

Transition to the Future

Meeting at the October 15-19 JEF-Aspen U.S.-Japan Council seminar near Washington, D.C., Japan Economic Foundation president Naohiro Amaya and Columbia University international business professor Hugh Patrick talked about the future problems and potential of Japan-United States economic relations. *Nihon Keizai Shimbun* senior economics writer Akira Kojima served as moderator for this far-reaching discussion.

Kojima: *To begin with, could you give us your comments about the future prospects for the world economic situation?*

Amaya: The oil-and-electricity civilization was born in the United States early in the 20th century, and America gained a

headstart over other countries in its development. After the war, the United States exported this civilization's technology and way of life all over the world. This dissemination triggered unprecedented high economic growth. However, this momentum was lost and the oil-and-electricity civilization has been in decline since the mid-1960s.

On the horizon, there is a new civilization rising which we might call the electronics-and-information civilization. Nobody knows exactly what form this new civilization will take, but it will likely

involve major changes not only in technology but in values, ethics, and economic and political systems, both domestic and international. In the meantime, we are going through a very unstable and tumultuous transition period. Since 1971, the GATT and IMF systems have experienced a series of earthquakes leading to greater instability throughout the international economic system. The world economic and political order will not be stable until the United States, Japan, and Europe have their feet firmly planted in the new age. The leadership for this will probably have to come from the United States. Japan will try to follow right along, but there is some apprehension as to whether or not Europe can keep up.

In any case, the question of how to cope with these transitional difficulties has become crucial. If we are to avoid falling into all-out protectionism or some such other chaotic situation, we must pass through this transition as smoothly as possible. The problems are already immense. The LDCs are in deep trouble, and the socialist countries also face difficult problems and serious instabilities. This transition poses some very fundamental problems of adjustment. However, just as some of the rules and structures of the international economic system will have to change as a result of the underlying technological changes, there are certain basic principles that should endure, among them the open and free movement of goods and capital and the flexibility necessary to adapt to various pressures. We will need leadership to make sure both that the good rules are defended and that obsolete rules are altered to meet changing conditions.

Patrick: The world economy is at a major crossroads. Either we are going to have a reaffirmation of our international economic system of open trade and relatively free economic relationships or, once the current recovery slows down, we may find that the underlying structural problems are so severe that the world moves into a new kind of protectionist environment. It is not yet clear to me which way the world will move.

In the short run, the United States eco-



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conomic recovery, the renewed relatively rapid growth of the Japanese economy, and general recovery in the world economy are all very positive features. There are optimistic predictions that this growth will continue and bring about a reaffirmation of our open economic system. But such growth is by no means guaranteed, nor will the recovery alone be sufficient for such reaffirmation. Much of economic life is locked into existing factories, buildings, and machinery. Industrial restructuring will not be easy. All advanced industrial nations are having to cope with this problem. I agree the United States and Japan have coped better than Europe in moving ahead more rapidly into the new era. To avoid the possibility that Europe may feel threatened by the joint supremacy of the United States and Japan, the presently poor trilateral relationship must be improved. What we have now are two bilateral relationships—the United States and Japan, and the United States and Europe—with very weak relations between Japan and Europe.

Amaya: The industries which prospered in the oil-and-electricity age, such as steel, petrochemicals, synthetic fibers, and so on, are now in trouble because they are not adapting to the new era. However, those smokestack industries are still much stronger than the new industries in terms of employment, production, and political influence. The smokestack industries are putting significant pressure on governments and politicians to introduce measures protecting smokestack interests. If we give in to this protectionist pressure, the path to the new era will be lost. But the new industries still comprise only about 10–20% of manufacturing employment, and naturally the politicians concentrate on the other 80–90%. The future is not their constituency.

Patrick: That is true in the United States, Japan, and Europe. At the risk of further complicating this issue, I would add that the transition involves not just a change in civilizations but also the spread of industrial civilization to more and more countries to take advantage of low production costs. It took some years for Japan to become the lowest-cost producer of steel. But we are now finding that, for certain types of steel, Korea is a lower-cost producer. In the future, we may see Korea or other countries producing good small cars cheaply and efficiently.

