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### CURRENT ACCOUNT FLOWS BETWEEN THE EUROPEAN UNION AND JAPAN: 1982-1991

The main feature of trade relations between the European Union and Japan is a substantial deficit on merchandise. The Union's best results are for trade in services, where it has a surplus on Transport, Tourism, which grew strongly in the second half of the period under review, and Other Services, which account for the bulk of the surplus on Services. It also had a surplus throughout the period on investment Income and unrequited Transfers. Although its structural surpluses on Services and investment Income are likely to lead to an appreciable improvement in its overall current account balance with Japan, they are still not large enough to offset the substantial deficits on merchandise. In 1991, the EU's Merchandise deficit with Japan accounted on its own for more than three-fifths of that recorded with the rest of the world. Throughout the period 1982-1991, the main reason for the EU's persistent current account deficits with Japan was therefore the worsening of its deficits on Merchandise. In order to provide a better picture of the various aspects of these flows, this document will deal in turn with the following: the Total current account Balance, Merchandise, Services (Tourism, Transport, Other Services), investment Income, unrequited Transfers, and the other current account items (labour Income and government Transactions).

#### PERSISTENCE OF THE EUROPEAN UNION'S CURRENT ACCOUNT DEFICITS WITH JAPAN

Current account flows between the EU and Japan expanded steadily throughout the 1980s. Between 1982 and 1991, current account credits with Japan more than trebled from ECU 17 billion to 59 billion, i.e. from 7 to 15<sup>0</sup>/00 of the EU's GDP. Over the same period, current account debits almost trebled from ECU 27 billion to 77 billion, i.e. from 10 to 16<sup>0</sup>/00 of the EU's GDP.

The volume of current account flows between the EU and Japan is not as substantial as that between the EU and the USA, but relations between the EU and Japan were much more dynamic between 1982 and 1991. It should be noted, however, that the USA is still by far the EU's leading trading partner. For

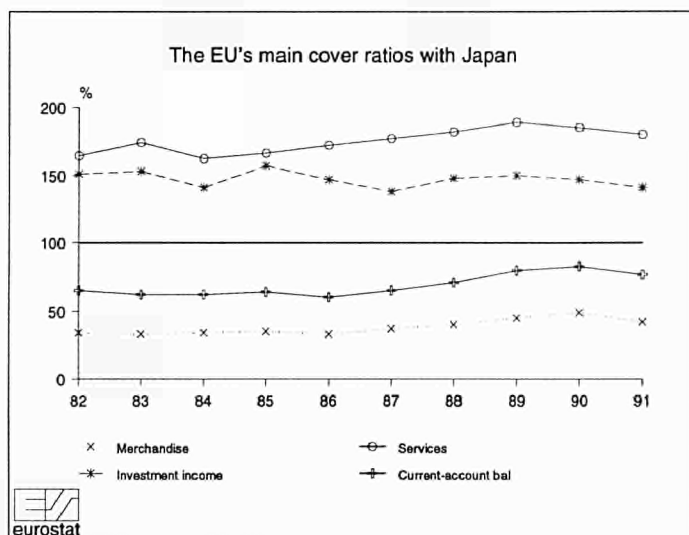
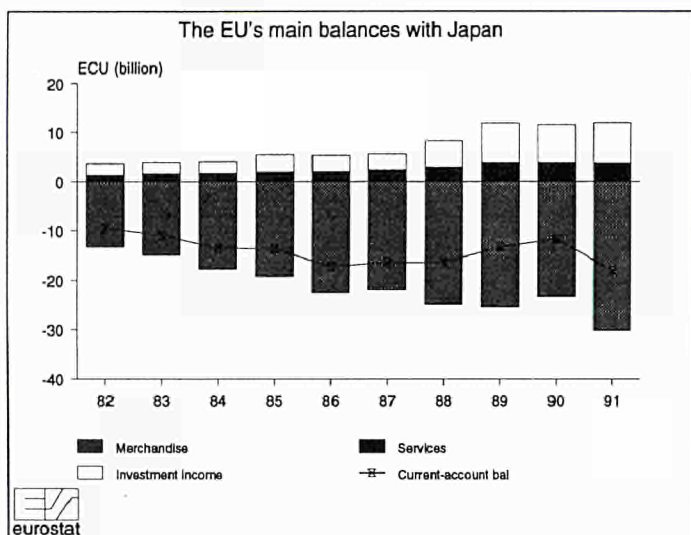
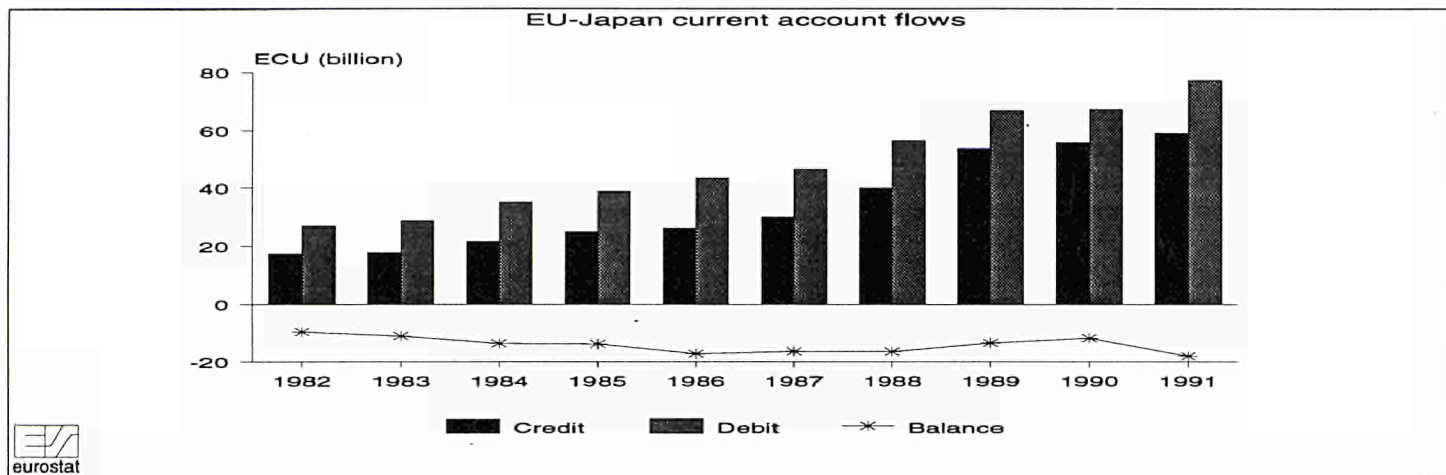
example, in 1991 the Union's current account credits with Japan represented 15<sup>0</sup>/00 of the EU's GDP, whereas the figure for the USA was more than double (36<sup>0</sup>/00). Similarly, the respective current account debits were 16<sup>0</sup>/00 with Japan and 40<sup>0</sup>/00 with the USA, i.e. almost treble.

