

# MANAGING THE WORLD ECONOMY THE ROLE OF JAPAN AND THE EUROPEAN COMMUNITY

by

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A free trade regime was created under the U.S. leadership in the aftermath of World War II. This regime centered on the General Agreement on Tariffs and Trade has provided enormous economic benefits to America's major trading partners, including Japan and the European Community. However, recent years have seen a growing number of trade disputes among the trilateral countries and a rapidly rising tide of protectionism, which undermine the regime's very foundation. While GATT's 93 member-countries account for more than 80 percent of world trade, only 20 percent of total trade is conducted under GATT rules<sup>1</sup>.

To understand why this has come about, we need first of all to put ourselves in a systemic perspective and examine the international structural changes that have taken place since the immediate postwar period. For the current crisis in U.S. - Japan relations is largely a function of America's hegemonic decline coupled with the erosion of the postwar bipolar structure, and of the inadequate responses to this changing reality on the part of the trilateral countries.

## I. Systemic Changes and U.S. Trade Policy

In the 1920s the United States replaced Great Britain as the military and economic hegemon in the world. But it was not until after World War II that the United States began to play its hegemonic role in establishing and maintaining a liberal world economic order. However, it became increasingly difficult

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1: *JEI Report*, No. 22A (Washington, D.C.: Japan Economic Institute, June 12, 1987), p. 1.

for the United States to perform that role effectively as its relative position in the world economy declined after the mid - 1960s.

In 1955 the share of America's GDP (gross domestic product) in the total world GDP was 40.3%, but in 1980 it was reduced to 23.3%. In 1957 the share of foreign reserves in U.S. hands constituted 40.1% of the world's total, but in 1972 it was reduced to only 7.3%. And in 1985 the United States, which had long remained the world's largest creditor nation, turned into the world's largest debtor nation, with its foreign debt amounting to as much as \$ 263.3 billion in 1986. In its stead, Japan became the world's largest creditor nation, with its foreign assets amounting to \$ 180.4 billion in 1986<sup>2</sup>

In the immediate postwar years the United States enjoyed international competitiveness in practically all domestic industries. But over the years it lost comparative advantage in an increasing number of them, such as textiles in the 1950s, steel in the 1960s, household electronics in the mid-1970s, automobiles in the late 1970s, and now even high-technology industries. Indeed, the U.S. global trade has registered a deficit ever since (except for two years), and the U.S. global trade in 1986 amounted to unprecedented \$ 170 billion; its trade deficit with Japan was about \$ 58 billion. Moreover, the U.S. high-tech trade turned into the red last year for the first time in the postwar history. Consequently, the U.S. government has become increasingly susceptible to protectionist demands from specific import-affected industries. In the monetary area the United States virtually surrendered its hegemonic role in 1971 when it announced the suspension of the convertibility of the dollar into gold, thereby paving the way for the current floating exchange-rate system.

In the meantime, the erosion of the postwar bipolar structure has reduced the U.S. incentive for practicing «one-way» free trade for maintaining the cohesion of the Western coalition against the socialist bloc. During the height of the cold war the United States had benevolently opened its market to imports from Japan and other allied countries, while allowing these same countries to be largely negligent in opening their own markets to U.S. products. The United States was then proud of being «Uncle Sugar». Since the late 1960s, however, the United States has become less patient with its traditional allies over bilateral economic conflicts and increasingly emphatic in demanding greater reciprocity in market access and «fair share» in international trade.

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2. Robert O. Keohane and Joseph S. Nye, *Power and Interdependence* (Boston and Toronto: Little, Brown and Co., 1977), p. 141; *JEI Report*, No. 21B, June 5, 1987, p. 4; *The Japan Times*, June 26, 1987.

## A. U.S. Trade Policy Since the Late 1960s.

While these systemic changes implied that U.S. - Japan economic conflicts would be more likely to escalate than before, the very U.S. efforts to correct its deteriorating trade balance with its major trading partners have tended to exacerbate bilateral conflicts.

