U.S.-JAPANESE TRADE: MYTHS AND REALITIES

Steve H. Hanke

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.

—Frédéric Bastiat, *Economic Sophisims*

Introduction

Even though more than a century has passed since Frédéric Bastiat faced 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.[1] By examining the myths and realities of trade relations between the United States and Japan, we will be able to demonstrate that free trade with Japan would be mutually beneficial and politically possible.

Before beginning our demonstration, we will review the free-traders' principles. Free trade is ultimately based on private property

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The author is Professor of Applied Economics at The Johns Hopkins University, Baltimore, Md. 21218. He also serves as a Senior Economic Advisor to the Joint Economic Committee of the U.S. Congress, and is a Senior Fellow at the Manhattan Institute for Policy Research in New York City.

[1]Charles N. Stabler, "How Economists Think About World Trade," *Wall Street Journal*, 28 November 1983.

and individual liberty. If free trade is restricted, sellers and buyers have their liberties restricted. In addition, they have some of their property taken. The transferability of property is a necessary condition for an efficient system of property rights. By hindering the transferability of property, trade restrictions hinder the movement of resources from less to more valuable uses. Consequently, restrictions on voluntary exchange cause a reduction in the value of property owned by sellers. In addition, restrictions reduce the wealth of buyers. By reducing the value of sellers' property and buyers' wealth, restrictions result in the taking of property by the state and also economic waste.

Although private property and individual liberty are often overlooked in trade policy debates, they remain the bedrock upon which free trade rests. Respect for private property and individual liberties will result in free trade, and economic benefits will ensue: Products that have the greatest cost advantage, when compared to their production cost in other countries, will be produced for export. Therefore, from an economic point of view, free trade will put in place dynamic forces that move resources out of industries with the lowest productivity and into those with the highest productivity.

Protectionist Sentiment and U.S.-Japanese Trade Relations

The protectionists in the United States have thrown the principles upon which free trade rests into the academic dustbin. They are interested instead in the fact that the United States is running a deficit in its merchandise trade account. And, in particular, they tend to focus their concern on Japan, a country with which the United States has a deficit. For example, in the period 1976–83, the United States incurred a cumulative trade deficit—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—of about $95 billion.[2]

The protectionists' general argument is captured by a recent (August 29, 1983) *Business Week* cover story, "America's Hidden Problem: The Huge Trade Deficit Is Sapping Growth and Exporting Jobs." As the title implies, protectionists argue that U.S. jobs are lost when we incur a trade deficit, and that this is something we should avoid. Japan has become the specific "whipping boy" of the U.S.

[2]Council of Economic Advisers, *Annual Report* (Washington, D. C.: Government Printing Office, 1984).

protectionists because we have a trade deficit with them and, perhaps more important, because we have been victimized by what are alleged to be "unfair" trade practices. The protectionists argue that U.S.-Japanese trade policies are asymmetric. They claim that the U.S. markets are "open" to the Japanese while Japan's markets are "closed" to the United States.[3]

The protectionists' argument is buttressed by the following complaints, which are directed at the Japanese:[4]

- Product design standards and their administration are intended to restrict the entry of U.S. products into the Japanese markets.
- Japanese importers must cut through unnecessary red tape to obtain permission to import U.S. products.
- Tariffs—particularly on finished lumber, tobacco, paper, computer parts, chocolate, and leather—inhibit U.S. exports to Japan.
- Import quotas and their administration restrict U.S. exports to Japan.
- 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.
- Japanese capital markets are restricted and heavily administered by the state.
- "Targeted industries"—particularly beef and citrus—are shielded from outside competition by Japan.
- Other "targeted industries" are awarded special favors by Japan, and this gives them on unfair advantage to penetrate the U.S. market.

Given these complaints—which, indeed, have merit, in varying degrees—and the rising protectionist sentiment in the United States, we have reacted with relatively mild, but potentially destructive, protectionist measures. "Voluntary" quotas for automotive vehicles were agreed to, and restrictions were placed on some types of steel, motorcycles, and several other products. But, to its credit, the Reagan administration has resisted other proposals for protectionist policies that would restrict Japan's ability to trade with the United States.[5]

[3]"America's Hidden Problem: The Huge Trade Deficit Is Sapping Growth and Exporting Jobs," *Business Week*, 29 August 1983.

[4]William E. Brock, "Japanese Trade Barriers," a memorandum for the president, 18 December 1981.

