AMERICAN POLITICS AND THE TRANS-PACIFIC ECONOMY

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For more than three decades the linchpin of Pacific economic development has been a relatively open, consumption-oriented American market. Even in the mid-1980s, two-way trade among the countries of Northeast Asia, Southeast Asia, and Oceania only accounts for around 15 percent of their total trade, while exports to the United States *alone* constitute roughly double that amount. In 1986, 39 percent of Japanese exports went to the United States, up from 23 percent only 10 years before, with the ratio of dependence on the U.S. market being even higher in several other nations of the Pacific.

This consumption-driven, U.S.-centric pattern in the Pacific Basin has generated both short-run prosperity and deep-seated, long-range structural problems, particularly the ominous recent increase in American debt. The huge scale and seemingly unending expansion of that debt — rising from nothing to $200 billion since 1985 alone, with widespread predictions of a $1 trillion American international debt by 1995 — would seem to dictate major structural readjustment at some point. The instability of the status quo was dramatically underlined by the global stock market collapse of October 1987. But change will be mediated through an American political system which, like the American economy itself, has undergone a basic transformation in the past two decades, to become much more deeply integrated with other major nations of the Pacific than is often realized. However unstable and painful the interdependence of the *status quo* may be, disengagement from trans-Pacific interdependence has become virtually impossible for the United States as well as for Japan and the smaller industrial nations of East Asia.

The scope of the internal changes within the U.S. political economy linking it more tightly with other Pacific Basin nations becomes graphically clear when one contrasts the stormy politics of U.S.-Japan trade in the early 1970s with more recent developments. Sixteen years ago, U.S. President Richard Nixon announced, with less than an hour's notice to the Japanese government, the suspension of the dollar's convertiblity into gold, and a 10 percent surcharge on all imports into the United States. Two months later the Nixon administration threatened to invoke the Trading with the Enemy Act of 1917 to pressure Japan into settlement of a bitter dispute over textile trade which had continued between the two nations for more than three years without solution. Two months later still, Secretary of the Treasury John Connally pressured Japan at the Smithsonian international conference into a net reval-

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uation of nearly 18 percent, which many observers at the time saw as potentially devastating to Japanese small business.

The U.S.-Japan trade deficit in 1970, as the bitter trans-Pacific conflicts of the early 1970s began to escalate, was $1.2 billion, and never rose above $3 billion at any point during that stormy period. By 1987 the U.S. bilateral deficit with Japan had reached 40 times the 1970 amount, complemented by large-scale deficits with Taiwan, South Korea, Hong Kong, and even Singapore, of which few in the early 1970s would have dreamed. The only remaining major U.S. trade surplus in the Pacific was with Australia. Of the expansion in U.S.-Japan trade between 1980 and 1986, 86.5 percent had consisted of Japanese exports to the United States, and patterns with nations elsewhere in the region were generally similar. Yet trans-Pacific tensions between the United States and its partners in East Asia remained remarkably muted, considering the magnitude of the economic imbalances. Congress in 1982 had defeated local content legislation for automobiles which proposed practices long prevailing in both Canada and most of Western Europe, and failed in 1986 to override Presidential vetoes of protectionist textile trade legislation. The White House itself continued to stand forthrightly for free trade, and increasingly influential state and local authorities were forging active links throughout the Pacific.

Political Transformation in the United States

Although American national response during the 1980s to the sharply larger U.S. trade deficit has been remarkably mild, there have been some fundamental changes over the past two decades in the structure of the American political economy.

One development has been its sharpening segmentation. Two oil shocks since 1973; the vast acceleration of defense procurements, with contracts favoring some regions over others; and the rapid pace of technological change over the past decade have all stimulated the emergence of different Americans, with both decline and new prosperity in evidence. As a consequence, opinion and interests on global trade issues has differed more and more along sectoral and regional lines.

Throughout most of the past 20 years, the South and West of the United States, broadly speaking, have steadily gained relative to the rest of the country in both population and share of aggregate national wealth. By 1990 the combined populations of these areas are expected to account for around 54 percent of the U.S. total. Despite deep recession in Texas and neighboring parts of the Southwest during the mid-1980s due to the sharp fall in oil prices, inflation-adjusted incomes have grown twice as fast in the South and West as in the Northeast and Midwest over the past two decades.

