Japan, U.S., EC: Self-Diagnosis

Policy in a Liberalized World Economy

By Bunroku Yoshino

There are many signs of crisis in today's world trade situation. On the part of the advanced countries, these include internationally rising interest rates, large trade imbalances, trade frictions, and the expansion of import restriction measures. On the part of developing countries, they include enormous external debts, an investment slowdown, worsening inflation, declining primary commodity prices and, in some countries, famine and natural disasters.

These factors notwithstanding, it should not be forgotten that the world economy itself is improving, albeit very gradually. Contrary to apprehensions, the U.S. economy does not seem likely to enter a sudden slump. On the contrary, there seems a clear tendency toward long-term stable growth as is evident from the extremely low inflation rate and a mild decline in domestic money rates. In Western Europe, a substantial drop in the unemployment rate cannot be hoped for as yet, but there is a firm undertone to the region's economic recovery, centering on West Germany. The British and French economies are expected to follow suit before too long.

Worthy of special note is the fact that world trade as a whole is expanding constantly, and that this is furthering a rapid integration of the world economy.

The protectionist wave has been gaining force by fits and starts, and such trade practices as counter-purchase and barter trade persist. But, on the other hand, market unification is accelerating in many areas. Although on the surface the voices calling for discriminatory and retaliatory import restrictions are growing more strident, in many areas unification and simplification of import specifications and standards are being stepped up. The general trend is toward reduction of customs, tariffs, and other trade barriers.

This rapid progress in the unification of world trade and, through it, the integration of the world economy are attributable primarily to the increasing fluidity and openness of import-export transactions under the floating exchange rate system, and secondly, to the concomitant liberalization of international finance. Of course, behind all this lie the move toward deregulation for policy reasons by the major trading countries, and technical innovations in communication networks which have made deregulation inevitable. Today, when the exchange rates of leading trade currencies can fluctuate rapidly and violently, it is widely recognized that tariff barriers are virtually useless for protecting domestic industries. Furthermore, production processes using new technologies and materials can force into extinction overnight inefficient production with cheap labor.

Extensive knowledge has been made readily available by technological innovation. The accumulation and application of this knowledge and experience, plus the ability to forecast future developments more accurately than in the past, are beginning to render meaningless traditional trade policies meant to guard national interests as defined by borders and race.

Global state needs flexibility

Given these new realities, it is extremely difficult in practice to isolate and protect a particular industry or corporate group of any single nation from international trade competition. It is now generally recognized that the economic burden forced on ordinary citizens by protectionism is enormous. Although it may be endurable over the short run, it is a sacrifice which cannot be tolerated indefinitely.

In a democratic nation, it is quite normal for people as well as corporations to put their self-interest first. This leads to competition, and is the mechanism behind so-called market forces. But today, it is no longer justifiable for a government or a specific industry to unilaterally obstruct market forces and intervene for the purpose of its own short-term profit. Market opening and trade liberalization are no longer ideological dalliances. They are part of the inevitable current of the times toward a global state.

Obviously, each country will need time to adjust its economy to these changes in the world economy and to retool domestic industries to meet shifting world trade patterns. Countries with rigid domestic economic structures will find it increasingly difficult to adjust their industries to the breakneck speed of technological innovation.

In such cases, trade frictions are sure to surface, and situations arise in which either the country itself will have to impose import restrictions or its trading partner or partners will need to voluntarily restrain exports. These measures, however, must be temporary expedients for alleviating domestic social unrest. Should such impediments to trade remain in force semipermanently, they would exact severe economic sacrifices from the people of the affected countries.

Expectations for the New Round

With this perception in mind, 1985 GATT started, at long last, preparations for the next round of multilateral tariff negotiations at its general meeting in November. The new round will likely be radically different from those that have come before, for the integration of the world economy is progressing at an ever faster pace.