[5]Herbert Stein, "U.S. Foreign Trade and Trade Policy," *The AEI Economist* (July 1983).

A New U.S. Strategy

Time is running out for President Reagan and his strategy to maintain free trade with Japan.[6] If the Reagan administration wants to keep holding back the protectionist sentiment in the United States, the president can no longer afford to just list our grievances with Japan and request that the Japanese redress their protectionist policies. It is time to drop the "we are right and you are wrong" approach to our trade relations with Japan. This approach, at best, can yield nothing more than minor concessions by the Japanese and more protectionist measures by the United States.

The president must begin to act as a statesman and leader. He must unilaterally offer the Japanese a policy that they cannot refuse and also one that will benefit the United States. This can be accomplished by realizing that Japan's economy depends on imports of raw materials. For example, the Japanese experience a trade deficit in all major categories of primary products. The Japanese process these raw material imports into manufactured goods for domestic consumption and export. Exports of finished products are, indeed, very large. This is attested to by the fact that the Japanese incur a trade surplus in all major categories of manufactured goods. In short, the Japanese economy has evolved to import raw materials and export finished goods. This is how the economy adjusts to its comparative advantage.

Even though there might be some merit in the argument that the Japanese markets are "closed" to the United States while our markets are "open" to the Japanese, this argument does not reveal the entire picture. The unrevealed portion of the picture is one in which U.S. law forbids the shipment of certain raw materials—which represent the imports that the Japanese desire and would welcome—to Japan. Therefore, while Japanese laws, regulations, and customs act to 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 raw materials to Japan. Specifically, oil produced in Alaska is, in effect, totally restricted and logs cut on federal lands are banned from being exported to Japan.

The message President Reagan should deliver to the Japanese is a simple one: His administration should propose legislation that would lift the restrictions on Alaskan oil exports and the bans on federal log exports. The president's proposals should be made unilaterally, with no conditions attached.

[6]Mike Tharp, "The Stalemate Lingers," *Far Eastern Economic Review*, 22 September 1983.

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 act 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, 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, who can overturn the presidential initiative by passing a joint resolution within 60 days.

If this were not enough, 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 Congress to confirm any presidental proposal to export oil.

The 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.[7] The Japanese are particularly hit hard by this fact, since they import almost all of their oil and Alaska would be their least-cost supplier under free-trade conditions.[8]

The Political Economy of Alaskan Oil

To understand why the United States has restricted the export of Alaskan oil, we must identify the major special-interest groups who advocate restrictions and grasp the nature of the benefits they derive from interventionist policies.

The maritime industry, environmentalists, some consumer groups, and others with an interest in national security represent the special

[7]S. Fred Singer, Milton Copulos, and David J. Watkins, "Exporting Alaska's Oil and Gas," Heritage Foundation *Backgrounder* No. 248, 22 February 1983.

[8]John S. DeMott, "At the End of a Floating Pipeline," *Time* (Special Issue): *Japan a Nation in Search of Itself*, 1 August 1983.

interests that have teamed up to support restrictions on the export of Alaskan oil. The maritime industry (seamen's unions and domestic shipbuilders) derives its interest in supporting restrictions on the export of Alaskan oil from the Merchant Marine Act of 1920, which is commonly known as the Jones Act. The Jones Act mandates that waterborne commerce between U.S. ports be carried out in U.S.-built, owned, registered, and manned ships. Thus, to the extent that the maritime industry can successfully propose and support legislation that limits the export of U.S. goods, it can—to the extent that these goods are traded in the United States and transported by water after the export limits—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.

The environmentalists generally adopt a "Mother Hubbard" view of natural resources. As they see it, there is a fixed quantity of various natural resources. According to the environmentalists, our standard of living will decline rapidly as the various natural resource cupboards become bare. Given this view, the environmentalists have supported restrictions on the export of Alaskan oil because they believe these restrictions will slow down—if not stop—the development and use of Alaska's natural resources.

Consumers' support for export restrictions on Alaskan oil derives from their belief that keeping oil in the United States will make oil prices lower than if exports were allowed. National security enthusiasts also support restrictions. In their view, the goal of building a self-sufficient oil supply will guarantee U.S. immunity to supply disruptions caused by foreign wars and embargoes.

