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Needed U.S., Japanese Macroeconomic Policies Explained

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[Article by EPA Economic Research Institute Director Masaru Yoshitomi]

[Text] Introduction

In this report, I am going to focus on the issues of the foreign exchange rate and domestic demands which are necessary to correct the large trade imbalance. When the matter of reducing the trade surplus is being considered, it would be unproductive to attribute the cause of Japanese trade surpluses to "Japanese problems" which are deeply rooted in Japanese society and culture and to have a discussion about "Who is at fault?" The current trade surplus can be analyzed and dealt with from the point of view of economics which should serve as the fundamental basis for discussion.

Fundamental Relationship Between Foreign Exchange Rate and Domestic Demands

The following has become common sense from the standpoint of international monetary policy as far as the exchange rate and domestic demands are concerned. In order for a country with strong currency to reduce its trade surplus as well as to maintain a domestic employment level, the country must increase domestic demands. In contrast, for a debtor nation with weaker currency, the domestic demands must be curtailed. In the case of Japan, a strong yen does hurt the price advantage of Japanese exports but reduces the prices of imports, thus canceling the effect of a strong yen which tends to reduce surpluses. Simultaneously, if a strong yen is abating exports, the only way to compensate for the loss is to stimulate domestic demands. Similarly, the U.S. domestic prices should not be increased as the prices of import goods increase in order for the weak dollar to reduce the U.S. debt to other countries. The price increases in domestic goods tend to upset the symmetrical relationship of import prices and domestic prices, thus allowing more foreign goods to be imported. The domestic goods price increases can be curtailed by reducing domestic needs. The U.S. has achieved nearly 100 percent employment (in June of 1987, the unemployment rate was 6.0 percent). It is believed that if the unemployment rate falls below the natural employment rate—5.5 to 6 percent— it will cause inflation. It should reduce the internal demands but rather increase the external demands by allocating capital as well as manpower to domestic production.

Evaluation of 1986 Macroeconomic Policies

Since the meeting of the September 1985 Plaza agreement, the U.S. dollar has been devaluated drastically. Therefore, it can be seen that Japan needed to stimulate internal demands while the United States needed to curtail internal demands. However, the examination of the structural government deficit of 1986 (normal government level) reveals that in Japan demand kept decreasing while in the United States it stayed about the same, thus not being able to reduce the government deficit (OECD, Economic Outlook 41, June 1987). Therefore, it can be concluded that both countries failed to do whatever was expected as far as government monetary policies were concerned. However, in the case of Japan the official bank rate kept decreasing, thus helping increase the internal demands. In fact the consumer purchases of houses increased at an annual rate of 15 percent (actual) from July 1986 to September 1986. But in the United States, M2 went over the upper limitation of 13.2 percent, thus resulting in stimulation of the internal demands. Thus as far as the year 1986 is concerned, the Japanese external demands (exports) decreased by only 1.5 percent of the actual GNP, yet this curtailed the trade surpluses. On the other hand, in the United States imports increased by 10 percent and internal demands exceeded the GNP in the same way as in the period of the strong dollar (1982 through 1985). It can be concluded that in 1986 the trade deficit of the United States did not improve as far as the figures were concerned but rather the actual deficits increased. This delayed the adjustments of the U.S. trade imbalance, thus causing impatience among people who complained that the effects of exchange rate adjustments never had been observed even after 1 year had passed since the Plaza agreement. What made matters worse were the 1986 monetary policies of the Japanese Government, which fundamentally caused weak dollars and strong yen in 1987—yen being exchanged for less than 140. What determines the exchange rates—strong yen and weak dollar—after the Plaza agreement is the trade surplus and deficit. The trade deficit has reached 4 percent of GNP, and the total foreign debt to credit is going to be 20 percent of GNP within a few years. Therefore, it is not right to blame the U.S. high-ranking officials who are responsible for a "talk down" policy for the resulting strong yen. Such talk could affect the exchange rates momentarily; however, it does not essentially determine the exchange rates. The fundamental determinant of exchange rates is trade imbalance which is controllable by the above-mentioned government spending and monetary policies, a fact which we should never forget.

Macroeconomic Problems of 1987-88

During April through June of 1987, the trade imbalance began to decrease for the first time. The peak of the trade imbalance was January through March. These improvements were aided by the fact that the U.S. Government started reducing the government deficit in fiscal 1987 (October of 1986 through September of 1987) in the amount of $35 billion (0.08 percent of GNP). At the same time as far as the monetary policies are concerned, the increase in M2 (annual increase) is less than 4 percent for the last 3 months, thus the market is being tightened. Aided by the aforementioned policies, the increase in the internal demands will be 1.5 percent and

2 percent in the years 1987 and 1988 respectively (OECD, Economic Outlook 41). Increases in the total exports will push up the GNP by approximately 1 percent in both 1987 and 1988, assisted both by the weak dollar and the decrease in internal demands.

The process of the U.S. Government's reduction of the government deficit has two important implications. The first is that even though the reduction of government deficits and gradual tightening of money are essential aspects of rectifying trade imbalance and of halting import inflation turning into domestic inflation, the reduction of internal needs could cause worldwide inflation. In fact the increases of internal demands of OECD countries in 1987-1988 will be 2.5 percent, compared with 3.6 percent in 1986 (above-mentioned OECD). However, this prediction is based on the assumption that the U.S. government deficits will not further decrease in 1988. Therefore if the government deficits do decrease in 1988 as they did in 1987, the internal demands of OECD countries might further decrease—and this could lead to the possibility of growth recession. Unless the trade imbalance can be rectified despite the possibility of growth recession, the world economy could cause financial depression because of the huge trade imbalance contributing to a drastically weaker dollar which in turn would cause rises in interest rates, expectation of inflation and distrust of the dollar. The financial depression in the United States could cause worldwide financial panic, aided by the rising interest rates of the dollar and problems of loans made to the Third World countries.

Intermediate Continuity of Fiscal Policies

The second implication is the question of whether trade surplus countries such as West Germany and Japan should stimulate the internal demands in order to avoid growth recession and fulfill "international responsibilities." Many economists do demand that the creditor nations expand internal demands; however, they fail to discuss the fundamental and most critical issue of conditions essential to sustain the intermediate internal demands.

It will take approximately 5 to 6 years to reduce today's enormous trade imbalance, thus making intermediate policies very important. That being the case, the government policies must also support the intermediate policies in order to reach our objectives. Thus, if the government were to set policies for the first and second years as rapid expandable fiscal policies as well as policies to expand the structural deficits rapidly and change the previous policies 180 degrees in the third and fourth year, it would be self-defeating.

With the analysis of the estimates of balances of consumer savings and investments for the next several years, it can be concluded that the ratio of excess savings over GNP will be at least 4 percent. Prior to 1990 the government will absorb approximately 2 percent and the trade surpluses will absorb roughly 2 percent—estimated from the selection of consumer portfolios. In 1985 the general government deficit was 0.8 percent of GNP. Therefore, even if the government were to increase the deficit by over 1 percentage point, the government should not exceed the deficits to GNP ratio of 2 percent, thus limiting and stabilizing the total deficit to GNP ratio to the comparatively low figure of 30 percent. The government policies which allocated 3 trillion yen at the end of May 1975 will raise the structural government deficit to 1 percent of GNP (approximately 3 trillion yen) after analyzing both the increases compared to the previous year's government budget and sources of revenue. Indeed, it is essential that the nominal growth of GNP and the balance of the government revenue and spending grow proportionally from 1987 on in order to meet the objectives of the intermediate government fiscal policies. Of course, besides the above-mentioned government policies it is required that money be loose within a range that will not cause inflation and that the policies structure change in order to increase internal demands continuously. We must understand that we need the structural change in order to shift the mode from exporting to non-exporting with the least losses of employment opportunities, capital and technologies, considering the fact that the yen will be appreciated more than its real value.

The Most Serious Problem

The problem we are facing now is whether the United States and Japan can maintain the aforementioned relationship of internal demands and GNP.

As far as the United States is concerned, it must limit the growth of internal demands to within 1.5 percent for the next few years through reducing the government deficit. Yet, imports will increase by 3 to 4 percent. Exports must increase by at least two times that of the imports, considering that the total amount of imports is one and a half times larger than the total amount of exports and that the accumulated interests are worsening the trade imbalance. This implies that the U.S. exports must grow twice as fast as the growth of the world market and that the U.S. market share will increase gradually every year. This has been taking place since the last half of 1986; what is important is to maintain this.

Unless the United States increases the total exports and reduces the government deficit, the dollar will further devaluate, thus raising dollar interest rates, accelerating inflation and possibly leading to worldwide financial panic. It can be said that today's dollar to yen exchange rate of 140 to 1 is the lowest that the dollar has moved against the yen. The increase in dollar interest rates from this past March through May and the rising expectation of inflation caused by the weak dollar are good examples. The 140 yen exchange rate is probably 20 to 30 yen more than an equilibrium exchange rate. However, in order to reduce the huge export surpluses of Japan the market share of Japanese exports must decline—the opposite of the United States. Even though the world market expands at 4 percent, Japanese exports can increase only at a far lower rate than 4 percent.

Unless the strong yen persists for the next few years, the surpluses will never decrease. This means that the decrease in the total exports will lower Japanese GNP by 0.5 to 1 percent every year. Unless the internal demands increase by 3.5 to 4 percent, the growth of the GNP will be less than 3 percent, thus possibly worsening the employment opportunities.

How can we maintain the 4 percent growth rate in intermediate terms? I believe that the real hardship to the Japanese economy will come after the effects of government spending of 6 trillion yen to stimulate the economy start fading away. If the demands for houses are satisfied and consumers are to spend a great deal, it is obvious that the policies regarding the uses of land will be the most important government policies for structural changes.

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MITI Official Questions Trade Friction Remedies

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[Article by MITI Deputy Vice Minister for Administration Yuji Tanahashi]

[Excerpts] Prime Minister Nakasone promised to the United States implementation of a comprehensive domestic-demand expansion policy. There is an opinion, within Japan, particularly in one quarter of the Finance Ministry, that questions the effectiveness of such a domestic-demand expansion to correct the Japan-U.S. trade imbalance and that claims that MITI is substituting one problem with another.

