

Article

US-JAPAN ECONOMIC RELATIONS

Kiyoshi ABE

1 INTRODUCTION

This short paper evaluates the recently concluded US-Japan Auto Accord in connection with the overall US-Japan trade imbalance. It tries to answer the following questions:

- (1) Why was the Clinton Administration's demand so escalated?
- (2) Does the auto accord help improve the US trade imbalance?
- (3) What are the fundamental reasons for the US trade imbalance?
- (4) Does the high yen help correct the Japanese trade imbalance?
- (5) A child binds a married couple together, and a person with a slight illness can take care of oneself and outlive. Do these old sayings apply here?
- (6) Will US-Japan economic relations deteriorate, improve, or remain the same?

2 NOMO MANIA

Nomo, a leading Los Angeles Dodgers (National League) pitcher, has brought Nomo mania to both sides of the Pacific. On the

US side, "No More NOMO" say non-Dodgers, while Dodgers say "More NOMO". Nomo has become not only an instant national hero in Japan, but also a goodwill ambassador to the US. Tens of thousands watch television. He is perhaps the most popular Japanese import since sushi. The 26-year-old tornado-like Japanese pitcher of the Dodgers is the brightest spot in recent US-Japan relations. With US-Japan economic relations sagging over a series of trade disputes, one commentator said Nomo is worth 100 diplomats. The brightness of NOMO Mania reflects how dark the politico-economic relations have become between the US and Japan.

3 US-JAPAN AUTO-TRADE ACCORD (June 1995)

Both the US and Japan finally reached a conclusion of the auto and auto parts trade talks on June 28, 1995 in Geneva, although the long negotiation often tended to be deadlocked. The conclusion happened just hours before the US deadline for imposing sanctions on 13 models of Japanese luxury cars. A head-on collision was thus averted at the last moment.

The no-more-NOMO-type attitude was shown by the US Trade Representative Mickey Kantor who defended the decision to impose punitive tariffs on 5.9 billion dollars worth of Japanese luxury cars. He and other Congressmen were tied up with the Big Three, representing their Midwest voters. Behind them was of course President Clinton who wants to be reelected in fall 1996 by gaining support of Midwest auto makers. This has escalated their unilateral demand.

There were some, however, who were rather the More-Nomo-

type or at least did not belong to the no-more-NOMO type. Political leaders such as Democratic Senator Bill Bradley of New Jersey and former trade representative Carla Hills warned that the US could get hurt by playing tough with Japan. Bradley said that a trade war with Japan would be a "gigantic gift" to the Germans, Swedes and English who would sell more of their luxury cars in the US, while US middle-class workers and dealerships handling the Japanese luxury cars would lose more of their valuable jobs.

4 EVALUATIONS OF THE ACCORD

Both the US and Japan made major sacrifices for paltry gains in the deal. The deal itself was a political compromise smacking of "managed trade" and lacking economic logic. The overall effect on the US-Japan trade imbalance is expected to be negligible.

First let us look at some gains. The agreement bailed out the Clinton administration, which would otherwise have been accused of pursuing a trade policy that distorted the market. That accord also helped both Japanese auto makers and US car dealers avoid serious losses.

Second let us look at problems. The first problem concerns disunity in interpretation of the auto accord. Japan's International Trade and Industry Minister Ryutaro Hashimoto insisted that the accord included no numerical target. But this did not stop US "estimates" from popping up. According to the US government, the estimates cover purchase of auto parts worth as much as \$12.75 billion by Japanese auto makers and increase the handling of US cars

to 1000. The agreement according to the US side is numerically verifiable (“managed trade”).

Many European and Asian countries were supportive of Japanese efforts to oppose the unilateral US imposition of managed trade. A majority of economists in Tokyo as well as many US economists sided with Tokyo. Japan and the US will not enjoy mature relations, until they join hands to lead the WTO to success.

The second problem was that Tokyo ended up placing auto makers’ “voluntary” business plans on the negotiating table, having long insisted that the private sector’s doings were beyond the government’s ambit. (In March 1994, Japanese auto makers made voluntary plans to purchase US-made auto parts. The US agreed that these plans were part of private corporate activity and outside the government’s responsibility. The US later became dissatisfied with the March 1994 plan and demanded that the Japanese government force private auto companies to revise their purchase plans upward. This smacks of managed trade and violates rules of free trade specified in the WTO.)

