

REORGANISATION OF NORTH-SOUTH TRADE: JAPAN'S FOREIGN ECONOMIC POLICY FOR THE 1970s

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I. *Introduction: A New Stimulus for World Trade Expansion*

The postwar world economy has experienced setbacks to its rapid expansion around the end of each decade, but has resumed its expansionary course due to some new stimulus on each occasion. Following the problem of pound sterling convertibility in 1947 and devaluation in 1949, American aid to Europe and Japan, and the Korean War, both helped speedy recovery and a resurgence of world trade. The recession of 1957 was mitigated by the emergence and success of European integration, within the E.E.C. and E.F.T.A., which resulted in unprecedented growth in world trade throughout the 1960s. In 1967 the Kennedy Round was concluded in June and the S.D.R. system agreed upon in September, both events preceding a series of monetary maneuvers including devaluation of sterling in November, the gold rush, and revaluations in Europe, all of which ultimately resulted in the new United States economic policy of August 1971 and the international monetary realignments in December.

The free world economy faces another turning point. Uncertainty will remain throughout much of the 1970s and there is a real danger that no substantial progress will be made with regard to either trade policy or the international monetary system.

The challenge is to create another major stimulus for trade expansion and the growth of economic interdependence. One such stimulus should come from the steady and dynamic economic development of the Third World. Another is likely to derive from the enlargement of the E.E.C.

Yet another stimulus could be brought about from the creation of new products and technology and the transformation of each country's industrial structure in order to establish an expansive and harmonious international division of labour. The aim in Japan throughout the coming decade will be to expand the new technology-based, or so-called "knowledge intensive" industries, which consist of more sophisticated heavy and chemical industry products and soft-ware. This transformation will open up wider opportunities to increase imports of processed raw materials and metals both from advanced and developing countries, on the one hand, and textiles and other labour intensive manufactures mainly from developing countries, on the other.

Japan should undertake positive, and hopefully dramatic, policy measures to promote developing countries' economic progress. Japan has accumulated substantial foreign exchange reserves since 1968 and will be able to maintain a favourable balance of trade for the coming decade. For Japan, trade with advanced countries cannot be expected to grow

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as smoothly as it has in the past. It will be more promising for her to assist the economic development of developing countries and to expand mutually beneficial trade with them.

The Japanese and developing economies are basically complementary and harmonious in their trade relationship. Furthermore, there is plenty of scope for Japan to adjust her industrial structure, and, thus, to increase imports of developing countries' products, primary goods as well as manufactures. How to "Live on trade with the LDCs" may be one of the main focuses for Japanese economic policy in the 1970s.

The establishment of a new international division of labour between advanced (the North) and less developed (the South) countries is a common task not only for Japan but also the United States and other advanced countries, although they are much involved in their own troubles. Once they focus on the common task, they could find different solutions to their mutual trade adjustment problems. It is regrettable, for example, that the long-term Textile Agreement and recent voluntary export restraint agreements on synthetic and woollen textiles restrict the growth of LDC exports to advanced countries. In order to focus on the common task, advanced countries should co-operate in development assistance programmes, in fostering their own structural adjustment to the advantage of LDCs and in expanding trade with LDCs. It may be that among all advanced countries, those in the Pacific have most incentive to co-operate in this way.

A reorganisation of the North-South trade is a major target in the 1970s for Japan as well as other advanced countries. In it, Japan's role and responsibility is crucial.

In the following, first in Section II, Japanese attitudes towards the changing international division of labour are explored from the viewpoint that structural adjustment in developed countries is essential to reorganization of the trade between developed and developing countries. Section III examines the origins of Japan's successful industrialisation with the aim of drawing out any policy implications from this experience for developing countries. In Section IV, Japan's aid and foreign investment policies are discussed and evaluated alongside American policies. Finally, in Section V Japan's trade policy towards developing countries is examined and experience with adjustment assistance policies reported. The conclusion stresses the need for an integrated aid, investment *cum* preference, and structural adjustment policy.

II. *The Reorganisation of North-South Trade*

The best choice for Japan is, as the Government declares, to expand and free mutual trade with every trading region. The present stage of her industrialisation, her dual pattern of trade with developed and developing countries, and her geographical location dictate such a choice. But it is also true that Japan's main interest continues to be directed towards the Asian-Pacific region. And it is Japan's role in the coming decade to promote a harmonious reorganisation of the North-South trade in this region which requires a large-scale aid-investment *cum* preference-structural adjustment scheme.

Japan's economic growth in the 1970s may decelerate somewhat compared with growth performance in the 1960s, but it will continue at about 9 per cent per annum in real terms, or 17 per cent per annum in current dollar price terms.¹ Thus, her gross national product

¹ Revaluation inflates the growth rate in current dollar price terms.

could be \$957 billion by 1980, compared with the \$200 billion it was in 1970. This is not an excessively optimistic forecast since there was sustained growth in Japanese real income of around 11.4 per cent per annum on average throughout the last decade, and considerably higher growth rates were achieved after 1965. In 1970, Japan's exports amounted to \$19.4 billion and her imports to \$15.7 billion. By 1980, Japan will have become the largest trading nation after the United States, with exports around \$92.2 billion and a 10.8 per cent share in total world trade.²

Trade with South-East Asian countries and with the United States is equally important for Japan, each direction accounting for a third of total trade. Japan's trade with South-East Asia has provided, and will continue to provide, her with a large export surplus. In 1970, Japan's exports to the area amounted to \$4.9 billion and she imported \$2.4 billion worth of supplies in return (both in f.o.b. values), the imbalance ratio being 2:1. Even if Japan tries to increase her imports from the area faster than her exports to the area, in 1980 exports will be \$19.1 billion and imports \$10.3 billion, the imbalance ratio still being 1.85:1. Filling this gap is a task for Japan. Moreover, because of the rapid increase of Japan's trade with South-East Asia, Japanese goods will account for 40 per cent of the area's total imports. This might well invite Asian antagonism towards Japanese domination.

Coupled with heavy trade dependence, the increased aid and investment flows presage a testing time for Japan's economic relations with Asian countries. This will be a major challenge to Japanese economic diplomacy in the seventies and it will require a new understanding of Asian problems and aspirations. Japan's policies towards LDCs should be focused on how to increase trade between Japan and developing countries, especially in the Asian region. Through trade growth, Asian economies are able to benefit from the rapid growth of the Japanese economy and promote their own economic development. How can Japan increase her imports from developing countries much faster than the growth rate of GNP, however? Further trade liberalisation and the provision of general preferences and other incentives favourable to the exports of developing countries are required. It is crucial for Japan to foster an industrial re-adjustment policy aimed at the contraction of those industries in which developing countries already have or are gaining comparative advantage. On the other hand, export capacity should be created and increased in developing countries. To accomplish this, Japanese aid and investments should play an important role in the efficient re-organisation of the North-South trade in the Asian-Pacific Area.

Currently, the North-South problem seems to be facing a turning point: there is a shift in emphasis from aid and trade expansion of a 'surplus disposal' type to that of a 'structural adjustment' type.

In the last decade, less developed countries sought as much aid as possible from the developed countries. This aid was mainly used to provide social overhead investment and to fill the gap in the trade balance incurred by accelerated imports of capital equipment. In short, it was not really directed towards increasing exports and efficiency criteria were frequently neglected. Substantial foreign debts have accumulated in many developing countries and repayments and service charges surpass new borrowings. Thus, in addition to increased aid and a softening of terms of aid, the expansion of exports from developing countries is

² Japan Economic Research Center, *Japan's Economy in 1980 in the Global Context*, Tokyo, March 1972. This projection seems to be mildly over-optimistic but is used in this paper as a reasonable reference point.

an urgent task.

On the other hand, developed countries have confined themselves significantly to providing 'surplus disposal' type aid, United States food aid under public law 480 being a good example. To take another example, Japanese aid has so far been provided mainly for the purpose of increasing her own exports of heavy manufactures and chemicals.

Since about 1960, developed countries, including Japan, have been subject to more inflationary pressure. Aid of the 'surplus disposal' type has not been continued so easily. A new concept of aid and new aid policies have become necessary.

Structural adjustment in developed countries is an essential element if new development policies are to be successful. Multilateral and non-discriminatory free trade is the most important principle which should be pursued by all advanced countries in order to increase world trade. How to provide the basic conditions which are necessary to realise and maintain the free trade system is an important problem to be explored at present. The international monetary system must be revised so that balance of payments disequilibrium is quickly and frequently adjusted by a *more flexible adjustable-peg system*. Then, many tariff and non-tariff barriers to trade which have been introduced, mainly for balance of payments reasons, can be eliminated. However, as a pre-requisite for trade-liberalisation and smooth adjustment of balance of payments, *structural adjustment is needed* in each country's industries in response to changes in comparative costs. Inefficient, old industries which have lost comparative advantage should be contracted and capital and employment must be transferred to other growing sectors through adjustment assistance policies. To do this development centers will have to be created. How to cure overall unemployment is another difficult task in structural adjustment.

Recently, the need for industrial structural adjustment, and for new trade relations, has been more keenly recognised in Japan. Five factors support the emergence of a new structure in production and trade. *First*, the availability of land and harbour facilities suitable for heavy industrial expansion is extremely limited. *Second*, the problems of environmental pollution are extremely serious, mainly because of bad governmental control but also because of the constraints of geography. *Third*, the logistic problems of supplying basic heavy industries with raw materials and energy from abroad will become too large to manage economically. In consequence it will be necessary to restructure production towards activities which require less basic raw materials and energy fuel. This implies a re-location abroad of basic industrial capacity to service Japan's requirements for intermediate manufactured goods. In part, this re-location can be assisted by Japanese participation in investment abroad, and it can also proceed through the establishment of links with reliable independent suppliers. *Fourth*, Japanese labour-intensive manufactures, including traditional light industries such as textiles, will lose their competitiveness in international markets as Japanese wages rise in step with national income. It can be confidently expected that by 1980 the Japanese worker will enjoy a 35 hour, five-day working week and that wages will be about four times their present level. *Fifth*, because of labour shortage in manufacturing and service sectors and rapidly rising wages, inefficient and small-scale farmers will have to be transferred to these sectors, with only modern large farms being retained.

