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Radha Sinha\*

## Are EC-Japan-US Trade Relations at the Crossroads?

*The Uruguay Round negotiations are currently passing through a critical phase after four years of strenuous bargaining. The ultimate success of the negotiations largely depends on the attitudes of the USA, the EC and Japan. What are the main contentious issues between these three and how are their trade relations likely to develop in future?*

The trade conflict between the European Community, the United States and Japan has been with us for some time. Under pressures from its trading partners, particularly the USA, Japan has continued to make trade concessions, of which the major beneficiary so far has been the USA. After the Second World War Japan "turned to the United States for its overall – not only economic, but political, security and cultural – relations".<sup>1</sup> The USA, for its part, saw Japan, after the communist take-over of China, as the linchpin of its anti-communist *jihad*. It not only poured massive aid into Japan but also allowed asymmetrical access to its domestic markets in much the same way as it had done with Europe. As a result, the trade links between Japan and the USA, as well as between the USA and the Western European countries, particularly those constituting the European Community, became stronger over time.

Apart from taking advantage of the extensive US market, Japan was mainly concerned with consolidating its position in Southeast Asia, which it has considered its own "zone of influence". With its preoccupation with the US, Southeast Asian and Chinese markets, Japan did not have much time for the European markets, some of which, such as the French and the Italian, became virtually closed to outsiders. Japan did, however, have bilateral trade relations with West Germany and the United Kingdom, but both these markets for Japan were much smaller than the USA.

With its growing economic might, some European countries have begun to reassess their position vis-à-vis Japan. Even the French have of late been inviting Japanese capital to come to France, although there is still some ambivalence in their attitude. Nevertheless, there has been a noticeable change in the Japanese attitude towards the EC after the ratification of the Single European Act in 1987. Japan, like the USA, has seen the inevitable European economic integration as a potential challenge as well as a threat.<sup>2</sup> With a combined population of over 320 million and a GNP of US \$ 5774 billion (1987) the EC will be a very attractive market for both US and Japanese business. Yet there is a fear that the EC may turn into "Fortress Europe". In cognizance of this risk, the US and Japanese businesses and financial institutions are increasing their presence within the EC countries. On the official level, a two-pronged approach is in evidence. Both the USA and Japan are anxious that there should not be a complete breakdown in the Uruguay Round of trade negotiations, while at the same time they are both seriously thinking in terms of bilateral agreements, as well as of creating a trading bloc in the Pacific. The USA has already created a "free-trade" area with Canada and is exploring the possibility of including Mexico and some Latin American countries. Japan, in co-operation with Australia, is pushing ahead with the creation of an "OECD-like body to serve the cause of Pacific co-operation".<sup>3</sup> Thus the future of international trade hangs in the balance at present. So also do the trade relations between the main trading

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<sup>1</sup> K. Ishikawa: The Challenge of Europe, Institute of International Affairs, London 1990, p. 13.

<sup>2</sup> Congress Research Service (CRS): European Community: Issues Raised by 1992 Integration, Report prepared for the Subcommittee on International Economic Policy and Trade of the Committee on Foreign Affairs, US House of Representatives, Washington, June 1989, p. 2.

partners, the USA, the EC and Japan, who collectively account for nearly two-thirds of world trade.

This paper looks into recent trade relations between the three trading partners, highlights some of the main contentious issues behind the trade friction among them and speculates on the likely future of this relationship, which has implications for world trade itself. Admittedly, sales of assets across borders – the “capital side” – are larger in volume than the current accounts and are important to “trade” disputes, but due to lack of space, this paper will concentrate on the merchandise trade.

### Volume of US-EC-Japan Trade

The volume of exports and imports of the main market economies is given in Tables 1 and 2. Between 1978 and 1989 the total exports of the market economies increased by 2.4 times from US \$ 1187 billion to \$ 2894 billion. During this period, the share of both the USA and FR Germany remained around 12 per cent while Japan's share increased marginally from 8.2 to 9.5 per cent. The overall share of the EC stood at 38.9 per cent in 1989 against 40.2 in 1978. In the case of imports, the share of the USA fell marginally from 15.3 per cent to 14.5 per cent between 1978 and 1989. There was also a slight decline in the share of Germany while the share of Japan showed a small increase from 6.5 per cent to 7.1 per cent. The total share of the EC in the market-economy imports decreased from 40.5 per cent to 38.9 per cent. In 1989 the EC exports were 4 times those of Japan and 3 times those of the USA. In the case of imports, the EC share stood at 5.5 times that of Japan and 2.5 times that of the USA. For both exports and imports the EC share was 1.5 times the combined total for the USA, Japan and Canada. Thus it is obvious that the economically integrated EC will be a formidable trading competitor to both the USA and Japan.

In terms of bilateral relations, the USA is by far the largest trading partner of Japan, accounting for 34 per cent of Japanese exports and 22 per cent of Japanese imports in 1988 (Table 3). Japan-EC trade remained relatively smaller. As late as 1988, the EC accounted for only 18 per cent of Japan's exports and 13 per cent of its imports. The share of Japan in both US and EC exports and imports (cf. Tables 4 and 5) is much smaller than their respective shares in Japan's trade. In 1989 only 12 per cent of US exports went to Japan; however, nearly 20 per cent of US imports came from Japan. In the case of the EC, trade with Japan represented only 4 per cent of EC exports and 10 per cent of its imports (Table 5).

