TRADE AND STRUCTURAL ADJUSTMENT

Implications for Japan’s external economic policies and reflections on future challenges for the OECD

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Introduction

1. The issue of globalisation raised a storm at the WTO Seattle Ministerial Meeting in December 1999 and negotiations on trade liberalisation were stalled. While coping with the effects of that storm, WTO member governments continued their efforts and achieved the successful launch of the Doha Development Agenda in November 2001. Despite the failure of the WTO Cancún Ministerial Meeting in September 2003, they have moved forward step by step with a view to the WTO Hong Kong Ministerial Meeting in 2005 and a possible conclusion in 2006.

2. With the emergence of BRICs (Brazil, Russia, India and China) as new sources of competition in world markets, along with accelerating technological change and shifting societal values, adjusting to globalisation has become an issue of concern to both developed and developing countries. The challenge is complex, as trade liberalisation involves more than tariff reductions: it also concerns broader domestic policies behind the border. There has been good progress in East Asia on regional trade agreements (RTAs) or economic partnership agreements (EPAs), but the core questions to be addressed in multilateral trade negotiations remain.

3. Globalisation and structural adjustment have been actively discussed in many forums and international organisations, including the WTO, the IMF, the World Bank, UNCTAD and the ILO. The OECD’s recently completed study under the Trade and Structural Adjustment Project (TASAP) undertook a sector-focused and forward-looking analysis of trade and structural adjustment supported by country-specific case studies, and the results were reported to the OECD Ministerial Council Meeting in May 2005 (OECD, 2005a).

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1 This short paper was prepared for the session at the OECD Tokyo Forum on Services, Trade and Structural Adjustment. It focuses on the implications of the OECD Project on Trade and Structural Adjustment for Japan’s external economic policies and business and on future challenges. The author is a former senior trade policy analyst and principal administrator at the Trade Directorate of the OECD Secretariat. He participated in the OECD project on structural adjustment and is now Deputy Director for Manufacturing Industries Bureau at the Ministry of Economy, Trade and Industry (METI) of Japan. The views expressed are those of the author and not those of the organisations for which the author has worked or is working. The author would like to acknowledge all the officials who participated in the OECD project with whom the author enjoyed useful discussions.

2 See e.g. Bacchetta and Jansen (2003); Hoekman and Javorcik (2004); ILO (2004); WTO (2004); UNCTAD (2005); and the IMF and World Bank (2005).
4. The OECD has been addressing structural adjustment issues for a quarter of a century. Following upheavals in the world economy in the 1970s, the OECD Council in 1978 proposed some general orientations for adjustment policies. It underscored the need to adjust to new conditions, relying as much as possible on market forces to encourage mobility of labour and capital to their most productive uses, with time-bound, limited and transparent government interventions to ensure sufficient domestic and international competition (the so-called “PAP” – Positive Adjustment Policy). As Komiya (1999) noted, Japanese structural adjustment polices have since been implemented in line with the PAP.

5. Because a comprehensive introduction to the TASAP is already available (OECD, 2005a; OECD, 2005b; Heydon, 2005), this paper will explore in Part I a specific aspect, the linkage between the TASAP and Japan’s external economic policies. Part II will then describe future challenges, including business concerns, and propose a further OECD analysis or case study relating to the Asian region.

I. Structural adjustment and Japanese external economic policies

6. Structural adjustment is a challenge for both developed and developing countries. The TASAP examined the requirements for successful trade-related structural adjustment via the reallocation of labour and capital to more efficient uses, while limiting adjustment costs for individuals, communities and society as a whole. The TASAP was undertaken in parallel with a related project, Growth in Services: Fostering Employment, Productivity and Innovation (OECD, 2005c) which analyses the services sector to identify factors, institutions and policies that could enhance its growth.

7. The overall picture provided by these studies is useful for setting the scene. The services sector accounts for over 70% of value added in OECD countries and there has been a shift of resources from manufacturing to services (OECD, 2005c). Already a quarter of a century ago, the services sector accounted for approximately 60% of GDP, and the shift to services now seems to be slowing (OECD, 2005a, p. 5), but competition within the services sector seems to be intensifying (OECD, 2005a, p. 6). The trend suggests that the challenge for OECD countries will be to revive a robust manufacturing industry and ensure a competitive services sector (see METI, 2004, for the case of Japan).

