Naval War College Review

Volume 40
Number 1 *Winter*

Article 5

1987

Competition in the Pacific Basin

Bobby R. Inman

Competition in the Pacific Basin

Admiral Bobby R. Inman, U.S. Navy (Retired)

I am going to focus on the future, but first we must glance briefly at the era immediately following World War II. Competition in the Pacific basin can reasonably be divided into three separate areas—military, political, and economic.

In the military sphere, the United States and the U.S.S.R. are the two superpowers. In the economic sphere, the United States and Japan are the two superpowers. In the political area we are no longer a superpower in the same way that we were when we exercised political authority in the years immediately after World War II. Indeed, that era of the American colossus, based on our absolute preeminence in military and economic power, has steadily eroded in recent years and it is not likely to be restored to its former grandeur.

My aim here is to concentrate on the political and the economic sides of the competition that lies ahead of us. In trying to understand how this world has changed and how it is going to change even more, we must look at the role that political stability in the Pacific region has played in developing strong economies in a number of countries that are our official or unofficial allies, but that increasingly are becoming our very tough economic competitors. Indeed, it was the post-World War II occupation, and later, our assistance in developing a consensus in Japan, that has been the basis for political stability in the Pacific since 1952. This political climate has been the underpinning of economic miracles. In South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Indonesia, and to some degree the Philippines and Thailand, progress has come from extended periods of political stability; not necessarily political structures that are satisfying to the broad American audience, but political stability in which it was entirely feasible to make great progress in economic development.

I will focus on the East Asian and Southeast Asian side of the Pacific equation. It is not that I discount the important role played by Mexico, Canada and the other countries bordering on the Pacific, nor should one overlook Australia, New Zealand, and the increasing number of island states. But in the economic competition that is going to have such a significant

Admiral Inman, Former Deputy Director of the Central Intelligence Agency, is Chairman, and Chief Executive Officer of Microelectronics and Computer Technology Corporation.

impact on what is possible in the Pacific region and on our political influence there, the action is primarily in East and Southeast Asia.

In looking at economic growth, we help fuel the great Japanese economy; not only through political stability, but by providing steady access to technology and business approaches. The Japanese took lessons in this country on such matters as quality control and the manufacturing skills they needed to accomplish much of the enormous economic growth that we have witnessed. In the late forties and early fifties, those of us on duty in, or visiting Japan, joked and made disparaging remarks about the copies of U.S. products that one found outside our naval bases. Steadily, through the late fifties and all through the sixties, the Japanese worked at improving the quality of their products. All the time they were gaining sophistication and moving into more complex technology. As late as 1973 their export-oriented economy was almost entirely dependent on technology acquired either from the United States or from Western Europe. Most of that technology was acquired legally. In many cases, it was sold to them at very reasonable prices.

In 1973, one of those periods when the United States was concerned about trade balance and balance of payments, there was some discussion about cutting off the outflow of technology as a way to deal with competitive problems. The Japanese took the threat seriously. The Ministry of International Trade and Industry (MITI), a primary source of government funds that focuses on the growth of export industries and transition from one industry to another, was given an additional challenge: to create new technology, as well as to facilitate its importation and use in the export of products. In this country we paid scant attention to this milestone. In 1974, for the first segment of that activity, MITI selected the information-handling industry. They looked at their successes in chemicals, steel, and automobiles and concluded that the information-handling industry was the next major growth area, and then they focused on the semiconductor segment as the place to start. The Japanese Government put up about $250 million over four years and that country's semiconductor firms both competed and cooperated with each other. They pooled their talent plus some matching funds, and out of that effort four years later came the 64K random-access memory chip and a major share of a world market.

This was not simply an act in creating technology. The lesson for us to learn is that we should focus not only on the process for early creation of technology, but also on the speed with which such technology should be implemented. Indeed, if one looks closely at our country, there were a great many efforts in a number of industrial, and even some government laboratories where comparable design work had been done on a 64K chip. The difference was, we did not perceive a market. Most manufacturing was focused on an 8K chip for those hand-held games that our youngsters enjoyed playing. The result was that we missed a major opportunity in the international marketplace.

