Then, however, the start of a new cooperation scheme was to mark a substantial shift in the sovereignty of decision-making from the ASEAN governments to multinational (Japanese) companies and to start a new phase of regional integration efforts.

⁷ The reason for this was the strong interest of Mitsubishi Motors in the Asian market. As it clearly lagged behind other Japanese automakers not only in Japan but also in the two important overseas markets of North America and Europe, it eagerly tried to catch up by taking a leading role in the production expansion in the ASEAN region. The same interest stood behind the decision to tie up with the company HICOM of Malaysia to establish Proton and jointly produce the Malaysian national car from 1983 onwards.

4 DEVELOPMENT THROUGH 1996: FIRST SUCCESSFUL STEPS TOWARD REGIONAL INTEGRATION LED BY JAPANESE AUTOMAKERS

In October 1988, the *Brand-to-Brand Complementation* (BBC) scheme was officially approved, meaning that the failed AIC concept of part-to-part complementation was *de facto* replaced by the new concept of brand-to-brand complementation. The BBC scheme offers car manufacturers a 50% tariff reduction and a local content accreditation for the parts they exchange between their ASEAN production facilities within one brand. These privileges, however, require that these parts have a local content rate of at least 50% to sustain existing barriers versus imports from outside the region and thus to support industrialization on a regional level.

Although the BBC scheme limited possible advantages mainly to Japanese companies (for they were the only ones with an extensive production network in Southeast Asia), it was finally accepted by ASEAN because it promised to overcome the main defect of the AIC scheme, namely the interstate competition for the same industry. As BBC restricted regulations and privileges of a regional parts exchange for every application to one brand and thus only one manufacturer, it seemed to guarantee to circumvent rivalry between single countries and by this to secure an efficient regional division of labor.

It is important to note that the start of the BBC scheme and its subsequent utilization by Japanese automakers were also supported to an important degree by an increasingly positive stance of Japanese car manufacturers toward a quantitative and qualitative increase of their production in ASEAN that was due to a number of reasons:

- 1) an appreciation of the yen;
- 2) stronger local content requirements that had made it increasingly difficult to stick with pure assembly activities that relied on large imports of components from Japan since 1985;
- 3) liberalization efforts, both on a regional scale as the decision to establish the ASEAN Free Trade Area (AFTA) in 1992 and within the automobile industry like the abolition of import bans on complete vehicles and the lowering of import tariffs, encouraging Japanese companies to foster a regional production approach;
- 4) rising European and US limits on Japanese auto exports making the ASEAN markets increasingly attractive to Japanese car manufacturers;
- 5) the strong economic growth in Southeast Asia that started again to boost auto sales after 1987;

- 6) the progress in industrial upgrading of supporting industries being of utmost importance as any new Japanese investment aiming at regional production specialization and the achievement of economies of scale required strong material and parts suppliers.

Table 3: Investment by Japanese automobile material and parts makers in ASEAN countries by investment cases per year

	62-69	70-74	75-79	80-85	86-90	91-95	1996	1997	Total
Thailand	13	14	5	13	48	63	38	14	208
Indonesia	–	5	12	3	12	28	14	8	82
Malaysia	1	5	4	13	16	21	1	–	61
Philippines	–	4	2	–	12	22	10	4	54
Singapore	1	4	9	2	1	–	–	–	17
ASEAN 5	15	32	32	41	89	134	63	26	422

Source: Fourin (1998a)

The process of upgrading Southeast Asian supporting industries is best illustrated by the strong investment of Japanese material and parts makers in these countries since the second half of the 1980s (see Table 3). It can be concluded that a clear convergence of the general environment of ASEAN auto policies and of Japanese car manufacturers' interests provided a promising starting point for the second phase of industrial integration in the ASEAN automobile industry at the end of the 1980s.

Between 1989 and 1996, BBC applications by Volvo, DAF, Mercedes Benz as well as the four big Japanese car manufacturers (Mitsubishi Motors, Toyota, Nissan and Honda) were approved and privileges were granted to them marking the first steps toward a regional integration of ASEAN automobile industries. However, only the regional parts exchange of the Japanese companies reached a level of substantial volume by 1996 and even they had to face a large number of problems that complicated the implementation process and hindered the exercise of BBC privileges. In particular, an effective abolition of the rivalry between the single countries proved to be too difficult to be realized.

A theoretically optimal division of labor was hindered from the start because Indonesia did not join the BBC agreement before 1995. Even then Indonesia refused the local content accreditation of imported BBC parts meaning that it did not allow any effective tariff reduction.⁸

⁸ In Indonesia import tariffs decreased with rising local content rates until 1999.

The need to apply for every car brand separately was further complicated by the requirement to file a new application with every model change resulting in new negotiations between the car manufacturer and the countries involved. For example, Mitsubishi Motors' production at the end of 1996 was based on 21 BBC approvals with another 8 applications pending (Yoshimi 1998, 19). The most difficult part of the negotiations was attributable to the need that the effect of every bilateral parts exchange on the trade balance of the countries involved had to be neutral. This reciprocity requirement was the legacy of the AIC scheme and forced the companies into numerous amendments of their initial production and export plans. This in turn remarkably narrowed the opportunities for an efficient use of existing capacities.

Another weak point was the provision that import tariffs were not to be initially reduced but only to be refunded later. In reality some countries actually refused these refund payments for a long time. Although this problem did not arise in the Philippines, industrial sources indicate that Thailand (and to some extent Malaysia) did not refund any import tariffs paid until 1996 (also see Shimizu 1995, 83; Ishizaki and Mori 1996, 12).⁹

Finally, it has to be noted that the restriction of the BBC scheme on car manufacturers excluded parts manufacturers and thus neglected the development of the supplier industry. By this, ASEAN countries removed growth incentives for the sector which forms the inevitable base for a stronger regional integration of the automobile industry and which offers local companies the best growth chances in the long run (Takayasu 1996).

Despite these limitations, the BBC scheme has been the most important and successful industrial cooperation scheme of ASEAN so far. By intentionally following the interests of Japanese companies, ASEAN governments have willingly transferred some sovereignty to them. However, at the same time they succeeded for the first time to some extent to circumvent national rivalries and to contribute to the build up of a regional division of labor within the Southeast Asian automobile industry (Fujita and Hill 1997; Funke 1997; Ueno 1997).

Taking Toyota as an example, Table 4 illustrates that there has been significant progress with the localization and regional specialization of its component production activities. Starting from nearly zero in 1992, the parts exchange of Toyota between Thailand, Malaysia, Indonesia and the Philippines – partly covered by BBC arrangements – rose to a volume of

⁹ The background of this refund problem in Thailand lies in internal quarrels between the Ministry of Industry and the Ministry of Finance. Put simply, the latter refused to meet commitments of the former by pointing to the negative impact of tax refunds on the current balance.

Table 4: Extension of the production network of Toyota within ASEAN countries until 1996

	Product	Start Production	Exports 1996	Export Destination 1996
Thailand	built-up vehicles	1964	1,300	Philippines, Pakistan
	floor panels	1979	100,000	Malaysia, Philippines
	diesel engines	1989	15,000	Malaysia, Indonesia, New Zealand, Portugal
	block castings	1989	640,000	Japan
Malaysia	built-up vehicles	1968	–	–
	steering gears	1992	110,000	Thailand, Indonesia, Philippines, Taiwan, South Africa, Turkey
	suspensions	1992	34,000	Thailand
Indonesia	built-up vehicles	1970	1,100	Brunei, Papua New Guinea
	engine blocks	1985	35,000	Malaysia, Japan
	gasoline engines	1991	19,000	Philippines, Taiwan, Japan
Philippines	built-up vehicles	1989	–	–
	transmissions	1992	120,000	Malaysia, Thailand, Taiwan, Portugal
	transmission parts	1992	56,000	Indonesia

Source: Toyota (1997)

20 billion yen in 1996 (Matsuoka 1997, 22). In addition, there has been an increased export of parts from Toyota plants in these countries to Japan and other countries (Table 4).

Although the extent of the regional division of labor and parts exchange of other Japanese manufacturers in Southeast Asia has not reached the volume of Toyota, they all have shown a similar development (Fourin 1995, 1998a). Table 5 illustrates that assemblers as well as big parts manufacturers like Denso have introduced a country-specific production concentration of parts and components. An interesting fact is the striking parallel with the allocation of certain component productions to particular countries. For example, the production of transmissions is concentrated in the Philippines, that of steering gears in Malaysia and the production and assembly of engines in Indonesia and Thailand. Thus, the evolving regional production specialization seems to be exactly the outcome that was once intended by the AIC scheme – however now decided and exercised by private companies and not by the planned allocation at the governmental level. Nevertheless, the still relatively low figures for the intra-ASEAN trade of the five companies in 1996 (see Table 5) indicate that a regional division of labor has only just started to develop.

Table 5: Regional pattern of parts production and trade of Japanese manufacturers within ASEAN countries

	Toyota	Mitsubishi	Honda	Nissan	Denso
Thailand	diesel engines stamping parts	casting parts suspensions	stamping parts	engine parts stamping parts	starters alternators
Malaysia	steering gear suspensions	steering gear stamping parts	plastic prod. suspensions	steering gear stamping parts	air-condition relay, flasher
Indonesia	gasol. engines cyl. blocks	engine parts	cylinder heads cyl. blocks	gas. engines ¹	compressors spark plugs
Philippines	transmissions transm. parts	transmissions	casting parts	transmissions stamping parts	instr. clusters
Intra-ASEAN trade volume					
– 1992	<2 bn yen	<0.5 bn yen	<0.5 bn yen	<0.2 bn yen	<10 mil. yen
– 1996	20 bn yen	3 bn yen	4 bn yen	1 bn yen	<0.5 bn yen
– 2000 ²	90 bn yen	>20 bn yen	>20 bn yen	20 bn yen	6 bn yen

1) The start of operations was originally planned for after 2000 but had to be postponed.

2) These estimates date to mid 1997 and thus to the time before the Asian economic crisis. Accordingly, they have to be reduced significantly, *e.g.* Toyota scaled back expectations for the year 2000 to 60 billion yen.

Source: data of single companies

Thus, with regard to the still unsolved problems of the BBC scheme, the direct impact of the BBC scheme on the evolving regional integration process of the Southeast Asian automobile industry must not be overestimated. All industry sources stress that even without the introduction of this scheme, Japanese car manufacturers would have expanded their regional division of production within Southeast Asia as a result of the change of the regional and global environment as described above and the subsequent shift in their global strategies (Shimizu 1994, 1995; Ueno 1997). While the BBC policies definitely encouraged the first steps toward a regional division of labor by new investments and the build-up of new component factories, the benefits of the BBC scheme alone have not justified these investments so far. They were also dependent on other factors on the Japanese and global side. The same will be the case in the future as will be illustrated by the next section on the current developments within the ASEAN automobile industry.

5 CURRENT SITUATION: THE ASEAN AUTOMOBILE INDUSTRY AT THE CROSSROADS – REGIONAL STANDSTILL OR GLOBAL INTEGRATION

Since the summer of 1997, the ASEAN automobile industries have been strongly suffering under the effects of the Asian economic crisis. In 1998 the regional demand dropped to less than 500,000 units which is just a third of the record sales figure in 1996. Most observers agree that it will take about five years for the ASEAN demand to recover to the previous record level of 1.4 million units reached in 1996. But before we deal with the effects of the current crisis in Southeast Asia, we have to focus on current regional cooperation schemes as the topic of industrial integration continues to hold the key to the future development of the ASEAN automobile industry.

5.1 The AICO scheme and the integration process since 1996

Based on the relatively successful experience with the BBC scheme and a multinational company led approach to a deeper industrial integration, the *ASEAN Industrial Cooperation* (AICO) scheme was agreed upon in 1996. It presents the so far most ambitious industrial integration effort of the ASEAN countries aiming at a deeper industrial integration by facilitating intra-regional parts exchange.

A review of the main features in Table 6 illustrates that the AICO scheme is planned to become the institutional framework for the eventual establishment of the AFTA. Under certain conditions, it already offers the same privileges to manufacturers today that will be automatically enjoyed by all companies within ASEAN from the year 2002 onwards.

A minimum of two companies in two different ASEAN countries are required to form an AICO arrangement. To form such an arrangement, the prospective companies must fulfill certain criteria that are similar to those that applied to the BBC scheme but less strict. The companies must be incorporated and operating in an ASEAN country and have a minimum of 30% national (ASEAN) equity to assure the participation of local companies.¹⁰ They also have to undertake resource sharing/pooling or some

¹⁰ There was no need for this condition within the BBC scheme because all foreign car manufacturers were (and most are) operating in Southeast Asia as joint ventures with local partners keeping an equity of 30% or more. However, the exemption of Thailand, Malaysia, Indonesia and the Philippines from WTO provisions relating to TRIM (Trade Related Investment Measures) will expire in the year 2000 meaning that these countries will have to abolish this requirement then.

Table 6: The AICO scheme in comparison to BBC and AFTA

	BBC	AICO	AFTA
Period of validity	10/1988–10/1996 ¹	since 11/1996	starting 2002
Regional coverage	ASEAN 4 ²	ASEAN 7	ASEAN 10
Sectoral coverage	car parts (only assemblers)	industry wide (only manufacturers)	industry wide (all companies)
Procedures	by approval	by approval	automatically
<i>Privileges:</i>			
Import tariff	refund of 50%	reduction to 0–5%	reduction to 0–5%
Local content accreditation	yes	yes	yes
<i>Conditions:</i>			
Local (ASEAN) content	50%	40%	40%
National (ASEAN) equity	–	30% ³	–
Complementation	yes	yes	no
Trade balance neutrality	yes	no	no

1) This is the period of application, privileges may be enjoyed until model changes.

2) There is no car assembly in Singapore and Brunei; participation of Indonesia started in 1995.

3) A waiver is possible if the company meets other criteria imposed by the participating country (*e.g.* export commitment, linkages to small and medium companies, introduction of new technology). For 1999/2000, the national equity requirement is waived totally.

Source: compiled from various ASEAN publications

kind of industrial complementation, but no longer need to form trade arrangements with a neutral effect on the trade balances of the countries involved. In addition, the required local content rate of production was lowered from 50% to 40% which will also be the AFTA figure. The most important change, however, is that AICO is no longer restricted to the automobile industry but open to all manufacturing companies including parts manufacturers making it the predecessor of the planned AFTA.

Despite the clear liberalization trend that started in the early 1990s, the Southeast Asian automobile industry continues to be characterized by import barriers, small isolated markets and the resulting production fragmentation as described before. Regarding this background, it comes as no surprise that the AICO scheme with its prospects of a partial abolition of trade barriers attracted strong interest from the automobile industry, especially from those makers enjoying BBC privileges which will be phased out with the next model changes. Of the total of 58 AICO applications (as by August 1999) about 50 were filed by companies of the automobile industry. These came from local affiliates of big Japanese car manufacturers like Toyota, Honda, Nissan, Mitsubishi or Isuzu and parts makers like Denso, Sanden, TSK or Mitsubishi Electric, with only 2 cases of non-Jap-

anese companies (Volvo and Ford).¹¹ All these companies aim at raising their production efficiency by concentrating different areas of their production in different countries and connecting them by a stronger exchange of parts to allow for larger economies of scale.

However, as with the BBC scheme before, the implementation process of AICO faces a large number of obstacles that result out of the national interests of the single ASEAN countries but also out of national problems within each of these countries (for an overview see Fourin 1997, 64–9). Thus, instead of achieving a fast approval of AICO applications, a prolonged bargaining process between single companies and ASEAN governments with few concrete results has dominated in 1997 and 1998. For example, the Malaysian government regards every privilege to be enjoyed by foreign car manufacturers as a threat to Proton and Perodua, its own national makers, that do not possess extensive production networks within ASEAN. But even in countries with a more positive stance, as in countries without a national brand (Thailand, Philippines), the governments are only interested in AICO arrangements that promise a net increase of production and thus additional exports and jobs.

This attitude forces the applying companies to convince the host governments that such a net plus will materialize. This has turned out to be a long and difficult process because it does not mean only to convince one department in the associated Ministry of Industry but to deal with a large number of interest groups in each country. As all AICO agreements imply additional imports for participating countries, they do not only face strong resistance from domestic companies but also often the opposition of the Ministry of Finance that fears the outflow of foreign exchange (*AutoAsia* October 1997, 36). This problem has become even stronger since the outburst of the current crisis and strongly resembles the old problem of tariff refunds under the BBC scheme. In some cases, Japanese companies have even been asked by officials of the host country's Ministry of Industry to present figures that show a clear positive net effect of the AICO agreement only to furnish these officials with data they can use against counterparts (Ministry of Finance, national firms) within the domestic discussion.

¹¹ All data related to AICO applications and production figures and strategies of Japanese manufacturers that are presented in this section without any source given are based on personal interviews of the author with representatives of the private sector and government officials in Japan and Southeast Asia between October 1997 and March 1999 and additional telephone interviews in November 1999.

Until the end of 1998 the requirement of a minimum national equity of 30% turned out to be the biggest single barrier for AICO approvals.¹² Although most applying companies fulfill this criteria, some of their local suppliers whose parts are included in the AICO packages to be traded between the single countries do not. These suppliers with a national equity below 30% (sometimes even 0%) usually are Japanese parts manufacturers which account for 40–70% of the local suppliers of Japanese automakers in ASEAN (Ueno 1997, 27–38). Although this large number is explained by Japanese companies stressing their demanding exigencies regarding quality, cost and delivery, ASEAN governments fear that their domestic supplier industries will be placed at a disadvantage in the long run. Regarding the close relationship between Japanese assemblers and parts manufacturers, such as between Toyota, Denso and their Japanese suppliers, ASEAN governments even argue sometimes that Japanese companies transfer their closed system of vertical *keiretsu* relations from Japan to Southeast Asia (also see Aoki 1992, 82; Hatch and Yamamura 1996, 158–71, 1997, 12–7).¹³

Among multinational companies Japanese manufacturers have pressed the most for further liberalization efforts within ASEAN reflecting their currently overwhelming production dominance in Southeast Asia. One expression of these integration efforts is the resurrection of the ASEAN Automotive Federation (AAF) in July 1996 which had been dissolved in the 1980s. This resurrection was carried out mainly by Japanese companies, from which chief executives of Toyota Thailand and Mitsubishi Indonesia became the first two presidents of the new AAF. By this, Japanese car manufacturers also dominate the work of the AAF which is the only officially accepted lobbying group within the ASEAN automobile industry.

¹² For 1999 and 2000 this requirement has been waived for all applications.

¹³ Recently this criticism has nearly disappeared as Japanese manufacturer-supplier relations have turned out to be one of the few remaining strengths that help to keep the ASEAN automobile industry alive (see the next section for a more detailed description). Regarding the more general criticism of insufficient technology transfer and restricted spill-over effects for local suppliers as a result of the so-called closed Japanese system, the reader is referred to general works on this topic (see e.g. Jeremy 1992; Simon 1997; Buckley *et al.* 1997; Kumar 1998 and Yamashita in this volume). With respect to the topic of this article 'regional industrial integration' it can be obviously concluded that the close relations between Japanese manufacturers and suppliers contribute to the implementation of the AICO scheme and thus to the integration process of the automobile industry in ASEAN.

But also in bilateral negotiations with ASEAN governments, the large market share of Japanese companies strongly supports their positions. This holds true especially in the present situation that is characterized by an economic downturn and sharply reduced sales figures. However, even for Japanese companies, the chances to play single governments against each other for the sake of short term profits are limited. The large investment volume for component factories like transmissions or engines requires a long term strategy with a high degree of capacity utilization. The originally planned engine factory of Nissan in Indonesia, for example, was expected to cost about 10 billion yen which is ten times the value of all parts traded by Nissan within ASEAN in 1996. This comparison clearly illustrates that only a strategy which encompasses the whole region promises the necessary exploitation of the economies of scale.

But exactly this challenge – to encompass all ASEAN countries at the same time – has limited the success of most AICO applications so far. Until August 1999, only 7 automobile companies had successfully gone through the whole process of approval including the issue of the official Certificate of Eligibility. These are: Volvo (Thailand-Malaysia); Sanden (Thailand-Singapore); Toyota (Thailand-Malaysia, Thailand-Philippines, Thailand-Indonesia, Malaysia-Philippines); Honda (Thailand-Malaysia, Thailand-Philippines, Malaysia-Philippines, Malaysia-Indonesia, Indonesia-Philippines), Isuzu (Thailand-Malaysia), Denso (Thailand-Malaysia, Thailand-Philippines, Thailand-Indonesia) and TSK/Armstrong Cycle (Thailand-Malaysia).

At first sight, this recent development might look as substantial progress in regional industrial cooperation lowering trade barriers and enforcing regional production specialization. However, the absence of Indonesia in AICO approvals other than of Toyota, Honda and Denso indicates the ongoing negative stance of this country toward the abolition of trade restrictions in the automobile industry. Thus – as with the development under the BBC scheme – the reluctance of Indonesia to join any AICO agreement continues to hinder the evolvement of an optimal regional division of labor encompassing all important ASEAN countries. The same conclusion has to be drawn from the fact that there have been so far only approvals on a bilateral basis between two countries. In addition, industry sources indicate that even successful AICO applications have been substantially compromised by demands for amendments by national governments during the approval process. Such amendments are in most cases the result of domestic pressure groups successfully lobbying for a reduction of products to be covered by an AICO agreement.

