US-Japan Trade Relations

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THE American merchandise trade deficit with Japan grew from US $ 9.9 billion in 1980 to US $ 19.4 billion in 1983. It nearly doubled in 1984, reached US $ 37 billion. The size of the deficit as well as its rapid growth, has created a situation that threatens good relations between the US and Japan. Both countries feel wronged by the other. The US blames the deficit on Japanese barriers to its domestic markets. The Japanese blame the deficit on American mismanagement of its economy—huge budget deficits and high domestic interest rates result in a grossly overvalued American dollar. The overvalued dollar makes American imports relatively inexpensive, while American exports find themselves priced out of many overseas markets. Many Japanese feel that they are being made the scapegoat for American domestic economic policy failures.

The root causes of the current situation go back to World War II. By the end of the war, the Japanese industrial structure—plant, equipment, transportation network, etc—had been essentially wiped out. Within thirty-five years of the end of the war, Japan became the world's second largest economy. An essential ingredient in this amazing reconstruction was the strong protectionism fostered by the Ministry of International Trade and Industry. A series of tariff and non-tariff barriers kept more competitive American and other foreign goods out. Similar policies restricted foreign investment in Japan. The man in the street was indoctrinated with the view that selling to foreigners and buying Japanese produced goods was a civic responsibility.

Japan has been under pressure from its trading partners since the early 1970s to open its markets to foreign goods. Over this period, her tariff and non-tariff barriers to trade have been lowered. The Japanese claim the process of opening their economy is essentially finished; Americans, Europeans, and many members of ASEAN claim that substantial barriers still remain. Where does the truth lie?

In the first place, the American argument that the sizeable trade deficit is, itself, evidence that Japan's markets are closed to US goods must be rejected. There are several reasons for this conclusion. First, Japanese purchases of American goods are substantial—over US $ 22 billion in 1983 which exceeded US exports to West Germany, France and Italy combined. Japan is the second largest importer of American goods (after Canada). Second, this argument ignores the effects of the overvalued US dollar on American imports and exports. Third, at the same time the Japanese economy was becoming more open, the trade deficit grew dramatically. Additionally, the trade deficit with Japan has declined as a proportion of the total US trade deficit. The $ 15.8 billion deficit in 1981 was 60 per cent of America's total trade deficit, while the $ 37 billion deficit last year was only about one-third of the total deficit. Fourth, it ignores completely the price and quality advantages that many Japanese products have over their American counterparts. Lastly, Japanese firms, on the whole, have tried harder to design and market their products to suit American tastes and culture than have American firms attempting to sell in Japan.

Japanese claims that the process of dismantling her protectionist barriers is completed must also be rejected. Japanese protectionism has been a cause, although perhaps not the major causes, of the US trade deficit. There is ample evidence to support this point of view. First, a comparison of the patterns of Japanese trade with other industrialised countries is quite revealing. From 1960 to 1980 the ratio of imports of manufactured goods to Gross National Product for the US, France, West Germany, and the UK increased dramatically, at least doubling for most of the countries. The Japanese ratio (2 per cent) was the lowest and remained constant over the entire 20 years. This certainly suggests an effective policy of restricting imports of manufactured goods. Second, although Japanese tariffs, on the average, are lower than those in the US and Western Europe, there are important tariff barriers in specific markets, for example, wood and paper products, agricultural machinery, alcholic beverages and wine. Third, there are many non-tariff barriers to trade including quotas on beef, citrus and cigarettes; complicated customs procedures; a refusal to accept foreign safety certification of products; etc. Finally, other countries perceive similar problems in their trade with Japan. For example, Taiwan temporarily barred the importation of 1,500 Japanese products in 1982 in retaliation for what it claimed were Japanese barriers to imports from Taiwan.

The Japanese government has recently implemented a series of recommendations made by its Advisory Committee for External Economic Issues. They are designed to improve access to domestic markets by encouraging imports, liberalise the domestic financial and capital markets, promote mutual investment and other objectives. As announced by the Ministerial Conference for Economic Measures on April 9, 1985, these measures include advanced implementation of the tariff reductions negotiated in the Tokyo Round Agreements, acceptance of foreign clinical test data for medical equipment, improving import conditions by providing import finance by the Export-Import Bank of Japan, lowering the Export-Import Bank of Japan's interest rate on loans to finance the importation of manufactured goods, import financing to purchase foreign communications satellites, licensing foreign banks to conduct a wider range of banking activities, as well as the widely publicised efforts to encourage Japanese to buy more imported goods.

There are several features of the domestic Japanese economy that, while not protectionist in the ordinary sense of the word, give Japanese firms a competitive edge. Japan has the highest domestic savings rate of any industrialised country. This provides a huge pool of funds for investment purposes since borrowing to finance consumption purchases is discouraged. As a result, domestic interest rates are low, certainly much lower than in the US. At the same time, Japanese firms rely much more on borrowed funds for expansion than do US firms. Consequently, Japanese firms can finance their growth with much lower profit margins. This gives them the ability to charge lower prices than their American competitors, even if their production costs are the same. The yen is undervalued. This is not the result of direct government exchange rate policy. It is caused by low domestic interest rates (or high US interest rates), as well as Japanese restrictions on capital inflows. An undervalued yen boosts Japanese exports.

Americans believe that fair trade is a precondition for free trade. Many think that Japanese trade barriers are a major cause of the US trade deficit. While this view is substantially incorrect, it does contain an element of truth. Pressure for retaliation against Japan is growing. The US Senate recently voted 92-0 in favour of a resolution calling on President Reagan to 'obtain the elimination' of Japanese practices that are viewed as unfair.

There has always been a strong isolationist element in the US. If the growth of the American economy slows further and unemployment remains high, there is a very real chance that Congress will vote retaliatory measures against Japan. The longer nothing is done to cure the basic disease—the huge budget deficits in the US—the more likely are attempts to treat the symptoms. Such treatment will only make the patient worse, in this case by precipitating a trade war with Japan.

The consequences of such ill-advised, short-sighted action would be disastrous, for not only the Japanese and American people, but the whole system of world trade.