

## TOWARD BETTER JAPAN-EUROPE ECONOMIC RELATIONS\*

Hiroya Ichikawa

1. The Japanese of the nineteenth century saw Europe as the epitome of progress. Europe was the symbol of political freedom, new technology, and new ways of thinking. Japan and the rest of the world were stagnant and weak. Today, the situation appears to be totally reversed, at least to Japanese eyes. During the coming decade, many in Japan foresee that Western European economic growth rates will be lower than Japan's. It is not totally surprising to them when they hear that Western Europe will also probably continue to have higher unemployment and inflation than Japan. The volume of international trade is not expected to show any dramatic increase in the near future, and newly industrializing countries (NICs) are becoming a threat to advanced countries. Many who foresee increasing rivalry among the industrialized nations for markets, resources, and investments point out that it will take time for Western Europe to modernize its industries and adapt to the new age. If inflation and unemployment will continue to be especially severe in Europe, and greatly intensified competition among the industrial nations is to be inevitable, with two of the main competitors being Europe and Japan, one might reasonably ask himself the following question: "Isn't it the time for both Japan and Europe to redefine their relationship into one that is more desirable by stepping back and taking a long and cool look at the illusions that their people hold about each other?" Japan and Europe are in a period of cogitation leading to fundamental adjustments in their views of the world, as they question their previous assumptions and seek new modes of action by placing their current trade and economic problems in a broader context.

2. Underlying the history of Japan-EC trade relations in the postwar years has been the conflict between West Europe's discriminatory response to Japanese exports to Europe and Japanese insistence on Most Favored Nation (MFN) treatment. As trade liberalization and currency con-

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vertibility progressed in the late 1950s and early 1960s, both in Europe and Japan, annual trade or payment arrangements were replaced by normal trade relations based on the free and non-discriminatory principle of the GATT. During this period, Japan made persistent efforts to obtain most-favoured nation treatment from major West European nations. When Japan became a Contracting Party to the GATT, fourteen countries refused to enter full GATT relations with Japan by involving Article 35 of the Agreement (which provides for the non-application of the Agreement between particular contracting parties if either of them does not consent to its application to the other at the time of either becoming a contracting party).

3. The matter was psychologically offensive to the Japanese since it made Japan a second-class citizen in the world of international trade. Thus, in the early 1960s, Japan started to pursue actively 'economic diplomacy' toward Western Europe. Finally, Britain withdrew the application of Article 35 of the GATT against Japan in April 1963 and 'the Treaty of Commerce, Establishment and Navigation' came into force in May 1963. This treaty, however, included two types of safeguard. There was a safeguard, applicable selectively in case of need, under which each government was permitted, after consultation, to impose restrictions on the import of the other country's goods, if those imports caused or threatened 'serious injury' to domestic producers. Moreover, a list was agreed of 'sensitive item' on which British restrictions would continue to be maintained after the Treaty came into effect (such items as cigarette lighters, stainless steel tableware, sewing machines, toys and pottery were included). In addition, the Japanese Government agreed to the 'orderly marketing' of certain textile products, transistorised radios and television receivers. Following the example of Britain, France and the Benelux countries revoked the application of Article 35 in 1964 in return for Japanese acceptance of similar safeguard arrangements. However, the acceptance of the Anglo-Japanese commercial treaty opened the way for the solution of the irritating unilateral trade discrimination against Japanese goods in Western Europe.

4. Reflecting the generally favorable economic situation during the 1960's, West European nations gradually reduced quantitative restrictions on Japanese goods and Britain totally eliminated them by the end of 1967. By 1981, the number

of discriminating restricted items decreased to 3 for West Germany, 27 for France, 38 for Italy and 9 for the Benelux countries (items such as textile products, pottery and china, table wares and light machines were included). However, the fear of market disruption by Japanese exports, has remained in Western Europe. In accordance with Article 113 of the treaty of Rome, the dialogue between Japan and the EC commission started in late 1961 in order for EC to adopt a common commercial policy toward third countries based on uniform principle. The strategy of the EC commission was to conclude a commercial agreement with Japan which would apply to all EC members and supercede bilateral agreements, but to do so only after the problem concerning sensitive items had been solved. However, there was a fundamental difference in attitude between Japan and the community over the inclusion of safeguard arrangements in a commercial agreement. The Japanese Government strongly maintained that Article 19 of the GATT would provide a sufficient safeguard.