Faulty Special-Interest Pleadings

The arguments favoring Alaskan oil export restrictions are fatally flawed. The maritime industry's pleadings are perhaps the most clear-cut case of a special-interest group arguing for a government bailout. It is true that the restrictions on exporting Alaskan oil have benefited maritime interests. But the costs created are large and outweigh the gains derived by the maritime industry.[9] The owners of Alaskan oil, for example, bear a large portion of these costs. The value (the

[9]Beth deHamel, James R. Ferry, William W. Hogan, and Joseph S. Nie, Jr., *The Export of Alaskan Crude Oil: An Analysis of the Economic and National Security Benefits* (Cambridge, Mass.: Putnam, Hayes, and Bartlett, Inc., 1983).

"wellhead" price—the market price minus transportation costs) of Alaska's oil assets is reduced by restrictions on exports, since producers are required to transport their products in high-cost U.S. tankers to uneconomic destinations in the United States.

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. That this reduction in the value of Alaskan oil occurs is evidenced by the fact that transport charges per barrel of Alaskan oil are $0.90 higher if the oil is shipped to the West Coast of the United States and $3.70 per barrel higher if the oil is shipped to the Gulf Coast, rather than to Japan.

By reducing the wellhead price for Alaskan oil, the restrictions mean that the incentives to explore for and develop more Alaskan reserves are reduced. Ultimately, this means less oil will enter the world oil market, and less competitive pressure will be put on OPEC's control of crude oil prices. Consequently, restrictions on the export of Alaskan oil strengthen OPEC's hand, which is another cost of the restrictions. Pure economic waste also accompanies the inefficient distribution of Alaskan oil and is a further cost of restricting Alaskan oil exports 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.

Consumers' arguments favoring export restrictions on Alaskan oil are totally without merit. Consumers do not enjoy lower prices when the oil they consume is delivered from Alaska rather than elsewhere. Oil is sold in competitive markets. Hence, supply and demand conditions, and not oil's source, determine (with some minor exceptions, resulting from the pricing policies of various OPEC countries) its price in the short run. In the long run—with less Alaskan oil being explored for and developed because of restrictions—consumers will actually pay higher oil prices, since less oil will be put on world markets with restrictions than without them.

If the environmentalists' "Mother Hubbard" view of natural resources was correct, the real costs of natural resources, including oil, would have been increasing over time. Analyses of the facts, however, refute the environmentalists' theory of natural resource scarcity. The long-term costs of energy, for example, have been falling, and this means that energy is becoming less, not more, scarce. Consequently, the environmentalists' rationale for government intervention to save us from running out of oil and other natural resources is unsupportable.[10]

[10]Julian L. Simon, *The Ultimate Resource* (Princeton, N.J.: Princeton University Press, 1981).

The national security alarmists' arguments, which favor export restrictions on Alaskan oil, are also flawed. Export restrictions will not promote energy security. In fact, restrictions will impede the attainment of energy security. By restricting Alaskan oil exports, the United States forces Japan, a strong ally in the Far East, to depend almost totally for its oil supplies on OPEC producers from the Middle East. If we supplied Japan with some of its oil, Japan's sources would be more diversified, and our important ally would be more secure in its energy supply. This, in turn, would help, not hinder, the overall security position of the United States.

The national security advocates should remember that they have, in a slightly different context, recognized the advantages of diversified sources and "trade" in oil. This is why they have been proponents of continued U.S. membership in the 21-nation International Energy Agency. Terms of membership in the group call for a sharing of U.S. oil with other members in times of emergency. Thus, although the national security proponents favor no trade in Alaskan oil during peacetime because it promotes our energy security, they argue that during emergencies forced "trade" should be mandated to ensure our security. The fact is that they have never quite gotten their facts and analysis straight. They should realize that free trade and the diversification of supplies that will result will enhance our security position.

Free trade and the export of Alaskan oil would also eliminate the pure economic waste, which was referred to earlier and exists in the current restricted trading system. The elimination of the considerable waste will benefit both the Japanese and the U.S. economies. This, too, will help, not hinder, the overall security position of the United States.

Again, we should not forget that our overall security would be enhanced by free trade and the consequent increased value of Alaskan oil. For, this increase in value will result in more exploration and development of Alaskan oil, which will result in more crude oil entering world markets. This will weaken OPEC's position and improve our overall national security.

