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Successes and Dangers of Japanese Foreign Trade Strategy

by Henry Krägenau, Hamburg*

Japan's high and increasing trade and current account surpluses have aroused in the other industrialized nations a growing fear of Far Eastern competition. Some countries consider that protectionist measures are the only suitable response to increasing imports from Japan. Japan's "unfair" conduct of its foreign trade is often cited as a reason for such a reaction. Is this reproach justified? What can be done to avert the dangers to both Japan's foreign trade and the world economy caused by this situation?

Despite pronounced fluctuations caused by oil prices Japan's trade and current account surpluses showed a marked increase during the 1970s. While the surplus on current account was already \$ 2 bn in 1970, by 1972 it had expanded to \$ 6.6 bn. After recovering from the first oil price shock, in 1978 it had risen to \$ 16.5 bn, with a balance of trade surplus of \$ 24.5 bn; after the second upsurge of oil prices Japan recovered from its large current account deficit more rapidly than other countries and – with a dynamic growth of exports – by 1981 again achieved a surplus of \$ 4.8 bn which should have risen to more than \$ 20 bn in 1983 (see Table 1). This surplus is balanced by high and growing deficits, particularly in the USA and Western Europe, towards the Far Eastern trading partner: in 1982 the American trade deficit amounted to \$ 16.8 bn (1970: \$ 1.5 bn) and the EC deficit to \$ 11.6 bn (1970: \$ 0.4 bn).

While the industrialized nations do to some extent admire the spectacular export success of Japanese firms, a more characteristic element is their increasing fear of Japanese competition. In some countries, more intensive protectionism is seen as the only response to the growth of Japanese imports. Japan's "unfair" conduct of its foreign trade is often cited as justification for this attitude. Borrowing from military terminology, an EC paper issued in the late 1970s expressed the situation as follows: "It is hard to accept the massive surpluses when, at the same time, the Japanese market is closed to outsiders and, like soldiers carrying out a sally from a fortress, Japanese exporters are causing chaos in some specially chosen industrial sectors of the Community. Simultaneously, the Japanese are also starting to encroach on those sectors in the EC's traditional export markets."¹

In many people's opinion, the Japanese foreign trade policy in the 1970s also contravened the "burden-sharing" amongst the industrialized nations which was agreed within the OECD when the first oil crisis occurred and whereby those nations should not try to pass their own burdens onto other countries by stepping up exports.² The Foreign Trade Committee of the European Parliament also takes this view. To further burden-sharing it urges the Japanese Government to adopt a policy of internationalizing the yen and not to intervene against the trend.³ This recommendation obviously implies the criticism of manipulating the yen for the purposes of trade policy.

The Japanese reject these criticisms: they feel that they are being made the scapegoat for the inability of European and American firms to compete successfully against Japanese competition on their domestic and foreign markets (including the Japanese market). In recent years a dangerous and increasing conflict potential between Japan and the other industrialized nations has been created. The dangers which more intensive protectionist initiatives represent with regard to the expansion of world trade and the recovery of the world economy must not be underestimated.

With some 8 % of the world's exports in 1982 Japan is today the third largest exporting country after the USA (12.5 %) and the Federal Republic of Germany (10.4 %). In the early 1960s the Far Eastern nation was still well behind countries such as Great Britain and

¹ Confidential report of an EC Commission study group quoted in: *Wirtschaftswoche*, No. 31, 30. 7. 1979.

² Cf. Jörn K e c k : Japan as a Trading Partner, lecture given at The Royal Institute of International Affairs, 28 October 1982 (manuscript).

³ Committee for External Trade Relations of the European Parliament: Report on trade relations between the EC and Japan, European Parliament, Session Records 1981/82, Doc. 1-240/81, p. 39.

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Table 1
Japan's Balance of Trade and Current Account,
1965-81
 (US \$ bn)

Year	Exports	Imports	Balance of Trade	Current Account
1965	8.3	6.4	1.9	0.9
1970	19.0	15.0	4.0	2.0
1971	23.6	15.8	7.8	5.8
1972	28.0	19.1	9.0	6.6
1973	36.3	32.6	3.7	-0.1
1974	54.5	53.0	1.4	-4.7
1975	54.7	49.7	5.0	-0.7
1976	66.0	56.1	9.9	3.7
1977	79.3	62.0	17.3	10.9
1978	95.6	71.0	24.6	16.5
1979	101.2	99.4	1.8	-8.8
1980	126.7	124.6	2.1	-10.7
1981	149.5	129.6	20.0	4.8
1982	137.7	119.6	18.1	6.9
1983 ^a	118.4	92.8	25.6	16.8

^a Jan.-Oct.

