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Japanese direct foreign investment and the Asian financial crisis

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Abstract

This paper examines the extent to which the Asian currency crisis of 1997–1998 impacted upon the behaviour of Japanese foreign direct investment (FDI) in the manufacturing sector. Much literature has claimed that transnational corporations (TNCs) are unlikely to be firmly embedded in the host countries where they operate. If this is the case, then Japanese firms in Asia might have exhibited a high degree of disinvestment or plant closure and transfer of operations to other countries following the onset of the financial crisis. Although the events surrounding the Asian crisis and subsequent recovery are still unfolding, FDI data, surveys of Japanese firms, and initial reactions by Toyota Motor Corporation and Matsushita Electric Industrial were reviewed to examine this proposition. In general, the evidence suggests that Japanese TNCs have not fled Asia bur rather they responded in the following manner. First, flows of Japanese FDI into Asia overall held steady throughout fiscal year 1997–1998, although it was set to decline thereafter, at least for the short term. Second, at the level of individual corporations, there is some evidence to show that major firms have maintained their operations, and that they have shifted to an export-orientation so as to earn income from their Asian production in overseas currencies. Third, the survey evidence points to a long-term commitment to Asia by Japanese transnationals.

Keywords: Asian currency crisis; Japanese FDI; Japanese transnational corporations

1. Introduction

The wild geese fall successively, following Japan –
('Senryu', short, humorous Japanese poem)

Prior to 1997, Asian economies were like wild geese (*ganko keitai*), following a lead wild goose Japan flying high in the sky and forming successive waves of development – or so the rhetoric went (Yamazawa, 1990). According to this view, Japanese firms transferred their future expectations of growth to Asia, especially as economies in the West wavered in the early part of the last decade (Edgington and Hayter, 2000). Throughout the 1990s Japanese companies invested heavily in Asia, and a wide array of literature monitored this expansion (see for example, Doner, 1991; Tokunaga, 1992; Doherty, 1994; Ernst, 1994; Chen and Drysdale, 1995; Nomura Research Institute, 1995; Sing, 1995; Hatch and Yamamura, 1996; Itagaki, 1997; Milelli, 1997). Led by the major corporations in the automobile and electronics industries (including Toyota, Honda, Mitsubishi and Matsushita), corporate Japan established a massive presence in Asia (Lindblad, 1998). For instance, Matsushita Electric Industrial set up 15 affiliates in Malaysia that reputedly accounted for 4% of the country's exports. A fifth of Malaysia's new manufacturing jobs in the 1990s were at Japanese companies (The Economist, 1997). By the middle of the decade Japanese firms had invested about \$5.7 billion in factories or property developments in Thailand, Malaysia, Indonesia and the Philippines, which represented just over a third of all foreign direct investment in the region as a whole, and far more in Thailand (Business Week, 1995). Japanese transnational corporations (TNCs) have similarly dominated foreign direct investment (FDI) in South Korea, and also China, the biggest target for FDI in the 1990s (Thompson, 1997).

However, starting with the Thai baht depreciation in July 1997, Southeast Asian economies, followed by South Korea, were hard hit by currency and stock market instability, and the consequent stagnation of their economies. By 1998, nearly every country in the

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region was affected (Gill, 1998; Montes, 1998). The Asian crisis created considerable difficulties for Japanese TNCs, to a greater degree than for American and European counterparts, because of the extent of their investments in the region and the importance of these investments to operations in Japan, especially as export markets (see Strange, 1998; Kwan, 1998). Indeed, a survey carried out by the Japanese Exim-Im Bank during 1998 found that 80% of firms with affiliates in Southeast Asia responded that these received negative impacts from the Asian crisis (Tejima, 1998). Conversely, Japanese TNCs' reactions to the turmoil of 1997–1998 were seen as crucial to the economic health of East and Southeast Asia, especially in Thailand, Indonesia, the Philippines and South Korea. These countries were understandably anxious that Japanese banks and manufacturers did not react to the region's economic disorder by either investing or lending less. If Japanese FDI flows were resilient in the face of the crisis, so it was argued, then they could assist the countries involved in the process of economic recovery (The Economist, 1997, UNCRD, 1998).

