

Influences by Japan on Mainland South East Asia: A Guiding Force to Success

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Introduction

Japan has functioned as one of the stronger nations when analyzing economic stability of a nation. From their initial move to establish themselves among the various other nations that lead global economies and trade, Japan has been a great model. The nations of South East Asia have relied heavily on the success of Japan to carry in to their own nations. Japan showed how to establish a physically small nation as one that gets recognized for a largely successful economic system. Japan has been a role model to the nations of South East Asia and thus any events affecting Japan have a transitive affect on South East Asia. This is seen by the financial crisis that occurred in Japan as its effects moved to all the nations that Japan dealt with. Unfortunately, Mainland South East Asia relied heavily on Japan for many transactions and that applied pressure to their nations.

The Japanese Financial Crisis is not only affecting Japan, but neighboring nations as well. The nations of Mainland South East Asia are feeling the effects. In November 1997, Tokyo stocks went into free fall. A single-day five-percent decline was fueled by fears that the shut down of Japan's fourth-largest securities firm, Yamaichi, was a precursor of more bankruptcies. The dramatic moment was captured by television. Millions watched a rare display of emotion in the Japanese business world as the president of Yamaichi shed tears and plead for help for the 7,500 employees who are now unemployed. Tamaichi and the rest of Japan were not the only ones shedding tears as the economic crisis hit hard with the nations of South East Asia on the Mainland.

The collapsing of the economic system in Japan seemed to foreshadow or act as a precursor to the downfall of all Asian markets and economies. Since South East Asia transacted closely to Japan, the shocks were being felt. Recognizing losses on domestic real estate, bonds and loans was going to force Japanese banks and other financial institutions to liquidate their foreign portfolios. Those foreign portfolios included South East Asia and those nations were seeing their model for economics “turn on them”. The nations of South East Asia needed the crisis to come to a conclusion, or they would find it difficult to function in the future.

Economic performance in Japan—the world's second largest economy, the largest in Asia, and the world's largest creditor country—went from bad to worse. Growth has essentially been flat since 1992, and the economy is now shrinking. During this prolonged period of subpar growth, Japan has accumulated a substantial "output gap" indicating that actual growth is well below potential.

Faster growth in Japan would not only benefit residents of Japan, but also facilitate economic recovery in the rest of Asia. Furthermore, Japanese growth would dampen political pressures in the trade arena. Japan must rekindle domestic demand, address its financial problems, and undertake structural reforms. As Japan attempted to restore its once sound economy some troubles were experienced as Posen describes,

“Actual fiscal stimulus was undertaken by the government between 1992-97 and was only around one-third the advertised amount. When a more substantial stimulus was tried in 1995, the economy responded. After consumption taxes were raised prematurely in 1997, the economy tanked.”¹

The errors in fiscal policy have been costly, particularly since monetary policy has been rendered relatively ineffective. As an expert in the fiscal policies of Japan and

other Asian nations, Paul Krugman stated that, “Interest rates are so low that they cannot be cut further—and by the accumulated problems of the banking system, which has been saddled with \$500 billion to \$1 trillion in bad loans”.² One monetary policy that is often used not only in Japan but Europe and all over the world is to adjust interest rates. The interest rates are decreased to encourage investing. The other monetary policy tool is to vary the money supply to change aggregate demand for currencies. This increase in aggregate demand for Asian currencies could also lead to the increase in trade, which betters the overall economies of Asia.

Now Japan faces a deflationary spiral. As prices fall, households and firms postpone purchases of durable goods in anticipation of lower prices in the future. The nations of Mainland South East Asia need this trade so that they can experience growth in their economies. The struggles that Japan is facing are being sent on to the Mainland South East Asian nations, and they feel the effects of reduction in trade. Japanese people won't buy products as much as they have in the past. This stifles any possible hope for rapid development in outside nations with regards for Japan. The deflation contributes to high real interest rates, which in turn impede investment. With consumption and investment, the two largest components of domestic demand falling, inventories rise, prices fall, and the economy contracts. With the economy in decline, households increase precautionary saving, further depressing demand. The economy goes into a self-reinforcing spiral of contracting aggregate demand and supply.

