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US - Japan Economic Problems

by

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Introduction

To the best of my knowledge, the current problems in the areas of trade and defense are very well summarized in Mr. John H. Holdridge's prepared statement on March 1, 1982 [1]. I find myself in basic agreement with him in evaluating the current situation between US and Japan and recommending certain directions and implementing speed of policies. The climate of Japanese argument and domestic politics surrounding those issues seems to be adequately conveyed to the House of Representatives Subcommittees by excellent testimonies like those of Prof. G.L. Curtis and others quoted at the end of this report. Historic evolution of US-Japan relations are interestingly summarized by Ambassador U. Alexis Johnson from the viewpoint of an US diplomat. If these statements are well understood by the Parliament members and the general public, reasonable solution of the economic problems between the US and Japan does not seem to be too difficult. In reality, however, much of the heat with the US-Japan relations comes from the misunderstanding and the political implications of the economic issues as well as the different styles of approaches in the two countries to resolve such conflicts. In this report I sum up first the common interests and values of both countries which unite them inspite of their obvious differences in social and cultural backgrounds.

Then I analyze the problem areas in the US-Japan relations. On the bases of the analyses, I lastly offer my opinions on the resolution of current and future conflicts between the US and Japan.

1. Japan as No. 2 in Western Alliance

No doubt, US, Western Europe, Canada and Japan collaborated in the OECD, the annual Summit meetings and some issue-specific international conferences. Through these meetings US and Japan must have come to realize their tremendous influence in economic affairs as the two largest economic powers in the world. Especially the shift of Japan's own image from a regional economic power to a global power as one of allies in the Western Alliance seems to have taken place in the recent few years. There is still some uncertainty to what extent one can extrapolate this latest trend into the future. If, however, one could assume that the trend persists into the rest of 80's and the 90's, this might imply that Japan had taken steps toward No.2 in Western Alliance. One can not doubt that Japan is one of leading members of industrialized, democratic countries in the world now, but the question is when Japan will be ready to take a leading role in the sphere of international politics, including military affairs. Unless Japan plays a certain political role appropriate to her own economic power, which may be economically and politically costly, she is likely to be criticized as remaining a sheer beneficiary and not sharing the responsibility of supporting and shaping the free world system. In other words, the problem facing Japan now is to find the best passage from contemporary Japan as an exclusively economic power to future Japan as No.2 in Western Alliance.

There are some circles of intellectuals, journalists, and politicians in Japan who try to assign Japan a task which does not require an alliance with Western countries, while benefiting from the free association and trade with them, inspite of her enormous economic power. This report will offer an indirect criticism on such positions.

2. Basic Common Interests and Values for Cooperation

The basic common interests and values which combine both countries may be the following:

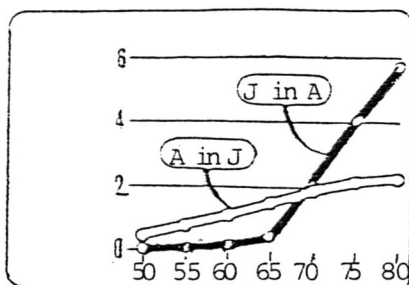
- (1) The geo-political position of Japan and the US in Asia and the Pacific, facing the Chinese continent, the Soviet Union's Siberia, and Asiatic Balkan, Southeast Asia. The presence of the US in Asia as the dominant military power gave Japan the ideal opportunity to reconstruct and rapidly develop its economy without causing any serious tension vis à vis other new nations in Asia as well as being harassed by the threat of the Soviet Union. The friendly relationships that have gradually developed across the Pacific and the economic achievement throughout the postwar years set a model stage in which peace, security and development can bring about to the welfare of war-devastated poor Asian countries.
- (2) The highly integrated economic interdependence makes not only the foreign trade between the two - amounting to 60 billion dollars in 1981 - essential to the prosperity of two giant economies but also indispensable to the development of the world economy, especially the neighboring LDC's.
- (3) The dedication to the same democratic values of government, freedom of expression and association and the guarantee of fundamental human rights. This is a unique factor in engendering Japan's alliance with the 'West', despite its location in the Far East. The political culture in Asia is so fundamentally different from the West-European or Anglosaxon tradition that the success of Japan in accepting the Western democratic values and institutions must be truly precious in offering the world the 'Japan model' in economic, social and political development.

