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April 9, 1985

Dear

Today Prime Minister Nakasone has announced his New Economic Initiative.

In his statement, he urged his nation to "discharge the responsibility and share the cost" with a view to maintaining and strengthening the free trading system which constitutes the very basis of Japan's economy. He further called upon the public and business community for the need to expand importation of manufactured goods in order to maintain harmonious economic relations with the rest of the world and to enhance their national economy.

He expressed his commitment to formulate "Action Programme" as early as possible with a view to improving access to the Japanese market, based on the recommendations of Dr. Okita's group (Advisory Committee for External Economic Issues).

The report of Dr. Okita's group recommends the government to adopt "Action Programme" for more improved market access which should cover (a) tariffs, (b) import restrictions, (c) standard, (d) government procurements, (e) financial and capital market and (f) services. The Report also recommends the Government to pursue steady economic growth led by the expansion of domestic demands, by relaxing government regulations, shortening working hours and reviewing tax system. The "Action Programme" will be formulated by mid July covering coming three years.

The Government has decided on immediate measures and policy programs including facilitations of satellite imports from the U.S. It has also decided to formulate a schedule of tariff reductions on specific items by the end of June 1985. With regard to wood products, it intends to positively consider reduction of tariffs approximately from the third year.

Prime Minister Nakasone's New Economic Initiative is designed to address mid-term policy directions, based on the recognition that a piecemeal measure is not sufficient and that a more drastic change of the Japanese trading system is required. It expressed the intention

of the Japanese Government to further promote its policy towards complete internationalization of Japan's economy.

I am convinced that Prime Minister Nakasone's Initiative will certainly make a great contribution towards strengthening the world trading system and expanding the international economy.

Please find the executive summary of the New Economic Initiative and the texts thereof enclosed with this letter.

Yours sincerely,

Nobuo Matsunaga
Ambassador of Japan

Enclosures

- (1) Executive Summary
- (2) Prime Minister's Statement
- (3) The Report of the Advisory Committee for External Economic Issues (Okita Group)
- (4) The Decision by the Ministerial Conference for Economic Measures: "External Economic Measures - Recent Decisions and Future Policy Direction."

Executive Summary of Nakasone's New Economic Initiative

I. Prime Minister's Statement

1. Stresses the Japan's role in international community corresponding to the size of economy occupying 10% of the world economy
2. Sets the principle that market should be free and that restriction should be allowed only as exception.
Calls for the need to minimize government's intervention and to maximize choice and responsibility of consumers.
3. Expresses determination to share costs and discharge responsibilities to maintain free-trading system.
4. Urges the public and business community to expand imports of manufactured goods for the development of national economy.

II. Okita Report

1. Improvement of market access
 - (1) "free" in principle and "restriction" only as exceptional cases which can be understood reasonable and justifiable such as national security and environmental protection.
 - (2) "Action Program" to improve market access in the areas of tariffs, import restrictions, standard and import processes, government procurement, finance and capital market, service, etc.
2. Steady growth of the Japanese economy led by the expansion of domestic demands.
 - (1) reductions of government regulations for activating the private sector.

- (2) expanding two day-a-week holidays.
 - (3) review of tax systems to stimulate domestic demand.
 - (4) introduction of vitalities of private sector in the public work.
 - (5) review of regulations concerning land and construction to promote business demand.
3. Promotion of the New Round
 - (1) Japan's initiative, cooperating with the U.S.
 - (2) readiness to abolish tariffs of manufactured industrial goods jointly with other developed countries, further improvement of GSP.
 4. Calls for rectification of strong dollar (strong dollar and rapid expansion of U.S. economy are big factors of U.S. trade deficit, and needs to rectify strong dollar.)

III. Decision by Ministerial Conference

1. Action Program

Outline of "Action Program" for coming three years will be formulated by mid July, 1985.

2. Immediate Measures and Policy Program

- (1) tariff reduction on specific items to be decided by the end of June.
- (2) positive consideration to reduce tariffs on wood products approximately from the third year.
- (3) acceptance of foreign test data for medical equipment and pharmaceuticals.
- (4) admission of high-cube container on Japanese road.
- (5) facilitation of telecommunication satellite import.

Statement of Prime Minister Nakasone
on External Economic Measures

April 9, 1985

1. In the course of the four decades following the war, our economy has developed its strength to such an extent that it now shares as much as one-tenth of the world economy.

This has been an achievement derived from the wisdom and efforts of the people, and also the result of receiving greatest benefits from the free trading system based on the IMF and GATT.

Today, however, we see that there is an unprecedented rise of protectionism caused by delays in structural adjustment, bringing high levels of unemployment and accompanying large imbalances in the current account, and which threatens to undermine the free trading system.

Although the powerful waves of technological innovation are leading the world economy into a new age of development, this rise of protectionism threatens to deprive us of the possibilities which can bring such new development. In order to strengthen the free trading system and to lead the world economy into this new stage of development, Japan will need to play a role both important and commensurate with its status in the world economy.

2. Today the government received a report from the Advisory Committee for External Economic Issues consisting of informed people in the private sector which contains medium-term policy recommendations for the further internationalization of the Japanese economy, and has decided upon external economic measures.

