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Policy Coordination in the Asian-Pacific Region

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I. Japan and East Asia: Wild Geese Flying Pattern and Invisible Thread

The industrial restructuring which Japan is undergoing today may usher in what could be termed a period of "grand transformation." Two factors seem to be crucial among the many which are at work behind this vast change. One is the workings of a price mechanism in response to a shift in the structure of relative prices in the world markets. During the first half of the 1980s, when the value of the yen was low and that of the dollar high, Japan's industrial structure became more dependent upon exports than before. At the same time, the cheap yen made the Japanese market inaccessible to foreign manufactured goods, almost completely cutting it off from the stimuli of competing imports. When Japan found itself trapped in a situation characterized by a growing dependence upon exports, an expanding trade surplus and a domestic market which was virtually closed to imports of manufactured goods, it was impossible to chart the course of the country's industrial structure. Similarly, individual firms in Japan were unable to draw up clear long-term corporate plans.

This situation changed drastically after the "Plaza Agreement" of September 1985 was put into effect, swiftly pushing up the value of the yen against the dollar, and significantly altering the international allocation of resources.

The appreciation of the yen produced far-reaching effects. Many firms in Japan began to actively develop markets for their products at home and shifted their production bases overseas to drastically reallocate their internal managerial resources. They also made strenuous efforts to buy parts and finished goods from overseas suppliers, and to increase direct investments abroad. At one point, it was feared that the increase in international activities might result in the "hollowing out" of some sectors of Japanese manufacturing or the "deindustrialization" of

Japan. But this apprehension was short-lived, primarily because the strong yen freed the Japanese economy from the threat of inflation in the near and distant future, and contributed to set up an internal mechanism ensuring automatic expansion of domestic demand.

The international currency realignment affected the Taiwan dollar, and subsequently South Korea's won, too. As a part of this process of exchange rate readjustment, Japanese industrial restructuring began, followed closely by similar efforts in the newly industrializing economies (NIEs) of Asia. In the first phase of the restructuring, Japan increased the volume of imports of manufactured goods from South Korea and Taiwan. These imports are likely to continue to increase rapidly in the years to come, as evidenced by the fact that the South Korean and Taiwanese manufacturers are rapidly making arrangements to produce goods for export to Japan, while efforts are also being made in Japan to make its market and distribution networks more receptive to these imports. The second phase has seen a reallocation of managerial resources from Taiwan and South Korea to the ASEAN countries, Thailand and Malaysia in particular. More specifically, under the impact of currency realignment, Taiwanese and South Korean manufacturers have begun to make direct investments in ASEAN, shifting increasingly large portions of their production bases in the labor intensive sectors to the ASEAN region.

The prospect of continuous increases in real wages in Japan, Taiwan and South Korea is also significantly affecting the allocation of investment funds in East Asia. We might say that under the combined effects of the currency realignment and soaring real wages in these countries, a new network of manufacturing operations is being developed along the chain of islands stretching from East to Southeast Asia, a network that is linked by an "invisible thread." The network may be likened to a flock of wild geese flying in formation, with Japan at the head, followed by Taiwan and South Korea, and then by the countries of ASEAN. The metaphor, of course, highlights the fact that each member of the region reaches a higher stage of development in succession; just as a flock of wild geese flying in formation, with the production operations peculiar to a certain stage of development successively handed down to the member that has reached that stage. But the metaphor's significance does not stop there. It also emphasizes another important feature of the region's developmental pattern — the fact that the process of continuous succession works smoothly being regulated by an "invisible thread," i.e., the price mechanism, just as the behavior of a flock of wild geese flying in formation appears to be regulated by an "invisible thread."

Thus, one factor underlying the considerable transformation taking place in East Asia today is the resource-reallocation function of an "invisible thread," namely, the price mechanism. The other important factor is the value-generating activities in Japan, which stands at the head of the flight formation. The mechanism of job transfer will work properly over a long period of time only if it is sustained by creative activities undertaken at its center. In the first half of the 1980s, the United States contributed a great deal toward the rise of the Asian NIEs by giving

them free access to its market. A strong dollar put the price mechanism into work, causing a reallocation of investment funds on an international scale. As many analysts are becoming aware of, however, the United States, in its very act of facilitating this international shift, allowed itself to suffer so severely from the "hollowing out" or "deindustrialization" that it failed to keep the mechanism of continuous succession functioning properly, or to keep the flight formation of wild geese in order. By contrast, Japan, while successively transferring jobs previously performed in the country to its Asian neighbors, is capable of creating a series of new economic activities within itself. Thus, the flock of wild geese in Asia is likely to stay in formation for an extended period of time, covering a long distance.