Thus the integration process keeps on being characterized by its slow pace and step-by-step liberalization progress exercised by single compa-

nies' efforts to rationalize their production on a regional scale. Regarding the national origin of companies applying for and obtaining AICO privileges the dominance of Japanese manufacturers is striking. Undoubtedly they will continue to lead the integration process and thus to determine the further development of the ASEAN automobile industry. The current economic crisis – while threatening the whole industry itself – even tends to strengthen this predominant role of Japanese companies. But it will also change the character of the integration process as will be illustrated in the next chapter.

5.2 The role of Japanese companies within the current crisis of the ASEAN automobile industry

Undoubtedly, the current economic crisis poses a severe threat not only to the further integration process of the ASEAN automobile industry facing rising protectionist demands in several countries but also to the whole industry itself. The enormous fall in the regional demand for automobiles has resulted in a sharply reduced output of vehicles that will remain low for some years to come. This will strongly affect the performance of all assemblers. In the case of affiliates and subsidiaries of multinational companies, however, a long term commitment to the region has already generated substantial financial backing by the home companies allowing them to stay in business (Fourin 1998b, 32–3). In Thailand, Toyota, Honda and Mitsubishi Motors have even injected additional capital into their local joint ventures boosting their respective shares to more than 80% in each case.

In contrast, many local suppliers lack such financial strength and it is feared that they will be forced out of business within the near future. These suppliers do not only suffer from a sudden decrease in orders for their products but also from a weak capital basis that is further eroded by the enormous rise of capital costs in Southeast Asia. Thus, a widespread bankruptcy of automotive suppliers in Southeast Asia has become the biggest and most urgent threat for the whole ASEAN automobile industry because the supporting industries embody the backbone of the whole industry.

Within this general bleak outlook, the strong Japanese presence within the ASEAN automobile industry, that surpasses the assembly stage and extends far into the supporting industries, offers some hope against a total collapse of the parts industry. The strong investment of Japanese material and parts makers in ASEAN countries in the 1990s has raised the number of Japanese joint ventures and subsidiaries in the region to more than 400 by 1997 (see Table 3). These companies strongly dominate the automobile

Table 7: Structure of the automobile parts industry in ASEAN countries by origin of capital 1998

	Total Number of Parts Manufacturers	Japanese Affiliates or Subsidiaries		US and European Affiliates or Subsidiaries	
		Absolute	Share	Absolute	Share
Thailand	750–800	209	27.0%	21	2.7%
Indonesia	150–200	82	46.9%	7	4.0%
Malaysia	200–250	61	27.1%	19	8.4%
Philippines	150–200	54	30.9%	5	2.9%
Singapore	about 50	17	34.0%	4	8.0%
ASEAN 5	1300–1500	423	30.2%	56	4.0%

Source: Fourin (1998a)

parts industry in ASEAN by comprising more than 30% of all parts manufacturers as illustrated by Table 7. In addition, more than 120 local companies are affiliated with Japanese manufacturers by technology tie ups without any capital holding by the Japanese company (Fourin 1995, 1998a).

This overwhelming presence of Japanese companies within the supplier industries of ASEAN countries has already proved to function as a counterbalancing power against the negative effects of the current crisis and can be expected to do so in the future too. In many cases, Japanese parts makers have followed the strategy of Toyota and Honda in Thailand and raised their shares in ASEAN joint ventures often turning affiliates into subsidiaries (Inoue 1998, 19; Fourin 1998d, 8–13). More than 80 Japanese material and parts makers injected additional capital into their local affiliates in Thailand only in 1998. Almost always, this injection of urgently needed capital took place on request of the local partner (*Nikkei Weekly* 15 June 1998, 20). In other cases, a close relationship with Japanese assemblers has helped suppliers to receive advanced payment for parts deliveries and other forms of support easing capital bottlenecks and thus securing their ability to procure materials and parts. Japanese companies like Toyota have even provided direct support in the area of cash flow by shouldering the cost of purchasing raw materials and offering letters of credit to its troubled suppliers (*Nikkei Weekly* 19 Oct. 1998, 18; Mori 1999).

Hence, the often criticized close relationship between Japanese assemblers (or first-tier suppliers) and their suppliers helps to keep in business at least the core suppliers of Japanese companies. These parts makers normally work under the direct supervision and guidance of a Japanese car manufacturer partly resembling the vertical *keiretsu* system in Japan (Ue-

no 1997; Hatch and Yamamura 1997). This relationship is based on mutual dependence and strongly encourages support by the car manufacturer for troubled suppliers as these usually represent a long term investment and thus an important company-specific asset within their production system. To keep this existing comparative advantage in Southeast Asia, also after the current recession, most Japanese automakers tend to assist their main suppliers out of a well defined self-interest.

A similar observation can be made in the area of employment relations, where we can see another unique characteristic of Japanese companies. Anxious to keep their well trained workers, most Japanese car manufacturers try hard to stick with a 'no layoff policy' for their core workers. Beside pursuing direct support measures for employees (including paid leave), they focus strongly on training programs in and outside of ASEAN. Financially supported by the official development assistance plan AOTS (Association for Overseas Technical Scholarship) of the Japanese government, all large assemblers have increased the number of employees from their ASEAN plants to be trained in Japan. A case in point is Toyota where the number of trainees for 1998 was increased from 250 to 500 while the length of their stay was extended from three to six months (Fourin 1998). By this, Japanese automakers do not only try to keep their valuable human resources but also contribute to a better education level of workers within the region in the long run.

Beside short term capital and employment support measures and with regard to the bleak sales perspectives within Southeast Asia, efforts to increase exports have gained rapidly in importance. This strategy is especially pursued by firms affiliated with foreign companies that offer access to global markets outside of ASEAN. Once again, Japanese manufacturers play a predominant role. In some cases, Japanese companies like Toyota, Honda or Aisin Seiki have strongly raised their imports to Japan from their Southeast Asian affiliates to help them through the crisis (Fourin 1998c, 6; *Nikkei Weekly* 19 Oct. 1998, 18). Toyota for example decided to raise parts imports from its ASEAN affiliates from 2.5 billion yen in 1997 to more than 14 billion yen in 2000. However, the viability of such a strategy on a wider scale requires an overall improvement in export competitiveness. Such an improvement, however, can be only achieved on the basis of an industrial structure that exploits economies of scale and advantages of regional specialization which leads us directly back to the topic of production fragmentation and the need for deeper industrial integration. Still the problem of high production costs resulting from a limited output per single plant stands against a rapid rise in vehicle or parts exports from ASEAN countries.

Only in the case of Mitsubishi's production of the *Strada*, a 1 ton pick-up, in Thailand we can see such an export already taking place to a substantial degree. In 1998, 59,000 Mitsubishi pick-ups were exported from Thailand and this figure is expected to reach 100,000 by the year 2000 through raising the number of export countries from the current figure of 40 to about 100 (*Nihon Keizai Shinbun* 7 Feb. 1998; Fourin 1998b, 33). But despite this export success story, it is interesting to note that Mitsubishi still refrains from exporting the Thai *Strada* to the US market. One main reason is the fear over eventual product liability claims. This implies the existence of unsolved quality problems that add to higher per unit costs. It underlines the fact that the export plans of other makers face similar limits reducing the hope for a quick export-led regeneration of the ASEAN automobile industry.

Nevertheless, the case of the Mitsubishi *Strada* provides a good example for a relatively efficient production based on regional specialization as it strongly relies on parts that are sourced under BBC agreements from Malaysia (doors, steering gears) and the Philippines (transmissions). The same idea of multiple-parts sourcing underlies, in principle, the production of the so-called *Asia-cars* by Honda (*City*) and Toyota (*Soluna*) and their AICO applications enabling them to achieve local (= ASEAN) content rates of 70% or higher. However, the prevailing problems with the AICO scheme and the general resistance toward further liberalization steps among ASEAN members as described above cast doubts on the possibility of a fast implementation of production plans based on regional specialization and a free flow of parts among the ASEAN countries. These problems also prevent a stronger integration of production sites in Southeast Asia into the global production networks of multinational companies as they hinder the exercise of scale economies to a large extent including the important nurturing of supporting industries.

Obviously, the ASEAN automobile industry stands at the crossroads where its future development will be decided. Regional standstill or global integration seem to be the only two options for the evolvement of an competitive automobile industry. The complete integration within different nations or even at the regional level does not seem feasible any more in Southeast Asia (and one may doubt if it ever did). As the current trend towards mega-mergers in the world automobile industry indicates, the need for consolidation clearly exists on a global scale. To overcome the core problem of Southeast Asia – the problem of production fragmentation – only a stronger integration of ASEAN production sites into the global networks of multinational companies promises to be a successful strategy. At the moment, Japanese automakers are the only companies in Southeast Asia that possess such production networks that enable an ef-

ficient integration of ASEAN production sites into the greater Asian or world market and thus an eventual revival of the regional automobile industry.¹⁴ But even such a positive scenario undoubtedly means that a country like the Philippines might end up to be the Asian supply center for one or two key components like transmissions. Thailand, in contrast, might become a leading assembly and export base for vehicles, however, without having an integrated supplier industry of its own.

6 CONCLUSION

ASEAN industrial policies for the automobile sector have traditionally shown a strong tendency toward industrial protectionism shying away from full-scale liberalization. This has hindered the enforced regional division of labor and exploitation of scale economies and restricted the international competitiveness of this industry thus far. Despite numerous liberalization efforts since the 1970s, it took until this decade for the first substantial progress in regional industrial integration to take place. This change was marked by a shift in ASEAN industrial policies away from failed approaches toward consensus-seeking integration efforts at the governmental level to a policy of gradually transferring sovereignty in decision-making to multinational companies, most being Japanese.

By relying on the natural interest of multinational companies in the regional rationalization of their production activities in different Southeast Asian countries, ASEAN governments have since started to achieve their first success in circumventing national rivalries and thus to lay the basis for a deeper regional integration of their automotive industries. But so far the success of this approach – formed in the application-approval concept of the BBC and AICO schemes – has been strongly limited by the provision of reserving national rights for disapproval and thus rejection of single companies' integration plans.

The current economic crisis in Southeast Asia is undoubtedly threatening the ASEAN automobile industry, especially at the level of supporting industries. The high commitment of Japanese companies to the region, however, has generated various support measures so far and thus helped to keep wide parts of the industry alive. Even accounting for the prolonged economic crisis in Japan, this role of Japanese companies will not change in the near future. The recent development under the AICO

¹⁴ These vast production networks within the ASEAN region also set Japanese automakers apart from their US competitors Ford and General Motors that recently built up large though isolated production capacities in Thailand.

scheme identifies Japanese companies to be by far the most important actors among all multinational players. Japanese manufacturers do not only work toward a deeper industrial integration by being the most powerful pressure group for liberalization but also by leading the build-up of regional production networks. The crisis of the Japanese economy will even raise the interest and pressure of Japanese automakers for faster industrial integration within ASEAN. This is due to at least two factors: First, production bases in Southeast Asia constitute an important part of their global production networks that lack – by contrast to US and European companies – other cheap production sites outside of Asia. Thus, most Japanese manufacturers cannot afford to abandon this region but instead will display the utmost interest in rationalizing their production activities there. Second, the announcement of the Japanese US\$ 30 billion initiative for Indonesia, Malaysia, Thailand, the Philippines and South Korea has strongly underlined the importance applied to this region by Tokyo. By tying most of the money to projects involving Japanese companies the Japanese rescue package is not only designed to assist Asian neighbors but also to revive the Japanese economy including its automobile industry that have become heavily dependent on trade with and investment in East Asia in the 1990s.

The limited integration success of all cooperation schemes so far has raised the hopes for the final implementation of the AFTA after 2002. The establishment of this free trade area is expected to mark a much more important turn in ASEAN trade liberalization than the shift from the AIC to the BBC scheme in 1988 as it will offer an automatic and irreversible removal of regional tariff trade barriers. However, the assessment of the eventual outcome of the AFTA must not be overly optimistic for the short and medium term. With regard to ongoing national rivalries and the rising opposition to liberalization efforts within single countries, there is a strong possibility that non-tariff trade barriers will grow in importance and continue to hinder the free flow of goods and thus a deeper integration of the automobile industry. The existence of an exclusion list even provides a loophole within the AFTA framework. It enables ASEAN governments to temporarily exclude certain products from trade liberalization if they fear a substantial threat to their domestic industries. And the automobile industry must be regarded as a strong candidate to be found on the exclusion list of some countries (especially Malaysia) even after 2002.

Thus, a mere – though accelerated – continuation of the step-by-step progress that could be observed all throughout the 1990s appears to be a more realistic assessment for the prospects of a deeper integration of the ASEAN automobile industry after 2002. Although the start of the AFTA

will promote regional integration to a certain extent, it will not mean the removal of all trade and investment obstacles. Thus it will fail to create a really equal playing ground for all players in the region, old and new. Instead, companies that are already strong will benefit most from such a gradual liberalization process. Consequently, Japanese manufacturers are those to profit the most from such a limited liberalization process as it allows them to keep their current advantages over eventual emerging competitors from the USA and Europe or from within the region itself.

The probability of such an outcome with its implicit strengthening of the position of Japanese companies within the ASEAN region has even increased with the *de facto* failure of regional trade liberalization efforts at the APEC level. The Japanese refusal of *early voluntary sectoral liberalization* (EVSL) in two of the proposed sectors, namely forestry and fishery products, at the APEC summit in Kuala Lumpur in November 1998 has shed grave doubts on the prospects of future liberalization progress under the APEC approach in other sectors, including the automobile industry, as well. The blunt refusal by Tokyo despite strong criticism by the USA and other countries did not only illustrate a general reluctance in Japan toward the realization of far-reaching liberalization. The same attitude could also be observed in many Southeast Asian countries. They silently supported the Japanese adverse position against a US driven liberalization movement regarded as pressure for the too fast opening of many of their sectors including the automobile industry.

Thus ASEAN and AFTA will continue to form the main framework for the regional integration of the automobile industry in Southeast Asia. Simultaneously, Japanese companies will stay at the forefront of the multinational companies engaged in this process backed by a strong interest coalition existing between them and the ASEAN governments. Obviously, their size will continue to matter for the further development of the Southeast Asian automobile industry as it undoubtedly did in the past. However, it remains to be seen whether – in contrast to the US movie *Godzilla* – the future development will end happily for both the Japanese firms and the ASEAN countries.

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THE ROLE OF JAPANESE OVERSEAS AFFILIATES AND TECHNOLOGY TRANSFER: IMPLICATIONS FOR INDONESIA

Shōichi YAMASHITA

1 INTRODUCTION: THE UNEMPLOYMENT PROBLEM IN INDONESIA

In East Asia¹, many countries experienced negative growth in 1998. Since their economies have maintained high growth rates until recently, no one could have forecasted the current economic depression. Because of the currency turmoil and the subsequent financial and economic crisis, economic activity in most countries in this region has shrunk abruptly. Many factories had to lay off their workers. As a result, the number of jobless people has unexpectedly increased and led to a severe problem of unemployment. A comparison of official (and highly underestimated) unemployment rates for 1998 (figures for 1996 given in brackets) shows the seriousness of this problem: Korea 6.8% (2.8%), Hong Kong 4.7% (2.8%), Thailand 4.0% (1.5%), Malaysia 3.9% (2.6%), Philippines 10.1% (7.4%) (Keizai Kikakuchō 1999, 326).

In Indonesia, the most affected country, the number of unemployed persons even was said to be more than thirty million throughout the year 1998. It was reported that at least twenty million people lost their jobs as a direct result of the economic crisis since July 1997. At the end of 1998, the unemployment rate of Indonesia was said to be roughly 30% of the labor force. Hence the most urgent task for Indonesia now, besides regaining political stability, is to reduce the rate of unemployment and thus the number of unemployed people.

As for solving this unemployment problem, it is argued here that an export promotion policy is recommendable. This view is supported by two factors. First, the devaluation of the currency will strengthen international price competitiveness and secondly, under the present economic conditions, an autonomous recovery in the domestic market cannot be expected in the short run. When exports increase, domestic production also expands. In turn, factories need to hire more workers and the economy is stimulated through the effect of positive linkages finally resulting in the creation of new jobs and thus in a decline of unemployment.

¹ In this paper East Asian countries include Northeast and Southeast Asian countries.

However, the actual situation in Indonesia is still very different from such a recovery scenario. In Indonesia, exports decreased by 8.1% in monetary terms (US dollars) in 1998 as compared to 1997 (Keizai Kikakuchō 1999, 334). The export of manufactured commodities showed both an increase and a decrease, with striking differences between single product groups. Commodities with increased exports were mainly agro-based industrial products such as shrimps and cocoa, or products which utilized domestic materials and components. However, the export of manufacturing commodities such as electrical products and electronics, high-tech commodities etc., drastically declined.

To understand this development it is important to know that the production style in Indonesia is still basically focussed on the final stage of assembly relying on imported components, parts and materials from Japan, Singapore and other East Asian countries. After the prices of imported parts and materials had doubled or tripled, most domestic manufacturers lost their comparative advantage and had to stop importing parts and components. In the case of the apparel industry, for example, foreign buyers have cancelled their contracts for the import of Indonesian apparel. Besides the fact that the costs of imported materials have increased, foreign banks refused to accept L/C (letters of credit) issued by Indonesian banks. The system of wholesale and retailing has been damaged, and the transportation network has also suffered, since these sectors had been mostly managed by overseas Chinese, many of whom have left the country since the start of the political turmoil.

The decline of exports and the shrinkage of the domestic market has lowered the operation rate of factories enormously and has forced many companies to lay off substantial numbers of their workers. This situation in Indonesia is similar to that in Thailand, Malaysia or the Philippines but differs by showing a more favorable exchange rate for export. Thus an export promotion policy seems highly recommendable. However, any increase in exports can be achieved only by an industrial base characterized by strong industrial linkages and high technological abilities. One way to build up such an industrial base, and probably the most promising way, is through the inducement of foreign direct investment (FDI) from abroad, especially when it comes with the necessary technology transfer.

This paper argues that such a FDI led export promotion policy is highly recommendable for Indonesia in tackling its current unemployment problems in the medium run and that it thus might help to prevent the disorder and riot that threaten to destroy the social and economic basis of this country. In referring to the benefits of such FDI, this paper focuses on Japanese affiliated enterprises and the crucial role for job creation these firms have played in the past and might continue to play in the future. The

crucial role of technology transfer is especially highlighted as it does not only set apart Japanese firms from their Western counterparts but as the character of Japanese technology transfer has also changed remarkably over time.

2 THE ROLE OF FOREIGN DIRECT INVESTMENT

The governments of East Asia should stimulate domestic production by increasing exports which in turn can be expected to stimulate the labor market. They should concentrate their efforts in one strategic area, namely the promotion of exports especially under the condition of the recent currency devaluation. In the immediate post war period, Japan faced a similar serious economic depression. At that time, the Japanese government led a strong export promotion policy. MITI (Ministry of International Trade and Industry) played a leading role in this respect. Additionally, JETRO (Japan External Trade Organization) was established as a supporting organization for the promotion of Japanese exports during the post war period and also in the following rapid growth period.

However, the present situation in East Asia is obviously not the same as it was in Japan fifty years ago. For the governments of East Asian countries, special strategies for inviting FDI have to be implemented because FDI can help the production of export commodities and open the foreign market for their products. In particular, Japanese companies have built up a lot of experience in joint venture business in East Asia over the last three or four decades (NRI and ISEAS 1995). Governments should utilize the know-how of foreign affiliates in operating factories, exporting domestically produced commodities and training their staff.

When we observe the impact of the economic crisis in each Asian country, the degree of damage seems to depend on the strength of the existing industrial linkages and the technological and managerial capabilities of the countries. In the last few decades Southeast Asian countries have enjoyed rapid economic growth. But their strategy, in short, has been to promote an export-oriented industrialization policy which solely relied on FDI and cheap labor (see Masuyama, Vandenbrink and Chia 1997). This strategy has come increasingly under pressure with newcomers like China entering the market as competitors.

Furthermore, Southeast Asian countries have not paid enough attention to the industrial deepening of their economies and to the necessity of human resource development. This is one of the structural reasons why Indonesia and other Asian countries have fallen into the recent economic problems. When we examine the recovery process from the crisis, we can

recognize a clear difference among different East Asian countries. The economic trends of Korea and even Thailand already show an upward swing, but the economic condition of Indonesia has further deteriorated which is not only due to the political situation. The government of Indonesia should be aware of the necessity of strengthening industrial linkages and the importance of upgrading national technological capabilities.

The significance of FDI and its contributions to recipient countries can be summarized as follows (also see Yamashita 1998, 65–7): first, foreign direct investment contributes to industrialization and economic development through job creation, technology and managerial transfer, to foreign exchange earnings through exports, and to the development of supporting industries; second, the training of local employees at foreign affiliated companies contributes not only to career development in one company but also to human development in the society in general; and third, by transferring advanced foreign technologies and managerial know-how, local managers and employees may change their attitudes and try to modernize their management style.

2.1 Japanese direct investment and job creation

Direct investment from Japan to Asian countries amounted to 112.3 billion US dollars in total from 1951 to the first half of 1998 as shown in Table 1. Indonesia, China, Singapore and Thailand are the main four recipients of Japanese FDI in this region, followed by Malaysia, South Korea and the Philippines.

