# ASIA IN JAPAN'S EMBRACE

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## Building a Regional Production Alliance

WALTER HATCH
and
KOZO YAMAMURA
*Henry M. Jackson School of International Studies*
*University of Washington*

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# *Preface*

At the turn of the last century, the United States was planted firmly in the Asia-Pacific region. It had opened trade relations with China and Japan, explored a number of islands, and even laid claim to its own archipelago, the Philippines. Puffed up with patriotic pride, expansionists such as Chauncey Depew crowed that the Pacific Ocean had become an "American lake" dominated by US merchant vessels and warships.[1] Asia's fate, they believed, was America's.

As a new century unfolds, US aircraft carriers laden with sailors and fighter jets steam in and out of Tokyo Bay, serving as floating symbols of America's now unrivaled military clout in a post-Cold War world. US container ships cruise these waters as well. But they are vastly outnumbered by Japanese vessels carrying automobile parts, machine tools, and myriad electric and electronic products manufactured by Japanese-affiliated firms all over the region. We are exaggerating only a little in saying that, in terms of commerce, the "American lake" has all but dried up; a "Japanese lake" is rising in its place.

The ebb and flow of economic power in Asia, the growth center of the world economy, is critically important to everyone inside and outside this region. While the industrialized economies of the world limp along, hoping for a growth rate of 3 percent a year, the industrializing economies of Asia are expanding at phenomenal rates of up to 13 percent. Developing Asia, which does not include Japan, generated only 9 percent of the world's output in 1990, but is generating a larger share every year and could, according to one estimate, contribute more than 50 percent

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of global production by the middle of the next century, the so-called "Pacific Century."[2]

Sadly, much of the discussion about what is transpiring in this corner of the world revolves around a nonissue, namely, whether Japan is building a regional trading bloc, a commercially based, peacetime version of the Greater East Asia Co-Prosperity Sphere it established during World War II. Many Western journalists believe it is. For example, Paul Maidment, a reporter for *The Economist*, says Japan has developed a new and little-noticed policy to use public and private resources to "sustain a stable and capitalist region that can provide raw materials, factories and, increasingly, markets for its industries."[3]

Neoclassical economists disagree, saying Japan is not building an exclusive or trade-diverting yen bloc in Asia. For example, Jeffrey Frankel uses a gravity model (which, in the world of statistics, is a form of regression analysis) to show that rising levels of intraregional trade in Asia are "correlated" with the geographical proximity and economic size of trading partners in the region, not any policy-induced bias or preference.[4] And Gary Saxonhouse, using a more traditional model of trade based on comparative advantage, finds "little evidence of a regional bias in Japan's relations with the rest of East Asia that goes beyond the existing pattern of East Asian resource endowments."[5] Frankel and Saxonhouse are, of course, correct – as far as they go.[6] An inward-looking yen bloc is not in the offing. Most countries in Asia, including Japan, remain highly dependent on export markets in the West.

So if Japan is not building an exclusive trading zone, then exactly what *is* it doing in Asia? That is the central question addressed in this book.

Some Western and Japanese economists argue that Japanese foreign direct investment (FDI) is merely a smart, or "rational," entrepreneurial response to changing cost conditions in Japan. Urata Shujiro, for example, writes that Japanese FDI "appears to be more or less consistent with the pattern of comparative advantage." Being "rational," direct investment from Japan, like that from other nations, has "contributed to the economic development of host countries not only by promoting capital formation, production and employment, but also by upgrading technological capability through technology transfer."[7] It is all part of a chain of unintended benevolence in which Japanese production begets Japanese economic growth, which begets overseas production in Asia, which begets technology transfer, which begets local economic growth.

