

## Economics, Foreign Policy, and United States-Japanese Trade Disputes

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# Economics, Foreign Policy, and United States-Japanese Trade Disputes

## I. Introduction: Economics and Foreign Policy

The most essential ingredients of foreign policy today are economic. This has been true for several decades, and increasingly is being recognized.

In a report prepared for the recent presidential transition, the Center for Strategic and International Studies (a respected Washington think tank) asserted that "there is consensus about the need to place special emphasis. . . on international economics because of [its] increased importance . . . for a successful foreign policy. Thus [this report] has revised the classic notion of 'national security' to ensure inclusion of the economic . . . dimensions of international affairs. . . ."<sup>1</sup> The report's chapter on "International Economic Policy" begins by asserting that "the importance of integrating international economic policy with other aspects of U.S. international involvement has become critical."<sup>2</sup> This illustrates how economics has become the dominant area of concern in foreign policy.

U.S. relations with Japan are discussed almost exclusively in economic terms. Furthermore, most of those discussions are characterized by a great deal of animosity toward Japan. I want to urge that we consider our relations with Japan in a much broader context than simply an economic one, though of course without underplaying the importance of economic relations. I want to urge also that we discuss our economic relations with Japan in a friendly, not a hostile, manner, though of course without underplaying the importance of the differences between us.

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1. CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, PRESIDENTIAL TRANSITION IN INTERNATIONAL AFFAIRS 1 (Nov. 10, 1988).

2. *Id.* at 42.

## II. Japan in the International Community

Japan is already a major power and is destined to grow in importance for at least the next century. It has become the world's second largest economy, an economic superpower, and is beginning to play a role commensurate with that status.

Until recently Japan kept a low profile in international affairs, seldom taking the lead and usually following our lead. In Japan, as in Germany, there remains (especially among educated people), a deep-seated sense of guilt and shame for the period from 1930 to 1945. The Germans, however, have more readily resumed their place in world affairs. This is perhaps explained in part by the fact that the Germans are active in a number of international organizations—for example, the European Economic Community and the North Atlantic Treaty Organization. Furthermore, the German place in world affairs had been established for centuries, whereas Japan began to participate only within this century. Germany also has close geographic, cultural, and historical ties with other leading powers, and people of German ancestry have long been included among the elites of North and South America, as well as Europe. Finally, many Japanese, especially of the generation now passing from the scene, have deep feelings of gratitude, obligation, and admiration toward America as a result of the way we behaved as conquerors—not just because of the atrocities we did not commit, but more from the political, economic, and social enlightenment to which we guided them.

All of these factors cause Japan to attach far greater weight to its relations with the United States than to its relations with any other country. The historical, geographical, and political factors are strongly reinforced by economic factors: not only are we the largest source of their imports and the largest market for their exports, but we are their main external intellectual resource for management, science, technology, and engineering.

It is revealing to contrast the Japanese and German responses during the period two or three years ago when the U.S. began urging both countries to stimulate their economies. The U.S. sought to reduce its trade deficits with these two nations. Whether this action in turn would benefit Japan and Germany depended on what stimulative measures they used to stimulate the economy. The results of fiscal and monetary measures would be fairly prompt, but they would be inflationary. The results of structural adjustments—reducing rigidities, reforming taxes, reducing regulations, opening competition, etc.—would be delayed, but beneficial. The Japanese initiated both fiscal and structural changes, and made a point of informing the U.S. of their plans and progress. The Germans suggested that we buzz off, or go fly a kite. (Both the Japanese and German economies seem to have benefitted from these opposite responses, but our trade balance has not.)

### III. United States Interests in the Pacific

Even though economics dominates our current relations with Japan, we must never forget that we have major, growing interests in the Pacific, and that Japan is the most important nation in the Pacific.

The most dynamic economies of the world are in the Pacific—not only the four “newly industrialized economies” (“NIEs”),<sup>3</sup> but also Indonesia, Malaysia, and Thailand are waiting in the wings. Australia is already a very significant friend and ally; it has a strong and growing economy, and brings constructive good sense to world affairs. Within the U.S., the five Pacific states may some day be our most important region.

In recent years, the Soviets have been increasingly active in the Pacific. At Cam Ranh Bay in Vietnam, they have one of the world's greatest naval bases. Of their four fleets, the largest is in the Pacific, amply supplied with ballistic missiles. The Soviets fish extensively in the South Pacific, both literally and figuratively. In many of the islands, such as Fiji, New Caledonia, Vanuatu, and Papua New Guinea, settlers outnumber the indigenous population and dominate democratic elections, thereby creating fertile soil for political unrest. (Even Libya has stirred the pot a little in Vanuatu.) In the Philippines, the communist insurgency continues; demagoguery has a good chance of forcing out our bases; and the long-run stability of the government is uncertain.