During the 1980s new growth points have also emerged, tied to defense and service-industry development in such states as New York, Connecticut, and Massachusetts. These developments, like the depression in the Southwestern oil industry, have narrowed some of the broad, regionally specific contrasts between growth and prosperity, implicit in the "Sunbelt Shift" pattern of the 1970s, to create a more nuanced picture. But the complex interweaving of prosperity and depression in Snowbelt states has complicated protectionist efforts there, as is clear, for example, in the state of Ohio.

The continuing shifts in the locus of economic power in the United States have encouraged parallel shifts in patterns of political influence, which have in turn reinforced the ongoing economic shifts. Since the assassination of John F. Kennedy in 1963, every president except Gerald Ford, who was appointed rather than elected, has had substantial Southern or Western political background. For a century before such background was a rarity among chief executives. In addition, for the past two generations, the chairmen of major congressional committees have tended to be Westerners and especially Southerners. Even though the Presidential candidates selected in 1988 will quite possibly not hail from the Sunbelt, the Super Tuesday Southern regional primary in early 1988 will probably be critical to their selection.

The increasingly salient regional and sectoral distinctions in the American political economy have, since the late 1960s, coincided ever more closely with attitudes concerning trade policy toward Japan. Generally speaking, protectionist sentiments have been concentrated in the relatively stagnant, heavily unionized, industrialized centers of the Northeast and Midwest, which have borne the brunt of competition with Japan. Unemployment rates during the first half of the 1980s across this so-called Rustbelt have been frequently double the national average, and anti-Japanese protectionist feeling, as expressed in state-enacted "Buy America" legislation, and strong support for federal domestic content legislation, has been high.

Yet despite the rising vehemence of anti-Japanese sentiment in these areas, there have been important regional counter-trends which have prevented a protectionist common front from emerging, even in relatively depressed Rustbelt areas. Several industrial states, including Ohio, New Jersey, and recently even Michigan, have both sought and successfully attracted Japanese investment. And the service industries rising throughout the country — especially banks, law firms, and consulting companies — have often had a major stake in transactions with Japan.

The South and West, together with the financial centers of the United States, have generally favored free trade more strongly than other parts of the United States. Underlying this relatively liberal orientation have been strong complementarities of economic interest with Japan and other manufacturers of the Pacific Basin. There is, for example, not a single integrated steel mill on the entire American West Coast. The only auto plant there is the recently-opened General Motors-Toyota joint venture plant in Fremont, California. Even in the semiconductor industry, Silicon Valley's relatively hard attitude toward Japan has been moderated by a broad market segmentation: California producers specialize in microprocessors and customized chips, while Japanese producers specialize in commodity RAM chips.

Roughly one-third of the entire U.S. trade deficit with Japan is accounted for by the trade that passes through California ports. Yet this has stirred remarkably little antagonism in California, due to the trans-Pacific economic complementarity and the state's relatively rapid growth. Indeed, San Francisco, San Diego, and Long Beach, like Seattle and Portland, profit substantially from shipping to and from East Asia, regardless of the direction in which trade predominantly flows. In addition, the auto and electronics dealer networks that have a substantial stake in a smooth flow of imports are large and vocal. And across the West, union membership as a proportion of total employment (excluding agriculture) ranges from a low of under 18 percent in right-to-work states like Utah, to around 27 percent in California. This is substantially lower than the 30 to 40 percent union-membership ratios common in the Midwest and Northeast.

Like the West, the South tends, broadly speaking, to be economically complementary with East Asia, and has been relatively quiescent on trade issues. The major Southern exports are agricultural — soybeans, corn, cotton, sorghum, and tobacco. The beef and oranges that have caused so much U.S.-Japanese political friction are not major issues in the South, except in Florida. And Japan imports over $5 billion in agricultural goods annually from the United States — mostly from the South.