### 1. *The Market Access Strategy*

U. S. efforts to persuade Japan and other major trading partners to open up their markets for U.S. products, instead of restricting imports from these countries, were rational and commendable. This market-access strategy allowed the United States to adhere to its free trade principle while hopefully rectifying trade imbalance and weakening domestic protectionism. But this strategy has not necessarily produced expected results. Let us briefly examine the effectiveness of this strategy vis-a-vis Japan. First of all, Japan's remaining Japanese import barriers involve precisely those problems that are difficult to resolve quickly in Japanese politics, and the Japanese response to the U.S. market-access demand have tended to be almost always «too little, too late» from the American point of view. Second, in the course of pursuing the market-access strategy vis-a-vis Japan and selling this strategy at home, U.S. officials have tended to exaggerate the closed nature of the Japanese market and actually ended up fueling further domestic protectionism, encouraging the reciprocity argument in reverse. Third, no matter how much Japan may eliminate the remaining import barriers, it will be next to impossible to substantially close the bilateral trade gap in the foreseeable future. According to various estimates, the maximum possible global impact of Japan's full liberalization would be in the range of a few billion U.S. dollars, which is only a fraction of the size of the annual Japanese trade surplus with the United States<sup>3</sup>. The American tendency to associate Japan's market liberalization with the closing of the bilateral trade gap has inevitably turned into further disappointment and frustration. In 1985, many U.S. congressmen came to suggest that U.S. government should enforce the existing trade laws in order to deal with the «unfair»

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3. C. Fred Bergsten and William R. Cline, *The United States-Japan Economic Problem* Policy Analyses in International Economic 13 (Washington, D.C.: Institute for International Economic, 1985), pp. 109-113; G. Hufbauer and J. Schott, *Trading for Growth: The Next Round of Trade Negotiations* (Washington, D.C.: Institute for International Economics, 1985), p. 64; Gary R. Saxonhouse, «The Micro and Macroeconomics of Foreign Ales to Japan, «in W. Cline, ed. *Trade Policy in the 1980s* (Washington, D.C.: Institute for International Economics, 1983), p. 264.

trading practices of Japan and other trading partners, instead of continuing trade negotiations with Japan that were increasingly seen as «a waste of time». Moreover, Congress became critical of the Reagan Administration for refusing to deal squarely with its macroeconomic policy problems which had exacerbated the U.S. trade-imbalance problem.

The Reagan Administration's 1981 tax cuts to boost domestic demand, coupled with a significant increase in the defense budget, swelled the budget deficit, and this in turn worsened the U.S. trade balance. On the Japanese side, Nakasone's preoccupation with administrative and fiscal reforms led to a series of tight national budgets, which had the unintended effect of perpetuating Japan's export-led economic policies.

## *2. The Exchange-Rate Adjustment*

The Reagan Administration had long been reluctant to intervene in the foreign exchange market, arguing that «the high value of the dollar is a reflection of the strength of the American economy»<sup>4</sup>. But once the G-5 intervention took place in September 1985, U.S. officials came to think as if the exchange-rate adjustment provided a panacea for solving the U.S. trade-deficit problem: if only the dollar's real value could be reflected in the exchange-rate market, the United States would be able to increase exports and reduce imports, thereby achieving more balanced trade. While the ongoing rate of about 185 yen to the dollar was already causing a near panic among Japanese exporting companies, Lester Thurow, a MIT economist, went so far as to suggest at a Boston symposium in March 1986 that the yen should appreciate much more so that we would have an exchange rate of approximately 100 yen to the dollar.

Because of the substantial yen appreciation, Japanese exports by volume began to slow down in 1986, creating an expectation that U.S. imports from Japan would decrease and U.S. exports to Japan increase sooner or later, even in dollar terms. That expectation has not been realized so far. The U.S. trade deficit with Japan (as well as with the world) increased substantially from 1985 to 1986. We saw a sign of possibly decreasing U.S. global trade deficit in the first quarter of this year, but the January-August trade deficit showed some

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4. Raymond J. Ahearn and Alfred Reifman, «U.S. Trade Policy: Congress Sends A Message,» (Paper prepared for the Conference on Current Trade Issues sponsored by the National Bureau of Economic Research, Cambridge, MA, August 8, 1985), p. 2; Hideo Sato, *Current History*, vol. 84, no. 506, December, 1985, p. 407.

increase over the same period last year. The deficit hereafter may level off, but it is unlikely to decline substantially, without some major policy changes on both sides.

