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EDITOR'S NOTE

This volume of the Working Papers series contains two seemingly separate papers. Furthermore, the author of one of them is not on the staff of the Institute for World Economics or a Hungarian citizen. The decision to pair the two studies is far from an arbitrary one, however, because they constitute a rare meeting of minds and ideas.

At a time when it is fashionable to ignore stories of success in Asia, Makoto Taniguchi, a former Japanese ambassador (to the United Nations, among other postings) and an ex-deputy secretary-general of the OECD, turns against the tide. He extrapolates from the past, present and future trends in Asia the conclusion that it can become again the most dynamic region of the world economy. The no less fashionable view that Japan is in crisis is challenged by András Hernádi, senior research fellow and director of the Japan, East and Southeast Asia Research Centre at the Institute for World Economics, who draws on analysis of numerous aspects of Japan's society and economy.

We sincerely hope that readers find this new approach in the Working Papers series not just provocative, but thought provoking. As always, their reactions will be extremely welcome.

The Editor

Makoto Taniguchi[*]

CAN ASIA BECOME THE MOST DYNAMIC CENTRE OF THE WORLD ECONOMY IN THE 21ST CENTURY?

FOREWORD

When I was working in the OECD from 1990 to 1997 as Deputy Secretary-General in charge of non-member countries, I wanted to know what the world economic map would look like in 2020. I also wanted more insight into the future (in 2020) relationship between OECD economies (developed economies) and non-OECD economies (developing economies), assuming that globalization continued at its present pace. For that reason, I initiated and directed a study entitled "The World in 2020– Towards a New Global Age", which was published at the end of 1997.

It was a very difficult study for several reasons. First of all, nobody could predict what would happen in the world economy as we approached 2020, particularly amidst globalization-induced rapidly changing world economic conditions. So, we focused on drawing a picture of the world economy based on various scenarios,[1] not on prediction. Secondly, this was the first interdisciplinary study covering several major departments in the OECD. And, as you know, it is almost impossible to coordinate the independent views of economists. Thirdly, some major OECD countries did not like the idea of doing specific studies on the possible impacts of globalization on the world economy.

1) THE WORLD ECONOMY IN 2020

The study showed that globalization would be dramatically changing the world economy towards 2020, and there would be a shift in economic power from the present OECD economies to non-OECD economies. This is what it would look like:

Table 1
GDP growth rates, 1995-2020
(average annual growth in percentages)

	High Growth	Low Growth
OECD	2.8	2.1
Non-OECD	6.7	4.2
Big Five (China, India, Indonesia, Brazil, Russia)	7.1	4.6
ASEAN	6.9	4.8
China (including Hong Kong)	8.0	5.6
India	6.8	4.3
Latin America	5.3	3.1
Sub-Saharan Africa	5.2	2.7

It was a shock to OECD economists to see that even with the high growth scenario (HG), the average annual rate of growth of the OECD economies in 1995-2020, which would be 2.8%, was slightly lower than that of 1971-1995, which had been 2.9%. In the low growth scenario (LG), the rate would be as low as 2.1%, whereas that of the non-OECD economies would be 6.7% in HG and 4.2% in LG. In particular, the Big Five economies (China, India, Indonesia, Brazil, and Russia) would grow by 6.7% in HG and 4.6% in LG. Of the Big Five economies, China's, including Hong Kong, would be growing by 8.0% in HG, and 5.6% in LG. In general, it could be said that the non-OECD

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[1] Scenarios: high growth scenario – a fast-track scenario of reform and adjustment (a "high performance" scenario); low growth scenario – a slow-track scenario of reform and adjustment (a "business as usual" scenario)

economies would be developing faster than the OECD economies, with a particularly fast rate for the NIEs and the Big Five economies.

Table 2 A&B
Changes in shares of the world GDP, 1995-2020

A – in 1992 USD, using PPP exchange rates

	1995 (%)	2020 HG/LG (%)
OECD	56	33/44
Non-OECD	44	67/56
Big Five	21	35/30
China (including Hong Kong)	9.3	20.4/16.9
USA	20	11/15
Japan	8	5/6
Russia	1.6	1.7/1.7

B – in 1992 USD, using market exchange rates

	1995 (%)	2020 HG/LG (%)
OECD	82.7	68/75
Non-OECD	17.3	32/25
Big Five	8.0	16/13
China (including Hong Kong)	2.8	8/6
USA	26.0	21/23
Japan	15.0	12.2/13.0
Russia	1.1	1.6/1.4

Based on the faster economic growth as seen above, the share of the non-OECD economies in terms of GDP (measured in 1992 USD, using PPP exchange rates), would exceed that of the OECD economies in 2020, in both the HG and LG scenarios. The total GDP of the OECD economies was 56% in 1995, and would drop to 33% in HG or 44% in LG by 2020, whereas the non-OECD economies, with a 44% total GDP in 1995, which would go up to 67% in HG or to 56% in LG by 2020. In particular, by 2020 China (including Hong Kong) would emerge as the biggest economy in terms of GDP (measured in 1992 USD, using PPP exchange rates) in both HG and LG, exceeding the USA.

Looking at the GDP share of the OECD economies in 1992 USD, using market exchange rates, it would still be 68% in HG and 75% in LG in 2020, while the total GDP of the non-OECD economies would be 32% in HG and 25% in LG. China's (including Hong Kong's) GDP share would be 8% in HG and 6% in LG.

There are considerable differences between the two yardsticks, but there is a common understanding that measuring the GDP using the PPP exchange rate is more accurate and a better approximation of reality than the market exchange rate.

There are different views on the future of China's economy, with some economists expecting it to evolve into a super power, while others argue against this happening. I, myself, am inclined to believe that by 2020 China's GDP will be somewhere between the two figures, but I am sure that the Chinese economic zone, including Hong Kong and Taiwan, will emerge as one of the largest economic zones in the world in that time-frame.

The trade share of the OECD economies would go down from 67% in 1995 to 49% in HG and 59% by 2020 in LG, while that of the non-OECD economies would go up from 33% in 1995 to 51% in HG and 41% in LG. This suggests that the non-OECD economies will become almost equal trading partners to the OECD by 2020 in a LG scenario, or even exceed it in a HG one.

Table 3
Changes in trade shares
(based on USD at 1992 PPP exchange rates)

	1995 (%)	2020 HG/LG (%)
OECD	67	49/59
Non-OECD	33	51/41
Big Five	10	21/14

Although the non-OECD economies would develop faster than the OECD ones, their per capita income would not be able to catch up that of the OECD economies except for some NIEs and some ASEAN economies. Singapore's per capita income is already at the top of the high income group, and several small East Asian NIEs should be able to move up to the high income group by 2020. However, the per capita income level of the Big Five economies will not increase as rapidly as their rates of economic growth, due to their population increases.

Table 4
Per capita income (HG) in 2020,
in 1992 USD, using PPP exchange rates

Japan	41,000
US	40,000
OECD	34,000
EU	32,500
ASEAN	25,000
China	13,000
Russia	12,000
India	7,000
Sub-Saharan Africa	2,500

As I mentioned it earlier, developing countries would grow faster than developed countries both in the HG and LG scenarios, and the economic size of the developing countries in terms of GDP measured in PPP would exceed that of the developed countries by 2020. Overall, this means that globalization is advantageous, rather than disadvantageous to the developing economies. However, as seen above, not all developing countries would enjoy equal advantages. The Big Five countries and the NIEs, particularly the Asian NIEs (Korea, Taiwan, Singapore and some ASEAN countries) would reap the greatest benefit from globalization. Unfortunately, the least developed countries such as Sub-Saharan Africa would be marginalized.

Globalization could provide a window of opportunity for all countries, irrespective of whether they are developed or developing, but these opportunities will not appear automatically, and some unfortunate countries will not benefit, for they will be unable to access the window.

The developing economies able to establish economic links with the OECD economies through trade, investment and technology transfers will be able to grow faster than the economies that cannot. While there is a bright side to globalization, the possibility of a growing income gap between fortunate developing economies and unfortunate marginalized developing economies could turn out to be the dark side.

The study suggests the general conclusion that globalization will enable the Big Five and the NIEs, particularly the East Asian NIEs, to catch up with the OECD economies very rapidly, just as Japan and West Germany caught up to the United States after the end of World War II. It also appears that the Asian economies could garner the greatest benefit of the rising tide of globalization through economic links with the OECD economies.

2) Asia's Potential to Be a 21st Century World Economic Growth Centre

As mentioned above, in the past 25 years, the Asian economies have had better chances of economic growth than other regions. At the end of World War II, some African countries were on higher economic development levels than the Asian ones. For instance, Nigeria's per capita income was higher than that of Korea in the 1950s. In 1980, Nigeria's per capita income was USD 1,010, which sank to USD 280 in 1997. Korea's per capita income was USD 1,520 in 1980, and rose to USD 10,550 in 1997. In 1980, there were many low income countries both in Africa and Asia, but the majority of the Asian low income nations moved up to become either low-middle or middle income countries, while the majority of the African countries remained in the low income bracket.

When I was working at the UN ECAFE (now ESCAP) secretariat in 1966-68, I was rather pessimistic about the future of developing countries in Asia. I tried to discover how their economies could break out of the economic vicious circle but saw no way, as the trade revenues of these Asian economies were almost stagnant with commodity prices showing a declining trend. At that time, the trade pattern of the Asian developing economies was focused mainly on outside developed markets and intraregional trade was limited, so that there was little chance to promote regional trade cooperation. In the 1960s, I had no way of foreseeing the present dynamic development of the Asian developing economies.

What, then, triggered the rapid growth of the Asian developing economies over recent decades? There are many studies on this question. In 1993, the World Bank published a study entitled “East Asia’s Miracle” which caught the world’s attention, and explained how the East Asian economies were developing more rapidly than other regions. I was surprised to learn that the World Bank approved of the course of development undertaken by some of the Asian economies, as it had been rather critical in the past. As far as I knew, organizations such as IMF, the World Bank and OECD had not been particularly happy with the route taken by some Asian economies including Japan and Korea following the end of World War II. The crux of their criticism was that many Asian governments were overly intervening in economic management, and that their policies were not necessarily pro-market.

Immediately after the World Bank study, Paul Krugman published an article called “The Myth of Asia’s Miracle” which appeared in *Foreign Affairs* (November/December 1994). His view on the future of the Asian economies was totally different from that of the World Bank. Krugman argued that the rapid development of the Asian economies would become bogged down before long as had been the case with the former Soviet economy of the 1950s. According to Krugman, the Asian economies, like the former Soviet economy, had utilized massive amounts of capital and labour for their rapid economic development of the 1950s, but had done so amidst low productivity, due to the low total factor productivity (TFP) in their economies. He compared the pattern of economic development of Singapore with that of the former Soviet Union in the 1950s, and found that the two were quite similar. I think it was a mistake to compare two countries which operated under totally different economic and political systems. Singapore was never a communist country and its economy has been the most open in Asia, as a free port and a world financial centre. Krugman also predicted that Japan’s per capita income would never exceed that of the United States, though it already has. As for China, he treated it as a Paper Tiger, but one look at China’s current economic development should be enough to counter that view. In general, I agree that improving TFP is a very important element in economic development on the longer term, and the Asian economies have indeed improved their TFP very rapidly since the 1970s. This was shown clearly both in the World Bank study “East Asia’s Miracle” and in the OECD study “The World in 2020”, while Krugman based his views on the future of Asian economic development on old data, and TFP was in fact quite low in the early 1970s.

