The U.S. and Japan: Deja Vu All Over Again?

Excerpted from a panel discussion at
Winning and Losing -- America in the new Global Trade Order:
The 1995 Economic Strategy Institute - Pacific Basin Economic Council -
U.S. 1995
Trade Policy Conference
Washington, DC
March 30, 1995

Participants:
Ms. Ayako Doi, The Daily Japan Digest;
Mr. James Fallows, The Atlantic Monthly;
Mr. Richard Koo, Nomura Research Institute;
Hon. Kiyohiko Nanao, Minister for Economic Affairs, Embassy of Japan;
Hon. Ira Shapiro, General Counsel, Office of the U.S. Trade
Representative.
MR. FALLOWS: The correlation of forces, as seen by the Japanese eye in the Framework talks, was that the . . . Clinton administration and the U.S. as a whole would not be able to sustain the argument for the sorts of targets that were involved in the negotiations. And, therefore, it was in Japan's advantage to say, "No, we will never again agree to these sorts of numerical targets. No, we are against managed trade." The assessment of the correlation of forces on that side was that cleavages within the American intellectual community and cleavages within the American political community would make it possible to say, "No, we're going to resist this approach . . . ."

The essential ingredient -- the reason why things have come to the point they have between the U.S. and Japan -- is not the flawed or superb logic of the Clinton plan from the beginning nor even the determination of the Japanese negotiators. Instead, it is the erosion of Bill Clinton's personal political capital. . . .

For reasons not of logic, but of old-style correlation of forces and old-style erosion of political capital, it has not been possible to move to any kind of different trading situation between the U.S. and Japan. And I see very little change on that front until these underlying situations of power, not of logic, change in the United States.

AMB. SHAPIRO: There has been a considerable impression that the administration was suffering from what some reporters have called Japan fatigue -- that the problems had been regarded as intractable and that, therefore, the administration was turning in a different direction and to other issues. I think that is not the case. . . .

We can't maintain support for an open trading system when we have situations that are manifestly not open market situations.

MIN. NANAO: On autos, certainly the linkage efforts are going on. But you must realize that the Japanese auto distributing networks are heavily linked with manufacturers originally -- they contributed capital, personnel. They are different corporations, but it's within the same family. . . .

Issues are still remaining because of it's a bigger ticket trading item and the U.S. deficit . . . continues. Symbolically, politically, also economically, it's an issue one cannot pass by. We really need to attend to this. . . .

Certainly, we have certain shortcomings in methodology, how to handle this issue. The famous issue of objective criteria . . . and numerical targets, and so on. We spent ten, twelve months debating it. But still it's a worthwhile exercise. And it's a sort of interface between two different societies. . . .
This is a test case, not to say vis-à-vis Asia specifically, but globally. If this approach succeeds, one can apply it to other countries' cases. There has been no case like this, penetrating into other people's kitchen board affairs, like budget deficits, U.S. competitiveness. Why doesn't your educational system improve in the U.S.? We're discussing that in a very constructive spirit. Americans are also coming into our internal affairs. We never do it in the multilateral organizations like the OECD, for instance. We are running ahead of the OECD.

MR. KOO: The strong yen is made in Japan. No one else except the Japanese can turn the situation around. And it's not made in Washington. The strong yen is not made in the White House.

On June 24th, last year, I think my worst fears came true. If you remember what happened on June 24th -- and I'm sure most of you here cannot remember . . . . But that's precisely the point. On June 24th, last year, President Clinton came out and said, "We don't want the strong yen. We want a stronger dollar. A stronger yen, a stronger deutsche mark, will be counterproductive to the world economy.

And with that massive announcement, he ordered the Federal Reserve Bank of New York, where I used to work, to intervene heavily in the foreign exchange market, and that was coupled with 19 other central banks joining the intervention efforts -- especially including the Bank of Japan, which was buying dollars to the tune of $2 billion a day. And the Federal Reserve by then had already raised the interest rates four times, seven times, until the most recent period.

In spite of all of those efforts, nothing happened to the exchange rate, and that's why you don't remember this date.