Table 1: Japanese foreign direct investment in selected Asian countries
(million US\$)

	1993	1994	1995	1996	1997	1998 (first half)	1951–97
World total	36,205	41,051	50,694	48,019	53,972	16,782	616,292
Asia total	6,637	9,699	12,264	11,614	12,181	2,977	112,276
South Korea	246	400	445	416	442	175	6,572
China	1,691	2,565	4,473	2,510	1,987	435	17,699
Thailand	578	719	1,224	1,403	1,867	709	11,678
Singapore	644	1,054	1,152	1,115	1,824	272	13,626
Malaysia	800	742	573	572	791	274	8,292
Philippines	207	668	718	559	524	136	4,618
Indonesia	813	1,759	1,596	2,414	2,514	635	23,505

Source: JETRO (1999)

The total number of employees directly hired by 11,600 Japanese affiliated companies in Asia (outside of Japan) was 1.9 million as of October 1998 (see Table 2). Japanese FDI has directly created 221,000 jobs in Indonesia, 467,000 in China and 338,000 in Thailand. Adding indirect employment creation, Japanese FDI might account for five to six million employees in Asia.² Thus the role of Japanese direct investment with regards to employment creation in this region must not be underestimated.

With respect to the role of FDI, an important factor is the training of personnel, especially the in-house training system based on OJT (on-the-job training). At Japanese affiliates in East Asia, this system was introduced more than three decades ago and thus benefits from its lengthy experience. Through this system, the Japanese government and Japanese companies have been working together with recipient countries of FDI and have been supporting their efforts in upgrading their national capabilities by technology transfer both through Japanese FDI and official technical cooperation. This combination of private companies' interest and the official sector's support clearly sets apart Japanese FDI from that of its Western counterparts including the way of conducting technology transfer and assistance.

Table 2: Number of Japanese overseas affiliates and number of their employees (as of October 1998)

	Number of companies	Total number of employees	Japanese employees dispatched
World total	24,952	3,080,120	54,323
Asia total	11,606	1,880,492	26,648
Korea	646	79,963	485
China	2,588	466,973	5,043
Thailand	1,469	337,540	4,917
Singapore	1,453	79,450	3,960
Malaysia	1,028	219,254	2,574
Philippines	501	121,113	1,188
Indonesia	764	221,339	2,284

Source: Tōyō Keizai (1999)

² This figure includes indirect and anticipated job creation in various industries as domestic parts and material suppliers, transportation, hotel and restaurant, and other services. It is an inference based on previous analyses based on input-output analyses in many Asian countries (also see Yamashita *et al.* 1989; Yamashita 1991, 1994, 1995, 1998).

However, comparing the number of employees in Japanese overseas affiliates in Asia as stated in Table 2 for 1998 with the previous years 1996 and 1997, we can see some decline in employment. This decrease reflects the immediate impact of the regional economic crisis on the activity and operation rates in single firms. Any rebound to a new and sustainable net job creation by Japanese affiliated enterprises can only be expected when two requirements are fulfilled. The first is a substantial recovery of the Asian economy, the second is the industrial strengthening and upgrading of Asian industries facilitating the re-attainment of international competitiveness. Thus FDI reflects both industrial strength and an important means in achieving it.

2.2 Changes in Japanese FDI strategy

Japanese FDI in Asia has gone through several stages in its development. It began in the 1960s with investment in large machine assembly plants to support Asian import substitution industrialization, and then in the 1970s moved into a phase based on natural resource development and importation. During the period of the yen's appreciation since 1985, investment sharply increased in Asia, taking advantage of reduced production costs in order to maintain international competitiveness, and establishing an export base in Asia for the markets of Japan, Europe and the USA but also increasingly for the Asian market itself.

The move towards local production by Japanese affiliate companies has helped to bring about substantial progress in the economic development and industrialization of Asian countries. From the Japanese perspective, moreover, the phased and chain-reaction like development of Asian countries with different levels of technology and income has generated beneficial effects both for Japan's growing and declining industries.

In addition to the region being considered an economic growth area and a large potential market, Japanese corporations find the Asian region especially attractive as every country is at a different stage of development, and all have been (until recently) involved in a cyclical structure of mutual growth. On top of this, all Asian countries in general welcome the introduction of export-oriented foreign investment, and thus provide the necessary conditions for the acceptance of Japanese-style management methods that focus on export promotion. For Japanese companies, one main effect of establishing production facilities overseas has been the increase of exports of parts, services and associated machinery to these affiliates abroad, especially in Asia. Until 1993, Japanese exports in terms of value have been highest to the USA, but since then exports to Asia took

the lead. Asia has now become the largest importer of Japanese products, including capital goods, parts and materials for domestic production.

3 TECHNOLOGY TRANSFER BEFORE THE YEN APPRECIATION OF 1985

One distinctive characteristic of Japanese corporate investment abroad before 1985 was that it was mainly carried out by large companies and that it was concentrated in labor-intensive industries which utilized cheap labor. The investment which was designed for import substitution in the domestic market was concentrated in three industries: (1) textiles, (2) automobiles (including motor cycles) and (3) electrical appliances and electronics. During this period, local Japanese affiliates made a number of changes in their education and technology training.

During the initial period of the advance of Japanese companies overseas from the 1960s until the 1970s, know-how in such areas as operation technology, machine repair and maintenance, and quality control was taught to local employees by means of on-the-job training. At this time, seniority-based promotion and lifetime employment were still prevalent, and the education of human resources was carried out under these systems. In other words, systems generally used in Japan were imported unchanged into the plants set up in Southeast Asia. This meant that operational technology was not just taught by the use of manuals, as was the case in European and American affiliates, but machine repair, quality control and production control were taught directly to local employees (Yamashita 1991, 14–20).

Unlike Western companies, which taught only operational technology as specified in manuals, Japanese affiliates taught a responsive system, which included the operational technology it was based upon, such as repairs, quality control and frequent model changes. In order to discover whether the Japanese or the US-European affiliates were more enthusiastic towards technology transfer and human resource development, a large-scale survey of Japanese affiliate companies in Southeast Asian countries was conducted by the author and others between 1984 and 1987 (Yamashita 1991, 14–22; Yamashita 1995, 343–52). Some of the findings will be described here.

Local government officials and many economists have long believed that Japanese affiliated companies are unwilling to carry out technology transfer. This impression was based on a simple comparison of the practices of Japanese companies with that of US or European companies in East Asia and the assumption that technology transfer would proceed automatically after the departure of foreign technical advisors. However,

this has been only seldom the case. By contrast, the fact that Japanese advisors normally stayed for longer periods than US and European advisors, turned out to be a decisive factor for successful technology transfer and thus led to an overall positive evaluation of the way technology transfer was conducted by Japanese firms (Yamashita 1995).

It is important here to be clear how the term technology transfer is being used. The Japanese affiliated companies had constantly trained local staff from operation technology to maintenance, repair, quality control (QC), and further technical know-how, not just simple operation techniques. The progress of technology transfer at Japanese affiliated companies is further highlighted by the results of another survey of Japanese managers in ASEAN countries during 1985–87 (Yamashita *et al.* 1989, Yamashita 1991). Employing the nine-stage hypothesis of technological development to this survey, technology transfer was assumed to progress according to the following stages: (1) operational technology, (2) repair and maintenance, (3) quality control, (4) process and procurement technology, (5) improvement of existing and (6) introduction of new technology, (7) molding and development of tools, (8) design, (9) development of new products and development of manufacturing plant and equipment.

The Japanese managers were asked which stage of technology transfer they had completed by that time. In this survey of automobile, electrical appliances and textile manufacturing companies in ASEAN countries, 74% of the managers answered that they had completed the first stage, the transfer of operational technology. The figure for repair and maintenance was 57% and for quality control 50%. For process and procurement technology, the figure dropped to about 28%, and for improvement technology to 11%. Almost no enterprise had yet done anything about design and new product development (Yamashita 1995, 342–7).

The survey results show that the early stages of technology transfer had already been set up at the Japanese affiliated enterprises. Japanese enterprises had been teaching these stages to local employees, whereas the European and American companies seemed to limit their technology transfer to the stage of operation technology. However, even at Japanese affiliated companies the later stages of technology transfer had not yet proceeded as the early stages did.

4 THE ‘BLACK-BOX’ PHENOMENON IN TECHNOLOGY TRANSFER AFTER 1985

Japanese FDI increased sharply following the yen appreciation after the 1985 Plaza Accord. The most striking difference in Japanese investment in Asia after 1985 was a shift away from securing markets towards constructing ex-

port platforms. The problem for Japanese affiliates was how to make up for the still existent deficiencies in the technical ability of local employees. As a measure to cope with this problem, Japanese affiliates introduced automated machinery and robots into the production line. Efficiency was greatly improved, and high-quality products for export were produced by the new production system. The training system was also changed and simplified by dividing the work into smaller process units, enabling the speedy induction of unskilled workers. This system also served to counter the frequent 'job-hopping' of local employees in this region. Indeed, with two or three days training, workers could be put to work on the factory floor.

Malaysia, for example, has succeeded in its policy of export-oriented industrialization, concentrating on the electrical appliance and electronics industries, and has become the world's leading exporter of both air conditioners and color TV sets. This has been achieved by the government's policy to support the construction of high-tech factories without any skilled local workers. The move towards machine production based upon automated machinery for the purpose of exports certainly allowed the production of high quality goods, but at the same time the level and range of technical skills acquired by local employees was restricted.

However, due to the introduction of automated systems incorporating high technology, local staff could not easily acquire high technology skills. Thus, local employees were just carrying out simple processing tasks, while automated systems carried out the high-level processing and inspection jobs. Although the quality of the product is guaranteed to be high, the skill level of local workers remains low. This can be called the 'black-box' phenomenon in the process of technology transfer (see Yamashita 1995, 347–52; 1998, 68–9) as the workers cannot see, touch, or otherwise directly observe the production process because of the employment of high technology machinery. Interestingly, the 'black-box' phenomenon can also be seen in the existing electric and electronic machinery plants that are located in rural parts of Japan.

Thus the characteristics and former advantages of Japanese technology transfer embedded in the responsive system described above were diminished and sometimes even disappeared totally. As a result the technological level of local firms and local employees could only be raised at a much lower speed despite running highly efficient companies and industries at the same time. Since the outburst of the Asian crisis, which is partly due to the insufficient upgrading of technological capabilities of local companies, most of these firms and industries have lost steam and thus threaten the further industrial development of Indonesia and other Southeast Asian countries. However, such a technological upgrading and shift to new industries has become absolutely necessary to stay com-

petitive not only versus other Asian countries like China or Vietnam but also on a global level. Thus new forms of technology transfer seem essential both from the perspective of Japanese (and other multinational) firms and from the perspective of Asian recipient countries.

5 THE TRAINING OF LOCAL EMPLOYEES IN THE AUTOMOBILE INDUSTRY

The training and technical guidance given to local employees in automobile production plants is different from the cases of the electronics industry examined above. The automobile industry still needs a lot of skilled workers, even in automated factories that are well equipped with robots and high-tech machinery. Thus the automobile industry presents an interesting industry for our analysis here (in addition it is an important industry in Indonesia).

In the electronics industry, even if skilled personnel are limited, high-tech goods still can be produced by automated machines that achieve the high quality requirements for export. However, in the automobile industry, a lack of skilled personnel raises problems in terms of quality control and inspection. Accordingly, automobile assemblers need to continue to train local technicians and operators. Japanese affiliated electronics companies in Asia have exported their products all over the world, but Japanese affiliates of the automobile industry in the same region have not which is mainly due to still existing technical problems.

Japanese automobile manufacturers have operated their assembly plants in Thailand and other Southeast Asian countries since the early 1960s. Their training method was basically OJT. Automobile makers strove to improve quality control, using manufacturing methods such as production control, QC circles, and suggestion systems (Sato 1993). They were aware of the need for employment education. They set up education sections at Japanese headquarters, established training centers within the company both in Thailand and Japan, providing a system for the acceptance of local employees for training, and carried out the systematic education of local employees. Japanese affiliates then increased the number of local employees dispatched to Japan for training.

Japanese automobile affiliates enthusiastically embrace the training of technicians and the transfer of technology to local plants. Automobile production is an industry calling for high levels of division in the production process. In producing automobiles with Japanese-style production control methods and concepts such as *kanban* and just-in-time systems, the need for skilled technicians has to be constantly borne in mind (for more details see Yamashita 1998, 69–79).

6 THE CURRENT STATE OF THE AUTOMOBILE INDUSTRY IN INDONESIA

In Indonesia, the production level of automobiles was 389,000 units in 1997, representing a record figure for Indonesia that even surpassed the production for Thailand in that year. But as a result of the prolonged economic crisis and the drastic changes in politics, the demand for automobiles declined sharply and reached only 58,000 units in 1998 (Fourin 1999). One Japanese affiliated auto-assembler was forced to reduce its operation rate of factories from 22 days per standard month to 9 days a month in 1998. For reasons of anonymity, this company will be referred to as T. Following this reduction, company T then laid-off workers. The total number of employees of the company was reduced to 3,600 as of the end of August 1998 from the levels of 6,000 people in January 1997 and 5,300 in January 1998.³

Company T has so far exported complete cars and CKD (complete knock-down) sets to Brunei, Malaysia and other countries, but it stopped these exports in 1998. Then the company restarted to export K-5 engines to its parent company in Japan helping the company T to stay in business in Indonesia. This example is instructive: When Japanese affiliates get enough support from their parent companies, they can survive even sharp business downturns as in the case of company T during 1997 and 1998. Recently, Japanese automobile assemblers, including Toyota, Nissan, Mitsubishi and others have decided to expand their imports of auto-parts from their affiliates in Southeast Asia. In the case of Toyota, this will mean an increase in the amount of imported parts made by its ASEAN affiliates from 2.5 billion yen, recorded in 1997, to more than 14 billion yen in the year 2000. This figure is six times that of the 1997 figure; Nissan and Mitsubishi also plan to increase their import of products from ASEAN (*Nikkei Weekly* 26 October 1998). These movements support the *keiretsu* auto-part makers in ASEAN whose operation rates have been significantly lowered.⁴

The situation is much more severe at auto-part manufacturers and small-scale subsidiaries in Indonesia, because assemblers themselves have not had the purchasing power to order parts from part makers. According to Herman Latif, chairman of the Association of Indonesia Automotive Industries, almost all auto-part subsidiaries ceased business, apart

³ These figures are derived from personal interviews of the author with directors of company T in August 1998.

⁴ For a closer analysis of the role of Japanese companies within the ASEAN automobile industry during the current crisis, see also the contribution of Legewie in this volume.

from Japanese affiliates like Denso, Akebono, Kayaba, Aishin and others. Japanese auto part makers are now trying to expand the export of their products to Japan and ASEAN region with the help of *keiretsu* assemblers in Japan. In contrast, local Indonesian part makers are in serious danger of not being able to return to business when the time comes to operate in the future. Thus there is a real danger of the destruction of the supporting system in the automobile industry which has been built-up during the last decades.

In Indonesia, the industrial structure is still biased towards low value-added sectors. Even the modern assembly sectors like the automobile and electronics industries still rely on imported parts and components for their final products. This means that localization rates are low and domestic inter-industrial relationships are still weak. We can easily observe the difference between the automobile industry in Indonesia and Thailand. The number of auto-part manufacturers in Thailand is about 800 and it is at most 150–200 in Indonesia (see Legewie in this volume). We need to recognize the difference in the history of automobile production and industrial organization of both countries. Human resources are also different in terms of quantity and quality directly relating back to the topic of technology transfer and the strong need of Indonesia for an enforced transfer of technological capabilities.

7 APPROACHES TO IMPROVE THE SITUATION IN INDONESIA

The question is how to solve the special problem of unemployment and the general problem of industrial development and technology transfer as described above and which role Japanese affiliated enterprises can play within this process. Japanese companies have established their factories and offices in Asian countries since the early 1960s. Since then they have been operating in this region accumulating experience and know-how not only of the business but also of the understanding of Asian people. As Japan as a whole should do, Japanese multinational firms should recognize the importance and significance of their close relationship with Asian countries and affiliates at a micro-level. The strong economic interdependence built up over decades requires a solution beneficial to both parties if it shall be of a sustainable nature.

Here, job creation in East Asia, especially in Indonesia, has been our major concern. In Indonesia, the government needs to consolidate conditions for export or to put it in concrete terms: (1) to conduct an export promotion policy with incentives, (2) to finance exporters or manufacturers that are going to export their products, (3) to invite export-oriented FDI

and, (4) to improve the channels and the system of international trade. The economic crisis in Indonesia can be considered to have partially been the result of a decline of FDI. In 1998, the total FDI decreased by 60% over the previous year (Keizai Kikakuchō 1999, 352). FDI from Japan has sharply fallen to less than 25% of the value of 1997 (see Table 3).

Table 3: Foreign direct investment approved by Indonesia

	No. of cases	Total value	Investment value (million US\$)				
			Japan	UK	Singapore	Hong Kong	USA
1996	959	29,928.5	7,655	3,391	3,131	1,106	642
1997	790	33,832.5	5,421	5,474	2,299	251	1,018
1998	834	12,935.7	1,191	4,740	1,194	356	565
1967–1998	6,353	215,910.9	42,598	37,681	20,150	18,971	15,081
		100%	19.7%	17.5%	9.3%	8.8%	7.0%

Note: Figures for 1998 only cover the period January and October 1998. The number of cases represents the number of new investments plus the change of status, while investment value represents the new investment plus expansion plus change of status.

Source: BKPM (1998)

At the same time, there has been an explosion of both urban and rural unemployment. The number of people below the poverty line has risen sharply and could soon reach 80 million, or 40% of the population. At present the Indonesian Government is preparing a ‘Social Safety Net Program’ (JPS, Jaring Pengaman Sosial) which aims at alleviating poverty by stimulating economic activities among the most economically disadvantaged segments of Indonesian society (for more details see Sumodiningrat 1999). Beside short-term support programs for the worst groups within the Indonesian population, self-help measures and sustainable strategies will be needed for Indonesia. Thus, the government should also study the possible ways for activating production and creating new jobs, by introducing attractive FDI policies in the medium and long term.

In the short term, the Indonesian government should give incentives and subsidies to exporters of local products and labor intensive manufacturing products which utilize domestic materials. This includes a pro-Chinese policy as many Chinese left Indonesia since early 1998 and withdrew their capital from Indonesian banks, exacerbating the situation. Chinese people have played a significant role so far in the process of economic development in this country. The government needs to induce them to return and provide proper investment policies both for domestic and for-

eign investors for export, making good use of the devaluation of the Indonesian rupiah. In the long run, the government should have a long-term national industrial development plan which aims at drastic industrial transformation from low-tech to high-tech industries and from low value-added to high value-added industries. FDI will be a decisive determinant in achieving this aim.

At present stage of the Indonesian economy, the private sector and companies from abroad play an important if not the decisive role in enabling an economic recovery. One possible way forward is through action led by Japanese *keiretsu* groups. Each *keiretsu* group of the automobile industry, for example, could work together in implementing relief measures for the Indonesian automobile industry. They could use each other's products and increase their sales through international channels and markets. Thus, they could create new industrial and business relationships and organizations in the region.

Japanese companies can also contribute to technology transfer and human development through their FDI. As we have noticed the importance and success of technology transfer (especially personnel training) carried out through private channels in the past, we acknowledge the ongoing importance of any means in upgrading the technological capabilities of Indonesian workers, firms and industries. However, the recent experience of only limited technology transfer as a result of the 'black-box phenomenon' and insufficient industrial upgrading serves as a strong reminder to look for new and more effective and sustainable paths of transferring technology. The long history of industrial engagement by Japanese firms in Indonesia and other Asian countries and the high degree of mutual dependence should work towards regional cooperation that is beneficial to both parties.

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FINANCIAL COOPERATION AND INTEGRATION IN PACIFIC ASIA: THE ROLE OF MULTILATERAL AND REGIONAL ORGANIZATIONS

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1 INTRODUCTION

Whereas in recent years most studies on regional cooperation in Pacific Asia were devoted to matters of the so-called real economy, since the East Asian financial crisis of 1997/98 set in, interest in monetary and financial matters has been increasing immensely. This paper is about the question whether cooperation on financial matters is primarily a *multilateral* issue, or whether there is some scope for *regional* action.¹ In answering this question, it is important to discuss under which institutional frameworks such cooperation could – and does – take place.

In the first section of this paper, based on the experience of the Asian financial crisis, we will discuss whether apart from multilateral international organizations (MIOs) like the International Monetary Fund (IMF) and the World Bank, regional international organizations (RIOs) played a significant role. We will do this by analyzing three principal aspects:

- 1) pre-crisis schemes aimed at the financial sector,
- 2) crisis management and immediate reaction,
- 3) follow-up, mitigation of effects.

This will lead us in Section 2 to discuss the principal areas for international organization (IO) activity in financial cooperation:

- 1) regional surveillance of financial system reform,
- 2) (additional) financial assistance scheme,
- 3) technical assistance for banking reform and supervision, management of currency policy, etc.,
- 4) analytical capability.

We do not intend to explicitly discuss currency cooperation here. The Asian area clearly seems to be decades away from anything similar to European currency cooperation and unification. The question of an optimal currency policy (currency board, peg, floating and their relative merits)

¹ In this paper, ‘multilateral’ is used as the opposite of ‘regional’. In this sense, the Asian Development Bank (ADB) is *not* a multilateral institution in terms of the terminology used here.

needs a more technical analysis of the mechanisms involved (see the contributions in ADB Institute 1998 and some remarks by Estanislao in this volume) than would be sensible and possible for this paper, which is concerned with institutional issues.

