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PACIFIC BASIN ECONOMIC RELATIONS: JAPAN'S NEW ROLE?

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I. INTRODUCTION

THERE has been a steady increase in interest on both sides of the Pacific in the past few years in economic developments and interactions in the Pacific Basin. In the United States, the importance of the Pacific Basin region has come to be fully appreciated as the weight of the region in the global economy has steadily increased and as economic relations between the United States and the region rapidly expanded. In Japan, the concept of Pacific Basin regionalism, which had been promoted by private groups for more than a decade, was given an official endorsement in 1980 and now constitutes one of the central pillars of its external policy. The Association of South East Asian Nations (ASEAN) seems to have changed its attitude toward Pacific Basin regionalism from an initial skeptical position to a more positive one, as expressed at the ASEAN ministerial meeting in 1984.

The countries in the region are at different levels of economic development and are characterized by various levels of natural resource endowment and factors of production. There have emerged certain patterns of economic relations, both complementary and competitive, within the region, presenting some areas for cooperation but sometimes generating friction and conflict at the same time.

The Pacific Basin is, of course, first and foremost a geographical concept.[1] Recently, however, it has come to take on an added significance in the context of global economic relations as more attention is paid to the possible formation of regional organizations or, failing that, some kind of regional cooperation. And yet, it is still premature to treat the Pacific Basin as a meaningful functional region. As discussed in the following sections, there are certain intra-regional economic trends and global developments that could lead to mutual agreements on trade and investment on a regional basis, but even under those circumstances, it seems highly unlikely that the Pacific Basin would turn into an economic union like the European Community (EC). That prospect leaves us with the question of the need at present for a regional mechanism for policy coordination

[1] This paper covers, as Pacific Basin countries, the group of advanced countries (the United States, Japan, Canada, Australia, and New Zealand); the Asian NICs (Singapore, Hong Kong, Taiwan, and the Republic of Korea); the "ASEAN 4" (Malaysia, Thailand, the Philippines, and Indonesia); and China. Mention of the Pacific Basin will be made frequently in reference to certain different subsets of the above list as the case may be. What it refers to should be clear from the context on each occasion.

and conflict resolution. Could or should such matters be properly handled in bilateral and/or global multilateral consultations? Or could there develop a gap that would have to be filled through regional arrangements? What are the political implications of future economic developments in the region? These are the questions to be addressed in this paper.

II. PATTERNS OF GROWTH IN THE PACIFIC BASIN

The countries in the Pacific Basin region are classified into groups according to per capita income level, natural resource endowment and factors of production (Tables I and II). The United States and Japan each constitute a unique category, both countries holding leading positions in the development and application of advanced technology. While the United States is endowed with fertile soil and energy resources (with 30 per cent of its exports consisting of primary products), Japan is extremely resource-poor and virtually all of its exports are manufactured goods. Canada, Australia, and New Zealand form another group characterized by favorable natural resources endowment and a high level of per capita income. Asian NICs are characterized by a middle position in per capita income and heavy concentration of exports in manufactured goods (with the partial exception of Singapore which serves as an entrepôt for other ASEAN countries' primary exports). The ASEAN 4 stand at a lower level of per capita income than the Asian NICs, with their exports still predominantly consisting of primary products. China forms a unique category both in terms of low per capita income and its large population. It is endowed with a vast labor force and is increasingly active in promoting labor-intensive exports.

Within the Pacific Basin region, there has emerged a rather clear contrast in growth performance over the past quarter century: the countries in Asia have outperformed the others in the Pacific Basin by a decisive margin. Focusing on the pattern and mechanism of the high rates of growth in the Asia-Pacific subregion, it is clear that the economies in the subregion have attained higher rates of growth not only compared to other countries in the Pacific Basin, but also relative to the average growth rates for the respective income groups to which they belong (Table I). Japan's growth rate has been half its previous high of more than 10 per cent per annum since the first oil shock in the mid-seventies, but still remains higher than the average of the developed country group. The developing countries in the Asia-Pacific region have sustained high rates of economic growth over the past quarter century and have emerged as the most dynamic group in the world economy. Growth performance has been most striking for the Asian NICs, with their per capita GNP doubling in each decade. The ASEAN 4, with the exception of the Philippines, have also registered respectable growth rates significantly higher than that of the middle-income group average. China has emerged as a growth-oriented economy with ambitious plans for modernization and recorded a rate of economic growth much higher than the low-income country group average, achieving an annual average rate of 9 per cent during the first half of the 1980s.