Source: The Bank of Japan: Balance of Payments Monthly, various years.

France. The growth in the exports of manufactures (SITC 5-8) gives a better impression of the dynamics of Japanese exports. Competition for exports of manufactures occurs essentially between the industrialized nations. Japan has managed to increase its share of the exports of manufactures from this group of nations from 6.8 % in 1965 to a present level of 16.1 %.

The successes of Japanese exporters on the various fronts are revealed by a rather more detailed analysis of their market position in relation to the main competing nations amongst which the EC countries, with their strong complaints about the pressure of Japanese exports, and the USA are predominant (see Table 2). The Japanese exporters have increasingly succeeded in reducing the shares of their competitors from the industrialized nations on the latter's own markets and on the markets of third countries.

Between 1970 and 1980, the Japanese managed to increase their exports by some \$ 21 bn by conquering larger shares of the industrialized nations' markets. Of this sum \$ 12 bn alone was derived from the market shares they had gained in other industrialized countries in competition with domestic suppliers.

Competing with the other industrialized nations, the Japanese have also considerably increased their shares of third countries' markets, including those of the developing and newly industrialising countries. These greater shares have resulted in a \$15 bn rise in exports.

When examined more closely, these major successes of the Japanese exporters on third countries' markets are hardly surprising. Due to some extent to its peripheral geographical position, surrounded solely by developing countries, Japan had at an early stage aligned its regional export structure to the rapidly growing developing countries, especially in South-east Asia, which were very receptive to the range of Japanese goods. Combined with the products which were well-adapted to the local conditions, traditional links enabled the Japanese suppliers to obtain larger benefits than their Western competitors from the expanding markets in those countries.

Overall, one-third of the growth of Japanese exports of manufactures between 1970 and 1980 can be attributed to the increased shares which they have won from the competing industrialized nations on their own and third countries' markets.

Export Successes with Falling Profits

At first sight the Japanese export successes seem to indicate that Japanese products are highly competitive. This view has to be modified, however, in the light of the development of prices and costs in Japan and the competing nations.

On the basis of national currencies, prices and costs rose more rapidly abroad than in Japan during the 1970s. The relative movements of prices and costs in a single currency (real exchange rates) show, however, that on a cost basis (unit wage costs) Japan has experienced a marked appreciation. The relative costs have risen by almost 30 % since 1970. As opposed to this, Japan has improved its relative price competitiveness – on the basis of average export values – by 7 %. This indicates that the Japanese exporting firms have "bought" their increased market shares by cutting profits.

The profit-sales ratio for exports showed a relative deterioration compared with the competing nations between 1970 and 1980. At the same time the ratio fell; it also deteriorated in comparison with the domestic sectors (see Table 3).

Yet the market shares and profit-sales ratios did not develop steadily during the period under review: especially the years of devaluation following 1978 – the nominal effective devaluation of the yen was 10.8 % in 1980 compared with the 1978 level – were a time of increased profits. In view of a distinct improvement of 26 % in the relative cost position – which also reflects the marked improvements in the productivity of

manufacturing industry after 1975 during a period of moderate wage costs which did not keep pace with the improvements in productivity – the profit-sales ratio of the Japanese exporters improved significantly in comparison with the competing nations and the home-market trade. Except in the general engineering sector, the profit margin on the home market was outstripped by the end of March 1980. The lost shares of the market (see Table 2) which were endured during that period lead us to conclude that the Japanese exporters permitted those losses in order to improve their profits. This applies particularly to 1979. In 1980 the Japanese firms were able once again to achieve a marked improvement in their market position but only by means of greater price concessions. On the basis of the average export values the real exchange rate fell from the previous year's level.

On balance, the strategy of Japanese exporters after the 1973 oil crisis was to strengthen their position on the export markets even if this meant that they had to endure a medium-term deterioration of their export profitability.

