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"A Mutual Accord for Economic Growth"

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ADDRESS BY U.S. SENATOR MAX BAUCUS
"A MUTUAL ACCORD FOR ECONOMIC GROWTH"
Tokyo, Japan
March 11, 1988

Introduction

This is my fifth visit to Japan. My first visit was in 1963. I was a college student, hitch-hiking around the world. I visited Tokyo, then took the bullet train to Kyoto.

It was a very different world in 1963. Kennedy was President. Ikeda was Prime Minister. The dollar was worth 363 yen. The United States had a $350 million trade surplus with Japan, and U.S. per capita income was five times Japan's.

The relationship between our two countries was the result of our relative economic and political strengths. As one Japanese diplomat says, America was the big brother, and Japan was the little brother. In 1963, one American trade negotiator described Japan as a "model for developing countries" and spoke of helping Japan to "emerge" as a world power.

Japan certainly has emerged. Today, 25 years later, America and Japan are both economic superpowers. Japan has become the world's largest creditor and has a per-capita GNP slightly higher than America's. Edward Deming taught the Japanese about quality control, and now the Japanese are reminding us about the importance of quality and service.

Bilateral Problems

What are the effects of these changes?

Essentially, our friendship and support for each other remain solid. Our combined economies account for about one-half of the free world's GNP. We have a strong security relationship. And our political leaders -- particularly former Prime Minister Nakasone, Prime Minister Takeshita and President Reagan -- have developed close personal relationships.

Nevertheless, there is a growing tension underlying our friendship because our bilateral relationship has not kept up with our changing economic fortunes. In particular, we remain locked in a seemingly unending series of reactive and ad hoc trade disputes which are putting serious strains on the free world's most important partnership.

The pattern is familiar, whether the issue is the GATT-12 dispute about Japanese agricultural quotas, Kansai airport, the Toshiba incident, or semi-conductors, or beef quotas.

U.S. negotiators identify a perceived trade barrier. Japanese negotiators object that the real problem is quality, price, marketing, or some other commercial factor. Positions harden on both sides.

Finally, the dispute reaches a boiling point. High-level negotiators shuttle between Tokyo and Washington. Headlines blare about an impending trade war. At the last minute, the President and Prime Minister intervene. They direct the negotiators to work it out. The issue is settled ... but only temporarily.

The Problems of Ad Hoc Incrementalism

This melodramatic pattern of resolving disputes may be exciting. But it doesn't befit two economic superpowers.

And it diverts attention from more serious problems. We're straining to make marginal progress toward limited goals. Meanwhile, our overall economic problems multiply. We're like passengers on a ship who spend their time arguing about the position of the deck chairs and ignore the iceberg ahead.

What's more, this pattern of resolving disputes is itself dangerous. In both countries, it generates suspicion and anger. The general public doesn't hear about the positive aspects of our relationship. They hear about an endless series of trade disputes.

Public opinion also reflects this frustration. Twenty-four percent of Americans, according to a recent poll, said our trade problems with Japan made them less inclined to buy Japanese products. A majority described our relations with Japan as only fair or poor. And eighty percent said that trade problems with Japan were at least partly to blame for America's economic problems.

These results are unsettling. If the public loses faith in our bilateral relationship, there will be dramatic political consequences.

This has already begun. The Gephardt Amendment in the U.S. House of Representatives' trade bill is the most obvious manifestation. Yes, it is blunt protectionism. Virtually every serious economist is against it. Yet, it passed the House of Representatives.

Hopefully the Gephardt Amendment will not be in the final legislation; but its passage by the House of Representatives certainly waves a red flag. Our bilateral relationship is under increasing strain. And time is running out.

Towards Mutual Economic Growth

That's the situation.

Ultimately, we have two choices. We can continue the old pattern of ad hoc reaction and incremental change.

Or, we can take another course. We can rise to the challenge and make a dramatic break from the old pattern.

How? By establishing a comprehensive bilateral accord that fosters faster, mutual economic growth -- and at the same time makes easier the task of correcting our potentially ruinous trade imbalances.

To accomplish this, the accord must contain two main elements. First, it must establish mutually agreed upon numerical targets for bilateral trade flows which increase trade and reduce imbalances. Second, it must outline specific steps each country is to take, in its domestic and international policies, to help achieve these targets.

The mutual economic accord of which I speak would treat trade balances as being of major importance, but it would recognize that trade is but one of the important elements in the economic relationship between the U.S. and Japan.

Further, the mutual accord I have in mind would be flexible. It would be mutually negotiated, not unilaterally imposed. It would not treat trade deficits as the exclusive measure of economic performance. And it would not blame the trade deficit entirely on Japan.

Rather, it would link trade policy with other policies to construct a package that would benefit both countries immediately and could lead to a bilateral free trade agreement.

Setting Targets

Let me take a few moments now to explain, in more detail, how the mutual accord might work.

The critical first step would be the establishment of overall trade balance targets.

The basis for these targets already exists. Both countries want to increase bilateral trade and reduce the existing imbalance in an orderly way.

To accomplish this, the agreement should set a minimum percentage target for an annual increase in bilateral trade and an annual dollar target for reduction in the trade imbalance.

Donestic and Fiscal Problems

To achieve these targets, the agreement would need to address a series of economic measurements.

Some analysts, for example, say that the U.S. budget deficit is responsible for more than half of the U.S. trade deficit. The point is valid.

The mutual economic accord must start with a more serious and more vigorous U.S. commitment to conquer its budget deficit problem. The U.S. should come up with specific reduction amounts, specific and credible means of achieving those reductions, and a specific time period over which it will be done.

