Japan's Problem Trade Surplus

By Chikao Tsukuda

Wherein lie the causes of today's massive Japanese trade surpluses? History offers one clue in that these enormous surpluses are a recent phenomenon dating from about 1983. Anyone who claims that the Japanese market became more closed to foreign goods after 1983 is patently mistaken. What changes there have been in Japanese trade practices and trade policies have been in the opposite direction—toward accepting and facilitating imports.

However, the timing does suggest that changes in the U.S. economy might account for Japan's trade surplus. The president's Council of Economic Advisors, Fred Bergsten, the late Malcolm Baldridge and other authorities have all attributed the U.S. trade deficit primarily to U.S. economic policy—specifically, the budget deficit, high interest rates and the dollar's resultant strength on exchange markets.

In January 1987 I chaired a U.S.-Japan economic symposium where Professor Robert Mundell of Columbia University rejected exchange rate adjustment as a means of correcting trade imbalances. He stated that an individual, firm or country's balance of trade is governed by the relationship between income (production) and expenditures (consumption). In this view, the exchange rate has nothing directly to do with the balance of trade.

Although initial Japanese trade figures seem to substantiate this argument, recent figures suggest that the yen's appreciation has begun to have an impact on the trade balance. In fact, Japanese exports declined 1.3% and imports increased 12.5% by volume in 1986. But because dollar-denominated export prices rose sharply as a result of the yen's appreciation and because import prices declined mainly as a result of lower oil costs, the Japanese trade surplus increased in dollar-denominated terms. In effect, exchange rate adjustment began to influence the Japanese trade balance in 1986, but this was more than offset by the J-curve effect and by the drop in oil prices. The exchange fluctuations were so steep as to be counterproductive.

The yen's rapid appreciation against the dollar is causing serious difficulties for the Japanese economy and depressing imports. And each time the yen appreciates further, it inevitably triggers a fresh J-curve effect and aggravates the existing disequilibrium. I do not think that further exchange rate adjustment is the way to solve the trade imbalance.

While Japanese exports have made life difficult for some American and European industries, they have been very good for foreign consumers and certain industries. As Herbert Stein, chairman of the Council of Economic Advisors under Presidents Nixon and Ford, wrote in the *Wall Street Journal,* the U.S. trade deficit is the result of Americans buying more abroad than they sell abroad. Japanese exports to the United States are the result of innumerable decisions by individuals who like Japanese cars, VCRs and other goods, as well as companies that want Japanese chips and other industrial products. It is these people's considered judgment that buying Japanese enhances their lives.

This said, I hasten to add that the trade surplus is a problem for two reasons. In the first place, trade has become highly politicized. While the General Agreement on Tariffs and Trade (GATT) represented a laudable attempt to separate political issues from economic issues by providing rules to govern trade among the contracting parties, the demarcation has become increasingly blurred. Thus mounting political pressures may result in undermining the existing free and multilateral trading system on which we all depend. Once this danger is recognized, it is clear that Japan should intensify its efforts to make the economy less dependent on exports and more receptive to imports, as recommended in the Maekawa report, and that all countries should cooperate to revitalize the GATT system and to prevent trade issues from becoming politically charged.

The second reason the trade surplus is such a problem for Japan is that the surplus means consumption is not keeping up with production—that the Japanese people are missing an opportunity to become better off. While this aspect is gaining increasing recognition, there are a number of practical reasons why awareness cannot be translated into action. One is the shortage of land. Because land is in such short supply and is so highly priced, much of whatever the government spends on public works goes to site acquisition, and there is little left for the purchase of goods and services, including imports. That obviously impairs the effectiveness of conventional public works projects and further strains the government's budget. Under the circumstances, we need to concentrate on projects that are not land-intensive and to modify the regulations concerning land utilization so as to make land less expensive.

While the Japanese trade surplus is largely a macroeconomic phenomenon, it is also often industrial and technological in nature, in that Japanese industry has been innovating much faster than American and European industry in a number of goods that figure prominently in modern life—and the resultant price and nonprice competitiveness has exacerbated trade friction. The sad fact is that the international trading system is not equipped to deal with this situation. Sanctions and retaliation are certainly not the answer.

Albert Bressand wrote in an article for *Foreign Affairs* some time ago that, for the first time in history, we have freedom simultaneously in three fields: trade in goods and services, exchange rates and capital movement. Taken separately, each of these freedoms is probably a good thing for everybody. But it is by no means certain that simultaneous freedom in all three fields is such a good thing. My hunch is that we should perhaps start thinking of ways to introduce a bit more regularity into international capital movement, make exchange rates less volatile and put trade on a somewhat more stable basis. ●

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