From the world economic perspective, this competition is a positive factor. But from the viewpoint of, for example, an individual steel company in the United States, and soon in Japan, it is not so positive. The problems of adjustment are very difficult to solve, and the industries needing adjustment are generally politically powerful. The policies the United States has pursued to protect its steel

industry without requiring it to raise productivity and reduce costs have been a serious mistake. It would be a dangerous mistake if Japan were to end up pursuing the same kinds of policies. There are certain parts of the steel industry in any country that will continue to be efficient and competitive, particularly specialty, high-value-added steels. Meanwhile, the Koreans, Taiwans, and Brazils should be allowed to compete fairly on the basis of their competitiveness in lower-value-added steels.

"The information revolution has made us much more aware of the rest of the world."

Amaya: The demand for human (non-automatable) labor will increase in the advanced industrialized countries as we get into the electronics-and-information age. However, the demand for blue-collar labor will decrease. The question is how to transfer people from blue-collar work to more technically advanced work. It is a difficult problem, but it must be solved.

Patrick: The time period in which decisions must be made is getting shorter, too. That is part of today's information and communications revolution. A hundred years ago, we had to wait until the ship arrived with information. There were weeks to think decisions over in the meantime. Today, information arrives almost

immediately and decision-makers have to respond almost immediately, and that has put pressure on political and other decision-making apparatuses. On the positive side, however, this information revolution has made us much more aware of the rest of the world. We can now see on television what a war does to people. We are much more immediately aware of the world's problems, and this forces us to become more internationalist. We have to take international events much more into account than we did 20 or 30 years ago.

Kojima: Yet it seems that people in the United States and Japan are becoming more nationalistic as a result of transitional stress.

Amaya: I do not think so. When the economy slows down, then people become inward-looking, but when the economy expands, so does their outlook. I do not think there is a strong trend away from internationalism.

Patrick: The average American is now exposed to a much wider range of foreign influences than ever before. Quite routinely, he is buying foreign cars, watching foreign-made TVs, and eating foreign foods. It is amazing how many Americans are using chopsticks now and eating Chinese and Japanese food. When people take these foreign things as natural rather than foreign, that broadens their horizons.

Amaya: Yet even though people are growing increasingly internationalist in their lifestyles, nationalism creeps back in

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when it comes to "special interests" such as preserving jobs.

Patrick: The reality of interdependence is seen as a threat by some people and some companies. But that does not make the reality go away, and it is the politicians' job to devise mechanisms to help reduce that threat. Protectionism is a very inefficient mechanism. It is much more efficient to help companies raise productivity, to diversify into new products, and so on. This takes time, but it is the kind of positive action that must be done.

Amaya: In the meantime, economic vitality is an essential prerequisite for preventing the rise of nationalistic sentiments.

Patrick: I am moderately optimistic about the short-run prospects for the United States economy. Yet the international trade situation is so bad now for the United States that some kind of Congressional reaction seems inevitable. This reaction may contain some strong protectionist sentiment, especially vis-a-vis Japan. This would be very unfortunate, and I am very concerned about this possibility. Much of this protectionism emanates from the macroeconomic problem of America's very high interest rates, which are related to the budget deficit.

The United States will have to respond to this deficit problem in its domestic and international economic policy in the next six to nine months, and this will be a real time of testing for the United States and, by virtue of America's leadership position, the world. Japan can help in formulating that response. Americans have outdated perceptions about Japan's fairness in economic behavior. They need to change their perceptions, but to do this they need signals from Japan, both explaining what the new reality is and taking further steps to reinforce the new reality.

One of the most important things the United States did at the end of World War II was to open its market to the world. Access to the United States market was one of the essential conditions for getting the postwar economic system going—indeed an open market is an essential condition to be a leader in the present world. This is an area in which Japan has made great progress, and can make further progress by saying: "Our markets will be open to the world. We know this will cause domestic political problems, we know that it will be difficult, but we will take our leadership role seriously and do it."

I do not think Japan has been particularly unfair. No country is completely open. It is difficult even to compare the degree of openness among different economies. But that is not the issue. The issue is one of leadership. If we do not have leadership exercised by several countries, and today this means the United States and Japan, then we have the danger of

losing the system that has worked so well for all of us.

Amaya: I agree 100% that the cooperative partnership between the United States and Japan is the key to maintaining the free trade system. The major problem in this partnership is the United States government deficit, but many Americans are not willing to look this problem squarely in the eye. Instead they use Japan and its trade surplus as a sort of scapegoat or red herring. This engenders a vicious circle of emotional charges and counter-charges across the Pacific and creates a widening rift in the United States-Japan partnership, increasing the danger that this partnership will deteriorate into a replay of the 1930s experience.

