Coping With Trade Surplus and Economic Friction

By Fumio Uesugi

"No sooner had countries of the former Eastern bloc started moving toward the free-market system than the market mechanisms of the West began to collapse," an official of Japan's Economic Planning Agency (EPA) said recently with a touch of irony. He was referring to U.S. President George Bush's visit to Japan in January, a controversial visit in which the president was accompanied by an entourage of America's top corporate executives.

Bush went home apparently pleased with an action program in which the Japanese government set targets for the purchase of U.S.-made autos and auto parts by Japanese carmakers. As the EPA official sees it, however, this program is a government-to-government agreement that effectively forces private enterprises to buy what they do not want. In this sense, it is an agreement that ignores the rules of the marketplace.

Japan's weakness

Certain "weaknesses" on the part of Japan led Tokyo to make such promises. One "weakness" is the resurgent trade surplus, particularly Japan's still large surplus with the United States that accounts for two-thirds of the U.S. global trade deficit. This trade gap is seen by many Americans as evidence that the Japanese market is still not open.

President Bush, seeking reelection in November, was in a situation in which he had to secure commitments from the Japanese government to cut the surplus. Without such commitments he would have again been labeled a "wimp" and found himself at a disadvantage in the election campaign. Japan, too, had compelling reasons to make concessions.

For one thing, the United States no longer has any major potential enemy now that the Soviet Union has ceased to exist, which means Japan could become America's new "target" unless it meets U.S. economic demands. Such a perception apparently prompted the Japanese government to work out the action program.

Still, the question remains: Is Japan really to blame for running a large surplus? Some Japanese economists and government officials maintain that U.S. criticism of the Japanese surplus is unwarranted, and that it is wrong for Japan to cut the surplus too much. A number of reasons are cited for this argument.

The first is that the Japanese surplus is an asset which can be used to cover the current global capital shortage. Among the economists who hold this view is Yoshio Suzuki, chief counselor of the Nomura Research Institute. He said, "We should not overlook the changes now taking place in the world economy. The world needs an enormous amount of capital now that the former Soviet Union and East European countries are shifting to market economies. But there is a global shortfall of savings. The Japanese surplus can be used to make up for that shortfall."

It is unclear just how much capital will be needed in the former Soviet bloc. But there is no doubt that the needs are enormous, given the lag in infrastructure development and huge investment in technological innovations and production facilities that will be required by privatized former state-owned enterprises.

Photos: Nihon Keizai Shimbun

Japan's trade surplus can help meet a global shortage of capital—especially in newly privatized enterprises of the former Soviet Union, which lag in infrastructure development and have a huge need for investment in technological innovations and production facilities.

It is simply impossible to meet such capital requirements by domestic savings.

It is not only the former Soviet Union and Eastern Europe that face acute capital shortages. Capital is scarce worldwide. According to the *1991 White Paper on the World Economy* published by the EPA, the world shortage excluding the former Soviet Union and Eastern Europe will be $103 billion in 1992, almost double the figure for 1991 ($54 billion). The reasons given for this explanation include the growing U.S. budget deficit and the concentration of capital flows within the European Community, now moving toward economic integration.

The current account of the balance of international payments is in deficit when investment in the government, business and household sectors exceeds domestic savings. It is in surplus when savings exceed investment. Thus Japan's surplus will drop if it increases domestic spending through stepped-up public investment and business capital investment, for example. At the same time, this means that Japan's domestic savings will decrease and that there will be less capital flowing out of the country to world capital markets. A global capital shortage would push up interest rates and could slow global growth.

It is not just Japanese experts who hold that a shrinkage of the Japanese surplus would lead to an increase in the global capital shortage. The vice president of the World Bank, Lawrence Summers, whose job is to see that the bank secures capital flows to developing countries, spoke in favor of Japan maintaining a large surplus in an interview carried in the December 2, 1991 issue of the *Nihon Keizai Shimbun*, Japan's leading economic daily. He said that the world needs Japanese capital badly and that he hopes the Japanese surplus will not shrink too rapidly.

Special factors

Others who favor the existing Japanese surplus argue that the current level of the surplus and the current trend in the international payments balance do not warrant such criticism.

