

The Ryukyuanist

A Newsletter on Ryukyuan/Okinawan Studies

No. 43

Spring 1999

This issue features an updated version of a paper earlier presented to the 1998 annual meeting of the Association of Japanese Business Studies (see *The Ryukyuanist* No. 41). In general, economists find Okinawa's economic policy issues uninteresting. Analytical discussions of the Okinawan economy are useless in the presence of large unprincipled handouts from the Japanese government driven by ulterior motives. Irremediable distortions have been built into Okinawa's price and incentive structures by the political domination of the economy. A "free trade" policy, subjecting Okinawa to the discipline of the global market forces, will help generate new, more rational dynamics of resource allocation and growth. Successes and failures will be determined by self-reliance, not by erratic paternalism of a remote government.

Free Trade Zones for Okinawa: A Forerunner of Japan's Complete Trade Liberalization?

A free trade zone (FTZ) is a limited accommodation to the ideal of full-fledged free trade in a country protected by trade barriers. Okinawa Prefecture desires a full liberalization of Okinawa's international trade, capital transactions and technology transfers, while maintaining the economic union with the rest of Japan (ROJ) that follows from Okinawa's prefectural status within the Japanese state.

This implies that Japan would then consist of two areas, Okinawa and ROJ, under different regimes of international trade, one under "free trade" and the other under Japan's conventional protected or managed trade. In the form of a slogan, this might be called "One Country, Two Regimes." One might also see it as analogous to two countries forming an economic union, while maintaining their different original regimes of international trade. This view would facilitate the analysis of the Okinawa-ROJ relationship with the help of the theory of economic integration

that is well established in international economics.

In Okinawa, however, people look for "realistic" approaches which only imply the perpetuation of the status quo dominated by special interests based on the current practices of trade protection. A first question that the suggestion of free trade for Okinawa evokes is how the Japanese government should treat goods with foreign contents exported from Okinawa to ROJ. As Japan's protectionism stands now, many goods and services that freely enter the liberalized Okinawa would be subject to tariffs and/or non-tariff barriers on arrival in ROJ.

There would be no problem if one simple principle of reciprocity were adopted: within the Okinawa/ROJ economic union, goods should move freely between Okinawa and ROJ with no question asked about the origin of the goods themselves or of their materials. But the protected special interests in ROJ would protest that cheaper foreign goods would flood ROJ through Okinawa. They would then demand

that foreign goods or foreign contents of goods exported to ROJ from Okinawa should be subject to appropriate tariffs and restrictions.

Interestingly, foreign goods imported by ROJ subject to Japanese tariffs and quotas freely move to Okinawa and are sold at prices made higher due to those duties and restrictions. Okinawa under free trade should demand that it be rebated with all import duties included in the prices of foreign goods imported through ROJ.

Such demands and counter-demands between Okinawa and ROJ would further complicate trade regulations, subverting the goal of eventual trade liberalization to which ROJ too is committed. All "transaction costs" of regulations can be saved by the adoption of the aforementioned principle of reciprocity.

Okinawa Prefecture's final official proposal was to begin with one or two FTZs and to expand them in steps eventually to cover the whole prefecture, envisaging something similar to the above "One Country, Two Regimes." When ROJ is fully liberalized, FTZs on sub-national scales will no longer be needed.

Okinawa's policy initiative and the Japanese government's responses offer students of Japanese business and economics an opportunity to re-examine Japan's problems of market access, deregulation and restructuring. In addition, the case also invites attention to the role of globalization in the economic development of a small, well-defined area like Okinawa.

History

Okinawa was under the occupation of the United States of America until 1972 with Japan retaining "residual sovereignty" over it. This historical

precedent's obvious lesson is that Okinawa can be detached from Japan and placed under an entirely different governing system. Compared with this experience, "One Country, Two Regimes" limited to international trade is a rather tame concept with no constitutional impact.

In the late 1950s, the U.S. Civil Administration of the Ryukyus permitted a free trade zone (a tiny area less than 1.5 hectares near the sea port of Naha, Okinawa's capital). The basic characteristic of any FTZ is "free trade" in the sense that the zone is considered to be outside of the customs territory of the national economy at large: i.e., exemptions from tariffs, non-tariff barriers, and other protectionist trade regulations when goods move in and out of the zone without entering the customs territory. It is only when goods move from the FTZ to the customs area that they become dutiable.