### *3. Controlling «Unfair» Trading Practices*

Having been frustrated with its unsuccessful efforts to reduce trade imbalance through the market-access strategy and the exchange-rate adjustment, the United States has of late intensified its criticism of «unfair» trading practices on the part of Japan and other major trading partners. If only America's trading partners would stop «unfair» practices, then the United States could compete in the international market place and the trade imbalance problem would be resolved accordingly. «Level playing field» has become a buzzword for U.S. trade negotiators in seeking reciprocity in the trading practices of other countries. While it is perfectly understandable why the United States should place such an emphasis on «unfair» practices, there is also a danger that this approach could be carried too far, ending up fueling protectionism at home. Moreover, some people argue that the United States is acting as both prosecutor and judge in determining fairness and unfairness.

In 1985 two analysts of the U.S. Congressional Research Service wrote: «Instead of seeking solutions through enforcement or negotiation of reciprocal agreements, non-discrimination, and, more generally, the rules of the GATT, the most prominent Congressional approaches are based on unilateral standards of reciprocity, discrimination, and the threat of retaliation. Successive administrations have opposed similar approaches on the grounds they violate U.S. international obligations, undermine U.S. global leadership, and are counter-productive economically»<sup>5</sup>. Indeed, the omnibus trade legislation contains numerous provisions smacking of such unilateralism.

What is also ominous is the current attempt on the part of the U.S. Congress to limit the Presidential discretion on trade policy, particularly with regard to the application of Articles 201 and 301 of the 1974 Trade Act. Should the omnibus trade legislation containing the relevant provisions become law without substantial revisions, the very nature of trade politics between the Executive and the Legislative branches would shift in favor of the latter, thereby making the U.S. government more susceptible to domestic protectionist pressures.

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5. Ahearn and Reifman, p. 2.

### *B. America's Self-Help and Beyond*

As seen above, the United States had tended to resolve its trade problem largely by making its major trading partners bear the costs of adjustment. But, the United States also needs to tackle its trade problem through self-help. Namely, the United States will have to set its own economic house in order by reducing its federal budget deficit, increasing and restoring industrial competitiveness, and becoming more aggressive and creative in marketing its products abroad. There has been some progress in these directions, but much greater efforts will be needed. The biggest enemy in this context is no other than complacency. «It is not yet clear», as Ezra Vogel says, «that America has the political will to overcome the decades of complacency that stemmed from the unique period following World War II, when, as the only major power not severely damaged, it could succeed economically without special efforts<sup>6</sup>».

Japan and the European Community, for their part, need to help the United States reduce its trade imbalance and to share the burden of maintaining the free trade regime. Fig. 1 presents in an illustrative fashion various factors promoting or constraining free trade. + indicates that a given factor contributes to free trade, whereas — shows just the opposite. It is to be noted that both the international economic and political structures, as they currently stand, are supportive of free trade, though such support has considerably weakened over the years. While the U.S. economic hegemony has been much eroded, the United States is still the world's most influential economic power with its basic commitment to free trade. This situation is quite different from that in the 1920s when Great Britain was replaced by the United States as de facto hegemonic power.

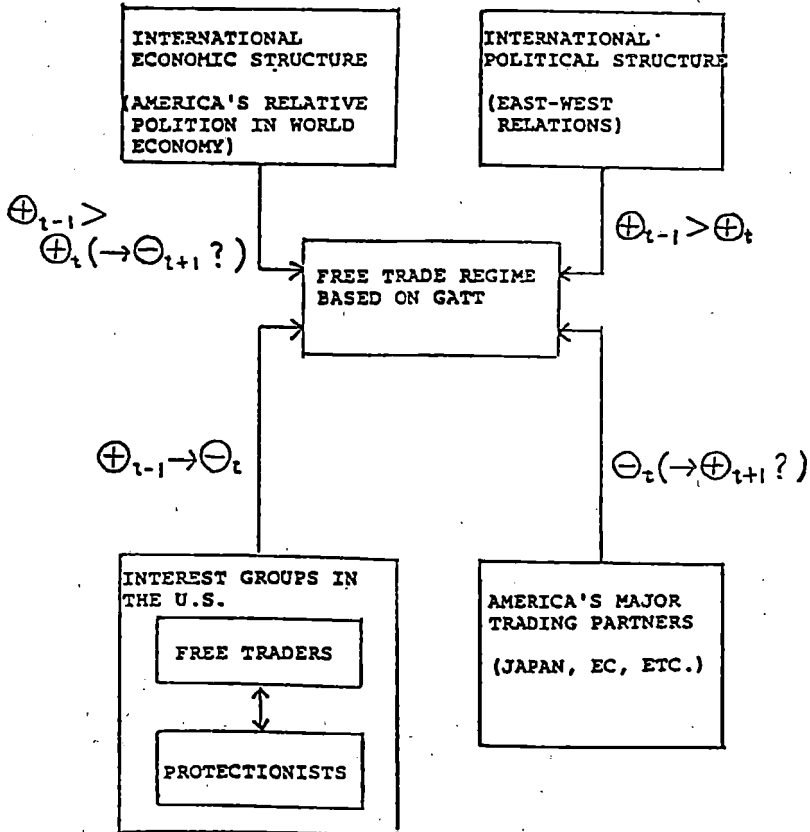
The two remaining factors have to do with the domestic political balance between free traders and protectionists in the United States, and with the attitude of America's major trading partners, including Japan and the European Community. At present, protectionists seem to have an edge over free traders in the U.S. interest-group politics, reflecting the current state of American industrial competitiveness and trade balance. In the perception of the United States, Japan and the European Community have not been sufficiently cooperative, still unable to overcome their passive attitude of relying upon the United States.