Narrow Range of Exported Goods

The competing nations feel the Japanese successes to be all the more threatening in that – unlike, for

example, the range offered by the Federal Republic of Germany – the range of export goods offered by the Japanese is concentrated to a large extent upon a few groups of products and market segments. Thus in 1980 40 % of Japanese exports of finished products to the EC related to only five out of more than 140 product groups (three-digit SITC commodity groups). The degree of concentration of Japanese exports to the USA was even greater: only four commodity groups, of which three alone in the motor industry (cars, heavy vehicles, motor cycles) accounted for 40 % of exports.

The dangers of this export strategy for Japan are felt particularly severely whenever international demand falls off and Japan makes extra efforts to export in an attempt to win additional market shares – especially for balancing out exceptional strains on imports, such as after the oil price explosions. This may possibly exacerbate the employment problems of the importing countries and encourage protectionist tendencies. Japan is fully aware of the problems aroused by this strategy. The question as to why that strategy is applied must be examined against the background of post-war development and the pronounced economic concentration. Exports are extremely important for Japan, a country with few raw materials, where industrial modernization began much later than in other industrialized nations. Since the early 1960s it has

Table 2
Changes in the Market Position of Japan's Manufacturing Industry in Relation to Competition from the Industrialized Nations¹ on Selected Markets
(US \$ bn)

Period	Export Position					Import Position	Overall Position (7)	Overall Position as % of the mean turnover of manufacturing industry
	Competing countries' markets		Third countries' markets	Total (5)				
	Export competition effect (1)	Import competition effect (2)	Total (3)	Export competition effect (4)				
	(1)	(2)	(1) + (2)	(4)	(3) + (4)			
70/73	0.64	2.26	2.90	2.23	5.13	-0.72	5.85	2.03
73/75	-1.19	0.52	-0.67	2.25	1.58	-0.67	2.25	0.55
75/78	9.10	3.05	12.15	4.47	16.62	-1.00	17.62	2.88
78/80	-2.40	2.26	-0.14	-3.72	-3.86	4.95	-8.81	-1.07
70/80	9.19	12.04	21.23	14.93	36.16	1.13	35.03	6.74

¹ Federal Republic of Germany, France, Great Britain, Italy, Netherlands, Belgium, Denmark, USA, Canada, Switzerland, Austria, Sweden, Norway, where:

Column: (7) = (1) + (2) + (4) - (6)

$$G_i = dc_{12}x_2 + db_{12}M_a c_{12} + dc_{13}x_3 - db_{21}M_i$$

$$c_{12} = \frac{X_{12}}{X_{12} + X_{22}} = \frac{X_{12}}{X_2}; \quad c_{13} = \frac{X_{13}}{X_{13} + X_{23}} = \frac{X_{13}}{X_3}; \quad b_{12} = \frac{X_2}{M_a}; \quad b_{21} = \frac{X_{21}}{M_i}$$

X_{12} : Japan's exports to competing countries

X_{13} : Japan's exports to third countries

X_{22} : Intra-exports of the competing countries

X_{23} : Competing countries' exports to third countries

M_a : Volume of the market in the competing countries

M_i : Volume of the Japanese market

Source: Concerning the concept of market position analysis and the data basis confer: Wolfgang Welter et al.: D-Mark-Wechselkurs und internationale Wettbewerbsposition der deutschen Wirtschaft, Hamburg 1982 (unpublished report commissioned by the BMWI).

Table 3
Movement of the Profit-Sales Ratio Indicator
for Japan's Manufacturing Industry

	Manufacturing Sector Total ¹	Export Sales ²
1970/71	-13.1	-11.5
1971/72	-4.6	-7.3
1972/73	12.2	4.2
1973/74	-2.9	9.3
1974/75	-19.3	-20.1
1975/76	6.1	-2.3
1976/77	-1.1	-4.2
1977/78	1.1	-2.3
1978/79	7.0	14.3
1979/80	13.7	9.5
1970/80	-1.0	-19.9