<sup>3</sup> S. Okita: Approaching the 21st Century: Japan's Role, in: The Japan Times, 1990, p. 230.

**Table 1**  
**Merchandise Exports of Selected Countries**  
1978 and 1989

|                        | 1978              |            | 1989              |            |
|------------------------|-------------------|------------|-------------------|------------|
|                        | Value<br>US \$ bn | Share<br>% | Value<br>US \$ bn | Share<br>% |
| USA                    | 145.8             | 12.3       | 364.0             | 12.6       |
| Canada                 | 48.4              | 4.1        | 121.4             | 4.2        |
| Japan                  | 97.5              | 8.2        | 273.9             | 9.5        |
| F.R. Germany           | 142.5             | 12.0       | 341.4             | 11.8       |
| France                 | 79.4              | 6.7        | 179.4             | 6.2        |
| UK                     | 67.9              | 5.7        | 152.3             | 5.3        |
| Italy                  | 56.1              | 4.7        | 140.7             | 4.9        |
| EC                     | 477.3             | 40.2       | 1125.0            | 38.9       |
| Total Market Economies | 1187.4            | 100.0      | 2894.2            | 100.0      |

Sources: IMF: International Financial Statistics, June 1990; The Bank of Japan: Comparative Economic and Financial Statistics: Japan and Other Major Countries, 1989.

**Table 2**  
**Merchandise Imports of Selected Countries**  
1978 and 1989

|                        | 1978              |            | 1989              |            |
|------------------------|-------------------|------------|-------------------|------------|
|                        | Value<br>US \$ bn | Share<br>% | Value<br>US \$ bn | Share<br>% |
| USA                    | 186.0             | 15.3       | 429.9             | 14.5       |
| Canada                 | 46.3              | 3.8        | 121.2             | 4.1        |
| Japan                  | 79.3              | 6.5        | 209.7             | 7.1        |
| F.R. Germany           | 121.8             | 10.0       | 269.8             | 9.1        |
| France                 | 61.8              | 6.7        | 193.0             | 6.5        |
| UK                     | 75.8              | 6.2        | 197.7             | 6.6        |
| Italy                  | 56.5              | 4.6        | 153.0             | 5.1        |
| EC                     | 492.0             | 40.5       | 1156.6            | 38.9       |
| Total Market Economies | 1216.1            | 100.0      | 2974.0            | 100.0      |

Sources: Cf. Table 1.

**Table 3**  
**Japan's Merchandise Trade by Areas and Selected Countries**  
1988

|                          | Japan's Exports |       | Japan's Imports |       | Balance<br>US \$ bn |
|--------------------------|-----------------|-------|-----------------|-------|---------------------|
|                          | US \$ bn        | %     | US \$ bn        | %     |                     |
| USA                      | 89.6            | 33.8  | 42.0            | 22.4  | 47.6                |
| Canada                   | 6.4             | 2.4   | 8.3             | 4.4   | -1.9                |
| F.R. Germany             | 15.8            | 6.0   | 8.1             | 4.3   | 7.7                 |
| France                   | 5.0             | 1.9   | 4.3             | 2.3   | 0.7                 |
| UK                       | 10.6            | 4.0   | 4.2             | 2.2   | 6.4                 |
| Italy                    | 2.8             | 1.1   | 2.9             | 1.5   | -0.1                |
| EC                       | 46.9            | 17.7  | 24.1            | 12.9  | 22.8                |
| Industrialised Countries | 141.6           | 53.4  | 60.5            | 32.3  | 81.1                |
| World                    | 264.9           | 100.0 | 187.3           | 100.0 | 77.6                |

Source: JETRO: White Paper on International Trade: Japan, 1989.

Thus in terms of trade relations, both the USA and the EC are more important markets for Japanese exports than vice versa.

The persistent trade imbalance between Japan and its trading partners has been one of the major bones of contention. In 1988 Japan had trade surpluses of \$47.6 billion with the USA and \$22.8 billion with the EC. The USA had a trade deficit of \$29.6 billion with the EC in 1987, which fell to \$11 billion in 1988; provisional estimates for 1989 indicate that the deficit has come down to only \$0.7 billion. The Japanese surplus with the

USA has also been declining but the rate of decline is rather slow.

In both the USA and the EC, academic opinion, as well as the official view, has rightly contended that in a multilateral setting bilateral imbalances ought not to become a basis for trade friction. It is also widely acknowledged in academic circles that the US overall trade deficit has resulted more from the failures of its domestic macroeconomic policies than the restrictive practices of its trading partners. Yet the trade surplus of Japan has become one of the main criteria for judging the "sincerity" of Japan in opening up its domestic market to foreign imports. The present author, on the basis of an extensive survey of official and unofficial sources, concluded as early as 1982 that many of the grievances of Japan's trading partners were not well justified, and that the reasons for the failure of US and EC imports to penetrate the Japanese market had to be sought in the inappropriateness of their products for the Japanese market, absence of drive and determination among the exporters, and their overall lack of competitiveness, rather than in the closedness of the Japanese market.<sup>4</sup> Since then a number of scholarly studies undertaken in the US have reached similar conclusions.<sup>5</sup>

