

Adjusting to Economic Integration

Although the winds of protectionism are blowing strong, Industrial Bank of Japan President Kaneo Nakamura argues that businessmen worldwide are agreed on the need to uphold the free trade system and prevent protectionism. This consensus is buttressed by the accelerating integration within the global economy.

Nevertheless, there is serious trade friction caused by the lack of coordination among national economic policies. Thus he urges Japan to do more faster, the United States to contribute to a solution by reducing its fiscal deficit so as to bring the dollar down on exchange markets, and all sides to avoid dangerous emotionalism.

Question: Before starting this interview, let me congratulate you on your recent award from the Harvard Business School. I understand you are the first Japanese to receive it.

Nakamura: Thank you very much. Winners of the Alumni Achievement Award are chosen from among alumni of the school who are top

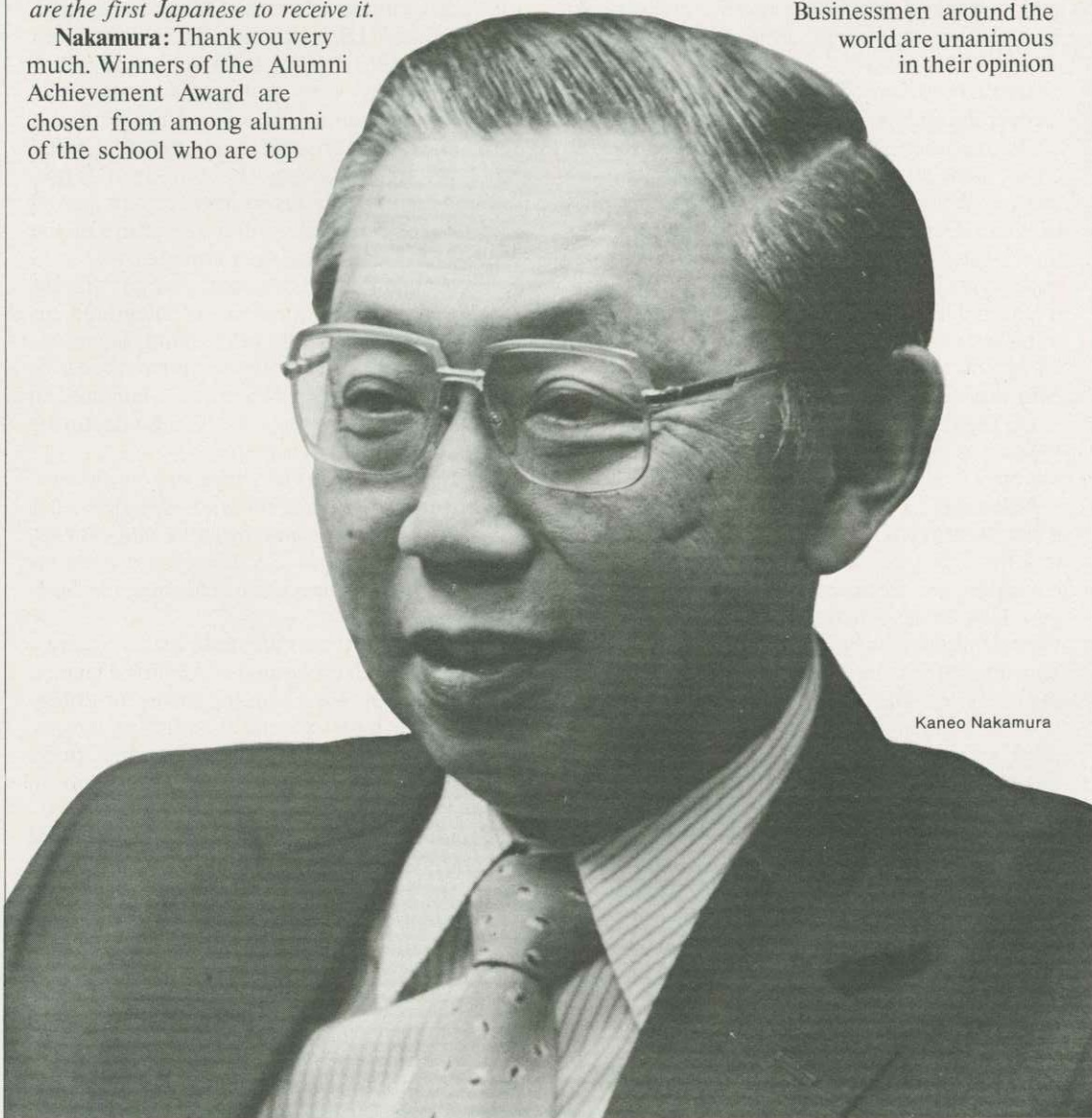
executives of major business corporations. The first recipient was Mr. Robert McNamara, former president of the World Bank. Since the award was established 20 years ago, I am the first Japanese and the second non-American recipient. I am truly honored to be given such a distinguished award.

