2-17-1986

The US-Japan Relationship

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Let me first thank Mr. Takeyama of Takeyama Associates and Global Resources Limited for inviting me to speak. As leading businessmen and executives, you are some of the most important architects and builders of the Japanese economy. But I have come, as a friend, to speak candidly about the future and the need to look beyond one's own national economy. The world trading system -- which has served us so well -- deserves the best efforts of Japan and the United States as we head toward the 21st century.

1986 will be a crucial year for the U.S. and Japan, and we must use our time wisely. I believe Japan has reached a new turning point in its history -- a time when Japan must make serious decisions about its future. The choices made in the coming months will have a significant impact on the country's economic well-being.

Japan in the post-war years developed a heavily protected economy dependent on exporting. This was necessary at that stage in Japan's history for economic survival and growth. The United States understood and supported that.
Japan has now reached another stage in its history, especially with respect to its role in the world as an economic superpower. As we approach the 21st century, it is time for Japan to mature in that role, to restructure its economy to meet the responsibilities of its present strength and position in the world.

Japan is tremendously powerful and wealthy - a nation whose policies and actions have a major impact on the welfare and stability of the world. A number of specific trade issues -- semiconductors, satellites, plywood, fish, and textiles, to name just a few -- have been the focus of attention in recent months. However, the trade problem is more than the sum total of each of these issues. As Japan's trade surplus grew to $56 billion in 1985, the United States, EC, ASEAN, China, and others all increased their calls for more access to Japan's markets.

Even though Japan is now the free world's second largest economy, it has become even more dependent on exports for its economic growth. Exports in JFY 1984 were a larger percentage of GNP than in JFY 1980, whereas imports as a share of GNP were actually lower in JFY 1984 than in JFY 1980. Consequently, Japan's trade surplus has grown tremendously in the last five years, and this has caused considerable international trade tensions.
1985 already saw the rise of a protectionist threat which could destroy the international trading system as we know it. The threat comes not only from the U.S. Congress, but also from Europe, as well as from many of Japan's other trading partners.

But at the same time, 1985 did see some real progress in opening the Japanese market to foreign products.

Through the process of bilateral consultations known as the MOSS (market oriented sector selective) talks, Japan has undertaken to lower tariffs in many areas, to ease standard and certification requirements which have been a barrier to trade for many years, and to tackle many other non-tariff barriers to imports. We appreciate Prime Minister Nakasone's leadership in these efforts, and in the trade measures contained in the July 30 Action Program.

The Prime Minister's position in trying to open markets is a difficult one, requiring political courage. President Reagan's veto last December of legislation which would have restricted textile imports also required courage. Frankly, we are fortunate now to have two national leaders who recognize the value of an open international trading system, and who are willing to work together to keep that system open.

It would be a serious mistake, however, to think that the threat protectionism poses to the world trade system is now
behind us. The $37 billion trade deficit the U.S. had with Japan in 1984 was the catalyst which sparked Congressional concern and some anger with Japan last year. The U.S. trade deficit with Japan in 1985 was $49.7 billion. The reaction from the U.S. Congress has already begun to be heard.

While there are threats to our close partnership caused by trade friction, there is also great potential for our alliance to grow even closer and stronger than ever, if we are both willing to face up to and address the fundamentals of the economic problem between us.

In looking at where we can be at the turn of the century, we should first recognize just how far we have come in the last fifteen years. In 1970 our bilateral trade amounted to only $11.6 billion (and our trade deficit with Japan was only $463 million). In 1985 our bilateral trade grew to over $95 billion.

The U.S. has become by far the most important market for Japan, taking 37 percent of all Japanese exports. At the same time, Japan is now the largest overseas export market for the U.S.

But there are fundamental problems we must solve.

On the U.S. side, we must realize -- and most do -- that our trade deficit is a global problem. Our overall trade
deficit in 1985 was $148.5 billion. The largest share of that, $49.7 billion, was with Japan, but we had large deficits with all of our other major trading partners as well. Our trade deficit with Western Europe was $27.4 billion. We had a $22.2 billion trade deficit with Canada, a $13.1 billion deficit with Taiwan, a $5.8 billion deficit with Mexico, and even a $6.2 billion deficit with Hong Kong. Our trade problem is obviously not all the fault of Japan.

To deal with our global trade problem, I believe we must first bring the budget deficit under control. The President's Budget Message for FY 86 estimated we will spend $142 billion this year just on net interest payments on our outstanding federal debt.

Passage of the Gramm-Rudman-Hollings bill, requiring the elimination of the deficit by 1991, demonstrates Congress' determination to take drastic measures to deal with our budget deficit. While it remains to be seen if the Supreme Court will find certain provisions of this law unconstitutional, the fact that it passed and is now being implemented, is eloquent testimony to the Reagan Administration's determination to bring the federal budget under control.

As for the international competitiveness of U.S. products, we export about 25 percent more than Japan does worldwide. But a big problem for U.S. exporters in recent years has of course been the high value of the U.S. dollar. A major adjustment
took place after the G-5 meeting last September, and we have since seen the yen appreciate considerably against the dollar. The G-5 is an important example of how effectively we can work together on international economic problems. Such cooperation must continue.

