

# A Study on International Trade Imbalance

Shinnosuke Yasuda

## Preface

The world economy in the middle of the 1980s featured a U. S. trade deficit, and a Japanese trade surplus. This imbalance can not be allowed to continue, either for the sake of the Japanese economy or the harmonious development of the world economy.<sup>1)</sup> This situation has arisen in an interdependent world economy, so Japanese policy responses alone cannot rectify this imbalance. International policy coordination is also needed, including reductions in the United States fiscal deficit. Nevertheless, as a country largely dependent upon free trade, a country accounting for one-tenth of world GNP, and the world's largest creditor nation, Japan must take the initiative in rolling back protectionism and defending the free trade system by seeking to achieve an internationally harmonious external balance and to make a positive contribution to the international economy and community.

This paper is composed of three sections and a conclusion. Section 1 analyses the United States trade deficit and its main causes. Section 2 analyses the main causes of the Japanese trade surplus. Section 3 analyses promoting the shift to a domestic-demand-led economy and contributing to a better world. The conclusion specifies the basic directions in which the Japanese economy has to move to secure prosperity in people's lives and the development of the world economy.

### (1) The U. S. Trade Deficit and its Main Causes

First, let us consider American's external imbalance and its main causes. Having maintained an almost constant trade surplus during the 1960s, the U. S. saw its trade balance go into a deficit during the 1970s. This was because of its increasing

---

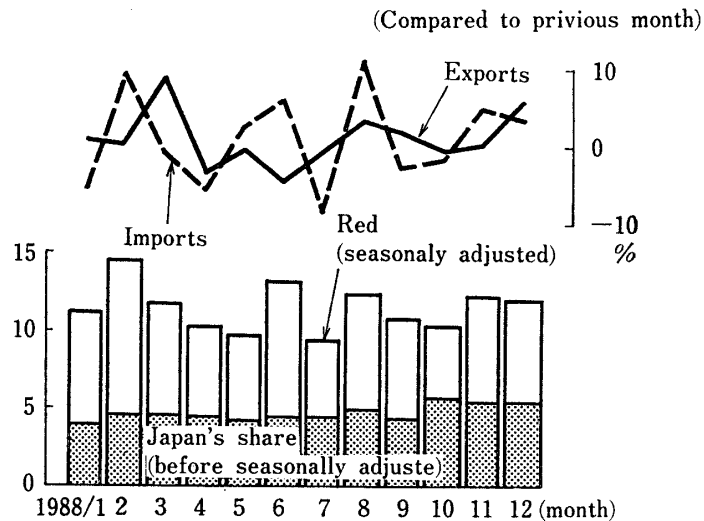
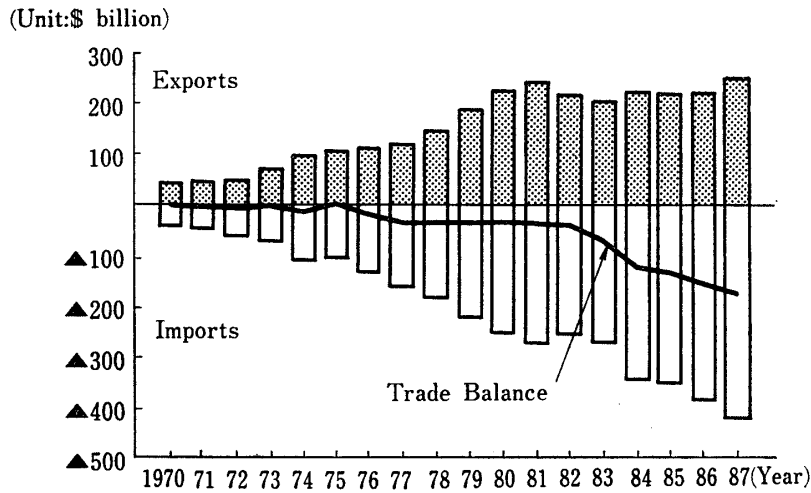
#### Notes

- 1) The Maekawa Report, published in April 1986 with the purpose of promoting international harmony, proposed adjustments to the structure of Japanese economy.