In identifying common factors behind the superior growth performance of

TABLE I

PACIFIC BASIN COUNTRIES: MAIN STATISTICAL INDICATORS

Country	1983 Population (Million)	1983 GDP (U.S. $ Billion)	1983 GNP per Capita (U.S. $)	Growth Rate, 1965-83			Share of GDP, 1983				
				Population	GNP	GNP per Capita	Mfg.	Exports (G&S)	GDS	NCI	GDI
U.S.	234.5	3,278	14,110	1.1	2.7	1.6	21	8	15	2	17
Japan	119.3	1,063	10,120	1.1	6.4	5.3	24	14	30	−2	28
Canada	24.9	324	12,310	1.3	3.7	2.4	16	26	22	−3	19
Australia	15.4	167	11,490	1.6	3.6	2.1	—	15	20	1	21
New Zealand	3.2	24	7,730	1.1	2.2	1.1	23	31	25	1	26
Singapore	2.5	17	6,620	1.6	10.3	7.4	24	176	42	3	45
Hong Kong	5.3	28	6,000	2.3	8.7	6.2	22	95	25	2	27
Taiwan	18.7	46	2,680	2.0	8.9	6.7	34	55	32	−9	23
Korea	40.0	77	2,010	1.9	8.6	6.7	27	37	26	1	27
Malaysia	14.9	29	1,860	2.5	7.1	4.5	19	54	29	5	34
Thailand	49.2	40	820	2.6	7.4	4.3	19	22	18	5	23
Philippines	52.1	35	760	2.8	5.4	2.9	25	20	21	7	28
Indonesia	155.7	78	560	2.2	7.5	5.0	13	25	20	4	24
China	1,019.1	275	300	2.1	6.7	4.4	—	9	31	−1	30
Developed countries	728.9	—	11,060	0.9	3.4	2.5	24	18	20	0	20
Developing countries:											
middle-income	1,165.2	—	1,310	2.5	5.8	3.4	21	24	21	1	22
low-income	2,335.4	—	260	2.3	5.3	2.7	14	9	—	—	22

Source: World Bank, *World Development Report, 1985* (Washington, D.C.: World Bank, 1985). For Taiwan, *Statistical Yearbook of the Republic of China, 1984* (Taipei: Executive Yuan, Republic of China, 1984).

Note: GDS=gross domestic saving,
NCI=net capital inflow (=current account deficit),
GDI=gross domestic investment (=GDS+NCI).

TABLE II

COMPOSITION OF MERCHANDISE EXPORTS, 1982

(%)

Country	Primary (Exc. Fuels)	Fuels	Manufacturing	Of Which: Textiles & Clothing	Machinery & Transp. Equip.	Other Mfg.	Export Volume Growth Rate, 1965–83
U.S.	21	9	70	2	44	24	4.8
Japan	2	1	97	4	56	36	10.0
Canada	22	24	54	1	32	21	6.5
Australia	41	37	22	1	5	16	6.0
New Zealand	71	5	24	2	8	14	5.2
Singapore	13	30	56	4	26	28	10.3
Hong Kong	6	2	92	34	19	39	11.5
Taiwan	6	0	94	30	31	33	17.3
Korea	7	1	92	21	28	43	23.2
Malaysia	42	35	23	3	15	5	6.5
Thailand	64	7	29	10	6	13	8.0
Philippines	38	12	50	7	3	39	5.9
Indonesia	11	85	4	1	1	2	6.2
China	20	26	54	15	6	34	—
Developed countries	14	12	74	4	37	32	6.7
Developing countries:							
middle-income	21	37	42	8	11	23	2.8
low-income	50	20	30	18	5	8	1.2

Sources: World Bank, *World Development Report 1985* (Washington, D.C.: World Bank, 1985); For Taiwan, *Statistical Yearbook of the Republic of China, 1984* (Taipei: Executive Yuan, Republic of China, 1984).

the subregion, two notable features emerge. First, the ratio of exports to GDP tends to be high (with Japan as a notable exception); secondly, the ratio of investment to GNP also tends to be high. These ratios have exhibited an upward trend (again with the exception of Japan, whose investment ratio declined in the 1970s), extending into the 1980s in many cases. What is characteristic of the Asia-Pacific developing economies is the coexistence of high export and investment ratios and the parallel rise in both ratios over time. (This characteristic does not apply to Japan, although some aspects of the mechanism of high growth seem to be relevant for Japan, as will be discussed shortly.)

The pattern of economic growth identified in the preceding paragraphs suggests a hypothesis concerning the mechanism of high growth in the Asia Pacific subregion.[2] The rapid growth of the Pacific Basin economies has been realized through a virtuous circle between export growth and increased investment, with the causality running in both directions and thereby generating successive waves of export booms and investment spurts. Economic growth is export-led in the sense that the expansion of exports opens up new investment opportunities. Investment opportunities arise not only in export industries themselves but also in other branches of economic activities to which export industries are connected, either through input-output linkages or income-multiplier channels. Economic growth is export-supported to the extent that export expansion alleviates the balance of payments constraint on the growth of investment by increasing foreign exchange earnings and improving the country's borrowing capacity in international financial markets.

Economic growth is investment-led to the extent that investment activities expand and diversify productive capacities and bring about improved productivity, leading in turn to stronger international competitiveness. One important source of investment opportunities is the possibility of technology transfer to improve productivity in an existing industry or to start up a new one. Technological backwardness, therefore, could be considered as a potential incentive to investment on the supply side.

Any understanding of rapid growth is incomplete, however, if interactions between export expansion and investment growth are not fully articulated. Export expansion is as much a result of supply-side conditions as it is due to world demand situations. In fact, given the global trade environment, differential export performances are accounted for solely by supply-side factors. Sustained export growth is typically achieved through the diversification of the composition of goods and services exported, which is brought about through changes in the direction of investment. On the other hand, if investment is efficient, resulting

[2] For additional and alternative viewpoints on the mechanism of Asian growth; see a masterly review and interpretation of the evidence by Ronald Findlay, "Trade and Development: Theory and Asian Experience," *Asian Development Review,* Vol. 2, No. 2 (1984). Also consult James Riedel, "Economic Development in East Asia: Doing What Comes Naturally?" mimeographed, School of Advanced Institute of International Studies, Johns Hopkins University (1985), for a broader but no less incisive review of East Asian experiences.

productive activities will bring about increased competitiveness leading over time to export expansion.

