Notes on U.S.-Japanese Trade Friction

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The United States and Japan have been enmeshed in a conflict concerning trade relations for over a decade, with the conflict likely to worsen in the near future. In this essay Larry Stollar analyzes the sources of this trade friction, looking for its underlying causes, not the issues that are discussed at the negotiating table. He then offers suggestions for both Japan and the United States which could lead to, if not a reconciliation, then, an alleviation of differences whereby both countries would gain and the negative consequences of continued conflict would be minimized.

The presence of trade friction as a problem in United States-Japanese relations has been obvious to followers of the popular media in both nations for several years now, as well as to those with more specific interests in business, government and the academic community. Charges and countercharges have regularly flown back and forth across the Pacific: companies alleging unfair trading practices, government officials protesting the actions of their counterparts and professors issuing worried warnings. In spite of the volume of material that has passed in front of the attentive observer, however, a broader perspective on the trade friction has often been lacking, lost under the weight of short-term concerns. This essay seeks to outline the deeper fundamental difficulties that underly the ongoing trade friction problem, and offers a few suggestions as to steps that may be taken toward remedying the situation.

On the American side, the economic factors pointed to by Japanese and American observers alike — relative productivity decline in many industrial sectors, lack of export consciousness on the part of U.S. businessmen, poor industrial adjustment policy, indeed, the lack of any serious industrial policy at all — are major proximate causes of current trade problems. Big Steel's failure to modernize, Detroit's ongoing struggle to supply the types of cars many Americans desire, the television and electronics firms movement offshore in search of cheap labor and union wage settlements that tempted firms to look outward are all typical of the economic elements that have combined to dull the American competitive edge. The results: decreased exports, rising import market shares, losses in employment and soaring trade deficits. This builds political pressure for protectionist measures

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which, if enacted, raise tensions with trading partners and usually serve to shield the industries in question from making the necessary hard decisions about rationalization and increased competitive efficiency.

Government economic policy has also contributed to the current round of trade friction. The combination of tight monetary policy and massive anticipated deficits has kept interest rates at high levels and attracted large flows of international capital into U.S. financial instruments. This bids up the value of the dollar, lowers import prices, and raises the price of American goods in international markets, making price competition extremely difficult. In August 1982, the dollar was trading at one dollar to 265 yen as Japanese capital flowed into the United States; financial experts saw a level of 210 to 230 yen per dollar as more appropriate to smooth trade relations. So, while one may or may not support the Reagan Administration's economic policy on its domestic merits, it is having a profound effect on deepening the trade deficit with Japan.

The final major contributing factor on the American side is the strategic approach chosen by the U.S. government to handle the trade imbalance with Japan. The primary thrust of government policy as expressed at the Department of Commerce, the Office of the Special Trade Representative, the State Department and the White House has been the "opening of the Japanese market" as the solution to the trade deficit. In and of itself there are advantages to such initiatives — they help to head off the type of direct protectionist devices used by many European nations to cut deficits with Japan, e.g., Italy's tough limits on Japanese auto imports. They also have the potential for raising overall trade levels. But to concentrate the greatest part of American efforts on noisy campaigns to promote market opening is not likely to have much real effect on the trade deficit, and it inevitably creates a tense political environment in its wake.

Why can't American market opening initiatives do the job on their own? First, it has yet to be shown that even a "total" opening of Japan's import markets would have more than a marginal effect on U.S. trade deficits of the current magnitude. The critical underlying problems would still confront U.S. goods: quality and price competitiveness, deficient export consciousness and inexperience in the Japanese market. Second, a total opening would not mean that American goods would be the sole beneficiaries. Grain from Australia and Argentina would compete with that from the United States. European luxury automobiles would fare as well as, if not better than, those from the United States.

Finally, the market opening pressure applied by the United States, while sometimes helpful in moving recalcitrant elements in the Japanese bureaucracy, has also produced very high levels of political tension. This tension in turn makes it very difficult for bureaucratic concessions to be made in Japan, and ultimately produces a tightening effect limiting further progress. A certain amount of this kind of pressure on Tokyo from its trading partners is probably inevitable and even desirable, as long as Japan continues to show a large trade surplus with other industrialized nations. But to make the "market opening approach" bear the primary burden of one's bilateral trade policy, as Washington has done in recent years, is not likely to yield positive results; the political costs are high and the lasting effects on the trade deficit marginal.

