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Japan's Trade and FDI Policies in the First Decade of the 21st Century Facts and Probable Trends

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SUMMARY

The impact of the Asian crisis in 1997–8 on Japan, was relatively great as the country had already gone through a decade of stagnation. Yet the author* has argued before, that this was no 'lost decade' but a period of transformation, leading to further internationalization (globalization) of the economy and society.

Before making predictions about the future in Japan's external economic policies, it is advisable to study some basic historical trends. Japan's share of world exports eased considerably in the last decade, while those of the United States and the EU decreased much less. The only country surveyed where the import share grew was the United States. It virtually stagnated in the EU and lost relative weight in Japan. Japan suffered a huge loss of international position in FDI exports in 1990–2003 while its main rivals retained or increased shares that were twice to four times as great initially. The relative weight of Japan's inward stock doubled, but remained modest compared with its competitors, whose shares did not change significantly

Although Japan's share of global trade decreased, it managed to retain its huge export surplus throughout the period under review. Its trade surplus between 1996 and 2003 was never less than USD 50 billion and in most years reached or even surpassed USD 100 billion. These annual surpluses represented 15–30 per cent of its exports.

Japan's annual exports of FDI rose from the USD 23–26 billion range in the second half of the 1990s to USD 32–38 billion. Western Europe has consistently held the greatest share since 1999, while Asia has also surpassed the United States. The trends reflect Japan's endeavours to moderate its dependence on the United States, in favour of neighbouring Asian countries and the third pole, Western Europe or the EU.

Japan's social and economic changes in the last decade were parts of a transformation process, bringing it increasingly into line with international macro development and micro business models, without losing its precious cultural and other traditions. There had been earlier efforts to cut back state intervention in the economy, notably during the premierships of Yasuhiro Nakasone in the 1980s, when 'planning' was almost erased from the vocabulary of economic policy-making. But by the end of the 1990s, there were more telling signs of this.

As foreign investors become more prominent in industry and domestic trade and market forces spread through the financial sector, the scope for administrative intervention or 'guidance' has narrowed. Even Keidanren, the organization that acts as spokesman for the biggest corporations, plays a much smaller role than it did. One possible explanation for all this may be the advance of the so-called IT revolution. The number of 'scenarios' and 'visions' put forward by the public sector has decreased consid-

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erably, while initiatives in this field by the private sector have become stronger.

The Japanese economy will have a growing need for foreign investors, not because of shortage of capital – the country has huge foreign-exchange reserves – but for the beneficial effects of new competitors and the transfer of foreign management methods. Here, however, the Japanese External Trade Organization (JETRO) comments self-critically, 'Japan must develop the type of domestic environment that attracts foreign capital and human resources.' This certainly relates to the methods of Japanese government.

Japan has been asserting its global interests mainly through GATT and then WTO membership. In a tripolar world economy, however, Japan has developed a stronger interest in regional cooperation schemes, such as ASEAN, PAFTA, APEC, the EAEC, PECC and AFTA, although it continues to emphasize its preference for 'open' as opposed to 'bloc-type' regionalism. In view of the failure or limited success of such schemes, Japan began at the end of the 1990s to turn to other means such as bilateral free-trade agreements.

In a peculiar way, the Japanese government has been continuously influenced in the same direction by the inflexibly protectionist behaviour of domestic business circles. Its policy consideration was to confront them, especially the agricultural lobby, with huge Japanese manufacturing corporations and trading houses operating on a global scale, which would have strong interests in free trade and in keeping up with rivals. For these mainly transnational companies have realized that processes towards regionalism in the world (such as NAFTA in North America and the EU in Europe) may crowd them out of significant commodity and capital markets or face them with latecomers' disadvantages. FTAs, on the other hand, have pressed competition on Japan and so given momentum to domestic structural changes continually called for in business at home and abroad. At the same time, priority is clearly being given to neighbouring East and Southeast Asian countries in the sequence of agreements being concluded.

INTRODUCTION

The paper begins by illustrating with hard, statistical and soft, survey data where Japan and its competitiveness stand compared with the other two poles of the world economy: the United States and the European Union (I). It goes on to recapitulate the main trends in Japan's foreign trade and FDI flows up to the present day (II), before considering the likely trends in Japan's external economic policies (III). It ends with some conclusions on the future of Japan's economic partnership and free-trade agreements (IV).

1) JAPAN IN TODAY'S WORLD ECONOMY

Per capita GDP data for 2003, measured at current prices and exchange rates, reveals a clear hegemony in the world economy of the United States, although Japan and the three largest EU members (Germany, France, and the UK) came quite close. While the total GDP of the EU 25 was almost identical with that of the United States, its greater population made the EU per capita figure much lower, whereas Japan's was only 10 per cent less *(Table 1)*. When purchasing-power parity (PPP) data are compared, the United States is still in the vanguard of the world and its position in relation to Japan becomes another 15 percentage points better *(Table 2)*.

Table 1
A comparison of GDP, population and GDP per capita in selected developed countries, USD, current prices and exchange rates, 2003

	GDP, USD billion	Population, millions	GDP p.c., USD thousands
United States	10895.5	291	37,440
EU 25	10930.5	455	24,020
Germany	2405.9	82	29,340
France	1752.1	60	29,200
UK	1786.0	59	30,270
Japan	4302.1	128	33,610

Sources: Author's compilation and calculations based on IMD *World Competitiveness Yearbook*, 2004; IMF *International Financial Statistics Yearbook*, 2003; ECB *Statistics Pocket Book*, July 2004.

Table 1
GDP, population and GDP per capita in selected developed countries, USD, PPP, 2003

	GDP, USD billion	Population, millions	GDP p.c., USD thousands
United States	10,628	291	36,520
EU 25	11,306	455	24,850
Germany	2,234	82	27,240
France	1,603	60	26,720
UK	1,583	59	26,830
Japan	3,518	128	27,480

Sources: As Table 1.