5. The speed of penetration of competing imports seems to have been a source of great anxiety in Europe, where traditionally a more conservative philosophy of industrial expansion has prevailed. European fears were reflected in their insisting on safeguards and on the restriction of imports of sensitive items. The Japanese reacted strongly against the European attempt in institutionalizing discrimination against Japan, as in Article 35 of the GATT; and selective safeguards. Japan insisted that discrimination was unduly preventive and that West Europe's real troubles were not due to imports from Japan, but were caused by European industrial failures or imports from other sources. However, it should be noted that Japanese opposition was not as strong when industrial sectoral difficulties were actually present. Since Foreign Minister Ohira's visit to Brussels in May 1973, consultative talks have been held regularly on the major issues of common interest at both ministerial level and the level of experts. Sectoral consultations have been held on automobiles, pharmaceutical products, silk yarn, iron and steel products, shipbuilding, agricultural products, chemical and marine diesel engines, etc. From mid-1972, as a result of these official and private consultations, self-restricting measures were introduced by Japanese exporters with regard to an increasing number of specific products. While it is often tempting to be alarmed by conflict in Japan-EC trade relationship, one should not lose

sight of the degree to which the Japanese exercised moderation in exporting sensitive products to West European markets. The effort made in the Tokyo Round to negotiate a new, more workable safeguards provision ended in failure as a result of unresolved differences between protection minded European countries and less developed countries that feared a more effective safeguards provision would be used too often against them. However, in order to remove psychological repugnance resulting from imports of specific sources being subject to restriction, a new, more workable safeguard provision should be internationally agreed upon in the nearest possible future.

6. Following a series of introduction of voluntary export restraint measures on the part of Japan, the European's emphasis seems to have shifted to the galloping bilateral trade imbalance and the closedness of the Japanese market. It is interesting to note that Europeans seldom took issue with Japanese tariff or non-tariff barriers until quite recently. This was partly a result of a lack of serious interest in the Japanese market. It should also be noted that the Community as well was subject to severe American criticism concerning its preferential trading policies and its protective trade measures particularly, in agriculture. Nevertheless, the strong and pervasive European feeling against Japan led them to express their belief that European companies never had a fair chance to penetrate the Japanese market because of import quota, high tariffs and restriction of investments during the period in the 1960s when the Japanese economy was rapidly expanding. Europeans argued that they did not hinder an expansion of Japanese exports in European markets. As the Japan-EC trade gap continued to widen during the 1970's, the renewed dis-satisfaction was dramatically shown during a visit to Western Europe of a Keidanren mission headed by Mr. Toshiwo Doko in October 1976. European criticism of the impenetrability of the Japanese market grew so strong that the Japanese government had to show 'good will' to the Europeans.

7. Various measures taken by the Japanese government included the following: an expansion of the import quota of skimmed milk powder, a veterinary inspector to be sent to France to examine whether Japanese requirements for the importation of French processed meat were being met, the number of shipments of passenger cars to Britain in 1976 was estimated not to exceed conspicuously the 1975 shipments, to hold bilateral meetings with the community on

the shipbuilding question, simplification of import procedures for manufactured tobacco products. The Japanese Government, however, pointed out that the reduction or elimination of tariff or non-tariff barriers should be solved most appropriately in the MTN on the basis of reciprocity. In addition to those, the then Japanese Government simplified the type-approval system for imported vehicles from 1 April 1977 onwards. It also decided to accept a substantial amount of preclinical test data on pharmaceuticals prepared abroad from 1 October 1976 onwards. From 1 April 1978, foreign automobiles companies, including the European ones, were allowed three years to adopt to the tougher emission standards which had gone into effect in Japan on 1 April 1978.

