

HOW TO MAKE THE BEST USE OF GLOBALIZATION

By Shirai Sayuri

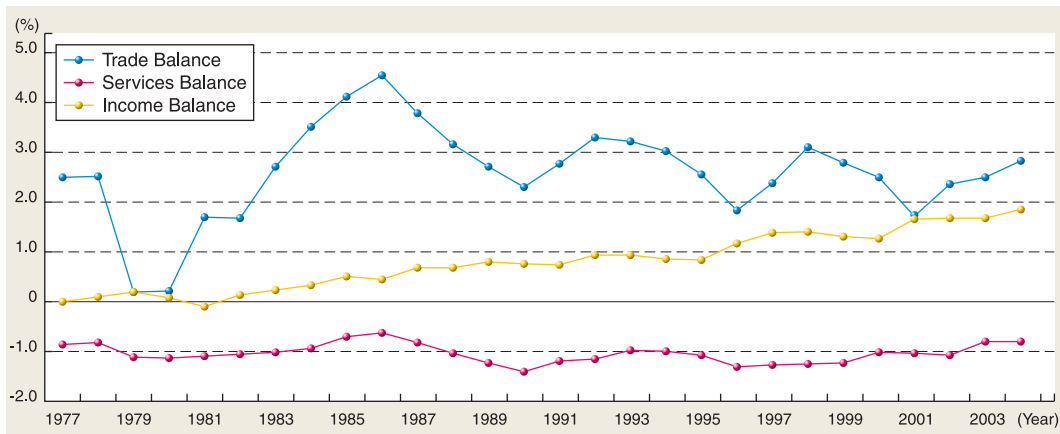
THE 21st century heralds a new age for Japan: one characterized by an aging society with a decreasing population, and by globalization and computerization. On the domestic front, this society will restrain high economic growth rates, so the challenge is to increase productivity and sustain a mild but steady growth rate of 1-2%. On the overseas front, while rapidly growing China and the developing nations are intensifying price competition in the world market, economic integration driven by free trade agreements (FTAs) is progressing at a hectic pace. To avoid being left behind by this wave of globalization and to maintain its position in the global economy, Japan must adopt a new economic strategy for external trade. It has to create a new and vigorous national structure boldly focusing on such new trends and moves to come to grips with the issues of globalization. In particular, we can expect that in 20 to 30 years' time Japan's relative economic and national strength will have diminished in relation to that of China or India, which will catch up with scale of their economies, their plentiful supply of labor, their standard of education and technology, and their growing military power. What needs to be done to ensure Japan's continued economic prosperity and to create a society in which its citizens can live with hope? In this article, I will argue how Japan might take best advantage of globalization.

Can Japan Maintain Its Large Trade Surpluses?

Apart from the two oil crises of 1973-1974 and 1979-1980, Japan has managed to maintain consistent trade surpluses for the last four decades. Despite such difficulties of repeated adjustments of the value of yen and the oil crises, Japan's manufacturing industry has proven to be capable of increasing its profitability, implementing energy savings, and producing industries that are truly price competitive on the international market. Also, since the latter half of the 1980s, Japan has succeeded in creating specialized manufacturing processes and moving some production bases to East Asia, carrying out labor-intensive production overseas and thereby reducing overall costs.

Trade surpluses peaked in 1985 (at 4.5% of GDP) before the major appreciation of the yen that followed the Plaza Accord, and while the extent of the surpluses has since then decreased, they are still running at a relatively high level. The 2004 surplus was equivalent to 2.8% of GDP. When the 0.8% deficit for trade-related services such as freight and insurance is included, the goods and services balance surplus equates to 2% of GDP. (see Fig. 1) Japan has managed to achieve consistently high trade surpluses over an extended period of time, but this is expected to

Figure 1 Japan's Trade Balance, Services Balance, Income Balance 1977-2004 (As a Percentage of GDP)



Sources : Compiled from data in *Balance of Payment Statistics* and *International Financial Statistics*, IMF

change dramatically in the years to come. Decreasing trade surpluses will push Japan's goods and services balance into the red, and by 2030 this deficit could possibly reach 2-3% of GDP. This slide into deficit will occur because an increasing number of Japanese corporations will set up operations in other Asian countries. Growth in exports from Japan will slow, and imports of goods produced by these corporations operating overseas will increase. Japanese corporations will become even more determined to set up operations overseas for two reasons. The first is that, as the economy matures to cope with a welfare society with an aging population and declining birthrate, labor and service costs in Japan will stay high, while international price competition will only intensify. The second reason is that a decreasing population reduces the scale of the market, thereby restricting sales opportunities. When considering a vision for Japan's future, it is extremely important for us all to understand that it is very probable that around the year 2030, Japan will join the countries with trade deficits.