The media in 1997–8 was awash with news of an Asian crisis. Front-page news tends to exaggerate. In this case, it would have been closer to the truth to speak of a crisis in Southeast Asia,[1] for

[1] The author and colleagues argued this in Annamária Artner, Zoltán Bassa, András Hernádi and Klára Mészáros (2000), 'The Far Eastern region: moving beyond an atmosphere of crisis'. *Journal of East Asian Affairs* XIV:2, 2000. See also Annamária Artner, Zoltán Bassa, András Hernádi, Klára Mészáros and András Székely-Doby (2003), *Far Eastern responses to globalization*, Working Papers 138. Budapest: Institute for World Economics (IWE).

it was far from general. China and India were practically unaffected, and other strongly 'regulated', smaller economies felt some limited impacts. Even the countries hardest hit, such as South Korea, Indonesia, Malaysia, and Thailand, overcame the crisis in a couple of years, returning to a growth path faster than the rest of the world's, and even more importantly, reappearing on their main export markets *(Table 3)*.

Table 3
GDP real growth rates in Asia (15), the World, the United States and the EU, 1996–2003

	1996	1997	1998	1999	2000	2001	2002	2003
Japan	3.5	1.8	-1.1	0.7	2.4	-0.6	1.2	2.7
People's China	9.6	8.8	7.8	7.1	8.0	7.3	6.7	9.1
India	7.8	4.8	6.5	6.1	4.4	5.6	4.7	8.1
South Korea	6.7	5.0	-6.7	10.9	9.3	3.1	6.3	3.1
Taiwan[a]	5.7	6.8	4.8	5.7	6.0	-1.9	2.6	3.2
Brunei	NA	NA	NA	NA	NA	NA	NA	NA
Cambodia	NA	NA	NA	NA	5.4	5.5	5.5[p]	5.0[t]
Indonesia	7.8	4.7	-13.1	0.8	4.9	3.3	3.7[p]	4.1
Laos	6.9	6.9	4.0	7.3	5.8	5.7	5.7	5.9[t]
Malaysia	10.0	7.3	-7.4	6.1	8.3	0.4	-0.7	5.2
Myanmar	6.4	5.7	5.8	10.9	6.2	10.5	5.3[p]	5.1[t]
Philippines	5.8	5.2	-0.6	3.4	4.0	3.4	4.4[p]	4.5
Singapore	7.7	8.5	-0.1	6.9	10.3	-2.4	2.2	1.1
Thailand	5.9	-1.4	-10.5	4.4	4.6	1.8	5.4	6.7
Vietnam	9.3	8.2	5.8	4.8	6.8	6.9	7.0	7.2[t]
World	4.4	4.2	2.6	3.5	4.5	1.6	1.7	2.5[p]
United States	2.8	3.3	2.8	3.3	3.4	0.8	1.7	3.1[p]
EU[x]	2.7	2.7	2.7	2.7	2.7	1.7	1.1	0.8

Sources: IMF *International Financial Statistics Yearbook*, 2003 (for 1996-2002) and IMD *World Competitiveness Yearbook*, 2004 (for 2003). For the EU: *ECB Statistics Pocket Book*. For Cambodia (all years), Laos, Myanmar and Vietnam (for 2003): UN ESCAP *Economic and Social Survey of Asia and the Pacific*, various issues. To avoid inflation impact and exchange-rate fluctuations, figures are based on GDP data in national currencies at constant (1995) prices. Sources for 1996–9: UN ESCAP, *Ibid.* For 2000-2002: Deutsche Bank Research (www.dbresearch.de). p) Preliminary estimate. t) Forecast/target. Source: UN ESCAP, *Ibid.* x) 1996–2000: average.

On Japan, the impact was relatively greater as the country had already gone through a decade of stagnation. Yet the author has argued before,[2] that this was no 'lost decade' but a period of transformation, leading to further internationalization (globalization) of the economy and society. Even growth rates had started to 'normalize' by 2003 and 2004.[3]

Table 4 illustrates global positions in exports and imports. The former can also be considered as a dimension of international competitiveness, while the latter reflect a country's absorption capacity for consumption, and perhaps more importantly, its readiness to invest or efforts at further development. As the table shows, the United States is the one country considered here that spent considerably more on imports than it earned by exports, thus contributing to one of its twin deficits. The EU 15 kept its leading trading position in the world, although Germany was the only one of its three biggest members to export more than either of the two leading Asian economies, Japan and the People's Republic of China.[4] (The People's Republic was already a bigger importer than Germany in 2003.)

[2] See, for example, Hernádi, András (2001), 'Crisis or transformation? Japan viewed from Hungary'. In: Hernádi, András, and Makoto Taniguchi, *Japan and Asia in a new global age*. Working Papers 114. Budapest: IWE.

[3] GDP forecasts for Japan for 2004 range between 3 and 4.5 per cent.

[4] The People's Republic of China appears under two headings in Table 4: Mainland China and Hong Kong. The data should be added to show the People's Republic's trading positions.

Table 4
Export and import positions of selected countries, 2003

	Exports, USD billion (%)	Imports, USD billion (%)
World	7530 (100.0)	7819 (100)
United States	724 (9.6)	1305 (16.7)
EU 15	2879 (38.2)	2788 (35.7)
France	386 (5.1)	390 (5.0)
Germany	742 (9.9)	596 (7.6)
UK	306 (4.1)	384 (4.9)
Japan	474 (6.3)	383 (4.9)
Mainland China	438 (5.8)	413 (5.3)
Hong Kong	224 (3.0)	232 (3.0)

Source: IMF *Direction of Trade Statistics Quarterly*, September 2004.

Table 5 shows overall rankings of the same countries for world competitiveness in 2000 and 2004. The United States kept its top position, but the other highly developed countries under discussion lost competitiveness. Only Mainland China and Hong Kong improved their positions.

Table 5
World competitiveness rankings of selected countries, 2000 and 2004

	2000	2004
United States	1	1
Germany	8	21
UK	15	22
France	19	30
Japan	17	23
Hong Kong	14	6
Mainland China	31	24

Source: IMD *World Competitiveness Yearbook*, 2000, 23 and 2004, 5.