The third problem concerns the WTO. Trade disputes are often rooted in narrow national interests and fly in the face of global economic trends. The agreement is out of whack with the WTO and a disappointment in terms of WTO’s goal of promoting multilateral free trade. An emboldened US administration might disregard the WTO again and resort to similar arm-twisting to settle trade disputes with Asian countries. Bradley cautioned that the US confrontation with Japan could be detrimental to the WTO. If the WTO ruled against the US, there would be pressure from the Congress to

withdraw from the WTO. This, Bradley continued, would further jeopardize the position of the US as the leader for a multinational trading system. The WTO proved to be unable to prevent Washington from using the threat of unilateral sanctions.

5 LESSONS OF THE ACCORD

There are at least two lessons to be learned from the accord. One lesson is for the US: The US must stop catering to special-interest groups. In order to improve the current account imbalance, the US should promote higher savings and correct overconsumption habits. Politicians should be more aware of this economic logic. US companies need to step up efforts to penetrate the highly competitive Japanese market. US corporate efforts to penetrate Japanese auto markets are still behind European corporate efforts. Of the Japanese car market, the compact car segment constitutes 80%. About 80% of the Japanese passenger car market has engine displacement under 2000cc. The Big Three does not have any of their models in this segment. They cannot force Japanese buyers to buy their large cars. It's up to consumers. European auto makers have invested in PDI (Pre-Delivery Inspection), auto parts and training facilities since early 1980s. Among the Big Three, only Ford has invested in an auto parts center and training facility, the other two consigning the business to Japanese companies. The procurement of US-made parts by Japanese auto makers has been increasing. It went up six fold from 1986 (US\$2.5 million) to 1993 (US\$15.5 billion).

Table 1 compares US Big Three in Japan and European Auto

TABLE 1 Corporate Efforts to Penetrate Japanese Market: US. Big Three vs. European Manufacturers

	U.S. Big 3	European Mfrs. (17 companies)
Number of Compact Car Models (Engine Size below 2 liters) Note: This compact car segment constitutes 80% of the Japanese market.	0	124
Number of Right-Hand Drive Models Note: This right-hand drive segment constitutes 90% of the Japanese market.	2	100 + α
Number of Pre-Delivery Inspection Centers	0	4

Source: JETRO, *Facts and Figures of the Japanese Market for Imported Autos and Auto Parts*, May 1995

Makers in Japan in terms of the number of compact car models, the number of right-hand drive models, and the number of pre-delivery inspection centers. It is self-evident that US corporate efforts to penetrate the highly competitive Japanese auto market still lag behind the corresponding European efforts. Japanese roads and regulations are different. Foreign car makers need to make appropriate adjustments.

The other lesson is for Japan: Japan needs also sweeping economic reforms to disarm criticism that its markets are closed. It should further scrap unnecessary regulations and reform administra-

tive procedures. The Maekawa report, which recommends sweeping deregulation and structural reforms, remains largely unimplemented. So are the SII agreements for both countries. Japan needs to implement it soon. Japan also has to suspend administrative guidance, the informal method the government uses to steer the private sector. Japan should set itself a specific goal for pruning the surplus and use macroeconomics policy to boost domestic demand.

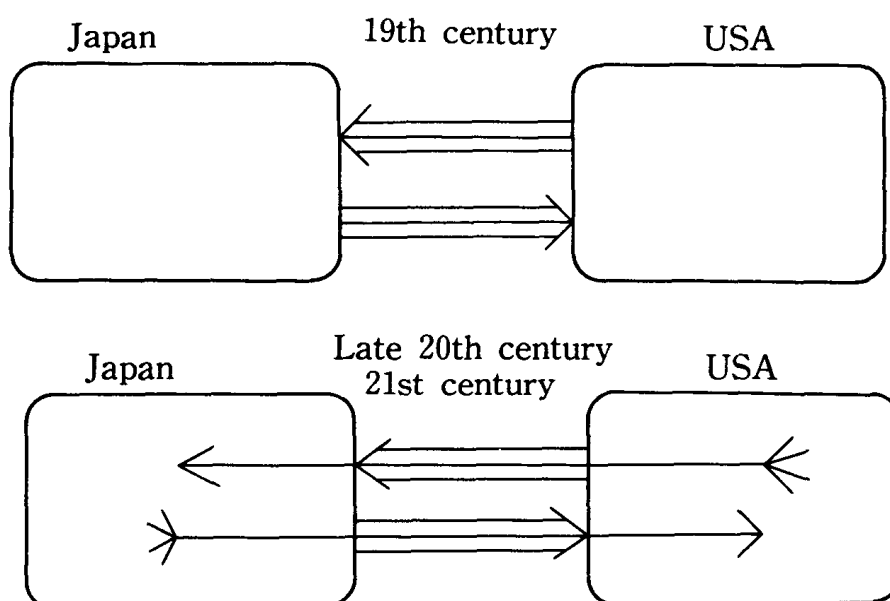
On July 18, 1995, a white paper on deregulation was approved by Japan's Cabinet, the first attempt to explain the government's deregulatory measures. The paper's content, however, true to bureaucratic practice, leaves something to be desired in the area of transparency, although greater transparency should be an integral part of deregulation. Deregulations are being done very slowly, because they are left in the hand of authorities concerned. Government licenses number 10,945 as the end of March 1994, 457 fewer than a year earlier. Of licenses required, 70% are based on laws and just over 20% on ministry ordinances. Government offices in Japan find it distasteful to revise or abolish them, as they want to guard their vested interests.

