Samurais No More

Jagdish Bhagwati

The failure of the February 11 Hosokawa-Clinton summit in Washington to produce a trade agreement on U.S. terms was marked by theatrics on the American side. Deputy Treasury Secretary Roger Altman's banter was typical. He declared, with the bluntness that Wall Street breeds, that the United States would wait "until hell freezes over" for the Japanese to accept U.S. demands. When Prime Minister Hosokawa finally said no to them, the American anger was palpable.

U.S. Trade Representative Mickey Kantor brought to center stage the Motorola cellular phones dispute, which the administration had readied to coincide with the summit by speeding up ongoing negotiations. Amenable to manipulation as "proof" of Japan's perfidy, the dispute was also the one most likely to be settled at a low cost, financial and political, by the Hosokawa government to save U.S. face: a crumb thrown to the United States, it could be called a cake.

Indeed Japan ended the dispute by bribing Motorola with investment outlays while affirming the dispute's uniqueness and reiterating the policy of saying no. The Clinton administration, predictably, performed a war dance, celebrating a victory in a skirmish as if it had won the war, attributing the Motorola settlement to American resolve and threats, particularly to the president's revival in March of the "Super 301" weapon, which authorizes the administration to highlight countries it determines are trading unfairly and, if it chooses, to impose trade sanctions in retaliation.

BREAKING ITS OWN RULES

The Clinton administration, however, cannot conceal the reality that its policy is fatally flawed. The policy makes demands that are inconsistent with the

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very principles on which the United States has itself provided leadership in shaping the world trading system over half a century. As important, the policy fails to grasp the significant changes that make both the style and the substance of these demands unacceptable to the new Japan. American policy is thus both unworthy and unworkable.

The problems with that policy concern "quantities" and "process." The United States wants managed trade: specifically, it wants the Japanese government to accept numerical benchmarks and targets for increased imports in specific sectors. It is also pressing for one-way concessions from Japan in areas where the United States has judged Japan to be either closed to imports or in violation of treaty obligations, acting unilaterally instead of using impartial procedures to which Japan would also have recourse. In both respects, the United States has the double disadvantage of having been roundly condemned by other nations and of having not the remotest chance of acceptance by Japan.

Benchmarks are only a weasel word for targets (that is, quotas), and these import targets quickly turn into export protectionism: they work to guarantee for American firms a share of the foreign market just as conventional import protectionism gives firms a guaranteed share of the domestic market.

These targets will multiply because they are open to manipulation by domestic firms that seek assured export markets. When Japan unwisely accepted the Reagan administration's demand for a numerical benchmark (for the first time in U.S.-Japan trade negotiations), economists had forecast that other firms and industries would soon jump on the bandwagon. It was too rewarding a precedent not to exploit, and indeed that is exactly what has happened. Now a complaisant administration has become the agent for the lobbyists of industries such as autos, auto parts and medical equipment, seeking to impose many more such agreements on Japan.

The proliferation of such import targets to several sectors would also bring other countries onto the scene demanding their own guaranteed share of the Japanese market. The reason is plain enough: Japan must be fully aware that if it opens up to imports but those imports do not come from the United States, the pressure from Washington will continue. So Japan will have a powerful incentive to divert its imports from other nations to the United States, even if the United States pretends that its objective is to open the Japanese economy, not throw contracts the way of American firms. Hence, properly fearing trade diversion, the European Union has always said that if Japan concedes import targets to the United States, the EU will be right behind.

If numbers rather than rules are accepted as the way to conduct trade, the prospect is then certain that Japanese industry would soon be subject to heavy regulation and compelled to produce the politically agreed market shares. This would be bad enough for Japan. But it would also be a low blow to the rules-based world trading system that the United States has professed to uphold at the General Agreement on Tariffs and Trade.

In consequence, the United States, traditionally the leader on trade issues to the applause of economists, has found itself opposed by economists, whether Democrats or Republicans. There is also little support for America's Super 301-aided unilateralism. Washington is isolated when it wants to take the law in its own hands, especially now that the Uruguay Round has produced a binding settlement procedure. Even if Japan were guilty as charged, it is unacceptable that the United States should become complainant, judge and jury.

THE NEW JAPAN

Japan's resistance to U.S. demands was urged worldwide—from Europe in particular—undoubtedly strengthening Hosokawa's resolve to say no. But that resolve comes from within Japan itself, reflecting the nuanced yet remarkable changes that Japan is undergoing. The Clinton administration simply does not get it: the new Japan is trying to be like the old United States just as the new United States, with its flirtation with industrial policy, embrace of demands for managed trade, and (as in the president's announcement of the Saudi purchase of U.S. aircraft) unabashed use of political muscle rather than economic competitiveness to succeed in world markets, is trying to be like the old Japan.