Yet the protectionist tendencies in both the USA and the EC have continued to grow, although the tone of EC complaints against Japan in recent months has been rather subdued, primarily for two reasons: first, that Japan has begun to take serious interest in the EC countries and second, that the EC countries are at least partial beneficiaries of the concessions made by Japan in its negotiations with the USA. So far as the USA is concerned, the trade friction has taken a rather nasty turn. As *The Economist* reported on Nov. 18, 1989, "The flames of anti-Japanese sentiment are now being fanned by a more worrying and dangerous group: the American press." Prestigious American publications, including *Business Week*, *Newsweek*, the *New York Times* and the *Washington Post* have asserted that Japan's markets are closed, that Japanese are "buying up" America "on the cheap" and that Japan's "perfidy" is responsible for much of the bilateral US trade deficit. Some academic writings have, perhaps unintentionally,

<sup>4</sup> R. Sinha: Japan's Options for 1980s, Croom Helm, London 1982.

<sup>5</sup> See for instance: C. F. Bergsten, W. R. Cline: The United States-Japanese Economic Problem, Institute for International Economics, Washington D.C., 1985; R. Dornbusch, Jeffrey A. Frankel: Macroeconomics and Protection, in: Robert M. Stern (ed.): US Trade Policies in a Changing World Economy, MIT Press, Cambridge, 1987; and G. Saxonhouse: The Micro- and Macroeconomics of Foreign Sales to Japan, in: William Cline (ed.): Trade Policies in the 1980s, Institute for International Economics, Washington D.C., 1983.

**Table 4**  
**US Merchandise Trade by**  
**Areas and Selected Countries**  
1989<sup>a</sup>

|                          | US Exports |       | US Imports |       | Balance  |
|--------------------------|------------|-------|------------|-------|----------|
|                          | US \$ bn   | %     | US \$ bn   | %     | US \$ bn |
| Canada                   | 80.5       | 22.2  | 89.0       | 18.7  | -8.5     |
| Japan                    | 43.9       | 12.1  | 93.6       | 19.7  | -49.7    |
| F.R. Germany             | 16.4       | 4.5   | 24.7       | 5.2   | -8.3     |
| France                   | 11.6       | 3.2   | 12.9       | 2.7   | -1.3     |
| UK                       | 20.4       | 5.6   | 17.9       | 3.8   | 2.4      |
| Italy                    | 7.1        | 2.0   | 11.9       | 2.5   | -4.8     |
| EC                       | 84.9       | 23.5  | 85.6       | 18.0  | -0.7     |
| Industrialised Countries | 234.0      | 64.7  | 291.7      | 61.4  | -57.6    |
| World                    | 361.9      | 100.0 | 475.1      | 100.0 | -113.2   |

<sup>a</sup> provisional.

Sources: Christopher L. Bach: U.S. Transactions, Fourth Quarter and Year, 1989; Survey of Current Business, March 1990.

**Table 5**  
**EC Merchandise Trade by**  
**Areas and Selected Countries**  
1987

|                          | EC Exports |                   | EC Imports |                   | Balance  |
|--------------------------|------------|-------------------|------------|-------------------|----------|
|                          | US \$ bn   | %                 | US \$ bn   | %                 | US \$ bn |
| USA                      | 82.9       | 8.6               | 53.3       | 5.8               | 29.6     |
|                          |            | 20.8 <sup>a</sup> |            | 14.8 <sup>a</sup> |          |
| Canada                   | 10.4       | 1.1               | 8.0        | 0.8               | 2.4      |
| Japan                    | 15.8       | 1.6               | 36.2       | 3.9               | -20.4    |
|                          |            | 4.0 <sup>a</sup>  |            | 10.1 <sup>a</sup> |          |
| F.R. Germany             | 116.0      | 12.1              | 144.6      | 15.7              | -28.6    |
| France                   | 105.9      | 11.1              | 77.3       | 8.4               | 28.6     |
| UK                       | 77.1       | 8.0               | 60.1       | 6.5               | 17.0     |
| Italy                    | 67.4       | 7.0               | 57.8       | 6.3               | 9.6      |
| EC                       | 560.5      | 58.5              | 560.5      | 60.9              | -        |
| Industrialised Countries | 765.0      | 79.8              | 703.5      | 76.4              | 61.5     |
| World                    | 958.1      | 100.0             | 920.6      | 100.0             | 37.5     |

<sup>a</sup> excluding intra-EC trade.

Sources: Bank of Japan: Comparative Economic and Financial Statistics: Japan and Other Major Countries, 1989; OECD: Monthly Statistics of Foreign Trade, January 1989.

provided ammunition for the protectionist lobbies, arguing that Japan's economy and society are in some ways so different from other developed countries that Japan must be handled differently from other trading partners.