Throughout the coming decade, the Japanese aim will be to expand the new technology-based, or so-called 'knowledge-intensive' industries. In the early 1980s, research and development-intensive industries, such as computers, aeroplanes, electric cars and other

transport systems; complex assembly industries, such as communications equipment, office machinery, pollution control instruments and equipment, and construction machinery; fashion industries, such as sophisticated clothing, furniture and musical instruments; and the information industry, will all become important and competitive sectors of the Japanese economy.³

Although these so-called 'knowledge intensive' industries are not yet well defined and identified themselves, they consist of the more sophisticated heavy and chemical industry products and soft-wares.

These structural adjustments will take place gradually by the early 1980s, creating huge outlet for developing country products. But the heavy and chemical industries will continue to dominate export specialisation throughout most of the seventies; and raw materials will remain a key factor in import specialisation until late in the decade, when there will be larger imports of intermediate goods. Meanwhile, a huge amount of industrial raw materials and fuel will be required to service Japanese industrial growth; in 1980, Japan will represent 30 per cent of the world market for these commodities. Securing stable supplies at reasonable prices is now a major task. Increasing imports of cheaper foodstuffs will be another. New sources of supply both of raw materials and foodstuffs will have to be developed all round the world, but Asian-Pacific countries will hold a large share in the growing market. In the coming decade, it is quite certain, that, as structural adjustments proceed successfully on both sides, a large market will be opened in Japan for labour-intensive manufactures from nearby Asian suppliers.

Knowledge intensive industrialisation has several important implications.

Because of the lack of natural resources and availability of able and industrious manpower, the Japanese economy has developed for the last 100 years basically through "processing trade," that is, importing raw materials, manufacturing them for domestic use and export except for the exports of staples such as tea and silk in the early days. Concern about balance of payments problems, among other things, has produced policies aimed at maximum domestic processing, protection of infant industries and restraint in the import of consumer manufactures, although machinery and equipment necessary to import-substituting industrialisation remained an important element in imports.

Successive new industries have been nurtured in the process of Japanese industrialisation over the past 100 years, but there were two major structural changes.⁴ The first was light industrialisation which began around 1900 and accelerated after World War I. The second was heavy and chemical industrialisation which started in the late 1930s but succeeded post World War II, 1955-1965. These structural changes and diversification and upgrading of industrial structure contributed to a decrease in the import-GNP ratio from 21 per cent in the 1920s to 8 per cent in 1970 due to the lower imported raw material content of the heavy and chemical industries as compared with the light-industries (mainly cotton textiles) and to the substitution of imported machinery and equipment for domestic production. In other words, to save import content and to increase domestic value-added have been the major objectives in industrialisation of the processing trade type. Now, it is felt that there should be a shift towards knowledge intensive industrialisation, a third significant

³ Ministry of International Trade and Industry, *Trade and Industrial Policies in 1970's*, May 1971.

⁴ Kiyoshi Kojima, *Japan and a Pacific Free Trade Area*, Macmillan, London, 1971, pp. 9-12.

structural change.

In the 1960s, the industrial structure of Japan shifted rapidly towards heavy and chemical industries catching up with the pattern of more advanced economies. In Japan's exports, foodstuffs and raw materials and fuels are unimportant. Almost all exports are manufactured goods (Table 1). The share in total exports of light industrial goods decreased from

TABLE 1. COMMODITY COMPOSITION OF JAPAN'S EXPORTS
(per cent)

	1955	1960	1965	1970	1980
Foodstuffs	6.6	6.6	4.1	3.4	1.4
Raw materials and fuels	1.9	1.6	1.5	1.0	0.4
Light industrial goods (Textiles, non-metal ore, and others)	53.5	48.4	31.9	22.4	11.9
Heavy and chemical industrial goods (Metals, machinery and chemicals)	38.0	43.4	62.5	72.4	86.3

Source: Japan Economic Research Center, *Japan's Economic in 1980 in the Global Context*, March 1972, p. 29.

53.5 per cent in 1955 to 22.4 per cent in 1970, and is expected to decline further to 11.9 per cent in 1980 according to the latest JERC projection. On the other hand, the importance in total exports of heavy and chemical goods increased rapidly from 38.0 per cent in 1955 to 72.4 per cent in 1970 and will rise to 86.3 per cent in 1980.

According to a different classification of export commodities, Table 2 shows that the share of commodities originating from technology intensive industries in Japanese exports increased and will increase further.

TABLE 2. COMPOSITION OF JAPAN'S EXPORTS BY TYPES OF INDUSTRY
(per cent)

	1955	1960	1965	1970	1980
Labour intensive industries	58.9	55.1	36.5	27.7	15.3
Resource consuming type industries	22.3	14.9	21.3	18.9	11.5
Technology intensive industries	18.6	29.6	41.6	52.7	73.2

Note: Labour intensive type—Foodstuffs, textiles, other light industrial goods and metal goods.
Resource consuming type—Raw materials and fuel, nonmetal ore, iron and steel, and non-ferrous metal.
Technology intensive type—Chemicals, general purpose machinery, electrical machinery, transport machinery, and precision machinery.

Source: Japan Economic Research Center, *Japan's Economy in 1980 in the Global Context*, March 1972, p. 31.

How are these changes reflected in import structure? In 1955, more than half of total imports consisted of raw materials (Table 3). Besides raw materials, foodstuffs and mineral fuels were essential imports for Japan's development of processing trade. Only 12 per cent of total imports comprised of manufactures largely essential machinery and chemicals. Heavy and chemical industrialisation in the 1960s brought about smaller relative

TABLE 3. COMMODITY COMPOSITION OF JAPAN'S IMPORTS
(per cent)

	1955	1960	1965	1970	1980
Foodstuffs	25.3	12.2	18.0	13.6	9.5
Raw materials	51.1	49.2	39.4	35.4	21.9
Mineral fuels	11.7	16.5	19.9	20.7	18.8
Processed manufactures	11.9	22.1	22.7	30.3	49.8
Chemicals	4.5	5.9	5.0	5.3	5.7
Machinery	5.7	9.7	9.3	12.2	19.0
Other manufactures*	1.7	6.5	8.4	12.8	25.1

Note: Other manufactures are consisted of iron and steel, textiles and non-ferrous metal.

Source: Japan Economic Research Center, *Japan's Economy in 1980 in the Global Context*, March 1972, p. 34.

dependence on imports of raw materials but this was almost compensated for by the increased dependence on imported mineral fuels. Further savings in these two items is one of the targets for the coming knowledge intensive industrialisation in the 1970s. On the other hand, the importance of imports of processed manufactures increased from 11.9 per cent in 1955 to 30.3 per cent in 1970 which is still lower than the corresponding ratio for other advanced countries; for example, 50.7 per cent for the U.K., 59.2 per cent for West Germany and 66.2 per cent for the United States. It is expected, if the knowledge-intensive industrialisation is successful, that processed manufactures will amount to about half total imports, resulting in increased horizontal trade in machinery (imports in 1980 are estimated to be \$16.9 billion) and chemicals (\$5.1 billion) mainly with other advanced countries and also the increased vertical trade in other manufactures (\$22.3 billion) with developing countries and natural resource processing nations. The JERC estimated that in 1980, 37 per cent of Japan's imports from South-East Asia will consist of other manufactures (textiles and other labour intensive products), amounting to \$4.1 billion.

An important turning point in Japan's trade was reached in 1965 when the trade balance (or current account balance) turned into surplus from a long-lasting deficit position. Until 1965, the Japanese business expansion was checked on three occasions by the balance of payments ceiling. It was reasonable under those earlier circumstances for Japanese policy makers to endeavour to restrain imports and promote exports vigorously.

Trade policy was focused on and justified on grounds of improving the balance of payments position. Not only agriculture but almost all manufacturing industries, old as well as new, were protected from foreign competition through tariffs, quota restrictions and other non-tariff barriers and they were encouraged through lower interest subsidy and tax incentives. Japan's trade liberalisation made its first rapid progress from 1960 to 1963 but another liberalisation phase began only as recently as 1969 to 1971 after the trade balance had turned to surplus.⁵

Since the trade balance position turned to surplus around 1965, trade policy should also have changed from the long-lasting protectionistic attitude towards a new philosophy. That change, however, takes a long time. First, it was thought that the trade surplus was merely

⁵ More detailed analysis will be presented later in Section V.

a short-run phenomenon and not a long-run trend. Secondly, the economic community was not ready to accept the new philosophy overnight, since protection policies had been so intensive and so successful in assisting exports to grow almost twice as rapidly as the world trade, resulting in a steady export-surplus trend. Although change towards a new philosophy has been taking place gradually since 1965 and dramatically in the last two years, the Japanese economy is not yet ready to open wider its market for LDCs manufactures and semi-manufactures. Before this can be done a third structural change designed to upgrade Japanese industries is urgently required. It seems to me that the delay in structural adjustment of the Japanese economy *vis-à-vis* developing countries is hindering the latter's industrialisation and trade growth. The economic position of Japan today may be compared with the United Kingdom in 1932 when she decided to receive textiles and other manufactures of a labour-intensive type from dominion countries under the British Preference.

