TRADE AND INVESTMENT

A shift toward horizontal trade

Automobiles ready for export
(Photo courtesy of Toyota Motor Corporation)

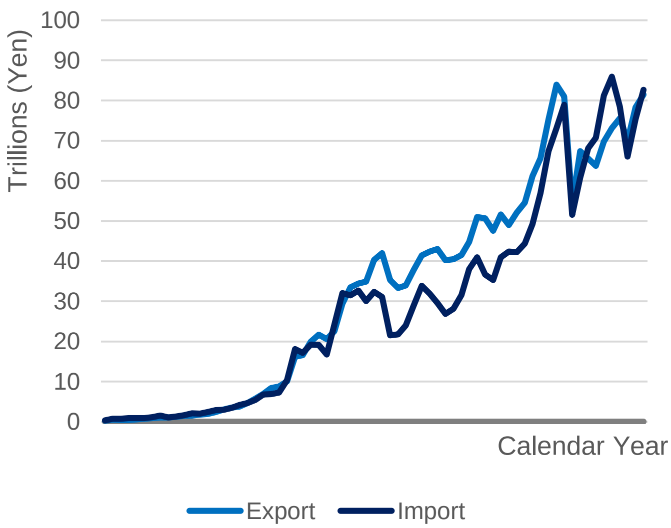
Introduction

Accelerating economic globalization continues to broaden and deepen Japan's trading and investment relationships with the countries of North America, Asia, and Europe. The trade-driven economic prosperity of Japan in the second half of the 20th century was made possible by progress made in achieving multilateral trade liberalization, progress that can be largely attributed to the workings of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). Since the late 1990s, however, WTO negotiations have stagnated, partly due to the diversification of issues being addressed and to the diverse and often conflicting interests of the growing WTO membership. In the absence of global WTO agreements, the trend in recent years has been to negotiate a free trade agreement (FTA) that applies only to them. Meanwhile, the Trans-Pacific Partnership free trade pact (TPP), to which Japan was allowed to join negotiations from 2013, reached a broad agreement. The Trans-Pacific Partnership (TPP) Agreement, which initially had 12 country members, became the Comprehensive and Progressive Agreeemnt for Trans-Pacific Partnership (CPTPP or TPP11) signed in March 2018 in Chile, excluding the US following its announcement of withdrawal from the agreement in January 2017.

Trade

Immediately following World War II, the devastation of Japan caused a continuing foreign trade deficit as well as a chronic lack of foreign currency. In 1952, however, Japan joined the International Monetary Fund (IMF) and three years later it joined GATT. Between the late 1950s and the late 1960s, the introduction of advanced technology and the building of an extensive domestic industrial infrastructure greatly increased the country's ability to export. During this period, Japan's trade was conducted on the vertical model of the processing plant, importing raw materials and exporting finished products. In 1964, Japan announced its conformance with article eight of the IMF charter, which stipulates the elimination of all restrictions on foreign exchange; this further spurred modernization and high growth. Japan's trade balance began to show a surplus starting in the second half of the 1960s, although the oil crises in 1973 and 1979 caused temporary balance-of-trade deficits. In the 1980s, Japan's trade rapidly transformed itself, shifting towards a horizontal model characterized by both the import and export of manufactured products.

Changes in Exports and Imports (1950-2018)



Source: The "Trade Statistics of Japan" issued by Ministry of Finance

Since the 1990s, the share of overall world trade represented by the exports and imports of East Asian countries has expanded greatly and with this expansion Japan's dependence on trade within East Asia, particularly with China, has also grown.

Since the start of the 21st century, imports and exports had been advancing smoothly in the face of the overheating of the U.S. economy and China's economic vitality. However, with the global economic crisis that followed the Lehman shock in fall 2008, Japanese exports have suffered a decline. In addition, the cost of oil and other imports has risen, causing Japan to record its first trade deficit in 28 years. Moreover, the deficit grew due to reductions in production and decreases in the exports of materials, which were instead distributed domestically, combined with increases in the imports of the materials needed for reconstruction in the wake of the unprecedented damage caused by the Great East Japan Earthquake of 2011.