- (4) The increasing importance of mutual cooperation in science and technology interchange. In the near future, if not now, both countries will lead the world in many of scientific and technological research and applications. According to UN data in '78 and Science and Technology Agency's Indicators of Science and Technology, 1981, the number of scientists and engineers and R & D expenditure are the following:

Table 1: R & D Expenditure and Personnel

	Scientists & Engineers	Expenditure for R & D (79)
US	541 (Thousand)	54.3 billions \$
Japan	399	18.6 "
France	66	10.2 "
Germany	104	15.1 "

- (5) The mutual permeation and appreciation of cultural interchange between East and West. Not only Japan has enthusiastically appreciated and successfully integrated the western and American culture but also an increasing number of US citizens have come to appreciate Japanese culture and begun to accept it as a part of modern American culture in a melting pot. This is very important if we understand that the basic conflicts between the US and Japan can only be resolved by overcoming the culture conflicts through mutual appreciation of different cultures and personal contact.



This aspect has gradually shifted from one way to two-way traffic across the Pacific. One symbolic fact is that the US citizens staying in Japan have been exceeded by the Japanese staying

in the US in 1970. The latter are almost 60,000 now, and it has become almost a daily event to meet Japanese and encounter Japanese things at least in big cities in the US.

The mutual benefit derived from foreign trade and security arrangement based on the US-Japan Security Treaty are too obvious to mention here. It had better be emphasized, however, that the economic benefit is indeed positive. Although the economic competition gets so serious at times that some irritated people tend to forget the benefit, particularly when faced with sluggish growth, it must be regarded always as a game of positive sum. The benefit of the US-Japan growth really spread over East and Southeast Asian countries. From the US perspectives, the benefit of maintaining forces and bases in Japan and having the expenses paid by Japanese government must be great. The security guaranteed for the Japanese nation by the military presence of US forces in Japan is essential to Japanese national security. These benefits are so great that it is inconceivable to expect any serious deterioration of US-Japan relations in the contemporary world situation. If, however, a major deterioration took place for any reason, it would demand enormously more resources for both countries to maintain the standard of living without the benefit of free trade and also quickly destabilize the economic and political order in East and Southeast Asia. In this sense Japan as a good partner of the US in the western Pacific is a "stabilizing force."

Indeed, the US-Japan partnership in Asia seems to have been accepted by almost all Asian countries, including China, as an ideally-balanced support to the region by two powers with the greatest political and economic influence. Asian nations hardly need a hegemony by one or the other and at the same time expect to match them to the potential threat of China

and the Soviet Union. The remarkable development of "Gang of Four" in Asia and other Southeast Asian countries is a bright aspect of otherwise gloomy North-South problems and may open up an outlet for our difficult dealing with the Third World.

The synergetic involvement of the US and Japan in East and Southeast Asia does not seem to have induced European countries to revive their interests in this region. West Germany shows some influence in Indonesia, and France in Indochina. But their influences are very limited so far.

The good balance in Economic sphere may be seen by the following two tables:

Table 2: The US and Japan's Share in ASEAN Trade, 1977

		Indonesia	Malaysia	Philippines	Singapore	Thailand
Exports	Japan	40.2%	21.1%	23.2%	9.5%	25.8%
	U.S.	27.7	15.6	35.3	15.5	10.0
Imports	Japan	27.1	21.3	24.9	17.5	32.4
	U.S.	12.5	12.6	20.5	12.6	13.4

Table 3: Foreign Capital Accumulated in ASEAN Countries up to 1977

(million dollars)					
	Indonesia*	Malaysia	Philippines*	Singapore	Thailand
Total	\$5,294	\$ 416	\$ 564	\$1,699	\$ 171
Japan	39.0%	23.4%	25.3%	15.3%	34.6%
U.S.	19.2	18.7	33.1	33.0	15.6

Source: JETRO, White Papers on External Trade, 1978

* These two countries' figures are based on permission figures.

