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NAFTA'S IMPACT ON JAPAN

Keiichi Tsunekawa
University of Tokyo, Komaba

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NAFTA'S IMPACT ON JAPAN

by Keiichi Tsunekawa[1]

The "Japan Card" in the NAFTA Debate

A month before the vote in the U.S. Congress on the North American Free Trade Agreement, or NAFTA, the "Japan card" suddenly became important to both its proponents and opponents. What is perplexing is that each side made a completely opposite assertion about NAFTA's impact on Japan.

On the one hand, in the now famous NAFTA debate with H. Ross Perot on "Larry King Live," Vice President Gore said "if we don't take this deal, you can bet, Japan will try to take this deal." What he was suggesting was that Japan would happily make a free-trade arrangement with Mexico if the United States did not do so first. President Clinton and other members of the government in favor of NAFTA also argued that Japanese products would compete with U.S. products more effectively in Mexico if NAFTA did not materialize. They argued as well that, if there was no NAFTA, Japanese companies would increase their investment in Mexico and take advantage of their Mexican facilities to export to the U.S. market with none of the constraints imposed by the rules of origin.[2]

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[1] Keiichi Tsunekawa, a 1993-1994 Woodrow Wilson Center Fellow, presented this paper at a Wilson Center colloquium held on December 9, 1993. Sidney Weintraub of the Center for Strategic and International Affairs, Washington, D.C., served as commentator. Tsunekawa is a professor of social and international relations at the University of Tokyo, Komaba, and director of the university's Center for Latin American Studies. He received his bachelor's and master's degrees in international relations from the University of Tokyo, and his Ph.D. in political science from Cornell University.

[2] Rules of origin require that certain materials or parts/components be produced in the region for a product to obtain zero-tariff status in regional trade. Thus, producers with less in-depth

Opponents of NAFTA, on the other hand, said that Japan would be happier with NAFTA because Japanese firms, just as their U.S. counterparts, could use the cheap labor force in Mexico and at the same time obtain zero-tariff access to the U.S. market.[3]

I would argue that both assertions are wrong; both rely on fears rather than facts. After studying trade and investment statistics and interviewing Japanese managers in the United States and Mexico, I can only conclude that NAFTA matters little for Japan, at least in the short run. For the moment, for most of the Japanese firms making decisions about trade and investment in the Western Hemisphere, the high value of the yen is a much more important factor. However, NAFTA could affect Japan in the long-run. The nature and depth of the impact will depend on how serious the trade and investment diversion from Asia to Mexico will be under NAFTA, how fairly the various provisions of the agreement are applied, and to what extent a NAFTA-like agreement expands throughout the Western Hemisphere in the future.

To prove this contention concerning the short- and long-term impacts of NAFTA on Japan, I will first examine the recent trend of Japan's trade and investment relationship with Mexico. The Japanese stake in Mexico is still very small in comparison with its stake in the U.S. market; the implication

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experience in the region, like Japanese firms, usually have more difficulty in intraregional trade than U.S. firms, which have already established vast supplier networks.

[3] See, for example, Shaiken and Levin 1993.

here is that one needs to look primarily at how NAFTA will affect Japanese competitiveness in the U.S. market.

A more detailed sector-by-sector analysis will follow to demonstrate that, while its impact differs from one sector to another, as a whole, Japanese firms can cope with NAFTA by shifting some of their production facilities from Japan and Asia to North America, especially to the United States. This analysis will also reveal that the real impact on Japan largely depends on Asian reactions to NAFTA-induced trade and investment diversions and to the policies to be taken by the NAFTA governments in the implementation process of the agreement.

To consider the long-term impact of NAFTA upon Japan, the possible impacts of a Western Hemisphere Free Trade Agreement (WHFTA) as an extension of NAFTA need to be explored as well. I will examine Japan's economic relationship with Argentina, Brazil, Chile, and Venezuela, which, together with Mexico, are Japan's most important economic partners in Latin America.[4] Finally, we will point out that Japan will need serious domestic adjustments in order to prevent NAFTA from becoming another step (as was the formation of the European Community) toward a world divided into three economic blocs.

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[4] In 1992, these five countries accounted for 95 percent of all Japanese investment in Latin America (excluding investment in Panama and the Caribbean islands made for tax purposes only). The share of these countries in all Japanese trade with Latin America was 59 percent in 1992. If the export of ships to Panama is excluded as a special case, the share increases to 68 percent. For statistics, see Gaikoku boueki gaikyo, December 1992, and Ministry of Finance of Japan, Annals of the Bureau of International Finance, 1993.

Japan's Economic Relationship with Mexico

(1) Mexico as a Trade Partner of Japan

The trade liberalization conducted by the Mexican government since the mid-1980s has contributed to a sharp increase of U.S. exports to Mexico. Mexico is the United States' third largest customer (after Canada and Japan), absorbing 9.3 percent of all U.S. exports in 1992. However, table 1 shows that Japanese exports to Mexico have also expanded in recent years. Japanese exports to Mexico in 1985 were equivalent to 8 percent of U.S. exports to Mexico in the same year; they increased to 10 percent by 1992. Most of the increase is accounted for by machines and transport equipment, which represented 78 percent of all Japanese exports to Mexico in 1992. If Mexico had continued to reduce unilaterally its import restrictions and lower tariffs, not only to its North American partners but also more generally, merchandise from Japan would have had greater access to Mexico, thus putting serious competitive pressure on U.S. products. NAFTA also eventually creates a relative advantage for U.S. producers through curtailing Mexico's 15 to 20 percent tariffs on U.S. machine products, a privilege not granted to the imports from Japan. Therefore, NAFTA can function as a kind of protectionist device for U.S. producers.

In spite of the potentially protectionist nature of NAFTA, its immediate impact on Japanese businesses in Mexico is expected to be small for three reasons. First, even if Mexico were completely captured by U.S. producers, the actual loss would be minimal; as seen in table 2, Mexico absorbed only 1.1 percent of all Japanese exports in 1992. In contrast, the

U.S. share of Japanese exports was 28 percent, and the share for the newly industrialized economies (NIEs), ASEAN nations, and China together was 33 percent. Given these facts, it is unlikely that Japan would risk antagonizing the United States and the Asian countries, each of which absorbs approximately 30 percent of Japanese exports, for just 1.1 percent of its exports.

Second, in view of the small size of the Mexican market, the relative trade barriers posed by NAFTA against Japanese exports to Mexico can be partially overcome by a minor shift of production facilities from Japan to North America in most, if not all, industrial sectors. By being insiders, Japanese firms would be able to take advantage of the low tariffs.

Third, due to the high value of the yen, NAFTA has come to be regarded as a secondary concern for the immediate future of Japanese businesses in the Western Hemisphere. If this *endaka* persists, the increasing number of Japanese machine-producing firms will need to shift more of their production facilities to North America (with or without NAFTA), to cope with the price disadvantage they may face with regard to U.S. producers. The question becomes then, "Where in North America do Japanese firms invest--in Mexico or in the United States?" Although Japan's dependence on the U.S. market has been declining as a long-term trend, the United States still represents the single largest market for many Japanese producers of machine products. Therefore, they are more anxious about how NAFTA will affect their competitiveness in the U.S. market.

Table 1. Relative Size of Japanese Exports to Mexico

	Japanese Exports as a Percentage of United States Exports					Share in Total Japanese Exports to Mexico
	1985	1989	1990	1991	1992	1992
All Sectors	8	8	8	9	10	100.0
Textiles	2	6	4	5	4	0.7
Chemicals	2	3	3	3	3	2.3
Iron & Steel	53	27	29	15	14	3.4
All Machines & Transport Equipment	12	13	13	14	16	78.0
Power Generating Machinery	19	10	19	18	21	8.4
Special Industrial Machinery	7	17	12	13	15	5.4
Metal Working Machinery	36	22	27	55	49	5.6
General Industrial Machinery	16	12	10	12	18	8.8
Automatic Data Processing Machines/Parts	10	14	19	21	15	1.9
Audio-Visual Equipment	17	28	49	36	33	3.0
Telecommunications Equipment & Parts	29	16	17	18	20	7.3
Electric/Electronic Apparatus/Components	9	12	13	13	14	19.2
Automobiles	1	41	13	23	37	3.0
Autoparts	9	12	10	11	12	12.1

Source: Calculated from United Nations, Commodity Trade Statistics, various years.