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6. Ezra F. Vogel, «Pax Nipponica?», *Foreign Affairs*, Spring 1986, vol. 64, no. 4, p. 763.

Fig. 1

## Factors Promoting or Precluding Free Trade



SOURCE: HIDEO SATO, «THE WORLD SYSTEM AND TRADE»,  
KOKUSAI SEIJI MAY, 1986, NO. 82, p. 129.

## II. EC-Japan Economic Relations

Instead of helping the United States maintain free trade or forming a united front to restrain U.S. unilateralism and protectionism, Japan and the European Community have too often been involved in trade disputes between themselves.

### A. The EC's Two-Track Trade Strategy

The European Community's trade deficit with Japan more or less leveled off at around \$ 10 billion in the early 1980s, but it increased to nearly \$ 20 billion in 1986. This is partly due to the fact that the yen has lately appreciated much more sharply against the dollar than against the European Currency Unit; over 65 percent against the dollar and only about 13 percent against the ECU within two years after the G-5 intervention of September 1985<sup>7</sup>. For some years now the European Community has been resorting to a two-track strategy of restraining Japanese imports while pressing Japan to liberalize its market for European products. Compared with the United States, EC countries have traditionally tended to impose more outright restrictions on Japanese imports. While there has been some significant change in this attitude, they still maintain many import quotas, including those specifically against Japanese products. In recent years, the Europeans have come to rely on the VER (voluntary export restraint) approach (as has the United States) to cut back on «sensitive» Japanese exports to Europe, such as automobiles, motorcycles, color TVsets, machine tools and video cassette recorders (VCRs). Japan has agreed to such VERs to get the Europeans to abolish their various quota (and restrictions specifically directed against Japan, as well as to defuse anti-Japanese protectionist pressures in general. This Japanese strategy has not necessarily succeeded and Japan has sometimes ended up accepting VERs at the Community level on top of European national restrictions on Japanese imports.

There is also a tendency for U.S. restrictions on Japanese imports to beget European restrictions on Japanese imports. The Europeans fear the diversion of exports by Japanese firms from the United States to EC markets. For instance, as soon as Japan agreed to limit its car exportation to the United States in 1981, the European Community sought a similar arrangement for fear of a diversionary effect on Europe. In recent years such European fear seems to be growing as the protectionist sentiment has been getting stronger in the United States. Washington's spring 1987 imposition of retaliatory tariffs on Japanese exports of 18- to 20- inch color televisions, certain power tools and 16 - bit portable and desk - top computers sparked a reaction from Brussels, and these same items were immediately put under surveillance.

Again following the footsteps of the United States, the Europeans have been pressing Japan to open up its market for foreign imports. Japan has made

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7. «Nichi-EC Kankei», a reference material provided by the Economic Affairs Bureau, Japanese Ministry of Foreign Affairs. October, 1987.