Structural adjustment policy usually focuses its attention on contracting old, comparatively disadvantageous sectors of the economy, but how to promote the growth of new, comparatively advantageous sectors is an equally important task for structural adjustment policy. How to cure overall unemployment is another problem which relates directly to the degree of flexibility and cost of adjustment programmes. This may be the most serious problem for such mature economies as the United States and the United Kingdom but not for Japan which is still young and suffers from labour shortage. Structural adjustment in declining, inefficient sectors is undertaken successfully only in a dynamic economy in which the growth sectors grow so rapidly as to absorb smoothly resources from contracting sectors. This is the general position of the Japanese economy today in respect of the rising ability of developing countries to export manufactured goods. A third structural change towards knowledge-intensive industrialisation is just what is required to allow adjustment towards developing countries.

First, knowledge-intensive industrialisation implies a partial shift from the processing trade pattern in Japan's economic development to the export of products based upon human resources with little import of overseas raw materials. This is applicable to the pure knowledge products such as information services, technological know-how, computer programme making, fashion design, and managerial skill on a contract basis. Exports of more sophisticated heavy and chemical products decrease dependence on overseas raw materials per unit of production and export. Thus, increased exports of knowledge-intensive products itself contributes to the reduction of the import/GNP ratio.

Second, heavy industrial expansion in Japan will slow down for the various reasons already mentioned. This implies a relocation abroad of basic industrial capacity and increased imports of intermediate manufactured goods. There will thus be wider markets for countries with abundant natural resources.

Third, if knowledge-intensive industrialisation is successful, it will become possible to transfer resources from traditional industries, mainly textiles and other labour intensive type industries. This will result in the opening of a wide market for manufactures from developing countries. It is expected that knowledge-intensive industrialisation will accelerate the transfer of resources from small and medium scale industries, which is the hard core problem for structural adjustment policy, for many knowledge-intensive industries are suitable not only to large-scale but also small and medium scale enterprise.

Fourth, if the expansion of exports in knowledge intensive products is sufficiently large,

the Japanese economy will be able to continue rapid growth with a lower import/GNP ratio. There is a reconsideration of policies designed simply to foster export expansion and restrain imports, resulting in a waste of domestic resources and neglect of social welfare. There is a need to increase public investment in infrastructure, anti-pollution measures, housing, social security, and the like. This will also contribute to a reduction in export growth and the import/GNP ratio. Too fast a growth of Japanese exports is criticised increasingly and orderly marketing is urged upon exporters. Knowledge-intensive industrialisation will make it possible to overcome these problems.

Thus, there is a strong belief that upgrading the industrial structure in Japan (and other advanced countries as well) through knowledge-intensive industrialisation would favour the industrialisation of developing countries as well as facilitate the re-organisation of North-South trade. But this solution crucially depends upon the prosperity of horizontal trade in knowledge-intensive products between advanced countries. How to promote this trade also needs serious consideration. In this sense, the North-South trade problem cannot be separated from the problem of maintaining harmonious growth in trade among advanced countries.

III. *Industrialisation and Trade Growth in Japan*

The success of Japan's knowledge-intensive industrialisation is important not only to her own economic development but also for the creation of a new division of international trade both with developing and developed countries. Although such industrialisation may not be an easy task, it can be undertaken determinedly and with the prospect of rapid progress, since the Japanese economy has plenty of experience in fostering structural change successfully in the past.

Recently Professor Vernon's "product cycle" theory has become well-known, but in Japan Dr Akamatsu, Professor Emeritus of Hitotsubashi University, propounded a "catching-up product cycle" theory as early as the mid-1930s. He originally called it "the wild geese-flying pattern" (*Ganko keitai*) of industrial development in developing countries since, as shown in Figure 1b, the time-series curve for imports of a particular product is followed by that of domestic production and later by that of exports, and they form a pattern like "wild geese flying in orderly ranks forming an inverse V, just as air-planes fly in formation."⁶

The concern of Vernon and others⁷ was to explain how a new product is invented and manufactured on a large scale in leading industrial countries (Figure 1a). Exports of this product grow in so far as a "technological gap" exists between the product developing

⁶ Kaname Akamatsu, "A Historical Pattern of Economic Growth in Developing Countries", *The Developing Economies* (The Institute of Asian Economic Affairs, Tokyo), March-August 1962, p. 11. See also *ditto*, "A Theory of Unbalanced Growth in the World Economy", *Weltwirtschaftliches Archiv*, Band 86 Heft 2, 1961, pp. 205-8. His theory is widely recognised by now, for example, Benjamin Higgins, in *Economic Development: Problems, Principles, and Policies*, rev. ed., Norton, New York, 1969, pp. 623-624; Miyoei Shinohara, *Growth and Cycles in the Japanese Economic Development*, Kinokuniya, Tokyo 1962, pp. 57-58.

⁷ For example, Raymond Vernon, "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics*, May 1966; G.E. Hufbauer, *Synthetic Materials and the Theory of International Trade*, Duckworth, London, 1966.

FIG. 1a. VERNON'S GENUINE PRODUCT CYCLE

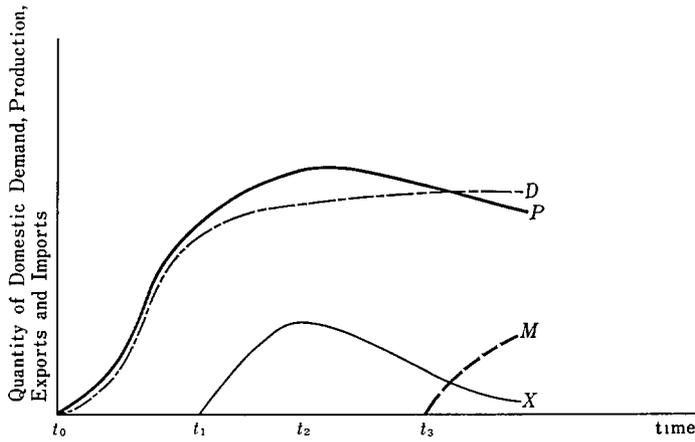
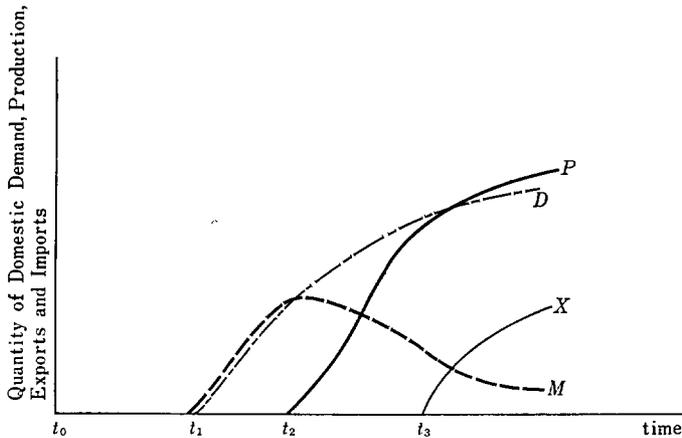


FIG. 1b. AKAMATSU'S CATCHING-UP PRODUCT CYCLE



country and foreign countries. Foreign producers imitate the new technology and follow suit. Then exports slow down and through direct investment an attempt is made to secure foreign markets. When the technology is standardised and widely disseminated and the limit of scale economies is reached, trade based on wage costs, or factor proportions, starts and the country turns to import this product from abroad.

In a developing, or catching-up country, the product cycle starts from the importation of the new product with superior quality. "Imports reconnoiter and map out the country's demand," and once increased demand approaches the domestic production threshold,

domestic production can be economically started.⁸ A learning process follows and is assisted by the importation of technological know-how and/or foreign direct investment. The expansion of production then leads in the exploitation of economies in scale, increases in productivity, improvements in quality, and reductions in costs. This involves an import-substitution process. But as domestic costs reach the international competitive cost threshold, foreign markets are developed, the scale of production is extended further, and costs are reduced again. Thus, the expansion of exports that is originally made possible by the growth of domestic demand, in its turn, provides a stimulus to industrial development.⁹ In sum, it may be appropriate to call such successive development of imports—domestic production—exports the catching-up product cycle. It should be noted that such a product cycle takes place only for standardised, not new, products and in developing, not leading, industrial countries.

According to Akamatsu's and our investigation,¹⁰ the catching-up product cycle is beautifully illustrated in the case of Japan, first for various kinds of textiles, then iron and steel, ships and boats, and light machinery, and also for radio and television sets, automobiles and motor-cycles, heavy machinery, as well as computers. This represents the fact that while each industry passes through its own catching-up product cycle, it creates demand for other products through backward-linkages and stimulates production through forward-linkages and interdependent repercussions. Thus the industrial structure of the Japanese economy as a whole has been upgraded and diversified in the process.

What factors contributed to successful development along catching-up product cycle lines in Japan? It is taken for granted that each successive product enjoyed the increased demand, domestic as well as foreign. The key to successful catching-up product cycle development was long-run decreasing costs of the nature revealed clearly for steel, automobiles and so on. Foreign direct investment and technological know-how were certainly important but the technological adaptability, active management, and industrious skill of the Japanese were much more important. Foreign technology was often amended and assimilated in a way which made its application in Japan more efficient.

In the stage of import-substitution, various kinds of protection for infant industries were granted, including protective tariffs and subsidies.¹¹ For certain key industries (especially steel, shipbuilding, trucks etc.) government purchases assured demand in the early stages of development.

