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Chairman Hasegawa, Chairman Morgan, and other distinguished members of the U.S.-Japan Business Council, it is a great pleasure to speak to the 23rd U.S.-Japan Business Conference.

When Mr. Hasegawa asked me to speak, he said he sensed that, and I quote, "We have come to a critical and volatile period between now and the U.S. elections in November", end quote. I agree that time is of the essence in dealing with the economic frictions which threaten to erode this most important of all bilateral relationships. At the same time, I also see this as an opportune time to solve the problems before us, instead of pointing fingers and blaming each other for problems for which both sides bear responsibility.

No one who understands the size of the U.S.-Japan economic relationship could fail to grasp its importance. We had $95 billion in two-way trade last year. The U.S. is by far the largest market for Japan, taking over 38 percent of Japan's exports in 1985. Japan is the largest market for U.S. exports except for Canada. Many jobs in both our countries depend on exports to the other.
Our economies are interdependent not only in the area of merchandise trade. Japan had a net long-term capital outflow of $64.5 billion in 1985. Of that over half, or $33.2 billion, was invested in the United States. A large portion of that investment was in U.S. treasury securities. This supply of capital from abroad assisted the U.S. government in financing its large budget deficit, which in turn has helped ease pressure on U.S. interest rates.

Japan had a direct investment position in the U.S. of $14.8 billion at the end of 1984, up from $11.3 billion the year before and approximately $20 billion at the end of 1985. It is estimated that this growth will continue at a rate of 14.2% to the year 2000. This direct investment creates jobs and is most welcome. All signs are that it will continue to grow. The U.S. direct investment position in Japan is also substantial, standing at $8.4 billion at the end of 1984, for the rest of East Asia about $20 billion; roughly $30 billion and of $233 billion the U.S. has in direct investments world wide.

It is the trade imbalance, however, which gets the most attention in discussing our economic relationship. Japan's large trade surplus with the United States, nearly $50 billion last year, is simply too large to ignore. Japan's global trade surplus, $61.6 billion in JFY 1985 - $12 billion above their $50 billion surplus with the U.S. -is a burden on the world trade system, and if it continues to
grow it threatens a breakdown in that system. At the same time, the large global trade deficit in the U.S., nearly $150 billion last year, illustrates all too clearly that our trade problem in America is not just a bilateral problem with Japan, but is a global problem. For example, nobody seems to mention our $22 billion deficit with Canada, our $13 billion deficit with Taiwan, our $6.2 billion deficit with Hong Kong, our $19 billion deficit with Latin America, our $26.4 billion deficit with Western Europe - in 1981 we had a $20 billion surplus with that area - and so on elsewhere. Incidentally in 1981 our deficit with Japan amounted to $13 billion.

I am well aware that as the congressional elections in the U.S. approach, the pressures to take short-term measures to deal with our trade deficit will become even more intense than they now are. The temptation to close our markets in the name of reciprocity is strong, but we must realize that protectionism is not a real solution. I am well aware, also, that the one person who has consistently prevented the enactment of protectionist legislation is President Reagan but, to repeat, the pressures are rising.

The U.S. administration opposes protectionist legislation, for the simple reason that the international trade system depends on open markets. The solution to our trade problem is more trade, not less trade. We all must open markets, not close them.
It is clear that trade wars would hurt all of us. All the work we have done in rebuilding the world economy and democracy in the wake of World War II would be destroyed by protectionism. It is the open international trade system which has led to world recovery and the tremendous growth we have seen in the last forty years.

We in the U.S. must not deceive ourselves into believing that only other nations would be hurt by protectionism. The U.S. would be damaged as well. Need I remind you that the U.S. is the world's largest exporter. On a global basis, the U.S. exported 25 percent more than did Japan last year. The reason we have such a large trade deficit is that we are by far the world's largest importer as well. Closing of foreign markets in reaction to protectionist trade legislation in the U.S. would result in the loss of many American jobs, jobs which depend on the existence of foreign export markets.

Japan, however, would be hurt much more by a loss in export markets than would the U.S. In fact, Japan has been almost totally dependent on exports for its real economic growth. When exports dropped in the first quarter of this year due to the strong yen, Japan's domestic economy was not strong enough to pick up the slack, and consequently Japan was left with a real decline in GNP of 2.1 percent at an annual rate.
This over-reliance on exports is the root of Japan's trade problems with the rest of the world. Japan is now the world's second largest economy, but rather than acting as a contributor to world growth by being a net importer, Japan has been benefiting from world growth as a net exporter.

To their credit, it appears that Japan's leadership now recognizes Japan is at a crossroads, and that Japan must deal with its chronic trade surplus in order to take its rightful place as a leading economic power. In accepting the report of his private advisory body known as the Maekawa Commission, Prime Minister Nakasone committed Japan to the task of reducing its large trade and current account surpluses to levels consistent with international harmony.

How to move to a more balanced trading relationship is of course the key question. As I see it, three things must happen if we are to succeed in this endeavor: first, more open access to the Japanese market; second, a stable and strong yen over the long-term; and third, structural adjustment in the Japanese economy to move away from dependence on exports to domestic-led growth.