For example, according to an informal tribal calculation of the Finance Ministry, a Y1 trillion domestic demand expansion package will only have the effect of correcting about $600 million of imbalance. According to one set of calculations made by MITI, it is seen to have the corrective effect of $1.7 to $1.8 billion. Supposing that "truth is in the middle," I do not think [the corrective effect] is less than $1 billion. During the latest visit to the United States, Prime Minister Nakasone stated that he would put into effect a comprehensive economic measure of over Y5 trillion.

If the calculation of MITI were correct, it should have a corrective effect of $8 to $9 billion per year, which will be considerable. According to the calculation of the Finance Ministry, it is $3 billion. Even if one takes the middle figure of the two calculations, one can say that the corrective effect of $5 to $6 billion is fairly certain.

Now, the problem is the content of this Y5 trillion. There is a term called "real money." The question here is how much "real money" is in the Y5 trillion. Measures with little "real money" are not effective. For example, in the supplementary budget of FY 1986, Y3.6 trillion was added, but the "real money" in it was merely between Y100 and Y200 billion. A bit over Y800 billion was appropriated from the general account, but about Y550 billion of it was for a natural disaster relief fund, which is appropriated each year for the past year's expenses and which does not add to the net amount.

We are in trouble if the present domestic-demand expansion policy were like the supplementary budget of the previous year. The Finance Ministry keeps insisting, "we cannot lower the flag of financial reform." It is not that MITI is insisting that the entire Y5 trillion be financed by the national budget. We can include a certain amount of fiscal investment and loan and also, to some degree, public work expenses that are shared by the central and local governments.

However, if we were to include in the Y5 trillion public work expenses financed solely by local governments and the capital investment by public utility companies such as electric power companies and NTT, wouldn't we repeat the same mistake as in the last year's supplementary budget? MITI is therefore insisting that the central government finance with its own fund a half or, if possible, about two-thirds of the entire amount, including a tax cut.

Corporate investment behavior is thought to be a problem. We cannot delay the implementation of the domestic-demand expansion measure. The prime minister has already stated clearly to the United States his intention to implement them in the month of August. Usually, the supplementary budget is ready in October to November, but this timing will be too late. We would like to finish drawing up the outline of the supplementary budget in July and to proceed with execution in August.

Given the situation of the sales tax, people are wondering about what kind of financial sources are available. It is true that enforcing the sales tax from January of next year has become impossible, but there is another means—to utilize the NTT stocks. With regard to the proceeds from the sale of NTT stocks that the government has on hand, it is stipulated by law that the proceeds will be put into the national debt consolidation fund to be used for redeeming government bonds.

However, the market price of the NTT stocks has gone up, largely surpassing the expected price, to around Y3 million. Assuming the price at the time of sale to be Y2.7 million per share and after using the sales proceeds for redemption of government bonds, there still remains Y5.3 trillion at the beginning of next fiscal year. We are talking about the idea of using this surplus for domestic-demand expansion.

Even if it goes down from Y2.7 million to Y2.4 million, there remains Y4 trillion. This can be considered a gift from heaven, and we should utilize it to the best advantage. The Finance Ministry keeps saying that they do not like to use the windfall profit as a fund for a continuous policy, but it seems their nuance has recently changed somewhat. The administrative and fiscal reform is a very important item, and I have a heart-felt respect for the truly wonderful results achieved by the Finance Ministry officials these past few years. I would like to ask these smart officials to recognize fully this harsh international environment.

Now, one important point of view is to realize that the domestic-demand expansion measure does not only serve to correct the trade imbalance.

If we carefully listen to the recent arguments of the Americans, we realize that they are concerned about the investment behavior of Japanese corporations. The Americans came to attack this point also in the semiconductor negotiations, but we repelled this accusation by saying that we, the Japanese government, cannot regulate capital investment by private companies, and that this is a problem that touches the basic principle of a free economy. However, the U.S. side is not necessarily satisfied with this answer.

According to the argument of the Americans, Japanese companies are export-oriented and make an enormous investment in plants and equipment which does not correspond to domestic need. For example, they invest to boost production capacity by three to five times domestic demand. And, when these facilities start operating, they start exporting and flood foreign markets with their products. The best example of this is the semiconductor. The Americans consider this to be an overly excessive investment.

By contrast, American firms make capital investment based on domestic demand, and if there is a surplus, it is directed to export. For example, American firm's thinking is to sell 10 units with a profit margin of 10 per unit in order to realize the total profit of 100, whereas the Japanese firm's approach is to sell 100 units with the profit margin of 1 per unit in order to secure the total profit of 100. This behavior is making a mess of the production structure throughout the world. The Japanese build facilities with too much capacity, and when they start to operate all at once, the operating rate is not lowered in order to lower the capital cost, and the products are sold at a huge bargain.

Now, a point is being whispered that argues the necessity of applying a brake at the stage of capital investment by setting up some kind of guidelines.

Think While Running

In other words, with regard to the Japanese domestic-demand expansion, it was expected to have primarily an effect to pull the world economy up as seen in the so-called "Japan locomotive theory," but today it is expected to have first an effect to change corporate behavior. This is an important change, and it requires a change in the Japanese industrial policy.

We do not as yet have a clear prescription as to what we, the Japanese, should do about this problem. Unfortunately, we have to think as we run. Our honest feeling is that we have been pressed to take measures for the very sudden rise of yen. At present, a "macroeconomic study group" has been set up in the ministry with the participation of people learned in each field, and they are earnestly looking into the question of how to advance a domestic-demand-oriented industrial policy from various angles. By mid-June, an interim report is expected to be finished for submission.

On one hand, for promoting adjustment of industrial structure, an adjustment-fund system is set up by law, and the policy is carried out using this fund as a lever. There already exists a system called an industrial base credit fund. The purpose of this fund is to discard or stop facilities, taking as objects structurally depressed industries such as textile, aluminum, or chemicals and to increase their competitiveness by slimming down their facilities and manpower. The Japan Development Bank's loan has been used for this purpose. But the new adjustment fund is a system with a radically different point of view.

First of all, the structural change is backed up by an extremely low interest loan by adding further interest subsidy to the Japan Development Bank's loan. Secondly, funds are provided for measures to be taken by local governments. The objective is to help strengthen and activate the management base by investing in the government and in private (academic) organizations centered in the third sector. For example, steel towns such as Muroran and Kamaishi have been hit hard by the elimination of blast furnaces from steel companies. At present, of over 100,000 steel workers, 40,000 are scheduled to be laid off during the period of 1988 to 1990. The shipbuilding areas are also being affected severely.

Frankly speaking, in the third sector under the provincial government, no one new enterprise is able to absorb immediately the workers laid-off by the steel and shipbuilding industries. Nevertheless, in order to secure jobs for only some of the workers, or to encourage industries outside the industrial fields under the MITI administration, we [MITI] would like actively to help any new enterprise that may have some possibility of generating jobs. The governor of Hokkaido comes to us frequently for advice. We, jointly with related ministries and offices, are going to support actively the establishment of recreational facilities utilizing the region's natural assets and educational facilities.

As a medium- to long-range view, according to a simulation analysis of the year 2000, 13 years from now, there is a macrocalculation that says that the industries such as electronics, bioengineering, and new materials (including superconductive materials) will rise to claim a market of over Y200 trillion at present value, and will generate from 1.1 million to 1.2 million new jobs. We need to have something to bridge over to that stage, and as for us, we would like to minimize domestic friction by taking realistic measures.

It Is Dangerous To Control Trade

I would like to mention a few problems coming in the future with regard to individual points of friction vis-a-vis other countries.

The big headache is the automobile industry. In order to ease the trade situation, we have been advising companies to produce cars in the United States. Each company has already begun or is about to undertake on-the-spot production by a 100 percent subsidiary company. From the end of 1987 to 1988, the production capacity [of on-the-spot production] is expected to reach about 1.5 million cars in the United States.

At present, the voluntary export restriction limits for the United States is 2.3 million cars. If one adds to this the 1.5 million cars mentioned above, the total number becomes a large one. It is a question whether nearly 4 million Japanese or cars of Japanese origin can be absorbed in the U.S. market, since the scale of the automobile market in the United States is 11 million cars [per year] and the annual growth rate is 2 to 3 percent, at most. Even if one discounts the increased export of Korean cars, it will be very difficult to have room in the market for 4 million Japanese or cars of Japanese origin.

The annual export value of the United States of bodies and automobile parts is over $50 billion. As on-the-spot production increases, so does the export of parts.

Because of this, Americans are demanding a large increase in local parts-delivery. There are criticisms saying that it is inexcusable to bring in 70 to 80 percent of the parts for on-the-spot production, because then it is no different from producing in Japan.

Also in the European Community, some opinions have it that on-the-spot production of a VTR, for example, is nothing but an excuse to avoid trade friction and that investment for assembly alone is not desirable. More and more on-the-spot production will be undertaken in various countries from now on, but as the above examples show, there are possibilities for future misunderstandings in Europe and in the United States. More delicate consideration, so to speak, is necessary. Overseas investment must be aimed not only to increase employment but also to nurture local industries.

The recent deflation due to the high exchange rate of the yen is not as serious as MITI says. Certainly the figure between Y130 to Y140 [per dollar] is too low, but it is doubtful that one cannot manage unless the rate goes back to Y170 [per dollar]. There is an opinion which says that one should accept the Y150 range if it is stabilizing.

However, it is true that medium- to small-sized companies and those related to export business are particularly affected by the deflation due to the high exchange rate of the yen. We are not exaggerating this fact. However, it is also true that there is no decisive bright idea to counter it. We can only try to survive the present predicament by taking all conceivable countermeasures.

In one quarter the idea of trade control is being whispered. The present Japan-U.S. disagreement on trade friction was caused by particular industries. In other words, it was caused by $50 billion of export to the United States of automobiles (including parts) and over $20 billion of export of several electronics-related items (electronics, office machines, VTR's, industrial machines). One cannot have the ship "Nihon-maru" ["Japan"] sink because of these export-heavy industries. In order to save the "Nihon-maru," is it not better to throw these so-called "main culprits" overboard and lighten the ship's load? Such an opinion, even if limited to one-quarter, is voiced among influential people in the financial world.

This opinion presents a very important problem. To put it another way, first of all, the United States will not evaluate such a measure by the Japanese as beneficial. Isn't it likely that they will interpret it as a means to evade the question of not being able to open the Japanese market by suppressing exports? Such an interpretation was given in the past, and it will happen again in future.