The two most efficient ways for countries to improve international competitiveness is to continue utilizing the advantages offered by export orientation and FDI inflows and outflows. The share of goods exports as a proportion of GDP in Japan (dependent on its domestic market, though it is considered a merciless exporter in some markets and some product categories) remained at 10–12 per cent over the 1996–2003 period. Shares in other countries with huge domestic markets either rose considerably (Germany: 20–21 per cent; People's China: 31 per cent), or decreased steadily (the United States from 10 to 6.5 per cent and the UK from 27 to 17 per cent). In the same period, all Asian economies reviewed and Germany improved their current-account positions as proportions of GDP (Japan: 1.5 and 3.2 per cent; Mainland China: 0.8 and 3.3 per cent; Hong Kong: -1.0 and 10.2 per cent; Germany: -0.3 and 2.3 per cent). The current-account position worsened significantly in the United States (-1.8 and –4.8 per cent) and to some extent in France (1.3 and 1.0 per cent) and the UK (0.1 and –1.7 per cent).[5]

Inward direct investment stocks in Mainland China in 2003 surpassed USD 500 billion, supplemented by USD 375 billion in Hong Kong (United States USD 1554 billion; UK USD 672 billion; Germany USD 545 billion; France USD 434 billion). Japan, with various liberalization and FDI-attraction schemes, continued to catch up (USD 90 billion). Some of the countries under review were very active in FDI exports. Direct investment stocks abroad in 2003 stood at USD 336 billion for Japan and for Hong Kong, and USD 37 billion for People's China (United States USD 2069 billion; UK USD 1129; France USD 643 billion; Germany USD 622 billion; Netherlands USD 384 billion).[6]

The positions of the United States and People's China in international competitiveness were remarkable for a number of factors. But *Table 6* shows that Japan, the leading Asian economy, excelled only in accumulating gold and foreign exchange reserves (SDR 450 bil-

[5] IMD *World Competitiveness Yearbook*, 1997 and 2004, and author's calculations based on IMF International Financial Statistics 2000 and October 2004.

[6] UN *World Investment Report*, 2004.

lion, highest in the world).[7] The only other notable Japanese statistics here were the share of high-technology exports in its total manufactured exports (25 per cent). Survey data did not show it a big achiever either.

2) Main trends in Japan's trade and FDI flows

Before making predictions about the future in Japan's external economic policies, it is advisable to study some basic historical trends. Japan's share of world exports eased considerably in the last decade (from 9.6 per cent in 1993 to 6.1 per cent in 2003), while those of the United States and the EU decreased much less (from 12.3 to 9.1 per cent and from 38.7 to 36.8 per cent respectively). The only country surveyed where the import share grew was the United States (from 15.8 to 17.3 per cent). It virtually stagnated in the EU (from 36.8 to 37.0 per cent) and lost relative weight in Japan (from 6.4 to 5.1 per cent).[8] Japan suffered a huge loss of international position in FDI exports in 1990–2003 (from 11.5 to 4.1 per cent) while its main rivals retained or increased shares that were twice to four times as great initially. The relative weight of Japan's inward stock doubled, but remained modest compared with its competitors, whose shares did not change significantly *(Table 7)*.

Although Japan's share of global trade decreased, it managed to retain its huge export surplus throughout the period under review. Its trade surplus between 1996 and 2003 was never less than USD 50 billion and in most years reached or even surpassed USD 100 billion (*Table 8*, Row 1). These annual surpluses represented 15–30 per cent of its exports.

The structure of this trade by main partners *(Table 8)* was remarkably stable on the export side. The Asian developing countries, the United States, and the EU all continued to account for outstanding, high and significant shares respectively. However, around the time of the Southeast Asian financial crisis in the middle of the period, Japanese exporters adapted fast to sluggish demand in Asian developing countries by increasing sales to the United States and the EU. Meanwhile the Chinese market (Mainland China and Hong Kong), not hit by the crisis, remained a voracious market for Japanese products, even increasing its share from 11 to 16 per cent after 2000.

Imports showed bigger changes. The US share declined steadily from 24 to 17 per cent, while that of the Asian developing countries increased from 37 to 44 per cent – above their share of Japan's exports. Again, China was the striking performer (12 to 19 per cent) and overtook the United States. A modest increase in the share of the Middle East after 1999 might be explained by considerations of oil-supply security.

Table 9, Row 1, shows that Japan's annual exports of FDI rose from the USD 23–26 billion range in the second half of the 1990s to USD 32–38 billion.[9] Western Europe has consistently held the greatest share since 1999, while Asia has also surpassed the United States. The trends reflect Japan's endeavours to moderate its dependence on the United States, in favour of neighbouring Asian countries and the third pole, Western

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[7] Japan improved that position further to USD 838 billion by the end of October 2004, the latest figure available. http://www.boj.or.jp/en/stat/sk/data/skeall.pdf/.

[8] Author's calculations based on IMF *Direction of Trade Statistics Yearbook*, 2000 and 2003, and *Quarterly*, September 2004.

[9] The 2003 figure of USD 29 billion remained close to latter range. UN *World Investment Report*, 2004.

Table 6
Selected factors for international competitiveness, 2002–4

	Total reserves: ranking (SDR billion)	Tax revenues as a proportion of GDP: ranking (%)	Employees' social security contributions as proportion of GDP p. c.: ranking (%)	Exchange-rate policy and company competitiveness: ranking (score)*	Government subsidies to firms as proportion of GDP: ranking (%)	Creation of firms hindered or supported by legislation: ranking (score)*	Investment incentives to foreign investors: ranking (score)	Total compensation of manufacturing workers: ranking (USD/ hour)	Average annual working time: ranking (hours)	Attitudes toward globalization: ranking (score)*	Values of society supporting competitiveness: ranking (score)*	High-tech as a proportion of manufacturing exports: ranking (%)
Japan	1 (447)	23 (27)	28 (15)	16 (6.1)	26 (0.8)	32 (5.9)	44 (4.8)	45 (20.3)	34 (1864)	20 (6.7)	32 (5.9)	14 (24.5)
People's China	2 (294)	12 (17)	1 (0)	10 (6.4)	27 (0.9)	23 (6.6)	13 (7.0)	5 (0.7)	23 (1958)	21 (6.7)	18 (6.6)	16 (23.3)
United States	8 (60)	26 (29)	19 (9)	4 (6.8)	15 (0.4)	6 (7.8)	16 (6.8)	49 (21.3)	29 (1895)	23 (6.6)	2 (8.4)	7 (31.9)
France	19 (24)	55 (44)	57 (51)	54 (3.4)	40 (1.3)	40 (5.3)	27 (6.2)	46 (20.8)	59 (1561)	56 (4.2)	56 (4.5)	20 (21.2)
Germany	11 (38)	42 (36)	35 (21)	49 (4.2)	44 (1.5)	48 (4.6)	45 (4.8)	59 (30.0)	55 (1674)	29 (6.2)	49 (5.0)	29 (16.6)
UK	15 (29)	39 (36)	20 (10)	43 (4.7)	16 (0.5)	35 (5.7)	28 (6.2)	44 (19.1)	38 (1787)	26 (6.4)	26 (6.2)	10 (31.4)