For one thing, the current account surplus has gradually decreased in recent years, from $94.1 billion in fiscal 1986 to as low as $33.7 billion in fiscal 1990. The surplus as a percentage of GNP has dropped markedly in the same period, from 4.4% to 1.1%. Though this downward trend was reversed in fiscal 1991 with the surplus rising to $72.5 billion (government estimate), the GNP ratio has stayed at a low of about 2%, still far below the 1986 level.

It should be remembered that some special factors have pushed up the surplus. One factor is the so-called gold futures investment account, a high-yield financial product that gained popularity on the crest of the personal investment boom in the late 1980s. Technically, investment in this product involves the import of gold, though no actual import takes place. So gold imports increased sharply—on paper, that is—up to around 1990, in parallel with increased investment in this gold futures instrument. With the ending of the personal investment boom, however, a large number of investors canceled their gold contracts. A resultant sharp drop in gold imports boosted the current-account surplus by $8 billion to $28.9 billion in the first half of 1991 alone. Also responsible for the surplus was a drop in oil prices, which had shot up during the Gulf crisis of 1990. Lower oil prices reduced the nation's oil bill and hence its overall imports relative to its exports.

In other words, the rapid rise of the surplus does not mean that Japanese companies have again mounted an export drive or that imports of manufactured goods, criticized in the past as being too small as a percentage of total imports, have decreased. Clearly the surge in the surplus is due largely to temporary factors.

Nor is the Japanese surplus likely to keep on expanding as rapidly as it has been in recent months. As an official of the Finance Ministry's International Finance Bureau puts it, "There is little possibility of the surplus growing endlessly." He does not believe, however, that the surplus will shrink rapidly in the immediate future.

Experts cite two structural factors likely to restrain the growth of the surplus on a long-term basis. One is the continuing uptrend of manufactures imports, which are expected to reach $1,000 per capita in fiscal 1991, more than double the figure of five years ago. The other factor is the prospect that the Japanese savings rate will gradually drop with the aging of the population.

There is also a view that it is unreasonable to make a big fuss about bilateral imbalances although it may be necessary to hold down the growth of the overall surplus. In the words of a senior manager with a Japanese automaker, "It does not stand to reason that we have to buy (U.S.-made) cars and other products simply because Japan is running a large trade surplus with the United States. European automakers have expanded their share of the Japanese market by improving the quality of their products and making serious efforts to boost sales here. In light of what they have done, the American approach looks unfair."

It is not always practicable to try to correct a bilateral trade imbalance by means of macroeconomic policy, i.e. by expanding domestic demand, because increased government spending or an easing of monetary policy, for instance, may not necessarily lead to increased imports from the United States. That is why, as in the action program that sets purchase targets for U.S.-made autos and auto parts, bilateral trade in selected products must be managed. Clearly, this runs counter to the free trade principle.

Protectionist forces

The Foreign Ministry is the only department of the Japanese government strongly calling for efforts to pare down the surplus. This is because of a belief by ministry officials that protectionist forces in the United States and Western Europe will gain strength unless the rising surplus is curbed, rather than thinking that the "closedness" of the Japanese market is primarily responsible for the increasing surplus.

Other government departments, particularly the Finance Ministry and the EPA, take a different view. Their officials feel deep down that there is no point in making a big fuss about the current level of the surplus. Yet in statements meant for foreign consumption they reiterate, unwillingly, that Japan will make efforts to hold down its surplus. This stance, however, is inevitably seen abroad as a sign of Japan's reluctance to come to terms with its external surplus.

I believe it is wrong for Japan to reduce its surplus by means of managed trade, such as setting import targets and putting "voluntary" restraints on exports. I also feel it is unreasonable to attribute the surplus solely to the "insularity" of Japanese systems. Japanese tariffs on industrial products are among the lowest in the industrialized world. And imports of manufactured goods as a percentage of total imports have, as already noted, continued to increase steadily in recent years.

However, if Japan's growing surplus is seen as a threat to foreign economies, that is, if Japan is seen as exporting unemployment, then it will not be in Japan's interests merely to assert that the surplus is justified. If foreign countries feeling thus threatened were to slap import restrictions on Japanese products and take other protectionist measures to close their markets, the Japanese economy would be shaken to its foundations.