The best year of the Occupation-era Okinawan FTZ was 1965, when the outgoing shipments from the FTZ (mostly, exports to the U.S. and other countries) amounted to \$4.5 million and incoming shipments (mostly, imports from Japan) \$3.8 million. The predominant activity within the FTZ was assembling of transistor radio sets. The out-shipments accounted for 5.3% of Okinawa's total exports, and the in-shipments 1.6% of total imports. To stylize, the Okinawa FTZ imported inputs and materials from Japan and exported processed goods to the United States. It was a kind of "export processing zone."

The occupation-era FTZ of Okinawa fizzled out after Okinawa's reversion to Japan in 1972. The Japanese government found an FTZ in Japan (of which Okinawa was now a part)

inconsistent with Japanese law and did not grant official recognition until 1987. In the 1980s, the intensified US-Japanese trade conflict apparently helped the revival of Okinawa's "free trade" zone. Japan was under tremendous pressure from the United States for trade liberalization. In 1992, Japan itself adopted a temporary measure to establish "free access zones" (FAZs) to encourage imports.

When it was reopened in 1987, the Okinawa FTZ added space and grew to 2.67 ha. This FTZ enjoyed its best years rather early, and has since been moribund. The number of firms on site decreased from the initial 27 to 11 in 1997. Even these remaining 11 firms are reportedly awash in red ink.

In 1989, in-shipments to the FTZ amounted to \$44.7 million (at \$1=120 Yen) and out-shipments \$45.2. In this year, the FTZ imported two-thirds of inputs and materials from abroad and shipped 96% of the output to ROJ (20%) and Okinawa (76%). The Okinawa FTZ looked like an "import processing zone."

By 1996, the activities in the FTZ had shrunk to a fraction of 1989. Imports from abroad had decreased to 36% of shipments received by the FTZ as against 64% from ROJ and Okinawa, while 100% of out-shipments went to ROJ (46%) and Okinawa (54%). "Foreign" trade was disappearing from the FTZ.

There are many reasons for the poor performance of the Okinawa FTZ. A major reason is the apparent hostility of the Japanese government toward the principles and practices of the FTZ. Even during the ante-reversion period, the Japanese government negotiated with the United States and obtained

restrictions on the tariff privileges of the Okinawa FTZ and the freedom of enterprise in it.

In the current FTZ, there is nothing new on top of the already existing system of bonded warehouses under the Japanese customs law. The usual tariff privileges that distinguish the FTZ from bonded warehouses are absent. In other words, the "free" trade zone, in Japan's Okinawa, is unfree.

New debate

In the 1990s, Okinawa Prefecture has been aggressively promoting an economic globalization policy. The perceived key to its success is the hosting of foreign enterprises in the prefecture.

Okinawa's geographical location is a disadvantage from Japanese perspectives: it is far away from Japan's all-important capital city, Tokyo. The catch in this, however, is that it may be an advantage if viewed differently: It is closer to Taiwan and the Chinese mainland than to Tokyo. Okinawa is also as close to Southeast Asia as to Northeastern Japan.

It takes only a little self-esteem on the part of Okinawans to see themselves located at the center of East and Southeast Asia. Okinawa Prefecture is betting on this new perception of locational advantage as a source of its future development.

The question then is how this "non-Japanese" geographical location may be tapped to Okinawa's advantage. In early 1997, the prefectural government appointed an advisory committee to explore ways of integrating Okinawa more closely with Asia. The committee was called "Industrial and Economic Promotion and Deregulation Review Committee."

The committee reported back and

recommended, among others, that the entire Okinawa Prefecture should become one FTZ, liberating the whole of Okinawa from Japan's "customs territory."

Taking an FTZ out of the "customs territory" is only a technical matter, but it can be misunderstood. As soon as Okinawa Prefecture floated the idea of a prefecture-wide FTZ, some people hastily and mistakenly interpreted it as Okinawa's separation from Japan. They likened it to the ante-reversion Okinawa under "alien" administration.