Source: Author's compilation based on various tables in IMD *World Competitiveness Yearbook*, 2004, covering 51 countries in 9 regions.
* Survey data given on a 0–10 scale of negative to positive perceptions.

Table 7
Japan's international position in stock of FDI exports and imports, 1990–2002

	Exports				Imports			
	1990		2003		1990		2003	
	USD billion	%	USD million	%	USD billion	%	USD billion	%
World	1758.216	100	8196.863	100	1950.303	100	8245.074	100
Japan	201.441	11.5	335500	4.1	9.850	0.5	89.729	1.1
United States	430.521	24.5	2069.013	25.2	394.911	20.2	1553.955	18.8
EU	797.102	45.3	4035.610	49.2	795.808	40.8	3335.454	40.5

Source: UN *World Investment Report*, 2004.

Table 8
The partner structure of Japanese foreign trade, %, 1996–2002

Partner	Exports							Imports						
	1996	1997	1998	1999	2000	2001	2002	1996	1997	1998	1999	2000	2001	2002
World, USD billion = 100	411.3	421.1	388.0	419.2	478.2	403.4	416.6	349.6	338.6	280.8	310.7	380.5	349.1	337.1
United States	27.5	28.1	30.9	31.1	30.1	30.4	28.8	22.9	22.4	24.0	21.7	19.1	18.3	17.4
EU	15.4	15.6	18.5	17.8	16.4	16.0	14.7	14.2	13.4	14.0	13.8	12.3	12.8	13.0
Australia & New Zealand	2.2	2.2	2.4	2.4	2.1	2.2	2.3	4.8	5.0	5.3	4.7	4.5	4.7	4.7
Asian developing	44.1	42.2	34.8	37.4	41.3	40.1	43.2	37.7	37.2	37.2	39.9	41.9	42.5	43.6
China & Hong Kong	(11.5)	(11.6)	(11.0)	(10.9)	(12.0)	(13.4)	(15.7)	(12.3)	(13.0)	(13.8)	(14.4)	(15.0)	(17.0)	(18.7)
European developing*	0.9	1.1	1.2	0.9	0.9	1.0	1.1	1.5	1.6	1.4	1.6	1.6	1.5	1.4
Middle East	2.6	2.7	3.5	2.6	2.2	2.8	2.9	10.1	11.3	9.1	9.9	13.0	12.7	12.1
Latin America	4.1	4.7	5.0	4.3	3.9	4.1	3.6	3.2	3.3	3.2	3.0	2.8	2.6	2.6
Other	3.2	3.4	3.7	3.5	3.1	3.4	3.4	5.6	5.8	5.8	5.4	4.8	4.9	5.2

Source: Author's calculations based on IMF *Direction of Trade Statistics Yearbook*, 2003. * Including all post-Soviet states.

Table 9
Regional distribution of Japan's exports of FDI, %, 1995–2003

Destination	1995	1996	1997	1998	1999	2000	2001	2002	2003*
World, USD million = 100	22,630	23,428	25,993	24,151	22,743	31,556	38,333	32,280	12,456
Asia	37.6	41.6	50.5	32.5	8.6	6.9	20.4	25.3	20.6
People's China	14.2	9.9	7.2	5.4	1.6	3.0	5.6	8.1	10.4
Hong Kong	1.5	4.7	6.8	3.3	-0.7	0.4	1.3	0.7	1.3
ASEAN	17.7	22.4	29.9	18.7	4.9	0.7	10.5	13.2	6.0
United States	39.3	47.3	28.4	23.5	31.2	44.7	18.5	23.5	26.7
Latin America	NA	-6.0	9.0	23.4	24.2	12.6	11.3	12.6	14.2
Oceania	NA	3.0	1.1	5.9	0.2	0.9	1.7	4.4	3.3
Western Europe	14.8	12.1	9.6	9.2	36.1	34.7	46.7	30.2	31.3
Eastern Europe	NA	0.4	0.4	0.8	0.6	0.5	0.2	0.4	1.9
Middle East	NA	1.1	0.8	0.5	0.5	-0.1	0	0.3	-0.2
Africa	NA	-0.5	0.5	1.4	0.9	-0.6	-0.5	0.7	2.1
Other	8.6	1.0	-0.3	2.8	-2.3	0.4	1.7	2.6	0.1

Source: Author's calculations based on data from Regional Balance of Payments, Bank of Japan, Ministry of Finance (www.mof.go.jp/bop), and IMF *Direction of Trade Statistics Yearbook*, 2003. * First half.

Europe or the EU. Another development worth mentioning has been the stabilization of Latin America's share at 12–14 per cent by the end of the period under review. (The relationship with free-trade agreements such as NAFTA and pact mooted between Japan and Mexico are mentioned in the next chapter.)

Special attention needs paying to intra-regional changes among the Asian countries. People's China showed a steady decrease between 1995 and 1999, followed by a steady increase, but together with Hong Kong, it only surpassed the combined share of the ASEAN countries in 2000 and in the first half of 2003. (Except in the first half of 2003, Eastern Europe hardly reached 1 per cent, with a relative weight of 0.5 per cent throughout the period.)

