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U.S.-Japan Economic Relations: The Tokyo Summit and Beyond

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Following is an address by Allen Wallis, Under Secretary for Economic Affairs, before the U.S.-Japan Economic Agenda Meeting, Washington, D.C., April 23, 1986.

Our Bilateral Trade Deficit

Many of you may know that I spent the early part of my career as a statistician. Statistics can aid in our understanding of a problem and help us make wise decisions. But they also can cause mischief when they are misused or when people think that they explain more than they do. Disraeli said that there are three kinds of lies: lies, damn lies, and statistics. Too many people use statistics the way a drunk uses a lamppost: for support rather than for light. Unless statistics are handled with care and objectivity, they may seem to prove things which are not at all true.

Probably the most cited statistic in U.S.-Japan economic relations is the size of our bilateral trade deficit: $49.7 billion in 1985. To many people, that statistic—the size of our trade deficit with Japan—says a lot. When it increases, anger with Japan increases—and also emotional charges that the Administration's trade policy has failed.

What the Trade Deficit Does Not Tell Us

But, because it is a statistic, we need to remember just what it is and what it explains, and what it is not and what it does not explain. That number—the size of our trade deficit with Japan—simply represents the difference between how much merchandise we sold to Japan, and how much we bought from them—nothing more and nothing less.

- It does *not* show how open the Japanese market is. The deficit rose by $13 billion in 1985, but Japan did not erect $13 billion worth of new barriers against our products.
- It does *not* show how successful we have been in opening Japanese markets. Indeed, we had a number of successes last year in gaining greater access to Japan, especially through the so-called MOSS (market-oriented, sector-selective) process, even while the deficit rose.
- It is *not* an indicator of how competitive American and Japanese industries are against each other. The United States—not Japan—is still the world's largest exporting nation and the world's technological leader.
- It is *not* a way of measuring how well Japan is assuming its international responsibilities. In fact, Japan is pursuing an increasingly active international role, in partnership with the United States. It is now the world's second largest aid donor and a leader with us in pursuing a new international trade round.
- Finally, it does *not* explain why there is a deficit or why it changes. It says nothing about the influence of foreign exchange rates, economic growth, business cycles, and different economic structures.

The Totality of Our Economic Relationship

Our trade balance with Japan reflects only one part of our economic relationship with Japan—a relationship which in size and importance is exceeded only by our economic links to Canada. In deciding whether his patient is healthy or sick, a doctor does not just take the patient's temperature; he examines the whole body. Singling out our merchandise trade balance means that we are not looking at the whole "body" of our economic relationship with Japan.

To many people, the size of our trade deficit with Japan says a lot about the state of our economic relations with Japan. What impresses me is what it does *not* tell us.

- It does *not* tell us that we sell more American products to Japan than to any other country in the world except Canada or that about 625,000 Americans owe their jobs to those exports.
- It does *not* tell us that we sold as much to Japan last year as we sold to France, West Germany, and Italy combined.
- It does *not* tell us that Japan is the best market in the world for American farmers or that only Canada buys more manufactured products from us than Japan does.
- It does *not* tell us that Japan has become one of the leading investors in the United States or that Japanese manufacture in 40 states and employ about 80,000 workers.

• It does *not* tell us that last year Japanese net flows of capital to the United States were about $75 billion and that this money increased the pool of capital available in our financial markets, made U.S. interest rates lower than they otherwise would have been, helped make our companies more productive, and helped finance our Federal Government deficit.

• It does *not* tell us how many services we sold to Japan, how much money we made from selling airplane tickets, licensing American products, and showing American films.

• It does *not* tell us how much money American banks and corporations made in Japan and sent back to the United States.

• It does *not* tell us that over 1.5 million Japanese tourists visit our nation every year, spending $1.4 billion and supporting 35,000 jobs.

• It does *not* tell us how Japanese imports are enriching our lives and supplying critical parts and components that help make our companies more competitive.

We must remember that U.S.-Japan trade does not take place in an economic vacuum. A bilateral trade deficit is not like the final score in a baseball game, because economic activity never ends. One of the basic principles of economics is that both sides gain from an exchange. When we buy from Japan, America's consumers, operating in a free market, get what they want—Japanese cars, cameras, computers, and so on. But the Japanese are not giving these things away. They take our dollars, but they do not hide them under their mattresses. They use them—to buy products and services from us and also from other countries, which in return then have dollars to buy products and services from us. The Japanese use those dollars also to provide capital to us and to other countries, to help promote economic growth in our countries and make our economies more productive. Every dollar that we spend on Japanese products will be used to buy American goods, services, or assets—though perhaps not by Japanese but by third countries who have sold things to Japan.