Some other people claimed that FTZ was a misnomer for a prefecture-wide regime of free trade. They insisted that an FTZ was a defined area where people worked but did not live. Since it would be absurd to evict Okinawans to make an FTZ out of the whole prefecture, these critics recommended that the proposed scheme should be called "free port" instead. (Successful examples of free ports where people live and work under free trade are Hong Kong and Singapore.)

The idea of an FTZ, regardless of scope, also ran into the opposition of vested interests that had grown up under Japanese protectionism, especially those tied to agriculture and fishery. They insisted on the continuation of protection against foreign competition. At most, they would tolerate an FTZ as a small stockaded area, although they would still object to "free" movements of the protected goods into or out of the FTZ.

The Japanese government was not amused either. In the first place, the very fact that a mere prefecture dared offer an independent international policy rubbed the officials of the central government on the wrong

side. They also fell into the same error of perception, as mentioned earlier, confusing "customs territory" and "national territory" and suspected Okinawa's desire to secede from Japan, or at least to replicate the Chinese invention, "One Country, Two Systems."

Attitudes toward this Chinese concept were not uniform, however. They ranged from favorable to hostile, depending upon how familiar individuals were with the history of Okinawa.

In this way, the concept of a prefecture-wide FTZ spawned a vigorous controversy in Okinawa and Japan. After many turns and twists, the prefectural government compromised: a few limited-area FTZs first and a full prefecture-wide FTZ in the future. When the latter should come about was also hotly debated.

The prefectural proposal was presented to the Japanese government, which turned it over to the National Institute of Research Advancement (NIRA) for an evaluation. NIRA's advice was eclectic, by and large supporting the prefectural proposal for a gradual extension of the FTZ to the entire prefecture.

In addition, NIRA recommended a number of incentives for encouraging the location of Japanese and foreign enterprises in certain designated areas of Okinawa. Most of the NIRA recommendations were adopted by the government and worked into the revision of the special measures law for Okinawa's economic development, passed in late March 1998.

The shape of the approved FTZs

Two kinds of FTZs are mentioned in the law; (1) special (new) FTZs to be created and (2) the existing one, to be expanded. In addition, the law creates airport

duty-free shops permitted to sell certain imports duty-free. Further, the law proposes a wide range of developmental projects supported by generous assistance and incentives.

The law specifies activities that may be undertaken in the FTZ: manufacturing, warehousing, and packing. The question of whether these activities are broad or elastic enough to cover all the activities that firms can undertake in the FTZ is the source of considerable apprehension. The question no doubt will be answered by ordinances, regulations, and other operating rules. But that is precisely the problem. These measures for the implementation of the law are formulated, handed down, and enforced by the state bureaucracy, which usually tends toward restrictions and rigidity.

Tax incentives are fairly clearly defined in the law. These include accelerated depreciation, tax breaks for investment, exemptions from local business and property taxes, and so on. Without changing the corporate tax rate, these measures bring down the effective tax burden from 37% to 22%.

In June 1998, the enforcement order of the Customs Law was revised to permit tariff options on raw materials or processed products. The revision also specified the goods that Okinawa's duty-free shops could, or could not, handle duty free.

Numerous products (mostly agricultural such as rice, sugar, beef etc.) are still subject to tariffs, quotas, and other restrictions, regardless of where they enter, the FTZ or the customs territory. This is clearly a victory of the agricultural interests. Food processing industry would therefore see little locational

advantage in the FTZ. The duty-free shops are allowed to sell duty-free all imports other than the articles currently privileged with the tourists' tax rebates, provided purchases per person do not exceed 20,000 Yen.

In March 1999, Okinawa Prefecture submitted an application to the Japanese government for the approval and designation of a part of the new Nakagusuku Bay Port (122 hectares) as a special FTZ. Five types of activity are envisaged: (1) food processing, (2) packing, (3) warehousing, (4) road transport/delivery services, and (5) wholesale business. Expected tenants should be large enough to employ 50 or more workers and capable of expansion in international markets. The prefecture hopes that by 2008, there will be about 90 firms employing about 6,000 workers and generating shipments worth about \$900 million.