These three factors — U.S. economic difficulties, a particular set of macro-economic policies and an overly narrow approach in dealing with Tokyo — comprise the major causes of trade friction coming from the American side. Trade friction is not, however, a one-way street; some of the sources of today's troubles must also be sought in Japan.

The question of market openness is likely to be a sore spot for some time. Regardless of the fact that market opening measures on Tokyo's part will not go the whole way in reducing the trade deficit with the United States, these measures can make a major difference to specific American firms and industries and serve as a powerful symbolic sign of Tokyo's commitment to free trade. The common Japanese response — "our markets are about as open as anyone's" — is partly true; on aggregate, formal and informal barriers are similar in extent to those of many European countries (but well above those of the United States). At a time when Japan is running massive trade surpluses with other nations, this response is not enough. Unless Tokyo is prepared to tolerate perpetually heightened political tension with its industrialized trading partners, further substantive steps in the direction of freer import conditions will be required. As the respected *Keidanren*[1] has noted, the *ad hoc* and piecemeal approach of the Japanese government, beset by bureaucratic infighting, is not coping well with Japan's international responsibilities; more forthright action is imperative, especially in the areas where competition in the eighties will be the strongest: electronic components, computers, communications equipment, etc.

The second major Japanese contribution to trade friction comes from Japan's one-dimensional view of the nature of interdependence in the modern world. It is true that most Japanese are far more aware of the economic importance of the outside world than are their American counterparts. This awareness, however, tends to flow in one direction. Interdependence means that things can happen *to* Japan: oil shortages, raw material cut-offs, food price changes, etc. There is far less evidence of sensitivity to the fact that Japan's exports have a series of effects, not

1. The *Keidanren* is a federation representing Japan's leading business interests.

all of them positive, on other nations. The export of manufactured goods, however justified by factors such as overseas demand, price and quality, can often conflict with the goals of particular interest groups, industries, regions and government bodies in importing nations via their impact on employment, expenditure patterns and domestic industrial wellbeing. Japan herself is aware of the damage that particular firms and regions can suffer under stiff import challenges. For example, the Japanese aluminum and petrochemical industries, unable to successfully adjust to import competition, are now demanding protection of their own. The relative lack of awareness of the similar effects that Japanese import penetration can have in overseas markets has contributed to the phenomenon of trade friction, inasmuch as it leads to Japanese public perceptions that the United States is trying to "punish Japan" for her "value-neutral" exports. Just as insufficient American awareness of the realities of international trade and competition is part of the trade friction problem, so too is the limited Japanese sensitivity to the less desirable side effects of such competition.

If the above are the essential causes of trade friction, what are the most effective solutions to the present problems in U.S.-Japanese relations?

An important first step that should be taken as soon as possible is some form of mutual Japanese and American acknowledgement of the positive, fundamental elements of the transpacific relationship. This could be done in the form of a summit meeting communique or a joint parliamentary-congressional statement; the format is not as critical as the substance. This mutual declaration should remind citizens of both nations that both countries share a common commitment to a free and open world economic system, that each makes its own contribution to the security needs of the other and that neither has a reasonable alternative to present levels of economic and political interaction. Such a declaration, if issued in a spirit of compromise and understanding, would go a long way toward putting trade friction problems in their proper perspective, that is, in portraying them as a quarrel, however serious, among friends, and not as a struggle among warring antagonists.

Such statements can, however, only go part of the way toward a meaningful resolution of trade friction. Direct action on the part of each government is required, as is a reassessment and reshaping of key attitudes in both the United States and Japan. None of these things can happen immediately, but the effort and patience demanded to carry them through will prevent, or at least moderate, future outbursts of trade-related political problems.

First, the United States: Unless very basic and thorough adjustments of the American economic system are pursued over the next decade, the trade deficits characteristic of the seventies will become permanent features of the U.S. balance-of-payments. These adjustments must include a rationalization of government policies that affect trade and investment, an awakening on the part of American executives to the realities of international competition, and organized labor's realization that the attitudes and tactics of the 1930s are not suited to the 1980s. A joint labor-business-government effort to reestablish traditional American standards of quality, price competitiveness and productivity is called for. Signs of such change are emerging and a growing "competitiveness literature" suggests increased attention in this direction.[2] And while it is possible to argue over specific measures and policies, the overall direction that must be taken is quite clear. In the absence of progress in this direction trade frictions with Japan and other nations will continue, and ultimately threaten the entire global trading system.