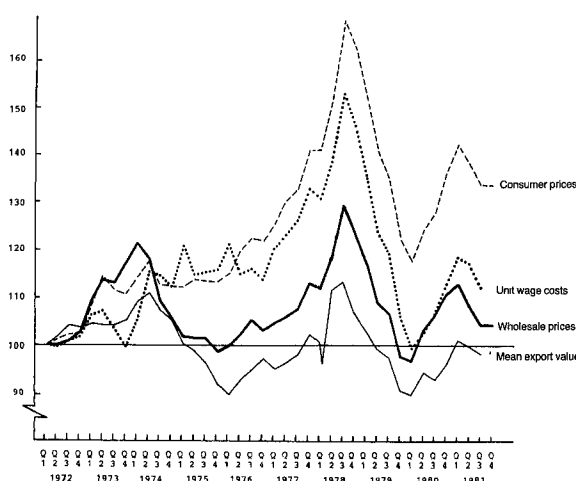
¹ Percentage change in producers' prices less percentage change in unit wage costs.

² Percentage change in mean export values less percentage change in unit wage costs.

Source: OECD: Main Economic Indicators; UN: Monthly Bulletin of Statistics, various years; author's own calculations.

based its industrial policy and its growth policy upon the heavy and chemical industries with their intensive use of raw materials. A large volume of exports has been needed to finance the imports of the raw materials required for those industries. Therefore, industries from which the Japanese hoped for high export earnings were given priority in assistance measures, including sealing off their own market.

Fig. 1
Movements in the Real Effective
Exchange Rate of the Yen
 (Competitive Position in Prices and Costs)¹



¹ Rising value = Deterioration of the Japanese competitive position in relation to the rest of the world.

Source: Hans-Eckart Scharrer et al.: *Japans Wirtschaftsentwicklung, Außenhandel und Wettbewerbsfähigkeit*, Hamburg 1982, p. 194.

The success of this policy must also be viewed against the background of the marked concentration of the Japanese economy. Six giant conglomerates – Mitsubishi, Mitsui, Sumitomo, Fuji, Sanwa and Dai-ichi Kangyo – now have a dominating influence over the Japanese economy and form the backbone of this world market strategy.⁴ Within the safety net provided by these groups it was possible to exploit economies of scale more effectively than elsewhere. Long-term research cartels formed between the groups – initiated by the State and partly backed by massive State assistance – are responsible for the low-cost development of technical innovations, which are particularly important since technology-intensive products are accounting for an increasingly larger proportion of exports.

One major element in the export strategy is that Japanese firms try to maximize their share of the markets they enter.⁵ For Japanese companies, market shares are “deferred and compounded rates of return. Japanese firms act therefore as if they were trying to maximize seven to ten year ‘moving average profits’ for the firm as a whole”.⁶ This policy aimed at long-term growth and profits is possible not least because due to the structure of the Japanese economy takeovers are “unusual”.

The deliberate concentration of resources upon a relatively narrow range of export goods – some authorities consider this to be a typical consequence of the marked concentration of the Japanese economy⁷ – has produced “learning curve effects” which increase productivity.

Although Japan has achieved brilliant successes with its export strategy, the increased need for “voluntary” self-restraint agreements (motor vehicles, steel, video recorders, machine tools, etc.) indicates the limitations of such a strategy.

Problematical Import Market

The industrialized nations' readiness to stop Japan's advance has increased as the impression has grown

⁴ “The concentration is unknown abroad only because it has a different legal organization than in the Western industrialized nations. By means of less intensive links with the other twelve large groups... this sextet acquires an agglomeration of economic power which has not even an approximate equal anywhere else in the world.” (Our translation) Helmut Becker: *Die Japaner kommen*, in: *Finanz und Wirtschaft*, No. 3, 14. 1. 1981

⁵ Cf. Yoshi Tsurumi: *Japan's Challenge to the U.S. Industrial Policies and Corporate Strategies*, in: *Columbia Journal of World Business*, Vol. XVII, No. 2, 1982, p. 91.

⁶ *Ibid*; p. 91.

⁷ Helmut Becker, *op. cit.*

that the Japanese market enjoys considerable protection from foreign competition. Japan's import structure shows significant differences from that found in the other industrialized countries. Whereas in the case of the EC countries – excluding intra-EC trade – manufactured goods account for some 45 % of imports, and for 55 % in the USA, these are less than 25 % in Japan. Japan's import structure thus corresponds largely to that of a manufacturing nation and not of a modern industrial state.

