A Comparative Analysis of East Asian and Latin American Industrialization Strategies: Implications for U. S.-Japan Relations

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I. Japanese Motivation: Income or Natural Resources?

This essay explores the general nature of U. S.-Japan relations in the developing world by investigating whether Japanese strategy toward that part of the world is governed more by a search for income or natural resources, and by analyzing how each effects Japanese relations with the developing world.

In growing interdependence, Japan's foreign economic relations includes (1) its relations with other developed countries, especially the United States, (2) its North-South relations, and (3) its cross-regional relations within the developing world. Policy arguments regarding Japanese foreign economic strategy are reducible to management of transnational economic linkages, particularly foreign trade, direct investment, aid, and public lending.

This essay argues that Japanese strategy aims at controlling the emerging global manufacturing system as a network of forward and backward linkages of commodity chains. This perspective enables analysts to capture Japanese motivations in a search for both natural resources and income because the chains involve raw material sourcing and sales of products. No ideal model exclusively oriented to either natural resources or income is tenable.

Nonetheless, this essay argues that the current interdependence dynamics has driven the Japanese strategy in the developing world toward income acquisition in the form of trade and capital surplus. It is crucial to comprehend why the current Japanese strategy parallels the economic success of developing countries under an outward-oriented industrialization strategy, rather than those under an inward-oriented alternative. The current strategy is well contrasted with the Japanese approach in 1970s which aimed at securing imports of natural resources from developing countries under an inward-oriented industrialization strategy such as newly industrializing countries (NICs) in Latin America.

Our analysis attempts to identify an interface between Japanese strategy in the developing world and the industrialization strategies of developing countries, with

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emphasis on a cross-regional comparison of East Asia and Latin America; they are export-oriented industrialization (EOI) and import substitution industrialization (ISI) strategies. This vantage point for analysis enables us to understand how Japanese relations with the developing world is affected by their different strategic focuses, in a search for either income or natural resources.

II. New Realities Under Transnational Intra-industry Trade

Growing interdependence has increasingly integrated the global market economy, where the management of transnational economic linkages dominates the economic success of developing countries. In such a dynamic global market, the opportunities and constraints that shape development choices for developing countries are constantly shifting. Whether the transnational linkages are incorporated into development strategies explains cross-regional variation in economic performance. It is essential to understand structural changes necessitated by the interdependence dynamics because, behind the short-term changes of macro-economic performance, there exists the long-term structural changes.

The emergence of transnational intra-industry trade and de-centralized global manufacturing networks denies a disciplinary assumption in international economics, or perfect competition, where the Heckscher-Ohlin inter-industry trade determines patterns of international trade. The assumption presupposes a horizontal international division of labor and a responding specialization on the basis of the comparative advantage of a national economy that is determined by static factor endowment. However, the Heckscher-Ohlin model hardly satisfies the assumption for analysis because the economies of scale and the learning curve are indeed subjected to policy manipulation for efficiency enhancement. In this sense, the international market economy is rather based on an imperfect, oligopolistic competition while comparative advantage is no longer static but dynamic in nature; a technological dimension of the international economy explains how trade and industrialization reinforce each other.

Most importantly, intra-industry trade characterizes the emerging global manufacturing system as a dominant driving force of growth of the world economy. Intra-industry trade has emerged in response to market pressures toward lower prices and higher qualities of commodities, which is made possible by the diversification of products and by the economies of scale in the oligopolitic international market. Intra-industry trade operates through an international network created by multinational corporations (MNCs). A parent company provides services to its overseas subsidiaries, including managerial and capital inputs. Its subsidiaries export not only finished products but also intermediate goods to either the parent company or other overseas subsidiaries so as to assemble them into final products.

As for the key unit of analysis, intra-industry trade has replaced the nation-state with the transnational networks, characterized by a complex network of production and distribution, an unprecedented degree of geographical specialization, commercial-

industrial subcontracting relationships, and global sourcing arrangements. The MNCs' strategy for survival in an intensified competition lies in internalizing the international market in their operation. Thus, intra-industry trade has much smaller effect on income distribution and adjustment costs in local economies than necessitated by the decay of the Hecksher-Ohlin inter-industry trade. These changes are now redefining roles of NICs in the world economy.

