Global Presence Demands Global Policies

By Shoichi Akazawa

The 1980s was a decade of extremely stable growth for the world economy. The news was not all good, however. The 1980s was also a decade in which two major structural imbalances emerged in the global economy.

The first imbalance is the ever-widening economic gap between North and South—between the industrial countries and the developing countries. Traditionally, the industrial countries have lent money to the developing countries to purchase the capital and other goods they need for industrialization. This cycle functioned smoothly in the 1960s and 1970s, but the confluence of political instability, economic policy failures and other factors had reversed this capital flow by 1984. With less capital being provided to the developing countries, the South ended up with a negative flow and the gap widened.

This is a serious problem for the world economy. It is especially serious for Japan—a country whose prosperity is inextricably trade-linked. Indeed, this concern does much to explain why Japan is today the world's No. 1 donor of ODA.

Another crucial imbalance is that between Japan and the United States. Given that the U.S. and Japan are the world's two largest economies, the development of an imbalance of this size is more than a bilateral issue and has global implications.

There are also two major structural changes redefining the global economy. First is the emergence of regional economies. The Free Trade Agreement between the U.S. and Canada and the negotiations between the U.S. and Mexico to bring Mexico in on this, for example, hint at the creation of a single North American market. In Europe, the 12 member countries of the EC are scheduled to integrate their markets by the end of 1992.

The second significant change in the global economy is the shocking disparity between the real economy and the paper economy. It is estimated that the total value of world trade in 1989 was $3.1 trillion. Since trade refers to the exchange of goods, this would seem to be the real economy. In contrast, the paper economy, or the scale of global monetary transactions, is about 15 to 20 times that. This phenomenon was not very evident in the 1970s but has come to the fore with the sudden rise of "Japanese money" since 1985. Fueled by the excess credit created by sky-high land and stock prices, "Japanese money" is now seen as an economic threat by some countries.

West German unification burden

With the many changes occurring in Europe over the last year or so, I had the opportunity to attend a number of international meetings in Europe and to talk with academics, top business leaders and leading politicians there. In October, not long before the Honnecker government imploded, I took my first trip to East Germany.

The first thing that greets visitors entering East Berlin is the stench. While West Berlin has numerous parks and strict automobile exhaust regulations that have kept the air fresh, East Berlin is a whole different world. You can smell the difference. Although I no longer remember it clearly, I suspect Japan smelled like this 30 years ago. Seeing the little East German cars spewing fumes into the air reminded me anew of the importance of environmental regulations.

It goes without saying that the unification of Germany is a major political and security issue in Europe and, as Western Europe approaches economic integration, there is considerable concern over how much economic power a unified Germany will have in the European market. The German issue will also be a major determinant for future changes in Eastern Europe.

Because of these anxieties surrounding German unification, the initial ebullience over the crumbling of the Berlin Wall has almost entirely disappeared. As realists, the Germans themselves have led the crowd in changing the focus from euphoria to what things will be like after unification. Currency union has already taken place, and progress is being made toward political union as well.

West Germany has announced that it has set up a fund of 110 billion deutsche marks to facilitate East Germany's integration into the West German economy over next four and a half years. Many observers claim that this is not enough. This money will ultimately have to come from taxes, and it is a sizable burden even for the dynamic West German economy. In effect, it means West Germany will be doling out nearly 25 billion marks a year to East Germany to ease the unification pains.

One German research institute has predicted that, once unification is completed and East Germany is part of the much more efficient West German economy, half of East Germany's companies will go belly-up, putting approximately two million East Germans out of work. Even fairly large East German companies are facing bankruptcy. Why? Very simply because their products do not sell. Prices being equal, West German quality is a better buy. This is the invisible hand toppling East German companies.

So despite the fact that the wall separating the two Germanies is gone, it will be a long and hard pull before East Germany has a free-market economic system that is up to Western standards. And West Germany will have to bear much of the burden of this process—just as all of the Western countries will have to shoulder a similar burden to bring the rest of Eastern Europe up to speed.

Given all of this, why the hurry to unify Germany? One answer I got is to stem the flow of East German immigrants to West Germany and prevent East German economic paralysis. Not only was

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U.S. Assistant Deputy Secretary of Finance Charles H. Dallara (left) greets Japan's Finance Minister Ryutaro Hashimoto prior to SII talks.

East Germany losing its best people, the sudden influx of poorer East Germans was disrupting West German communities. When I was in West Germany in February, for example, Bremen had just begun implementing a decision not to accept any more East German immigrants.

