

## Strategy Bulletin Vol.185

## The significance of UK premier May's epoch-making visit to Japan - Britain seeks a new wave of globalization

### (1) Prime Minister May pursues new international coordination

#### Japan's importance clearly stressed

At the end of August, British prime minister suddenly visited Japan, and with Prime Minister Abe made a joint communiqué stressing security guarantees and economic cooperation. This was just after North Korea fired a missile over Japanese territory, and both premiers simultaneously released a statement condemning the North. Ms. May's first visit to Asia after becoming prime minister was to Japan, not China. This contrasts markedly with the record of German chancellor Merkel, who over the past decade has visited China nearly every year and who for reasons of convenience has visited Japan only twice: the Hokkaido Toyako G-8 Summit in 2007 and the Munich Summit preparatory meeting in 2015.

This is likely because a post-Brexit Britain recognizes the substantial strategic importance of Japan. In the economic realm, about 1,000 Japanese companies have advanced into the UK, and employed 160,000 persons. After its departure from the EU, it is extremely important that Japanese companies remain in Britain. And conclusion of the Economic Partnership Agreement (EPA) with Japan will become the axis for Britain's post-Brexit world strategy.

#### Exit from the EU produces major benefits

The result of the referendum on leaving the EU was unexpected. World leaders like the IMF and President Obama had recommended staying, and with departure negotiations with the EU expected to be difficult, they had the impression that the "erroneous Brexit choice will mean a steady decline for Britain." But this was wrong. Premier May has no intention of returning her country to the EU orbit, and has begun to think about its post-EU world strategy. As noted in detail below, Britain has the world's most liberalized and globalized economy, is furthest away from protectionism and isolationism, and cannot do without globalism. It is preferable to understand that the choice is gravitating away from EU-linked globalism toward free globalism. For Britain, departure from the EU has the advantages of freedom from the domination of Germany and the huge influence of the bureaucrats in Brussels not elected in the election.

#### Stress on security

Ms. May's Japan visit was notable for its stress on security guarantees. During her stay, she visited the Maritime Self Defense Force base in Yokosuka and boarded the destroyer *Izumo*. She also attended a special meeting of the National Security Council, hosted by Prime Minister Abe. In a joint communiqué she announced reinforcement of England's contribution to the Asia-Pacific region, in the form of dispatch to Asia of a British aircraft carrier and to the South China Sea of the new aircraft carrier *Queen Elizabeth* when it begins operations in 2020, making clear the intent to restrain China's maritime advances there and elsewhere.

#### Will this become the germ of international cooperation to protect liberal democracy?

With their dedication to the rule of law, freedom and democracy, human rights and the like, Japan and England share the values of liberal democracy. Both are maritime countries that support freedom of navigation. Under the Trump administration the U.S.'s international presence has temporarily declined, so Japan-Britain cooperation has great significance. Together with the U.S., Britain is a mother country of the centrality of globalization, capitalism, the market economy and democracy, as well as business protocols related to the English

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language and legal systems. Both are the core of the world order. England is the nucleus of the British Commonwealth, incorporating multiple international relationships. Mobilizing this historical legacy looks to create a new wave of globalization, of which Ms. May's Japan visit is believed to be the start.

If a world strategic axis can be determined for the Trump administration, there may become visible a postwar international linkage of the U.S., Japan and Britain to advance liberal democracy. The British prime minister's Japan visit may come to have historical significance in building resistance to efforts by China, Russia and others who propose to rewrite the international order.

## (2) Brexit has a full economic justification

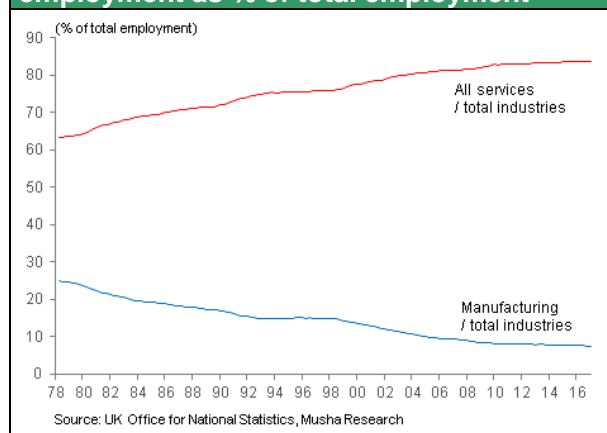
On June 27, just after the June 23 referendum in the UK, our Strategy Bulletin No. 164 titled, "A key turning point – Will eliminating Brexit uncertainty cause stocks to rebound?" conducted the following analysis, which we still believe is accurate.