To grow successfully from the import-substitution stage to the exporting stage costs have to become lower than the international price and good quality has to be achieved. Even if these are attained, there are still a number of difficulties, of the kind present-day developing countries confront in expanding overseas markets, since there are huge barriers

⁸ Albert O. Hirschman, *The Strategy of Economic Development*, Yale University Press, New Haven, 1958, p. 121.

⁹ Cf. Kiyoshi Kojima, *Japan and a Pacific Free Trade Area*, Macmillan, London, 1971, p. 13.

¹⁰ Kiyoshi Kojima, ed., *Structure and Development of the Japanese Trade*, Shiseido, Tokyo, 1972.

¹¹ See, Ippei Yamazawa, "Industry Growth and Foreign Trade: A Study of Japan's Steel Industry", *Hitotsubashi Journal of Economics*, February 1972. *Ditto*, "Industrial Growth and Tariff Protection in Pre-war Japan", *Keizai Kenkyu*, October 1972. Also U.S. Department of Commerce, *Japan, The Government-Business Relationship*, Washington D.C., April 1972, tells how such industries as computers, automobiles, and steel in post-war Japan have developed in close cooperation between business and government.

to new entry into advanced country markets. Assistance to "infant trade" instead of infant industry, may be justified.

Barriers to new entry in advanced economies include, besides tariffs and other ordinary barriers, (1) economies of scale which advanced country enterprise has but developing country enterprise has not realised; (2) advanced technology which advanced country enterprise monopolises and developing country enterprise can only use with royalty or through foreign direct-investment; (3) product differentiation in brand or design which makes adaptation by developing countries difficult; and (4) other barriers such as marketing and information networks, vertical and horizontal integration in production and sales with which only big multinational corporations are equipped. Because of these barriers to new entry for developing countries, they may better utilise the advantages and excellent facilities of multinational enterprises through direct investment both in production and marketing.

In Japan, general trading firms¹² which are unique to Japan and perhaps world-wide international corporations in character, played an important role. They have hundreds of subsidiaries and branches throughout the world and identify best the comparative costs between Japan and abroad. They now participate substantially in Japan's direct investments abroad. Present developing countries may establish similar organisations and/or utilise the facilities of Japanese trading firms.

After World War II, the Japanese government established JETRO (Japan External Trade Organisation) for trade promotion and information services. The government also provided effective incentives for export promotion¹³ through tax reductions for export earnings and subsidised interest rates for export financing, long-term export credit on a deferred payment basis, and subsidies for export and export-oriented production which were designed to encourage exports by influencing the profitability of enterprises engaged in export activity. Even reparations payments and the provision of tied aid worked to give exporting activity extra profit. Particularly export interest subsidisation worked very effectively in Japan. Incentive interest rates are accorded to foreign exchange bills which conform to the rule of standard settlement. Such trade bills become eligible to be discounted by, or qualified as collateral acceptable to, the Bank of Japan, and enjoy the benefit of discount or borrowing at interest rates lower than those prevalent in the country.¹⁴ Early availability of export earnings discounted with lower interest rates is a big benefit for enterprise as compared with longer deferred payments in domestic marketing, for their own capital is very limited and availability of money from outside the firm is critical for business expansion. Thus, with other export incentives, it may have been profitable for enterprises to export goods at, say, 10 to 15 per cent lower than domestic price. This incurred not only waste of resources but also condemnation of dumping from abroad. Such practices should be fully rectified as soon as possible.

Moreover marginal pricing practices in exports particularly of mass-production type are common in Japan and are even encouraged by the government, as can be seen from the

¹² The ten largest firms, in the 1970 fiscal year, handled \$ 21.9 billion or 55.6% of Japan's imports and exports.

¹³ See, Kiyoshi Kojima, "Nontariff Barriers to Japan's Trade", *Hitotsubashi Journal of Economics*, June 1972.

¹⁴ In fact the Bank of Japan raised interest rates on export related loans to the level of interest rates on domestic-related loans effective August 10, 1971, thus eliminating export incentives with regard to interest rates.

White Papers of the Economic Planning Agency and the Ministry of Trade and Industry.

To diversify and upgrade the industrial structure of an economy is another difficult task which needs much broader macroeconomic consideration than the present paper can cover. I believe that the structure of comparative advantages is basically regulated and changed by factor-proportions à la Hecksher-Ohlin theory.¹⁵ Diversification and upgrading of the industrial structure usually implies progress towards more capital and technology intensive industry and production-processes. To accumulate capital (inclusive of such human capital as scientists, engineers, managerial skill, skilled labour, etc.) and to raise the capital/labour endowment ratio is the major force for economic development. In order to do this, as the Japanese economy has, limiting the demonstration effect upon consumption in early period of industrialisation and a high rate of saving are essential. A comparison of the capital/labour endowment ratio with those abroad, should dictate the choice of industries with appropriate factor intensities. When the economy expands excessively through structural change, it must choose production processes with lower capital intensities in all industries, resulting in a set back in per capita income. But once the structural change is accomplished and capital accumulates further, then the economy can enjoy a steady growth. It is also usual for the economy to suffer from trade deficits in periods of structural change and enjoy trade surpluses in later periods.¹⁶

Perhaps the Japanese economy has been fortunate since its industrial take-off was relatively early; it could find markets abroad for its industrial output; and its domestic market as incomes rose, was large enough to establish large scale intermediate capital goods industries.

As compared with the Japanese economy, presently developing countries confront two basic problems. First, many developing countries already have a clear comparative advantage in labour intensive goods such as in textiles and clothing, and there is a considerable danger of oversupply of these goods and a consequent fall in the commodity terms of trade unless advanced countries foster accommodating structural change, thereby opening wider markets for developing country exports. This can be clearly understood when the two charts of Fig. 1a and 1b are compared.

Secondly, many developing countries want to establish intermediate capital goods industries, although only some countries have reached that stage. They must reconsider whether their factor endowments allow the establishment of such industries or whether it involves over-ambitious investment. They also have to overcome smallness of market for utilizing economies of scale either through economic integration among neighbouring developing countries or through production integration with advanced countries.

IV. *Japan's Aid and Foreign Investment Policy*

Now the Japanese economy has to move towards knowledge-intensive industrialisation, as stressed in the previous section. This implies, however, a basic switch from development

¹⁵ Cf. Hal B. Lary, *Imports of Manufactures from Less Developed Countries*, National Bureau of Economic Research, New York, 1968.

¹⁶ Such a model is presented in Kiyoshi Kojima, "Capital Accumulation and the Course of Industrialisation, with Special Reference to Japan", *Economic Journal*, December 1960.

characterised by the catching-up product cycle to the creation of its own genuine product cycles. The Japanese economy should enter into innovative competition in new products on an equal footing with other advanced countries and promote horizontal trade with them in new products. Upon this, the success of reorganisation in the international division of manufacturing production depends. Although the patterns in Fig. 1a and 1b look similar, the genuine product cycle is basically different from the catching-up product cycle. Imitation and learning are much easier than invention and innovation. The Japanese R&D investment in 1967 was 1.7 per cent of GNP which was far smaller than 3.6 per cent in the United States, 3.0 per cent in the United Kingdom, and 2.8 per cent in West Germany. Therefore, it is not an easy task for Japan to make the coming structural changes effectively. Also it might prove necessary to have international specialisation and coordination among advanced countries in innovation of new products for the creation of growth sectors in the world economy is most needed for the benefit both of advanced and developing countries.

Another new task for the Japanese economy in the coming decade is how to increase its aid and direct investment to developing countries in such a way as to facilitate harmonious structural change both in Japan and developing countries, with the aim of successful reorganisation of the North-South trade.

There is room for pessimism on the chances of fulfilling the Pearson Commission's recommendations that "the 1 per cent target . . . be fully met by 1975, at the very latest", and that "official development assistance should be raised to 0.70 per cent of donor GNP by 1975, and in no case later than 1980".¹⁷ (The Tinbergen Report¹⁸ sets a more ambitious target and UNCTAD III proposed a much more strict target).

The total financial flow (let us call it the total aid) from DAC members to LDCs has increased at an annual growth rate of 5.6. per cent, from \$ 8.1 billion in 1960 to \$ 14.7 billion in 1970, but the ratio to donor GNP has declined from 0.89 per cent to 0.74 per cent over the same period. This is mainly due to the fact that total aid from the world's largest source, the United States, has declined from 0.75 per cent in 1960 to 0.55 per cent in 1970, whilst official aid declined from 0.53 per cent in 1960 to 0.31 per cent in 1970. The future of United States aid policy is still to be decided, but a marked recovery is unlikely in the next few years. The United States is likely to press for the internationalisation of aid efforts, and to place more emphasis on the role of private investment flows.¹⁹

On the other hand, there is a growing realisation in Japan, both at the public and government level, that the country must assume a greater responsibility in aid-giving. A healthy balance of payments will render additional transfers relatively painless.

In 1970, Japan's total aid amounted to \$ 1,824 million, second only to the United States (\$ 5,393 million): other large donor countries of the free world are France (\$ 1,805 million), West Germany (\$ 1,409 million), and the United Kingdom (\$ 1,216 million). Japan's aid accounted for 0.93 per cent of GNP as compared with the average of 0.75 per cent for all DAC countries.

However, Japan's official development assistance is limited to \$ 458 million. It com-

¹⁷ Pearson Commission, *Partners in Development*, 1969, p. 18.

¹⁸ Committee for Development Planning, *Preparation of Guidelines and Proposals for the Second United Nations Development Decade*, 1970.

