Japan-US Midwest Society

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I want to thank Chairman Hasegawa for his gracious invitation to speak to you today. It is no secret to anyone interested in Japan that I believe the U.S.-Japan relationship is the most important bilateral relationship in the world, bar none. It is a relationship based on mutual trust, mutual benefit, and -- thanks to the efforts of groups such as yours -- mutual understanding.

I'd like to go over with you some developments that have taken place in the last few months, whose effect on U.S.-Japan relations remains to be seen, but will doubtless be significant as we move into 1987.

The first major development -- the results of the mid-term elections in the United States. There has been some speculation that the change of majority party in the Senate from Republican to Democratic will lead to increased tension in U.S.-Japanese relations. This would be unfortunate. Our bilateral relationship is too important -- to the U.S., to Japan, and to the rest of the world -- to be sacrificed to partisan politics on either side of the Pacific.

This is not to say that we should ignore or gloss over the real problems we face. In 1985, our trade deficit with Japan was almost $50 billion; this year's deficit may top $60 billion. At the same time, the enormous worldwide U.S. trade deficit -- nearly $150 billion last year, likely to be even higher this year -- illustrates that our trade imbalance is not just a bilateral problem with Japan, but is a global problem.

Faced as we were in 1985 with the largest trade imbalance between the U.S. and Japan in history, there were many calls for the seemingly easy solution of market closing and protectionism. But as the painful experience of the Great Depression shows, protectionism serves no one's interests. Our governments rejected protectionism. In co-operation with the Japanese and other G-5 nations we reached an agreement which resulted in a yen-dollar exchange rates that broadly reflects economic fundamentals. Secretary Baker and Finance Minister Miyazawa
recently re-affirmed their commitment to this agreement. It has been a long and painful process -- a process that entailed the very real risk of inflation in the United States and recession in Japan.

The threat of protectionism remains high, but I believe we have turned the corner on our trade imbalances. This past August, the U.S. trade deficit with Japan declined 15 percent, from $5.2 billion in July to $4.4 billion. In September, it declined an additional 11 percent to $3.9 billion.

The U.S. global trade deficit declined 27 percent, from $18 billion in July to $13.3 billion in August, and declined a further 5.7 percent to $12.5 billion in September. This is the first back-to-back monthly decline in both our global and U.S.-Japan trade deficits in over a year. This is certainly good news, and while two months do not make a trend -- and there will be temporary setbacks -- the evidence points to a continued decline in the trade deficit.

There is one disturbing characteristic, however. Most of the reduction in our trade deficit with Japan is due to a decrease in Japanese exports to the United States. This is only a partial solution at best. The U.S. is not looking for trade deficit reduction based on declining trade. Trade expansion is the goal. We need to increase U.S. exports to Japan. We need access to the Japanese market.

In 1985, the U.S. and Japan started the market oriented sector selective -- MOSS -- negotiations concerning telecommunications, electronics, forest products, and pharmaceuticals and medical equipment. And we're beginning to see results. In the first half of 1986, U.S. exports to Japan in these four sectors were up 4 percent in dollar value: in forest products -- up 10 percent to $1.1 billion; telecommunications -- up 10 percent to $640 million; pharmaceuticals and medical equipment -- up 8 percent to $447 million.

The one sector which declined was electronics -- down 0.2 percent, probably reflecting the worldwide computer slump. Even with the decline, the U.S. exported 1.5 billion -- that's 1.5 billion -- dollars worth of electronics to Japan in the first half of 1986.

But the health of the world trading system shouldn't be measured in terms of deficits and surpluses. It should be measured in terms of the commitment by nations to foster a free and open trading system. Both President Reagan and Prime Minister Nakasone share that commitment, and both of these leaders have advanced the cause of free trade in the face of opposition by special interest groups.

Fortunately, the U.S. and Japan are not alone in that commitment. In July of this year, the members of the General Agreement on Tariffs and Trade -- the GATT -- agreed to begin a
new round of multilateral trade negotiations. When government leaders met in Punta del Este, Uruguay, a breakdown in the international trading system loomed on the horizon. Bilateral deals, voluntary restraint, managed trade and reciprocity were on the rise, and disagreement over the inclusion of services and agriculture in the new round threatened to cause a stalemate. But with the help of many countries, including Japan, and with compromise on all sides, agreement was reached to start a new trade round that will include both services and agriculture.