Tabele I

## Japan's Direct Investment in the European Community

(Unit: Million dollars)

	1984			1985			1986			1950-1986		
	cases	value	%	cases	value	%	cases	value	%	cases	value	%
UK	68	318	3.9	85	375	3.0	142	984	4.4	1,190	4,125	3.9
West Germany	48	245	2.0	48	172	1.4	59	210	0.9	817	1,552	1.5
France	50	117	1.2	60	67	0.6	52	152	0.6	742	970	0.9
Italy	6	22	0.2	11	32	0.3	18	23	9.1	156	203	0.2
Belgium	11	71	0.7	10	84	0.7	7	50	0.2	249	793	0.7
Netherlands	30	452	4.5	38	613	5.0	60	651	2.9	354	2,337	2.2
Luxemburg	7	315	3.1	12	300	2.5	16	1,092	4.9	99	2,307	2.2
Ireland	1	1	0.0	5	81	0.7	4	72	0.3	62	332	9.3
Denmark	1	1	0.0	1	1	0.0	2	1	0.0	39	17	0.0
Greece	0	9	0.1	1	35	0.3	—	—	—	16	96	0.1
Spain	11	140	1.4	8	91	0.7	15	86	0.3	163	601	0.6
Luxemburg	7	315	3.1	12	300	2.5	16	1,092	4.9	99	2,307	2.2
Spain	11	140	1.4	8	91	0.7	15	86	0.3	163	601	0.6
Portugal	2	0	0	1	0	0.0	2	3	0.0	28	27	0.0
EC 12	235	1,691	16.7	280	1,851	15.1	377	3,323	14.9	3,915	13,363	12.6
Europe (Include East Europe)	269	1,937	19.1	313	1,930	15.8	404	3,469	15.5	4,324	14,471	13.7
U.S.A	757	3,359	33.1	921	5,395	44.2	1,232	10,165	45.5	13,757	35,455	33.5
World as a whole	2,499	10,155	100.0	2,613	12,217	100.0	3,196	22,320	100.0	40,123	105,970	100.0

Source: Economic Affairs Bureau

Japanese Ministry of Foreign Affairs, September 1987

a series of concessions in recent years, including the «Action Program» of 1985 and the latest 6 trillion (\$ 42.9 billion at Y 140=\$ 1.00) stimulative package. In addition to arguing that most of these concessions have not been extensive enough, the Europeans have complained that these Japanese concessions have tended to favor the Americans. At the 1987 EC-Japan annual meeting, the European Community submitted a list of «world.-class» EC products, including aircraft and medical, electric and telecommunications equipment. Tokyo was also asked to allocate \$ 1 billion to specifically reduce the EC-Japan trade imbalance. Moreover, the Europeans have been demanding, as has the United States, better access to large Japanese infrastructure projects, such as the Kansai International Airport and the Tokyo Bay development, and acceleration of Japan's financial market liberalization program.

### B. Some Hopeful Changes

While there is still a lot of room for improvement in EC-Japan economic relations, we can point out some positive developments, particularly over the past year or so. European exports to Japan have been growing faster than European imports from Japan, the pace of Japanese direct investment in the European Community is accelerating, and there has been growing industrial collaboration between Japanese and European companies.

In 1986, Japan's exports to the European Community rose 8.5 percent, but its imports jumped 10.4 percent. Compared with the first half of 1986, Japanese imports from the European Community grew 32.4 percent (Imports from all countries were up 6 percent) in dollar terms<sup>8</sup>. Over the last couple of years, Japan has either purchased or decided to purchase high-unit-price European products. In spring 1986 the Japanese government purchased three Super Pumas produced by Aero Spatiale of France. In December 1986, All Nippon Air ways decided to purchase aircraft manufactured by Airbus Industrie (worth 160 billion). In August 1987, the Maritime Safety Agency decided to adopt Falcon-900s (produced by Dassault-Breguet of France) as a long-distance search and rescue aircraft (worth Y 10 billion).

Commenting on the latest development in EC-Japan economic relations, Andreas van Agt, head of the European Community's delegation in Tokyo, stated recently in Ishikawa as follows: «There was a time when our relationship could be said to have revolved almost exclusively around our anxiety over the avalanche of Japanese car exports to Europe, then videotape record-

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8. «Positive Japan-EC Developments in 1986-7,» a report prepared by the Economic Affairs Bureau, Japanese Ministry of Foreign Affairs, September, 1987.

ers, ball bearings, copiers and again more cars. Meanwhile the EC was painstakingly, and with little response, asking Japan to open its market, while the Japanese surplus with the EC got bigger and bigger. During the past year, things have started to change. We are both now exporting more to each other than ever before. In fact, the EC is the only part of the world with which Japan's two-way trade is growing<sup>9</sup>.