The conclusion is that the method should be "managed trade" by which they mean bilateral negotiation of the level of exports and imports between governments, sector by sector. Some go so far as to argue that Japan is incapable of changing course and that the international community will find that Japan will continue to "fall far short of fulfilling its international responsibilities in virtually all areas including trade, defense, aid, or the environment."<sup>6</sup> As we shall see later, some of these conclusions are based on shaky premises and ignore the fact that Japan's trade successes relative to the USA and other trading partners are based on its capacity to adjust much more quickly to the changing market situations. The structural changes brought about in response to the oil price rises in the 1970s and the rapid appreciation of the Yen after the Plaza Accord are cases in point.

## Japan's "Differentness"

Over several hundred years, Japan has developed its own traditions, culture, art, literature and way of governing itself. In this sense it is "different". But is this relevant to trade relations? Those who contend that it is put forward various arguments in favour of their proposition. One such author<sup>7</sup> suggests that "exports from Japan have tended to be more concentrated than those of other nations ... and have become more concentrated over time." But he concedes that this does not necessarily imply that Japan resorts to "unfair" export practices. He further adds that although automobiles have become the most dominant item in Japanese exports to the USA, West Germany outranks Japan here, and concedes that the Japanese import penetration into the US car market was triggered in large part by the second oil shock, not by Japanese competitive tactics. The US government's General Accounting Office had already pointed out in 1979 that it was mainly the reluctance or inability of the US manufacturers to produce small and energy-efficient

cars that had helped Japanese cars in the US market.<sup>8</sup> It may also be remembered that the slack created by the voluntary export restrictions (VERs) on Japanese cars was not taken up by US manufacturers. The VERs simply resulted in a rise in the price of Japanese cars.

Japanese success in export markets may be due to commodity concentration, but a much more important reason lies in its ability to phase out its declining industries and to bring about structural changes at a rapid pace.<sup>9</sup> It needs to be emphasized, as a recent OECD report does, that "speedy transformation of Japan's exports reflects the underlying adjustment in the production structure achieved through a rapid pace of 'domestically generated' efficiency and innovation in manufacturing. Japanese firms have traditionally pursued a policy of increasing market shares at the initial stage of the product cycle rather than maximizing short-term profits. A major consequence of competition for market shares is falling product prices through curtailing unit profits, and lower costs of production through the 'learning curve' effects. The lower price stimulates demand for products, which allows initial development costs to be recuperated despite low unit profits ... It is also notable that such a strong price competition is maintained in these markets despite the presence of few foreign competitors, supporting the view that Japan's strong competitiveness has its origins in severe competition among Japanese firms both at home and in the world markets."<sup>10</sup>

## Import/GNP Ratio

Another piece of evidence for the proposition that Japan is different is concerned with its low import/GNP ratio. On the basis of cross-country regressions it is argued that Japan imports 25 to 45 per cent below expectations for a country with certain of Japan's attributes.<sup>11</sup> It is also argued that if one takes account of manufactured goods only, Japan's imports are 40 per cent lower than they ought to be on the basis of the "normal" behaviour of a developed country in the income range of Japan.<sup>12</sup> Such studies start from the basic assumption that imports are a function of per capita income, which is used as a proxy for economic development. Allowance is made for the size of the

<sup>6</sup> Cf. for example William R. Nester: *The Foundation of Japanese Power: Continuities, Changes and Challenges*, Macmillan, London, quoted in: Jeff Kingston: *Japan's Capacity for Reform Remains Remote*, in: *The Japan Times*, July 10, 1990; see also James Fallows: *Containing Japan*, in: *Atlantic Monthly*, May 1989; and K. van Wolferen: *The Enigma of Japanese Power*, Alfred A. Knopf, New York 1989.

<sup>7</sup> Edward J. Lincoln: *Japan's Unequal Trade*, The Brookings Institution, Washington 1990, pp. 30-37.

<sup>8</sup> Government Accounting Office: *United States-Japan Trade: Issues and Problems*, Washington D.C., pp. 38-39.

<sup>9</sup> R. Sinha: *Japanese Management in an Era of Rapid Technological Change*, in: Blumenthal: *Japanese Management at Home and Abroad*, Ben Gurion University of Negev Press, Negev 1988.

<sup>10</sup> OECD Economic Surveys: Japan, 1988/89, Paris 1989, pp. 75-76.

<sup>11</sup> Bela Balassa: *Japan's Trade Policies*, in: *Weltwirtschaftliches Archiv*, 122, 1986, quoted in: OECD (1989), op. cit., p. 119.

country, its proximity to other industrialized countries, availability of raw materials and so on. But does a low import/GNP ratio mean that Japan is an "unfair" trading partner? Not necessarily. It can plausibly be argued that even though Japan has achieved a high level of per capita income, this has been reached in a short period of time which is not sufficient for a change in consumption habits. Visible changes in consumption habits are now taking place; imported luxuries have become status symbols in Japan. But as far as mass-consumption goods are concerned, change takes much longer. One has also to recognise that imports are not only a function of income and other related macroeconomic determinants within the importing country. It is also important that the exporting countries provide appropriate products. Evidence on this point is somewhat mixed. Admittedly, foreign exporters have to face some informal trade barriers (other countries have their own barriers) but it is also true that they have often failed to compete favourably on quality, after-sales service, etc.