Discussing the areas of possible policy activity, we will have the following considerations in mind:

- 1) the economic case for and against IO involvement,
- 2) the case for regional as opposed to multilateral schemes,
- 3) the political economy of existing or potential IO schemes in this context,
- 4) paying particular attention to the role of Japan and of Japanese actors (bureaucracy, politicians, etc.).

Put in a different way, Section 1 intends to do a positive analysis of which IOs – either on a multilateral or on a global level – did what, whereas in Section 2 we intend to follow a normative analysis while explicating the criteria used, taking economic rationality as a point of departure.

2 THE ASIAN FINANCIAL CRISIS AND THE ROLE OF IOs – POSITIVE ANALYSIS

It is almost impossible these days to start any discussion on financial integration and cooperation in Pacific Asia without reference to the 1997/98 crisis. The questions of what happened during the crisis, what went wrong, what IOs have done and what they might have done or should have been doing are often discussed. However, this is not the place to attempt a careful *post-hoc* analysis of the crisis. Rather, we will concentrate on the role of IOs.

Three phases can be distinguished:

- 1) pre-crisis schemes aimed at the financial sector,
- 2) crisis management and immediate reaction, in particular agreements with the IMF,
- 3) follow-up, mitigation of effects.

2.1 *Pre-crisis schemes aimed at the financial sector*

Although there are different opinions on the origins of the 1997/98 Asian financial crisis, it is usually accepted that an important point of departure for any explanation is the increasing trade deficits of several East and Southeast Asian countries since about 1995, accompanied by – in some cases – even more significant net capital imports. Relying on exchange rate regimes with currencies having been pegged to the US dollar for many years, international investors, including banks, were confident in

investing in the seemingly invincible Asian newly industrializing economies. Indeed, a vicious circle was involved: while foreign capital kept pouring in, the Asian governments tried to neutralize its impact on the money supply by driving up interest rates. This, however, rather deepened the belief in the strength of the upturn in Pacific Asia, and international capital was even more attracted by the high interest rates – particularly, as US and Japanese interest rates were kept disappointingly low from an investor's perspective. Of course, not only international lenders took part in this game, but potential debtors in Asia also played their part in making this capital pump keep on running, not to mention deliberate government moves to make the inflow of low interest dollars even easier, e.g. through the notorious Thai International Financing Facility.

This circular causation of a continuing upturn – despite of the current accounts pointing to some upcoming problems – critically depended on an appraisal of investment in Asia to be prudent and promising. Doubts were being raised, though. Whereas with respect to Thailand it was slowly realized that a lot of investment only fuelled the real estate and financial assets boom, not being employed in productive endeavors, for other countries the prudence of debtors was being challenged. For Indonesia, incidences of crony capitalism were raised, and for Korea, the spider-like spread of the *chaebol* company groups was being questioned. Despite these differences, there is the common feature that 'security valves' in the financial system were neglected in almost all those countries: no clearly enforced bankruptcy laws, no strict supervision of indebtedness and financial soundness, not even transparent information on basic status and performance indicators of the financial systems existed. For instance, only rather belatedly it became obvious how much capital has since 1995/96 been imported on a short-term basis, while often being employed in long-term projects, with the need of frequent roll-over agreements under – hopefully – favorable terms.

In July 1997, the first speculative wave hit Southeast Asia, whereas Korea was hit in the autumn shortly followed by the strong and important fear of regional contagion. As Southeast Asian currencies were devalued significantly, it became ever more unlikely that other East Asian countries with their competing product ranges could uphold their exchange rate levels, because that would have implied losing price competitiveness on an unprecedented scale with little scope for counterbalancing its effects.

As for the role of IOs, it seems to be almost universally felt that RIOs were nearly invisible prior to the crisis, whereas MIOs had played a role, but were unable to prevent the crisis. While this general impression is not misleading, one should have a somewhat closer look at the details.

As for the MIOs, the first reproach to be found in much of the literature concerns the lack of warning signals given. The obvious candidate which should have functioned as a signaling device is the IMF, given its Article IV consultations. Several authors have shown that in its publications and statements leading up to the crisis, the IMF did not fulfil such expectations which the global public may have held:

The Fund maintains it was warning Thailand over a year ago [*i.e.*, compared to January 1998; W.P.]. But its December 1996 report on that country raises no suspicions; and its 1997 Annual Report does not find fault with Thai or Korean macroeconomic management. In the most recent IMF report on International Capital Markets, released at the Bank/Fund Annual Meeting in Hong Kong in September 1997, any warnings of possible contagion or even backward-looking analysis were conspicuously absent. Only five pages out of 265 were devoted to the Asian currency crisis (Ito and Portes 1998, 1).

A second point concerns the lessons that should have been learned from the earlier financial crises, particularly from the 1995 Mexican Peso crisis. During that event, it was also noticed that information on national financial systems was too scarce, untimely and unreliable. The IMF did indeed start a campaign to raise the quality of supplied data, particularly by means of setting up and promoting an advanced data dissemination standard, but participation was voluntary and no sanctions or other convincing incentives were involved.

It is sometimes suggested that an important aspect of international financial crises, namely the regulatory role of national financial systems and their transparency, was almost but overlooked by international organizations. In September 1997, however, the Basle Committee on Banking Supervision² issued the so-called Basle Core Principles for Effective Banking Supervision. An earlier version had been prepared by April 1997, well before the crisis started. In terms of its contents,

[the] Principles represent the basic elements of an effective supervisory system. They are comprehensive in their coverage, addressing the preconditions for effective banking supervision, licensing and structure, prudential regulations and requirements, methods of on-

² The Basle Committee on Banking Supervision was set up in 1975 by the central bank governors of the Group of ten countries, namely Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, United Kingdom and the United States. The secretariat is located at the Bank for International Settlements (BIS) in Basle, Switzerland.

going banking supervision, information requirements, formal powers of supervisors and cross-border banking (BIS 1997).

The report contains timely warnings about unhealthy capital flows into the emerging economies. While in several respects the Principles may not go far enough, they do constitute a major step towards transparency and the reform of national financial systems, developed by a multilateral institution. Incidentally, East Asian economies were involved in this process. While the western-dominated Group of Ten endorsed the report and its conclusions, the 'document ... [was] prepared in a group containing representatives from the Basle Committee and from Chile, *China*, the Czech Republic, *Hong Kong*, Mexico, Russia and *Thailand*. Nine other countries (Argentina, Brazil, Hungary, India, *Indonesia*, Korea, *Malaysia*, Poland and *Singapore*) were also closely associated with the work' (BIS 1997; emphasis by W. P.).

As for regional cooperation, despite the frequent suggestion that neighbors know best about issues in the region and have the biggest incentive to rectify problems in their own area, efforts to pre-empt the upcoming crisis were quite inconspicuous. Nevertheless, one should mention at least three areas of action.

Firstly, the Executive Meeting of East Asia and Pacific Central Banks (EMEAP) had been founded in 1991 upon Japanese initiative.³ In its 1996 Governors' meeting⁴, EMEAP decided to take up three issues in the form of working and study groups, among them banking supervision. The governors were mainly concerned with issues of improving their expertise through sharing of knowledge, though. The item is deliberately termed a Study Group, not a Working Group, and the statement lacks any sense of urgency or imminent importance (Bank of Japan 1996).

On a different level, several monetary authorities of Pacific Asian economies have started since about late 1995 to sign bilateral repurchase (repo) agreements. Such agreements enable a country to exchange its US dollar treasury securities for US dollars held by another central bank up to a certain limit. Such dollars can then be used to defend one's own currency. It has been suggested that interest in such agreements rose when regional central banks came to see the possibility of depreciation, in which case one may consider interventions in terms of supporting one's currency by selling dollars (Moreno 1997). Repo agreements could thus be un-

³ 11 central banks and monetary authorities from Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand are represented.

⁴ Governors meet once a year, while there are additional meetings twice a year at Deputies' level.

derstood as preparations for eventually critical situations. However, one should not exaggerate the regional cooperation aspect of such deals. After all, repo agreements and currency swap agreements are standard procedure among the industrialized economies in the G-7 or Bank for International Settlements (BIS) framework, so the recent wave of agreements rather shows the poor state of regional cooperation, in which even those rather simple mechanisms were noteworthy innovations.⁵

What possibly comes first to mind when one thinks about regional cooperation, though, is Asia-Pacific Economic Cooperation (APEC), founded in 1989. As is well known, this group brings together the governments of the Pacific region, whereas business and academic circles have gathered in structures like PECC (Pacific Economic Cooperation Council) or PBEC (Pacific Basin Economic Cooperation). APEC's mandate however, does not lend itself too easily to deal with financial cooperation (Adlan 1998): its three main pillars are trade and investment liberalization, business facilitation (harmonizing product standards, etc.), and economic and technical cooperation. Although there is a financial dimension to these issues, the emphasis is clearly on facilitating the real economy, and finance in this context is rather understood as a service industry.⁶ As part of the APEC Finance Ministers' process, since early 1997 efforts aimed at training schemes for banking supervisors and securities regulators or the development of suitable pension schemes have been launched. It is still somewhat misleading though, when in the Vancouver Declaration of late 1997 it was said 'that as the region's most comprehensive economic forum, APEC is particularly well suited to play a pivotal role in fostering dialogue and cooperation' (APEC Leaders Meeting 1997) on financial systems. In the same declaration, it was clearly stated that the IMF is to retain the central role in responding to the crisis.

The role of the Asian Development Bank (ADB) is small indeed. As of 1996, the regional development bank spent only some 3.8 percent of its loans on financial sector issues. The emphasis was on improving the effectiveness of the domestic banking and financial systems in the various member countries with their widely varying situations (Pascha 1999). For instance, in South Asia, which has been dominated by a public banking

⁵ Swap arrangements among ASEAN economies (*i.e.*, participating countries swapping their own currencies compared to repo arrangements involving a third currency, namely US dollars) already have a longer tradition, but again, such arrangements are not evidence of a particularly close currency cooperation.

⁶ For instance, in the statement it is explicitly said 'that the impetus for much of our work on developing and strengthening capital markets was to facilitate private financing of infrastructure' (APEC 1998).

system until recently, the focus was on appropriate deregulation under domestic considerations. A somewhat embarrassing fact is the publication of the glossy report 'Emerging Asia. Changes and Challenges' as late as mid 1997 (ADB 1997a), which repeats the usual upbeat folklore about the bright future of Asia.

What are the reasons that the ADB was surprised to such an extent by what was going to happen on its very doorstep? One answer is that the ADB's capacity was stretched too thinly over the various sub-regions with very different situations. Another aspect is that ADB did leave pre-crisis efforts to other institutions working on a multilateral level. After all, the crisis which started in East and Southeast Asia might also have started elsewhere. In early 1997, the Czech crown was under attack, and in 1998, as is well remembered, the financial markets focused on Russia and on Latin America. Thus, the neglect of certain issues of multilateral importance by RIOs may indeed be explainable and even legitimate. This statement casts a revealing light on later attempts by them to play a major or at least pro-active role, as will be shown below, because for many issues it is questionable indeed whether a regional institution can play an effective role.

2.2 Crisis management and immediate reaction

Let us now turn to the actual financial crisis and to responses and activities of IOs in terms of cooperation efforts. For our purposes, we can limit the relevant period to what happened between early July 1997 (depreciation of the Thai baht) and February 1998 (debt rescheduling for Korea).

It is obvious that the lead in managing the crisis, particularly in negotiating the assistance schemes with Thailand, Indonesia, and Korea, was taken by the IMF. This is consistent with its perceived role in international economic relations.

The only challenge came from the proposal to set up an Asian Monetary Fund (AMF), which by different accounts was originally raised either by Prime Minister Mahathir of Malaysia or came from within Japan's Ministry of Finance (MOF). It entered the official stage, when it was proposed by Japanese Finance Minister Mitsuzuka at a G-7 finance ministers' meeting immediately preceding the IMF/World Bank meetings of September 1997 in Hong Kong (Rowley 1997). There are suggestions that such a proposal was earlier endorsed during the Shanghai EMEAP governors' meeting of July 1997. ASEAN finance ministers, when discussing financing arrangements during a special meeting in early December 1997, reiterated that they had already 'endorsed a proposal for an ASEAN financing arrangement' (ASEAN 1997b, Point 8.) in their First Meeting in

Phuket, March 1997. Reading the Joint Press Communiqué of that earlier meeting, though, there is little which resembles an endorsement of such a major policy issue (ASEAN 1997a).

There remains some doubt, though, who was the originator of the idea. Even in the case that it originated from Southeast Asia, it certainly was taken up as a decidedly Japanese initiative through proposing it in the G-7 framework. What was the motive behind it? Some observers (*e.g.* Rowley 1997) see Sakakibara Eisuke behind it, who is reputed to be an outspoken critic of the Washington institutions; as the Vice Minister at the MOF he was in charge of international finance during the time of development of this idea. Apart from this and possibly more important than such personal factors, bureaucrats may have thought that they could demonstrate a Japanese regional leadership role – and as the fear of global contagion was not to be neglected, such activity would even have had touches of assuming global responsibility. Still it is somewhat strange that of all ministries, the usually tight-pocketed MOF was so willing to promise a lot of money for cases of an external emergency. Possibly, the ongoing turf-war between the various ministries played a role. MOF is constantly fighting over influence with, among others, the Ministry of Foreign Affairs (MOFA) and the Ministry of International Trade and Industry (MITI). As for the important relations of Japan with Asia, these competitors, and MITI with its policy of constructing a Pacific Asian network of cooperating industrial economies in particular, are not to be neglected. Forces within the MOF may have seen a chance of consolidating its position on the Pacific Asia policy arena by promoting the concept of an AMF. Moreover, as the MOF bureaucracy is under constant criticism from the public due to its presumed mismanagement of the Heisei recession, it may have welcomed sponsoring the idea of an AMF in order to be appreciated as the savior of Pacific Asia's economic recovery – and of the world economy in general.

The AMF-proposal received an extremely cool welcome during the G-7 Finance Ministers Meeting and on the sidelines of the following IMF and World Bank meetings in Hong Kong. It was feared by North American and by European representatives that an alternative mechanism for receiving assistance in emergencies could undermine the authority of the IMF, by possibly offering 'discount' programs with less strings attached.

In the original format of a second fund or facility, the idea did have trouble to survive the Hong Kong meetings, although the programmatic term was still periodically heard in late 1998 when the New Miyazawa Initiative was announced and before the Hanoi ASEAN Meeting. Possibly, as a kind of face-saving device, the Washington institutions agreed in Hong Kong that there was some role for a regional surveillance scheme.

We will report on the ensuing process below, but whatever way that may turn out, it did not have an impact on the immediate crisis management.

Although regional institutions or cooperative frameworks were not directly in charge of managing the crisis, it is conceivable that regional meetings helped smoothen crisis management. For instance, it has been suggested that the quick decision making about offering multilateral aid to Thailand in the summer of 1997 was significantly facilitated by the earlier EMEAP meeting in Tokyo. After all, not only the IMF promised money in the Thailand (and in later) assistance packages, but also national governments and the ADB (see Table 1). It seems that an informal consensus on a concerted effort among regional economies might already have been achieved in the Tokyo meeting.

Table 1: Official financing commitments

Organization	IMF	World Bank	ADB	Bilateral commitments	Total
Thailand	3.9 (505%)	1.9	2.2	12.1	20.1
Indonesia	10.1 (490%)	4.5	3.5	22.0 ¹	40.0
Korea	21 (1,939%)	10.0	4.0	22.0	57.0
Total (bn US dollar)	35	16.4	9.7	56.1	117.1
Memo: Mexico	17.8 (689%)	1.5	1.3 ²	21.0 ³	51.6

Notes: Numbers in brackets refer to IMF quotas.

- 1) Including the use of a 5 billion US dollar Indonesian contingency reserve.
- 2) Inter-American Development Bank.
- 3) In addition, there was a credit facility of up to 10 billion US dollar with G-10 central banks, which was never activated.

Source: BIS (1998, 134)

There still remains the rather ironic question, though, whether such an early consensus was indeed helpful. One of the critical points raised against IMF-led support during the Asian crisis is that the solutions decided upon put too light a burden on the international creditors, who are frequently thought to have less than carefully invested in Pacific Asia. Bailing them out may possibly have increased moral hazard, as international investors may have got the impression from the Mexican and Asian incidents that they eventually do not bear a significant risk when investing in less than transparent environments. Seen in this light, early consensus on how to deal with Thailand may have contributed to this malfunction of the global financial system. It is conceivable that regional economies, gathering in EMEAP, were quite interested in a quick-fix of Thailand's difficulties with little regard for external diseconomies to-

wards the world economy, as they were quite aware that what had happened to Thailand might soon be encountered by them.

Japan's role as a leading voice within EMEAP is somewhat dubious as well because of its own domestic problems. Japan also had a motive to be interested in a quick fix, and money to be spent on such a scheme was one of the few resources over which the Japanese government thought it still had rather ample command.

On a somewhat different level, there are hints that ADB may also have been somewhat over-enthusiastic to be part of the crisis management process. Reaching an agreement in the case of Korea during the first days of December was somewhat tricky, as Korean government officials tried to circumvent harsh conditions. In this environment, ADB published its intention to be part of the deal even before the agreement between IMF and Korea had been finalized (ADB 1997c), which may not have done much harm, but which at least must be considered somewhat unprofessional and did not help the case of seriously negotiating with Korean government officials.

2.3 Follow-up, mitigation of effects

Turning to the situation after the agreements on how to deal with the imminent crisis had been achieved, two issues have to be separated: the first is how the agreements were followed through and the second is what further effort was made to prevent future crises and to prevent the supra-regional contagion of the Asian problems.

As for the first issue, the Washington institutions and the IMF in particular were in charge of keeping in touch with the national governments to see to the faithful implementation of the agreements. The most critical issue, of course, was to deal with political and social unrest in Indonesia and with its somewhat dubious plan to introduce a currency board for the rupiah; we cannot deal with those events and issues in more detail here. Also in other countries, the IMF had to act in a difficult environment, in which at least some of the problems were ascribed to the IMF programs and their harsh conditions. In Korea, for instance, there was a conspicuously nationalist anti-IMF movement. Taking this atmosphere into consideration, the Washington institutions have acted remarkably smoothly, flexibly and calmly in trying to cope with the implementation process.

IOs, through endorsement by national governments, offered additional support in the aftermath of the crisis. Much of it was contributed by or in association with the World Bank, and during the early months of 1998 a remarkable shift towards measures to safeguard social stabilization could be noted. In Korea, for example, the combined impact of the Wash-

ington institutions turned from one forcing the country to change its economic organization briskly to one reminding the government that doing something about social stability was important as well. It is said that a visit by World Bank president Wolfensohn in early 1998 was critical in convincing the Korean government to use scarce public funds, implying an increase of the deficit, to act in this field (Pascha and Kwon 1998).

Turning towards measures to reduce the probability of further crises, of inter-regional contagion and of further waves of the current Asian crisis, we cannot properly discuss the overall measures of IOs here, for instance in terms of how they dealt with Russia.

Instead, we will concentrate on measures at the regional level and their relative importance. Arguably, the most important aspect is the process set in motion through the so-called Manila Framework, which arguably is a reaction to the doomed thrust to promote the idea of an AMF. It was drafted by 14 APEC economies in November 1997 to enhance regional cooperation and promote financial stability. More specifically:

[It] includes four major initiatives: 1) a mechanism for regional surveillance to compliment [sic] global surveillance by the IMF; 2) enhanced economic and technical cooperation particularly in strengthening domestic financial systems and regulatory capacities; 3) measures to strengthen the IMF's capacity to respond to financial crisis; and 4) a cooperative financing arrangement that would supplement IMF resources (ADB Institute 1998b; see also Manzano and Moreno 1998, 42–3).

Among these, the call for a regional surveillance mechanism is the most specific, while the fourth point is a reminder of the concept of additional emergency finance capacities. In particular, ASEAN has taken up the challenge of how to introduce regional surveillance.

Whereas quite a few observers have argued that regional organizations played but a small role in making efforts to prevent a future crisis, this critique has been repudiated by others based on the notion that the major accomplishment of mechanisms like APEC and ASEAN was to defend the notion of open trade. To some extent, of course, force was used by MIOs to make Korea, Indonesia and Thailand open several sectors to international competition through their IMF loans. They did not do so out of their own free will, and there is little evidence to suggest that peer pressure within RIOs was decisive. Moreover, in some cases barriers were indeed raised, for instance where tariffs had not yet exhausted the maximum rate set by the WTO agreement.

Nevertheless, as many countries of the region have in the past followed industrial development policies involving some conscious ele-

ment of targeted protectionism, it is indeed remarkable that they have not right away turned towards protectionism as a way out of the current crisis. To some extent, insight into the danger of a possible vicious circle of devaluation and protectionism among trading partners, based on the lessons of the 1930s depression, may have convinced them not to follow such a strategy so far. Still, discussions in regional forums may have been helpful. It should be noted that as late as June 1998, the ASEAN trade ministers reaffirmed their will to realize an ASEAN Free Trade Area (AFTA) by 2003. Although that target may appear overly ambitious these days, it is a courageous call for free trade, which makes it more difficult for individual governments to seek refuge in more protectionist pseudo-solutions.