¹⁹ Rudolph Peterson (Chairman Task Force on International Development), *U.S. Foreign Assistance in the 1970s: A New Approach*, Washington, 4 March 1970, p. 21.

prised only 0.23 per cent of GNP (compared to the DAC average of 0.34 per cent) or 25.1 per cent of total aid (against a DAC average of 46.3 per cent). Technical assistance was only \$21.6 million, 1.2 per cent of total aid, which was one of the lowest proportions among DAC. In addition, the terms of official direct loans were harder than the DAC average. Only a limited amount of Japan's official aid was in grant-form, and future aid policy must be directed towards a significant softening of overall official development assistance terms.

On the other hand, the largest financial flow from Japan to developing countries (approximately 75 per cent) consisted of export credit and private investment, both of which were provided from Japan's commercial interests in order to promote exports of capital goods and imports of raw materials, particularly mineral fuels and metals. In 1970, export credits from private and official sources amounted to \$736 million or 40.4 per cent of the total aid. Similarly, direct investments in LDCs amounted to \$408 million or 22.3 per cent of the total aid.

Although the lag in the share of official development assistance is recognised, the rapid growth of total aid is very substantial. The total aid contribution in 1970, \$1,821 million, was 4.78 times as large as that in 1961 (\$481 million), and it grew in the last decade at an annual rate of 16.9 per cent. In the same period, the total aid of DAC countries taken together increased by \$5,476 million, from \$9,249 million in 1961 to \$14,725 million in 1970. Therefore, the increment of Japanese aid accounted for 26.3 per cent of the increment of total DAC aid: similar ratios of the contribution to the increase of total DAC aid were 15.4 per cent for the United States, 10.3 per cent for West Germany, 7.3 per cent for France, and 6.2 per cent for the United Kingdom.

Increased foreign aid and investments will be major factors for Japan in curbing the growth of the international payments surplus. The political will is growing in Japan to mobilise larger resources for foreign aid. According to the New Social and Economic Development Plan of 1970, Japan will be able to attain the 1 per cent target by 1975, with \$4,000 million worth of total aid (although the amount in terms of the dollar ought now to be somewhat inflated owing to revaluation of the yen). However, it may be difficult to provide 0.70 per cent of Japan's GNP for official development assistance. This amounts to \$2,760 million, even in terms of the old exchange rate, and it would have to increase so rapidly as to be 6 times the figure for 1970 (\$458 million). It is also large when compared with the figure of \$6,800 million, which was the total official development assistance of DAC countries taken together in 1970. Japan's economic growth is so fast that she cannot afford to share an equal burden of the international aid contribution. Developing countries might not be able efficiently to absorb such a rapid increase in Japanese official development assistance and, even if they could, they might fear the domination of Japanese aid.

It may be more realistic for Japan to increase official development assistance at 15-20 per cent annually, with a higher growth rate than in GNP, thus raising gradually its proportion to GNP. If official development assistance on this scale is efficiently utilised in close combination with direct investments, total aid will surpass the 1 per cent target in 1975.

Another characteristic is that Japanese foreign aid has been heavily concentrated on neighbouring South-East Asian countries. In 1970, about \$1,000 million (65 per cent) of the total aid and \$277 million (75 per cent) of the official development aid was directed to this area. If such a heavy concentration is maintained, Japanese influence in the area might become too strong, arousing fears of Japanese domination. It is therefore desirable for

Japan to diversify the area to which bilateral aid is provided, by giving more aid to Latin America, the Middle East and Africa, and also to provide more aid through international organisations. Such diversification will be achieved as total aid increases, but it is true that Japan's main interest continues to be directed towards the Asian region.

Japan has already pledged herself to play a major role in post-war reconstruction in Vietnam. If the policies of post-war Vietnam allow such involvement, a large part of reconstruction in the Republic of Vietnam and nearby countries should be financed by Japan, as reparations payments cease elsewhere. This is an appropriate chance for Japan to offer a large scale "Asian Reconstruction Programme" or "Marshall Plan for Asia".

Although there are commitments to a substantial increase in the 'official' component in Japan's total aid, foreign investments will play a more significant role in assisting LDC development. At the end of 1969, Japan's total foreign investments abroad (including advanced countries) amounted to \$2,690 million (Table 4). Total investments will rise to

TABLE 4. BALANCE OF JAPAN'S DIRECT OVERSEAS INVESTMENTS BY INDUSTRY
(\$ U.S. million and per cent)

	Balance of Investments		Percent of Total	
	1969	1980	1969	1980
Resource-oriented	1,092	13,881	40.7	50.8
Labour- and Market-oriented	620	7,148	23.1	26.2
Finance and services	969	6,280	36.2	23.0
Total	2,683	27,309	100.0	100.0

Notes: Resource-oriented—Agriculture, fishery, forestry
Labour-and market-oriented—Foodstuffs, textiles, chemicals, iron, non-ferrous, machinery, electrical machinery, transport machinery and construction
Finance and services—Commerce, finance and insurance.

Source: Japan Economic Research Center, *Japan's Economy in 1980 in the Global Context*, March 1972, p. 50.

\$11,500 million by 1975 and \$27,000 million by 1980²⁰ and the outflow in those years will be around \$2,000 million and \$3,500 million respectively. Of this, in 1980, \$1,900 million will be directed to Asia and this will account for 20 per cent of the total foreign investment flow to this area. By 1980, there will be an accumulated Japanese investment in Asia of around \$7,000 million. These rapid increases in Japan's investments may well arouse Asian nationalism against Japanese domination.

Direct foreign investment, that is, the transmission to the host country of a package of capital, managerial skill, and technical knowledge, is a potent agent of economic transformation and development.²¹ A large increase in Japanese direct investment in developing countries, in so far as it is welcomed by them, will significantly contribute to developing their natural resources, their agricultural production and their processing industries, on the one hand, and, on the other, to transferring from Japan to developing countries those manufacturing industries suitable to each developing country.

²⁰ Japan Economic Research Center, *Japan's Economy in 1980 in the Global Context*, Tokyo, March 1972, pp. 45-51.

²¹ Harry G. Johnson, "The Multinational Corporation as a Development Agent", *Columbia Journal of World Business*, May-June, 1970.

Japan has endeavoured to invest in developing countries with the object of securing increased imports of primary products which are virtually important for her economy. This is called "development assistance for import". It was first directed (and is still being directed in increasing amounts) towards natural resource development projects such as oil, natural gas, iron ore, coal, copper, bauxite, and other metals. Wood and timber also have high priority. Benefits of such development assistance are limited, however, to those countries where abundant natural resources are available, and the employment and training effects are small in so far as the goods are exported in the form of raw materials. If we can extend our development investment for import to agricultural products, benefits will be spread more widely in developing areas. Thailand's successful development of exports to Japan of maize is a good example. Since February 1970, the Asain Trade Development Corporation has been providing subsidies to development assistance for import, with regard to various agricultural products produced in the wider Asian area. The government is also considering whether to provide low interest rate foreign exchange loans to those enterprises which venture to develop new natural resource deposits.

In the field of natural resource development, developing countries have strong nationalistic fears against foreign extraction and they sometimes nationalise such enterprises. Therefore, new forms and new codes of behaviour should be devised for foreign investment. Joint venture with local capital is preferable. Import-linked investments and production-sharing methods, as have been adopted by Japan, may also be recommended; and progressive transfer of ownership may be necessary.

The development of natural resources, including timber, in developing countries is not only highly risky but also expensive for private enterprise since it has to provide infrastructure related to the natural resource development, such as roads, railways, harbours and towns, which are usually provided by the host government in advanced countries. A close combination of private investment and official development assistance should be considered so that the latter accommodates needed infrastructure, making private investment more attractive. Otherwise, natural resource development in advanced countries will go ahead and that in developing countries may be delayed. Also, a risk-insurance system should be introduced by governments or international organisation.

The establishment of facilities for the processing of natural resources within the developing countries where they are extracted, is desirable from the point of view of both developing countries and Japan. But it is not necessarily economical. More careful case by case study is required.

Japan's direct investment for creating manufacturing capacity in developing countries is important and plays a harmonious role for both sides provided appropriate manufacturing industries are selected. The industries to be chosen should be those in which Japan is losing comparative advantage while developing countries are gaining it (or are expected to gain it). Such industries should preferably be export-oriented, not merely serving for the benefit of the economically privileged local classes.

Japanese foreign investment has to date been "trade-oriented". It was aimed at complementing Japan's comparative advantage position. The major part of investment was directed towards natural resource development in which the Japanese economy is comparatively disadvantaged. Even investment in manufacturing has been confined either to such traditional industries as textiles, clothing and processing of steel in which Japan has

been losing its comparative advantage, or the assembling of motor vehicles, production of parts and components of radios and other electronic machines in which cheaper labour costs in Southeast Asian countries are achieved and the Japanese firms can increase exports, substituting for exports of final products, exports of machinery and equipment for the factory and technological know-how. In this sense, Japanese foreign direct investment is quite complementary to changes in its comparative advantage position.

The majority of Japanese foreign direct investments in manufacturing are undertaken by small and medium sized firms which transferred technology suitable to local factor proportions, with larger employment and training effects than those characteristic of 'enclave' investments. Joint ventures have been preferred to wholly owned subsidiaries. Transfer of only parts of the package may be considered, if the recipient country desires, through loan-cum-management contracts or by transfer of technology through licensing arrangements rather than direct investment.

Suppose that a textile industry which is losing comparative advantage in Japan moves away from Japan through increased direct investment in developing countries. This will promote structural adjustment in Japan and open wider markets for developing country products. If other advanced countries do the same markets for developing country products will become very large. The Japanese textile industry has long experience of excellent management and technology which is more suitable to developing countries than that of America or Europe. When abundant relatively cheap labour is combined with this in developing countries, the joint venture products will certainly succeed in international competition.

