Volume Title: Trade with Japan: Has the Door Opened Wider?

Volume Author/Editor: Paul Krugman, editor

Volume Publisher: University of Chicago Press, 1991

Volume ISBN: 0-226-45458-4

Volume URL: http://www.nber.org/books/krug91-1

Conference Date: October 19-20, 1989

Publication Date: January 1991

Chapter Title: Front matter, Trade with Japan. Has the Door Opened Wider?

Chapter Author: Paul R. Krugman

Chapter URL: http://www.nber.org/chapters/c8657

Chapter pages in book: (p. -16 - 0)

TRADE *with* JAPAN

Has the Door Opened Wider?

Edited by

PAUL KRUGMAN

With a new Preface

This Page Intentionally Left Blank

Trade with Japan

A National Bureau
of Economic Research
Project Report

Trade with Japan

Has the Door Opened Wider?

Edited by Paul Krugman

With a New Preface

The University of Chicago Press

Chicago and London

The University of Chicago Press, Chicago 60637
The University of Chicago Press, Ltd., London
 Published 1991
Paperback edition 1995
Printed in the United States of America
00 99 98 97 96 95 5 4 3 2 1

ISBN 0-226-45459-2

Library of Congress Cataloging-in-Publication Data
Trade with Japan : has the door opened wider? / edited by Paul Krugman ; with a new preface.
p. cm. — (A National Bureau of Economic Research project report)
Includes bibliographical references and index.
ISBN 0-226-45459-2 (pbk.)
1. Japan—Commercial policy. 2. Industry and state—Japan. 3. United States—Commerce—Japan. 4. Japan—Commerce—United States. I. Krugman, Paul R. II. Series.
HF1601.T734 1995
382′.0952073—dc20 94-36436
CIP

∞ The paper used in this publication meets the minimum requirements of the American National Standard for Information Sciences—Permanence of Paper for Printed Library Materials, ANSI Z39.48–1984.

Relation of the Directors to the Work and Publications of the National Bureau of Economic Research

1. The object of the National Bureau of Economic Research is to ascertain and to present to the public important economic facts and their interpretation in a scientific and impartial manner. The Board of Directors is charged with the responsibility of ensuring that the work of the National Bureau is carried on in strict conformity with this object.

2. The President of the National Bureau shall submit to the Board of Directors, or to its Executive Committee, for their formal adoption all specific proposals for research to be instituted.

3. No research report shall be published by the National Bureau until the President has sent each member of the Board a notice that a manuscript is recommended for publication and that in the President's opinion it is suitable for publication in accordance with the principles of the National Bureau. Such notification will include an abstract or summary of the manuscript's content and a response form for use by those Directors who desire a copy of the manuscript for review. Each manuscript shall contain a summary drawing attention to the nature and treatment of the problem studied, the character of the data and their utilization in the report, and the main conclusions reached.

4. For each manuscript so submitted, a special committee of the Directors (including Directors Emeriti) shall be appointed by majority agreement of the President and Vice Presidents (or by the Executive Committee in case of inability to decide on the part of the President and Vice Presidents), consisting of three Directors selected as nearly as may be one from each general division of the Board. The names of the special manuscript committee shall be stated to each Director when notice of the proposed publication is submitted to him. It shall be the duty of each member of the special committee to read the manuscript. If each member of the manuscript committee signifies his approval within thirty days of the transmittal of the manuscript, the report may be published. If at the end of that period any member of the manuscript committee withholds his approval, the President shall then notify each member of the Board, requesting approval or disapproval of publication, and thirty days additional shall be granted for this purpose. The manuscript shall then not be published unless at least a majority of the entire Board who shall have voted on the proposal within the time fixed for the receipt of votes shall have approved.

5. No manuscript may be published, though approved by each member of the special manuscript committee, until forty-five days have elapsed from the transmittal of the report in manuscript form. The interval is allowed for the receipt of any memorandum of dissent or reservation, together with a brief statement of his reasons, that any member may wish to express; and such memorandum of dissent or reservation shall be published with the manuscript if he so desires. Publication does not, however, imply that each member of the Board has read the manuscript, or that either members of the Board in general/or the special committee have passed on its validity in every detail.

6. Publications of the National Bureau issued for informational purposes concerning the work of the Bureau and its staff, or issued to inform the public of activities of Bureau staff, and volumes issued as a result of various conferences involving the National Bureau shall contain a specific disclaimer noting that such publication has not passed through the normal review procedures required in this resolution. The Executive Committee of the Board is charged with review of all such publications from time to time to ensure that they do not take on the character of formal research reports of the National Bureau, requiring formal Board approval.

7. Unless otherwise determined by the Board or exempted by the terms of paragraph 6, a copy of this resolution shall be printed in each National Bureau publication.