Table 2. Basic Figures on Japan's Economic Relationship with the Western Hemisphere and Asia

	Share in Total Japanese Exports (%)	Share in Total Japanese Overseas Investment (%)		
	1992	1991	1992	1992 Accumulated
Mexico	1.1	0.5	0.2	0.6
Latin America	4.7	1.6[a]	1.8[a]	3.1[a]
U.S.A.	28	43.0	40.5	42.0
Asia	33[b]	14.0	18.8	15.5

Sources: Calculated from United Nations, Commodity Trade Statistics, 1992; Ministry of Finance of Japan, 1993.

a) Panama and the Caribbean islands excluded. The investment in those "tax havens" amounted to 9 percent of all accumulated Japanese investment overseas at the end of 1992.

b) NIEs, ASEAN, and China.

Table 3. Number of Japanese Firms and Representative Offices in Mexico (July 1993)

	Subsidiaries	Maquiladora	Rep. Office	Total
All Sectors	121	58	52	231
Manufacturing	73(28)[a]	58	16	147
Food	4(1)	1	2	7
Textiles	2(0)	0	0	2
Chemicals	6(0)	3	2	11
Metals	1(0)	2	0	3
General Machinery	13(7)	0	3	16
Precision Machinery	11(7)	1	1	13
Electric/Electronic	12(9)	29	6	47
Automobiles & Parts	17(2)	9	1	27
Others	7(2)	13	1	21
Agriculture & Fisheries	2	0	0	2
Mining	2	0	1	3
Commerce	14	0	2	16
Finance & Insurance	1	0	19	20
Construction/Plant Engineering	6	0	2	8
Transportation & Storage	4	0	5	9
Other Services[b]	19	0	7	26

Source: Japanese Embassy in Mexico, et. al., 1993.

a) The figures in parentheses indicate the number of firms engaged only in importing and repairing, not manufacturing.

b) Hotels, tourism, restaurants, etc.

Interestingly enough, both proponents and opponents of NAFTA believed that, due to its cheap labor and proximity to the United States, Mexico would provide Japanese firms with an ideal export platform for the U.S. market. However, their assessment differed concerning how NAFTA alters Mexico's usefulness for Japanese firms. Opponents argued that the tariff reduction between the United States and Mexico under NAFTA would eventually benefit Japanese investors in Mexico by facilitating their access to the U.S. market. Proponents suggested that the rules of origin contained in NAFTA would obstruct Japanese exports from Mexico to the U.S., thus curtailing Japanese competitiveness in the U.S. market.

(2) Mexico as an Investment Site for Japanese Firms

It should first be recognized that Mexico's share of all Japanese overseas investment was as little as 0.5 percent in 1991 and 0.2 percent in 1992. Mexico's share of all Japanese accumulated investment overseas at the end of 1992 was 0.6 percent. In contrast, the U.S. and Asian shares in the same year were 42 percent and 15.5 percent, respectively (see table 2).

During the NAFTA negotiations, Mexican officials did not conceal their expectation that a free trade agreement with the United States would bring more Japanese investment to Mexico since cheap labor and free access to the U.S. market should prove irresistible for Japanese investors. However, there has been no sign of increasing Japanese investment in Mexico despite the prospect of NAFTA. Japanese investment in Mexico for the last decade has been virtually concentrated on two narrow sectors: the automobile and autoparts industries and the electric and electronic industries in the

maquiladora sector. Furthermore, in each sector, investment has been made by only a small group of companies.

Table 3 shows the number of Japanese business entities in Mexico by sector and by nature of their activities. Among the 231 entities, fifty-two are "representative offices" of Japanese corporations, which are only engaged in gathering information in Mexico. Fifty-eight out of the remaining 179 entities are maquiladora firms, many of which are subsidiaries of the U.S.-based subsidiaries of Japanese corporations that operate in Mexico to take advantage of the cheap labor force and to export their products to the U.S. market. However, the number of Japanese maquiladora firms is negligible compared to the almost 1,400 U.S. maquiladora plants.

Japanese subsidiaries in Mexico's non-maquiladora sector consist of 121 entities, of which seventy-three are in manufacturing industries. However, twenty-eight of these seventy-three manufacturing firms are actually not engaged in productive activities, but only in import and repair services. Therefore, only forty-five non-maquiladora firms are potentially in the position to use Mexico as an export platform for the U.S. market. Fifteen of these forty-five firms are in the automobile and autoparts industries. As shown in table 4, in terms of the amount of Japanese investment, the automobile and autoparts industries occupy a dominant position.

Among the fifteen automobile and autoparts companies, five are subsidiaries of the same company, which produces wire harnesses; another three have been established by a producer of audio-cassette equipment for

automobiles. The audio-cassette companies, together with four other companies, supply components and parts for the Nissan Motor Corporation, the only Japanese automaker that has been allowed to produce and sell four-wheel automobiles in Mexico.

As for the maquiladora sector, one-half of the fifty-eight firms belong to the electric and electronic industries. Most of them rushed to Mexico during the 1980s to produce electric appliances, such as color television sets, cassette decks, refrigerators, vacuum cleaners, and electric and electronic components. In addition to the twenty-nine firms categorized as electric and electronic firms, three of the thirteen companies in the category of "Others" are actually producers of cabinets and plastic parts for electric appliances. Unfortunately, information on the value of Japanese maquiladora investment is not available since the statistics of Japan's Ministry of Finance, on which table 4 is based, do not include most of the investment made by U.S.-based Japanese subsidiaries. However, the electric and electronic firms in the maquiladora sector reportedly represent the second largest cluster of Japanese investment in Mexico.

Except for these two sectors--the automobile industry and electric and electronic maquiladoras--there has been no sign of an increase in Japanese investment in Mexico. Why have more Japanese firms not taken advantage of cheaper labor and looser environmental regulations in Mexico, which are supposed to make their products more competitive in the U.S. market? I would argue that there are three principal reasons.

Table 4. Japanese Direct Investment in Mexico (US$ Millions)

	Up to 1988	1989	1990	1991	1992
All Sectors	1,670.8	36.2	167.5	192.6	60
Mining & Petroleum	502.1	0.0	0.0	0.0	2
Manufacturing	980.1	20.5	149.7	154.0	53
Food	40.1	1.0	18.0	0.0	0
Textiles	7.1	0.6	0.0	1.0	0
Wood/Pulp	0.0	0.0	0.0	0.0	0
Chemicals	46.5	1.1	11.8	1.2	2
Metals	109.5	7.7	9.3	2.0	9
General Machinery	42.8	0.8	0.0	1.4	22
Electric/Electronic Equipment	30.2	8.0	1.6	1.4	1
Tranportation Equipment	697.9	1.1	104.6	139.8	17
Others	6.1	0.2	4.4	7.2	2
Trade & Services	165.6	14.1	17.8	38.6	5
Banking/Insurance	12.0	0.0	0.0	0.0	0
Agriculture/Forestry	2.0	1.6	0.0	0.0	0
Fisheries	8.0	0.0	0.0	0.0	0

Source: Ministry of Finance of Japan, 1990, 1991, 1992, 1993.

Table 5. Mexican Imports of Electric and Electronic Equipment, 1992 (US$ Thousands)

	Total Imports	U.S.A.	Japan	Asia
Television Receivers	353,478	194,162	19,435	117,725
Radio-Broadcast Receivers	254,307	50,149	57,206	123,576
Sound Recorder, Phonographers	234,581	52,374	64,677	109,122
Photo/Thermocopy Apparatus	121,547	97,504	21,209	1,907
Parts of Copying Machines	97,696	73,792	10,617	513

Source: United Nations, Commodity Trade Statistics, 1992.