### Intra-industry Specialisation

Further evidence of Japan's being "different" is believed to be seen in its relatively low intra-industry specialization. It is argued that developed countries attain a certain level of specialization within commodity groups which means that the same country may be importing as well as exporting commodities within a particular group. For instance, the USA imports computer parts and accessories and exports the computer system. However, there are other empirical studies which show that Japanese behaviour in terms of imports is not very different from other developed countries. For instance, Bergsten and Cline in their regression analysis found that Japan's import/GNP ratio was satisfactorily explained by the very same factors which explained the import/GNP ratios of eleven industrial countries.<sup>13</sup> In a recent OECD study, Barbone found that Japan's merchandise imports were well explained but a significant negative dummy was found for the imports of manufactures, signifying that these were lower than expected.<sup>14</sup> This, as the OECD report points out, could be attributed to comparative advantage or to trade barriers. A study by Saxonhouse has attempted to explain Japanese trade behaviour on the basis of the theory of comparative advantage. His argument is that Japan is by now a highly industrialised,

high wage country, and therefore its exports are more in capital-intensive categories while its imports are in labour-intensive categories. He found that in only 8 of the 62 industries he had examined, did Japan's import levels differ significantly from his predictions.<sup>15</sup> Thus, as the OECD report stresses, the "results of the empirical analyses are inconclusive."<sup>16</sup>

### Import Barriers

Admittedly, Japan has formal as well as informal trade barriers which inhibit the expansion of imports into Japan. But by now, there is considerable information from both official and unofficial sources to counter the claim that Japan has more tariff or non-tariff barriers than the USA or the EC. A recent study by the office of the US Trade Representative indicates that "the EC started from a higher level of protection in 1980 than did the United States, and that protectionist barriers have gone up on both sides of the Atlantic, with the United States implementing restrictive actions on manufactured goods of somewhat wider scope than the EC in 1981 and 1982 and of somewhat narrower scope than the EC in 1983." The study also noted that Japan started from a high level of restriction in 1980 but has enacted no further trade restrictive measures since then.<sup>17</sup>

In fact, under pressure from its trading partners, Japan has continued to open up its market to foreign products. It is well known that after the Tokyo Round, the import duties on industrial products in Japan, at 2.6 per cent, are the lowest. The corresponding figure for the EC is 2.9 per cent and for the USA 3 per cent. Even in the case of non-tariff barriers (NTBs) Japan does not come out worse than either the EC or the USA. According to a World Bank study,<sup>18</sup> the proportion of merchandise imports covered by NTBs in Japan in 1986 was only 43.5 per cent against 45 per cent for the USA and 54.1 per cent for the EC. Among the EC member countries,

<sup>15</sup> G. Saxonhouse: Differentiated Products, Economies of Scale and Access to the Japanese Market, Research Seminar in International Economics, Discussion Paper 228, University of Michigan, Department of Economics, October 1988, pp. 4-5, quoted in: E. J. Lincoln, *op. cit.*, p. 24.

<sup>16</sup> OECD, *op. cit.*, p. 121. As the OECD report underlines, the results of such empirical analyses depend on the assumptions and the choice of variables (both dependent and independent), the selection of countries for comparison with Japan, the choice of period for comparison at a time when rapid changes are taking place in the structure of Japanese imports, and the problem of measuring the cost of transport. Above all, there is the problem of interpreting the residual. It may reflect official or unofficial trade barriers, taste differences, competitiveness of Japanese products vis-à-vis imports or simply errors of estimation.

<sup>17</sup> R. Dornbusch, J.A. Frankel, *op. cit.*, p. 107.

<sup>18</sup> S. Laird, A. Yeats: Trends in Non Tariff Barriers of Developed Countries, World Bank Working Paper No. 137, December 1988, quoted in OECD, *op. cit.*

<sup>12</sup> Robert Lawrence: Imports in Japan's Closed Markets or Minds? Brookings Papers on Economic Activity, No. 2, 1987.

<sup>13</sup> C. F. Bergsten, W. R. Cline, *op. cit.*, pp. 109-116.

<sup>14</sup> *Ibid.*, p. 120.

France had the highest rate of 81.6 per cent and the lowest was for Italy at 30.1 per cent. A comparison of NTBs by product categories suggests that NTBs covered a much higher percentage of the Japanese imports of foodstuffs, agricultural raw materials and ores and metals than in the USA. For manufactures the coverage was much higher in the USA than in Japan, except in the case of chemicals.

Yet Japan's trading partners complain of the pervasiveness of the "informal barriers" which include product standards, testing and certification procedures, customs clearance procedures, protection of intellectual property rights, government's procurement policies, differences in the legal framework, government regulation of retail marketing channels and so on. Private business practices have also come in for criticism. In the so-called Structural Impediment Initiative (SII) talks, the US negotiators presented a 250-point "shopping list of changes" they wanted Japan to implement.<sup>19</sup> Japan has conceded some of these. The Japanese commitments (covering nearly 57 pages) included increasing public expenditure on infrastructure development in Japan by US \$2.8 trillion over the next ten years; provisions for additional land for housing; deregulation in the distribution and transport sectors particularly by amending the Large-Scale Retail Store Law which would allow for the expansion of chain-stores; more rigorous enforcement of the Anti-monopoly Act; transparency and fairness in administrative guidance; effective patent examination; surveying and publicizing differences between high Japanese prices and foreign prices and the abolition of the law under which the government can restrict foreign direct investment. The commitments also included promises to make *Keiretsu* (the Japanese business groupings) more open and transparent. The US side for its part promised to reduce the federal budget deficit and the federal debt; increase federal funding on research and development and improve the quality of education. It was also decided to establish a monitoring procedure and a review of the procedure in three years.

