New Economic Challenges

By Hatakeyama Noboru

The first and most important event of the last several years in international trade was the successful conclusion of the Uruguay Round negotiations last December. I heard this good news with a mixture of feelings. Until 1992, each December I was in either Brussels (where the Uruguay Round ministerial level committee meeting was held in 1990) or Geneva (where the General Agreement on Tariffs and Trade head office is located) for the negotiations with my colleagues from many industrialized and developing countries. I missed the most important meeting!

What does the resolution of these negotiations mean to Japan and the rest of the world?

The decision that every GATT dispute should be judged through the GATT mechanism is a good one. For example, the use of unilateral action like the Super 301 provision of the U.S. Trade Act would be prohibited, or at least

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strictly contained. In addition, the GATT secretariat will be established officially as an international organization based upon an international treaty. Up until now it has existed only on a de facto basis.

Second, the scope of GATT will be extended to services, trade-related intellectual property, and trade-related investment measures. Although a commitment by many countries to lift such service trade restrictions as U.S. shipping regulations or France's audio-visual regulations could not be obtained, the inclusion of service trade in the General Agreement on Trade in Services, or GATS, is a very good first step in broadening the scope of GATT.

Third, even in the area of traditional commodity trade, agricultural products and textiles will be incorporated substantially in the GATT for the first time. Until now, although they were included formally there have been many loopholes, such as agricultural import restrictions under the name of "waiver items" as practiced by the U.S., the "residual import restrictions" of Japan, or textile import restrictions under the name of multinational fiber agreements (MFA). The Uruguay Round will require that every agricultural import restriction be replaced by tariffication, with very few exceptions, and that MFA be phased out over the next 10 years.

There are additional pluses to the Uruguay Round agreement, but its most important implication impacts on two key changes that have occurred in international trade.

First, with the end of the Cold War, the principle of free trade is no longer the value cherished by Western allies as one of the main pillars of the free world. As a result, the temptation toward trade protectionism has become apparent here and there, analogous to regional conflicts in the political arena since the end of the Cold War.

In addition, regionalism as opposed to multilateralism has come into vogue, as the EC'92 and the North American Free Trade Agreement (NAFTA) demonstrate.

Therefore, had it not been for a successful end of the Uruguay Round negotiations, the world would not have been able to overcome the temptations toward protectionism or fortress regionalism.

Regional frameworks

There are two types of regional frameworks: regional integration such as a customs union like the EC'92, or a "free" trade agreement like NAFTA; and regional groupings such as the Asia Pacific Economic Cooperation (APEC). The former requires free flow of commodities among member countries but discriminates against non-member nations in terms of tariffs and so on. The latter is a loose body which does not discriminate against non-member countries other than "membership" itself.

Regional integration can be viewed as an exception to the principle of "most favored nation" treatment under GATT. Indeed, a special article has been incorporated into GATT which examines the appropriateness of regional integration under the name of customs union or free trade agreement.

Specifically, there are two criteria in Article 24 of the GATT. The first is not to raise external barriers, the second is to cover substantially all trade in products among members.

Based on these two criteria, the EC'92 and NAFTA need to be examined carefully. In particular, NAFTA seems to have many problems. Let me mention one example. According to NAFTA's automobile rules of origin, for an automobile to be deemed a North American product, 50% local content is necessary for the first four years. However, this local content ratio is raised to 56% for the next four years and 62.5% after that. This might violate the first criterion to the effect not to raise external barriers.

APEC, consisting of Japan, South Korea, ASEAN (Singapore, Thailand, Malaysia, Indonesia, the Philippines, Brunei), the so-called three Chinas (China, Taiwan, Hong Kong), the U.S., Canada, Australia and New Zealand, held its fifth meeting in Seattle in the U.S. last November. On this occasion, Mexico was admitted to APEC.

Currently all of NAFTA countries are also members of APEC. The question arises whether APEC will be "NAFTized" or NAFTA will become "APECized;" that is, will APEC become a free trade area or will NAFTA become a much more open regional framework? In this regard, it is encouraging that Mexico passed a bill last November providing any non-NAFTA country the same treatment in terms of foreign direct investment that member countries will enjoy.