As for the report of this Advisory Committee, the government intends to take fullest account of its policy recommendations and seeks to carry out their implementation.

Especially, on the improvement of market access, the government accepts the basic approach of "Freedom in principle, restrictions as exceptions" and will follow the recommendation that "exceptions" be limited to a necessary minimum. Accordingly, it will prepare an Action Program as soon as possible and seek its implementation without delay in order to minimize government intervention and to "leave the options as well as the responsibility to the consumers".

3. We have seriously conducted continuing consultations with the U.S.A. in the four sectors of telecommunications, electronics, pharmaceuticals and medical equipment, and forest products in accordance with the agreement reached in the Japan-U.S. summit meeting held in January this year.

In the telecommunications sector, the liberalization of telecommunications business has been carried out following the privatization of the Nippon Telegraph and Telephone Public Corporation (NTT) as of April 1, 1985.

In addition, there will be simplifications made on a large scale for technical standards of terminal equipment and transparency will be ensured in the creation of standards by allowing members of foreign affiliated firms to participate in the Telecommunications Council.

The fact that this liberalization has been carried out in a most advanced sector which promises to lead our economic progress into the next century is indeed dramatic, and I believe that it will contribute immensely to the expansion of world trade and increased exchange in technology.

In the electronics sector, Cabinet decisions have been made approving a bill for the protection of rights in semi-conductor chips, and an amendment of the Copyright Law for the protection of computer program rights so that intellectual property may be appropriately protected.

Also, following the mutual elimination of tariffs on semiconductors implemented between Japan and the U.S.A. as of March 1, this year, the government will enter into consultations with the U.S.A. and other industrialized countries with a view to extending the idea of mutually eliminating tariffs in the electronics sector.

As for pharmaceuticals and medical equipments, when they are submitted for the examination for approval, we have decided to accept foreign clinical test data for medical equipments and in vitro diagnostic reagents in case they are immune to ethnic differences. We will continue to seek further simplified and expedited procedures in granting approval and licensing in these areas.

As for forest products, the government will, for the next five years, take special measures for the promotion of the domestic forestry and the wood product industry. While observing the developments of such promotion measures, the government intends to positively consider reduction of tariffs on plywood etc., including those made of softwood and hardwood, with a view to starting implementation approximately from the third year.

Although these consultations covering the above four sectors have been conducted with the U.S.A., the results obtained will not only benefit the U.S.A. but also benefit countries all over the world.

4. Concerning other measures, we will give full consideration to the industrialized countries including the U.S.A. and the developing countries, including the countries in Asia with which Japan has close ties. We have decided in particular to carry out the decisions to lower the tariff of particular items in the early part of this year.

We will also seek the further improvement of standards and certifications and import testing procedures among others and encourage the import of manufactured goods and exchange in the field of investment.

As for the liberalization of financial and capital markets and the internationalization of the yen, the government has been making continued efforts in accordance with the agreement reached in the Japan-U.S. Yen Dollar Committee, and will steadily continue such efforts.

As for official development assistance (ODA), we will set new mid-term objectives for the period after 1986, make efforts to increase our ODA and at the same time seek improvement in terms of quality to the fullest extent possible.

5. These measures announced today have been the result of intensive studies made on the basis of discussions in the Advisory Committee as well as requests by other countries, and were decided after overcoming various domestic difficulties. Needless to say, the government intends to attain economic growth led by the expansion of domestic demand, and seeks a balanced expansion of trade through further improvement of access to our market and vigorous encouragement of imports. We will constantly review domestic institutions including administrative procedures in particular from the view- point of simplicity, transparency, non-discrimination

between nationals and non-nationals as well as the opening of markets and make efforts to improve them so they may better benefit a country called upon to play a leading role in the free and open international economic system.

As for the difficult domestic problems which may arise in this process, it will be necessary to tackle them vigorously with an awareness that we need to bear responsibilities and costs in order to maintain and strengthen the free trading system which is in fact the very basis of our economy. We will make further efforts to promote the GATT New Round from the same considerations.

6. I wish to take this opportunity to make an appeal to the nation. Japan's important and long standing external economic measures after the war have been aimed at the promotion of exports. However, export promotion is not the only means to enrich the national economy. To have more choice of goods through the encouragement of imports can also be a means to this end.

I ask all of you, therefore, to be willingly receptive toward foreign products for the purpose of enriching your livelihood. And I hope that people in business circles will fully realize the fact that export alone cannot bring about a balanced expansion of trade nor harmonious external economic relations and will endeavor for the increased import of manufactured goods.

Finally, I should like to appeal to the international community. Whether or not we will be able to pass on the world's present state of progress and prosperity to the next generation depends on our resolve. Japan is firmly determined to play a role and discharge responsibilities befitting its economic strength. It is my ardent hope that the international community will continue to progress along the path of stability and prosperity through free and ever increasing exchange and cooperation, never yielding to the temptation of protectionism.

