Misperceptions in U.S.–Japan Trade Relations

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Katsuhiro Nakagawa is a Special Representative of the Japanese Ministry of International Trade and Industry (MITI). In this speech, which he delivered at the Fletcher School of Law and Diplomacy on 10 December 1981, he addresses one of the most pressing and volatile issues in Japanese–American trade relations: the Japanese trade surplus with the United States. Mr. Nakagawa explains that much of the ill-feeling on this side of the Pacific results from American misperceptions of the Japanese position in the world trade and the impatience of American companies trying to penetrate Japanese markets. He concludes that there is much room for negotiations between the two nations, but warns that constructive action will only be hindered if the Japanese–American Trade relations become a political issue in the United States.

Few people recognize that the majority of US trade now occurs with the nations of the Pacific Basin, and not with the advanced industrialized countries of Western Europe. This situation is evidenced by US export and import trade volumes for 1980. Asian countries accounted for $134 billion of the US trade volume, while Western Europe was slightly lower at $114 billion. With respect to the United States and Japan, movement toward increasing interdependence is reflected by an export and import trade growth in 1970 from $10.5 billion to $51.5 billion in 1980. Japan remains the second largest foreign market for US products and, of course, the United States is Japan's largest trading partner.

I suppose the American affinity with Europe and its state of affairs can be partially attributed to various historical and cultural factors. Close relations within the Atlantic Community may also be understood as having been furthered by the relatively low economic development of many Asian countries.

As a consequence, one should perhaps not be surprised that, despite the interdependence of the American and Japanese economies, there has been little substantive communications between the two countries. By "substantive," I mean a mutual understanding by each country of the other's socio-economic-political systems, and of the kinds of policy problems and choices that the other country may confront given its national and domestic interests.

This lack of communication and mutual understanding has inevitably contributed to several misperceptions about Japan. Although I am encouraged by the trend toward greater coverage of Japanese topics and issues by the US mass media, the nature and quality of the coverage are sometimes misrepresenting and overly simplistic. More disturbing is that common misperceptions about Japan exist with American opinion leaders and, therefore, can have an unwarranted influence on shaping bilateral US–Japanese relations. Given the critical issues on bilateral and international agendas, misperceptions can only complicate unnecessarily the coordination of US and Japanese policy responses to these issues.

Perhaps the most recent misperception arises from an unfavorable trade balance against the United States in US–Japan trade relations, i.e., the commonly held argument that the trade imbalance results from the "closedness" of the Japanese domestic market. The United States alone might face a trade deficit with Japan of around $15 billion this year.

The US Administration has been adamant in its contention that Japanese trade barriers account for most of the mounting trade deficits with Japan. This is unfortunate because it fails to reflect accurately the fact that many factors contribute to a Japanese trade surplus. The United States losing a competitive edge in some areas and the strengthening of the dollar by high US interest rates should be seen as key factors, although I do not deny a partial explanation might also be the difficulty of penetrating the Japanese market. As to its "closedness," however, I can say that the Japanese domestic market is open and has been for some time, with few exceptions. The so-called secondary *Jones Report* of the House Subcommittee on Trade of the Ways and Means Committee reached the same conclusion.

I would like now to outline the evidence as to why the Japanese domestic market is open.

In terms of tariff rates, one actually finds that the average tariff rate after the multilateral tariff cuts agreed to at the last GATT negotiations — the Tokyo Round — is lower in Japan than in the United States and the European Community. The average weighted level of tariff rates after the Tokyo Round tariff cuts will be 3 percent for Japan, 4 percent for the United States, and 5 percent for the EEC. Indeed, even before the Tokyo Round, Japan's averaged tariff rate was less than the tariff rates of the United States and the EEC. A final point is that Japan is now considering accelerating the GATT tariff reductions unilaterally by two years; they were originally scheduled for 8 years.

Turning to residual import restrictions, Japan has twenty-seven. Twenty-two of these restrictions pertain to agricultural items. By comparison, France imposes forty-six residual import restrictions. As is generally understood, the agricultural sectors of many countries enjoy a high degree of protection from foreign competition because of domestic political considerations. Japan is not exceptional in this regard. Of course, I think further efforts should be directed toward liberalizing trade in agricultural commodities. Incidentally, Japanese residual import restrictions numbered 118 in 1969 and twenty-seven in 1976.