If we examine – as we have for exports – how the competitive position of the rival industrialized countries has evolved on the Japanese market, it becomes obvious that exporters from those nations had only slight success there in the 1970s. Despite some considerable improvements in relative prices to the advantage of foreign suppliers – import prices for manufactured products fell by 21 % against wholesale prices between 1975 and 1978 – no penetration of the market could be recorded.

Therefore, non-price factors are the principal elements in the debate on trade policy. Thus the industrialized nations complain about serious trade restrictions while the Japanese authorities are eager to point out that the Japanese market is quite open – perhaps even more so than in other countries. The average duty on imported goods is, in fact, lower than in the EC and the USA but the criticisms put forward by the industrialized nations are concentrated principally upon non-tariff barriers to trade.

Consequently, blame is directed more towards the Government's procurement policy and unofficial limiting of foreign products, such as computers, communications equipment and semiconductors.⁸ Many products are subject to standards which are excessively rigorous when compared with international usages. Although Japan is a member of the International Electrical Commission (IEC), it raises difficulties concerning the acceptance of IEC standards.⁹ Complicated testing procedures and safety regulations are also deterrents for foreign exporters and are to some extent discriminatory. Very precise design and production documentation often has to be delivered before marketing permits are issued. Many enterprises discovered that this information was passed on directly to Japanese firms.¹⁰ This is a major reason why some

US firms are reluctant to conclude technology contracts with the partially state-controlled NTT.¹¹

At the beginning of 1982 after long negotiations with the USA and the EC the Japanese Government promised under pressure to remove 67 non-tariff barriers to imports.¹² It had been presented with a list of 99 of those barriers. After the Japanese had repeatedly repudiated such restrictions, the list of improvements of import procedures was the first official acknowledgement of their existence. Measures in this direction are undoubtedly a real step towards remedying the tensions in trade between Japan and the industrialized nations. Yet even if these barriers were entirely removed, it is doubtful whether access to the market would become as open as in other countries, partially because of the industrial concentration in Japan. It is very likely that, owing to group solidarity, intra-group trade would take priority even at the expense of short-term profits.¹³ One factor favouring this view is the close "cultivation of contacts" between the firms of the various groups. Regular meetings are held at many different levels in order to "exchange information and cultivate friendship".¹⁴ Major elements encouraging group discipline are not only group-controlled funding but, in particular, the regular rotation of board members, directors and consultants.

Foreign enterprises are prevented from taking-over Japanese firms by "measures to protect shareholders".¹⁵ There is therefore no possibility of purchasing an existing firm as a basis for opening up a difficult market, as can be done in other countries. Large concerns could perhaps have safeguarded their market interests more intensively by setting up their own distribution and servicing offices but the life-time employment system makes it difficult for foreign firms to find skilled staff when entering the market.¹⁶ Many medium-sized exporting firms which – as in the Federal Republic of Germany – play a major part in foreign trade

⁸ Cf. Comptroller General of the United States: *Japan Trade: Issues and Problems*, ID-79-53, Washington 1979, p. 18; Arthur D. Little Inc.: *The Japanese non-tariff barrier issue, American views and the implications for Japan-US trade relations*, Tokyo 1979, p. IV-19.

⁹ Cf. Jörn Keck, op. cit.

¹⁰ Cf. Sind Japans nichttarifare Importbehinderungen Absicht oder willkommener Zufall?, in: *Neue Zürcher Zeitung*, No. 197, 27. 8. 1982.

¹¹ Lionel H. O'Imér: *Japan's Drive for Technological Pre-eminence Challenges U.S.*, in: *Business America* (ed. Department of Commerce), No. 2, 24. 1. 1983.

¹² JETRO Special Report: *Japan improves import procedures*, in: *Focus Japan* (ed. JETRO), Vol. 9, 1982, No. 2, pp. 5ff.

¹³ Cf. Jörn Keck, op. cit.; Suetō Sekiguchi: *Japan must do away as much as possible with import restrictions*, in: *The Japan Economic Journal*, No. 956, 26. 5. 1981; Helmut Becker, op. cit.

¹⁴ Cf. Fuyo Group Rising to Challenges, in: *The Oriental Economist*, Vol. 50, No. 855, 1982, p. 18.