Both the US and Japan must approach and yield to each other in order to mitigate the bilateral trade imbalance.

6 RELATIONS BETWEEN COUNTRIES

Relations between countries have been changing over time. In the 19th century, national borders were important. Three line arrows between borders in Diagram 1 depict official relations

Diagram 1 Increasing Intertwinement: 19th and the 20th century pattern



between governments. Official relations took precedence over unofficial ones. It sometimes is said in Japan that high technology belongs to the 20th century, economics to the 19th century and politics to the 18th century. Old-fashioned politicians still depend on the government to push their demands. This may be true of some extreme US politicians.

In the late 20th century, however, relations are different. National borders have lost importance especially in the post-cold-war period. Economic relations between Japan and the US are deeper and more widespread. More and more goods, services, and capitals are traded. Japanese and US companies are increasingly intertwined. In a borderless age of economic globalization, the official relationships between two national borders (three-line arrows between borders) are less important than they were in the last century. Private sectors gain in importance. Nationality con-

tinues to lose importance. Companies in different countries are subject to the same market forces wherever they may be on earth.

Various industries, companies, or individuals of one country are increasingly involved in their counterparts of another country. What is good for one tends to be good for the other. This is true of US-Japan economic relations. The more intertwined the two economies are, the more common interests they share. The larger the perceived common area of business interest, the more likely will Washington have to give up imposing unreasonable unilateral demands on Japan. Political interest groups behind Congressmen might recede in influence. This may sound optimistic but we need to keep in mind that closer relations accompany more responsible action on both sides. The need is especially important to policy makers.

It is noteworthy that only Washington and Midwest auto industries were against Japan in the auto dispute; other cities and states remained critical of or indifferent to the anti-Japanese mood of Washington. These less hostile attitudes will likely spread. The US congressmen representing certain interest groups have been supporting unilateral demands, but will probably find it more difficult in the future to make such demands, due to the increasing need to assume a more responsible attitude in the world. Policy makers should not forget the fact that, behind the political disputes, increasing economic intertwinement is taking place. Unreasonable political demands cannot persist long. Economic logic will prevail. Binding forces will come to the fore and stay in the front regardless of political pressures, as shown by the recent auto accord. Economics and politics must keep balance. According to the *ECONOMIST*,

June 24, 1995 (p. 25), stability of US-Japan relations depends on a careful balance between economics, politics and security (President Bill Clinton's three-legged stool).

ECONOMIST, June 24, 1995 (p. 25) shows a cartoon with one armored swordsman driving a US car facing and approaching the other armored swordsman driving a Japanese car. The economic war appears threatening. Spectators look on with their mouths wide open. The reporter refers to the "good news" that both sides (the US and Japan) are closer to each other than they have ever been. A tense atmosphere prevails. Both threaten to attack each other with pointed national spears. Nobody knows what will happen thereafter. The cartoon shows on the one hand the bad news that danger is imminent, but on the other hand the good news that both are "closer" than they have ever been. The increasing closeness brings about this kind of skirmish or even an economic "war". Closeness (good news) coexists with conflicts (bad news). According to The ECONOMIST article, some in the US argue that a bit of wobbling would not be a bad thing.

A child binds a married couple together. A slight illness can help one stay healthy and eventually live a full life, for such a person takes good care of oneself. US-Japan skirmishes may be like the child or the slight illness, helping to strengthen mutual ties eventually. A disengagement or breakdown of the US-Japan relations is least imaginable, however tense the political atmosphere might become, due to the solid economic background and the increasing intertwinement. Both have been making enormous cross-investment and are committed to operate overseas transplants successfully.

