Asian Studies Center

Backgrounder

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HOW TO NARROW THE TRADE GAP WITH JAPAN

INTRODUCTION

> Our opponents have adopted a tactic that puts us in a most embarrassing position. When we expound our doctrine, they accept it in the most respectful manner possible. When we attack their principles, they abandon them with the best grace in the world. They ask only that our doctrine, which they accept as true, be relegated to books, and that their principles, which they admit to be faulty, constitute the rule in the realm of practical affairs. Grant them the management of tariffs, and they will leave to you the domain of theory.
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> Frederic Bastiat (1801-1850)

Although more than a century has passed since Frederic Bastiat thus phrased the interventionists' refrain, little has changed. Free traders are still told that their principles are correct but that free trade, as a policy, is impractical and politically unattainable.

The political hysteria over trade with Japan is a modern-day example of Bastiat's observation. Free trade with Japan would be harmful to the U.S., the argument goes, as long as Japan maintains unfair barriers against U.S. goods and subsidizes its exporters. Yet the evidence demonstrates that free trade with Japan would be mutually beneficial and politically possible.

Protectionists in the United States are obsessed with the fact that the U.S. is running a deficit in its merchandise trade account, and they ignore the economic factors behind that deficit. Their greatest concern is directed toward Japan. In the period 1976-1983, the U.S. incurred a cumulative trade deficit with Japan of about $95 billion--primarily as a result of Japanese penetration into U.S. markets for textiles, television sets, automobiles, motorcycles, radios, photographic equipment, video tape recorders, watches, machine tools, and steel. The protectionist argument is that U.S. jobs are lost whenever a trade deficit is incurred--and so a trade imbalance is something the U.S. should attempt to avoid at almost any cost.

Japan has become an ideal whipping boy for the protectionists, because of the trade deficit and, perhaps more important, because it can be argued that U.S. firms have been victimized by what are alleged to be unfair trade practices. The protectionists argue that more open U.S. trade would hurt America, because U.S.-Japanese trade policies are asymmetric. U.S. markets are open to the Japanese, they claim, while Japan's markets are closed to the U.S.

The protectionist argument is buttressed by the following complaints:

- o Japanese product design standards and their administration are intended to restrict the entry of U.S. products into the Japanese markets.
- o Japanese importers must cut through unnecessary red tape to obtain permission to import U.S. products.
- o Tariffs--particularly on finished lumber, tobacco, paper, computer parts, chocolate, and leather--inhibit U.S.exports to Japan.
- o Import quotas and their administration restrict U.S. exports to Japan.
- o Direct foreign investment in Japan is difficult because Japan's policies are not clear and foreign investors are not accorded the same treatment as Japanese nationals.
- o Japanese capital markets are restricted and heavily administered by the state.
- o Targeted industries--particularly beef and citrus--are shielded from outside competition by Japan.
- o Other targeted industries are awarded special favors by Japan, and this gives them an unfair advantage in penetrating the U.S. market.

Given this laundry list of complaints, the U.S. has reacted with relatively mild--but potentially destructive--protectionist measures. "Voluntary" quotas for automotive vehicles have been set, and restrictions have been placed on some types of steel, motorcycles, and other products. But to its great credit, the Reagan Administration has resisted other proposals for protectionist policies that would restrict Japan's ability to trade with the U.S.

Yet time is running out for President Reagan and his strategy to maintain free trade with Japan. If the Reagan Administration wants to hold back protectionist sentiment in the U.S., the President can no longer afford to just list America's grievances with Japan and request the Japanese to rescind their protectionist policies. The White House must drop the "we are right and you are wrong" approach to trade relations with Japan. At best, this approach can yield nothing more than minor concessions by the Japanese and more protectionist measures by the U.S. The President instead must unilaterally offer the Japanese a policy that they cannot refuse, which will nonetheless benefit the U.S. By announcing that he will press Congress to eliminate export controls on two American products the Japanese desperately want--timber and Alaskan oil--President Reagan could break the trade policy deadlock, improve the trade balance, and open the door to a real trade détente with Japan.