One is the diminishing importance of labor cost in the total production cost of modern machines and equipment, which represent more than 80 percent of all Japanese exports to the United States. This is due to the development of new process technologies, such as robotics and computer-guided automation, and new inventory techniques, such as the "just-in-time" method.

The second reason is the difficulty of establishing reliable supplier networks in Mexico, where the business environment is still unknown to many Japanese firms, industrial infrastructure is inadequate, and small- and medium-size industries are generally regarded as inefficient. It is well known that the high quality of Japanese products and their quick response to consumer preferences are important bases for Japanese competitiveness, and these are largely dependent on close cooperation between large manufacturers and their suppliers.

For these reasons, non-labor factors such as the nearness to the market and suppliers, better industrial infrastructure, the technological maturity of the host society, and the long-term reliability of the political and economic environment are increasingly taken into account by Japanese investors.

Finally, since the U.S. represents the single largest market for many Japanese firms, investors fear a protectionist backlash from the United States were they to increase exports from Mexico. (In this regard, it is only necessary to recall the outcry raised in the United States over the rush of Japanese electric-appliance producers to the Mexican maquiladora sector in the mid-1980s.) Consequently, Japanese firms in North America have been

investing mostly in the United States and have been establishing supplier networks there, thus gradually increasing the local content of their products.

Therefore, the argument that Japan would invest massively in Mexico if there were no NAFTA is largely misleading. No substantial change in these conditions is expected under NAFTA. The important factors--the trend toward labor-saving techniques, the lack of reliable infrastructure and supplier networks in Mexico, and the fear of U.S. protectionism--cannot be easily altered. However, since the reaction of Japanese firms to NAFTA may vary from one sector to another, a sector-by-sector analysis will give a more accurate evaluation of NAFTA's impact on the investment pattern of Japanese corporations.

Sector-by-Sector Analysis of NAFTA's Impact on Japan

(1) The Automobile Industry

The automobile industry is one of the sectors in which the protectionist tendency of NAFTA provisions is most noticeably observed. The producers of passenger cars and light trucks as well as certain important components, such as engines and transmissions, are obliged to increase regional value content of these products from 50 percent in 1994 to 62.5 percent by 2002 in order to receive preferential tariff treatment. Other vehicles, such as buses and heavy trucks and other autoparts, will require 60 percent regional content by 2002.

Since the Big Three automakers are already served by a vast network of suppliers in North America as well as Mexico, they will have no difficulty satisfying these rules of origin. However, Japanese and European automakers will face disadvantages in cross-border transactions in North America. This cannot help but affect their competitiveness in both Mexico and the United States.

As mentioned above, the Nissan Motor Manufacturing Corporation is the only Japanese automaker operating in Mexico; it is currently the second largest seller of automobiles there. Under NAFTA, the Big Three are free to import vehicles from the United States or Canada, thus increasing the models and sizes they can offer in Mexico.[5] Nissan has to counter this challenge either by importing various models of vehicles from Japan or by increasing its and its suppliers' investment in North America. Nissan probably cannot rely on the import option since it is disadvantaged by Mexico's 20 percent import duty. Neither will the investment option bring about an easy solution. Even with its Mexican supplier network, which includes five autoparts producers brought from Japan to Mexico, Nissan still cannot satisfy the 62.5 percent regional content requirement unless it and its suppliers make substantial investments in Mexico.

Other Japanese automakers may now sell vehicles in Mexico, but only if they establish assembly plants there and satisfy minimum local value-added and trade balance requirements. According to the NAFTA provisions

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[5] To be accurate, the Big Three as well as the other automakers in Mexico are obliged to fulfill a trade balance requirement under the Mexican automobile decree. This requirement, however, will be gradually eliminated over the next ten years. A local value-added requirement is scheduled to be reduced from 34 percent to 29 percent over the same period.

(Appendix 300-A.2 and Article 1106), Mexico is obliged to abolish any performance requirement (such as local content and export obligations) imposed on foreign investors no later than January 1, 2004. However, according to the new General Agreement on Tariffs and Trade (GATT) accord concluded last December, Mexico, as a "developing country member," is expected to abolish performance requirements by the year 2000.[6] Although it is not yet known how the contradiction on timing between NAFTA and GATT will be resolved, even under NAFTA's timing provision, automakers with no production facilities in Mexico now may be able to sell cars in Mexico in no more than ten years.

The only possible pitfall here is Article 1113 of NAFTA, which stipulates that a NAFTA government can deny investment-related benefits to any firm that is owned by a non-party investor and has no substantial business activities in the party's territory. This means that, even after 2004, the Mexican government may not allow automakers to sell vehicles in Mexico if they do not have production facilities there.

When Japanese automakers eventually decide to invest in Mexico, the local market may not be large enough to support feasible scale economies. New investment would then need a North America-wide strategy. However, in order to export from Mexico to the United States or Canada, they would have to satisfy the rules of origin as well as Mexico's local content requirement. Thus, automakers venturing to build new assembly plants in Mexico would have to bring many suppliers together, which would require a

[6] According to the "Agreement on Trade-Related Investment Measures," a "developing country Member" is obliged to abolish performance requirements within five years after the agreement comes into effect, which is expected to be in 1995.

huge investment; this is not something easily done. In addition, uncertainty about the rules of origin also makes Japanese automakers hesitant to invest in Mexico. While the method for calculating regional value content under NAFTA may be clearer than the one used in the Canada-U.S. Free Trade Agreement (CFTA), tracing the origin and value of each part and component built into a car is not an easy job, and there remains broad room for an arbitrary judgment by NAFTA governments.

Although labor-saving techniques have been widely introduced in automobile production, labor cost could substantially affect competitiveness in certain product lines where the total value added is limited and where there is a severe competition among the firms. The small-sized car is such a case. Japanese automakers may quicken their effort to shift from a low-priced, small car market to a higher-priced, larger car market in the United States.

Given all of the above, it would be extremely difficult for Japanese automakers to use Mexico as an export platform for the U.S. market. Thus, the argument of NAFTA proponents is correct as far as the automobile industry is concerned.

(2) Electric and Electronic Industry

In the electric and electronic industry, the most prominent Japanese presence in Mexico is in the audio-visual equipment sector. All major firms in this sector have maquiladora plants in which they mainly produce color television sets and components.

Panasonic, Toshiba and Hitachi once had television assembly plants near Mexico City. However, during the 1980s trade liberalization of Mexico, Toshiba and Hitachi terminated almost all their manufacturing operations and turned to importing. Now imported high-quality products flood the Mexican market, making domestic production uncompetitive. Panasonic is virtually the only producer left in the Mexican color television sector. Judging from Panasonic's recent establishment of an independent Latin American department in its parent firm,[7] the company may be considering making Mexico one of its production centers in Latin America. So far, this is an isolated case.

As mentioned above, all Japanese audio-visual equipment companies except for Panasonic have turned to the importing business in Mexico. However, table 1 shows that imports of these products from Japan declined between 1991 and 1992 compared with imports from the United States. This is partly because Japanese firms shifted some of their supply-source from Japan to other Asian countries. Table 5 demonstrates that the value of Asian exports of audio-visual equipment to Mexico now greatly exceeds Japanese exports. These Asian exports are made by both independent Asian producers and Japanese subsidiaries stationed in Asia.

The Japanese firms also shifted part of their supply source from Japan to their maquiladora plants in Mexico. They now sell a portion of their

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[7] *Nihon Keizai Shimbun,* September 29, 1993.

products directly in Mexico or re-import the products assembled in the United States with Mexican-made components.