Historically, the South has had a pronounced free-trade orientation. In addition, much of Japan's rising investment in the United States — projects such as Nissan's truck plant at Smyrna, Tennessee — are concentrated there, with most of the rest in other Sunbelt states such as California. Overall, well over half of Japanese manufacturing investment in the United States during the mid-1980s is concentrated in 16 Sunbelt states; the top three being California, Texas, and Georgia. Yet enough investment is distributed elsewhere to undercut protectionist activity even in the Rustbelt states most adversely affected by economic competition with Japan, such as Michigan and Ohio. Japanese investment in the United States, totaling over $25 billion in 1986, already provides over 250,000 jobs, with this number expected to quadruple to over one million within 15 years.

Like the economically healthy regions, the sectors of the U.S. economy that have grown vigorously over the past decade have found themselves in a broadly symbiotic relationship with Japan. For construction, Japan has often meant cheaper steal or better delivery times — and hence increased profits on bids. In finance, Japan has meant increased market opportunities: a wide range of American banks with fund surpluses, many of them regional and local, have benefited by financing much of Japan's rapidly growing dollar-based trade and investment. Since the mid-1980s, a growing number of U.S. state and local governments have also been raising funds for a broad range of public purposes in Japan.

Reinforcing these regional and sectoral complementarities with Japan are the growing stakes that many U.S. multinationals have in maintaining smooth trans-Pacific relations. These stakes are especially high in electronics, banking, energy, and automotive sectors so central to the U.S. political economy. By the end of 1986, direct U.S. investment in Japan was $11.3 billion and rising, particularly in high-technology sectors. Today Texas Instruments produces all the 64K RAM computer chips for its global operation in Japan, and IBM sources over half of its IBM PC components there. General Motors, Ford, and Chrysler have all recently concluded major agreements to expand captive exports to the United States from Japan of both components and finished automobiles.

To a much greater extent than most Americans realize, Japan's trans-Pacific trade surplus stems from sourcing decisions of such multinationals, together with those of major U.S. distributors, rather than from autonomous export drives by Japanese firms. Over 10 percent of Japan's current exports to the United States consisted of parts exports — largely to U.S. firms. Roughly seven percent are items like video tape recorders and 35-millimeter cameras that are virtually not produced in the United States yet are marketed by U.S. retailers under Japanese brand names. A further two to three percent of Japan's exports to the United States are OEM exports, sold under the private brands of U.S. distributors — Japanese-made Sears home appliances, for example. Finally, around five percent represent exports of finished products from Japan to the United States by foreign firms — largely American — that manufacture in Japan. In short, over a quarter of Japan's current exports to the Untied States appears structurally linked to the production and marketing activities of U.S. firms on their home territory. Thus, U.S. firms have a massive economic interest in imports from Japan; in practice this inevitably limits the options of U.S. policymakers. A predictably strong exchange value for the yen will be required to change this and even then it will probably occur only slowly.

The explosive growth of Japanese capital markets during the mid-1980s has inspired additional interests among multinationals in smooth dealings with Japan, for they see potentially enormous opportunities in funding, underwriting, and brokerage activities. The Tokyo bond market, well over five times the scale of 1980, passed London to become the second largest in the world during 1984. During 1984-87, virtually all the major American multinational financial firms sharply increased their securities and merchant banking staffs in Tokyo, sensing an expanded global role for the yen as well as rapidly growing offshore dealings there in Western currencies.

Traditionally, much of Japan's attractiveness for U.S. multinationals has been rooted in profitability. Although U.S. companies employed only one percent of the Japanese work force during 1982, they registered 3.3 percent of the corporate profits in Japan. Over the past 15 years, the return on investment of U.S. manufacturing firms in Japan has averaged roughly twice the return realized by U.S. affiliates in Canada, the United Kingdom, or France. In addition to its profitable domestic markets, U.S. multinationals often find in Japan an excellent production base for sourcing operations worldwide. Both the quality of the work force and the favorable regulatory climate seem to have enouraged this development — as does the yen's pronounced weakness in trade terms. Since June 1982, U.S. firms in Japan have been eligible for Japan Development Bank loans on a case-by-case basis, and have received low-interest government small-business financing as well. Favorable regional development incentives are being given to U.S. high-tech firms willing to start up operations in Japan, and export financing is reportedly available for sales from Japanese production bases.