A STRATEGY FOR FREER TRADE WITH JAPAN

Such a strategy is based on recognizing that Japan's economy depends on imports of raw materials. For example, the Japanese typically experience a trade deficit in all major categories of primary products. They process these raw material imports into manufactured goods for domestic consumption and for export. Exports of these finished products constitute a large part of Japanese trade, and the Japanese incur a trade surplus in all major categories of such manufacturered goods. In short, the Japanese economy has evolved into an efficient system of importing raw materials and exporting finished goods. This is how the economy accommodates its comparative advantage.

Even though there is merit in the argument that the Japanese markets are closed to the U.S., while the U.S. markets are open to the Japanese, this argument does not present the entire picture. Not revealed is that U.S. law forbids the shipment to Japan of certain raw materials--imports that the Japanese desire and would welcome. While Japanese laws, regulations, and customs restrict the entry of some U.S. goods to Japan, the major restrictions on U.S. exports to Japan are the result of U.S. laws that prohibit U.S. individuals and firms from exporting certain raw materials to Japan. Specifically, oil produced in Alaska is, in effect, totally restricted, and logs cut on federal lands are also banned from export to Japan.

The Reagan Administration should propose legislation that would lift the restrictions on Alaskan oil and federal log exports. The President's proposals should be made unilaterally, with no conditions attached. This action could have far-reaching effects. It would be an important U.S. gesture toward the goal of free trade--and one bringing tangible benefits to the U.S. in terms of jobs and new exports. As such, it would put additional and much-needed pressure on the Japanese government to relax the artificial trade barriers that burden the citizens of both nations.

ALASKAN OIL

In January 1968, significant reserves of oil and gas were discovered at Prudhoe Bay on Alaska's North Slope (ANS). Following the ANS discoveries, there was much congressional testimony and debate about alternative plans for transporting oil and gas to market. Finally, in 1973, the Trans-Alaska Pipeline Authorization Act was passed. This allowed for the construction of a pipeline across federally owned lands from the ANS to southern Alaska--where crude oil would be loaded on tankers at the port of Valdez and shipped to market. This Act included the requirement that any exports to noncontiguous countries, such as Japan, must first receive presidential approval.

The Trans-Alaska Pipeline Authorization Act established two criteria for determining whether exports would be allowed: (1) the President must conclude that exports "would not diminish the total quantity or quality of petroleum refined within, stored within, or legally committed to be transported to and sold within the United States," and (2) if the President makes such a determination, then he is required to report his findings to Congress, which can then overturn the Presidential initiative by passing a joint resolution within 60 days.

The 1977 and 1979 amendments to the Export Administration Act (EAA) placed additional restrictions on the export of oil to noncontiguous nations. For example, the 1979 amendments require that any Presidential proposal to export oil be confirmed by both Houses of Congress.

The tight restrictions contained in the Trans-Alaska Pipeline Authorization Act and the Export Administration Act make it virtually impossible to export oil from Alaska to noncontiguous nations. Japan is hit particularly hard by this restriction, since it imports almost all of its oil. Alaska would, under free trade conditions, be Japan's least-cost supplier.

The Political Economy of Alaskan Oil

To appreciate why the U.S. has restricted the export of Alaskan oil, it is necessary to recognize the various special interest groups advocating restrictions and to understand how they claim they would benefit from such interventionist policies.

Maritime Lobby: The maritime industry (that is, the seamen's unions and domestic shipbuilders) bases its interest in supporting restrictions on the export of Alaskan oil on the Merchant Marine Act of 1920, commonly known as the Jones Act. The Jones Act mandates that waterborne commerce between U.S. ports be carried in U.S. built, owned, registered, and manned ships. When the maritime industry can successfully obtain such legislation limiting the export of U.S. goods, it can--to the extent that these goods would then be traded in the U.S. and transported by water--artificially increase the demand for U.S. seamen and ships.