8. Setting aside the problem of the impenetrability of the Japanese market for a moment, the real problem seems to arise from the speed of penetration by Japanese exports into European market, and not so much from the Japanese share of markets possibly with the exception of certain specific products to certain specific markets. The sudden surge in the imports of specific products makes adjustments by the affected industries difficult. Furthermore it also renders their future so precarious that the industries are unable to work out a sensible strategy for the future. Considering the fact that 60-70 percent of Japan's total exports to EC markets are machinery and equipment and that about half of these exports consist of five items, namely TV and radio receivers, tape recorders, automobiles and ships, the impact of such Japanese exports tends to be felt all the more strongly by specific industrial sectors or importing countries in Western Europe. Particularly when the economy of the importing country is depressed, such a situation, because of its implications on employment, engenders an attitude of outright rejection rather than that of constructive accommodation to the realities of international economic life on the part of the industries affected.

9. As MITI's 1981 white paper on international trade points out, the degree of international horizontal division of labour in Japanese manufacturing industries measured by specialization indexes with respect to imports and exports is far more unbalanced than those in the United States and West Germany. Where Japan has comparative advantages such as in steel, general machinery, electric machinery, transportation machinery, Japan's export specialization indexes of those industrial sectors are far higher than the average ones of OECD nations. Similarly, where Japan has comparative dis-

advantages, Japan's import specialization indexes of such industrial sectors are far smaller than those average of OECD countries. Such a Japanese trade structure characterized by the sharp discrepancy between export and import specialization indexes can be sharply contrasted with those of the United States and West Germany. In case of the United States, where export specialization indexes exceed the average of OECD nations (such as in transportation machinery and general machinery), their import specialization indexes of the corresponding industries also exceed the average of OECD nations. Such a trade structure suggests that the U.S. does export as well as import products of industries in which they have international competitiveness. In other words, a higher degree of horizontal international division of labour can be observed in the trade structure of the U.S. economy.

It is of interest to note West German's export structure measured by export specialisation indexes resembles the import structure more than that of the U.S.A., largely reflecting the highly degree of horizontal international division of labour within the EC manufacturing sector.

Export (import) specialization coefficient  $S$  is defined as follows:

$$S = \frac{\text{Commodity A's share in Country X's total export (import)}}{\text{Commodity A's share in total exports (imports) of OECD Nations}}$$

10. One of the most important factors responsible for present Japan's trade structure stems from the very fact that there did not exist any highly advanced homogeneous industrial nations in Japan's neighbourhood. Lack of natural endowments (resources and energy), together with such a condition described above did not encourage the promotion of horizontal international division of labour in Japan's manufacturing sector until very recently. As a result, the Japanese industry had to build up a self-supply system of manufactured goods. However, it is worth mentioning that as newly industrializing nations have been emerging in the neighbouring area, the degree of horizontal international division of labour has been deepening (particularly with Asian neighbours) in the field of labor intensive consumer goods and intermediate industrial materials. A second factor is that Japan's large domestic market has made it possible for mass-production type industries to enjoy merits of econo-

mies of scale, while German manufacturing industries, for instance, could benefit from horizontal international division of labour on the basis of the European market.

11. Coming back to the question of the openness of the Japanese market, the resentments of threatened industries in Europe were often psychologically aggravated by the fact that many of them felt they never had a chance to build up a market share in Japan in the 1960s while they were licensing technology to Japanese firms. Today, there is a widespread awareness in Japan that in order to avoid further trade conflicts in Western Europe, it is highly desirable for Japanese exporters to avoid concentration on specific exports in specific markets, although stiff competition among Japanese firms producing the similar products in trying to expand their shares in European markets makes this very difficult. During the visit of Mr. Doko's Keidanren mission in October 1976, European businessmen pointed out that "the closed Japanese market severely hinders European exports. Japan's accessibility is already limited by geographical distance from Europe, and, added to that, a completely different culture, lifestyle and system of business practice also work against European penetration. Artificial tariff and non-tariff barriers make exporting to Japan frustrating and arduous". The Europeans seem to be of the view that there exist "structural barriers" in the Japanese economy which hinder the importation of manufactures. All in all, the pervasive and persistent view is that the European failure to penetrate the Japanese market is largely due to various barriers on the Japanese side and that their removal will substantially increase European exports to Japan, if not immediately restore a balance in bilateral trade.