3 WHAT ROLE SHOULD REGIONAL INSTITUTIONS PLAY? – NORMATIVE ANALYSIS

We now turn towards normative analysis and ask what role RIOs should play in regional financial cooperation. Basic criteria for drawing such conclusions are derived from the public choice point of view (Vaubel 1986). According to this line of reasoning, IOs make sense

- 1) when there are international scale economies,
- 2) when there are international public goods or externalities,
- 3) when there are international cooperation failures (*e.g.* in prisoners' dilemma situations).

From our perspective, these factors have to be specific to or possess peculiarities on a regional level in order to allow for public action on that level. Moreover, one has to assess whether the gains to be realized through RIOs, based on one or more of the three factors mentioned above, may possibly be compensated by losses through organization failure, which might emerge through principal-agent problems between individuals, national governments and organizations with their peculiar governance structure, coordination failure between RIOs and MIOs, influence of vested interest groups, domination of certain players, etc.

Based on Section 1 and what can be found in the literature, it may be sensible to focus our discussion on the following options for activities, which make up for a rather eclectic list:

- 1) regional surveillance of financial system reform,
- 2) (additional) financial assistance scheme,
- 3) technical assistance for banking reform and supervision, management of currency policy etc.,
- 4) analytical capability.

3.1 Regional surveillance

There is a clear case for international surveillance of the current state and reform of financial systems, as there may be cases of a collusion of interests between the national government (regulator) and its financial industry at the cost or risk of outsiders who suffer from information asymmetry. For instance, both government and financial industry could be interested to make the banks appear more sound than they actually are and share the profits of the resulting competitive edge.

The question, however, arises whether regional institutions can play a meaningful role. After all, multilateral institutions have already acted, as shown above. Along these lines, Morris Goldstein (1998) of the Institute for International Economics has argued that the Basle Accord offers a reasonable framework for banking reform and that countries which commit themselves to such a reform could endorse the IMF to overlook their accomplishments. From a technical point of view, a multilateral 'sign of approval' certainly makes sense, because the standards to be applied are universal, so the most straightforward solution is to commission only one institution with the certification process.

The only argument for *regional* action in this context rests on the case that multilateral activity has not been and is not going to be speedy and encompassing enough in comparison to what ought to be achieved. Indeed, it has to be noted that the Basle Accord is still somewhat weak and can only be regarded as an encouraging first step. Thus, it has to be discussed whether regional engagement might deliver more.

It has been suggested that regional support may be helpful, because it could lead to peer pressure being exerted on governments to make them intensify reform measures. This is actually the path taken by the ASEAN process based on the Manila Framework mentioned in Section 1. The argument rests on the expectation that the more neighboring economies are interrelated with each other in terms of trade and investment flows, the larger is their incentive to make sure that each other's financial systems are sound. The recent experience of the regional contagion has strengthened this argument, as the regional governments are well aware of their mutual interdependence. However, this understanding of a shared fate may also be interpreted in terms of a collusion of interests: Regional governments – as national governments – have a shared interest to make their economies and financial systems *appear* more sound than they actually are. Looking at the evidence of Pacific Asian economic cooperation in the past, one gets the impression that forces reinforcing and legitimizing each other's strategies were much stronger than those pushing a neighbor into a more sensible, albeit painful policy.

In conclusion, in order to limit the role of such collusion it makes sense to attach surveillance in the sense of data collection and presentation to the multilateral level. The two major reasons are to ensure universal standards and to minimize the possible influences of those interested in biasing information collection and presentation in a certain way. Apart from this mechanism, as a second-tier strategy it could be helpful to have a regional discussion process on the basis of the published multilateral evaluation. This could indeed lead to applying peer pressure, as the true situation – at least as far as the truth is known at all – is already public knowledge.

As for the institutional issue, because the case for peer pressure rests on the interests derived from economic integration, the area engaged in this process should not be too wide. From this point of view, the ADB region would be too wide, because it also covers Western, South and Central Asia, where concerns are totally different, and the same holds for APEC which covers the whole Pacific. Possibly, the Manila Framework group (including Taiwan) or EMEAP would be a sensible delineation.⁷ As for how to organize the discussion process, different examples come to mind, ranging from formalized EU-type of coordination with a tight organizational superstructure to informal, yet high profile meetings like G-7 or G-8, and rather detached and issue-oriented processes like OECD. Because applying peer pressure among sovereign nations is highly sensitive, more detached OECD-like solutions seem more appropriate.⁸

3.2 Financial assistance

As for financial assistance, it has been doubted whether such multilateral efforts make sense at all. The main reason is that it is very difficult to insulate the curative aspects of support from the negative impact on incentives to act prudently in the first place (moral hazard). However, this paper is not concerned with this more general question, and in the following, it will be accepted that some provision of financial assistance on a transnational level does make sense.

⁷ As for the political economy of group size and participation, developments in the real world lead to ever more complex set-ups. Recently, on a multilateral level an ad-hoc group of advanced and emerging economies (G-22) has gained prominence, as – it is said – American policy makers are concerned about the dominance of European players in G-7 or G-10 (Chote 1998).

⁸ In contrast to the OECD, it may not be helpful to publish detailed country appraisals on a regular basis, though.

An additional financial scheme on a regional level as a possible *substitute* for multilateral assistance, orchestrated by the IMF, is not sensible, though. Even under the condition that such an additional program offers more adequate solutions, there would be competitive pressure among both programs to get accepted. Hence competition would force down conditionality and make painful, but important decisions more difficult to achieve.

It is therefore important that there is an unconditional commitment to offer such assistance only additionally, in case multilateral aid delivery is not speedy enough or funds are lacking on that level. To what extent are those dangers real? As for speed, at least so far the most time consuming aspect of emergency measures was to negotiate the conditions of assistance, not the actual disbursement. Only in the case of an actual lack of funds may additional regional offers therefore make sense. As for the present, although some additional provisions on the IMF level have been made (see Section 1), the difficult situation in Eastern Europe and doubts about the well-being of Latin American economies have led to a shortage of disposable funds at the IMF, which could legitimize an additional regional tranche.

Nevertheless, even under the conditions that financial assistance can be used without serious moral hazard problems and that it is only given with multilateral endorsement, there is still the danger that the public knowledge of the availability of funds puts additional pressure on the national governments to push for this potential aid to be used, and on the IMF or any other multilateral gate-keeping institution not to obstruct the use of regional means for regional purposes.

On another level, introducing such a fund on the regional level gives additional weight to those regional governments in regional affairs which make these funds available. In the current environment, this means that the position of Japan as the main holder of usable assets would be strengthened. Japan is consistently asked to make more efforts to support the region, and Japan currently has few other possibilities of action, because of its well-known shortfall of macro-economic demand, the inefficacy of past fiscal stimuli, etc. Therefore, there would be additional pressure to utilize stand-by funds. Under the current political situation in Japan, it is doubtful whether the Japanese government would and could be self-confident enough to make its strengthened influence felt in favor of prudent emergency measures. There is a real danger that a Japanese government not being able to hold a stable majority in domestic politics in the foreseeable future would act in favor of quick fixes to stabilize its popularity and to silence foreign criticism, instead of opting for sustainable long-term solutions.

3.3 Technical assistance

There is a general impression that those international institutions which have the means to offer technical assistance should concentrate more on doing so than on providing financial assistance. This holds in particular for international development banks like the multilateral World Bank or the regional ADB (e.g. Culpeper 1997). The principal reason is that these days the capital markets are better developed than the markets for technical expertise, which involve considerable information asymmetries, heterogeneous products, difficulties to assess product quality, etc. Consequently, there is less need to complement the financial markets, while market failures with respect to technical expertise can still legitimate public action.

Whereas the basic argument in favor of the growing role of technical assistance for IOs is quite sound, it is much more questionable to what extent *regional* IOs can play a meaningful role. After all, the norms and standards of good banking and effective financial systems generally speaking are universal, particularly in such a globalized industry.

Defending a role for RIOs is usually done by referring to the peculiarities of a region.⁹ However, the Pacific Asian region is very diverse and it is hard to see that the variety of financial system issues – and not only those – experienced in this region possesses less variety than those experienced on a global scale. Put differently, the peculiar problems of *emerging* or newly advanced economies appear rather similar in East Asia and Latin America, so they can be approached from a multilateral perspective. Instead of a regional IO, there may rather be a case for IOs specializing on economies with peculiar characteristics (i.e., special entities for island economies, newly advanced economies, transformation economies, etc.), although this might go somewhat too far.

One might argue that at least when significant problems appear within a region, which are clustered because of intra-regional interdependence like in the case of East/Southeast Asian financial contagion, a regional institution could redirect its resources better than a truly multilateral organization with its multitude of tasks. However, successful redirection is difficult to achieve because know how and human capital resources of an organization cannot easily be shifted from, say, agricultural development to banking supervision. Moreover, even when this is possible, a redirection of resources implies that other important issues are being neglected.

⁹ Recently (September 1998), an ADB banker defended the role of ADB in the Far Eastern Economic Review by arguing: 'And the ADB's competitive edge lies in its being closer to the ground and understanding the region' (Tripathi 1998).

Currently, there is unrest among the poorer member economies of the ADB, for instance, because they feel too much money and effort of the bank is spent on the richer members with their acute financial problems (Tripathi 1998).

Based on similar reasoning, it is difficult to build new organizations around specific issues or to attach units to organizations like APEC otherwise unrelated to giving such technical assistance. After they have eventually built up enough know how, the basis for multilateral or regional policy making may have already shifted. There have been studies arguing that because of this phenomenon, there are many existing IOs in search of a new meaning, as the old legitimization has gone (Vaubel 1986).

Another argument in favor of RIOs giving technical assistance does not rest on supposed intra-regional peculiarities, but on the role of competition among IOs for better results. The importance has risen since the Washington institutions are under mounting criticism that their strategies to overcome the crisis are too austere. In such a case, a regional alternative with superior programs would be welcome news. However, the knowledge market, as mentioned, is not transparent and it is not clear whether the instrumental variable through which various IOs compete would really be quality in terms of achieving superior economic performance. A national government might settle for technical assistance from institution B and not – as we assume to know – from superior A which offers better advice, because less disturbing questions may be asked, because there are interpersonal links, or for similar reasons.

Usually, one might assume that the government had strong disincentives to favor advice from B over A, because the public would find out about the government having chosen inferior advice and would punish the government accordingly, for instance in the next elections. However, for the public it will be very hard to evaluate whether A's or B's advice are superior and whether the government has deliberately avoided an arguably better advice. The public may not even learn from evolving economic events whether A's or B's advice were better in the first place. This holds, because it is very difficult to link economic performance clearly and unequivocally to earlier policy decisions. Put differently, the public as the principal in charge has a significant informational disadvantage to evaluate its agent, namely the government, when this agent chooses an advisor. Because of these imperfections of the knowledge market, simply introducing competition may not lead to superior outcomes; on the contrary, it is not too difficult to imagine scenarios in which competition would merely lead to inferior selections being made.

3.4 Analytical capacity

In order to avoid this incentive problem, a possible solution could be to make sure that the competing institutions A and B are checked by some other competitive mechanism which is able to evaluate quality. To our mind (see also Pascha 1999), peer pressure from the international community of social scientists in a wide sense and from economists in particular would be such a mechanism. To make this idea work, though, it would be necessary

- 1) for the participating institutions to have clearly spelled-out strategic concepts competing against each other,
- 2) and thus to possess enough intellectual capacity to engage in such activity,
- 3) plus an open international discussion with a high-quality evaluation of institutional performance.

For these prerequisites to be fulfilled, relatively ill-equipped RIOs would hardly do. For instance, the ADB so far lacks the personnel to engage in such high-caliber activities. As for high-profile reports like 'Emerging Asia' (ADB 1997a), in the future it will not do to hire well-known outsiders like Jeffrey Sachs for such important, strategic tasks.

In this context, it may indeed be interesting to make the voice of the region more audible in international affairs. It has often been argued that the model of East Asian developmentalism might offer an alternative to Western concepts of industrialization and to the approach of the Washington institutions in particular (*e.g.* Ohno and Ohno 1998). It may suffice here to mention the controversy on the 1993 East Asian Miracle report of the World Bank in this context. However, no institution of the region has yet proposed a convincing and consistent alternative view with strong analytical and predictive power. While it is true that the Washington institutions have been somewhat helpless with respect to forecasting and dealing with the crisis, the regional institutions, which think of themselves as knowing best what is going on in Pacific Asia, have not fared better. For instance, the famous flying-geese-approach, which has often been referred to when making political efforts towards more economic cooperation in Pacific Asia, shows remarkably little regard for financial systems and political-economic conditions.¹⁰

¹⁰ This is not to argue that representatives do not possess interesting insights. I remember a conversation with Professor Ippei Yamazawa of Hitotsubashi University, who is a leading proponent of the flying-geese-approach in the wider sense, which he prefers to refer to as catching-up product cycle approach. I asked him what he thought to be the next major issue, for instance to be tackled by one of his students. He answered that he considered the financial markets most impor-

Japan could play an important role in making the means available for setting up a research framework to look for alternative explanations and recipes, which could compete with the intellectual resources concentrated in Washington, D.C. This would also be well in line with Japan's intention to make a noticeable mark in international relations. It would be important, though, to accept global standards of scientific discussion and critique for such an effort. A cozy regional environment would not do to develop a challenge to conventional theoretical and policy knowledge.

As for institutional affiliation, the newly founded ADB Institute could serve well such a purpose. This institute will have to be drawn into a global framework of scholars and policy makers, though, and must not develop the character of a more or less functional service unit for the immediate tasks of the Manila-based ADB. Moreover, it will need a critical minimum of resident scholars and frequent visitors to be of consequence.

4 FINAL REMARKS

This paper has dealt with financial cooperation and integration in Pacific Asia both from a positive and from a normative point of view addressing the questions of what is being done and what ought to be done. Whereas most contributions stress the role of multilateral – in the sense of globally operating – institutions, this paper has focussed on the role of *regional* institutions. Reducing what has been argued above, our view on what has been done on the regional level and what could and should be done is quite pessimistic. The most basic reason is that in the financial markets multilateral interdependence is so strong that it is quite difficult to make the case for a regional approach.

Should regional cooperation in financial matters still play a growing role? If one wants to propose such an argument, we argue that it can hardly rest on economic grounds. Rather, there may be political reasons to suggest that the advanced and emerging economies of Pacific Asia need more channels of cooperation to smoothen their relations based on mutual interdependence. This would be an ad-hoc approach, not resting on foreseeable economic cases for cooperation on specific issues, but on eventually emerging topics. Such an open agenda would be very similar to what has been proposed for APEC during its inaugural years.

However, there are not only potential benefits of such an open agenda, but also dangers. The major problem is that cooperation within a regional

tant – and this remark was made in 1983 or 1984, not only before Japan's Heisei recession, but even well before the bubble economy.

club may not only lead to activities which benefit all, both insiders and outsiders, but may also lead to collusive behavior, impairing outsiders. In this paper, we have identified various scenarios in which that may happen. Therefore, it is legitimate for the international community to discuss the pros and cons of such developments as regional cooperation in finance is not only a regional matter.

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THE NEED FOR STRONGER REGIONAL FINANCIAL INSTITUTIONS IN EAST ASIA

Jesus P. ESTANISLAO

1 INTRODUCTION

The financial crisis, which affected several South East Asian economies in the middle of 1997, has now been analyzed numerous times by scholars, policy makers, and market players. Thus far there is no agreement on any single cause for this complex phenomenon, though, different analysts have highlighted different causes, and assigned to them varying degrees of importance.

The typology of causes covers a broad field, stretching from borrowing and lending decisions at the level of enterprises and institutions to distortions in the financial and economic system and to weaknesses in the international financial system (see for instance Krugman 1998; Radelet and Sachs 1998; Montes 1998 and Moreno, Pasadilla and Remolona 1998). Depending on which economy is analyzed, and who the analyst is, the relative importance given to any of the causes varies.

The scholars who have focused upon the close relationship between government and business, previously touted as a factor for the roaring success of the East Asian tiger economies, point to crony capitalism as a core cause of the crisis. Indonesia is cited as a clear case, where this financial crisis has led to wider and deeper consequences, in large part due to the incestuous relationship between government and business, see Radelet (1998) for a discussion on the events leading to the crisis in Indonesia.

Other scholars emphasize financial and economic distortions. Pegged exchange rates in smaller economies, while the much bigger economies surrounding them have observed more flexible exchange rates, led to distorting policy actions and consequences. These included higher relative interest rates, the attraction of short-term foreign exchange flows, over-expansion of credit, over-investment and the 'bubble' in asset prices in several sectors, *e.g.* real estate and construction, and 'irrational exuberance' in the stock markets. Thailand is presented as a prime example in this regard.

Still others prefer to give full weight to the imperfections of the international financial system. Prime Minister Mahathir has blamed big institutional investors, who can move huge financial resources in and out of

relatively small economies, and who have few scruples about exploiting opportunities to feed their greed for profits. The United States has been blamed for being long in rhetoric and advice, but short in financial contributions to rescue and aid packages for the crisis-affected economies. Many have been blaming the IMF for prescriptions that were wrong and merely aggravated the crisis situation.¹ Moreover, it has been claimed that the 'relief' in the IMF (International Monetary Fund) rescue packages was too little and too late.

Considering the depth to which the crisis affected specific economies, it is possible that several causes may have converged and mutually reinforced each other. Each of these causes may have an element of truth, but the degree to which each cause holds may vary from one economy to another. Thus, it is possible to highlight the differences between the economies and in particular the extent to which the crisis adversely hit different countries.

But it is also possible to highlight the fact that the East Asian economies were all affected by the crisis. Indeed, the speed and the breadth in which the crisis spread in the region of East Asia, may indicate that the causes have been broadly similar, and that the economies in the region have become much more inter-dependent than they were a decade or two ago.

If this is the case, then the approach to the crisis can not be confined to single reform measures undertaken separately by individual economies in the region. If the crisis can be traced to a complex set of causes, then each economy should look at a broad range of reform measures, which may have varying degrees of relevance. Moreover, it would be more effective for all the economies in the East Asian region to undertake the range of reforms in consultation, and where called for, also in cooperation with each other.

2 A PACKAGE OF REFORMS

Reforms, to be effective, have to start at home. In fact, before the economies of East Asia can consider working closely with each other, each one of them may have to look more closely at the internal dynamics of its constituent units, and then figure out which reform should be undertaken at home first. Unless each one of them focuses its priority efforts on strengthening the internal economy, any collective efforts at forging economic cooperation in order to strengthen the East Asian region, the

¹ See for instance, Feldstein (1998). The IMF has recently released a preliminary assessment of its programs in Indonesia, Korea and Thailand in Lane *et. al.* (1999).

broad APEC region, and the international financial system would be in vain.

The effort at strengthening the internal economy should begin with improving corporate governance. Reform should start at the enterprise level, since enterprises are the basic units of any economy. Enterprises, which increasingly have to operate in more open and free markets, must also increasingly go through the paradigm shift of anchoring success on the building up of institutional strength, rather than on the firming up of the iron grip of personal, patriarchal authority. This is because open and free markets, operating under the rule of law, tend to place much greater premium on institutions, particularly those with a corporate juridical personality, rather than on patriarchs, with their more limited individual or personal juridical personalities.

Corporate entities follow a pattern of organization, with a clear structure that delineates responsibility and specifies accountability. Responsibility and accountability are not only internal, but also external. The latter is a recognition that enterprises have different stakeholders, which naturally include the enterprises' shareholders, but are not limited to them.² Among the other stakeholders are the enterprises' customers, creditors, and regulators. In the case of creditors and regulators, in common with management, labor, and shareholders, they have an interest in obtaining information about the conduct and results of corporate operations.

Only objective, accurate, regular and timely information can satisfy such an interest. But the provision for this kind of information calls for proper book keeping, which adheres to accounting standards, adopted nationally, and in keeping with international norms. Standards and norms call for monitoring to check and ensure compliance with them and with other prudential rules as well as regulations. External auditors and the participation of external professionals in the Board of Directors can reinforce the principle of checks and balances and allow for independent opinion and advice. They provide additional guarantees of objectivity and transparency in corporate decision-making as well as in the public reporting of corporate information.

Objectivity and transparency of public information are required of corporations because they are vested with responsibilities to the public, especially their different stakeholders. But those to whom corporate information is made available should incorporate such information into their

² Zhuan (1998) discusses how moral hazard arises from the different preferences of different stockholders of a firm, and why corporate governance is important. Among others, one argument is that the accumulation of private risks could lead to systematic risks and eventually to a crisis.

regular assessment and eventually into the judgments they make about the corporation. Regulators must see to it that all norms of prudence are observed in corporate decisions and operations.

In fact, over time, as markets become more open and free, there should be no reliance on guarantees and protection which corporations may enjoy from governments. Protective tariffs are falling down rapidly. Guarantees, whether explicit or implicit, often prove to be illusory in practice, and particularly in times of crisis. Safety nets do not open up and generally come up short, when the going gets rough. Indeed, governments are being forced to keep some healthy distance from business enterprises, which must rise or fall on the basis of economic performance in the playing field subject to market competitive discipline, rather than at the behest of their political connections.

Competition principles are increasingly applied and adhered to. More and more sectors and industries are opened up. Only an exceptional few industries are reserved to national groups. This development should not be construed to mean the removal of all rules and regulations. Instead, a solid regulatory framework should be provided, to ensure an even playing field for all market participants, rather than to continue mercantilist and nationalist practices. These practices are increasingly becoming an anachronism in a more inter-dependent world.

