4-4-1988

A Mutual Accord for Economic Growth

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ADDRESS BY U.S. SENATOR MAX BAUCUS
"A MUTUAL ACCORD FOR ECONOMIC GROWTH"
Seattle, Washington
April 4, 1988

Introduction

It's fitting that the Mansfield Foundation is holding this event here in Seattle. Montana and Washington have many things in common. The economic and cultural connections are obvious.

There's also a strong political connection. It's embodied in the careers of two men: Mansfield and Jackson. They came to the Senate together in 1952, the only Senate Democrats elected that year from west of the Mississippi. They disagreed about many things, including defense policy, but they worked together closely to provide steady, forward-looking national leadership.

There's an interesting footnote. When President Reagan took office, Scoop Jackson personally ensured that Mike Mansfield remained as Ambassador to Japan under the Reagan Administration. I'm sure that personal loyalty motivated Jackson, but I'm also sure that he was motivated by something else. He and Mansfield shared a commitment to free trade, a deep understanding that America is a Pacific Rim nation, and that that's where our economic future lies.

With that in mind, I'd like to talk about an idea I proposed last month in a speech at the Foreign Correspondents Club in Tokyo. It calls on the United States and Japan to establish a mutual economic accord in order to expand bilateral trade and reduce bilateral tension. This is an example of the kind of subject with which the Mansfield Foundation is concerned.

The Current Situation

The bilateral relationship between the United States and Japan remains 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, tension continues to grow. Our bilateral relationship has not kept up with our changing economic fortunes. As a result, we remain locked in a seemingly unending series of reactive and ad-hoc trade disputes, and these create serious bilateral strains.

The pattern is familiar, whether the issue is the GATT-12 dispute about Japanese agricultural quotas, the Kansai airport, the Toshiba incident, semi-conductors, or, for that matter, 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 the 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 way we resolve 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 while ignoring 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. It hears about an endless series of trade disputes.

Public opinion reflects this. According to a recent poll, <u>twenty-four</u> percent of Americans said our trade problems with Japan made them less inclined to buy Japanese products. A <u>majority</u> described our relations with Japan as only fair or poor. And <u>eighty</u> 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 is the most obvious manifestation. <u>Yes</u>, it was blunt protectionism. Virtually every serious economist was against it. Yet, it <u>passed</u> the House of Representatives.

Fortunately, the Gephardt Amendment was not included in the final trade bill; but its passage by the House 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 <u>break</u> from the old pattern.

How? By establishing a comprehensive bilateral accord that fosters faster, mutual economic growth -- and at the same time makes it easier to correct 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 will 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 something of major importance, and would recognize that trade is but <u>one</u> of the important elements in the economic relationship between the U.S. and Japan.

Further, the mutual accord would be flexible. It would be mutually negotiated, not unilaterally imposed. It would not treat trade deficits as the exclusive measure of economic performance.

Rather, it would link trade policy with other policies to construct a package that would benefit <u>both</u> countries immediately, and eventually could lead to a 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.

Domestic and Fiscal Problems

To achieve these targets, the agreement should 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 propose 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 saving rates and to reduce the artificially high consumer prices for food and housing. I compliment Japan for the steps it is already taking. Yet under a mutual economic accord, Japan would 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 rollercoaster, with the dollar rising from 200 yen in 1980, to 250 in 1985, then falling to about 125 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 firm commitments to meet exchange rate targets.

Therefore, under a mutual economic accord the U.S. and Japan would 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.

Japanese trade barriers <u>are</u> 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 them. Both countries, therefore, should 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 would otherwise 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 agreement 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 its GNP, or $1,200 per capita.

Although it may be politically impractical for Japan to dramatically increase its 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.

Is it Achievable?

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, expanded trade through growth and the reduction of trade barriers, and burden sharing.

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.

A Window of Opportunity

What's more, we now have a special opportunity because we are about to elect a new President. The President will have a "honeymoon" period in which he and the Congress can work together, 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. The good news is the window will be opening soon. The bad 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 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. Or it could become a positive mandate for enhancing 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 before us.

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.

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 to adequately encompass major economic and fiscal programs 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.