I thought that the fact that exchange rates didn't move on that day was the real news. Because if, as some people have alluded, the U.S. had some hand in the strong yen -- and quite a few people have actually said that it's actually made in White House, it's a Clinton conspiracy, and so forth -- then President Clinton coming out openly and saying we don't want the strong yen, we want the strong dollar and backing that up with a massive intervention and raising of interest rates, means that the dollar should have strengthened by at least five yen, if not ten yen . . . . The fact that exchange rates didn't move at all suggests that the U.S. was completely out of the picture.

This development on June 24th, I think, proved conclusively that the U.S. was actually powerless. But no Americans want to be told that they are powerless.

When you're doing intervention in the foreign exchange market -- and I was
actually at the foreign exchange desk for the New York Fed -- there's certain conditions that have to be satisfied before the intervention works. For the intervention to work, you have to have speculators on the other side. . . .

Central bank intervention proved most ineffective because the people who were selling in the foreign exchange market were Japanese exporters.

The difference between the speculators and Japanese exporters is that if you squeeze the speculators hard enough, they will go from dollar sellers to dollar buyers. The Japanese exporters will be always dollar sellers. It's totally irrelevant to them whether Greenspan is raising interest rates or President Clinton is talking up the dollar. They need the yen cash at the end of the day after selling all of these Toyotas and Nissans in the United States.

At that time, the Governor of the Bank of Japan, Governor Mieno, in a very rare pronouncement said in rather candid words, "There is no point in continuing this monkey business." The actual word he used was a little stronger than that -- monkey business referring to the intervention. "We've got to deal with this trade imbalance."
This particular comment got him into a lot of trouble with the Japanese government. Because the government was trying to maintain that the strong yen is all speculation and it's all a conspiracy and it has nothing to do with Japan. . . .

In the '80s, we had Japanese investors. These happy people bought Rockefeller Center, and U.S. Treasury bills, and whatever. As long as those people who are buying U.S. assets -- and to buy Rockefeller Center you need dollars, you cannot buy that stuff with yen, not yet anyway -- those people are buying dollars and selling yen. And they were filling the gap between the Japanese exporters and importers. And that's how harmony was maintained.

During the '90s, I can assure you that those guys are totally out of the market and, if anything, they are on the selling side, not on the buying side. So those people dropped out of the market and that's why we have this strong yen with us. I don't think we can turn the situation around until those investors are back in the market. But that's the hardest issue that facing the Japanese economy at the moment: How are you going to convince those Japanese investors to come back to the foreign markets again? Not just the U.S., but all foreign markets.

Those people lost something like $470 billion in foreign exchange losses over these years. Four-hundred-and-seventy billion is a lot of money to lose. And after losing that much money, they got a little wiser. Well, they actually studied why they lost so much money. And then they came to this conclusion: If you invest abroad, you're basically lending money to foreigners -- Americans, Canadians, Australians. And we are not doing this for charity. This is our
insurance money... We've got to get paid back at some point. But when you think about the situation, how can foreigners ever pay you back? Only by exporting goods to Japan, that's the only way.

And what did the Japanese do to foreigners trying to pay the debt back to the Japanese in the 80s? Well, we basically said, "No, we don't want your goods. They're of a lower quality. They don't meet the fire requirements. It's this, it's that. You guys are not working hard enough" -- as though it was someone else's business.

Well, it's the same Japanese who lent the money, and it's the same Japanese who refused to accept the goods from the people who were trying to pay the debt back. After realizing that was the situation, all the investors said, "This is suicide to invest abroad. Until the market is open in Japan, there's no point in investing abroad at any exchange rate because foreigners can never pay us back." And that's where we are now.

To convince Japanese investors that it's safe to invest abroad again, that foreigners will be able to pay them back, you've got to have a serious market opening in Japan. And this only the Japanese government can do -- or Japanese industry, for that matter. There's nothing Americans can do. And the more President Clinton or Undersecretary Summers... tried keeping the dollar high against the yen, the more they realized that's a lost cause...

MS. DOI: The Hosokawa government that came into being in the summer of 1993 was something very different from all the governments that we've had in Tokyo in the past 40 or so years. I know that at that time, the U.S. trade negotiators were saying, "Deja vu. It's the same faces. They have the same intransigence. They don't want to negotiate. They don't want to open up," and so on. I think they were wrong.