To what extent the defects of the existing FTZ operations may be remedied by the new legal/administrative measures remains to be seen. The poor reputation of the existing FTZ which has been losing tenants is in the every-day details.

For example, suppose an FTZ firm for purposes of cost saving wants to use its own employees, equipment, and transportation to carry cargo directly from ships to its FTZ factory. The current regulations require that all work must be done by the workforce maintained by the customs office until the cargo is first hauled into the bonded warehouse for proper customs procedure. These work rules make the FTZ an "unfree zone" and a high-cost work site.

All this indicates that the Japanese government either has no clear notion of what an FTZ

should be or is unwilling to accept and encourage a properly understood type of FTZ in any part of Japan. (FAZs are also languishing throughout Japan mainly because the Customs Law stands in the way of "free" access.)

The basic problem is obviously the government's disinclination to accept free trade. This age-old problem is not likely to disappear any time soon. The fact that Okinawa is the only place in Japan where there has been an FTZ may also have prejudiced the central government officials. It may have been viewed as an "un-Japanese" legacy of the American occupation. Shortly after the reversion, in fact, the Japanese government wanted to abolish it, but stopped short of doing so due to Okinawa's strong resistance.

If even the miniscule FTZs had to be hamstrung in the manner mentioned above, prospects are certainly not too bright for Okinawa's eventual transition to a prefecture-wide FTZ. Okinawa as a Hong Kong of Japan evokes no favorable response from the Japanese leaders in Tokyo. They would not permit such an alien institution to invade one of Japan's 47 prefectures. The sovereignty and unity of the state should not be breached by an Okinawan exceptionalism.

Conclusion

Trade liberalization envisaging global free trade in the foreseeable future is the trend of the times. Okinawa's prefecture-wide FTZ, even if it came about instantly, would yield differential benefits to Okinawa only until Japan itself becomes a free trader, a nation-wide FTZ. Of course, the longer Japan holds out, the more benefits Okinawa will reap from going ahead for free trade.

But the policy makers in Tokyo

seem to resent local institutional innovations that require equally innovative responses from them. They tend to make a bogey of Okinawa's initiative and consider it damaging to the international reputation of Japan as a powerful, well-governed nation-state. FTZs in Okinawa, though a good idea that is consistent with global trends, are not welcome in Japan.

It is unfortunate that the economic value of Okinawa's geographical location has been overlooked by corporations and business persons of Japan, Asia and the world at large. It is doubly unfortunate that there has grown up a special interest group who alone values Okinawa's location; i.e., military strategists of the United States and Japan. To the question "why Okinawa?" their stock answer is "location, location, location!" It is too bad that this military view of Okinawa's locational value is not widely shared by business strategists of the world.

References

For research on Okinawa's FTZ issues, one might begin with the section on "the Ryukyu Islands" in the exhaustive files on the "Tax-Free Trade Zones of the World" written, maintained and constantly updated by Walter H. Diamond and Dorothy B. Diamond (Matthew Bendier & Co., Inc.)

On Okinawa's FTZ experience with an institutional and quantitative emphasis, see The Bank of the Ryukyus Research Department, Sengo Okinawa keizaishi (Postwar Okinawan Economic History) (Naha, 1984). The author/editor-in-chief of this monumental monograph (1,347 pp.) was MAKINO Hirotaka, who has just been appointed vice-governor

by the newly elected Governor INAMINE Keiichi.

On recent experience, see OSHIRO Hajime, "Institutional Characters of Tariffs and Free Trade Zone" (Japanese text), Ryukyu University Economic Review, No. 55 (March 1998).

On the "pro" side of the controversy over the prefecture-wide FTZ proposal for Okinawa, there are several sophisticated books:

HIRANO, Okinawa zenken FTZ no chōsen (The Challenge of Okinawa's Prefecture-wide FTZ) (Tokyo: Dōbun Shoin International, 1998).

MIYAGI, Hiroiwa. Okinawa jiyū bōeki ron (Free Trade for Okinawa) (Naha: Ryukyu Shuppansha, 1998).

