JAPAN'S GOVERNMENT POLICY ON TRADE

An Article for the Encyclopedia of Japan

William V. Rapp
Morgan Guaranty Trust
23 Wall Street
New York, New York 10015

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Trade Policy

In its narrowest sense, Japan's trade policy refers to specific government measures or actions taken with respect to encouraging or discouraging the export or import of various commodities. More widely viewed, however, it spans a broad range of industrial and economic policies involving all sectors of the economy and designed to promote basic economic goals such as growth, industrial change, higher living standards, and a positive balance of payments.

Japan's modern trade policy began in Meiji after the Tokugawa isolation. It was an integral part of her objectives to achieve parity with the West. However, until the end of the unequal treaties in 1899, the government was limited as to specific actions it could undertake. Until then tariffs and trade were in the hands of the Western Powers. Nevertheless, the government did wish to promote industrialization and economic development. This it did via subsidies, loans, and technical assistance, including demonstration plants. This process in turn necessitated the import of equipment, ships, steel, and other commodities which Japan did not make herself. To pay for these imports then required exports. Initially such exports were primary products like silk, green tea, and copper, but they expanded to include manufactures as the economy grew. In this way evolved what has remained a fundamental part of Japanese trade policy to the present day. Japan exports to import, and exports and imports reflect the economy's competitive development.
Though the composition of exports and imports has changed dramatically over the last 110 years as Japan’s economic structure has evolved, there remain many products which Japan does not possess in quantity and must import for her economy to function and develop. Today these necessary imports are fuels like oil and uranium; raw materials like coal, iron ore and alumina; and food like soybeans, fish and wheat. To pay for these imports, Japan must export, now mostly manufactures. It has only been in the post World War II period that an additional export policy has evolved where exports are viewed as having benefits over and above their favorable impact on the balance of payments. In this second case, exports are seen as a way of extending an industry’s growth and economic life beyond what can be supported by the domestic market alone. Yet in this sense, trade and trade policy are still functions of industrialization and economic growth. Growth has not been the result of Japan’s desire to trade or export level.

These facts indicate that the appropriate approach to analyzing trade or trade policy’s importance to Japan is to assess Japan’s need for a particular import and its percent of self sufficiency or the relative size of a particular industry and its percentage of exported production. Exports or imports as a percentage of GNP are deceptive policy guides since these figures do not indicate Japanese industry’s overriding dependence on specific imports or exports. Further, GNP is a value added measure whereas as exports and imports are gross valuations.
Within the overall policy parameters of trade as a way of supplying and paying for required imports or as an extension of industry growth, specific policies have changed as the economy itself has developed. In the late 19th century, industrialization and military requirements caused the government to promote imports of the manufactured and capital goods Japan didn't produce as well as raw materials. Then to foster exports, the government introduced policies to improve the quality, production, and standardization of potential or existing exports. In the case of silk, for example, experts were brought from Europe and product standardization and production cooperatives were introduced. Indeed, the effort to improve quality and productivity was so successful that Japan soon replaced China as the main supplier of silk to the West, especially to the U.S. Similar policies were followed for other products, introducing a policy theme that has persisted to today. For instance, after World War II, the government, through MITI (Ministry of International Trade and Industry) established export quality checks. Firms' exports were screened, and technology imports and quality controls were both regulated and encouraged. Further, to avoid cut-throat export competition that could prove self-defeating for individual firms and the economy as well, export cartels could and were organized during the 1950's and 1960's, in specific situations like textiles, steel or petrochemicals. Currently the government is supporting research and development in computers and semiconductors with the objective of making Japanese producers internationally competitive.
The policy interaction between trade and industrial development became increasing comprehensive and complex after 1899 through the 1970's. After 1899 tariff protection of specific industries was possible and undertaken. Steadily rising tariffs were combines with the previous policies of loans, subsidies, technical assistance, and government contracts to promote various industries, particularly those with a perceived military importance like iron and steel or chemicals. On the other hand, tariffs on raw materials were kept low, increasing the effective protection to value added and further stimulating manufacture. Protection of the home market was, of course, extended to the colonies and the occupied territories. Exports of heavy industrial products to these areas rose throughout the 1920's and 1930's while food and raw materials represented most imports. Indeed, trade with all political dependencies rose to 53.4% of exports and 40.4% of imports by 1938 from 2.2% and 0.9% in 1896.

