

# Bilateral Friction: The Vicious Cycle

## —Report on the 5th JEF-Aspen U.S.-Japan Council—

By Akira Kojima

The relationship between Japan and the United States has become closer than ever in every field, including politics, the economy and trade, and the mutual dependence between the two countries is deepening. Despite the deepening of their relations, however, tension and irritation are mounting between the two.

The history of tension and friction between Japan and the U.S. is old. The nature of the friction, however, has changed with the times. Not only that, but the world economic and political environment affecting the two countries is changing minute by minute. One thing remains the same, though. This is the fact that the relationship between Japan and the U.S. is very important to the stability of their economies as well as of the world economy as a whole.

The Aspen Institute for Humanistic Studies of the U.S. and the Japan Economic Foundation, which cosponsor a Japan-U.S. conference every year, share this view. Japanese and American scholars and other intellectuals attend the annual conference and freely exchange opinions from a long-range and broad perspective. The venue for the 5th conference was in the foothills of Mt. Fuji in the late fall of 1988. It was the first time that the JEF-Aspen U.S.-Japan Council had been held in Japan. The previous four conferences were all held in Maryland, where the Aspen Institute has its facilities.

Among participants in the 5th conference from the U.S. were David T. McLaughlin, president of the Aspen Institute; Norman D. Shumway, member of the U.S. House of Representatives; Glen S. Fukushima, deputy assistant, U.S. Trade Representative for Japan and China; Clyde V. Prestowitz, senior fellow, Carnegie Endowment for International Peace; and Charles R. Stevens, attorney at law, Coudert Brothers.

Japanese participants in the conference included Naohiro Amaya, president of the Japan Economic Foundation;

Ariyoshi Okumura, managing director of the Industrial Bank of Japan; Shinji Fukukawa, adviser to the Ministry of International Trade and Industry; members of the House of Representatives Koji Omi, Iwao Matsuda and Kaoru Yosano; Tsuyoshi Kawanishi, executive vice president of Toshiba Corp., and Goro Takeda, former chairman of the Joint Staff Council of the Self Defense Forces.

Having attended the annual JEF-Aspen U.S.-Japan Council since its inception in 1984, I felt keenly at the latest conference that a new perception gap has emerged between Japan and the U.S. Most Japanese participants expressed the view that the structural change taking place in the Japanese economy triggered by the yen's appreciation is not a temporary phenomenon but a lasting one. Against this, the American participants expressed the view that "the world may change but it is difficult to change Japan" and doubted that the structural change taking place in the Japanese economy would be lasting.

### Previous optimism

At the previous year's conference, Japanese and American participants had expressed relatively optimistic views against the background of the progress in the adjustment of the yen's exchange value against the dollar and in the coordination of macroeconomic policies via such international meetings as G-5, G-7, and the annual summit conference of leaders of the major Western industrialized countries. What caused the perceptions to change during the past year? Conceivable factors behind the difference are: (1) the delay in America's economic adjustment as compared with Japan's, (2) the American people's resentment at the sharp increase in purchases of American firms and real estate by Japanese companies, (3) progress in the new round of detente between the U.S. and the country which President Ronald Reagan once called the

"evil empire," the Soviet Union, and (4) a mounting systemic sense of crisis in the U.S. as observed in the widespread acceptance of the "decline of America" theory.

Several Japanese participants gave reports on the structural adjustment of the Japanese economy. Okumura explained the following points: (1) the Japanese economy is driven by domestic demand and is continuing to attain moderately high growth; (2) industrial restructuring has advanced markedly; (3) the proportion of Japanese production overseas has risen so much that some products made by Japanese manufacturers overseas are being imported into Japan and a boomerang phenomenon has appeared; and (4) as a result of progress in multinationalization of Japanese enterprises, 85% of Japan's total audio equipment production and 22% of Japanese automobile production will be relocated overseas by the end of 1990.

For my part, I stressed that the yen's current rise against the dollar is fundamentally different from the yen's appreciation of 1971 and 1978 in the following aspects: (1) the latest yen appreciation is of a big margin and of long duration; (2) the change in the exchange rate, taking place against the background of relatively mild inflation throughout the world, leads to substantial changes in price competitiveness; (3) because the inflation rate is small, there is no danger of a third oil crisis being triggered for the time being, and consequently there is no possibility of Japan's huge trade surplus disappearing overnight. As a result, the yen will stay strong for a long time; (4) powerful competitors have emerged in the form of the NIEs; and (5) the lure of protectionism is becoming stronger throughout the world. Because of these factors, the changes that have taken place in the macro and micro economic scenes since 1987 are genuine and enduring. This was the viewpoint which I expressed.