Much progress has been made in opening Japan's markets to foreign competition, but much more remains to be done in many areas. There is no excuse for protecting any sector of Japan's market from outside competition when Japan runs a trade surplus of over $61 billion. Unfortunately there are still too many exceptions to Japan's stated policy of
"markets free in principle, with import restrictions only as exceptions." To too many foreign businessmen it sometimes looks as if the exceptions are the rule.

Agriculture is perhaps the clearest example of protected markets in Japan. The Japanese consumer pays a high price for food so that farmers in noncompetitive sectors can enjoy a standard of living well above that of average Japanese working people. Without the protectionist quotas, tariffs, and import cartels on agricultural products, foreign competition would bring down the cost of food considerably. By the way, the U.S. in May, '85 – for the first time on record – imported more farm goods than it exported.

There are many other areas where free competition is not presently allowed. A diverse range of products from soda ash and tobacco to wine and chocolate still suffer from high import duties and distribution restrictions which effectively limit competition, and keep prices in Japan high. Again, it is the Japanese consumer who suffers and pays the price.

I do not intend to list all the sectors where more market access is needed, but I would like to mention one area of particular concern, the Kansai International Airport. At present foreign companies are not being allowed to bid on this major construction project in an open manner. When we look at the many Japanese construction and design companies, and other service companies, which compete
and operate freely in the United States, then this is simply not acceptable. The Congress is increasingly aware of this issue, and I urge that it be resolved before it becomes another thorn in our relationship.

These and other market access issues must be dealt with and solved. We all know about domestic political restraints and vested interests which get in the way of opening markets and granting free access and competition. Nevertheless, we cannot accept a situation where Japanese companies enjoy free access to other's markets, but foreign companies do not enjoy the same access to the Japanese market.

Having said this, we must all realize that although market access in Japan is a problem, market access alone is not the solution to the trade imbalance. In addition to more open markets, there must also be over the long term a strong and stable yen relative to the dollar. Much of the U.S. global trade deficit came about as a result of the appreciation of the dollar against major international currencies in the period from 1980 to 1985. This situation has turned around considerably since the G-5 meeting in New York last September 22, when our finance ministers agreed to cooperative measures to bring down the value of the dollar and strengthen the yen. The results have been good -- the yen went from 242 the day before the meeting to the 160 range today.
If the dollar is to stay at current levels in the long run, we in the U.S. are going to have to deal with our budget deficit. As long as the budget deficit sucks in foreign capital by keeping interest rates high, then upward pressure on the dollar will continue. Even though the Supreme Court recently ruled parts of the Gramm – Rudman law unconstitutional, we can only hope that the Congress still realizes the urgency of tackling the budget problem. No one else can do this for us. I do not know too much about Gramm – Rudman but, if it forces Congress to face up to the deficit and do something about it, it will have achieved a worthwhile and necessary objective.

To move to balanced trade, in addition to market opening and a strong yen, there must also be structural adjustment in the Japanese economy, adjustment to an economy led by domestic growth rather than export growth.

Such an adjustment to domestic-led growth is necessary if Japan is to meet its global responsibilities as an economic superpower. The developing nations particularly need export markets if they are to have the opportunity for their own economic progress. The United States is and has been for some time the major importing nation in the world. The availability of the U.S. market has been a major factor in the tremendous economic growth the globe has seen since World War II. Japan is now the second largest economy in the world, and in many ways it's the wealthiest nation of
the world. It is time for Japan to shoulder its responsibility for growth in the rest of the global economies, economies which contributed so much to Japan's own economic recovery.

More domestic-led growth is also needed for Japan's own economic survival. The Japanese economy has been overly dependent on exporting, and thus very vulnerable. As I mentioned earlier, when the quantity of exports dropped due to the strong yen, Japan was left with insufficient domestic growth, and suffered from a real decline in GNP of 2.1 percent at an annual rate in the first quarter, the first decline in GNP in eleven years.

I hope Japan as soon as possible will get own with implementation of the recommendations contained in the excellent report of the Maekawa Commission, recommendations which if enacted should promote domestic growth in Japan, and also promote imports from other nations. The time has clearly come for the ideas contained in the Maekawa Report -- ideas such as major income tax cuts, tax incentives for housing investment, taking a hard look at the tax free savings system, growth in wages, deregulation of the economy, expanded infrastructure investment, financial liberalization, free market access, internationalization of agricultural policy, and the like.

Fundamental changes in the structure of the Japanese economy obviously will not come without a certain amount of
domestic pain in some sectors of the economy. However, the resounding victory of the Liberal Democratic Party in the recent election shows that the Japanese people accept the policy of shifting Japan's economy away from one dependent on exports to one led by domestic growth. The mandate given to go forward with these changes shows that the Japanese people recognize their new responsibilities as a super economic power, with a major role to play in contributing to world economic growth via a strong yen and a strong domestic economy.

In closing, I would just like to say that time is indeed of the essence in resolving the economic frictions between us. Many of the trade issues we now face have festered for too long. The time is ripe for solutions to our trade disputes, as well as for implementation of the structural adjustments which must take place if we are to have a balanced and harmonious economic relationship over the long run.

The U.S. - Japan partnership remains strong and vital. It is much too important to both of our nations, indeed to the entire free world, for us to allow trading problems to constantly threaten to sour the relationship. The way to deal with these problems is not to try to hide them, but to face them and to solve them. We have our work cut out for us, and we had best get on with it, so our relationship can grow even stronger.