¹⁵ For details see Hiroshi Okumura: *Japanese Business Groupings Face World Criticism*, in: *The Oriental Economist*, Vol. 50, No. 866, 1982.

¹⁶ Cf. Lionel H. O'Imér, op. cit.

cannot "single-handedly" penetrate the Japanese market with its network of linkages. The necessary time and expense alone make this impossible. The Japanese themselves do not deny that the extremely strong and, in many cases, monopolistic position of Japanese importers caused by this and many other factors often results in a marketing policy which runs counter to the contractual partner's interests: in view of the high prestige of foreign products they fix high prices so that only limited sales, though with high profits, can be achieved.

The complex Japanese distribution system is not deliberately arranged to discriminate against foreign competition but often appears to the foreign supplier as a labyrinth in which he is in danger of losing control over the marketing of his products.¹⁷ In addition, the distribution channels for some groups of products right down to the retail sector and repairers are strictly controlled by Japanese producers so that no foreign equipment is stocked.¹⁸

In sum, we see that a large number of restrictions exists on many different levels. If their cumulative effect is taken into account there can be no question of an open market, as alleged by the Japanese.

Inevitable Consequences

Bilateral deficits and surpluses are not unusual in a multilateral system of world trade. The other industrialized nations' most serious criticism of the high Japanese surpluses has been aroused by the fact that they have been partially created as a result of exports concentrated on relatively few groups of goods and market segments and inadequate access to the Japanese market for manufactured products. The USA in particular also complains about the strict protection against agricultural imports.

This situation involves considerable dangers for Japan's foreign trade and for world trade. The Far Eastern country itself has rapidly become more and more dependent upon exports; the proportion of export-related private investments rose from 27 % to 43 % between 1978 and 1980.¹⁹

Increasing dependence also implies an increasing vulnerability to protectionist initiatives. This has in fact been brought home to Japan particularly in the past few years. Even such a liberal country as the Federal Republic of Germany has felt obliged to restrict

Japanese car imports. A considerable number of the import restrictions directed towards Japan are unarguably caused by the fact that the industries in question are not sufficiently prepared and able to adapt.

It is certainly not permissible to penalize a country for its efficiency. However, if Japan has been made the victim of protectionist measures, this is also because of the fact that in the course of its post-war development Japan concentrated its energy upon exports without fully appreciating the advantages of imports of manufactured products.²⁰ Japan still continues to contribute little towards the international division of labour and has a high level of self-sufficiency for manufactured products in nearly every sector.²¹ At present it imports only the same volume of finished products as Switzerland, whose economy is ten times smaller.

It will be a matter of importance for Japan in future to safeguard its role in world trade by making its markets more accessible. Initial steps in this direction have been noticeable in recent years. As the competing nations must realise, however, increased liberalization can be implemented only in the course of medium and long-term adjustment processes because it is linked with changes in the existing structures.

The competing nations on their part are required to intensify their efforts on the Japanese market whose size is large enough to mitigate the growth and employment problems of the Western European and North American economies. The creation of an EC common trade policy vis-a-vis Japan – so far nine or ten countries have each been speaking individually – could increase the pressure to allow genuine access to the Japanese market.²²

Japan should work towards a progressive reduction of its high level of self-sufficiency in manufactured products. The resources released by such an action could be used by Japan to diversify its range of exports. If this does happen, the Japanese economy will no longer be under pressure to win permanent market shares with comparatively few products in order to fund its deficits in trade in raw materials and food. After successful adjustment, this would in fact be possible even if the market shares remained constant. It would also help to destroy the basis for protectionist tendencies.

²⁰ MITI: White Paper on International Trade, Japan 1978, p. 62.

²¹ Ibid.

²² Cf. George Koopmann: Handelspolitik der EG: durch Abstufung mehr Kohärenz, in: Eberhard Grätz (ed.): Abgestufte Integration – Eine Alternative zum herkömmlichen Integrationskonzept?, Strasbourg 1984 (shortly to be published).

¹⁷ Cf. Arthur D. Little Inc., op. cit., p. IV-49

¹⁸ Comptroller General of the United States, op. cit., pp. 47, 90ff.

¹⁹ Cf. Charles Smith: Japan urged to rethink export strategy, in: The Financial Times, 24. 2. 1983.