Exports

From the late 1950s, the makeup of Japan's exports shifted to heavy-industry products and away from textiles and light-industry products. In the 1970s, the importance of industrial raw material exports such as chemicals and steel dropped, and exports of machinery and electronics jumped as increasing emphasis was placed on value-added products.

From the 1980s through the early 1990s, exports of technology-intensive products—such as computers, semiconductors, consumer electronics, machine tools, facsimile machines, and automobiles and other transportation equipment—increased rapidly. The rate of export increase slowed significantly in the mid-1990s, partly due to the establishment of overseas manufacturing facilities by Japanese companies. Trade friction led automobile manufacturers and other companies to build factories in the United States and Europe, and in order to maintain price competitiveness in the face of the rise of the yen, many companies moved the production of labor-intensive and technically less complex parts and products to China and other Asian nations. The Japanese manufacturing presence in China has greatly

UNIQLO expands oversea (photo of its Opera store in Paris)

spurred exports of capital equipment, components, and parts to that country. Since 2010, exports of infrastructure to emerging countries, which are regarded as a key part of the government's growth strategy, have remained steady.

Imports

In the immediate postwar era, primary import items included raw fibers that were processed into textiles. In the 1960s and 1970s, following the shift to heavy industry, essential imports included hydrocarbon fuels and metal ore. As a result of the two oil crises in the 1970s, crude oil prices soared, and in 1980 mineral fuels were approximately 50% of total imports. In recent years mineral fuels have fluctuated between 15% and 20% of imports, partly as a result of changes in crude oil prices.

The ratio of manufactured products to total imports has increased from 20% in the decade of the 1970s to 50% in the 1980s and to 60% since the 1990s, a ratio that closely parallels those of the advanced economies of the West. An important factor in the increase in imports of manufactured goods has been the expansion in exports to Japan from manufacturing facilities that Japanese companies have established abroad since the 1980s, mainly in China and the rest of Asia.

In particular, trade with China has expanded since the late 1990s. Japanese companies accelerated their Chinese operations after that country's domestic demand expanded and it joined the World Trade Organization in 2001, and trade between the two countries continues to increase.

Imports of computers and other information technology products have grown, and for some consumer electronics products, such as televisions, sales in Japan of import models exceed those of domestic models.

Trade Friction

Although Japan imports a high percentage of its fuel, foodstuffs, and the raw materials used by its industries, these are often exported in the form of value-added goods, which have gained a large share of the market in many countries with which Japan trades. This sometimes results in trade friction, which has been a recurring problem since the mid-1950s.

Until the early 1980s, friction primarily involved efforts to control rising Japanese exports in response to accusations of "dumping" (the sale of products overseas at lower prices than in the country of origin). Complaints by the United States led Japan to place voluntary restrictions on U.S.-bound exports of cotton goods (1957), steel (1969), wool and synthetic fibers (1972), color televisions (1977), and automobiles (1981). Japan also agreed to restrain steel exports to Europe in 1972.

On the other hand, since the early 1980s the focus of trade friction, particularly with the United States, has more frequently involved attempts to increase exports to Japan by giving foreign companies greater access to the Japanese market and eliminating so-called "non-tariff barriers." Aiming for import liberalization, Japan's government has taken such policy steps as unilateral tariff cuts, removal of import restrictions, reform of the standards certification system, and import promotion campaigns. Liberalization of agricultural imports, a politically sensitive issue, has led to the elimination or reduction of restrictions on beef, citrus fruits, and many other food products.

Dissatisfied with the pace of market-opening measures, in the first half of the 1990s the United States demanded a predetermined share of the Japanese market for such items as semiconductors, automobiles, and automobile parts. This led to disputes over numerical targets, which were vehemently opposed by Japan. Since the mid-1990s, efforts to solve trade friction have gradually shifted to international arenas, such as the WTO, where many countries are involved in the negotiations. Bilateral trade and economic issues between Japan and the United States continue to be addressed through such vehicles as the United States-Japan Economic Harmonization Initiative. On 7 October 2019, the Japan-US Trade Agreement was signed in Washington DC, and came into effect on 1 January 2020. This agreement seeks to eliminate or reduce tariffs pertaining to agricultural and manufactured products. It stipulates that Japan will eliminate or reduce tariffs on agricultural products and processed food such as pork and meat, while the US is committed to eliminating or reducing tariffs on manufactured goods.