There is no doubt that the mutual tariff reductions agreed upon in the previous round of talks have greatly helped to move the world economy toward in-

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tegration. However, lowering tariffs will no longer be an important objective in the new round. Rather, clearing away non-tariff barriers, such as import restrictions and domestic certification standards, will take center stage. People are no longer satisfied with removing just the so-called waterfront trade barriers. The focus has shifted to the elimination of barriers within each country's domestic economy. Removing a skin-deep tumor is no longer enough; the scalpel must be thrust deep for major surgery.

At the same time, national borders have virtually disappeared as a result of technical innovation, and the interchange of services has become more significant in people's lives than the exchange of goods. The advent of computer- and sensor-controlled systems has led to automated production processes, and development of biotechnology has enabled mass production of organic products of a uniformly high quality. The physical siting of production plants is no longer the important consideration it used to be. Instead, the basic know-how (technology) of production has become the most valuable object of transaction.

In one sense, this, too, is an exchange of services. However, standards for transactions between countries in the services have yet to be firmly established, and governments are still groping in the dark for appropriate policy. Standards for the unrestricted flow and non-discriminatory treatment of services are to be hoped for, especially as regards technology. But how to establish such guidelines remains a vexing problem. For instance, agreements between countries for non-discriminatory treatment in finance and copyrights, both considered part of the service sector, will differ greatly from each other.

In this sense, GATT's new round of multilateral negotiations should take up the question of how to handle the service sector. Yet many developing countries have not agreed to add the topic to the agenda. Even if they do, negotiations will have to be preceded by adequate analysis, research, and preparation by experts. This cannot be done overnight, and it is inconceivable that any conclusion to this pressing problem can be reached soon.

Few would dispute the contention that a world currency conference is needed to ensure coordination between world trade currencies. Indeed, this is an essential prerequisite for restarting GATT negotiations. The problem is that simply holding such an international conference has no meaning without obtained results, while the situation today is such that there is little prospect of reaching an early conclusion. How to stabilize exchange rates has become an extremely difficult problem. Yet even if fixed exchange rates prove unattainable, a system with rates fluctuating within a specific target zone would at least be far superior to the current floating rate system.

Today the volume of currency traded for financial purposes is 10 to 30 times that used in trade transactions. Moreover, the U.S. dollar is the overwhelmingly dominant currency both in trade and finance. Under such circumstances, it is extremely doubtful whether any exchange rate consistent with purchasing power parity can be established and, even more importantly, maintained semipermanently. For the time being there seems to be no alternative but the kind of makeshift coordinated intervention agreed upon by the finance ministers of the Group of Five last September.

Support for the world economy

There is no need here to explain the American economy's astounding recuperative power and its impact on the economies of other countries. Suffice it to say that this fact has been borne out in no uncertain terms by developments since the end of 1982. In view of the overpowering impact of the U.S. economy, it can only be hoped that the American government and its people will become more aware of their economic strength and their responsibility vis-à-vis the world economy. In light of the changes that have swept the world economy since the Mexican debt crisis, it is utterly irrational to blindly believe that so long as the U.S. government manages its domestic economy well, other nations will automatically follow suit.

At the same time, if Japan and West Europe, the other two pillars of the world economy, do not adequately fulfill their responsibilities, they will hardly have the right to criticize the United States.

Japan should be given high marks for implementing a number of market-opening measures over the past two years. This has been the result of strenuous efforts by the Japanese government. However, from the standpoint of the true internationalization of the Japanese economy—i.e., integration into the world economy—the measures taken so far are still not sufficient.

What Japan must do now is not to expend all its energy responding to each and every demand made by the U.S. Congress, but rather to search for a way to improve the composition of the Japanese economy and make it a real support for the world economy. If policy measures to stimulate domestic demand end up only as short-lived fireworks that stir up little more than inflation, Japan's contribution will be minimal. The urgent need now is for Japan to build up the economic muscle it would take to prop up the entire world economy. Obviously, the way to do this is not by fostering export industries but by building up an economic constitution capable of digesting in huge quantities the products manufactured by developing countries. ●