In individual economies committed to implement the principles of competition policy, there is a need for rules which are kept simple but strictly enforced. In the enforcement of these rules, especially at the enterprise level, supervisory authorities can focus their attention on financial institutions and their relations with the enterprises that borrow from them. Rules are best enforced on financial institutions, which in turn can help enforce them on the enterprises that come to them for loans. Financial institutions can insist on the observance of basic norms of financial prudence such as capital adequacy, proper asset valuation and loss provisions, conservatism in observed financial ratios, and adherence to standards of financial and over-all corporate performance. Through the credit evaluation and screening process, financial institutions can provide an important line of defense for the financial and economic soundness and strength of the enterprises to which they lend.

In turn, banks themselves should have to meet financial standards set up within the financial system. They too must prove that their capital is adequate and their capital base is strong. Moreover, together with the supervisory authority, they must agree on and observe reasonable mechanisms for asset valuation and loan loss provisioning. In addition, benchmarks would have to be adhered to so that all the fundamental supervisory principles covering issues such as licensing, information sub-

mission requirements, prudential norms for all facets of banking operations, adequate supervisory powers to enforce those norms, are observed. In this regard, there is no need to re-invent the wheel. The Basle core principles for banking supervision have already been adopted by various national supervisory authorities. For those authorities that have yet to do so, all they need to do is to conform, adopt, and implement them. Stiglitz (1998), however, argues that Basle standards do not deal adequately with the broader aspects of risks to banks.

Financial supervisory authorities should have to pay special attention to systemic and economic information that can make apparent the state of strength of the financial system. The range of information of concern here should not be limited to inflation and real GDP growth. It should include trends and turning points for real exchange rates, current account deficits, and asset prices. Kaminsky, Lizondo and Reinhart (1998) present a number of indicators that signal when a currency crisis may take place within the following 24 months. Special attention has to be paid to the expansion of bank credit, and particularly of short-term foreign debt. The recent crisis has also revealed the need for giving information that is as accurate as possible on any possible encumbrances on the economy's foreign exchange reserves. It should be noted that forward contracts may render reports on the absolute level of such reserves inaccurate and misleading.

On a sub-regional ASEAN basis, and subsequently also on a broader, East Asian basis, it should be possible for the financial supervisory authorities of the different economies to exchange information with each other. The information exchange can include only a few critical items, such as those that have just been cited. But the value of such an exchange should lie in providing a basis for the different financial supervisory authorities to exchange policy experience and insights into making the exercise of their supervisory functions more effective. Once such a basis is provided, these authorities can explore possible avenues to tightening supervision, strengthening their respective financial systems, and eventually devising mechanisms and arrangements by which to anticipate and prevent future sub-regional and regional financial crises.

In sum, before we begin to think about a new financial architecture for the global economy, we should first address the need for reforms much closer to home. In the first instance, each individual economy must craft a program by which gradually, but with the least delay, they can comply with the basic principles of corporate governance and competition policy. Then, in an almost parallel move, each economy needs to strengthen its financial supervision. In fact, several economies in East Asia have recently set up such separate authorities and have vested in them autonomy, inde-

pendence, and broad powers for effective supervision, not only of banks, but also of other financial institutions.

In this regard, with all the work that needs to be done, it is only proper that in the foreseeable future, the different autonomous financial supervisory authorities in East Asia should get together. They can now do so productively, if they exchange information and experience, and agree on basic items that can be monitored on an East Asian-wide basis. They can also learn from each other on issues of common and vital interest to them. These issues relate to the strengthening of individual financial systems. Over time, when conditions are ripe, they can and should be gradually expanded to include possible cooperative endeavors for the strengthening of the inter-related financial systems in East Asia.

3 THE TEN EAST ASIAN ECONOMIES

The history of cooperation in Southeast Asia is three decades old. At the time when the financial crisis was beginning to hit the original ASEAN members, ASEAN was celebrating the 30th anniversary of the Bangkok Agreement, by which ASEAN was launched. In fact, it would have been a much happier celebration, were it not for the financial crisis. After all, ASEAN could point to many feathers in its cap. Its accomplishments have been held with pride, and have justifiably earned it great respect from the international community.

But the fragility and limitations of those accomplishments have been revealed by the financial crisis. Since the accomplishments were generally in the area of international good will, good neighborliness, and the liberalization of trade and investments, the mechanisms that ASEAN set up for consultation and coordination were ill suited to take on the challenge presented by the financial crisis. ASEAN Finance Ministers had resumed meeting only in the early 1990s. In the IMF, the World Bank, and ADB ASEAN economies belonged to different constituencies, as they do up to the present. While the avenues for consultation and cooperation between ASEAN Finance Ministers and Central Bank Governors have always been open, and each year there are a few occasions when they could do so, still the fact remains that they were peripheral to the core ASEAN process. Foreign Ministers and Trade and Industry Ministers have always been the ones to tend to the ASEAN process.

The cooperation process, especially during the past few years, has led to greater integration of ASEAN economies.³ At the start, the process

³ See Tan (1996) for a discussion of the impact of AFTA on ASEAN.

moved on very slowly. Indeed, for most of the initial years of ASEAN, its call for economic cooperation has always been much sharper than its bite. But in the past decade, greater economic inter-dependence gradually began to take on more substance, reckoned from the standpoint of trade. Trade inter-dependence becomes more significant if we expand the sub-region from the original ASEAN (the ASEAN 5 of Indonesia, Malaysia, the Philippines, Singapore, and Thailand), and include the other East Asian economies (the 3 Chinese economies of China, Hong Kong, Chinese Taipei, plus South Korea and Japan).

Trade and investments do tend to reinforce each other. Once trade flows between inter-related economies, their links soon expand beyond trade to include finance. The financial crisis of July 1997, which affected all the original ASEAN members almost simultaneously, has highlighted this close linkage in financial and monetary developments between ASEAN economies. Moreover, as the evolution of the crisis has shown, it has revealed that such close linkage goes beyond the original ASEAN 5.

Before 1997, it was said that the movement in the exchange rate of the yuan and of the yen, relative to the US dollar, gradually created to some degree pressure on the currencies of ASEAN.⁴ Most of the original ASEAN economies decided to turn a blind eye to this pressure, and failed to make the appropriate adjustments in their exchange rate. But by mid-1997, such pressure, exacerbated by a number of other factors, which varied from one economy to another, could not longer be resisted. Market pressure forced several ASEAN economies to adjust their exchange rates to levels which were broadly comparable with the rate of depreciation earlier of the yuan and of the yen.

The defensive move of Chinese Taipei, which devalued its dollar by 10% in October 1997, raised the fear that a competitive devaluation in East Asia could worsen and prolong the crisis. The same fear has always loomed large with respect to China, and today this remains one of the 'threats' to the recovery of several South East Asian economies. The Hong Kong dollar was subjected to occasional speculative attack, and this forced the government to intervene and abandon its longstanding hands-off policy with respect to financial markets. Commencing with the Thai baht and the resulting contagion throughout East Asia, the South Korean won had to be devalued within less than 6 months after the start of the crisis.

The existence of the contagion argues for some cooperative arrangement on financial and monetary issues in ASEAN and in East Asia. The

⁴ See Noland *et. al.* (1998) for an empirical investigation of the impact of the devaluation of the Chinese yuan on Asia.

trade interdependence they had built up within the past decade has arguably made them into an economic region, and financial markets have started to regard them as one.

ASEAN has already taken the initial move to broaden cooperation in the field of finance. The ASEAN Finance Ministers decided in early 1998 to start a mechanism for consultation and cooperation, which can include peer review. The same decision has also been taken by APEC, which counts among its member economies the 10 economies of East Asia. These initial moves, which are taking a long time to implement, form part of the general response to the crisis.⁵

But both groupings are not co-extensive with the parts of East Asia that have been most directly affected by the financial crisis. ASEAN has new members, which are still in the early stages of integration into the international market economy. APEC has become a very broad grouping, which includes economies way beyond East Asia. Within APEC, there has been some recognition that the 21 economies comprising it would be too broad a grouping for the financial crisis that started in East Asia. Within it, a more limited Manila Framework Group has been set up. But again, this is not co-extensive with the East Asian ten. It excludes Chinese Taipei, but includes the USA, Canada, Australia and New Zealand.

For the 10 East Asian economies that have been thrown into the forefront of having to confront the financial crisis, there is a clear and urgent need for functional arrangements of consultation and cooperation, which are flexible and open. Such arrangements should initially and generally be limited to them. Under the principle of subsidiarity, they should be implementing joint solutions to the problem that started in the East Asian region. They should be able to consult freely with each other, without anyone else complaining that a great divide is being artificially made between the eastern and western side of the Pacific, and between the northern and southern portions of the Western Pacific. In fact, each time the Europeans get together, everyone hails the effort as potentially constructive and positive. Similarly, everyone welcomes the Free Trade Area of the Americas (FTAA), which puts together virtually all the economies of the Americas, as a building bloc towards the construction of a more open and free international trading system.

But as with the FTAA, the functional grouping becomes a building bloc towards a bigger, more global system, provided it remains open. Similarly, the 10 East Asian economies that should consult with each other more closely, can become a positive group contributing towards the build-

⁵ See Manzano and Moreno (1998) for a discussion of the regional responses to the crisis.

ing up of a new global financial architecture, only if they remain open and flexible. Indeed, it is only realistic for them to include the United States in many of their meetings. It is also of strategic long-term importance for Australia and New Zealand to be invited to their consultative meetings.

In fact, before they can move on to anything else, the 10 East Asian economies should spend a great deal of time implementing mechanisms for more regular consultation amongst themselves. They can share information. They can exchange assessments. They can make arrangements so that a regional dimension is introduced into each one's day-to-day information assessment of developments in financial markets. In this regard, they already have the model of the G-7, which meet very often informally, and exchange assessments of financial market movements frequently, many times over the phone, even on a daily basis. It is proposed that what the G-7 already do, the 10 East Asian economies should also do. In this way, national financial authorities simply parallel what the inter-connected global financial market does, and which now happens to regard East Asia as one region.

Once the 10 East Asian economies make their informal consultation mechanism work, it would soon follow that they cooperate with each other more closely. They could coordinate efforts at speeding up their process of recovery from the crisis. For instance, the Miyazawa initiative, which is now an umbrella for bilateral economic relations between Japan and South Korea as well as several of the ASEAN economies, can be folded into the East Asian 10 mechanism. This could then form a basis for other positive initiatives, which the region as a whole can undertake.

In the wake of the East Asian crisis, there is a gamut of such initiatives, which in time will be called for. In addition to speeding up the recovery in each of the East Asian economies, there are many elements in the reform package, which can be undertaken in close cooperation with each other. The adoption and implementation of competition policy principles, the restructuring of corporations, banks, and industries and, the strengthening of financial supervision, all require a broad vision and deep commitment. If undertaken alone, they will prove to be difficult and expensive. If undertaken on a more cooperative basis, with support from other economies and international financial institutions (IMF, World Bank, ADB, etc.), the possibility for speedy success will be much higher. Effective regional consultation cannot operate in a vacuum. To be of any value, policy support at the regional level must improve the ability of policymakers to identify and respond to shocks in a timely fashion (Manzano and Moreno 1998).

The 10 East Asian economies can never lose sight of their need to restore the stability of their exchange rates and their financial and economic

systems. The crisis has brought home the point that stability of the exchange rate is better secured through operational and structural policies, which bring stability and market discipline to their financial and economic systems. This means that it is vain to focus on exchange rate stability alone, unless determined and sustained efforts are expended towards a package of measures for strengthening the banking system and for developing the economy under open market rules. This is a very broad field, with a myriad of specifics, for close cooperation among these 10 economies. Once they get started in this direction, the 10 East Asian economies can begin experimenting with subsidiary arrangements that could more directly bring greater stability to their currency markets.

These ten economies have great stakes in the new financial architecture, which can have an influence in the way the major currencies – the US dollar, the Japanese yen, and the European euro – are going to move in relation to each other. The more stable these major currencies are to each other, the less pressure they have to adjust their own currencies. The more realistic and flexible the proportions they keep of these major currencies in the basket of their individual exchange reserves, the less pressure for adjustment they are subjected to every time the major currencies move relative to each other. This basket of major currencies and their relative proportion in the exchange reserves the 10 East Asian economies each keep should be a topic they could consider amongst themselves.

They should also consider arrangements by which they can avoid competitive devaluation within East Asia. They would already be taking long strides in this direction through the sharing of information and assessment, and in time through their peer review process. But they may also wish to go beyond the early signals they send to each other, and the neighborly persuasion for the early correction of destabilizing trends they create to each other. Since they are decades away from locking firmly and permanently their currencies to each other, they may wish to consider the softer and more realistic alternatives that are available. Surely, they should be able to find a reasonable middle ground between the two extremes of a permanently fixed peg and the completely free float. If they manage to strike a flexible balance between the two, and can show the rest of the world that they can make it work, then they can contribute a meaningful regional structure to the construction of a new global financial architecture.

In sum, Europe has already united even more strongly, with the euro as one more bond that inextricably ties those economies that have decided to join the euro zone. In the Americas, there is an inexorable tendency towards tying the currencies of various American economies to the US dol-

lar. The current dollarization proposal of Argentina follows the example of Panama, and it is gaining momentum due to the instability in Brazil.

In East Asia, there are ten economies that are faced with the financial crisis, and with no clear arrangements or fixed mechanisms even for consultation amongst themselves. The crisis has made it necessary that on financial and monetary issues, these ten economies should begin to consult with each other more regularly and frequently but consultation can and should lead towards cooperative initiatives. For as long as these initiatives, from and for East Asia, lead to arrangements and mechanisms that are open and flexible, they can be viewed positively. They may even be able to contribute a constructive building block towards the new global financial architecture, now being openly discussed in the world economy.

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ACTION AND REACTION, DIRECT AND INDIRECT LEADERSHIP: RE-EVALUATING JAPAN'S ROLE IN ASIAN REGIONAL COOPERATION

Verena BLECHINGER and Jochen LEGEWIE

1 INTRODUCTION

In the 1990s, political and economic cooperation in Asia¹ gained momentum. While the region was divided into two rival camps, adhering – to varying degrees – to different models of social, political, and economic organization, this bipolarity gradually faded after the collapse of the Soviet Union. Similar to other parts of the world, new channels of communication opened within and outside of Asia, involving both state and non-state actors. The globalization of economic activities pushed forward regionalization in Asia which theretofore had been characterized by business activities organized along single country lines. Regional cooperation was mainly promoted by multinational firms interested in building up a horizontal division of labor with regional production and sales networks to connect their various overseas activities on a more efficient regional scale. On the political side, Asian governments became more interested in cooperation and dialogue to preserve stability in the area. The increasing globalization of economic structures also forced governments in the region to develop political means to adapt to growing interdependence. These developments were stimulated by trends toward regional integration in other parts of the world, especially Europe or North America. The 1997/98 Asian economic crisis added a further dynamic to this process. It painfully illustrated the high degree of mutual

¹ In this paper, the term Asia refers to Northeast and Southeast Asia, made up by Japan, the People's Republic of China, Mongolia, the Republic of Korea, the Democratic People's Republic of Korea, Taiwan and such territories as Hong Kong and Macao, as well as by Singapore, Malaysia, Thailand, Indonesia, the Philippines, Brunei Darussalam, the Socialist Republic of Vietnam, Myanmar, the People's Democratic Republic of Lao, Cambodia and Papua New Guinea. This definition of Asia stands in contrast to that of a wider Asia-Pacific region also including countries like Australia, New Zealand, the United States, Canada, Mexico or Chile. It also excludes countries such as India that are located outside the core of the regional cooperation process in Asia.

dependence of Asian economies and made it clear to political and economic decision makers that one country alone would hardly be able to withstand similar situations in the future.

While visible integration progress in the Asia-Pacific region, with the Asia-Pacific Economic Cooperation forum (APEC) at its core, stagnated in the late 1990s partly due to protectionist strategies of individual member states including Japan, cooperation in Asia has been on the rise. With regard to security matters, institutionalized communication and consultation has already been taking place since the mid-1990s within the ASEAN Regional Forum (ARF) (see, for example, Hook 1998). In the late 1990s, a similar though much more informal framework took shape for economic and foreign policy issues. The 'ASEAN plus three' forum, involving ASEAN member states, China, South Korea, and Japan, is the first Asia-only consultation group. Initiated by ASEAN, the political leaders of the 'ASEAN plus three' have met annually since 1997 in the context of the ASEAN Summit Meetings to discuss economic, political and security issues involving the region. As the heads of state of the 'ASEAN plus three' member states pointed out in their Joint Statement at the third 'ASEAN plus three' summit meeting in 1999, the aim of this framework is 'to support and complement' the activities of international and regional fora such as the Asia-Pacific Economic Cooperation (APEC), the Asia-Europe Meeting (ASEM), or the World Trade Organization (WTO) (Joint Statement on East Asian Cooperation, Manila, 28 November 1999).

Previous articles in this volume introduced attitudes and expectations of Asian political leaders and civil society regarding a Japanese role in Asia and addressed the various measures taken by state and non-state actors, bureaucrats, politicians, and business on closer political and economic cooperation in Asia. This article sums up and re-evaluates the process of regional cooperation in Asia and Japan's role within it. As the leading economy in Asia – Japan still accounted for two thirds of the regional GDP (gross domestic product) in 1998 (Keizai Kikakuchō 1999) – and as the only Asian member state of the G 8 group of advanced industrial nations, Japan is of key importance for the success or failure of regional integration in Asia.

Who are the key actors in this process and where and how does this process take place? We will analyze state and non-state, public and private actors. By addressing the various layers of the process of regional integration, we will examine the international, national and subnational level. We will point out the core areas of regional cooperation and integration and discuss the specific role of Japan in this process. We will further discuss what model of regional integration and cooperation Japanese decision makers of the political and economic sphere are favoring and what

activities they take to implement it. We will pay special attention to the effects of the Asian economic crisis on the process of regional cooperation and include the most recent developments in our analysis. Did the experience of the crisis motivate Japan to take on a leading role in Asian integration, or did it rather cause skepticism? Are Japanese political and economic elites willing to play a leading role in Asia? Or are the actions taken by the Japanese government merely a reaction to the crisis and will not proceed further once the most pressing problems are solved?

It will be argued that there is a strong trend of deepening regional cooperation in Asia, both in the political and the economic arenas. Japan did and will continue to influence and shape this process. The main driving forces are to be found in the economic sector, in which Japanese actors play a distinct role. In the 1990s, actors of the Japanese business sector have shown a growing interest in regional cooperation in order to respond to the pressures of globalization. Within this process, Japanese economic actors are more interested in deeper regional cooperation in the Asian region (or single subregions within it) than in the wider region of Asia-Pacific. Pushed forward by the forces of economic regionalization, Japanese political elites are also more willing to adopt a regionalist perspective than in the past. The recent experience of the Asian economic crisis has even strengthened the pro-Asian forces.

However, this trend toward a more regional view faces strong limitations by political and economic dependencies outside the Asian region. Because of these limitations, the broader concept of Asia-Pacific that also includes the United States will keep its current importance for Japanese political elites. While achieving their objectives, Japanese decision makers are reluctant to play a pro-active leadership role where leadership is understood as dominating decision making; rather, they prefer a style of indirect support and background mediation. This preference is mainly the outcome of structural constraints on the domestic level. Political decision making processes in Japan are shaped by different actors with split competing objectives and thus require compromises. As a result, for the Japanese government, pro-active leadership with clear-cut longterm strategies is not possible. A more short-term and case-by-case 'reactive' policy approach is thus the more rational choice for Japanese policy makers.

2 TERMINOLOGY

Before discussing Japan's role within regional cooperation in Asia, some remarks about the terminology used in this article are necessary. In the fields of international relations and international political economy, dif-

ferent definitions of 'region', 'regionalism', 'regionalization' and 'regional cooperation' are in use. It is therefore important to clarify the basic conceptions referred to here.

Most authors understand regions in geographic terms and talk of regions as groups of physically contiguous countries that entertain a high degree of political, economic, military, and/or social relations. However, in this article, regions are not seen as geographically specified areas, but as products of social and political construction processes. In the same way that modern nation states have to be understood as 'imagined communities' (Anderson 1991), regions are created by conscious policy choices by key political decision makers. Regions can only come into existence when there is a shared feeling of regional identity among the people(s) of the countries involved. Depending on the issues at stake and the political priorities of the most influential political actors in the countries that are part of a region, the degree of 'regionness' can vary in intensity (Higgott 1998a, 338).

The complex of ideas, attitudes, and loyalties contained in concepts of regional identity is usually referred to as 'regionalism'. Regionalist ideas are promoted by national political elites, both from the state and non-state sector, with the strategic motivation to influence public perceptions of 'regional affairs'. Thus, key political actors influence national political communities to support policy convergence and bring about an increase in political and economic activities between the member states of a region (Mansfield and Milner 1997, 3). Regionalism is therefore an ideological concept aimed at creating a sense of regional identity among the people(s) living in a region.

In contrast, 'regionalization' is an economic process driven by actors from the private sector, *i.e.* multinational corporations. It does not have an ideological basis and is caused by the spread of economic networks within or across geographical regions (Higgott 1998a, 339). Regionalization is an undirected process that often influences government policies. Economic networking in a certain geographic area and problems related with it can become an incentive for political decision makers to develop political strategies for this region and to adopt regionalist ideas. As a consequence, 'market-led open regionalism' (Higgott 1998b, 43), the prevalent concept of regional identity in Asia-Pacific, took shape.