12. Such perception contributes to a strongly negative image of Japan as a nation which does not play the international trade game fairly, and it provides ammunition for those in Europe who advocate restrictive measures against Japan. In reply to these views, the Japanese argue that the basic reason for the low level of EC exports to Japan is a lack of European efforts. In Japan, the dominant perception is that Japan's market for manufactured products is as open as any in the world. Moreover, it is widely believed that while Japan has been liberalizing market access very rapidly, there are growing signs of protectionism in Europe, the United States, and elsewhere. In a sense, all national markets are to some extent "closed". As the Japan-United States Economic Relations Group known as "the Wisemen's

Group" concluded in its Report of January 1981, "in terms of average tariff levels and quotas on manufactured products, Japan's market at the end of the phasing of current reductions will not be more closed than that of the United States". "Indeed, given informal U.S. 'quota' in the form of orderly marketing arrangements, Japan's market may well be less closed". Indeed, as a result of Japan's tariff reduction commitments during the Tokyo Round, its average tariff level on GATT-bound industrial products (on a trade-weighted basis) will be only 3.2% by the end of the eight-year period for passing in MTN-agreed tariff cuts. Whether GATT-bound or applied duty rates are used as the basis of calculation, Japan's average tariff levels on industrial products will be lower than U.S. tariff levels on comparable products by the end of 1987. As for quota, Japan now has quota for only five manufactured products, the most significant being leather goods. Because Japan has agreed to orderly marketing agreements on voluntary restraints on some of its exports to Western Europe and the United States, "the Wisemen's report" concluded that Japan now is far more the victim of other countries formal and informal quota than a perpetrator of quota restrictions in international trade in manufactured goods.

13. Behind the ongoing trade between Japan and the Western industrialized countries, there seems to lie a considerable degree of psychological elements which have come to make the problem all the more complex and potentially extremely dangerous. While EC and the U.S.A. are losing patience with the "unfair", "sneaky", "inscrutable" Japanese who "only sell but refuse to buy", the Japanese, to the same extent, are getting uneasy about what increasingly seems to be an abusive stance of those "presumptuous" Westerners.

Repeatedly threatened and told off by the Americans and Europeans, Japan has been acting on what is alleged to be less formal official import barriers, such as the practical administration of standards, customs, procedures and investment approvals as well as intangible national cultural attitudes toward foreign trade they hope will be able to please overseas criticism. Yet, many Japanese suspect that Western Europe and the United States after all, will not become fully satisfied with Japanese efforts as long as economic and industrial gaps remain. Those Japanese believe that Europe will keep pressing Japan to do something. There is strong suspicion among Japanese that the Western



demands on Japan could be "endless". And this suspicion may make the Japanese look sneaky and inscrutable. To the Japanese public, it is always the Westerners who speak loudly and high-handedly in an attempt to force themselves, while to the Japanese perception, the Japanese remain silent without shouting back. A Keidanren mission led by Chairman Yoshihiro Inayama to European capitals last autumn, which was barraged with harsh-worded demands and accusations, presented a typical case to Japanese eyes.

This of course does not justify unreasonably difficult institutional barriers against imports and, after all, it is in the national interest for Japan to eliminate them. Those perceptions, and whatever realities lie behind them, represent very serious problems in Japan-Europe relations, since they lead to strong resentments, often bitterly expressed in the political arena and widely reported in the media.