In July 1997, East Asia underwent a financial crisis. The hardest-hit countries were Thailand, Malaysia, the Philippines, Indonesia and Korea, but all except Indonesia have shown significant signs of recovery, and are once again growing (I shall return to this issue).

Now, I would like to analyze some of the major reasons why the Asian economies had better chances of development than other regions.

2.1. A favourable economic and geographical climate and environment surrounded the Asian economies

The Asian economies are diversified in their stages of development, and this factor can be distinctly advantageous when compared to other developing regions. In Asia, there are different groups of countries and economies: Japan, Asian NIEs, ASEAN, China, India, Pakistan, Bangladesh, Vietnam and others.

Japan is still the most advanced country, and Japan’s recovery after the end of World War II was most conducive to the rapid growth of Japan’s neighbours, and economies such as Korea, Hong Kong, Taiwan and Singapore (known as Asia’s Little Dragons or Tigers). And the rapid development of these economies was also conducive to the development of other ASEAN economies. Next comes a big economy, China, followed by India, Vietnam and others.

This pattern of development has most recently been referred to as a new "Wild Geese Flying Pattern", which is an advanced version of the original "Wild Geese Flying Pattern"[2] introduced by the late Kaname Akamatsu of Hitotsubashi University in the 1940s. I am not sure whether flying wild geese alternate among their leaders in exactly the same way as economies do, but it is clear that no country or economy can maintain rapid economic growth forever.

After the end of World War II, Japan grew at a very rapid rate of about 15%/annum for several years. Then, Korea, some of the ASEAN economies and China took turns leading the flock, and experienced the same periods of rapid growth, alternating their leadership just like the wild geese.

I would like to discuss my own development pattern concept for the Asian economies, which I call a "Cumulative Development Pattern". I believe the Asian economies have been developing cumulatively, pushing each other forward, rather than replacing leaders as in the "Wild Geese Flying Pattern". Japan's economic development triggered the development of the Asian NIEs, which resulted in ASEAN's development, followed by that of China, India and others. With this pattern of development, it is important to see the process of development as a cumulative one. This being the case, Asia could become the most dynamic centre of the world economy in the 21st century.

[2] Kaname Akamatsu's original "Wild Geese Flying Pattern" was an observation of changes in Japan's leading export commodities in the Meiji Period. The shift went from silk to cotton and other textiles, and then, from textiles to light industry products, and so on. Most recently, Akamatsu's theory has been applied to the shift by leading developing economies.

2.2. The favourable economic fundamentals of most of the Asian economies

a) Fairly high quality of labour

b) Very high domestic saving rates

Table 5
Domestic saving rates in 1998

East Asia & Pacific	37%
Latin America & Caribbean	20%
South Asia	17%
Sub-Saharan Africa	15%
Singapore	51%
Malaysia	47%
China	43%
Thailand	36%
Korea	34%
Indonesia	31%
Philippines	15%

Source: The World Bank – World Development Report 1999/2000

As shown above, in 1998, the domestic savings rate for East Asia and the Pacific was by far higher than that of other regions, and that of Singapore was as high as 51% followed by Malaysia (47%) and China (43%). The high savings rate of East Asia has been one of the most important triggers of rapid economic growth because it results in a high accumulation of capital.

c) Good economic policies

In my experience, East Asia in general has applied much more realistic and flexible economic policies than other regions of developing countries, adjusting their policies to changing world economic conditions. For example, when I was working at the ECAFE secretariat in 1966-68, almost all the Asian developing economies were operating with import substitution policies to protect their infant industries. However, the East Asian economies quickly shifted from import substitution to export promotion policies, adjusting to the increasingly open trade policies of the developed countries, in particular, of the United States. Meanwhile, the

Latin American economies and the South Asian countries such as India and others, stuck to their import substitution policies. This is how the East Asian economies expanded their exports, mainly to the United States market, in the 1970s and 1980s, while Latin America was unable to. In the 1980s, 10 East Asian economies ranked among the top 30 trading economies of the world.

In addition, the East Asian economies were at the forefront when it came to establishing "economic links" with the OECD economies in the 1970s and 1980s, because they were able to introduce capital flows and technologies from the developed economies, and thus expand their trade to them.

d) High level of international reserves

Table 6
Gross international reserves in 1998
(million USD)

Japan	222,443
China	152,843
Korea	52,100
Thailand	29,537
Malaysia	26,236
Indonesia	23,606
Philippines	10,789
USA	146,006

Source: The World Bank – World Development Report 1999/2000

As seen above, the East Asian economies had a very high level of gross international reserves in 1998, even after the Asian financial crisis. Both Japan and China had the highest level of gross international reserves, higher than that of the United States.

e) Rapid TFP growth in HG

Table 7
TFP growth in HG, 1990-2020
(percentage)

	1990-1995	1995-2000	2000-2010	2010-2020
US	0.5	0.6	0.8	1.0
Japan	-0.4	1.9	2.0	2.1
EU	0.8	1.3	1.6	1.6
Total OECD	0.5	1.1	1.3	1.4
China & Hong Kong	4.9	4.2	3.3	3.0
India	0.9	3.6	3.7	3.0
Indonesia	2.5	3.1	2.8	2.7
Russia	-	1.1	3.1	2.8
Other dynamic Asian economies	2.8	3.0	2.9	2.7
Other Latin America	0.9	1.7	2.4	1.8
Sub-Saharan Africa	-0.7	1.4	1.5	1.5

Note: Figures for 1990-1995 are real, other figures are estimates.
Source: OECD, "The World in 2020"

As seen above, the overall growth rate of Asia's TFP is becoming higher than that of other regions. Accordingly, this could be a strong challenge to Paul Krugman, who predicted that the rapid growth of the Asian economies would come to a halt because of their low "Total Factor Productivity."

3) What Should the Asian Economies Do to Become the Most Dynamic Centre of the World Economy in the 21st Century?

3.1. Suppress protectionism and keep the economy open

In the past 25 years, it was trade that motivated the rapid development of the Asian economies, and trade should continue to be a major engine of their development in the 21st century, too. Therefore, it would be very important for the Asian economies to maintain "orderly economic links" to the OECD economies.

However, it would not be wise for the Asian economies to put too much pressure on the OECD markets, in particular, on less competitive markets, by exporting massive quantities of competitive and low cost products. At the same time, the Asian markets should be reasonably open to the products of the OECD economies.

3.2. Avoid financial crisis

The Asian financial crisis began with the Thai financial turmoil in July 1997, and spread quickly to neighbouring countries such as Malaysia, the Philippines, Indonesia and Korea. The crisis had serious repercussions not only on the nations directly hit by it, but also on the East Asian economies as a whole. Moreover, the financial crisis also spread to Russia and to Brazil.

My analysis indicates that the Asian financial crisis hit 5 economies which had been developing amidst favourable economic fundamentals. The average economic growth rate of these 5 economies was as high as 8.4% in 1995 and 7.0% in 1996. Their inflation rates had been kept in the single digits and their domestic saving rates, except for the Philippines, were 30-37%. Their unemployment rates were low, and their foreign reserves were steadily increasing.

However, one shot of financial crisis totally reversed these economic fundamentals from positive to negative. After the crisis, their average economic growth rate went down to 4.5% in 1997 and to -9.1% in 1998. Indonesia was the hardest hit among the 5 economies, and it is my view that the economic gains Indonesia had made in the past 10 years were totally lost.

What were the causes of the recent Asian financial crisis? In my opinion, there were three major factors: (i) premature liberalization of financial and banking markets, in spite of still weak financial and banking infrastructures, (ii) defects in the IMF system and policy, when dealing with financial crisis in emerging economies, and (iii) over-dependence on foreign capital inflows, in particular, on short term capital (*e.g.* hedge funds).

The East Asian economies, and in particular the 5 economies which were directly hit, paid very dearly for the lessons of the recent financial crisis, and would be wise not to repeat the same mistakes. Yet, there is no guarantee that financial crisis can be averted, and amidst globalization it could hit any region at any time.

Under these circumstances, the Asian economies should avoid over-borrowing foreign capital, particularly short-term capital. As mentioned earlier, the East Asian economies have extremely high domestic savings rates, so there should be no need for them to be so dependent on foreign capital unless they are aiming for much faster economic growth. If they are over-ambitious and ignore their own capabilities, I am afraid they will repeat the same mistake. I strongly suggest that they rethink their development paradigm and ask themselves if they really need such high growth rates, and make a better choice between rapid and volatile growth or a somewhat slower but more stabile growth rate.

On their way to recovery they should pay special attention to the following issues:

a) Regional cooperation

At present, the IMF system is not sufficiently effective to manage global financial crisis. Although there is a growing sentiment even among the G7 countries that the IMF system needs to be fundamentally re-designed, it would be unrealistic to believe that this can be done in the near future. So, in order to prevent the recurrence of financial crisis in emerging economies, which may happen at any time, more realistic and immediate measures need to be taken.

In my view, much closer regional cooperation is necessary to prevent contagion to other regions as happened during the last Asian financial crisis. Of course, IMF definitely should be involved in that cooperation. For example, if financial crisis hits Latin America, the Inter American Development Bank should play a major role in combating it, while if it is in Asia, that job should go to the Asian Development Bank. At present, these regional banks are not capable of managing that huge an effort, so their mechanisms should be reinforced, to enable them to prevent the recurrence of financial crisis through regional surveillance and monitoring functions.

b) Japan's responses to the Asian financial crisis

When the financial crisis hit the East Asian economies, Japan quickly proposed the establishment of an "Asian Monetary Fund" to contain the crisis. Sadly, the idea was rejected by the United States Treasury, IMF and China. Then, Japan introduced relief measures including the "Miyazawa Plan", which totalled about USD 88 billion to revitalize the hard-hit Asian economies. I am pleased to note that in June 2000, the ASEAN finance ministers + 3 (Japan, China and Korea) met in Thailand and agreed to establish an "Asian Reserve Currency Swap Fund" as a measure to prevent the recurrence of financial crisis in Asia. The idea behind this new Fund is similar to the original idea of an "Asian Monetary Fund" which was killed when Japan first introduced it in 1997. I regret that it was rejected with very little discussion, and that Japan did not negotiate more convincingly at that time.

c) Economic recovery from the financial crisis

The Asian economies seriously hit by the financial crisis began to recover in 1999, and average rates of growth (excluding Japan) were estimated to be 6.9% in 2000 and 6.5% in 2001.

Table 8
GDP growth rates estimates
(percentage)

	2000	2001
Hong Kong	8.5	8.8
Korea	8.3	6.0
Singapore	8.0	6.0
Taiwan	6.8	6.3
China	7.5	7.2
Indonesia	3.5	5.0
Malaysia	7.8	7.0
Philippines	3.8	4.3
Thailand	4.5	4.6
Vietnam	6.0	6.5
India	7.0	7.0
Pakistan	4.5	5.0

Source: Asian Development Bank

3.3. Save on energy and natural resources

a) The energy shortage

As the Asian economies continue to develop at high growth rates, the first thing we need to worry about is the energy shortage, in particular, the oil shortage.

Table 9
Net oil imports as a share of oil consumption
(percentage)

	1994	2010
China	3	40
India	54	87
Indonesia	-	43

Source: IEA, "World Energy Outlook" (OECD, Paris, 1996)

China became a net oil importer in 1994, and will be importing 40% of its oil consumption in 2010. Although it is quite understandable that India would be importing 87% of its oil consumption in 2010, it is surprising to see that Indonesia, which is an OPEC member, will soon become a net oil importer, and will be importing 43% of its oil consumption in 2010.