Another frequent consequence of economic regionalization is the formation of regional economic and political institutions aiming at coordinating political and economic activity within the region and also between the region and other areas of the world. While the term regionalism refers to ideological and rhetorical concepts of regional identity promoted by political elites, and regionalization describes an undirected process of in-

creasing economic activities, 'regional cooperation' addresses the institutional level of policy formation and coordination within a region (Higgott 1998a, 340). The term regional cooperation is used to describe trade arrangements such as the North American Free Trade Agreement (NAFTA), cooperation fora like the Asia-Pacific Economic Cooperation (APEC), but also highly institutionalized organizations like the Association of South-east Asian Nations (ASEAN). The key actors in this process are state decision makers. For fully understanding the processes of regional cooperation, however, the actions and positions taken by business representatives and associations, policy advisors, scholars, and think tanks also have to be taken into account.

Earlier articles in this volume have discussed economic regionalization and Japanese and Asian concepts of regionalism as well as Japan's Asia politics in international financial institutions such as the World Bank and the Asian Development Bank. In this article, we sum up these findings and reevaluate Japan's role within the process of regional cooperation in Asia. In the next paragraph, we give a brief overview of the various actors in Japan that shape Japanese political and economic activity in Asia and address their specific role within regional cooperation in Asia before and after the Asian economic crisis.

3 JAPAN'S ROLE WITHIN REGIONAL COOPERATION IN ASIA – ACTORS AND SCALE OF ACTIVITY

Analyses of regional cooperation mostly follow a state-centered approach. Focusing on the aims and objectives of leading politicians and government bureaucrats, questions are asked about the depth of regional integration and cooperation, or about determinants of the institutional strength or weakness of regional arrangements. The majority of such studies portray national governments as united actors whose decisions are guided by a clearly defined 'national interest' or strategy. Japanese regional foreign and economic policy is very often described as lacking such a clear-cut national strategy and being a merely 'reactive state'. It is criticized for only 'coping' with issues and problems raised by other states (Calder 1988; Blaker 1993). The mainstream view of Japan's approach toward regional cooperation in Asia is one of indecisive manoeuvring and indifference (Gordon 1993; Grieco 1997, 168).

In this paragraph, we argue that Japanese politics toward regional cooperation is not merely reactive, but is based on a strategy of national interest defined by Japanese political elites. Japanese political decision makers, however, should not be seen as a monolith. Politicians and

government bureaucrats are split into several different factions, motivated by different interests, and pursuing different strategies for Japan's regional and global role. It is also important to take the interests of business, which is again split into different groups with often competing agendas, into account.

Japanese multinational enterprises, the driving forces of regional economic integration, push national government decision makers to support their claims for market liberalization and the standardization of economic exchange while, at the same time, other domestic economic actors speak out against such moves out of fear to be left behind. Different groups lobby for different policy options, and different parts of the national government support different positions. Both politicians and bureaucrats advocate those strategies that best serve their clients' interests. Japan's policy toward regional cooperation therefore has to be seen as the product of a compromise between competing concepts and opinions within the national political elite (and supported by a wider community of business and other interest groups, private and government think tanks, researchers, and the media). This compromise has to be understood as the smallest common denominator that all actors can agree upon and thus as the minimum definition of 'national interest' supported by all political elites.

Liberal institutionalist scholars such as Keohane (1984) and Nye (Keohane and Nye 1977; Keohane and Nye 1987) have pointed out the importance of actors from the private sector for foreign policy decision making. This is especially true for Japan's role within regional cooperation in Asia, which, as a consequence of economic regionalization, is mainly market-driven. Economic and, to a lesser degree, other non-state actors play a crucial role in shaping cooperative agreements in the region and influence the degree of their institutionalization. For the case of Japan, three reasons why the interests of business and other non-state actors 'count' in political decision making processes about regional cooperation in Asia have to be mentioned. First, structural problems in official Japanese foreign policy institutions impede or at least slow down government decision making processes and open the door for interference and mediation by non-state actors. Second, since the mid-1980s, the Japanese private sector has built up extensive networks and contacts within the Asian region enabling business actors to conduct independent economic diplomacy in the region. These structures are supported by private-sector information gathering facilities that make business associations and also multinational enterprises independent of – or sometimes even superior to – government sources of information. Third, with the end of the Cold War and the ensuing breakdown of levels of governance, a process of pluralization of Jap-

anese foreign policy has set in that further challenges the supposed foreign policy monopoly of state actors.

3.1 Structural problems of official foreign policy institutions

The majority of Japanese foreign policy proposals is drafted by bureaucrats. Factionalism and inner-party power struggles within the LDP, Japan's longterm ruling party impede the development of longterm foreign policy initiatives by politicians. Regular changes of government also prevent government ministers from shaping their ministries' agenda. Aside from exceptions like the former prime ministers Tanaka or Nakasone, Japan's foreign policy is thus developed by the bureaucracy that has kept its position as 'gatekeeper' (Pempel 1977) in Japanese international affairs since the early postwar period. However, bureaucratic control of foreign policy decision making is limited by structural problems of Japanese political institutions that encourage mediation by politicians or actors from the private sector.

Jurisdiction over Japan's international relations is divided between several government agencies, mainly the Ministry of Foreign Affairs (MOFA), the Ministry of Finance (MOF) and the Ministry of International Trade and Industry (MITI). While MOFA is the government agency most involved in foreign policy making, MOF and MITI take charge of international financial and economic politics. Other ministries like the Ministry of Post and Telecommunication, the Ministry of Transport, or the Ministry of Education are also striving to increase their influence on Japan's international affairs. As the Japanese bureaucracy is vertically structured with only a few linkages between ministries, sectionalism is one of the main characteristics of Japanese government institutions (Koh 1989, Muramatsu 1997). For foreign policy decision making, the split jurisdiction between ministries is a permanent source of conflict, especially in times of limited budgetary resources. In frictions between MOFA and MITI, for example, there is a tendency for the larger and politically more influential MITI to prevail, partly also due to the political backing of a large number of ex-MITI bureaucrats among Japanese Diet members (see for example Calder 1997, 3–11).²

Rivalries and turf wars are not only taking place on the inter-ministerial level, they are also shaping the relations between bureaus and divisions within ministries. Within MOFA, for example, internal conflicts be-

² Of the 500 members of the politically more influential House of Representatives of the Japanese Diet, currently 6 are former MOFA bureaucrats compared to 11 former MITI and 21 former MOF officials (Seisaku Jihōsha 1999, appendix, pp. 7–9).

tween the Asia and the North America Bureaus are frequent, as are disputes between the North America Bureau and the Economic Affairs Bureau. Public officials in both bureaus talk to and interact with different counterparts both within Japan and abroad, and consequently often come up with conflicting policy preferences. Bureaucrats of MOFA's North American Bureau, for example, focus rather on security issues and thus promote strategies to keep the US involved in the region, both militarily and politically. Their colleagues from the Economic Affairs Bureau, in contrast, who have a long history of dealing with US-Japan trade conflicts, prefer strategies of controlling and balancing US influence in the region. Due to the early specialization of bureaucrats within their ministries, such internal splits are not only visible within MOFA itself, but also affect Japanese diplomacy down to the level of Japanese embassies abroad (Fujiwara 2000).³

As communication between ministries is rather complicated, inter-ministerial domain conflicts open a channel for politicians or interest group representatives to act as mediators. One well-known case of open conflict between MITI and MOFA that was settled due to political mediation was the initiation of APEC in the late 1980s. While MITI has been actively involved in setting up APEC from the beginning, MOFA officials, who not only favored different regional concepts like the Pacific Economic Cooperation Council (PECC), but also were concerned that MITI was invading MOFA territory by promoting APEC, took a rather critical position. At the initial APEC meetings, observers noted the presence of 'two Japans', represented by MITI and MOFA, which had two different agendas and were thus stalling the APEC process. The split between the two

³ Frequent domain conflicts and sectionalism make it rather difficult for Japanese government ministries to share or exchange data. To support their policy positions and to become independent from (or to supplement) government sources of information, Japanese foreign policy institutions also have think tanks. MOFA receives strategic information, for example, from the Japan Institute of International Affairs (JIIA) and the National Institute for Research Advancement (NIRA). MITI funds a similar organization, the Japan Economic Foundation (JEF). By sponsoring international conferences or funding research projects, for example, ministries are actively gathering information and promoting new policy ideas. Government think tanks not only enhance their ministry's standing in inter-ministerial turf wars, but also keep close contact with interest groups related to the ministry. Aside from their function as sources of information, these institutions also enable the ministries to informally address issues beyond their jurisdiction. In this context, think tanks contribute to building up support both in Japan and abroad for policy ideas whose promotion would otherwise lead to the creation of new frontlines in the inter-ministerial power struggle.

ministries could only be solved in 1989 after former MITI Minister Mitsuzuka Hiroshi was appointed Minister of Foreign Affairs. Well familiar with MITI interests and complaints, it was Mitsuzuka's mediation that made MOFA increase cooperation and coordination with MITI and thus gave the APEC process a push forward (Funabashi 1995, 211–13).⁴

3.2 Influence of non-state actors on foreign policy decision making

Domain conflicts and infighting within or between government ministries do not only open up a channel for political mediation, they also encourage interest groups from the private sector, itself split into various competing factions, to join forces with parts of the bureaucracy and to thus promote their own agendas. Non-state actors from the private sector generally use two channels to influence foreign policy decision making: first, they do so by keeping in close contact with the regulating bureaucracy in the ministries in charge of their area of business, and secondly, by the active lobbying of high-ranking politicians or political party headquarters.

Individual companies keep direct contact with bureaucrats in the central government ministries in two ways: first, they participate in government advisory committees (*shingikai*), and secondly they hire retired bureaucrats as advisors for their company (*amakudari*). Both practices are of special interest for international economic policy making. All ministries cooperate with special advisory committees (*shingikai*) that include scholars and interest group representatives. These committees are set up by government ministries in order to, among others, obtain information on recent developments and trends in the Japanese (and international) economy, to detect the need for new regulation, and to ensure that a broad range of opinions is considered in the law making process (for a detailed study of *shingikai*, see Schwartz 1993; Schwartz 1998). For multinational companies and business associations, the participation in *shingikai* provides an opportunity to articulate their claims and expectations toward future Japanese foreign and foreign economic policy. After retiring, a high number of Japanese top bureaucrats take on jobs as advisors or counselors in the private sector (*amakudari*) (for details, see for example Johnson 1995, Schaefer 1995). For companies expanding their activities on the international level, the hiring of retired government bureaucrats especially from MITI has to be seen as a means of securing access to the foreign (economic) policy establishment. As these ex-bureaucrats still dispose of a wide net-

⁴ For another example of conflict between MOFA, MITI and MOF with regard to Japanese foreign policy toward Asia, see the article by Yasutomo in this volume.

work of contacts within the agency, business interests can thus informally influence Japanese international economic policy decision making. Through such informal access paths, interest groups from the private sector stay in permanent contact with the regulating bureaucracy and can easily bring up issues on their agenda for the Asian region with the public officials in charge.

To further increase their pressure on official government decision making processes, both big multinational companies and business associations also lobby intensely with Diet members. Representatives of organized business associations mostly target official party institutions of the ruling parties, such as the LDP Foreign Affairs Committee. The Japan Federation of Economic Organizations (Keizai Dantai Rengōkai, Keidanren), the largest and most influential Japanese business association, has been maintaining close contacts with the LDP since the party was founded in 1955. By collecting money from its member associations, Keidanren has been the most influential donor for the party's political activities and election campaigns (Iwai 1992, 109, 113–17) until it stopped the practice due to a series of major political corruption scandals in the mid-1990s (Blechinger 1999, 57–60). Also, after stopping the collection of political funds for the party, regular policy meetings between Keidanren officials and LDP leaders continue to take place and provide business interest groups with a forum to state their expectations toward domestic and international policy. Moreover, Keidanren organizes various study groups, staffed with journalists and academics, which discuss international economic and political issues and work out policy proposals. In April 1997, the association also founded its own research institute in order to increase its input of ideas in the policy making process. The 21st Century Public Policy Institute (*21seiki Seisaku Kenkyūjo*) conducts, among other things, research projects on Japan's international relations. Keidanren is thus actively promoting its own foreign policy agenda and is exerting pressure on government institutions to implement them. Keidanren is only one example of the foreign policy activities of Japanese business associations. Other organized business interest groups, for example Keizai Dōyūkai, the Japan Association of Corporate Executives, lobby in similar ways for the inclusion of Japanese business interests into foreign policy decision making.

Parallel to the activities of business organizations, Japanese big business also has a long tradition of conducting its own economic diplomacy. Often initiated by Keidanren, business representatives engage in informal consultations with foreign political and business leaders to promote Japan's economic relations with certain countries or regions, such as China. Consultations often parallel or precede government talks and can thus be

seen as coordinated with official foreign policy (see for example Masumi 1995, 296–304). One important actor with a long tradition in the field of private sector economic diplomacy is the US–Japan Business Council, which is usually co-chaired by one Japanese and one American leading business executive. Its activities contributed, for example, to the solving of Japan–US trade friction in the early 1990s. The former chairman of this council and also Chairman of Fuji Xerox, Kobayashi Yōtarō, used this forum to foster understanding for the Japanese interest in Asia on the side of his US counterparts (see Blechinger in this volume).

As a consequence of the growing globalization of the Japanese economy, business also built up independent information gathering and policy planning facilities. While up to the 1980s, the Nomura and Mitsubishi Research Institutes (founded in 1966 and 1970) were the only business-related think tanks in Japan, since, banks, financial institutions, and public relation companies have created their own research institutes. Many of these private think tanks show a strong interest in regional political and economic issues. The Nomura Research Institute, for example, has demonstrated increased interest in Asia by opening three new offices in Taipei, Seoul, and Manila in the last 6 years, adding to their already existing representations in Hong Kong and Singapore. Another private think tank with a strong focus on Asia is the Sakura Institute of Research (Sakura Sōgō Kenkyūjo) founded in 1991. This institute is running a special research department, the Center for Pacific Business Studies (Kantaiheiyo Kenkyū Sentā) which conducts research projects on political and economic problems in Asia. Think tanks not only provide the Japanese private sector with strategic information about Asian countries and their markets. They also make business independent from information and data otherwise only available from government institutions, thus enabling it to develop its own independent trade diplomacy or foreign policy initiatives.

3.3 Pluralization of Japanese foreign policy after the end of the Cold War

During the Cold War, security concerns dominated not only Japanese foreign policy, but also most other policy areas. Trade friction with the US, for example, was buffered by Japanese government security concerns, and government officials cautiously avoided to damage the alliance with Japan's most important partner. The Cold War dogma also set clear limits to the area in which other actors of the Japanese political elite could pursue their agendas – compared to the importance of national security, the interests of, for example, the business community, did enjoy lower priority. Japanese business did conduct independent economic diplomacy already during the Cold War and was often successful in its pursuit of is-

sues that were considered sensitive in the context of the Cold War, as for example engaging in closer economic relations with China. However, it has to be argued that such efforts could only be made in cooperation and coordination with the government. After the Cold War ended, the absolute priority of security issues subsided, too, and domestic actors got more freedom and more opportunities to engage in international relations. Political relations in the region are no longer controlled by the state, and political and economic regional integration in Asia is now taking place simultaneously in various parallel layers. As illustrated by Hook in this volume, the process of regional cooperation in Asia is currently involving the state, but also the substate level, giving certain regions within states the chance to pursue their own foreign policy agenda and to increase their contacts with either states or other regions. Furthermore, there are not only governments, either national or prefectural, or private sector interests involved in this process. The end of the Cold War also brought about a boost for democratization movements in Southeast Asia that resulted in a growing and increasingly active civil society that is gradually, and sometimes even state-induced, met by a growth in the activities of non-governmental organizations in Japan as well (see also Shutō in this volume).

The process of foreign policy making in Japan and especially decision making about Japan's relations within the region is thus no longer determined by a small elite of decision makers, but is becoming more and more pluralized with every new layer that is added to it. It will thus also become increasingly difficult to define concepts like 'the national interest' – the more actors will be involved, the more necessary it will become to form coalitions of interest between and across the various layers of the process of regional cooperation, and the less possible it will be to follow monocausal, state-centered explanations of Japanese foreign politics.

4 JAPAN'S ROLE WITHIN REGIONAL COOPERATION IN ASIA – THE ACTUAL IMPACT

In this section, we will analyze the role Japan played within the process of regional cooperation in Asia. We will point out that Japanese foreign policy elites since the early 1990s were torn between two competing concepts of regionalism. One was the idea of a broader Asia-Pacific region that not only involved Asia, but also its 'neighbors' on the other sides of the Pacific, especially the US. This concept is expressed in the APEC idea, and it has long been favored by the traditional foreign policy establishment. The rival concept limits regional cooperation to the countries of Asia, thus ex-

PLICITLY excluding Japan's most important ally, the US. This concept, promoted mainly by Malaysia, can best be seen expressed in the proposal by Malaysian Prime Minister Mahathir to create an East Asian Economic Caucus (EAEC). We will show that while the Japanese government was strongly supporting the former concept until the start of the Asian economic crisis, the situation has changed somewhat since the crisis ended. Currently, we will argue, Japanese political and economic decision makers rather favor the smaller-scale Asia-only concept of regional cooperation.

4.1 Japan's role until 1997

The APEC process has undoubtedly been the most visible and important development of regional cooperation in Asia since the late 1980s and the end of the Cold War. Within this process, Japan has played a very distinctive and often influential role shaped and characterized by its general interests, dilemmas and approaches toward regional cooperation. Who were the decisive actors? What were Japanese motivations and objectives for APEC? Which strategies were adopted and what action was taken? Finally, what was Japan's impact on APEC? By answering these questions, we will also encounter the many faces of Japan in the process of regional cooperation that interpose Japan between action and reaction, and direct and indirect leadership.

Probably the clearest phase in this concern was that leading to the start of APEC. Based on the findings of its so-called Sakamoto Report, MITI started in August 1988 to discuss strategies for economic cooperation in the Asia-Pacific region with Australian trade officials. As highly trade-dependent countries lacking membership in any trade bloc, both sides feared the division of the world economy into competing regional blocs and thus shared the same interest for the creation of an Asia-Pacific economic forum. MITI willingly let Australia take public leadership until the inauguration of APEC and beyond while it worked efficiently behind the scenes canvassing support for the initiative in general and for the inclusion of the US in particular. This turned out to be comparatively easy because all countries involved shared the common interest of closer cooperation on a regional scale, though each for different reasons. Within Japan, however, MITI faced stiff resistance by the Ministry of Foreign Affairs (MOFA) that felt MITI intruded on to its home turf, foreign policy. As stated above, it was only when former MITI minister Mitsuoka became foreign minister in June 1989 that it was possible to break this domestic opposition (on the process leading to APEC, see Funabashi 1995, 55–69).

Looking at the successful inauguration of APEC in November 1989, Japan's (or more accurately MITI's) policy up to that time had shown nothing less than vision, strong action and effective leadership, though in an indirect way or to use the term of Rix (1993) as 'leadership from behind'. Since then however, any clear judgement on Japan's role within APEC has become more difficult. The main reasons for this are the above-mentioned domain conflicts between various Japanese government ministries, competition between and within political parties (factionalism), and also differences of interests between various actors within the economic sector. Thus, from the start, Japan's stance toward and within the APEC process has become the outcome of various conflicting objectives. Numerous resulting conflicts prevented the emergence and implementation of one overall clear-cut strategy, but did not hinder Japan to exert strong influence at several steps along the way of APEC.

The potential for internal conflicts is best illustrated by the extensive Japanese agenda for APEC (for the following see Funabashi 1995, 195–202; Pascha 1999). The main objectives until today are

- to ensure US security presence in the region,
- to elevate Japan's status to that of a global political power in the long run,
- to strengthen political and economic ties with ASEAN while reducing fears about Japan as a hegemon,
- to engage China to contain its ambitions for regional supremacy but also to get access to its huge markets,
- to ease bilateral trade tensions with the US,
- to secure liberalized world markets and work against the emergence of trade blocs in Europe and North America, and
- to support established Japanese business in Asia.

The first important point to note is the explicit concerns in the area of foreign policy. These concerns offer a permanent source of conflict as they might clash with economic interests. The most far-reaching aspect is probably the question of US inclusion into the regional agreement which appears as a must from Japan's political point of view but which might run against the particular interests of the economic sector (we will refer to this point in more detail below). But even neglecting conflicts over objectives or strategies, the mere combination of political and economic interests almost automatically leads to collisions between the two most important actors, MITI and MOFA. This rivalry was not only obvious during the period prior to the start of APEC, but also in the years leading to the 1993 Seattle meeting. Only when President Clinton took the initiative to upgrade the annual summit to a real leader's meeting involving all presidents and premiers, MOFA felt adequately involved and gave up its

initial resistance (Pascha 1999; Hirata, Okamoto and Ōgita 1996). The general rivalry between both ministries, however, continues and is far from being solved.

The second area of diverging interests and potential disunity lies in the economic sphere itself. Problems here are diverse as they relate to different industries and actors. But basically they all boil down to one point, the Japanese position in the debate over 'liberalization versus cooperation' (Funabashi 1995, 119), which are the two pillars stressed as APEC's main objectives in the 1994 Bogor Declaration. While industrialized countries tend to see APEC mainly as a vehicle to push trade liberalization, most developing countries are skeptical about their chances in a fully liberalized environment. Hence they prefer to use APEC to press developed countries for cooperative measures (*e.g.* technology transfer, technical assistance, human resources development) in exchange for trade concessions. Within this 'North-South' dispute, Japan's position has been far from one typically associated with a clear member of the North camp of industrialized countries. Instead, Japan has preferred to present itself as a mediator between the developing economies of Asia on the one hand and the camp of those favoring fast liberalization led by the US on the other. As one example for such a bridging function, Japanese officials point to the 1994 launch of the Partnership for Progress (PPF) program. This Japanese initiative aims at the longterm strengthening of weaker APEC economies by support measures of stronger countries mainly in the area of human resources development.

