

GEARING THE JAPANESE ECONOMY TO INTERNATIONAL HARMONY

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I. INCREASING EXPECTATION FOR JAPAN

INTERNATIONAL expectation has recently increased that Japan should play a greater role to match its economic capability and strengthened creditor position. How well is Japan prepared to meet this expectation? It does seem that there has emerged an increasing recognition within Japan of its greater international role.

The expectation is for Japan to recycle the current account surplus in the forms of private investment and official development aid (ODA). However, recycling is only a part of the country's new international role, and the economy is being geared to international harmony in other aspects as well. The aim of this paper is to describe the Japanese challenge in a broader context.

Restructuring or structural adjustment has become popular terminology in development cooperation. The IMF prescribes that heavily indebted countries should not only adopt austere policies but also restructure their economies to achieve sustainable growth and improve trade balances. In Japan, restructuring is under way in quite a different context, but it is nevertheless a full-fledged effort to meet international expectations.

In what follows we will overview the country's restructuring efforts in five areas: macroeconomic policy, development cooperation, restructuring of industry and trade, institutional reform, and international network for cooperation. These areas actually exceed the conventional notion of restructuring. For example, macroeconomic policy is often discussed independently from industrial and trade policies, but as long as restructuring proceeds mainly based on autonomous response by private firms and households, macroeconomic policy provides an important framework for their restructuring efforts. As a matter of fact, the macroeconomic policy change in 1985-87 has succeeded in inspiring an ongoing restructuring of the Japanese economy. International network for cooperation is based on our

This paper is based on my report of the same title at the Association for Development Institutes in Asia and Pacific Eighth General Meeting held in Manila in October 1989. The main theme of the conference was "Asian and Pacific Region in the 1990s: Challenges and Responses" and I was assigned to explain the Japanese restructuring efforts toward the 1990s in the face of Japan's greater economic influence and huge trade surplus in the 1980s. I expanded this from the mere recycling of trade surplus to the restructuring of industry and economy and economic policy stance in a wider context. This paper is a revised and expanded version based on comments and questions during the conference.

recognition that our restructuring efforts can only be achieved through closer cooperation with our trading partners.

The restructuring of the Japanese economy is already under way but it cannot be free from various difficulties and impediments which have to be overcome or circumvented in order to be complete. The last section will identify major problems and give future prospects for our efforts.

II. MACROECONOMIC POLICY

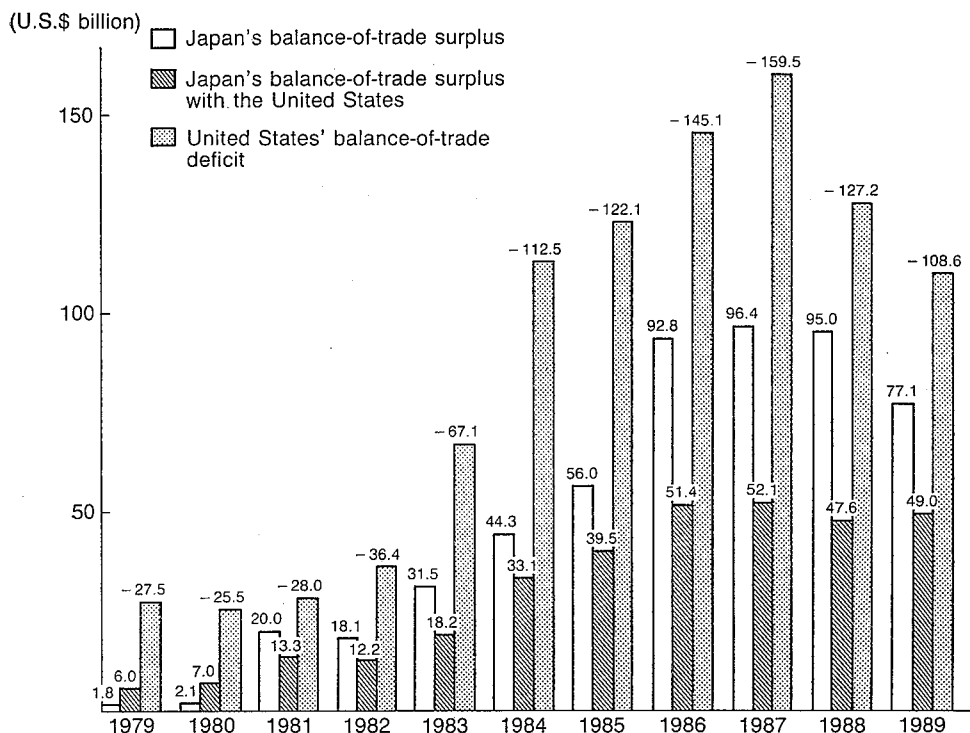
In the past two decades we have observed a worldwide fluctuation of petroleum and primary commodities. Major industrial countries were affected by the sudden constraint of raw materials and energy input to their industries and tried to overcome it by implementing policies and adjusting their industrial structures. Some countries have done better than others and there have resulted huge trade imbalances between them. Japan, with its high dependence on imports of raw material and energy, was affected most seriously by the fluctuation but made a better adjustment, recovering quickly from the setback of growth, and increasing its share in world production and trade.