American multinationals have grown increasingly active in U.S. trade policy formation since 1970, as they have come to perceive their interests threatened by protectionist sentiment both in Congress and abroad. Generally, this rising multinational activism, through such groups as the Emergency Committee for American Trade (ECAT), has helped keep U.S. markets open to Japanese imports — a substantial and rising share which, as noted above, has been captive imports by U.S. multinationals from Japan to the United States. Since 1981, the AT&T consent decree, the end to the Justice Department suit against IBM, and the Reagan administration's generally supportive attitude toward multinationals have significantly increased the leverage they can exert on behalf of free-trade policies.

A parallel development has been the rising activism and influence of major distribution firms on Congress — a result of their growing stakes in an open trade regime. Companies like Sears Roebuck and K-Mart, together with the smaller-scale automobile and appliance distributors, have massively increased their foreign sourcing over the past decade — to their considerable profit. The strength of the dollar between 1981 and 1985 increased this profitability, insofar as an oligopolistic market structure prevented exchange-rate windfalls from being passed on to the consumer. But even the sharp revaluation of the yen during 1985-87 did not extinguish it, both because Japanese exporters absorbed much of the exchange rate shift, and also because many of the goods handled by distributors were from newly industrializing countries (NIC's) like South Korea and Taiwan, whose currencies did not rapidly appreciate. The distributors are said to be highly active on Capitol Hill; the fact that their outlets are scattered across a broad geographic area, and the often intimate involvement of local distributors in grass-roots politics, serve to enhance these firms' political influence. Because distributors can benefit from any sort of merchandise transaction, and because Japanese manufacturers have placed a high priority on establishing and rewarding a distribution network, these distribution firms have become powerful open-trade advocates.

A little noticed but increasingly active and potent political ally in the United States of an open trade and financial system is state and local government. With the gradual retrenchment in non-defense federal government spending over the past 15 years, and the active devolution of governmental function to the states which the Nixon, Ford, and Reagan administrations have encouraged, local government's role in the overall federal system has expanded. Promotion of new investment was a traditional function of local governments long before the recent expansion of their responsibilities: they have seized on the expansion of foreign investment as a major new opportunity. State and local governments have taken generally moderate stands on international trade and financial policy questions, to the extent they have addressed them; Indiana Governor Orr's recent opposition to Congressional sanctions against Toshiba, with a major Toshiba plant investment decision in the United

States pending, is a typical case in point. Thirty-two American states now have representation in Tokyo, most of it oriented toward investment and export promotion. With Japanese investment alone in the United States expected to rise ten-fold over the next 15 years, creating a four-fold increase in jobs and possibly an even greater rise in local tax revenues, the non-federal element of government in the United States cannot easily be anything but a force for moderation and for deepening trans-Pacific integration, possible tensions due to cultural differences notwithstanding.

In addition to this support from multinationals, distributors, and local government, foreign firms striving to preserve an open trade regime have potent help from Washington's largest corps of professional lobbyists. In the mid-1980s, lobbyists for the Japanese government and private sector, working both to catalyze the diverse supporters of an open trade system in the United States and to explain United States realities in Japan, reported fees double those received by representatives of any other nation. Knowledgeable Washington analysts estimate total Japanese lobbying expenditures at over $60 million annually, including outlays for which formal reports are not required. One out of every five registered Washington lobbyists currently works for Japan. Since congressional decision-making processes have gotten much more complicated over the past 15 years, as the subcommittee system has expanded, there are now many more access points at which outside groups can exert their influence. Japan's representatives, and those of other foreign economic partners of the United States, clearly benefit from this situation.

Just as the strength of U.S. groups with interests complementary to those of other Pacific economies has risen since 1970, the position of antagonistic groups has declined. Most notably, the political clout of organized labor has fallen off sharply as a result of high manufacturing-sector unemployment, declining union membership, and the anti-labor sentiment of much of the conservative Sunbelt coalition. According to AFL-CIO estimates, union membership has declined from 35 percent of the work force in 1955 to less than 19 percent today. This drop has been especially steep since the 1979 oil shock. Between 1981 and 1983, for example, union membership declined by 800,000. That of the United Steelworkers Union has fallen by half — from 1.4 million to 700,000 — just since 1981. Other indications of the erosion of labor's position include the union concessions and give-backs that have been common in recent labor agreements, the 1982 failure of domestic content legislation and other protectionist efforts, and the fortunes in 1984 of the AFL-CIO's endorsed candidate Walter Mondale — both his difficulties against Gary Hart in the primaries and his subsequent sweeping defeat by Ronald Reagan.