Actually, I think, what was different in the Hosokawa government was that there was a sort of opening of the spirit in Japan, which I have never felt as a Japanese in or out of Japan. There was a definite sense that they wanted to do the right thing, as opposed to not doing anything that disturbed the cozy arrangement that's been in place -- making minimum changes only if they were threatened by a foreign power. There was an atmosphere in Tokyo, at least at the beginning of the Hosokowa government, that we should stop doing monkey business, as somebody said, and do the right thing for a change -- open up, open up the business, get involved in the world affairs, contribute more to the good of the world, and so on.

There was some skepticism in Japan, too, but greater skepticism in Washington, and that was very unfortunate. It's almost mind-boggling to me that the Clinton
administration missed what was happening in Japan in terms of psychological change -- of moral change, you might even say. . . .

The Framework policy was based on the past Japan, whose governments were intransigent; whose governments were not willing to make any more changes than the minimum necessary; which featured a cozy arrangement with the bureaucrats, and politicians, and big businesses. There was no real inner desire to open up and the Framework policy was based on that. That's why they said, "We have to have a target. . . ."

I think that was very counterproductive, to say the least -- perhaps insulting to the Japanese government, as well as to the people, who were excited about what was going on with the new reform government then. So, I think . . . one basic problem of the Framework policy was the lack of intelligence on the part of the Americans. . . .

The American negotiators and commentators talk about how good the Japanese PR was in the Framework talks, saying that the American argument is wrong, that they're after managed trade, and so on and so forth. Knowing the Japanese government and bureaucrats, and having had many discussions about public relations, I can almost certainly tell you that there was no concerted effort. They're not capable of doing that. . . .

One very detrimental thing for the United States [resulting from] launching the Framework talks was that the U.S. lost the moral high ground in the trade argument. . . .

Unfortunately, we missed the opportunity as Americans and Japanese and other people -- people who trade with Japan -- the opportunity of making a real change in Japan with a reform government. I'm not saying whose fault it is that this government fell. It's the Japanese fault. After all, it's the Japanese people who have the power to change the government. But now, we are stuck with a government that is determined to sit on its hands, to do nothing unless forced. . . .

I might even go back to Adam Smith and say that the only thing that will take care of the trade imbalance problem is economics. And it is happening already with the yen. With the yen so high, Japanese manufacturers are forced to buy foreign parts. In order to stay competitive, they are moving the facilities overseas. And, so, economics is part of it.

I think one thing that the U.S. can do is what it did do in the SII talks a few years ago. In these Structural Impediments Initiative talks, [America tried] to find an
ally in Japan. And the U.S. found an ally, in Japanese consumers and much of Japanese business, which wanted to get rid of this arcane distribution system. What consumers want is cheaper goods, a bigger store, more convenient locations. And the U.S. at that time succeeded in convincing the Japanese people that maybe this policy is good for Japan. But not in the Framework.

MR. FALLOWS: I personally had eight or nine conversations with Foreign Ministry officials presenting arguments extremely similar to those we've heard from Ms. Doi -- that it would be a shame for the U.S. to step away from the high road, that SII was so popular.

The idea that the rest of the world was raising its hands in horror at the idea, at the very idea of managing trade with Japan, is a little hard for me to believe. For example, from the Europeans with their car agreement with Japan, which I'm sure you're all aware of here.

When I first went to Japan, a little more than nine years ago, I was told and I believed that sooner or later two things were going to break down if the trade relations were not balanced.

One was the world trading system. And it was Ira Shapiro who said, "How can the U.S. make an argument for open trade, when it has this huge problem?"

The other was the defense relationship. Now, nine years have passed and there is really no sign that either of those things has been harmed by nine years of hugely unbalanced trade. So maybe it is possible that, from the Japanese point of view, this situation can be sustained forever. Because the U.S. will keep pushing for a world trade system and the defense relationship won't be in jeopardy. And the only thing that will change it would be, as Richard Koo said, if the investors in Japan feel that they are just somehow being squeezed out if the market doesn't open up. So, maybe there is nothing at all the U.S. can do.