The point is that it is better for Japan, as she has done, to transfer, one by one, out of those industries in which she is losing her comparative advantage, and to invest in developing countries which are gaining a comparative advantage in the same industries.²² In other words, foreign direct investment to developing countries should be, as Japan's was, "trade oriented", that is, aimed at complementing and strengthening comparative advantage in investing and receiving countries respectively.

In Asia, the success of free trade and investment zones in Kaoshiung, in Taiwan, and the development of a similar area at the Jurong Industrial Estate, Singapore, as well as the successful industrialisation in Korea and Hong Kong is impressive. These demonstrate the need for step-by-step transfer of manufacturing industries from advanced to developing countries.

Foreign direct investment in harmony with changes in comparative advantages will accelerate structural adjustment in Japan for contracting traditional industries of the labour-intensive type. It is in the mother company's interests to make the invested activity prosperous by opening markets both in Japan and other advanced countries even through taking advantage of general preferences provided only for developing country products. The mother company's marketing facilities are indispensable, as mentioned above, for the new entry of developing

²² Here the importance of selecting the right kind of industry in foreign direct investment is stressed. Certainly there is another problem of behaviour and performance of direct investment with which, however, it is not possible to deal here. A new modality of foreign direct investment to LDCs should be seriously considered. This was discussed intensively at the Chile Conference. See, H. W. Arndt, "Economic Cooperation in the Pacific: A Summing Up", a paper presented to Conferencia del Pacifico, Vina del Mar, Chile, from 27 September to 3 October, 1970.

country products to advanced country markets. Foreign direct investments for Japanese small and medium scale firms, which played major part in past manufacturing investments, are a promising outlet for their survival and a great accelerator to internal structural adjustment.

In contrast to Japan, it seems to me that the United States has transferred abroad those industries which ranked in the top of her comparative advantage and has thus brought about balance of payments difficulties, unemployment and then need for protection in her remaining industries.

According to Reymond Vernon, "the U.S. trade position in manufactured goods is based heavily on a comparative advantage in the generation of innovations, rather than on the more conventional notion of relatively cheap capital" and "the big post-war increase in U.S. overseas investment in manufacturing subsidiaries has come about mainly in the kind of industry that would be expected to have participated in such a process: industries associated with innovation and with oligopoly. It explains why so much of the investment is found in the chemical industries, the machinery industries, the transportation industries, and the scientific instrument industries".²³ They are "highly innovative and strongly oligopolistic", and "multinational enterprises are found principally in industries that devote a relatively high proportion of their resources to research and advertising and that tend to be dominated by very large firms".²⁴

Thus, the American economy is split into a dualistic structure:

(a) those innovative and oligopolistic industries, or, in brief, new industries, and
 (b) traditional industries (textiles, steel, agriculture, and so on) which are price-competitive and stagnant. The genuine product cycles and foreign direct investments take place successively only within the innovative and oligopolistic industry group. Foreign direct investment from such new industries which ranked at the top of American comparative advantage are "anti-trade-oriented" or involve foreign direct investments which work against the structure of comparative advantage. Those new industries should strengthen exports of their final products if they were conscious of national economic interests, but actually they set up foreign subsidiaries, cutting off their own comparative advantage and inducing increased imports of those products from abroad where they invested. Both the loss of foreign markets and reverse imports later on resulted in balance of payments difficulties and the "export of job opportunities".

It may be true, as many researchers²⁵ claim, that the new industry sector contributed on balance to foreign exchange earnings due to increased exports of intermediate goods and equipment, the return flow of earnings from past investment, and the like. It should be stressed, however, that if they had been conscious of national economic interests, by refraining foreign investment and strengthening export promotion, those new industries would have earned greater export surpluses and covered import surpluses in other sectors.

²³ Reymond Vernon, "The Economic Consequence of U.S. Foreign Direct Investment", *United States International Economic Policy in an Interdependent World*, Papers I, Washington, D.C., July 1971, pp. 930-937. A similar view is seen in Stephen Hymer, "United States Investment Abroad", A paper presented to the Third Pacific Trade and Development Conference, Sydney, August 20-22, 1970.

²⁴ Reymond Vernon, *ibid.*, p. 930.

²⁵ For example, see, Emergency Committee for American Trade, *The Role of the Multinational Corporation in the United States and World Economies*, February 1972.

If American foreign manufacturing investment was "trade-oriented", rather than new industries oriented, it would be welcomed by developing countries and accelerate the reorganisation of North-South trade, as in the case of Japan's investment.²⁶

Moreover, since innovations and foreign direct investment cycles have been confined to the new oligopolistic industry sector, much inflow of resources from the traditional sector was not allowed and structural adjustment was hindered. An increased labour force was available for employment in traditional industries but they have been losing comparative advantage. In consequence, there has been a rise in protectionistic attitudes. Thus, the American economy has fallen into a vicious circle due to foreign direct investment of the anti-trade oriented type.²⁷

It may be concluded as regards foreign direct investments, first, that foreign direct investment should be trade-oriented and that, since this is most beneficial for both sides, this type of investment should be much encouraged from advanced to developing countries so as to accelerate the reorganisation of North-South trade.

Second, as far as new manufactured goods are concerned, horizontal trade mainly among advanced countries should be promoted instead of direct investment. The decisions and performance of U.S.-based multi-nationals may be rational and, perhaps wise, in terms of the firm for its profit-maximisation. But such investment of anti-trade oriented type is in conflict with national-economic development as explained above. Labour is still immobile internationally and, therefore, economic development and welfare should be considered in terms of national economy. The monopolistic or oligopolistic nature of multinationals internal as well as global, should be rectified, for it results in a wastage of world resources. If all the advanced countries liberalise imports of new goods and exporting countries make hard efforts at exporting mutual trade in these goods among advanced countries certainly will expand and there is of no need to undertake foreign direct investment. If still a firm dares to undertake direct investment, it is because it expects a certain monopolistic profit which should not be allowed.

Technological know-how should genuinely be a public-good provided that there is enough incentive for innovation, and should not be the source of monopolistic or oligopolistic gains. Innovation of new goods is required for the reorganisation of and new dynamism in the international division of labour, while innovative human resources are relatively scarce in the world as a whole. It might be desirable for advanced countries to arrange an agreement of specialisation in the line of innovation in which each country concentrates its effort. Assurance of specialisation and accompanying economies of scale will promote liberalisa-

²⁶ An American labour union researcher states that "U.S. based multinational operations may adversely affect host countries as well as the U.S. The balanced economic and social development of developing economies, for example, is not necessarily promoted by the establishment of electronic subsidiary plants, with high productivity and low wage—with production for export from countries that urgently require basic educational, health and housing facilities, as well as balanced growth of domestic investment and consumer markets." Nat Goldfinger, "A Labor View of Foreign Investment and Trade Issues", *United States International Economic Policy in an Interdependent World*, Papers I, Washington, D.C., July 1971, p. 927.

²⁷ Dunning makes an interesting comment on British investments: "there is probably too much U.K. investment overseas in traditional-type industries and not enough investment at home in the newer technologically based industries", John H. Dunning, *Studies in International Investment*, George Allen & Unwin, London, 1970, p. 91. Perhaps, a proportionate increase in investment of both types is desirable.

tion of trade in these commodities.²⁸ They might also be able to spare innovative human resources to create technology which is more suitable to developing countries.

As in the case of direct investments, aid should also be provided in a close combination with investments so as to facilitate the donor country's structural adjustment although major aid is directed towards infra-structural investment. Untying aid is also an important objective.

V. Japan's Trade Policy and Structural Adjustment

It becomes very clear that Japan and other advanced countries should develop an integrated aid, investment *cum* preference, structural adjustment policy in order to establish harmonious and expanding North-South trade relationships in the 1970s. Although the key factor is structural adjustment in advanced countries as has been stressed repeatedly, a brief survey on Japan's trade policy especially in relation to developing economies is in order since the provision of wider market access in advanced countries to developing country manufactures is a crucial problem.

Japan's trade liberalisation made its first rapid progress from 1960 to 1963. This might be regarded as the spurt which allowed movement into GATT Article XI and IMF VIII status country. Liberalisation was forced along again from 1969 to 1972. This was prompted with a view to first bringing the liberalisation of trade and capital to completion rather than revaluating the yen, since large surpluses of international payments have been accumulated. However, from 1964 to 1969, the pace of liberalisation was extremely slow and delayed. During this period residual import restrictions were maintained with few positive initiatives, placing some industries under a state of over-protection. It must be said that Japan's trade liberalisation has been too slow, although the above mentioned intermediate period coincided with the time of Kennedy Round tariff negotiations and the Japanese government was too busily occupied in those negotiations to give attention to its own trade liberalisation.

Although there are several kinds of non-tariff barriers, the most important in Japan is import quota restrictions. The number of items under the residual import restriction was 120 in April 1969 which was rapidly reduced to 33 (24 agricultural, 1 mineral (coal) and 8 manufactured items, in terms of BTN 4-digit) by April 1972. The problem of the residual import restrictions on manufactured goods might be said to have nearly come to an end with only eight items remaining unliberalised.²⁹ Of these, four items are raw hide and leather (bovine cattle leather, equine leather, sheep, and lamb skin leather, and goat and kid skin leather) and one is leather footwear. The liberalisation of these items is said to be difficult because of the protection that will have to be accorded to subsistence producers in the so-called "dowa" districts where minority tribe lives on this work. The other four

²⁸ This is an application of my "agreed specialisation" to the innovative activities. See, Kiyoshi Kojima, "Towards a Theory of Agreed Specialisation: The Economics of Integration", in W.A. Eltis, M.F.G. Scott, and N.N. Wolfe, eds., *Essays in Honour of Sir Roy Harrod*, Oxford 1970 (reprinted in *Japan and a Pacific Free Trade Area*, Macmillan, London, 1971, Chapter 2.)