Federal Logs

To appreciate why demands are made to continue a total ban on the export of unfinished logs cut on federally owned lands and why the arguments supporting the bans are unfounded, we must first understand something about the nature of the U.S. timber industry.[11] The nation contains 488 million acres of commercial forest land. This is equal to about 25 percent of the land area of the continental United States. Table 1 contains a breakdown of U.S. commercial forest lands, classified by regions and types of ownership.

The concentration of public forest lands in the West is a result of the direction of United States settlement from east to west and land disposition policies. Land disposition policies were designed to

TABLE 1

U.S. COMMERCIAL FOREST LAND
BY REGION AND OWNERSHIP, 1977
(Millions of Acres)

Region	National Forests	Other Public	Forest Industry	Other Private	Total Percent*
North	10.1	21.2	17.8	121.6	170.7
Percent	6	12	11	71	35
South	11.0	6.7	35.8	134.9	188.4
Percent	6	3	19	72	38
Pacific	31.5	12.9	12.3	14.1	70.8
Percent	45	18	17	20	15
Rocky Mtn.	36.4	6.8	2.1	12.5	57.8
Percent	63	12	4	21	12
U.S. Total	89.0	47.6	68.0	283.1	487.7
Percent**	18	10	14	58	100

*Percent of U.S. total by region.
**Percent of U.S. total by ownership.
SOURCE: U.S. Department of Agriculture, U.S. Forest Service, *Forest Statistics*, 1978.

NOTES: The rows in Table 1 show millions of acres and percent of total U.S. commercial forest lands by region and owner. In the North region, for example, 121.6 million acres, or 71 percent, of the total 170.7 million acres of commercial forest land is owned by the "Other Private" class of owners. Forest land owners in this class grow and sell timber, but do not, in general, engage in wood processing. Total commercial forest acreage in the North region amounts to 35 percent of the U.S. total.

Figures in the columns of Table 1 indicate regional acreages by ownership. For example, the column under "National Forests" indicates that total commercial acreage on the national forests is 89.0 million acres, or 18 percent of the U.S. total, and that 45 and 63 percent of the forest land areas, respectively, in the Pacific and Rocky Mountain regions are in the national forests.

[11]Barney Dowdle and Steve H. Hanke, "Public Timber Policy and the Wood-Products Industry," in *Forest Lands, Public and Private*, ed. M. Bruce Johnson and Robert Deacon (Cambridge, Mass.: Ballinger Publishing Co., 1984).

implement private ownership during the nation's formative years. These policies were changed to promote public ownership, especially of timberlands, around the turn of the century. Consequently, many of the lands in the West, which were settled last, remained in public ownership.

Commercial forest lands, while important from the standpoint of future timber supplies, do not necessarily indicate where lumber and plywood will be produced in the near term. Sources of supplies of these solid-wood products will be determined for the next several decades, in large part, by the location of existing inventories of mature softwood sawtimber (see Table 2). While most of the commercial forest land is in private ownership (72 percent), the public sector currently owns most of the mature softwood sawtimber (63 percent). The national forests alone contain over half (51 percent) the total inventory.

The disparity between the public ownership of commercial forest land (28 percent) and public ownership of mature timber (63 percent) arises because past timber harvests were concentrated in the private sector. For example, during the first 50 years of their existence (1905–55), the national forests contributed about 3 percent to total softwood timber output.

TABLE 2

SOFTWOOD SAWTIMBER INVENTORIES
BY REGION AND OWNERSHIP, 1977
(Billions of Board Feet, Int. ¼-Inch Log Scale)

Region	National Forests	Other Public	Forest Industry	Other Private	Total Percent*
North	7.1	12.8	23.1	54.2	97.1
Percent	7	13	24	56	5
South	33.8	13.9	87.3	204.9	340.0
Percent	10	4	26	60	17
Pacific	706.4	166.1	175.8	116.9	1,165.4
Percent	61	14	15	10	59
Rocky Mtn.	260.8	42.7	23.3	53.5	380.4
Percent	69	11	6	14	19
U.S. Total	1,008.1	235.6	309.5	429.5	1,982.8
Percent**	51	12	16	21	100

*Percent of U.S. total by region.
**Percent of U.S. total by ownership.
SOURCE: U.S. Department of Agriculture, U.S. Forest Service, *Forest Statistics,* 1978.

As a result of past timber harvests originating primarily in the private sector, much of the private timber inventory now consists of immature timber which was established on previously cutover lands and will not reach maturity for several years. In the interim, the wood-processing industry will be heavily dependent upon public timber supplies. Likewise, public timber policies, which played a minor role in the past, will play a significant role in the future.