In this situation, the standard remedies are expansionary monetary and fiscal policies. Government spending boosts aggregate demand while an expansionary monetary policy reduces interest rate (stimulating investment), generates expectations of

future price increases (discouraging postponement of expenditures on durables), and contributes to exchange rate depreciation (boosting foreign demand for domestic output). The preferred mix of policies in the current situation is debatable, but Japan must make some actions or the Mainland South East Asian nations will fall apart. The basic bone of contention is how Japanese households regard government spending. Argument is that they will simply increase saving to offset future tax liabilities, so that stimulus should come solely through monetary policy. Allen Meltzer feels, "this would tend to generate a bigger exchange rate depreciation and larger trade surpluses."³ That exchange rate depreciation directly affects the nations in South East Asia. The trade will suffer through currency exchanges. It will end up costing more for the nations to trade with Japan.

The real risk is that Japanese households and institutions could lose confidence in the economy and the sanctity of the financial system and Japan could experience capital flight. In such an instance, the yen would weaken precipitously as the Japanese economy was contracting. That contraction directly affects the nations of South East Asia on the Mainland. Yet, since Japan is the world's second largest economy (and the largest in Asia) developments within its borders have implications not only for itself, but the rest of the world as well, particularly the rest of Asia. The faltering Japanese economy is a significant impediment to economic recovery in the rest of Asia.

Background

If the facts are told, the history of the 13th-19th century has been so far neglected, particularly when it comes to Mainland Southeast Asia. This remark is fitting of the history of pre-thirteenth century "great builder kingdoms" or of modern history since the

beginning of the 20th century, or of investigations into political science or ethnology in the societies of today.

An understanding of this period is crucial to the comprehension of the present, particularly regarding the formation of the modern states; the determination of vast cultural zones (Theravâda Buddhism countries, Confucian and Mahâyâna Buddhism countries, Islamized or Christianized societies); and the representation of the position of South East Asia in the Western world vision (including Europe's interests and ambitions), then the partition of this region into areas of colonization or of influence. South East Asia struggled through World War II and faced much devastation and destruction through warfare. After World War II, few to no countries had good relationships with Japan. Japan was considered the worst nation due to their decisions in battle. The Japanese were not well liked and that made an effect on the relationships with other nations. The legacy of World War II had the Japanese trying to regain respect from foreign nations. South East Asia found it difficult to deal and interact with Japan, after the role that Japan played in the war. Because of Japan, the Mainland South East Asia nations were faced with a lot of rebuilding of their nations, not only physically but also emotionally.

The nations were trying to regenerate their nations after they played a role of bystander in the war. Many families faced significant loses of family members. Structures and buildings could be redone, but the loses of people were unrecoverable. Japan was turning out to be the outlet for most angers since they were heavily to be blamed. The Vietnamese found it extremely difficult to overcome their hatred feelings towards the Japanese. Many citizens could not understand the logic or mentality that

Japan used while being a participant of World War II. Their thoughts were centered on the losses and devastation that South East Asia experienced.

The Japanese tried to provide rationalization for their actions, but South East Asia was not interested in any excuses, instead actions were preferred. Japan did provide some compensation, but had many other things to deal with. Japan corrected the errors that they made and started moving towards the future. The success that Japan experienced with regards to their economics was extremely high. South East Asia realized that Japan would be a world leader in the global economies, but the decision to interact with Japan was still at hand. Japan had caused so much suffering and hurt for South East Asia, which it would make it difficult to institute, close relations. The nations of South East Asia made the decision to look beyond past interactions between nations and deal with Japan and follow their models.

The South East Asian nations belong to an organization called ASEAN (Association of South East Asian Nations). This organization, ASEAN, was founded to provide a framework and mechanism for regional cooperation. This was a wise decision since the individual nations would no longer have to deal with other nations individually, but will now have a type of leverage through the use of ASEAN. ASEAN would act as a unified front to obtain goals for each of the small nations that together make up the organization. As a direct reference from the chartering of the organization,

“On 8 August 1967, the Founding Fathers spelled out the first three aims and purposes of ASEAN as follows:

1. To accelerate the economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations;

2. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of the United Nations Charter; [and]

3. To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields; ..."⁴

Through the pursuit of these goals, the nations have become stronger and more productive. The ASEAN allows nations to exchange methods of trade and how to run their economic systems. Japan has been a guiding factor for the ASEAN to conduct business and mainly research on. All the nations were not initially in ASEAN and it was a steady process of incorporating each of the nations to the concept that the South East Asia Nations should come together and corroborate. The signing of the Bangkok Declaration by the foreign ministers of Indonesia, Malaysia, the Philippines, Singapore, and Thailand (Brunei was added a member in 1984, and Vietnam in 1995) was a start.⁵ The ASEAN nations have come to focus on market and export oriented economic strategies