In addition to curtailing the duties among member countries (15 percent to 20 percent in the case of Mexico), NAFTA imposes various rules of origin on electric and electronic equipment. In the case of color television sets of fourteen or more inches in size, firms are required to manufacture the picture tubes in North America for the first five years. Main printed circuits on chassis will be added to the obligation list thereafter. NAFTA also stipulates that duty drawback is to be terminated by January 1, 2001. This means that the maquiladora system eventually will be abolished. The Japanese maquiladora producers will be, in most cases, required to pay full Mexican duties on the parts and components they import from Japan and Asia.

The rules of origin are not major obstacles for Japanese firms in this sector. Most of them are already assembling chassis in their maquiladora plants. In addition, at least two firms have been operating picture-tube plants in the United States. However, due to the NAFTA provisions on preferential tariffs, the firms that export products from Japan and Asia to Mexico will face competitive disadvantages vis-à-vis the firms that export from the United States. Although no serious U.S. competitors are left in this sector, the competition among Japanese and Asian firms may be enough to force them to invest more in North America.

Competition in the U.S. market as well in Mexico will strengthen the aforementioned trend. Although the U.S. tariffs on electric and electronic products are already very low, the high value of Japanese currency and the

severe competition among the producers may make a small tariff differential a decisive factor here.

At first glance, Mexico may appear to be the most appropriate location for audio-visual producers considering additional investment in North America. The assembly of audio-visual equipment and their components is relatively labor-intensive, and many Japanese firms already have production facilities in the maquiladora sector. However, the import-duty differential between Mexico and the United States could discourage investment in Mexico. Since U.S. tariffs on audio-visual parts and components is one-third or less than their Mexican counterparts, firms doing assembly in Mexico may face cost disadvantages vis-à-vis the firms established in the United States.

As for other electric and electronic equipment, such as copying and facsimile machines, the prospect of Mexico as an investment location is weaker. In the case of copier machines, Japanese firms currently compete with U.S. producers in the Mexican market by importing finished products and spare parts from Japan. NAFTA may force Japanese firms to shift part of their production facilities from Japan to North America; however, the pressure to relocate may not be felt as strongly as in the color-television sector because the number of firms in the copier machine market is smaller and they specialize in various sizes and types of machines. For the same reason, the incentive to use Mexico's cheap labor to compete in the United States is lower than in the case of the color-television and small-size car sectors.

Moreover, the rules of origin for copier machines are more demanding than for television sets. For a photocopying apparatus to be accepted as a zero-duty product, its five major components have to be assembled in the region. In addition, at least one important part for each of the five components has to be of North American origin. Japanese firms have no production facilities for copiers in Mexico but have built several plants in the United States. Under these conditions, exporting from Mexico to the United States will be more difficult and costly. The Japanese firms will most likely increase their investment in the United States and serve a part of the Mexican market with the products from their U.S. plants. The import-duty differential on parts and components will also make location in the United States more attractive. Most of the facsimile machines imported into North America come from Japanese firms located in Japan and Asia. Since there are no serious competitors for Japanese firms in this sub-sector, NAFTA will have little effect, at least in the short-run.[8] Whether firms finally choose Mexico or the United States depends on the individual firms' evaluation of labor cost, duty differentials, and other factors, such as industrial infrastructure. What should be noted here is that the NAFTA does not *a priori* benefit Mexico as the primary investment site of Japanese firms, even in relatively labor-intensive industries.

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[8] This, however, does not necessarily exclude the future possibility that some of the facsimile-machine makers will establish productive facilities in North America. If their operations are successful, the competition among Japanese companies may trigger an investment rush in this sector, too.

(3) Industrial Machine Industry

In the industrial machine industry, metal-working machines, textile machines, and steam power generators are among the most important products sold to Mexico by Japanese firms.

As table 1 demonstrates, Japanese exports of metal-working machines to Mexico (as compared with exports from the United States) doubled between 1990 and 1991, with just a slight drop-off in 1992. It is not fortuitous that the U.S. Department of Commerce specifically mentions in its recent sector-by-sector analysis of NAFTA's impact that NAFTA will benefit U.S. producers of metal-working machines at the expense of their Japanese competitors.[9]

What the report overlooked is that the major Japanese firms have already established productive facilities in the United States, and one of them is already using its U.S. plant as the major supply source for Mexico. Another metal-working machine firm that currently imports its products into Mexico from Japan is also considering the possibility of partially switching its supply source to the United States in order to cope with NAFTA. None has a plan to invest in Mexico so far. Just as with the automobile and copier machine industries, the lack of supplier networks and the rules of origin, together with the insufficient infrastructure (such as the inelasticity

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[9] The metal-working machine industry is the sole sector in which the report mentions the U.S. prospective advantage over Japanese products as part of NAFTA's utility. U.S. Department of Commerce, North American Free Trade Agreement:, pp. 2 and 9 of the section on "Metalworking Machinery and Equipment."

of electricity provision and deficiencies in the road transportation system) discourage investment in Mexico.

The textile machine sector is one of the most promising in the Mexican machine market. NAFTA immediately removes import quotas for Mexico-produced textiles and apparel, and the textile quota system as a whole will be eliminated by the new GATT agreement in ten years. In the meantime, Mexico will enjoy a privileged position in the U.S. market. NAFTA's rules of origin dictate that either yarns or fibers have to be of North American origin for many textile and apparel products. These provisions, it is believed, are going to stimulate the Mexican textile and apparel industries and lead to an increase in the demand for textile machines.

Table 6 shows that European producers lead in the Mexican market of spinning and weaving machines. Japanese and U.S. producers are stronger in the sewing machine sub-sector. In this sub-sector, general-purpose machines are produced only by Japanese and European firms; U.S. firms specialize in the manufacturing of specialty machines. Among the three Japanese makers of general-purpose sewing machines, one has two subsidiaries in the United States. One of these subsidiaries was purchased from the last remaining U.S. company in the industry four years ago and produces sewing machines with almost all U.S. parts. Although this company has serviced the Mexican market through exports from Japan, it could switch its supply source to the United States if it becomes necessary under NAFTA.

Table 6. Mexican Imports of Textile Machines, 1992 (US$ Thousands)

	Total Imports	U.S.A.	Japan	Europe
Textile & Leather Machines	496,229	99,530	53,749	308,435
Sewing Machines & Parts	92,676	35,809	30,470	10,305
Spinning & Extruding Machines	150,153	11,220	7,269	130,567
Weaving & Felt Mfg. Machines	118,498	12,079	11,220	88,053

Source: United Nations, Commodity Trade Statistics, 1992.

Table 7. Mexican Imports of Power Generating Machines, 1992 (US$ Thousands)

	Total Imports	U.S.A.	Japan
Power Generating Machines	1,097,888	572,439	125,072
Steam Generating Boilers, etc.	92,611	10,297	16,722
Steam Turbines	92,851	7,551	56,464
Internal Combustion Piston Engines	520,535	323,103	15,394
Rotating Electric Plant	238,758	120,404	35,320

Source: United Nations, Commodity Trade Statistics, 1992.

Table 8. U.S. Imports of Textile and Apparel Products, 1992

	Textiles		Apparel	
	Value (US$Mil)	Share (%)	Value (US$Mil)	Share (%)
Total Imports	8,215	100.0	32,951	100.0
Mexico	359	4.4	1,196	3.6
Central America	67	0.8	1,637	5.0
Caribbean	27	0.3	1,678	5.1
Japan	671	8.2	139	0.4
Asia	3,635	44.2	23,813	72.3

Source: United Nations, Commodity Trade Statistics, 1992.

Another Japanese sewing machine firm granted a production license to a Mexican company that imports major components and parts from Japan and assembles simple industrial sewing machines; more complex machines are imported from Japan. Under NAFTA, the U.S.-based firm will be in a better competitive position in Mexico than the Mexico-based one. The former can take advantage of the tariff preference of NAFTA, while the Mexico-based firm must pay high Mexican duties for both parts and finished products. The disadvantaged company could invest more in Mexico to cope with the challenge of its competitor in the United States, but it would be costly to build up a supplier network in Mexico.

