

## ECONOMIC COMMENTARY

by

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### The U.S. Trade Deficit with Japan

In recent months, so much mud has been slung on both sides of the Pacific Ocean that I would not be surprised to see a new set of islands popping up between Los Angeles and Tokyo. Somehow, the combination of the U.S. recession and election-year politics has produced a new torrent of Japan bashing. Judging from the recent protectionist rhetoric, we may be caught with mud on our hands just when we need to be grasping the opportunities arising from freer world trade.

Increasingly, Americans have become upset about the multi-billion dollar trade deficit with Japan. At times, "Buy American" slogans have degenerated into sentiment to "Buy Anything But Japanese." The Los Angeles County Transportation Commission recently decided to shred its contract to buy automated rail cars from Japan, and in the Midwest, picketers appeared at several Japanese-brand auto dealers. Fay Vincent, the commissioner of major league baseball, decided that Japanese investment in the Seattle Mariners was inappropriate.

#### Is a Bilateral Trade Imbalance Always a Problem?

Because the United States has had a trade deficit with Japan for the past 28 years, we may be tempted to conclude that the Japanese are engaged in unfair trade practices. Frequently, we hear, "They can sell to us, but we cannot sell to them." While our concern for free and fair trade should be paramount, we must not jump to the conclusion that our deficit with Japan implies unfair trading practices.

The U.S. trade deficit with Japan, in and of itself, tells us nothing about the openness of Japan's markets. Indeed, it's possible that a permanent trade deficit with Japan could be a sign of a perfectly healthy trading relationship—one that could last forever without causing problems.

How can this be the case? It's simple. Because there are countries in the world other than Japan, we can be net importers from Japan as long as we are net exporters to the rest of the world. The only requirement for a country is that its *overall* trade flows be balanced in the long run. *Bilateral* trade flows never have to meet this requirement.

We should focus on comparative advantage rather than the trade deficit. The comparative advantage premise states that a country should specialize in making the products for which it has a relative cost advantage. The country should export these products and import others.



#### Do Japan's Trade Patterns Make Economic Sense?

Japan has virtually no natural resources, but it has many people and much capital. So, according to the comparative advantage theory, Japan should export manufactured goods and import raw materials and energy. Consequently, Japan should tend to run perpetual trade surpluses with other developed countries, like the United States, and trade deficits with countries that are rich in raw materials, like Brazil. Indeed, this is what happens.

To require any country, including the United States, to maintain a perfect trade balance with every trading partner would be extremely costly and inefficient. Such a practice simply would not make good

economic sense. For example, I have a trade deficit with my barber. I get my haircuts from him, but he buys nothing from me. On the other hand, I have a trade surplus with my employer. I sell my services as an economist but, in return, buy nothing. Yet, I have balanced trade overall. The same principle applies in global trade, only the numbers are larger.

This is not to say that Japan has free and open markets. Japan does have formal trade barriers, such as tariffs and import quotas, as well as informal trade barriers, such as trade groups that prefer to deal with other Japanese companies. However, Japan may not be that unusual compared with other developed countries. Japan's average tariff on industrial products is 2.6 percent, compared with 3 percent in the United States and 2.9 percent in the European Community. Both Japan and the United States use nontariff barriers (NTBs), such as quotas, licenses and voluntary export restraints. The United States tends to protect manufacturers with NTBs more than Japan, while Japan tends to protect agriculture with NTBs more than the United States.

It has been said that "Free trade is the opposite of what two countries do to each other when they go to war." Similarly, protectionism designed to create balanced bilateral trade should be recognized for what it is—economic warfare that ultimately hurts both nations.

The United States needs to position itself in the global market to take advantage of the opportunities and challenges arising in the world today. This means promoting free and open markets at home and around the world; it does not mean making sure that U.S. imports from any one country exactly equal U.S. exports to that country.