Secondly, there is the great danger of losing a brake. What happens to the exchange rate of the yen if exports are reduced to $20 billion? How about to $30 billion? There is no assurance of a particular result or a clear perspective. In addition, whether it be automobiles or electronics, what kinds of influence will be felt in the related industries when the export is cut by a certain percentage? The great worry is that it will give rise to a serious depression if deflation due to the high exchange rate of the yen, which may not be necessarily corrected, continues to exist.

If one haphazardly carries out trade control without clearly understanding these points [raised above], one can no longer call it a "policy" taken by a responsible government.

As for us, we believe that the only possible way is to carry out a basic domestic-demand expansion policy, while smoothing present friction, by individual measures and avoiding international isolation. Even if each measure brings an improvement of only a few billion dollars it becomes a fairly large flow if one measures all the effects. As a medium-range objective, we would like to build a sound vision for bringing the Japanese industrial structure into an international mode. The "Nihon-maru" is a tanker of 1-million ton capacity, so to speak. It can overturn if its direction is changed all at once.

We pray to be able to steer the ship in a way that, when looking back on the sea passage after 5 to 10 years, we can say, "we turned it around correctly at that time."

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Division of Labor Between Country, Asian NIC's Discussed

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[Article by Hitotsubashi Univ Professor Ippei Yamazawa]

[Excerpts]

1. Broader Perspective.

Tension in Japan's competitive relationship with South Korea and the other Asian NIC's has surely increased in fields such as textiles, shipbuilding, and steel. The NIC's have only been exporting to Japan about 10 years, but their textiles have been competing with Japanese goods in the American and European markets for the past 20 years. So, Japan has been feeling extremely intense pressure from the Asian NIC's. But it seems a little short-sighted for us to perceive this only in terms of a threat.

The Asian NIC's appear to be formidable competitors if we restrict our consideration only to their bilateral relationships with Japan, and focus only on specific products traded, their total export and import volume, and look at only the most recent 10 years or so. But if we consider the Japan-Asian NIC's relationship within the context of multilateral foreign trade, focusing on the change in the structure of exports and imports and the long-term development process on both sides, we discover an undeniable complementarity behind this severely competitive relationship.

That is to say, up to now we have seen growth in both the competitive and the complementary aspects of the relationship in the developmental processes of the Asian NIC's and Japan, and I believe that both aspects will continue to grow hereafter. The more we emphasize the difference in size between Japan's economy and those of the Asian NIC's, and differences in stages of development, the stronger the complementary aspects of the relationship become. So this essay explores the international division of labor between Japan and the Asian NIC's—the current situation and its likely evolution in the future—rather than their race to overcome Japan.

The analysis below selects South Korea and Taiwan for analysis from all of the Asian NIC's. The city-states of Hong Kong and Singapore both are heavily involved in transit trade, and their industrial structures depend heavily on the financial and service sectors. While our international division of labor with those two countries also is important, it is qualitatively different from our competitive and complementary relationship with South Korea and Hong Kong.

Table One [not reproduced] illustrates the recent commodity trade relationship between Japan and the Asian NIC's. Japan accounted for 12.3 percent of total exports during FY85, and 14.0 percent during FY86. Japan's share of total imports during the 2 years amounted to 7.0 percent and 10.0 percent respectively. Both showed remarkable increases. Second, each of these four countries and the region as a whole have large trade deficits with Japan. And that is in spite of the fact that Taiwan has a large global trade surplus and the other three are in global balance. The reader should maintain a sense of the macro relationship between Japan and the Asian NIC's as expressed in these aggregate statistics while reading the remainder of this article.

ASEAN and China too are following the Asian NIC's in their industrialization process, earning them the title of "quasi-NIC's." This means that the competitive and complementary relationship between Japan and the Asian NIC's in the future will be intimately related to the level of ASEAN and PRC industrialization.

2. Our Competitive Relationship With the Asian NIC's.

The Asian NIC's reached the take-off point in economic growth and industrialization during the 1960's. They provide a typical example of Gerschenkron's "spread of industrialization." All of them followed the strategy of industrializing in the labor intensive light industries and exporting. The decade of the 1960's proved a propitious time for their efforts with international trade rapidly expanding at 6.5 percent driven by rapid economic growth in the developed nations and trade liberalization.

Economic growth rates in the advanced nations dropped to lower levels during the 1970's after the first oil shock, but the Asian NIC's were able to maintain their high rates of growth through promotion of exports to the oil producing nations. In 1978 the OECD (Organization for Economic Cooperation and Development) published a report entitled "The Challenge of the NIC's." This report referred to the developing nations that exported major manufactured products as NIC's (newly industrialized countries), and analyzed their export potential to the OECD nations. In addition to the Asian NIC's, the group included countries such as Brazil, Mexico, Spain, and Yugoslavia. Demands for import restrictions increased during the recession that followed the oil shock as domestic manufactures in the OECD member countries complained of adjustment problems resulting from competition with the NIC's' imports.

But the OECD report stressed the complementarity between the two groups, arguing that the economic growth rates of the OECD countries was being supported by demand for their intermediate and capital goods generated by continued high rates of economic among the NIC's during the 1970's.

The advanced nations shifted to fiscal and monetary retrenchment after the second oil shock in 1979, fearing higher rates of inflation and creeping government deficits. This created a serious worldwide recession by 1982, which this time dragged down the growth rates of even the Asian NIC's.

However, economic prospects brightened for the less developed countries with the sudden drop in the price of oil and other primary products after 1983. The growth rates of the oil producing countries and the exporters of primary products dropped to zero and then into the minus range with the sudden loss of export income. South Korea and Taiwan, on the other hand, were able to maintain moderate rates of growth, benefitting from the decline in the price of imported raw materials. Further, their exports to the United States increased dramatically when the United States reintroduced positive fiscal policies and with the return to high levels of economic growth and imports in 1983.

The products of the Asian NIC's didn't really begin to compete with Japanese products in the Japanese market until the 1980's. But they had begun to replace Japanese goods in the American and Western European markets rapidly since the beginning of the 1970's, especially in textiles, footwear, sundry goods and electrical equipment. So, commercial competition between Japan and the Asian NIC's in the Japanese domestic market developed as an extension of their competition in our export markets.

Yet another factor promoting this trend was the rapid adjustment of the exchange rates of currencies such as the Japanese yen and West German mark after the G-5 meeting in September 1985. The South Korean won remained steady and the Taiwan dollar rose only slightly against the U.S. dollar. This made both relatively cheap versus currencies such as the Japanese yen and the West German mark, and strengthened their export competitiveness. Further, with only small foreign exchange markets, exchange rates are determined by central bank intervention in both South Korea and Taiwan. Since the G-5 meeting the Taiwan dollar has crept up slightly, increasing 10 percent against the U.S. dollar in one year. The South Korean won remained fairly constant against the U.S. dollar during the first year, but began to rise after the end of 1986 (the cumulative rate of evaluation during 1986 was 3.2 percent). Still, both remained fairly cheap against the Japanese yen and the West German mark, strengthening the price competitiveness of both countries' products.

Recently, both countries have experienced considerable increases in their exports to Japan. In the clothing category, both countries' most important export to Japan, South Korea's exports of knit outerwear were up 63.3 percent in 1986 over 1985, while those of Taiwan rose 25.8 percent during the same period. During the first 4 months of 1987 they were up 116.2 percent for South Korea and 30.8 percent for Taiwan over the first 4 months of 1986. South Korean knitted underwear sales to Japan in 1986 were up 56.1 percent over 1985 and 76.9 percent for the first 4 months of 1987, while comparable sales figures for Taiwan were 83.9 percent and 103.9 percent. (All figures are from the customs statistics.) Steel plate and semiconductor imports too are rising rapidly intensifying cries of warning from import-impacted domestic producers.

3. Complementarity Behind Competition.

Still, as we see in Table One, South Korea and Taiwan both have large trade deficits with Japan. Although their exports to Japan are increasing, their imports from Japan are increasing at an even more rapid pace. Expansion of this trade deficit with Japan has become a point of irritation for both countries, and they take every opportunity to demand that Japan buy more from them.

On the other hand, both countries have large surpluses in their global trade balances. Estimates for 1986 indicate that South Korea's surplus has reached $5 billion and Taiwan's $16 billion. Taiwan's foreign currency reserves have now reached $50 billion, and South Korea is rapidly reducing its foreign debt which amounted to $24.6 billion at the end of 1984. The remarkable difference between the overall trade balance picture of both countries and their trade balances with Japan reflects the nature of the international division of labor between them and Japan.

Analysis of the structure of their exports and imports to and from Japan clarifies this situation. As indicated above, South Korea's main export products for the Japanese market are textiles (22.0 percent of the 1985 total), foodstuffs (19.2 percent), steel (10.4 percent), and electrical machinery (8.8 percent). Taiwan's major export items to China [as published] are foodstuffs (33.8 percent), sundry manufactures (15.2 percent), textiles (10.8 percent), electrical machinery (9.4 percent), and steel (4.1 percent). In contrast, South Korea's primary imports from Japan are general machinery (25.0 percent), electrical machinery (21.2 percent), chemicals (14.1 percent), steel (11.5 percent), and textiles (5.3 percent). Taiwan's primary imports from Japan are electrical machinery (25.7 percent), general machinery (18.0 percent), chemicals (12.8 percent), steel (10.1 percent) and textiles (4.7 percent).

Other than foodstuffs, we can see that the major export and import items overlap. We recently hear a lot about "Horizontal international specialization" which is often said to be a desirable international division of labor for the Asian NIC's. But it seems to mean different things to different people, and is rarely used according to a strict definition. Strictly speaking it refers to the mutual export and import of products that are used for the same purpose which have been manufactured by similar processes which are differentiated by brand name and quality. It describes the pattern of trade among some members of the European Community (excluding the countries of Southern Europe that recently joined), for example, which have similar levels of income and similar demand conditions, with no big differences in the level of production technology and production factors.

We should not refer carelessly to the overlap of exports and imports under discussion here as "horizontal international specialization." They belong to the same general category, but they do not belong to the same stage of production—finished goods, for example. Rather, they are differentiated by the various stages of production, such as finished goods and intermediate goods or parts.

South Korea and Taiwan also export the above mentioned goods to countries other than Japan, and a high percentage of the parts and intermediate goods required for their production are imported from Japan rather than supplied by local manufacturers. Thus, the more that South Korea and Taiwan export to other countries, the more they will import intermediate goods and parts from Japan. True, some of their finished goods find their way into the Japanese market, but not in quantities large enough to make up the difference in the balance of payments.

