

“US-Japan Relations Under Bush”

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My motivation for speaking today is that for the past six months I have talked with many Japanese visitors in the US who were interested in the election. All of them were more excited about the prospect of George W. Bush winning because the GOP was expected to make Japan the center of its Asia policy, while the Democrats were expected to make China the focus. This analysis is much too simplistic and I would argue that there could be some problems for Japan under President Bush. Also please remember that while people think that the Armitage Report is evidence that the GOP tilts toward Japan, that report was bipartisan (Joe Nye and I were involved).

First, what matters most for US-Japan relations is the US economy. This concern is less Bush related. Recently, US growth has lowered unemployment, which has begun to push inflation up. The Fed responded by raising interest rates to slow growth deliberately and lower inflation. The tricky part is that we believe that we can fine tune monetary policy, but economics is not precise (it is a social science) and lags exist between information and reality and between change in interest rates and a corresponding change in the economy. These factors make it difficult to engineer a soft landing and a recession is possible. A US slowdown would be bad for Japan because Japan's growth last year was due to rising exports (which may cease if US demand falls). Moreover, if US unemployment grows, US-Japan trade could become an issue again.

My second concern, which is more Bush related, is that I find the Administration's economic policymakers disappointing. First, Larry Lindsey, a radical monetarist supply-sider, is Bush's chief economic advisor. Lindsey is nuts; for example, he would like to abolish the IMF. Lindsey is head of the National Economic Council, which may not exist much longer, so he may be pushed aside. Next, Bush has Paul O'Neill, a man who knows nothing about finance, as Secretary of Treasury. Yes, Mr. O'Neill served at OMB, but budgeting is much different from finance. You may argue that the secretary should be good at dealing with Congress because of his bureaucratic experience, but that means the number two should have technical expertise. Yet Bush is proposing Kenneth Dam, an arms negotiator, as deputy. Finally, Robert Zoellick is a bit better because he worked on international economics at State and Treasury, but he has no trade experience. He

has a simplistic free market ideology and will be aggressive in pressuring Japan to reform and deregulate.

As an economist, my third concern is that Bush's team has a strong tilt toward security policy. The security related positions were filled first, before economic positions. The Secretary of State, Colin Powell, and his deputy, Richard Armitage, are both from military backgrounds. The assistant secretary for Asia, James Kelly, is also a military person. So, many of the top to middle officials at the State Department are security experts, but the department's mission is to look at international issues more broadly (human rights, environment, women's issues, technology, etc.).

Fourth, and this has happened before, the strong personalities at the top (Rumsfeld and Powell) will create a struggle over foreign policy. It will take about a year to figure out who has the final word. Rice, Powell, and Rumsfeld are all Cold Warriors. These people are out of date and not creative for developing a post Cold War policy. One example is their proposed national missile defense. Most specialists think an NMD is a bad idea and will damage our relations with China and Russia. Moreover, an NMD would create a dilemma for Japan: Japan will be asked to support the project but in doing so it will hurt its relations with China. Another example is that if you look at the fine print in the Armitage Report, you will see a strong push to increase Japan's role in the US-Japan alliance. If there were a Gulf War II, this administration would want Japan to provide soldiers on the battlefield.

Finally, I would like to touch on trade policy, although this may be too early to predict. I am concerned that the Bush administration may not emphasize a new WTO round. I believe that the WTO round should be at the core of our trade policy. But there is not much enthusiasm for the new round in Washington. Starting a new round will require the Democrats and Republicans to reach a consensus on the terms of negotiations. The Democrats want labor and the environment addressed and there must be some kind of compromise on this issue, but I am not sure if it is possible. If Bush is not interested in the WTO, he may go for an FTAA. Bush is from Texas (on the border of Mexico) and he speaks Spanish. He will be more interested in an FTAA than the WTO or a US-Japan FTA.

I would like to say that for all the problems between the US and Japan, let's face it, we get along. The US and Japan are developed countries that have intellectual property and anti-trust laws. China is different. China will come into the WTO with enforcement problems, which may absorb Bush. But it won't be "Japan passing." On Asia, Zoellick will push for Japan to deregulate. Armitage, too, will want a healthy Japanese economy

and will therefore push for Japanese deregulation.

In conclusion, a new administration is a new start and can bring fresh policies. The US flip-flops between policies every four or eight years. There is considerable talk in Washington about what will change, but we will probably see that there will be not much change at all.

Question and Answer Session

Q: What is your advice to Japan based on your analysis of the Bush Administration?

Lincoln

Japan should say, "We have a deregulation and reform program" before the Bush people even ask for it. You should emphasize the WTO and play a bigger role in getting a new round started. If the US establishes an FTAA, Japan may think about agreements with Korea, Singapore, or even China, but it is hard to predict what the US response will be.