3. Problem Areas: Trade and Defense

The partnership is not without occasional strains. Earlier in post-war years, strains were more on the Japanese side, particularly against the US military presence on Japanese soil which was exploited by leftish anti-Americanism and utopian pacifists - those who could only live post-war years on the basis of their wartime anguish. In recent year, however, strains are felt on the US side. They are caused by the unexpected success of Japanese industries rather than malicious rivalry. The trade frictions seem to have aggravated the sentiment of some circles in the US against Japan's 'free riding' or 'cheap riding' for defense despite its enormous economic power. Thus Trade and Defense are problem areas.

The trade conflicts appear as follows:

- (1) The commodity trade balance between the US and Japan is always seriously unfavorable for the US.
- (2) Although the US current balance of payments have been foorable, the gap is narrowing. The commodity composition is changing toward less income elastic items, so that unless the Japanese rate of growth remains substantially above the US rate, this imbalance seems to persist.
- (3) Japan has reduced the custom duties substantially so that its tariffs are lower on the average than most EC countries, But the so-called non-tariff barriers are prevalent, and the entry into the Japanese markets are far more difficult than the entry into the US market. It may imply that the second largest economic power is still unwilling to carry its share of the burden in supporting the free trade and free capital movement system.

Each of these problems will be discussed further in later sections.

As for defense area, Japan has accepted in principle to assume primary responsibility for its local defense, particularly air defense and protection of its sea-lanes up to 1,000 miles in cooperation with the US forces in the western Pacific area. The problems seem to be the following:

- (1) Do we jointly have enough capabilities to achieve the objectives? If not, we must take the appropriate steps to prepare ourselves. The speed with which the Japanese government wishes to make progress may not match the one that the US government wishes Japan to do.
- (2) Joint planning, joint exercises, cost-sharing, exchange of military technologies must proceed as smoothly as possible and at the highest level of their technicalities. There is much to be desired.
- (3) Economic sanctions and other means to keep our comprehensive balance of power against the Soviet Union as favorable as possible must be undertaken in good coordination not only between the US and Japan but also jointly with all Western allies. This is by no means easy.
- (4) Japanese ODA must be increased. In spite of a large deficit and zero growth budget, the expenditure for defense and international cooperation has been increased. Foreign aid cannot be a substitute for defense in the strict sense, but it is an important means of buying the trust of many new nations with Japan and seems an important step for her to recognize her global role not only as an economic power but also as a political, if not military, power in the world. She is now finding a way

of contributing to peace and stability by aiding Turkey, Sudan, Egypt and Jamaica as well as the ROK. Such policies certainly supplement the US policies and support the US's position in international politics. To explain such policies to the public may be a wise step to educate the Japanese public opinions or mass media.

- (5) For the sake of national security, strategic stockpiles of oil and food are highly desirable. The Japanese government can do a lot more, even if she can not do as much as the US government wishes Japan to do. Even these are not done mainly due to the budget constraints now.

These problems related to defense will not be discussed in this report but delegated to the next report.

4. Trade Conflicts: The "Peril Points"

There is no doubt that the current strains between the US and Japan are the psychological irritation rather than the true economic conflicts which will persist for a long time. It is true that there are some genuine issues which both governments must try to and can solve. The reduction or elimination of non-tariff barriers is such an example. But there are some issues also which cannot be resolved so easily for good reasons. Protection of some agricultural products to some extent is such an example.

Whenever a certain conflict occurs between one country and another, it occurs in the unfavorable social or political circumstance. After studying the Tanaka riots in Thailand and Indonesia, I discovered that if Japan's share in capital investment exceeds about 30% of all foreign investment, then the indigenous capital and overseas Chinese capital

jointly arouse nationalistic antagonism. I called it the "peril point". In the case of the US, there are some sensitive areas where the psychological irritation of US workers or political leaders becomes particularly touchy.

Such "peril points" may be expressed in the following five indexes.