3) Probable trends in Japan's external economic policies

Japan's social and economic changes in the last decade were parts of a transformation process, bringing it increasingly into line with international macro development and micro business models, without losing its precious cultural and other traditions. There had been earlier efforts to cut back state intervention in the economy, notably during the premierships of Yasuhiro Nakasone in the 1980s, when 'planning' was almost erased from the vocabulary of economic policy-making. But by the end of the 1990s, there were more telling signs of this.[10]

Loss of importance and prestige by the hitherto mighty Ministry of International Trade and Industry (MITI) and Ministry of Finance (MoF) had become apparent by the end of the 1990s.[11] A huge change in the system of government administration was introduced on January 6, 2001, at a cost of some USD 400 million dollars. Files and workplaces of 33,000 employees were moved and the number of ministries and agencies cut from 22 to 12 plus a Cabinet Office.[12]

As foreign investors become more prominent in industry and domestic trade and market forces spread through the financial sector, the scope for administrative intervention or 'guidance' has narrowed. Even Keidanren, the organization that acts as spokesman for the biggest corporations, plays a much smaller role than it did. One possible explanation for all this may be the advance of the so-called IT revolution.

The number of 'scenarios' and 'visions' put forward by the public sector has decreased considerably, while initiatives in this field by the private sector have become stronger. A Keidanren document about long-term prospects, for example, predicts a stronger global attitude in Japan.[13] The thrust of Japanese

[10] Two rather general, but revealing statistics are the share of the public sector in total employment and that of public expenditure in GDP. The former in 1999 was 3.2 per cent in Japan, but 6.1 per cent in Italy (with about half the population). The latter proportion increased in Japan from 35% in 1993 to 38% in 2003, while in Italy it eased from 56 to 48 per cent. OECD figures cited in *Magyar Hírlap*, September 19, 2003, p. 2, and *The Economist*, March 20, 2004, 114.

[11] After relinquishing its almost daily handling of the banking sector, the MoF was no longer allowed to devise the state budget either. Fundamental figures and ratios are now formulated by a new council under the prime minister's Cabinet Office (*The Economist,* January 9, 2001, 51.)

[12] Government officials stressed efficiency rather than cost-cutting when justifying the changes. Shigeki Suzuki, responsible for reorganizing the hitherto independent Ministry of Post and Telecommunications, hoped, for example, that passports and driving licences could soon be issued at post offices (*Nikkei Weekly,* December 4, 2000, p. 3).

[13] *Japan 2025: Envisioning a vibrant, attractive nation in the twenty-first century.* Tokyo: Nippon Keidanren, Japan Business Federation, Keizai Koho Center, 2003.

knowledge and technologies will move from the domestic economy to the international arena, while a 'free economic sphere' will emerge in East Asia under Japanese leadership. It is also worth noting how the document the economy to be based on 'a self-regulating economic system driven by the private sector and market concerns'.[14] Keidanren itself is foreseen as 'a bridge between the private and public sectors', based not on a close relationship with the administration, but on 'rivalry with the Japanese government'.[15] The organization sees multilateral and bilateral trade agreements as the institutional framework for economic cooperation not only in the East Asian region, but globally, as means of regional economic development based on free movement of goods, people, services, capital and information, solving global problems that endanger progress in the region. In Keidanren's view, Japan does not see the emerging East Asian economies as threats, but as supplementary forces, although Japan should reassure these countries that it will remain open to their investments, goods and immigrants.[16]

The wording reflects mounting pressure from some of the Japanese private sector for looser immigration controls. Ageing of the population points to the need to ease (structural) shortage of labour.[17] So Japan can obviously be expected to open its doors gradually to immigrants, especially nurses to take care of the elderly and technicians (mainly from China and India) capable of performing routine computer-related tasks.[18] A perhaps far-fetched UN estimate holds that Japan will need an annual 600,000 immigrants to cover its labour demand.[19] Behind such estimates lie obvious considerations: certain activities and services cannot be exported, as the demand for them appears domestically. For example, mounting unwillingness to take jobs like caring for the elderly and similar low-prestige tasks is increasing the need for foreign labour. The outsourcing of some call services and software tasks will take place in parallel.

The Japanese economy will have a growing need for foreign investors, not because of shortage of capital – the country has huge foreign-exchange reserves – but for the beneficial effects of new competitors and the transfer of foreign management methods. Here, however, the Japanese External Trade Organization (JETRO) comments self-critically, 'Japan must develop the type of domestic environment that attracts foreign capital and human resources.' This certainly relates to the methods of Japanese government.[20]

[14] *Ibid.,* 4.

[15] *Ibid.,* 12.

[16] *Ibid.,* 9.

[17] Japan's population is expected to peak at 128 million in 2007 and then shrink rapidly. At present, there are some four active earners for each pensioner, but by 2025, there will only be 2.2. Taxes and welfare payments, now 36 per cent of GDP, will exceed 60 per cent by 2025 (*The Economist,* July 1, 2000, 28).

[18] A first hesitant step was taken toward opening the labor market in November 2004, when Japan and the Philippines agreed the principles of an economic partnership agreement (EPA), under which both would select candidates in the Philippines among nurses and health care workers who were certified there. Those selected would enter Japan with special visas and be required to take Japanese language training for six months. Their stays in Japan, however, would be limited to about four years, but workers acquiring Japanese qualifications would be allowed to extend their visas every three years. However, the sensitive decision on the maximum number of such workers Japan would admit was shelved and the final pact was not expected to include an annual figure either (*Nikkei Weekly,* November 22, 2004, 1 and 7.)

[19] *New York Times,* September 23, 2001, 18.

[20] *White paper on international trade and foreign direct investment. Summary.* Tokyo: JETRO, 2003, 39.

4) ECONOMIC PARTNERSHIPS AND FREE-TRADE AGREEMENTS[21]

Japan, like other highly industrialized countries, has been asserting its global interests mainly through GATT and then WTO membership. In a tripolar world economy, however, Japan has developed a stronger interest in regional cooperation schemes, such as ASEAN, PAFTA, APEC, the EAEC, PECC and AFTA,[22] although it continues to emphasize its preference for 'open' as opposed to 'bloc-type' regionalism.[23] In view of the failure or limited success of such schemes, Japan began at the end of the 1990s to turn to other means such as bilateral free-trade agreements.