#### Summary of the Proposals of the Maekawa Report

① Expanding the domestic demand ② Transform the industrial structure to make it more compatible internationally. ③ Strive harder to improve market access, promote imports of manufactured products, etc. ④ Support stable international currency values ⑤ Promote international cooperation and contribute to the world economy ⑥ Public financing and financial policy—Flexible administration of the public finances and financial policy, improvement of the tax system.

Fig. 1-1 Trade Trends in U. S. (1970~88)



Source : U. S. Department of Commerce.

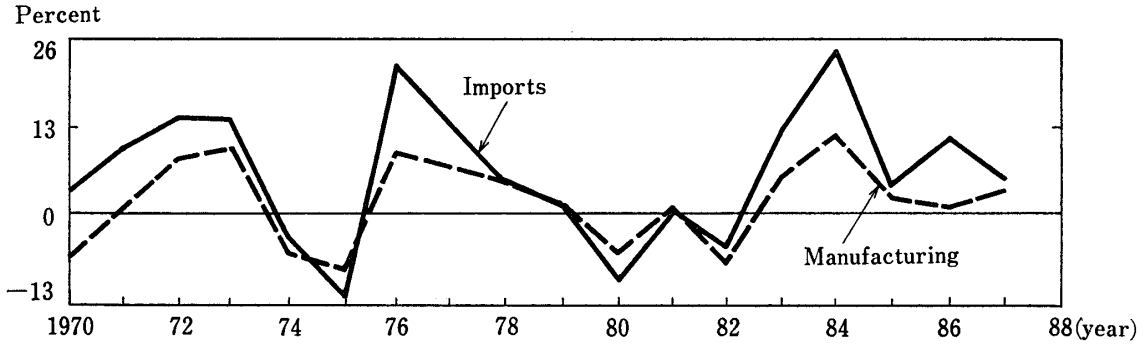
import of manufactured goods, which greatly expanded the size of the deficit. (Fig. 1-1)

During the first half of the 1980s, imports of nearly all categories of goods tended to widen the trade deficit, but those categories which have had a particularly deleterious effect on the trade balance are automobiles, communications equipment, and certain other items such as clothing.<sup>2)</sup>

U. S. imports from Japan and West Germany has increased rapidly because of its high income elasticity to imports, while its exports to the two countries have lagged because traditionally Japan's ratio of manufactured imports has been low, and West Germany has traded more with its EC partners than with the U. S.. Major U. S. export items, agricultural crops face competition with European Communities

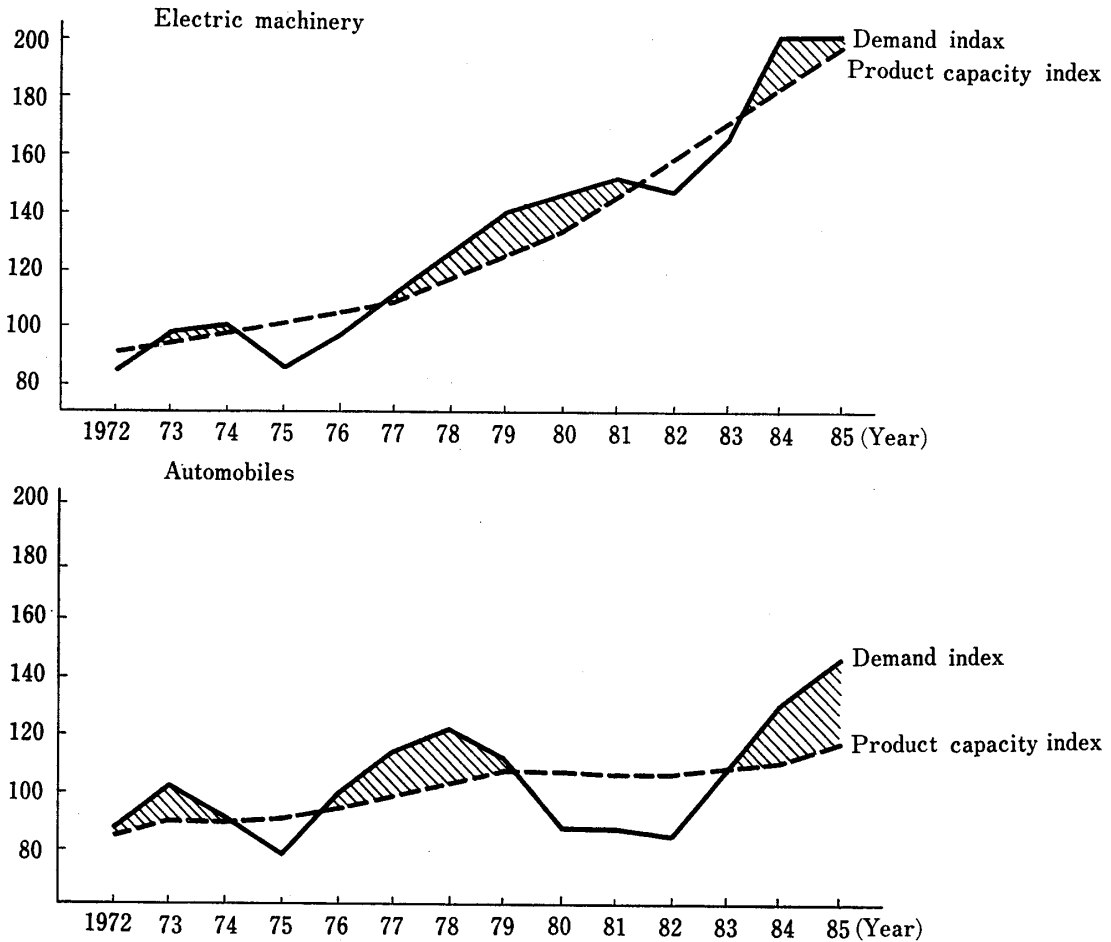
2) See MITI "White Paper on International Trade 1987" p. 110~111.