Q: Three questions. One: What will Bush's approach toward the international financial institutions be? Two: Will Mr. O'Neill change the strong dollar policy? Three: If Lindsey is a monetarist, will he talk about our fiscal policy?

Lincoln

If we are lucky, Lindsey will push for reform of the IMF rather than trying to abolish it. People have been talking about ways to reform the IMF for a while (just look at the Meltzer Report).

The US does not have an exchange rate policy. They say they have a "strong dollar policy" but it is not an operative policy. The monetary authorities only intervene when the exchange rate hits extremes. This policy has been consistent since Reagan.

Lindsey says there will be no *gaiatsu* from the US, but he asks Japan to eliminate its government deficit quickly, which would drive growth down. The US spoke up before because Japan is a friend and ally. Recently, even Larry Summers has been quiet.

Q: Can you comment on Andrew Card as White House Chief of Staff? How can the US survive with its huge current account deficit?

Lincoln

Dick Cheney is the real Chief of Staff. It is true that the US cannot have a current account of 3% of GDP forever. Maybe a fall in US growth will lower demand and help this problem. But as a political issue, the current account has not been a problem since the early 1990s because US economic growth has been strong and unemployment low. Economically, a trade or current account deficit can be sustained for a long time.

Q: Which sectors will be of interest to Bush? Is there any prospect of a new WTO round?

Lincoln

Bush and Cheney have strong links to the oil industry, which has global interests and will encourage the administration to go easy on trade disputes. Textiles is not a party issue: it is a regional issue. If you look at the Electoral College votes, you will see that the whole center is Republican; this is agriculture land. Grain is an open industry.

The GOP sees international organizations as potentially violating sovereignty. Larry Lindsey wants a stronger Bank for International Settlements and stronger rules, which is good. But he would like to have a strong BIS replace the IMF.

Q: The US should focus on investment and competition rules, not on labor and environment issues. The US stopped the last WTO round so it is your responsibility. The US lost WTO games because the US is protectionist. The US needs to restructure. Why do you still protect your steel sector?

Lincoln

Labor standards are a liberal issue; it is not about protectionism. Liberals are upset with the standards and working conditions at factories in some countries. So far these people have been successful in affecting US corporate policies. The environment is no less important than the other issues.

On the WTO, the US has won 17 cases and lost only three. The US lost the color film case with Japan. It could have been a landmark case.

There has been more structural reform in the US than in any other country in the world. Look at the shifts in employment. How can Japan complain about US steel without

bringing up agriculture? The beauty of the WTO is that while we all have political problems of protectionism at home, we can trade concessions at negotiations. If the US gave up antidumping and Japan gave up agriculture, it would be a good bargain for Japan. Let's keep working on the WTO and stop blaming each other.

Q: If Japan leans toward China, what will Bush do? What if Japan makes a regional agreement?

Lincoln

Bush may say OK to Japan leaning toward China because the administration does not want China to be a problem, or he could get irritated by Japan moving toward China. It will depend on the personalities in the US government. A Japan-China FTA, though, would certainly create a problem in Washington. On the other hand, I think Washington should be relatively tolerant of a somewhat broader ASEAN plus three FTA because the US has asked Japan to show leadership for many years. Leadership means doing something.

My personal reaction, however, is that it would be unfortunate if Japan shifted away from APEC (open regionalism), toward China or ASEAN plus three (closed regionalism). I like APEC because it is open on an MFN basis. I am against an FTAA too.

Q: The Armitage Report recommends a "dialogue" on investment and that businesses should be involved. What does this mean exactly?

Lincoln

The report left that point vague on purpose. We were simply proposing the principle. A dialogue must be action oriented. The business component must have ideas and proposals.

Q: Will there be a change in policy toward China? Will the US remain vague on Taiwan?

Lincoln

Only the rhetoric on China will change. The GOP will have to listen to businesses' concerns on China. The US should remain vague on Taiwan.

Q: I propose that Japan have a more transparent relationship with China.

Lincoln

Yes, there should not be any games. Otherwise you risk a new Cold War, which would be stupid. I have a high regard for James Kelly and Richard Armitage as voices of reason as both Japan and the United States sort out how to deal with China.

Q: What are Bush's views on APEC?

Lincoln

I have heard nothing from them on APEC.

Q: Singapore and South Korea came to Japan interested in FTAs.

Lincoln

The EU was formed for political reasons—to end armed conflict on the continent. A similar case could be made for a Japan-South Korea FTA. As I noted earlier, I do not favor FTAs, but I do find the possible strategic benefits of this one interesting.

Q: Regional blocs can soften external shocks.

Lincoln

Trade blocs should not limit international capital flows. And much of the capital flow in Asia comes from and goes to the US, which is outside of the region. Therefore, regional blocs may be irrelevant to the question of external shocks.

-The RIETI editorial department is responsible for this article.