Gist of the Report
Submitted by the
Advisory Committee for External Economic Issues

- I. Introduction: Basic Perceptions on International Economic Situations and the Need for Internationalization
 1. The rising tide of protectionism threatens to undermine the free trading system.
 2. Japan is being called upon to play an international role commensurate with its position, including
 - A. Improving market access,
 - B. Promoting sustained economic growth grounded in domestic demand, and
 - C. Enhancing its overseas economic assistance.
 3. The basic policy in internationalization should be "freedom in principle and restrictions as exceptions."
- II. Implementation Status of External Economic Measures
 1. Economic friction and external economic measures

The recent economic friction has different features from previous friction. They are:

 - A. Greater attention to market accessibility
 - B. A sectoral shift from goods to financing and other service industries, and
 - C. Greater geographical spread.

2. Assessment of measures to date
 - A. Assessment should be made in terms of market accessibility.
 - B. Some countries have expressed dissatisfaction at past external economic measures, saying that:
 - a. They are insufficient,
 - b. They lack clarity in the medium- and long-term perspective, and
 - c. They are slow and reactive.
 - C. There is also criticism of the administrative discretion on interpretation and enforcement.

III. Basic Perceptions on Current Account Imbalances

1. Trends and Outlook for Japan's Current Account Surplus
 - A. Japan's current account surplus with the United States is due to
 - a. The dollar's excessive strength on exchange markets as a result of high interest rates in the United States and
 - b. A rapid increase in Japanese exports to the United States as a result of the strong economic recovery in the United States.
 - B. Japan may continue to register a surplus in its current account.
2. Japan's Role as a Capital Exporter
 - A. Some of Japan's current account surplus is attributed to structural causes.
 - B. Japan has a role to play as a capital exporter providing capital to countries with savings deficiencies.

3. - Correcting the Dollar's Overvaluation

- A. The dollar's exchange strength has caused current account imbalances worldwide and fueled protectionist pressures.
- B. Japan should ask the United States to restore balance between savings and the demand for funds and to seek to bring the dollar back into line by lowering real interest rates.

IV. Recommendations for Medium-Term Policies for Further Internationalizing the Japanese Economy

- 1. In advancing effective external economic measures, the government must clearly enunciate its determination to actively promote internationalization on its own initiative.
- 2. This should involve the following six points.
 - A. Further Improvement in Market Access
 - a. The basic approach should be one of freedom in principle and restrictions as exceptions. The only areas where restrictions should remain are those pertaining to national security, environmental conservation, the maintenance and safety of the lives of the people, and other items that are fully justifiable internationally.
 - b. The government should embark promptly upon formulating the Action Program for the medium term (about three years) aimed at improved market access and should reach its conclusions as soon as possible.

- c. In fields where liberalization will take more time or where there are difficulties in domestic adjustments, clear reasons fully acceptable to the international community should be given for any delay and the measures implemented in phases.
 - d. The Action Program should be characterized by
 - i. Autonomy and positiveness
 - ii. Internationalism
 - iii. Effectiveness and transparency
 - e. In drawing up the Action Program, it will be necessary to sort out and examine the problems in, and define goals for, each individual field. It is desirable that, as necessary, the corresponding measures to facilitate each action be studied as quickly as possible and promptly put into action.
 - f. The Action Program should include, for example,
 - i. Tariffs,
 - ii. Import restrictions,
 - iii. Standards, certification, and import procedures,
 - iv. Government procurement,
 - v. Financial and capital markets, and
 - vi. Services.
 - g. Follow-up arrangements need to be made for the Action Program.
3. Sustained economic growth centered on domestic demand
- A. Deregulation
 - B. Promotion of the five-day work week and shorter working hours

- C. Efficient upgrading of priority social capital with the introduction of private-sector vitality
- D. Reassessment of the tax system to contribute to sustained economic growth buoyed by domestic demand
- 4. Expanded investment and industrial cooperation
 - A. Revitalization of the industrial economies through investment and industrial cooperation
 - B. Expanding the frontiers of the world economy through technology exchange
- 5. Promotion of the New Round
 - A. Japan should play a leadership role in preparations for the New Round of GATT talks such as, for example, implementing the Action Program.
 - B. In particular, Japan should:
 - a. Announce that it is ready to reduce tariffs on industrial products to zero in concert with the other advanced industrialized countries and
 - b. Improve the Generalized System of Preferences, including, for example, expansion of quota ceilings and coverage.
- 6. Response Toward the Developing Countries
 - A. On economic and technical cooperation, the government must endeavor to promote its ODA in the medium term on a planned basis and make positive efforts to untie its aid.
 - B. On market access issues, the government should respond appropriately to such issues as tariff escalation and GSP.

- C. Efforts should be made to include in the Action Program measures contributing to the developing countries' economic development.
- 7. Efforts to avoid friction
 - A. Efforts should be made to avoid concentrating specific-product exports in specific regions.
 - B. Dialogue among Japanese and foreign business leaders should be promoted.

Conclusion

- A. Making Japan more open to the rest of the international community -- leading the move for internationalization -- is imperative.
- B. Consensus formation is indispensable to promoting further internationalization.
- C. It is of utmost importance that the Japanese people be more international-minded.

Provisional
translation

Report of
the Advisory Committee
for External Economic Issues

April 9, 1985

Foreword

The Advisory Committee for External Economic Issues has been asked by the Ministerial Conference for Economic Measures to go into (a) the review of the implementation status of external economic measures decided by the Ministerial Conference for Economic Measures and (b) the medium-term issues in promoting further internationalization of the Japanese economy.