As seen in table 7, Japanese products are also competitive in the Mexican market for steam turbines. It is reported that 70 percent of steam-turbine generators purchased by Mexico's Federal Electricity Commission are provided by one Japanese company. Since this company enjoys world-wide competitiveness, it expects to be little affected by NAFTA. It is considering procuring some auxiliary parts from the United States and expanding its boiler production in Mexico to export to the United States and to South America. However, as one would expect, it continues to import major portions of its machines from Japan.

(4) Textile and Apparel Industries

Although the textile and apparel industry are among the most promising sectors in Mexico, the importance of the Mexican market is negligible for Japanese producers in the industry (see table 1). The Japanese position is slightly better in the U.S. market; still, its exports to the United States are

tiny compared to exports from Asia (see table 8). In addition, the textiles exported from Japan to the United States are mainly "high-tech" specialty products that cannot be produced easily in North America. Japanese textile producers, therefore, expect that NAFTA will have little direct effect on their competitiveness. There could be trade diversion from Asia and the Caribbean Basin countries to Mexico as a result of NAFTA. Japanese textile firms have production facilities in the Asian and Caribbean basin countries and sell fibers and yarns to the local producers; thus NAFTA could affect Japanese firms indirectly.

More serious for Japan in the long run will be potentially troublesome reactions from Asian countries in the event that large-scale trade diversion does occur in the industry.[10] Since many Asian countries still depend on the U.S. market for 20 to 30 percent of their exports, the formation of an Asian FTA and a resulting trade war with the United States are not likely for the moment. However, the trend toward Asian regionalism represented by Malaysian Prime Minister Mahathir could certainly be strengthened and might put Japan in a difficult position between its Asian neighbors and the United States.

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[10] The Japan Chemical Fibres Association sent a mission to the United States, Mexico, Costa Rica, and Jamaica in November 1993 to investigate the possible impact of NAFTA on Japan's textile industry. Its interim report published in January 1994 is inconclusive about NAFTA's impact on Asia. The mission obtained the impression that the apparel firms in the United States currently procuring materials and products from Asia will decide their future strategy only after observing how NAFTA is implemented. See Working Group for Investigating Economic Regionalism, 1994.

(5) Iron and Steel Industry

Of the major Japanese exports to Mexico, iron and steel represent a peculiar case: a constant decline in exports of these products relative to exports from the United States. Table 1 demonstrates that Japanese exports of iron and steel products to Mexico declined from 53 percent of U.S. iron and steel exports in 1985 to 14 percent by 1992. This can be partially explained by Japanese steelmakers' launching joint ventures with their U.S. counterparts during the 1980s in an effort to cope with the trade friction between the two countries.[11] The Japanese firms have since shifted part of their supply source for Mexico from Japan to the United States.

Since a huge investment has been made in the United States in the process, it is unlikely that the steel makers located in the United States will move their production facilities to Mexico. Mexican producers have a good chance of increasing exports to the United States, but their products are intermediate or lower value-added ones. In exchange, Mexico will increase imports of higher value-added products, such as cold flat-rolled steel for automobile bodies as well as high-quality pipes and tubes, mainly from the United States and secondarily from Europe and Japan.

The high regional value content requirement in the automobile industry is another factor that will contribute to the trend of trade diversion from Japan to the United States in the iron and steel industry. Nissan may need to stop importing cold rolled steel for car bodies from Japan and instead procure it from the United States so as to increase regional content.

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[11] See *Nihon Keizai Shimbun*, October 2, 1993.

(6) Chemical Industry

The chemical industry is one of the sectors in which Japanese exports to Mexico remain smaller than expected, representing only 3 percent of U.S. exports in recent years (see table 1).[12] Direct investment does no better. There are only nine Japanese chemical manufacturers in Mexico, three of which are maquiladora operations. They are small-scale, downstream operations.

One reason for the small Japanese presence in this industry is the monopoly of upstream petrochemical operations by the state-owned oil company, Petróleos Mexicanos (PEMEX). Since the price and quality of materials provided by PEMEX are not satisfactory, Japanese firms prefer to import them either from Japan or the United States. NAFTA's tariff reduction and rules of origin will certainly increase imports of U.S.-made materials.

Although the Mexican government has liberalized direct foreign investment in the secondary petrochemical industry, few Japanese companies are interested in investing. Since the upstream petrochemical production is highly capital-intensive, it is too risky for them to commit investment capital unless they can also control the supply of the basic petrochemical materials.

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[12] Japanese exports of chemical products exceed U.S. exports in Asia. Consult United Nations Commodity Trade Statistics.

(7) Non-Manufacturing Sectors

All Japanese general trading companies have subsidiaries in Mexico. They are active in commercial activities, but some of them are also engaged in manufacturing businesses in both the maquiladora and non-maquiladora sectors. As a whole, they regard NAFTA as good for their business because it is expected to expand the trade between Mexico and the United States, and they expect to increase their participation in the flow.

The financial sector is another story. NAFTA allows only U.S. and Canadian financial institutions to establish subsidiaries in Mexico, although they are subject to certain market share limits. Currently, only one Japanese firm, Tokyo Marine Insurance Company, has a subsidiary in Mexico. Fifteen banks and four insurance companies have no more than "representative offices" (see table 3). Under NAFTA, Japanese banking subsidiaries in the United States and Canada theoretically can establish subsidiaries in Mexico. However, in order to do so, they must obtain permission from U.S. and Canadian financial authorities, which is unlikely to come because their operations in these countries have not attained minimum asset requirements to move abroad. Unless the Mexican government allows Japanese banks to enter directly from Japan, they will be forced out of the Mexican financial market.

(8) Summary

The preceding sector-by-sector analysis has demonstrated that NAFTA's impact on Japanese businesses in North America differs from one

sector to another according to the market structure of individual sectors, the nature of the scale of production and labor intensity, and the location and degree of existing Japanese manufacturing operations in North America.

First, the more competitive the market, the more NAFTA forces Japanese firms to invest in North America. The pressure for investment will be felt even stronger in sectors such as the automobile industry, in which the existence of well-entrenched U.S. competitors makes Japanese firms vulnerable under rules-of-origin requirements. Even if serious U.S. competitors do not exist, the Japanese will be forced to invest in North America in the industries in which there is severe competition among Japanese and Asian producers; the audio-visual equipment industry is such a case. In contrast, where no serious competition exists, NAFTA is not likely to stimulate Japanese investment in North America. The producers of facsimile machines, "high-tech" specialty textiles or fibers, and steam power generators for power plants expect to feel little effect from NAFTA and plan to continue to export their products from Japan or Asia to North America.

Second, labor-intensive industries or production lines are expected to be most competitive if they are located in labor-abundant Mexico. The apparel industry and the assembly operation of small cars and audio-visual equipment are among these industries, although the automobile industry requires large scale-economies at the same time. NAFTA has supposedly solved the scale problem for Mexico by enlarging its market to the north. However, NAFTA rules of origin discourage Japanese investment in Mexico's large-scale, capital-intensive industries, such as the automobiles and

industrial machines. Potential investors need to build not only assembly plants but also a large number of supplier shops to move their products across the U.S. border without paying duties. This is an extremely risky and expensive venture in a country such as Mexico, where supplier industries are still underdeveloped. Therefore, NAFTA in some ways encourages but in others discourages Japanese investment in Mexico.

Third, NAFTA's impact on Japanese businesses also varies according to where and to what extent Japanese firms are conducting manufacturing activities in North America. When firms have established sufficient production bases in one country, they tend to concentrate their manufacturing activities in that country as well, since it is easier for them to satisfy the rules of origin for exporting their products to NAFTA partners. It is also more convenient for just-in-time operations.

In all manufacturing industries except for the audio-visual equipment sector, Japanese firms have deeper roots in the United States than in Mexico. Therefore, the Japanese producers of copier machines, metal-working machines, and sewing machines as well as iron and steel products are expected to maintain or expand their U.S. operations and increase exports to Mexico.