The maritime industry's actions to support restrictions on the export of Alaskan oil have paid large dividends. Currently, more than 90 percent of the U.S. flagship capacity, measured in deadweight tons, is committed to carrying oil from Alaska to U.S. ports.

Environmentalists: The environmentalists have joined the maritime industry lobbyists because they generally adopt a "Mother Hubbard" view of natural resources. As they see it, there is a fixed quantity of various natural resources, and the nation's standard of living will decline rapidly as each natural resource "cupboard" becomes bare. Given this view, the environmentalists quite understandably support legislation that restricts the development and use of natural resources--since restrictions put off the day of reckoning. The environmentalists have supported restrictions on the export of Alaskan oil because they believe that, although export controls do not stop the development and use of Alaska's oil reserves, they at least slow down the process.

Consumerists: Consumer groups' support for export restrictions on Alaskan oil derives from their belief that, by keeping oil in the U.S. market, domestic oil prices are lower than if exports were allowed.

National Security: Advocates of strong national security also support oil export restrictions. In their narrow view, a ban is justified because a self-sufficient oil supply will guarantee U.S. immunity from the supply disruptions caused by foreign wars and embargoes.

The Flaws in Special Interest Pleading

The arguments favoring Alaskan oil export restrictions, while plausible rhetorically, are flawed in practice. The maritime industry's pleadings, in particular, constitute no more than a special interest group arguing for a government bail-out.

It is true that the restrictions on exporting Alaskan oil have benefited maritime interests. But the costs imposed on other industries and citizens are large, and they outweigh the gains to the maritime industry. The owners of Alaskan oil bear a major portion of these costs, since the market value of Alaska's oil assets is reduced because producers are required to transport their products in high-cost U.S. tankers to uneconomic destinations in the U.S. With the market price of oil a given, higher transportation costs mean lower net receipts at the wellhead and a lower value on Alaskan oil. The burden of lost value on Alaskan oil producers is considerable. Transportation charges are $.90 per barrel higher, if Alaskan oil is shipped to the West Coast of the U.S. rather than Japan, and $3.70 per barrel higher if the oil is shipped to the Gulf Coast.

By reducing the wellhead price for Alaskan oil, export restrictions mean that the incentives to explore for and develop more Alaskan reserves are reduced. Also less oil enters the world oil market, and less competitive pressure is put on the Organization of Petroleum Exporting Countries (OPEC). Consequently, restrictions on the export of Alaskan oil strengthen OPEC's hand.

Pure economic waste also results from the inefficient distribution of Alaskan oil, and becomes another cost of restrictions on its export to Japan. This waste is equal to the delivered price at U.S. ports of Alaskan oil minus the delivered price at the same ports of oil imported from foreign sources.

Consumerist arguments for export restrictions on Alaskan oil also lack merit; prices are not lower simply because oil is delivered from Alaska rather than elsewhere. Oil is sold in competitive markets. Hence supply and demand conditions, and not the oil's source, determine its price in the short run (there are some minor exceptions to this, resulting from the pricing policies of various OPEC countries). With less exploration and development of Alaskan oil because of export restrictions, less will be put on world markets, and in the long run, consumers will pay higher prices for oil.

If the environmentalists' "Mother Hubbard" view of natural resources were correct, the real costs of natural resources, including oil, would have been increasing over time. The plain facts, however, refute the environmentalists' theory of natural resource scarcity. The long-term costs of energy, for example, have been falling; it would seem that energy is becoming less, not more, scarce. Consequently, the environmentalists' claim that government intervention is needed to save the U.S. from running out of oil and other natural resources is unsupportable.

