

What Worries Japan

By Takuji Shimano

Skimming through the progress report on European Community market integration issued by the EC Commission in November 1988, one is impressed to find that the community is moving toward achieving its goal nearly as quickly as originally planned.

The report lauds the overall achievements since the EC summit conference in Milan in June 1985, and praises the willingness of the 12 EC member countries to put aside their immediate interests and work for a unified market, despite the growing economic disparities between them.

It is welcome news for the future of the world economy that the results envisaged in the Cecchini Report—*The European Challenge 1992* by Paolo Cecchini—are already beginning to come about. Japan, too, is keenly interested in the progress of EC integration. But Japanese companies and the Japanese press are also deeply concerned about two of the most controversial aspects of these moves—the possibility of a new economic bloc in Europe and the issue of reciprocity.

Resurgent regionalism

While few would dispute that EC market integration is desirable overall, mass media reports in Japan throughout 1988 tended to zero in mainly on the danger of a new trade bloc arising at the expense of the free trade system and inspired by resurgent regionalism.

While acknowledging that the vitalization of the EC economy would increase imports to the region from Japan and other countries, the press also warned that integration would have significant trade diversion effects. Press articles speculated that giving more power to the EC Commission would leave Japanese business, until now used to dealing with both the commission and the governments of individual EC nations, at a loss as to how to trade with and invest in the EC region. And even while reporting that

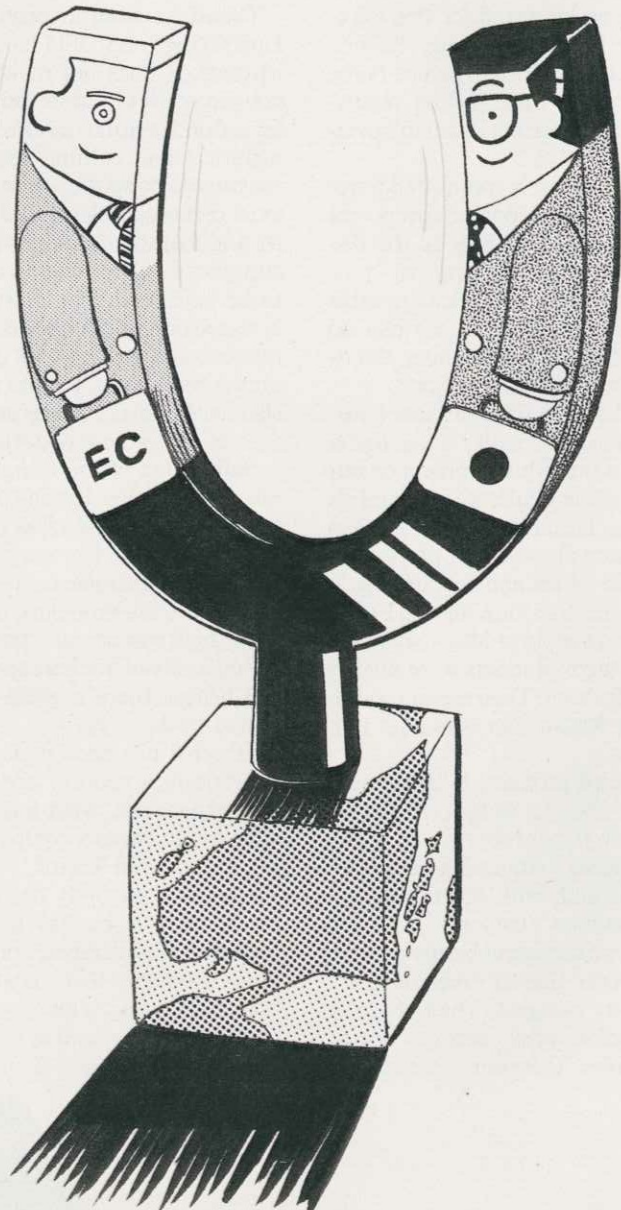
European industries would likely welcome more Japanese direct investment as a way of upgrading their own lagging high technology, reporters and commentators cautioned they would also demand higher local content ratios.

To be fair, not all the anxiety over the formation of an EC trade bloc stemmed from EC moves toward market integra-

tion. In part, they reflected recent trends in U.S. economic policy, as seen by the enactment of the protectionist-tinged Omnibus Trade Law as well as the conclusion of a bilateral free trade agreement with Canada.

Is the world economy really leaning toward a new round of bloc formation?