Past and Future U.S. Trade Policies

A number of years ago, I wrote in a textbook that "Statistics is a body of methods for making wise decisions. . . ." For this, a statistic must be understood properly. If we base our trade policy toward Japan—and, indeed, our attitude toward that country and its people—on one number, we will have bad policy and provoke results that are not in our interest.

The focus of U.S. trade policy toward Japan for two decades has always been on market access. By resisting calls for protection in the United States while working for open markets in Japan, our policy has been consistent, promoting free trade at home and abroad. Our concern has not been with the bilateral deficit per se, because there is nothing inherently good or bad about a bilateral trade surplus or deficit.

But during the 1960s and 1970s, we were able to "kill two birds with one stone." Pursuing market access did deal de facto with the bilateral imbalance. This was because from 1965 to 1975, our trade deficit with Japan averaged only $1.5 billion annually, and Japanese restrictions on our access to their market probably did account for all of that amount. It may have been logical, therefore, to conclude then that our trade deficit with Japan did, in fact, indicate how open the Japanese market was and the degree to which Japan was assuming its international responsibility to maintain the international trading system.

But restrictions on Japan's market today account for only part of our bilateral deficit. Guesstimates vary from $5 to $15 billion. But no matter which figure is chosen, they all agree that market access is the smaller part of the problem. We also need to remember that even if all Japanese market restrictions were removed, our global trade deficit will not change as long as total investment in the United States exceeds our domestic savings. In that case, opening access in Japan will simply redistribute our global trade deficit among other countries and other products.

Nevertheless, to many Americans the continued growth of the deficit is seen as further "proof" of Japanese market restrictions and an indication that U.S. trade policy has failed. Even though fair-minded people know that the deficit is the result in large part of broader macroeconomic and structural factors, there is a clamor for more action and increased calls to "get tough" with Japan. We then search out and publicize more and more Japanese market restrictions. We probably have more trade specialists in the U.S. Government, and more lobbyists and lawyers, focusing on Japan than on any other country. As a result, we probably know more about Japanese market barriers than those of any other country. Even the most technical issues are raised to a political level and put in the public spotlight. Meanwhile, the trade restrictions of other countries, many of which are far more egregious, receive less public attention.

By focusing public attention on that part of Japan's market which is still closed to American goods, we reinforce the perception, left over from the 1960s and 1970s, that Japan's doors are slammed shut to U.S. products and services. We contribute to the mistaken belief that Japan's market restrictions are the primary cause of the bilateral trade deficit. And when Japan does take steps to ease these restrictions, they are seen as unlikely to make much of a dent in the trade deficit. That is something that we knew when we started, but, nevertheless, there is frustration all around—in the Congress, in the Administration, and in Japan.

In my present position, I know as well as anyone the restrictions that Japan imposes on our ability to sell American goods and services. Those restrictions are, indeed, multifarious and exasperating, and they are harmful—to Japan, in fact, as much as to us. We hear from many American companies that face obstacles to doing business in Japan, and we are committed to helping them remove those barriers. But Washington is a place that people come to when they have a problem. We do not hear very often from those companies that do well in Japan and that have made Japan the second largest export market in the world for our farmers and businessmen.

Trends in the Japanese Economy

It would be both costly and dangerous for us to base our current and future trade policies with Japan on our memories of the past 25 years of Japanese policies and practices. What we should be looking at are current Japanese policies and practices, how they are changing, and what influence we can expect to have on them.

• We would like to see broad-gauged changes in Japan that remove the policies, practices, and attitudes that discriminate against foreign companies, products, and services.

• We would like to see Japan become an importing superpower, not just an exporting superpower.

• We would like to see greater internationalization, deregulation, freedom, and openness throughout the Japanese economy.

• We would like to see Japan remove those inefficiencies that characterize much of its economy and which contribute to the trade imbalance.

The fact is, there are more and more Japanese who agree with us, from Prime Minister Nakasone on down. There are internal pressures and trends already at work in Japan, pointing its economy in these new directions. Our policy should be to encourage Japan further in these directions, to help reinforce and accelerate trends that already are underway. All of those changes would be beneficial to Japan, even more than to us.

You all are familiar with *shoji*, sliding Japanese doors. Rather than having to pound on doors to open Japan's markets, we now have allies on the other side helping us slide Japan's doors open. Japanese banks and securities firms were just as interested in capital market liberalization and yen internationalization as we were. Japanese shipping companies also wanted to see restrictions eased on the movement of trucks carrying containers of high capacity. Japanese electronics firms outside the NTT [Nippon Telephone and Telegraph] "family" of suppliers also wanted to see deregulation of the telecommunications industry, as well as greater openness in NTT procurement. Japanese as well as American pharmaceutical companies wanted regulations eased. In contrast to years past, today when we work to open Japanese markets, we have many friends in Japan who work with us, because they know that greater market freedom is in their interest.