According to a Mainichi Newspaper/George Washington University survey of US Congressmen in 1991, 87% of the respondents agreed with the statement that the maintenance of friendly US-Japan relations is very important and 58% of them agree with the statement that US-Japan friendship will overcome all our problems. The Mainichi Daily News editorial of November 25, 1991 concludes that many of the criticisms voiced such as “unfair Japan” and “deceitful Japan” come from misunderstanding or prejudice. It should be noted that such attitudes are not strong among postwar US congressmen and those hailing from the US West Coast. The survey is dated but still remains valid.

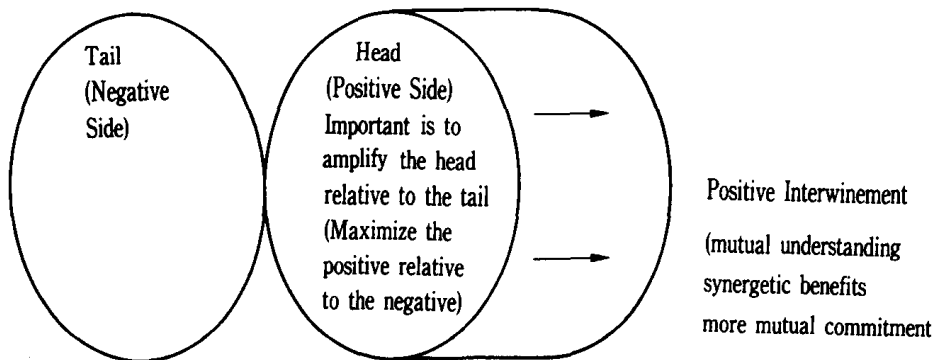
Dr. T.J.Pempel of Cornell University four years ago said, “I guess I am reasonably positive on the long-term (US-Japan) relationship, but this will not be without its difficulties. The biggest saving factor in the relationship is the tremendous amount of cross-investment beginning to develop between companies in both nations. It is going to become harder and harder to disengage single products. As this occurs, there is going to be more economic pressure from companies that are truly integrated to encourage politicians to stay out of disputes. And I think that Japan will continue to liberalize too, which will make things a lot easier.” (Mainichi Daily News, October 20, 1991). His statement in 1991 is relevant and increasingly so. It has become even harder to disengage single products, for example, autos and auto parts.

7 TWO SIDES OF THE COIN

A good Japanese car pleases US consumers but displeases US auto makers. The same is true of a good US car in Japan. US-Japan auto trade has both positive sides and negative sides. The positive sides are for example satisfaction of US consumers, satisfaction of producer needs, employment of US workers, and revitalization of US local economy. The negative sides are trade conflicts, adversely affected US industries, investment friction, xenophobia, misunderstanding, lack of communication and the like. Japanese direct investment in the US has both positive aspects and negative aspects.

It is important is to maximize the positive relative to the negative. In other words, accentuate the positive (More Nomo-type) and eliminate the negative (No more NOMO type) . Successful US-Japan deals of any kind run more or less in this line. One cannot focus only on one side. Both sides belong to the same coin. Both aspects accompany more or less any bilateral economic interrelationship.

Diagram 2 Positive and Negative Aspects of the Two Sides of the Coin (US-Japan Relations)



A person with a slight illness takes good care of oneself and can stay healthy.

8 THE US-JAPAN TRADE IMBALANCE

Trade conflicts arise from a current-account imbalance between the US and Japan. A current account according to macroeconomics is the difference between what a country consumes and what it produces. When a country consumes more than it produces, the excess consumption must come from abroad in the form of imports. The current-account imbalance is thus linked with saving and investment.

Saving and investing are done by three sectors of the economy: the household sector, the corporate sector, and the government sector. Each sector both invests and saves (or dissaves—that is, consumes more than its income). The excess of investment over savings and the excess of government expenditures over taxation equals the current account deficit. The excess of savings over investment and the excess of taxation over government expenditure equals the current account surplus.