The Advisory Committee has met 11 times since its first meeting on December 20, 1984, and conducted vigorous discussions on these two topics. In the process, the Advisory Committee has heard the views of its Special Foreign Advisors as well as other foreign advisors, and some Advisory Committee members visited the United States to exchange views on Japan-U.S. economic relations with government, Congress, and business leaders there.

This report has been drawn up on the basis of the Advisory Committee's deliberations and has made some policy proposals.

The Advisory Committee would like to take this opportunity to express its appreciation to the Special Foreign Advisors (Mr Herbert F. Hayde, President, American Chamber of Commerce and Industry in Japan; Professor Khoontong Intarathai, Kyoto Seika University; and Mr W.J. Minzinga, Chairman, European Business Council) as well as to other foreign advisors (Mr Paul A. Dudler, President, Ciba-Geigy (Japan); Mr Lee Kil-Hyun, President, Samsung Japan; and Mr Edgar Morris Weatherstone, President, Australian Chamber of Commerce and Industry in Japan) who participated in the discussions.

April 9, 1985

Tokyo, Japan

Members of the Advisory Committee for External Economic Issues are

Chairman Saburo Okita (Chairman, Institute for Domestic and International Policy Studies, and former Minister for Foreign Affairs)

Member Shoichi Akazawa (President, JETRO)

Takashi Hosomi (President, Overseas Economic Cooperation Fund)

Hitoshi Ikeda (Executive Director, National Chamber of Agriculture)

Tadao Kato (former Japanese Ambassador to the United Kingdom)

Haruo Maekawa (ex-Governor, Bank of Japan)

Akio Morita (Chairman, Sony Corporation)

Miyohei Shinohara (Chairman, Institute of Developing Economies)

Tadanobu Usami (President, Japanese Federation of Labor)

Keizaburo Yamada (Vice Chairman, Mitsubishi Corporation)

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I. Introduction

Basic Perceptions on the International Economic Environment

Propelled by the U.S. economic recovery, the world economy is recovering on the whole. Yet dark clouds of protectionism loom overhead and economic friction is intensifying around the world. Protectionism does not stem only from the stagnation of the world economy in recent years but also against a background of structural problems. It is deep-rooted and serious.

In the United States, plant and equipment investment is robust, and the economy appears to be on a steady path toward vitalization. However, the United States economy is plagued by twin deficits in its budget and current accounts that could potentially block its sustained growth. The current account deficit in particular, which reached an all-time historical peak of \$101.6 billion in 1984, forms the background to protectionist pressures in the United States.

In Europe, the unemployment situation remains severe, despite the economic turnaround. Europe's unemployment problems derive from its slow adjustment to the rapid global changes in industrial and trade structures in the 1970s. Since the problems do not lend themselves to easy solution, protectionist sentiments remain strong.

Developing countries continue to suffer difficulties, due partly to stagnating prices of primary commodities. High interest rates in the United States are increasing their debt burdens, and, the rising investment costs are forcing them to reassess their economic development strategies. Lacking the means to pay back their debts as long as they are unable to earn foreign currency through trade, debt-ridden countries are increasingly demanding that the advanced industrialized countries open their markets.

-- Need for Internationalization --

Japan also has benefited from the global free trading system, maintained and strengthened over four postwar decades, that has enabled it to realize rapid economic growth. This free trading system is now threatened by the emergence of protectionism. It must be realized that Japan is now in an unprecedentedly demanding environment.

Japan is now being called on to play a role in the international community commensurate with its status. Japan must internationalize itself as befits its role as one of the world leaders.

To avoid a crisis in the world free trading system and ensure global economic progress and stability, Japan must take concrete measures from a medium-term perspective in such areas as improving market access, fostering sustained economic growth driven by domestic demand, expanding its overseas economic cooperation programs, and encouraging manufactured imports. The basic approach must be a bold one of "freedom in principle, restrictions as exceptions," one designed to open Japan to the world.

II. Implementation Status of External Economic Measures

1. External Economic Friction and Economic Measures

-- Recent History of Economic Friction --

Economic friction with foreign countries has been intensified in three periods in the recent past: 1969-72, 1976-78, and 1981 to the present, and the government has drawn up and implemented series of packages of economic measures. These periods correspond almost exactly with those when (1) Japan has had a large current account surplus, (2) its trading partners have had large trade and current account deficits, and (3) Japan has had large bilateral trade surpluses with its trading partners. Also working to exacerbate economic friction in the recent past has been the fact that current account imbalances are not fully reflected in exchange rates.

-- Features of Recent Friction --

The latest round of economic friction (i.e., since 1981) has globally been more complex and more serious in terms of its background, extent, and depth than ever before. The friction involving Japan, in particular, has changed qualitatively in the following manner.

First, besides the friction over Japan's sharply expanding export volumes, the focus is now on demands to improve market access so as to rectify inequality of opportunity to enter the Japanese market. Japan's policies, institutions, and practices have also become issues.

Second, whereas friction used to be sparked by sharp increases in exports of specific items such as textiles, steel, color televisions, and automobiles, the

focus has increasingly shifted to high-tech sectors in recent years. Friction has in some cases arisen for national security or other reasons with respect to those high-tech products which are expected to enjoy expanded markets in the future. The areas of friction have also expanded from goods to finance and services.