OTANI, Raymond Yoshiteru. Nihon no kaikaku wa Okinawa kara (Japanese Innovations Start from Okinawa) (Tokyo: World FTZ Association Japan Bureau, 1996).

TAIRA, Asao. Nihon no ikkoku niseido (Japan's One Country with Two Systems) (Tokyo: Hon-no-izumi-sha, 1998).

On the "con" side, one outstanding work has come to our attention:

KURIMA, Yasuo. Okinawa keizai no gensō to genjitsu (The Illusion and Reality of the Okinawan Economy) (Tokyo: Nihon Hyōronsha, 1998). Fifty-six references appended to this book are a helpful survey of the state of knowledge on this topic.

There are also many critics of free trade. They are worried about a pervasive lack of competitiveness on the part of Okinawa's industries and business persons. These pessimists include Vice-Governor Makino, who earlier wrote a strong critique of the previous administration's internationalization projects: Saikō Okinawa keizai (Okinawan Economy Reconsidered) (Naha:

Okinawa Times-sha, 1996).

Two more high-profile scholars may be added on the "con" side: MAESHIRO Morisada of the University of the Ryukyus and TOMIKAWA Moritake of the Okinawa International University. They are prolific writers whose articles and essays have appeared in a variety of periodicals, journals, newspapers, etc.

A curious impression from the institutional affiliations of the scholars prominent in the debate on the FTZ is that free traders are with Okinawa University, while protectionists are with the Okinawa International University!

Publications (XXIX)

We gratefully acknowledge the gifts of the following publications:

Harrison, Selig S. and Clyde V. Prestowitz, Jr., eds. 1998. Asia After the Miracle. Washington, D.C.: The Economic Strategy Institute. 349 pp.

Subtitled "Redefining U.S. Economic and Security Priorities," this book makes recommendations some of which are directly relevant to Okinawa where there is a large concentration of U.S. military presence. For example, "Instead of waiting for some future Japanese government to ask for the departure of U.S. forces, the United States should declare its readiness to turn over all of its bases and facilities to the Japanese Self Defense Forces within an agreed period, such as five years, and to withdraw all American combat forces from these bases, including bases in Okinawa" (p. 63).

Murphy, Patrick D. 1998.

"Introduction to Three Okinawan Poets," Organization & Environment, Vol. 11 No. 3 (September): 3363-370.

Translates and comments on three poems by three different Okinawans expressing memories and sensibilities about nature, spirit, death, poverty, hunger, thirst, etc. in the settings of wartime and postwar Okinawa. The poets are MAKIMINATO Tokuzo, KAWAMITSU Shinichi, and YONAHA Mikio.

Shimabukuro, Jun. Seiō shokoku oyobi Nihon ni okeru riijonarizumu (Regionalism in Western European Nations and Japan). Okinawa: Kinjo Insatsu, 1997. ii, 236 pp.

A doctoral dissertation in political science submitted to Waseda University in 1996. Reviews theories and practices of regionalism in Western Europe, offers detailed case studies of the United Kingdom and Spain, and examines regionalism in Japan in light of conclusions from European regionalism. Considerable attention is paid to Okinawa's ethnic regionalism as a force making Japanese regionalism look a bit more like European than otherwise would have been.

Kudos

Professor Naoshi Koriyama's poem, "Song of the Tiger," is translated and published in the monthly Korean journal, Literary Movement and Trends. World Poetry (W.W. Norton), an anthology of poems, includes translations of three Japanese poems by Naoshi Koriyama and Edward Lueders.

Let's have fun:

Suppose the Department of Asian Studies of your university adds a course on Ryukyuan/Okinawan studies to its curriculum and asks you to teach it. You gladly accept the offer and develop a syllabus. **The Ryukyuanist** would like to collect as many syllabi

as possible. In appreciation, we will award the best three with recognition and pecuniary prizes. A committee of referees will be organized as soon as submissions reach five. Please send in your syllabus to the desk.

For inquiry on the syllabi contest and other matters, contact: Koji Taira, Institute of Labor and Industrial Relations, University of Illinois, 504 E. Armory Ave., IL 61820. Tel.: (217)333-1483. FAX: (217)244-4091. E-mail: <k-taira@uiuc.edu>.