In 1986 the European Union had a very substantial current account deficit of ECU 17 billion (i.e. 5<sup>0</sup>/00 of its GDP) on its trade with Japan, accounting for over a third of its total deficit with the rest of the world (ECU 38 billion). The following year saw the beginning of a break in the steady worsening of its current account balance with Japan, leading to an improvement which was confirmed each year until 1990.



This improvement was due to an appreciable increase in Japan's current account imports, an improvement in the Merchandise cover ratio from 33% in 1986 to 42% in 1991, and the European Union's good performance throughout this period in the areas of Services and investment Income, the annual cover ratios for which were generally in excess of 150%.

In 1991 the EU had a record current account deficit with Japan, amounting to ECU 18 billion or more than a third of its deficit with the rest of the world (ECU 59 billion). This was mainly due to a serious deterioration of its merchandise balance, which went from ECU 23 billion to 30 billion between 1990 and 1991 as a result of a downturn in exports and a sharp increase in imports.

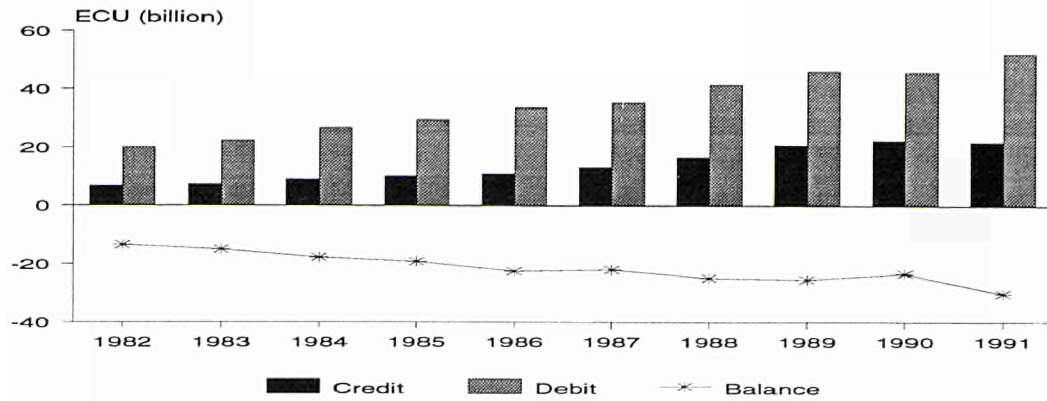


## WORSENING OF THE EU'S DEFICIT ON MERCHANDISE TRADE WITH JAPAN

Between 1982 and 1991 the European Union had a persistent and increasingly large deficit on its merchandise trade with Japan. On average, its exports covered only two-fifths of its merchandise imports from Japan. This persistent deficit was the result of a sustained increase in imports between 1982 and 1991. It was only from 1986 onwards that there was a significant rise in the EU's exports, leading to an appreciable improvement in its cover ratio from 33% to 49% in 1990.