14. When the Inayama mission was in European capitals, strong grievances were expressed in meetings with Keidanren delegation by leaders of Britain, France, West Germany, the EC commission and the Union of European Community Industries (UNICE).

Particularly vehement complaints, almost emotional in tone, were raised in Britain and France. It was suggested that there was even the possibility of some strong action being taken against Japan if the trade gap with Japan remained unresolved. One of the leaders of the Confederation of British Industry (CBI) said that 60 percent of the British imports from Japan was concentrated in a few sectors, causing problems to British domestic industries. If the pattern of exports persists, he warned, Japan could be the target of adverse reaction everywhere in the world. He declared that the CBI would be compelled to demand that the British government take some strong action unless the Japanese appreciate the seriousness of the situation and take concrete measures to remedy it at once. While in West Germany, the Keidanren mission heard that, while Germany hopes to follow its traditional free trade policy, it would have no choice but to go along with the rest of the EC members in the event of EC decision to apply restrictions on imports from Japan.

A proposal was put forward by the French employer organization CNPF (Conseil National du Patranat Francais) that Japan announces a target on the export-import ratio in an attempt to correct the bilateral trade imbalance. However,

this proposal presents problems. First, under the free trading system, consumers and industrial users are free to choose either domestic or imported products. Secondly, trade imbalances are inevitable between any two nations. The problem of trade disequilibrium ought to be taken up on a global basis and with reference to developments in the invisible trade as well.

15. The European Community's bilateral trade deficit with Japan increased from \$ 8 billion in 1979 to \$ 12 billion in 1980 according to EC Statistics (\$ 5 billion in 1979 and \$ 8.8 billion in 1980 according to Japanese Statistics), the \$ 4 billion increase coming solely from higher Japanese exports; EC exports to Japan were stationary in 1980. The latest figures available for 1980 show a \$ 5.4 billion surplus in Japan's favour during the period of January-June 1981 (Ministry of Finance, Japanese statistics). In the light of the structural nature of the problem of the imbalance of trade and of the difficult situation, Europeans in brief make the following points in common: The European economies are afflicted with unemployment, inflation, stagnant growth and external trade deficits. In the face of the deteriorated economic conditions, the rapid growth of Japanese exports in some sectors are giving rise to political and social problems. If the trade imbalance continues to be unchecked, the protectionist pressures would intensify to an uncontrollable point. For this reason, Europe wants Japan (1) to exercise moderation in exports, (2) to open the Japanese market further to imports and (3) to expand the imports of manufactured goods.

European specific requests include a lowering of relatively high tariffs applied in Japan on some products, the expansion or abolition of quota controls on agricultural and other products as well as the improvement or removal of the so-called nontariff barriers including the import inspection procedures on chemical and pharmaceutical goods. The Keidanren mission also came across frequent suggestions that Japan should get rid of the "buy Japanese" mentality.

Some of the European complaints like those concerning complicated import procedures and the quota controls of farm products, however, deserve Japan's serious attention. For its part, Japan must study concrete measures to further improve access to the Japanese market, because supporting the open international trading system and closing the trade gap through import expansion is a sheer necessity for Japan.

16. While Japanese businessmen want EC businessmen to understand that as long as European products offer an advantage over competing Japanese suppliers in terms of quality, price, delivery dates, etc., Japanese users have been and will be willing to choose the European goods, there exists now a widely held awareness that the danger rises in tension in Japan's external economic situation for Japan. If this situation is allowed to drift further, many Japanese feel that the liberal trading system and even the Western solidarity itself would be thrown into jeopardy. Upon returning home, the Keidanren mission reported to the Japanese business community as well as to the Japanese government about the tense trade situation with Europe. The Japanese Government, after taking into account findings reported by the Keidanren delegation, is now preparing for adoption of external economic measures. Acting on behalf of private industry, Keidanren has worked out a proposal concerning counter-measures to solve the trade problems and submitted it early December last year to the government, urging its prompt implementation.