Hosokawa, and the large numbers of reform-minded Japanese who voted the Liberal Democratic Party out of power, wish an end to old-fashioned regulation. Managed trade would turn the clock back when they want to push it forward. The reformers also believe in reciprocal rights and obligations; they reject unilateralism and want multilateralism; they want due process, not the peremptory judgments of the United States (which reflect the self-serving finger-pointing of individual U.S. companies).

Ironically, but predictably, these are American ideas. They have spread rapidly to Japan because, among other reasons, Japan has large numbers of its young citizens abroad. Over 40,000 Japanese students are in the United States today, learning to put their feet on the table in the classroom instead of meekly bowing to the *sensei* (the venerable teacher). With the dramatic shift in the 1980s in the share of Japanese direct foreign investment away from the poor countries to the rich, prompted in part by the outbreak of protectionism in the EU and in the United States, which restricted export access to these markets, great numbers of Japanese women and children also live in the West. They are a subversive, modernizing force. Increased numbers of Japanese academics can now be found on U.S. campuses, speaking English fluently and working with Americans at the frontiers of science when only a decade ago there were practically none.

The Japan that was so set on what the historian Henry Smith has aptly called "controlled openness"—drawing carefully on what it liked in other cultures rather than abandoning itself, like the United States, to free cultural influx and experimentation—is now beyond such control. The globalization of the Japanese economy and modern communications imposes its own logic on the nation. But the Clinton aides in charge of Japan policy, mainly Wall Street luminaries and high-profile lawyer-lobbyists with lifestyles that leave little room for reflection and put a premium on going for the jugular, appear to be ignorant of this historic transformation. These Clinton warriors think they are fighting the samurai when they are facing GIs.

Indeed, these aides manifested their lack of comprehension of the new Japan with tactical errors in negotiations leading up to the summit. The bureaucrats in Japan were assumed to be the problem. The new politicians, keen on reform, were assumed to be U.S. allies in seeing the manifest virtue of demands for managed trade to "open Japan." But the new politicians were the ones who had principled objections to managed trade and also to U.S. unilateralism.

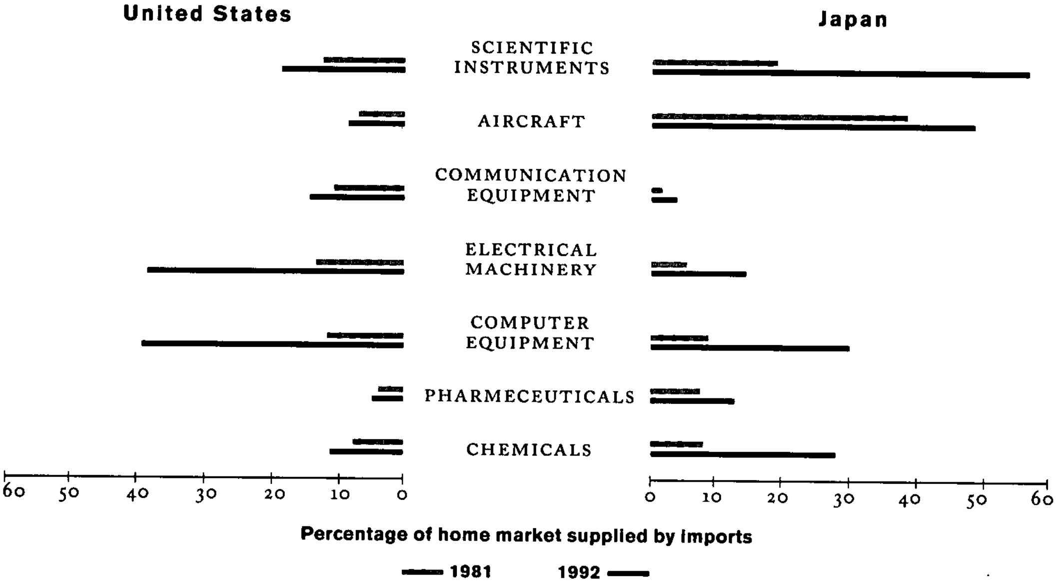
While the United States was pretending that benchmarks were different from targets, Kantor did not even bother to dissimulate when, in the semiconductor agreement, the U.S. market share fell recently below the 20 percent benchmark; instead he came out swinging with both hands, complaining about the shortfall as if the benchmark were a target and demanding corrective action. Moreover, the president, indulging in Japan-bashing to promote the North American Free Trade Agreement, had already promised revival of Super 301, taking the incentive away from the Japanese to settle on U.S. terms in order to avoid the provision's reenactment. The Clinton aides failed to understand that their twin assumptions about Japan—that nothing but bluster can succeed and that bluster cannot fail—were no longer valid.

