No. 29 June 11, 1985

U.S. SERVICES EXPORTS: TIME FOR JAPAN TO LOWER BARRIERS

INTRODUCTION

The United States' whopping trade deficit with Japan--some $37 billion last year--is well publicized. Much less well known is the $3 billion, perhaps much bigger, surplus enjoyed by the U.S.in 1983 in exporting services to Japan. Services is a broad but expanding category that includes banking, insurance, tourism, communications, legal fees, and countless other categories of transactions essential for modern societies. While the U.S. services surplus currently scarcely offsets its trade deficit, eventually it could make a huge dent in it. Indeed, one of the most promising areas of U.S. export expansion is in services. Americans enjoy an edge in innovation, technology, imagination, variety, and experience in the services field. As such, U.S. policy makers concerned with staunching the flood of red ink on trade should begin examining means for boosting the export of American services.

One of the most promising markets for these services not surprisingly is Japan. As in the U.S., services in Japan now generate about 60 percent of the Gross National Product (GNP) and employ more than half of its total work force. Spurred by the rise in Japanese personal incomes and in the number of elderly citizens, such service-related industries as recreation and health care have greatly expanded.

Japan's international trade in tourism, transportation, royalties, and communication, too, has increased rapidly. Service exports expanded more than 240 percent between 1973 and 1983, from $6 billion to $22 billion, while Japanese imports of services climbed more than 310 percent during the same period, from $10 billion to $34 billion. The U.S. is the single largest supplier of services to Japan, comprising about 30 percent of

Japan's total service imports. The U.S. has enjoyed a services account surplus for the last ten years.

Americans and other foreigners would be able to export even more services to Japan were it not for obstacles existing in that country. How to deal with these obstacles and how to remove the most serious of them should be a main item on any agenda of U.S.-Japanese or worldwide trade talks. While Tokyo in the past year has taken some steps to give foreign services greater access to the Japanese market, such as opening its financial markets to foreign participation, much more could be done.

Analyzing trade in services is much more difficult than analyzing trade in goods. For one thing, there is no complete, accurate, internationally accepted standard for keeping records on service trade. Some service exports, such as U.S. airliners carrying passengers and cargos, can be recorded easily and accurately. Other transactions, however, are recorded partially or not at all. Example: when Japanese firms with subsidiaries or offices in the U.S. purchase American legal, advertising, communications, transportation, and other services in the U.S., they are not recorded as a U.S. service export or Japanese import. Because of the difficulties in recording services transactions, the balance of payment statistics on services is often questioned.

For another thing, liberalizing service flows is a mixed blessing. While the opening of Japanese financial markets and the granting of favorable treatment to U.S. banks have led to a large capital inflow from Japan to the U.S. and a stronger dollar, this makes it more difficult for the American manufacturing sector to compete in Japan as well as in the international market.

Finally, to expand U.S. service industries in Japan often requires establishing subsidiaries there and staffing them with American professionals. This typically runs afoul of Japanese investment and immigration laws, which act as barriers to the growth in Japan of U.S. service industries.

Unless international norms are set for the services trade, Japanese regulation of this trade could become a new source of conflict between Washington and Tokyo. To facilitate international service transactions and to avoid yet another U.S. trade row with Tokyo, the U.S. and Japan should seek a new round of bilateral, and preferably multilateral, service trade negotiations. These talks should aim at establishing more realistic data collection and standards in the service trade. In addition, these talks should include further liberalization of Japan's service market. Examples: Japan could provide practical opportunities for foreign security firms to become members of the Tokyo Stock Exchange; Japan could increase the opportunities for qualified foreign nationals to perform legal services without unreasonable visa constraints; and Japan could guarantee that foreign firms will be treated equally in entering large-scale communication data network services.

THE SERVICE INDUSTRY IN JAPAN

Japan is following the path pioneered by the U.S. in rapidly becoming an economy of service-oriented industries. Today, the Japanese services industry generates nearly 60 percent of Japan's GNP and employs about 55 percent of its total work force. Since 1970 about seven million new jobs have been created in Japan, of which 70 percent are in the service industries. Current trends suggest that the service sector will continue as the principal creater of new jobs for Japanese. The number of service workers is expected to exceed 60 percent of the total labor force by the year 2000.