In fact, I think that as a result of the current appreciation of the yen, the Japa-



nese market has interfaced with the global market for the first time. Even when domestic supply capacity becomes short, commodity prices do not rise because the domestic supply shortfall is made up for by the supply capacity of some other country.

The American participants took exception to my view. One of them said, "In Japan, the market mechanism is not functioning properly. Changes are admittedly taking place in the Japanese economy, but the Japanese and foreign perceptions of these changes are different." Another American participant remarked, "The recent economic growth led by domestic demand is certainly desirable to the entire world, but it seems to us that this is a temporary phenomenon. We are afraid that when domestic demand becomes weak, the Japanese economy might go back to the export-led pattern again."

## U.S. shut out

Still another American participant said, "We are rapidly becoming pessimistic about the trade imbalance between Japan and the U.S. No matter what measures the Bush administration might take and regardless of whether or not the U.S. fiscal deficit diminishes, the outcome will be the same. Some Americans believe that America's trade deficit with Japan will not decrease substantially during the next 10 years."

He went on to stress, "Throughout the 1950s and 1960s, the Japanese government completely shut out American manufacturing industries from the Japanese market. In those days, American companies were highly competitive. They were able to penetrate the European market, but they were shut out from the Japanese market. American manufacturing industries are still affected by the Japanese government's shutout policy. They still have no distribution channels in Japan because of this shutout."

Both Japanese enterprises and the Japanese government refute the overseas criticism that the Japanese market is closed. The reply to such critics goes something like this: "You are wrong. The Japanese market is open. The problem



The three days of talks reflected the emergence of a new perception gap between Japan and the U.S.

lies on your side. American companies are not making really serious efforts to export products to Japan." When this point was made, the American side reiterated, "We have been able to penetrate European markets, but we have not been able to enter the Japanese market. Why?"

I think that both sides are partly right and both sides are partly wrong. As pointed out by an American participant, the Japanese market in the 1950s and 1960s was tightly closed. I think it is true that American companies are suffering from the aftereffects of their inability to relocate their manufacturing plants in Japan in those days. As far as this point is concerned, the American participants were totally correct.

During the past several years, however, Japan's market-opening has progressed remarkably. In addition to this, the yen's exchange rate has changed greatly. As a result of these factors, the Japanese market interfaced with the global market for the first time in history, as I mentioned earlier. As a result of the yen's appreciation, the size of the Japanese market (annual GNP) is approaching \$3 trillion. Many countries woke up suddenly to find a mammoth Japanese market lying before them. Having made this discovery, not only South Korea, Taiwan and the other NIEs but also European countries have changed their strategy toward the Japanese market. Britain has launched a semigovernmental drive, "Opportunity Japan," to double British exports to Japan during the next three years. A West German automaker has changed its past practice of leaving everything up to its Japanese agent, and has established its

own network of dealers in Japan and is now stepping up its exports to Japan. As a result of this export offensive, sales in Japan of West German cars are increasing sharply.

Compared with the companies of NIEs and of some European countries, most American corporations are not using to their advantage the change in the foreign exchange rate and changes taking place in the Japanese market. It seems that many American corporations think that they will be able to do better business by sending their executives to Washington instead of to Japan.

Actually, however, there are no business opportunities in Washington. They are in the Japanese market, the structure of which has begun to change.

An American participant with abundant experience in the U.S. business community commented that American corporations which have neglected the need to maintain a long-range perspective in business management are partly to blame for this. He lamented the corporate takeovers and buy-outs rampant in the U.S. these days.

## Impact of detente

An aspect of the 5th conference which was strikingly different from the preceding year's conference was that the American participants were beginning to feel the real impact of a new detente. The detente refers to changes in the framework of world politics and security surrounding Japan-U.S. relations.

One American participant said, "After World War II, the Soviet threat served as a



glue to consolidate Japan-U.S. relations. However, today neither Japan nor the U.S. thinks about the Soviet threat as strongly as before." He asked, "Will there be no glue to keep Japan and the U.S. stuck tightly together?" Daniel Yankelovich, an expert analyst of public opinion, says that as a result of the new U.S.-Soviet detente, the adversarial confrontation has shifted from the military to the economic sphere, and Japan is replacing the Soviet Union as a threat to the U.S.