AMB. SHAPIRO: I don't quite see the correlation of forces the way Jim does.

In the auto sector, I think of the fact that now, as opposed to five or ten years ago, the U.S. industry has made such a significant effort, both to bring back its competitiveness and to make progress in the Japanese market. To me, it contributes to a somewhat different correlation of forces. I was on the Hill in the 1980s, and part of the continuing difficulty in U.S.-Japan trade policy was the argument that the U.S. companies were not trying hard enough.

Now, frankly, I opposed, I thought, our policy at that time. And our lack of action at that time was the wrong policy. But there were reasons why you
couldn't get support for a stronger policy on the U.S. side, including the ideological predispositions of the Reagan and Bush administrations.

I think that if you look at it now, you see an administration with a different viewpoint but you also see a different situation because of what the industry has done to bring itself back. . . .

Numerical targets -- which we are not seeking -- arise because of an absence of alternatives oftentimes. . . . I remember when certain people started writing about numbers, they were writing about them precisely because of the difficulty of bridging the gap between two basically different economic approaches. And that it was not exactly a rewarding enterprise to label systems as fair or unfair. And, so, what was the answer?

Well, one answer was to think about what results might look like. Now, of course, that has been somewhat an undermined policy and targets are not what we're seeking. But the question is, we can solve this together jointly and reduce the barriers, or we face a more difficult situation, where the U.S. will constantly have to be present.

QUESTION: Richard Koo, supposing took your argument to its extreme and we persuaded Secretary Rubin to stand up tomorrow and say, "There has been a change of thought in the U.S. Government. A strong dollar doesn't necessarily correlate to strong nation. So we're willing to let the yen rise as high as it possibly can go until our trade problems with Japan are solved." Would that bring about sufficient pain and would it work?

MR. KOO: Well, I must say that Japanese companies have unbelievable amount of resources to take pain. And this is part of the system of lifetime employment. If you have lifetime employment, but you have business cycles, what do you do during the bad times when you cannot lay off workers?

Well, what you do is, during the good times . . . when you make lots of profit, you don't distribute them out like in the United States. You keep them. So during the bad times, you have the money to pay the workers even though your revenue and profits might be way down.

But I must say that the strong yen is working. It's hurting Japanese companies in no small way. Very many companies are screaming. Except that this time around . . . I asked them, "How come you're not screaming as loud as before?" And everyone of them without exception told me that, with the kind of government we've got, there's no point in screaming. It's hopeless. [But they are also] trying to get out of Japan as quickly and as quietly as they can. [And] if you scream, you attract the attention of the media. They see that you're moving production
systems abroad. They say, "Hey, you're deserting Japan; you're betraying Japan," and things like that. So that's why they are very quiet this time around.

But hollowing out is continuing, and I think it's a very unfair punishment for Japan, because the strong yen hurts Japan's best industries -- those people who worked the hardest after the war and brought Japan to where it is today, while leaving the protected industries like rice farming completely intact. And this is, I think, a very unfair situation. It's all brought about by the Japanese system of closed markets, of course. It has nothing to do with the U.S. action, but it's a very sad outcome.

Very many people are aware that we are going down the wrong track. But we don't have a critical mass yet to turn the situation around.

MIN. NANAO: I think that the Murayama cabinet shouldn't [be portrayed] as so uniquely weak, in contrast to other G-7 governments. It's the post-Cold War age, the post-industrial age. Everybody has got problems. All leaders have only one-third support.

MS. DOI: I fault former Prime Minister Miyazawa for agreeing to pursue the Framework agreement, too. You know, he was on the way out. He didn't care what would happen to the negotiation.

The yen as high as it is, it seems to be finally dawning on the Japanese business people that we can not continue on restructuring, cost cutting, having pain in Japan to stay competitive abroad.

AMB. SHAPIRO: I remember writing a speech for Senator Rockefeller in 1987, in which I used the phrase or he used the phrase, "Change is in the air in Japan," and then we went on to indicate the things that were changing. And, certainly, there is still that. And the problem here has been and continues to be a pace-of-change problem.