- (1) The unemployment rate exceeds 7-9%.
- (2) Japanese share in the US market exceeds 15-20%.
- (3) The share of export in Japanese production approaches 50%.
- (4) One or two 'politically influential' enterprises are seriously affected.
- (5) Competition involves strategically important industries.

The first factor is an index of recession. Unemployment, inflation, production index, GDP etc. can be used as an index. Most of conflicts were observed in 1976-77 and 1980-82, when the ratio of unemployment to labor force exceeded 7-9%. In the first case, the issues were color TV, Iron & Steel, whereas in the second case the issues were about automobiles, IC and Tele-communication systems. Even if the balance of trade with Japan was unfavorable, the trade conflicts did not necessarily occur unless serious recession set in. In fact the US balance of merchandise trade has been almost always unfavorable, as is shown in Table 4, but trade conflicts were serious only in the above-mentioned years.

But the current balance of payments have been generally favorable, as the last column of Table 4 shows. The US commodity trade is largely offset by the large amount of services and transfers, whereas the same items are greatly negative. This problem is not always recognized even among experts. Table 5 shows this information. The overall balance of payments are positive for the US in 80 and 81 and negative for Japan

Table 4: US Merchandise Trade and Balance with Japan and the World

	Export	Import	BOT	BOT with world	(million US\$) BOP with world
1973	8,313	9,676	-1,363	911	7,140
1974	10,670	12,338	-1,659	-5,343	2,124
1975	9,563	11,268	-1,705	9,047	18,280
1976	10,145	15,504	-5,359	-9,306	4,384
1977	10,522	18,623	-8,101	-30,873	-14,068
1978	12,885	24,458	-11,573	-33,759	-14,259
1979	17,581	26,248	-8,667	-39,469	-705
1980	20,790	30,701	-9,911	-27,350	118

Table 5: Services & Transfers, 1973-80 (million US\$)

	Japan	US	Germany	France	UK
1973	-3,824	6,229	-9,970	-1,295	3,747
1974	-6,129	7,467	-10,390	-1,547	4,610
1975	-5,710	9,233	-11,740	-1,003	3,657
1976	-6,207	13,690	-11,270	-1,294	5,121
1977	-6,393	16,805	-14,150	-273	3,619
1978	-8,062	19,500	-13,810	3,074	4,390
1979	-10,599	28,681	-19,710	3,122	3,995
1980	-12,871	27,472	-20,960		3,662

in 80 and 81. In 1982, however, this may be reversed. The US criticism on Japan's bilateral balance of trade with the US can hardly be justified.

Nevertheless, the irritation of US industries has its own logic. The US colored TV Protection Committee was formed, when the market share of Japanese TV jumped from 15.7% in 1975 to 30.1% in 1976. The US steel industry appealed to the court as dumping, when the market share of EC-Japan export reached 17.8% in 1977. The US automobile companies

made a coalition with UAW, when Japanese share exceeded 16.6% in 1979. Mr. K. Kawamata, Chairman of Nissan Motor Co. remarked that 16.5% may be about the maximum allowance that the US to Japanese automakers. It is not clear if this is really so. It remains to be seen what happens, if the ceiling set at 1.68 million can be removed after several years of adjustment period.

If the share of exports approaches to 50%, the argument for demanding to invest abroad becomes forceful. Mr. Frasec of UAW criticized Japanese industrialists on his recent visit to Tokyo by saying that Japan is exporting unemployment if it directs its production exclusively to exports. All these arguments have no justifiable ground since they do not consider the benefit to consumers. But it is one of the peril points which can persuade the public.

In any country producers are politically more influential than consumers. Unless some influential producers are beaten, Japanese exports do not cause any social or political concerns. Examples are: VTR, Motor-cycles, Desk calculators, camera or watches. But once Bethlehem loses, or Zenith lays off one quarter of its employees, Japanese iron and steel exports have to be restrained. Many Japanese TV producers then began the production in the US.

It is expected now that the highly technology-intensive industries like LSI, computers, bio-technology may become very competitive between Japan and the US. In this area, the US defense expenditure may be making significant contributions to the R & D in the field, whereas MITI in Japan in supporting similar front R & D. We must find some way of achieving cooperation before getting into conflicts with each other.