Low-saving countries (e.g. US) tend to run a current account deficit, although high-saving countries (e.g. Japan) tend to run a current account surplus. A current account deficit country has an excess of M (imports) over X (exports), which is equal to the excess of I (investment) over S (savings) and the excess of G (government expenditures) over T (taxation). Therefore the following important equation holds:

$$\text{Deficit country's current account: } M - X = I - S + G - T > 0$$

In order to have the deficit corrected, M , I , and G must be decreased, while X , S , and T must be increased. This is simple but

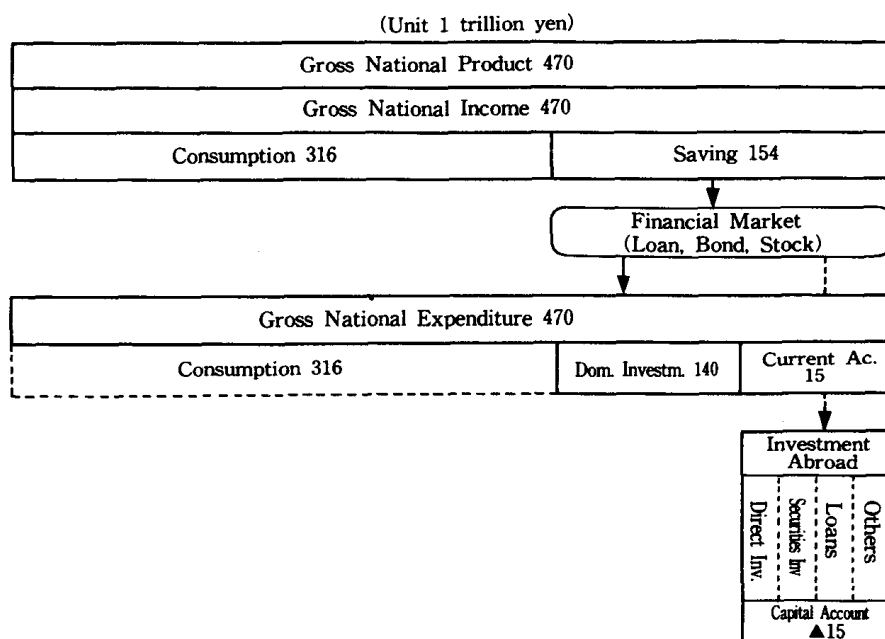
quite important. Overspending by business, consumers and governments must be corrected, so that less imports may result. Domestic savings by individuals must be increased. Tax revenues must be increased. On the right-hand side, efforts must be made to enhance export competitiveness as well as to discourage imports. For a current-account surplus country the following holds:

$$\text{Surplus country's current account: } X - M = S - I + T - G > 0$$

S and T here mean private and government saving, respectively, so that both can be regrouped as total savings. I and G mean private and government investment, respectively, and both together can mean total investment. Thus redefined, the current account surplus is equal to the excess of total saving over total domestic investment.

Diagram 3 shows how Japan's GNP is disposed of in 1993. Total

Diagram 3 Investment, Saving and Current Account of Japan 1993

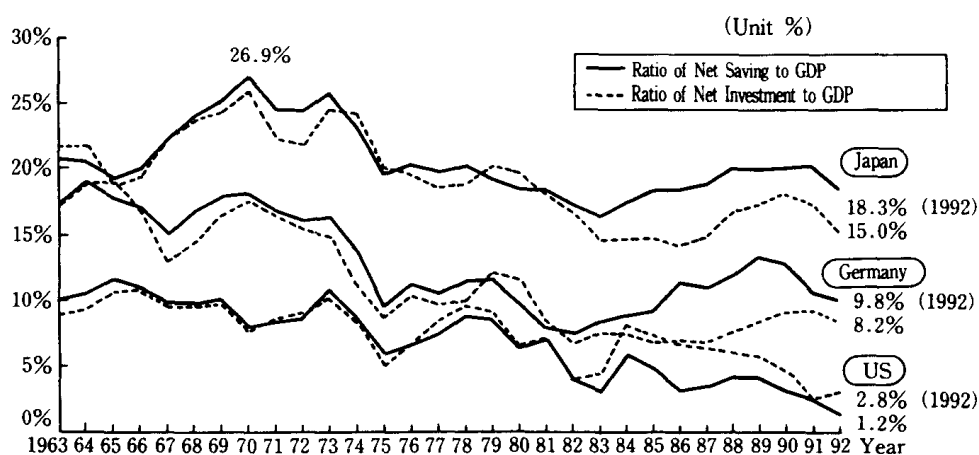


Source: EPA, National Economic Accounts Yearbook: MITI Trade Report (White Book on International Trade), May 1995

saving amounts to 154 trillion yen but total domestic investment only to 140 trillion yen. The gap 15 trillion yen (=154-140) is equal to the current account surplus, which is used for direct investment abroad, securities investment abroad, loans and so on. What comes into Japan in the current account goes out in the capital account. The net capital account is in the red with 15 trillion yen roughly matching the current account surplus.