Third, friction has been spreading geographically against the background of Japan's large current account surplus, such that there is now friction between Japan and the United States, Japan and Europe, and Japan and the ASEAN countries. Thus there is mounting criticism of Japan from all around the world.

2. Features of Past External Economic Measures and their Implementation Status

-- Features --

As economic friction has mounted, the government has adopted six packages of external economic measures between December 1981 and December 1984. These packages have been characterized by the following four features.

First, the packages have been implemented in realization of the importance of maintaining and strengthening the free trading system. Second, content-wise, they have been very broad and diverse. Third, although the packages have had a side to them that was passive in nature in the sense that the measures they contained have been based on foreign demands, they have been taken unilaterally without seeking reciprocal concessions on the part of Japan's trading partners. Fourth, while market opening can conceptually be divided into improving market access and expanding actual imports, the measures in the packages have been taken primarily with the aim of improving market access in the expectation that this will also yield import expansion.

-- Implementation Status --

The implementation status of the external economic measures is shown in Appendix 1.

3. Overseas Assessment and Requests concerning External Economic Measures

The Advisory Committee for External Economic Issues held two hearing sessions with three Special Foreign Advisors (January 30 and March 19, 1985), and on March 12, 1985, it heard the views of other foreign advisors. Two Committee members also took part in the 12th meeting of the Joint Executive Committee of the Japan-U.S. Businessmen's Conference, held on February 3-5, 1985, where they exchanged views on Japan-U.S. economic relations with participants from the United States. In addition, two Committee members also heard opinions in the United States from members of the business community and met with government, Congress, and business leaders on March 6-8, 1985. The following is an outline of the general overseas assessment of the successive packages of external economic measures, including views presented at the Advisory Committee's hearings. (See Appendix 2 for details.)

- a. Although the posture taken in the market-opening measures is generally highly regarded, the measures are described as "too little, too late." (the United States and the EC)
- b. Despite successive packages, there has been no change on crucial points, nor have there been any significant results. (the United States and the EC)
- c. The process of making and implementing policies is not transparent and leaves too much scope for administrative discretion. (the United States in particular)
- d. The measures so far gave little consideration to the developing countries, being "biased towards Europe and the United States." (the ASEAN countries and the Republic of Korea)

e. The measures so far have not been oriented toward the Oceanic countries.
(the Oceanic countries)

The overseas assessment can thus be generally described as critical of
Japan's external economic measures.

4. General Assessment of the External Economic Measures

-- Effect of the Measures --

The successive packages of external economic measures are judged to have had the effect of improving market access as a result of their implementation. However, dissatisfaction remains on the part of Japan's trading partners, and they are critical in their assessments. The impact of the packages should nevertheless be measured in terms of ease of access to the Japanese markets, and not in import or current account trends, which can be affected by such variables as exchange rates, differences in phase of economic cycle, foreign products' international competitiveness, and firms' marketing efforts.

-- Background to Foreign Criticism --

Foreign criticism is triggered by the following background factors.

First, the contents of the packages could not fully satisfy foreign requests on each occasion, owing to, inter alia, the need for adjustments with domestic industries concerning the measures to be incorporated into the packages.

Second, it was not clear how the measures fit in with the medium- and long-term thrust of Japan's internationalization. In other words, it was unclear how fast and in what directions the response to internationalization would proceed, and what significance individual measures had at the stage when they were introduced.

Third, the measures were not always presented in a timely manner. At the same time, they tended to be studied in a reactive rather than an active approach.

-- General Assessment --

Reviewing the successive packages of external economic measures in light of the above, they can be given credit for improving market access. Nevertheless, much remains to be studied on the methods and approaches used. Moreover, although market opening is making progress in terms of legislation, institutions, and procedures, further improvements are being sought on the grounds that there is scope for administrative discretion in their application and room for arbitrary decisions. Bearing in mind the danger that the credibility of Japan's response may be lost if things are left as they stand, we must carry out future external economic measures in light of Japan's position and role in the world economy and the lessons learned in formulating and implementing past packages.

III. Basic Perceptions on Current Account Imbalances

1. Trends and Outlook for the Current Account Surplus

-- Trends and Causes --

Japan's current account surplus reached \$20.8 billion in 1983 and \$35.0 billion in 1984. By region, trade with the United States was \$33.1 billion in surplus in 1984 and that with the EC countries \$10.1 billion in surplus. The increase in the trade account surplus from 1983 to 1984 (\$13.1 billion) corresponds roughly to the increase in the trade surplus with the United States (\$14.9 billion) while the surplus with the EC showed some decline (\$300 million).

The factors underlying Japan's large current account surpluses of recent years are either short-term, cyclical ones or special factors, such as: (1) exchange rate factors, (2) differences in economic cyclical phases at home and abroad, and (3) lower oil prices. The trade imbalance underlying the current economic friction with the United States is believed largely attributable to the dollar's exchange strength as a result of high domestic interest rates, and to increased imports into the United States as a result of its rapid economic expansion. The fact that Japan's trade surplus with the EC is not increasing when the yen has appreciated against European currencies suggests that exchange rates are one of the factors having an important bearing on the trade account.