While it is clear that only continuous value-generating activities can keep the grand transformation going, it would be irrational to assume that such activities are unrelated to the years of experience and knowledge accumulated thus far. It seems more appropriate to consider that various economic actors, who have been sustaining Japan's economy and society, are making new strides based on their own experience, performing a pivotal role of jacking up and propelling the grand transformation.

II. The Need to Look at High Technology from a New Perspective

The scenario for Japan, then, should be one of transferring some of its domestic sources of employment to the other geese in Asia through the workings of the price mechanism and through the liberalization of its markets, while endeavoring to create new jobs at home. But this scenario also has a large bearing upon international problems, because the creation of a self-reliant and creative atmosphere conducive to the scenario depends, to a significant extent, on the research and development capabilities of the entire nation, especially in the high-tech areas, and also upon individual firms' innovative capabilities.

Advanced technology has become a focus of hot debate in the international community, because it arouses fears that a country which succeeds in high-tech-related R&D might assume undue supremacy over others in international affairs. This is supported by the fact that all of the recent high-tech-related controversies between Japan and the United States have been fought with the purpose of preventing the other party from consolidating its advantage in the area concerned.

Let us take, for instance, the question of the FSX, the next generation fighter-support plane. When the United States pressed for joint Japan-U.S. development of the airplane during the initial phase of the negotiations, it did so, it appears, with a view to preventing Japan from developing, by itself, such items of multi-purpose technology as monobloc formation of the plane wings out of carbon-based compounds, high-performance radar, and stealth materials capable of electronic snooping. At present, however, the U.S. Congress, among others, is strongly requesting Japan to import its airplanes from the United States. This new argument is based on the view that Japan's entry into the aerospace industry, an area in

which the United States wishes to maintain its supremacy, should be prevented by all means.

In this way, questions of technological innovation, especially those in high-tech fields, are often interpreted, in particular in the context of Japan-U.S. relations, as issues affecting a country's hegemonic status. It is my contention, however, that a more rational approach to the question of technological innovation should be to view it in terms of its potential contribution to the creation of an open international economic order. The validity of this point of view regarding technological innovation is supported by the fact that a process of domestic-demand-oriented economic growth which in turn promotes technological breakthroughs has already emerged within Japan, and has been in progress for some time. In order for Japan to transfer some of its domestic sources of employment to other countries and to keep this mechanism going, rather than bring it to a standstill after a short while, Japan must have within itself a core around which to launch technological innovations and create new values. New technology developed to create such new values, including high-technology, ought not to be regarded as a factor responsible for re-ranking of nations into a technologically determined hierarchy, but rather as a prerequisite for the establishment of an open international economic system. The controversies over high-technology should be viewed from a completely new perspective.

In East Asia, Japan is at once the largest market and the center for developing new technology and new products. While Japan increasingly specializes in the production of technology-intensive capital goods and high value-added durable consumer goods, the NIEs and the ASEAN countries produce greater quantities of standardized consumer durables and nondurables. As production technology and production processes are transferred from Japan to the Asian NIEs, and then from these throughout the ASEAN countries, the industrial structure of the East Asian region as a whole will advance, and its supply capabilities will improve. Thanks to the inflows of inexpensive manufactured goods from the East Asian countries, Japan will be able to maintain a high level of purchasing power without falling prey to runaway inflation, and will be able to continue to serve as a lucrative market for the region's manufacturers. This is the growth dynamism that is upholding throughout the East Asian region today.

III. The Flight Formation of Wild Geese Benefits the United States

If Japan manages to sustain its growth in an automatic manner by relying primarily upon domestic demand, instead of exports, and increase imports from its Asian neighbors, this will create an environment favorable for the increase of U.S. exports on a continuous basis, and make the unavoidable economic adjustment in the United States easier. In fact, Japan and the four Asian NIEs (i.e., South Korea, Taiwan, Hong Kong and Singapore) together are absorbing a greater proportion of the recent increments in U.S. exports than the 12 countries of the

European Community put together. It is safe to say that a sustained, healthy growth of the East Asian region as a whole, including non-NIEs, is the key to a recovery of U.S. exports.

