

# The Task of External Economic Policies in the 21st Century

## – Sense of Emergency Found in the White Paper on International Trade 2001–

By Kimura Fukunari

The first *White Paper on International Trade* in the century is written in a modest tone but contains a lot of issues we should consider in the new environment of the world economy. In particular, Chapter 4 – “External Economic Policy Challenges in the 21st Century” – proposes an integrated approach of international commercial policy and domestic policy. It claims that, in the globalization era, international commercial policy should work as an active catalyst or trigger for domestic economic reform.

### The Task of External Economic Policy

The Japanese economy has not yet recovered from the long-lasting economic slump of the past decade. We know that we are rapidly facing an aged society, which is likely to trigger a serious collapse of pension and social security systems in the future. We also recognize that the government has accumulated a gross public debt that exceeds one year's gross national product (GNP), which will necessarily affect our generational distribution of income.

The Japanese believe that the economy has to change, but they do not want to change themselves. The unemployment rate is still around the historical high. However, we do not hear stories of starving people in this country; we have not observed the desperate, brutal demonstration of labor unions; nor do we find many beggars in towns. We have become rich after all and have not really felt threatened about achieving economic reform. People are sometimes too compassionate for a small number of people losing the vested interest and are prone to forget the virtue of competition. The memory of successful days is still too vivid to understand how fast the world is changing. According to the Japan Center for

Economic Research, the overall potential competitiveness of the Japanese economy ranked 3rd in the world in 1990 while the ranking drastically fell down to 16th place in 2000.

The writers of the White Paper obviously possess a strong sense of emergency. They boldly tackled the difficult questions of how to reform the Japanese economy and how to prepare a new economic environment before we get too old. They then claim that one of the key triggers to initiate changes is external economic policy. As they wrote in the report, the task of external economic policy in the latter half of the 20th century was mainly to deal with various frictions due to the reconstruction and subsequent rapid growth of the Japanese economy. In the 21st century, however, we must effectively integrate domestic and foreign economic policies.

The writers believe that external economic policies can bring two virtues. One is to motivate and accelerate domestic policy reform. The other is to catch up with the wave of globalization

in the world. This is probably the first time the White Paper has openly revealed the intention of constructing external economic policy so as to influence domestic issues. Early this year, the Ministry of International Trade and Industry (MITI) was renamed as the Ministry of Economy, Trade and Industry (METI), where we can find the ambition to integrate domestic and foreign economic policies. Since domestic policies are under the jurisdiction of various ministries and agencies, inter-ministerial coordination necessarily becomes the issue. Although it may not be easy for METI to step into the territory of other ministries, the courage and enthusiasm for economic reform must be highly appreciated.

### The Small Presence of Foreign Companies in Japan

Among the Organization for Economic Cooperation and Development (OECD) member countries, Japan is an obvious outlier in the performance of hosting foreign direct investment

Table 1 Harmonization menus and modes

		Menu / mode		Specific examples	
Harmonization	Convergence	System uniformity		<ul style="list-style-type: none"> <li>● Anti-Competition Law (EU)</li> <li>● Postal systems</li> <li>● Telecommunications systems</li> <li>● Weights and measures</li> </ul>	
		Mutual recognition	Mutual recognition of other countries' systems	<ul style="list-style-type: none"> <li>● MRAs</li> <li>● TBT agreement</li> </ul>	
	Cooperation	Regulatory forbearance	Restriction of government intervention to the bare minimum (stipulation of measures governments should not adopt)		<ul style="list-style-type: none"> <li>● GATS market access provisions</li> </ul>
		Minimal requirements	Establishment of minimum levels (no duplication or contradiction among countries' domestic systems)		<ul style="list-style-type: none"> <li>● TRIPS</li> <li>● BIS standard</li> <li>● Bilateral agreements concerning cooperation on anti-competitive activities</li> </ul>
		Non-homogeneous regulatory targets	Methods left to the discretion of individual countries, which are only obliged to produce results		<ul style="list-style-type: none"> <li>● Basel Convention</li> <li>● Framework Convention on Climate Change</li> </ul>
		Peer-pressure	Autonomous adjustment based on information disclosure (no specific obligations placed on countries)		<ul style="list-style-type: none"> <li>● Convention on Nuclear Safety</li> <li>● Supplementary NAFTA agreements (labor, environment)</li> </ul>