The second answer is the miserable state of the Soviet economy. Recent reports indicate that the Soviet GNP grew 1.4% in 1989 while inflation was at 6% and industrial production showed zero or even negative growth. The economy is the worst it has been since Gorbachev took over in 1985.

The German interpretation of this is that it is the price the Soviet Union is paying for having been so hesitant in moving to a free-market economy. It is increasingly evident that the Soviet economy is being torn apart by inconsistencies as some sectors are still firmly under state-planning control and others are following anything-goes market principles. If they are going to make the switch, they should bite the bullet and do it. This is all the more important in light of the Soviet Union's tremendous size and population.

Inevitably, the shift from a planned economy to a market economy will be accompanied by inflation and widespread unemployment. But the German answer is to do it in one fell swoop and get it over with. The Soviet paralysis has proved the importance of implementing fundamental reforms as quickly as possible.

With these upheavals in Europe, the idea of an "Eastern Europe" is falling out of currency. Since the crumbling of the wall, the distinction between East and West has gradually faded and the notion of a "Central Europe" has been revived. The regeneration of Central and Eastern Europe, however, will take time. Cleaning up the putrefied Elbe River, for example, will be a decade-long task, and environmental problems of a similar scale are scattered throughout the region.

There has been a surge of Japanese interest in this region, but I wonder if we are prepared to take the same long-term perspective and undertake the same burdens that Western Europe will bear in integrating Central and Eastern Europe and in ensuring a robust pan-European economy. Study missions are all very well and fine, but they have to be grounded in an awareness of the very real problems the region faces.

Unexpectedly, this impinges on the economic gap between North and South. At the May Pacific Basin Economic Council (PBEC) Tokyo International General Meeting, the Latin American and Asian participants expressed concern that world attention had shifted to Europe and that they were being forgotten. They said they were afraid that the rush of capital and technology to Europe would actually be at the developing countries' expense. It is imperative that Japan maintain a balance in its foreign aid and cooperation to all of these regions.

Japan's persistent trade imbalance with the U.S.

Rather than look at only Europe or only Asia or only our own country, we have to recognize that a truly global economy is emerging. What happens in one country affects all countries. This globalization is different from internationalization. Internationalization is the process of interacting effectively with foreign companies and foreign people, with the focus on how to get along with the other side. Globalization on the other hand implies looking at the world as a single whole. For a company, this means building factories at the best sites and selling products in the best markets, in essence treating the entire world as a borderless economy.

Yet despite the rapid economic globalization, there has been no sudden expunging of national borders or political sovereignty. Much though we speak about internationalization, at heart Japanese are Japanese. The same goes for all peoples. Chinese are Chinese, Americans Americans, and Germans Germans. Given the present political realities, we have to pay close attention to national borders and sovereignty even as we forge ahead with globalization.

The most direct expression of globalization is in overseas investment. Total direct overseas investment outstanding worldwide as of the end of fiscal 1988 was $1.03 trillion, reflecting the powerful wave of investment sweeping across the world. America's 31.7% accounted for the largest chunk of this total, and Japan ranked third with 10.7%. Japan's rush to invest abroad in recent years, however, has put it in the spotlight.

Globalization creates interesting questions for trade statistics. What happens when a Japanese company buys thread in Thailand, ships it to a Korean subsidiary for processing, and then sells the finished garment in America? Whose export is it? The thread is from Thailand, so it is recorded as a Thai export to Korea. The product itself is shown as a Korean export to the U.S. Even though the Japanese company is running the whole show, it does not surface in these statistics at all. As globalization advances and national borders become more porous, trade statistics tell us less and less about the real situation between two countries.

Still, it is the trade figures that people watch. Japan's trade figures for 1989, for example, document a 28% decrease in Japan's overall surplus but only a 5.5% decline in its surplus with the U.S. Even though Japan's overall trade structure has been changing as reflected in the January 1990 figures (the trade balance almost even and the current account balance slipping into the red), the imbalance with the United States persists.

What happened to the Japanese trade structure in the latter half of the 1980s? First, in terms of volume, exports increased only slightly. Because of shifts in the exchange rate and other financial factors, however, this showed up as a 10% increase in monetary terms. On the other hand, there has been a flood of imports, up 40% since 1985. The Japanese trade configuration has clearly undergone dramatic change. In fact, it is difficult to think of any other country that has seen its trade pattern change so significantly in only 4 to 5 years.