In the 1930's protectionist policy went beyond tariffs and quotas to include a major devaluation between 1930-33 when the value of the Yen declined to $.29 from $.50. Also companies like Ford and GM with assembly plants in Japan were forced to shut down and the import of cars and trucks assembled or in parts was restricted. Ultimately, trade policy extended to war, as one rationalization for World War II was the need to secure raw materials and markets in a hostile and depressed world trading environment, the so-called "Asian Co-Prosperity Sphere."
The congruence of economic and trade policy with colonial and military ambitions was terminated with the end of World War II. Yet, from and economic policy viewpoint the need to protect and develop trade or to gain access to raw materials and markets was never stronger. Many Japanese were returning from overseas; the economy was at early 1920's levels of per capita income; there were acute shortages of goods, food and foreign exchange; and the industrial and trade structure was either destroyed or worn out. There was an immediate need to resuscitate the economy, especially trade, while at the same time building a foundation for future improvement in income levels and industrial strength. Given Japan's shortage of land and raw materials but large labor force this could only be done by promoting manufacturing and manufactured exports. There thus developed a series of policies impacting trade and industry that were quite comprehensive in nature even compared to prewar Japan.

Specific trade related measures were quotas on imports including critical raw materials like coal, oil, wool, cotton, and chemicals in addition to luxury goods, various manufactures, and food. There were protective tariffs on manufactures while raw materials were allowed in essentially duty free. Some manufactures necessary to rebuild key industries (e.g. equipment for steel, fertilizer, and textile production) were also allowed in duty free in the late 1940's and early 1950's until Japanese industry was rebuilt and able to produce them. Further, because foreign exchange was scarce, there were foreign exchange quotas for various classes of imports on top of the tariff and quantitative restrictions already noted. And finally, because Japan needed to modernize
and update her manufacturing base while conserving foreign exchange, the government regulated the import of and price paid for needed technology whether licenses or equipment. Priorities for imports were set by the government in conjunction with business. And industries with either export potential (e.g. textiles and handicrafts) or strategic economic importance (e.g. steel, power, fertilizer, coal and shipbuilding) were favored. Specific assistance was given or removed as industries developed or gained strength. Thus steel was favored first then auto's in the 1950's and computers in the 60's and 70's.

At the same time, the government encouraged exports via special tax and credit incentives: i.e. more rapid depreciation on equipment, special tax reserves for overseas marketing, greater credit availability at lower cost, a linkage system with restricted imports, preferential foreign exchange and quota allocations for imported equipment and raw materials, and so on. Though the long-run economic impact of these programs is considered minimal by most researchers (e.g. Yoichi Okita, "Japan's Fiscal Incentives for Exports," in I. Frank, ed. The Japanese Economy in International Perspective 1974) at the margin for specific industries or firms they may have been important. Further, they clearly demonstrate the psychological and political pressure on industry and trading companies to develop export markets. Additionally there was organized a senior advisory body on trade to the Prime Minister called the Sanken. It was composed of senior labor, industrial, and academic figures whose function was to set trade policy.
Since trade trends are a reflection of the economy, fundamental economic policies have had an equally important an impact on trade as those that were trade specific. The government's push to industrialize placed a premium on investment and growth. Financial resources were channeled through the city banks, the government development banks, the tax structure, and the government's expenditure patterns to areas such as steel, chemicals, shipping, shipbuilding, and so on. The primary architect of this plan was the Heavy Industry Bureau of MITI along with the MOF (Ministry of Finance).

This focus on growth and industrialization in turn led to rapid increases in manufacturing investment and productivity which increased Japanese competitiveness. As domestic competition in a given industry was encouraged via equal access to credit markets, technology, and financial incentives, this situation resulted in constantly lower prices and expanding markets, at first domestically and subsequently overseas. Expanding markets led to more investment demand, increased productivity, lower prices, more growth, and so on. Hence the great investment booms of the 1950's and 1960's, and the rapid expansion of Japan's industries and exports. As the industrial structure shifted towards heavy industries like steel and chemicals or towards more sophisticated manufactures like ships, cars, and electronics, the pattern of imports in percentages terms changed, too. Cotton and wool decreased while coal, iron ore, oil and alumina increased. There was only one constraint on the above growth scenario in the 1950's and 1960's.
As investment demand and the domestic economy boomed, the need for imports increased while production capacity available for exports shifted to the domestic market. Soon imports exceeded exports, and the government's foreign exchange reserves dropped. The monetary policy brakes were then applied, restricting the funds available from the banks for industrial investment. These were the Balance of Payments induced growth recessions of the postwar period. The result was a reduction in imports but greater capacity available for exports. The latter were encouraged by the need to operate close to capacity to cover high interest and relatively fixed labor costs.

After 1952, the government borrowed abroad as well to reduce the Balance of Payments constraint and to develop key industries like steel. But it resisted foreign investment since its objective was to develop indigenous firms. The interaction of investment, growth, and exports by Japanese firms was a well-established pattern of industry development by the late 1950's, and the need for many of Japan's more draconian import controls ended. The linkage system for instance was dropped in the middle 1950's, and in 1961 she adopted a 3-year program to liberalize 80 percent of her imports. In the first step 257 items representing 44% of imports by value were freed. But this program and later versions had limited impact until around 1971. This was because the percentages liberalized referred only to the value of imports permitted and not to the available market in Japan. Also the liberalization applied only to the quantitative quotas and not to the restrictions on foreign exchange usage or technology imports. These remained in effect. Furthermore, Japan's effective rates of tariff protection to value
added remained high. Indeed they had actually risen during this period as value-added per unit of production declined with increases in productivity. Sekiguchi and Krause estimate that only 2.7% of the growth in Japanese imports between 1961 and 1971 was due to liberalization. ("Japan and the World Economy," Asia's New Giant," H. Patrick and H. Rosovsky, ed. 1976).