This growth not only has occurred in the traditional service industries, such as distribution, finance, transportation, and public services, but also reflects fundamental changes in demand. As personal incomes have risen, Japanese travel, hotel, and restaurant industries and recreational and cultural activities have expanded. An increase in the number of the elderly, meanwhile, has boosted demand for medical services, nursing home services, and health-related activities.

There has been a concomitant expansion in Japan's trade in services. Its exports of services increased 240 percent from 1973 to 1983, from $6 billion to $22 billion. During the same period, services imports increased 310 percent from $10 billion to $34 billion. As such, Japan's chronic services trade deficit mounted from $4 bilion in 1973 to $12 billion in 1983. About 25 percent of this 1983 deficit resulted from transactions with the U.S., where the service trade has always shown American surpluses. The U.S. export of services to Japan increased from about $3 billion in 1973 to $12 billion in 1983, which yielded a U.S. service surplus with Japan of about $3 billion.

There are a number of reasons for Japan's services deficit. For one thing, many more Japanese visit the U.S. than Americans visit Japan. And Japanese businessmen, meanwhile, make many more business trips to the U.S. than do American businessmen to Japan. For another thing, Japan is becoming increasingly dependent on American carriers, mainly air cargo, for exports to and imports from the U.S. in goods. This also means that Japan's payment of fees at American ports or airports has mounted steadily. In addition, Japan's payments for what are called "other private services" have increased substantially. These include payments for technological know-how, royalties, patent fees, consulting fees, brokerage fees, motion pictures and TV tape and film, advertising, engineering fees, and other personal and business services. The statistics for these payments include only those made by the Japan-based parent companies and not those made by Japanese subsidiaries or branches in the U.S.

JAPANESE MARKET BARRIERS FOR U.S. SERVICE INDUSTRIES

U.S. service industries hold a comparative advantage in almost all international trade. Over the last 35 years, the U.S. has moved rapidly toward a more service-oriented economy. U.S. service output as a percentage of GNP has risen from one-half in 1950 to two-thirds today. Their long history and greater experience in the fields have made American service industries very competitive, especially finance, insurance, law, telecommunications, data processing, and management consulting. By boosting its service exports, the U.S. should be able to offset a significant share of its enormous merchandise trade deficit with Japan. To do this, the U.S.would have to expand not only such traditional merchandise-related services as shipping and transportation but also banking, brokerage, insurance, data communications, and legal services.

Banking Services

The Japanese capital market was rather tightly regulated by the Minister of Finance (MOF) throughout most of the post-World War II period. Foreign banks were severely restricted in establishing branches in Japan and accepting yen deposits. In the past three years, however, Tokyo has begun to open Japan's financial markets to foreigners. The most important liberalization took effect in April 1984 and, in part, included:

1) Elimination of the restrictions on forward foreign exchange transactions, which Japanese and foreign corporations now can conduct freely. As such, foreign banks can increase their volume of such transactions.

2) Ending the restrictions related to the conversion of foreign currencies into yen. Now foreign corporations can bring their money freely into Japan.

3) Ending the limitation on currency swaps. Now both Japanese resident and nonresident corporations can swap foreign currencies for yen without government restrictions. U.S. banks and investment firms are very active in such exchanges.

4) Permission for foreign banks to enter the trust banking business. This is important because U.S. banks now will be able to enter the Japanese pension funds market.

These and other changes in recent years virtually have freed Japanese financial markets of formal restrictions on the international movement of funds. Japan also effectively granted foreign banks treatment equal to that of their Japanese counterparts.[1] At least 209 foreign banks now operate in Tokyo; about

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1 Charles Pigott, "Financial Reform in Japan," Federal Reserve Bank of San Francisco Economic Review, Winter 1983, pp. 40-41.

