

“Economic Restructuring and Trade Policy in Japan:  
Is the New WTO Round a Threat or Opportunity?”

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It was June 2000, upon returning from Washington, D.C., that I started working for the Research Institute of Economy, Trade and Industry (RIETI), METI's think tank. As executive director and later vice president, my work there included managing the *Miyakodayori* newsletter and hosting Brown Bag Lunch (BBL) seminars. I hope some of you may find these useful. I treasured the opportunity to work with Masahiko Aoki, RIETI president and professor at Stanford University, as well as the many excellent fellows whom Dr. Aoki handpicked for the Institute. It was really an intellectually stimulating experience for me.

Among the Institute's research areas, reform of the Japanese economy has been and remains central. And yet, as is the case in the banking and financial sectors, I am still very much concerned that we lack a strong driving force for change. Whenever President Bush sees PM Koizumi, he never forgets to ask him about the non-performing loan problem of Japanese banks. The NPL issue has been raised in so many international conferences and seminars that it looks like it has become the Japan Problem itself. But it is a tip of the iceberg, an iceberg of the whole Japanese system.

We can call it people's belief in the post-war model of economic growth: they are lifetime employment, seniority system, main-bank governance system, corporatism, government-private sector linkage, and an education system that created uniformity. Dr. Aoki defines this shared belief as an "institution" and he argues that Japan is undergoing an "institutional crisis." Nobody wants change until the day he is forced. People such as politicians, bureaucrats, business people, or professors, who are in a particular system, help create what Dr. Aoki calls "bureau-pluralism" in his system. But failure of Japan's economy is not only Japan's problem, but also a global problem. It is time that we stop procrastinating.

While insiders cannot reform as they are often trapped in the web of vested interests, change often comes from outside in such forms as foreign direct investment, imports, M&As, and outside directors through the mechanisms of corporate governance. An excellent example of this is Carlos Ghosn of Nissan: he is Japan's national hero of corporate restructuring. Uniqlo, a casual garment store chain, is another example of innovation in Japanese retailing business. Tadashi Yanai, CEO of Fast Retailing, spoke eloquently at a RIETI BBL about his new business model of retailing and importing subcontracted clothes from China. Companies like these know it is no longer a choice between free trade and protectionism, but rather between restructuring and the bone yard. GE's annual report of 1990, more than ten years ago, explicitly mentioned these points and urged the need for speed. Here, the government's role is limited to the creation of a friendly environment for corporate restructuring and welcoming inward FDI and trade. Whether it is at the national or corporate level, keeping an open system is a key for institutional reform.

Now, my new job: as of January 8, 2002, I have taken the position of Director-General, Multilateral Trade System Department of Trade Policy Bureau, METI, succeeding Mr. Toyoda, though I will continue to do work for the RIETI as a visiting senior fellow.

Doha successfully kicked off the Doha Development Agenda, a new round of trade

negotiations, yet to conclude it in three years is a more challenging task. There is no question that strengthening the free trade system is crucial. It is an essential element in establishing the freer, more open economic systems that provide countries with the best chance to survive in global, mega competition, through forceful domestic restructuring. In this light, rich countries should further liberalize their economies, setting an example for the developing countries; however, story I learned was slightly different. I was pleasantly surprised with the remark of Dr. Zhao Jin-Ping from the Development Research Center of Beijing at one of our BBLs. He said of his country's WTO accession, "China faced many hardships in the process of liberalization, but we are now more confident. We need outside forces to reform China." This was also the case for Japan after the War. We have gradually shifted our economic system to a more open one through accession to the GATT, IMF, and OECD. Now we may recall our experience from the Chinese accession to the WTO.

Recently globalization also pushed the GATT to reorganize itself as the WTO by extending its scope from traditional market access to rules, services, intellectual property, and investment, in the Uruguay round. And Doha Development Agenda will further expand its scope to environment, investment, competition, trade facilitation, etc. The Singapore agenda, new issues, are of utmost importance to make this round relevant in a changing world. We have to harmonize more and more of our domestic rules in addition to border measures, as economies integrate with one another.

Though it is becoming ever more difficult to negotiate and to make a consensus through multilateral forums, quick fix case-by-case bilateral deals may invite frustration between trading partners. Regional economic arrangements and bilateral FTAs are coming to the fore, as they provide the important modus operandi to further open economies of like-minded countries. More than a hundred RTA's have been reported to the WTO, and 93 were in the last decade. Recently, the need for system harmonization by economic integration has been dramatically increased. Japan has recently changed its position to one that is more receptive to regional arrangements than before. It has just completed its first bilateral arrangement with Singapore. This Japan-Singapore New Age Economic Partnership Agreement is a breakthrough for future arrangements with Mexico, Korea, and ASEAN. This is a major policy response to the ongoing economic integration in East Asia; new-age features of globalization and informatization require new frameworks for international relations. They include capital investment flows, information flows, and labor mobility. The Japan-Singapore EPA is an attempt to respond to these challenges.