Some Asian (but non-Japanese) economists offer a competing argument that is guided more by empirical research and less by neoclassical suppositions, but that remains theoretically confused. According to this view, Japanese multinational corporations (MNCs) expanding into Asia behave quite differently from Western MNCs. They are, for example, far more reluctant to transfer technology. Advocates of this view are, unfortunately, hard pressed to explain why. Although she concedes that Japanese MNCs are "stingier" than their Western counterparts, Pasuk Phongpaichit, a Thai economist, cautiously attributes this to the fact that they have been in Asia for a relatively short period of time, and thus have not yet faced the same protracted pressure to "localize" operations that Western firms have faced. "Generosity is not a function of race," she told us.[8] Mingsarn Santikarn Kaosa-ard, another Thai economist, appears stumped by the apparent difference. "There is no good theoretical explanation why nationality ought to explain the effectiveness of transmitting technology," she says. "What reason is there to believe that Japanese TNCs [transnational corporations] would be more or less generous in transferring technologies than other nations' firms?"[9]

The reason they behave differently, of course, is that Japanese firms are in fact different. They are shaped not only by market forces, but – like all firms – also by the distinctive set of institutions, policies, and norms that have evolved over the history of their society. For instance, in Japan, there is an unusual amount of cooperation between firms (especially those belonging to the same *keiretsu*, or enterprise group), between industry and government, and between labor and management. This cooperation allows firms to capture maximum gains from technological innovation and make the most efficient use of resources over time. Without a clear understanding of Japan's political economy and, in particular, Japanese-style cooperation, we cannot begin to comprehend the actual impact of Japan's deepening economic presence in Asia. This is because Japanese MNCs are trying to replicate their domestic system of networking in the region as a whole.

In this book, we argue that Japanese capital and technology are stitching together the disparate economies of Asia, integrating them into a multilevel production alliance. Trade data reveal Japan's increasing presence in the region. In 1970, the nation's total trade with the rest of Asia was worth only about half its trade with the United States. By 1990, however, Japan was trading more with Asia than with America.[10] High-technology products, especially machinery components, have come to occupy an increasingly important share of that intraregional trade.

This production alliance, as we suggested earlier, is not an exclusive trading bloc. It is in fact made up of literally thousands of vertically structured and quasi-integrated networks built across Asia by Japanese high-technology manufacturers hoping to maintain and even bolster their international competitiveness. These networks, promoted and nurtured by the Japanese government, are based on a division of labor; the parent firm in Japan generally supplies the most technology-intensive components used in production, while affiliates in Asia contribute less sophisticated parts. Risks are contained. Costs are minimized.

Japanese elites in government and business are using this alliance to buy time. After building and maintaining a political economy based on the interests of export-oriented, high-technology producers, not on the interests of consumers, they now face demands at home and abroad for fundamental change. They hope to prolong the life of this embattled system by regionalizing it, by building a broader foundation for economic revitalization. But what about the other economies of Asia? Like subcontractors in a vertical *keiretsu,* they enjoy the benefits of quasi-integration, including access to capital and technology. To varying extents, all Asian economies have used this Japanese production alliance to expand their manufacturing exports. On the other hand, they have become embraced by, or dependent on, Japanese capital and technology. It is difficult to imagine how these countries would maintain such high rates of economic growth without Japan's support.

We do not suggest here that a nefarious plot is afoot. Japanese high-technology industry is building a production alliance in Asia with the help of its government because it views such a strategy as efficiency-enhancing, not because it wants to beggar the other regions of the world. The effect, however, may end up being the same. Unless US and European MNCs establish themselves more firmly in Asia, they may be gradually squeezed out by the increasingly tight and exclusive nature of this highly competitive Japanese production alliance.

This is our argument, which is spelled out much more clearly and comprehensively in the first two chapters. Chapter three is a theoretical discussion of the economic concept of cooperation that makes two central points: cooperation is far more efficiency-enhancing than most neoclassical scholars have allowed, and cooperation is, by definition, exclusionary. In chapters four and five, we examine the political economies first of Japan and then of the rest of Asia in light of this economic concept of cooperation. We conclude that Japan, a nation of networks, is organized in such a way as to rapidly adopt new technology, while the rest of Asia is – to varying degrees – less equipped to do so. Chapter six shows how Japanese MNCs use their networks to control the pace of technology transfer to the rest of Asia.