The national security alarmists' arguments for export restrictions are also flawed. For the fact is--such restrictions impede the attainment of energy security. Moreover, U.S. restrictions on Alaskan oil exports force Japan, America's most important ally in the Far East, to depend almost entirely on Middle East OPEC producers for oil supplies. If the U.S. were to supply Japan with some of its oil, however, Japan's sources would be more diversified, and its energy supply more secure. This, in turn, would help the security position of the U.S.

The increased value of Alaskan oil due to free trade would of course prompt more exploration and development of Alaskan oil and bring more crude oil to the world markets. Thus weakening the OPEC monopoly would also improve the U.S. national security position.

Free trade and the export of Alaskan oil would also eliminate the pure economic waste cost referred to earlier. Not only would this benefit both the Japanese and U.S. economies, but it, too, would contribute to the overall security position of the U.S.

FEDERAL LOGS

The U.S. contains 488 million acres of commercial forest land. This is equal to about 25 percent of the land area of the continental U.S. Federal land policies, however, have imposed costly inefficiencies on the timber industry and, what is much worse, have created an artificial timber famine. As a result of this, special interests demanded an embargo on logs produced on public lands. These demands were met in 1968 with the Morse Amendment to the Export Administration Act, which ordered that timber cut from federal lands must be subject to primary processing before it can be exported. In addition, the amendment contained a provision that prohibited substitution. That is, a firm that owns private timber cannot export unprocessed logs from its private land and then purchase federal timber for processing in its domestic mills.

Timber Industry: The timber and wood-products industries have supported the export ban on federal logs. Owners of sawmills, who depend on logs cut on federal lands for their raw material, do not want federal logs exported. As they see it, the export prohibition helps to keep domestic log prices lower than they would otherwise be. Timber companies owning large acreages of private timber not subject to the export ban also like it. For these log exporters, the ban means less competition in international log markets. In addition, the wood-products industry supports a log export ban because they want to export finished products, not logs. They see the ban as a way to force foreigners to purchase finished goods rather than logs.

Environmentalists: Environmentalists support the export ban as a way to reduce the quantity of logs cut on timber-rich federal lands on the West Coast and in Alaska. Given their "Mother Hubbard" theory of natural resources, any policy that reduces natural resource use is a good policy.

The Flaws in the Export Ban Argument

The basis of the argument used by the various special interests to support the ban on the export of federal logs has been the alleged timber famine in the U.S. But in fact, the U.S. has today a larger total inventory of commercial timber than it had at the turn of the century. To the extent that there is a famine, it has been created artificially by federal restrictions on the annual allowable cut in public forests. The government could alleviate this condition either by privatizing its commercial timberlands or changing its method of determining the annual amount of timber cuttings.

Another argument used to support the log export ban is that exporting finished products rather than logs generates more employment and income in the wood processing industry. But this argument would work only if the U.S. enjoyed monopoly power in the market for finished products. But no such monopoly exists.

By not exporting federal logs to feed the 20,000 mills in Japan, employment in the timber industry has been limited as Japan has switched to other log suppliers. The ban, in other words, means that the U.S. does not even gain the employment that would be generated by cutting and shipping logs to Japan.

CONCLUSION

To break the stalemate in trade with Japan, promote free trade, and improve U.S.-Japanese ties, President Reagan should propose legislation to eliminate the self-imposed embargoes on the shipment of Alaskan oil and federal logs to Japan. This not only would increase the value of these natural resources and U.S. employment, but also would reduce the U.S. merchandise trade deficit with Japan. If oil exports eventually grew to an annual value of $15 billion, and federal logs to $1 billion, these products alone would almost eliminate the trade deficit with Japan.

By putting national interests ahead of narrow special interests, President Reagan would be able to satisfy his free-trade supporters and the general public. He would be able to deal with some of the concerns of those who fret over bilateral trade imbalances. But perhaps most important, by such a move, the President could break the current deadlock and produce concessions from Japan affecting the full range of U.S. exports.

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