

# White Paper on International Economy & Trade 2021

By Naoyuki Haraoka

METI's White Paper 2021 describes the background to the need for new trade policies and shows why world trade is at a turning point in history. With the consequences of the Covid-19 pandemic becoming more apparent both economically and politically, the need to upgrade the free trade system is increasing, as the White Paper suggests. The pandemic has mostly exacerbated the challenges that the world economy was already facing. Social divisions and the emergence of more populist policies in developed nations have been brought about mainly by the increase in income inequality under globalization. The pandemic has further widened these divisions with its differing impacts on various business sectors and individuals. Whereas hotels, restaurants, retail businesses, transportation services and other face-to-face services have been severely damaged by the lockdown of major cities due to the pandemic, the IT service sectors have benefitted from the expansion of working remotely. White collar workers able to work remotely at home with computers have not been greatly damaged, but essential workers and others engaged in face-to-face services have suffered significant losses of earnings.

This exacerbated income inequality could lead to further political divisions and instability. Nationalism and anti-globalization sentiments are prominent features of social divisions, as poor people see globalization as one of the main reasons for this inequality. They feel particularly threatened by the increase in the number of immigrants arriving in their countries as a consequence of globalization, as this could undermine their job security. Under the pandemic, these sentiments could continue or even be accelerated by increased income inequality. They resulted in trade conflict among major nations some years ago, in the most serious of which the United States and China raised tariffs on each other's imports. This trade war did not remain as it was, but developed into a confrontation between regimes, namely democracy versus authoritarianism and market capitalism versus state capitalism. This was triggered by growing concerns about economic security as digital technology has become a key element in the manufacturing and service industries, and sensitive information on national economic security possibly contained in their products could be easily accessed by people in competing nations through

such technology. High-technology products especially may contain sensitive technology in terms of national security, so trade in such goods could lead to leakage of sensitive information to rival nations. The US-China tariff war eventually turned into friction around economic security in high-technology products. This trade war has occurred in the absence of any robust rules on trade and national security. The pandemic elevated this confrontation into a battle between democratic and authoritarian regimes, provoked by the claim that authoritarian states had been more successful in containing the pandemic than democratic ones. It was also accelerated by the competition between democratic and authoritarian nations in producing vaccines for the pandemic among developing nations, which suffered severely from shortages.

In order to bring this situation under control, as the White Paper mentions, we need a rules-based approach. Otherwise, this struggle for power will result in a game of survival of the fittest in a jungle where the more powerful would always win. This power-based game would not achieve fairness for all the players and thus the weak would suffer unreasonably.

National security is not the only issue affecting international trade: the global environment and due diligence on human rights are also major concerns commonly shared by nations. Assuming that these three factors in particular will need to be addressed in trade policies as well, we will have to integrate them into a new trade regime where they can be addressed appropriately in accordance with free trade principles. This is the reason why we will need to upgrade the free trade system, as the White Paper mentions.

In addition, as we are now living in a digital economic society where data serve as key elements of the competitiveness of businesses and knowledge of individuals, we will need new rules on digital technology for promoting "Data Free Flow with Trust". This should also be part of an upgraded free trade system, and we would have to explore exactly what this upgrading means and clarify how it can be achieved. But it is a fact that nations have never discussed the need to upgrade the free trade system.

The Japan Economic Foundation (JEF) is celebrating its 40th anniversary this year. It was founded in 1981 to defend



the free trade system against the rising protectionism in the US and Europe to restrict Japanese exports. Since then, JEF has always been a strong advocate for free trade. So the proposal for a new trade policy different from the trade liberalization policy taken so far by the Japanese government strikes us as an historical turning point. As the White Paper suggests, this paradigm shift in trade policy will be inevitable due to the drastic changes in the economic environment under the pandemic, and the effects of domestic and international geopolitics mentioned above.

As can be seen in the Roundtable discussion, some economists may feel that upgrading the free trade system must be achieved with great prudence in order to prevent issues such as national security, the environment or human rights disguising an increase in protectionism, with governments intervening in trade only to protect their industries. It is certainly still important to continue advocating for the economic theory that assumes free trade can always achieve the highest efficiency of economy and contribute best to enhancing economic growth. Otherwise, we will increasingly see world trade slipping far from the optimum that economics textbooks teach. We must remember the differences between the real world and the ideal, otherwise we will lose our ability to judge criteria. It is important to maintain benchmarks and economics textbooks can continue to provide them.

Meanwhile, it is important to have a holistic approach to trade issues as well. Today's world is different from yesterday's, and international trade has become more complex due to risks associated with domestic politics and international geopolitics. We will need to pursue an interdisciplinary approach integrating politics, international relations and economics. The White Paper suggests this holistic approach to international trade. New trade rules must be developed to reflect interlinkages between free trade and a variety of concerns to stop trade and the global economy falling into chaos caused by the confrontation of the superpowers.

Another important suggestion in the White Paper is to enhance the involvement of the private sector in this new rule-making process. The challenge for businesses in this paradigm shift is how to cope with political risks, both

domestic and geopolitical. Businesses need to become accustomed to examining these non-economic factors, as the rule-making process will help mitigate these risks and reduce uncertainties. Businesses should therefore be involved in the government's rule-making efforts as much as possible in the early stages, and this should be welcomed by the government. In particular, in pursuing rules on trade and national security, the government will need to know exactly what technology or information would be most sensitive in order to address the issue properly. Private businesses in the high-tech sector will know about these things much better than the government. So in this regard as well, government-private business collaboration would work well in achieving well-balanced rules on security and trade.

The White Paper also highlights the importance of strengthened resilience of supply chains. This means that businesses need to be well prepared for all kinds of risks, including the pandemic, and agile in responding to them.

The Cover Story of this issue introduces a summary of the White Paper on International Economy & Trade 2021 and a Roundtable discussion on it by distinguished economists. I hope what I have briefly mentioned here about the White Paper will prompt readers' interest in it.

## (Brief Introductions)

### COVER STORY 1

#### White Paper on International Economy & Trade 2021 – Summary

By Policy Planning & Research Office, Trade Policy Bureau, Ministry of Economy, Trade & Industry (METI)

### COVER STORY 2

Roundtable with Prof. Fukunari Kimura, Prof. Junko Shimizu & Kayo Matsumoto

#### Roundtable Discussion on the White Paper on International Economy & Trade 2021: Trade Policy at an Historical Turning Point

By Japan SPOTLIGHT

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