Chapters seven through ten examine different manifestations of networking in the region: cooperation between Japanese government and business officials in the development and implementation of Japan's foreign economic policy toward Asia; cooperation between Japanese elites and Asian elites in the development of a Japanese production alliance; cooperation between management and labor in Japan's manufacturing facilities in the region; and, finally, cooperation between

Japanese assemblers in Asia and their parts suppliers and distributors. Chapter eleven considers the impact of this emerging Japanese production alliance on regional and global trade. Chapter twelve, the conclusion, has two goals. One is to stress the need for a much better understanding of why Japanese firms behave differently, both at home and abroad, from the firms of other industrial nations. The other is to recommend policy initiatives that the United States, Europe, and Asia might wish to take to avoid regionalizing the economic conflict that has been simmering for so long between Japan and the West.

Although most terms used in this book are defined in the text, a few require immediate clarification. For example, when we refer to "Asia" we generally are referring to the sum of China, South Korea, Taiwan, Hong Kong, Singapore, Thailand, Malaysia, Indonesia, and the Philippines. Occasionally, when noted, we throw Vietnam into the mix. Using technological capacity as our yardstick, we frequently divide the larger Asian region into sub-regions: the "NICs" (the newly industrializing countries) or the "Four Dragons," which are South Korea (sometimes referred to simply as "Korea" in this book), Taiwan, Hong Kong, and Singapore;[11] and the ASEAN-4 (core members of the Association of Southeast Asian Nations), or the "Four Little Dragons," which are Thailand, Malaysia, Indonesia, and the Philippines.[12] On the basis of its technological level, China should be lumped together with the ASEAN-4.

We carefully define the term *keiretsu* (or enterprise group) in chapter four. But because it is such a central concept in this book, and because we somewhat casually invoke it in chapters one through three, we offer a working definition here. While the Japanese word, translated directly into English, means "lineage," it actually refers to the close-knit networks that link many firms in Japan. In most Western minds, the postwar *keiretsu* are vaguely associated with the prewar *zaibatsu*, the large financial cliques such as Mitsubishi, Mitsui, and Sumitomo. Indeed, Japan today has six horizontal or "financial" *keiretsu* that share the same main bank and engage in joint ventures of many types (production, sales, resource exploration, etc.). In addition, however, it has many vertical or industrial *keiretsu*, linking parts suppliers with large assemblers, as well as many distribution *keiretsu*, linking distribution outlets with a major manufacturer. Although they are legally independent, the members of a *keiretsu*, both horizontal and vertical, are bound together over time by a number of very real commitments. These may include cross-shareholding, interlocking directorates, and intragroup trade, as well as capital, technology, and personnel transfers.[13]

Two other terms warrant attention here. "Dynamic technological efficiency" (DTE) is used to describe a firm's ability to adopt successively more sophisticated technology, thus reducing the cost of production and increasing the firm's competitiveness both in domestic and international markets. As we argue in chapter four, Japanese firms have enjoyed unrivaled success in achieving this kind of efficiency.

The other term, "developmentalism," is closely related. It refers to a set of policies and practices that promote cooperation between government and business, between otherwise unrelated firms, and between management and labor. Developmentalism, which we discuss in chapter three, is an effective vehicle for achieving DTE.

This book is an unusual hybrid. Scholars may find it excessively relaxed, even a little too breezy, in places. They may ask: Why do you rely so heavily on interviews, on anecdotal evidence? Where are the rigorous, econometric studies to support your conclusions? On the other hand, lay readers may find the book excessively ponderous or overly analytical in spots. They may wonder what all this theory really contributes.