8. As quite a few European examples demonstrate, government policies have shifted from the large-scale subsidies of the 1980s to today’s policy measures to improve market conditions and enhance innovation (e.g. European steel case in OECD, 2005b; Foreman-Peck and Federico, 1999). In 2000, the European Union launched the Lisbon Strategy to boost research and innovation and improve education to make the EU the world’s most dynamic and competitive knowledge-based economy by 2010. It re-launched the strategy in 2005 with a focus on growth and employment (EU, 2005).

9. A recent study on manufacturing by the Japanese government points out that manufacturing makes up about 20% of Japan’s GDP, but accounts for 90% of the country’s exports and R&D investment. Japan’s manufacturing industry is experiencing a positive cycle, creating new products from R&D, developing new demand, restoring production and raising profits, notably in digital consumer electronics (METI et al., 2004). The Japanese economy is recovering at moderate pace, and the challenge is to sustain and spread the recovery (Monthly Economic Report, Cabinet Office, May 2005).

10. In this regard, a range of structural reforms have been undertaken to facilitate corporate revival and industrial reorganisation and create new industries. Japan’s external economic policies have been a core element of these structural reform efforts. For example, the Japanese government recently
declared that economic partnership agreements in East Asia would facilitate structural reform (Council of Ministers, 2004).

11. Three points that have been identified in the TASAP case studies as important to successful structural adjustment have implications for Japan’s external economic policies.

**The basic policy framework and the synergies – institution building**

12. First, the TASAP finds that in tackling the challenge of structural adjustment, all countries, developed and developing – albeit with differing degrees of emphasis – will benefit by adopting at the national level an appropriate policy framework: macroeconomic policies which promote stability and growth; labour market policies which help develop workers’ skills and facilitate a smooth transfer of resources from declining to expanding activities; an efficient regulatory framework; an institutional and governance framework; and liberal trade and investment policies which support structural adjustment by contributing to growth, innovation and competitiveness. The TASAP further emphasises that governments are well-advised to pursue reform across different policy areas in a complementary way to reduce resistance to change, by helping ensure that those disadvantaged by one reform benefit from another, and to foster synergies between policies.

13. In one case study, the TASAP examined the Japanese shipbuilding industry, which overcame unprecedented recessions through the 1970s and 1980s by adjusting capacity to reflect market changes. The key point underlying the policy-making process was the industry’s recognition of the need for adjustment. The Japanese government established a Council, composed of experts, industry representatives and other interested parties, which provided the necessary information and advised on possible courses of action.

14. Many other Japanese industries have also faced the challenge of structural adjustment. Komiya (1999) demonstrates that Japan’s stable macroeconomic conditions in the 1970s and 1980s, together with less reliance on import-restrictive measures, contributed to the success of structural adjustment in manufacturing industry. In terms of institution building, it was pointed out that a basic action plan in accordance with legislation and the process of formulating the plan played a prominent role in structural adjustment by providing information on the present and future condition of the particular industry and enhancing understanding of the need for reform (Komiya, 1999, Chapter 2). The relevant legislation covered most manufacturing industries facing adjustment and the basic plan provided comprehensive measures for each industry, including financial and tax incentives for labour adjustment and innovation within the limited timeframe.

15. Since the 1980s, economic and industrial policies have evolved further in the face of globalisation. The most recent approach, the New Industry Creating Strategy, has been developed through intensive interviews and field work with business and local community and a comprehensive strategy has been proposed to address globalisation, societal concerns and the challenges facing local communities. The Strategy builds on broader co-ordination among industries, governments, academia and local communities while relying on market forces (METI, 2004).

**Targeted assistance and trade safeguards**

16. The TASAP recommends that governments should rely, as much as possible, on generally applicable adjustment measures, including through the tax and social security system, for reasons of both equity and efficiency. However, the TASAP also states that targeted measures may in some cases prove effective for addressing certain aspects of the adjustment process, for example to correct for market failure or to address political economy concerns; when used, these measures should be
transparent, cost-effective and compatible with general safety net arrangements. Concerning the use of trade safeguards measures, the TASAP recommends doing so on the basis that their potential benefit in providing breathing space for – and public acceptance of – structural adjustment exceeds the costs they entail. Two questions are worth examining as relevant for Japanese external economic policies: a targeted nation-wide adjustment programme and trade safeguards.