On the Japanese side, there are also fundamental problems to tackle. Japan's global trade surplus in 1985 was $56 billion. Private forecasts for Japan's JPY 1986 trade surplus go as high as $70 billion. These are extremely large numbers, and they cause friction with all of your major trade partners, not just the U.S.

First of all, more complete market opening in Japan is essential as a matter of principle. As I said earlier, Japan is no longer a poor developing country needing protection from foreign competition.

Much progress has been made, but there are still too many sectors of your market that remain closed or that inhibit foreign competition. There is no excuse for protectionism of any kind in an economy that runs chronic trade surpluses as large as those of Japan.

While the lack of open markets is an essential part of the trade problem, opening the market is not the full solution. Reasonable estimates are that an increase in U.S. exports to Japan of $10 billion would occur, if the Japanese market were
completely opened. This alone will not solve our trade problems. Other fundamental changes must also take place.

The yen's recent strength should be maintained or increased to reflect the true position of the Japanese economy in today's world. The immediate effects of the G-5 meeting on the yen have been very good. The yen's strength must be sustained.

What is also required, and what is probably the most important element in easing Japan's long-term economic relations with her partners, is a structural change to move the Japanese economy away from its over-dependence on export-led growth, toward more domestic-led growth.

Opportunities for promoting domestic investment and domestic-led growth in the Japanese economy abound.

In JFY 1984, Japan had real GNP growth of 5.0 percent, healthy by any standard. However, too much of that growth was based on exporting. Japanese net exports grew 49.2 percent in real terms the last fiscal year. On the domestic side of the economy, growth was relatively weak. Private consumption was up only 2.6 percent, and housing investment was up only 0.4 percent. Private plant and equipment investment did increase 10.9 percent, but this was primarily export-related growth, since most of the investment was in export manufacturing sectors of the economy.
So how can Japan increase growth in the domestic side of the economy? This is of course a difficult and sensitive issue, one which gets considerable debate in Japan. If I may, as an outsider -- though one who has been here for almost nine years, look objectively at your economy, I would like to offer some observations.

One reason growth in private consumption has remained weak is that growth in real disposable income has fallen behind growth in the economy. Real income can be increased by cutting personal income tax rates, as well as by raising wage rates. Most of the large trading profits enjoyed by Japanese companies in recent years have not entered the domestic economy in the form of higher wages or increased investment, but have been sent abroad to take advantage of high interest rates.

The savings rate in Japan is very high by international standards. The large gap between the domestic savings rate and the domestic investment rate is a major factor behind the current account imbalance. Given this situation, there is little need for additional stimulation of savings through the tax-free savings account system known as the "maruyu" accounts.

The high savings rate is also directly related to housing investment in Japan. The lack of substantial or full deductability for mortgage interest means most families must save for very large downpayments on their homes.
Housing investment has been the weakest sector of the domestic economy for a number of years. Housing investment was actually lower in JFY 1984 than in JFY 1978. This is therefore an area of great potential domestic growth. Deregulation of the housing industry is one promising approach.

There has also been a great deal of talk within Japan recently about the need to build Japan's social capital for the future. I am, of course, aware of the budgetary restraints on public works spending.

Notwithstanding these restraints, there is a great need to build up Japan's infrastructure in areas such as transportation, housing, recreation facilities, schools, environmental protection, and the like. As the population ages, it will become more difficult to make such improvements in the future.

The Prime Minister's advisory council hopefully is considering these questions not just in terms of how to deal with the present threat of protectionism, but in the broader context of Japan's role in the world in the twenty-first century.

Japan in the post-war period has benefited tremendously from world economic growth, but over-reliance on exporting has meant that Japan has not made a contribution to that world growth commensurate with its economic prosperity.
By increasing domestic growth and attracting more imports, Japan will aid world economic growth, particularly in the developing nations. And this is very important.

Many of you have heard be speak about the coming Century of the Pacific. It is upon us now. When we look at that huge Pacific Basin -- an area on which four continents impinge: four South American states, all of North and Central America, Australia, New Zealand, the islands in between, all of East Asia. It is a region just brimming with potential -- 58 percent of the world's population lives there; there are tremendous natural resources, great market potentials, and on the whole, friendly peoples and governments. Japan and the U.S. must contribute to the Basin's growth. This is essential if it is to develop steadily and peacefully.

The present situation -- a Japan dependent on exports for growth, making little contribution to growth in other nations -- is destabilizing. If structural changes are not made by Japan on Japan's own initiative, then it is going to be difficult to keep the international trade system as open as it is today.

On the other hand, Japan now stands in a position to become one of the leaders of world growth, if it assumes new responsibilities as an international major economic power.
As I said earlier, I am confident that if we both tackle the fundamentals of our economic problems, we can go on into the 21st century with an even stronger partnership than that which we enjoy today. We in the U.S. must do our part, and you in Japan must do yours.

Japan itself made an extraordinary transition from the devastation of World War II to become the free world's second-largest economy. The challenge before you now is even greater -- to be the architects and builders of Japan's new position as a true world leader.

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