The chemical industry is a special case. Although Japanese producers of basic petrochemicals are not active in the United States, Japanese chemical firms plan to increase purchases of U.S.-produced materials, rather than invest in the Mexican petrochemical industry due to the monopolization of the sector by PEMEX.

As a whole, NAFTA will serve to increase Japanese investment in and procurement from the United States. The combination of the NAFTA rules of origin and the current concentration of Japanese production facilities in the United States is a strong stimulant for further investment there. In addition, the import-duty differentials between Mexico and the United States may put Mexico at a disadvantage. Since import duties on parts and materials are approximately three times higher in Mexico than in the United States, machine assemblers or downstream producers that rely on imported inputs from Japan and Asia may find their operations in Mexico to be more costly than those in the United States. This disadvantage, of course, will be eliminated if the Mexican government lowers the import duties to the level of the United States. It should also be noted that Japanese firms, fearing another surge of anti-Japan sentiment in the United States, their largest market, might avoid shifting production facilities to Mexico. Deficiencies in infrastructure, such as instability of the electricity supply and poor road conditions, also discourage Japanese investment in Mexico.

One should expect that Japanese firms will try to locate and utilize as many production facilities as possible in the United States. A large-scale survey of Japanese manufacturing plants in the United States supports this conclusion. According to the survey conducted in September 1992 by JETRO, as table 9 shows, only 4.1 percent of the plants responded that they have decided to establish new plants in Mexico, are considering establishing new plants, or plan to transfer existing plants to Mexico in an effort to deal with NAFTA. Sixty-six percent responded that they have no plans to do so.[13]

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[13] Therefore, the argument (made by both proponents and opponents of NAFTA) that the Japanese are moving to Mexico in droves is wrong. President Clinton and Vice President Gore should have

Implications of a WHFTA for Japan

After the bitter battle fought over NAFTA, the Clinton administration will not be able to take steps toward new free trade agreements without first showing that NAFTA is not as harmful to U.S. jobs as its opponents have insisted. NAFTA is expected to be harmless since the major companies in search of cheap labor have already moved to Mexico. In addition, the reduction of high Mexican tariffs will benefit producers and exporters based in the United States. Moreover, Japanese investment will increase in the United States. Before long, the situation will be ripe for negotiation of free trade agreements with Chile, the Caribbean Basin Initiative (CBI) countries, Argentina, etc. If the U.S. government decides to take advantage of the opportunity, a WHFTA will gradually emerge.[14]

I argued earlier that most Japanese firms will have little difficulty coping with NAFTA by means of increasing investment in North America, especially in the United States. NAFTA is, after all, the formalization of the already existing regional economy in North America. However, a U.S. move to enlarge NAFTA into WHFTA could pose more serious problems for Japan.

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argued that if there is a NAFTA, the Japanese will be forced to invest more on this side of the Pacific, especially in the United States, thus creating more jobs. Mexico's expectation that it will be the main beneficiary of Japanese investment under NAFTA will be unfulfilled. What is worse is that the NAFTA-induced behavior of Japanese firms may worsen Mexico's trade balance with the United States by increasing imports from the United States.

[14] President Clinton appears positive about the expansion of NAFTA. Soon after NAFTA was passed, he told a delegation of Central American Presidents that he was ready to support a Central American application to join NAFTA (Mexico & NAFTA Report, Latin American Newsletters, London, January 20, 1994). The New York Times reported in February 4, 1994 that Clinton administration "officials" stated that it planned to invite Chile to join NAFTA in 1995 and to form a WHFTA in ten to fifteen years.

Table 9. Planned Strategies of U.S.-Based Japanese Manufacturing Plants to Cope with Nafta (September 1992)

Build Plants in or Transfer Plants to Mexico

	Total Number of Plants	Build/Transfer Plants in/to Mexico				Plants Already in Mexico		Don't Know or Unknown	
		Positive		Negative					
All Sectors	1012	41	4.1%	668	66.0%	84	8.3%	219	21.6%
Food/Kindred Products	102	1	1.0%	81	79.4%	2	2.0%	18	17.6%
Textiles	38	0	0.0%	23	60.5%	8	21.1%	7	18.4%
Wood & Pulp Products	21	0	0.0%	17	81.0%	0	0.0%	4	19.0%
Chemicals	210	7	3.3%	121	57.6%	36[a]	17.1%	46	21.9%
Metals	152	5	3.3%	113	74.3%	4	2.6%	30	19.7%
General Machinery	120	6	5.0%	77	64.2%	6	5.0%	31	25.8%
Electric/Electronics	131	9	6.9%	70	53.4%	14	10.7%	38	29.0%
Transport Equipment	99	3	3.0%	61	61.6%	12	12.1%	23	23.2%
Precision Equipment	50	2	4.0%	36	72.0%	0	0.0%	12	24.0%
Other	89	8	9.0%	69	77.5%	2	2.2%	10	11.2%

Source: JETRO, 1993.

a) This number exceeds the number of chemical firms operating in Mexico. This seeming contradiction occurs because the unit of the survey questionnaire, on which this table is based, is not a firm but a plant. The questionnaires were sent to every plant even though some of them belong to the same firm.

NAFTA presents some potentially troublesome elements for Japan. The reduction of import restrictions and tariffs among NAFTA countries will put imports from Japan and Asia at a disadvantage. The rules of origin may present obstacles to Japanese (and Asian) manufacturers with inadequate supplier networks in North America, and some of the rules of origin are not drawn accurately enough. Products made by Japanese (and Asian) firms in North America may be refused acceptance as zero-tariff goods according to arbitrary judgment by the NAFTA governments. NAFTA also contains some unclear provisions. One example is the definition of "NAFTA investors." To be treated as a national company in each of the NAFTA countries, one has to qualify as a "NAFTA investor," defined in the text as an enterprise with "substantial business activities in a NAFTA country." Being a legal entity in a NAFTA country is apparently not enough to qualify for the status of NAFTA investor. The question then arises: How "substantial" do business activities have to be?

If we can assume that a future WHFTA will have more or less similar provisions as NAFTA, then Japan will be facing these problems in both North and South America. What if all of the major Latin American economies are captured by the United States? Latin America, not including Mexico, absorbed 3.6 percent of all Japanese exports in 1992. Although small for the moment, some countries in the region, especially Brazil, Chile, Venezuela, Argentina, Colombia, and even Peru, are potentially very promising markets. Many of them have actually recovered from the recession during the "lost decade" and have started to grow steadily.

Many Latin American countries have liberalized their economies since the latter half of the 1980s. Japanese firms have shown a conspicuous but economically rational behavior pattern in the face of these policies. They have reduced their presence in the manufacturing sector and switched to import and repair operations. Since import restrictions have been largely eliminated and tariffs cut, many Japanese producers of automobiles, electric appliances, and other machines have discovered that by importing finished high-quality products from Japan they can compete more effectively than by manufacturing in Latin America.

The investment and trade figures in tables 10 and 11 clearly point out this change in four countries. Table 10 indicates that the share of Japanese investment in the manufacturing sector has declined overall since 1985 in Argentina, Brazil, and Venezuela. This decline has been most notable in textiles, transportation equipment, and metals, although the latter sector still shows the largest concentration of Japanese investment in Brazil and Venezuela. Although Japanese investment in the electric and electronic industries has for the most part apparently expanded in Argentina, Brazil, and Venezuela, it is reported that many firms have totally or partially switched to import and repair operations.[15]

Only in Chile has the share in the manufacturing sector increased, with expansion notable in textiles, wood/pulp, and metals. However, Japanese firms in the wood/pulp sector are only producing wood-chips for the

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[15] A detailed account on this point is given in a paper that I wrote on the basis of field research in 1992. See Keiichi Tsunekawa, 1992.