Considerable weight is given to the argument that Japanese non-tariff barriers (NTBs) are so extensive as to hinder any substantial inflow of US commodities. The include product and safety standards, government procurement policies, customs procedures, and the like. Here I must admit that this argument was once true, but then only in part. The contemporary situation is much different than the early developmental days of the Japanese economy, and is still changing rapidly. On the other hand, one should understand that many NTBs are not intended as instruments of trade policy. Instead, they are often reflections of national culture, habits, and tradition.

I think it nevertheless useful to continue those efforts at resolving problems of Japanese NTBs at the US–Japan Trade Facilitation Committee, which the two countries set up several years ago. Ninety-three cases have been to date submitted to the Department of Commerce, with an additional sixty-three to the American Embassy in Tokyo. Of this total, twenty cases were judged by the Trade Facilitation Committee as legitimate enough to warrant joint discussion. Thus far, eighteen of these twenty cases have been resolved and agreement is expected on the remaining two cases. Seven new cases were recently filed with the TFC.

As to government procurement policies, it is true that the barriers against foreign goods are sometimes high in the semigovernmental corporations such as Nippon Telephone and Telegraph (NT&T). However, there are still some twenty US states with "buy American" requirements which are still in force for the state governments' purchases of steel and other items. Moreover, bilateral agreement to promote open bidding was reached last December in the NT&T case on a reciprocal basis.

I have always been slightly puzzled by the logic and implications of those people who categorize Japanese psychological and social characteristics as the source of non-tariff barriers. For instance, the Japanese distribution system is in some instances too complicated to be efficient. There are many small speciality shops, wholesalers, and other middlemen on the road from factory to retailer. Even Japanese businessmen find it frustrating to work through this system.

The logical implication of this categorization is that the Japanese should socially and culturally change for economic reasons. This idea does not strike me as realistic. Granted that social and psychological changes may follow from certain economic developments, needs, and pressures, they can only occur over a long time period. Instead, American businessmen must learn to operate within the confines of the system, which is quite possible. The most successful firms in Japan have appointed Japanese nationals as presidents of their Japanese subsidiaries. They have retained wise corporate counsel and have formed strong partnerships with the major banks and retail networks.

There is no real Japanese propensity to buy only Japanese products. Japanese consumers are similar to their American counterparts in that they will always buy the same good or service of best price and quality, regardless of its origin. The important variable, therefore, becomes one of adequate market research and designing of products to meet individual national tastes. American businesses attempting to enter the Japanese domestic market occasionally ignore or neglect these basic requisites to successful market penetration. This is the reason why some American goods which sell well in Western Europe might not be terribly successful in the Japanese market.

In short, whatever Japanese social or psychological barriers to American imports may exist, they can be overcome by patient efforts by the American firms to understand the system and its particular procedures, and by changes in market strategies and corporate operations. I honestly suspect that the language barrier accounts for much of the foreign frustration with doing business in Japan. And, after all, I believe that the Japanese had to hurdle many social and psychological barriers when we first entered the US domestic market. We had to overcome the stigma that "Made in Japan" meant a poor-quality product of cheap price with a questionable lifespan. Drawing from the Japanese experience, American firms intending to penetrate the Japanese domestic market should be prepared to enter a learning process of many years and to devise long-term strategies which may well preclude any short-term profits. The Japanese Government can assist this process by institutionalizing the promotion of US imports to Japan — such as the Manufactured Imports Promotion Organization (MIPO) office and large trade missions.

Thus far, my argument has been that several widespread explanations for the US–Japan trade imbalance are mostly misperceptions. Likewise, to view the trade imbalance only within the bilateral context of the US–Japan relationship is a misperception in the sense of being theoretically misleading. Questions centering on trade accounts should instead be analyzed within an overall balance-of-payments context.

Japan, for example, must buy annually from the OPEC countries about 5.4 million barrels of oil per day. To pay for these OPEC inputs, Japan's only option is to gain foreign currency earnings through exports of high value-added manufacturers. The only commerical markets of any significance for such manufacturers are currently in the United States and Western Europe, and these markets are the only ones with an ability to buy Japanese exports. In this context, therefore, the probability of a given bilateral trade relationship to be in imbalance or deficit is high because of structural factors. On the other hand, a bilateral imbalance may be partially offset if considered within a country's current account. This is the present situation of the United States which possesses a favorable balance with the European Community.