In the near term, the Reagan Administration should broaden its Japan policy; placing continued heavy emphasis solely on market opening will yield rapidly diminishing returns. This broadening should include the opening of discussions with Tokyo on establishing "rules of the game" on issues such as joint ventures, research collaboration, export assistance measures and cooperative rationalization measures for declining sectors. Also, the administration should incorporate the trade problem with Japan into the "big picture" of U.S. economic performance, avoiding a narrow focus on the bilateral trade balance. To zero in solely on this dimension is to draw attention away from the more basic economic challenges posed above; no amount of bilateral headbutting with Tokyo can solve the underlying problems of American competitiveness. Pressure for the continued liberalization of Japan's goods, service and capital markets can be part of a policy to deal with American trade difficulties. But the government must concentrate on the facilitation of productive investment and export activity across the American economic system as a whole. Without steps of this kind, the "quick fix" approach of market opening measures will create more political problems than it solves.

While the United States pursues the revitalization of its competitive base and a realignment of its attitudes on international economic activity, Japan should also be taking positive steps to assess and adjust its own place in the international system. The one-way view of global interdependence must be widened to include an awareness of the negative, as well as the positive, effects of Japanese economic strength. The traditional "Japan is a small and weak nation" concept is no longer suited to an age in which

2. For example, Richard Bolling and John Bowles, *America's Competitive Edge* (New York: McGraw-Hill, 1982); *see also*, Ira Magaziner and Robert B. Reich, *Minding America's Business: The Decline and Rise of the American Economy* (New York: Harcourt, Brace, Jovanovich, 1982).

most of the world's nations regard Japan as economically very big and very powerful. If Japanese government and business are able to make the transition to a more up-to-date view of their nation, a series of policy steps can be taken that would go a long way toward relaxing trade tensions.

The first of these steps, based on the realization that the outside world is no longer a "black box" that can absorb unlimited quantities of Japanese exports, would be to extend the governments famed administrative guidance to include the encouragement of a more flexible and sensitive pattern of exports on the part of Japanese companies, especially where foreign unemployment and regional well-being are involved. This does not mean a retreat from free trade: What it does mean is that a country running a massive surplus can no longer afford to see itself as a *jitensha sogyo,* a "bicycle operation," where production and export must be pushed hard or the machine will come to a halt. To continue pedaling furiously in a recessionary environment ultimately presents more of a threat to the world trading system, by virtue of its capacity to generate protectionism, than does timely restraint on the part of exporting firms.

Second, a far more coordinated and less defensive approach to market opening measures should be pursued. While many of the actions taken so far are commendable, more remains to be done on publishing clear product standards, streamlining testing procedures and opening the government procurement process to foreign companies. Agricultural adjustment should also be seriously considered; nations finding their agricultural exports to Japan blocked by political considerations will not be strongly inclined to resist political forces at home demanding restrictions on imports of Japanese goods. The Japanese capital markets should gradually be brought up to international standards and foreign exchange controls eliminated. Tokyo must look toward playing a world role in the international financial system, rather than relying on the financial isolation of previous years. Again, none of these market-opening devices will eliminate current deficits. They will, however, demonstrate Japanese commitment to truly free trade and make Tokyo less of an international "lightning rod" for global criticism.

Finally, Japan should seek to recycle its persistent surplus more efficiently through the expansion of untied foreign assistance disbursements and investment abroad. While Tokyo may justifiably point with pride to the current levels of foreign aid, its present surplus position again imposes a special burden on Japan to sustain and expand those commitments.

The above list of suggestions for the United States and Japan is by no means exhaustive, indicating only the general directions that both nations should take if trade friction is to be appreciably lessened. It is worth stressing once again the importance for both Japanese and Americans of bearing in mind the high costs of pursuing radical alternatives to the present level of bilateral economic activity, regardless of the specific policy routes chosen. Japan cannot find in Asia, Europe, the U.S.S.R. or anywhere else the stable markets and reliable supplies of food imports afforded by the United States. And were the United States to drastically limit trade with Japan, it would find that domestic consumer goods price levels would rise sharply and unemployment would strike import-reliant sectors hard. So the incentive for dealing with the present-day trade difficulties within the context of ongoing positive U.S.-Japanese relations is strong on both sides of the Pacific. The hope is that this incentive can be translated into constructive policy that aims toward mutually beneficial economic and political relations in the decades to come.