Toward a New U.S.-Japan Economic Alliance

By Keiya Toyonaga

A widespread perception remains strong in the United States and, indeed, throughout the Western nations, that Japan is a closed society, dedicated to minimizing the importation of foreign products or investments. The prevailing opinion appears to be that Japan, at best, half-heartedly supports free international competition, and does everything in its power to make international trade a one-way street. Critics claim that Japanese markets become open to imports only after extreme pressure is applied, with threats of retaliatory action by other governments.

It is not my purpose to debate the merits of the endless stream of individual conflicts that have characterized trade relationship between the U.S. and Japan. But it seems evident that something must be done, promptly and effectively, to halt the deteriorating relationships between the two countries. Continuation of the "Japan-bashing" which characterizes many debates in the U.S. Congress, and the grudging reaction which frequently takes place in Japan, threatens to undermine the basic security and economic links which are vital to the maintenance of world peace and prosperity.

Altered attitudes

The answer, I am convinced, rests on the creation of a new, comprehensive, cooperative relationship between the United States and Japan, providing world leadership in furtherance of liberalized trade and investment, currency stabilization and a sharing of economic burdens in fields such as aid to less developed countries and national security expenditures. Such a cooperative alliance would require major changes in policies and attitudes in both the United States and Japan, but the future economic health of the free world may well depend on the adoption of such significant innovations.

During the last fiscal year, which ended March 31, I served as chairman of a group of business and financial leaders in the Osaka area which conducted an intensive study of the causes and cures for the deteriorating atmosphere in U.S.-Japanese economic relationships. This study group, the Committee for International Affairs, Kansai Keizai Doyukai, has recently produced a forward-looking report which we hope will serve as the starting point for further deliberation among experts in both countries, looking toward a new era of mutual respect and cooperation.

The report, entitled "Toward a New Economic Alliance between the United States and Japan," contains a number of far-reaching recommendations. To place these proposals in proper perspective, it is necessary to review briefly a few basic factors which have led to the current economic problems between the United States and Japan.

At the conclusion of World War II, the United States assumed responsibility not only for maintaining the military security of the nations of the free world, but also for restoring their economic health. The U.S. helped to rebuild the war-ravaged industries of Europe, Asia and the less developed countries, opened its vast markets to foreign products, and provided a stable monetary climate for international transactions through creation of GATT (the General Agreements on Tariffs and Trade), the World Bank and the IMF (the International Monetary Fund).

In the ensuing decades, the economic growth of many free world nations has been remarkable. Although the economy of the United States itself has continued to show admirable stability and vigor, the unquestionable fact is that the U.S. dominance of the world economic scene has been changing. Other nations have grown relatively much faster, particularly Japan, which now enjoys the second-largest GNP of any country. While the rapid development of other nations may be attributed to the success of America's postwar efforts, the truth is that it has resulted in a weakened world economic leadership.

The U.S. now has difficulties in exercising an effective leadership single-handedly, and no other nation has yet been prepared to share that responsibility with the United States. The simple fact is that Japan benefited greatly, and without substantial cost, from international public assets made available in the postwar decades by the United States, such as in the maintenance of peace, development of a free-trade system, and assurance of a stable international monetary system. Unfortunately, however, Japan has been slow to take more responsibility, commensurate with its economic development, for contributing to the maintenance and development of world political and economic order.

Policy mismatch

This has led to criticism in the United States and other nations that Japan is a "free rider." For its part, the United States—despite its role of providing world economic leadership—has failed to coordinate its policies adequately with other nations, focusing instead on domestic concerns for maintaining "a strong

America." Thus, in recent years, both nations have fallen short of meeting their international responsibilities, in part due to a lack of will to pursue a coordinated macroeconomic policy.

Indeed, in our opinion, the single most important factor leading to recent economic friction between the U.S. and Japan is the fact that, since 1980, the two countries have pursued diametrically opposite macroeconomic policies. Throughout this decade, the United States has adopted excessively stimulative fiscal policies while Japan has until recently adopted a policy of austerity.

During the early 1980s, the United States implemented large-scale tax reductions combined with substantial increases in total government expenditures (primarily defense-related). This expansive fiscal policy resulted in a rapid growth in consumption–and a huge increase in the federal budget deficit. While the demand for capital increased, the government adopted a tight-money policy to curtail inflation.

The net result was an inadequate supply of capital and soaring interest rates. These conditions attracted a massive flow of dollars back into the United States from Japan and elsewhere, which served to sustain the high value of the dollar. It was, in short, a perfect scenario for encouraging the importation of foreign goods into the United States.

By contrast, during these same years, Japan maintained a stringent fiscal policy, in order to restore its fiscal soundness. As a result, domestic demand for products in Japan stagnated, encouraging the Japanese economy to rely excessively on exports for its growth.

In short, the conflicting macroeconomic policies of the two countries provided a vast incentive to export products from Japan to the United States, thereby creating an enormous imbalance in U.S.-Japanese trade.

Despite Japan's huge trade surplus with the United States, the yen remained low relative to the dollar in the first half of the decade because of large capital flows from Japan to the U.S. (induced by inadequate capital demand in Japan and a significant difference in interest rates in the two markets). When the major nations attempted to rectify disparities in the world economy through the Plaza agreement of 1985, excessive priority was given to the realignment of exchange rates, causing a sudden appreciation of the yen and a decline of the dollar, despite the fact that the underlying macroeconomic causes where being addressed much more slowly.