The Plaza agreements, which led to a substantial appreciation of the yen against the dollar and to a lesser extent against the European currencies, are one of the possible explanations for this increase in the EU's exports to Japan. The trade balance worsened in 1991 as a result of a downturn in merchandise exports, whereas imports rose sharply. It stood at around ECU 30 billion, compared with only 23 billion in 1990.

### Merchandise



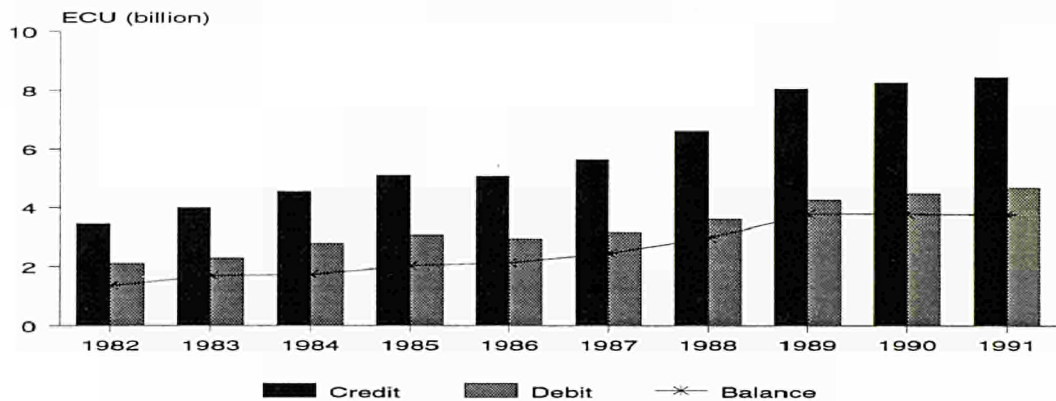
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## THE EUROPEAN UNION'S BEST RESULTS ARE FOR TRADE IN SERVICES

Trade in services is the European Union's main trump card in its relations with Japan. It achieved large surpluses on all the main Services items between 1982 and 1991. However, these surpluses were nowhere near

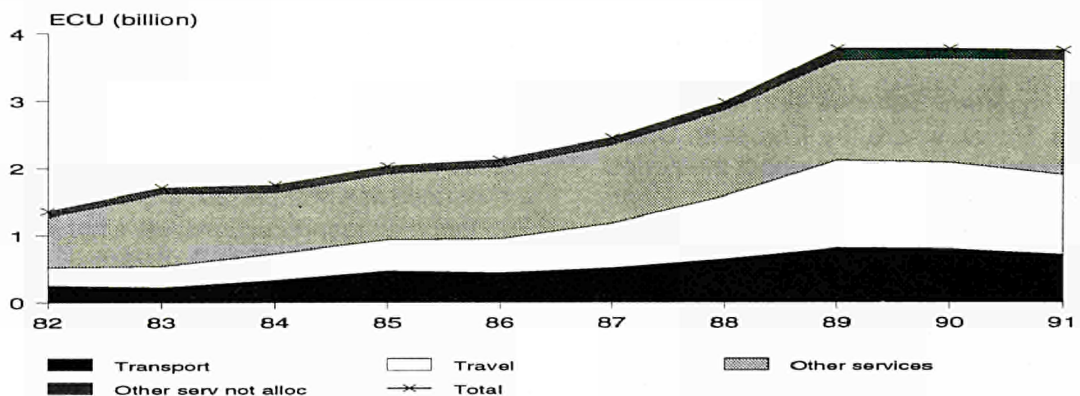
enough to offset the enormous deficits on merchandise trade. Its overall surplus trebled between 1982 and 1991 from just over ECU 1 billion to more than ECU 3 billion.

### Services



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### Breakdown of the services surplus