At the same time, Japan has been one of the strongest proponents of an open multilateral trading system, rejecting any bilateral trade agreements and pledging full support for the trade and investment liberalization as agreed upon in Bogor 1994. As a highly trade dependent economy, such a liberal attitude might be expected from Japan, especially with regard to the markets in Asia which overtook North America as Japan's No. 1 export region in 1991. Another pro-liberalization force has grown constantly within MITI. Hereby we refer to the sections dealing with cross-industry issues that are often in favor of deregulation (Pascha 1999, 13).

De facto however, the Japanese government has always displayed a very negative stance toward liberalization in APEC, at least in the US sense of a rapid legalistic lowering of trade barriers. Despite, or perhaps more accurately by, making a strong pledge to the concept of 'open regionalism' (Garnaut 1996) with an unconditional and non-discriminative liberalization approach, it avoided being forced into real commitments any open regionalism approach struggles may generate. By exerting a strong influence before and at the Osaka 1995 Summit, it made this attitude very clear. Having fervently lobbied behind the scenes prior to the

summit, Japanese actors successfully collected support for their stance against the US position. This US government had demanded a strict and collective rules-based approach to commit the region to trade liberalization by fixed dates. However, instead, Japan presented a so-called flexible approach based on unilateral voluntary liberalization which was finally accepted to become the Osaka Action Agenda (Moffett 1995, 14; Ching 1995, 48). In the years to follow, the no-commitment character of exactly this agenda should effectively prevent any tangible liberalization progress and thus should suit Japanese interests perfectly.

However, we would be mistaken to assume the outcome of Ōsaka to be the result of one clear Japanese strategy. Rather, we can identify different interests within the Japanese political elite running against a liberalization course in at least three main areas. The first comes with agricultural policy in general and the protectionist stance against the liberalization of rice imports in particular. The fears of any Japanese government and especially the LDP to alienate the still powerful rural electorate and its lobbying forces are well-known and need no further explanation here.

A second group comprises Japanese multinational corporations (MNCs) that are already highly involved in business activities in Asia. As early starters in the region, they enjoy strong first-mover and insider advantages in these countries (for the automobile industry see Legewie in this volume). But as most Japanese firms lag behind their Western competitors in the globalization of their activities outside of the region, the majority still oppose full-fledged liberalization fearing to lose from international competition on an equal playing-field (Legewie and Meyer-Ohle 2000).

This defensive argument holds strongly on the micro-level. But it also has to be applied to the macro-level where it constitutes a third area of Japanese interest against fast trade liberalization in Asia. It relates to the discussion whether rapid trade and investment liberalization helps or threatens the economic development of developing countries in the long run. Regardless of the answer to this question, Japan – as an Asian country – is clearly more in need of strong neighboring economies than, for example, the US. This holds true for the best-case scenario of a free world trade regime but in particular for any kind of bloc scenario in which geographical proximity even counts more. Thus, the Japanese emphasis on supporting and cooperative over liberalization measures for its neighbors does not only represent the short-term interests of single actors. It also stands for an overall country interest regardless whether concrete cooperation measures tend to favor Japanese companies (which they often do) or not.

Summing up Japan's role in APEC until the Asian economic and financial crisis, we return to the questions for the main actors, objectives,

strategies and impact. Within our brief review, we have encountered numerous political and business actors with diverging interests often standing in direct conflict to each other. The Japanese position displayed at the APEC level has thus turned out to be the product of compromise. Put in other terms, it has been a negative selection of competing views and visions that reduced concrete action to the smallest common denominator achievable under various domestic constraints. While this might sound like a trivial or disappointing finding, it had huge implications for Japan, the APEC process and regional cooperation in Asia in general. While the world economy was kept open and the US politically and economically engaged in the region, the Japanese government succeeded to use APEC as a vehicle to serve its basic economic interests. It managed to reduce bilateral trade tensions, while at the same time it succeeded to avoid a more forceful execution of the much stricter framework of GATT. Undoubtedly, the APEC process until 1997 strengthened Asia-Pacific regionalism and regional cooperation to a certain extent. But probably more importantly, it brought together Asian actors that had been much further apart from each other before November 1989.

The mainstream in the Japanese foreign policy establishment thus clearly supported an Asia-Pacific identity that centered around APEC and that prominently involved the US. The Japanese government therefore reacted outright negatively at first, then rather evasively, to the concept of an Asian only regional identity, as it was expressed in the proposal by Malaysian Prime Minister Mahathir Mohamad, to form an East Asian Economic Caucus. This grouping was supposed to include only the ASEAN member states, China, South Korea, and Japan (for details on Malaysia's position and motives, see Kimura in this volume). Some MITI officials signaled interest in the first initial stages of the proposal, and there certainly also was support from some parts of MOFA since the former Japanese minister of foreign affairs, Okita Saburō, was actively involved in the drafting of the proposal as Mahathir's friend and advisor. The official response by the Japanese government to the EAEC was, however, outright negative. The main reason for this can be seen in the strong opposition the plan received from the US, but also in the views held by the Japanese foreign policy establishment in support of free trade and in opposition to the formation of any kind of trade bloc. After ASEAN adopted the idea of installing the EAEC as a council working within the APEC framework, the official Japanese government position changed from outright opposition to non-committal statements (for details, see Blechinger in this volume). Some parts of the Japanese political elite were ready to flirt with the more narrow concept of regionalism, however, the majority of decision makers believed in the inclusion of the US as the better choice and supported the

Asia-Pacific model of regional identity. We will see in the next paragraph, however, that the perspectives changed in the wake of the Asian economic crisis of 1997/98.

4.2 Japan's role since the Asian crisis 1997

Two and a half years after the floating of the Thai baht in July 1997 and the start of the Asian economic and financial crisis, it has become obvious that this crisis will have a lasting impact on the process of regional cooperation in Asia. This comes as no surprise as any regional 'crisis fosters reexamination' (Pempel 1999, 224) and makes 'tighter regional organization a desirable commitment mechanism' (Haggard 1997, 46). The two main effects are an increased interest of Asian state and non-state actors to engage in regional integration and a trend toward executing such cooperation efforts more within Asia than within the wider Asia-Pacific region. While both statements refer to the general recent trend in Asia to become more inward-looking after the shock of the crisis subsided, they also describe the Japanese position toward regional cooperation. To illustrate this, we will review in more detail Japan's reactions toward the Asian economic crisis. We will also point to areas that are not related directly to the crisis, but in which Japanese actors recently have been exerting a distinct influence on the process of regional cooperation.

Japan was not directly hit by the crisis and did not suffer under strong currency fluctuations, short-term debt problems and rapid contractions of economic output like Thailand, Indonesia, South Korea, or Malaysia. However, the crisis painfully demonstrated that the strong economic interdependence built up between Japan and other Asian economies since the 1980s has made Japan vulnerable to any instability and weakness of its Asian neighbors. Japanese exports to Asia, whose share of total Japanese exports had grown from 25% in the mid 1980s to more than 44% in 1996 (Sōmuchō Tōkeikyoku 1999), plunged sharply contributing to the Japanese recession in 1998. At the same time, Japanese firms and their regional production networks suffered strongly from the turmoil and reduced regional economic activity (see the articles by Tejima and Legewie in this volume).

As the only Asian nation and the most affected economy among the G 8 group of states, it is not astonishing that Japan was quick to react to the crisis. More as a surprise came the Japanese proposal for an Asian Monetary Fund (AMF), a multilateral revolving facility of US\$ 100 billion drawn from the combined reserves of Japan, China, Hong Kong, Taiwan, Singapore, and other Asian nations. This far-reaching proposal presented an unexpected step in regional leadership by the Japanese government. It

clearly aimed at altering the economic policy framework in Asia by creating the first Asia-only institution within the US dominated global financial architecture. In October 1997, after months of quiet lobbying within Asian diplomatic circles, Japan presented the AMF idea to the public at the IMF (International Monetary Fund) and World Bank meeting in Hong Kong. Japan had dared take this step after interpreting the absence of the US from the IMF rescue package for Thailand as a signal that such an initiative would be tolerated (see also Yasutomo in this volume; on the original AMF proposal see, for example, Shinohara 1999 or Mathews and Weiss 1999).

But that expectation turned out to be only wishful thinking. The IMF and the US Treasury briskly refused the AMF proposal. They accused it to be a mere duplication of IMF functions that would only enhance 'moral hazards' by its relative absence of conditionality for loans. Obviously, there was some economic reasoning for this argument. However, the outright opposition of the 'Washington consensus' to the AMF was also fueled by fears of a Japan-led threat to the supremacy of the US dollar in Asia and the general US dominance in international finance (Legewie 1999, 28). As a result, by the end of 1997, Japan had backed down on its proposal.

However, Japan did not deny financial support to crisis-hit Asian economies. As Hirono and Daquila describe in this volume, Japan provided by far the largest sum of money of all donors adding up to more than US\$ 73 billion at the end of 1998. It did so by various multilateral and bilateral schemes and programs that range from its participation in the IMF rescue packages for Thailand, Indonesia and Korea and special ODA loans, over export credits and humanitarian aid to the US\$ 30 billion pledged as bilateral help by the so-called Miyazawa Initiative. All these support measures simultaneously served different political and economic actors with various objectives and were thus easily generated by the Japanese system despite the deep financial problems within Japan itself at that time. Speaking in terms of the three main ministries, MOFA was glad to polish the Japanese image in Asia, MITI welcomed the opportunity to hand out direct and indirect support to Japanese firms suffering from the effects of the crisis in the region, and MOF under Finance Minister Miyazawa happily took the initiative to extend its influence in Asia and international finance (see Sender 1999; Furukawa 1998).

The Miyazawa Initiative of the MOF is by far the most interesting and telling of all mentioned support measures for a number of reasons. After the brisk dismissal of the AMF in 1997, a year later this initiative bore the clear intention to reclaim the initiative in Asian financial cooperation as it also called for consideration of an international institution for Asia offer-

ing financial guarantees (Furukawa 1998, 1). Although the Miyazawa initiative threatened to usurp some authority from the IMF, this time the Japanese proposal was not blocked by the US, the IMF, or the World Bank. These former opponents had meanwhile turned their focus to the financial crisis in Brazil while the IMF had come under additional pressure for its dealing with the Asian crisis. This meant an opportune time for the MOF that succeeded in presenting the package to cash-stripped Asian countries as an substitute for the original AMF by referring to it as the 'New Miyazawa Initiative'. Parallel to its calls for closer regional financial cooperation, Japan also became the most outspoken proponent among industrialized countries for stronger control mechanisms of international capital flows.

On a theoretical level, the financial crisis and growing concerns for regulation needs have given the 'liberalization versus cooperation' debate for Asia an important new turn. In contrast to the area of trade – where Japan stands somewhere in between 'North' and 'South', liberalization and protectionism – Japan clearly belongs to the group of Asian economies with regard to international finance. While it is leading the US in regional manufacturing (but lagging behind globally), in finance, it is trailing the US even in Asia. The region never developed to a yen-bloc but remained clearly under the predominance of the US dollar (Frankel 1993; Kwan 1999; Gyohten 2000). Hence, one might argue that the vulnerability of Asia and Japan exposed by the financial turmoil of the crisis has catapulted Japanese interests into an Asia-only camp brought together by the joint interest for more regulation and cooperation and the eventual opposition to the US, the US dollar and the call for ultimate liberalization of capital flows.

The Japanese interest in the internationalization – or at least the 'Asianization' – of the yen and the Tōkyō financial center is by no means a new or altruistic one as neither is its interest in a closer regional cooperation of financial affairs (Gyohten 2000). Already in 1991, Japan had launched the so-called Executive Meeting of East Asia and Pacific Central Banks (EMEAP) that deliberately excluded the US (see Pascha in this volume), but this and other similar initiatives never went very far. However now, closer regional cooperation in the financial sector appears that it will become an eventual venue for stronger regional cooperation and institutions in the context of 'Asian 10' or 'ASEAN plus three' (see Estanislao in this volume). While skepticism toward any regional financial institutions is still strong for a number of practical but also theoretical deliberations (see Pascha in this volume), the recent development suggests at least the possibility of spill-over effects for a closer regional cooperation in general. By this we refer to the noteworthy fact that the recent 'ASEAN plus three'

meetings have started from discussions of financial matters and meetings of finance ministers. By November 1999 and the last informal ASEAN summit, they had developed for the first time to a meeting involving all three political leaders of Japan, Korea and China.

Indirectly, the Asian crisis has also influenced the further development within the APEC framework. APEC has clearly lost most of its influence in the regional cooperation process in the aftermath of the crisis. Not prepared to deal with financial matters that stood at the center of regional cooperation efforts, APEC's focus on trade and investment liberalization made it badly equipped to stay on course amidst rising calls against the forces of globalization and for protectionism and regulation. At the Kuala Lumpur summit in November 1998, Japan dealt APEC a fatal stroke when it refused to move on demands for import tariff cuts on fish and forestry products. These cuts had been demanded under the first early voluntary sectoral liberalization (EVSL) package of nine sectors in total which had been selected for early liberalization a year before at the Vancouver meeting.

Most observers simply explained the Japanese government's refusal to liberalize these sectors with the infamous argument of the strong agricultural lobbying force in Japan (see, for example, Hiebert and Crispin 1998, 21). However, such a monocausal argument must be seriously questioned. Rather, one has to take into account the far-reaching consequences for other interest groups if such a liberalization step like the first EVSL package had gone through. It would have been nothing else than the precedence for the collective liberalization approach favored by the US. Thus, it would have set the pace for further liberalization steps and troubles in other sectors as well. One example is the Japanese automobile industry – already agreed upon for the second EVSL package in Vancouver – that strongly opposes a trade liberalization process for Southeast Asia orchestrated by APEC (see Legewie in this volume). A similar opposition attitude can also be assumed for other Asian nations that silently supported the Japanese position.

A change in the official Japanese position toward liberalization could also be noticed in the process leading up to the selection of the new head of the WTO. Japan clearly supported the Thai candidate Supachai Panitchpakdi over Michael Moore of New Zealand who was the favorite of the 'liberalization' camp led by the US. Once again the Japanese government representatives closed ranks with Asian nations preferring Supachai, who is generally regarded as a representative of developing economies' interest and who takes a more careful approach to liberalization than his New Zealand counterpart Moore. The eventual decision to have both serve half terms can even be interpreted as a partial success for Japan

that resists liberalization on the WTO level and thus on the global scale. The fact that Supachai will succeed Moore even gained in significance, at least symbolically, after the failure of the WTO talks in Seattle in December 1999. Hence, for the time being, Japan seems 'safe from liberalization pressure' on both the wider Asia-Pacific (APEC) and the global (WTO) levels.

While the APEC process and with it the Japanese mainstream political elite's preference for an Asia-Pacific model of regional cooperation seems to lie in shambles for the present, the concept of an Asia-only region seems to grow on an increasing number of decision makers in the Japanese foreign policy establishment. With the regular meetings of the 'ASEAN plus three' group of states which started in December 1997 and whose membership is identical to the EAEC, the grouping *de facto* came together without making explicit reference to the ideological context of the original proposal. Within this group, the Japanese government plays an active role in agenda setting. The Japanese support projects for troubled Asian economies that were summarized and further extended in Manila in November 1999 clearly underline the Japanese claim for a leadership role that is equivalent to Japan's economic position in the region (MOFA 1999; see also Blechinger in this volume).

The arguments made above suggest a turn of the economic and political preferences within the Japanese political leadership from the Asia-Pacific model to an Asia-only concept, presenting both regional identities as 'either-or' alternatives for cooperation efforts. The recent willingness of Japan to consider bilateral trade pacts as cooperation options, however, shows a new and total different policy approach as it does not favor *per se* either Asia-Pacific or Asia. Currently, such bilateral free-trade agreements are under study for Korea, Singapore and Mexico. This new thinking, promoted by MITI and JETRO, is labeled as 'multi-layered', meaning that both bilateral and regional free-trade pacts are regarded important to complement the multinational free-trade scheme of the WTO. It also signals an important turn in Japan's stance that so far had always stressed multilateral trade arrangements (Shimizu 2000; Yamamoto and Ng 1999).

While this new policy can be seen as based on a rational decision amid the current stand-still in regional (APEC) and global trade liberalization, one might also argue that at least some groups within the Japanese policy making elite consider these bilateral pacts as a back-door entrance and intermediate move toward an Asia-only free-trade agreement. Thus, this new development toward bilateral free-trade pacts can also be regarded as an important first step toward the implementation of the 'concentric circles' concept as suggested by Estanislao. This model describes the regional cooperation process in terms of waves, emanating from various

agreements – bilateral, subregional, regional, global – with each being linked but at the same time autonomous (Funabashi 1995, 129). Distant as this may sound today, such a development appears not totally unrealistic as other Asian economies like China and Korea also lack membership in any regional trade pact other than APEC and thus present interested and suitable partners. This applies not only for a closer bilateral trade relationship between Japan and Asian countries but also for the future relationship among other Asian countries themselves as shown by the recent bilateral free-trade talks between Thailand and India.

5 CONCLUSION

Summing up and evaluating the findings above, two main conclusions can be drawn.

First, it has become obvious that regional cooperation in Asia continues and indeed is intensifying. This is especially true for the period after the Asian economic and financial crisis that painfully illustrated to the states in the region and beyond how far economic interdependence in Asia has already become a reality. The crisis has strengthened the feeling of regional identity among the Asian states, brought Asian countries closer together, and made them more keen to initiate communal structures that will help to prevent similar situations in the future. Such moves have been further stimulated and supported by anti-globalization and anti-liberalization movements within various countries of the region. The influence of such movements could last be seen at the 1999 Seattle WTO meeting whose breakdown led to a stand-still of further trade liberalization. However, any desire for a regional solution for problems brought about by globalization and trade liberalization is constrained by severe problems. The definition of common interests and goals did not resolve conflicts of interest and conflicts stemming from different and often contradictory strategies of governments and business within the various Asian countries. This closer cooperation in Asia is not as much a consequence of a newly achieved unity over the issue of what the majority of Asian governments and private sector interest groups agree on, but rather the outcome of a negative reaction to the demands raised toward Asian countries from outside the region.

Second, within this process of closer regional cooperation in Asia, both state and non-state actors from Japan play a distinctive and influential role. Japanese government representatives and big business can be regarded as exerting leadership in the region. This leadership, however, is not pro-active in a sense that Japanese political or economic leaders publicly engage in agenda-setting and pushing for the implementation of

goals defined by Japan. As the APEC process has shown, Japanese actors are rather following the concept of 'leading from behind' (see the article by Calder in this volume), engaging in behind-the-scenes mediation and acting as speakers for Asian interests on the international level. The political and economic mainstream in Japan has been supporting and promoting closer regional cooperation. However, until 1997, such activities were clearly defined in an Asia-Pacific context that involved the US and that was centered around APEC.

The reason for this behavior was not only the fear of friction with Japan's most important ally, the US, which strongly resented any regional frameworks without its active participation. It also resulted from the fact that a focus on a regional concept along the lines of an Asia-Pacific framework also was what the various competing political and economic actors within Japan could best compromise on. To mention only two of the groups involved in this decision making process, the closer cooperation within the Asia-Pacific region, involving the US, did not only come closest to the agenda of Japan's traditional foreign policy elites in MOFA who wanted to continue the basic policy lines of Japan's postwar foreign policy. It also suited the interests of big multinational firms that needed Asia as a production site, and in addition needed close relations to the US as Japan's most important single market.

After the crisis, the compromise between Japan's foreign policy and economic elites rather shifted toward an outspoken commitment to the Asian region. Not only were Japanese domestic political and economic actors trying to save and support their own clients whose investments in the region had suffered severe damage in the wake of the crisis, but these motives dovetailed nicely with the expectations of their Asian counterparts. Negative experiences with international organizations involving and often dominated by the US have made Asian political leaders turn to Japan for support and have thus lessened concerns that made some of them speak out against a strong Japanese leadership role in Asia.

For the future, two developments can be expected. First, the process of political and economic cooperation and integration in Asia will continue and will become of more central importance for Japanese foreign policy than before. However, due to security and other constraints, this process will not lead to the same institutionalization as we have, for example, in Europe or in North America. Second, Japan will stay in the center of this process and will play an important leading role. However, it will fulfill this role not as a rival, but as a partner to the US which will keep its important position in the region. Japanese political leaders will continue to strive to keep the US involved in Asia to counterbalance the increasing importance and hegemonic ambitions of China, and to consult and coor-

dinate policies toward new actors coming up at the fringes of the region such as India. With the breakdown of levels of governance after the end of the Cold War and the higher amount of freedom for domestic actors to pursue their own international agendas, official Japanese foreign policy activities will be more and more supplemented by non-state actor activities. However, the distinctive pattern of compromise and the search for the smallest common denominator between political and economic domestic actors within Japan as the leitmotiv of foreign policy making will stay intact and will further shape the distinctive pattern of action and reaction, direct and indirect leadership in Japan's relations with Asia.

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