**Fig. 1—2** Changes in Merchandise Import and Manufacturing output  
(Both in 1982 \$)



Source: U. S. Department of Commerce

**Fig. 1—3** Supply-Demand Trends in Major U. S. Industries



- Notes 1. Demand index =  $(\text{Index of industrial production}) \times (\text{Shipment value} + \text{Import value}) / (\text{Shipment value})$
2. Product capacity indexes were obtained by multiplying peak value of operation rate (estimated from past long-term trends) by product capacity index announced by FRB.
3. Shaded parts indicate excess of demand.

Sources U. S. Department of Commerce "U. S. Trade Data 1972-1985", FRB "Capacity Utilization" MITI "White Paper on International Trade 1987" p. 121.

products, due to slackening world demand. As a result its export growth is limited. Some U. S. manufactured goods encounter consumer resistance abroad because of the incompatibility of U. S. standards with those of the overseas markets.<sup>3)</sup>

On the other hand, there appears to be no clear correlation between technological intensification and the rate of increase in imports, there having been a substantial growth in imports even of high-tech products. However, those industries in which there is growth in domestic demand also experience growth in imports. The growth in imports during the first half of the 1980s is owed less to reduced price competitiveness deriving from the strength of the dollar than to the vast excess in U. S. demand. (Fig. 1-2, 1-3)

In the first half of the eighties the U. S. balance of trade worsened with practically all countries and regions, but the roles played in this by individual products differed according to region.

In trade with Japan, 70% of the worsening is attributable to four items: automobiles, communications equipment (including VTRs), office equipment and electrical machinery. Thus certain specific items play central roles in aggravating the trade deficit.

The U. S. international balance of payments further deteriorated, with its current accounts deficit rising from \$156.2 billion in 1986 to \$171.2 billion in 1987. This condition was affected by such factors as the trade balance (on FAS-CIF basis) is concerned.

Apart from the exchange rate there are three important factors contributing to the increasing disequilibrium in Japanese and U. S. world trade.