Another structural factor contributing to the US–Japan trade imbalance stems from US domestic economic policy. If a tight money supply is necessary to mitigate inflationary pressures in the US economy, then one should also recognize that the subsequently high US interest rates often affect the US trade balance negatively. Relatively high interest rates insure an inflow of foreign capital, a defense of the dollar's exchange value, and a strong US domestic demand for imports, while holding the price to foreigners of US exports high.

The real danger, however, of such structural factors is that a fundamental misunderstanding or misperception of them leads to the risk of politicizing the trade imbalance issue. Unfortunately, any movement in this direction could further politicize the overall US–Japan relationship because of strong tendencies to link economic problems with political issues. A linkage between economic and political issues usually obfuscates the inherent complexity of just individual issues and, consequently, makes differentiating solutions and mutual policy responses more problematic. Finally, politicization of any significant magnitude would probably reinforce protectionist pressures which would not be in the long-term interests of the United States, Japan, the EEC, or the international economic system.

A final set of misperceptions can still influence indirectly an understanding of issues such as the trade imbalance, that is, the misleading argument of Japan as "Number One" or of "Japan, Inc." The latter notion distorts how industrial policy is actually formulated and implemented in Japan. The relationship, for example, between MITI and industry is not one where MITI wields vast dictatorial authority over industry. MITI's statutory power to influence industry is limited. Moreover, MITI's direct controls have been drastically reduced in the past decades as seen in trade and capital liberalization. Also true is that government assistance to business is modest. MITI's budget comprises only 1.5 percent of the national budget, amounting to about three billion dollars. Tax preference measures for business such as fast depreciation, tax reserves, and tax credits are small in terms of the tax-cut amount. Business now introduces new products and develops export markets at its own initiatives.

Similarly, the above notion misrepresents how a relationship of trust and cooperation between government and business is achieved. First, the business community knows that MITI is interested in the welfare of the industries. Second, MITI does provide useful information and analysis on the domestic and external economic situations. Third, many formal and informal levels exist at which MITI and corporate leaders of a given sector meet to discuss and exchanges views. Fourth, and perhaps more importantly, MITI usually works in accordance with the consensus in an industrial sector or in the business community as a whole.

Real differences of opinion can nevertheless arise between government and business, as is often the case in the United States. The primary cause for these differences is the understandable focus by business on profits while government is responsible for the general economic welfare. As a consequence, an individual business may not appreciate how its advancement may hurt the overall well-being of an industrial sector or of the domestic economy.

Both of the above notions produce two additional effects. First, they discount or ignore the fact that several traditional Japanese industrial sectors will confront increasing difficulties in the 1980s. To a great extent, these difficulties will originate from the newly industrialized countries (NICs), and from a general shift in global distribution of industrial production. Developments which critically affect overall Japanese economic performance are also ignored or diminished in importance, e.g., an aging labor force, rising energy prices, a dependency on vulnerable energy sources, changing social values, etc.

The second effect is the preclusion of any realistic assessment of the relative strengths of the US economy and industries. For instance, I think there is an overemphasis on the relative decline of US economic performance in terms of labor productivity, corporate and public research and development expenditures, savings, and real capital investment. My impression is that a preoccupation with declining US relative growth rates has resulted in a somewhat unbalanced assessment of the US economy. Albeit that relative growth rates are analytically important, the overall viability of the US economy is maintained by absolute levels in the various measurement categories that far exceed comparable foreign levels.

With regard to Japan, trade problems arising from strong foreign competition pertain only to some maturing industries. Indeed, even those maturing American industries now facing competitive pressures are far from losing their long-term international or domestic competitiveness. The US auto industry is foremost in this category. In addition, often forgotten is the substantial lead the United States enjoys in several industrial sectors which have established the United States as the major competitor in those sectors, e.g., computer technology.

A final stength is American development of new industries. Even though the precise futures of industries such as genetic engineering, bio-technology, and energy alternatives cannot now be discerned, their economic potentials and spin-offs are indeed promising and significant. Economic viability and scales of production in such new industries is a distinct possibility for the future.

Lastly, I hope that a better understanding and a more candid exchange of opinions will develop between the United States and Japan.