For its part, Japan could take specific steps to release pent-up consumer demand. For example, Japan could agree to reduce savings rates and to reduce the artificially high consumer prices for food and housing. Japan is to be complimented for the steps it is already taking. Yet, under a mutual economic accord it could agree to do more.

These items absorb disproportionate shares of the Japanese consumer's budget and restrict his purchases of consumer goods. Releasing this tremendous consumer demand would increase sales of both domestic and imported products. This would inevitably increase U.S. sales to Japan and reduce the trade imbalance.

Exchange Rates

Second, both nations must reach an agreement on how to stabilize exchange rates within an acceptable range.

The yen and the dollar have been on a roller-coaster, with the dollar rising from 200 yen in 1980, to 250 in 1985, then falling to about 130 yen today. No company directly involved in trade can begin to cope with such uncertainty.

The G-7 agreement has helped modify the volatility. But, frankly, it's only a half-hearted beginning. Like it or not, we can't make real progress until we are willing to make commitments to meet exchange rate targets.

Therefore, under a mutual economic accord the U.S. and Japan could regularly agree on an acceptable range of exchange rates between the dollar and the yen in view of trade flows and other economic factors.

Once this range is agreed upon, the central banks of both nations could be obligated to hold exchange rates within that range. The exchange rate stability produced under this plan would benefit both nations, and the world.

Obviously, both countries will need to retain some flexibility. And they would need to coordinate their actions with the rest of the G-7 nations. The key is for the United States and Japan to acknowledge that informal coordination is inadequate, and to take the lead in establishing a strong enforceable regime.

Trade Barriers

Next, the accord must address the issue of trade barriers.

I know this is a delicate subject. And, although a Diet member recently told me that I am known in Japan as the "Beef General," I'm not here today to lecture about the evils of Japanese protectionism.

Japanese trade barriers are part of the problem. In fact, they may account for as much as 30 percent of the bilateral trade imbalance.

But we have to avoid over-emphasizing trade barriers. Both countries therefore could agree to pursue trade remedies more selectively. On the U.S. side, this might mean emphasizing those cases that would most improve the trade balance. This would break the endless cycle of trade squabbles over relatively small issues like the GATT 12 case and legal services.

And, in any case, the main pressure for opening markets would come from the mutually agreed upon overall trade targets. Both nations would have to make concessions in order to meet trade targets, but they would have some flexibility in selecting those concessions.

The mutual economic accord could also provide that Japan open its markets to less developed countries -- particularly the Latin American LDCs.

Over the last ten years, the U.S. has taken 60 percent of the exports from LDCs. Japan, on the other hand, has taken only about 5 percent -- even though it has the fastest growing economy in the developed world.

This disparity diverts exports into the U.S. and undermines the economies of many LDCs -- some of which otherwise would be good export markets for U.S. goods. Therefore, a new system of preferences should be instituted to encourage more LDC exports to Japan.

Burden Sharing

Finally, the agrement must address our relative international security and foreign assistance commitments.

Most of us are familiar with the general outline of the problem. Japan spends about 1 percent of its GNP on security. That comes to about $120 per capita. The U.S. spends about 7 percent of GNP, or $1,200 per capita.

Although it may be politically impractical for Japan to dramatically increase its per capita defense expenditures, Japan could meet its burden sharing obligation with sizable increases in foreign assistance, direct payments to the United States, or some other method.

But whatever the choice, the bottom line is that Japan would make a firm commitment to increase its spending for the common achievement of our international obligations.

<u>Is it Achievable?</u>

That's the outline: a mutual agreement, trade balance targets, specific steps to reduce the U.S. budget deficit, provisions to increase Japanese consumer demand, exchange rate stabilization procedures, reduction in trade barriers, and more equal sharing of international obligations. All leading to expanded trade, correction of trade imbalances, and -- hopefully -- eventual development of a free trade agreement.

Yes, that's ambitious -- and, yes, it wouldn't be easy. Inertia is a powerful force. And both countries will be reluctant to make bilateral commitments in areas that have been traditionally reserved for domestic policy.

But the alternative, of uncertainty and deterioration, is much worse.

<u>A Window of Opportunity</u>

What's more, we now have a special opportunity, because the United States is about to elect a new President.

Observers of American politics recognize that that event -- the election of a new President of either party -- affords the single best chance for implementing important new policies.

Starting with the new President's election in November, there will be a "honeymoon" period in which the President and the Congress will come together, working in a non-partisan manner, to promote the common good.

What does this mean for those of us convinced of the need to strengthen U.S.-Japan economic relations?

It means there is going to be a window of opportunity for us. The <u>good</u> news is the window will be opening soon. The <u>bad</u> news is it probably will start closing six to eight months into next year.

Another point: Given the tenor of the current campaign, the next President is likely to have a mandate to make dramatic changes to improve America's international competitiveness.

We must recognize that mandate could be interpreted two ways. It could be considered a mandate for protectionism. <u>Or</u> it could become a positive mandate for enhancing economic relations between the U.S. and Japan.

Obviously, time is critical. All of us who care about the direction and quality of our two nations' long-term relations should begin at once to prepare for the opportunity that will be presented.

Conclusion

Our challenge is to define the economic issues between the U.S. and Japan in a way that produces a positive mandate for change in both countries. That's what the bilateral economic accord -- which I am suggesting -- would do.

It would emphasize that our approach to solving our bilateral problems has not fallen short because it has been too ambitious, but rather because it has been too narrow.

It has been too narrow because it has failed adequately to encompass major economic and fiscal problems which by their nature define and limit the potential for international trade.

It is time to free ourselves of the limitations of our current approach to resolving trade disputes. And if we do that the economic potential for both nations is almost unlimited.

We should start today.

Thank you.

* * *