Japanese market; only one firm plans to produce pulp in the future. Japanese investors have been shifting from pure mining to metal production (copper and iron) in Chile, but the degree of manufacturing in this sector is still low.

Of all the other sectors, the only ones that have seen an expansion in Japanese investment since 1985 are fishery and trade/services in Argentina; mining/petroleum and banking/insurance in Brazil; agriculture/forestry in Chile; and mining/petroleum and banking/insurance in Venezuela.

This investment pattern is congruent with the pattern of trade between Japan and these Latin American countries. As shown in table 11, most growth was in exports of Japanese automobiles to Argentina, Brazil, Chile, and Venezuela between 1990 and 1992. Principal Japanese imports from the Latin American countries were raw or semi-processed natural resources. The products that have shown greater penetration into the Japanese market during the 1990s are fish/shellfish and feeding materials from Argentina; foodstuffs, iron ores, and non-ferrous metal from Brazil; fish/shellfish, other foodstuffs, and metal ores and scrap from Chile; and metal ores and scrap, crude oil, and petroleum products from Venezuela. Most of these products are from sectors in which Japanese investment is already large or expanding.

Table 12 shows that imported Japanese products are competitive in the major Latin American economies. Japanese participation in all sectors of these markets as compared with U.S. participation has been increasing since 1990, except in Brazil, the country in which economic liberalization has been most delayed. There seems to be a firm trend: the more liberalized an

Table 10. Distribution of Accumulated Japanese Overseas Investment in Four Latin American Countries by Sector (%)

	Argentina				Brazil				Chile				Venezuela			
	1980	1985	1990	1992	1980	1985	1990	1992	1980	1985	1990	1992	1980	1985	1990	1992
Mining & Petroleum	0.0	0.0	0.0	0.0	5.2	3.9	3.8	5.4	63.0	43.4	27.1	20.5	0.0	0.0	0.6	0.7
Agriculture/ Forestry	0.0	0.1	0.1	0.1	3.4	2.7	2.2	2.7	0.0	0.0	6.1	20.7	0.5	0.5	0.5	0.4
Fisheries	4.5	7.3	7.8	8.1	0.2	0.2	0.1	0.1	17.3	13.9	18.2	13.6	1.3	1.1	0.4	0.3
Manufacturing	40.4	37.5	24.9	23.9	65.0	68.3	62.0	60.3	3.9	3.1	18.4	17.3	84.6	84.6	66.3	71.8
Foodstuffs	0.1	0.0	0.1	0.1	3.5	2.9	2.7	2.4	0.0	0.1	0.4	0.3	0.1	0.1	0.0	0.0
Textiles	17.1	5.9	2.2	1.9	10.0	7.6	5.7	5.6	0.0	0.0	2.9	2.1	2.3	2.0	0.8	0.6
Wood/Pulp	1.4	0.4	0.1	0.3	6.2	4.1	2.9	3.0	0.4	0.3	2.8	5.4	0.0	0.0	0.0	0.0
Chemicals	2.7	0.7	0.3	0.2	2.8	3.4	4.9	4.6	0.0	0.0	0.7	0.5	0.2	0.5	0.2	16.4
Metals	0.0	0.0	0.0	0.0	20.4	31.5	26.6	24.6	0.0	0.0	8.5	6.5	76.3	67.9	50.0	42.8
General Machinery	1.1	0.3	0.1	0.1	7.6	6.8	5.6	5.6	0.0	0.3	0.2	0.2	0.0	1.9	1.4	1.0
Electric/ Electronics	14.3	10.9	14.4	14.5	5.8	5.2	6.8	7.6	0.3	0.2	0.5	0.4	1.6	1.4	4.9	4.6
Transport Equip.	1.6	9.3	3.9	3.4	6.3	5.6	5.1	5.1	3.2	2.2	1.3	0.9	3.8	10.5	8.6	6.3
Other	2.2	10.1	3.8	3.4	2.3	1.7	1.9	1.8	0.0	0.0	1.2	0.9	0.4	0.5	0.2	0.2
Trade & Services	27.9	44.8	63.4	64.6	16.7	15.3	13.5	13.0	5.5	29.9	19.4	17.5	8.7	9.5	30.4	25.4
Banking/ Insurance	24.3	6.4	2.4	2.1	7.1	8.0	16.8	16.9	5.0	3.5	6.6	1.8	0.0	0.0	0.0	0.0
Total (US$ Mil)	42	160	431	489	2,908	4,587	6,560	7,195	124	180	311	413	115	132	341	469

Source: Calculated from Ministry of Finance of Japan, 1989, 1991, 1993.

Table 11. Japan's Merchandise Trade with Four Latin American Countries

Argentina	1980	1990	1991	1992
Value of Exports (US$ Mil)	998	196	448	709
Value of Imports (US$ Mil)	287	539	603	512
Trade Balance	711	-343	-155	197
Share of Total Exports (%)				
Textiles	2.9	1.2	1.6	0.9
Chemicals	3.0	13.4	8.1	5.5
Metal Products	14.5	2.3	3.5	3.1
Automobiles	20.6	3.9	12.5	19.0
Other Machinery/Equipment	45.8	58.9	57.5	57.8
Share of Total Imports (%)				
Meat	10.2	3.7	3.5	3.6
Fish and Shellfish	4.2	7.1	11.6	20.5
Feeding Materials	3.2	18.5	32.0	26.5
Textile Materials	23.4	4.5	2.0	2.6
Other Raw Materials	6.7	6.8	4.1	3.8
Chemicals	9.0	2.7	2.7	4.0
Iron and Steel	0.0	7.3	6.7	0.5
Nonferrous Metals	22.2	23.4	14.6	11.6
Machinery and Equipment	6.9	9.9	8.4	5.8

Brazil	1980	1990	1991	1992
Value of Exports (US$ Mil)	1,115	1,225	1,226	1,140
Value of Imports (US$ Mil)	1,561	3,173	3,180	2,847
Trade Balance	-446	-1,948	-1,954	-1,707
Share of Total Exports (%)				
Textiles	0.8	0.8	0.7	0.4
Chemicals	7.5	6.7	6.5	7.7
Metal Products	16.2	6.8	5.1	4.0
Automobiles	0.0	0.1	0.9	5.4
Other Machinery/Equipment	67.2	76.9	71.1	69.3
Share of Total Imports (%)				
Foodstuff	15.3	13.4	15.8	19.5
Textile Materials	1.2	1.5	1.0	1.0
Iron Ores	51.3	28.1	28.3	29.2
Wood and Pulp	6.6	4.5	3.7	4.4
Soybeans	0.7	7.1	2.2	4.3
Chemicals	5.8	3.6	4.4	4.4
Iron and Steel	3.2	17.8	18.3	11.4
Non-ferrous Metals	0.0	16.1	18.2	18.0
Machinery and Equipment	7.8	1.2	2.0	2.1

Table 11 (Continued). Japan's Merchandise Trade with Four Latin American Countries

Chile	1980	1990	1991	1992
Value of Exports (US$ Mil)	462	483	631	959
Value of Imports (US$ Mil)	644	1,622	1,888	1,876
Trade Balance	-182	-1,139	-1,257	-917
Share of Total Exports (%)				
Textiles	4.2	1.2	0.9	0.8
Chemicals	1.3	1.9	1.9	1.5
Metal Products	8.0	5.6	2.6	2.8
Automobiles	41.2	41.6	51.7	56.7
Other Machinery/Equipment	32.4	38.5	34.3	30.6
Share of Total Imports (%)				
Fish and Shellfish	3.8	7.8	8.8	14.9
Other Foodstuffs	5.2	9.5	10.1	12.6
Metal Ores and Scrap	63.2	25.4	28.8	31.4
Wood and Pulp	8.9	9.6	8.6	8.4
Other Raw Materials	2.1	1.2	1.3	1.5
Chemicals	0.6	2.0	1.5	0.9
Non-ferrous Metals	15.6	32.8	26.6	16.2
Venezuela	**1980**	**1990**	**1991**	**1992**
Value of Exports (US$ Mil)	835	298	529	833
Value of Imports (US$ Mil)	691	640	468	448
Trade Balance	144	-342	61	385
Share of Total Exports (%)				
Textiles	1.8	1.4	1.3	0.7
Chemicals	2.1	4.8	3.3	2.4
Metal Products	31.2	7.6	6.4	2.2
Automobiles	5.3	28.4	36.0	45.4
Other Machinery/Equipment	50.3	53.1	45.5	43.5
Share of Total Imports (%)				
Foodstuffs	1.0	1.5	3.6	1.4
Metal Ores and Scrap	0.1	7.8	9.0	11.4
Crude Oil	61.1	5.9	9.9	8.8
Petroleum Products	1.8	10.0	3.7	13.8
Nonferrous Metals	32.8	64.3	64.1	58.6

Source: Gaikoku boueki gaikyo, December of various years; United Nations, Commodity Trade Statistics, various years.