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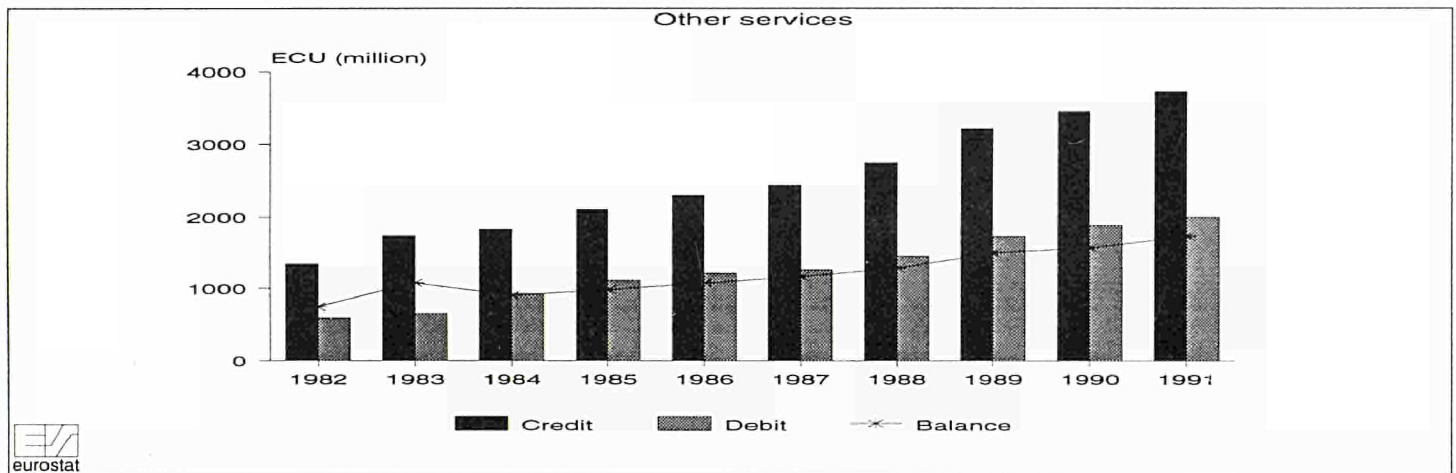
## The bulk of the Union's surplus with Japan is generated by other services

The item Other Services is a very important one, since it comprises all trade in services other than Tourism and Transport and covers such highly varied sectors as trade earnings, insurance, banking activities, business services, construction, communication, and property income. On average throughout the period, the EU exported twice what it received from Japan in respect of Other Services. Its average cover ratio was around 200%, but this conceals a slight downward trend at the end of the period.

Trade Earnings make the greatest contribution to the volume of flows of Other Services. They comprise all commissions linked to merchandise trade and international merchanting. The high level is therefore correlated to that of merchandise, which represents the biggest component of current account flows between the EU and Japan. The Union's surplus is due largely to the scale of financing of commissions linked to imports from Japan.

Banking activities cover the commissions received for the management of accounts and the other transactions conducted by banks and financial institutions. Interest is not included but is classified in investment income. The United Kingdom alone generates almost half of the surpluses, thanks to the dynamism of its banking network. The establishment of branches of Japanese banks in the Union and the relative importance of international bond issues, together with the net outflows of portfolio investment, have led to an increase in receipts and commissions and account to a great extent for the EU's surpluses with Japan in respect of banking activities.

Business services comprise all technical, computer and professional services, and constitute an important source of income from trade in Other Services between the EU and Japan.



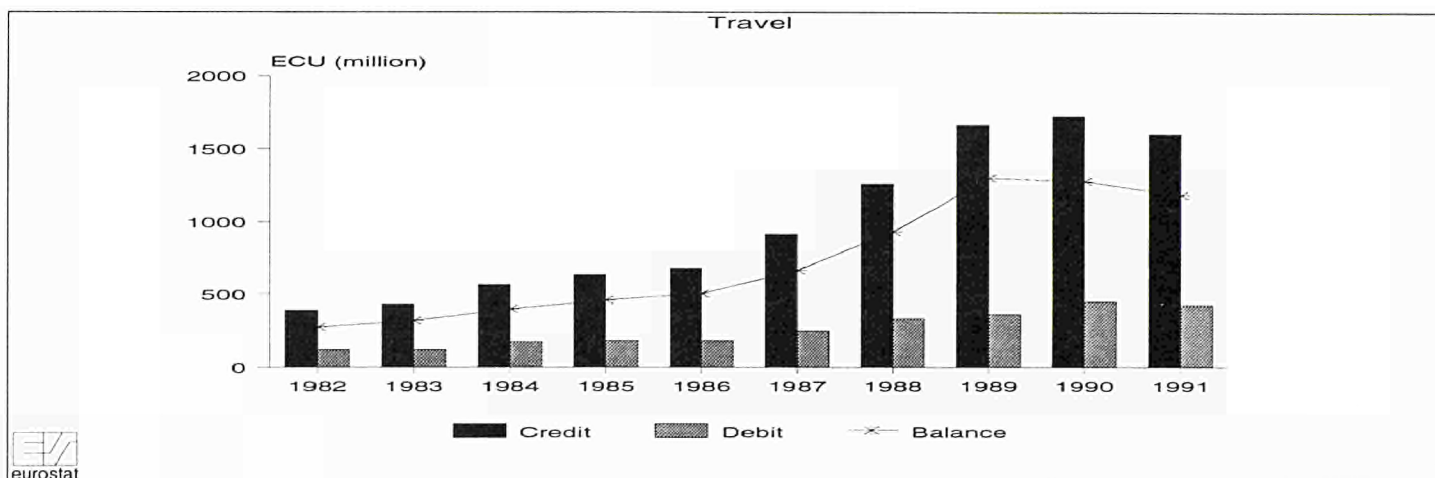
## Strong growth in Japanese tourism to the EU in the second half of the 1980s

The second most important Services item is Tourism, also referred to as Travel, where the European Union recorded excellent performances throughout the period from 1982 to 1991. It quadrupled its surplus with Japan from ECU 0.27 billion to over 1 billion. The EU has in fact become a prime destination for Japanese tourists, leading to high cover ratios of between 300 and 400%. This item made a substantial contribution to the sharp increase in the overall balance of its trade in services with Japan between 1986 and 1991. The appreciation of

the yen from September 1985 onwards doubtless stimulated the rapid growth of Japanese tourism to the EU, thanks to the resultant lowering of transport costs and the induced rise in Japanese tourists' purchasing power. The fact that cost reductions were not passed on to the Japanese domestic market gave rise to a shift in the consumption of certain imported goods, especially luxury goods which had become much less expensive abroad, and hence to an increase in Japan's tourism expenditure.