5. Trade Conflicts: Productivity Gap and Growth Gap

The entry of Japanese industries into the areas, long considered the US preserve, has caused a serious concern about the future division of labor between the US and Japan. Table 6 shows the commodity composition of US trade with Japan by major category.

Table 6: US Merchandise Trade and Balance with Japan
by Commodity Group, 1979 & 80

	(billion\$, fas)					
	US Imports		US Exports		Balance	
	1979	1980	1979	1980	1979	1980
Total	26.2	30.7	17.6	20.8	-8.6	-9.9
Food, Feeds, Beverages	0.2	0.3	4.7	5.4	4.5	5.1
Indust. Supplies & Materials	5.3	5.9	7.7	9.5	2.4	3.6
Cap. Goods ex. Auto.	5.7	6.6	3.5	4.1	-2.2	-2.5
Automotive Vehicles	9.3	11.4	0.2	0.2	-9.1	-11.2
Consumer Goods	5.6	6.2	1.0	1.2	-4.6	-5.0
Other	0.2	0.3	0.4	0.4	0.2	0.1

In terms of more specific commodities, it is known that the export items are: soybeans, maize, logs, wheat, cotton, rawhide, scrap metal and airplanes, whereas the import items are: automotive vehicles, iron & steel products, radio receivers, motorcycles, tape-recorders, cameras, metal fasteners, TV, office machines, metal cutting machine tools and calculators. One may get the impression that the US is almost like a plantation supplying Japan with raw materials and buying back high-technology manufactures. The impression is not quite right, because agriculture is technologically advanced and some exports are airplanes and other very high technology products.

A more important problem here is that these agricultural commodities have low income elasticities and low price elasticities. As the relative prices of such products tend to deteriorate, an increasing quantity of US exports of primary products are going to be required for the same quantity of imports of sophisticated manufactured goods from Japan in the long run. Unless, therefore, the growth rate of the Japanese economy always remains considerably higher than that of the US economy, the trade balance would tend to move in favor of Japan. In this connection it is highly desirable to permit the export of Alaskan oil to Japan. A key to overcome this imbalance in the long run is, however, to shift the commodity composition of US exports toward higher value-added manufactured goods. This implies to improve the competition capacities of US manufacturing industries vis à vis Japan. This does not seem to be very easy.

A surprising fact is that Japanese workers are equipped with more and more capital goods or machines per head than the US workers at the present time. Look at Table 7.

Table 7: Gross Capital Formation per Capita, 1980

	GNP per capita	% of GCF to GDP	GCF per capita
US	11,536	18.1	2,056
Japan	8,902	32.0	2,848

Moreover, the higher percentage of Gross Capital Formation in Japan than that in the US is in the form of private capital formation. There is no doubt that the Japanese manufacturers as a whole will be more productive in the future as well as now.

This does not necessarily lead to more serious trade conflicts, if the wages in the US can remain self-restraint and inflation does not get out of hand. As we argued above, it is the general recession which causes the trade conflicts. The balance of payment can be resolved sooner or later by the flexible exchange rate between the countries like the US and Japan. To run the national economy on the sound track is the most important thing.

6. Non-Economic Considerations

There seem to be some additional considerations that we must keep in mind in our effort to resolve the conflicts between the US and Japan.

(1) Attitudinal difference: The Japanese leaders and officials tend to respond only to the US request at the bare minimum level.

If it is repeated, resentment accumulates, perhaps in both countries. Japan views itself as a scape-goat for domestic problems or politics of US industries, whereas many Americans view Japan as the cause of their misfortunes and remember "infamy" at the Pearl Harbor. Some such expressions are remarked by a number of people nowadays. What is important here is to start negotiations early, try hard to compromise very soon, implement policies quickly with adequate public relations.