This year's White Paper on International Trade had the following to say about Japan's trade with the Asian NIC's: "Up to now the focus has been on process specialization that takes advantage of the benefits of profits based on comparative advantage and economies of scale through mutually exporting the products of the same production process at different stages of production. But a new product differentiation is developing between high and low value-added traded goods with the current appreciation of the yen," (pp 279-80). For example, if we categorize products such as synthetic resins into low, medium, and high price ranges and then compare the exports and imports of the Asian NIC's we see that it is only in the low price range that Japan's imports amount to 80 percent of exports. The medium and high price ranges are still dominated by exports with almost no imports at all. This new trend seems worthy of notice. This is a division of labor within the stages of the production process (this "intra-industrial division of labor" includes specialization based on product differentiation and stage of process differentiation).

As a result South Korea and Taiwan are both highly import dependent (imports over domestic demand) on Japan, and a new pattern is developing in which imports from Japan inevitably increase when South Korean and Taiwanese exports increase and they experience increases in export- oriented production and economic growth. Both South Korea and Taiwan have large trade surpluses with the United States and are being asked by the United States to increase their imports of American goods. This contributes to South Korean and Taiwanese demands for increased Japanese imports of their products.

This relationship has been changing gradually during the last 2 years due to the appreciating yen. Appreciation of the yen raises the price of imported parts and intermediate goods for South Korea and Taiwan, squeezing the profit margins of their exports to the United States for which prices have remained constant.

South Korea's and Taiwan's trade surpluses with the United States in 1985 were $4.2 billion and $11 billion respectively, while Japan's trade surplus with the United States for the same year was $49.7 billion. Although considerably smaller in actual value, their surpluses are creating friction for both countries in their relationship with the United States similar to U.S.-Japan trade friction. The United States is pressing South Korea and Taiwan for up-valuations of their currencies against the U.S. dollar as one means of reducing the tension. This issue was mentioned in the economic statement at the Venice Summit, and we can expect pressure on both countries for up-valuations to continue.

Up-valuations of the won and the Taiwan dollar will reduce the price of the above mentioned parts and intermediate goods imported from Japan, but it is unlikely that pressure on profits from exports will be eased unless they can raise the dollar price of finished goods exported to the United States. A longer-term solution would be domestic production of the intermediate goods and parts they need for their exports, and their has been steady movement in that direction since the beginning of the 1980's resulting in a remarkable decrease in import dependence in a number of specific products. But the size of the South Korean and Taiwanese economies impose limitations on this trend. Unlike Japan, it would be inefficient for them to produce most of their intermediate goods and parts domestically. Modern manufacturing processes are extremely complex, requiring many intermediate goods and parts. So they are likely to continue to depend heavily upon imports for most of them. That means their overall import dependence upon Japan cannot drop beyond a certain point, and we must accept the fact that this limits their ability to reduce their trade deficits with Japan. Instead, we should consider shifting some of our production of intermediate goods and parts to South Korea and Taiwan through joint ventures and technology exchange, reversing the flow by importing those goods from them.

4. The Need for Cooperation in Industrial Structural Adjustment.

The most serious international economic problem Japan faces today is the continuation of trade surpluses with her major trading partners, especially the industrialized countries. These surpluses provide opportunities for "Japan bashing" and emergence abroad of the "Japan problem." Of course there is no need to achieve bilateral trade balances within a multilateral world trading system. But Japan's global trade surplus exceeds $100 billion, which together with the U.S. global trade deficit of $170 billion constitutes a situation of macro economic global imbalance reflected in the bilateral imbalances of our major trading partners.

A cooperative macro economic policy coordination effort by the major countries is required to solve this macro imbalance. It has become more difficult to implement monetary policies which are different from those of other countries in the present world environment of rapidly increasing flows of capital across national borders. Fewer and fewer people call for further adjustments in exchange rates, and progress is being made on cooperation in fiscal policy.

But it is unlikely that the present U.S.-Japan trade imbalance will be corrected with macro adjustment policies alone. It may well require reform of the industrial structure itself, and support for that policy is thought to be the only appropriate way to proceed. Adjustment of the industrial and trade structure of one country naturally will influence the industrial and trade structure of that country's major trading partners. So industrial structural adjustment in one country even requires the cooperation of its major trading partners. We must examine Japan's international division of labor with the Asian NIC's within this context. As was stated in both the first and the second "Maekawa Report," Japan is now clarifying her plans for adjustment of Japan's economic structure, and both South Korea and Taiwan too are being forced into structural adjustment. Trade friction with the United States is one source of the pressure, since as mentioned above both countries are faced with trade friction very much like that experienced by Japan. Beginning with textiles, voluntary restraints have been imposed on their major exports to the U. S. market and they are being pressed to liberalize their domestic markets. They have plans for trade liberalization which are supposed to be realized by 1988.

The third requirement for structural adjustment arises from both countries' status as semi-developed countries. They lead the ASEAN countries in industrialization and export orientation, and their domestic production of automobiles, electrical machinery, and steel has replaced imports and even provided for exports in a short period of time. They are rapidly catching up with Japan. But the ASEAN countries, on the other hand, are rapidly industrializing and becoming competitive in products such as textiles and plywood. South Korean and Taiwanese competitiveness in purely labor intensive exports is being threatened by their rising standards of living and wages, and by up- valuations of their exchange rates.

ASEAN-style industrialization is even possible in China. Pressed between Japan on one side and ASEAN and China on the other, the destiny of the semi-developed countries depends upon adjustment of the structure of trade. At present both sides are trying to improve their levels of technology with introduction of ambitious policies of direct aid that range from better education to creating a foothold for the development of small and medium-sized sub-contracting industries. But here too are dependent upon Japan for advanced technology, a problem they are trying to solve through diversification measures, such as moving closer to the EC.

Thus, both the Asian NIC's and Japan face the need for structural adjustment, with each country's adjustments affecting that of the others. Here we must give some thought to cooperative structural adjustment in production and trade of manufactured goods. The lines on the graph in Figure One illustrate the mutual relationships involved as Japan, the Asian NIC's, and ASEAN pursue industrialization. In the normal course of events late industrializing countries import new products, accumulate know-how adequate to substitute domestic production for those imports, and soon export the same product. Since the Meiji period (1868-1912) Japan has introduced modern industries one after another, and they all have followed the traditional pattern of development from importing to domestic production and then to exporting. The vertical axis of Figure 1 [not reproduced] is defined as domestic demand over domestic production, while the horizontal axis indicates the passage of time. The 1.0 line on the vertical axis indicates the complete substitution of domestic production for imports. So, when the line goes above 1.0 the product is being produced for export, and when it drops back below 1.0 again the product is being imported.

The top half of the graph compares the stages of development of the textile industry in Japan, South Korea, Taiwan, and ASEAN. Japan already has moved back into import status, while ASEAN has just entered its export stage. The bottom half of the graph compares the same three stages of the development for the steel industry. Japan has already entered the mature stage of development, while South Korea and Taiwan are in the early stages of exporting and ASEAN is still at the import substitution stage. Hereafter South Korea and Taiwan will pass industries such as textiles on to ASEAN and focus on industries such as steel. Japan will pass its steel industry on to Taiwan and South Korea (this has already begun) in order to move into more technologically advanced fields. This does not mean that Japan is being over-run by the NIC's. Rather, we should consider achievement of this "stratified division of labor" a positive development.

Too large a gap in the structural adjustment processes of various groups involved in this game of catch-up runs the risk of surplus equipment and excessive competition. Some people believe that international controls on investment and allocation of production are required to avoid this, but they would be difficult to achieve. Japan, too, tried this sort of industrial policy during the 1950's and the beginning of the 1960's but failed to allocate investment in equipment among industries and to control production. If it is difficult to achieve within even a single country, we can not expect much from efforts to regulate sovereign nations.

We can discuss cooperative international structural adjustment efforts, but in the end we will not realize policy measures capable of overcoming national sovereignty. The best we can hope for is an exchange of information about structural adjustment appropriate to the level of development of the various countries involved and the formation of a general consensus on the direction in which we should be heading. Then at least we can expect to cooperate to the extent that the countries involved will not implement policies that go against the direction that everyone agrees to be desirable.

A new round of GATT trade negotiations began last year. Abolition of various off-shore trade protection measures and recovery of a new GATT trade and investment order will require the general agreement of the countries involved over trends in trade and production adjustment. Or put another way, without such agreement there is no reason to expect any success in the end from this new GATT round. With developing nation participation in this new round of negotiations impossible, it is desirable for Japan to strive to reach agreement on the international division of labor with the Asian NIC's and to work together to promote the success of the new GATT round.

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New Trade Insurance System Explained

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[Text]

Outline of the Explanation by Noboru Hatakeyama, Director General of the International Trade Administration Bureau of MITI

1. Background of the Enactment of the New Trade Insurance Bill

Japan, which currently has a large trade surplus, needs to recycle the trade surplus to LDC [less developed countries] debtor countries. As a measure to achieve this goal, we have established two new insurance products—the insurance for third country transactions and the insurance for prepaid imports—in addition to the existing overseas investment insurance in order to promote product imports, third country trade and overseas investment. The Trade Insurance Law which provides the three insurance products was enacted on 1 April 1987, and those insurance products will become available from 1 October. By this law, the former Export Insurance with the world's largest balance of 14 trillion yen will be integrated in the new trade insurance system which was designed to meet the needs of export insurance users. At present we are working on the details of the operational procedures and will try to meet their needs as much as possible.

Together with the revision of the insurance system, the insurance account funds will be increased by 1 billion yen making the total 7 billion yen in order to strengthen the financial basis of the account.

2. Insurance for Prepaid Imports

Because import payments are usually deferred until after goods arrive, it has been believed that there was no risk of transaction at the waters' edge. In recent years, however, prepaid imports have increased. In FY 1985, of the total import payments of $120-130 billion, approximately $11 billion was prepayment for imports that required 50 percent or more of the bill be prepaid. This method provides merit to both exporter and importer: The exporter can obtain capital needed for production at a low cost and the importer can expect a lower price for products. As this method becomes more common, however, we cannot avoid such a risk as non-shipment of goods in spite of prepayment. In order to cover such a risk, the insurance for prepaid imports was established.