Table 2

### Major Examples of Japanese Investment to EC by Countries

#### United Kingdom

Nissan Motor Manufacturing, UK Limited (automobile production; 12 billion capital operations begun in July 1986).

Yamazaki Machinery UK Limited (production of numerically controlled lathes and machining centers; Y8 billion capital; operations begun in June 1987).

Komatsu Ltd.'s factory in UK (production of construction machinery; Y3.1 billion capital; operations begun in July 1987).

#### FRANCE

Sony's Alsace factory (production of CD players and 8 mm video equipment; Y5.8 billion capital; operations begun in April 1987).

Toshiba-Thomson joint venture (production of microwave ovens; Fr 25 million capital; operations begun September 1987).

#### WEST GERMANY

TDK Recording Media, Europe (production of audio tape; Y800 million capital: operations begun December 1986).

#### ITALY

Sony's Robeleit factory (production of audio cassette tapes; Y2 billion capital; operations scheduled to begin in 1988).

Seiko-TEKNECOMP joint venture (production of liquid crystal paxels, 8 billion LIT capital; operations scheduled to begin in autumn 1987).

#### The NETHERLANDS

Nihon Radioator-Ti Silencer joint venture (production of automobile mufflers; fl 3 million capital; operations begun April 1986).

#### BELGIUM

Toyo Soda's capital participation in Eurogenetics NVSA (development of clinical test systems; BF 69 million invested; research activities begun in 1986).

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Source: Bureau of Economic Affairs,  
Foreign Ministry of Japan, September 1987

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9. quoted in *The Japan Times*, October 28, 1987.

Instead of simply exporting manufactured products to Europe, Japan has been increasing direct investment in the European Community, and the high value of the yen is accelerating this trend (Table 1). While the European Community has expressed unhappiness over several «screwdriver» Japanese factories in Europe, it has been generally receptive to Japanese direct investment, which can possibly result in greater European employment, technology transfers, and revitalization of the European economy.

A growing part of Japanese direct investment to the European Community takes the form of joint venture and other industrial collaboration, as shown in the examples of major Japanese investment given in Table 2. It is hoped that increasing transnational industrial collaboration as such will eventually help reduce inter-state economic tension.

### C. Further Tasks

Needless to say, both the European Community and Japan must try to make further efforts to accelerate the process of improving economic relations between themselves, so that the two economics can better cooperate in fighting protectionism in the world. It is essential that the European Community reduce existing barriers and not to create new ones, not only vis-a-vis Japan but also in relation to other countries. While the Community plans to create a fully integrated market for trade among its member countries in 1992, it should go out of the way to make sure that development not end up promoting discriminatory and protectionist trade policies toward outside countries. EC countries have become more successful of late in exporting products to the Japanese market, but they need to make even more aggressive marketing efforts vis-a-vis Japan and other countries. Moreover, since the United States cannot go on buying more European goods because of its huge twin deficits, the Europeans need to become much more self-reliant in promoting economic growth. According to the Commission's annual report which has just come out, the EC's GDP growth is expected to be only 2.2 percent in 1987 and 2.3 percent in 1988, with its unemployment approaching 16 milion<sup>10</sup>.

Similarly, Japan will have to become more dependent on domestic market in achieving higher economic growth, in addition to implementing further market liberalization. The domestic stimulative package announced at the Venice summit is welcome news. But, as proposed by the Meakawa Report (1st and 2nd), Japan needs to carry out structural reforms of its economy so that there will be a built-in guarantee for less-export-dependent economic growth. More-

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10. *The Japan Times*. October 17, 1987.

over, as the world's largest creditor nation, Japan is naturally expected to increase aid to debt-ridden developing countries. Earlier this year, the Japanese government disclosed its plan to recycle \$ 20 billion to the developing nations. As part of this plan, the Association of Southeast Asian Nations will receive the \$ 2 billion «ASEAN Fund» for enhancing the «growth of the private industrial sector, including joint ventures, and (to) contribute to the future development of financial markets in the ASEAN area.»<sup>11</sup> This is a big step in the right direction, and such aid could be further increased in the future. Japan's commercial banks, too, can possibly increase loans for specific, economically feasible projects in developing countries.