In a peculiar way, the Japanese government has been continuously influenced in the same direction by the inflexibly protectionist behaviour of domestic business circles. Its policy consideration was to confront them, especially the agricultural lobby, with huge Japanese manufacturing corporations and trading houses operating on a global scale, which would have strong interests in free trade and in keeping up with rivals.[24] For these mainly transnational companies have realized that processes towards regionalism in the world (such as NAFTA in North America and the EU in Europe) may crowd them out of significant commodity and capital markets or face them with latecomers' *disadvantages*. FTAs, on the other hand, have pressed competition on Japan and so given momentum to domestic structural changes continually called for in business at home and abroad. At the same time, priority is clearly being given to neighbouring East and Southeast Asian countries in the sequence of agreements being concluded.[25]

This recognition gained poignancy after the 1997–8 financial crisis in Southeast Asia,[26] when thorough study of

[21] The former (EPAs) are vehicles for wider economic cooperation, including services, labour and capital movements, standards, royalties, environmental and other fields, and even harmonization of government policy. The latter (FTAs) are designed simply for removing tariff (and non-tariff) barriers to trade. For more detail, see Jung Sung Chun, 'Japan's policy for an East Asian FTA and Korea's response', *Korea Focus,* July-August 2004, 141–56.

[22] ASEAN – Association of South-East Asian Nations. PAFTA – Pacific Free Trade Area. APEC – Asia-Pacific Economic Cooperation. EAEC – East-Asian Economic Caucus. PECC – Pacific Economic Cooperation Conference. AFTA – ASEAN Free Trade Agreement.

[23] With regard to RTAs, the WTO has ruled out the creation of discriminatory arrangements by referring to the concept of 'open regionalism'. It changes the interpretation of most-favoured nation (MFN) from exclusive MFN required from members only, which is the GATT norm, to inclusive MFN (also for non-members). It also changes the norm of reciprocity from specific direct balancing of benefits to more diffuse and general give and take. See 'WTO obligation and outward orientation of RTAs'. In: *Meeting the challenges in an era of globalization by strengthening regional development cooperation*. New York: UN Economic and Social Commission for Asia and the Pacific, 2004, 43. The same source cites APEC as an example of open regionalism (*Ibid*, 45.)

[24] The biggest were car companies (Toyota, Nissan, Suzuki, Honda, Mazda), manufacturers of electrical and electronic equipment (Matsushita, Toshiba, Sony, Sharp, Fujitsu, NEC), and the *sogo shosha* or general trading firms (Mitsubishi, Mitsui, Sumitomo, Nissho-Iwai, *etc.*)

[25] According to some observers, negotiations with Mexico, for example, were otherwise going quite well until deliberately slowed down, so that it would not become the first FTA deal with a country from outside the region. Preferential treatment for the region, according to the political scientist Professor Takashi Inoguchi of Tokyo University, should be seen even in the creation of a post of state minister in charge of East Asian affairs, who retains the rank of deputy prime minister (*Nikkei Weekly,* December 22, 2003, 37). Most recently, Prime Minister Junichiro Koizumi announced on December 20, 2004 that he would himself take on the role of coordinating ministries to promote EPA talks (*Ibid.,* December 27, 2004–January 3, 2005, 6).

[26] The after-effects of this crisis were the subject of a study at the Japan East and Southeast Asia Research Centre: Artner, Annamária, András Hernádi, Klára Mészáros and András Székely-Doby (1998), *The Far Eastern region: moving be-*

the chances for regional and bilateral trade agreements began also at MITI.[27] This was undoubtedly helped by the fact that strong opposition from the United States and China had thwarted Japan's attempt to establish an Asian Monetary Fund. It therefore had to be satisfied with bilateral forms of rendering financial aid to countries in crisis.[28]

Figure 1 summarizes the framework in which the author sees Japan's global, regional and bilateral trade and FDI policies being pursued. It shows Japan seeking appropriate responses to challenges that appear on three different levels.

Figure 1
The main frames of Japan's external economic relations: trade, investment, finance

GLOBAL SCHEMES:	JAPANESE RESPONSES:
UN, WTO, World Bank, IMF	UNDP, JETRO, JICA
REGIONAL SCHEMES:	
ADB, APEC, ASEAN + 3 RTAs*	Summits, 'AMF', FTAs?, Yen bloc?
BILATERAL SCHEMES	
PTAs**, FTAs	FTAs, EPAs

* As of July 2003, only three WTO members (Macao China, Mongolia and Taiwan were *not* party to at least one RTA. ** Preferential trade agreements. *** Economic partnership agreements.

(i) On a global level, Japan has striven for a seat on the UN Security Council and long been the main financial contributor to the UNDP, and through its global network of embassies and JETRO and JICA (Japan International Cooperation Agency) offices, it also represents the interests of its private sector, from huge transnationals down to small and medium-sized firms. In addition, Japan has been recognized as a leading supply of aid, in terms of absolute volume provided.[29]

(ii) On a regional level, Japan has played a lead in the Asian Development Bank and Asian Pacific Economic Co-operation forum, initiated and 'operated' ASEAN + 3 (summit and lower-level meetings of 10 ASEAN members plus Japan, China and Korea), promoted, as mentioned, the idea of an Asian Monetary Fund, and supported several other regional schemes. It signed, for example, a joint declaration on the Comprehensive Economic Partnership (CEP) between ASEAN and Japan on November 5, 2002, providing for early measures to realize economic cooperation, including elements of a possible free trade area within ten years.[30] Afterwards, at Prime Minister Koizumi's meeting with ASEAN leaders in Djakarta on September 4, 2004, they agreed on a deadline of March 2007 for an EPA. Two of the most recent schemes for regional cooperation, the East Asian Summit (EAS) meetings and East Asian Community (EAC),[31] are aimed at a free-trade area, financial cooperation and a security pact. These are the types explicitly intended to offset the in-

yond an atmosphere of crisis. Working Papers 91. Budapest: IWE.

[27] Since renamed the Ministry of Economy, Trade and Industry (METI).