### Britain has the world's most liberalized economy

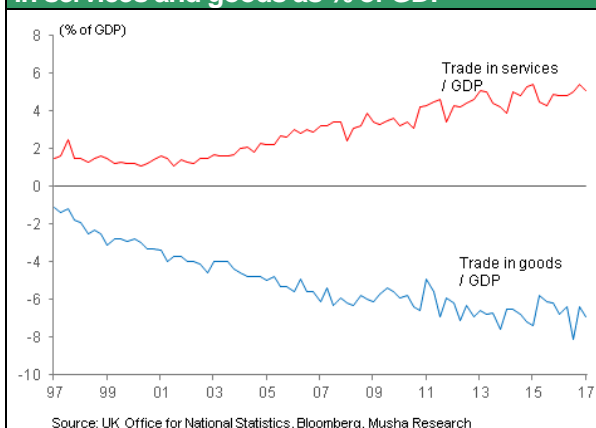
Brexit will create more problems for the EU than for Britain. There are several key characteristics of the British economy.

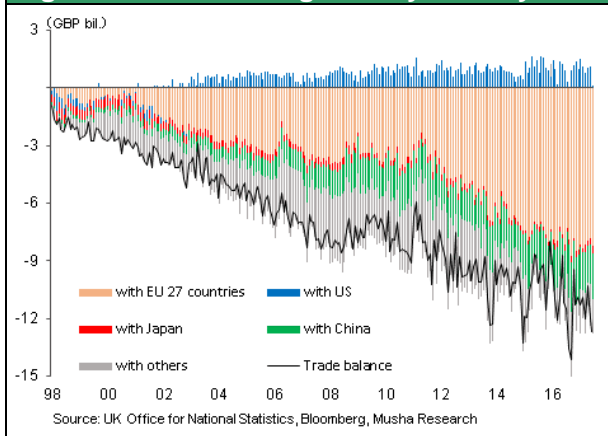
1. No other country has an economy that has gone farther with the switch to services while downsizing the industrial sector. Britain accounts for less than 3% of the world's merchandise exports but ranks second after the United States in service exports with a 7% share. Manufacturing is 8% of all jobs, the lowest among developed countries, and bank assets are 800% of the GDP, the highest in the world by far.
2. No other country has an economy that is more open. Direct foreign investments in Britain are 70% of GDP, the highest in the world. This ratio is only 42% in Germany, 28% in the United States and 16% in Japan. Furthermore, foreigners own 54% of listed stocks in Britain, again the highest in the world.
3. Britain has an international payment balance structure in which service exports and huge direct investments from other countries cover the country's massive trade deficit. Britain has a very large EU trade deficit. However, this deficit is offset by services provided to members of the Commonwealth of Nations (formerly the British Commonwealth) and income received from these countries.