### III. Japan and the European Community in the Multilateral Trading system

If Japan and the European Community are to contribute to the stability of the free trade system, they need to minimize economic conflicts between themselves and to help the United States set its economic house in order, as pointed out above. But they also need to contribute more directly to the multilateral trading system. As stated at the outset, the GATT is not functioning well, in part because those countries which created it have come to break its rules. Now a new round of multilateral trade negotiations called the «Uruguay Round» is under way. Japan and the European Community must cooperate with the United States in making this round a success. Otherwise, we might end up witnessing the demise of the GATT system in not so distant a future.

#### A. Implications of the U.S. -Canada Free Trade Agreement (FTA)

On October 4 this year, two years after the free trade pact with Israel went into effect, the United States concluded an even more far-reaching agreement with Canada. It calls for phasing out tariffs in 10 years and reducing barriers in services, agriculture, energy, high technology and investment. In the near future, the United States may conclude a similar agreement with Mexico, possibly followed by a few of the newly industrializing countries of Asia. One wonders if the world is moving in the direction of competing economic blocs, away from the multilateral trading system. Canada's major objective was apparently to avoid getting hurt by a new surge of protectionism in the United States. But if Canada is exempted, other countries could be hit harder.

On the other hand, the FTA between the United States and Canada, which is yet to be approved, either by the U.S. Congress or by the Canadian provinces, could become a model and a building block for a viable multilateral free

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11. *JEI Report*, No. 39B, October 16, 1987, p. 4.

trade system. The FTA could also be used as leverage to induce other nations to join the bandwagon moving in the direction of trade liberalization. U.S. officials have been saying that they would go the bilateral route if there was little progress in the multilateral round. This means that if Japan and the European Community want to prevent the United States from concluding exclusive FTAs, they would need a strong enough political will to produce agreement in the Uruguay Round. In any case, an integrated North American market would mean that Japanese and European companies would have a stronger incentive to invest there, if only to avoid trade protectionism. Hopefully, increasing Japanese and European direct investment in North America will end up expanding trade as well.

## B. Japan and the Community in the Uruguay Round

In the past, the United States always took the lead role in multilateral trade negotiations, such as the Kennedy Round and the Tokyo Round. While the U.S. leadership will still be essential in the Uruguay Round, the U.S. government will be much less capable of playing an effective role, given the rapidly growing protectionist sentiment at home. It is here that Japan and the European Community must step in; they must take a much more active part in the new round so that the «Big Three» can share leadership in producing a viable agreement. There are several, particularly important issues that they need to tackle in the new round.

### 1. *Improving the Dispute Settlement Process*

The present dispute settlement mechanism under the GATT is too ineffective. Under Article 23 of the GATT, any member country can file a complaint alleging a violation of GATT rules. If bilateral negotiations fail to produce an agreement, a panel of experts is then established to judge the case. But, since the member countries decide by consensus whether to accept the report, the alleged violator has the power to veto any recommendation. The United States has suggested a «binding arbitration» approach, and this is something Japan and the European Community might consider seriously. The U.S. -Canada FTA has incorporated a similar mechanism which might actually work. According to the FTA, disputes not resolved in consultations would be automatically referred to arbitration panels, composed of neutral, independent experts in the particular matter under dispute. In all but the most exceptional circumstances, the parties would agree on a settlement based on the panel recommendations. A party taking action inconsistent with the panel recommendation

or other agreed solution would have to justify its action and would risk countermeasures by the other party<sup>12</sup>.

## 2. *Improving the Safeguards Code*

Article 19, the so-called «escape clause», has not been much used by GATT members as they have preferred to bypass the requirements of injury proof and compensation payment. Instead, they have chosen an easier path of bilateral VERs and OMAs (orderly-marketing agreements). This kind of selective protectionism clearly violates the principle of non-discriminatory behavior. According to an OECD (Organization for Economic Cooperation and Development) study, the value of manufactured exports from Japan and the NICs subject to such trade restrictions by OECD countries increased from \$ 14.9 billion in 1980 to \$ 31.7 billion in 1983<sup>13</sup>. George Ball, who negotiated VERs on textiles for the Kennedy administration, wrote in 1968: «On any objective appraisal the 'voluntary agreements' have been both a convenience and a danger. Though they have helped to quiet the outrage of protectionist lobbies they have had a demoralizing effect on both our government and industry, since, being too easy to work out, they have tempted hardpressed government officials to yield to industry pressure.»<sup>14</sup>.