According to the OECD study, the East Asian region (including China, Indonesia and Japan) will become the world's largest net oil importer, with its dependence on oil rising from two-thirds at present to almost

90% by 2020. And the most serious problem in this connection is that these massive oil imports will most probably be depending exclusively upon the limited oil supplier countries in the Middle East. If a third shock-wave hits the oil market, it will have much more chaotic repercussions than the previous ones, and its impacts on the world economy could be grave.

b) Food dependency

East Asia, particularly Japan, China and India, is likely to become the world's largest consumer of food in the 21st century. At present, Japan is the world's least self-sufficient country in terms of grain (approximately 25%). According to the OECD study, if China were to forsake food self-sufficiency as a policy goal, it could emerge as a sizeable net agricultural importer by 2020, on par with Japan, with an import need amounting to roughly USD 170-175 billion. And the United States would be the only major supplier of food to these large consumers. Thus, both China and Japan would face the problem of food security if there were to be a world food shortage. At the same time, it is encouraging to note that India, which has suffered from serious famines in the past, will become a small net agricultural exporter by 2020.

3.4. Control population explosion

It is generally known that Asia is the most over-populated region of the world, for it includes China, India and Indonesia which are 3 of the world's most highly populated countries. In 1998, Asia's population accounted for about 3.58 billion of a world total of 5.9 billion. Included in this was China's 1.25 billion, followed by India's 0.98 billion and Indonesia's 0.206 billion. In 2050, India's population is expected to be about 1.53 billion, surpassing China's 1.48 billion. While population size tends to enlarge the size of the GNP as has happened with China and India, it is also true that due to large populations, the per capita income level of these over-populated economies does not increase in ratio with the growth rates of their GNPs. Thus, it is important for over-populated economies in Asia such as China, India and Indonesia to restrict their populations to their own sustainable levels.

It should also be noted that population problems are closely linked with environmental problems. Rapid population growth necessitates additional food production and consumption of water and energy resources as well.

Furthermore, a rapid population increase in Asia could create problems of so-called megacities, cities with populations of 8 million or more. In 2000, there were 45 megacities in the world, of which 17 were located in Asia. In 2020, the number of megacities in Asia could increase to 28, or to about 2/3 of all the megacities in the world. The impact this would have on Asia's environment would be grave indeed.

3.5. Prevent aggravation of the environment

All problems mentioned above (energy, food, population, *etc.*) would culminate in a serious aggravation of the environment. In fact, when tackling it, the environmental problem should be treated as the most serious obstacle to Asia's sustainable growth. How then, can this problem be overcome, while maintaining high growth rates?

Table 10
Shares of world carbon dioxide emissions
(percentage)

US	23
China	13
Russia	7
Japan	5
Germany	4
India	4
Indonesia	1
Brazil	1

According to the OECD study, there were eight environmentally important countries in the world in 1995 as listed in *Table 10*.

As shown above, four Asian economies were listed as major polluters of CO^2 in 1995, and China was listed as second largest polluter in the world, following the United States. Meanwhile, a recent IEA study shows that China is likely to become the largest CO^2 polluter by 2010. The rise in China's CO^2 emissions between 1993 and 2010 is expected to almost equal the total increase in CO^2 emissions by all the OECD economies combined. This really would be an appalling phenomenon not only for China but also for the rest of the world.

Any country, irrespective of whether it is developed or developing, has the right to advance and we welcome China's development. But something has to be done about its environmental problem. The Chinese authorities are well aware of this serious concern, but, China alone cannot solve it, so international cooperation, including financial and technical cooperation, is needed to assist it in its efforts to combat the aggravation of environmental difficulties.

4) A New Development Paradigm for the Asian Economies – Regional Cooperation between Japan and Asia

4.1. Sustainable growth for the Asian economies

It would be wise for Asia's economies to target moderate rates of growth rather than very high ones, and thus, to overcome these problems and maintain sustainable growth. Of particular concern are the serious environmental problems that go with high growth rates in large Asian economies, such as China, India and Indonesia.

By way of explanation, I would like to discuss China, since China is still aiming for a growth rate as high as 7~8%, as it approaches 2020, while India is targeting a more moderate rate of 5~6%. As for Indonesia, at this time it would be difficult to predict its economic future as it is still suffering the aftermath of the recent financial and economic crisis, and the size of the Indonesian economy is far smaller than those of China and India, both in population and in GNP.

4.2. Why does China have to develop at a high rate of growth?

Although it is difficult to say whether its reasons are political or economic, the truth is likely to be a combination of the two. China has succeeded in reducing poverty through rapid growth, but it still has about 200 million people who live on less than one US dollar per day. And China has to create jobs for a growing population and for the unemployed, who have become the victims of privatization, which China is destined to continue. The only solution to these concerns is rapid economic growth. This may well be true, but how can China overcome environmental problems, while maintaining a high rate of economic growth?

In this connection, let me quote two interesting estimates from the OECD (*Table 11/A*) and the United Nations University (*Table 11/B*).

These two studies show some very interesting trends. First, China's GDP growth rate will slow down towards 2020 and the UNU study estimates that after 2020, it will slow down even further, to 3.7% in 2041 – 2050. Second, up to 2020 the UNU estimates are somewhere between the OECD's HG and LG estimates. Judging from the estimates made by these two studies, I tend to think that the OECD's HG estimate is too optimistic, and that the UNU estimates are closer to reality. At the same time, I am afraid that China will be unable to attain a level even slightly lower than the UNU estimate, if it is unable to control its environmental aggravation and keep it down to a sustainable level.

Table 11 A&B
China's growth scenarios

A – China's GDP growth rate
(average annual growth in percentages: based on 1992 PPPs)

1996-2000		2001-2010		2011-2020		1995-2020	
(HG)	(LG)	(HG)	(LG)	(HG)	(LG)	(HG)	(LG)
9.3	7.9	8.2	5.3	7.2	4.8	8.0	5.6

Source: OECD, "The World in 2020, Towards a New Global Age", 1997, p. 92.

B – China's GDP growth rate
(percentage)

1996-2000	9.1
2001-2010	7.7
2011-2020	6.0
2021-2030	5.0
2031-2040	4.4
2041-2050	3.7

Source: UNU, "China's Sustainable Development Framework. Summary Report", edited by Fu-Chen Lo, Yu-qing Xing, 1999, p. 13.

4.3. Regional cooperation in Asia

In coming decades, it will be very important for Asia's economies to develop regional cooperation, in particular in the following fields:

a) Maintaining financial market stability

It is absolutely vital for the Asian economies to give top priority to preventing the recurrence of financial crisis in the new era of globalization. And as mentioned earlier, the Asian economies should be targeting the stabilization of their financial and banking sectors, by strengthening their infrastructures. They should also aim for more moderate growth and less dependence on foreign capital, particularly on short-term funds, such as hedge funds.

In this field there is ample scope for regional cooperation between Japan and other Asian economies. Japan is still the most advanced economy in Asia, and Japan should offer more financial and technical cooperation to the Asian economies in consolidating their financial and banking infrastructures. In this context, I was quite pleased with certain recent developments such as a move to establish a "Foreign Currency Exchange Swap Fund" taken by the "ASEAN + 3" Finance Ministers' meeting, mentioned earlier.

b) Environmental cooperation

There is no need to reiterate that the most serious bottleneck in the sustainable development of the Asian economies in the 21st century is the environment. China's large-scale environmental pollution is most acutely affecting its neighbours, including Korea, Japan and Taiwan. Here, too, Japan is the technically most advanced nation, so Japan would be best able to assist China in its efforts to combat any further aggravation of the environmental situation (*e.g.* to help China in its efforts to tackle the environmental problems of its midwestern region).

c) Development of information technology (IT) industries

The Asian NIEs, especially Singapore, have developed rapidly by introducing state-of-the-art technologies from the OECD economies. And now other ASEAN economies as well as China and India are trying to bring in the high-tech gap between them and the OECD economies, including in IT. For example, India and Singapore have worked together to set up a Computer Centre in Bangalore. Both China and India have been training large numbers of engineers. China is already a major producer of appliances and electronics such as TV sets, refrigerators, computers, *etc.*

At present, there are 60 million mobile telephones in operation in China, exceeding

Japan's 58 million. China already has 20 million Internet hosts.

Table 12
Diffusion of electronics in Asia
(per 1,000 people)

	Mobile telephones (1997)	Personal computers (1997)	Internet hosts (Jan. 1999)
China	10	6.0	0.14
Hong Kong	343	230.8	122.71
India	1	2.1	0.13
Korea	150	150.7	40.00
Singapore	273	399.5	210.02
Malaysia	113	46.1	21.36
Japan	304	202.4	133.53
(USA)	206	406.7	1131.52

Source: World Bank, World Development Report 1999/2000

As seen above, alongside China and India, the Asian NIEs have also diffused electronics. Hong Kong and Singapore are more or less equal to, or even more advanced than Japan in the utilization of electronics. Asia is far behind the level of the OECD economies in its technological innovation, particularly in high-tech, but in the application of technologies developed by the OECD economies the Asian economies in general have the potential to catch up with the OECD. In the "New Global Age", if the Asian economies want to catch up with the OECD, it would be crucial for them to narrow the technological gap, particularly in high-tech. It was a very appropriate initiative by Japan, therefore, to propose the establishment of a "Fund to Prevent a Digital Divide in Developing Countries" at the G8 Summit in Okinawa, in July 2000. Japan pledged USD 15 billion for the Fund, with a view to utilizing it effectively to advance the technology level in the developing countries including Asia.

4.4. Establishment of "East Asian Economic Cooperation"

a) Movements towards regional integration

It is interesting to see that even in the age of globalization there is a trend towards regional integration as is manifest in the enlargement of the EU in Europe and NAFTA on the American continent. According to the WTO, there are more than 230 regional agreements in the world at present, taking the form of free trade agreements or customs unions, and the like. Although Japan belongs to the APEC (Asia-Pacific Economic Cooperation) and PECC (Pacific Economic Cooperation Council) which are very loose forums of economic cooperation or economic consultation that are quite different from the EU or NAFTA in nature, Japan does not belong to any other major regional groups.

In the past, Japan did not support "exclusive regional integration" as a matter of principle, and at OECD forums, Japan has repeatedly argued that "multilateral free trade" was better than "regionalism." Actually, at that time, Japan was the only OECD country that did not belong to any major regional group. Other OECD countries belong to either the EU or NAFTA. (Australia and New Zealand have established a bilateral "Free Trade Agreement".)

Table 13
Scales of economy in Northeast Asia
and East Asia & the Pacific, 1998

	Population (millions)	GDP (USD, billion)
EU	375	7,548.1
NAFTA	397	9,444.0
Northeast Asia (Japan, China , Korea)	1,418	7,628.4
East Asia & the Pacific (including Northeast Asia)	1,817	9,677.2

Source: World Bank, World Development Report 1999/2000

Furthermore, to date China and Korea, like Japan, do not belong to any regional groups except APEC and PECC.

These three nations are quite significant economic powers, and if they were to establish a regional economic group, it would be one of the most powerful, as *Table 13* indicates.

In terms of population, Northeast Asia is much larger than the EU or NAFTA, and in terms of GDP it is slightly bigger than the EU. If we look at East Asia & the Pacific as a whole, its GDP is larger than that of NAFTA. Since East Asia's growth rates are expected to be higher than those of the OECD economies, it is quite possible to expect East Asia's total GDP to become much higher than those of both the EU and NAFTA.

b) The feasibility of establishing regional integration in East Asia

In addition to population size and GDP, East Asia has the potential to move towards closer economic integration for reasons of high intraregional trade and intensive intraregional investment flows.