As I look to the future, the most worrisome aspect in competing with the Japanese is the fact that we keep talking about a "level playing field," and operating as though one deals with it purely through access to the U.S. market. Instead we should be focusing on the very different elements of these two superpower economies, and on understanding the difficulty that we are going to have in pacing them and keeping them in a collaborative mode in the years that lie ahead.

But first let us look at the economic change taking place in the next tier of Pacific states; a challenge beyond the current Japanese-U.S. competition. We are already seeing the Republic of Korea move into heavy durable goods. Taiwan, Hong Kong, Singapore and Malaysia have moved into the electronic field with success. I do not mean to imply that they are bastions of modern technology; however, there are occasional areas where they have moved into the forefront in introducing new technology. Still, the major challenge from that second tier of economic competitors is in the large and broad market segment where the technology is already beginning to decay, and where cost of production is the critical element in any long-term competition.

Lurking beyond that second tier of competition is a third tier, the People's Republic of China. The recent political changes and the willingness to shift economic goals in China have led to one of the most dramatic changes in this post-World War II era. If you had asked me in my earlier government service if it were likely that a major Communist country would reorient its priorities away from heavy industry and military products to light industry, what we consider consumer goods, I would have told you *very unlikely*. What I did not understand at that time was the enormous impact that the "cultural revolution" had on the ruling party. Those who fought their way back to power after the cultural revolution—essentially all of the present leadership was sequestered at one time during that cultural revolution—were determined that never again could a radical element of the party plunge that enormous country into such chaos.

Following this experience, they deliberately set out to build a base of support for the party through economic activity. They focused first on the great peasantry in the rural areas and as that began to succeed beyond their wildest expectation, they then moved to the cities. It is an uneven record of achievement. They lacked management talent, they lacked capital, and I do not consider it a certainty that that whole process will be continued if Deng Xiaoping were to die soon. However, business people who have been there recently, who have seen him, tell me that he is more vibrant than they have seen him in many years. Give the process another four or five years and the PRC will be far enough down the road toward a consumer oriented society so that even with a single Communist party, it would be exceedingly difficult to reverse the process and totally redirect the economy back to heavy industry.

What does this portend for us as a competitive economy? It portends that somewhere around 2010 or 2015, mainland China is likely to be a major player in economic markets currently serviced largely by U.S. industry. The potential will exist also for a large import market, but that is going to take a great deal of change and growth before being realized.

Who are the nonplayers in that part of the world? First, there is North Korea. The North Koreans show no signs of developing the economic activity that would allow them to become significant players at the international marketplace. Next, Vietnam; and again, the issues are political stability and capital investments. The former four states of Indochina—North and South Vietnam, Kampuchea and Laos—either directly under the rule or under the total influence of Vietnam, are not showing any of the growth aspects that are needed if they are to be significant economic players over the next 10 or 15 years. At this point I see little likelihood that the Soviet Union will be a significant economic player in the Pacific basin. That country's role, its power, is totally dependent on its military superpower strength. Successful Soviet retention of this position will be decided by their ability to sustain the level of investment needed to maintain this role.

Let me focus now on the level playing field we keep hearing about as the way to manage economic competition. Those who espouse the need for a level playing field tend to view this problem in fairly simplistic terms—that you can simply level the field by putting up barriers in tbe U.S. marketplace. The problem has been aggravated over the last five years because of the inflated value of the dollar as compared to the yen. But there have been some significant gains in the value of the yen against the dollar since February of 1985, and we now see heavy equipment coming in from Japan that is priced as high as U.S products. However, it is going to take an even greater adjustment in the dollar-to-yen value to cut into the U.S.-Japanese trade imbalance. Statistics I have seen recently indicate that to achieve a trade balance would require a ratio of about 135 yen to the dollar for five years.

The second major element of the trade balance problem is that U.S. manufacturing would have to grow at double its current rate. If the whole economy grows at 3 percent, U.S. manufacturing would have to grow at a rate of 6 percent, and much of that would have to go into exports if we are going to be able to deal successfully with the trade balance purely by the price of the dollar and free market float.