III. Two Strategies: EOI vs. ISI

Those developing countries incorporated into a transnational network, particularly NICs, are upgrading their economic activities from labor-intensive to capital-intensive, and to technology-intensive stages: (1) the commodity-exporting, (2) export platform, (3) international subcontracting, (4) component-supplier, and (5) independent-exporter roles. Asian NICs are moving toward the capital-intensive and, in some industries, technology-intensive stages, while Latin American NICs are still largely at the labor-intensive stage as typified by Mexico's *maquila.* Asian NICs aggressively pursued transnational integration based on global sourcing and geographical specialization. On the other hand, Latin American NICs sought their national economic autonomy. They established a similar set of industries under highly protected domestic markets throughout the region and created an economic structure only to produce goods with higher prices and inferior qualities

These cross-regional differences in performance, however, cannot be explained simply by the traditional dichotomy of EOI vs. ISI. These two strategies are not mutually exclusive but increasingly converging because developing countries recently strive for economic reform through economic stabilization, privatization and internationalization. In this light, EOI and ISI are rather complementary and interactive in its evolutionary process. Although timing and specific products involved vary considerably, both strategies begin with the primary ISI which shifts imports of basic consumer goods to local manufacturing. Then, Asian NICs followed a path toward the primary EOI involving exports of manufactured goods, while Latin American NICs entered into the secondary ISI characterized by heavy and chemical industrialization. This is the only period when the two approaches are distinctive. Their convergence occurred when Asian NICs adopted the secondary EOI, while Latin American NICs pursued diversification of export and promotion of the secondary ISI.

Neither EOI nor ISI is a self-sufficient model for development. Both are susceptible to systemic constraints such as recurring balance of payment problems, persistent inflation, and disruption of key trading relationships that could worsen vulnerabilities of developing countries.

Transnational economic linkages may not be just constraints but opportunities for developing countries. Policymakers of Asian NICs considered international openness as the optimal policy stance, whereas those of Latin American NICs regarded international trade as a major impediment to development. Neither region had not accumulated an essential magnitude of capital for industrialization, which necessitated

its reliance on external capital sources. Asian NICs obtained foreign aid and loans, while Latin American NICs depended on transnational corporations and commercial banks, particularly those of the United States. Asian NICs viewed that foreign capital could be acquired, and that the state could better control the use of such a fund. On the other hand, Latin American NICs regarded that host governments were weak *vis-à-vis* MNCs, international banks and foreign governments, whereas unable to establish rules for investment and profit remittance and compelled to provide incentives to attract foreign investors.

These two distinctive approaches produced different levels of manageability of transnational linkages. Asian NICs enjoyed a high manageability where, serving for foreign debt, they secured a high degree of autunomy in economic decision making. Asian NICs were less vulnerable to external shocks generated by the world economy, because they primarily relied on foreign aid and loans and they had to negotiate only with donor govemnments. In other words, Asian NICs succeeded in securing their autonomy and flexibility in decision-making. On the other hand, Latin American NICs suffered from a low manageability where they were exposed to a negative power of foreign capital, while losing autonomy in decision-making. A prime example of this kind is the Latin American debt crisis in 1980s where fluctuating interest rates resulted in unmanageable indebtedness, which compelled Latin American NICs to accept a tough structural adjustment policy. This means that Latin American NICs should have had to incorporate their changing national priorities into the framework of MNCs' decision making, or their global manufacturing system.

The industrialization strategy of Latin American NICs has been devoid of effective management of the relationship between the state and MNCs. In these countries, MNCs play a primary organizational role to facilitate industrial integration in a national economy, while, in Asian NICs, major private firms of national capital have achieved the same function. The state in Latin American NICs had to intervene directly in productive activities, operating public corporations, so as to secure its autonomy in economic decision making because a large part of the industrial sector was controlled by foreign capital. On the other hand, the state in Asian NICs intervened only in allocation and planning because they could rely on their national capital in industrial integration.

The global macro-economic dynamics in early 1980s led to the debt crisis, while determining development patterns. These patterns shaped and reinforced a vicious downward spiral of the economies of Latin American NICs and a synergistic upswing of those of Asian NICs. It is during this crisis period when large-scale public corporations in Latin American NICs at the secondary ISI stage were effective in establishing a broad industrial base, whereas inescapably inefficient without being exposed to international market competition under a heavy government protection. Contrarily, infant industries in Asian NICs at the primary EOI stage gradually materialized efficiency and international competitiveness, while the U. S. market absorbed their exports. In this process, the overall importance of foreign capital increased in

Latin American NICs but drastically decreased in Asian NICs. After the debt crisis attacked the developing world, Latin American NICs experienced a sharp decline of gross domestic investment, whereas Asian NICs steadily increased domestic investment by using their export surplus. Due to a deteriorating balance of payment (BOP), Latin American NICs suffered from a considerable capital flight, thereby reinforcing their reliance on foreign capital. On the other hand, an improving BOP and a positive effect of income distribution enabled Asian NICs to further household saving and investment, which increased their creditworthiness necessary for indebted industrialization.

IV. Growing Transnational Market Forces and New Opportunities

Our cross-regional analysis has revealed trajectories of development patterns, historically and structurally, without falling into an oversimplified interpretation of traditional statist and *dependencia* theories. The primacy of management of transnational economic linkages demonstrates that the state's choice of industrialization strategy determines the roles of foreign capital, not *vice versa.* To retain autonomy in economic decision making really matters, and structual determinism of *dependecia* theories is refuted. These findings are particularly true when the secondary ISI and EOI converge. Developing countries are advised to incorporate themselves into an emerging web of intra-industry trade, thereby attracting foreign direct investment and technology transfer to establish a national technology core.