The United States' trade deficit with Japan peaked at 70.8% of the total U.S trade deficit in 1981, and has been gradually declining since 1992, dropping to 10.5% in 2007. With factors such as the reduction of the U.S. trade deficit, strengthened investment relations, and improvements to the WTO's dispute settlement system, the friction in Japan-U.S. economic relations has been replaced with a harmonious relationship of constructive dialogue. After the Great East Japan Earthquake of 2011, however, Japan has experienced a trade deficit which peaked at 12.8160 trillion yen in 2014, although this has been falling since then.

Investment

In the immediate postwar era, the involvement of Japanese businesses in overseas economies centered on the export of goods. In the 1980s, direct overseas investment by businesses began to grow.

Among the reasons for this were the shift to overseas production due to trade friction, as in the case of the North American and European automobile markets; the shift to overseas production due to the strong yen, particularly electric and electronic goods manufacturers who moved to Southeast Asia and China in search of high-quality, low-cost labor; and the shift of production facilities to countries such as China in order to develop markets where there would be potential for major increases in demand. In the 1980s, a large part of Japan's direct foreign investment went to North America and Europe. In the 1990s, the ratio of investment in Asia rose. According to the international balance of payments trends announced by the Ministry of Finance and the Bank of Japan, foreign investment was 13.23 trillion yen in 2008, up 52% from the previous fiscal year and the largest figure ever recorded. It temporarily dropped due to the global financial market turmoil in the fall of 2008 but has risen again since 2011. Measures aimed at encouraging investment in transportation, machinery, tools, and other areas of the manufacturing industry were largely responsible.

Although Japanese businesses have been slow, in comparison with businesses in the United States, to become multinational enterprises, the move towards globalization continues.

Balance of Payments

The most frequently used component of balance-of-payment performance is the merchandise trade balance, which is defined as the difference between a nation's exports and imports. Since the mid-1960s, Japan has consistently run a surplus, which expanded rapidly in the 1980s. This surplus reached a new high of 12.39 trillion yen in 1994 before increases in import activity and other factors caused it to fall back to ¥6.74 trillion in 1996. Subsequently, the stagnation of the Japanese economy resulted in a slump in import activity, and this, combined with the strength of the U.S. dollar, sent the surplus in 1998 back up to about 16.08 trillion yen. Since then the surplus has fluctuated, but it experienced a downturn in 2011 with the occurrence of the Great East Japan Earthquake.

In 1996, Japan revised the method used to calculate its international balance of payments, and it began stating official statistics only in yen rather than in both yen and U.S. dollars. The change resulted in the combination of merchandise trade and service trade into the balance on goods and services category and the elimination of the differentiation between long- and short-term capital account balance categories. These changes reflect the increasing importance of the service trade and international capital flows.

Within its current account balance, Japan has had a chronic deficit in its current transfers balance and its service trade balance. Contributing to the service trade deficit are Japan's negative balances with respect to transport fees, licensing fees, and tourism (around 16.2 million Japanese tourists traveled abroad in 2015). In 2003 Japan’s service trade deficit fell considerably, partly as a result of a drop in overseas travel caused by SARS and partly due to an increase in royalty income from patents held by automobile manufacturers and other Japanese companies overseas. The current account balance has also been affected by the global economic crisis that struck in the fall of 2008. In addition, the trade deficit grew due to an increase in imports of fuel, mostly for use in thermal power plants, since the Great East Japan Earthquake of 2011. However, the overall current account balance moved into the black in 2015 due to increases in consumption in Japan by visitors from foreign countries. The trade balance deficit was also reduced significantly due to a fall in oil prices.