At the same time, the trends in the income balance, including dividends, interest and cash transfers, show that Japan's trade surplus has continued to increase since the late 1980s when Japanese corporations actively began to set up operations overseas. This is due to the transfer of dividends from overseas subsidiaries to their parent companies in Japan and the returned earnings from investment in foreign securities and bank financing which are stimulated by the foreign currency accumulated from the trade surplus. If the movement of Japanese corporations overseas gains further momentum, the revenue from those operations will increase, which will further build up dividends. It is expected that by 2030 the amount of income balance in the surplus will double from the current 2% of GDP to 4%. However, because the trade and service balance will worsen, Japan's current account balance will drop considerably below the present 4% by 2030. With

this in mind, Japan needs to think of ways to transform itself from a large exporting country to a large investing country; one that applies its superior management resources and technology, strengthens its product-technology development divisions and head-office functions within Japan, and invests overseas to take advantage of low labor and service costs in order to develop specialized production systems. This is how Japan can maximize the advantages of globalization.

■ Points for Japan to Consider

In order to take advantage of globalization, and to produce a vibrant society capable of meeting new challenges, Japan must come to terms with the following issues. First of all, it is important that corporate head offices should remain in Japan, and that the high added-value aspects of the production process should also be carried out with goods exported from Japan. Measures that further enhance technological and developmental capabilities should be considered and introduced. For this to happen, Japanese society needs to become more open, and we need to create a society where people, goods and money can circulate over the constraints of national borders. While lifting Japanese education to the global standard, we must aim to create a nation that attracts high-caliber personnel and corporations regardless of their nationality. In doing so, we can advance the nation's technological innovation and accumulation of knowledge. Organizational reform and deregulation, which are required to increase productivity, should also be promoted. Fiercer competition in domestic service industries will improve efficiency, enabling them to provide even higher quality service. To this end, we need to remove the barriers hindering the entry of foreign corporations and accept skilled and qualified foreign workers into our workforce in a selective and strategic manner.

Second, it is important that measures are taken to increase the number of for-

ign tourists visiting Japan. An increase in foreign visitors not only helps to expand domestic employment and income (an improvement in the services income shown in the figure) and reduce regional income gaps, but also boosts the number of people with an affinity for Japan, thereby encouraging economic, social and cultural exchange. In the long term, this increases the number of countries friendly to Japan, which contributes Japan's national interest because it may boost support for Japan gaining a permanent seat on the United Nations Security Council. At present, approximately 4.8 million foreign tourists visit Japan each year, which is still fewer than the numbers for China, Hong Kong, Malaysia and Thailand. Japan ranks only 35th in the world. To boost the number of incoming tourists, Japan needs to foster a tourism industry that will help to attract foreigners and make them feel happy to choose to visit Japan, and to adopt promotion policies that have the cooperation of the whole community. We also need to ensure that Japanese citizens will be more open toward foreigners than they are at present.

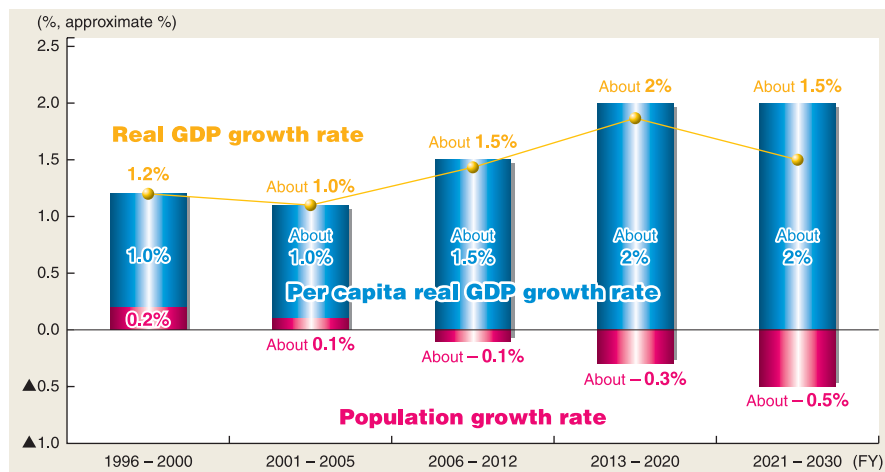
Third, we need to create firm economic relations with East Asian countries by encouraging the establishment of FTAs or economic partnership agreements (EPAs), as the region is expected to continue to record strong growth. The speed of Japan's regional economic integration is hindered by the protection of some agricultural goods and the opposition to accept foreign labor. To avoid being left behind in the global trend toward regional economic integration, within the next one or two years Japan should push hard to establish formal economic links among the countries of East Asia, and in particular, commence negotiations towards the establishment of an EPA with China, which would produce a major economic effect. At the same time, Japan needs to continue to work toward the multilateral liberalization of trade and investment through the World Trade Organization (WTO). Despite being the world's largest