How, then, can the Asian countries achieve sustained growth? A conventional view asserts that, up to the first half of the 1980s, Japan and the Asian NIEs were able to enjoy high growth rates thanks to rapid increases in their exports to the United States. But this view fails to explain the developments since 1985. It is my contention that, as pointed out already, the process of the yen's appreciation that began in September 1985 has brought into existence a relationship of "interaction and diffusion" in Asia, which links, through the working of the price mechanism, three groups of economies which are at different stages of development — Japan in the lead, with South Korea and Taiwan forming the second group, and the ASEAN countries forming the third group. The entire system of such "interaction and diffusion" is what I mean by the flight formation of wild geese.

In the autumn of 1986, one year after the yen began to appreciate, the restructuring of Japan's industry started to accelerate. Many Japanese manufacturing firms began to procure increasingly larger portions of their part supplies from South Korea and Taiwan. Assembly manufacturers, in particular, decided that in order to overcome the impact of the soaring yen, it was imperative not only to step up exports, but also to lower the costs of production by switching from domestically-made parts to imported parts, which had become far less expensive because of the yen's appreciation. Overseas direct investments also began to increase phenomenally in the same year. Delegations of Taiwanese businessmen and government officials toured Japan to recruit Japanese firms willing to build plants in Taiwan. Thus, the appreciation of the yen set the price mechanism into operation, and through it the allocation of jobs and investment was radically altered.

The year 1987 saw the United States apply pressure on Taiwan, and somewhat later on South Korea, forcing them to revalue their currencies upward vis-a-vis the US dollar. Not only Japan's trade surplus with the United States, but also that of the Asian NIEs was found intolerable by the United States. The appreciation of the Taiwanese and South Korean currencies had the effect of extending the relationship of "interaction and diffusion" farther to the ASEAN countries. For instance, immediately after the rise of the Taiwan dollar, the number of direct investments from Taiwan to Thailand increased markedly. Similarly, the appreciation of the South Korean won prompted the relocation of shipbuilding and ship-repairing operations from South Korea to Singapore. Through the price mechanism, the relationship of "interaction and diffusion" spread to the ASEAN region. Eloquent proof of this is the marked improvement of each ASEAN country's economic performance in 1988: Thailand attained a real growth rate of 12%; Singapore 11%; and Malaysia and the Philippines between 6 and 7%. The flock of Asian wild geese began to fly in neat formation, as if guided by an invisible thread, with Japan in the lead.

It has become clear by now that the process of "interaction and diffusion" is regulated by the price mechanism, but what driving force is propelling this flight

formation? Up to the mid-1980s, the rapid increases in U.S. imports had been the prime factor that enabled the region to grow fast. Since then, however, Japan, through its very act of boosting domestic demand and rapidly increasing the volume of imports of manufactured goods in the wake of the currency realignment, has come to perform the role of the prime mover that pulls the flight formation ahead. There is hardly any criticism voiced by the members within this flight formation against the policy Japan has been pursuing to counter the effects of the strong yen, the policy that emphasizes domestic demand, not exports, and the opening up of its import markets.

For instance, the South Korean government foresees in its economic plan that the country's chronic trade deficit with Japan will be resolved by 1992. Indeed, the durable consumer good sectors of South Korea, the country's export leaders, are still procuring most of their supplies of important materials and parts from Japan, and most of their sophisticated assembly and processing machines as well. This fact, however, is not considered to be much of a problem, because the Japanese market has now begun to open enough to make the prospect for resolving the bilateral trade imbalance convincing.

So long as Japan keeps trying to stimulate domestic demand, stabilize prices, and make its market accessible to imports, the flight formation of wild geese with its own driving force and a built-in mechanism of "interaction and diffusion," is unlikely to be disrupted too much even if the U.S. economy enters an adjustment phase and its imports stop increasing for a year or two. Not only that, the flight formation might even help facilitate the American economic adjustment process by providing a ready outlet for its exports, the expansion of which will be an important part of the adjustment.