(Resolution adopted October 25, 1926, as revised through September 30, 1974)

Contents

Preface

A man from Mars might well be tempted to assert that trade conflict between the United States and Japan cannot possibly be a first-rank policy issue. After all, in 1992 total world merchandise trade—imports plus exports—totaled more than $7 trillion. Of that, less than $100 billion represented Japanese exports to the United States, less than $50 billion U.S. exports to Japan. Surely a dispute over 2 percent of world trade, no matter how intense, cannot be more than a minor concern?

Well, the Martian would be wrong. Whatever economists may say, as a political matter trade with Japan is *the* central problem of U.S. international economic policy—and since the U.S. government increasingly regards international trade as crucial to domestic economic policy (and domestic economic concerns as the prime concern of foreign policy), trade conflict with Japan has become increasingly central to the whole of our policy debate.

This centrality has only increased since the hardback edition of this book was published. The papers in this volume were written during the Bush administration, which was strongly committed to the ideology of free trade. Yet even during the Bush years there was a steady drumbeat of newspaper articles, best-selling books, and even top-grossing movies (*Rising Sun*) alleging that the economic relationship between America and Japan is asymmetric in a way that damages the American economy, perhaps fatally. The Bush administration responded to this chorus: despite its free-trade sentiments, it found itself engaged in abrasive negotiations over access to the Japanese market. But with the election of Bill Clinton as president, trade with Japan was moved very close to the top of the policy agenda. Clinton chose as his chief economic adviser Laura D'Andrea Tyson, the first specialist in international trade to head the Council of Economic Advisers—and the author of a book, *Who's Bashing Whom?* advocating forceful trade policies toward Japan. In that book, Tyson argued that the United States needed to go beyond the traditional format of trade negotiations, which focus on the removal of *de jure* trade barriers such as tariffs and import quotas. To deal with what she (like many others) claimed was the *de facto* closed nature of the Japanese market—and the effect of that closure on the U.S. economy—she argued that the United States should demand that Japan agree to quantitative targets for its imports of high technology products. And that policy recommendation became the official position of the U.S. government in the spring of 1993—leading to an atmosphere of unprecedented confrontation. Indeed, early in 1994 the diplomatically unthinkable happened: a Japanese prime minister visited an American president, and instead of the usual bland expressions of goodwill the meeting ended in open discord. The political and financial repercussions of that rupture were still echoing at the time this preface was written.

Why does the issue of trade with Japan excite such passion? In part, no doubt, the reasons are discreditable: because the performance of the U.S. economy over the past two decades has been disappointing, while Japan's wealth and technological prowess have steadily grown, it salves American pride to blame Japan for our failures. To be vilified and demonized, to be told that one's prosperity rests on exploitation, has been the fate of every economically successful nation in its time (remember how Third World leftists viewed the United States not too long ago). Yet the peculiar intensity of the debate over trade with Japan is not merely the product of envy: it also reflects the reality that the Japanese economy is different from the economies of other advanced nations, in ways that make it difficult for the United States to treat it as just another trading partner.

Even Japan's most ardent defenders will not deny that her economic system differs in many ways from that of any other advanced nation. Japan's system of industrial organization—in which on one side many firms belong to *keiretsu,* vast but loose business groups; but in which on the other side major corporations rely on long-term relationships with their suppliers rather than vertical integration, so that they directly employ far fewer workers than their Western counterparts—seems to defy our usual categories, so that we don't even know whether to think of Japanese firms as being smaller or larger than our own. Japan's labor market, which combines lifetime employment at large firms with a surprising persistence of the kind of dualism usually associated with less developed countries, similarly puzzles us. Japan's distribution system, with its proliferation of small shops, seems archaic and inefficient at first glance—but is it really? And so on down the line. Every economy is unique, but some are more unique than others.

This Japanese difference raises a series of questions. First, *why* is Japan different? Implicit in this question is the related question of whether the Japanese difference is eroding over time. Second, what effect does the Japanese difference have? In particular, do the differences in Japanese institutions have the effect, as is so often argued, of effectively closing the Japanese market to imports and/or investment? Third, do the effects of Japanese differences have a serious adverse effect on other nations, especially the United States? And finally, what if anything should the United States try to do about Japan?