In addition to this purely monetary and financial factor, there was an appreciable improvement in the quality of tourist facilities in the Union, the special efforts made by France being an outstanding example. The EU's substantial surplus was confirmed in 1991, although

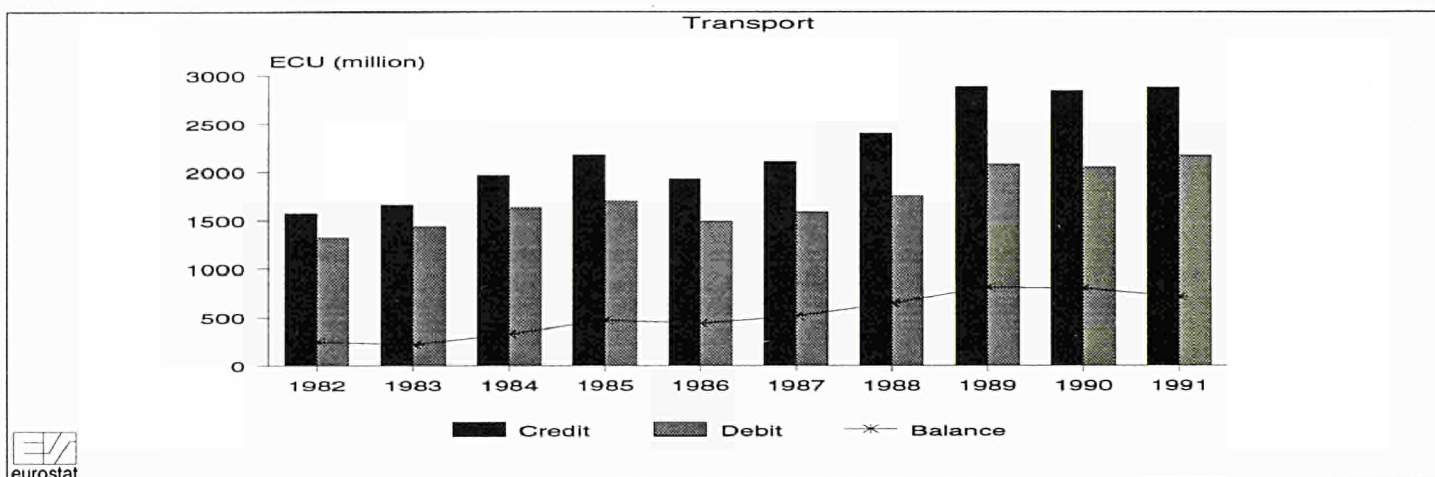
there was a slight downturn which might have been partly attributable to the bursting of the speculative bubble. The abrupt decline in the nominal wealth held by Japanese families probably had a knock-on effect on foreign travel, particularly to the EU.



### Good performance by the EU in transport

The third most important Services item is Transport, where the European Union still had a surplus with Japan between 1982 and 1991. Its balance rose from ECU 0.2 billion in 1982 to almost ECU 1 billion in 1990. There was a slight slump to ECU 0.7 billion in 1991, connected with

the pattern observed in merchandise trade for both credits and debits. Between 1982 and 1991 the Union recorded cover ratios ranging from 115 to 139% but had relatively lower surpluses than those for the other services items.