APEC will continue as an open regional group without becoming a free trade area. Japan is opposed not only to APEC becoming a free trade area but also to Japan becoming a member of any other free trade area. With both the EC'92 and NAFTA having already commenced, is Japan not feeling left out of the tidal current for a free trade area? Not necessarily.

Japan is committed to multilateralism rather than regionalism. As stated before, a free trade area has discriminatory aspects toward non-member countries, therefore rendering it inconsistent with the GATT principle of most favored nation treatment.

Additionally, in this high-tech era, many companies internationally are looking for a special niche for their special high technology products. In many cases, even if each niche market is united regionally, the area is too small for even one company. Therefore niche market-seeking companies must seek a role in the world market as well.

The epoxy plastic market is one such example. Although Sumitomo Chemical Co., Ltd holds 65% of the world market, its total sales of this special high-tech product amount to less than ¥1 billion. If Sumitomo is complacent in its regional market, it will not pay off. Perhaps the concept of regional market integration is most suitable to mass production items, such as steel or basic chemicals which are not necessarily the typical products of highly developed countries in this high technology era.

These are the two reasons Japan will not give in to the temptation of, or solicitation to, a free trade area. As the

U.K. did in the 19th century in European politics, Japan will maintain "splendid isolation" in terms of a free trade area if necessary in order to support multilateralism in world trade.

U.S.-Japan trade friction

If Japan's trade surplus last year is estimated in U.S. dollar terms, it is possible that it increased to $140 billion globally, of which $50 billion might be with the U.S. However, measured in yen terms, it is already shrinking, at least globally, by approximately 6%. This discrepancy between U.S. dollar and Japanese yen terms reflects the 14% appreciation of the yen last year.

In due course, shrinkage of the trade surplus in yen terms will be noticeable in dollar terms as well. It is possible that the Japanese trade surplus of this year will begin to decrease both globally and with the U.S. There is always a time lag between policy decisions and the announcement of statistics.

Last June the so-called framework talks with the U.S. began with the intention of reducing Japan's trade surplus. In January 1993, the Advisory Committee for Trade Policy and Negotiations, which advises the U.S. trade representative and is comprised of approximately 40 members, such as John F. Akers (former IBM chairman), George Fisher (Motorola), and James D. Robinson (former American Express chairman), published a report which outlined its proposals for U.S. trade policy toward Japan.

Unfortunately, this report adopted the "invisible trade barrier" theory without any deliberation as to whether or not such a theory is valid. Foreigners, including Americans, often argue that "although Japan may have no government controls on industrial imports, there are many invisible trade barriers." Well, it is hardly possible to counter this, not because this assertion is true, but because the argument is based on things that are invisible, which means evidence cannot be provided. It is impossible to prove the existence of something invisible, much less prove that something that is invisible does not exist.

"Silver services" that target an aging society are attracting attention as new industries that may propel Japan's economy in the future.

According to this report, Japan's trade is defined as "noncommercial," meaning that decisions are not based on price and quality but on noncommercial factors such as *keiretsu*.

Clearly, this report is based on mistaken assumptions. Japan is the largest market for U.S. agricultural exports as well as the second largest market for U.S. industrial exports. Is it possible that these purchase decisions were made on a so-called "non-commercial" basis?

Using the invisible trade barrier theory as its cornerstone, this report proceeded to propose so-called temporary quantitative indicators (TQI). According to the Advisory Committee report, Japan and the U.S. should agree upon TQIs for each important sector to encourage Japan to set quantitative import targets "voluntarily" for the future. If the targets are not met, the report noted that sanctions would "probably" be applied.

Should this indeed occur, this "voluntary import expansion program" would amount to imports virtually forced upon Japan by the U.S. government. This would constitute more than simply managed trade.

Ms. Laura Tyson, chair of the Council of Economic Advisors, wrote in *Who's Bashing Whom?* that she endorsed voluntary import expansion, or VIE, calling it better than voluntary export restraint (VER). Her reasoning was that the former would expand trade, while the latter would reduce trade. This opinion misses the point that VIE would end up with trade forced upon Japanese purchasers by the Japanese government in an attempt to avoid the unilateral action of the U.S. government should the target not be met. In modern society, a government clearly cannot force its people to buy or import something against their will.