Articulation of the hypothesis concerning the virtuous circle between exports and investment points to the need to distinguish countries in the Asia Pacific subregion in terms of the nature of their export growth. As has been already touched upon, there is a significant difference in the composition of exports between Japan and the Asian NICs on the one hand and the ASEAN 4 on the other—the share of manufactured exports is much higher in the former group than in the latter. This difference corresponds to an equally clear contrast in the growth rate of the volume of exports: the rates are double-digit for Japan and the Asian NICs, distinctly higher than the ASEAN 4 rates.

It seems that the virtuous circle hypothesis applies much more to Japan and the Asian NICs than to the ASEAN 4. Japan and the Asian NICs may be characterized as the most efficient producers in a wide range of manufactured products. Japan's competitive strength lies in "high-tech" and "mid-tech" areas that require efficient organization of complex manufacturing systems, where accumulation of technical and managerial know-how, scale economies, and quality improvement through intra- and inter-firm coordination are critical factors in international competitiveness. The Asian NICs' competitive edge consists of a broad range of standardized product categories in which the cost and quality of the labor force is a dominant factor in international competition. They have sustained high rates of export growth through the successive upgrading of the composition of their manufactured exports toward more skill-intensive and technology-intensive products.

It is true that the ASEAN 4 have recorded high rates of growth in manufactured exports in the 1970s and 1980s. It is also true, however, that their manufactured exports are dominated by specialized processing and assembly activities employing unskilled labor (typically in clothing and electronics) while domestic market-oriented industries remain protected and often highly inefficient. Under the current prolonged commodity slump, the ASEAN 4 face a serious task of structural adjustment to resume a momentum of growth through efficiency-oriented industrialization.

China faces a similar but more fundamental task of structural adjustment in the present program of economic reform and modernization, insofar as the realignment of the domestic price structure with international prices necessitates a total reorientation of national economic management. In fact, China's export performance in the recent past has been spectacular, recording a real growth rate equal to that of the Republic of Korea (albeit starting from a small base in the early 1970s). In view of lower-than-expected prospects for energy exports, it seems certain that China will further strengthen its efforts to expand manufactured exports by adopting pragmatic policies in trade and foreign investment.

III. EMERGING TRENDS IN TRADE AND INVESTMENT

The pattern of growth identified in the preceeding section has been shaped in the context of international economic interactions and in turn will influence the future evolution of economic relations within the Pacific Basin and the global economy. In this section we will discuss competitive and cooperative relationships within the Pacific Basin with a focus on the two leading economic powers, the United States and Japan.

Major private business concerns in the Pacific Basin region have become increasingly more globally-oriented in mapping out their strategies for procurement, production and marketing. Japanese private businesses have lagged behind their U.S. (and European) counterparts regarding a strategic commitment to the globalization of corporate structure, but recently they also have expanded the scope of their international activities from marketing to production. This trend is reflected in an increased proportion of foreign direct investment for local production rather than for marketing and servicing of exported products. The switch to local production was initially adopted as a defensive measure aimed at maintaining the market share in foreign markets under increasing restrictions on export sales. Over time, however, local production has come to be viewed in a more positive light as an essential aspect of internationalization. Major Japanese corporations are increasingly more confident of their competitive advantages over their rivals overseas, not only in the application of production technology and quality control but also in the development of new techniques and products. The strengthening of the competitive position of Japanese enterprises first in production and marketing and subsequently in R&D has eroded the U.S. (and European) dominance in many subsectors of manufacturing, prompting U.S. firms to revise corporate strategy with regard to procurement, production, marketnig, and R&D.

Challenges from the Pacific Basin are not limited to those from Japan. The Asian NICs have come to occupy a significant and rapidly expanding share in the world trade in manufactured goods, compounding the adjustment problems of less efficient producers in export markets. In some areas (e.g., consumer electronics) there are signs of increasing local production through direct investment in market countries, often prompted by actual or expected barriers to exports, similar to the Japanese experience. The ASEAN 4 and China have expanded their manufactured exports in labor-intensive products such as electronic parts and components and clothing. No small part of manufactured exports takes place in the context of intra-firm trans-shipment (in electronics) or international subcontracting (in clothing).

As is clearly indicated by (but not limited to) this last example, part of the change in trade flows is generated by the strategic decisions taken by multinational corporations (MNCs) of the importing countries. The other side of the "challenge of the Pacific Basin," insofar as it is based on productive efficiency of the region's producers, is the newly available opportunities for a more efficient reorganization of the global business activities of the MNCs. It is imperative, therefore, to pay attention to micro (firm) level decision-making in order to come to grips with the dynamic and interactive aspects of transnational economic relations.

Viewed from the perspective of MNCs in the United States, the challenge from the Pacific Basin will necessitate the changes in "make or buy" decisions in some areas, but will also present opportunities to produce in or procure from the region enabling them to be competitive against rivals in the region, especially

Japanese. Examples of the switch from "make" to "buy" are found in the increased practice among U.S. manufacturers in various branches of the machinery industry to import finished products from Japan and the Asian NICs and sell them under their own brand names. Through this decision they maintain or even increase their market presence while concentrating their own productive resources on areas in which they have a comparative advantage. Cases of changes in production site and source of procurement are numerous but most conspicuous in electronics and electrical machinery throughout the Asia-Pacific subregion.