"The bilateral problems are made difficult by emotionalism."

Patrick: In the United States, many different people in positions of responsibility have very different views, and they all speak out quite openly. It must be very difficult for foreign observers to interpret how important any one particular remark might be. The Japanese press has not done a very good job in this. Inevitably, we have to expect a certain amount of noise and emotionalism in the Japan-United States partnership. The main issue is how the responsible business and government leadership creates the appropriate environment for the future.

The American Administration should plainly say: "Our bilateral trade balance is not the issue. We have to look at it in broader terms. We have to look at our total trade situation. Although other countries may have some blame in this, the major responsibility is our own. We will tackle this directly." That kind of policy position would do much to reduce bilateral tensions, but it requires that the American leadership rise above what it has been. My hope is that the United States government will do that, and at the same time, Japan will be seen as taking some initiative, continuing its market-opening process on its own rather than just reacting to United States policy. We need both of these positive steps to create a new environment for the Japan-United States relationship.

Amaya: The United States and Japan have shared economic interests and should collaborate in constructing a solid base for cooperation. There will be occasional spats, but they should be resolved quietly and objectively. Fundamentally, the bilateral problems are not so difficult. They are made difficult by emotionalism. There is a solid foundation for United States-Japan cooperation. For instance, there is the question of how to contribute

to China's solid economic development. The United States and Japan can do quite a lot together in this. The LDCs are another big question. Most LDCs are in serious trouble. Ignoring them will only cause greater instability in the world economy. Further decline in Europe could remove an essential pillar supporting the world economy. We cannot dismiss this as simply a European problem—it is everyone's problem.

There is also much to be done to make the energy situation more stable. The Pacific Basin includes many energy-producing countries as well as energy-consuming countries, but there is little co-operation among them. Australia, China, Canada, and the United States are fighting over who will supply coal to Japan. The Japanese government estimates of Japan's energy demand outlook together with the macro-economic policy goals have persistently tended, since the so-called Nixon shock, to exceed the reality, and so there is now oversupply in coal and LNG. The supply and demand sides should communicate more closely. Some coordination is needed among energy suppliers for the sake of stability in the Pacific Basin.

Patrick: I see cooperation essentially at the governmental level. Governments should cooperate in establishing the rules of the game, in staying informed, and especially in setting up the institutional and policy framework in which private business operates. Some of those rules have to be designed, in principle, for the world as a whole; but at the same time some have to be thought of in terms of regions, or even specific countries such as China.

We can do a lot in cooperation, but we have to expect that companies are going to compete with each other. We should have cooperation at the national and international levels while we have competition at the private-sector level. The important thing is to set up the rules of the game to allow for competition and then let the companies show how effectively they can compete. We should let market forces operate.

We should have both a global institutional and regulatory framework and some way of approaching specific problems that are more regional in nature. For instance, the developing-country debt problem is centered in Latin America, and the extreme poverty problem particularly in Africa.

The Pacific Basin has a different set of problems and a different set of opportunities. Frankly, I think the prospects for co-operation in the Pacific Basin are excellent in terms of opportunities, but at the same time there is the very real danger that United States-Japan cooperation may become so close that it is perceived by

Southeast Asians as being a conspiracy against them, rather than in their interest. This would be very destabilizing. Cooperation *per se* does not necessarily mean that others will view it as beneficial. The United States and Japan should cooperate in a way that takes everyone's needs and perceptions into account.

The basic problem about China is the uncertainty factor regarding their future political development. We do not know but, there may be yet another fundamental policy shift in the next decade or so. It is that kind of political risk that makes better information and mechanisms for reducing that risk important. If several nations, such as the United States, Japan, and those of Western Europe formed a consortium with China for Chinese industrial development, and if a major policy shift destroyed the consortium, the Chinese would be alienating not just one country but a whole group of countries. Such multinational consortiums reduce the political risk and make the climate more attractive. We need arrangements among governments to make sure that we have that kind of framework.

Kojima: *On the subject of Japan-United States relations, have you seen any changes in Japanese and American perceptions about each other recently?*

Patrick: The severe recession in the United States has made Americans more inward-looking and more prone to blame foreign scapegoats for domestic ills. As the American economy picks up, we should see less of this. Some Americans are coming to see Japan as an economic threat, not just an economic challenger. That is very unfortunate, but it is only one part of a mixture of perceptions that are floating around in the United States. The United States is a very heterogeneous country—autoworkers in Detroit are quite anti-Japanese while auto buyers in California are quite pro-Japanese. Most of the negative reactions that we see have been from people who feel their livelihoods are threatened by the loss of jobs to Japan specifically.