A successful safeguards code should include both incentives and sanctions to persuade countries to adhere to GATT principles in taking further safeguards actions. An important question to ponder is whether or not the GATT secretariat should be given a role in designing and monitoring import restraint programs, similar to the International Monetary Fund's role in debt negotiations.

## 3. *Issues of Concern to Developing Countries*

Unless the GATT becomes more receptive to issues of concern to developing countries, it will be virtually impossible to sustain their interest in the GATT negotiations. On the other hand, it would be counterproductive to make protectionist concessions just to make developing countries happy. In general, Japan and the European Community, as well as the United States, should be prepared to concede on issues of developing countries' concern so long as

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12. «U.S.—Canada Accord Would End Tarrifs in 10 Years», *Background Bulletin*, Press Office, United States Information Service, American Embassy, Tokyo, October, 1987.

13. *JEI Report*, No. 22A, June 12, 1987, p. 4.

14. George Ball, *The Discipline of Power* (Boston: Little, Brown and Co., 1968), p. 193.

such concessions are made in the direction of liberalizing trade. They could include a possible elimination of the tariff escalation with regard to processed food and raw materials and a gradual phase out of quotas on textiles and apparel currently managed under the semi-permanent MFA (Multi-Fiber Arrangement) regime. At the least, trade in textiles and apparel should be returned to GATT rules.

The issues of «graduating» some of the newly industrializing countries, such as South Korea and Taiwan, from special trade preference normally given to developing countries would be extremely delicate. The United States has been interested in this particular idea for some time now, but its implementation would mean a movement away from free trade as it involves introducing or highering tariffs on certain products exported by the NICs. On the other hand, the generalized system of preference would be more meaningful if such special preference could be extended to only those poor countries that really need help. The European Community might be more indifferent (than Japan or the United States) to this issue of «graduation» because its member countries do not have a particularly high stake in their trade with the Asian NICs. Japan, for its part, would find it difficult to rationalize its support of the proposal, given the delicate nature of its relationship with these Asian countries. One may ask if enhancement of reciprocal free trade may be a better alternative.

#### *4. Services and Agriculture*

Japan and the European Community would do well to support the U.S. proposal to liberalize trade in services because the efficiency argument that support free trade in goods apply equally to services. A big question is what to do with those developing countries which are strongly opposed to the idea on account of the «infant industry» argument.

The issue of liberalizing trade in agriculture is a highly sensitive one as most countries, including the trilateral countries, have been very protective of agriculture. But, as Dr. Otto Graf Lambsdorff stated in his Ushiba Memorial Lecture in Tokyo this past September, «Without the success of agricultural negotiations within the GATT, there can be no positive conclusion of the new round».<sup>15</sup> While it will be politically impossible to eliminate agricultural protection overnight, it will be certainly worthwhile to work toward reduction of

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15. Otto Graf Lambsdorff, «The Multilateral Trading System: Problems and Outlook from a European Perspective», Ushiba Memorial Lecture delivered in Tokyo, September 1, 1987, p. 12.



agricultural support. For one thing, protective measures for agriculture are getting too expensive even for the trilateral countries. In the United States, the costs of agricultural programs rose from \$ 4 billion in 1980 to as much as \$ 26 billion in 1986. In Europe, the Common Agricultural Orogram has pushed the European Community to the brink of bankruptcy. The cost of the CAP rose to about \$ 23 billion in 1986. Japan paid out about \$ 10.5 billion in farm subsidies in 1985<sup>16</sup>. In this context, both Japan and the European Community would do well to pay attention to the U.S. proposal of eliminating all product-related agricultural support measures in ten years, at least as a material for constructive discussion.

Indeed, the Uruguay Round may be the last chance to «halt and reverse protectionism», and neither Japan nor the European Community could afford not to play an active and responsible role. It would be a serious mistake to regard the round simply as another U.S. game, for we are «all in the same boat».

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16. *JEI Report*, No. 22A, p. 11.