Japanese manufacturing corporations are not yet as fully multinationalized as their U.S. counterparts, especially in the area of international sourcing of industrial raw materials, parts, and components. In recent years, however, there has appeared a clear trend toward increasing the import of manufactured products in general and of parts and components in particular, even under prevailing conditions of an undervalued yen. At present, in the wake of the dramatic appreciation of the yen vis-à-vis the U.S. dollar and all the currencies of the Pacific Basin developing countries, Japanese manufacturers are accelerating their external sourcing efforts in part by increasing direct investment in the Asian NICs and the ASEAN 4.

Recent business trends, both in the United States and Japan, toward increased diversification of the international activities of the MNCs is likely to bring about a significant change in the pattern of trade flows in the Pacific Basin region.

The existing pattern of trade relationships among the United States, Japan, and the rest of the Pacific Basin region is characterized (see Table III) by the flow of manufactured goods to the United States from Japan, the NICs, and other developing countries in the region; the flow of consumer durables, capital goods, and industrial raw materials from Japan to the United States and other Pacific Basin countries; and the flow of primary products and energy resources from the United States and other resource-rich countries in the region to Japan and (increasingly) to the NICs. The United States is by far the single most important market for manufactured exports from the Pacific Basin, while Japan absorbs a large proportion of primary exports from the region.

At present, imports of manufactured goods account for around 30 per cent of Japan's total imports. This is an extremely low figure compared to the international "norm" (i.e., 55 per cent average for the advanced country group). It is true that the two rounds of oil price increases caused a ballooning of the dollar value of oil imports from the pre-oil shock level of 20 per cent to the recent level of 50 per cent of Japan's total import bill. That, however, is not the reason for the present low ratio of manufactured goods in Japan's imports, at least in an ex-post accounting sense. In fact, this characteristic of Japan's import composition predates the successive rises in oil prices in the mid-1970s and early 1980s: The ratio was no higher than the present level even before the first oil shock. The alleged "aversion" to manufactured imports appears to be an intrinsic characteristic of the Japanese economy.

Analytical scrutiny of the pattern and performance of Japan's manufactured imports since the early 1970s, however, reveals a significant functional relationship between import prices (relative to those of domestic substitutes) and volumes.

TABLE III

THE PACIFIC BASIN ECONOMY: TRADE INTERDEPENDENCE, 1983

.(U.S.$ billion)

From \ To		World	Pacific Basin[a]	(% of World)	Of Which: U.S.	Japan	Canana	Austrl. +NZ	Other Asia[b]	Asian CPE
World	T	1,807	621	(34)	254	111	51	23	159	23
	P	298	94	(32)	29	28	5	2	25	6
	F	383	249	(39)	53	54	4	3	34	1
	M	1,089	372	(34)	170	28	41	18	98	16
Pacific Basin[a]	T	625	387	(62)	143	63	43	15	110	13
	P	120	64	(53)	13	22	4	1	21	3
	F	63	51	(81)	14	21	2	1	13	0
	M	428	260	(61)	112	18	36	13	73	0
% of world	T	(35)	(62)		(56)	(57)	(84)	(66)	(69)	(57)
	P	(40)	(68)		(45)	(79)	(73)	(62)	(85)	(58)
	F	(16)	(34)		(27)	(39)	(46)	(44)	(39)	(8)
	M	(39)	(70)		(66)	(64)	(87)	(70)	(74)	(50)
U.S.	T	196	90	(46)	—	21	37	5	25	2
	P	47	20	(43)	—	9	3	0	7	1
	F	10	5	(51)	—	2	3	0	1	0
	M	133	58	(44)	—	10	28	3	16	1
Japan	T	147	92	(63)	43	—	4	5	35	5
	P	3	B	(50)	0	—	0	0	1	0
	F	1	0	(40)	0	—	0	0	0	0
	M	142	88	(62)	42	—	4	5	33	4
Canada	T	74	62	(84)	54	4	—	1	2	1
	P	19	18	(93)	7	2	—	0	1	1
	F	10	10	(99)	9	1	—	0	0	0
	M	42	36	(86)	35	0	—	0	1	0
Austrl. +NZ	T	25	14	(58)	2	6	0	2	4	1
	P	15	8	(55)	2	3	0	0	2	0
	F	5	3	(64)	0	2	0	0	1	0
	M	5	3	(55)	0	0	0	1	1	0
Other Asia[b]	T	158	116	(73)	42	27	3	4	36	4
	P	29	19	(66)	3	7	0	1	7	1
	F	32	30	(94)	5	14	0	1	10	0
	M	94	65	(69)	34	6	2	2	18	3
Asian CPE	T	25	15	(59)	2	5	0	0	8	—
	P	7	4	(56)	0	1	0	0	2	—
	F	5	4	(73)	0	3	0	0	1	—
	M	12	7	(57)	1	1	0	0	4	—

Sources: United Nations, *Monthly Bulletin of Statistics*, Vol. 39, No. 5 (May 1985), idem, Vol. 40, No. 2 (February 1986).

Note: Asian CPE=Asian centrally planned economies, T=total trade, P=primary (excl. fuels), F=fuels, M=manufacturing.

[a] Larger than the Pacific Basin as defined here; see "Other Asia."

[b] Asia minus Middle East, 20 per cent larger in trade than the sum of the Asian NICs and the ASEAN 4.

There are two factors related to this causal relationship between prices and quantities, one long-term, the other cyclical. The long-term factor refers to the trend of widening wage differentials between Japan and the developing countries of the Pacific Basin, which has brought about increasingly superior cost competitiveness for the latter in the Japanese market as well as in third-country markets. The cyclical element in relative price effects is caused by the ups and downs of exchange rates. The long-term trend is further accentuated when the yen is strong, but attenuated when it is weak. Increases in oil prices, causing the depreciation of the yen, served to mask the long-term trend toward the increase of manufactured imports into Japan.

