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Japanese Ambassador Extraordinary and Plenipotentiary

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Cover Page Footnote

Text of the speech delivered by H.E. Ambassador of Japan at the Institute of Business Administration on November 25, 2006

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Japan Pakistan Economic Relations Challenges and Opportunities from Japan's New Economy *

Seiji Kojima

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INTRODUCTION

I want to express my heartfelt gratitude to the Institute of Business Administration (IBA) for giving me a chance to speak about the economic relations between Japan and Pakistan. This Institute has history of 50 years, and is the oldest business school outside North America. I am very happy to learn that although this highly renowned institute was established with the financial support from USAID, it has also developed strong connections with Japan. Prof. Danishmand, Dean and Director of the Institute of Business Administration, has worked for the Atlas Group and Suzuki Motorcycles Pakistan. Prof. Fujita, a senior volunteer from JICA, is already teaching at the IBA the theory and practice of the Japanese concept of Management.

JAPAN PAKISTAN ECONOMIC RELATIONS AS TODAY'S SUBJECT

I have various reasons to discuss the economic relations between Japan and Pakistan today. First, one of the most important and urgent tasks that the Pakistani Government faces is of course to achieve a robust and stable economic growth, thereby enabling to eradicate poverty from this country. As the largest bilateral donor and a major trade partner of Pakistan, it would be quite natural for Japan to place importance on the economic aspect of the relations with Pakistan. Second, this is an institute of business administration, and I imagine that the audience will show interest in the economic side of the bilateral relations, although our relations have been increasingly becoming multi-faceted. Third, Karachi is the commercial center of Pakistan, producing 65 % of GDP of the country, and would be the right place for me to discuss economics. Fourth, almost every day articles on Japan's economy and the relations between Japan and Pakistan appear in major newspapers in Pakistan, they are not often discussed in a comprehensively manner and in an analytical way. But, I have to hastily add that my speech today may not fully satisfy you in terms of its coverage and analytical depth of the subject. This may prove to be a reckless attempt by an amateur.

Although today's subject is the economic relations between Japan and Pakistan, my discussion will not be confined to the bilateral relations *per se*. I also discuss political and economic surroundings of the two countries and the collaborative moves in South Asia and East Asia, which may influence the future of our relations. Today's argument is, in fact, based upon the premise that the fundamental changes in the Japanese economy will play a key role in shaping the future relations.

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THE LOST DECADE IN JAPAN

I would like to start my presentation by sketching what happened in the Japanese economy since the late '80s. The '90s is, as many of you know, often termed in Japan as well as overseas, as “a lost decade”. In 1990, asset prices collapsed dramatically in Japan. In the '90s, Japan's annual economic growth came down to 1.6% from 3.8% in the '80s. The unemployment rate rose from 2.1% in 1990 to 5.4% in 2002. Before the collapse, the stock price was over 38,000 Japanese yen in 1989 it came down to the level of 16,000 Japanese Yen in 2005. As the result of a series of fiscal measures, Japan is now faced with a huge amount of the public debts.

There are arguments among economists about the causes for the long economic sluggishness. Looking at the supply side of the Japanese economy, some economists point out a decrease in potential growth capacity. Some economists argue that the demand was not strong enough to fully make use of the economic potential in the Japanese economy. This school also points out a delay in the easy monetary policy in the early part of '90s. As a former lawyer of the Asia Development Bank, I would not make any conclusion now, leaving it to the hands of experts of proper disciplines.

A NEW ECONOMY OF JAPAN

As the result of progress in structural reform since the late '90s, especially under the Koizumi Cabinet since 2001, Japan's economic bases have been strengthened. Banks have started lending gingerly. The non-performing loans (NPLs) have dwindled from more than 8% to below 2%, and the “three excesses” in employment, equipment and debts in the corporate sector have almost been eliminated. Current profits of corporation have seen a fourth consecutive annual increase in fiscal year 2005 and business investment continues to grow strongly. For my convenience, let me name the Japanese economy after 2001 as a “New Economy” without any clear definitions.