[28] Under the Miyazawa Initiative (named after the then minister of finance), all in all some US$ 30 billion has been made available to Thailand, Indonesia, Malaysia, the Philippines and Korea.

[29] For a longer analysis, see Hernádi, András (2003), *Japan's ODA policies.* Budapest: IWE, mimeo.

[30] See Sen, R. (2004), *Free trade agreements in Southeast Asia.* Southeast Asia Background Series I. Singapore: Institute of Southeast Asian Studies, 78.

[31] See, for instance, 'East Asian diplomacy: Yankee stay home', *The Economist,* December 11, 2004, 50.

creasing importance of the European and North American regional blocs in the world economy. Later, a challenge to Japan's external economic policy might be posed by South American blocs or even a single Pan-American bloc. The South American Community of Nations (SACN) is a regional trade accord signed in Peru on December 8, 2004, between the member-countries of MERCOSUR and the Andean Community. But it has yet left so many issues open that it has rightly been described as a loose, long-term project, only tangential to intra-regional trade.[32] Thus, the Free Trade Area of the Americas (FTAA), a hemispheric scheme much promoted by the United States, seems to be even more far-fetched at present.

The special, inter-regional cases that link regionalism to global scenes are also worth considering. The ASEM (Asia-Europe Meetings) Dialogue, initiated by France and Singapore in the 1990s, also enjoys Japan's active support.[33] New elements in this include the submission of a report on October 8, 2004 by the ASEM Task Force for Closer Economic Partnership (CEP) to the ASEM meeting in Hanoi.[34] This calls for more 'rational and beneficial' use of Asian savings, to reduce ASEM members' 'potentially destabilizing over-dependence on the US dollar', enhance international use of the euro, and create a more balanced international monetary system. It was also recommended that ASEM leaders should take the initiative to create a regional bond market in East Asia, using a basket 'YES' (yen–euro–US dollar) basket of currencies.[35] Clearly by 2020, however, the Chinese yuan (renminbi) will have to be playing a similar role in such a basket if China keeps increasing its share of world trade, especially in trade in Asia. Two minor news items about relations between Japan and Europe are interesting in this respect. German Chancellor Gerhard Schroeder remarked on a recent trip to Tokyo that Europe could learn from the interventionist Bank of Japan. Meanwhile a senior Japanese finance ministry official said that Japan and the euro zone authorities were discussing the prospect of joint intervention if the yen and the euro continued to strengthen against the dollar.[36]

(iii) On the bilateral level, Japan started its series of FTAs with Singapore, as the most developed of its partners in the region, and as it had no agricultural products to be afraid of. For the same reason, the Ministry of Agriculture, Forestry, and Fishing (MAFF), representing the agricultural lobby in Japan, has preferred multilateral agreements over bilateral ones, because the preparation process takes longer. Representatives of sectors that appear protectionist at multilateral negotiations may promote bilateral agreements that do not impinge on their sector's imports.

The Japan-Singapore Economic Partnership Agreement (JSEPA), which came into force on November 30, 2002, brought a number of advances. (1) It eliminated tariffs on goods accounting for 98.5 per cent of current trade. (2) It committed both countries to improve the speed and efficiency of mutual cus-

[32] See, for instance, 'South American unity still a distant dream', *Financial Times,* December 9, 2004, 4.

[33] The ASEM process is reviewed by the author at greater length in a Hungarian-language paper in the *Műhelytanulmányok* (Workshop studies) series No. 23. Budapest: IWE.

[34] At the same meeting, all the ten new EU countries were admitted into ASEM, making it a more comprehensive inter-regional forum.

[35] 'Asia quietly seeks to move out from under U.S. dollar', *Nikkei Weekly,* November 29, 2004, 39.

[36] *International Herald Tribune,* December 11-12, 2004, 4; *Financial Times,* December 11-12, 24.

toms clearance of goods and replace paper-based trade documents with more cost-effective electronic versions. (3) It increased vastly the commitments by both countries to liberalize and facilitate transactions in the services sector, with special regard to tourism, ICT, the media and broadcasting, and finances. (4) It guaranteed each other's citizens entry and work permits and administration of their investments under liberal conditions. (5) It contained detailed provisions on investment promotion and protection. It also promotes mutual recognition and cooperation in competition policy, provides procedures and regulations for government procurement, initiates collaboration and cooperation on intellectual property, enhances cooperation in science, technology and human resources, and offers orderly settlement of disputes.[37]

Negotiations with Mexico and Korea were more problematic for both sides. Those with Mexico have profoundly illustrated the strong interests and counter-interests behind the FTAs. Japanese manufacturing companies, by a NAFTA regulation of 2001, were stripped of the tax-free status that they enjoyed as component suppliers under the so-called Maquiladora Programme so long as assembly was followed by re-export – mainly to the United States. This made these Japanese companies very keen to see an FTA between Japan and Mexico.[38] However, strong doubts have also been aired. Japanese agricultural producers, with their traditionally protected positions, were obviously resistant to an FTA with Mexico once they knew that similar treaties were in the offing with countries much closer to Japan.[39] (Similar considerations led to a few products being excepted from the tax-free category in the FTA with Singapore.) After sorting out, or rather postponing solution of a number of issues regarding imports by Japan of pork and orange juice, and by Mexico of cars and steel products, the agreement was signed on September 17, 2004, with implementation postponed until April 2005. So, notwithstanding some limitations, Japanese businesses became entitled to take part in public procurement opportunities for which a precondition was an FTA between Mexico and the partner country.[40]

The obstacles to an FTA with Korea are similar. There are additional problems, such as historical tensions between the two countries, although the atmosphere was improved somewhat by the two countries' success in planning, coordinating and hosting the 2002 World Cup Soccer Championship. The main economic consideration hindering the negotiations is protectionism initiated by less competitive Korean sectors.[41] The general fear on Korea's side is that its trade deficit with Japan will grow considerably, if and when import tariffs are abolished, as exports of Korean manufactures already face almost no duties at all.[42] To sum up, the fate of the agreement will depend on the interest shown by Japanese companies in investing in Korea. Rivalry between the two countries – Korea's endeavours to compete internationally with Japan in more and more fields – will also emerge in the final stages of the negotiation process. One

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37 Sen (2004), 27–32.