30 of these are American. Japanese banks, in fact, have begun complaining that U.S. banks in some respects receive better treatment than Japanese banks. Example: Japanese banks are not authorized to participate in trust banking activities, but U.S. banks in Japan can by forming ventures with Japanese trust companies. Pacific Security Bank, whose headquarters is in Los Angeles, joined with Sumitomo Trust and Banking Corporations, Citibank with Yasuda Trust and Banking Corporation, Morgan Guaranty Trust Company with Mitsui Trust and Banking, and Manufacturers Hanover Trust Company with Daiwa Bank.[2]

Though Japan no longer has explicit restrictions against foreign banks, Ministry of Finance regulations on interest rates, financial instruments, and financial structure have the effect of discriminating against foreign banks. Only members of the "big four" Japanese securities companies, for example, are allowed to be the lead manager of a new securities issue. Further liberalization of the domestic financial system is needed so that all financial institutions, Japanese and foreign, can participate as fully as possible in Japan's financial system. For example, Japanese banks are not allowed to enter the trust banking and security businesses, while trust and securities companies are not allowed to go into the banking business. These divisions between banks, trust business, and securities will have to be deregulated.

<u>Securities</u>

Foreign securities firms since 1971 have been free to establish full-service branches and representative offices in Japan. Today over 70 foreign security firms, including such U.S.companies as Merrill Lynch Pierce Fenner & Smith, Inc., Bache Halsey Stuart Shields Ltd., Smith Barney, Harris Upham Inc., Goldman Sachs Corporation, and Salomon Brothers Ltd. have offices and branches in Tokyo. In 1982, foreign securities firms were allowed to hold seats on the Tokyo Stock Exchange. But because the number of seats on the exchange is fixed at 83, the price of membership, when available, is very high. The restricted number and high price have been barriers to foreigners. When a vacancy recently occurred, for instance, Merrill Lynch reluctantly withdrew from the bidding. A Japanese company, Utsunomia Security Company, paid $6.5 million for the seat.

<u>Insurance</u>

The Japanese insurance market accounts for nearly 11 percent of the world's total insurance premiums of nearly $50 billion.[3] Japan's insurance industry is highly regulated. The number of entries into the industry, the approval of new products, the price

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2 The Japan Economic Journal, April 2, 1985.

3 Arthur J. Alexander and Hong W. Tan, Case Studies of U.S. Service Trade in Japan, A Rand Note, September 1984, p. 26.

of the policies, and the distribution system are regulated by law and supervised by the Ministry of Finance. In essence, life and non-life insurance firms in Japan offer uniform products at uniform rates. Companies thus do not compete through aggressive rate cutting or highly innovative policies but rather by expanding sales volume. The Finance Ministry has issued no new licenses to Japanese firms for 30 years and limits the industry to 20 firms in life insurance and 22 firms in the non-life domestic insurance sector. With the exception of two companies, all were established soon after the end of World War II.

In recent years, however, the Ministry has licensed about 60 foreign non-life and life insurance firms. Most of these are U.S. firms, such as American Life Insurance, American International Group, AIU Company, Sony-Prudential Company, Seibu-Allstate Insurance Company, Combined Insurance Company, American Family Life Assurance Company of Columbus, INA Life Insurance Company, and Equitable Insurance Company. Like their Japanese competitors, these U.S. insurance companies are highly regulated. In some instances, the Japanese companies complain that foreign firms, especially American, receive more favorable treatment. They cite, for example, the fact that the Ministry has issued new licenses to foreign firms but none to Japanese firms. Another complaint is that Japanese firms can write earthquake insurance only up to 15 percent of the insured's assets, while foreign firms can write up to 60 percent.

The main problem confronting U.S. insurance firms in Japan is the highly regulated Japanese market. It is not likely that U.S. insurance firms will be able to penetrate that market further until there is more deregulation.