The employment situation is also improving and the unemployment rate has decreased from 5.5% to just above 4%. The demand-supply gap has been eliminated and the consumer prices have been in the rising trend. The eradication of deflation has come into sight, with the improvement of the GDP deflator from minus 1.2% in the April-June quarter to minus 0.8% in the following quarter this year.

In the July-September quarter of this year, Japan's GDP expanded 0.5% as compared to the previous quarter, and on an annualized basis it grew 2.0% in the July-September quarter. Japan's economy has been in an expansion phase for 58 months. This is Japan's longest postwar recovery. The Japanese economy is expected to continue a moderate recovery led by private demand with the continuing growth of consumption and business investment, although in the July-September quarter, private consumption declined 0.7%.

Of course, there are risks to the outlook of the economy. They are the further surge of oil prices, the slowdown of the US economy and the possible inventory adjustment in the IT sector.

CHALLENGES AND OPPORTUNITIES FOR PAKISTAN

In the era of globalizing economy, Japanese economy can enjoy the economic growth of the world economy, and in turn will contribute, with its openness and vitality, to growth of the world economy, especially the sustainable development of Asian countries. Now, I would like to discuss challenges and opportunities presented to Japan as well as to the world economy by the New Economy.

First, Japan's exports doubled from 275.2 billion dollars in 1989 to 598.2 billion dollars in 2005. In fact, the economic recovery after January 2002 was first led by exports. Despite the economic sluggishness, Japan's imports also recorded a remarkable increase from 210.8 billion dollars in 1989 to 359.1 billion US dollars in 2001, and then 518.6 billion dollars in 2005. In 2005, the major trade partners of Japan are East Asia, the US, EU 25 and the Middle East.

Second, in 2005 Japan's FDI on a balance of payments basis recorded 45.5 billion dollars, the highest level during the last 15 years. It increased by 46.8% over 2004. In the manufacturing sector an amount of 26.1 billion US dollars was invested. Japanese automobile companies invested in the US and Asia for the actual or future expansion of production. Japan's FDI to Asia amounts to 16.2 billion US dollars with an increase of 53.4% over the previous year, and the US enjoyed 12.1 billion US dollars with an increase of 61.1%.

Third, as the manufacturing firms go abroad, so do financial institutions, many of which once rationalized their overseas operations during the post-bubble period. Some financial and insurance companies bought local institutions in order to strengthen their operational bases in Asia.

Fourth, although Japan has struggled out of the long economic recess, it is still suffering from its aftermath. If the debts of the central and local governments are added, the amount will become 775 trillion Japanese yen or 151% of GDP in 2006. The government pledged that it would balance the annual budget before debt payments by 2011. This has posed big challenges not only to Japan, but also to ODA recipient countries including Pakistan. I will discuss this issue later.

Fifth, in East Asia, more than half the total trade for the region is conducted within the region itself, demonstrating how tightly-knit the region truly is. Japan has already concluded or is currently negotiating economic partnership agreements (EPAs) with the ASEAN countries and with the Republic of Korea. By the way, while a FTA traditionally focuses on trade of goods, an EPA also includes trade in services, intellectual property and cooperation. We are also promoting joint studies with India and with Australia. In addition, with regards to the economic tie-ups among Japan, China, and the Republic of Korea, academic research by specialists has already been launched. Japan believes that the East Asia Free Trade Area and the East Asia Investment Area will also contribute to promoting regional economic integration. Looking nearer at South Asia, the countries have not yet made full use of regional arrangements, known as SAFTA. I will come back to this issue later.