Changing Course in Japan

After he met with President Reagan at the White House on April 14, Prime Minister Nakasone said that Japan must transform its economy to rely more on domestic demand and imports, especially manufactured products.

One week before he met the President, the Prime Minister accepted the report of an advisory group he established on economic structural adjustment, the Maekawa commission. Nakasone said that Japan now is at a historic turning point in its relations with the international economic community. He said that Japan must change its traditional way of thinking and establish a "national goal" to reduce its current account imbalance to a level "consistent with international harmony."

The Maekawa commission was a private group, but its report is a watershed in Japan's postwar economic history. Some of its major recommendations are:

First, to expand domestic demand by:

• Promoting housing construction by easing building restrictions and expanding tax deductions;

• Stimulating private consumption by boosting wages, cutting taxes, and reducing working hours; and

• Increasing the role of local governments in funding public works.

Second, to transform Japan's industrial structure by:

• Encouraging investment in manufacturing abroad;

• Rationalizing Japan's many depressed industries; and

• Erasing restrictions on agricultural imports.

Third, to continue to improve market access by:

• Implementing last summer's trade action plan, which said that Japan's market should be free in principle, with restrictions only as exceptions; and

• Promoting greater imports of manufactures and streamlining Japan's distribution system.

Fourth, to further liberalize Japan's capital and financial markets.

Fifth, to expand Japan's international economic cooperation by:

• Expanding imports from the less developed countries;

• Increasing its overseas economic development assistance; and

• Promoting a new GATT [General Agreement on Tariffs and Trade] round.

And finally, to strengthen the management of its fiscal and monetary policies, including the abolition of the tax-free interest break on small savers' accounts.

Prime Minister Nakasone and the Maekawa commission are not the only people calling for change in Japan. The Keidanren, Japan's most prestigious business organization, recently issued its own policy proposals, stating that transition to a totally free trade system must become a Japanese national goal. It said that Japan should remove all import restrictions, abolish all tariffs on manufactured goods, undertake thorough deregulation of its economy, and achieve openness in its administrative systems and operations. The Ministry of International Trade and Industry, in its report on the future of Japanese industry, said that Japan must open up its market further to foreign products and "positively increase" imports of manufactured goods by promoting a horizontal division of labor, so that imported manufactured goods will be woven into Japan's production and consumption structures. Finally, a national commission in Japan is now considering what changes need to be made in Japan's tax structure. Japan's present tax structure provides a number of incentives to save and disincentives to consume and invest which increase the imbalance between savings and investment, so we will be interested in the report of this commission as well.

A Comprehensive U.S. Trade Policy for Japan

I said earlier that if we base our policy on the statistical measurement of just one part of a broad and diverse economic relationship, we will have bad policy. Likewise, if we base our trade policy on the memories of past Japanese policies and practices and our own outdated perceptions, the results will be costly and dangerous.

U.S. trade policy toward Japan must keep its eye on the future, and it must be comprehensive in its scope. Our policy does that. We do not seek market access to Japan because we have a trade deficit. Free trade and open markets are goals in themselves, because they are in the interest of both countries. Even if we had a trade surplus, it would be important to reduce barriers and open markets.

• We will continue to seek the removal of individual trade barriers which affect a wide variety of American goods and services.

• We will continue to seek open and liberalized markets for entire industrial sectors through the so-called MOSS process.

• We will continue to deal with the financial issues that lie behind our trade balance, by encouraging further liberalization of Japan's domestic capital markets and by cooperating in the International Monetary Fund and related organizations.

• As necessary, we will take unilateral action under our own trade laws to remove unfair trade practices.

• We will continue to cooperate with Japan at the international level to strengthen the world trading system and promote the success of a new GATT round.

• And finally, as a result of the President's meeting last week with Prime Minister Nakasone, we have agreed to discuss structural economic issues in both our countries. Our goal is structural change in both countries which will affect the trade balance and remove the strains in our relationship.

Conclusion

During their meeting last week, the Prime Minister told the President that the kind of fundamental policy change Japan is now poised to make occurs only once in a century. A hundred years ago in Japan, an intellectual debate raged between the free traders and the protectionists. The leading spokesman for the free traders was a man named Taguchi, who had read deeply in Adam Smith and English commercial history. He argued against state protection of industry because it would give favorable treatment to the samurai class and encourage them in their traditional lazy habits. But Taguchi and his supporters lost the argument. The samurai class had a lot of political "clout" during the Meiji Restoration, and they were encouraged in their views by advocates and practitioners of protection in the United States and Europe.

Today, Japan has another chance. I believe that by the end of this century, Japan will have the freest trade in the world, after the United States, because that is where Japan's interests lie. It must be our task to encourage Japan in this direction and to help it make the right decision. To be sure, the principal beneficiaries will be the people of Japan, but we and the rest of the world will benefit, too. ■

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