Data Communications

Japan's telephone company, Nippon Telegraph and Telephone Corporation (NTT) was established in 1885 as a government-owned monopoly and came under the regulatory authority of the Ministry of Posts and Telecommunications (MPT) in 1952. In response to public pressure for improved efficiency, services, and competition, the Japanese government transferred NTT from the public to the private sector on April 1, 1985. The MPT is still, to some extent, attempting to regulate not only basic services, involving ownership and operation of comunications circuits, but also secondary services such as the value-added networks (VAN) services.

The VAN services include all networks that use telephone lines linked to computers and software systems and that perform a variety of operations on data transmissions, such as money transfers for the banking industry, credit card verification, and monitoring retail inventory levels. VAN services were divided into a large-scale nationwide system and networks limited to specific business groups or small companies. Foreign firms are now allowed to provide services to a specific business group and such U.S. firms as IBM, AT&T, Burroughs Corporation, and others have entered this field.

Claiming that it is protecting privacy and national security, the MPT has tried to maintain its jurisdiction over large-scale VAN services. U.S. corporations fear that this will blunt the enormous American advantages and experience in this field. It is estimated that Japan's large-scale VAN service within a few years will be worth more than $500 million annually.[4]

IBM Japan, the wholly-owned subsidiary of the U.S.-based International Business Machines Corporation notified the MPT in early April 1985 that it will begin large-scale VAN services. Such other American companies as American Telephone and Telegraph Company, NCR Corporation, and Tymnet Inc. are eyeing the large-scale VAN market. Tymnet is also teaming up with Hitachi Ltd. of Japan, while the U.S. General Electric Corporation is working with Japan's NEC Corporation.[5]

The Legal Profession

Private law practice in Japan is practically closed to American and other foreign lawyers, except for a small number of attorneys licensed before 1955 and those authorized to practice on Okinawa when that island was returned to Japan in 1972. Lawyers are required to pass the Japanese national bar examinations to be able to practice. Fewer than 2 percent of the 2,500 applicants passed the exam in 1983. In effect, this keeps out almost all non-Japanese.

American lawyers are not completely excluded from the Japanese legal services market, and hundreds of American lawyers are consultants on U.S. and international law at Japanese law firms or corporations. Meantime, American lawyers in Japan for a short time can advise clients on specific issues. When it comes to the long-term residence of foreign attorneys, the Japanese government treats it as an immigration issue. Foreigners applying for residence have faced long delays or rejections. Japanese authorities explain that immigration laws are quite rigid. While Japan is entitled to set its own conditions for residence there, the matter is becoming quite important as Tokyo's role in international economics grows. Existing arrangements for issuing long-term visas to American lawyers are a legitimate matter for negotiation between Washington and tokyo. The restrictions could be eased.

PROBLEMS OF INTERNATIONAL TRADE IN SERVICES

No Clear National Interest

Analyzing trade in services is much more difficult than doing so for trade in goods. For one thing, the market access in services industies *per se*, such as establishing branches of

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4 *The Japan Economic Journal*, May 1, 1985.

5 *The Japan Economic Journal*, April 23, 1985.

banking, insurance, and law firms, does not create tangible benefits for U.S. overall national interest. Opening branches and offices of banks in Tokyo, for example, creates jobs in Japan, not in the U.S. Though it assists U.S. exporters' finances, it does not directly increase merchandise exports from the U.S., while increasing purchases of such services as rental space, communications, transportation, and accounting from Japanese sources. In short, opening up service markets in Japan will not necessarily benefit U.S. manufacturing and agricultural interests or American workers.

Liberalization of Japanese service markets such as banking and insurance, moreover, is a mixed blessing. It is this liberalization that led Japan to export nearly $60 billion in capital last year. While very much in the interests of the U.S. banking community, it bolsters the U.S. dollar and weakens the Japanese yen, at least in the short run. This makes U.S. goods relatively costlier in Japan, creating problems for American agricultural and manufacturing sectors.