(2) Protection of Japanese Agriculture: While it is almost impossible now to justify most non-tariff barriers (standard, procedures, permit, associations' exclusive agreements etc.), it must be admitted that the present level of self-supply of food around 45% is almost the minimum level for national

economic security. Negotiations with the US can be concluded only by compromises. It is not wise to completely liberalize the trade of agricultural products. This must be understandable for any considerate experts.

(3) Regional Considerations: In the US some regions are particularly affected. Japanese economic federations and government may well consider the appropriate counter measures like investment in the nearby areas or extending loans. The same kind of policies are undertaken in order to promote the relocation of industries inside Japan. The states of Ohio, Michigan, Pennsylvania or California could certainly absorb some new industries from Japan.

(4) Japan's Industrial Policy to be reconsidered: As I argued ([7], [8]) the Japanese government tried to develop all kinds of manufacturing industries by adapting "one-set-ism," mainly to reduce the imports. This resulted in the extremely low ratio of imports of manufactured goods. So far this policy was very successful, but now Japan must give up a number of labor-intensive industries to NIC's or LDC's and even some technology-intensive industries to the US, Canada and other countries according to the principles of comparative advantage. This is the way to co-prosperity.

7. Policy Recommendations

In these circumstances, what kind of policy-mix should be recommended? Ceteris Paribus the unfavorable balance of payments should make Yen revalued or dollars devalued, but due to the high rate of interest in the US, the

Yen/dollar rate remains as high as 230 Yen/dollar. There are several policy-mix alternatives to overcome this kind of economic conditions. They may be listed here and will be evaluated later.

- (1) On the one hand the Bank of Japan should tighten the supply of money and thereby raise the rate of interest, while at the same time the Japanese government increase the fiscal expenditure and more than compensate the deflationary effect of tight money policy. On the other hand the US government should take the reversed policy-mix. This will narrow the interest rate gap and reverse the direction of capital movement.
- (2) The export duties may be imposed on Japanese exports, whereas the imports may be subsidized or the import duties may be reduced as much as possible.
- (3) The quantitative control may be imposed upon the export of some specific commodities in question by bilateral negotiations. This is certainly a moderate form of protectionism.

The degree of market intervention is the highest in (3) and the lowest in (1) but the immediate effect is also in the order of (3), (2) and (1). There are, however, serious problems in (2) and (3) in the long-run. Although these policy-mix may be able to improve the US balance of payment with Japan in the short run, they will not solve the fundamental problems, so that the controls regarded as emergency counter-measures are likely to persist and the same kind of problems will reappear with other commodities or with the same commodities in different ways. As the result, the misallocation of resources is unavoidable both in the US and Japan. This is precisely what must be

avoided to revitalize the world economy, especially the industrialized, democratic countries' economies.

The first orthodox prescription (1) does not have such defects but has several other difficulties:

- (a) It requires the widening deficit in Japanese budget which is already suffering from very serious shortage of revenue. The resistance to tax increase is very strong in the midst of government administration reform at the moment (1982, Spring).
- (b) Under the circumstance this policy-mix will crowd out the private capital formation not only in the short run but also in the long run. This will reduce the productive capital formation and decrease the efficiency of the Japanese economy.
- (c) The Japanese Ministry of Finance is controlling the international finance. For instance the finance of Yen to overseas corporations has been strictly controlled until May 15, 1982. The restrictions on Japanese commercial banks' loans are still quantitatively controlled. Were it not for such restrictions, the raising funds in the Tokyo market by foreign government and businesses would be much easier. The US rate of interest can come down more easily

For these reasons, the above mentioned three policy-mix all have some difficulties to remedy the current situation in a quick way. One should not expect the hit-and-run kind of effect now. What ought to be done is:

- (1) Take all feasible measures to open up the Japanese market.
- (2) Be prepared for slow economic growth until the US economy picks

up and wait until the rate of interest in the US comes down. Hasty measures to lower interest rates like those taken in Germany and the Netherland early May do not seem to be warranted in Japan now.

- (3) Promote the government administration reform so that efficiency of the public sector may be maintained in Japan. This is the area in which all the western democratic countries failed in the past. Japan should learn to be wise by the folly of others and demonstrate a lesson for the success for the followers.

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