As previously stated, there has been a strong surge of manufactured imports into Japan in the past few years, starting even before the dramatic appreciation of the yen following the G5 accord in the fall of 1985, caused in no small part by the increased practice of overseas procurement by Japanese MNCs. The new high for the yen will further accelerate the internationalization of Japanese MNCs in increasingly diversified aspects of business activities, while at the same time forcing less adaptable Japanese manufacturers out of some product lines. Many of Japan's leading industries seem to be entering the stage of full-fledged transnationalization that their U.S. counterparts went through during the past decade.

The effects of the increased transnationalization of business activities on the pattern of trade flows are multifaceted. Extensive offshore production and porcurement will increase trade flows not only of procured products but possibly also of flows (in the opposite direction) of materials to be processed and components to be assembled. Direct investment in the market country, on the other hand, will replace some export sales even as it generates new trade flows of imports needed for newly-started local production units.

The combined effect of trade creation and trade replacement resulting from the transnationalization of Japanese industries will bring about a steady shift in Japan's import structure toward a higher share of manufactured imports. The expected change in Japan's import composition will open up new trade opportunities for manufactures in the Pacific Basin, just as similar development in the U.S. manufacturing sector has done and continues to do.

The internationalization of business activities is not confined to manufacturing activities. Of increasing importance is a similar trend in service industries. In fact, service trade is more closely intertwined with international business in the following two senses. First, there are certain types of services that take place only in the context of international transactions, in such areas as transportation, communication, insurance, finance, legal, accounting and other business-related services. Business firms involved in these transactions are necessarily involved in international activities. Secondly, in most, if not all, service industries, provision of service requires the presence of suppliers where transactions actually take place. Construction, restaurants and auto rental are perhaps the most obvious examples illustrating this point. Because of this characteristic of service industries, "international trade" in services tends to be realized through foreign investment. Here it should be noed that "international trade" does not necessarily involve inter-country transactions in the provision of services, just as local sales of manufactured goods by foreign investors do not involve inter-country shipment and therefore are not registered in trade statistics.[3]

U.S. businesses in many service industries are strongly competitive and the U.S. government is now actively seeking the opening up of service industries overseas. However, resistance to foreign domination will be at least as strong, and probably stronger, in the service sector than in the manufacturing sector, especially in those branches where economies of scale and/or superior technology tend to produce monopolistic control, such as communication and financial services. Developing countries have as strong an interest in fostering infant service industries as they do in promoting manufacturing industries. At present, it is not clear whether and what kind of international division of labor will emerge in the service trade. The same logic as the one that governs trade in manufactured goods, i.e., product cycle dynamics, seems to have some relevance for service trade as well, but not to any large extent.

Service trade will become an increasingly important element in international economic relations in the Pacific Basin in years to come . There is a high likelihood that conflicts related to service industries will come to occupy a center stage in trade negotiations between Pacific Basin countries as well as in the new round of multilateral trade negotiations (MTN) to be started in the near future. Similarly, trade-related issues in the context of direct investment, i.e., performance crietria such as export and domestic content requirements, could become a source of serious conflict. How will we be able to manage these and other problems likely to affect economic relations in the Pacific Basin? The next section will address issues related to leadership in the Pacific Basin.

IV. LEADERSHIP ISSUE IN THE PACIFIC BASIN

Expanding and diversifying trade and investment flows among the Pacific Basin countries have generated friction, disputes and, as a result, rising tensions. These problems seem to be unavoidable political side-effects of increasingly closer economic relations within the region. Negotiating partners, be they private businesses, labor unions or governments, tend to make, at least initially, mutually incompatible claims partly because their perceptions and expectations differ and also because they believe that starting from an uncompromising negotiating position will help gain more points in final agreements. There are, however, real conflicts of interests that must be taken seriously. International economic negotiations necessarily involve national politics, which oftentimes boils down to local and particularistic politics based on specific interests. National governments, as well as business and labor leaderships, have to see to it that specific demands or protests from their domestic constituencies will not damage overall international relations to the detriment of broader national interests. They have

[3] For a conceptual exploration of some issues related to international trade in services, see an elucidating article by Jagdish N. Bhagwati, "Splintering and Disembodiment of Services and Developing Nations," *World Economy*, June 1984.

to make sure that reason and spirit of cooperation prevail among nations even when disputes take on acrimonious tones. There are two ways of achieving this goal: setting rules and making compromises. These two ways of conflict resolution interact with each other in the sense that compromises have to be made for rules to be agreed upon and, in turn, compromises are influenced by an existing set of rules. However, they do represent differing approaches or styles in the resolution of conflicts. Rules are designed to provide codes of conduct that contracting parties are obliged to observe, thereby assigning rights and duties to them. Compromises, in contrast, are means to attain ad-hoc, ex-post adjustment of conflicting interests through give-and-take negotiations on each others's claims. These two modes of conflict resolution (or conflict prevention) both call for leadership and coordination, although probably in different proportions.

Leadership in setting rules concerning international economic transactions has been and continues to be exerted by the United States. U.S. initiatives were instrumental to the establishment of the post-war system of free and open international trade and to the initiation of previous rounds of multilateral trade negotiations for trade liberalization. Indeed, the agenda for the forthcoming MTN round has been set under strong U.S. leadership. The United States is also increasingly active and persistent in setting trade and investment rules on a bilateral basis.