In hindsight, APEC has served as an excellent training ground for Asian countries' ministries to think and behave internationally, while European countries have been practicing for over 50 years—starting with the ECSC, the EC, and then the EU. The level of integration has reached the stage of monetary union, which requires a wide range of domestic economic policy coordination and harmonization of domestic institutional arrangements. Germany provides an interesting example of using its international framework for domestic reform. The OECD's "Growth Report" identified Japan and Germany as the big losers of 1990's, as their economic growth rates declined substantially from the 1980's. The report pointed out that low investment in information

communication technology (ICT) and the slow pace of deregulation were partly to blame.

But the first step is to stop focusing on our past successes. These success mentalities have been burned in our minds from the miraculous economic recoveries after the War defeat. Japan and Germany have in common relatively low levels of inward foreign direct investment relative to GDP; this fact has often been cited as proof of economic closed-ness.

Recently Germany has taken notice of this problem and has begun strengthening its restructuring efforts—deregulation in network services such as telecommunications or electricity, tax reform, new markets for ventures, pension reform, etc. Tax incentives to reduce cross-share-holding aims at drastic reform of "Rhineland Capitalism" by introducing more foreign capital. While Germany's political future is strongly committed to the EU, there is nowhere for Germany to move but to compete with other European countries by reforming itself and harmonizing with European standards. Germany's competitiveness measured by the IMD index shows that it bottomed out but now it is rising, while Japan is still floundering in the bottom. Japan must establish international frameworks to restructure domestic institutions, as is China trying with the WTO and Germany with the EU. At the end of the day, restructuring will certainly lead Japan to an economic revival, which is most urgently desired by other nations.

Obstacles for us to move ahead will come from stronger resistance from lagging sectors. C. Fred Bergsten once said that the unfortunate failure of the Early Voluntary Sectoral Liberalization (EVSL) in APEC came from the fact that the economically small but politically sensitive issue of agricultural liberalization prevented Japan from taking a leadership role at APEC for important regional economic policy issues when the Asian financial crisis occurred. While Japan was certainly blamed, the US administration also made a mistake in priority setting for the APEC.

China is reportedly challenging Japan by successfully convincing ASEAN countries to initiate negotiations for a bilateral China-ASEAN FTA, which may be completed within ten years. While there are still many sectors that are protected by relatively high tariffs, Japan's average tariff rate is one of the lowest in the world. Nevertheless, the services sector is heavily protected by regulations. Fortunately one of Prime Minister Koizumi's favorite phrases is, "Reform without sanctuary," and yes, I think and I hope that we will stop avoiding taboos.

During his recent visit to Asia, Koizumi announced his Initiative for Japan-ASEAN Comprehensive Economic Partnership to ASEAN countries. He also signed the Japan Singapore New Age Economic Partnership Agreement. He will soon navigate the rough seas of the new round of WTO negotiations. President Bush praised him as a "true reformer" in his visit to Tokyo. It is crucial that we must show the strongest political commitment to domestic reform, in accordance with external economic policy. We call this trade strategy a "multi-layered approach" because we are targeting multiple levels of economic integration at the same time: starting with bilateral Economic Partnership Agreements, then up the ladder to regional economic integration, and

ultimately serving the global multilateral system, which includes the WTO. Another dimension to this strategy is that we consider its implications on domestic restructuring.

In this context, such visionary ideas as David Asher's US-Japan Common Market or Bruce Stokes's US-Japan Open Marketplace should not be considered impossible. The history of US-Japan trade relations shows that bilateral trade disputes may also have contributed to the liberalization of the economic systems especially in service sectors like finance, telecommunications, and transportation. But this process created frustration in both sides; Bruce Stokes says, "If two economic superpowers do not have a long-term goal defining their economic relationship, that relationship gets defined by a laundry list of short-term problems." And "this is the trap Washington and Tokyo now find themselves in." Their ideas must be taken more seriously to harmonize rules and regulations between the two leading countries in the world. We must also consider the untapped benefits of new technology, globalization, and the information economy. It would not only provide a chance for Japan to reform its hardest core sectors, but also help Japan to invite knowledgeable people and foreign capital to revitalize its economy.

Among the missions I set for RIETI, one of the most important was that we create a "policy market" in Kasumigaseki where we, an economic policy "Team B" offer an alternative set of policies for reform. We have been trying our best in such sectors as finance, banking, communications, social safety net, and education. Yet we still have many more sectors to examine for restructuring.