17. The United States adopted in 1962 the Trade Adjustment Assistance legislation which addressed general unemployment assistance and active labour market assistance by providing temporary assistance to workers losing their jobs as a result of trade liberalisation. However, identifying the cause of job displacement has been no easy task. Moreover, the economic rationale remains controversial because it is not clear whether trade-displaced workers should receive more adjustment assistance than other job losers facing difficulties. The TASAP referred to the Australian Structural Adjustment Programme that was initiated in 1973 following significant tariff cuts. The programme targeted workers displaced by trade, but it was terminated after only three years following a government evaluation which found that the provision of special benefits to designated displaced workers and the determination that recipients were unemployed as a result of government policies were arbitrary. A recent study by Australian Productivity Commission provides information on broad-based reforms (Productivity Commission, 2001; OECD, 2005b, Chapter 3). The US case suggests that once a programme is adopted, it is politically difficult to terminate it.

18. Japan has no institutionalised comprehensive trade-related targeted assistance. Japan has implemented structural adjustment policies through cross-cutting framework legislation which stipulates a mechanism to provide information and time-bound incentives to applicant sectors. In this regard, METI (2002) examined several structural adjustment issues. Its approach is similar to the TASAP: it underscores the importance of generally applicable measures and states that for the Japanese economy to achieve a self-sustained recovery led by private demand, it will be important: (1) to promote the reduction and elimination of employment mismatches by encouraging smooth shifts of labour, adjusting to the diversification of work modes, and developing highly specialised personnel; and (2) to build safety nets to reduce the risks accompanying unemployment.

19. There was heated debate concerning trade safeguards in Japan following the Japan-China dispute in 2001 regarding Japanese action relating to three agricultural products: welsh onion, fresh shiitake mushrooms and tatami-omote (see Nakagawa [2002] for the history of the case; Araki and Kawase [2004] provide a comprehensive analysis of the safeguards under the WTO agreement) and the US steel safeguard action in 2002 (See OECD, 2005b, Chapter 7). Facing the first safeguard case in history, the subcommittee on Special Trade Measures of the Industrial Structural Council at the METI stated in 2001 that safeguard measures should be instituted for the relevant products if the competitiveness of the domestic industry was expected to recover during the safeguard period or if adjustment of the domestic industry was to be achieved through other means.

20. Having examined the merits and demerits of imposing safeguards measures, METI (2002) notes that the application of safeguard measures generally means higher prices and fewer choices for consumers, user companies and other economic agents; it also impacts negatively on a country’s GDP. The study acknowledges, however, that safeguard measures temporarily alleviate the social pain that accompanies import surges and provide industry with a grace period to carry out structural adjustment. It should be noted that the WTO safeguard agreement focuses on restructuring industry rather than on the reallocation of resources released by the contraction of import-competing sectors or economy-wide adjustment (WTO, 2004). WTO (2004) also emphasises the importance for structural adjustment of complements to trade policy, including macroeconomic policy, the quality and cost of infrastructure services, policies affecting domestic market structures, and sound institutions.
The TASAP examined the US steel safeguard case and found that, in the absence of such measures, adjustment pressures would undoubtedly have been higher and resulted in more far-reaching industry adjustment. Moreover, a high price was paid, in the form of diminishing competitiveness in steel-consuming sectors, to protect domestic steel producers (OECD, 2005b, Chapter 7). In another example, concerning the Harley Davidson motorcycle in the United States, the company was able to recover its international competitiveness during the safeguard period starting in 1983 by introducing new technology and a just-in-time inventory system and finally asked the US administration to remove the protective tariffs one year ahead of the scheduled five-year safeguard period (OECD, 2005b, Chapter 3). Even in this case, however, a well-regarded US economics textbook argued that the success of the measure came at an estimated cost to US consumers of USD 400-600 per motorcycle (Appleyard and Field, 2001).