Sources: METI

Figure 1

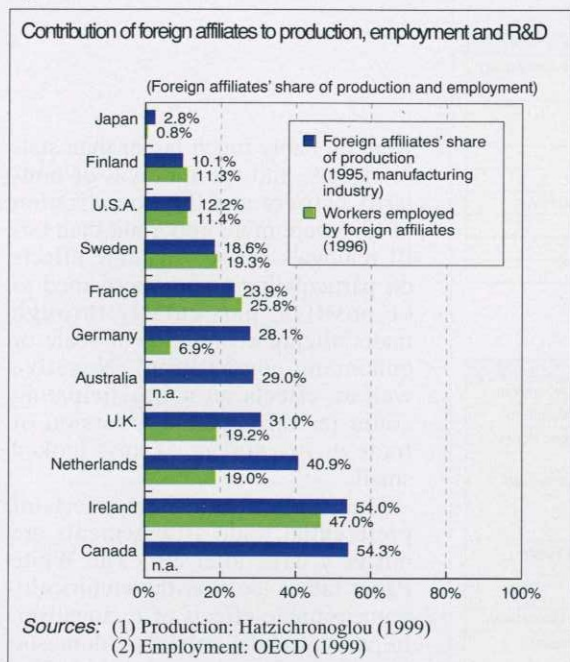
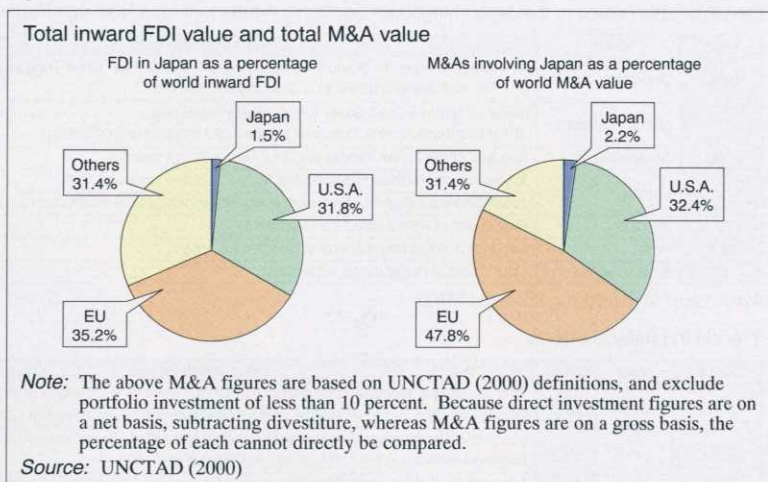


Figure 2



(FDI). Although inward FDI has drastically increased since 1998, the presence of foreign-owned companies in Japan is still minimal. The share of foreign-owned companies in terms of employment is merely around 1%, which is the lowest figure among the OECD countries. (Figure 1) Despite the worldwide FDI boom in the past few years, particularly in the form of cross-border mergers and acquisitions (M&As), Japan attracts only 1-2% of the total FDI or M&As in the world (Figure 2).

Based on the experience of structural reform in other developed countries, the White Paper claims that inward FDI can be helpful to vitalize the Japanese economy by enhancing competition and materializing technological/managerial spillovers. Although it is not easy to provide rigorous empirical proof for the link between inward FDI and economic performance, our intuition suggests that hosting FDI is likely to accelerate corporate reforms in Japan. The presence of foreign companies in Japan is still too small for us to worry about possible drawbacks from foreign giants' dominance. We of course need a strong, credible backup by competition policy but should keep in mind that government regulations typically accommodate anti-competitive behavior.

Among various possible measures to help Japan attract inward FDI, the

ability are not free of charge. However, we desperately need such business practices to effectively mobilize resources.

### Globalization and Rule-Making

The White Paper then turns to an extensive investigation of international rule-making. Starting from the historical review of international rule-making in various fields of activities, it argues that the scope of rule-making has expanded from limited border adjustments to more sophisticated coordination of domestic institutions. It examines new areas of rule-making, namely, investment rules, competition policy and e-commerce.