In short, we have important political, security, and economic interests in the Pacific, and we need friends there. Australia is our best and most trusted friend and ally in the South Pacific; Japan plays the same role in the North Pacific. There are serious economic issues between us and Japan. It is important that we resolve those issues, and no less important to us than to Japan that we resolve them in ways that build mutual confidence and friendship.

### IV. The United States and Japan in a Multilateral Context

Unfortunately, in international trade the United States has a reputation for arrogance and bully-boy behavior. We say we want fair trade. Who could object to that? But who defines “fair trade?” We do, unilaterally; and too often what we mean by “fair trade” is only that trade in which we sell and others buy. We charge unfairness, we pass judgment and we impose penalties—again unilaterally. We're the biggest, so we can get away with it. This “American Unilateralism” in trade, however, is universally resented. That resentment affects all aspects of our international relations.

In our defense, it must be recognized that internationally recognized rules of trade are few and feeble; enforcement of those rules is almost nonexistent. In the General Agreement on Tariffs and Trade (“GATT”), not only does it take forever to deal with charges of viola-

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3. Hong Kong, Singapore, Taiwan, and South Korea.

tion, but the defendant can veto a guilty verdict. In such circumstances, occasional resort to frontier law is hardly surprising.

It is critically important for the future of the world trade that the Uruguay Round of GATT Negotiations be completed on schedule by 1990; that it establish workable rules for trade in agricultural services, intellectual property, and trade related to investments; and that it create an effective means of resolving disputes. The United States and Japan were prime movers in launching the Uruguay Round. The Europeans, especially France, were the main obstructionists, and in the current negotiations they are blocking efforts to abolish subsidies that distort trade in agriculture over a ten-year period.

## V. The Bilateral Trade Relationship: The United States and Japan

Turning specifically to trade relations between the U.S. and Japan, several important issues dominate the debate.

### A. The Trade Deficit

The size of our trade deficit with Japan is not important economically. Obviously it is of great importance to journalists and politicians. Through them it has acquired great symbolic importance to most laymen and businessmen, in the same way that feeding hormones to beef cattle has acquired real psychological significance in Europe. But it is only a "dagger of the mind, a false creation."

The trade balance with any single country does not matter. We should expect to have deficits with some countries and surpluses with others. Even the aggregate trade balance has little economic significance. Trade in goods is only part of the economic intercourse between countries. The total flow of considerations is always equal in both directions. If a country has a large trade deficit, as does the United States, then it has an equally large surplus in its capital flow. In fact, the trade deficit is essentially equal to the amount by which investment in the United States exceeds the amount saved in the United States.<sup>4</sup> The United States remains the best place in the world to invest, and the amount of American money invested abroad is far exceeded by the amount of foreign money invested here.<sup>5</sup> In sum, our trade deficit has little to do with either our competitiveness or the trade barriers of others.

### B. Japanese Barriers to Trade

It follows from the first point that trade barriers in Japan do not have much effect on the *size* of our trade deficit with Japan. In fact, Japan has been lowering its trade barriers. It is almost the only major country to

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4. Conversely, Japan's trade surplus equals the amount by which savings in Japan exceed the amount invested there.

5. Those who claim, erroneously, that the United States is a debtor nation do so partly by regarding all foreign funds invested here as money owed by Americans.

do so; we have been raising ours. Yet despite lower formal barriers to trade, our trade deficit with Japan has risen. Japan's trade barriers might more accurately be called "impediments," since with the exception of agriculture, Japan has low tariffs and few quotas. These impediments, however, are detrimental to the United States because they seriously distort the *composition* of our exports to Japan. They prevent the United States from concentrating on products where we have the greatest comparative advantage, and limit us to exporting those items which, while advantageous, are not the most advantageous.

### C. The Inefficiency of Japan's Economy

The impediments to the U.S. achieving maximum advantage from trade chiefly result from the fact that Japan's economy is astonishingly inefficient. The gains to Japan itself from removing the impediments that restrict us would far exceed the gains to the United States.

Japan's export sector success has created the illusion of a miraculously efficient economy. Notwithstanding that popular image, however, much of the Japanese economy is backward and inefficient. It is ironic that Japan, which in its foreign trade has been so effective in directing its resources and talents into the most productive areas, has not allowed the same kind of efficiencies to operate in its domestic sector. Consider some illustrative examples.