On the other hand, Japan's better performance has resulted in persistent trade surplus. Figure 1 shows the rapid increase in trade imbalance during the first half of the 1980s. Three trade imbalances changed in parallel. Japan's trade surplus with the United States increased from U.S.\$12 billion in 1981 to U.S.\$51 billion in 1986. Bilateral trade imbalance reflects individual overall imbalances of the two countries. Japan's overall trade surplus expanded from around U.S.\$20 billion to U.S.\$93 billion, whereas the U.S. overall trade deficit expanded from U.S.\$28 billion to U.S.\$148 billion over the same period. Japan's prolonged trade surplus has aggravated trade conflicts with its major trading partners, especially with the United States. Restoration of external balance and resolution of trade conflicts have become the major focus of policy.

Japan's macroeconomic policy changed drastically over these years. At the time of the two oil shocks Japan, like other developed countries, implemented macroeconomic policies mainly in order to overcome the oil shocks. On both occasions the country had a minus growth, incurred a current account deficit, and suffered from a persistent threat of inflation. The government tightened money supply and adopted an austere fiscal policy, especially in the second oil shock when the setback of growth was much less than in the first. Japan's growth recovered quickly mainly through export expansion, which added to the trade surplus.

After the G5 Agreement in September 1985, the government redirected its macroeconomic policy mix to the external balance. The exchange rate appreciated from 240 to almost 120 yen per dollar within three years, and the Bank of Japan's rediscount rate was reduced to a historical low of 2.5 per cent in early 1987 and kept at that low level for two years. Government expenditure was expanded successively after 1986 and combined with tax reduction. Both firms' capacity investment and household consumption have been boosted so that domestic demand has sustained a boom of more than thirty-six months.

Fig. 1. Trade Imbalances of Japan and the United States



Sources: For the Japan's balance-of-trade surplus, Japan Tariff Association, *Japan Exports and Imports: Country by Commodity*, various issues; the Japan's balance-of-trade surplus with the United States was calculated as Japan's export to the United States (f.o.b.) minus Japan's import from the United States (c.i.f.), based on custom's data, Ministry of Finance; and for the United States' balance-of-trade deficit, U.S. Department of Commerce, *Survey of Current Business*, various issues.