### Implementation of Promises

Both sides are sceptical about the implementation of the promises. But even those elements which can possibly be implemented may not necessarily reduce the bilateral US trade deficit with Japan. For instance, improvements in the Japanese infrastructure might or might not increase US imports into Japan or provide opportunities for US construction companies, but they

would certainly improve the efficiency of Japanese industries and thereby increase their competitiveness. The amendment (or the repeal) of the Large-Scale Retail Stores Law will help US chain-stores only if they can compete with their Japanese counterparts.

US government officials concede that the impact of the measures agreed upon will take three to five years to materialise. In the interim period it is rumoured, as *The Economist* reported, that Japan may be prepared to pay more of the cost of keeping US troops in Japan. It also suggested that NEC may not compete for a big Indonesian telephone contract, making it easier for AT&T to win the contract and that the National City Bank may find it easier than expected to open a larger network of retail banking in Japan.<sup>20</sup> Implementation of promises on the US side is more problematical. The changes in Eastern Europe resulting from *perestroika* and the reduced Soviet military threat had created conditions for the reduction of US defence expenditure, but with Iraq's invasion of Kuwait the prospects for such reductions are rather remote. Similarly, a considerable reduction in welfare expenditure is inconceivable, especially in view of the ageing US population.

### Intrusion

Even if the SII negotiations bring some tangible results, in principle negotiations of this type are not particularly desirable for two reasons: first, they give a boost to bilateralism over multilateralism. Second, they concede the right of a trading partner to intrude into the internal affairs of another country. As *The Economist* commented, "The two countries have ventured into a never-never land by presuming, as sovereign states, to tell each other how they ought to be organising their societies." It added, "In the case of Japan's lecture to the United States, the intrusion is fictitious."<sup>21</sup> The informed Japanese know this and many, in both official and unofficial circles, resent the repeated US intrusions. Yet they feel that the annual "spring tribute" of trade concessions is a price worth paying to keep the Americans quiet. In fact, the history of Japanese trade concessions has proved a chimera. As soon as one set of demands is met by Japan, new demands appear. The concessions started with textiles as early as the 1950s. Then came steel, automobiles, machine tools, semi-conductors and the satellites. Pressures are continuing to open up the construction trade and the agricultural sector, particularly the rice trade. Aircraft, biotechnological products, financial services, etc., are

<sup>19</sup> *The Economist*, April 7, 1990, p. 48.

<sup>20</sup> *The Economist*, June 30, 1990, p. 75.

<sup>21</sup> *Ibid.*, p. 19.

other sectors in which future demands for concessions may appear. There is a growing conviction in the USA that Japanese government and business change only under pressure from outside (*gaiatsu*). The academic credibility for this policy of *gaiatsu* has come from the recent developments in international trade theory. Some economists argue that if monopoly profits are being made at the expense of either foreign or domestic consumers, then state intervention in international trade with a view to supporting its domestic producers may enable them to capture a larger share of these monopoly profits.<sup>22</sup> Yet others advocate the use of a strategic trade diplomacy involving commitments, threats and promises.<sup>23</sup> It can be argued that Super 301 (provisions of the US Omnibus Trade and Competitiveness Act, which allows for retaliatory trade restrictions) did act as a threat and forced Japan to make concessions on satellites. But to many economists, it was a unilateral attempt to change the rules of the game and a gross violation of GATT provisions. The US Congress has seen Super 301 as a "trade-opening" measure, yet the bilateralism implicit in such moves threatens to undermine the Uruguay Round negotiations, the ultimate success or failure of which largely depends on the attitudes of the USA, the EC and Japan. We shall therefore now examine some of their major differences.

### Agriculture

There is a general agreement on the need for reducing agricultural protectionism and internal support. Both the EC and Japan (together with other negotiating countries) have agreed to the US proposal for converting all non-tariff measures into tariffs for an interim period, subsequently to be negotiated away. But there are very substantial differences on several issues. For example, Japan is not willing to open up its rice market on grounds of "food security" although there is some indication that it may be prepared for a limited opening of the rice trade.

The EC has suggested a two-tier tariff, a part of which is to be fixed, with provisions for negotiated reductions, while the other part would be variable, to compensate for major shifts in exchange rates. The EC is also asking for "rebalancing", i.e. the freedom to tax agricultural commodities so far imported tax free, to compensate for overall tariff cuts. None of these proposals is acceptable

to the USA or Japan. The other major issue related to agriculture has been the difference of opinion between the EC and its trading partners over the question of agricultural subsidies. The EC insists on using what it terms the aggregate measure of support (AMS), which includes the cost of domestic farm support and border protection as well as the export subsidies, while the US wants to concentrate on the reduction of subsidies.<sup>24</sup> The EC reservations were reflected in a recent speech by John Gummer, the British Minister for Agriculture, who argued that it would be impossible politically to defend reform proposals that singled out export subsidies, when the USA was writing into its new farm bill increased forms of support "which they think will avoid GATT censure".<sup>25</sup> Whether the US government will be able to offer major reductions even on export subsidies is, at present, open to question. Although the House Appropriation Committee has cut the next year's budget for export subsidies from \$900 million to \$500 million, in the face of a bumper crop, export subsidies have already been offered to all the major US customers.<sup>26</sup>