### INVESTMENT INCOME: THE EUROPEAN UNION'S STRUCTURAL SURPLUS WITH JAPAN

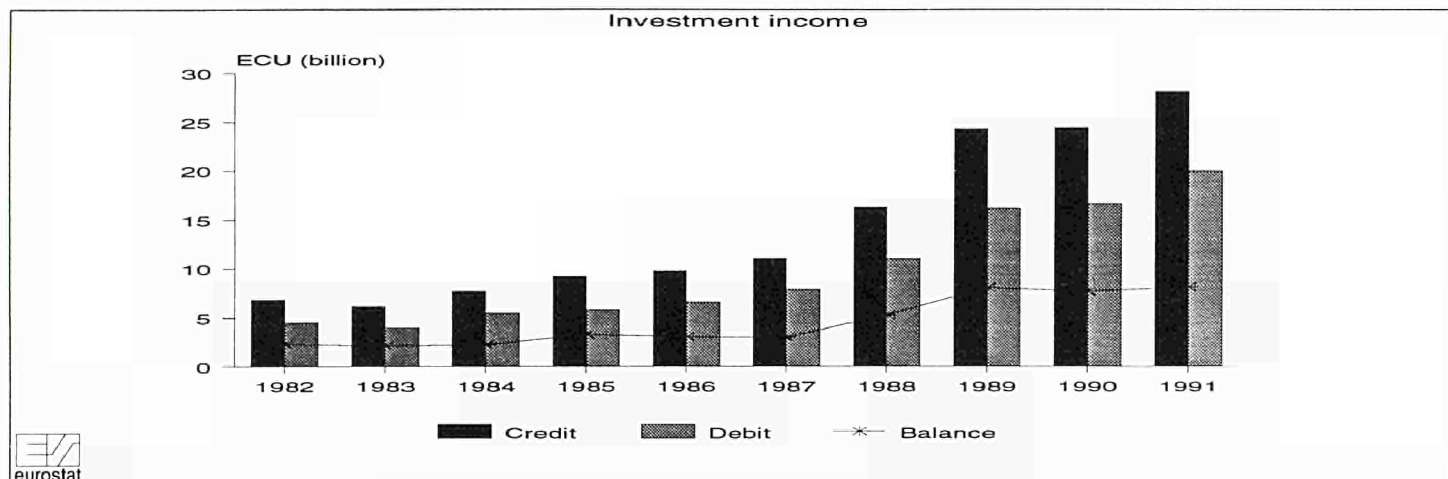
This item includes interest on loans and dividends on direct and portfolio investment. The European Union's investment income earned in Japan increased fourfold between 1982 and 1991, whereas the opposite flow increased to a much lesser extent. The EU's credits amounted to ECU 7 billion in 1982 and rose to ECU 28 billion in 1991. It should be noted that the surplus on investment income was achieved almost entirely by the

United Kingdom. For example, in 1991 the UK's credits on Japan in respect of investment income amounted to ECU 14 billion, i.e. almost 50% of the EU's credits. These results are connected with the activity of many Japanese banks established in Europe, especially in London. A large proportion of the Union's surplus is probably due to interest on short-term loans granted to Japan by these banks.



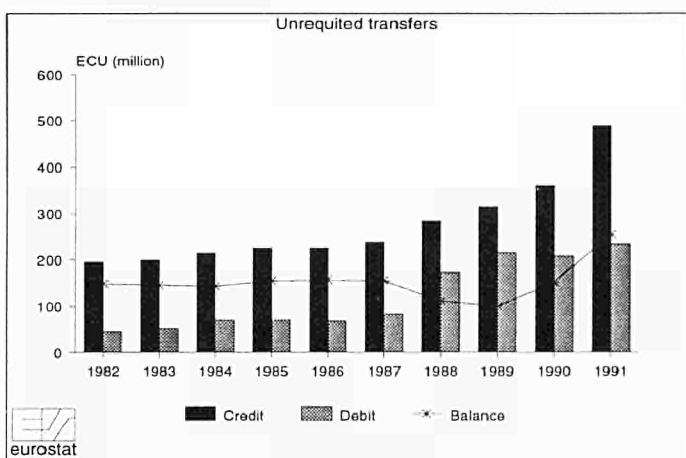
However, reinvested earnings are not included in investment income, since there is no relevant information in either the Japanese or the European source. Given the

scale of Japan's direct investment in the European Union, the latter's surplus on investment income would have been largely offset if it had been taken into account.



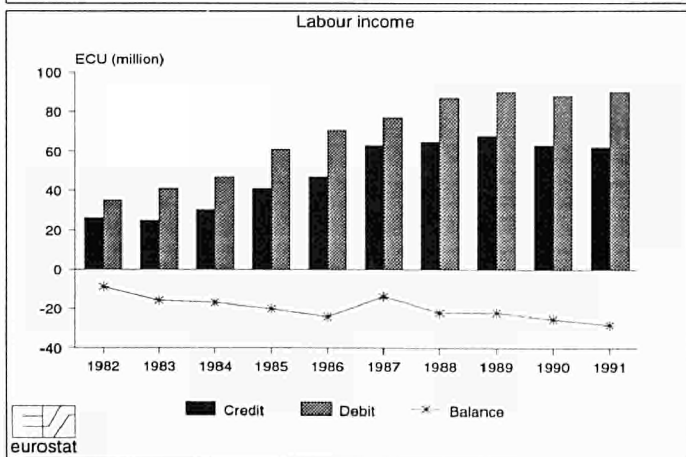
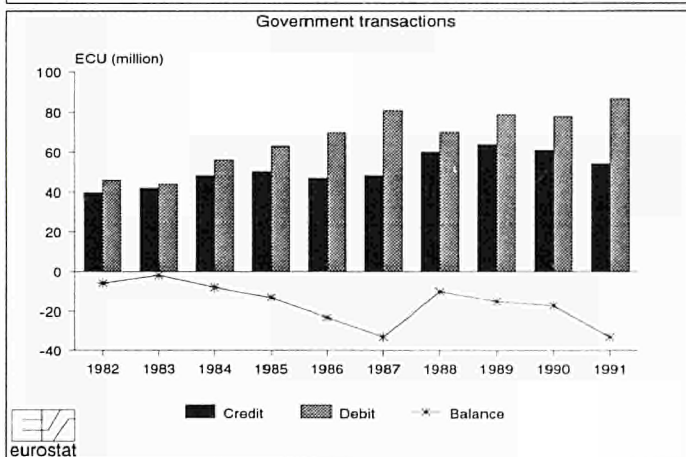
## THE EUROPEAN UNION'S STRUCTURAL SURPLUS ON UNREQUITTED TRANSFERS