The size and timing of public timber offered are indicated by policies that are largely unrelated to market conditions. The practice of "sustained yield" forestry dominates public forestry. This practice means that only the annual increment in a forest's growth can be cut in any year. As a result, cutting on mature public forests is very small and inventory adjustments are difficult to make. In addition to this severe constraint on the volume of public timber that is allowed to be marketed, the industry also faces additional problems in obtaining timber from public forests because many public forests are being withdrawn completely from commercial use.

From an economic point of view, government agencies are attempting to manage timber, which is a capital asset, without counting capital carrying charges on the assets they hold. This results in too little current output and the holding of too much inventory.

An important consequence of the Forest Service's faulty inventory policy is that supplies of timber are not being made available to meet timber demands during the private sector's transition from virgin timber to "second-growth" timber supplies. By restricting supplies, the Forest Service is creating an artificial timber famine.

The Political Economy of Federal Logs

As a result of the government's creation of an artifical timber famine, special interests demanded an embargo on logs produced on public lands. These demands were met in 1968, with an amendment to the Export Administration Act. This so-called "Morse Amendment" dictated that timber cut from federal lands must be subject to primary processing prior to export. In addition, the amendment contains a substitution provision that disallows "substitution." That is, a firm that owns private timber cannot export unprocessed logs off its private land and then purchase federal timber for processing in its domestic mills.

The timber and wood-products industry has collaborated with environmentalists to support the ban on the export of federal logs. Those who own sawmills and 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 otherwise would be. Timber companies owning large acreages of private timber that are 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 it wants to export finished products, not logs. It sees the ban as a way to force foreigners to purchase finished goods, rather than logs.

The environmentalists, too, view the prohibition on log exports favorably. They believe that the export ban is 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 the use of natural resources is a good policy.

Faulty Special-Interest Pleadings

The primary argument used by all special interests to support the ban on the export of federal logs has been the alleged timber famine in the United States. The timber famine, which gives rise to the demand for bans on federal log exports, is not real. In fact, the United States presently has a larger total inventory of commercial timber than it did at the turn of the century.[12] To the extent that we have a famine, it is artificially created by federal restrictions on the annual allowable cut on public forests. To correct for this, the government should either privatize its commercial timberlands or change its method of determining the annual amount of timber that can be cut.

The other argument that is used to support the log export ban is that we can generate more employment and value-added in the wood processing industry by exporting finished products, not logs. This argument can only work if we have monopoly power in the market for finished products. But we do not have such a monopoly. By not exporting federal logs to feed the 20,000 mills in Japan, we have reduced employment in the timber industry because Japan has switched to other log suppliers.[13] Therefore, because of the ban, we do not even obtain the employment that would be generated by cutting and shipping logs to Japan.

Conclusion

To break our trade stalemate with Japan, and promote free trade and improved U.S.-Japanese ties, President Reagan should make a

[12]Sherry H. Olson, *The Depletion Myth: A History of Railroad Use of Timber* (Cambridge, Mass.: Harvard University Press, 1971).

[13]Erick Larson, "Logging Sales," *Wall Street Journal*, 7 May 1982.

unilateral offer that his administration will propose legislation to eliminate the existing, self-imposed embargo on the shipment of Alaskan oil and federal logs to Japan. This would not only increase the value of these natural resources and U.S. employment, but would also reduce our merchandise trade deficit with Japan. For example, oil exports could eventually grow to $15 billion annually,[14] and federal logs to $1 billion annually.[15] This alone would almost eliminate our trade deficit with Japan.[16]

By putting the interest of the nation ahead of narrow special interest, President Reagan would be able to satisfy his most ardent free-trade supporters and, for that matter, most of the public. At the same time, he would be able to silence neo-mercantilist critics who fret over bilateral trade imbalances. Moreover, such a bold move by the president would, no doubt, produce concessions from the Japanese.[17]

[14]Beth deHamel et al., *Export of Alaskan Crude.*

[15]Steve H. Hanke, "Timber Sales to Japan,' a memorandum to the Honorable David Stockman, 7 January 1982.

[16]It is important to mention that, although bilateral trade balances have no particular economic significance, they can have great political significance. This is the case with our trade balance with Japan. Therefore, if the promotion of free trade with Japan will reduce our trade deficit with the Japanese, a stronger political case for free trade can be made by *mentioning the trade-deficit reduction impacts of the proposed free-trade* policies.