IV. A Multilateral Trade Regime and Japan's Role in It

In looking into the possibility of policy co-ordination in the Asia and Pacific region, there are two factors that need to be scrutinized closely, one the principle governing the behavior of Japanese firms, and the other the direction to which the international trade regime is heading. In my opinion, neither of these are a cause for concern. Fortunately, a majority of the Japanese firms have already started to restructure themselves actively, realizing that the persistence of a strong yen and the need for liberalizing the Japanese market are unavoidable. They are actively participating in the organization of a new flight formation in Asia. It is also important to note that, even though Japan serves as the driving force for this formation, it does not seek a hegemony in it.

Immediately before the end of World War II, the Allied nations, and the United States in particular, harbored a strong desire to create a multilateral economic order which would be free, indiscriminatory and wide open, and which would be conducive to resolving international economic problems on a multilateral, not bilateral, basis. A treaty concluded in 1944 in Bretton Woods, New Hampshire, gave shape

Table 1. INDUSTRIAL METAMORPHOSIS AND ITS CONSEQUENCES

	Japan up to the Present	Japan in the 21st Century
Characteristics of the industrial network	The core of the industrial network that is contained within Japan	The navigator for a manufacturing network extending along the islands of East Asia
Characteristics of inter-firm division of labor	Intra-industry division of labor between big firms and their affiliates and subcontractors	Big firms diversify into many different lines of business by externalizing accumulated experties; medium-sized firms find markets for their knowhow
Firm size	Coexistence of large firms and medium/small firms	With corporate restructuring completed, firms with functionally optimum work-forces of one to several hundred employees predominate
Characteristics of makeup of industry and society	Smokestack industries, mass distribution, and separations of workplace and residence	Workplaces and the residences form organic entities, where people have closer ties with each other
Relative importance of software and hardware	Hardware is dominant, with software playing a secondary role	Hardware and software are mutually substitutable
Women's role in industry	Women perform mostly auxiliary roles	With workplaces and residences brought closer together, women's chance to seek social advancement is significantly improved

to this desire, calling for the establishment, after the war, of what is now known as the Bretton Woods system, consisting of a free, indiscriminatory and multilateral trade order and a mechanism of international settlement. This system proved pivotal in enabling the countries of the Western camp to attain high economic growth. The system benefitted Japan more than any other country by enabling it to grow at an unprecedented pace, far in excess of the growth rates of other countries and its own growth rate in the prewar era.

Unfortunately, however, the free, indiscriminatory and multilateral system has, for some time now, been unable to respond satisfactorily to various problems that are vexing the international economy, and, moreover, it is being challenged by new trends toward regionalism, the most noteworthy being the European Community's plan to integrate the markets of its member countries by 1992. If the EC becomes a fortress closed to the outside, and discriminates against nonmembers, it will shake the Bretton Woods system to its foundation. Already, many

firms outside the EC, afraid of being affected by the plan, are thinking that they may have to establish production or sales bases within the fortress before 1992. There is a cause for concern that the year 1992 will turn out to be the most important watershed for the international economic system since the end of WWII.

I for one, however, do not believe that the idea of tackling international economic problems on a multilateral basis has lost its appeal. On the contrary, I think that concrete actions to stop further degeneration of the multilateral order have been gaining momentum lately. One example is the General Agreement on Tariffs and Trade (GATT), which is recovering some of the functions it had lost previously.

More specifically, the GATT panel (Subcommittee for the Resolution of Disputes) is proving itself increasingly competent to put a brake on a standard or law unilaterally imposed by a country without subjecting it to multilateral examination and without obtaining the approval of the countries affected by it. In January 1989 the panel ruled that Article 337 of the U.S. Tariff Act is in contravention of Article 3 of the GATT, which stipulates that prohibiting imports of a commodity for reasons of its infringement of patent rights could be applicable only to the commodity concerned, and that discrimination against the firm manufacturing that commodity is not justifiable.

Article 337 of the Tariff Act stipulates that when an American firm believes that its patent is being infringed upon by the producer of an imported commodity, it can file a request with the International Trade Commission (ITC) calling for a ban on imports of the commodity. The Omnibus Trade Act that was enacted in August 1988 revised Article 337 of the Tariff Act, making it possible for an American firm to sue a foreign firm for infringement of its patent rights without proving the damage actually caused by the alleged infringement, and thus have the import of the commodity halted more easily.