Multilateral and regional co-operation

22. The TASAP underscores that multilateral efforts, including through the Doha Development Agenda, the work of the international financial institutions, donor co-ordination and greater efforts to enforce core labour standards, are of particular importance in promoting the mutual interests of trade liberalisation, locking in domestic reform and building mutual confidence between enterprises and civil society.

23. Concerning the possibility of international co-operation and co-ordination on structural adjustment, Jackson (1989) earlier pointed out that very little existed in the way of international norms or explicit institutional obligations with respect to structural adjustment. Jackson did note that from time to time the issue had been raised of promoting international structural adjustment to facilitate implementation of the economic policies that lie behind the GATT/Bretton Woods System for international trade. The creation of the WTO in 1995 with its substantial membership was no doubt progress in this regard. For example, adjustment costs can be reduced if trade policy reforms are underpinned by international commitments. Bacchetta and Jansen (2003) argue, for example, that participation in international agreements, such as the WTO agreements, may enhance the credibility of trade reform and thus facilitate adjustment. Workers and firms will adjust more effectively and with less delay to trade reforms if they are convinced that the reforms will not be reversed.

24. In a global market economy, if developed countries provide subsidies to support production in a declining industry while developing countries provide export subsidies for the same industry, which is a growth industry in their countries, this would generate overcapacity at the expense of taxpayers and be a huge welfare loss for the world as a whole (Ito, 1998). To achieve efficient allocation of resources, policy co-ordination between developed and developing counties is essential. Apart from negotiations under the Doha Development Agenda, which include reduction of trade-distorting subsidies, multilateral efforts in the OECD on steel and shipbuilding seek to promote structural adjustment by forging international norms (OECD, 2005b, Chapters 7 and 8).

25. Japan’s external economic policies are largely set in the context of the WTO, but at the same time Japan pursues regional and bilateral economic integration, notably in East Asia. Japan’s economic partnership agreements are viewed as complements to the multilateral trading system. The Council of Ministers of the Japanese government declared in December 2004 a basic policy of further promoting EPAs, stating that they facilitate promotion of structural reforms in Japan and its partners, including fostering the establishment of an East Asian community.

26. The TASAP included a case of trade in health-care services, notably concerning health-care workers, between Japan and the Philippines and Thailand and concluded that domestic reforms and liberalisation of trade in health-care services in Japan would provide opportunities for positive
linkages between structural adjustment in the Japanese health-care system and that of its trading partners (OECD, 2005b, Chapter 10). These positive linkages could be further strengthened if combined with broader efforts at institution building (Nippon Keidanren, 2004).

27. In this regard, we may recall that after the failure of the WTO Seattle Ministerial Meeting in 1999, the OECD in conjunction with the WTO as well as APEC took initiatives to build confidence in trade liberalisation by promoting trade-related capacity building. These efforts focused on institution building together with further preferential tariff cuts for least developed countries (see APEC, 2000; WTO/OECD Doha Development Agenda Trade Capacity Building Database, 2002). In the meantime, the IMF and the World Bank have been strengthening their activities in support of trade, notably in the areas of technical assistance, capacity building and institution building (IMF and World Bank, 2005).

28. The TASAP described current efforts at trade-related capacity building and underscored the recent increase in the amount of assistance for trade policy and regulations delivered through training sessions and workshops at relatively low cost but with potentially high return in terms of institution building (OECD, 2005b, Chapter 3).

II. Business perspectives and future challenge

29. This section explores the linkage between the TASAP and business perspectives and discusses future challenges, including potential future work by the OECD. In this regard, the author proposes three dimensions for future OECD work on trade and structural adjustment, namely (1) a link to business perspectives; (2) a link to a range of economic issues discussed within the OECD; and (3) a link to expertise of other international forums and organisations.

Business perspectives

30. The TASAP drew on 31 country-specific and sector-focused case studies. Forward-looking case studies were chosen for examples of good practice in terms of successful structural adjustment. It was determined that successful structural adjustment should be defined as involving reallocation of resources to more efficient uses, while limiting adjustment costs for individuals, communities and society as a whole.