[17]Yoshisumi Matsuda, "Japanese Market More Open than U.S. Thinks," *Los Angeles Times*, 26 September 1983; and U.S. Embassy in Tokyo, "Government of Japan Announces External Economic Measures Program to Reduce Trade Surplus," a cable (22589) to the Secretary of State, 16 December 1981.

"U.S.-JAPANESE TRADE": A COMMENT

Gary Hufbauer

The Japanese Trade Debate

Professor Hanke has come up with a new and refreshing proposal—no small accomplishment in the realm of policy commentary.[1] With this proposal, Professor Hanke has joined a minority school that says the United States spends too much time worrying and whining over Japanese trade practices. A second member of that school is Gary Saxenhouse, who argues that the Japanese have not closed their economy noticeably more than the Germans or Americans. A third member is Philip Trezise, who, over the years, has tried to moderate Washington passions about Japanese economic issues. I am sure there is a fourth member of the school, but his name does not spring readily to mind.

Opposed to the minority school is a large community of Japan watchers. When the full moon rises, some can be heard baying. In calmer moments, the majority school can recite abundant examples of Japanese trade restrictions that seem preposterous on their face—for example, on cigarettes, citrus, and beef imports—and restrictions that seem designed to undercut the Japanese government's nominal commitment to trade liberalization—for example, on semiconductors, machine tools, and pharmaceuticals.

Prompted by these bad examples, Lester Thurow recommended, early in 1983, that "we abolish all of our current restrictions on specific Japanese exports and replace them with a general system of reciprocity."[2] John Maynard Keynes once remarked that political

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The author is a Senior Fellow at the Institute for International Economics, Washington, D.C. 20036.

[1]Steve H. Hanke, "U.S.-Japanese Trade: Myths and Realities," *Cato Journal* 3 (Winter 1983/84): 757–69.

[2]See the comment by I. M. Destler, "The Wrong Approach to Japanese Trade," *Washington Post*, 16 March 1983, p. A23.

proposals often reflect the half-remembered ravings of a forgotten academic. In this instance, the time horizon was much compressed. In the 98th Congress, Representative Fortney Stark offered a bill that would have limited the bilateral U.S.-Japan deficit to $10 billion a year.

An interesting analogy can be drawn between the Japan trade debate and the disarmament debate:

- Most observers agree that both the United States and the Soviet Union would be better off with mutual disarmament.
- Most observers agree that both the United States and Soviet Union would be worse off if each were to accelerate its spending on armaments.
- But observers disagree, with much passion, as to whether one country, namely the United States, could improve its welfare by unilaterally reducing its arms expenditures, regardless of the response (in terms of arms spending) by the Soviet Union; or whether one country's unilateral reduction of armaments would prompt the other country to reduce its arms—at a faster pace or to a greater extent than might be accomplished through mutual agreement.

Parallel agreements and disagreements mark the commercial policy debate between the United States and Japan:

- Most observers agree that both the United States and Japan would be better off with a mutual reduction of trade barriers.
- Most observers agree that both the United States and Japan would be worse off if each were to escalate its barriers against the other's products.
- But again there is passionate disagreement as to whether one country, the United States, could improve its welfare by unilaterally reducing its own trade barriers, even if there was no liberalizing response in Japan; or whether one country's unilateral liberalization would prompt the other to reduce its barriers—at a faster pace or to a greater extent than would be achieved by negotiation.

The Hanke Proposal

In this debate, Professor Hanke takes the high road: He argues for unilateral U.S. trade liberalization, regardless of the Japanese policy response. Underlying Hanke's strategy is a bold political arithmetic. By eliminating restrictions on oil and log exports to Japan, the United States would, at the same time:

- Do itself an economic favor by realizing more from its natural resources;
- *Realize this self-serving favor very much sooner* than through the tedious process of negotiations; and
- Do the world trading system a political favor by reducing the bilateral trade imbalance between Japan and the United States by up to $15 billion a year, thereby removing a source of ill-informed, but very real, political tension.