Figure 1 also shows the adjustment of trade imbalances toward the end of the 1980s. In spite of the rapid appreciation of the yen and drastic changes in macroeconomic policies since 1986, Japan's trade surplus continued to increase until 1987 when it reached its peak and started to decline. The adjustment was more evident in the surplus of current account as is shown in Table I. The current account surplus also peaked at U.S.\$87 billion in 1987 and decreased to U.S.\$57 billion in 1989. This greater adjustment of current account surplus was contributed to by the overall deficit in service account items, which, however, was the combined result of both net surplus and deficit items. A major surplus item is investment income, which has been increasing rapidly as a result of the increasing external assets of Japan, mostly in the form of security investments, and amounted to a net surplus of U.S.\$23.4 billion in 1989. Deficit items include

TABLE I
RECYCLING OF JAPAN'S CURRENT ACCOUNT SURPLUS

	(U.S.\$ Million)				
	1985	1986	1987	1988	1989
Current account balance	49,169	85,845	87,015	79,631	56,975
Long-term capital account balance	-64,542	-131,461	-136,532	-130,930	-87,928
Overall balance	-29,217	-73,862	-43,297	-37,668	-33,286
Major items of outflows:					
Securities investments	59,773	101,977	87,757	86,949	113,285
Direct investments	6,452	14,480	19,519	34,210	43,786
ODA	3,797	5,634	7,454	9,134	—

Sources: Bank of Japan, *Balance of Payments Monthly*, No. 282 (January 1990).
The 1989 figures are preliminary estimates.

Note: — shows figures are not available.

transportation, insurance, and travel. The balance in travel shows the difference between foreigners' expenditure in Japan and Japanese expenditure abroad, the latter of which has recently been increasing rapidly. This has resulted in an increasing net deficit of U.S.\$19.3 billion in 1989, the biggest in the world, and has offset almost a quarter of the trade surplus.

However, Japan's trade surplus has still as much as U.S.\$77 billion in 1989 and it will take time to be reduced to the level of the early 1980s, as will the American trade deficit. Economists in both countries consider slow adjustment desirable since a rapid contraction of the American trade deficit through decreased imports may depress the world economy, and they recommend the soft landing adjustment of trade imbalances. However, the United States Congress appears to be irritated at the slow rate of adjustment and tends to add to conflicts between the two countries. Monthly figures of trade balances show erratic movements of improvement in a few successive months followed by a big deterioration but the long-run tendency of improvement should not be missed, and it can be endorsed by a careful analysis of structural changes in Japanese industry and the economy, presented in the following sections.

To sum up the analysis of macroeconomic policy changes, they have provided a macroeconomic framework within which the restructuring of the Japanese economy has been under way. First, slower growth itself enforced firms and industries to undergo structural adjustment. Second, the rapid appreciation of the yen and improved terms of trade on a few occasions (in 1973 before the first oil crisis, 1978, and after 1985) hit severely export-oriented and import-competing industries and changed drastically their competitive edge. Third, trade imbalance, trade conflicts, and a series of market liberalization measures have encouraged imports and increased competition in the domestic market. Fourth, the stimulation of domestic demand encouraged more firms to produce for the domestic market and to explore new frontiers.

III. DEVELOPMENT COOPERATION

So long as the trade surplus continues, it has to be recycled back to deficit countries. Active portfolio investment as well as active foreign direct investment (FDI) have contributed to the recycling of Japan's surplus. So has ODA by the government to developing countries.

Table I shows the recycling of the current account surplus evidenced in the balance-of-payments table. The current account surplus of around U.S.\$80 billion has been far exceeded by the long-term capital outflow of around U.S.\$130 billion for the past few years. It has resulted in a big deficit of overall balance, which is financed mainly by short-term borrowings by foreign exchange banks.

Securities investment and direct investments by the private sector are the two leading items of capital outflow. Ninety-four per cent of the securities investment went to other OECD countries (42 per cent to the United States and 49 per cent to the EC). On the other hand, 55 per cent of direct investments went to the United States, 17 per cent to the EC, and 8 per cent to Southeast Asia.