Sixth, Japan is increasingly becoming an aging society and the population has started to shrink with the peak year of 2004. The population of 65 years old or older now represents more than 20% of the total population, and the fertility rate has gone down to 1.25. These demographic changes require a major transformation in the Japanese economy. In the future, Japan has to rely more upon trade. New technologies, innovations and growth of productivity also hold the key for Japan to cope with the problems caused by the aging population. In other words, the Japanese economy should be more knowledge-based, relying increasingly on less sophisticated industries abroad. Japan may have to consider the acceptance of more professional or technical workers.

The aging society will produce more people who are retired but are still active and who enjoy travelling. They have already travelled abroad extensively, and are not satisfied with the ready made, less adventurous travel schedules. Pakistan, with its natural beauties, historic sites and exotic handicrafts, can be a good destination for these people.

IS PAKISTAN READY TO MEET CHALLENGES AND TO GRASP OPPORTUNITIES?

(Japan's Exports to Pakistan)

As an export destination for Japan, Pakistan has been more or less successful. With the exports of 2001 as the bottom of Japan's exports to Pakistan, Japan's exports to Pakistan increased and reached the level of 1.51 billion US dollars in 2005, representing 0.3% of the total exports of Japan. Through the exports of such items as machinery, automobiles and auto parts, Japan can, I am sure, contribute to strengthening and widening the industrial base of Pakistan so that Pakistan will export a wider variety of industrial goods in the future.

(Pakistan's Exports to Japan)

Pakistan's exports to Japan are in a really miserable situation. The amount has kept on decreasing since 1996, and in 2005 it became a quarter of the amount in 1995. Now, Japan's imports from Pakistan are a negligible amount of 143.7 million US dollars. Why did this happen? What should we do? First and foremost, the corporate sector of Pakistan must strive towards improving its competitiveness and increase its economic competitiveness and increase its economic value added.

The exports of textiles and clothing occupy about 60% of the total exports from Pakistan to Japan. Without a recovery of competitiveness of that sector, you cannot expect a dramatic increase in Pakistan's exports to Japan. I know that Pakistan's textile industry is at a crucial juncture with a fierce competition in the international market, especially after the Agreement on Textiles and Clothing expired in January 2005. It is said that the industry faces the decision to choose yarns and fabrics on the one hand and made-ups and garments on the other. I am not in a position to advise anything, but before making any decision they have to conduct a thorough research in the foreign markets. The sector also needs to upgrade its technology and to develop human

resources. I hope that through works on drawing up a “Textile Vision 2012”, the Government and industry will find strong solutions.

On our part, JICA, JETRO, the Association for Overseas Technical Scholarship (AOTS) and other Japanese organizations are ready to assist the Pakistani public sector and small and medium enterprises through human resource development and transfer of technology. In Karachi, with the assistance by the Japanese Government, the Plastic Technology Centre (PTC) was upgraded and JICA has started technical assistance to the PTC.

(Pakistan as a Destination of Japan’s FDI)

FDI plays a crucial role to upgrade and modernize Pakistani industries. As often argued, trade and FDI are closely related, and more FDI often means more trade, especially exports from the country of investment destination.

In the last three years, Japanese companies have invested more than 100 million US dollars in Pakistan. I hope that the volume of Japanese investment in Pakistan, particularly in the automobile sector, would increase further in the near future, since this sector in Pakistan is expanding. The number of automobiles produced in 2010 is estimated to be 500,000 with an annual increase of approximately 25%. I am therefore very hopeful that in the coming future the Japanese vendors and suppliers would also invest here. This will certainly improve the production quality of the local vendor industries that are still dependent upon the old production techniques.

In the New Economy the concept of a small government will be pursued further. More infrastructure construction and operation will be transferred to the hands of the private sector in Japan. It may become easier for the Japanese private sector to come to Pakistan. On the Pakistan side, the finalization and approval of projects should be further facilitated.

Despite these welcoming trends, Pakistan has not enjoyed a golden share of Japan’s recovery of FDI after the economic revival in Japan. Japan’s FDI to Pakistan of 45.2 million US dollars in 2004/05 is a modicum of Japan’s total FDI of 45.5 billion dollars in 2005.