A rather abstract but important discussion follows on the framework of rule-making in the 21st century. It classifies the method of international harmonization of institutions into two: convergence and cooperation, and further disaggregates cooperation into five modes: mutual recognition, regulatory forbearance, minimal requirements, non-homogeneous regulatory targets and peer pressure. (Table 1) The discussion extends to the involvement of the private sector in the rule-making process.

The argument, however, is not quite complete, in my opinion, in the sense

that it leaves the scope of institutional harmonization unclear. It is true that the globalization of economic activities calls for wider and deeper harmonization of institutions. However, we should be careful that the heterogeneity of institutions stems from the path-dependent nature and thus often carries certain economic rationale. Furthermore, domestic institutions are often based on indigenous objective functions including national values, equity consideration and others, which are typically different from international policy disciplines based solely on efficiency consideration. The White Paper proposes flexibility when applying international policy rules, but discretionary practices may have a trade-off with the effectiveness of policy rules. Rather, it would be constructive to explicitly argue how far institutional harmonization should go. Without straightforward discussion, we cannot properly deal with new issues such as those related to labor and the environment.

### Regionalism

Two years ago, the White Paper of 1999 declared a historical departure from the traditional strategy on international commercial policy. Up to the late 1990s, the Japanese government solely supported the multilateral channel of international commercial policy issues led by the World Trade Organization (WTO) and consistently criticized regionalism as forming possible stumbling blocks against worldwide liberalization. However, realizing that the recent regionalism boom had actu-

Table 2

Developments related to the Japan-Singapore Economic Agreement for a New Age Partnership		
Year	Month	Main developments
1999	December	At a Japan-Singapore Summit meeting, Prime Minister Goh Chok Tong proposes concluding an FTA, with leaders deciding to launch joint research
2000	March-September	Japan-Singapore Joint Study Group meets five times (Prominent academics, business leaders and government officials)
	September	Release of the Japan-Singapore Joint Study Group report
	October	Keidanren announces Expectations for the Japan-Singapore FTA Japan-Singapore Summit. Agreement to launch negotiations toward concluding a bilateral FTA
2001	January	First round of negotiations (in Singapore)
	April	Second round of negotiations scheduled (in Tokyo)
	By the end of December	Conclusion of negotiations scheduled

Note: As of March 2001 Source: METI

#### Trends in bilateral efforts

Country	Year	Month	Main developments
Korea	1998	Oct.	"Strengthening of economic cooperative ties" included in annex to the Japan-ROK Joint Declaration
		Nov.	Discussion on a Japan-ROK FTA at the first Gathering of Japan-Korea Cabinet Ministers
		Dec.	Inauguration by the private sector in both countries of the Study Team "Toward Closer Japan-Korea Economic Relations in the 21st Century," launching of joint research
	1999	March	Announcement of the Japan-ROK New Agenda for Economic Partnership at a Japan-ROK Summit
	2000	May	Release of a joint research report by the above team Joint symposium held by the above team (in Seoul)
		Sept.	Agreement by the above group to the early establishment of a Japan-ROK FTA Business Forum and launching of considerations in this forum Joint symposium held by the above team (in Tokyo)
Nov.		Mexican President visits Japan, proposes consideration of a Japan-Mexico FTA and investment treaty	
Mexico	1999	Feb.	Based on the President's proposal, Committee for Closer Economic Relations between Japan and Mexico formed (non-governmental base)
		April	Keidanren releases Report on the Possible Effects of a Japan-Mexico Free Trade Agreement on Japanese Industry
	2000	April	JETRO and the Mexican Department of Commerce jointly release a report Keidanren Japan-Mexico Businessmen's Joint Committee Meeting releases Joint Statement Regarding the Early Commencement of Negotiations Leading to a Free Trade Agreement between Japan and Mexico
		Oct.	The New Japan-Mexico Commission for the 21st Century proposes launching government-level research on FTA
		Nov.	Keidanren releases Results of a Questionnaire Survey on the Need for a Japan-Mexico FTA
	2001	Jan.	METI Minister Hiranuma Takeo visits Mexico. Mexican Minister of Commerce proposes the early launching of negotiations on a Japan-Mexico FTA
Chile	1999	Nov.	External Relations Minister Juan Gabriel Valdez visits Japan, announces that Chile wants to launch research on a Japan-Chile FTA
	2000	Feb.	Chilean Vice-Minister for International Economic Relations of the Ministry of Foreign Affairs Jara visits Japan (proposes joint research with JETRO)
		May	Inauguration of the JETRO Japan-Chile FTA Study Group
		June	The JETRO Study Group holds a seminar
	2001	March	The JETRO Study Group to release a report
Australia	2000	Oct.	Agreement reached between METI Minister Hiranuma and the Australian Trade Minister to engage in wide-ranging discussion at the private-sector level concerning measures to strengthen bilateral economic relations for a new era
		Nov.	Private-sector research groups established in both countries
		March	Research to be concluded