This restructuring was not engineered by the government. It evolved out of the management policies of Japanese business leaders as they responded to the changing environment. When it looked like the yen would top ¥100 to the dollar, management's priority was on cutting costs to absorb the negative impact of appreciation. Second was the vigorous shift of company resources to the domestic market. This entailed, for example, refocusing the product development emphasis from exports to the domestic market. The third strategy was to import more to take advantage of the yen's appreciation. In the past few years, imported goods have become an integral element of industrial strategy. And the final strategy was to invest overseas while the yen was strong.

Devising global trade rules

Before coming to my present post, I was at JETRO promoting imports for six years. When those efforts were first initiated, we expected strong resistance from the Japanese small-business sector. Yet once people realized that the service plugged them into quality imported goods, there was a growing number of people coming to us for information and assistance.

With one eye on the exchange rate, Japanese management now accepts imports as an integral part of any business strategy. Exports, on the other hand, are no longer as attractive as they used to be now that the exchange rate is ¥130 to ¥150 to the dollar. If this pattern continues to hold, Japan's current account surplus will continue to shrink. Last year, the surplus was down $22.6 billion, and this year it is forecast to decrease another $20 billion–pushing the surplus below 2% of GNP. If the truth be known, the score or so of people who drew up the 1986 "Maekawa Report" wanted to set 2% of GNP as a target, but we shied away from including this in the report because we doubted the surplus could be reduced that much.

Despite this improvement, however, the problem with the U.S. has yet to be resolved. This is a problem with global implications. Throughout the SII talks, I was dismayed that the Japanese media were almost exclusively concerned with what the talks meant for Japan. Whether they viewed the U.S. suggestions as heavy-handed interference in Japanese policy affairs or saw them as a welcome chance for Japan to become more consumer-oriented, the analysis was in terms of the impact on Japan. No one really analyzed American motives or the global impact.

My impression was that the Bush administration was making a concerted effort to rein in the managed trade theories of revisionists who see Japan as a "special case" that has to be "contained" and was trying to gain Japanese cooperation to ensure the success of the GATT Uruguay Round by the end of the year. The SII talks were an effort to depoliticize the situation and to get back on the multilateral trade track.

Yet they were only a first step. The real test will come at the end of this year with the Uruguay Round. Japan has thrived in the free-trade climate, and it is hard to see how we can continue to prosper unless free trade survives. This may mean making some hard political decisions to protect free trade. The central problem for Japan, of course, is rice. My fear is that this one problem could substantially undermine Japan's national interests unless we are able to deal with it from the global trade perspective.

The U.S. is moving into another election season, and it is vital that the Bush administration have something to show for its support of the free-trade system. It is imperative that Japan and the United States clear up this problem as soon as possible and cooperate to make the Uruguay Round a success. Unless we can agree on international trade rules for the next 5 to 7 years, the multilateral structure will splinter and we will be thrown back to bilateral agreements that are increasingly vulnerable to "special treatment" and "exceptions."

The key to a successful conclusion of the Uruguay Round by the year-end is for Japan and the U.S. to show the way. As in the SII talks, America's main request is that Japan take the initiative in creating a market that is not identical to but compatible with the American market. No one is asking Japan to abandon its cultural heritage or to become the 51st state. But there is a need for greater compatibility, not just with the United States but with all nations in the global economy.

Developing an international presence

In my years at JETRO, I consciously refrained from using the term "major economic power," and I even advised against its use by other JETRO people. There are a number of reasons for this. First, this term tends to inflate Japanese egos unduly. Second is that the size of the economy is not in question. What is being questioned is the quality of the Japanese economy. In numerical terms, Japan's 15% share of world GNP, $350 billion in foreign assets and $60 billion trade surplus rank it as a major economic power. But these are just the numbers. What is needed is an improvement in the quality of the Japanese economy.

The third reason for not using this term is that a nation's international presence is defined by more than just its economic muscle. Presence also includes military strength, diplomatic persuasiveness, cultural attractiveness and many other factors. Just as strong sales figures do not necessarily translate into respect for a company, nor does economic size alone qualify Japan as a world power.

In fact, Japan will not be a world power until diplomatic considerations are just as important as domestic political considerations in policy formulation. History is clear on the fate that befalls great trading nations that ignore the international imperatives. Unless Japan can look at itself from the global perspective, that will also be our fate.

I am confident that we can do this and Japan can take its rightful place as one among many global presences, but I do not believe it will be easy.

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