Structural transformation within the American political economy will never be complete, as the process of change is a continuing one. The effects of transformation are mediated through two major political parties, which in the American context stand on contrasting social bases. The Democratic Party has had more sympathy for and stronger ties to Snowbelt and organized labor groups adversely affected by the emergence of the trans-Pacific economy than does the Republican Party, and might well be more solicitous of these disadvantaged groups in a prospecitve Democratic administratiom after 1989, should that emerge. But as noted above, the role of organized labor in the American work force is in a process of long-term decline. The locus of influence in both the Democratic Party and the nation as a whole has shifted elsewhere, as the travails of Walter Mondale in the 1984 campaign would seem to indicate. Suburban and minority inner-city electorates appear to have gained relative salience for Democrats. More generally, the decline of organization in American politics, a continuing phenomenon since at least the 1950s, has made it more difficult for groups affected adversely by economic change to express their opposition effectively through the political process.

IMPLICATIONS OF TRANSFORMATION IN THE AMERICAN POLITICAL ECONOMY

Multiple factors have clearly influenced U.S. trade and financial policy formation over the past two decades, with structural transformation itself being only one of them. In particular, the constraints of a global international role, and the related linkages between security and economics, have encouraged the United States to be a supporter of open international regimes even when many of its workers, domestically based industrial producers, and even farmers would probably have preferred a more bilateral, possibly protectionist approach. But the crucial point is that structural transformation toward greater toleration of deficits and rising national debt, itself encouraged by the open initial American orientation to international trade and finance, has in turn reinforced that open orientation. Transformation has helped sustain an open orientation politically through a period of depression in the American industry and agriculture of the Midwest and Northeast during the early 1980s which accompanied the strong dollar and the huge current account deficits generated by the Reagan administration's simultaneous defense buildup and tax cut. Without domestic transformation during the 1970s, resistance to the persistent strong dollar and rising trade deficit of the early 1980s would probably have been much stronger, even had capital inflows from Japan softened the economic effects. The general atrophy of political organization in the United States, particularly in the large industrial cities of the Snowbelt, also helped insulate national policy making from protest against the adverse local effects of the economic transformation underway.

The transformations in the American political economy over the past two decades have not prevented politics from occasionally skewing trans-Pacific trade and financial relations in a non-market oriented direction. Following the 1969 U.S.-Japan voluntary trade restraint agreement in crude steel, trade in color televisions (1977), automobiles (1981-85), and semiconductors (1986), to name only a few prominent sectors, were subjected to bilateral restriction. But the restrictions introduced did not impair, and in many cases actually enhanced, the profitability of foreign American multinationals importing into the United States, because the restraint agreements were defined in quantitative terms. They were less onerous, and probably less extensive, than they would have been had domestic industrial production had stronger political support.

While reducing pressures for across-the-board protectionism, transformation in the American political economy since 1970 has also increased the active receptivity of Americans to imports, both of goods and of capital, from overseas. With the economic expansion and the increasing political prominence of large distributors, as well as multinationals dealing in captive imports, the constituency benefiting from imports has broadened significantly beyond individual consumers. Investment bankers and other financiers have also gained a rising positive stake in the current structure of the debt-oriented U.S. economy through their expanding overseas sales of Treasury bills and other debt instruments — America's current growth export industry.

Transformation in the domestic U.S. political economy, of course, has not occurred in isolation. It has occurred, as was noted at the outset, in the context of an intensification since the early 1970s of East Asian, particularly Japanese, economic dealings with the United States. Nearly 40 percent of Japanese exports currently flow to the United States, and the importance of the American market in strategic and profitability terms for specific Japanese firms, particularly in finance and high-technology industry, is often higher. The seriousness with which Japanese firms view the American market and the prospect of its foreclosure can be graphically seen in Toshiba's recent reaction to Congressional proposals to curb its access to the U.S. market in retaliation for technology diffusion by its subsidiary to the Soviet Union.

Given the deep and rising economic stakes on both sides of the Pacific in an open international trade and financial system, and the political decline of interest groups and regions of the United States which are harmed by such an open system, the likelihood, contrary to much mass media supposition, is that widespread trade protectionism in the United States will *not* occur.