The first factor concerns finance: the U. S. has been enlarging its fiscal deficit under its deflationary financial policy, which produced high interest rates and high exchange rates for the dollar. The strong dollar had the effect of creating an imbalance in U. S. trade relations with Japan and West Germany. As a result it placed U. S. products at a disadvantage in trade.<sup>4)</sup>

The second factor was inadequate production capacity in the U. S. In industries such as general and electrical machinery and automobiles, where the growth in imports was most striking, a considerable excess in demand developed. Investment in equipment, which made a rapid recovery in the early eighties, was directed wholly at information processing equipment and commercial buildings, while investment in the expansion of productive capacity remained rather low. (Fig. 1-4)

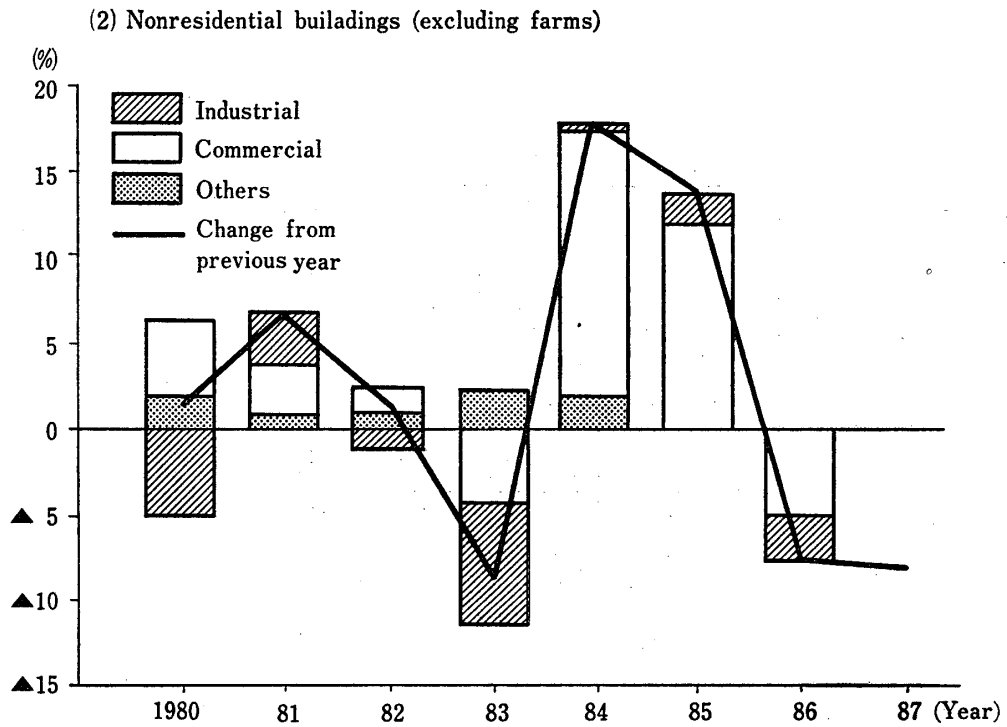
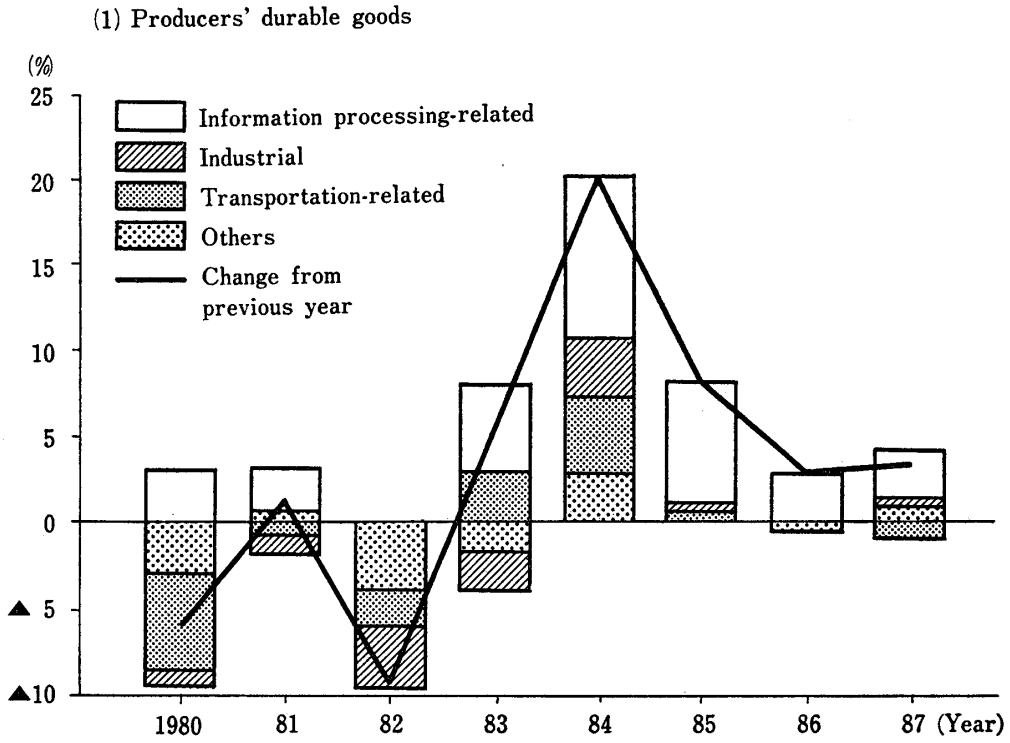
The third factor was that the saving rates difference among the countries concerned brought about large black figures in the saving and investment balance in