American participants pointed out the following: "Americans feel that although America destroyed Japan in World War II, Japan is today invading America economically and is buying up American real estate and American corporations. The fact that a bill calling for surveillance on foreign investment in the U.S. was submitted and debated in the U.S. Congress is one of the signs of this feeling among the American people."

They also said that foreign investment in the U.S. now accounts for over 4% of America's GNP, and it has become an element vital to the U.S. economy. Although U.S. Congressmen are well aware of this, they are under the impression that they have been hoodwinked by Japanese excuses for many years. In their view Japan took a policy to protect its trade on the ground that it is a resources-poor country, but in fact it was not necessary for the Japanese government to take such strong protective measures. They argue that Japan amassed its trade surplus by protecting its industries and is now increasing its investment in the U.S.

Because the 5th council was held immediately after George Bush's victory in the presidential election, Japan-U.S. relations under the coming Bush administration were discussed at length. As for the policies of the Bush administration, there was almost unanimous agreement among the participants that it will be "pragmatic." It was pointed out that (1) President-elect Bush lacks the charisma that President Reagan has, (2) his policy lacks ideology, (3) in the recent election, the two presidential candidates did not disclose specific platforms in seeking the people's judgment. Instead, both employed the negative campaign tactic of

denouncing each other and each other's party, and Bush won the negative contest, and (4) President-elect Bush's influence in the U.S. Congress—where the Democrats control the majority of seats—will be weak, because he has aroused feelings of bitterness among the Democrats and because his policy itself did not get the people's mandate.

Considering these points, there will not be the traditional "honeymoon" period between the Bush administration and the U.S. Congress in the post-inauguration period. Even if there was a honeymoon, it would be extremely short-lived.

Bush's weak leadership and pragmatic policy line makes it conceivable that there will be no quick shrinkage of the U.S. budget deficit. In that event, confidence in the U.S. dollar would not revive. The foreign exchange market would continue to be unstable. Markets all over the world would become irritated at the lukewarm policy measures of the Bush administration, with the result that there might be a repeat of the Black Monday of October 1987. Faced with market disturbance, the U.S. would probably change its policy. Such developments, if they should become a reality, would make Japan-U.S. relations all the more severe.

## Worrisome scenario

The following kind of scenario is also conceivable: The structural adjustment of the Japanese economy progresses smoothly. Japan's trade surplus shrinks much more than the U.S. expects. The delay in America's economic adjustment, however, obstructs the improvement of America's trade balance against the whole world. As a consequence, although Japan's trade surplus as a whole shrinks, that with the U.S. does not shrink much. A disparity in the speed of adjustment between Japan and the U.S. is probable.

If this scenario should materialize, the worrisome problem would be whether or not the financing of the U.S. by the rest of the world would go smoothly. This would be a test for the functioning of the world's monetary and foreign exchange markets. It would pose a challenge for international policy coordination.

It seemed to me that the possibility of this scenario becoming reality made the viewpoint of the American side at the latest JEF-Aspen Council more pessimistic than in the preceding conference.

Under a pragmatic Bush administration it is likely that negotiations and debate between the U.S. and its allies regarding so-called burden-sharing will become animated. In 1988 Americans began to think seriously about their nation's position in history. This is indicated by Paul Kennedy's opus, *The Rise and Fall of the Great Powers*, which is as thick as a brick and became a big best-seller. This book gave birth to the argument of America's "relative decline" among American policymakers and opinion leaders. Even if the decline is relative and not absolute, it must be irritating for the U.S. to admit it.

When the Japanese side stated, "Japan sincerely hopes that the U.S. economy will regain its soundness," one of the Americans said: "Japan hopes for a resurrection of a strong America probably for reasons of Japan's own profit. If the U.S. should become strong, Japan-bashing would die down and the argument that Japan is getting a free ride on security would vanish, and Japan would be able to export to the U.S."

Strangely enough, Paul Kennedy's book became a best-seller in Japan, too, and fanned discussion of its theme of the rise and fall of great powers. The discussion in Japan, however, is somewhat different in nature from that in the U.S. The Japanese are not interested in the rise and fall theory as a matter of realistic policy. To them it is just a matter of intellectual curiosity.

This is where the difference between Japan and the U.S. lies. Today's issues between Japan and the U.S. are not just bilateral problems. For our next homework we should ponder the shape of U.S.-Japan relations within the great structural changes that are taking place in the world's political and economic systems.

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