Readers may complain about the small percentage of financial flows directed to developing countries. However, the absolute amount of private financial flow to these countries (both portfolio and direct investments) exceeded the ODA and the small percentage share reflects the limited absorptive capacity of the developing countries. As regards securities investment, the rapid development and growth potential of the securities markets in Asian NIEs and ASEAN countries have been attracting American and European financial companies as well as Japanese. But its size is still small, only U.S.\$180 billion in terms of the total issue amount of stocks at current prices for the four Asian NIEs, Malaysia, Thailand, and Philippines combined, in comparison with U.S.\$2,700 billion for Japan. Except for Singapore and Hong Kong where foreigners have free access to the stock exchange, direct purchase of local stocks by foreigners is either prohibited (the Republic of Korea and Taiwan) or strictly restricted (Thailand and Malaysia). Even with restricted foreign financial flows, some of these markets have seen a stock fever and the possibly adverse impact is seen as a cause for concern. Huge Japanese funds have in fact been directed to Europe and North America, but direct investment is affected by many factors other than the availability of funds and takes longer time for preparation. It cannot increase as fast as securities investment.

ODA leads the recycling to developing countries. As a matter of fact, commitments to increase ODA have saved Japanese prime ministers from criticism by fellow members at summit meetings. They delivered not only lip service but have been able to demonstrate actual achievements. Japan's ODA doubled between 1978 and 1980, again doubled between 1981 and 1985, and now a third doubling is under way between 1986 and 1992. In 1988 Japan's ODA amounted to U.S.\$9.1 billion, second to the United States with U.S.\$9.8 billion, and the country is now one of the largest contributors to multilateral aid programs. A Japanese Marshall Plan of 1987 proposed the transfer of a U.S.\$30 billion fund over three

years (1987–89) and 91 per cent has been committed for the first two years. In July 1989 the government announced a proposal to expand this program to a total of U.S.\$65 billion for five years 1987–91. These funds are completely untied to any commercial transaction. Japanese aid agencies (Overseas Economic Cooperation Fund, Export-Import Bank of Japan, and Japan International Cooperation Agency) cooperate closely with the World Bank, the International Monetary Fund, and the Asian Development Bank. In addition, private loans have been supplied via ODA to developing countries amounting to U.S.\$16.8 billion in 1987.

Besides these conventional forms of cooperation, the Japanese government has started recently such new forms as technical assistance to export promotion, preservation of tropical forests, and more efficient and pollution-free use of energy.

IV. RESTRUCTURING INDUSTRY AND TRADE

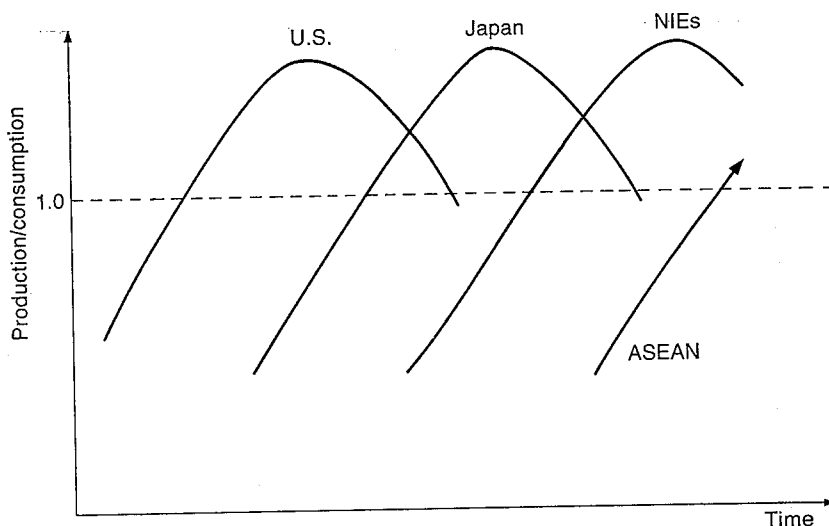
Japan's industrial structure has changed drastically during these years. The share of primary, consumer, and basic material industries declined steadily throughout the 1980s and the decline will continue in the 1990s. On the other hand, the machinery industry has increased rapidly during the past decade and will continue its increase but at a decelerated rate. Service industries have expanded and will continue at a faster rate hereafter. The increasing share of service reflects a move toward a service economy, but a careful examination of the change in its content shows the increasing share of service in intermediate inputs such as consulting, lease, and information services which support business activities as well as machinery, parts, and materials. These services were originally provided within individual machinery firms, but they have been separated from parent firms to be independent and therefore show up in service statistics.