Table 14
Intra-non-OECD trade, 1995
(as percentage of total trade)

Latin America	20.3
CEECs*	19.1
Africa	9.6
ME**	8.4
Developing Asia	34.9

* Central and Eastern European Countries
** Middle East
Source: OECD

Table 15
East Asia's trade dependency by regions
(percentage)

		East Asia	Japan	NAFTA	EU	World
Export dependency	1985	26.3	16.9	30.9	10.8	100.0
	1990	32.9	14.6	25.2	15.7	100.0
	1996	38.9	13.4	21.3	15.4	100.0
Import dependency	1985	26.3	22.8	15.1	10.9	100.0
	1990	32.6	20.4	14.8	12.6	100.0
	1996	37.2	18.4	12.9	12.7	100.0

Source: IMF, Direction of Trade Statistics Yearbook

Tables 14 and *15* show that intraregional trade in developing Asia was the highest of the developing regions, at about 35%. When I was working at the ECAFE secretariat in 1966-68, developing Asia's intraregional trade was only 6-7%, and their trade dependency on the OECD market was very high. East Asia's intraregional trade dependency in both exports and imports increased by more than 10 percent in 1985-96, and its dependency on the US and Japanese markets decreased, while East Asia's dependency on the EU market increased over the same period.

As mentioned earlier, Japan contributed USD 88 billion as a relief measure to the East Asian countries hard hit by the recent financial crisis, and as the East Asian economies are recovering, Japan's private investment in these countries is expanding again. Even apart from Japan's investment, East Asian intraregional investment flows are increasing. About 65% of direct investment in China is coming from overseas Chinese interests, including massive Taiwanese money. Such being the case, I would conclude that there is a strong economic potential to establish regional economic cooperation in East Asia. However, it will take a long time before that potential materializes, for the following reasons:

* First, historically there has never been a strong political incentive to promote regional integration in East Asia, with the exception of ASEAN.

* Second, Asia is not uniform, and is, in fact, quite diversified politically and culturally.

* Third, there are differences in the stages of development in Asia. For example, in East Asia, Japan is the most advanced nation, followed by the Asian NIEs, ASEAN, China, Vietnam, and others.

* Fourth, it is not easy for Japan and China, two big economic powers, to find ways to cooperate and agree on how they can do it.

However, there is no need for pessimism about future "East Asian Economic Cooperation". The recent financial crisis in East Asia offered the nations of the region a chance to cooperate with each other. As mentioned earlier, when Japan proposed the establishment of an "Asian Monetary Fund" in 1997, China joined the US, which strongly opposed the idea. But after having gone through the serious trauma of the financial crisis, East Asia is becoming more cooperative and "ASEAN + 3" (Japan, China and Korea) have started working closely together, not only on financial matters but also in various other fields. ASEAN was responsible for the initiative of setting up the vehicle of "ASEAN + 3" cooperation, and Japan and China have joined in. The "ASEAN + 3" cooperation vehicle is similar to the concept of the "EAEC (East Asia Economic Caucus), which was originally proposed by Prime Minister Mahathir of Malaysia at the end of 1990. Unfortunately, strong opposition from the United States and Japan at that time killed the EAEC idea. I hope that this time "ASEAN + 3" cooperation will receive positive and constructive promotion and become a core which would lead the way to the establishment of "East Asian Economic Cooperation".

At the same time, Japan is now taking the initiative to establish a "Free Trade Agreement" with Singapore and Korea. These agreements will contribute to activating the economies of East Asia through the expansion of trade and investment not only among the three countries, but also among other East Asian economies as well, for the following reasons:

* First, Japan's Free Trade Agreement with Singapore would be able to establish closer economic ties between Japan and other ASEAN economies through Singapore.
* Second, Japan's Free Trade Agreement with Korea would be able to open the way to closer future economic cooperation with other Northeast Asian countries including China, Taiwan, Mongolia and possibly even North Korea.
* Third, it is hoped that these Japanese initiatives will be able to connect with efforts to establish "East Asian Economic Cooperation" in the early part of the 21st century.

CONCLUSIONS

Now I have to respond to my own question, which was the main theme of this article, that is "Can Asia become the most dynamic centre of the world economy in the 21st century?" My answer is "Yes, Asia can," if the Asian economies are able to adjust to a new development paradigm, and if Asia can introduce a more stable and sustainable growth policy in coming decades.

To do this, it will be absolutely necessary to establish regional cooperation. I believe that if Asia can develop in an open, stable and most of all, sustainable way, and as a result, becomes the most dynamic center of the world economy in the 21st century, the benefits will accrue to the world economy as a whole.

In the 21st century, globalization will continue to be the mainstream of economic activity in the world economy, and at the same time regional integration also will advance, and eventually each individual regional integration will be amalgamated under the umbrella of globalization. I believe that in this process, Asia can definitely play an important role in the balanced and sustainable growth of the world economy.

* * * * *

András Hernádi*

Crisis or Transformation? Japan Viewed from Hungary[1]

1) Is Japan in Real Crisis?

By the end of the 1990s it had become the vogue to speak about the crisis in Japan, especially in the sensation-hungry daily media, and even in some under-informed scientific reviews. In my opinion, however, Japan is neither in crisis, nor in any lasting recession[2], as in the period of 1990-2000 there was only a single year, 1998, when its real GDP declined; and latest OECD, EPA, and *The Economist* forecasts for 2001-2002 also reckon with growth rates of 1.1-2.5 percent.

Other encouraging signs are that in the 1996-1999 time-span there was a 2% rise in labour productivity behind that growth, and one-third of that was the result of investments in information technology (IT). Japan's net public debt is only about 40% of its GDP and, by extending the tax base, it still has ample opportunity to further increase government revenues. The per capita GDP was about USD 36,000, despite the current weakness of the yen, and no less than 25,000 dollars, even at purchasing power parity. Japan is still the world's number one creditor (its international assets were put at USD 829 billion while Japanese investment abroad earned an income of USD 55 billion in 1999 alone). In the autumn of 2000, Japan's gold and foreign exchange reserves surpassed USD 350 billion, and its foreign trade surplus at the end of the century had become somewhere in the order of a steady USD 100 billion.

How, then, can one explain the current widespread and extremely pessimistic view of the Japanese economy and its society? I believe there are both superficial and more profound reasons behind this phenomenon.

As far as the superficial ones are concerned, which in my view are related to factors of calculation, prices and other statistics, they seem to have pushed 'realia' into the background. Under this heading I would mention that

(a) owing to the great variety of GDP figures on Japan (*e.g.* real, nominal, calendar and fiscal year[3]), data for one and the same year can vary considerably, depending on which of the sources one chooses to cite;[4]

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[1] This paper is an abridged version of another study, written by the author in the framework of Éva Ehrlich's OTKA project on "Japan and Southeast Asia at a Turning Point". My thanks go to those colleagues and friends in Japan with whom I had the chance to discuss many current concerns of the Japanese economy and Japanese society overall: Masaru Eto, Japan Institute for Labor, Tokyo; Kozo Horiuchi, Hosei University, Tokyo; Masahiko Itaki, Ritsumeikan University, Kyoto; Satoshi Mizobata, Institute of Economic Research, Kyoto University; Shoshichi Sugimoto, Hannan University, Osaka; and Makoto Taniguchi, Waseda University, Tokyo. I also owe a debt of gratitude to István Papp, Hitotsubashi University, Tokyo, for supplying me with a great deal of recent statistical data. However, all responsibility for any statement made in this paper, rests with me, alone.

[2] The Economic Planning Agency (EPA), Government of Japan, defines any period as recessional if the value of the GDP drops in two consecutive quarters of a year.

[3] The fiscal year in Japan runs from April 1 to March 31.

[4] The variety of data has been further increased by a change announced at the end of 2000, when Japan introduced the SNA93 national income accounting system, accepted by the UN in 1993. Based on this system, Japan's real GDP figures for 1997, 1998 and 1999, for example, would have been 0.3, 1.3 and 0.9 percentage points higher, calculating with expenditures on computer software and the consumed part of social overhead costs. ("Transition to the SNA93 and Benchmark Year Change in Japan", Economic Re-

(b) consumer prices in Japan have shown a declining trend over the past two years, even in absolute terms;

(c) Japan's GDP is usually expressed in dollars, a practice most often pursued by doomsayers at times when the yen is weakening, even if in the long run it has tended to become stronger;

(d) in general, too much emphasis has been placed on the fluctuation of real estate and stock prices.

In short, the conceptual point at issue is whether it is correct to value the performance of a country, the assets of a company or even of a family, according to actual changes in domestic and/or international prices (*i.e.* exchange rates). In my view, neither the GDP of Japan, nor the wealth of a company or a family would become physically smaller from one year or month to the next (let alone from one day to the other!) as a consequence of a change in prices. It is, of course, another matter that if some part were to be offered for sale, it would then command a lower price.

Various phenomena triggering a crisis mood, primarily because of their psychological impact, deserve a middle-of-the-scale position, somewhere between the superficial and the profound reasons. To illustrate the pessimistic mood pretty much dominating the country, it should suffice to mention that the 1990s are increasingly called the 'lost decade.'

(1) In 1993, the first time for 38 years, the governing Liberal Democratic Party, lost the elections even though only temporarily, and people's readiness to vote has been diminishing ever since. At the time of the last general elections nearly 50% of the voters claimed to have no party preference at all, and, quite unusually for the Japanese, one third of them did not even go to the polls.

(2) It is a centuries-long tradition of the Japanese people to worry about the future instead of enjoying the present. They reacted to the burst of the financial bubble[5] in the early 1990s, and to bankruptcies of companies and financial institutions coupled with record unemployment rates[6] by the end of the same decade, by cutting back on their consumption and investing their savings in domestic government bonds and postal deposits notwithstanding the nearly zero interest rates.

(3) As a reflection of their fear, the Japanese people began to work even harder than before. Visible symptoms of this included more rigid human relations, a rise in juvenile delinquency, overwork leading to death (*karoshi)*, and a wave of suicides, especially among 40-50 year-old men.

But the real, profound reasons for the crisis mood, in my opinion, have been the pressures of adjustment to new situations, arising simultaneously in a number of areas. For the Japanese people had to realize that

(i) the maturity of their economy was slowing down the growth rate;

(ii) the age of loan abundance created artificially had come to an end;

(iii) new challenges, called globalization and information technology, had appeared, and were pushing inward from the outside;

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search Institute, Economic Planning Agency, December 4, 2000.)

[5] Real estate and stock prices plummeted and bad debts rose to the level of USD 600-1,100 billion. For 1990-1998 the total loss in real estate value was about USD 7,300 billion, and the securities loss was about USD 5,200 billion. If they had been considered *real* losses, they would have equalled one third of the GDP for the same period.

[6] By international comparisons the 4.9 percent unemployment rate was still moderate. But one has to take into consideration that experts in Japan and abroad reckon with an at least 2-3%-point higher actual rate. Apart from the differences in methods of calculation, there are some deep-rooted reasons behind the traditionally low unemployment rates. Takamitsu Sawa, for example, talks about 'built-in' waste and irrationality in Japanese society. ("End of the Road for Japanese-Style Capitalism", Japan Review of International Affairs, Fall 1999, pp. 182-183.)

(iv) the traditional systems of employment and management had become obsolete: shareholder capitalism had got the upper hand over stakeholder capitalism; and

(v) Asia overall had taken a hit to its significance, as a result of the US moving into a hegemonic position, the European Union becoming stronger, and a financial crisis putting the countries of Southeast Asia into a state of shock.