The revision of Article 337 of the Tariff Act was, in fact, regarded by many observers as the most problematic aspect of the Omnibus Trade Act. The provisions of the revised article, it was feared, would encourage American firms to make unfounded claims of patent violations against certain foreign-made commodities and thus virtually deny these items access to the U.S. market. Many of the foreign exporters facing such accusations would find it necessary, although they might be reluctant to do so, to seek out-of-court settlements and pay huge sums of compensation, just to avoid troublesome court procedures.

With the ruling that Article 337 runs counter to GATT's national treatment clause, which calls for indiscriminatory treatment of domestic goods and imported goods, the GATT panel determined that Article 337 of the U.S. Tariff Act does not constitute a measure indispensable for protection of patent rights provided for by the U.S. Patent Act. It seems inevitable that the Omnibus Trade Act will be amended in accordance with this ruling. Already, the ruling is beginning to affect the settlement of Japan-U.S. disputes concerning intellectual property rights. A case in point is a dispute between Motorola and Hitachi over semiconductor patent rights, in which Motorola has sued Hitachi for infringement of patent, but has not filed a complaint with the ITC. Previously, it would have also asked for

an ITC action to halt imports of the Hitachi products in question, concurrently with instituting a law suit.

The fact that the dispute-settling functions of GATT are being reinforced carries great significance, especially at a time when the integration of the EC and the U.S.-Canadian Free Trade Agreement are arousing anxiety elsewhere that these regional arrangements might unduly discriminate against outsiders. Also important is the fact that the Uruguay Round multilateral trade negotiations resulted in an agreement in April 1989 on substantive and gradual reduction of agricultural protection. The procedure for reducing agricultural protection over the long-term using the "aggregate measure of support" as the index of the intensity of protection seems workable and promising.

V. Industrial Structural Adjustment as a Concrete Means of Policy Coordination

Several new trends are emerging in the world. One is the flock of wild geese flying in formation in full vigor in East Asia. The flight formation is different from an ordinary attempt at forming a regional common market; it is characterized by the mechanism of interaction and diffusion, and by the leadership role Japan is playing as its driving force. However, given that the interaction and diffusion are realized by means of the price mechanism, both China and Soviet Siberia will remain unaffected by the new trend. In my view, the examination of possible impacts this trend will have on the economic impact of East Asia on international trade is crucial.

Some would argue that it is nearly impossible to define policy coordination in the Asia-Pacific region, because the region is unlikely to have an institutional basis for regional cooperation comparable to the U.S.-Canadian Free Trade Agreement or the full integration of the EC market. However, I believe that it is possible to conceive a scenario in which Japan's industrial restructuring will play a critical role in helping the individual economies of the region to grow in harmony with each other. As a first step towards drawing up a probable scenario for the region as a whole, I would like to consider how the ongoing industrial restructuring of Japan will transform Japanese society by the year 2000.

Among many possible scenarios, I believe that the most plausible one is as follows.

(1) The yen will grow stronger, reaching the level of 100 to the dollar by the year 2000.

(2) The East Asian manufacturing network will grow more tight and complete, and Japan will become a gigantic import country.

(3) The pattern of the international division of labor will be such that, as the network of manufacturing operations becomes global, Japan will put technological innovations in machinery, information and communications equipment and crucial electronics parts into practical application one after another, becoming the supply base for technology-intensive capital goods.

(4) Many jobs, especially in manufacturing, will be transferred to various parts of East Asia, with Japan generating new jobs and workplaces at home. The creation of new jobs and workplaces will continue to push up real incomes, generating new demands within Japan, specifically demands for better living conditions, including community improvements, and for service diversification.

How can these qualitative changes be translated into changes in the country's industrial and employment structure? My answer is that Japan will experience a significant decrease in the production of automobiles as durable consumer goods, an increase in the output of microelectronics-based machines, equipment and related parts, an advance of the construction industry, and increases in services for individuals and business. I have undertaken a number of simulation analyses assuming different sets of values for these factors.