Table 12. Relative Size of Japanese Exports to Five Latin American Countries

	Japanese Exports as a Percentage of United States Exports				
	1985	1989	1990	1991	1992
Mexico					
All Sectors	8	8	8	9	10
All Machines & Transport Equipment	12	13	13	14	16
Automobiles	1	41	13	23	37
Argentina					
All Sectors	33	18	18	24	24
All Machines & Transport Equipment	42	25	26	37	35
Automobiles	22	31	184	504	174
Brazil					
All Sectors	20	28	25	21	21
All Machines & Transport Equipment	33	36	33	24	26
Automobiles	2	9	2	11	34
Chile					
All Sectors	25	47	31	36	41
All Machines & Transport Equipment	39	71	43	59	62
Automobiles	165	304	309	443	346
Venezuela					
All Sectors	11	7	10	12	16
All Machines & Transport Equipment	17	11	17	17	24
Automobiles	911	138	242	132	88

Source: Calculated from United Nations, Commodity Trade Statistics, various years.

economy is in Latin America, the greater is Japanese penetration vis-à-vis the United States. This trend is also observed in the "automobiles" section of table 12. In Argentina, Chile, and Venezuela, where the automobile trade has been largely liberalized, Japanese exports of finished units of automobiles have exceeded U.S. exports at least since 1990 (except in Venezuela in 1992). In Mexico and Brazil, where the automobile trade is still under heavy government control, the Japanese presence, although expanding, is still smaller than the U.S. presence.

As a whole, under the conditions brought about by general economic liberalization polices, Latin American markets for Japanese products have been expanding. However, if these markets are captured by the United States, one after another, it could mean a loss of long-term business opportunities for Japanese firms. To address this problem, these firms will be forced to establish new production facilities in the Western Hemisphere instead of doing so in Japan or Asia.[16]

The actual scope and degree of trade and investment diversion will partially depend on the extent to which Japanese exports to Latin America

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[16] Where the Japanese firms locate their production facilities in the Western Hemisphere will also be a controversial issue. Latin American countries are in a less favorable position than Mexico in terms of distance from the U.S. market, and Mexico and Brazil in terms of level of industrial development. Still, if Mexico cannot be a prime receiver of Japanese industrial investment under NAFTA, the other Latin American countries can never hope to become so under WHFTA. Since U.S. firms have been more deeply rooted in the Latin American economies, they may increase investment in production facilities of Latin America more readily than their Japanese counterparts. However, it is doubtful that these facilities could create sufficient export income to help Latin American countries finance the import of manufactured goods. Latin American countries will, in all probability, end up exchanging their raw or semi-processed natural resources for manufactured products primarily provided by the United States. To achieve sustainable growth, Latin American countries will need first to refurbish and then upgrade their manufacturing sector. They cannot solely rely on WHFTA for this purpose. They also will need to strengthen domestic and regional (Latin American) markets for their industrial products.

have expanded by the time a WHFTA is realized. In practice, though, many Japanese firms already seem to be moving toward the "three pole" business strategy, in which each of the major markets--Asia, the Western Hemisphere, and Europe--is to be served by production facilities established in each region. In this way, the Japanese firms believe, they will continue to be competitive in each market.

Asian producers, however, may not be so confident, and Asia's reactions against WHFTA may be troublesome for Japan. For Asian countries, the Latin American market is negligible (receiving 1.6 percent of all exports in 1990).[17] Their real stake is in the U.S. market. Since Asian firms specialize in relatively low value-added exports to the United States, Latin America under WHFTA could pose a more serious competitive threat for Asia than it does for Japan. In-depth research is needed to make any accurate assessment of trade and investment diversion from Asia to Latin America under WHFTA.[18] What can be pointed out here is that there exists a danger that Asian regionalism may be strengthened if a large-scale trade and investment diversion occurs.

Conclusion

NAFTA will put Japanese firms at a competitive disadvantage by lowering Mexican import duties for U.S.-made products, not for products

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[17] United Nations, International Trade Statistics Yearbook 1991.

[18] Although several studies have been done on NAFTA's impact on Asia, the subject has yet to be fully analyzed. See Carlos Alberto Primo Braga, 1992; Robert Mathieson, 1993; and Nancy Hamilton, 1993.

made in Japan, and by imposing a variety of rules of origin for intra-regional trade. In this respect, the contention of NAFTA proponents concerning NAFTA's impact on Japan is more accurate than the contention made by its opponents. However, their argument that the Japanese would try to arrange a free trade accord with Mexico and use Mexico as an export platform for the U.S. market was groundless and misleading. Mexico still shares very little in the foreign trade and the overseas investment of Japan.

A sector-by-sector analysis has shown that NAFTA's impact on Japanese businesses varies by sector according to conditions such as the sector's market structure, the scale of production, and the labor intensity, location, and degree of existing Japanese manufacturing operations. As a whole, however, Japanese firms will be able to cope with NAFTA-induced disadvantages by increasing direct investment in North America.

Contrary to the apparently dominant belief, the cheap labor of Mexico will not be sufficient to attract Japanese investment. NAFTA may encourage Japanese investment in Mexico in competitive and labor-intensive industries. On the other hand, NAFTA's rules of origin, together with the insufficient development of supplier industries in Mexico, may deter Japanese investors from choosing Mexico as their investment site. Problems such as the import-duty differentials between the United States and Mexico, the many deficiencies in Mexico's infrastructure, and the Japanese fear of U.S. protectionism will all contribute to discouraging Japanese investment in Mexico as well. We can expect that the primary investment site of Japanese firms under NAFTA will be the United States.

Although little immediate impact on Japan is expected from NAFTA, there remains a possibility that long-term effects will be more serious. This depends in part on how NAFTA is implemented. If the Japanese and other Asian firms that eventually transfer their production facilities to the other side of the Pacific are treated in a discriminatory way and if unfair judgments are made on the regional value content of their products, the Japanese and Asians may start paying more attention to Mr. Mahathir's idea of an Asian grouping. Such a trend will be strengthened if the trade and investment diversion from Asia to Latin America expands under a WHFTA. In that case, Japan will find itself in a difficult position between its two closest partners, the United States and its Asian neighbors.

One way for Japan to avoid this danger is to take the initiative in negotiating more multilateral frameworks like the GATT, the World Trade Organization (WTO), and the Asia-Pacific Economic Council (APEC). In order to exercise this kind of international leadership, Japan will first need to take serious steps to remove its remaining trade barriers by fostering the deregulation of domestic businesses.

Considering the possibility that what happens in the Western Hemisphere in the next few years could affect the shape of the world economic order, Latin American countries should play a broader role in designing these new frameworks.

The U.S. public should also be aware of the possibility that NAFTA and WHFTA, instead of helping to consolidate a world-wide free trade regime, could deteriorate into a discriminatory mechanism that gradually divides the

world into economic blocs. Given its control over the U.S. market, still the largest in the world, U.S. policy will be crucial in shaping a new world economic order.

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