Unfortunately, despite its problems, the Advisory Committee report seems to have had a substantial impact on the Clinton administration. Initially, the administration appeared interested in the TQI idea as indicated by its attempt to establish "multiple benchmarks." Use of import targets, therefore, cannot necessarily be ruled out.

At any rate, on July 10, the U.S. and Japan, agreed to initiate the so-called framework talks. Accordingly, they agreed to assess progress in industrial sectors based upon "objective criteria" consisting of relevant information and data.

The Japanese press has, however, asserted that the definition of "objective criteria" is very vague and therefore might cause problems in the future. What is clear, though, is that Japan is determined not to accept the import target idea because of the many reasons mentioned above.

How to reduce the surplus

The question then naturally arises as to how the Japanese government should deal with its "huge trade surplus."

First of all, Japan will continue to promote domestic demand-led growth in the years to come. For this purpose, the Japanese government will implement measures that include fiscal and financial policies, if necessary. In fact, Japan has already introduced three economic stimulus packages recently: the first announced in August 1992 for $86 billion, the second announced last April for $116 billion, and the third announced last July for $58 billion. The effects of these additional measures will be reflected in due course on Japan's economic growth.

Second, the appreciation of the yen will ultimately increase foreign exports to Japan while reducing Japanese exports to foreign countries. Due to the J-curve effect, the impact on the trade balance will be reflected in trade statistics only after a lag of one and a half or two years. In addition, we should note that the yen appreciation will make it more difficult to attract foreign investment to Japan. Since in many cases foreign exports accompany foreign investment, the increased value of the yen may not boost growth in exports to Japan.

Third, the competitiveness of foreign industry, including that of the U.S., has rebounded recently. While competitiveness is necessary for export growth, it alone is not a sufficient factor. A company has to commit to the export market to the same degree as to the domestic market. In addition, one has to comply with the demands of the export market in terms of design, delivery, after-sales service and so on. Pricing policy is clearly also a very important factor.

There is also the question of deregulation. I think deregulation should be expedited in areas that lead to the creation of new industries. In the past, deregulation of telecommunications, for example, led to a boom in home faxes and cellular telephones. Further deregulation of the communications sector would again bring about the birth of new industries.

In addition, deregulation of the service sector is important. Restrictions on financial services, transportation and other service sectors should be relaxed.

There is the perception that deregulation will encourage imports of commodity sector goods rapidly. This is, however, not the case as there is no domestic protection for industrial products. Clearly, "relaxation" of regulations is impossible in their absence.

There are, naturally, some regulations on industry, such as consumer safety and environmental protection. As in other countries, however, such regulations are in most cases necessary and desirable.

Therefore, deregulation will not result in tremendous import growth of industrial products.

Prospects for the Japanese industry

Considering the measures and circumstances outlined above, Japan's trade surplus is bound to decline.

Further questions arise, however, as to whether Japan can maintain its low unemployment ratio in light of the measures already implemented and those planned, such as deregulation, overseas investment and import expansion. As you may know, there is a strong perception that so-called "industrial hollowing" will occur in Japan in the future as a result of plant and factory relocation.

I hope this perception is misguided for two reasons: First, Japan will have to cope with its labor shortage; and, second, deregulation would lead to the birth of new industries and lower production costs, thereby strengthening the competitiveness of many related industries once again.

What kind of industries will prosper in Japan?

According to a recently completed report by one of the councils of the Ministry of International Trade and Industry, the future of "social needs industries" and "industrial goods industries" appears promising.

Social needs industries refers to industries that address such social issues as environmental protection, urban congestion, and Japan's rapidly aging society. In particular, the following industries might be considered pertinent: recycling, land utilization, and home self-care where the results of simple self-examinations would be transferred on-line to a medical facility. Related industries will further develop as necessary. After all, need is the mother of invention, and thus of new industries.

Industrial goods industries are those industries that produce high quality parts, components and factory machinery. As assembly work tends to be shifted from Japan to developing countries, industries producing high-technology parts and components will remain in Japan and continue to enjoy dynamic competitiveness.

Guiding the advanced economies is similar to riding a bicycle: If we lose momentum, we will fall. The momentum of the global economy lies in our effort to address social needs through technological invention and innovation. The advanced industrialized countries, including Japan, must continue to shift existing industries to developing countries in order to free resources for the new, advanced high-technology industries that provide the wheels for continued momentum. JJTI

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