38 Japan's Ministry of Economy, Trade and Industry estimated that the absence of such an FTA lost them USD 3.7 billion in annual profits and 32,000 jobs (*Nikkei Weekly,* December 15, 2003, 6).

39 Fukushiro Nukaga, Chairman of the Council on FTA-related Affairs and a leading governing-party politician, clearly aimed to dispel such anxieties when he said Japan should consider compensating farmers who lost by FTAs concluded with Asian countries (*Nikkei Weekly,* December 15, 2003, 6).

40 *Nikkei Weekly,* September 20, 2004, 5.

41 This is the opinion of Jwa Sung-hee, president of the Korean Economic Research Institute, cited in *Nikkei Weekly,* September 15, 2003, 29.

42 At the time of writing, Korean goods in Japan met average tariffs of 2.7 per cent, while Japanese goods in Korea met average tariffs of 9.2 per cent (*Nikkei Weekly,* October 27, 2003, 44).

might go so far as to say that strong Korean nationalism and a possible change in the relationship between the two Koreas might equally have a significant influence on the outcome in the opposite direction.[43]

Concluding an FTA with Korea could bring closer a trilateral trade agreement with People's China, as mooted in the communiqué by the three leaders after a meeting in Bali on October 8, 2003.[44] (There Japan and the 10 ASEAN countries also signed a framework agreement on economic cooperation, holding out the prospect of a regional FTA among them.) Bilateral FTA negotiations with Thailand, the Philippines, and Malaysia continue with expectations of being concluded in 2005. They are likely to be followed by FTAs with Indonesia and People's China.[45] Apart from similar agricultural problems, the sensitive issue with Thailand and the Philippines is liberalization of the Japanese labour market. (Both countries would like freer access there for their doctors and medical assistants.) Malaysia, in turn, would like to retain a kind of infant-industry status for its car manufacturing.

The *Nikkei Weekly*, Japan's influential business periodical in English, carried a front-page article on how Japan would start a strong campaign to conclude further EPAs and FTAs.[46] The main points made there seem to offer an effective way of concluding what has been said in this paper and showing the likely priorities in Japan's choice of partners for such agreements, up to the end of the decade. 'Looking to move the free trade process forward, the Japanese government aims by 2010 to ink economic partnership agreements (EPAs) with at least ten nations and regions, including China, Brazil and Australia. Tokyo… seeks to reach agreements with countries and regions with high growth potential or a wealth of natural resources… The government is also preparing to launch talks next year with the entire Association of Southeast Asian Nations. The government is looking to strengthen economic ties through the EPAs and use them to promote domestic structural reforms… Bolstering ties with the emerging so-called BRIC economies – Brazil, Russia, India and China – is seen as a pressing issue… In Asia, the government is studying potential agreements with China… Australia is seen as a likely candidate because it would provide a stable supply of natural resources. South Africa, Chile and Middle Eastern countries are emerging as possible candidates for EPA partnership, according to informed sources.' The article was accompanied by a revealing table showing pros and cons for the countries and regions discussed:

[43] The process might also be influenced indirectly by the FTA Korea concluded with Chile in February 2004, although Chile is far smaller and more remote (*The Economist,* February 28, 2004, 59).

[44] *Nikkei Weekly,* October 13, 2003, 2 and 28.

[45] The Osaka-based business lobby, which includes the CEOs of Matsushita Electric, Sanyo Electric, Sharp and other corporations, seems to be the most enthusiastic advocate for such an FTA between Japan and China. COFCO, China's top food trader, is also promoting the idea. Its president, Liu Fuchun, said, 'Many wealthy Chinese would buy Japanese rice even if they had to pay 10 times the price of Chinese rice.' See 'Unlikely voices may back FTA with China', *Nikkei Weekly,* July 5, 2004, 32. However, the United States is apparently 'trying to deter Japan and China from entering into a FTA,' which may add an extra dimension to the issue. (See, for instance, *Nikkei Weekly,* June 7, 2004, 22).

[46] 'Tokyo ramps up EPA talks, eyes at least 10 by 2010.' *Nikkei Weekly,* September 6, 2004, 1 and 7.

Table 10
Candidate countries/regions for future EPA talks

Country/region	Expected results	Problems
China	Would contribute to forming East Asian community. Japan would help China develop intellectual property protection and other systems.	Tariff cuts will have serious impact on agricultural, forestry and fisheries products for both countries. China urged to first steadily implement international rules.
India	Expanded business opportunities for Japanese firms. Liberalization would have significant effect on this high-tariff country.	Tariff reduction would have serious impact on some industries in Japan, e.g. textiles. Uncertainty about possibility of high-level EPA.
MERCOSUR (including Brazil)	Opportunity to strengthen relationship with Latin America as a whole.	Serious impact on agricultural, forestry and fisheries producers in Japan.
Australia	Significant for securing resources.	See above, as for MERCOSUR (Brazil).
Middle East (including Saudi Arabia)	Help in securing resources, including crude oil, in long term.	Limited effect on trade.
Chile	Significant for securing resources.	See above, as for MERCOSUR (Brazil).
South Africa	Beachhead to African market.	Weak economic ties with Japan.

Source: Nikkei Financial Daily, as cited by *Nikkei Weekly*, September 6, 2004, 1.

However, an editorial in the same newspaper a few weeks later called attention to some inherent problems: 'Tokyo's FTA bids have been hobbled by uncoordinated and cumbersome policy-making. The Ministry of Economy, Trade and Industry is pressing trade partners to open their markets to Japanese industrial products. At the same time, the Ministry of Agriculture, Forestry and Fisheries is doing everything in its power to protect domestic farmers from cheaper imports. And the Foreign Ministry is not doing its job as policy coordinator. This situation can only be changed by centralizing policy-making, vesting a single minister with the authority to oversee and coordinate trade policy from a strategic perspective. Without a clear leader for this mission, Japan could well suffer a costly defeat in the FTA stakes.'[47]

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[47] 'Lack of leadership handicap in FTA race', *Nikkei Weekly,* September 27, 2004, 28.