However, liberalization did continue through the 1960's and early 1970's as Japan's industrial strength and export surplus developed further. After 1968 particularly, Japan's export surplus grew rapidly due to the Vietnam War, rising U.S. inflation, and Japan's improving productivity. In turn, external pressures, especially U.S. pressures, for real and substantive liberalization increased markedly. But the government still did not quickly embrace full liberalization, not yet really appreciating Japan's international competitiveness or her growing structural trade surplus. Thus, it took till 1971 for her to liberalize 80 of the 120 articles still restricted in 1969, including 45 of the 73 agricultural items. In 1972, an additional four agricultural and 3 manufactured items were released.

The remaining 24 agricultural items such as fruits and meats, however, continue to be restricted. These are politically sensitive since a large portion of LDP's support remains in agriculture. The size of these quotas has thus continued to be an important part of trade negotiations including the Tokyo Round. As for the more unliberalized manufactured items, these included bulk film, pharmaceuticals, computers, semi-conductors, and leather goods. With the exception of the last, these were finally liberalized on
a schedule in 1974-75. However, the schedule does not allow for full liberalization on some items like film until 1980. Leather will continue to be handled specially due to the problem of the Brakumin who work extensively with it.

In 1971-72, too, as a result of the Nixon shock, Yen revaluation, and other pressures, the government began to really dismantle its technology import restrictions and foreign exchange quotas as well. For foreign exchange this was at first via a positive list, i.e. various stated items were liberalized or eligible for automatic approval. Nevertheless, considerable paper work was still necessary and administrative guidance always possible. More liberalization was then temporarily set back in 1973-74 by the impact of the oil crisis on Japan's trade balance. But finally in 1975, this system was changed to a negative list in which only items that were specifically regulated needed approval. These are now minimal for traded goods though the stand-by authority is there. As for technology, MITI increasingly left negotiations to individual firms after 1968 and particularly after 1971-72.

Import liberalization has in fact represented part of a growing opening of the economy to foreign competition that has included capital liberalization too. Japan has now caught up with the West in per capita incomes and international competitiveness. The Balance of Payments is no longer a growth constraint. Rather a new problem has emerged, large trade surpluses that were temporarily masked by the oil crisis and the resulting large increase in Japan's import bill. Therefore Japan's current trade policies are more oriented towards encouraging imports while keeping the volume of exports down. This has created the need for major institutional
reversals which have been difficult to achieve. However, some
obvious policy steps have been taken, including unilateral tariff
cuts, stockpiling of strategic raw materials and fuels, import
financing by the Export-Import Bank, promotion of foreign goods,
and elimination of the sole agency system for imports. In addition,
there have been periodic "voluntary" restrictions on export items
to specific markets, primarily the U.S. and EEC in items like
textiles, steel, and TV's. The government has also run large
fiscal deficits to encourage domestic growth, consumption and invest-
ment. And monetary policy has been aggressive. Foreign investment
by Japanese firms to substitute foreign production for exports has
also been facilitated by credit availability, tax benefits and
exchange control liberalization. But much remains to be done
to change ingrained procedures, while leading Japanese firms continue
to have unused capacity and to be cost competitive. The incentives
and ability to export thus remain, especially when one notes Japan's
low inflation rate and the fact that the market growth for many of
Japan's leading industries is now overseas.

The solution to Japan's trade surplus will not be easy to find.
Yen revaluation has influenced the marginal firm in marginal
industries, but overall export volume has remained remarkably constant.
Therefore, the dollar denominated surplus has grown. Further,
past government policies of encouraging and promoting domestic
investment and savings have kept the government sector relatively
small and the GDP multiplier low. Stimulative fiscal policies have
therefore had important but limited impact on economic growth and
in turn imports. It will take some time for the new policies to
work, time that protectionist pressures in Japan's trading partners
may not permit. This change in trade and economic policy thus represents Japan's new trade policy challenge in the coming years. Her economic direction must change towards more domestic growth, emphasizing consumption and services to improve the quality of life rather than only manufacturing investment and international competitiveness. Further imports of a broad range of goods and services must be both permitted and encouraged if Japanese exports are to be accepted abroad in quantity. Only in this way can her growing economic strength be a stabilizing rather than a destabilizing influence in the world economy.

BIBLIOGRAPHY


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