Our approach, while unconventional, is easily defended on both fronts. First, we believe the anecdotal evidence presented here allows us to paint a richer picture of what is happening in the real world, and why. To ignore or downgrade such evidence is to go on believing in an imaginary world, a world free of people and thus complexity. Those who fail to see or choose not to see the utility and significance of anecdotal evidence remind us of the targets of an old Japanese proverb: *Mekura hebi ni ojizu* – blind men do not fear snakes.

In conducting their econometric studies, for example, neoclassical economists typically must make many assumptions, some of which strain our imagination (such as: all markets are perfectly competitive; all economies use the same technology). That is, they must concoct a world free of slithering snakes, free of all the messy realities that anecdotes tell us exist. This, of course, does not mean that econometric studies have no value. In many instances, they can be very useful as tools for summarizing quantitative findings (see chapter six), provided their assumptions are made explicit and the results are used in specific, limited ways. All this means is that such studies cannot be relied on as the foundation for analyzing problems in human society.

Second, the theoretical framework constructed here allows us to accommodate, or make sense of, all the bits of reality we encountered during our research. We do, as we must, make some assumptions. But we hope readers will find that our assumptions are realistic, thus helpful in presenting an analysis that attempts to describe a world of people and snakes.

The approach taken in this book suits its authors nicely. One of us is a reformed economist, increasingly dissatisfied with the narrow field of vision afforded by neoclassical theory; the other is a former journalist who has begun to question the utility of ungrounded analysis and meandering musings. Out of both faith and necessity, then, we have followed an interdisciplinary approach that is guided by theory but not controlled by a mechanical model. We give equal weight to the statistics of disinterested scholars, the experiences of affected individuals, and our own observations. In most cases, this is the same lively, bubbly stew of human "evidence" from which any good social scientist must draw. We hope both scholars and lay people will find some merit in this approach.

Names of authors are presented as they appear in the publication cited. In the case of an interviewee, we follow the standard practice used in that person's country. Thus, the family name of the Japanese, Chinese, and Koreans we quote will in most cases appear first. In the case of Thai, Indonesian, Malay, and Filipino interviewees, the given name comes first.

In the course of writing this book, we incurred many debts. One of us, for example, spent five nights at the Bangkok area home of the Kasem Choangulia family, which not only graciously shared its space and time, but also helped set up interviews and give directions in Thai to local taxi and *tuk-tuk* drivers. Thank you! Others in Thailand who guided us were Prasert Chittiwatanapong of Thammasat University, and Chaiwat Khamchoo of Chulalongkorn University. In Kuala Lumpur, public affairs analyst Noraini Abdullah not only helped arrange interviews, but offered insights on Malaysian politics as well. In Singapore, the staff at the Institute of Southeast Asian Studies was exceedingly helpful. In Korea, we relied on the generous assistance of Lee Keum-hyun, a freelance journalist, as well as Lee Jung Bok of Seoul National University and Kim Yong Kyu of Korea University's Asiatic Research Center. Officials of the Japan External Trade Organization (JETRO) all over the Asia-Pacific region, but especially Kuzumi Masayuki in Bangkok, provided useful data.

Literally dozens of people in Japan came to our aid, but perhaps none so much as Kitamura Kayoko of the Institute of Developing Economies (Ajiken), Iyori Hiroshi and Takeishi Akira of the Mitsubishi Economic Research Institute, Tanaka Tatsuo of the Center for Global Communications at International University, Matsunaga Kengo of the *Mainichi shinbun*, Ishii Toru of the *Asahi shinbun*, and Inoguchi Takashi of the University of Tokyo. We are deeply grateful to the many people who gave valuable time being interviewed for this book. Since we did not offer anonymity, this was not always easy – especially for some company officials. Nonetheless, a few worked overtime on our behalf, contacting colleagues at overseas affiliates to encourage them to meet with us. For doing so, we wish to extend our appreciation to Nishina Akira of Mitsubishi Electric, Ozaki Tetsuo of Nissan, Miyagi Kenichi of Fujitsu, Ono Shuichi of Marubeni, Nagano Akira of Matsushita, and Koiso Shigeru of Sony.

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