The latest action taken by the Suzuki government was one in improving import inspection procedures. This was decided following recommendations by the Ad Hoc Investigation Council on International Economic Problems of the ruling Liberal Democratic Party, which acted in quick response to grievances among the other industrialized democracies on the various non-tariff barriers restricting their exports to Japan.

The Japanese government also decided to establish a new headquarter (the so-called Ombudsman) for resolving grievances pertaining to opening Japan's market. It is noteworthy that the Japanese government could take these actions in a fairly short period of time after it decided on advance implementation of tariff reduction for 1,653 items. However, as long as the huge trade imbalances between Japan and the other industrialized nations remain unchanged, their dissatisfaction with Japan's efforts will be left unabated. Any substantial improvement in the imbalances cannot be expected without parallel efforts by the other trade partners to penetrate the Japanese market. It takes a formidably long time before the latest action in reducing non-tariff barriers can be reasonably effective in alleviating criticism against Japan's trade policies.

17. Even after the complete elimination of all non-tariff barriers in Japan, there is a strong sense of skepticism among Japanese economists and businessmen that Japan's bi-

lateral trade imbalance with EC would be corrected. Instead, many in Japan believe that promotion of direct investment, technological exchanges and cooperation in third markets will be a most promising course of action leading over the medium- and longer-term to the development of more solid Japan-Europe economic relations. The Japanese and the Europeans must begin by recognizing that their societies, politics, and economies all share the same values and common interests. Building factories in each other's economy is extremely useful in promoting industry and deepening understanding into the bargain. Many economists in Japan point out that trade between Japan and Europe will never balance out unless the two regions develop a horizontal division of labour in their industrial setup. Neither Europe nor Japan has anything to gain if Europe reverts to protectionism and closes its markets to try to resolve the trade problem. Both parties must join forces and reach a common solution.

18. As one peers into the future of the Japan-Europe relations, it should be observed that there are factors which could shake the basic structure of the Japan-Europe relationship. With the disappearance of the international system based on "Pax Americana", the management of the international order has to be carried out through coordinated efforts of a number of states whose behavior can effect the order in a material way. Today, many nations are tempted to pursue their individual policy orientations, and a basic consensus on a concrete common policy objective is hard to achieve. If both regions do not pay constant and careful attention to these factors and confront them squarely, they could affect the prospect of a substantial development of a healthy and constructive relationship. Japan and Europe should continue to strive hand in hand. If the Japan-Europe economic relationship is viewed only in terms of trade, there will be only limited means to solve problems and the prospects for constructive development will be lost. It is necessary that they promote broader and closer economic relations not only in trade but also in the industrial field and, further, to try to coordinate their economic interests. They will be able to base their economic relations on a solid foundation only by expanding exchange in technology and investment in addition to exchange in goods. The promotion of exchange in investment will result in increasing employment, while technological exchange will facilitate the modernization of industry and help strengthen international competitiveness. Japan once introduced scientific techniques

from the West European countries to create a modern industrial nation.

Even today, the West European countries are still ahead of Japan in such fields as aircraft and nuclear energy, while technological progress is seen in electronics and other fields in Japan. It is considered necessary for Japan and Europe to promote and cooperate in research and development in the field of such frontier technologies for the prosperity of mankind as a whole. Their cooperation in third-country markets is also very important. It is possible for Japanese and European enterprises to increase their economic efficiency by sharing risks inherent in major projects in third countries through the formation of international consortiums, etc., seeking the optimum combination of mechanical equipment, manpower, technology, knowhow, and funds, etc., while specializing in those fields where they excel. These efforts will provide new opportunities for cooperation in the economic development of third countries and lead to the expansion of trade for both Japan and Europe, instead of causing their existing in third-country markets to diminish. In coping with the present situation and its economic difficulties, misunderstanding and ignorance of each other's positions contribute to only worsening the economic relationship between the two sides. Somehow, the political system as well as the economic system in both regions should find ways in building up a constructive relationship.

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