Japan must therefore consider and implement measures to prevent the surplus from expanding to a level that would threaten other countries. However, ad hoc measures of the kind taken thus far by the Japanese government will not help. What is needed is long-term measures to ease economic friction and restrain the growth of surpluses. Specifically, what should Japan do to that end? A number of measures should be taken.

First and foremost, the behavioral pattern of Japanese corporations should be fundamentally changed. Simply put, this means reforming the ingrained habit of keeping in line with other corporations and the expansionist strategy of boosting production and investment. The concentration of exports on selected markets and of direct investment in targeted sectors stems from this policy. Unbridled competition aimed at expanding market share is another case in point.

Other characteristics include: the endless capital investment race to keep abreast with or stay ahead of other companies (from fiscal 1988 to fiscal 1990 capital spending increased at double-digit annual rates—something abnormal in a mature economy like Japan); the slow progress of technology transfer (because companies want to do everything by themselves); the long working hours (the government is calling for a reduction of working hours, but Japanese workers still put in about 2,000 hours a year, or 200 to 400 hours more than American and European workers).

This pattern of corporate behavior is seen as being "essentially different" from that of American and European corporations, which pursue management strategies that seek reasonable profits and take into account such non-economic factors as respect for workers' human rights and protection of the global environment. The strong competitiveness of Japanese companies springs from this "Japanese way" of doing business.

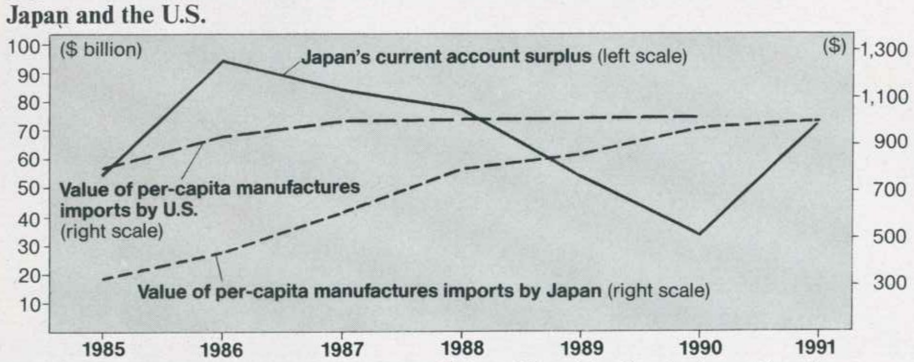
These same competitive efforts of Japanese corporations have enabled them to export low-price, high-quality products to all corners of the globe. But if this is being done at the sacrifice of Japanese workers and at the expense of foreign ones, then the Japanese way must be reexamined.

Savings balance

Let me make another point in this connection: corporate capital investment should not be overstimulated to increase domestic demand because this will only lead to further expansion of the surplus in the long run. As stated earlier, whether the current account of the international payments balance is in surplus or in deficit depends on the savings-investment balance in various sectors. Therefore, domestic demand should be expanded by boosting investment not in the corporate sector but in the public sector by increasing investment in social infrastructure, and in the household sector by stimulating personal consumption.

Summing up, the Japanese surplus is not as large as it once was. It can even be seen as necessary to maintain a fairly large surplus—provided it does not increase too fast and too much—in order to cover the global capital shortage. However, this rising surplus is bringing critical international scrutiny to bear on the expansionist behavior of Japanese corporations. Japanese corporations' expansionist behavior has played a vital role in the rapid postwar growth of the Japanese economy, but these same Japanese corporations have now reached a stage where they should review and reform their business behavior, with emphasis placed on coexistence with foreign companies and employee welfare.

Japan's Current Account Surplus and Per-capita Manufactures Imports of Japan and the U.S.



Notes: 1. Japanese statistics (for fiscal year) by Finance Ministry; U.S. statistics (for calendar year) from the *Survey of Current Business*.
2. 1991 figures for Japan's current account surplus and per-capita manufactures imports are projected by EPA.

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