There is the obvious disparity in labor costs, but that is not as significant now as it has been in the past, particularly as the dollar's value begins to change. Much more important are attitudes over how labor is employed: How does one deal with productivity over the long term? Also, it is very difficult for me to see how we are going to build a level playing field in what may be the most critical ingredient in this international competition: capital formation—savings rates, and the cost of captial for introducing, manufacturing, and marketing new products.

As one looks at the world today, Japanese banks sit on the boards of their country's largely vertically-integrated corporations. They make timely decisions to introduce new technology. There is no year spent in testing to decide whether or not there is a market. They loan money to introduce new products at interest rates that are very attractive in comparison to those available in this country. The result is that the Japanese start out with a strategy that encourages the rapid introduction of new technology with high quality control, and with a plan to recover those costs over a long time. They are not driven—as most U.S. industry is—toward determining the probability of the market in order to get financing, and then paying very high interest rates which drive U.S. businesses to recover as much of that cost and reduce their debt as rapidly as possible.

The next area of concern in this question of level playing field is that of manufacturing technology. Here the two countries have taken different approaches to dealing with capital formation and labor costs. Let us return to the semiconductor industry for an example. When the United States began to feel competition from Japan in the semiconductor area, a field that we started and dominated, the U.S. financial community responded by encouraging offshore search for cheap labor. There may have been occasions when we went offshore to guarantee access to a market, but they were rare. Our decisions were primarily driven by a search for cheap labor.

By 1980 the Japanese were beginning to feel their own wage price pressure in the semiconductor area, some of it coming from the output of U.S. offshore manufacturing, but much of it coming from the steadily increasing wages within Japan itself. The Japanese response was very different from that in this country. With no inhibition from government or by law, the Japanese semiconductor firms got together, pooled their resources, and gained the support of the Japanese equipment manufacturers. At that time, U.S. equipment manufacturers dominated production of mass memory chips; but with their pooled investment and the necessary capital available, the Japanese equipment companies designed and produced state-of-the-art equipment for automated production of mass memory chips. At this stage the Japanese unions supported, and the banks funded the installation of automated manufacturing equipment. As a result of this process, by 1985 Japan could locally manufacture top quality mass memory chips at a price that no U.S. firm could match, no matter where in the world they manufactured them.

As I look at our country, I find significant efforts by large corporations—GM, IBM, AT&T, GE—to introduce automation to deal with the manufacturing of high technology products. But, and perhaps this is even more significant, they are trying to deal with the cost of change as opposed to simply the cost of production. However, I do not see this as being broadly available to the bulk of U.S. manufacturing operations. The increasing gap in manufacturing technology is one of the major challenges this country faces in our ability to compete effectively in the international marketplace. Steadily we are going to see comparable introduction of such capabilities in the second-tier economic countries. It is already clear that it is coming in South Korea where facilities have been built and will be fully operational when demand increases.

What does the future hold in this kind of environment? There are those in this country who would argue that we should relax, let market factors work, ignore the different nature of the competing economies, and not worry about our increasing dependence on foreign supply. This would apply not only for energy, but for a whole range of commodities, and increasingly, for commodities that are integral parts of U.S. weapon systems. Others disagree. As one looks at the proposals on how to deal with this economic competition, those that are put forth most frequently seek to erect trade barriers (these are easy to put into effect), and to move manufacturing offshore to reduce costs. Occasionally someone proposes that the U.S. Government fund or underwrite U.S. competitiveness in a specific market sector—semiconductor manufacturing is likely to be the next test case where that matter will be pursued.

Yet, I hope that the United States has learned this important lesson over these last 30 years: when we let a commercial marketplace slip away and when an industrial sector becomes entirely dependent on Defense—as the underwriter, the funder, the sole customer—ultimately the cost goes up substantially. Fortunately, we have not yet lost our commercial base in many areas. If we are to meet our national security needs, it is absolutely essential that U.S. industry find ways to remain commercially competitive.