Diagram 4 demonstrates how low the US saving and investment ratios are compared with Japan's and Germany's corresponding ratios and how divergent in each country the saving ratios and the investment ratios have been since early 1980. Until then both ratios had been showing similar movement in each country. By the early 1980s, capital liberalization was completed in industrial countries, enabling the US to borrow from abroad (e.g. Japan) easily to finance its current account deficit and fiscal deficit. The US has thus

Diagram 4 Saving and Investment Ratios of Japan, Germany, and the US



Source: OECD, National Accounts; MITI Trade Report (White Book on International Trade), May 1995

been able to spend more than its income, invest more than it saves through borrowing (selling bonds or increasing debts). Japan and Germany, in turn, have been recycling their current account surplus through financial market (e.g. purchase of US Treasury bonds). The US current-account deficit matches its capital-account surplus, while the Japanese current account surplus matches its capital account deficit.

The household saving ratio of the US (4.1%, 1993) is much lower than that of Japan (14.3%, 1993) and similar differences exist in the savings as a percentage of GDP. Japanese household savings as a percentage of income remained on average about 15% from 1983 to 1993, especially high as compared with other countries' ratios. The low saving rate of the US is one of the reasons for the US current account deficit and relatively low manufacturing activity inside the US. The US-Japan gap is clear, despite some differences in accounting conventions and conceptual inadequacies (Bergsten and Noland, pp. 36-38).

Both the US and Japan today incur deficits in government budget. Japan used to suffer from large deficits up until 1985, some gradual improvement being noticeable thereafter. The US federal deficit is more serious and much larger than the Japanese. The budget deficit and the current account deficit belong to what is called the "twin deficits of the US". The present budget situation in the US is not promising. The US federal debt is now close to \$5 trillion as of June 1995. It has risen by \$259 billion since the fiscal year began October 1, 1994. The debt was \$910 billion in 1980 and has since then kept on rising steadily.

By contrast, the Japanese budget went into the black in fiscal 1994. The general account racked up a surplus of 606 billion yen (\$7 billion) in fiscal 1994 ending March 31, 1995, reversing two years of deficit. (Japan's fiscal bill of health, however, remains shaky since the amount of deficit-covering bonds issued during the year surpassed the amount of the surplus.)

The US-Japan trade imbalance is structural and cannot be remedied overnight. The effect of the high yen on the export reduction is nowadays almost negligible for structural reasons. According to an analysis of Solomon Brother Tokyo Branch, the elasticity of the export volume reduction to the yen (% reduction in export volume over % rise in yen exchange rate to the US dollar) is almost zero in recent years. The elasticity was about 0.2 from 1990 to 1992, but has started declining since early 1993. It now stands at 0.02, almost zero. This is due to buoyant overseas demands for Japanese goods and service as well as the so called J-curve effect of foreign direct investment. Some Japanese goods find no competing or substitute goods abroad and still enjoy comparative advantage internationally. As the higher yen pushes more and more Japanese companies to move abroad, the exports of plant equipment and components accompany them, regardless of or despite the rising yen. And this applies typically to intercompany trade.

Intercompany trade (trade between same companies across borders) constitutes a major part of the bilateral imbalance. Japanese direct investment abroad tends to increase, rather than decrease, initially, due to the so-called J-curve effect of foreign direct investment. Japanese transplants initially require imports of