31. Since the inception of the TASAP in 2003, the project has drawn on sector-specific and concrete examples to develop practical recommendations. The Business and Industry Advisory Committee to the OECD (BIAC) initiated an enquiry on successful structural adjustment within its business association networks. For example, the United States Council for International Business, one of the BIAC networks, made enquiries on its Internet site (USCIB, 2004) and Nippon Keidanren suggested some of its recent proposals on trade policy (Nippon Keidanren, 2004). Many countries suggested forward-looking cases for analysis, and the TASAP finally included a few company-specific case studies: Nissan’s revival in Japan, the Harley Davidson safeguards, and international sourcing of IT and business process services in India, including a focus on Infosys Technologies Ltd.

32. Given business confidentiality, particularly in the areas of restructuring of the labour force and strategic decision making for enhancing competitiveness, it is hard to use current examples, but it would be interesting to examine past experience at the firm level. A WTO study (Bacchetta and Jansen, 2003), for example, undertook a literature review and distinguished cases of worker adjustment and firm adjustment. It pointed out that economists tend to look at resource allocation, and particularly workers, when talking about adjustment issues, but that a firm’s investment strategy to regain competitiveness should be included in questions regarding adjustment, since domestic adjustment assistance often covers both displaced workers and companies so as to help the latter regain
competitiveness. Although, the OECD’s analytical advantage is comparative country data over the whole range of economic policies, company-level case studies on trade and structural adjustment are of great interest.

33. As we may recall, the OECD provides a forum for discussion of economic issues. It encourages member and non-member governments to learn from one another about a wide range of issues and facilitates the understanding of such issues. Japanese business people are perhaps familiar with so-called soft law areas such as the Arrangement on Officially Supported Export Credits and the OECD Guidelines for Multinational Enterprises. At the same time, as the world biggest think-tank, the OECD provides advanced analytical work. In the post-Uruguay round era, the OECD’s initiative on regulatory reform has been the source of quite a number of inputs to Japan’s external and internal economic policies (OECD, 1997).

34. Concerning two very recent studies on the service economy and trade and structural adjustment, the OECD Ministers in May 2005 agreed on the need to deepen the understanding of the impacts of globalisation in OECD and non-OECD economies, recognising the need to share experience on best practice and policy response. They decided to call for a follow-up study on globalisation and structural adjustment (OECD, 2005d, paragraph 17).

35. The TASAP covered eight sectors, including two services sectors – health services and international sourcing of IT and business process services. In the manufacturing sector, other major clusters, such as the consumer electronics industry (notably digital products) and the chemicals industry (e.g. APEC Chemical Dialogue), will be interesting to examine in the light of globalisation. In the services sector, many sub-sectors have trade dimensions and synergies can be expected between the next generation of the Services Project and the TASAP follow-up. In this regard, it should be noted that firm-level case studies in the Services Project (OECD, 2005e) showed that an open market was a key policy lesson.

The advantage of OECD wide-horizontal work

36. The OECD’s analytical work covers almost all public policies and economic activities except national defence. Its extensive statistics are one of the world’s most widely used and respected sources of internationally comparable economic data. Apart from trade-related work, the OECD’s twice yearly Economic Outlook and national regulatory surveys provide valuable input into policy making in capitals, as does its work on employment policy, education, agriculture and the environment (OECD, 2004).

37. The TASAP project team comprised economists and experts in different OECD directorates: the Trade Directorate, the Economics Department, the Directorate for Science, Technology and Industry, the Directorate for Employment, Labour and Social Affairs, the Directorate for Food, Agriculture and Fisheries, the Directorate for Financial and Enterprise Affairs, the Development Co-operation Directorate and the Development Centre. This reflects the diversity of globalisation and structural adjustment issues, and the synergies are enormous.

38. For specific subjects, other relevant international organisations exist, albeit with different objectives. It is impossible to name them all, but examples include: for macroeconomic policies, the IMF and the World Bank; for employment, the ILO; for agriculture and fisheries, the FAO; for education, UNESCO; for trade and development, the WTO, UNCTAD and the World Bank. A strong point of the OECD is the ability to tackle effectively a range of cross-cutting economic issues within a single organisation with effective co-operation with other organisations.
The linkage to the other forums and organisations

39. Effective co-operation with other organisations is essential to maximise the advantage of the OECD’s horizontal work. Globalisation and structural adjustment need to take a broad perspective. In this regard, the author would like to draw attention to a question of the definition and causes of structural adjustment.