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The trading that is occurring between Japan and the nations of South East Asia have stalled and there is a very bleak outlook for the overall trading. The major method for the trade to occur is through AFTA (ASEAN Free Trade Area). AFTA is the major trading avenue for the nations to use. The founding of AFTA was in January 1992, when the ASEAN member states signed the Singapore Declaration, marking the commitment to intensify economic cooperation in the entire region. The main parts that AFTA covers are “several areas of cooperation including the harmonization of standards, the reciprocal

recognition of testing and certification.”⁶ At the heart of the Declaration is the creation of the AFTA within 15 years. A Free Trade Area in ASEAN means the removal of obstacles to free trade among member states. This includes the abolition of high tariffs or taxes on traded goods and the scrapping of quantitative restrictions (QRs) and other nontariff barriers (NTBs) that limit the entry of imports. At the same time, each member is still free to set its own level of tariffs on imports from nonmembers. This agreement moves goods and services smoothly through the various different nations in South East Asia. A major core of the AFTA agreement is the Common Effective Preferential Tariff (CEPT). This scheme helps the trade between nations through the reduction of tariffs on products to a maximum of twenty percent for the next five to eight years. The ultimate goal is to have it lowered to approximately zero to five percent by the year 2008. That gives a time frame of ten years for the tariffs to be virtually eliminated.

There are major issues that could cause collapse of AFTA, but it is looking like it will pull out in the end and stay intact. Despite temporary displacements, AFTA will have a very positive impact on all levels of employment, according to the regional adviser of the International Labor Organization (ILO). This simply means AFTA may cause layoffs to non-competitive firms in the short-run, but result in new jobs and better wages in the long run for competitive firms even in the same industry. The regional adviser, Abello, expects increases in wages in Indonesia and the Philippines as investments move in search of higher returns into labor-abundant areas.

Many fear AFTA may displace workers in losing industries, but the displacement costs for labor are likely to be minimal, given the fact that trade with ASEAN for the fast-track products accounts for only seven percent of total trade. Moreover, safeguards and

certain levels of protection on certain products are allowed under CEPT. In cases of labor displacements, the Department of Labor and Employment (DOLE) has declared the government's four-point program of "social safety nets" to cushion the effects of AFTA. Many precautionary methods or actions have already been made to ensure the cohesiveness of AFTA.

Japanese has decided to heavily invest with the South East Asia nations. After a long delay, Japan has decided to invest in Mainland South East Asia and its operations. The market has been exposed very little and appears to be on the move of growing substantially. The opportunities are being brought out due to the help of AFTA. Now the markets have the strength to go out and interact with other member nations through the support of the other nations. Organizations in Japan are starting to heavily invest now, so they will be involved in the expansion of the Mainland South East Asian markets.

The Japanese have not had a large share of imports and exports with South East Asia. In fact there is only a market share of seventeen percent of South East Asia involved with exports. The imports from South East Asia make up fifteen percent for Japan. These numbers are relatively low considering the opportunity for expansion that is present in South East Asia. Japan is looking to conduct business and trade since geographically Japan has little to no room for growth. Woodlands and forests currently constitute sixty-seven percent of Japan's land usage. In addition to that the arable land is down to eleven percent.⁷ This remarkably low number forces Japan to utilize other nations to develop. The export and import numbers show that there is already an interaction between Japan and the South East Asian Nations, but those relationships could be expanded.

As Japan starts funding projects in South East Asia, the trade off will be very beneficial. Japan would pump money in to the economies of South East Asia and in return receive goods and services that will help Japan and their economy. The output would cause and increase of large trade transactions. The increased size of transactions leads to higher productivity and increased efficiency. Japan would start to recover their world power in the economic sense and experience growth. Japan had growth up to three and nine tenths percent in 1996 but then fell back in 1997 to one percent due to the expansionary fiscal policies and declining tax revenues due to the recession that occurred.⁸

The “ASIAN CONTAGION” is the effects of the financial crisis as it affects various nations. The central bank of Japan has been faltering and caused effects felt all around through many nations. Without the fuel of central-bank monetary inflation, an economy has inefficient production and stagnate or slow-growing standards of living. One thing mistaken for the main event of faltering is bankers' sudden loss of risk aversion. Loss of risk aversion is when there is an increase in taking risks, since there is no timidity in defaulting. Increasing riskiness of projects and the corresponding risk of loan default is a necessary aspect of central-bank monetary inflation and credit expansion. Without intervention, bankers balance their portfolios of loans, and accept additional risk only at higher interest rates, and extend loans to their most credit-worthy customers for the projects most likely to generate profit. The additional credit created by the central bank should be extended to less credit-worthy customers, both consumers and entrepreneurs, for projects less likely to be profitable, which encourages development universally and also in Mainland South East Asia.