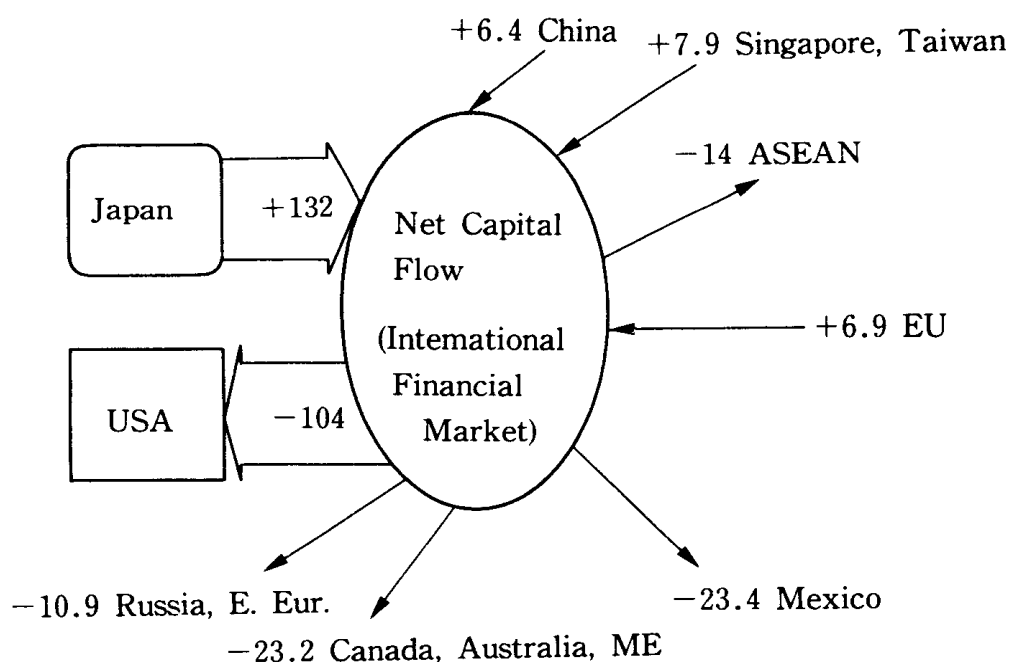
necessary machines and other materials from Japan. According to a research of the Long-Term Credit Bank, Tokyo, about 75% of US exports to Japan are done by intercompany exports, while about 84% of US imports from Japan are by intercompany imports. Of the US intercompany exports from Japan, 18.3% is by US MNCs (multinational companies) and 56.6% by Japanese MNCs. Of the US intercompany imports from Japan, 8.6% is by US MNCs and 75.5% by Japanese MNCs. The trade between Japanese multinational companies across the Pacific far exceeds the trade between US multinational companies. No wonder, the high yen does not affect Japanese exports during these years.

9 JAPANESE OVERSAVINGS MATCHING US OVERCONSUMPTION

Diagram 5 shows net flow of capital (+net lender, -net borrower) of major countries in 1993. Japan is the biggest lender with a net capital outflow (+\$132 billion), while the US the biggest borrower with a net capital inflow (-\$104 billion). Evidently, the majority of Japan's capital flows into the US market.

Japan saves more than it invests and exports that excess in the form of capital. The US invests more than it saves and imports capital (savings) from abroad to make up the shortfall. The US keeps its interest rates higher than do the Japanese to attract capital from abroad. The capital flows from Japan to the US, which needs capital to make up the deficit, current-account or budget deficit. The US demand exceeds its domestic supply, the gap being filled up

Diagram 5 Flow of Capital among Major Countries (Unit billion dollars)



Source: IMF, BOP; MITI, Trade Report 1995

with imports or import supply. The import bills are paid by the money recycled from Japan. Japanese oversaving (underconsumption) matches US overconsumption (or undersaving). Both are linked financially. The US economy consumes Japan's savings.

The US must keep its bond market attractive. What happens if the US bond markets fail to attract foreign, especially Japanese, investors? Such fear is also expressed by Jeffrey A. Frankel who says "What happens when the foreign central banks grow weary of increasing their dollar holdings? If foreign private investors do not renew their interest in dollar investing, the currency will have to depreciate further" (FOREIGN AFFAIRS, July/August 1995, p. 15).

The Bank of Japan uses Japan's surplus dollars to buy US

treasury bonds to make up for the US fiscal deficit. The capital flows unnoticed by ordinary US citizens who are indifferent to the fiscal debt or the weaker dollar. The US is now the world's largest debtor nation, though Japan the world's largest creditor nation. The US fiscal deficit shows no sign of decreasing, but cannot go on increasing indefinitely.

One cause of the huge federal debt is federal programs. It is not possible to keep wasteful and redundant federal programs running in the US. Endless articles and speeches are made in the US about the need to shrink the government, but there seems to be no improvement. Narrow political interests take precedence. Vested interests dominate. At the present rate, US insolvency may crop up sooner or later. It is impossible to keep on borrowing indefinitely. Fiscal discipline is definitely needed.

So far, Japan has been providing the US with needed capital. It is actually individual investors (especially institutional investors such as life insurance companies) that purchase US government bonds. Here is a stern warning. What would happen if the US bond market loses attractiveness? The Japanese government cannot force private institutional investors to buy US treasury bonds. Buyers are private investors, not government officials.