Given the above-mentioned reasons, I would tend to speak about a necessary transformation of the Japanese economy and its society, rather than about crisis. Needless to say, this process of transformation bears the characteristic features of all social and economic changes in Japan; it is evolving gradually, it retains old traditions, and is slow in giving way to new trends.

2) Main Areas of Transformation in the 1990s [7]

2.1. Employment, the structure of production

The Japanese view the ageing process as one of the biggest social challenges they face. Apart from its multiple economic impacts, it involves the danger of inter-generational tension in a society where respect and support for the elderly have been traditionally accepted principles. Moreover, the years of recession and the new, slower rate of economic growth have led to feelings of uncertainty fuelled by erosion of the system of lifetime employment, and to the appearance and prospect of unemployment. As opposed to the reassuring traditional career, where the steps of advancement had been nearly automatic (based almost exclusively on seniority), employees were now forced to increase efforts or even to make radical changes (in jobs, occupations, or work shifts) by a performance-centred wage-system and other new management methods introduced in the interests of the country or the company.

The structure of the economy underwent considerable change in the 1990s. At this time, as a great deal of production was relocated abroad, the share of manufacturing in the GDP started to decrease: at the beginning of the decade manufacturing accounted for 28.2% of the GDP, and by 1997, it had gone down to 24.3%.[8] A rise in business services and communal, social and private services partially offset this loss. However, and perhaps precisely due to the relocation process, the trend line showing the ratios of the various domestic industries within the GDP barely changed, suggesting a far lower flexibility on the part of the domestic market, or at least its clear priority in total sales. Yet, the manufacturing pattern was being upgraded, as was made obvious by the continuously growing added value it produced: 39.7% in 1990, and 41.8% in 1995.[9]

2.2. The role of women and the young in society

Traditional gender roles are being relaxed and male supremacy is declining. Legally, women have achieved equal rights, which

[7] In this section I am partly making use of some of the findings of an earlier research project of mine. (See: András Hernádi, "Society and the Economy in Japan on the Eve of the Third Millennium: Change versus Tradition", Working Papers of the Institute for World Economics of the Hungarian Academy of Sciences, No. 89, February 1998.) For their participation in that project, my thanks are due to Gábor Bakos, Zoltán Bassa, Judit Berényi, Antal Ferenc Kovács, István Kőrösi, Éva Ozsvald, Éva Süveges and Tibor Tejnóra.

[8] Comparative Economic and Financial Statistics, Japan and Other Countries, 1999, Bank of Japan, International Department, pp. 33-34.

[9] International Yearbook of Industrial Statistics, 1996 and 1999, UNIDO.

they more or less succeed in asserting in everyday life. We are witnessing epochal changes: women marry and give birth later, have fewer children, and sue for divorce more frequently. Their participation rate in employment (and in management positions) and education is growing. Parallel to the growing role of women outside the family, earlier 'women's duties' like caring for the elderly and the sick are gradually being shifted to the sphere of social duties.

By the end of the 1990s, significant changes had occurred with the appearance of relatively high (4.5% plus) unemployment rates, a rising number of people deciding to retire before the obligatory retirement age, and a growing number of young people being supported by their parents. Unemployment rates for youth in their teens and twenties were between 6 to 12 percent. An interesting, even if somewhat extreme, wording was put forward about the crossroads the young in Japan today have come to by Masahiro Yamada, Tokyo Gakugei University.[10] When referring to 'parasite singles' he had in mind the young people who wanted to remain with their parents for good, had no special object in life, and enjoyed spending money without thinking about the future. The term 'children of parasite parents' in turn meant parents who expect their children to care for them when they become older, in other words, who want to rely on their children's bank accounts in their old age. The Tokyo correspondent of *The Economist* even went so far as to report on a crisis among young Japanese, saying that the last decade had brought up a generation of young people who had lost their illusions.[11] These youngsters do not want to, and should they want to, they would be unable to follow the examples of their fathers in remaining at their first workplaces and giving priority to their companies over their families or personal aims.

2.3. Savings, domestic investments

Though falling, the Japanese household savings rate remained one of the highest in the world in the 1990s. In 1994, for instance, it stood at 12.8 percent, which was over three times the rate in the United States. The Japanese are encouraged in long-term saving by relatively high housing prices, education costs and old-age expenses, and although the savings rate may decline even further, funds will remain available for investment at the macro level, even if interest rates are low. Financial deregulation, to be discussed below, has allowed mutual funds to open up new target areas for household savings, since these quickly spreading ventures are particularly active in investing in new, dynamically expanding high-tech businesses.

Productive and non-productive investments undoubtedly play an important role in the growth process of the economy, even though growth has slowed down significantly. The financial resources required are supplied partly by personal savings, partly by the high proportion of centralized income, and partly, and significantly, by the trade surpluses built up year after year. (In the 1990s, the yearly foreign trade surplus was in the range of 0.5-2.3% of the GDP, while the share of government consumption expenditures and investments, including public works and outlays on infrastructure, went up from 15.6% to 18.3%. Concurrently, private fixed investment and money spent on housing showed a declining trend.[12]) Visitors to Japan are struck by the large number of infrastructural investments. Motorways, high-speed rail services, barrages, flood-control projects, tunnels and like projects are being built at immense cost using public resources. In the 1990s alone, a total of 112 thousand billion yen, the equivalent of more than USD 1,000 billion, was spent on public works programs intended to stimulate the economy, despite a

[10] The Nikkei Weekly, October 16, 2000, p. 4.

[11] "The Young", The Economist, December 23, 2000, Survey, pp. 11-13.

[12] Main Economic Indicators of Japan, August 2000, Ministry of Finance.

great deal of public criticism. Many people believed that wrongly chosen development projects, such as highways and railroads leading to remote areas of the country, would not have long-term benefits as they did not promote moves to the areas by either companies or people.[13]

2.4. Education and training

The fields of infrastructure in which even the Japanese believe they still lag behind their global competitors are in the intellectual rather than the material realm. They include education and training, which play crucial roles in social and economic development. There is much talk of the need for radical change in these areas, though the criticism is not aimed at the amount or proportion of expenditure. In these respects, especially regarding the contributions by private companies, Japan does not lag behind the other leading industrial countries. Yet, while Japan might be on par with them in outlays for basic education, funding for higher education (*i.e.* universities) should be increased.

Reform advocates call for conceptual or attitudinal changes, mainly inspired by fears that Japan may lose its international competitiveness. Most are calling for greater emphasis on the individual (as opposed to traditional group orientation) and creativity (as opposed to the adaptation approach). The reformists are calling for an end to the current uniform curriculum, identical in all Japanese primary and secondary schools, and to a resultant educational system, which holds the standard of education down to 'average' and has no place for the faster/individual development of more talented students. They want to end Saturday morning classes and introduce five-day teaching, and there have even been some unrealistic proposals calling for cutbacks to three school-days/week to give students more time for individual specialization. Not much is said, however, about the urgent need to re-educate the teachers themselves. There are, of course, fierce traditionalist opponents of school reform involving more independence and school choice.[14]

2.5. Research and development (R&D) and information technology (IT)

Post-war economic development was partly triggered by new technology. According to the Economic White Paper of the Japanese Government, 40% of GDP growth in the 1980s was still the result of technical development. By the end of the decade, however, growth had suddenly slowed down, which also cut back development outlays. In 1993 and 1994, R&D expenditure decreased even in absolute terms, and their 3% share of the GDP in 1990 and 1991 went down to 2.8%, recovering again in 1995, but not achieving the 3.5% target set for the early 1990s. The number of researchers, though, kept on increasing throughout the decade, indicating that interest in research by individuals, companies and overall society had not diminished, even though expenditure per researcher had dropped. On the other hand, an earlier trend of a relatively small (around 20%) share of publicly financed R&D, remained unchanged in the 1990s.[15]

In its section on R&D, the Economic Planning Agency (EPA) 'plan' for 1996-2000 did not focus on basic research, but on the fastest possible application of results, thereby hoping to stimulate economic growth. The document pointed to the most

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[13] David Asher, a Japan specialist at the Massachusetts Institute of Technology (MIT), has dismissed these projects very graphically, calling them examples of 'strategic surrealism'. (Far Eastern Economic Review, November 11, 2000, p. 42.)

[14] Hidenori Fujita, dean of, and professor at the Tokyo University College of Education is typical of the critics, believing that the reform ideas are neo-liberal, market-oriented concepts that aim to privatize education and turn it into a 'product'. ("Japan: Crisis, Public Education and the Role of Teachers", NIRA Review, Vol. 4, No. 3, Summer 2000, pp. 16-20.)

[15] Indicators of Science and Technology, Science and Technology Agency of Japan, various issues.

important new areas of research, such as new materials, IT, telecommunications, electronics, and life sciences, and stressed the need to specify areas and sub-fields on which new industries could be built. The government also passed a special 'plan' on science and technology policy for 1996-2000 in early July of 1996. The main target was to raise the share of the public sector in financing R&D to that of the other leading industrial countries, that is, to around 1% of the GDP.

In the middle of the 1990s, a number of Japanese experts sounded an alarm, saying that the technological great-power position of the country was at risk. As an extreme example of pessimism, it is worth quoting the following train of thought and then comparing it with Japan's actual international positions in information technology and some of its outstanding R&D achievements at the end of the decade: "A crisis is threatening Japan, the technological great-power. The technological foundation for the majority of manufacturing industries is continuously weakening. Japanese companies have been lethally wounded and are no longer competitive in the fields of IT and communications, the fundaments of the next industrial revolution… We must not be content with the vanishing glory we have achieved in product manufacturing. We must urgently create a technological basis capable of accomplishing an industrial revolution built on information and communication technologies."[16]

A survey published recently by *The Economist*[17], presents a heterogeneous picture of Japan's international position in global IT-competition. In 1999, the US led the world in personal computer (PC) density, with 55 computers per 100 capita, while Japan was roughly on the same level as France and Germany with 32-33/100 capita. All three lagged behind Sweden, Australia, Canada and Britain. Meanwhile, 36 of the world's 50 highest-turnover IT companies were from the US, 9 were Japanese, and only 4 were European. IT equipment in the US accounted for 7% of the total capital assets, whereas the respective figure for Japan and Germany was 3%. The share of IT production in the GDP was 7% in the US, 6.5% in Japan, and 4% in Europe. As to the share of investments on IT in the GDP, the leading industrial countries were basically on par with one another (*i.e.* 7-8%), with the exception of Germany (5.5%). With respect to the number of Internet providers per 1,000 capita in July 1999, the US ranked first with 160, way ahead of Britain (35), Germany (20), France (15), and Japan (10), while the costs of off-peak ten-hour usage was exactly the reverse, ranging from USD 35 to 90.

Japan's strong technological and R&D position at the end of the decade included the following features:

* Japan's leading position had not changed with respect to 'traditional' industrial robots. In 1999, the Economic Commission of the United Nations gave total numbers in Japan as 402,000, with only 93,000 in the US, and 81,000 in Germany. Japan also ranked No. 1 in sales with 36,000, ahead of the US (15,000) and Germany (11,000).[18]

* The application of robots offers countless new opportunities. One of them involves a robot capable of imitating the synchronized use of the human brain and hands, a problem solved by a research team at Keio University.[19]

* Medical researchers at Osaka University announced that they succeeded in developing an artificial lung that could be introduced without the danger of inducing inflammation.[20]

* Researchers at Tokyo Science University reported the discovery of an ingredient

[16] Atsoru Kokubo, "Gijutsu taikoku Nippon no kiki", Voice, October 1999.