Q: I understand you won the award for your achievements as an international businessman. Based on your long experience, how do you view the current free trade system which has supported the world economy since the end of World War II? Some suggest that the system is on the verge of collapse.

Nakamura: There seems no end to difficult problems. But I do not think the free trade system is in danger of collapse.

Businessmen around the world are unanimous in their opinion

Interview with Kaneo Nakamura,
president of the Industrial Bank of Japan
by Hisao Yoshimura



Kaneo Nakamura

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Business integration has gained momentum rapidly.

that the free trade system must be upheld, or to put it differently, that protectionism must be prevented. The new difficulties can be attributed in part to a weakening of the U.S. position and the relative strengthening of the position of other Western countries. And politics has further complicated the issue. Some Americans are becoming emotional as mid-term elections approach next year. That is the general picture of the current situation, I think.

Q: *Trade frictions are rising between Japan and the United States, two pillars of the free trade system. The main reason is the massive trade imbalance. What do you think is the fundamental cause of this imbalance?*

Nakamura: It is difficult to pinpoint the cause, because there are various factors on both sides. But I would like to point out that different orientations and approaches in the Japanese and U.S. economies lie behind the current Japan-U.S. trade imbalance. Under President Reagan, the United States oriented itself toward becoming a strong nation once again by boosting defense spending and promoting corporate investment. The goal was to strengthen its worsening military position vis-à-vis the Soviet Union and vitalize its economy. This policy helped business recover in the U.S. and strengthened the dollar.

On the other hand, Japan, hard hit by two oil crises, went all out to conserve energy and resources. We rely almost entirely on foreign countries for oil, and have no other alternatives. Japan thus overcame the oil crunch, and Japanese enterprises boosted their international competitiveness. These differences accelerated the trade imbalance between Japan and the U.S., until the latter now suffers from the so-called Siamese twin deficits.

Q: *The U.S. trade deficit with Japan is expected to reach as much as \$50 billion this year. Isn't that too large?*

Nakamura: The U.S. trade deficit with Japan is surely growing. But it must be remembered that the U.S. trade deficit is growing with other countries, too. Between 1981 and 1984, the biggest U.S. trade deficit was with the European Communities. The balance of trade also worsened with Latin American and newly industrializing countries. During the three-year period, the U.S. trade balance improved only with members of the Organization of Petroleum Exporting Countries. When one considers trade imbalances, one should always remember that business integration in the world economy has gained momentum rapidly for the past decade and particularly so in economic relations between Japan and the United States. From the 1960s through the 1970s, American multi-national corporations grew fast. As a result, many American companies invested directly in Japan and exported back to America the finished products and parts manufactured here. On the other hand, an increasing number of Japanese companies are supplying parts or manufactured goods abroad through so-called original equipment

manufacture (OEM) schemes within the framework of the worldwide production setups of American companies. The electronics industry is a good example of accelerating integration among Japanese and American businesses.

Japanese and American companies increasingly need each other. One Japanese calculation shows that about 30% of Japanese exports to the United States are based on Japan-U.S. business integration as typified by the electronics industry. One view has it that the total monetary value of U.S. exports to Japan combined with U.S. companies' production in Japan roughly equals the total of Japanese exports to the United States and Japanese companies' production in the U.S.

Q: *So the acceleration of economic integration means balance of payment figures no longer reflect the actual economic picture?*

I consider it ill advised to discuss the trade issue solely on the basis of balance of trade figures.

Nakamura: Yes. I must say, first of all, that Japan and the United States have different statistical standards. For instance, Japan calculates the value of its exports to the United States FOB, whereas the U.S. calculates its imports from Japan CIF. Apart from such statistical differences, we must note that goods produced in Japan through direct investment by American companies and brought back to the United States are treated as exports from Japan. If production facilities are taken into account as well as products, a radically different picture of the Japan-U.S. trade imbalance emerges.

Take integrated circuits as an example. Surely, Japan exports great quantities of integrated circuits to the U.S. On the other hand, Japan imports IC-manufacturing apparatus from the U.S. We can say that Japan-U.S. trade is balanced in the IC industry, so long as IC-manufacturing apparatus are also considered.

Q: *Disputes cannot be settled without first getting a clear picture of the situation. Otherwise, they only cause more misunderstanding and distrust. Do recent moves in the U.S. Congress give you the impression that Americans are blaming the Japanese without reason?*

Nakamura: It seems the trade issue is increasingly tinged with emotional and political factors. Some Americans are blaming Japan for unfairness on the basis of certain statistical figures. This is very awkward for Japan. Not a few Americans are convinced that Japan is unfair solely on the basis of unilateral data.