importer of agricultural products, Japan gives the world the impression that it is opposed to trade liberalization because it gives an extremely generous level of protection to specific domestic agricultural goods such as rice. In terms of displaying the leadership necessary to ensure the stability and prosperity of the global economy, the world's second largest economic power should not be giving such an impression. Swift agricultural reform, including subsidy systems and the entry of private corporations, is essential to keep such protection from hindering the liberalization of regional and global trade.

Fourth, in keeping with the strengthening of regional economic ties, the concept of an East Asian Community, proposed by Japan, must be promoted. The concept is currently being carried forward by the ASEAN+3 (Japan, China and South Korea). This includes a wide range of nations – from low-income countries such as Cambodia, Laos and Myanmar to high-income countries like Japan – gathering up the different stages of economic development and maturity of the financial and capital markets. Because regional differences make it extremely difficult to implement common economic policies, slogans on economic and monetary union never quite manifest themselves in reality. In this context, the time has come for Japan to review its Official Development Assistance (ODA) and to lead the way in considering efficient and effective ways to reduce these regional income differences. In particular, as Japan requires drastic fiscal reform to deal with its large budget deficit, levels of aid cannot be increased, so new strategies are needed to improve the quality of aid. Also, Japan needs to organize its ODA in a way that links it to FTAs and EPAs, creating a consistent strategy that provides ODA mainly to low-income countries and strengthens trade and investment with countries that have graduated from the low-income category so as to encourage regional economic integration.

Fifth, Japan should take the lead in promoting currency and finance cooper-

Figure 2 The View of the Per Capita Real GDP



Source : *Japan's 21st Century Vision*, Council on Economic and Fiscal Policy

Notes : Per capita real GDP growth rate = Real GDP growth rate - Population growth rate

The real GDP growth rate is somewhere in the order of 1.5%, and per capita real GDP grows at about 2%.

ation so as to prevent the kind of systemic economic crises that occurred in East Asia in 1997-1998 and to mitigate against fluctuations in exchange rates within the region. In order to secure stable, sustained growth in East Asia, it is necessary to greatly expand the scale of the network of bilateral swap arrangements focused on the ASEAN+3 framework established in 2000. At present, financing over 10% of the amount available to be drawn from under the arrangements must occur in conjunction with an IMF support program. No independent permanent body exists to monitor trends in the macro-economy, finance or capital movement of the participating countries. The scale of support for such regional cooperation should be expanded, and we should create methods of flexible financing, while at the same time being carefully avoiding duplication of IMF activities and moral hazard problems. We should also strengthen surveillance mechanisms and promote discussion and exchange of information on macro-level economic policy within the region. In addition, in order to further stabilize the currencies of the region, we should consider urging the emerging market economies and the East Asian countries that are already liberalizing capital movements to employ a basket-peg regime against the US dollar, the euro and the yen. The US dollar is used to an overwhelming extent today,

but including the yen in the basket and encouraging foreign exchange transactions between the yen and other Asian currencies would further the internationalization of the yen. Ultimately, if trade, investment and foreign exchange transactions become more active in East Asia, and income differentials decrease, the way will be open for currency integration that will allow the yen and the other main currencies of Asia to mutually stabilize the foreign exchange market.

Conclusion

The benefits of globalization are many and varied. It provides low-priced but high quality goods and services, promotes the enhancement of industries, spreads technological innovation, encourages diversified investment and improves convenience in life. However, these are relatively imperceptible benefits, and the negative aspects of globalization, such as rigorous industrial and employment adjustments, tend to be emphasized. Rather than responding defensively and passively to the challenges that globalization presents, Japan should work to create ways to use them to its advantage. **J.S**

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