[17] "Untangling e-conomics. A survey of the New Economy", The Economist, September 23-29, 2000, pp. 1-44.

[18] The Economist, October 21, 2000, p. 142.

[19] The Nikkei Weekly, May 24, 1999, p. 3.

[20] The Nikkei Weekly, October 11, 1999, p. 9.

that could simultaneously prevent the metastasis of cancerous tumours and boost the impact of other anti-cancer drugs.[21]

* On behalf of the Organization for the Development of New Energy and Industrial Technologies, a research team of Hitachi Ltd. and three other companies designed a more effective method of using heat in the treatment of cancer.[22]

* 'Electronic guides', introduced to the market in the summer of 1997, are essentially handheld navigational computer terminals beamed at the Global Positioning System (GPS). They operate like the navigational mapping software built into cars and always show the quickest route to a given destination. By 1998, there were 1.24 million in use world-wide, and Japan has produced four-fifths of them. They are tiny, handheld, and not restricted to cars. Opportunities for sales are almost limitless as they can show the way to all shops, businesses and services ready to pay for being included on their maps. NTT Communications Network Inc. is planning to include the GPS function in their cellular phones.[23]

* There is likely to be a high demand on the Japanese market for computers capable of translating the spoken word. They are more advanced than the highly popular electronic pocket dictionaries, since they include voice-recognition. The system, introduced in Japan in July 1999, was jointly developed by the Advanced Telecommunications Research Institute (ATRI) and Matsushita Electric Industrial Co.[24]

[21] Ibid.

[22] The Nikkei Weekly, October 25, 1999, p. 11.

[23] The Nikkei Weekly, May 31, 1999, p. 11.

[24] The Nikkei Weekly, September 6, 1999, p. 7.

2.6. Financial deregulation, the so-called 'Big Bang'

Plans for a 'Big Bang' to liberalize the financial system in Japan were begun in 1996 by the then ruling Hashimoto administration, allegedly because of fears that Japan might lose its role as the financial centre of Asia to Singapore and Hong Kong.[25] I, myself, was rather sceptical of this monumental reform program, particularly regarding the idea of introducing it in one fell swoop that would result in a free, transparent, reliable and internationalized financial market. As the time horizon was set at about 2003-2004 by the various governments, the program can rightly be called the 'Big Bang *à la Japonaise*'. The process began with the abolition of foreign exchange controls in April 1998, followed by a series of financial reform laws, which significantly expanded opportunities for financial investment, freed up the prices of financial services, and allowed new actors much easier access to the financial service markets.[26] Numerous regulations were scrapped under the deregulation watchword but, as one critical expert from Japan put it,[27] not much has been done to set new rules or to establish the physical infrastructure necessary for the accomplishment of (new) financial transactions. Ikeo even went on to say that with respect to a basic index such as the rate of own resources compared to profits, Japanese institutions would have to cut it back by at least 50% if they wanted to match their Western counterparts. They also needed to significantly reduce their operating costs.

The last two years also have seen the Japanese system of accountancy more closely approximate international norms. From 1999 on, Japanese rules of accountancy have forbidden a formerly widely used practice in which banks and industrial com-

[25] The Japan Times, October 4, 2000, p. 20.

[26] We shall cover the liberalization of the market for banking and insurance in the next sub-heading.

[27] Kazuhiko Ikeo, "Reforming the Financial System to Revitalize the Economy," Japan Review of International Affairs, Summer 2000, pp. 122-125.

panies 'buried' their losses within partially owned sister-companies. Another change put an end to a trick used mainly by car manufacturers, which did not include the losses of their dealers in their year-end results. In 2000, a new regulation was adopted under which companies were obliged to record their assets in securities not at book, but at daily market value. One expected outcome might be to force companies holding and cross-holding shares, which they commonly did as gestures of 'friendship', to either share the risk or get rid of the bad papers.[28] Apart from outlining the most urgent tasks, the proposal submitted to the prime minister by the Council for Economic Strategy in February 1999, also included suggestions for structural and social reforms. By the end of 2000, banks should have got rid of the majority of their bad loans and companies ought to have straightened out their balance sheets.

2.7. Liberalization in the banking and insurance sector

The changing international role played by Japanese banks and other financial institutions in the 1990s deserves special attention. In 1993, calculating in amount of monetary deposits, 18 of the world's 25 biggest banks were Japanese. Total deposits at Norinchukin Bank, which ranked No. 1, surpassed USD 386 billion, whereas at the Bank of Tokyo, No. 24 on the list, deposits were USD 176 billion. However, the share of bad debt bank portfolios rose suddenly: by 1995 it was USD 500 billion, or more than 10% of the GDP and of all bank deposits. The problem of handling bad debts will not be resolved earlier than the present decade, since no ruling government would dare to risk a radical purge of bank portfolios. That type of intervention would surely result in a series of immediate bankruptcies, which would shake overall trust in the financial system.[29]

As an alternative solution, the biggest Japanese banks seem to have chosen the strategy of 'forward escape'. In less than three-quarters of a year, between August 1999 and April 2000, the biggest commercial banks of Japan have accomplished the process of merging into groups. As a result, Mizuho, the biggest group, combining the forces of Industrial Bank of Japan, Dai-ichi Kangyo and Fuji Bank, came out as No. 1 in the world by assets,[30] with Sumitomo Mitsui Banking Corp. finishing as No. 2. In March 2000, the Sanwa-Tokai-Asahi group was established, and then in April 2000 an earlier 'couple', the Bank of Tokyo-Mitsubishi Bank was joined by Mitsubishi Trust and Banking Corporation, Nippon Trust Bank and Tokyo Trust Bank, thus bringing the process to (temporary?) completion. Yet, notwithstanding the fact that these big banks all showed profits in 2000, and the biggest 17 Japanese banks have already written off some 50 trillion yen (about USD 440 billion) in bad debts since 1995, they still had, according to their own estimates, bad or uncertain debts totalling 19.5 trillion yen (almost USD 180 billion). A foreign expert working at ING Barings put the amount at USD 310 billion.[31]

The situation in the fall of 2000 was criticized quite severely in an editorial by The Japan Times: "It appears that they are

[28] However, in a typically Japanese way, news has been leaking in on possibly postponing the introduction of this regulation or on creating loopholes. The deadline for recording assets at market value has been deferred to 2003 on real estate kept for investment and not commercial purposes, and on sister-company stocks kept as long-term investment. In connection with the latter, the share of securities appearing in last year's company reports under the heading of 'long-term investment' has grown by leaps and bounds at the expense of the 'marketable' securities rubric. (The Economist, November 18, 2000, p. 115.)

[29] There were, of course, some minor bankruptcies with an impact that was not merely psychological, and this was a likely contributor to a substantial increase in the popularity of US treasury bonds among the Japanese.

[30] At the end of March 1999, they were estimated to hold 142 trillion yen or about USD 1,300 billion, roughly 1.5 times more than Deutsche Bank and almost twice as much as Citigroup.

[31] The Nikkei Weekly, October 18, 1999, pp. 1-4, The Economist, March 18, 2000, pp. 84-85, and May 27, 2000, p. 90.

looking inward to compete mostly with domestic rivals, instead of looking outward to play on the world stage. In fact, international expertise is one thing that they need badly to compete with US and European megabanks. They need, for example, analysts and traders with a global perspective and experience, as well as finely calibrated strategies for cross-border mergers and acquisitions… The real test for Japan's financial giants will be whether they can match their size with strength and quality. For that, they need an offensive strategy aimed at the global market, not a defensive policy geared to the domestic market."[32] As a part of such an outward looking strategy, foreign participants could undoubtedly play a bigger role. One very specific example of foreign penetration involves the Long Term Credit Bank, formerly in state ownership, that was sold to an American consortium in September 1999.

As if to follow suit, insurance companies have also established groups. The four biggest groups are the Mizuho Financial Group, the Mitsubishi Tokyo Financial Group, UFJ, and the Mitsui Sumitomo Banking Group.[33] Over the last year-and-a-half foreign firms have elicited a breakthrough with buy-ups. The first one, in April 1999, was Manufacturers Life Insurance Co. from Canada, which reached a joint venture agreement with Daihyaku Mutual Life Insurance Co. It was followed by General Electric Capital Corp. which, together with the bankrupted Toho Mutual Life Insurance Co., set up GE Edison Life. Artemis from France bought Aoba Life Insurance Co.; the American Aetna International Co. acquired 33% ownership in Heiwa Insurance Co.; Axa Life Insurance Co. from France and Nippon Dantai Life Insurance Co. set up Axa Nichidan Life Insurance Co. Foreign penetration continued in 2000. At the beginning of the year the Winterthur Group from Switzerland bought Nicos Life Insurance Co.; in May the US based Prudential Insurance Co. became the owner of Kyoei Life Insurance Co; and in September, American Family Life Insurance Co. reached a cooperation agreement with Dai-ichi Mutual Life Insurance Co. Perhaps the biggest deal of all was on October 10, when AIG (American Investment Group Inc.) undertook to mend Chiyoda Mutual Life Insurance Co., which had been bankrupted with a debt worth about USD 27 billion. AIG must have been strongly motivated by the chance to acquire Chiyoda's vast list of customers (at the time it had over 1.3 million contracts).[34]

2.8. Foreign trade

Changes in the domestic economy were partly reflected in Japan's external relations in the 1990s. The most striking changes were likely the ones that occurred as a result of the trend-like resettling of the manufacturing industry abroad or, as the Japanese put it, the 'hollowing out'.

The regional structure of exports in the 1990s reflected a practically stable 30% US share and a very dynamic increase of that of the People's Republic of China (from 2.1% to 5.6%), while the role of the other Asian markets dropped somewhat, as the likely consequence of the Southeast Asian financial crisis of 1997-1998. In this respect the only exceptions were the Philippines, Vietnam and Taiwan, where the crisis had a smaller impact. The decrease in the share of Germany (from 6.2% to 4.5%) is also thought provoking, but one has to wait for the data of the next decade to see if a new tendency was in the offing. The regional structure of imports showed more change even though the share of the US remained stable (22-23%). The most significant moves here were the spectacular increase in the share of the PRC (from 5.1% to 13.9%) and the drop in that of the Middle East and Indonesia (from 13.3% to 9.9%, and from

32 "Banks must get better not just bigger", The Japan Times, October 4, 2000, p. 20.

33 A detailed description of the participants in the groups and on the ongoing process of intertwining can be found in The Nikkei Weekly, November 6, 2000, p. 2.

34 The Nikkei Weekly, October 16, 2000, p. 1.

5.4% to 4.1% respectively). In addition, there has been a general trend towards a slow but continuous decline in the shares of West-European trading partners and a similarly slow but continuous growth in those of Southeast and East Asian countries. As for the commodity structure as defined by the single digit SITC classification, there has hardly been any significant change in exports as the share of machinery and transport equipment (7) held fast at 70%, and that of other industrial products (6+8) at around 20%. But there have been significant modifications on the import side, where the share of raw materials (2+4) and that of fuels (3) went down (from 13% to 9%, and from 24% to 19%, respectively), while that of machinery and transport equipment (7) grew from 15% to 25%. Clearly, a decline in the relative energy and raw material intensity of the Japanese economy, a drop in the prices of fuel and raw materials,[35] and a need to meet a part of domestic demand left open by the departure of certain manufacturing capacities, and more 're-imports' were the factors behind this major structural change.