The structural changes mentioned above are often described as a shift from "heavy, thick, long, and big" (H & B) to "light, thin, short, and small" (L & S). H & B industries used to be the leading industries during the high-growth period in the 1960s when they achieved economies of scale and cost reduction, thereby acquiring international competitiveness. However, the price hike of petroleum and raw materials caused a deterioration in their competitive edge and the slower growth after the oil shock enforced low utilization of existing capacities. Interest payment for under-depreciated capacities added financial burden to the H & B firms. Retrenchment of existing capacities thus become a major solution adopted by many of them.¹

On the other hand, the expansion of machinery and services characterizes the shift to L & S. The machinery industry comprises the production of a variety of parts and their assembly. Its advantage lies not only in being free from the disadvantages of H & B but is also based on the vast technical possibilities of responding to a great variety of needs, ever-changing consumer taste, and user's demands for sophisticated functions. Instead of mass production of a small variety, small-lot production of a large variety is required and it has to be achieved without

¹ Refer for further details to I. Yamazawa, *International Trade and Economic Development: A Japanese Model* (Honolulu: University of Hawaii Press, 1990), Chapter 9.

Fig. 2. Flying-Wild-Geese Development of an Industry in the Pacific



Note: The production/consumption ratio starts from zero when a new industry is introduced, increases as its import is substituted by domestic product, exceeds unity at the export expansion stage, but eventually turns to decline as it loses competitive edge at mature stage. This gives a life-cycle curve for the industry, a rational pattern of industry development in a late-starting country with a domestic market of an appropriate size. The life-cycle development in one country is interrelated with those of earlier-starting countries and later-starting countries. Its development in Japan was introduced from the United States, but has superseded the U.S. development and achieved exportation to the United States. It is in turn being caught up with by Asian NIEs as they gain comparative advantage, but NIEs will also be superseded by ASEAN and later China. The "flying-wild-geese" pattern was named after the superposition of one country's life-cycle curve over another country's, and describes a rational pattern of industry transfer among Asia-Pacific countries. The flying-wild-geese pattern has become popular as a desirable pattern of transfer of industry in the discussion of Pacific economic cooperation. Refer for further details to Chapter 2 of my book cited above.

increasing cost and with shorter lead time. Fortunately the Japanese have had a fairly long experience and well-established organization in machinery production, are well-equipped with appreciation expertise, and endowed with a big domestic market of high-income level to experiment with new products. The shift from H & B to L & S is observed across all industries and does not fit exactly to the conventional industry classification. Although neither H & B nor L & S can be unambiguously defined, the shift is often mentioned as a desirable direction of restructuring in industrial policy discussion in Japan.

This structural change implies that Japan has now outgrown the traditional

TABLE II
CHANGES IN EXPORT AND IMPORT STRUCTURE

	1970	1975	1980	1985	1988
Export structure:					
Textiles	12.5	6.7	4.9	3.6	2.6
Chemical	6.4	7.0	5.2	4.4	5.2
Metal	19.7	22.4	16.4	10.5	8.2
Machinery	46.3	53.8	62.8	71.8	74.3
Office machines	1.7	1.4	1.8	4.4	6.9
Semiconductor	0.4	0.8	1.8	2.7	4.7
VTR	—	—	1.5	3.8	2.3
Car	6.9	11.1	17.9	19.6	18.4
Import structure:					
Foodstuff	13.6	15.2	10.5	12.0	15.5
Raw material	35.4	20.1	16.9	13.9	15.0
Mineral fuels	20.7	44.3	49.8	43.1	20.5
Chemical	5.3	3.6	4.4	6.2	7.9
Machinery	12.2	7.4	7.0	9.6	14.2
Official machine	1.7	0.9	0.7	1.2	1.8
Other manuf.	12.8	7.4	11.4	15.2	26.9
Iron & steel	1.5	0.3	0.6	1.1	2.5
Textile	1.7	2.3	2.3	3.0	5.8
Manuf. subtotal	30.3	18.4	22.8	31.0	49.0

Source: Japan Tariff Association, *Japan Exports and Imports: Country by Commodity*, various issues.