By definition, this item comprises all unrequited transfers, whether of private (remittances by immigrant workers to their country of origin etc.) or public origin (contributions to international organizations, gifts, payment of pensions, etc.). The EU has a structural surplus with Japan in respect of unrequited Transfers (averaging around ECU 150 million). Between 1982 and 1991 the EU's unrequited transfers to Japan amounted on average to only a third of the flow in the opposite direction. The sharp increase in the balance in 1991 was due to the fact that Japan made a large transfer to the EU as its contribution to the financing of the Gulf War.



## COMMENTS ON THE OTHER CURRENT ACCOUNT ITEMS

Between 1982 and 1991 the EU had a deficit on its flows with Japan in respect of both labour income and government Transactions (current Transactions linked to embassies, consulates and official bodies abroad). However, these items involved relatively small amounts which made an insignificant contribution to the worsening of the current account deficit. The average deficit was less than ECU 20 million for labour income and around ECU 15 million for government Transactions.



# EU-JAPAN CURRENT-ACCOUNT FLOWS

ECU million

ITEM	*	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
MERCHANDISE	C	6854	7427	9135	10318	11072	13135	16583	20806	22473	21819
	D	20204	22374	26865	29578	33620	35118	41423	46212	45870	52064
	B	-13350	-14947	-17730	-19260	-22548	-21983	-24840	-25406	-23397	-30245
SERVICES	C	3465	3994	4546	5115	5083	5632	6616	8050	8270	8453
	D	2107	2289	2801	3086	2958	3179	3630	4263	4482	4686
	B	1358	1705	1745	2029	2125	2453	2986	3787	3788	3767
Transport	C	1574	1664	1966	2176	1933	2105	2405	2890	2847	2884
	D	1325	1443	1635	1703	1492	1589	1755	2075	2044	2167
	B	249	221	331	473	441	516	650	815	803	717
Travel	C	391	434	567	639	681	913	1262	1665	1729	1603
	D	118	116	169	179	178	247	332	363	449	422
	B	273	318	398	460	503	666	930	1302	1280	1181
Other services	C	1347	1735	1830	2100	2292	2434	2741	3219	3443	3724
	D	596	658	928	1118	1216	1266	1454	1725	1882	1999
	B	751	1077	902	982	1076	1168	1287	1494	1561	1725
Other goods and services not allocated	C	153	161	183	200	177	180	208	276	251	242
	D	68	72	69	86	72	77	89	100	107	98
	B	85	89	114	114	105	103	119	176	144	144
INVESTMENT INCOME	C	6881	6212	7798	9200	9753	11011	16317	24355	24467	28208
	D	4546	4058	5536	5856	6643	7977	11015	16204	16694	19990
	B	2335	2154	2262	3344	3110	3034	5302	8151	7773	8218
LABOUR INCOME	C	26	25	30	41	47	63	65	68	63	62
	D	35	41	47	61	71	77	87	90	88	90
	B	-9	-16	-17	-20	-24	-14	-22	-22	-25	-28
GOVT TRANSACT	C	40	42	48	50	47	48	60	64	61	54
	D	46	44	56	63	70	81	70	79	78	87
	B	-6	-2	-8	-13	-23	-33	-10	-15	-17	-33
UNREQUITED TRANSF	C	195	199	214	225	225	238	284	315	360	488
	D	46	53	70	70	68	83	173	215	208	234
	B	149	146	144	155	157	155	111	100	152	254
CURRENT ACCOUNT BAL	C	17461	17899	21771	24949	26227	30127	39925	53658	55694	59084
	D	26984	28859	35375	38714	43430	46515	56398	67063	67420	77151
	B	-9523	-10960	-13604	-13765	-17203	-16388	-16473	-13405	-11726	-18067