2.9. Inward and outward direct investments

Japan's foreign direct investments were aimed not only at acquiring and keeping markets (even if that remained their main motivation) but were also an organic part of the cost-cutting strategy of Japanese companies. Wage costs in Japan were surpassed only by those of Germany among the highly industrialized countries. As a result, for example, Matsushita, one of the biggest Japanese manufacturers of electric and electronic appliances, doubled its overseas workforce between 1991 and 1998 (increasing it to 134,000), while its domestic one grew by only 6,000 (to 148,000).[36] Moving R&D and component production out of the country has started to play an increasing role in investments. In R&D, the countries of the Far East were the preferred sites for planning and development directly preceding the manufacturing process, while the US and Western-Europe, better off in expertise and more liberal in their economic regulations, were chosen for basic research.[37] The direct investment boom of the 1990s (the total sum of Japan's FDI in the course of nine years was USD 420 billion![38]) was a major contributor to increasing the proportion of foreign-based production by Japanese manufacturing companies from 6.4% to 10.0% from 1990 to 1994. The respective shares in the production of transport equipment and in the electronics industry grew from 12.6% and 11.4% to 20.3% and 15.0%.[39] (According to the advisory council of the prime minister, Japan's overseas production should reach 19% of its GDP by 2010[40] – an almost four-year-old forecast I would accept with reservation.) The average value of foreign direct investment by Japan has more than quadrupled in the course of the decade (from USD 9.3 million to USD 38.1 million), in my opinion, reflecting Japan's having joined the global M&A megabusiness.[41]

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35 On the basis of volume indices, there has been no reduction in imports in absolute terms in these commodity groups.

36 International Herald Tribune, November 12, 1999, p. 15.

37 Masato Ishizawa, "Industry Shifts More High-Tech R and D Overseas to Tap Foreign Talent Pool", in: Japan Economic Almanac, 1996, Nihon Keizai Shimbumsha, p. 38.

38 Equalling 7% of the cumulated amount of all private fixed investments at home in the course of the decade. (The respective flow figures in 1991 and 1999 were 6.5% and 9.5%.)

39 See fn. 37 and Takeshi Shitani, "Reasons for the Fall in Japan's Trade Surplus and the Outlook for the Future", Japan Research Quarterly, Summer 1996, p. 120. A more recent source has put the share of overseas manufacturing at 13% for 1997. (K. Cowling – P.R. Tomlinson, "The Japanese Crisis: A Case of Strategic Failure?", The Economic Journal, June 2000, reviewed in "Japan's Hollowing Economy", Economic Intuition, Fall 2000, p. 4.

40 The Nikkei Weekly, March 31, 1997, p. 26.

41 My own calculations on the basis of the Internet database "Foreign Direct Investment", Ministry of Finance, Japanese Government (http://www.mof.go.jp/english/fdi/e1c008h1.htm).

Foreign direct investments into Japan appeared meagre beside the capital exports of Japanese companies. The weak position of foreign investors in Japan was indicated by a survey made in March 1994 by the Ministry of International Trade and Industry (MITI) among 1,199 companies that were at least one-third owned by foreigners. It found that they had a mere 0.9% share in Japan's the total trade turnover. Their share in manufacturing was somewhat higher (2.3%), but was even smaller in the field of services (0.4%).[42] FDI inflows in the 1991 fiscal year totalled a record-high USD 4.3 billion, then fell or levelled out in the years of economic stagnation, but by 1996 they were up to USD 7.1 billion. Another setback in 1997 was followed by a dynamic rise in 1998 and 1999 (to USD 10.2 billion and USD 21.1 billion). Although the average value of the yearly FDI inflows by the end of the decade remained relatively small (USD 12 million), it was twelve times bigger than 9 years earlier, still suggesting a phase delay compared with outflows, and the *de facto* survival of some FDI controls.

2.10. New management methods

Foreign concerns playing an increased role in Japan have also left their mark on Japan's well-known business methods. By the 1990s, investors from the US and (Western) Europe had realized the relative vulnerability of the Japanese corporations they had formerly envied, and had begun to realize that the key to their success lay in transferring their management methods, often even coupled with their own top managers, to Japan. At the same time, several leading Japanese firms decided to put 'local', in other words Japanese, managers who had gathered vast experience abroad, especially in the US, into top positions.

An excellent example of these methods was the way Renault, viewed with huge interest by the world, found its inroad into Japanese car manufacturing. Simultaneously to buying up 37% of Nissan, Renault assigned their former vice-president, Carlos Ghosn, who had been born in Brazil as the son of Lebanese parents and later settled and acquired citizenship in France, to reform Nissan. Similar cost-cutting measures were introduced at Mazda, where the American Ford Motor Co. had a 33% ownership share. It appears as if the participation of foreign capital, apart from other advantages, has offered Japanese companies wider leeway in making unpopular moves. In a replica of the Renault-Nissan deal, the German-American firm, Daimler-Chrysler, acquired a 37% share in Mitsubishi Motors and sent in their own man, Rolf Eckrodt, as CEO. Further news on the internationalization of Japan's car manufacturing includes an announcement on September 14, 2000, that General Motors would double its 10% ownership in Suzuki Motor Corporation, and John F. Smith Jr., the chairman of GM would serve on a part-time basis (!) as one of the top persons at Suzuki. The two companies have also held out the prospect of changing off their experts in business and model planning, sub-contracting and finances.[43]

A production revolutionizing innovation, introduced in electronics manufacture, was aimed at breaking with the assembly line, once considered the manufacturing industry mainstay. The chairman of Nippon Electric Company's (NEC) Saitama production facility argued that the assembly line was simply eating up electricity, taking up too much room, and adding no value to the product. Its only purpose, said he, was to move objects from one place to the other. But by seating workers close enough to each other, the conveyor belt could be fully dispensed with.[44] It is quite easy to identify the practice of combining the traditional and the new, so typical of Japan. On the one hand, we can identify the Japanese way of economizing on space, raw materials and energy (in short, miniaturization), while on the

[42] "Sekai to Nihon no Kaigai Chokusetsu Toshi", JETRO, 1996, pp. 64-65.

[43] The Nikkei Weekly, September 18, 2000, p. 8.

[44] Look Japan, August 1996, pp. 8-10.

other, we also can see the idea of 'humanization' that started out from Sweden decades ago. Members of a work group seated in a U-shaped assemblage became multi-functional, as opposed to the single operations required by a strict division of labour, and thereby achieved a 40-45% rise in productivity. "Automation does, of course, increase productivity but to a certain point only, as machines cannot think. The human potential is, however, limitless. You just have to give them the proper motivation and they will become unbelievably efficient."

Regarding the change in management methods, the most general summation seems to be that the typically Japanese management system known as 'stakeholder capitalism', aimed at simultaneously meeting the interests of suppliers, employees, employers and owners, is gradually giving way to the more universal system of 'shareholder capitalism', where decisions are made exclusively from the point of view of the shareholder. It might not be an exaggeration to say that this change, with its impacts on the economy and society, equals the one the countries of Eastern Europe went through when they moved from planned to market economies. Continuing with parallels, we might say that both processes were not simply transitions but transformations.

2.11. Domestic policies

It became increasingly obvious in the 1990s that the end of the Cold War had also robbed the 35-year-long hegemony of the Liberal Democratic Party (LDP) of one of its supports. There was no longer an outside force that had to be impeded, and the weakening of the economic pillar of stability and the stagnation of the 1990s undermined faith in the success of the 'Japanese economic miracle' and in the subsequent period of much slower growth. These worries were aggravated by the financial crisis (the 'bursting of the bubble') and corruption scandals. All these developments brought about a loss in trust of such magnitude that a political metamorphosis appeared unavoidable.

The necessity of change was also realized within the governing party. Conflicts among the former factions of the party and their typical behind-the-scenes infighting and compromises came to the surface. Some leading figures within the LDP, realizing that the party was undergoing a crisis of confidence, thought to preserve their positions and conservative rule by leaving the party and founding new ones. In keeping with the wisdom that necessity knows no law, temporarily accepting a coalition with the Social Democratic Party fit into their tactics, even to the point of offering the post of prime minister to the Social Democrat leader, Tomiichi Murayama, in 1993. These difficult-to-follow coalition combinations, party and government (re)shuffles hardly changed any fundamentals of the policy pursued by the successive governments. The result was that the Japanese public became deeply disillusioned with politics and sceptical of policy-makers. But, those who did not turn their backs on politics altogether still preferred the stability (or hope of stability) in the LDP to the 'reformers', which seemed better at party manoeuvring than at real reforms. As an understandable result of these machinations, the circle of people disappointed with, and staying away from, the political parties or simply not voting kept on growing, the LDP, which was able to simultaneously preserve and reform conservative traditions still got the highest vote of confidence. The left-right division of earlier decades has more or less come to an end, as the Socialist Party has lost its base among the electorate. As the political polarization relaxed, other political problems were put on hold, so that the government could concentrate on stimulating the economy and/or financial stabilization.

2.12. Foreign policies

While Japan has developed into an economic giant, the Japanese public has been opposed to having the country play an active role in world politics. However, it is increasingly argued that Japan has to become more important on the international political scene simply to sustain its economic superiority. The chances of its doing so have much improved as other countries have shifted away from criticizing the country ('Japan-bashing') to vying with it ('Japan-passing').[45]

However, there is a clear consensus that Japan's role in world politics is shaped basically by its alliance with the United States. A new element in this relationship was the joint security declaration signed in the spring of 1996, which showed a move by the Japanese towards relatively greater independence and burden-sharing. The ambitions to achieve more independence were not only triggered by the international political rearrangement after the Cold War, but by the economic 'overload' in the Japan-US relationship, manifest in disputes over the flow of goods, capital, and technology. In our view, the same factors may also explain the momentum given to strengthening Japan's contacts with Western Europe (and less importantly Eastern Europe), and the renaissance of its relations with the Far East in the 1990s.

This might just as well be called a reinforcement or completion of the third side of a world-wide trilateralization, but Japan's true motives are perhaps better understood in terms of establishing and having reserve (economic) alternatives to the United States. This argument is supported by developments in the Asia-Pacific region, where Japan's leading position has been weakened by the emerging sub-regional and global influence of the Chinese Community (China itself, with Hong Kong, Taiwan, Singapore, and the economic elite of some other Southeast Asian countries), and in general by the significant decline in its growth rate. Yet, these developments also gave Japan some theoretical ammunition, which it communicated to the other two poles of the world economy. It pointed out that should they choose to turn inward, Japan, too, could turn the Asia-Pacific 'bloc', which it had brought into being and had been initially proud to keep open, an inward-looking one.

In the 1990s, following the Middle East and former Yugoslavia, the Far Eastern was the region where conflicts posed the greatest risk to international security (the two Koreas, the People's Republic of China and Taiwan, rapid regional rearmament). Japan has been increasing its role in UN peacekeeping – initially providing mainly intellectual[46] and financial assistance, but latterly sending Japanese forces abroad, as well. It has begun to lobby strongly for permanent membership of the UN Security Council. However, it still gives priority to enhancing the security of its 'own' region by economic and political means. Its diplomatic efforts, like its aid policy, have been subordinated to this, offering, for example, increasing amounts of help to various sub-regional initiatives. Japan clearly realized that the increase in interdependencies would automatically lead to a lessening of the threat. This multilateral activity has helped to allay regional fears of a revival of Japanese militarism.

With Russia, the post-war territorial issue of the northern islands is still pending, which prevents the conclusion of a peace treaty and hampers the expansion of economic relations. Unsurprisingly, therefore, Japan has strongly objected to Russia joining the G7 group. However, direct relations with specific Russian territories and organizations in the Far East, circumventing Moscow, and Japan's strikingly active interest in the Central Asian successor states are worth attention.