Certainly, EC moves toward a unified



market are motivated to some degree by regionalism. The common external tariffs and other measures called for in the integration process draw a clear line between the internal and external markets. To that degree, they do give the impression that the EC is seeking to build a new "Fortress Europe."

Yet at the same time, an October 1988 press communique issued by the EC Commission contains much to allay such fears. The communique states that the EC will meet its international obligations, both bilateral and multilateral. And it says that in sectors where there are no multilateral rules, the EC will help strengthen such existing multilateral systems as the Uruguay Round. So long as the EC maintains this basic stance on external trade policy, Japan should have little to worry about.

The communique would be even more reassuring if it had not contained several points seemingly contrary to the spirit of these commitments, however. First it suggests that until multilateral agreements take effect, the EC will automatically and unilaterally deny third countries the benefits of its integrated market. And secondly, it says the EC will only share those benefits with third countries to the degree that reciprocity and a balance of benefits can be achieved.

On an emotional level, it is easy to see why EC nations should feel entitled to preferentially receive the benefits of a common market. After all, they have continued and will continue to make many sacrifices for market integration. Yet at the same time, given the rapid liberalization and internationalization of financial and capital markets in the U.S., Japan and the EC itself, it is no longer possible for an EC market to be sufficient in and of itself, relying solely on the strength of its own internal economic activities. The fastest shortcut to a livelier, more prosperous EC is globalization, not bloc formation.

If the world has learned any lesson from the unforgettable nightmare of bloc formation in the 1930s, it is that any country that seeks to pursue its own interests in total disregard of the interests of other nations will ultimately see its trade shrink, and lose even the bene-

fits it might have gained otherwise.

In this regard, the behavior of Japanese companies leaves something to be desired. While pursuing their ambition of expanding their operations worldwide on the one hand, on the other they continue to harbor an anachronistic desire to keep their management under homogeneous, Japanese control. While taking full advantage of the convenience of the free trade system, they have failed to pay the costs expected of them by other nations. The result has been to win the antipathy of other nations, and to stir deep-rooted distrust of the Japanese economy.

Given this track record, Japanese industrialists should seek not only to consider issues related to EC integration from a Japanese perspective, but should also try to consider issues related to Japan from the standpoint of an integrated EC market.

Rules of the game

Most of the merchandise trade between the industrialized nations involves goods and products strongly affected by economies of scale. That being the case, it is time that countries reconsider the standards they use for decision-making on trade issues. As a sort of social contract, even reciprocity might be a useful principle when establishing the ground rules for the "trade game" between two nations.

Some would counter that GATT is the arbiter of the rules of this high-stakes game, and argue that any bilateral rules that might subvert multilateral agreements are highly dangerous. Yet at a time when the binding power of GATT is weakening, it is no longer reasonable to leave such thorny issues as the services trade, investment and high technology solely to multilateral negotiations in GATT. Reciprocity should not be seen as springing from distrust of GATT, but rather as a tool that could indirectly help GATT in its functions and further the expansion of world trade in certain carefully delineated areas.

Unfortunately, the EC position on the place of reciprocity in its external policy leaves ample room for misunderstanding.

While the EC Commission has said that it will not apply reciprocity across the board on trade categories, it has yet to spell out how reciprocity actually will be applied. Today the burning concern of many of the study groups formed in Tokyo to study EC integration—including two groups to which the author belongs—is to accurately access the references to reciprocity in the community's external policy.

The Commission's October 1988 press communique calling for non-Community countries to benefit from the mutual balance of advantages that occurs means balancing the results of trade, and poses a real danger of shrinking trade overall. In the author's view, reciprocity should be seen as a yardstick for negotiating the division of profits outside of the market, to be used when disparities arise in the division of trade profits resulting from different economies of scale and externality.

While the tendency among some elements of the Japanese press to label all talk of reciprocity as "protectionist" is overly simplistic, the EC Commission should do its part to clarify what it means by reciprocity as quickly as possible so as to prevent further misunderstanding. This is especially true of the Commission's stand on how reciprocity in the services and other areas unaffected by international obligation will be reflected in its proposal on banks and government procurement.

Clarification of these issues would do much to smooth and expand cooperative Japanese-EC economic relations. It would accelerate industrial cooperation, including Japanese direct investment in the EC region, and would contribute to resolving such pending problems as anti-dumping measures, demands for higher local content ratios and the emerging frictions in high technology. ■

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