In the decision of an investment project, the investor takes into account several factors. First, the macro-economy and policy of the destination country are to be analyzed. Pakistan is currently pursuing a liberal foreign investment policy as part of its economic reform programme and in so doing it has initiated structural reforms as well. On this front, I think that Pakistan has done remarkably well in registering a substantial increase in the net inflow of FDI over the last six years.

Second, the structural reforms and policy changes will remain insufficient if they are not supported by well-collaborated legal, macro-economic and infrastructure framework which is constituted by avoidance of double taxation, establishment of industrial standard for quality control, protection of intellectual property rights and patents, adoption of a long-term consistent policy, provision of roads, railways and ports, access to a reliable power supply, and human capital formation and skills development.

Third, the investment climate in any country can be judged from some basic indicators in doing business, such as its entry regulations, disclosure requirements, bankruptcy procedures and so on. There is no doubt that Pakistan has shown some improvement in these indicators. The improvement is quite encouraging but still further improvement is required in this regard.

Fourth, the security situation is also very important. Nowadays, it would be quite natural for the private sector to assess the safety and security situation including the state of the relations between the destination country and its neighboring countries.

Even if a country improves its investment environment, prospective investors compare the environment of the country with that of other markets. In the case of Pakistan, they compare Pakistan with the countries in East Asia and other South Asian countries. In other words, Pakistan has to compete with these countries.

Here, I would like to introduce to you a case of Japan's FDI to Pakistan. As all of you must know that the automobile industry in Pakistan has been dominated by the Japanese automakers. They started to invest in Pakistan decades ago, when no other foreign automakers showed any interest towards Pakistan. The CEOs of the Japanese automakers have never thought Pakistan as only a market of automobiles. They had a long-term perspective to develop a robust automobile industry in Pakistan, by providing technologies, conduction research and development works, and training managers and engineers, thereby creating a lot of job opportunities in this country. If the Japanese automakers had not invested in this country, there would not have been any automobile industry in this country.

(Pakistan as an Important Partner Country for Japan's ODA)

In order to contribute to the development goals set by the UN, Japan continues its efforts towards the goal of providing ODA equivalent to 0.7% of our gross national income (GNI). We intend to increase our ODA by 10 billion US dollars over a period of 5 years. In order to achieve these goals, ODA in general and ODA to Pakistan in particular should be supported by a wide range of Japanese people. In this regards, Foreign Minister in February 2006 said that:

“Pakistan is a front country in the fight against terrorism. Since ancient times it has been a strategically important transport transit juncture, and many people may not realize this, but it shares a land border with Iran. Helping to build the infrastructure of such country will lead to stability in Afghanistan and central Asia and also has the value of conserving the distribution routes in the surrounding region. As the leading nation in Asia, Japan will suffer if Pakistan is not a calm stabilizing force. You can understand here too the situation in which assistance for Pakistan is also in line with the interest of Japan.”

Then, he concludes by saying that while he was in India and Pakistan in January this year, he thought that Japan's ODA to India and Pakistan would become more and more important in the future.

ODA to Pakistan being justified, in what areas should we give priorities? The Government of Japan formed its long term “Country Assistance Programme” for Pakistan in 2005. In this programme, Japan made the “Construction and development of a sustainable society” the uppermost goal of its ODA to Pakistan, and set forth the following three priority directions for cooperation:

- (1) ensuring human security and human development;
- (2) developing a sound market economy; and
- (3) achieving a balanced regional socio-economic development.

We will apply this programme to our operation in the coming 5 years, respecting fully the Medium-Term Development Framework (MDTF), the Poverty Reduction Strategy Paper (PRSP) and other documents of Pakistan.

After the resumption of the yen loan in 2005, it would take little more time to make the system fully operational, and mainly through yen loans, Japan continues to assist Pakistan in constructing its infrastructure. In addition, Japan will be more active in participating in dialogues on structural reforms and policy issues, and promoting governance, capacity development, devolution, etc. Japan together with other donors actively participates in organizing aid coordinator suitable for Pakistan.