U.S. leadership, indispensable as it may be for any multilateral negotiations to be successful, often generates resentment and antagonism among negotiating partners, especially among developing countries, because of high-handed U.S. negotiating stance. Developing countries tend to have narrow and passive perspectives on international economic issues. They are always fearful of domination by greater economic powers and are extremely eager to preserve autonomy and protect national interests.

As hinted above, U.S. leadership alone might not suffice in the future in bringing about cooperative arrangements for the prevention or resolution of political conflicts arising from increasing economic interactions among the Pacific Basin countries. It will therefore be opportune to examine a possible role for Japan as one of the region's leading economic powers. Conceptual clarifictaion of different aspects of economic leadership will help facilitate the discussion of Japan's new role.[4]

As discussed in the preceding sections, Japanese industries have come to occupy a leading position in the generation and commercialization of technical innovations as well as in the organization of production relationships (both within and between enterprises) which are best suited for the efficient utilization of technological advances. Japan is ahead of other advanced countries in the exploration and exploitation of new technological frontiers opened up by the merging of mechanics and electronics (the so-called mechatronics), as illustrated

[4] The following discussion was inspired by W. W. Rostow's stimulating article, "Is There Need for Economic Leadership: Japanese or U.S.?" *American Economic Review*, Vol. 75, No. 2 (May 1985), in which he offers "two reasonably unambiguous definitions of the inherently ambiguous concept of economic leadership" (p. 285).

by the wide-spread application of industrial robotics and flexible manufacturing systems. It is clear that Japan has acquired a leadership position in the industrial and technological domains (or "techno-economic leadership," for short).

"Techno-economic leadership" is an important (one might even argue, essential) ingredient of another kind of leadership—leadership in managing international economic relations (or "politico-economic leadership," for short). The former, however, does not seem to be sufficient, in and of itself, to qualify a country to be a leader in the latter sense because that requires political rather than technological or economic capabilities. Will Japan be willing and capable to take a "politico-economic leadership" role in the Pacific Basin? Will other countries in the region accept Japan's leadership? What are the needs for and constraints on Japan's new role? These are the questions that will be addressed (if not fully answered) in what follows. Our aim here is to identify economic factors that relate to the question of "politico-economic leadership" either in terms of the need for such leadership or in terms of constraints.

Let us first examine Japan's self image and then the Japanese view of its new role in the Pacific Basin. There exist commonly shared perceptions among Japanese political, economic and intellectual leaders regarding the nation's image and its future role so far as economic affairs are concerned. The degree of unanimity is such that it allows us to speak of *Japan's* self image and *the* Japanese view, which might be characteristically Japanese phenomena of no small import. The presence of a widely accepted domestic consensus enables Japanese policy-makers to take consistent, and therefore credible, positions on international economic relations, contributing to a more effective leadership role. On the other hand, it seems also probable that what exists is only an appearance of consensus in general, and sometimes intentionally vague, terminology which glosses over varied and conflicting interests and viewpoints on specific decisions. To the extent that that is the case, the Japanese government will suffer from discrepancies between general statements of principle and concrete actions, with the possible loss of trust among negotiating partners.

What is Japan's self image? First and foremost, the Japanese believe that their economy possesses a high level of vitality, defined as the capacity to promote growth and the ability to adapt to change, as manifested by increased activities in technological development, engineering and organizational efficiencies in manufacturing production and flexibility and adaptability to changing conditions both at the micro (enterprise) level and macro (national economy) level.

Secondly, Japan has come to define itself as a capital-exporting country. Theoretical underpinnings for this view have been provided from macroeconomics, in terms of a structural gap between domestic savings and investment, and also from economic history, in the form of a stage theory of balance of payments. Economic vitality and capital surpluses are deemed to constitute supply-side conditions for Japan's role in the international economy.

The third aspect of Japan's self image relates to the recognition of its "international responsibility" as one of the leading economic powers. Extremely general and ambiguous as it might sound, this notion captures very well the current mode of thinking and overall intellectual atmosphere among Japanese decision-makers. It is Japan's internatoinal responsibility, so the consensus goes, to respond to calls for greater contributions to the international community.

More long-standing and deeply ingrained in the minds of the Japanese is a strong sense of vulnerability due to heavy reliance on imports of food, raw materials and energy resources. This sense of insecurity, arising from the situation of external dependence, makes the Japanese feel uncertain and uncomfortable with an unqualified notion of their nation being an economic power. This preoccupation with secure access to foodstuffs and natural resources has represented an integral part of Japan's self consciousness—"amounting almost to a national obsession"—and is unlikely to disappear any time soon, despite the recent persistent falls in the prices of primary products and the prospects of permanent oversupply.[5]

Last, but by no means least, there is a more general, but no less acute, sense of dependence on international trade. This awareness in part derives from the need to earn foreign exchange to finance imports of primary products. It is also based on the recognition that the nation's economic health depends on continued access to export markets for manufactured goods. The Japanese economy would go down the drain if it should be denied access to world markets (and so would vitality, capital surplus and all that, needless to say). This only adds to the fundamental sense of vulnerability alluded to previously.

Mixed sentiments of powerfulness ("Japan as No. 1") and powerlessness ("A Fragile Blossom") shape Japan's attitude and approach toward international economic relations. Japan *wishes* to find itself in an ideal world characterized by "dynamic and harmonious development," a vision of world economy which captures Japan's Weltanshauung almost completely. Unfortunately, however, the real world is far from ideal and dynamism tends to disrupt harmony, as the recent batch of trade disputes demonstrated as forcefully as ever.