Consumers, who could not obtain credit otherwise, are now able to entice entrepreneurs to satisfy their preferences by spending borrowed money. Individuals, who could not enter the ranks of entrepreneurs before, now find bankers willing to lend them start-up money. As a boom matures, bank portfolios are filled with loans that would not have been made, either due to too much risk or too little return, in the absence of credit expansion. This helps various nations, such as those in Mainland South East Asia, to strengthen their economies. Since more activity will be occurring in the economy, each nation's Gross Domestic Product (GDP) will increase.

The short-term effect of the Japanese economy and its crisis will be felt heavily. The South East Asian nations have taken the right step by forming the AFTA, but work still needs to be done. Japan's banking system does not look like they will be recovering in the short term, as defined by one to three years. The damage was done and the financial collapse, that was precursored when the Yamaichi Securities fell⁹, seems to have a ripple effect. The collapse of one of the largest securities firms in the industry signaled serious demise for various other industries. The short term is where South East Asia must focus on developing within themselves so that they will be prepared to participate with Japan as the crisis comes to a conclusion. This conclusion refers to the long-term plan, which should take effect in three to five years. At that point in time the Japanese banking system should be restored to a lesser degree to what it once was, but still composing a strong economy. The long term will have Japan moving towards their old role as a prominent nation in the global community.

Conclusion

The financial crisis that struck Japan had heavy effects on the Japanese economy, but along with that, the implications were felt in Mainland South East Asia. South East Asia nations were put in to the situation of having to decide a method to generate their economies. The development of AFTA was the wisest decision that was made. This organization facilitated the trade operations not only among the South East Asian nations, but propelled each nation to higher trading with outside countries.

AFTA is very important for South East Asia while they wait for Japan to restore not only their economy, but the banking system too. The monetary policy is changing for Japan and the crisis was the cause of it. The economy of Japan appears to be improving and will be prepared for major trading to resurrect itself. AFTA has given South East Asia nations the experience to be able to deal with Japan, among others. South East Asia has the potential nations to raise themselves in the opinions and relations with nations around the world.

The success that South East Asia has had with their development is through their commitment to decisions. Mainland South East Asia divested themselves fully in to all decisions regarding trade, monetary policy, and relations with other nations. This has to continue for them to experience success. The ASEAN has strengthened the ties between nations of South East Asia. This strengthening has taken large efforts by many parties. Although there are worries “that regular security discussions with Japan would feed Chinese fears of encirclement.”¹⁰ One of the most beneficial processes was the annual meetings that leaders of the ASEAN use to work out a recovery plans.¹¹ While they are individual nations, the ASEAN has played a large role in building the strength of these

nations. Vietnam was a once disheveled nation after World War II, but dealing with other small nations in South East Asia has provided incentive to become a stronger nation economically.

The success that South East Asia has experienced will serve as a model for small nations around the world. In addition to that, with regards to Asia specifically, a precedent will be established for future disputes. South East Asia has been successful and the relations with Japan have been strengthened. Multiple nations were incorporated and that encouraged interaction between nations for stronger cooperation.

Mainland South East Asia will move successfully in the future as demonstrated by their past actions and experiences. The nations came together to form unions, so they are well prepared for future problems. The issues were dealt with a very diplomatic process as the smaller nations interacted with Japan to strengthen not only their own country's status, but also relationships with Japan and other world leaders for future experiences to come.

End Notes

¹Posen p. 24-27

²Krugman 1998a

³Meltzer p. 16-17

⁴ASEAN Charter

⁵<http://wellsfargo.com/inatl/wrldalmn/intro/asean/>

⁶<http://is.eunet.ch/astarte/pbo/afta/afta0.html>

⁷<http://www.odci.gov/cia/publications/factbook/ja.html>

⁸Noland 1996 p. 442-447

⁹http://www.pbs.org/newshour/forum/december97/asia_12-8.html

¹⁰The Economist Jan 18, 1997 p.37

¹¹The Economist Dec19, 1998- Jan 1, 1999 p.47-48

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