²⁹ See Kiyoshi Kojima, "Nontariff Barriers to Japan's Trade", *Hitotsubashi Journal of Economics*, June 1972. Ryutaro Komiya, "Japan's Non-tariff Barriers on Manufactures", a paper presented to the Fourth Pacific Trade and Development Conference, October 7 to 10, 1971, Carleton University, Ottawa.

items consist of digital-type electronic computers, their machinery and parts, and integrated circuits. The protection for these items is justified by infant industry arguments. Therefore, there are no big nontariff barriers in manufacturing goods. In the agricultural field, in addition to the 24 items, several other items such as rice, wheat, butter, tobacco, etc. are controlled under state-trading.

Therefore, Japan's agricultural imports have been and still are restrained by quota while manufactured goods are protected mainly by tariffs at present. Recently, Japan reduced tariffs to a fairly low level in accordance with the Kennedy Round reductions. After that reduction is completed, in 1972, tariffs on dutiable nonagricultural products will average only 9.9 per cent in the United States, 8.6 per cent in the EEC, 10.8 per cent in the United Kingdom, and 10.7 per cent in Japan.³⁰

Although the average level of Japan's tariffs on manufactures became not excessively high, there is an obvious tariff-escalation, since the big tariff revision of 1961 took the escalation as its principle. Some examples of tariff escalation in nominal rate and estimates of "effective rate of protection" are shown in Table 5.

TABLE 5. EXAMPLE OF TARIFF ESCALATION IN JAPAN
A) Yamazawa's estimate for before the Kennedy Round reductions.

	Nominal rate	Effective rate
Cotton	free	—
Cotton yarn	5.0	9.9
Cotton textiles	16.0	36.2
Clothing	27.8	48.8
Pulp woods	free	—
Pulp	5.0	3.3
Paper and paper board	13.6	30.2
Manufactured paper and paper board	15.0	16.7
Iron ore and scraps	free	—
Pig iron	10.0	24.4
Steel ingot	12.5	47.0
Rolled steel	15.0	35.1
Automobiles	36.0	66.5

Source: Ippei Yamazawa, "Tariff Structure and Protection of Industry", (in Japanese) *Sekai Keizai Hyōron*, June 1967.

B) Watanabe-Muto's estimate of tariff escalation for 1968 after partial Kennedy Round tariff reductions.

	Nominal rate*	Effective rate* of protection
1. Raw-materials	3.9	0.9
2. Capital goods	15.2	22.3
2a Intermediate goods	14.1	21.7
2b Finished capital goods	16.9	23.2
3. Consumer goods	23.6	35.8

* The unweighted average rates for several commodities belonging to each category.

Source: *Kanzei Chosa Geppo*, Vol. 24, No. 2, April-June 1971, p. 71.

³⁰ See, Ernest H. Preeg, *Traders in Diplomats*, Brookings Institution, Washington, 1970, Chaps 13-15.

Secondly, tariffs on finished consumer goods still remain high even after the Kennedy Round reductions for heavy protection once imposed on infant industries has not reduced sufficiently (for example, tariffs on automobiles were 20-40 per cent in the 1960's and reduced to 18-24 per cent in 1970 and to 10 per cent in 1971), while tariffs on traditional products or labour intensive type is still relatively high (for example, in 1971, laces and tules—24.5 per cent for cotton and 15-17.5 per cent for others), knitted underwear—24.5 per cent for cotton and 15-17.5 per cent for others, 25 per cent for Hong Kong flowers, 15-20 per cent for plywoods, etc.). However, these defects of our tariff structure will be revised within a year by the Tariff Committee of the Finance Ministry.

Following the EEC, Japan has begun since August 1971 to provide general preferences to developing countries. Before the introduction of the system, we tried to estimate its effects. First, as regards twelve sensitive commodities of importance to all developing countries, the increase of Japanese imports in consequence of the extension of 100 per cent tariff preferences would amount to 24.7 per cent of these imports but only \$ 0.91 million, on 1964 trade figures.³¹ Second, in consequence of preferential tariff elimination, Japanese imports would increase by \$ 3.7 million, or 5.3 per cent of her dutiable imports from 9 Southeast Asian countries (the Philippines, Indonesia Singapore, Malaysia, South Vietnam, Cambodia, Laos, Thailand and Burma) on 1967 trade figures and \$ 15.6 million, or 11.8 per cent of her dutiable imports from the developing countries in ECAFE.³² These show that although the percentage increase appears large the size of the increase is relatively insignificant when compared with annual increases in Japanese exports of the order of \$ 3-4 billion.

Actually the benefits of Japan's general preferences have so far been rather limited since the range of commodities under the scheme is limited and the quota ceiling is also so small it was mostly filled within one or two months. The system should be improved, as the government has already promised, so that the preference margin is more generous.³³

The general preferences to developing country products are not sufficient for opening wider markets in advanced countries, although the longer-term effects might be more significant. Thus, it should be stressed again that extension of trade preferences is unlikely to be practicable or effective unless complementary and adjustment policies are implemented in both advanced and less developed countries alike.

Where tariffs remain important, advanced countries should work towards the adoption of a system of *value added tariffs* on imports from less developed countries.³⁴ *Value added tariffs* involve the levy of duties solely on that portion of the value of an imported commodity which is added to materials and components in the less developed country itself. This concession is important where manufacturing activity in less developed countries depends heavily on foreign capital equipment, and on parts and components imported from advanced countries. *Value added tariffs* would minimise the impact of tariff escalation in advanced countries and encourage the migration of inefficient advanced country industrial capacity to efficient locations within less developed countries. United States Tariff Item 807 permits

³¹ Kiyoshi Kojima, *Japan and a Pacific Free Trade Area*, Macmillan, 1971, pp. 107-108.

³² Kiyoshi Kojima, Saburo Okita and Peter Drysdale, "Foreign Economic Relations", in Asian Development Bank, *South-East Asia's Economy in the 1970's*, Longman, 1971, pp. 297-299.

³³ On the EEC preferences, see Richard N. Cooper, "The EEC Preferences: A Critical Evaluation", *Inter Economics*, April 1972, pp. 122-124. Japan's is basically similar with the EEC preferences and stands for the same critical evaluation.

³⁴ Kiyoshi Kojima, Saburo Okita and Peter Drysdale, "Foreign Economic Relations", *ibid*, p. 302.

this kind of concession, although its terms are too restrictive. The Australian preference scheme for less developed countries can also be used to the same effect. Japan has also recently extended *value added tariff* concessions to Korea on a limited number of items. Perhaps the most promising means of achieving generalisation of *value added tariff* systems is by negotiation among groups of interested countries. It is important to establish now a regional forum through which these negotiations might take place.

While Japanese trade policy has been reluctantly changing in favour of manufactured exports from developing countries, our imports have increased rapidly in terms of growth rate. For instance, imports of textile goods from other Asian countries increased from \$ 5.8 million in 1965 to \$178 million in 1971; imports of machinery from \$2.2 million to \$45 million; and raw silk was an important export item for many decades for Japan, but four years ago Japan became a net importer. However, the size of total imports of manufactured goods from developing countries is yet very limited.

What is Japan's basic attitude to the rising ability of developing countries to export manufactured goods? Many in Japan think that she still maintains a strong comparative advantage in traditional labour-intensive manufacturing industries of the type most competitive with potential export industries in developing countries and that there is no scope to import them from the point of view of employment and social problem. Thus, Japanese structural adjustment continues to lag.

In liberalising Japanese trade, no voluntary and positive action is taken unless pressure is exerted from foreign countries. Once a certain target has been established under foreign pressure, great progress is made. The rapid progress of liberalisation in recent years since 1969 was forced mainly by the pressure from the United States and as a natural result only on those items in which the United States is seriously interested. Thus, developing countries' interests have been rather neglected, coupled with the fact that they lack counter-offers for reciprocal concessions. In the textile negotiations between Japan and the United States in 1971, the United States should not force and Japan should not accept voluntary export restraints which necessitate similar barriers against developing country exports, but, instead, both countries should endeavour to determine on a policy of structural adjustment for their textile industries.

Thus how to undertake structural adjustment effectively becomes a central issue for advanced countries in order to open really wide market for manufactured goods of developing countries. Strong resistance, both economic and political, can be expected. Various steps will have to be taken to assist the adjustment, along the lines of those under the US Trade Expansion Act of 1962 and the amended act of 1968.³⁵

The Japanese economy has only limited experience of adjustment assistance policy, although it has plenty of experience in promoting infant industries as has already been mentioned.

The first example is recent policy of adjustment in rice cultivation, which should be examined since it is most important although it is not directly concerned with manufacturing. Heavy price supports have been provided for rice production, while imports of rice have been controlled by a state-trading system. The implicit tariff rate on imports of rice is at

³⁵ This US adjustment assistance policy is critically evaluated and needed improvement is suggested by *U.S. Foreign Economic Policy for the 1970s: A New Approach to New Realities*, National Planning Association, Washington, November 1971, pp. 194-211 (written by Frances M. Geiger).

least as high as 70 per cent and probably higher than 100 per cent, depending on the rice type and price quotations in Japan and abroad selected for comparison. Coupled with rapid productivity improvement, this has brought about overproduction of rice in Japan, resulting in difficulties for Asian rice-exporting countries. A land-retirement scheme was introduced since 1970. The government provides compensation for those farmers who contract rice production acreage in the hope that they may switch to other occupations. This has not worked as expected. "Rice is far more profitable than other farming enterprises, which prevents desirable shifts in the production pattern, and also more profitable than most non-farm employment: this discourages farmers from making a complete shift to non-farm work."³⁶ The rice price was raised every year to take into account increases in non-farm wages. Such price determination should be changed and the rice price should be lowered. Even if the rice price is lowered, the fulltime farm unit, as far as it attains a sufficient size of business, can make enough profit. Agricultural pressure groups in Japan are still strong, but they have declined substantially and a more determined agricultural policy may be expected in the not too distant future.