- Notes: 1. Percentage shares in total export and import values.
2. Manufactures subtotal is the sum of chemical, machinery, and other manufactures.

catching-up industrialization (introducing new products and technology from the United States and Western Europe, mastering the technology, and reducing production cost, thus achieving import substitution and then exporting abroad) and now must lead the way in exploring new industrial frontiers. This will affect significantly the industrialization of Asian NIEs and ASEAN countries, which have followed Japan in catching-up industrialization of textiles and then metals and machinery, often described as the "flying-wild-geese" pattern of industry transfer (Figure 2). Further restructuring of the Japanese industries as well as their FDIs will induce further upgrading of industrialization of these countries. They themselves face drastic changes in comparative advantage in the midst of worldwide macroeconomic adjustment.

These structural changes are bringing forth drastic change in international specialization between Japan and its Asian neighbors, as is evidenced in changes in Japan's export and import trade with these countries and its active foreign direct investment in them. Table II shows increasing imports of such manufactures as textiles and standardized electronics mainly of the H & B type, while export of parts and equipment increased to support the upgrading of industrialization of its Asian neighbors. The trade balance has so far turned out a big surplus

on Japan's side but it will decrease quickly as import substitution proceeds in these Asian countries.

This drastic structural change has resulted from free response by individual firms to changes in material supply and market. But how has the industrial policy of the Ministry of International Trade and Industry (MITI) promoted it? MITI's industrial policy has so far been geared mainly to the retrenchment of H & B as is evidenced by a series of Depressed Industry Adjustment Laws (1978-), although there are divergent views on its effectiveness. On the other hand, while L & S is widely recommended as the direction of restructuring in many MITI reports and competent firms strive for it across all industries, strong "picking the winner" policy for L & S, like the promotion programs for steel in the 1950s and automobiles in the 1960s, have not been implemented. MITI now plays only a guiding role except for moderate financial assistance to small and medium firms and general promotion of R & D activities, which is a desirable change in industrial policy stance toward transparent economic management.

Trade policy has been geared mainly to conflicts with major trading partners during this period. Various market liberalization measures (reduction and removal of tariffs and nontariff barriers, improvement of standards and procedures of import, and deregulation for such foreign services as construction and finance) have partly been triggered by requests by trading partners but certainly increased competition at home and improved efficiency of the Japanese economy. On the other hand, voluntary export restraints (VER) have also been imposed on many machinery exports as the results of bilateral negotiation with the United States and the EC. VER could settle fierce trade conflicts in the short run, but they will cause serious distortion in the long run. Rigid share agreement among rival exporters tends to depress competition and maintain higher prices, thus injuring the welfare of consumers and user industries.

A new element of Japan's trade policy is an increasing demand by the Japanese producers of standardized manufactures for the restriction of imports from developing countries. In the face of the persistent huge trade surplus, MITI has been soothing these demand as much as possible, refraining from resorting to the MFA restrictions, and has kept VER at a minimum (knitwear and cotton yarn). VER will give only short-term relief and import competition will soon resume as the transfer of industry proceeds. The best policy is to encourage domestic producers to adjust positively to the catching-up of our Asian neighboring countries. In fact, demand for import restriction is based on vested interests at home and it is not easy to persuade them to give up smoothly. The current Uruguay Round of the GATT negotiations provides a unique occasion through which we can suppress the tendency toward managed trade together with the United States and the EC.

V. INSTITUTIONAL REFORMS

It has been recognized increasingly that conventional policies alone are not sufficient to institute adjustment and that the economic system or institutions

should be reformed in order to assist the progress of conventional policies. That is, it is private firms and households who produce, consume, and engage in trade within the current institutional system and their performance is largely confined by institutions as well as conventional policies. This has been recognized widely at the OECD, and the Arche Summit last June assigned specific institutional reforms to individual member countries.