-- Medium-term Outlook for the Current and Capital Accounts --

Japan's current account surplus is likely to persist, although it will be heavily affected by economic trends in the United States and exchange rate

movements. Since a substantial part of today's large current account surplus and capital outflow is a reflection of the large United States current account deficit and capital inflows, although there is not sufficient evidence to justify predictions that these large external imbalances will continue in the medium term, one cannot explain Japan's present current account surplus entirely in terms of short-term cyclical or special factors. It is undeniably due in some degree to structural factors. We thus have to pay attention to Japan's structural surplus, particularly in the medium term.

2. Japan's Role as a Capital Exporter

Many countries -- in particular those in the developing world -- tend to suffer savings shortages and need to be supplied with capital. Assuming that United States capital imports continue, countries that have hitherto relied on foreign savings will encounter difficulties in raising capital and consequent obstacles to stable economic development unless other countries come forward to supply capital. Japan must therefore continue to act as a capital exporter, with the caveat, however, that this must not be used as an excuse for delaying such necessary measures as those for improving market access.

3. Correcting the Dollar's Overvaluation

The nominal effective exchange rate of the dollar stood 65% higher at the end of 1984 than the average for 1980 while the real effective rate stood 60% higher, according to the 1985 Annual Report of the Council of Economic Advisers of the United States.

Although the dollar's strength contributes to price stability in the United States by holding import prices down, it also weakens the international competitiveness of United States export industries. Moreover, high United States interest rates filtering through to other countries act as a drag on their capital investment and exacerbate the plight of debtor countries. In Japan's case, the strong dollar makes Japan more dependent on external demand. The overvalued dollar is exacerbating the problem of current account imbalances around the world. Not only is it aggravating protectionist pressures; it is also having an undesirable impact on long-term economic vitality in other countries.

Efforts by the United States to restore its balance between savings and the demand for funds would lead to a reduction in real interest rates, and, by correcting the overvalued dollar, achieve a contraction in its current account deficit. The government should therefore ask the United States government to make efforts in this direction.

IV. Proposals for Medium-Term Policies for Further Internationalizing the Japanese Economy

In order to draw up effective packages of economic measures, it is indispensable that the government act positively on its own initiative to elucidate its intentions and goals in internationalization.

In doing so, it will need to implement, in a timely fashion, measures that are effective in the medium term and can stand as a declaration of international goals for the maintenance of the free trade principle throughout the global economy. The government must not stop at short-term fixes but must demonstrate clearly its determination to internationalize by taking external economic measures from a medium- and long-term viewpoint.

The Advisory Committee makes its proposals on the basis of the lessons gained from the successive packages of external economic measures taken over the last few years.

1. Further Improvement in Market Access

(1) Establishment of Basic Principle

Japan should act in full awareness of the significance of internationalization and respond with a basic stance of "freedom in principle and restrictions as exceptions."

The only items restricted as exceptional cases should be those pertaining to national security, environmental conservation, the maintenance and safety of the lives of the people, and other items that are fully justifiable internationally. Restrictions should be kept to an absolute minimum.

(2) Formulation of an Action Program to Improve Market Access (hereinafter "the Action Program")

To demonstrate the intentions and directions of Japan's internationalization at home and abroad, the government should urgently embark on the formulation of the Action Program designed to improve market access in line with the following guiding principles, while determining the period to be covered by the Action Program (about 3 years) and should reach a conclusion as soon as possible.

In fields where liberalization will take more time or where there are difficulties in domestic adjustments, clear reasons that are fully acceptable to the international community should be given for any delay and the measures implemented in phases.

-- Character of the Action Program --

The Action Program must have the following characteristics.

- a. Autonomy and positiveness: It should not be drawn up reactively on the basis of demands from other countries, and it should contain measures that enable Japan to play a positive role for the maintenance of free trade.
- b: Internationalism: Its content must be fully acceptable to other countries in view of the prevailing international economic situation.
- c. Effectiveness and transparency: The specific procedures for achieving the program must be clearly explicable.

In drawing up the Action Program, it will be necessary to sort out and examine the problems in, and define goals for, each individual field. It is desirable that, as necessary, the corresponding measures to facilitate each action be studied as quickly as possible and promptly put into action.

-- Content of the Action Program --

The Action Program should include the following items.

a. Tariffs

i. Tariffs on industrial products

Maximum efforts should be made to negotiate bilateral agreements with advanced industrialized countries for the abolition or drastic reduction of tariffs, as was done in the case of semiconductors. The results of the negotiations will then be shared with other countries under most-favored-nation treatment.

With respect to the New Round of trade negotiations in GATT, Japan should announce that it is ready to reduce tariffs on industrial products to zero in concert with the other advanced industrialized countries.

- ii. Reexamination of tariffs on agricultural, forestry, and fisheries products.
- iii. Reexamination of tariff escalation.
- iv. Improvement in the Generalized System of Preferences (GSP), including, for example, expansion of quota ceilings and coverage.