**Figure 1: UK all services and manufacturing employment as % of total employment**



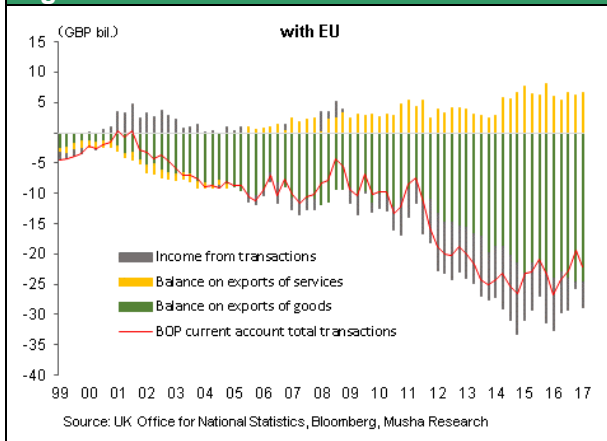
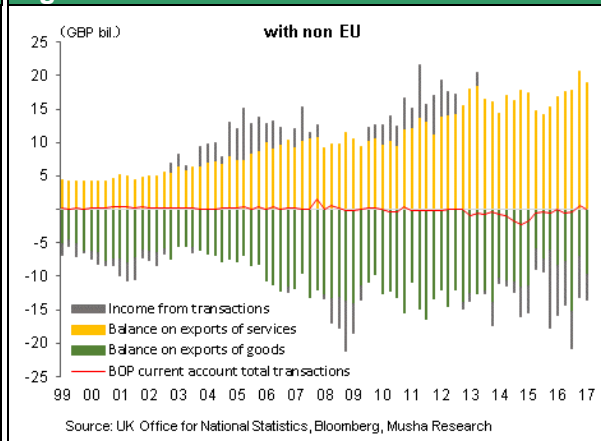
**Figure 2: UK current account balance on trade in services and goods as % of GDP**



**Figure 3: UK trade in goods by country**

To summarize, Britain is the EU's second-largest export market after the United States and has an enormous EU trade deficit. But Britain is the European base for many Japanese and US companies and financial institutions. So Britain benefits by receiving income from EU investments. As a result, Britain and the EU are dependent on each other. Brexit and the accompanying weakness of the pound will significantly reduce Britain's EU trade deficit. However, there will be a drop in EU-related investments in Britain. Moreover, Brexit will weaken Britain's competitive edge as a center for international finance. So there are advantages and disadvantages for Britain.

A comparison of these advantages and disadvantages shows that the advantages are likely to be much greater. EU membership is not a major reason for the appeal of Britain concerning international finance and international service industries. Companies have been choosing Britain due to characteristics that have existed since well before the EU was created. Britain participates in the single passport system, which allows companies with a British financial business license to operate anywhere in the EU. Losing this right will have a negative impact to some extent. But there may be measures to reduce the effects of rapid changes. Britain has advantages in terms of information collection, the formation of networks and other aspects of business operations. That means Frankfurt or some other European city is unlikely to replace London as a center of international finance.

**Figure 4: UK BOP current account with EU****Figure 5: UK BOP current account with non-EU**

### Britain's competitive advantages as a global financial center are very well established

The United States and Britain lead the world in terms of all aspects of globalization: capitalism, a market economy, democracy, the English language, the rule of law and business protocols. In addition, these two countries are pillars of the world order and the nucleus of the world's English-speaking countries. Furthermore, Britain and the United States play key roles in a diverse array of international relationships. Consequently, there will probably be no change in Britain's advantageous position as a base for international finance and service industries after Brexit. After all, Switzerland has maintained sound business relationships with the EU without becoming a member.

**Britain has not become opposed to globalization**

Britain has a well-established reputation as a country with an economy that is open to the world. As a result, Brexit is unlikely to make Britain a closed and xenophobic country, which is what some people fear may happen. In fact, Brexit will probably lead to stronger ties between Britain and countries and regions outside the EU. So the result is almost certain to be more progress with globalization, but in different direction. In the coming years, the EU will not be a significant source of global economic growth. Instead, the United States, India, the ASEAN region, African countries and other countries outside the EU will fuel economic growth. Britain now has the option of enlarging its international network beyond the core of the Commonwealth of Nations, a vestige of the British Empire. This network can be extended to cover countries and regions making big contributions to the global economy. If this happens, the EU will be unable to turn its back to a post-Brexit Britain. Furthermore, southern European countries like Italy, Spain and Greece are unlikely to abandon a strong and reliable currency (the euro) and its low interest rates by leaving the EU (regardless of how much the influence of populism increases in these countries). This is clearly evident from the shift in the stance of the administration of Greek Prime Minister Alexis Tsipras concerning that country's debt crisis. Obviously, there is no basis to embrace extreme interpretations of Brexit as the beginning of the end of European unity or the failure and demise of globalization.