Japan sees international economic relations as "positive-sum games" in which one party's gain does not necessarily imply another's loss, calling for increased efforts toward "positive adjustment" to changing economic conditions according to the evolution of "dynamic comparative advantages." Protectionism based on a zero-sum mentality has to be resisted in favor of free and expanding trade. Japan will serve as a provider of capital and technology to help improve supply-side conditions in an effort to facilitate "industrial revitalization" in trade-affected sectors. There must be a multilaterally agreed-upon scheme for international economic transactions to maintain and strengthen an open and free world trade environment.

Let us now examine how Japan sees its role in the world economy at large. A report on "economic restructuring for international harmony," submitted to the Prime Minister in April 1986, allows us to make an assessment of the official view as it now stands.

[5] The quoted phrase is from Peter F. Drucker, "The Changed World Economy," *Foreign Affairs,* Vol. 64, No. 4 (Spring 1986). The article presents an insightful, if not totally convincing, view of irreversible, fundamental changes in the world economy.

One striking feature of this document is the recognition that "continued large current account imbalances create a critical situation...for the harmonious development of the world economy."[6] This represents a retraction, at least in part, of the previous, more sanguine outlook of Japan as a capital-exporting country. The report goes on to discuss the need for "a historical transformation": "The large current account surplus is basically linked with Japan's economic structure such as being export-oriented, and there is an urgent need for Japan to implement drastic policies for structural adjustment and to seek to transform the Japanese economic structure into one oriented toward international coordination."

As for the main foci of policy orientation, the report's recommendations include: (1) expansion of domestic demand; (2) transformation of industrial structure; (3) improvement of market access and encouragement of import of manufactured goods; (4) internationalization of financial and capital markets and of the yen; and (5) promotion of international cooperation in financial and technical assistance.

It is true that there is hardly anything new in this listing of policy recommendations, as many critics and skeptics were quick to point out. The report is of great significance nonetheless in that it has acknowledged that the Japanese economy needs structural adjustment in order to be in better harmony with the world economy. Japan has finally yielded to the international political reality and accepted "responsibility" to maintain harmony in the international economy even at the cost of diminished dynamism of its own economy. As is revealed rather symbolically by the recognition of international responsibility under political pressures from abroad, Japanese policy making in external economic relations is in essence reactive and defensive. Japan seems to lack the intellectual capability to design a system of international economic relations based on its positive vision of global economic development, nor does it seem to possess the political clout to have a blueprint implemented even if it had one.

How about Japan's role in the Pacific Basin? The Pacific Basin occupies a central position in the Japanese vision of "dynamic and harmonious development" of the world economy. It is considered to be a region in which the vision has the best chance of being realized, economic vitality of the region in its turn contributing to the revitalization of the world economy as a whole. And the dynamism and potentialities inherent in the region do seem to warrant prospects for continued growth and structural transformation.

Will Japan have a better chance of successful leadership in the Pacific Basin? —Yes and no. The region's economies tend to be more future-oriented than the rest of the world and are eager to ride on the "wave of the future." Japan's "techno-economic leadership" will continue to generate a powerful "demonstration effect"[7] throughout the Pacific Basin and its capital and technology will help

6 "Kokusai kyōchō no tame no keizai kōzō chōsei kenkyūkai hokoku" [The report of the advisory group on economic restructuring for international harmony], April 1986, a report by the private advisory panel to the prime minister.

7 See Staffan B. Linder, *The Pacific Century: Economic and Political Consequences of Asian-Pacific Dynamism* (Stanford, Calif.: Stanford University Press, 1986), for a systematic discussion of the demonstration effect.

promote the region's economic development along the line envisaged in its aim of "dynamic and harmonious development."

When it comes to managing international economic relations, however, Japan will not be able to exercise effective leadership. That is partly because Japan lacks the capacity to design an international system even at a regional level, but also because many developing countries in the Pacific Basin fear Japan's domination of the region. The memory of the "Greater East Asia Coprosperity Sphere" is evoked at the mere mention of Japan's political leadership; Japan is still politically crippled vis-à-vis its Asian neighbors.

What will be the role, then, in which Japan is likely to be effective and useful in managing international economic relations in the Pacific Basin? The most appropriate for Japan seems to be a *coordinatorship* role in an effort to achieve an alignment of diverse interests and to form consensus, or an appearance of it at least, among the region's countries with respect to intra-regional and global economic issues. Coordinatorship, as characterized above, will be much more in tune with Japan's domestic political culture and negotiating style. It will also be less visible than a leadership role and therefore much less likely to arouse emotional reactions from its Asian neighbors.

As discussed in the first part of this section, there seems to be the need for such a coordinator in view of the increasingly confrontational negotiating stance practiced by the United States and rising political tensions generated by international economic disputes.[8] To say this does not imply that Japan is a third party to those disputes and tensions. Far from it. Japan is right at the center of the international economic problems among the Pacific Basin countries: for the United States, Japan remains the number one target for its recent offensive in the pursuit of "reciprocity" and "fair" trade; for the developing countries in the region the (alleged) closed nature of the Japanese market and Japan's (allegedly) malign neglect of their calls for improved market access are no less of a problem than the more open and blatant U.S. protectionism and market-opening pressures. The perception that Japan is much more forthcoming in yielding to U.S. demands than it is willing to heed, or even listen to, LDC demands is widespread and strongly felt in Asian countries.