### Services

Major differences in opinion have emerged also with regard to services covering civil aviation, shipping, banking and securities. The EC would like to include all services within the purview of the General Agreement on Trade in Services (GATS). Because of the pressures of various lobbies and their respective ministries of finance, the USA and Japan would wish to exclude civil aviation, maritime transport and banking from any liberalisation accord.<sup>27</sup>

After the Houston Summit the prospects for the inclusion of financial services in GATS have improved. It is likely that some provisions will be made for sectoral rules to enable the governments to regulate the money supply or control the securities market to protect investors. The EC would like special provisions also for audio-visual services in order to restrict foreign television programmes if it felt it desirable to do so.<sup>28</sup> This demand is not particularly acceptable to the USA because it suspects that such provisions may be used to restrict the entry of US television programmes. The EC also insists on GATS providing for effective access to foreign markets. It is worried that in spite of the non-

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<sup>22</sup> Alan V. Deardorff, Robert M. Stern: Current Issues in Trade policy: an Overview, in: R. M. Stern (ed.), op. cit., pp. 45-46.

<sup>23</sup> See, for instance, J. David Richardson: The New Political Economy of Trade Policy, in: Paul Krugman (ed.): Strategic Trade Policy and the New International Economics, MIT Press, Cambridge, 1986. For a summary of various approaches see Avinash Dixit: How Shall the United States Respond? in: R. M. Stern, op. cit.

<sup>24</sup> The Economist, June 30, 1990, p. 101.

<sup>25</sup> Financial Times, July 20, 1990.

<sup>26</sup> Financial Times, July 19, 1990.

<sup>27</sup> The Economist, July 14, 1990, p. 82.

<sup>28</sup> Ibid.



discrimination provisions of the GATS, access to the Japanese banking and securities markets may be limited because of the special national regulations governing these markets. But Japan is against the inclusion of such specific commitments.<sup>29</sup>

### **Intellectual Property Rights**

Intellectual property rights include various types of safeguard, such as patents, copyrights, trademarks etc., to protect the interests of inventors or other originators of ideas with innovative potential. Piracy of innovative ideas and equipment and counterfeiting of products is not new, but with high development costs in electronics, pharmaceuticals and biotechnological products, there is a growing demand for providing greater protection to intellectual property rights in most developed countries. A 1988 study by the International Trade Commission estimated the total loss resulting from inadequate property protection to be as high as \$23.8 billion.<sup>30</sup> There are obvious differences in the protection of intellectual property rights between the three trading partners. These have given rise to numerous patent infringement suits filed by American and European companies. The US firms have complained that the process of granting patents or trademarks in Japan is very slow. It may take up to six years to obtain a patent and four years to process a trademark, which delays the entry of foreign firms into the Japanese market. It is also contended that Japanese copyright protection for sound recording is inadequate.<sup>31</sup> The USA complains about insufficient protection to copyrighted products in certain EC member countries such as Greece, Italy, Spain and Portugal. The US businesses producing audio-visual products complain of video-cassette and compact-disc piracy in Belgium and suggest that the Netherlands is one of the main centres of home video product duplication and distribution.<sup>32</sup>

Most industrialised countries would like to see safeguards for intellectual property rights strengthened but major issues of disagreement have emerged between the USA and other industrialised countries. The USA insists that the Berne Convention on copyright covers only economic rights and not the moral or personal rights of an author to determine the nature of the use of his work. Under US law, the licensee has the

freedom to use films or any other intellectual work as he likes. He is not prevented from using an excerpt from a book or a film for advertising even if the author disagrees.<sup>33</sup> There is also a difference of opinion over the concept of an "author". In US law, the term "author" refers to any legal entity, a company or a person. In the EC view, copyright originates with the natural person although it may be transferred to companies. The USA also opposes statutory protection to performers. The most controversial issue relates to geographical indications such as the appellations of origin for wines. The EC would like to have specific provisions to prevent the European appellations being used by the USA or any other country. The USA strongly opposes such a move because some of its wine-makers use European appellations.<sup>34</sup>

### **Dumping**

There is a major disagreement between Japan (and some of the newly industrialising countries) on the one hand and the USA and the EC on the other, with respect to anti-dumping measures. Japan and its allies have argued that both the USA and the EC use arbitrary and often unjustified methods to demonstrate dumping, which have resulted in large numbers of anti-dumping cases against their exports. According to the latest figures published by the GATT, between July 1980 and July 1989 as many as 74 Japanese exporters were subjected to anti-dumping duties, in 12 cases by the EC and in 28 by the USA. The USA imposed anti-dumping duties on 29 exports originating in the EC. The EC had imposed such duties on only 10 US exports.<sup>35</sup> The arbitrary nature of anti-dumping action has been widely commented upon by trade experts who have stressed that "the description and characterizations of concepts such as 'fair value' (used in determining and deterring dumping) are inherently vague and can be interpreted restrictively and with bias against foreign suppliers. This indeed has been happening."<sup>36</sup> In view of such arbitrariness, Japan is pressing for clearer and more objective rules.