While the stock market crash may suggest the need for closer macroeconomic coordination, protectionist backlash would only compound the consequences of poor financial coordination, as the experience of the 1930s makes quite clear.

This does not mean that the political way is clear to the development of a harmonious Pacific Basin community. Although protectionism does not loom as an overwhelming threat to the trans-Pacific relationship, many other prospective irritants remain — particularly issues of national security and national autonomy, in their relationship to the huge overhang of American debt, and its concentration in the hands of the Pacific Basin foreign investors. Americans may not like the fact, as one investment banker put it recently, that "our interest rates, as well as our televisions, are manufactured in Japan," particularly when they fluctuate as rapidly as they have in late 1987. Some may recoil against the ongoing surge of foreign investment into the United States. Yet most, particularly at the state and local level in the large areas of the United States lacking fundamental conflicts of interest with East Asia, will welcome such investment, and seek to build a broader structure of interdependence that will help neutralize its prospective volatility. Deep American material and psychological interests were invested, and continue to be engaged, in the status quo despite the immense debt burden it has engendered. The prevailing economic and security tradeoffs reflect the short-run preferences of the American political process as well as those of transnational dominant groups in nations across the Pacific Basin. It will take more than the events of the past weeks to fundamentally reorient the trans-Pacific relationship.

National Defense and the Politics of Trans-Pacific Economic Relations

Only one sort of development could readily elicit American policy measures seriously threatening the progress of the emerging trans-Pacific economy. That would be unmistakable and broadly accepted evidence that an open trade and financial system was threatening American national security, in the narrow military sense in which Americans are accustomed to define such terms.

National security threats have powerful salience in American politics for several reasons. Defense-industry producers are among the most powerful of interest groups in the United States; the regions and sectors of the American political economy which have gained increasing ascendency over the past 15 years, as indicated earlier, have unusually strong traditional concerns with issues of defense. This orientation is particularly pronounced within the Republican Party, but is more broadly bipartisan as well. In addition to the foregoing, national defense as a symbol has the potential for igniting the subliminal fears of American decline and foreign dominance which are growing, and could well intensify, as the American standard of living inevitably declines relative to Japan due to dollar devaluation, higher interest rates and decreased American consumption, or some combination of these two.

The explosive potential of national defense as a potential irritant in trans-Pacific, and particularly in U.S.-Japan relations, was dramatically illustrated during the summer of 1987 in the so-called Toshiba affair. Although the military significance of the diversion of technology by Toshiba Machine Co. remains controversial, the issue was immediately seized upon by a broad range of groups in Congress and the Reagan administration, leading to legislative proposals to ban all exports of Toshiba products to the United States. These proposals were neutralized only through intensive lobbying and through major corrective measures by both Toshiba and the Japanese government. Should the relationship between the United States and the Soviet Union begin to ease during 1988 or thereafter, and a parallel Japanese relationship with Moscow ensue, moves by either the Japanese government or Japanese corporations to outpace the United States could generate dangerous strains to U.S.-Japan bilateral economic relations. This could be true even if the Japanese should be using only the relatively more active Western European overtures toward the Soviets as a benchmark for their own behavior. Americans will want to hold Japan — given the substantial benefits it receives from the trans-Pacific economy, and the greater military potential of Japanese technology — to a restrictive standard similar to their own.

In the absence of catalytic, national-security related shocks, however, it seems likely that the U.S.-Japan economic relationship, and the broader trans-Pacific framework of which it is at the core, should continue to deepen, even if the global multilateral structure of finance and trade continue to erode. For East Asia the United States, and to a lesser degree Canada and Australia, are among the few politically stable prospective sites for the rising industrial and capital surpluses which East Asians cannot readily consume at home, even if American capital markets sometimes move precipitously, as was true this past October. Conversely, for the advanced Western nations of the Pacific, East Asian capital, particularly Japanese capital, is the only alternative to sharp declines in local standards of living, and East Asian markets, for all their limitations, remain among the most rapidly growing in the world. The trans-Pacific economy is in the process of inevitable formation, and its emergence will not be easily restrained by spasmodic political forces, although the requirements for policy coordination which it generates have become dramatically clear.