Lack of Accurate or Reliable Data

Unlike merchandise trade, which is recorded systematically as an export or import in customs documents when goods cross national boundaries, the vast majority of transactions in services cannot be recorded in the nation's balance of payments. To be sure, transactions such as shipping goods or transporting passengers between countries, as well as contractual arrangements such as selling patents and technical know-how, can be recorded easily as an export or import of service trade. But other business services truly remain invisible. Example: the nearly 4,000 Japanese companies in the U.S. increase annually their purchase of such business services as legal advice, accounting, management consulting, financial consulting, advertising, insurance, communications, and office rental. Purchases of these services should be recorded as a U.S. export to Japan. Yet they are completely omitted from the service trade balance.[6]

For this reason, many economists believe that the trade in services statistics greatly underestimate the value of U.S. service trade.[7] The U.S. Department of Commerce, for example, recorded $140 billion in 1981 in U.S. exports (or receipts) for services, including investment profit earned overseas and repatriated to the U.S. On the other hand, the Office of the U.S. Trade Representative estimates that American services may amount to nearly $300 billion.[8] A study conducted by The Center for

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6 "Services Data: Expanding Our Understanding," Business America, March 4, 1985.

7 "Services Data: Expanding Our Understanding," Business America, op. cit.

8 "America's 'Invisible' Trade Surplus," Nation's Business, November 1984.

Strategic and International Studies at Georgetown University estimates $400 billion in U.S. service exports.[9] The vast discrepancies in these estimates illustrate the inaccuracy in data collection for trade in services. Japanese government statistics, moreover, for U.S.-Japan trade in services are quite different from those compiled by the U.S. This lack of reliable data bases complicates the efforts of the two countries to work together on bilateral and multilateral issues concerning the trade in services.

Service Trade Issues vs. Investment and Immigration Issues

The ability of a company to conduct service business in Japan depends, in many cases, on whether or not U.S. professionals such as lawyers can move freely across national borders. Trade in services depends even more heavily on the movement of people than does trade in merchandise. When U.S. service companies send their professionals to Tokyo for long periods of time, they run up against tough Japanese immigration laws. Current international trade rules do not cover immigration disputes.

To enhance service activities in Japan, U.S. service industries must be able to invest and establish branches or subsidiaries in Japan. Thus exports of service to Japan are related to the openness of foreign investment regulations of Japan. Yet investment regulations are not covered by international trade rules. Most governments, including the U.S. and Japan, traditionally have separated trade issues from investment and immigration matters in which they have tended to be more protectionist.

CONCLUSION

The U.S. is the world's leading producer and exporter of services. In spite of its importance, the current available statistical data on the services trade, especially service exports, provide only a partial picture of U.S. achievements. To promote better understanding of service transactions, Tokyo and Washington should try to establish a mutually acceptable definiion of the services trade and a framework for collecting realistic data on service trade. For example, U.S. business services, such as legal work, management consulting, financial consulting, and communications that are provided to Japanese companies in the U.S. should be included in the overall U.S. exports of services.

Many American service industries, such as insurance and legal firms, would like to produce services within Japan in addition to exporting them from the U.S. Thus, the U.S. and Japan should include investment and immigration issues in bilateral service trade negotiations and develop a common framework for eliminating barriers to American investment and the movement of American professionals.

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9 John N. Yochelson and Gordon J. Cloney, eds., Services and U.S. Trade Policy (Washington, D.C.: The Center for Strategic and International Studies, 1982).

Along with the bilateral talks, the U.S. should pursue a policy to reduce Japanese market barriers in individual sectors. In the past, such efforts led to the removal of restrictions on banking, insurance, data communications, and other restrictions that were hampering U.S. companies. For example, the U.S. should continue to press Japan to provide practical opportunities for foreign security firms to become members of the Tokyo Stock Exchange, to increase the opportunities for foreign nationals to perform legal services without unreasonable visa constraints, and to treat U.S. firms the same way that Japanese firms are treated when they compete for business (such as telecommunications) in the expanding service sector.

These bilateral demarches have been relatively successful in reducing the barriers to Japanese markets for certain American corporations. But since barriers to the services trade can be found worldwide, the U.S. and Japan should also promote multilateral service trade negotiations through initiatives in the Organization for Economic Cooperation and Development and at the level of the General Agreement on Tariffs and Trade.

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