Outline of the Insurance for Prepaid Imports

1) In the case when the importer had prepaid all or a part of the import bill prior to shipment; 2) —the exporter had not fulfilled all or a part of the contract obligations; 3) —therefore, the importer had requested a refund of the prepayment within a certain date; 4) —but, the refund has not been made by either of the following reasons: (a) war, restriction on foreign currency transfer (unanticipated reasons); (b) bankruptcy of the exporter, no refund has been made over 6 months (credit reasons); 5) —the insurance system will reimburse 90 percent of the unrefunded portion of the prepayment (the law permits reimbursement up to 97.5 percent at the maximum); 6) Insurance premium rates are currently under study with reference to various foreign examples.

Qualifications for the Insurance: 1) Exporters who are registered with the trade insurance authority after having undergone the required credit investigation; 2) Limitations on the period of insurance liability are currently under study. (At present, the MITI is considering 5 years.)

3. Insurance for Third Country Transactions

While Japanese marketing and product supply have developed globally, and production and sales bases are growing overseas, three-way trade where Japanese industry is the intermediary is also growing, and in 1984 reached roughly $4.5 billion. Even under the current export insurance system, in plant export, etc., transactions are covered where supply to a third country is less than 50 percent of the total. With the new intermediary trade insurance, cases where amounts surpass 50 percent are now covered.

Outline of the Intermediary Trade Insurance System

1) In the case where a Japanese firm has conducted intermediary trade accompanying the movement of goods between three nations, (note: a necessary condition is that the Japanese firm is the intermediary and this will not apply if there are direct imports between the nations); 2) the third country buyer for reasons specified—the same reasons listed under the section on insurance for prepaid imports above—does not make payment; 3) as a general rule, compensation will be made for 90 percent of the amount of payment not received 4) Insurance rates are currently under review and various foreign examples are being studied. (As a basic rate, from 0.8-0.9 percent per year is estimated. The policy is also to set premium rates to differ according to region or time frame.)

Furthermore, as to those covered by this insurance: 1) As a general principle it will be limited to third country buyers who have registered with the trade insurance authorities and who have undergone the required credit investigation. 2) With the exception of plant export and related items, the time period for insurance liability is planned to extend up to 2 years.

4. Overseas Investment Insurance

The recent increase in overseas investment by Japanese firms has been striking, but much of this investment has been directed toward advanced nations, and investment in developing countries is not necessarily sufficient. To deal with this insufficiency a necessary reform which is calculated to reduce investment risk has been enacted with the inclusion of credit insurance protecting against bankruptcy at the location where investments are made in addition to already existing coverage for extraordinary crises such as expropriation and war. We are proud of the fact that there is no example for this elsewhere in the world.

Furthermore, we revised the method of calculating the amount of loss from the method of "valuation immediately before bankruptcy-valuation immediately following bankruptcy" used heretofore, to the "investment amount-returned amount" method, since in cases of bankruptcy and the like, the worth of the assets just before bankruptcy were greatly reduced.

Outline of the Overseas Investment Insurance System

1) In cases where Japanese firms have invested abroad (this includes financing, acquisition of debentures, guarantees, and not just investment of funds); 2) bankruptcy at the location of investment; 3) as a general principle, compensation for 40 percent of the amount of loss accompanying such investment (the government's portion of the compensation will be lower than that of the firm's).

Furthermore, the scheme for this insurance is expected to be as follows: 1) As a general rule it will be for the manufacturing industry. However, in cases where special conditions are met it may apply to other industries besides manufacturing. 2) We will conduct a study of the credit of the investor and an examination of the subject of the proposed investment. 3) The insurance premiums will, as a general rule, be paid annually, but depending on the business results of the investment target, we are studying an adjustment of the period within fixed limits. (Insurance premiums are presently under study but are estimated to be on the order of 1 percent.) 4) We will set a guarantee limit amount per one transaction (on the scale of Y10 billion). 5) A fixed period immediately following the commencement of operations (2 years) is exempt from coverage. 6) The amount of loss which will be compensated for will be the amount collected subtracted from the amount invested.

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Business Leaders Discuss Solutions for Japanese-U.S. Trade Friction

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[Panel discussion in search of solutions for Japanese-U.S. trade friction among Eiji Toyoda, chairman of Toyota Motors, a vice chairman of the Keidanren [Federation of Economic Organizations]. Takuji Matsuzawa, adviser to the Fuji Bank, a vice chairman of the Keidanren; Toshikuni Yahiro, chairman of Mitsui & Co., Ltd, a vice chairman of the Keidanren; Isao Nakouchi, chairman of Daiei Co., Ltd.; Tadahior Sekimoto, president of Nippon Electric Company, Limited; moderated by Masanari Miyoshi, managing director of the Keidanren]

[Text] Miyoshi: The enormous trade imbalance amounting to $58 billion (last year) is being cited as the principal cause of Japanese-U.S. economic frictions. But since the beginning of this the J-curve effects have rapidly dissipated; as a result, the dollar-based global trade surpluses of our country are expected, according to a trial computation by the MITI, to decline by some $15-19 billion a year. In yen-based and volume-based term, this trend becomes even more pronounced.

Meanwhile, there are no signs of improvement in the U.S. trade balance. This is why discontent has risen in and around the U.S. Congress, and a heated debate is in progress over a protectionist omnibus trade bill. Moreover, with the COCOM violation case as a turning point, the activity of Japan's economic sector is now being made an issue in the context of security.

Against this backdrop, my question is, how do you view the current state of Japanese-U.S. relations? I would like to hear your view first, Mr Yahiro.

Omnibus Trade Bill Could Lead to Global Stagnation

Yahiro: I believe that Japanese-U.S. frictions have indeed reached a point more critical than ever before.

Despite a 70-percent appreciation [as published; obviously meant depreciation] of the dollar since the Plaza Agreement, the extreme trade imbalance has not improved at all, which has exasperated those of the U.S. administration, Congress, and industrial sector; furthermore, partly as a result of the Democratic Party's having taken up the trade question as one of the issues for the upcoming presidential election, the trade issue has become intertwined with political and security questions, resulting in an amplification of the friction—this, I believe, is the situation that exists today. What makes the situation all the more worrisome is the omnibus trade bill, which is about to be taken up by the House and Senate Conference Committee of the U.S. Congress. The contents of this bill are by and large strongly protectionist in tone: particularly such provisions as Article 301 and the Toshiba clause of the Senate bill and the Gephardt clause of the House bill, if passed as they are written—the possibility of presidential veto notwithstanding—will be a direct blow to Japan for sure; moreover, passage of such a bill not only poses a fundamental threat to the GATT system envisioned in the new round of negotiations, but also could conceivably lead to stagnation of the global economy in the end—an alarming prospect, indeed.

Contrasting Economic Structures

Matsuzawa: I, too, share the view that Japanese-U.S. relations are in a state of crisis. One of the causes of the Japanese-U.S. trade imbalance, I believe, is in the economic structures of the two countries that are so drastically contrasting to each other.

During the period of mid-1940's through mid-1960's, Japan was plagued by recurring shortages of foreign currencies. Being a country lacking in natural resources, Japan had to earn foreign currencies by means of increasing its exports. For this reason it resorted repeatedly to an economic policy designed to impose monetary restraints, to suppress domestic demands, and to stimulate exports. Consequently, its economic structure has become increasingly export-oriented, and its current-account balance has consistently been in the black since 1975. In the works of scholars, Japan is a country where the imbalance between excessive savings and inadequate investment is being manifested in the form of exports. In other words, Japan is so completely steeped in this tendency that it is almost like its constitutional disposition.

The United States, on the other hand, started off as a country almost completely self-sufficient in the first place. Never in its history has the United States even attempted to promote exports by means of implementing a domestic belt-tightening policy. On the contrary, the propensity to import more when the domestic business conditions are good has turned into the nation's second nature.

Faced with the kind of chronic trade deficit it is experiencing now, logically the United States should curb domestic demand and stimulate exports. I believe Japan would have done exactly that, but the United States, never.

In my view, as long as the debate is kept on the superficial level without going into these structural problems, the root causes of the friction will not be resolved.

Three Partners of the Free World

Sekimoto: I agree with what Mr Matsuzawa has said. Being blessed domestically with a favorable economic environment in terms of energy, economic environment in terms of energy, food, and other essentials, the United

States has been lacking the drive to export. Furthermore, when it comes to industrial products, which constitute the core of the friction, U.S production bases have been moved to overseas.

Consequently, of the industrial products the United States is buying from Japan, one-third are items indispensable in the lives of American people. If you look at American electronics businesses, quite a few of them have moved their production bases to Asian NICs; their products, made abroad, are being imported into the United States.

In other words, the United States has thoroughly become an "information society." It is importing hardware but its software items are excellent—it is these software items the United States should try harder to sell. I also think that Japan, for its part, should make the effort to buy these fine software items from the United States.

Another point is that Japan and the United States, together with the EC [European Community], are partners of the free world. If one goes bankrupt, other will suffer as well. This idea should be the basic premise from which the two countries must figure out how to cope with each other as partners—I believe this is important.

Miyoshi: As the top leader of the manufacturing sector, what is your view, Mr Toyoda?

Conglomerates and Vietnam War Are Culprits

Toyoda: I believe that conglomerates and the efforts of the Vietnam war are partly responsible for the trade imbalance.

Lately you do not hear the term "conglomerate" used very often, but what may be an offshoot of the same concept is very much alive even today. the M&A [mergers and acquisitions] activity, for example, is tantamount to an act of snatching a once successful business using the power of money: Who would want to foster a business or an industry with tender care under such circumstances? If a business has had a good performance record, it usually has accumulated reserves, making it possible for the new management to siphon off profits from it for a period of time. But as soon as the business starts going downhill, the management will sell it off with no second thoughts. In such a situation, there is no way for industries to grow.

As for the other fact the Vietnam war, I believe it served to demoralize the spirit of the working population. In order to put an end to this spell and to have the country regain its characteristic energy and soundness, the Reagan administration has been striving in many ways including some policy measures, but I am afraid the United States still has not sufficiently regained the kind of sincere, hard working attitude which its workers used to demonstrate in the 1960's.

Miyoshi: Well, we heard Mr Yahiro say that much of the Japanese-U.S. friction is political in nature. You being a frequent visitor to the United States, what is your feeling on this, Mr Nakauchi?

Use of Customs Statistics as Sole Basis for Judging Trade Imbalance Is Antiquated

Nakauchi: The issue is an emotional one but only at the federal level; at the state level people are very friendly. I believe that lurking in the background of Japanese-U.S. frictions is a problem of "perception gap"—as in other situations. In these days, called an era of "no national boundaries," to talk about trade imbalance solely on the basis of customs clearance status is in itself antiquated, is it not?