America's farmers are five times as productive as Japan's and could provide food to Japanese consumers at a much lower cost. In many cases quotas and high tariffs prevent them from doing so. Rice is a bulwark of the Japanese diet, yet rice sells in Japan for approximately seven times the world price. Soybeans also sell for about seven times the world price. Because an inefficient sector is protected, the Japanese consumer suffers, as does the Japanese economy as a whole. But we in the United States, and other countries with comparative advantages in agriculture, suffer also since we are unable to make the most of our advantages.

Japan buys logs from the U.S., but if our sawmills, which are much more efficient than Japan's, process those logs into plywood or paper, Japan levies a high tariff on them. The result is that Japanese houses and furniture are excessively expensive. Every time anyone in Japan puts pen to paper or remodels his house, he is subsidizing an inefficient industry. Again, Japan prevents the United States from making the most of our efficiency, which would otherwise benefit both the U.S. and Japan.

Japan's cumbersome distribution system increases the price and decreases the availability of goods, especially imported goods. Moreover, Japan's retailing law limits the size of stores, and can prevent a larger retailer from providing a greater variety of goods at a lower price.

When industries in Japan become depressed, Japan subsidizes them by providing specific tax benefits and loan guarantees. It also protects a number of them by cartels which bar lower-priced imports. Today, twenty-two industries in Japan—most of them in basic materials such as

petrochemicals, fertilizers, paper, textiles, and aluminum—are classified as depressed. Industrial users are forced to buy the more expensive products of inefficient domestic industries.

Even aside from these cartels, many Japanese companies prefer to buy products made by companies in their own “groups” with which they have been doing business for many years. Part of the reason for this has to do with the nature of Japanese society. But the result is that outsiders, whether foreigners or Japanese, are excluded. This prevents the end-user from obtaining the best product at the best price. Though this practice has not been unknown in our own country, deregulation, intensified competition, take-over threats, and foreign imports have reduced it to insignificance.

Finally, Japan’s surplus savings have been moving overseas. Many old-line industries are able to block competitors who would invest the savings in modernizing the industry, and this has limited opportunities for investing Japan’s large savings in Japan.

#### D. Japanese Investment in the United States

Japanese investments in the United States are very much to the United States’ advantage. This is one respect in which Japanese inefficiencies work to our advantage.

As indicated above,<sup>6</sup> Japan’s balance of payments surplus is essentially equal to the excess of its domestic savings over its investment. Its savings are large, but because its economy (except for export industries) is generally inefficient, only part of those savings is invested in Japan. A large part of the savings is invested abroad, especially in the U.S. Thus, Japanese saving provides us with capital that makes our labor, our management, our natural resources and our technology more productive, rather than benefitting Japan.

#### E. Domestic Political Influence

The politics of trade issues are very much the same in Japan—or, for that matter, in any democracy—as in the United States. Why, for example, did the Japanese put up so much resistance to opening their citrus market? Why did the U.S. campaign so aggressively to open the Japanese citrus market? The answer to both questions is the same. In both countries, a comparatively small group of producers was in a politically strategic position that gave it great leverage with the party in power. What are called international economic issues are mostly domestic political issues; they result from efforts of small groups to gain unearned advantages from other groups in the same country.

#### F. Maintaining Good Will

We have brought strong and unrelenting pressure on Japan to lift impediments to trade in one area after another. In virtually every

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6. See *supra* note 4 and accompanying text.

instance, eventually, Japan has gone a long way toward meeting our objectives. But, with the possible exception of semiconductors, the steps taken have been at least as beneficial to Japan as to us. Market openings that we have achieved have been equally available to all countries (except probably for semiconductors). These openings have discriminated in our favor only in the sense that the impediments we have attacked may have been more important to us than to others. We have made better progress in opening markets in Japan than in almost any other country, and we must keep in mind the limits on Japan's fund of goodwill toward the United States. We must not overdraw that account. The United States's stake in future U.S.-Japanese relations is just as great as Japan's.

## VI. Conclusion

We have an important stake in the Pacific, and fortunately have strong and friendly ties with the two most important countries in the Pacific, Australia and Japan. With Japan we have serious problems arising primarily from impediments that limit our exports of the products where our greatest comparative advantage lies. Those impediments are more damaging to Japan than to us, and many Japanese recognize that. The obstacles to lowering the impediments arise from the power of special interests—the “tyranny of minorities”—that characterizes democracies, perhaps all governments. Indeed, much of the pressure on Japan to open its markets arises from special interests in the United States. Opening Japan's markets would be beneficial to both Japan and the United States. Competent officials should, therefore, be able to work together in a spirit of goodwill, and with understanding of each other's domestic politics, to advance our common interest in freer, more productive trade.