This paper addresses the question of corporate resilience by examining how Japanese manufacturing TNCs with operations in Asia responded to the region's financial crisis. Our goals are to identify these responses, especially in terms of decisions about production levels, product mix, local linkages, market orientation and investment plans, and to assess implications for future long-run corporate strategies in the region. Empirically, the paper draws from recent official data on Japanese FDI, person to person interviews with senior managers of Japanese companies, and case studies of corporate strategies in the auto assembly and consumer electronics sectors. The paper identifies responses that were undertaken in the 18 months following the onset of the financial crisis in July 1997, and discusses plans and expectations of Japanese companies as expressed in 1999.

The conceptual point of departure for the paper is provided by the debate over the embeddedness (or otherwise) of FDI in host economies (Dicken et al., 1994). Since our analysis focussed on Japanese FDI in Asia, we implicitly link this debate to the flying geese literature (Edgington and Hayter, 2000). As Dicken et al. note, there are strong suggestions in the literature that FDI is relatively footloose and not well connected to local economies. Thus, ideas about location flexibility, the ephemerality of contemporary capitalism, the new international division of labour, reduced national sovereignty, as well as the dependency literature, have conjured up the notion of highly mobile capital in which corporate interest has little overlap with local interest (Bluestone and Harrison, 1982; Shapiro, 1983). Still, Dicken et al. (1994) offer a contrasting view to this model of 'placeless' TNCs that have no allegiance to country, region or local community. In their view, the rise of flexible production, the emergence of local and regional 'networks' as well as entrepreneurial firms, have all led to a re-evaluation of this stereotypical model (ibid.). Cox (1997a) also questions the general assumptions of 'hyper-mobile capital', and argues for more empirical studies of just how global-local tensions play out in a complex world economy. From this perspective: 'The real question to ask of (transnational corporations) is not why they are always threatening to up and leave a country if things seem to go bad for them there, but why the vast majority of them fail to leave and continue to stay put in their home base and (other) major centres of investment? TNCs are very reluctant to uproot themselves because they get entrenched in specific national markets, and with local suppliers and dealers'(Hirst and Thompson, 1992, cited in Cox, 1997b, p. 4).

Hirst and Thompson's view of embeddedness is, however, first and foremost rooted in the home countries of TNCs. In host countries, the nature and extent of embeddedness is more problematic and inevitably contingent on circumstances. In this regard, as the flying geese model predicts, Japanese FDI in Asia for the last 20 years or so has represented a growing commitment to the region as a whole. It is a commitment that has helped to establish Asia-Pacific as a rival 'triad' economy and as a complement to the North American and European metropoles. The financial crisis of 1997, nevertheless, threw this commitment into turmoil. Consequently, we explore the short- and long-term implications of this crisis for the strategies of Japanese TNCs. Did this 'shock' and subsequent social turmoil in the region necessitate withdrawal from local involvement or even a shift to greener pastures? Or did the shock encourage more lasting, locally integrated adaptations? The first section of the paper examines the various reasons for the surge of Japanese manufacturing FDI into Asia in the fifteen years or so leading up to the crisis to provide a framework for assessing these questions.

2. Japanese production systems and the Asian financial crisis

Following sporadic, pioneering investments in the late 1960s, Japanese FDI in Asia gradually gathered momentum during the 1970s and 1980s, although this momentum was by no means continuous and smooth. Nonetheless, the substantial appreciation of the yen in the mid-1980s (*endaka*), in the context of generally booming economies in many Asian countries, and the opening up of China, encouraged a major expansion of Japanese FDI in the region. Indeed, Tejima (1998) argues that Japanese firms became increasing embedded in Asian host countries following 1986, and thereafter a