

Summary

“The US-Japan Relationship after the Election”

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One of the greatest joys in my life, when I was a US government official-at the National Security Council, the State Department, etc.-was to share ideas. We must build solid relationships over time so that when problems arise, we can come up with solutions together.

Today, I was supposed to speak about the next administration, but we in the US won't know for a while who the next president will be. In any case, there would be stark differences between a Bush Administration and a Gore Administration:

In the realm of US-Japan relations, a Bush Administration would be more positive and creative. The US government reviews its foreign relations whenever there is a change in administration. It has been eight years of not much change. The auto talks were basically a disaster: there were many complicating legal questions. In the current administration, we started off on the wrong foot, and we continue to be on the wrong foot or no foot at all. Investment talks were a success because we got businesses involved.

If there is to be a Gore administration, I do not see anything to suggest a shift in policy.

I do know the Bush people, however, and they are free traders. In fact, they helped to found APEC. I worked with Secretary Baker back then.

We have been fortunate so far in the bilateral relationship that US employment has been so low. Otherwise, the US would not have been so quiet about its record current account deficit.

I have three predictions:

A US slowdown has started, which will end a period of rapid expansion and possibly bring a recession. My first prediction is that after we have two consecutive periods of growing unemployment, trade will become an issue again in the US. And I see this situation coming within 12 months.

My second prediction would be that US companies will make more use of US antidumping laws, given that Senator Byrd's amendment adds incentives for lawyers to take these cases.

My third prediction would be that, as the US economy slows, the Fed will face a policy dilemma:

The dollar is currently overvalued and will, eventually, fall. But how much will this depreciation open up opportunities for US exports? Not much. The majority of our exports, being the high tech and service industries, are price inelastic. With the dollar falling, the Fed will face higher inflation from the prices of oil and other exports, yet it will want to lower interest rates to stimulate economic growth. The dilemma will be the following: is it preferable to lower rates and risk higher inflation or raise rates and risk further recession?

While the dollar is overvalued, the yen, by contrast, is undervalued. When the yen gets stronger, macroeconomic policy will become more complicated in Japan. First an appreciating yen will bring more deflation in the economy, which it does not need. Second, a stronger yen will kill exports—the one current bright spot in the Japanese economy. What can the Bank of Japan do about a stronger yen? Practically nothing. Interest rates are already next to zero.

Given this background, money will return from the US to Japan. And economic conditions will synchronize between the US and Japan. Meanwhile, the world economy will slow since the US won't be absorbing as many Asian exports.

The Japanese and American governments will have to work on re-vitalizing bilateral talks on regionalism. Mr. Bush, if elected, will try to get fast track and will work with APEC. As I see it, the GOP will have the necessary votes to secure fast track authority. An FTA is a possibility—an APEC-wide FTA offered to all APEC members (but members would have the option of leaving the arrangement).

The WTO should re-examine GATT legality of customs unions and free trade agreements because, with its trade “associations,” the EU is hurting the world trade agenda. The subject of FTAs should come back to the WTO and a revitalized APEC might help. The positive influence of such an arrangement could offset negative elements between the US-Japan relationship.

Question & Answer

Q: What are the positive aspects in the US-Japan relationship?

The two countries should continue the discussion on investment liberalization. But in the telecommunications sector in Japan, laying wire should not be a public sector job. Japan should consolidate taxation. Japanese businessmen spend more time engineering their accounting books than engineering their products' designs. Of course, Japanese labor must be more mobile. The MOF is still unwilling to address the lack of portable pension. I don't understand why they can't get such a bill through the Diet.

Q: Are US businesses disinterested in Japan?

If the GOP takes the White House, there will be positive interest in Japan. In any event, trade will become an issue again. In the late 1990s, US businesses shifted their interest toward China, but now these companies are finding the same problems that Japanese companies found in China a few years before. For example, foreign companies are welcome in China until they start making money, then they find it hard to pull their money out.

Corporate America will re-focus on Japan. As an investment, Japan's macroeconomic conditions are presently a negative variable. Investors won't take a broader view of Japan until its GDP growth picks up. I am a medium term bull on Japan. Japan must take advantage of the Internet revolution, by encouraging businesses to relocate in the country's smaller towns, which may improve the standard of living of the employees. If Japan takes fuller advantage of the Internet, GDP growth could jump up to three or four percent.

Q: What industries would this APEC FTA cover?

I was surprised by Japan's decision to establish an FTA with Singapore because such an agreement would not be the strongest possible case—the potential gains are small. Sure, an FTA with Singapore would be easier in a technical sense, but I think something broader would be more convincing to the US.

For an APEC FTA, Australia and New Zealand would be easy; Singapore, Thailand, and the Philippines would be fine; Korea would have some problems; Japan would be a question mark; and Taiwan and China would decline.

If the arrangement develops into a real FTA, it would cover most trade, investment barriers, and non-tariff barriers. In this case, it would be like NAFTA and US industries would support it. If the Republicans are in control of the White House, at least labor won't be an issue.

Q: As Japan's population ages and draws from its savings, might Japan's higher interest rates become an issue in the US-Japan relationship? Will Japanese seniors spend enough of their savings to help consumer demand?

Japan's aging population will not have a direct effect on the external numbers. Actually, if Japan's higher interest rates end up appreciating the yen, it could help to reduce the US current account deficit. But I do not think that older people in Japan will be spending that much more, unless they become more comfortable with their asset foundations (and that doesn't look likely).

Q: Can you comment on the Quad Group's performance at the ASEAN meeting?

The Quad (US, EU, Japan, and Canada) was an abysmal failure at ASEAN. Unless we show leadership, we will give new life to the nonaligned movement. By providing preferential treatment to LDCs, we are decreasing the market incentives for those economies.

Q: Will Japan ever dollarize?

It is not something to worry about because MOF won't even consider it. To an extent, dollarization is a fad. In terms of monetary unions, I am not even sure if the euro is set yet. Fiscal policy works more slowly than monetary policy. Without monetary policy a country can be devastated during tough times.

Q: Will an APEC FTA cover textiles?

It must cover all trade, yes. The rules of origin, however, will become very complicated. Even between the US and Canada it is difficult to enforce these rules.

Q: When will the US modify its antidumping laws?

The US will only address its antidumping laws when the economy is booming and the Republicans control the White House and Congress. The other way would be for

enough pressure to mount from abroad against US A/D laws; but this is doubtful.

Q: Will the next US administration change its position on Japanese macroeconomic policy? Will the GOP have a different view on China?

To the first question, I would say that the new economic team under Bush would start with a clean slate. For the past few years, the American and Japanese economic players have had big egos and tended to talk at each other. In general, it is better for the US to encourage Japan to pursue certain goals like reviving domestic demand.

As for the second question, the Republican philosophy toward China will be different, more hard nosed. And Japan will play a larger role.

Q: You say that the yen will appreciate. But I am more worried about the yen depreciating as the economy continues to stall.

There will be an adjustment in the US stock market and the Fed will lower interest rates. Relatively speaking, Japan will become more attractive and money will leave the US for Japan, which will strengthen the yen.

Q: What will the international reaction be to the next financial crisis?

The problem with financial crises is that we never foresee the next big problem. We need a good prudential framework that goes hand-in-hand with liberalization. It is impossible to guess what the next crisis will be, but it will probably have something to do with the spillover effects of a sharp dollar decline.

-The RIETI editorial department is responsible for this article.