And yet, there seem to be possibilities for Japan to play an effective coordinator role so far as Japan is willing to do its "homework" in keeping with the spirit and principle of "economic structural adjustment for international harmony." Let us try to map out the main issues that will have to be included in an agenda for the coordination of the varied interests among the countries in the Pacific Basin. Hopefully, this exercise will help identify what Japan will be able to do as well as what Japan will have to do.[9]

The first issue relates to heightened protectionist sentiments in the United

[8] For a detailed and systematic review of trade frictions in the Pacific Basin, see Linda Lim, *Rising Trade Tentions across the Pacific* (New York: Asia Society, 1985). Also consult articles by her and her associates in recent issues of *Southeast Asian Business* for up-to-date information.

[9] The following discussion was prompted by Charles E. Morrison, *Japan, the United States and a Changing Southeast Asia* (New York: Asia Society, 1985).

States as reflected in a recent series of trade bills in Congress and to increased pressures from the Reagan administration for "fair" trade and liberalization of foreign investment. The ultimate nightmare for Asian exporters is the closing off of the U.S. market. Compared to that contingency, all other options are less dreadful. The Reagan administration's offensive, however, falls directly upon the areas where developing countries feel most vulnerable and are most afraid of foreign domination: services, industry targeting, patents and property rights, national treatment for foreign investors. All the countries in the Pacific Basin have a common interest in keeping the U.S. market open. There seem to be, however, varied degrees of willingness to accept U.S. demands for "fairness" and "reciprocity."

Access to the Japanese market is another issue for which common recognition and common interest exists among the Pacific Basin countries (including the United States), although specific categories of goods and services of particular interest vary from country to country. Small countries, in particular, will be interested in adopting a collective bargaining approach, as has been already practiced by ASEAN.

The third issue is concerned with the question of "graduation" for advanced developing countries, i.e., the Asian NICs in the Pacific Basin context. There are two aspects related to this issue. One relates to becoming a "full" member of the international economic community in terms of privileges and obligations in international economic relations: no more GSP, no more aid, and full reciprocity in trade and investment. The other side of the graduation issue, viewed from the perspective of Asian NICs, concerns the prospect of continued upgrading of their industrial structure and development of "national" enterprises strong enough to compete with foreign rivals on an equal footing.

Similar supply-side concerns apply to industrial development of less advanced developing countries, i.e., the ASEAN 4 and, to a limited extent, China. For them, the central task is to improve the efficiency of the manufacturing sector so that it will contribute to increased foreign exchange earnings, a higher rate of labor absorption, and an elevated rate of economic growth. Insofar as prospects for primary exports remain dim, there is no choice but to follow an export-oriented industrialization strategy in order to resume high rates of economic growth and employment expansion.

Last, but not least, China. All the countries in the Pacific Basin will stand to gain from continued growth and opening up of the Chinese economy. It will serve as a spur to the region's economic growth by providing trade and investment opportunities. At the same time, however, China is widely perceived as a source of "disruption," especially in the area of labor-intensive manufactured exports. An exaggerated image of China flooding world markets with its cheap exports is difficult to wipe out, however unrealistic it might be. (It is no less unrealistic than a similarly megalomaniac view of China as a limitless market.)

There are two specific issues related to all the issues raised in the preceding paragraphs: a "Pacific Basin Community" and the new round of GATT negotiations. We will conclude the paper with brief remarks on these issues.

V. CONCLUDING REMARKS

Japan seems to consider the formation of a Pacific Basin Community as a desirable long-range goal, provided that it remains "open" to the rest of the world. The question of leadership and membership seems to be kept open so as to avoid the impression of domination by larger economic powers and of a closed prospective community. Japan is now encouraging developing countries in the region, especially ASEAN, to take an active initiative for regional cooperation in the Pacific Basin, while urging the United States to play a low-key, supporting role in collaboration with Japan. The more favorable attitude toward Pacific Basin regionalism recently adopted by ASEAN is most welcome for Japan.

While a Pacific Basin Community is likely to remain a hypothetical, amorphous concept for some time to come, the next round of multilateral trade negotiation will be started in the near future (although the conclusion of the new MTN round will be years away). The United States and Japan are both eager to have the new round successfully concluded, albeit with different motivations: the United States intends to set rules at the global level with regard to so-called new issues —trade in services, trade-related investment, high-tech products, intellectual property rights—areas of vital concern for U.S. business; Japan, while sharing many business interests with the United States, is more concerned with maintaining an institutional framework for an open trade environment and keeping the United States committed to a free and multilateral trade system.

For the United States, the new MTN round is nothing more than one of many alternative avenues through which it attempts to achieve the goal of setting the rules of the game. In fact, the U.S. trade negotiators are increasingly active in initiating bilateral negotiations, armed with a broad "presidential retaliation power" strengthened under the Trade and Tariff Act of 1984. Furthermore, there is a possibility that the United States will also try a "plurilateral" alternative, seeking trade agreements with groups of countries. ASEAN will be a most likely candidate group for "plurilateral" negotiations.

At present, Japan seems to be counting heavily on the success of the new MTN round for the maintenance and strengthening of global free trade. The United States, on the other hand, will explore and exploit all the alternatives open to it. It is not unthinkable, therefore, that the Pacific Basin region will be totally covered by a set of bilateral (and possibly plurilateral) trade agreements between the United States and the rest of the region. A Pacific Basin Community might be formed, de facto, under the sole leadership of the United States. That situation, in all likelihood, would not diminish the need for a coordinatorship role by Japan, however, if "dynamic and harmonious development" is to be realized in the Pacific Basin.