Professor Hanke recognizes that his political arithmetic faces some hard practical realities. He can count on the certain opposition of the U.S. maritime unions, the chief beneficiaries of the present restrictions on oil exports to Japan; he can also count on the opposition of timber-deficient Western lumber mills and their associated unions, unless the U.S. Forest Service enlarges the permitted timber cut on public lands. In addition, Hanke's plan faces opposition from U.S. industry lobbyists and U.S. trade negotiators who want concessions from Japan. These lobbyists and negotiators would feel pangs of anguish if trade "chips" were simply "thrown away"—with no trade trophies from Japan to show in return.

On the theory that you can tell a good argument by its opponents, I think Hanke's package should commend itself to President Reagan.

Extending Hanke's Approach

I would like to explore a further question. Should Hanke's approach be extended to other trade barriers? Should the United States (or other countries) embrace a policy of unilateral disarmament of trade restrictions on imports as well as exports? This, of course, would represent a highly ambitious extension of Hanke's position.

The "con" arguments against an ambitious extension of the unilateral approach can be readily summarized. First, there is the argument that, even if the internal resource reallocation process works smoothly, the country that unilaterally liberalizes may take a beating on its terms of trade. The terms-of-trade argument is ultimately an empirical question, but I happen to think that the fear is greatly exaggerated. I find it difficult to believe that unilateral liberalization by the United States, to the extent of even $20 billion, would adversely affect the U. S. terms of trade by as much as 2 or 3 percent.

Second, there is the argument that a negotiated solution will produce better results. Mention is often made of the progress accomplished in seven rounds of GATT negotiations. My own belief is that negotiated progress has become increasingly labored. Analysis of the

Tokyo Round by Deardorff and Stern[3] shows extremely meager gains from tariff cuts, and even those limited gains took a long time and many large side payments to achieve.

The third con argument concerns adjustment costs. It can be reasonably argued that resources freed up do not move quickly to new lines of employment—with the result that taxpayers are burdened with large social programs.

Fourth and finally, there is the fear that unilateral liberalization, as applied to sunrise industries, would give foreign industrial nations a leg up on economies of scale and learning curve effects. The liberal trade country will supposedly miss out on the early phases of the industry, when capital can be accumulated at rates of return upwards of 40 percent annually. This fear is widely believed, but poorly documented.

On the "pro" side, it can be argued that a policy of unilateral trade disarmament would accomplish two important things. First, it would enable faster improvement in resource allocation than the path of tedious negotiations can yield—provided that adjustment difficulties can be overcome. Second, it is just possible that unilateral trade barrier reduction, if practiced by two or three leading countries, would prove contagious, and break the prevailing logjam of protectionist sentiment.

These pro and con arguments lead me to suggest a new tactical approach toward trade negotiations. In the new approach, the United States (and like-minded countries) would implement unilateral trade barrier reductions. However, if those concession were not matched with satisfactory reciprocal concessions within a reasonable time period, they would be rescinded, on a *non* most-favored-nation (MFN) basis.

The magic of this tactical approach—if it has any magic—lies in the difference between birds in the hand and birds in the bush. It is a tactic for deliberately destabilizing the political balance—in Japan, in the European Community, in Mexico, and in other countries. It presupposes that exporting firms abroad would more energetically prompt their own governments to give a concession in return—if those firms could tangibly count the markets potentially at risk to third-country competitors through a non-MFN recision of the original concession. The fear of losing present markets should prove at least

[3]Alan V. Deardoff and Robert M. Stern, *An Economic Analysis of the Effects of the Tokyo Round of Multilateral Trade Negotiations on the United States and the Other Major Industrialized Countries*, study prepared for the Subcommittee on International Trade, Senate Committee on Finance, 96th Cong., 1st Sess., June 1979, pp. 92–108.

as compelling in the quest for trade liberalization as the hope of gaining future markets.

Let me hasten to add that the country that pursues a policy of unilateral liberalization would need to pursue, simultaneously, active companion policies in two related spheres. First, liberalization—whether unilateral or reciprocal—critically depends on a policy of managing the exchange rate with an eye to the current account balance. The removal of trade barriers would be much more palatable to domestic producers if they could rely on macroeconomic policy to ensure that exports of goods and services approximately equal imports.

The second companion policy is a more active adjustment program. Elsewhere, Howard Rosen and I have explored this question.[4] The basic point is that political incentives should be changed so that declining industries are better rewarded by scaling down their activities than by erecting political barriers to preserve the status quo.

[4]Gary Clyde Hufbauer and Howard Rosen, "Managing Comparative Disadvantage," unpublished manuscript, Institute for International Economics, Washington, D.C., December 1983.