Unfortunately, the lack of required coordination in macroeconomic policies between the two countries, along with negotiating postures which emphasize each individual sectoral issue, have resulted in an unhealthy and counterproductive atmosphere in U.S.-Japanese relations.

In the United States, manufacturers, unions and national politicians, alarmed by the flood of imports from Japan, have become vociferous about alleged unfair pricing and other trade practices which they claim have caused unfair competition with U.S. manufacturers, and have become equally caustic in charges that Japan prevents American firms from competing in Japanese markets. The result has been an outpouring of legal and legislative actions and proposals, many with far-reaching consequences not only for scores of Japanese industries, but also for the world trading system as a whole.

All talk, no action

It should be noted here that the United States has its own problems to be solved, and that problems in the U.S.-Japan relationship do not lie solely with Japan. In this article, I will not reiterate problems which the United States is responsible for. Rather, I will focus my attention on the Japanese aspects of the troubled relationship.

It is further observed that Japan has not done much on its own initiative to create fundamental improvements in U.S.-Japanese relations or to propose methods whereby Japan can contribute toward stabilizing the global economy. This is, in fact, the genesis of the widespread perception that Japan has a deliberate policy of procrastination with regard to changes being sought by U.S. interests, that Japan is "all talk, no action," and that unfair Japanese practices will not be altered unless extreme pressure is applied.

Japan must overcome its passiveness, begin to respond more positively to criticism, and suggest a comprehensive agenda for improving U.S.-Japanese economic relations. Otherwise, I am convinced, there are likely to be a number of unfortunate consequences:

(1) American distrust of Japan, as well as Japanese resentment of America, will intensify, jeopardizing vital basic relationships between the two countries.

(2) If improvement of the U.S. trade deficit is delayed and the U.S. economy declines, there is a danger that isolationist sentiments may resurface in America and that protectionism may replace liberal trade as a national goal.

(3) An American tendency toward bilateral agreements may be intensified, thereby undermining GATT and other multinational arrangements which protect the rules of liberal international trade. The U.S. has already worked out free-trade agreements with Canada and Israel, as well as a framework for consultation with Mexico, and such principles of reciprocity and bilateralism may be extended to other countries.

What is required most urgently is a practical means of dealing with the basic instability that now exists in virtually every aspect of the world economic system–including trade, currency, finance

and the debt problem. There are many indications that the current economic system, which supported the postwar expansion, has become seriously weakened and requires restructuring.

Dual leadership

Ideally, to meet this challenge, the United States, Japan, members of the European Community and other major nations should cooperate in developing a new structure which will provide a reliable system for international policy coordination. The obvious problem, however, is that in light of competing national interests, it would be impossible for a multinational effort to reach agreement on such a complex structure within a reasonable time frame. In fact, a vital element in the successful creation of such a new system is strong, effective leadership. While the U.S. acting alone can no longer provide this leadership, a joint effort by the two nations with the largest GNPs—the U.S. and Japan—could establish a structure which would win the cooperation of other nations.

The fundamental objective of the proposed economic alliance is simultaneously to achieve two fundamental needs, namely, elimination of U.S.-Japanese economic friction and stabilization of the world economy. This will require a new, comprehensive set of policies which our report set out in a section on a "New Economic Alliance between the United States and Japan." The basic elements in the proposed alliance are as follows:

Free-trade program

In general, all tariffs, quotas and other trade barriers would be removed between the two nations in stages over a 5-to-10-year period. This would include domestic Japanese practices which inhibit the entry of foreign goods and services. While this liberalization was taking place, both countries would avoid the imposition of additional trade restrictions either through administrative or legislative action. With regard to sectors of the Japanese economy where friction now exists (such as agriculture, construction, the distribution system, finance and insurance), entry barriers should be reduced promptly to a level acceptable to the United States.

Furthermore, the U.S.-Japan movement toward free trade should be designed so that it could be applicable to other countries, insofar as possible. The intention is that a bilateral free-trade effort would serve as a nucleus for a broad multinational program moving toward liberal trade.

Currency stabilization program

To alleviate the burden on the dollar as the key currency, the yen would be internationalized to a greater extent, and Japan would play an active role in making the yen complement the dollar.

In addition, a framework would be created to permit the U.S. and Japan to adjust their macroeconomic policies swiftly and effectively in order to assist in the stabilization of international currencies.

Burden-sharing program

Japan would cooperate with the U.S. in sharing the future burden of international public assets. In this regard, Japan would not only utilize its economic resources to sustain world peace, free trade and currency stability, but would actively contribute toward: (1) expanding and improving aid to developing countries; (2) resolving the problem of accumulated international debts; (3) spreading among the free world nations the benefits of basic technological developments; and (4) increasing imports from developing countries.

The report further recommends that, as an integral part of its international obligations, Japan should take unilateral action to reform aspects of its economy which have been widely criticized. In particular, it says, reform is required in the following areas: (a) government deregulation, including specified reductions in items requiring licenses or permits; (b) free-market mechanisms, to permit both government and private businesses to reflect shifts in exchange rates in their domestic prices; and (c) strengthening and coordinating administrative functions so that Japan's foreign policies can be implemented effectively.

It is my hope, shared by other members of the Committee for International Affairs, that scholars and political leaders specializing in international economic issues will study and debate our proposal for a new economic alliance between the U.S. and Japan, make suggestions for its improvement, and then press vigorously for the implementation of such a program in the form of a binding agreement between the two governments.

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