The automotive industry and other assembly industries of Japan will be hard hit, because when Japanese wages become the world's highest in terms of dollars, these industries will not have much room left for further rationalizaion, and will not be able to continue earning large profits.

Let us assume that automobile production will decrease by one third by the year 2000. The effects of this decline, calculated by using of the input-output table for 1984, will be as follows:

(1) Sectors experiencing significant decreases in production: rubber industry (minus 15%); cast and forged steel industry (minus 9%); petrochemical industry (minus 4%); and industries related to non-ferrous metals, synthetic resins, pig iron and crude steel, rolled steel as well as electricity, banking and insurance, real estate, stationery, and packaging (minus 3 to 4%).

(2) Sectors with significant declines in their workforces: automobile (320,000 persons); commerce (290,000 persons); service (excluding public service; 170,000 persons); and rubber products, general machinery and foodstuffs (more than 30,000 persons each).

On the whole, production will decrease by 3.41% and the number of employees by 1,550,000. Even though these results are based on the assumption that the effects of the production cutback in the automotive industry will proportionally affect employment, the fact that the unemployment rate will double from the present figure is not reassuring.

However, if the light electric machinery industry manages to increase its output by 9% and the service industry by 5% while the automobile production is contracting by one third, overall production decrease will remain at a small 0.53%, and employment will show a net increase of 78,000 jobs. This suggests that, assuming the advance of microelectronics and service industries, industrial restructuring is unlikely to have a crippling impact on the Japanese economy as a whole.

With a view to drawing up a picture of the Japanese industrial structure in the year 2000, I have shown the results of a simulation analysis based on the most pessimistic assumption conceivable according to which the country's automobile production will decline by one third. I have also indicated what kind of industrial activities will be needed to offset the impact of the cutback in the automobile

production. These results suggest that while workers in the manufacturing sector will become somewhat redundant, workers with expertise and high technological competence will be in short supply.

The metamorphosis which the Japanese industrial structure is likely to undergo may be summarized in the table below. This structural change will definitely accelerate the economic development of the Asia-Pacific region; what is required of Japan, I would say, is to display the capability to renovate itself from within.

VI. Internationalization of the Yen and Policy Coordination

The new progression of international division of labor centered around East Asia has given rise to a new policy issue, namely, the internationalization of the yen. The yen's appreciation has accelerated the opening of the Japanese market for imports of manufactured goods. The volume of such imports from Asian NIEs, in particular, has been growing considerably, increasingly by 30% measured in yen, or by a dazzling 50% when measured in dollar, over the one year period from mid-1987 to mid-1988. For the Asian NIEs, the United States remains the largest market for their exports, but they cannot hope to increase their exports to the United States by such high rates as in past. By contrast, their exports to Japan have a high potential of increasing. It seems safe to say that the whirlpool of trade is shifting its center from the United States to Japan. As these Asian countries come to view not solely the U.S. market, but also, increasingly, the Japanese market as major outlet for their exports, they will be attracted more closely to the yen. To take the cases of South Korea and Taiwan, for instance, the more consumer goods they export to Japan, the more capital goods and industrial raw materials they will import from Japan. In particular, as they expand the production of many varieties of durable consumer goods in small quantities, they will have to buy the types of machines, developed in Japan, that can flexibly cope with diversified production. I have pointed out that Japan's imports from the Asian NIEs are growing by 50% annually when measured in dollars. It should also be noted that this 50% increase is accompanied by a 30% increase in Japan's exports to these countries, also measured in dollars.

As this interdependence gets more solid and permanent, the use of the dollar as a means of settling transactions will become awkward and inconvenient. Furthermore, if the yen appreciates further, the Asian NIEs, whose currencies are tied closely to the dollar, in particular South Korea and Taiwan, will suffer from swift increases in the import prices of capital goods. If they want to avoid such import-generated inflation, they will find it desirable to link their currencies more closely with the yen, that is, to settle their trade accounts with Japan in yen, instead of dollars. It is true that, supposing the yen continues to appreciate and the dollar to depreciate, these countries will still be able to expand their exports to the United States as well as Japan, even if they keep their currencies tied to the dollar. My argument here, however, is that steep rises in the dollar-denominated

prices of capital goods imported from Japan would be far from welcome for the NIEs, which are so intent on improving their production capabilities.