Note: As of February 2001 Source: METI

ally accelerated the liberalization process, the government made an important decision to have multiple negotiating channels of international commercial policy, which include regional trade arrangements such as free trade agreements (FTAs).

Since then, Japan has conducted studies on the possibility of forming free trade areas with Korea, Singapore, Mexico, Chile and Australia. (Table 2) Among them, the relationship with Singapore is already at the stage of official governmental negotiation, and an FTA called the Economic Partnership Agreement (EPA) is supposed to be concluded by the end of this year. Because the WTO new round

has not been successfully launched yet, a series of these studies have taken an important role in keeping the momentum toward liberalization in Japan.

The White Paper provides a well-balanced review of the pros and cons of regionalism. The theoretical overview neatly summarizes the existing academic literature on the static/dynamic effects of preferential trade agreements and the dynamic link between regionalism and multilateralism. Then the discussion proceeds to the survey of empirical studies on the representative regional arrangements, the North America Free Trade Agreement and the European Union. Most of the previous studies concluded that dynamic effects

were probably much larger than static effects, and the removal of non-tariff barriers and the liberalization of FDI were more important than tariff removals per se. Welfare effects on participating countries seemed to be positive, particularly through materializing economies of scale or enhancing competition. Negative welfare effects on nonparticipating countries through the diversion of trade or investment, if any, looked small.

The measurable welfare effects of preferential trade arrangements are not very large after all. The White Paper rather looks at the empirically immeasurable effects of regionalism. In particular, the impact on domestic structural reform is emphasized. The removal of various barriers by implementing FTAs would enhance the cross-border mobility of resources, technology and ideas of institutional arrangements, which would accelerate domestic structural reform. The expectation of a more globalized environment would encourage corporate firms to reform themselves to be more creative and competitive. The process of negotiating FTAs itself would reveal various problems hidden in lagging sectors and help us break the fortress of vested interest.

To make regionalism beneficial in this respect, the White Paper stresses two characteristics of recent FTAs.

First, the scope of recently concluded FTAs tends to go far beyond simple tariff removals. (Table 3) The WTO rule just imposes limited policy discipline on trade in goods (General Agreement on Tariffs and Trade [GATT] Article XXIV) and trade in services (General Agreement on Trade in Services [GATS] Article V), and policies on other international transactions are mostly left to each country's discretion. By taking advantage of the degree of freedom, a number of countries are seeking wider and deeper economic integration with partner countries to make the fruit of regionalism even larger. Some strategic promotion of new industries can be included in the form of promoting de facto standards. By accumulating various policy know-

Table 3 Comparison of items covered by FTAs

	US-Israel	NAFTA	US-Jordan	FTAA	Canada-Chile	Mexico-Chile	EU-Mexico	ANZCE RTA
Tariff elimination	■	■	■	■	■	■	■	■
Banning of quantitative restrictions		■		■	■	■	■	■
Safeguard measures	■	■	■		■	■	■	■
Anti-dumping and countervailing duties	■	■		■	■		■	■
Rules of origin principle	■	■	■	■	■	■	■	■
Tariff evaluation and customs procedures		■	■	■	■	■	■	■
Investment		■		■	■	■	■	■
Services	■	■	■	■	■	■	■	■
Standards and conformity assessment (MFAs)		■		■		■	■	■
Phyto-sanitation	■	■		■		■	■	■
Government procurement	■	■	■	■		■	■	■
IPR	■	■	■	■		■	■	■
Competition		■		■	■	■	■	■
Dispute settlement	■	■	■	■	■	■	■	
International balance of payments clause	■		■				■	
General exceptions	■	■	■		■	■	■	■
Economic and technical cooperation			■				■	
Joint committees	■	■	■		■		■	

Note: The labor and environment-related rules included in NAFTA and the Canada-Chile FTA are stipulated not in the main agreement but in supplementary agreements. ANZCERTA is the abbreviation for the Australia-New Zealand Closer Economic Relationship Treaty Agreement.