You may have a clearer picture about our ODA, if I take up some future ODA projects in Karachi. Karachi is the heart of Pakistan economy, and an engine for the growth of the whole of Pakistan. Therefore, Japan assists Karachi to vitalize itself through the improvement in the basic industrial infrastructure. Japan has also been assisting to improve the quality of life in Karachi by developing a long-term plan for the establishment of the public transportation network and the elimination of traffic jams to secure smooth movement of workers.

(Regional Cooperation in South Asia)

Traditionally, the south Asian economies are closed ones. The shares of trade to GDP for Pakistan and India are around 30 and 40%, while those of the East Asia economies exceed 100%. Accordingly, the inter-regional trade is still limited. Although there are issues and difficulties in regional trade cooperation in general and SAFTA in particular, I am sure that Pakistan will benefit from regional trade in the long run due to improved competitiveness and access to the large market to South Asia. The integration of South Asian countries with the population of 1.5 billion has become more important, when East Asia has been increasingly integrating itself, and attracting far more FDI. In this regards, it would be gratifying to note that IBA and SAARC Chamber of Commerce & Industry, Islamabad (SCCI) jointly organized in January this year a regional conference on investment and trade.

The economic cooperation among the countries in South Asia will generate a favourable atmosphere for further political dialogues among the members. At the same time, it is also true that the promotion of trade and investment between countries tends to be deterred by the negative moves of the countries. From this point of view, we welcome

the Composite Dialogue process including Confidence Building Measures (CBMs) and hope that Pakistan and India will resolve their differences on various issues including the issue of Jammu and Kashmir.

(Japan's Aging Society and Pakistan)

As I have discussed earlier, Aging Japan again gives Pakistan various opportunities from the promotion of trade and investment to the dispatch of professional and technical workers and also the promotion of tourism. Here, I only discuss tourism and knowledge-based economy.

Pakistan, unfortunately, is not a popular destination for the Japanese tourists with only 13,400 visitors a year, while more than 17 million Japanese go abroad a year. Pakistan is full of tourist resources such as mountains, Buddhist sites, Indus civilization, World Heritage sites, deserts, etc. In Japan, many retired people together with unmarried women and environment-oriented people find interest in Pakistan. Retired people are interested in history, geography and even mountains. Pakistan can easily meet a variety of needs of the Japanese tourists. Challenges here are the quality of various services provided and the safety and security of the region. Our relationship should be developed and supported by grass-root activities. Tourism can contribute in promoting the people to people contacts. So the tasks of accepting more tourists from Japan deserve thoughtful consideration.

According to a recent press report, President Musharraf called for developing knowledge-based economy through the promotion of quality science and technology education in Pakistan. In fact, Japan is one of the countries that Pakistan has asked to assist in setting up a University of Engineering, Science and Technology (UEST). Japanese Academia is now reviewing feasibility and modalities of cooperation. The embassy will make every effort to facilitate this process. I hope that an early conclusion will be made.

CONCLUSION

As I have already discussed, the New Economy in Japan present challenges and opportunities to Japan. Pakistan has also been given challenges and opportunities by the New Economy. If Pakistan is not successful in solving issues and seizing opportunities in a timely manner, our relations will miss a very important chance to be promoted further. Japan is, on its part, always ready to assist Pakistan. In this regard, Pakistan Japan Business Forum (PJBF) has played a very important role since its inception in 2001 and has held dialogues with its Japanese counterpart organization (Japan-Pakistan Business Cooperation Committee). Japan-Pakistan High-Level Economic Policy Dialogue is another forum for strengthening the trade and investment ties and economic cooperation between the two countries. The two forums are closely linked by another forum, the Joint Business-Government Dialogue. I hope that through the dialogues at these forums tangible results will be made.