We are tempted here to crack a joke or outline a provocative scenario. How about integrating US and Japan? Why not incorporate Japan into the US as its 51st state? Why not integrate the US as the 48th prefecture of Japan? Then all trade conflicts would disappear. The exchange risk would disappear. The US trade imbalance and the Japanese surplus would disappear. The US federal budget deficit

would disappear. It is difficult to change the structural mutual involvement. Financially speaking, both are de facto integrated or at least intertwined structurally. Both have passed a point of no return. The joke or the provocative scenario might sound a bit preposterous but has some economic reasoning and some attractiveness.

10 CONCLUSION

The US-Japan auto and auto parts dispute lasted quite a long time. Clinton administration's political interests were behind the unreasonable unilateral excessive demand against Japan. The auto accord concluded in June 1995 will contribute little to improve the US trade imbalance.

Fundamental reasons for the US trade imbalance lie in overconsumption, dependence on import supply, low saving rate, lack of fiscal discipline, precedence of short-sighted political interests, disregard of economic intertwinement and the like. Unless drastic sustained efforts are devoted, the US will remain the world's largest debtor country.

Japan also needs more sustained efforts to improve the high yen. The effect of the high yen is indeed noticeable in the steady rise of product imports and Japanese tourists abroad, but the high yen does not help correct the Japanese export surplus and trade imbalance very much. This is due to buoyant overseas demand for Japanese high-tech goods, huge intercompany trades, the J-curve effect of direct investment, still existing regulations, administrative guidance and governmental protection of industries. Among intercompany

trades, the trade between Japanese MNCs across the Pacific far exceeds the trade between US MNCs, decreasing the effect of the higher yen on the trade account.

Interesting in the auto accord was the fact that only Washington and Midwest auto industries were adamantly against Japanese assertions, other cities and states remaining indifferent or sympathetic with Japan. This kind of split has been in existence for more than a decade and will continue more in the future, with unilateral demand from Washington gaining less and less support and reasonable solutions based on WTO principles gaining more and more support. This is necessitated by increasing economic intertwinement and globalization.

A husband and wife are often different in character, but they do not necessarily find it easy to separate. This applies especially to a mature couple. A mature married couple can become more intimate and their relationship stronger after the happy solution of each skirmish or disengagement. Likewise, the US and Japan, though different in some aspects, do not find it easy to disentangle. Skirmishes do happen between Tokyo and Washington, but often result in opening the way for further talks. As an article in the *ECONOMIST* says, "a bit of wobbling will be no bad thing". Persons with slight illnesses who take good care of themselves can continue to live a full and productive life. As a child binds a married couple together, so can a skirmish bind the two countries together.

There are two sides to every coin. Important is to maximize the positive side relative to the negative side. Various actors of both countries are increasingly involved in the affairs of one another,

irrespective of occasional skirmishes. More kitchen talk goes on. Both have passed the point of no return. Increasing cross-investment makes it hard to disengage. Cautious optimism therefore stays in future US-Japan relations.

The US and Japan have been learning from past mistakes, disagreements, and misunderstandings. The mutual involvement of both economies has been, and will be, in progress, enlarging common ground. Both Japan and the US stand on such a solid basis of intertwinement. Political leaders should be more aware of the economic intertwinement. Skirmishes will be in store in the near future, but the two economies will and must continue to live and learn together. Symbiosis must stay. Small quarrels on the surface therefore should not affect underlying good relations.

Both the US and Japan, however, need to make sustained efforts according to the SII agreement. The Maekawa report and the SII agreement are already dated but still remain very relevant; the proposals of both have not yet been put into practice. They are left as nothing but pie in the sky. Greater transparency should be an integral part of Japan's deregulation. Drastic structural reforms based on the Maekawa report and the SII agreement are called for. Deregulation, left in the hands of government officials, goes slowly in Japan. The US government must cope with the twin deficits (federal budget deficit and current-account deficit). To increase exports, US industries need to make more effort in Japan, just as Japanese companies are doing in the US. Sustained structural reforms are needed in the US.

Japan's surplus capital has been flowing into the US, making up

for the US deficits. What would happen if the US financial market lost attractiveness? What would happen if Japanese institutional investors fail to purchase US treasury bills and shift to EU bonds? Who can guarantee that such a shift will not happen? Such a risky possibility may occur in the future unless sustained efforts are made in each of the two countries. In both countries politicians are obsessed by short-term vested interests, but this must be changed, so that they can have a long-term and global perspective and consistent policy. Both the US and Japan must join hands to lead the WTO to success.

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