The papers in this volume are, for the most part, concerned with the first two questions: trying to understand the Japanese difference and its effects. That is as it should be. All too often, Americans project their own fears and desires onto Japan. Many people see Japan as a proof of the effectiveness of interventionist government policies—Japan is or was protectionist, Japan has succeeded, therefore protectionism is a good thing. But that's not everyone's perception. In *Free to Choose,* Milton Friedman held Japan up as a proof of (surprise!) the power of free markets. In *Wealth and Poverty,* George Gilder thought he saw proof of something else: the superiority of traditional families, in which women stay home while men go out to work. And now the increasingly assertive leaders of Asian nations hold up Japanese success as proof that Western notions of individualism cannot and indeed should not be exported. The only way to get beyond Japan-as-symbol is to study carefully how the Japanese economy really works. And as the papers in this volume show, there are many surprises behind the stereotypes. Apparent Japanese strengths may be compensations for hidden weaknesses—for example, the emphasis on long-term business relationships is at least in part a response to a legal system that has trouble enforcing contracts. Conspicuous shortcomings may be more conspicuous than real: the proliferation of small shops may not be as inefficient as it looks. Images of Japanese industrial policy may be outdated: MITI is not the force it once was. And Japan's institutions, especially in financial markets, were showing many signs of strain even before the onset of recession.

While the Japanese economy does not conform wholly to any of the common stereotypes, however, some of the conventional wisdom about the Japanese economy does seem to be true. Japan does import less than one might have expected given its size and income; the considerable growth in manufactures imports since the mid-1980s has come disproportionately from overseas subsidiaries of Japanese firms; and all of this is reflected in higher consumer prices than in other advanced nations.

While the papers in this book have a lot to say about how the Japanese economy is different, and what effect this difference has on its behavior, they did not have much directly to say about the other two big questions: what effect does Japanese difference have on the rest of us, and what can or should we do about it? This was deliberate: the point was to understand the situation, not directly to change it. But events since the book's hardcover publication—the simultaneous hardening of American policy toward Japan and the rise of an internal Japanese reform movement—have made the question of whether and how to respond to Japan a matter of immediate practical, rather than merely academic, interest. So it may be useful to ask what light the studies in this book shed on these policy concerns.

One thing that many of the papers seem to do is to confirm that there is a "Japan problem." That is, Japan is not just different in an innocuous way: the institutional differences in the Japanese system do seem to lead to substantially smaller levels of imports, especially of manufactured goods from other advanced nations, than one might otherwise expect. And the cracks in the wall, while they seem to be widening, have not yet gone far enough to make Japan a normal importing nation. Japan's unusually low level of imports presumably does leave the real income of its trading partners lower than it would be if Japan were more open.[1]

On the other hand, the studies in this volume do not support the image of a predatory "Japan Inc." Japanese markets are closed (to the extent that they are) not because of the conspiratorial actions of a few bureaucrats, but because of a set of deep-rooted institutional differences. And it remains arguable that the main victims of the Japanese difference are not foreign competitors but the Japanese themselves. Certainly the rise of the reform movement and the at least temporary ouster of the Liberal Democrats from power show that the Japanese public is not as convinced as some foreigners of the virtues of the existing system of business-government cooperation.

But perhaps the most important lesson to be drawn from this book, and from many other studies of Japan as well, is a point that should be obvious but often is not: that Japan is a real country, whose impressive strengths go along with serious weaknesses, whose remarkable capacity for change is accompanied by the normal human degree of political and institutional inertia. Too often outside observers have imagined that Japan is somehow free of the vicissitudes that affect other nations: that the Ministry of Finance can prevent asset market bubbles from bursting, that Japanese banks can never become overextended, that Japanese exporters can remain profitable no matter how high the yen—and that the Japanese government can deliver whatever we want, if only it so chooses.

At the time of writing, the American effort to push Japan into a radical market opening appeared to have been put at least temporarily on hold. After all, Japan had just seen two reformist prime ministers fall from power in quick succession; instead of the monolith of myth, Japanese politics were starting to look like those of postwar Italy. And efforts to pressure Japan were widely blamed, rightly or wrongly, for a worldwide slump in the value of the dollar.

The effort to change Japan will no doubt resume, both from inside and outside. When it does, let us hope that it will be based on a clear understanding of the realities of the situation and the magnitude of the task.

1. It is important, however, to maintain some perspective about the likely size of the costs imposed by closed Japanese markets. Clinton administration officials have estimated that a truly open Japan would buy an additional $20 billion from the United States each year—an estimate that many outside experts find plausible. But $20 billion in extra exports translates into a much smaller net gain, since producing those exports requires scarce resources; as a result, it is hard to argue that even a radical opening of the Japanese market would add much more than 0.1 percent to U.S. real income.

Acknowledgments

The papers and comments contained in this volume were presented at a National Bureau of Economic Research conference held in Cambridge, Massachusetts, on October 18–20, 1989. Financial support for the research was generously provided by The Ford Foundation. I would like to thank Kirsten Foss Davis, Ilana Hardesty, and Mark Fitz-Patrick of the NBER staff for their assistance with both the conference and publication.

Paul Krugman

This Page Intentionally Left Blank