The importance of services and agriculture to the health of the international economy cannot be over-estimated: 68.5 percent of the American work force and 56.6 percent of the Japanese work force are employed in the service sector. And their numbers are growing. Service workers are not only waitresses and store clerks, but include doctors, teachers, computer programmers, airline pilots, lawyers and other professionals. As a government employee, I work in the service sector. As international communication and travel become easier, services will play an increasing role, not just in our domestic economies, but also in world trade.

For cultural and historic reasons, most countries today practice some form of agricultural protectionism. We are all guilty. The trade distortions and inefficiencies caused by agricultural protectionism cost millions of jobs in the manufacturing sector. Even more unfortunate is the devastating effect that this protectionism has on the economies of the developing nations. Now is not the time for finger-pointing and recrimination. Now is not the time for bilateral deals. If we are to tackle the issue of agricultural trade it must be done multilaterally. It was in this spirit that USTR Clayton Yeutter rejected the recent Rice Millers Association 301 petition against Japan on rice. We hope that Japan will be responsive to our concerns in this area during the upcoming trade round.

The negotiations on agriculture in the GATT are going to be difficult. There is no guarantee of success, but we have already come further than anyone thought possible one year ago, and we must continue this effort.

Trade negotiations alone will not solve our trade problems. There are still things that U.S. and Japan must do. For the Japanese this means structural adjustment. For the U.S. this means controlling our massive budget deficits.

Many Japanese, led by Prime Minister Nakasone, recognize the need for change. In accepting the report of the Maekawa Commission, Prime Minister Nakasone committed Japan to changing the structure of the Japanese economy, in order to reduce its large current and trade account surpluses to levels consistent with international harmony. In this regard, the Japanese have instituted a 3.6 trillion yen ($22 billion) package of comprehensive economic measures to stimulate domestic demand. If fully implemented, this will increase Japanese demand for imports
and permit Japanese companies to prosper by producing goods for domestic consumption, as well as for export.

The United States must share some of the burden. We must work to reduce our massive federal budget deficit. Simply put, with our large federal budget deficit and low savings rate, we consume more than we produce, and to a large extent our trade deficit mirrors this simple fact. Even with the 1987 Budget and the Reconciliation Bill, the federal budget deficit is still projected to be $154 billion in 1987. While this would meet the target for the Gramm-Rudman-Hollings Bill, it falls short of what is needed. Painful choices remain in the years to come.

In addition, we must become more competitive. Improve productivity. Improve quality. We must take the offensive in world markets and prove once again that the U.S. can turn out the best products at the best price.

In the past several years the American spirit has been rejuvenated. We face the international scene with renewed confidence in our political system and renewed confidence in our foreign policy. The time has come to restore the American spirit in our economic system and our economic policy. We must look beyond this quarter's profits to the futures of our companies. We must take pride in our work and in the quality of our products. We cannot afford to abandon markets. We must enter into a spirit of cooperation among labor, management and government to maintain our economic power and position. Competitiveness, not protection, is the key to our economic future.

But it would be a terrible injustice if the U.S.-Japan relationship were to be defined only in economic terms. In the field of defense, the Japanese have made remarkable strides forward. Their support for the Strategic Defense Initiative (SDI), their more than $1 billion annual contribution toward the upkeep of U.S. military forces stationed on Japanese soil, and their increased defense spending testify to their solidarity with the world's industrialized democracies. The U.S. has consulted closely with Japan in its efforts to reach an equitable, verifiable arms agreement with the Soviet Union, and we appreciate Japan's support for our efforts against international terrorism.

Japanese and American scientists cooperate in a broad range of basic scientific research -- in medicine, space science, and oceanography. 1986 marked the 25th anniversary of the U.S.-Japan Committee on Scientific Cooperation agreement, the first major bilateral scientific agreement between the U.S. and another country.

Ultimately, the U.S.-Japan relationship is only as strong as the many human bridges that link our two countries together, and groups like the Japan-U.S. Midwest Society play an important role in fostering the goodwill and understanding that help us see each
other as individual human beings, not as stereotypes. We have our work cut out for us, but as long as we work together, I am confident that we can solve the problems before us.

Thank you.

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