I cannot explain the change in Japanese perceptions the same way. Japanese have grown less fond of Americans, but I do not think it is because of the recession. Perhaps the United States has pushed Japan too hard—and I think the United States has overplayed its hand—and there is some resentment and anger at this.

Amaya: Many people in America's smokestack industries perceive the Japanese competition as a threat, and this situation may get worse before it gets better. But in the long run, if the United States succeeds in developing its high-tech industries, as I am sure it will, the Japanese competition will come to be seen as a beneficial stimulus for the United States and for the world economy.

If the United States were the only country to develop the high-tech industries, it would risk isolation, but if Japan follows suit and both countries make efforts to explore and develop new worlds, this will snowball to include the ASEAN nations, Europe, and eventually the rest of the world. The United States and Japan should try to provide leadership in that direction. The question, however, is what to do about the declining industries in the interim. No matter what we do, the declining industries will decline and new industries develop. The future lies with the new industries.

Patrick: This is a problem of how to handle the declining industries and the people whose livelihoods have been affected—Japanese farmers, American steel and auto workers, and so on. These are knotty problems and they do take time.

Amaya: If there exists a World, Inc., the president should be the United States. Japan might be the vice-president, but Japan does not have the capacity to be leader of the world. Neither does Europe. Only the United States, if it succeeds in dealing with its declining industries, has the capacity to be president of World Inc.

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Patrick: I agree with you, but the same time, the United States wants to delegate more and more responsibility to the vice-president. I should point out that the problem of declining industries is getting bigger in Japan. Not only Japanese agriculture, but also Japanese smokestack industries are going to face increased foreign competition, and the way Japan has restricted imports of Korean steel reflects the same kind of mistakes the United States has made in the past.

Amaya: Given the rapid increase in steel imports, I find it hard to believe there are any barriers.

Patrick: My impression is that Japanese importers of Korean steel face severe penalties from Japanese steelmakers, and I suspect there are some private business practices penalizing importers which would be illegal under United States anti-trust laws.

Amaya: Japan has similar laws. If such practices are discovered, the Japanese steel company will certainly be punished.

Patrick: Even with the law, part of the problem is to establish the procedure for discovering such things. Does the government decide to look for them, or what? Each procedure has its advantages and disadvantages. Under United States anti-trust laws, a private company that is hurt can sue another company and get triple

damages. That means it has an economic incentive to sue if it is truly suffering. An additional advantage is that this law tends to prevent companies from breaking the law. The disadvantage is that it results in many lawsuits and may be misused to prevent some kinds of desirable actions.

Japanese law does not provide an injured party the same incentive to sue the other party. It relies much more on the government to take the initiative, and I have the impression that the Japanese government does not have the staff to engage in many anti-trust suits. So your answer still leaves much to be desired.

Kojima: *Do you have any specific suggestions or proposals for the new governments in both Japan and the United States?*

Patrick: To the United States government, I would say that there is a very real danger that the United States will mismanage its economic relationship with Japan. The administration should put less emphasis on the bilateral trade imbalance and more on the overall context of the United States balance of payments situation.

On the Japanese side, my hope is that Japan will move from being perceived abroad as a country that only reacts to foreign pressure to becoming a country that takes the initiative in exercising leadership and in laying out a vision of the open-market economy that Japan will be. I think Prime Minister Nakasone has been incredibly effective in changing the United States perception of Japanese defense. This has helped the United States-Japan relationship a great deal. If he could do the same thing on the economic side—if the United States perception of the Japanese market could be made more up-to-date and accurate—that would be the greatest contribution Japan could make to improving the relationship.

Amaya: The growing United States budget deficit is a cancer that must be removed from the American economy before it proves fatal. The Reagan administration has always promoted smaller government, yet this growing deficit is a sign of oversized government. If Reagan is sincere in his efforts to shrink the government, he should reduce the government deficit to bring interest rates down and promote private-sector plant investment to raise productivity and develop new industries. This would enable the United States to exercise stronger leadership. This is the key to the American future. The administration should cooperate with Congress and do something substantial as quickly as possible.

With regard to the Japanese government, I quite agree that Japan still has the mentality of a small nation such as it was 20 or 30 years ago. Japan has grown up to become an economic superpower, and it is time Japan's self-image came of age too. ●