According to "The Movement of Companies with Foreign Capital," a MITI report issued in September 1987, 434 American companies based in Japan recorded total sales amounting to Y8,475.9 billion during the fiscal year 1984. This figure, which I believe was not less for fiscal 1986, if computed at the exchange rate of $1:Y150, is equivalent to $56.5 billion. By comparison in the same year Japanese companies based in the United States produced goods worth $31.1.

Assuming these figures remained pretty much the same for fiscal 1986, Japan sold to the United States goods altogether worth $98.6 billion: $85.5 billion of which representing exports from Japan and $13.1 billion representing goods produced by Japanese companies in the United States. The United States, meanwhile sold to Japan $84.4 billion worth of goods, of which exports accounted for $26.9 billion and the sales by U.S. companies in Japan for $56.5 billion. The margin is a mere $15.2 billion surplus in favor of Japan. If the invisible trade balance favoring the United States is taken into account, Japan's net trade surplus is only about $8 billion, an amount hardly worth quarrelling about.

Sekimoto: Those are the kind of facts which the Japanese Government itself should have an accurate grip on. This year 6 million Japanese are expected to travel abroad as compared with 2 million foreigners expected to visit Japan, which means Japanese travelers will outnumber foreign visitors by 4 million. The money these Japanese spend on their foreign travels for such things as lodgings, food and drinks and souvenirs adds up to a considerable sum. There are other items which should be clearly reflected in statistics: for example, the copyright fees Japanese are paying for American best-seller books [Japanese translations] being sold in Japan. Arguing about trade balance solely on the basis of primary and secondary products will never lead to a solution. What one must not forget is that the trade imbalance between Japan and the United States exists because the economies of the two countries are mutually complementary.

The United States Should Change Import-Oriented Disposition

Yahiro: Taking the amounts of invisible trade into account will, as Misters Nakauchi and Sekimoto are saying, reduce the size of actual trade imbalance; nevertheless, a large imbalance still remains. This is due to the structural differences in the economies of the two countries.

Over a long period of strong dollars the United States turned completely into a nation of import-dependence and rendered itself into a relationship of inseparable interdependence with Japan, a nation inherently export-oriented. By force of natural consequences an extreme imbalance has developed between the two nations—this is the situation we have today. In order to correct this imbalance, Japan is now trying, by implementing the Maekawa Report, to stimulate domestic demand, to reduce its traditional reliance on the United States simultaneously undertakes a structural reform in the direction opposite to what Japan is pursuing, the problem will not be resolved. This is precisely the point I am making to those Americans concerned with this problem when I appeal to them on my visits to the United States to please implement "a reverse Maekawa Report."

Miyoshi: In addition to the ongoing trade imbalance question, lately the security issue has been brought to the fore. Regarding this situation, some people are apparently saying that the United States is venting all of its frustrations in the direction of Japan.

Toyoda: Europeans, too, are saying that Japan has simply concentrated on economic growth without worrying about military preparedness. In other words, they are saying that while they are running clad in armor, we Japanese are running wearing only athletic shirts, which makes it only natural that we Japanese can run faster. How about showing some restraint?—This, in essence, is what they are saying to us.

U.S. General Consumers and Industrial Circles Are Not As Upset As Members of the Congress

Yahiro: for a number of reasons, one of which is that Japan's defense budget is 1 percent of its GNP while in the United States the ratio has reached 6.5 percent, there has always been a complaint about Japan's having a free security ride. Now, to make things worse, there is the huge trade imbalance coupled by the recent case of a COCOM [Coordinating Committee for East-West Trade Policy] violation by a Japanese firm. All these things seem to have led to gradual exacerbation of U.S. frustrations.

Nevertheless, criticism against Japan among these election-conscious members of the Congress aside, most of the general consumers and business circles in the United States do not seem nearly as upset as we may think they are about the imbalance issue. In and around Washington every word spoken seems to have something to do with Japan bashing, but I tend to doubt whether Japan bashing has reached such a point if you look at the United States as a whole. For instance, an amazing number of 590 Americans, mostly couples, led by 7 governors of such states as Georgia, Virginia, North Carolina, and South Carolina, is expected to come to Japan for the 12th Conference of Japanese-U.S. Southeastern Regions to be held in Tokyo on 4-6 October—this fact alone makes me wonder what happened to Japan bashing!

Japan Should Promote International Cooperation

Matsuzawa: I believe that the following two factors can be cited as major causes of the Japanese-U.S. trade imbalance:

First, since the end of World War II the global economic might has become decentralized from the monolithic control by the United States into a tripolar force comprised of Japan, the United States, and Europe. This means that the economic strength of the United States has declined in relative terms. Despite this, the United States as the leader of the Western alliance has continued to bear the enormous security costs in the post war years. It may even be said that this imbalance between the burden and the declining strength of its relative economic position has led to the colossal budget deficit of the United States. It is this budget deficit which the United States is filling with financing from abroad.

The other factor is the structural difference of the economies. The United States is based on the principle of free enterprise: the only constraint on business activities is the Antitrust Act—just about. As such, there is no national industrial policy; the matter of moving production bases to overseas is decided solely at the discretion of individual enterprises. As a result, there has been progressive "hollowing out" of its industries.

In Japan, on the other hand, the situation is reverse—so much so Japan is even called a nation of regulations: Activities of all enterprises have always been subjected to various ordinances and administrative guidelines; of course there have been coherent industrial policies as well.

Although these two factors are largely responsible for the trade imbalance, what cannot be ignored is the reality that the United States is currently suffering from twin deficits. Should this situation remain unchanged, the dollar is likely to decline even more in the medium to long terms. There are some, such as Martin Feldstein, former chairman of the CEA (Council of Economic Advisers), who even anticipate the dollar's decline if left unchecked. There may be a repeat of the great panic of 1929. To wit, there is the danger that loss of confidence in the pivotal currency could drive trade into a state of regressive balance. I believe that this kind of situation must be avoided at any cost.

For Japan, therefore, it is necessary to promote international cooperation in line with its economic strength and to take the attitude of willingness to do everything possible toward that goal.

Nakauchi: The colossal budget deficit of the United States, which is causing the dollar's decline, is due to its bulging defense expenditure. Hopefully the recent trend toward easing of tensions between the United States and the Soviet Union will facilitate reduction of arms. At the same time, Japan, too, should do its part toward easing the tensions worldwide by taking over some of the foreign aid burdens from the United States; once such an effort is underway, it should be made the theme of an aggressive, sustained PR campaign. I fully agree with Mr Matsuzawa's view.

Miyoshi: Will there be an industrial policy in the United States? What do you think, Mr Sekimoto?

The United States in Transition From an Industrial Society to an Information Society

Sekimoto: It will be difficult for the United States to revert to the industrial structure by bucking the tide of history running from an agrarian society to an industrial society and then to an information society. For its part, Japan should figure out how it can become a good partner to the United States, a nation senior to Japan like an elder brother, which is in transition to becoming an information society.,

Nakauchi: I wonder whether the term "partner" might not be controversial from the U.S. standpoint. In my way of thinking, the United States is a "daimyo" [a feudal lord] and Japan a "chonin" [a tradesman]. It would seem more to the point for Japan to say to the United States, "We will accommodate you with necessary funds."

Yahiro: Also, the United States seems to loathe the thought of Japan becoming a "bushi" [warrior].

Toyoda: It has not been that long since the United States emerged as the number one. But most of today's Americans have been raised and educated since their country became number one; therefore, subconsciously, they seem to take this label for granted, and the thought of being anything less is instinctively disagreeable to them.

Sekimoto: Although the nuances vary depending on what words are used to describe Japanese-U.S. relations, that the two countries are in a mutually complementary relationship is an unshakable truth. Essentially, I believe that the United States must reorient its thinking on the premise that it is a country in transition to an information society and can no longer revert to an industrial society. Still being in a transition period, on occasion it may be necessary for the United States to be alert to the need for emergency-escape measures such as MOSS [market oriented sector selective].

Miyoshi: It appears that the United States itself is beginning to recognize the seriousness of the falling value of the dollar, which is the pivotal currency, in terms of the impact on the global economy; largely it seems to have begun to exert itself for the restoration of international competitiveness among its industries.

Industrial Policy Has No Place in the U.S.-Style System

Sekimoto: Although such an effort would be much welcome, I wonder whether any attempt to introduce an industrial policy into the American-style system of today might not create a situation basically alien to that environment.

Toyoda: I beg your indulgence for blowing my own horn, but when we at Toyota Motors decided to establish a joint venture (NUMMI) [New United Motor Manufacturing Inc.] in California, we thought the outlook would be bleak to say the least if we had to accept a traditional American labor union. But the circumstances were such that we could not very well shut out the UAW; so, we made a proposition that only on condition that they go along with our way of doing things would we hire UAW union members, to which the UAW made some concessions. In the end, the matter was resolved with the understanding that the Toyota Formula would be adopted. Any problem having to do with the American labor union should properly be taken care of by Americans; in this case, however, it was we from Japan who rendered a helping hand in solving the issue. I believe it is necessary for Japan to help U.S. industries revive themselves—here and there, in various ways, within the limit of Japan's capability.

Reforms Making Headway in Japan

Yahiro: In the midst of a continuing decline of the dollar, as one approach to their structural reform Japanese corporations are moving their production bases to the United States. As a result, before long, not only will Japanese exports to the United States begin to shrink, Japanese products manufactured in the United States will be exported to Japan. When these things happen the trade imbalance as it exists today is bound to improve gradually.

As a matter of fact, Japan's industrial structure has changed. The ratio of manufactured goods in percentage of total imports has risen from abut 30 percent 2 years ago to 45 percent this year. The volume of our total imports, too, has been increasing steadily on a month-to-month basis as compared with a year ago: the figure for August this year, for example, showed an increase of 33 percent over the same month last year. All this seems to indicate that the reform effort within our industrial sector is finally bearing fruit, albeit slowly. Even those at the MITI are now beginning to say, "At long last the uptrend in Japan's imports looks like something real."

By the way, I have heard recently that there is a move afoot among some American businesses to transfer their overseas production bases back to the United States. Do you think there is something to this story, Mr Sekimoto?

Sekimoto: I am aware of some cases in which domestic production facilities of certain American companies have been strengthened with the help of Japanese firms; as for the question you raised, there may have been some special cases, but I do not believe that the move has developed into a general trend yet.