Finally, Japan upgraded its participation in various international institutions (the

[45] Professor Toru Iwami, Tokyo University, uses this distinction in his paper written for the Institute of Foreign Affairs in Rome. ("Japan's Foreign Economic Policy in the Age of Globalization", Tokyo, 1997, Mimeo, p. 2.)

[46] The post of the UN High Commissioner for Refugees, for example, has long been held by Ms Sadako Ogata, a former professor of Japan's Sophia University. Since January 1, 2000, she has been working as director of the UNHCR's regional office in Tokyo.

OECD, the World Bank, IMF, EBRD, the Asian Development Bank) in the 1990s. The most recent development was a proposal put forward by Japan at the Hong Kong meeting of IMF in September 1997, proposing that an Asian Monetary Fund worth USD 50-60 billion be established. Having heard vehement objections from IMF and the United States, Japan and some Southeast Asian countries, by then in a position of enhanced dependence in the wake of financial developments, decided to make do with a less provocative version of the original idea, more in line with the existing international financial organizations. Yet the initiative enjoyed a very enthusiastic reception from the Southeast Asian countries.[47] In its dealings with the transitional economies of Central and Eastern Europe, the popularization of Japan's post-war economic policies and the financial and technical assistance rendered for environment control deserve to be mentioned.

3) Prospects for the Next Decade

The first scenario for transformation that has so far proved indisputable was written in 1985 by Taichi Sakaiya, who was recently removed from his position as chief of the Economic Planning Agency (EPA) by prime minister Mori. Sakaiya, in his book "Chika Kakumei" (Knowledge-Value Revolution),[48] argued that industrial society had to be replaced by a system that rested on an intellectual foundation, where the two most important management resources were wisdom and knowledge. He realized that, in an era when multinational corporations can transfer production to any country where manufacturing costs are low, Japan could not remain the world's factory. Japan can sustain its international position only if it learns to shift its focus from producing 'physical value-added' to creating 'intellectual value-added'.

As for the areas to be developed, more concrete proposals were put forward by Professor Shigeto Tsuru, rightly renowned both in and outside of Japan, in his book "Japan's Capitalism".[49] Based on Japan's comparative advantages, he has suggested developing Japan into a world centre of tourism and healthcare. Tsuru believes that Japan should do its utmost to promote the international exchange of cultural and artistic activities in order to make the UN University in Tokyo the world's centre for education, research, and technological innovation, which could contribute to the social and economic development of the Third World. In the interests of this latter goal, he also called on Japan to increase its volume of financial and technical assistance to the developing countries and to open its markets even more widely to the manufactured products of these countries.

Events in the corporate sector in 2000 have made it obvious that the process of concentration in the banking and insurance sector will be followed by similar ones among industrial and commercial companies. The mergers and strategic alliances typical of the world economy in the 1990s have undoubtedly also promoted this. In addition, the corporate sector is likely to put pressure on the government to ease Japan's immigration regulations, as the ageing of the Japanese population will soon require measures to reduce the (structural) shortage of labour.[50] This makes it more likely that the government will become more prone to al-

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[47] The Nikkei Weekly, September 29, 1997, pp. 1 and 23. No matter that the idea of an AMF was not realized, in the framework of the so-called Miyazawa initiative Japan has offered the region bilateral loans worth USD 64 billion.

[48] Cited by The Nikkei Weekly, January 17, 2000, p. 7.

[49] "Japan's Capitalism: Creative Defeat and Beyond", Cambridge University Press, 1993, pp. 226-235.

[50] According to demographers, after a peak of 128 million (to be reached in 2007) the population will begin a rapid decline. While today, there are four people in the economically active sphere to support one retiree, in 2025 there will be only 2.2 economically active people per Japanese retiree. At present, taxes and welfare costs combined constitute 36% of the GDP, and that ratio is expected to surpass 60% of the GDP by 2025. (The Economist, July 1, 2000, p. 28.)

lowing in immigrants, especially nurses able to care for the elderly and (Chinese and Indian) technicians who excel in handling simpler computer concerns.

A change in the commercial code scheduled for implementation in 2002 is due to make a distinction between huge corporations whose shares are traded publicly and smaller ones with only privately traded shares. It is intended to promote the establishment of small businesses. Changes in legislation to simplify annual shareholders' meetings and reduce the personal damage liability of board members are intended to facilitate foreign participation.[51]

Japan appears to be a pragmatist in cultivating international relations. Considering the obstacles to advancing (Asia-Pacific) regional cooperation, it might prefer to enlarge its circle of bilateral free-trade agreements. As negotiations on FTA with Singapore are already in an advanced stage, it is holding out the prospect of similar agreements with Canada, Chile, Mexico and South-Korea.[52] At the same time, a document entitled "Japan's Goals in the 21st Century"[53] repeatedly names, not too typically for Japanese officialdom, two countries in East Asia, the PRC and the Republic of Korea, with which they hope to build long-term relations based on stability and confidence. Another telling comment alludes to 'the Korean peninsula' (surprising for Japan, even in brackets). While it targets the market of the PRC with its growing need and ability to pay for infrastructural development, Japan is certain to keep open its option to play the 'Taiwan card'. When in late 2000, Japan announced an agreement on a major deal to supply Taiwan with high-speed rail cars and control systems,[54] it was clearly understood that this was a springboard to winning contracts for similar projects in the PRC, in competition mainly with European rivals.

Some recent agreements in international relations suggest that the corporate sector is continuing to drastically change its way of thinking. In the spring of 2000, for example, Mitsubishi Heavy Industries Ltd. and Boeing Co. were putting the finishing touches on a comprehensive business alliance agreement, under which they could acquire a leading position in the USD 200 billion global aerospace market.[55] The same agreement covers cooperation in R&D for the next generation of satellites and missiles, and in passenger aircraft maintenance. The joint development of telecommunication satellites and Boeing's superjumbo jets was also included in the deal.

As to Japan's role in international finances, there are numerous conjectures regarding the future of the yen. As opposed even to my own earlier view that the Japanese currency would increase its international role, it now appears more likely to lose some of it, as the dollar has succeeded in increasing its popularity on the heels of 1980s changes in world politics and the growing economic power of the US in the 1990s. Moreover, the appearance of the euro and its manifestation as 'real' money (*i.e.* bank notes and coins), reinforced by the deepening and enlargement processes of the European Union, offers a globally applicable alternative that is tempting even to Japanese companies.[56] However, it is also true that Japan's financial leaders have never really wanted to burden the country by turning their national currency into an international means of payment.

The role played by government or other top-level interventions will decline in Japan as the country will, in this respect too,

[51] The Nikkei Weekly, September 11, 2000, p. 2, and The Economist, November 18, 2000, p. 91.

[52] The Economist, November 18, 2000, p. 80.

[53] "Japan's Goals in the 21st Century", Background Information about Japan, Foreign Press Center, Japan, No. 005, January 28, 2000, pp. 11-12.

[54] A consortium of Japanese companies will supply the USD 3 billion worth of trains, scheduled to go into service in October 2005 on the rail line connecting Taipei and Kaohsiung, 350 kilometres apart. (The Nikkei Weekly, December 18, 2000, p. 2.)

[55] The Nikkei Weekly, April 10, 2000, p. 8.

[56] Sony Corp., for example, announced in April 1999 that they had chosen the euro as the sole means of accounting in their European transactions. (The Nikkei Weekly, January 10, 2000, p. 13.)

gradually 'blend in' with global development trends. One might have noticed, even at the end of the 1990s, that ministries formerly enjoying huge prestige and importance, like the Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MoF), had to face a relative decline in the importance of their domestic positions. This tendency will, no doubt, go on,[57] notwithstanding the fact that on January 6, 2001, a huge organizational change was introduced to Japan's government administration. At a cost of USD 400 million and requiring 33,000 employees to move, the number of ministries and 'agencies', was cut from the previous 22 to 12 plus a cabinet level office for the prime minister. Meanwhile, foreign investors acquiring an increasing role in domestic industries, and market conditions gaining ground in the financial sector, also will reduce chances for administrative intervention (or, if you will, 'guidance'). Even Keidanren, the Federation of Economic Organizations representing the biggest private companies, has started to play a low key role as a go-between. All these developments can also be interpreted as concomitants of information technology.

As if to echo Sakaiya's fifteen-year-old view cited at the beginning of this section, it seems obvious by now that the manufacturing industry cannot remain the mainstay of the Japanese economy. As shown earlier, its share in the GDP already started moving downhill in the 1990s. More and more Japanese economists are calling for a switchover to 'sustainable' manufacturing, which would resolve the dilemma of environment control by almost fully recycling all products. The best way to translate the expressions used by the Japanese to depict their concept might be to speak about 're-collecting industries' as opposed to 'forwarding industries'. (The comparison they draw is also very expressive: they speak of arteries and veins.)

A report submitted to then prime minister Keizo Obuchi on July 5, 1999, by the former president of Toyota Company, Shoichiro Toyoda, Chairman of the Economic Council, and entitled "Ideal Socioeconomy and Policies for Economic Rebirth",[58] was a document setting forth the country's goals for the next ten years but deliberately avoiding the word 'plan'. As such it was the first one formulated in Japan since the publication of the famous ten-year national income-doubling plan of 1960. When giving it the title, the intention was to express the changeover from traditional government control to a free economy oriented towards individuals. In this spirit, the Economic Council truly encouraged citizens to express their views on the draft. Local symposia were held and reactions over Internet were encouraged.

The report included three groups of priorities, together with the respective measures to be taken by the government. In spite of wording which is quite general, the priorities are worth citing: (i) Promotion of societal development, characterized by a variety of knowledge, freely accessible and attractive economic conditions, transparent and fair market relations, and adequate protection of consumers' rights. (ii) Preparation of society for the long-term consequences of low birth-rates, ageing and even a declining population,[59] which must include the establishment of a reliable and efficient social security system, the building of an age-neutral society, and the proper handling of low birth-rates. (iii) The environment has to be brought into harmony with society. To this end, a cyclical socio-economy has to be set up, equally incorporating production, consumption and recy-

[57] After having to give up its former, nearly manual, control of banking activities as of 2001, the MoF, for example, is no longer the sole authority in designing the national budget: the key figures and core ratios will be set by a new council under the (cabinet level) office of the prime minister. (The Economist, January 9, 2001, p. 51.)

[58] "Ideal Socioeconomy and Policies for Economic Rebirth – To the Era of Knowledge", Economic Planning Agency, Government of Japan, 1999 [?]. (Year of publication and page numbers were not indicated.)

[59] In 1995-2000, the population rose by a mere 1.1%, the lowest rate in the post-war era. Growth was equal to 0.2%/annum. (The Nikkei Weekly, December 25, 2000 – January 1, 2001, p. 2.)

cling, and proper answers must be found to the global problems of the environment.

The report "Japan's Goals in the 21st Century" cited above, was almost revolutionary in its call for the empowerment of the individual, shackled neither by family, nor by company (!). It emphasized that "the top priority as Japan enters the 21st century must be to bring forth the latent strengths of the nation and its people." To achieve these goals, the report proposed a change in the relationship between populace and government, from the current top-down style of governing in which the public sector controls the private one, to the "joint creation of a new public domain by individuals acting responsibly, and working in cooperation with various actors" (*i.e.* corporations, institutions, *etc.*).[60]

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[60] See fn. 53, pp. 1-2.