\* C: Credits, D: Debits, B: Balances

## BILATERAL COVER RATIOS FOR EU → JAPAN CURRENT-ACCOUNT FLOWS

ITEM	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
MERCHANDISE	34	33	34	35	33	37	40	45	49	42
SERVICES	164	174	162	166	172	177	182	189	185	180
Transport	119	115	120	128	130	132	137	139	139	133
Travel	331	374	336	357	383	370	380	459	385	380
Other services	226	264	197	188	188	192	189	187	183	186
Other G and S not allocated	225	224	265	233	246	234	234	276	235	247
INVESTMENT INCOME	151	153	141	157	147	138	148	150	147	141
LABOUR INCOME	74	61	64	67	66	82	75	76	72	69
GOVT TRANSACT	87	95	86	79	67	59	86	81	78	62
UNREQUITED TRANSF	424	375	306	321	331	287	164	147	173	209
CURRENT ACCOUNT BAL	65	62	62	64	60	65	71	80	83	77



**EU -> WORLD CURRENT-ACCOUNT FLOWS\***  
ECU million

ITEM	**	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
MERCHANDISE	C	277411	293477	343207	372767	337100	331052	350856	397612	408159	401967
	D	298929	308607	357653	374093	307400	316359	351994	412246	426089	448495
	B	-21518	-15130	-14446	-1326	29700	14693	-1138	-14634	-17930	-46528
SERVICES	C	93510	98076	110591	120266	109857	109220	117596	135453	145792	149929
	D	79256	82062	91928	97379	91023	94905	104528	121836	135073	139329
	B	14254	16014	18663	22887	18834	14315	13068	13617	10719	10600
Transport	C	31990	32186	36706	39140	33940	34770	40016	46163	46689	48841
	D	31209	32504	36581	37664	32559	34294	37177	43789	44868	46187
	B	781	-318	125	1476	1381	476	2839	2374	1821	2654
Travel	C	18997	22578	26612	30572	28123	28335	30039	34145	36616	35372
	D	16130	16327	17795	19300	20898	23196	25883	28585	32709	32040
	B	2867	6251	8817	11272	7225	5139	4156	5560	3907	3332
Other services	C	40132	40784	44286	47400	44989	43324	43996	51308	58645	62021
	D	31202	32547	36800	39636	36920	36740	40450	48314	56356	60010
	B	8930	8237	7486	7764	8069	6584	3546	2994	2289	2011
Other goods and services not allocated	C	2391	2528	2987	3154	2805	2791	3545	3837	3842	3695
	D	715	684	752	779	646	675	1018	1148	1140	1092
	B	1676	1844	2235	2375	2159	2116	2527	2689	2702	2603
INVESTMENT INCOME	C	102510	93657	110488	116100	98039	94160	112516	147864	155343	167575
	D	113538	102354	118673	127007	103835	99901	119702	144386	165199	176532
	B	-11028	-8697	-8185	-10907	-5796	-5741	-7186	3478	-9856	-8957
LABOUR INCOME	C	3411	3402	3549	3968	4095	4552	5010	5058	5196	5094
	D	2647	2799	3166	3499	3423	3279	3833	4199	4312	4127
	B	764	603	383	469	672	1273	1177	859	884	967
GOVT TRANSACT	C	8080	9219	10446	11716	11344	11918	11678	12224	12261	12849
	D	4169	3897	3880	4179	3842	3887	4331	4423	4747	4760
	B	3911	5322	6566	7537	7502	8031	7347	7801	7514	8089
UNREQUITED TRANSF	C	10367	10888	12578	13939	13657	12567	14693	15814	17493	21974
	D	19440	19820	22940	24300	26114	24774	28274	30804	34981	43993
	B	-9073	-8932	-10362	-10361	-12457	-12207	-13581	-14990	-17488	-22019
CURRENT ACCOUNT BAL	C	495289	508719	590859	638756	574092	563469	612349	714025	744244	759388
	D	517979	519539	598240	630457	535637	543105	612662	717894	770401	817236
	B	-22690	-10820	-7381	8299	38455	20364	-313	-3869	-26157	-57848

\* Rest of the world, excluding intra-EU flows

\*\* C: Credits, D: Debits, B: Balances

**EU CURRENT-ACCOUNT FLOWS/GDP**  
Declarant: EU

Per thousand											
PARTNER	*	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
JAPAN	C	7	6	7	8	7	8	10	12	13	15
	D	10	10	11	12	12	13	14	15	15	16
	B	-3	-4	-4	-4	-5	-4	-4	-3	-2	-1
USA	C	43	44	51	54	44	41	40	41	39	36
	D	46	44	46	46	36	34	37	40	40	40
	B	-3	0	5	8	9	7	3	1	-1	-4

\* C: Credits, D: Debits, B: Balances

**JAPAN CURRENT-ACCOUNT FLOWS/GDP**  
Declarant: Japan

Per thousand											
PARTNER	*	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
EU	C	24	22	22	22	22	22	23	26	30	29
	D	16	14	14	14	13	15	16	21	26	27
	B	8	8	8	8	8	8	7	5	4	2
USA	C	46	47	59	60	50	46	44	49	49	44
	D	33	31	32	29	23	23	26	33	36	32
	B	13	16	28	31	27	24	18	17	13	12

\* C: Credits, D: Debits, B: Balances