Matsuzawa: But if the dollar's decline continues and reaches, say, the level of $1:Y100, is it not likely that those America businesses will eventually come to the conclusion that it would be better to move the production back to the United States.

Sekimoto: I think it will take a rather forceful policy to make them "gather the spilt water back to the bowl."

U.S. Problem Is Not Deindustrialization But Structural Shift

Nakouchi: There is, I believe, the need to clearly define the meaning of "deindustrialization" or "hollowing out" of the industry. In the United States, what the members of Congress and the administration want is to reduce unemployment. They do not care whether the jobs are provided by the secondary or tertiary industries; all they want is to provide people with employment opportunities. So it seems to me that the question of how to create jobs has become the number one issue.

Matsuzawa: As I said at the beginning, when in the past trade deficit occurred, Japan adopted a general policy of suppressing demand and thereby tightened up the domestic economy so much that the employment picture worsened and there were even some companies going bankrupt while in the black. By contrast, the United States will have nothing to do with such a policy; furthermore, what is ironic is that, despite the critical state of its trade deficit, its jobless rate has been improving more and more—in August, the rate dropped to 6 percent.

Yahiro: It is because the service industry is absorbing workers seeking jobs.

Sekimoto: From 1980 through 1986, under the Reagan administration, the U.S. manufacturing sector cut its work force by some 1.3 million while the service sector increased its work force by some 11 million, which means that nearly 10 million more workers found jobs during the period.

Nakauchi: What is happening in the United States is not a case of deindustrialization; rather, it is a shift in the industrial structure. I think the United States, too, should be more careful with the use of terminology.

Miyoshi: The point made by Messrs Nakauchi and Sekimoto, as I understand it, is that the current situation in the United States is more a switchover phase in the industrial structure than deindustrialization—a point which the Japanese Government ought to make with the U.S. Government, insisting that the trade imbalance issue should not be debated on the basis of customs statistics alone.

Be that as it may, right now we are faced with, shall I say, an emergency situation: The House and Senate Conference Committee of the U.S. Congress is deliberating on the omnibus trade bill. Some are saying that, if we hope to make a meaningful input into that deliberation, Japan must either make some concessions or otherwise demonstrate by action its willingness to take a policy measure of one kind of another toward resolution of the trade issue. This, too, I believe, is a point well taken. I also believe that Japan, after it has taken some policy measure first, can still put forth certain demands to the U.S. side. It is on these points that I would like each of you to comment.

Stimulate Domestic Demand by Relaxing Regulatory Controls

Toyoda: In any event, as a practical matter, I think Japan will have to do something about its trade surplus. When the other side is deliberating on a trade bill, for us to say that such a trade bill is in violation of the GATT is not only ineffectual for the most part but will simply further complicate the issue.

As a matter of basic stance, first of all Japan must somehow find ways—even at the expense of logic to a degree—to prevent a head-on collision between the two parties. To do this, Japan will have to undertake without failure what it must, including, making some compromise— even if doing so is somewhat disagreeable. In fact Japan is compromising quite a bit already. There are of course many things we want the United States to do, but it would be a folly for us to think that the issue will get resolved if we kept on finding fault with the United States.

The first thing Japan should do probably is to stimulate its domestic demand. To be able to do that, whatever else might be said, Japan simply will have to speed up the easing of regulation controls. Once unnecessary regulations are removed, the rest will be taken care of by the private sector. Relaxing regulatory controls also has a bearing on the matter of opening up the market.

Having said that, there is another thing I would like to add. Lately I have been hearing time and time again the argument that Japanese businesses ought to change their behavior—from fighting over market shares to putting more emphasis on profits. But in the United States, too, during its heyday of the past, there was a competitive struggle being waged over the market shares. The result was that an oligopolistic situation developed, the fight over market shares subsided, and the country's economy began sliding on a path devoid of vitality. More recently, managers of American enterprises have been under so much pressure to produce profits above anything else that they can ill afford to sacrifice profits even temporarily for the sake of expanding their market shares.

Likewise, in Japan, too, undue pressure to suppress excessive exports may produce grudging compliances initially, but soon a sense of futility—what is the use of even trying!?—is bound to drive the managers of the export businesses to settle for a reasonable retirement allowance rather than staying on their jobs. Should this happen, the industry will wither, and Japan will end up on the same path which the United States has already taken.

Policy for Sustained Growth of Domestic Demand Is Preferable Than Sporadic Increases in Public Investment

Matsuzawa: The Maekawa Report is out, and there is a national consensus supporting it as a government-level policy. So, it seems fair to say that the things Japan must do have at least gotten on track. As for the matter of stimulating domestic demand, which is the most important of all issues, it is already known that a Y6 trillion "domestic-demand expansion budget" is to be prepared for fiscal years 1987-88. This means that the fiscal and monetary policies designed to stimulate domestic demand are all in place.

Although money supply is still being controlled, the basic tone of the current monetary policy is in favor or credit relaxation in order to help stimulate domestic demand. Our interest rate is extremely low in comparison with the prevailing rates elsewhere in the world; it is providing a foundation conducive to domestic-demand growth. Our government is moving aggressively on the fiscal front as well; a sizable portion of the budget is being allotted to the purpose of beefing up infrastructural investments. Such being the case, it is fair to say that Japan is doing the things it should be doing.

In the final analysis, Japan's current drive to stimulate domestic demand signals a shift from complete devotion of production capacity to exports, to an all-out effort to improve infrastructural investments within the country, for which all technological, funding, and economic resources of the country are to be fully mobilized. Although it is often being said that the stimulation of domestic demand has been compelled by external pressures, I would like to think that it is an effort for Japan's own interest—an effort motivated by the desire to take greater interest in putting domestic affairs in good order while we have affordable economic strength to do it.

At the same time, stimulating domestic demand will lead to lessening of the pressure to export and to an upturn in imports; it also has a bearing on the foreign exchange issue. So, for the medium and long terms, I believe this effort will produce a reduction of the trade imbalance to a certain level; for this reason, I think it is necessary for Japan to maintain this policy of stimulating domestic demand for sometime to come.

I have a word of caution, however: I am cautioning people about entertaining the notion that Japan's fiscal operations have turned into an aggressive mode as a result of implementing the measures to stimulate domestic demand—this, I believe, is a very dangerous view. Sporadic increases in public investment is not that significant; what is far more important is a policy that will ensure sustained growth of domestic demand. For example, Japan's income tax system is very hard on the working classes; this is one of the reasons why I believe that the tax reduction measure should be extended to fiscal 1988, instead of being terminated at the end of fiscal 1987, so that the living standard of individual citizens may be improved.

Likewise, reducing the corporate tax, too, will have a salutary effect on the expansion of domestic demand, for it will increase retained profits and thereby will facilitate corporations' efforts to improve the welfare and work-environment of their employees. At the same time, as an integral part of the tax reduction policy, we need to keep our mode of thinking trained toward reforming the government's spending structure, in keeping the growth-prone administrative machinery in check and bringing about a small government. Otherwise today's fiscal burden will turn into a monstrous burden for the generations to follow.

Needed Are Relaxation of Regulatory Control, Easing of Licensing Procedures, and Simplification of Import Process

Yahiro: To somehow improve the trade imbalance with the United States is the biggest and the most urgent problem for Japan. Nevertheless, as I stated at the beginning, for Japanese exports to become subjected to involuntary suppression as a result of the emergence of a strongly protectionist move by the United States is not a desirable state of affairs for Japan. I think that Japan should, if possible, devise its own approach to solving this problem by such means as voluntary dispersion of exports in terms of the countries of destination and a switch to the OEM made in the United States.

Meanwhile, what is more important than anything else is for Japan to make constant efforts to increase imports. As the Keidanren has been saying for some time, we need to open up our market to say the least. citing the unsatisfactory state of Japan's move to open up its market as the reason, some are even talking about the inevitability of further devaluation of the dollar down to the #1:Y100 level. Compared to the kind of impact such as eventuality would have on us, whatever adverse impact—there will be some, for sure—from voluntary opening-up of the market would be much more bearable.

For this reason, I believe it behooves the government to act boldly in order to remove those factors that are impeding the process of opening up the market; specifically, the government should relax regulatory controls, ease the licensing procedures, and simplify the import formalities—the measures which have been requested by the Keidanren repeatedly in the past and which are likely to be resisted by bureaucratic elements within the vertical administrative structure.

There are two things I expect most from the newly-formed cabinet: one is tax reform; the other is to open up the market. For those items currently under import controls, the government should announce a definite schedule for removing such controls and try to meet the schedule in opening up the market for them.

Miyoshi: I would also like you to spell out the kind of things you want the U.S. side to do in order to promote its exports. How about you start off, Mr Nakauchi?

Japan Should Make An Explicit Promise on the Timetable for Its Market Opening

Nakauchi: Although for the medium and long terms I think it is important for Japan to put forth its views more plainly to the U.S. side in order to deepen their understanding of Japan's position, what is essential for the short term is to faithfully implement the Maekawa Report as we already said we would. In this connection, our market must be opened up based on a set schedule exactly as suggested by Mr Yahiro. In doing so, it is imperative to open up the market for everything, for leaving even one or two exceptions would lead to further misunderstandings.

There are obstacles abounding for American businessmen trying to get something going in Japan. For instance, if an American wants to set up a store, he is blocked by the restrictions of the Big Store Act; even if he succeeded in setting up a store, if he wants to extend his store hours he is told that he cannot keep the store open during evening hours because local merchants would oppose it. If another American wants to develop waterfront property as a venture into a resort business, he runs into the question of compensation for the local fisheries, forestry, and agriculture; moreover, due to the peculiarities of the vertical administration, he is required to report to a number of different ministries, such as Ministry of Transportation, Ministry of Construction, MITI, and even Ministry of Education, if he wants to set up and operate just one yacht harbor—otherwise, he cannot. An attempt by Americans to sell rice to Japan is choked off by the Foodstuff Control Law; if it is liquor they want to sell, there is the problem of liquor tax which makes the license very difficult to obtain. All these problems are utterly hopeless unless regulatory controls are eased—I tend to think this may very well be the most serious issue.