Study should also be given to legislation to delegate authority to the government to enable the implementation of temporary tariff rates under set conditions.

b. Import restrictions

Import restrictions should be reexamined in the context of international trends.

c. Standards, Certification, and Import Processes

- i. Standards, certification, and import processes should be rationalized on the basis of the principles of simplicity and transparency. Consistency with international standards should be ensured and the scope for administrative discretion reduced.
- ii. Pre-customs procedures should be simplified and streamlined.

d. Government procurements

- i. Procurement procedures should be improved, including a thorough reassessment of the single tendering procedures.
- ii. Procurement of foreign products should be expanded.

e. Financial and capital markets

The report of the Yen/Dollar Committee should be carried out as recommended, especially the promotion of liberalization of financial and capital markets.

f. Services

Services, including advisory activities by foreign lawyers, should be further liberalized.

In all the above, special consideration should be given to measures that will promote economic development in the developing countries.

When drawing up the Action Program, moreover, it will be necessary to bear in mind the need for consistency with other policy programs and plans, revising those policy programs and plans if necessary.

(3) Establishment of a Follow-up System for the Action Program

Efforts should be made to implement the Action Program drawn up on the above basis promptly. It will also be necessary to provide a system for following up its implementation on a continuing basis.

(4) Promotion of Manufactured Imports

Coming from a different historical and cultural milieu, foreign firms find some aspects of Japan's distribution systems and commercial practices difficult to understand.

Yet the expansion of manufactured imports is vital to internationalizing the Japanese economy. Besides calling on foreign firms to make greater efforts, Japan will have to foster understanding of its commercial practices and market characteristics and enhance public receptiveness to imported goods. A fuller range of effective measures must be provided to support foreign firms' export efforts. In particular, it is hoped that the private sector will actively endeavor to import in sophisticated high-tech fields when other countries' products are of superior quality and price.

2. Sustained Growth Centered on Domestic Demand

Stimulating domestic demand is just as crucial in rectifying the external imbalances that are the primary cause of economic friction as improved market access is. Expansion of domestic demand will not only have the effect of increasing imports but will help correct external imbalances in that it reduces the pressure to export.

For this, it will first be necessary to abolish or relax, in a planned fashion and within a set period, official regulations that restrict the free activity by the private sector. The easing of official restrictions is also a key element in improving market access, and at the same time it conforms with the domestic need to nurture private-sector vitality through "small government" as recommended in the report of the Provisional Commission for Administrative Reform. In this respect, if there are restrictions which unfairly restrict entry into the market, they should be eliminated.

Second, the five-day work week will need to be put into wider practice and working hours reduced. These steps would increase opportunity for greater consumption and thus augment domestic demand. An effort should be made to increase leisure time consistent with the pattern of international labor practices.

Third, social overhead capital should be upgraded efficiently and on a priority basis while endeavoring to introduce private sector vitality into public works projects. Continued reassessment of restrictions on land use and construction will be needed in improving housing and community facilities, one of the key elements in expanding domestic demand.

Fourth, it will be important to review the tax system so that it works in favor of sustained domestic-demand-centered growth. Basically, the tax system needs to be reassessed with a view to achieving a better balance among savings, consumption, and investment.

3. Expanded Investment and Industrial Cooperation

-- Vitalization of the Industrial Economies through Investment and Industrial Cooperation --

Further efforts are needed to promote direct overseas investment and other forms of investment and technology exchange. It is vital that both Japan and other countries mutually improve the climate for private-sector operations in these fields. Positive measures are needed, such as continued government and private sector negotiations for the abolition of the unitary tax in the United States and support for overseas investment by technology-rich small businesses. Active measures will be needed in view of the fact that direct investment into Japan is currently much less than Japanese direct investment overseas.

-- Need for Technology Exchanges --

International exchanges and cooperation in science and technology and technology transfer are an inducement to technology development around the world and have the effect of expanding the frontiers of the global economy. Keeping in mind our position as a technologically advanced nation, we should respond fully by fostering joint development projects with the industrial countries and encouraging the joint expansion of research and development programs. An effort must be made to ensure that the results are transferred to other countries.

4. Promotion of the New Round

-- Significance of the New Round --

The present GATT institution now faces a number of problems owing to basic changes that have taken place in the global economic structure in recent years. A New Round of trade negotiations in GATT therefore needs to be promoted.

First, against the background of global protectionist pressures, the postwar free, non-discriminatory trading system has been eroded, as seen in the proliferation of such "gray" measures as voluntary export restraints. The system needs to be reconstructed under a new set of trade rules.

Second, an attempt will need to be made within the New Round to improve the trade climate for the developing countries, especially those with debt problems.

Third, there is the question of how to integrate into the international trading system the new situations such as that in services and high-technology trade that has arisen in conjunction with changes in economic structure over the past several years.

-- Japan's Basic Position for the New Round --

It is desirable that as many countries as possible participate in the New Round, developing countries and industrial countries alike, and that the discussions cover as many fields as possible. From this viewpoint, Japan has appealed strongly to other countries for the early launching of the New Round. It is believed that Japan should play a leading role in the preparation and

negotiation of the New Round by, for example, implementing the Action Program referred to above.

To this end, Japan should announce that it will not introduce any new protectionist measures and should prepare positive and concrete offers for the New Round. There is a particularly urgent need to (1) announce that Japan is ready to reduce tariffs on industrial products to zero in concert with the other advanced industrialized countries and (2) improve the GSP, including, for example, expansion of quota ceilings and coverage.