How can job opportunities be created for those farmers who are discharged? The farm is diversifying its production from rice to dairy industries, cattle growing, poultry, and fruit, which necessitate protection. Many farmers already obtain income from outside the farming. A Law for Promoting the Introduction of Industries into Rural Villages was introduced in 1971, retraining schemes for farmers and a farmer's pension scheme was also introduced. But structural reform has not yet been made effective. One hope is that natural contraction of the farm population will take place. "The age distribution of the farm population is heavily biased towards the upper age groups: in 1970, out of 4.0 million males engaged mainly in farming, 1.3 million were aged over 60 and 0.7 million were aged 50-59. It seems likely, therefore, that during the 1970s the control of nearly two fifths of the farms in Japan will pass to the next generation."³⁷ Anyway, agricultural reform in Japan is a genuinely political and social problem rather than an economic problem.

Second, the Japanese coal industry experienced dramatic structural adjustment since the war. Immediately after the war, in December 1946, coal and steel industries were taken up as priority industry to be recovered. Governmental money, steel and other inputs, labour, food and clothing for labour etc. were spared with top priority to coal mining from scarce resources. The production of coal increased from a mere 6 million ton in 1945 to 30 million ton in 1947 and to 50 million ton in 1951.

The situation completely changed after the switch in policy towards the importation of oil in 1949. This was due to the fact that the price of coal is too high and oil more efficient in various uses. Perhaps also, the major international oil companies were interested in expanding markets in Japan. The coal industry changed to rationalisation and contraction under a law enacted in 1955, and amended in 1960. The law aimed at scrapping 3 million ton of old inefficient capacity and another 12 million ton later by using tariff revenue levied on imports of oil. The coal mining firms were confronted with strikes and other resistance of labourers who had to move to other jobs. But, the scrapping of old, inefficient mines was rapidly undertaken during 1963 and 1964 perhaps due to the fact that it was better

³⁶ Michael Tracy, *Japanese Agriculture at the Crossroads*, Trade Policy Research Centre, London, May 1972, p. 21.

³⁷ Michael Tracy, *ibid.*, p. 25.

for the firms to switch to other lines of activity sooner than other firms since the superiority of oil to coal was obvious, and that it was also beneficial for labourers to find other jobs while the Japanese economy was growing dramatically.

A third example is the textile spinning industry. This industry in Japan was originally a very capitalistic enterprise and depended little upon the governmental assistance before the war. It grew through the growth of several small firms, integration into big firms, reduction of production through cartel, diversification of production lines from cotton to synthetic and chemical fibres. However, after the war, the spinning industry introduced government intervention through Textile Structural Adjustment Law of 1956, and amended Law of 1964 and 1967. Those Laws aim at scrapping old, inefficient spinning mills and building new, more efficient mills of optimum size. Governmental moneys were provided as compensation for scrapping old spinning facilities. New spinning capacity was limited. But because of the superior efficiency of new capacity, the volume of production did not decrease but increased. In other words, the governmental assistance to the spinning industry contributed to increased production, to modernisation of the industry and to strengthening of its international competitiveness, rather than a reduction in production capacity and to promotion of the reallocation of resources to other industries. Since it consisted of big firms, the spinning industry is more alert and adaptive to do structural adjustment than smaller processing textile firms.

Fourthly, how to undertake structural adjustment in small and medium sized firms is a most difficult problem in Japan. Many adjustment assistance policies have already been set up. There are many laws, financial organisations, semi-governmental corporations, and so on specifically to assist the huge number of small and medium sized firms. They are perhaps too piecemeal, cumbersome and *ad hoc*, so that firms cannot make effective use of governmental assistance. They might well be better integrated into a single, comprehensive law and big organisation. These policies intend to fill disadvantages or handicaps which, they believe, small and medium sized firms have as compared with big, modern firms. They work to make small and medium sized firms survive, sometimes leading to their modernisation and rationalisation, but usually do not assist them to move them out into growing industries. A new law is added each time just to compensate for whatever loss unadaptable firms suffer, for instance, due to the revaluation of yen in December 1971.

Other difficulties arise from the fact that a certain district is entirely specialised in producing specific exportables, for example knives and forks in the Tsubakuro area, certain types of processed textile in the Japan Sea districts, and the like. This involves a similar problem as in the case of agriculture. There is much hope for Japanese small and medium sized firms to establish subsidiaries and joint ventures abroad and to move up to knowledge-intensive industries.

The American adjustment assistance policy is confined to cure unemployment caused by the increased imports along the same lines as general unemployment insurance. Japan and other industrialised countries of Western Europe "deal with the difficulties of business firms and works in a much broader and longer-term context. For them the adjustment problem is one of industrialisation and development."³⁸ Such a broader but well integrated policy is advisable since successful structural adjustment heavily depends upon dynamic

³⁸ National Planning Association, *U. S. Foreign Economic Policy for the 1970s*, *ibid.*, p. 202.

upgrading of industrial structure of a country as a whole.

Structural adjustment assistance policy for inefficient, declining industries should consist of two aspects.³⁹ One is a measure to promote the running down and transfer of those inefficient industries to other sectors. For this purpose public infrastructural investment, low-cost loans, investment grants and subsidies, tax benefits, technical assistance, and training programs, should be undertaken in a much more systematic way. Secondly, some safeguards for the gradual running down of inefficient, protected industries are needed. But this safeguard should not be abused for protectionistic purpose. It should assure the transfer of inefficient industries. Therefore, the GATT Article XIX should include obligations to implement structural adjustment and to specify the duration within which the safeguard expires.⁴⁰

There is one particular measure that would assist the adjustments desired. A fund for assisting structural adjustment should be established in every advanced country. This should become an international obligation similar to the one per cent of GNP foreign aid target. A certain percentage (say, a half of one per cent) of GNP could be collected through taxation for this purpose.⁴¹ The fund should be used for bringing about the gradual elimination of uneconomic industries and the transfer of factors of production to more productive activities where the advanced country enjoys a comparative advantage.

These funds would be more efficient than direct aid to developing countries, for they would serve to raise incomes and efficiency in developed countries as well as promoting industrialisation in the developing countries. From the point of view of advanced countries, there is a clear parallel between the reclamation of uneconomic industries suggested here, and the urban renewal already widely undertaken by governments.

Trade preferences for developing countries are justifiable if divergence from the principle of non-discrimination within GATT is temporary and they foster liberalisation of world trade. They are positively desirable if they encourage transformation in the international division of labour in such a way as to strengthen specialisation in the export of labour-intensive exports from developing countries. However, preferences alone may not bring about sufficient benefits as shown already. Aid and investment linked directly to preferential tariff and structural adjustment (an integrated aid, investment *cum* preferences and structural adjustment policy) could offer more benefits to developing countries. Firstly, directly productive aid and investment in the form of capital goods, advanced techniques of production, managerial know-how and worker training should be provided to developing countries on an increasingly large scale if the efficiency of new export-oriented industries, primary as well as manufacturing, is to be improved to the point where they become increasingly competitive in world markets. Secondly, developed countries should provide preferential treatment to developing country exports launched with the help of directly productive aid and investment, coupled with multinational firm's sales promotion. Preferences aimed at ensuring wider

³⁹ "The optimum policy for bringing about the graceful retirement of uneconomic industries would be a "package" of subsidies to allow uncompetitive production to continue over the retirement period and of a cash grants to finance the closing down of productive capacity. Facilities should be provided, in addition, for the retraining and movement of redundant labour." David Wall, *The Third World Challenge, Preferences for Development*, The Atlantic Trade Policy, London, 1967, p. 51.

⁴⁰ Curzon proposed the adoption of an international adjustment assistance code. See Gerard and Victoria Curzon, *Global Assault on Non-Tariff Trade Barriers*, Trade Policy Research Center London, 1972, p. 32.

⁴¹ See Kiyoshi Kojima, *Japan and a Pacific Free Trade Area*, Macmillan, 1971, p. 125.

markets would serve as a sort of aid and investment 'after-care', and might well be regarded as indispensable to realising the full benefits of aid and investment. It is important that the provision of preferences should be closely linked with the provision of aid and investment, since either is likely to be ineffective and result in a waste of resources if applied independently. Thirdly, a receptive structural adjustment in advanced countries should be closely linked with the result of the aid and investment.

In conclusion, first, structural adjustment to contract an inefficient sector, if it is done independently, is very difficult. It is most important for advanced countries to succeed in developing new growth sectors in which resources can be absorbed. In order to do this, specialisation and coordination in innovation and prosperous horizontal trade in new sophisticated goods are most needed among advanced countries.

Secondly, all the policies of advanced countries for increasing exports of manufactured goods from developing countries should be so accommodated as to promote structural change on both sides and harmonious development of North-South trade. Thus, an integrated aid, investment *cum* preference, structural adjustment policy is required.

Finally, it is clear that a large scale aid-investment *cum* preference-structural adjustment scheme could be given more effect by a group of like-minded advanced countries. It is also desirable that aid-giving and investment should be multinationalised, and freed as far as possible from bilateral tying. To realise these objectives, the possibilities for and advantages of closer cooperation among advanced countries in the Asian-Pacific region should be studied.