40. In accordance with the experience of the OECD and after deliberations with member governments and experts, the TASAP chose to focus on efficiency and equity and put some emphasis on labour market policies (OECD, 2005b, Chapter 2; Kongsrud and Wanner, 2005) as part of a comprehensive discussion of trade-related economic policies (OECD, 2005b, Chapter 3). However, various definitions of structural adjustment are to be found in the literature at the other forums and organisations. According to the author’s preliminary research, the term structural adjustment is used to allude to enhancement of competitiveness, increased flexibility of labour mobility, regional or rural development, poverty reduction and economic growth. The word “structural” seems to imply a long-term economic situation and framework. Similar terms are also frequently used, such as industrial policy, structural policy, structural reform, adjustment policy and adjustment assistance. These terms are used in relation to specific objectives and targets, such as workers, firms, industries, communities and the economy in general. As discussed above, a distinction between policies for workers and policies for firms or industries seems to be important. When it comes to policies to enhance the competitiveness of firms, “industrial policy” is frequently used. On the other hand, “structural reform” often refers to public-sector reforms. It should be also borne in mind that “trade policy” includes trade liberalisation, trade promotion and protective measures.

41. Evaluation of the causes of adjustment is also relevant. As the TASAP shows, causes of adjustment include not only trade but also technological change and societal concerns. In some cases, changes in government policies themselves necessitate further adjustment and enforcement of national legislation or implementation of international commitments. The TASAP finds that trade may be part of the cause but is also part of the solution. That said however, trade is not a panacea and the importance of complementary policies is emphasised.

42. The debate on the definition and causes of structural adjustment suggests the possibility of further progress on this subject. In this regard, the exchange of knowledge in various forums and international organisations and the sharing of information on national experience by governments are useful. For example, the TASAP held a technical workshop in Paris in February 2005 and invited a number of experts from other forums or international organisations. The workshop discussions were summarised in a brochure prepared for the meeting at Ministerial level in May (OECD, 2005a).

III. Concluding remarks

43. The TASAP was a result of team work within the OECD Secretariat and intensive contacts and co-operation with outside experts and organisations. As earlier colleagues predicted a quarter of a century ago, the challenge of further development of analysis and policy response on trade and structural adjustment remains. Valuable forward-looking efforts could certainly be made through co-operation with non-OECD member economies in East Asia.
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As a result, economic activity in Q1 likely contracted. As Japan waits for more vaccines to be distributed, domestic demand will likely remain sluggish into the summer, though accelerating growth in the rest of the world will provide support for Japanese exporters. In the second half of the year, however, growth will accelerate, thanks to sizable fiscal stimulus at home and abroad. Despite these efforts, Japan still faces economic challenges exacerbated by the COVID-19 epidemic. The epidemic has affected Japanese manufacturing and has caused exports and tourism to dwindle. Three structural challenges that Japan currently faces have been exacerbated by the COVID-19 epidemic, which is causing the worst recession since the end of the Second World War. As is the case for most countries’ economies, the global pandemic means that the outlook is bleak for the Japanese economy in the short term. There is also increasing tension between Japan and China over disputed islands in the East China Sea where the previous conflict over the islands resulted in anti-Japanese protests and boycotts. Among the most serious external challenges facing Japan, of particular importance is that of rising China - a country, which is close geographically, but distant in the context of the political and economic values it upholds. The changes in Japan’s defense policy were reflected in the adoption by Abe’s cabinet of a number of laws in 2015 that altered the interpretation of Article 9 of the Japanese Constitution and allowed to use the right to collective self-defense to protect an ally's forces even in the absence of an attack on Japan, but in the presence. OECD Journal: Economic Studies Volume 2014 © OECD 2015. Japan’s challenging debt dynamics. by Yvan Guillemette and Jan Stráský. A small simulation model is used to evaluate the contribution that the three arrows of the government’s strategy – bold monetary policy to achieve higher inflation, flexible fiscal policy and growth-boosting structural reforms – could make to reversing the rise in Japan’s public debt ratio, currently about 230% of GDP.