5. Response Toward Developing Countries

-- Basic Stance --

Developing countries aspiring to economic development are asking Japan to make a greater contribution to their economic development commensurate with its economic position. Japan needs to make an effective response in keeping with their stages of development and their natural and social conditions in various fields, ranging over economic and technical cooperation, improved market access, investment, and industrial cooperation. In particular, further increases in manufactured imports from these countries should be promoted.

The Asian and Pacific Basin, which includes the ASEAN countries and such Asian NICs as the Republic of Korea, occupies an important position for Japan for a number of reasons, among them its close trade and economic relations with Japan. Japan should promote a further increase in manufactured imports from these countries in particular. Japan has contributed to their economic development of the region through private direct investment, exporting capital goods, and official assistance, and it will need to promote their industrialization and assist the diversification and maturation of their industrial structures.

-- Promotion of Economic and Technical Cooperation --

Japan's basic stance must be one of efforts to achieve internationally announced quantitative and qualitative goals for Official Development Assistance (ODA). It must endeavor to promote its ODA in the medium term on a planned basis and make positive efforts to untie its aid. In cooperation, its response should include not only bilateral cooperation but also multilateral

cooperation through international organizations and the promotion of joint financing between international organizations and the private sector. Efforts should also be made to expand technology transfer, finance, and investment by the private sector so as to help strengthen the developing countries' export capabilities.

In addition to aid of an emergency nature, such as that to relieve the serious famine in Africa, aid will have to be expanded in basic human needs from a longer perspective, especially cooperation in agricultural fields including the provision of facilities for increasing food production capacity, transportation, and storage.

-- Improvement of Market Access --

From the viewpoint of the developing countries, the measures Japan has implemented so far are seen as insufficient. They expect Japan to take measures commensurate with its position in the international community. In particular, tariff escalation, the scope and content of GSP, and other problems have become issues as the developing countries increasingly shifted toward manufactured exports. In formulating and implementing the Action Program, special consideration should be given to measures that will help promote their economic development. Items of special interest for which some developing countries are seeking political consideration should be dealt with in a medium-term perspective, corresponding measures to facilitate such action being studied as necessary.

6. Efforts to Avoid Friction

With a view to maintaining and strengthening the open world trading system based on an expansionary equilibrium in trade, Japan should, in addition to the above efforts, endeavor to see that exports of specific items are not concentrated in specific regions. It would be highly beneficial if dialogue could be held by business executives from the industries concerned and at the working level for a full exchange of views in an effort to resolve problems in specific sectors before they burst into bilateral political issues. The government should make the necessary efforts such as having the United States government exercise its good offices if United States anti-trust law proves an obstacle.

The present Office of Trade and Investment Ombudsman (OTO) within the Japanese government should be actively utilized to handle foreign complaints and other problems related to market access.

Conclusion

Seeking to make Japan more open to the rest of the international community, the Advisory Committee has made proposals in the medium-term timeframe for improved market access, economic growth sustained by domestic demand, expanded cross-investment and industrial cooperation, promotion of the New Round, responsiveness to the needs of the developing countries, and efforts to avert economic friction.

The Advisory Committee strongly hopes that the government will move without delay to implement these proposals and the follow-up which they entail. Positive progress on these proposals is consistent with Japan's playing an international role commensurate with its economic importance. It is also a clear statement of Japan's firm commitment to fulfilling its international responsibilities and, given the strident circumstances in which Japan finds itself, it is very much demanded of Japan.

This process of internationalization will not be entirely painless. As one of the leaders in the international community, however, Japan must go forth willingly to meet and overcome these difficulties. The time has come for Japan to courageously pay the price of internationalization and to contribute positively to the betterment of the international community.

Making Japan more open to the rest of the international community -- leading the move for internationalization, as it were -- is in Japan's own national interest. Yet internationalization has lagged behind as the economy has grown rapidly stronger, and a national consensus on internationalization has yet to be formed in Japanese society. Such consensus is indispensable if Japan is to promote further internationalization, and this in turn requires a determined

effort by people in all walks of life in both the public and the private sectors.

The perception gap has often been cited in connection with international economic friction. Much of this perception gap is rooted in differences in social and cultural mores, and it is important that Japan work untiringly to gain fuller international understanding of Japan and to narrow the perception gap by its own internationalization. In this vein, it is essential that there be broad-based contacts between Japanese and other peoples in all walks of life so that everyone can learn from everyone else and mutual understanding can thus be achieved. It is a long process, but we must continue making efforts.

It is important that we be internationally minded and most careful not to fall into the trap of simply pontificating on our differences or wind up self-centered international outcasts. This is especially true of people responsible for policy-making and policy-implementation.

In this regard, it is crucial that every effort be made to increase the opportunities to hear the views of foreign parties concerned (in response to their recently mounting requests) and to ensure transparency in the process of drafting Japanese government policy.

It may well be that some friction is inevitable with the international community as interdependent as it is today and with the Japanese economy such an important part of the world economy. If this is so, it is all the more essential that the parties concerned respond calmly to ensure that the situation not be politicized. This can only be done within the context of a broader bilateral relationship of friendship in the political, cultural, and other spheres sufficient to managing the tension in economic relations. Never before has it been so important that everyone strive to forge strong bonds of friendship with the rest of the international community.