Japan has been working on this issue since the early 1980s through two advisory groups to the prime minister. The Maekawa Group (study group of economic structure adjustment, 1985–86) focused on the external aspects and proposed improvement of access to Japanese market and the promotion of manufactured imports, further promotion of adjustment of declining industries, and liberalization of money and capital markets. The Administrative Reform Council (1981–83 and 1987–) focused on the governmental organization and succeeded in privatization of three state-owned enterprises and is now working on the deregulation of official administration in seven areas including distribution systems and rice and other cereals.

However, institutional reform inevitably affects vested interests and causes difficult political and social problems. Tax reform, land reform, and inflow of foreign laborers make up the three major institutional issues currently faced by Japan. Tax reform was promoted by the Ministry of Finance and a 3 per cent consumer tax has been introduced since last year over a wide range of commodities and services so that the heavy reliance on income taxes is being corrected. However, the new consumer tax, together with widespread complaints about the unequal tax burden, has induced a revolt against the ruling Liberal Democratic Party and brought forth instability in Japanese politics.

Secondly, the current land system causes another big stumbling block for the further development of Japan. The scarcity of land in metropolitan areas has been aggravated by the lack of effective governmental measures over past decades and has led to an abnormal hike of land prices. Such an abnormal land price has caused a big difference in well-being between the haves and the have-nots of landed property on the one hand, while accelerated land speculation and excessive liquidity resulting from it have built an inflationary pressure in the Japanese economy on the other. An effective land reform is imperative in Japan.

Thirdly, big income differentials between Japan and neighboring countries have induced the inflow of an increasing number of foreign workers. Japan's immigration law admits the local employment of only foreign workers with professional skills, while a large number of illegal, unskilled workers are flowing in under the big push factor mentioned above. There is a big pull factor as well, with the acute shortage of labor at home in the current continuing boom. They enter on tourist visas, remain unlawfully beyond official deadlines, and are often employed under illegal working conditions. The government wishes to maintain the current immigration requirements but respond with an expanded trainee program, which, however, falls far short of the rapid increase of foreign workers. A consensus has not been formed yet among Japanese on this issue.

Institutional reform became a hot issue when President Bush proposed U.S.-

Japan bilateral talks on the subject under his Structural Barrier Initiative. The United States has become irritated with Japan's persistent deficit and the slow implementation of adjustment policies. The talks include both American request for broader distribution channels and import expansion on the Japanese side and the Japanese request for American efforts to increase savings and strengthen export competitiveness. Shadowed by the possible American resort to retaliatory measures under Article Super 301, the talks have continued since September 1989 and are to be concluded by summer 1990. Institutional reforms come up against resistance by vested interest groups and radical changes are often difficult. Institutional reforms take time to be implemented effectively, but once stated they are irreversible and will in the long run promote significantly the restructuring of the Japanese economy.

VI. INTERNATIONAL NETWORK FOR COOPERATION

In spite of increasing economic influences, Japan does not wish to exercise hegemony in international politics, realizing that strong political initiative will not be welcomed by its Asian neighbors because of past performance. Instead Japan has been attempting to strengthen the international network for cooperation within which collaborative efforts will be achieved. International cooperation seems to be a more rational policy for the Japanese to compromise between the large economic body and a small political voice. As a matter of fact, Japan has been one of the most collaborative members of the summit meeting and OECD, and the largest contributor to such multilateral cooperation schemes as in the United Nations, the World Bank, and IMF. The country has been promoting the current Uruguay Round of GATT negotiation so that the free multilateral trading system can be preserved.