The percentage of Japanese exports settled in yen was 29.4% in 1980, 36.5% in 1986 and 33.4% in 1987. The drop in 1987, when the yen appreciated rapidly, seems to be due to the fact that Japanese exporters, faced with ever harsher competition in the export markets, found it impossible to insist on settling accounts in yen. That would have meant forcing their importers to suffer from swift increases in the dollar prices, and therefore they chose to settle some of their transactions by means of the dollar, instead of the yen. If, however, Japan's exports become more centered around capital goods as a result of further progression of the international division of labor in East Asia and elsewhere, it is reasonable to expect that there will be a gradual switch from the dollar to the yen as the key currency for settling international transactions in the region.

The appreciation of the yen has induced an increasing number of Japanese firms to relocate their production bases offshore. Some of these overseas investments in East Asia by Japanese firms have taken the form of investments in projects for "development and import," namely, to launch new overseas production operations with the explicit goal of importing the products into Japan. One noteworthy aspect of the recent development of the international division of labor is that it has not only induced Japanese firms to go offshore, but is prompting an increasingly large number of South Korean and Taiwanese firms to relocate their production bases elsewhere in Asia. The appreciation of the South Korean won and the Taiwan dollar have made it inevitable for these firms to relocate production overseas. And, when these South Korean and Taiwanese firms go abroad, they do so with the purpose of exporting the products of their offshore operations to the United States and Japan, which means, again, that their offshore production activities are in need of production facilities manufactured in Japan that can flexibly respond to changes in the market trend. This being the case, machines and precision parts manufactured in Japan are often regarded as indispensable for overseas operations of South Korean and Taiwanese firms. In other words, machinery and equipment made in Japan seem to constitute a crucial factor in the manufacturing network now being formed in Asia. In this respect, too, we may assume that the role of the yen as the settlement currency in the region is becoming more important. It seems very reasonable to conclude, therefore, that in the emerging system of the international division of labor in East Asia, the use of the yen as a common standard of value, one of the important functions of a key currency, will increase.

Let us list the important factors that will contribute to the increase of the use of the yen as a settlement currency. One is the market factor already noted, the factor that is evident in the whirlpool of increasing manufactured exports to Japan caused by the opening of the Japanese market and increased domestic demand. This whirlpool will be observed throughout the East Asian region.

The second factor is the increase in the exports of capital goods from Japan.

As the manufacturing network spreads throughout East Asia, the system of international division of labor will advance rapidly. Machinery and equipment supplied by Japan will form the core of this manufacturing network, which means that the yen will be accepted by many East Asian manufacturers as the basic standard of value. Put differently, Japan's role as a supplier of machines will enhance the role of the yen.

Thirdly, there is the financial factor arising from the abundant funds accumulated in Japan, which will cause the yen to play an increasingly important role. The growth of the manufacturing network will be accompanied by a growing demand for capital funds, which will be satisfied mainly by abundant yen funds carrying low interest rates. It would be a mistake, however, to assume that Japanese financial institutions alone will monopolize the financing business; financial institutions of Asia, and those of the United States and Europe, will try to participate in the growing business of making yen loans.

Thus, the three key factors are all words that begin with the letter M — market, machine and money. They will accelerate the shift from the dollar to the yen as the dominant settlement currency of East Asia. This process, however, should never be mistaken as one leading to the formation of a yen bloc, dominated by Japanese nationalism. Rather, the process should be understood as a reflection of the denationalization of the yen, similar to the internationalization of Japanese *sumo* wrestling. Offering the yen for use by many people abroad is like providing a *sumo* wrestling ring for many non-Japanese players to play on it. If wrestlers of many different nationalities play the game in the same arena along with the Japanese, *sumo* wrestling will cease to be Japanese national sport. The ring will have to be governed by a set of transparent rules acceptable to international players. Likewise, the denationalized yen will become a part of the institutional framework for the creation of a new international economic order.

The rise of the yen's international standing, therefore, should not be seen as a manifestation of the formation of a yen bloc, but rather as a manifestation of the denationalization of the yen. After all, the opening up of the Japenese market should not stop at the internationalization of its market for goods, but should proceed to the internationalization of its market for services as well, financial services included.