In the end, the flaw in U.S. policy derives from the exaggeration of Japan's differences of yesterday as much as from an ignorance of its rapid convergence to the United States today. Washington is obsessed with the view that Japan is different and special, a predatory exporter and an exclusionary importer that must be dealt with as an outlaw, what Jonathan Rauch has called an "outnation," with tough external *gaiatsu* (foreign pressure) and targets to restrain exports and expand imports.

Economic analysis hardly supports such stereotypes. The simpleminded assertion coming from the Clinton administration that, because Japan's share of manufactured imports in GNP is below the average of the Group of Seven industrialized nations, Japan "underimports" and has a closed market requiring special measures is nonsense. By that token, since Canada's share is substantially higher than the United States', the United States should be judged closed relative to Canada. Sophisticated econometric studies of the question are badly divided; the better-crafted of these certainly do not support the thesis that Japan imports too little, nor do they indicate a special and extraordinary effect of informal trade barriers that make Japan a fit case for unusual treatment in the world trading system.

Even the imports by Japan of manufactured goods, a persistent source of complaint, have grown in the last decade to over half of its imports. Moreover, the foreign share in many of Japan's high-tech markets, so dear to Clintonites, is by no means static or small. The table on the following page, based on recently released data from the National Science Foundation, shows that in seven important high-tech markets, the U.S. and Japanese import shares look pretty similar, so much for entry

IMPORT PENETRATION OF SEVEN HIGH-TECH MARKETS: 1981 AND 1992



so that if the industries and the countries were blacked out, one could well mistake the U.S. chart for Japan's.

The notion of Japan's overwhelming difference nonetheless persists because it is reinforced by the egregious fallacy, often repeated by the president and his aides in public, that Japan's huge bilateral surplus with the United States is surefire proof that Japan's markets are closed, requiring a concentration of one's wrath and energy on Japan. Occasionally, counterintuitive economic sense will prevail for a moment, but then fallacy, so compelling to the untrained mind, resurfaces. Convincing Washington that bilateral surpluses are no index of the openness of markets is as difficult as convincing a peasant that the earth is round when it appears flat to his naked eye.

Nor does Japan's multilateral surplus set it apart as wicked and bizarre. Its persistence is shorter-lived than America's own surplus in the two decades after the Second World War. Japan's surplus reflects its excess of domestic savings over investment and is generally to be applauded as a contribution to world net savings at a time of huge demand for investible funds in the developing and the former socialist countries. In the immediate short run, Japan can certainly contribute to its own recovery and indirectly help the United States by undertaking the significant fiscal stimulus that Hosokawa had worked to get. But all macroeconomists agree that the spillover or "locomotive" effect of Japanese stimulus on U.S. prosperity will be small, making even this obsession of the Clinton administration seem strange. In short, nothing here requires that the United States think that Japan is "off the curve" in responsible macroeconomic management: its mistakes are no more gargantuan than those of the United States, for example, during the decade of fiscal irresponsibility from which it has just emerged.

COOPERATION, NOT CONFRONTATION

The cancer at the core of the U.S. policy then is the view that the United States needs a differential treatment of Japan and a special framework agreement. The justifications for that premise, never strong, are particularly implausible today. They must finally be abandoned.

There is nothing extraordinary even about the specific trade disputes with Japan. Similar complaints can be made with regard to other nations. The accounts of the delays experienced by Motorola in getting its cellular phone system adopted in the Tokyo-Nagoya corridor (one of two in Japan), for example, must be set against the facts that Motorola was not allowed to set up its own system at all in France and Germany and had to adapt to a different system there, and that entry into the U.S. market itself has been impeded by antidumping harassment. Such examples can be readily multiplied.

The time has come to admit that Japan must be allowed to trade by rules rather than quantities, and that the rules must include the adjudication of disputes by impartial procedures available to both parties. The notion that U.S.-Japan trade issues are so special that they must be dealt with bilaterally in a framework that permits the United States to impose one-way demands on Japan and to pronounce unilaterally its own verdicts that Japan has "failed to live up to its agreements" must finally be laid to rest.

Will the president, no stranger to principled and bold changes of course, rise to the occasion? It will not be easy: the failed trade policy toward Japan is most likely his own. After all, the North American Free Trade Agreement and the Uruguay Round were Republican initiatives; he needed one of his own. The Silicon Valley entrepreneurs were the first to swing to him during the campaign; he bought their view of Japan. He chose advisers that shared these jaundiced views. He chose a U.S. trade representative and a commerce secretary who proudly say that they disdain economic "theology" and want results; so they reflect interests, not principles, as they confront Japan.

The president may have fancied that he would have the glory of "opening Japan," as a sort of modern-day Commodore Perry. That historical parallel will not work. The tragedy is that, by persisting in the current policy, he may put two great nations on a course that may repeat history in less agreeable ways.