In Asia and the Pacific, Japan has been promoting economic cooperation activities. In the late 1960s joint initiatives were taken to start a businessmen's forum, the Pacific Basin Economic Council (PBEC, since 1967), and an economists' gathering, the Pacific Trade and Development Conference (PAFTAD, since 1968). In 1978 the late Prime Minister Ohira proposed in his inaugural address the formation of the Pacific Basin Community, which, in collaboration with then Prime Minister Fraser of Australia, led to the first meeting of the Pacific Economic Cooperation Conference (PECC) in 1980. PECC, with its regular task force activities, has initiated a unique occasion of free discussion among three participant groups of business, academia, and government and contributed to the formation of Pacific consensus on various cooperation issues. PECC will provide an operational framework for coordinating adjustment efforts between member countries, and Japan has been an active member since the beginning.²

Japan also supported strongly the recent initiative taken by Prime Minister Hawke of Australia and started in 1989 a new series of Pacific cooperation talks

² For further information on Pacific economic cooperation, refer to I. Yamazawa, ed., *Review of Pacific Economic Cooperation Activities* (Tokyo: Japan National Committee for Pacific Economic Cooperation, 1988).

at ministerial level, the Asia-Pacific Economic Cooperation Conference (APEC), with stronger political commitments for official implementation of cooperation issues.³ However, Japan is not interested in expanding PECC and APEC to a Pacific bloc vis-à-vis the Single European Market toward 1993. It would run counter to the country's global economic interest and it is of no use to stir up a European alert on the Pacific. A better strategy is to link the two most dynamically changing areas, Europe and the Pacific, for the benefit of the world as a whole.⁴

VII. FUTURE PROSPECTS

We have seen so far that Japan has more or less geared its restructuring efforts to external imbalance, that is, persistent current account surplus, aggravated trade conflicts, and increasing expectations of a greater role for Japan in the world economy. However, Japan has not merely aimed to soothe complaints by its partners at the expense of internal balance. Rather the aim has been to correct external imbalances which otherwise may constrain the country from continuing further development and revitalizing the economy and industries through restructuring and institutional reforms. Although the need for gearing to international harmony has become widely understood, the true aim of gearing has not been perceived correctly so that it tends to deter restructuring efforts themselves. Let me elaborate this on three specific points.

First, industries and sectors directly affected by liberalization suffer from adjustment difficulty and tend to resist changes in policy. While the economy as a whole will gain, they suffer from the harsh realities of closure and unemployment and request adjustment assistance, which, however, turns out to be backward looking compensation for their foregone income. In other words, they tend to become vested interest groups and resist changes in policy. Labor-intensive industries and agriculture are typical examples of this behavior. Patient persuasion and positive adjustment assistance are the only means to promote their restructuring.

Second, although being geared to international harmony, Japan's economic policy management is not so transparent that neither taxpayers can see the cost and benefit of the policy changes nor foreign partners understand their policy intention and possible results from them. It is anticipated that Japan will have a larger aging population and face a severer trade-off between social welfare and other governmental expenditure. Taxpayers should be more informed to make a correct choice.

Third, the Japanese government has been resorting to external pressure in order to force their policy changes and adjustment. Especially in negotiations with the

³ The partnership between Japan and Australia is emphasized in P. Drysdale, N. Viviani, A. Watanabe, and I. Yamazawa, *The Australia-Japan Relationship: Toward the Year 2000* (Canberra: Australia-Japan Research Centre; Tokyo: Japan Center for Economic Research, 1989).

⁴ The author discussed in detail the interaction between the Pacific and Europe elsewhere. Refer to "Pacific Economic Cooperation and Single European Market," Proceedings of the conference held at the Japan-German Centre, Berlin, September 1989. The proceedings are available from the host institute.

United States, the government has emphasized the unity of the Western alliance and security, and persuaded resisting groups to accept their concessions to the United States. Many voluntary export restraints as well as market liberalization measures have resulted from these arguments. Such external pressure has helped and promoted trade liberalization, but the frequent use of VER and other managed trade practices will have serious adverse effects and bring forth distortion in the long run. Under the ongoing détente, the Western alliance argument will be less persuasive and economic conflicts will be more visible in the Japan-U.S. relationship. An emotional reaction may increase against foreigners' requests, especially for such domestic issues as institutional reforms. Restructuring efforts should not be thwarted by their disguised external pressure but should be reinforced through pursuing goals for their own merit.