Despite all the gloom, Japan still looms as a potentially attractive market. However, those who have watched Japan closely for a long time know that there really are three Japans. One-third is the Japan, Inc. that we talk most about—cradle-to-grave security for its employees, large vertically-integrated companies; very successful and very competitive. The next third is distinguished by being one of the world's most antiquated agricultural systems. And the final area, the small business and service sector, is, in fact, as chaotic as any you will find in any economically developed country in the world. There is no security in that final sector. It is the continuing alliance between the antiquated agricultural sector and Japan, Inc. which provides the political stability. Should that political stability be eroded or totally disrupted, the economic consequences would make Japanese competition a little easier to deal with. But the political consequences, the course taken by that great country, could be one over which we would have no control, and we could well find it unpleasant strategically.

In South Korea, President Chun is committed to holding elections in March of 1988. But his is a country without a tradition of honoring promises about elections. The Olympics, scheduled for Seoul in the Summer of 1988 are a potential deterrent to the elections and an attractive target for North Korea. It is certain that we will see pressures build to deter the elections because they will be too risky. Thar is going to put severe strains on the Republic of Korea, and as a result, it will cause some stress in the United States.

As for Taiwan, how much longer will Chiang Ching-kuo's health permit him to be the president? That is a major unanswered question, one that has been unanswered for ten years. However, there are indications that his health is deteriorating fairly rapidly. When he departs rhe scene, the political succession will be uneasy and uncertain.

We already know what is in store for Hong Kong with the transition of political control to the mainland scheduled for 1996. In Singapore, Lee Kuan Yew and his Political Action party have been in power since 1958. We were concerned about him then, wondering what role the Communists would play. In fact, Lee's turned out to be one of the most stable regimes this world has seen—authoritarian, but one that has given an enormous leash to economic growth.

There was a period in the late seventies, into the eighties, when I though I could perceive the next leaders, but they have either passed on or been removed. Age is catching up. Indeed, unless Lee Kuan Yew is able to reach down, probably two generations, and bring along a leader, continued political stability in Singapore is not a certainty.

In Indonesia, Suharto may well be elected to another term and here we are seeing a repetition of Singapore's problem. No matter how able the leadership, when strong leaders occupy office for a long period of time, they find it exceedingly difficult to accept the reality that someone else might also be capable of providing long-term stable leadership.

In the Philippines, we have been luckier than we had any reasonable right to expect in the transition. But it is by no means a secure road to the future. Thailand will soon have another election. Again we are addressing a situation where political stability has been maintained largely because of cohesion within the military and with the king, but there are signs of that fraying again. It already has been a factor in holding back Thailand's economic growth in comparison to other countries in that region.

I have already discussed the future of the People's Republic of China and the longevity of Deng Xiaoping. The question is, can he implement a transition—when dipping down two generations in leadership—to sustain a momentum that increasingly integrates them into the international market-place and dampens the enthusiasm of military activity?

And finally, the Soviet Union. Mr. Gorbachev and his colleagues, all those who have moved into positions of power, are the offspring of Andropov.

They are his selectees. On the balance, it looks like he was fairly effective in his selection process. At least these men are far better educated than their predecessors. While they have had time to learn how to deal with power, they have some tough choices ahead of them. The major capital investments undertaken between 1965 and 1970 that provided the base for the great modernization of their military forces are now at a stage where they need to be made all over again. To be able simply to maintain the level of their military superpower status, much less to improve it, they will have to make some major investments in capital goods for heavy industry. Such a decision would virtually eliminate the prospect for any increase in the consumer goods and investments that would permit the Soviets to be a larger player at the international market. Such an environment will require some very tough choices.

It could be our good fortune if this new group of Soviet leaders would take a major political gamble by reordering their internal priorities toward light industry, thereby becoming a significant factor in the international marketplace. But their military, I believe, would resist such a move, and given that political risk, one has to worry that their chosen approach would be to steadily apply their burgeoning military capability externally as the way to unify support at home. In that climate, political instability in the Pacific region would offer Moscow an opportunity that we would find very troublesome.

A very exciting and challenging world beckons, a world that could offer the opportunity for sustained economic growth. If it were to be undertaken at this time, the Pacific basin would increasingly become the center of U.S. interest as it has been increasingly a major factor in our own economic activity. Should we prove unsuccessful in these endeavors, we may well find that the instabilities which are unleashed in alliances will leave us in a troubled environment in the Pacific region, onward to the year 2000.

This article is a version of a lecture delivered to the 1986 Current Strategy Forum at the Naval War College.