### **Textiles**

The US stand on textiles is hampering the progress of the negotiations. Textiles do not affect the developed countries directly but if they do not make concessions on textiles and farm products, the developing countries are not likely to agree to concessions on services and

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<sup>29</sup> Financial Times, July 18, 1990.

<sup>30</sup> J.E.I. Report, No. 8, p. 9.

<sup>31</sup> Office of the United States Trade Representative: Foreign Trade Barriers, Washington D.C., 1989, pp. 104-105.

<sup>32</sup> Ibid., pp. 60-61.

<sup>33</sup> Financial Times, July 19, 1990.

<sup>34</sup> Ibid.

<sup>35</sup> Financial Times, July 24, 1990.

<sup>36</sup> J. B h a g a t i: Protectionism, MIT Press, Cambridge 1988, p. 50.

intellectual property rights. In this context, the US insistence on a global quota is a major impediment to the successful conclusion of the Uruguay Round. A textile quota bill was passed by the US Senate on July 17. If this becomes law, it will replace the quotas agreed bilaterally under the Multi-Fibre Agreement by a global quota which would exclude only Canada and Mexico.<sup>37</sup> It would also lower the rate of increase of textile imports from 3.4 per cent annually to only 1 per cent. Japan is critical of this move.

### **Japan's Vulnerability**

All in all, the future of the trade negotiations is hanging in the balance. No one would like to see the negotiations fail but it is quite likely that on some of the major issues differences will continue even after the negotiations have officially ended. This would mean that some of the causes of trade friction will continue to haunt the trading partners and with their large shares in world trade, both the USA and the EC will continue to exert political pressures on Japan to make further concessions.

Because of its dependence on foreign sources of raw materials, Japan cannot overcome its sense of vulnerability. It is for this reason that Japan has become actively involved in mending its fences with its Asian neighbours. The apology to the Koreans by the Emperor and to other ASEAN countries by the Japanese Foreign Minister on the occasion of the Asia Pacific Economic Cooperation (APEC) Forum meeting in Singapore has to be viewed in this context. Japanese industrialists and businessmen have always been conscious of the importance of the raw materials and minerals of the region. With the rapid economic development of Japan during the last four decades, the need for raw materials, minerals, fuels as well as cheap labour has become all the more important. Japan has therefore directed its trade, aid and foreign investment towards the attainment of a Japan-dominated bloc in Asia. Because of the sensitivities of its neighbouring countries, the aim of creating a trade or monetary bloc was pursued with less visibility. But Japanese leadership is becoming much more confident in pursuing a more aggressive foreign policy as was demonstrated in the Houston Summit as well as in the SII negotiations. Although the initiative in the creation of the APEC came from the Australian Prime Minister, some Japanese officials believe that it will eventually become one of the poles of a tri-polar trading bloc, with the United States-Canada and economically integrated Europe as the two other poles.

Given the diversity of culture and tradition and the lingering suspicions of Japanese motives among the Asian countries, it is difficult to predict whether the APEC will ever reach the level of economic integration possible in Europe, but economic interdependence between Japan and its Asian neighbours is growing rapidly. Whether Japan will be the sole leader of the region or whether it will have to share the leadership with the USA is also difficult to say. There are other countries such as China and the Soviet Union who may currently be having serious economic problems, but whose potentiality as major players in the international arena cannot be easily written off. One cannot say with certainty that Europe will be so engrossed with the Eastern European problems that it will leave the lucrative markets of Asia and the Pacific solely to Japan.

### **Tri-polar World Order**

The situation is far too fluid to make any firm prediction about the so-called new international economic order. Japan would like to see a tri-polar world order and the sharing of power between the USA, the EC and Japan in the ratio of 5-5-3 as conceived by Takakazu Kuriyama, a Vice-Minister in the Japanese Foreign Ministry.<sup>38</sup> His advice to the "minor powers" is to accept the international order as given and to adapt their foreign policy accordingly. In his view, any effort by the "minor powers" to influence the international order dominated by the major powers is not likely to have more than marginal success. If this represents the official position of the Japanese Foreign Office or the Japanese leadership in general, Asian countries would be forced to take a very dim view of a regional grouping in which Japan has a dominant role.

The developing countries of the region who have had to fight hard for their independence guard that independence jealously. It makes sense for them to have economic and political relations with all the major powers of the world and not to commit themselves to any one of them. In the circumstances, the prospects for Japan's success in forming an economic and political bloc for itself may not be very bright. Nevertheless, given its economic power, it does deserve a major role in world affairs. In our view, the chances of success will be much greater if Japan and, for that matter, all the major powers including the USA and the EC, were to concentrate their efforts at the world level, such as the UN and IMF, World Bank and the GATT, rather than at regional levels.

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<sup>37</sup> Financial Times, July 18, 1990.

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<sup>38</sup> Takakazu Kuriyama: 5:5:3 – New Old Power Formula, in: Asahi Evening News, June 6, 1990.