Americans, meanwhile, instead of continuing to say they cannot sell to Japan, should make the effort to sell—they should study the Japanese market so that they can adapt themselves to it. Also, we ought to tell the U.S. side in no uncertain terms that it is ludicrous to let the kind of logic go unchecked—logic that Japan is not buying American goods, therefore Japan is at fault. There are some positive signs, however: right now, in the United States, a kind of one-village-one-product movement is spreading in many states, and competitive spirit is on the rise—our company,for example is witnessing this surging competitiveness on the part of Americans in their drive to sell beef. Obviously Americans are learning, albeit slowly, about the Japanese market: these days they are doing things like packing the meat in boxes to please the fancy of Japanese consumers.

Meanwhile, as Mr Yahiro has pointed out, I believe the time has come for Japan to make a clear-cut commitment as to when it will fundamentally liberalize its market. It will only invite further misunderstandings if Japan should continue to stall using this and that as excuses, giving in an inch at a time as if to say why should we voluntarily go naked when it is going to hurt us. It would be better, I believe, for Japan to declare its intention to strip itself bare by a certain time, for this will leave the United States without any excuse to criticize Japan. Am I wrong to think that it behooves Japan to stop practicing its traditional negotiating tactics of giving in just a little only when so demanded by the other side?

Miyoshi: By the way, do you suppose that problems are likely to occur in the days ahead in the high-tech sector as well?

Japanese Enterprises Should Study Ways To Contribute To, Harmonize With The International Community

Sekimoto: I think it is inevitable that the high-tech sector will become the center of controversy. It seems fair to say that this is an area in which we are making some contributions but, at the same time, we have generated jealousy and envy as well.

I would like to make the following three points. First, there exists a culture gap, which may also be called a perception gap, between Japan and the United States. Take the power relationship between the legislature and the government, for example: this interbranch relationship is ever so delicately different in Japan as opposed to the United States, depending on the issue at hand. Thus, the notion that everything will be fine as long as our government, legislature, and private sector maintain a line of communication with their respective counterparts in the United States is simply unrealistic. Some issues are well understood by the government but not by the legislature; on each issue we must know to whom we should address ourselves. For this reason, I think it is important for each segment of our society to make it a habitual practice at all times to cultivate personal connections within the United States through various means. Otherwise needless misunderstanding might very well be brought on over such issues as one involving the high-tech sector.

My second point has to do with the conduct of business. Japanese business are said to be concentrating on market-share competition without regard to the profit factor, but my point is that even for American businesses a higher market share means a greater profit, and that therefore the share question and the profit question are not mutually unrelated. But looking back at the historical development of Japanese industry, it is true that considerably more emphasis has been placed on the promotion of exports than on the promotion of domestic demand—this is something we probably need to reflect on. It is also true, however, that Japanese goods have been exported because they have been sought after; they have never been forced on anyone. But viewed in terms of the end result, the criticism that Japanese exports have, in some sense, inflicted damages on the industries of the recipient countries is partially correct, I believe. I should think, therefore, that all of our business firms and industries ought to weigh domestic and foreign issues from a strategic standpoint, adopt more of the line of thinking which moves away from total preoccupation with exporting, and to figure out specific ways to contribute to and harmonize with the international community.

My third point is that to date Japan, while saying it will do this and that, actually has not shown much movement. Take, for instance, Japan's plan for the recycling of its surpluses, it is being said that the "net value" of the plan amounts to only $5 billion or so. The point is, this sum being inclusive of what has already been recycled, it is nowhere near the $30 billion being envisaged in the international expectations. On the question of opening up the market, too, once a promise is made, it is essential to keep that promise. The United States has already secured the application of the waiver provisions of the GATT to 13 of its agricultural products. This is a matter about which the Japanese Government should have something to say; on the other hand, Japan cannot maintain that the status quo is all right—it must, within the limit of Japan's realities, put forth a proposal spelling out its intentions.

On the question of tariffs, I think the tariffs on industrial products should be be abolished. Already semiconductors and computers are exempt from tariffs. For certain special items a time limit may be imposed, but the important thing is to eliminate tariffs on all industrial products in order to facilitate the inflow of foreign products of this category.

Meanwhile, there are two things which I would like to call on the United States to do. First, I want the United States to reduce its budget deficit. The United States has already demonstrated its will to do so by enacting the Graham-Rudman Law on its own initiative; I hope it will vigorously pursue this course. Second, keeping in mind that marketing is something Japan learned from the United States, a pioneer in marketing, the United States should go back to the drawing board and once again start producing the kind of hardware and software based on the needs of the customers in the marketplace. What is essential is for U.S. private businesses to make aggressive efforts to gain access to the Japanese market. Right now they are tackling this problem with the help of the government—this may do for now, but it simply cannot go on forever. Looking at the rate of growth in exports to Japan during 1986, in the case of the United States it was 12.6 percent in dollar terms, whereas in the case of Europe, even though the foreign-exchange adjustment to its currencies was less than that to the U.S. dollar, the growth was 46.6 percent. In comparison with 2-3 years ago, not only has Japan opened up its market to a significant degree, the exchange value of its currency has been adjusted. It is under these circumstances that Europe and the NICs have increased their exports to Japan but, regrettably,that has not been the case with the United States.

Miyoshi: Before closing, I would like each of you to comment on one more subject. Japan and the United States are supposed to be important partners sharing the responsibility of supporting the global economy. But the question is: Will this point ever become a widely accepted perception not just among the government leaders but among the leading opinion makers of the two countries as well? Your outlook on this question and thoughts on the future of Japanese-U.S. relations, please.

Japan Must Do More Recycling of Capital

Matsuzawa: I think enough has been said already, but if I may venture to say a few more words, the first thing is that both Japan and the United States must realize the fact that their relationship, in a nutshell, is one of mutual dependence which has been so shaped and forged over the 40 postwar years. If the United States catches cold, so does Japan; if something goes wrong with Japan, so it goes with the United States. Getting back to the trade issue we discussed earlier, if Japan should seriously restrain its exports, conceivably this could hurt the United States as well.

My second point is that, although Japan will, for the medium and long terms, try to restructure its economy into the domestic-demand-oriented mode, we must constantly insist on the need for a stable exchange market as a sine quo non for that effort by Japan.

My third point is a question: In connection with Japan's intention to resolve the trade imbalance problem over the medium and long terms, what should Japan be doing right now? I believe the answer should be the recycling of capital. This is what the prime minister promised at the Venezia summit; we cannot let it be just a PR balloon and do nothing about it. The recycling of capital, if it is to be substantive and systematic, will have to be mainly in the form of ODA [official development assistance]. The private-sector funds will probably have to augment the ODA program. Due to budgetary constraints, Japan's ODA program is still lagging behind those of the Western advanced nations. Unless we move now to beef up our ODA program, we, Japan will be accused of paying only lip service to the structural reform, while Japan will be demanding Americans to shake themselves free from the import dependency. The problem is, neither the structural reform of our economy nor their shedding the import dependency is something that can be done over night.

Japan Must Share With the United States the Responsibility To Lead International Society

Yahiro: The relationship between Japan and the United States, in essence, is that between brothers. As long as there is the Security Pact, Japan will be under its umbrella, enjoying the status as the world's number two economic power accounting for 15 percent and 10 percent of the world's trade and GNP, respectively. As such, I believe Japan must share with the United States the responsibility to lead in the international community.

As I said earlier, the problem of trade imbalance with the United States is the biggest issue facing us, but this is not the kind of problem which can be remedied either quickly or distinctly—this is a point of which we need to seek the U.S. side's understanding. In the meantime, as to the question of what, Japan should be doing for the good of the world community, the recycling of capital as suggested by Mr Matsuzawa seems to be the answer after all. In dealing with this question, Japan should carefully weigh the modality of the recycling in order to ensure that whatever action taken by Japan will not only lessen the load of the United States but also prove beneficial—even indirectly—to the United States. This is a point which we raised with Finance Minister Miyazawa when we had him over at a meeting of the Japan Foreign Trade Council: essentially, what I am saying is that we should avoid any form of recycling in which the money we contribute produces no palpable results. Whether our money is channeled through the World Bank of some other entities, shouldn't there be some arrangements made whereby we can observe and confirm how the money is being used to the end—just like in the case of a tied loan? For instance, if it can be so arranged that our money is used to foster purchasing power of the Central and South American countries to enable them to buy that much more goods from the United States, the end result would be tantamount to Japan's helping out the United States as much this way as it is unable to help with the bilateral imbalance question. Wouldn't there be a room for such an approach?

Reform of International Monetary System Needed

Toyoda: For Japan and the United States, problems of common interest and areas requiring mutual cooperation are increasing more and more; it therefore behooves Japan to come to a firm realization that there are now more problems than ever before, the solutions to which cannot be found from Japan's egotistic standpoint alone.

I believe a more fundamental solution to the world economic problem lies in a reform of the international monetary system. I think what is needed is to devise a dollar standard that will check the dollar's incontinence. There is the ECU [European currency unit] based on the EMS [European monetary system], but the question is whether the concept can be expanded somewhat to cover the entire Free World. It seems to me that the ECU is unquestionably one possible option, but this whole question will never be resolved unless the United States becomes so inclined. Seeing the light only at the end of the tunnel is no way to find a solution to any problem; it is a case of letting nature take its own course.

Pluralistic Mutual Understanding Needed

Nakauchi: First, we need to gain a better U.S. understanding of Japan's realities; for that purpose, it is important that we hire American PR experts so that, with their help, we can explain things in the way more convincing to the American people. Second, we must implement the Maekawa Report in good faith: in this regard, I think it is important for us to make it clear that we will ease regulatory controls, open up our market, and do away with tariff and nontariff barriers. Third, I hope to see the U.S. side do more to improve its productivity which, in a way, is the root cause of the trade imbalance. I also hope to see Americans rid themselves of the notion that anything sold on their domestic market must be sellable to Japan; for one thing, Japanese do have their own taste; this is why I especially would like to see Americans do research on the Japanese market. Fourth as Japan and the United States have been woven into the same economic fabric, it is essential for them to have mutual understanding, not a perception based solely on customs clearance statistics but an understanding covering a wide variety of angles. Lastly, I think it is important for us to forge a national consensus on the question of how best Japan should recycle the wealth it has earned.

Sekimoto: Americans are a people who tend to talk a lot; I think we Japanese, too, as their friends, should speak up. In order to gain their better understanding, we need to discard, among the other things, conventional statistical data and replace them with a set of updated data gathered through a new statistical approach befitting the changing times. When we present our case clearly while showing such new data, I am sure Americans will understand our position.

In short, I believe we ought to maintain ample opportunities for dialogue at each phase and state our case in a truly straight forward manner.

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