Source: Japan Machinery Export Association (2000)

how and experience, countries with FTAs can even influence the scope of multilateral negotiations in the WTO and other forums.

Second, speed is an important factor in regional arrangements. The White Paper points out that some of the recent FTAs had very short negotiation periods. For example, two new FTAs in 2000, namely the U.S.-Jordan and European Free Trade Association-Mexico FTAs, took only five months of negotiations. Such quick maneuverability is a big advantage of regionalism vis-à-vis WTO-based multilateral negotiations. Speed is also a crucial factor if we claim that FTAs would be useful to keep the momentum for multilateral liberalization.

**Relationship with the Multilateral Channel**

The White Paper stresses that the Japanese government continues to treat the WTO as the most important forum for commercial policy issues. It clearly states that regionalism must be promoted conforming to the WTO policy rule.

The issue, however, is not simply the legal consistency with the WTO rule. GATT Article XXIV and GATS Article V are well known as insuffi-

cient policy rules. Even if an FTA conforms to these articles, it does not guarantee that the FTA is beneficial to all countries in the world at all. The WTO framework, however, does not have any effective dispute settlement procedure on regionalism issues. If the Japanese government truly places the WTO at the center, it should not interpret WTO policy principles in an opportunistic way but must try to pursue the spirit of the WTO.

Namely, the most effective way to mitigate the undesirable impacts of regionalism is to pursue the most-favored-nation (MFN) -based liberalization. The source of vicious consequences of regionalism is its discriminatory nature. The fear of tariff wars among economic blocks, the inhospitable rule of origin, the complication of having multiple FTAs (i.e., “spaghetti bowl” effect) and so on all come from differential treatments between member countries and non-member countries. The MFN treatment solves all of these problems. Therefore, if Japan claims that FTAs accelerate worldwide liberalization, it must at the same time promote WTO-based liberalization more aggressively.

As of May 2001, we are not yet sure whether the new round of WTO negotiations can successfully be initiated this year. In such a situation, it is natural for this year’s White Paper to put little weight on WTO issues. However, the next year’s volume will have to discuss multilateralism more extensively.

We observe a hint of protectionism in the recent case of safeguard measures. On April 23, the Japanese government started conducting the 200-day provisional safeguard measures on the import of stone leeks, *shiitake* mushrooms and rushes used to weave *tatami* mats. The consistency of the measure with the WTO rule will perhaps become one of the issues in the near

future. However, even if the measure is not explicitly violating the WTO rule, we must be careful whether it is consistent with the WTO spirit. The next year’s White Paper will be tested on this issue.

**In the Coming Years**

It now seems likely that the Japan-Singapore EPA will be concluded soon. Since the Japanese economy has heavily invested in East Asian countries, it is natural for Japan to take a quiet initiative to seek further economic integration in East Asia. Compared with the recent advancement of forming FTAs in other parts of the world, East Asia has rather moved slowly so far. Japan must express its clear intention to conduct further liberalization and structural reform.

The Japan-Singapore EPA may exclude lagging sectors such as agriculture from the list of liberalizing trade. The basic stance of the agricultural lobby is not to make any liberalization commitment outside the WTO negotiations. However, the cost of protecting specific sectors in such a way will become even larger from now on. Protectionism in lagging sectors not only generates the loss of national welfare but also forces Japan not to participate in further FTAs. No country would seriously take Japan’s intention toward liberalization if a convincing plan of restructuring industries were not presented.

The claim of the White Paper on the role of international economic policy is the right one. Yes, international economic policy can be an effective trigger for the structural reform of the domestic economy. Such a link, however, cannot be completed without the corresponding effort in domestic policy reform. The Japanese must share a sense of emergency with the writers of the White Paper. JTI

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