Paradoxically, this means Japan has not worked hard enough to help Americans understand the situation correctly. Americans should realize that Japan is their biggest customer for farm products and commercial aircraft. Japan should do more to get these facts across. As for passenger cars, Japan has gone so far as to completely abolish customs duties, whereas the U.S. still imposes 2.6 percent duties. Under the recently announced market access action program, Japan is also scheduled to completely abolish duties on such auto parts as tires and

windshields. It is unreasonable for Japan to be accused of unfairness despite such extensive market access efforts. Japan must work harder to publicize its efforts.

Since we have different cultures and customs, we should realize we will not be able to narrow the perception gap with the United States unless we more than redouble our efforts to make ourselves understood.

Q: *Japan has erred not only in failing to clarify its position but also in only announcing its market access measures bit by bit.*

Nakamura: Frankly speaking, Japan's market access measures so far leave something to be desired. They are incomprehensible to the Americans. And there is too much bureaucratic control on import procedures such as standards and certification.

Furthermore, Japan has resorted to its traditional piecemeal approach in dealing with vociferous American demands. But I would say the latest market access measures represent the maximum Japan can do at present.

Q: *But the Americans say they are not satisfied with the action program.*

Nakamura: That's right. I don't think there are many things we can do that would have an immediate impact. But, at a time when political factors are entering the picture, we at least want something to give the action program some public relations appeal. Short-term emergency imports or purchases of satellites or aircraft may be one answer.

Q: *But such imports will not amount to much in monetary terms and can give only temporary relief.*

Will there be any effective long-term measures?

Nakamura: It will take time to resolve the trade friction with the United States. We can use some public relations appeal in the short run. But it will be more important for us to stick by long-term measures in order to get our sincerity across to the Americans. I envision three such measures.

First, we should advance the timetable of the action program, though this may involve domestic political and economic problems.

Secondly, we should promote direct investment in the United States. This will greatly benefit the U.S. because of its effectiveness in creating job opportunities for American workers.

Thirdly, we should expand domestic demand. Japan should issue construction bonds more vigorously to promote public investment and increase social capital. This will help recapture surplus funds now invested in U.S. securities. Unless we stimulate domestic investment, we will not be able to stop the capital drain.

The United States must issue high-interest treasury bills to manage its deficit-ridden finances. In contrast, Japan has surplus funds and low interest. It is only natural for these funds to flow into the United States from Japan. But now Japan must reverse the flow and make more use of private capital at home. To this end, Japan should introduce a policy of mobilizing private

capital for public investment, with governmental financial institutions guaranteeing final risks and subsidizing interest.

Q: *I agree that domestic demand can best be stimulated by mobilizing surplus funds. But shouldn't America be trying to lower the value of the dollar? Many people believe the high dollar is the real cause of the Japan-U.S. trade imbalance.*

Nakamura: When I pointed out the economic integration between Japan and the United States, what I meant to say was that not only Japan but also the United States must do what is expected of them. So long as they fail to consider this business integration, Japan and the United States will only continue to blame each other and will not reach a business-like settlement. The strong dollar is depriving the United States of export competitiveness in agriculture and some industrial products.

The United States should consider more seriously ways to bring the overvalued dollar down to a proper level. It is wrong to argue that there is no way of righting the value of the dollar because the United States has no regulations controlling its value. The United States should endeavor to reduce the twin deficits. Americans should also try harder to promote exports by producing exportable goods. For instance, they should realize it is difficult to export automobiles with left-hand drive to countries with left-hand traffic.

Q: *Don't you think the current exchange system itself leaves something to be desired?*

Nakamura: Ideally speaking, fixed exchange rates are better. The current floating rate system is not the best. With no other options available, it at least comes in as the second best, but excessive fluctuations hamper business plans and can lead to a money game. We should work more to establish a currency system capable of keeping in step with the growing integration of the world economy. Neither complete deregulation nor complete liberalization will do. I am not saying that financial liberalization is not necessary. I have long advocated a review of the Japanese government's investment and loans program and the introduction of lower taxes on investment. But unrestricted financial liberalization would block the flow of funds into the postal savings system and paralyze government investment and loans programs which depend on postal savings for funds. It could even imperil the administration of the Liberal-Democratic Party. Americans, even financial and monetary experts, are poorly informed about the fundamentals of the Japanese financial and monetary system. But in the United States, as well, farmers and banks could go out of business if the overvalued dollar and shaky finances are left unchecked. In order to maintain the free trade system, each country should be aware of the growing business integration between nations and understand the economic systems of other countries. Based on that understanding, it will be essential for each country to continue to do its utmost to resolve these problems. ●

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Establish a currency system in step with growing integration....