But, it is a fallacy to believe it possible to replicate the Asian NICs model in the new global manufacturing system. The triangle between the United States, Japan and Asian NICs has emerged, whereas a global imbalance of payment has been generated in the form of U. S. trade deficit. Before the Plaza agreement, Japan was a supply base of capital and intermediate goods toward Asian NICs and Southeast Asian neighbors as its export platform, and the U. S. market plays a demand-absorber role. The sizes of the Japanese and the Asian NICs economies were unequal, and their stages of industrial development were different. Therefore, there existed a strict limit to expand a horizontal division of labor based on product differentiation between the two.

Japan after the Plaza agreement has become a major demand absorber next to the United States. After the alignment of exchange rates, Asian NICs' trade with the United States has declined slightly, whereas their trade with Japan has been in an upswing. The relations between Japan and Asian NICs has now become a horizontal inter-industry division of labor according to product differentiation. The relations between Japan and ASEAN countries has become a vertical intra-industry division of labor where Japan exported capital goods and services to ASEAN countries and they exported raw material and low value-added products to Japan. In addition, the relations between Asian NICs and ASEAN countries in part has become a vertical intra-industry division of labor through Asian NICs direct investment in ASEAN countries which has created labor-intensive manufacturing industries. This shift occurred because cheap labor has been no longer available in Asian NICs.

The post-Plaza alignment of exchange rates also opened great opportunities for Latin American NICs because Japanese and U. S. MNCs are re-locating their labor-intensive productive facilities located in Asian NICs in a search for cheap labor. In this sense, Latin American NICs have comparative advantage with a broad industrial base, cheaper labor, and rich raw materials. Mexican *maquila* is a harbinger of this new wave. The emerging democratic governments of Latin American NICs have tried to capture new opportunities by economic reform through liberalization and privatization. Further more, the United States has entered into a Free Trade Agreement with Mexico, whereas Japanese MNCs have become involved in this process, both directly from Japan and from their subsidiaries located in North America.

Apparently, the key for industrialization toward the next century is to capture the dynamics of the global manufacturing system. Thus, developing countries have to find their suitable niches in it, while developed countries, particularly the United States and Japan, need to assist and promote such efforts.

V. The Emerging U.S.-Japan Dual Economic Hegemony

The Japanese strategy facilitates developing countries to manage transnational economic changes and to participate in the global manufacturing system. The Japanese strategy is characterized by a de-centralized management style where the government only takes initiatives and induces the private sector. Among Japanese transnational linkages, international trade and investment are in the hand of the private sector, whereas the government only have a direct control over its economic assistance and credit lending. In addition, the absolute sizes of the latter two are considerably smaller than those of the former two. In this sense, Japanese strategy is not a well-established action program but a series of de-centralized activities with a clear sense of direction defined as policy goals.

The Japanese strategy has inevitably re-commercialized bilateral aid and loans because it need rely on the private sector that is driven by profit-making motivation. The Japanese government, in cooperation with the private sector, has helped developing countries to build necessary socio-economic infrastructure for manufacturing activities. Thus, it is practically impossible to untie aid and loans from commercial interests, whereas possible and necessary to avoid explicit tying practice in order to maintain the existing open international economic system short of regional blocs.

Japanese presence in the developing world has been strengthened, and such a change is creating a dual economic hegemony of the United States and Japan in that part of the world. The currently shifting international distribution of power has re-structured the international politics of development assistance, in such a way that Japan has superseded the United States as the largest bilateral aid donor. The dual hegemony is already in East and Southeast Asia, while emerging in Latin America where the United States invited Japanese involvement, especially its banking community, in the debt crisis management. Because of the nature of Japanese corporate group, Japanese manufacturers are also inescapably penetrating into Latin America after their major

banks which more concern insolvency. The governments of Latin American countries use Japanese presence to counterweigh the traditional U. S. dominating influence. The dual hegemony necessitates power sharing in which the United States must give up at least a part of its power to Japan, whereas Japan is compelled to contribute more to the stability and prosperity of the developing world.

Lastly, the current Japanese strategy in the developing world is governed more by a search for income. But, this statement must be understood in the light of the global manufacturing system, not of the traditional dichotomy of EOI and ISI. If the Japanese aggressively pursue the current course, their presence will create a dual economic hegemony in the developing world. Even if not, however, the conclusion regarding the future course of Japanese behavior remains essentially the same. The strategy in a search for natural resources would exclude developing countries from the global manufacturing system and cause their bankruptcy. In such a senario, Japan as an economic power with global outreach would be forced to become engaged in the economic reconstruction processes of these developing countries.