---

3) See EPA "Economic Survey of Japan 1987-1988" p. 57.

4) Ibid., p. 59.

**Fig. 1-4** Level of Contribution to Increase in Real U. S. Equipment Investment, by Purpose of Investment



Source: U. S. Department of Commerce (MITI "White Paper on International Trade 1988" p. 13)

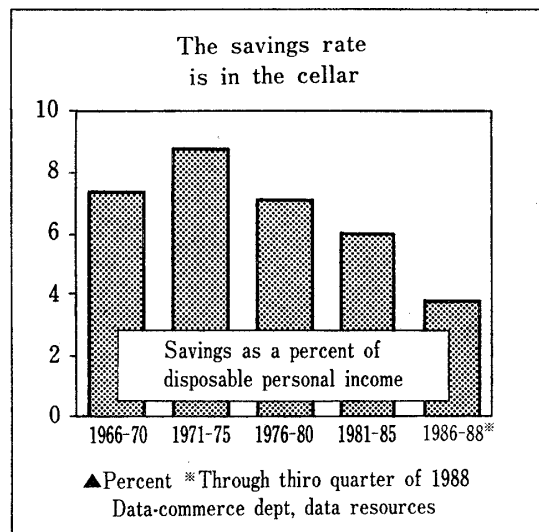
Japan and West Germany against substantial deficits in the United States.<sup>5)</sup>

The fourth factor was the expansion in overseas procurement that took place during the period. With the dollar high, the U. S. manufacturing industry, seeking ways of making up for the decline in the price competitiveness of its products, developed sources of good-quality, low-priced components and intermediary goods overseas. There were also a number of cases where declining international competitiveness led to finished products being procured OEM for resale.

Overseas subsidiaries played a very significant role in foreign procurement. Entering the eighties, the U. S. became an increasingly important sales outlet for its overseas subsidiaries. Exports to the U. S. accounted for as much as 62.1% of all exports of Canadian subsidiaries of U. S. automobile manufacturers and 72.4% of all exports of Asian subsidiaries of electric component manufacturers.<sup>6)</sup>

The fifth factor was the management policies of U. S. businesses. One reason for the decline in U. S. competitiveness in world markets is that U. S. businesses have neglected to make any long-term management policies. For example, in the iron and steel industries, the failure to actively apply the results of the technological revolution virtually invited a decline in international competitiveness, while in the construction machinery industry, a conservative financial posture led to a reluctance to improve productive capacity to meet demand, resulting in an increase in imports.

- 5) The U. S. foreign trade imbalance was brought about by private spending and government expenses increasing at a faster rate than productive capacity. In particular, the decline of individual saving rates over a long period of time caused consumer product imports to expand and put private net savings in the red.



Source: *Business week*, November 21, 1988

- 6) The total direct Japanese investment abroad has been growing rapidly. Since the beginning of the present decade, and in 1986 increased more than 80% over the previous year, to top the U. S. \$ 20,000 million level. In the first half of fiscal year 1987 (April to September), direct investment abroad increased also by 70% over the same period a year earlier. With the transfer of production bases overseas as a result of the appreciation of the yen, it seems we have reached the age of investment abroad.

## (2) Japan's Trade Surplus and its Main Causes

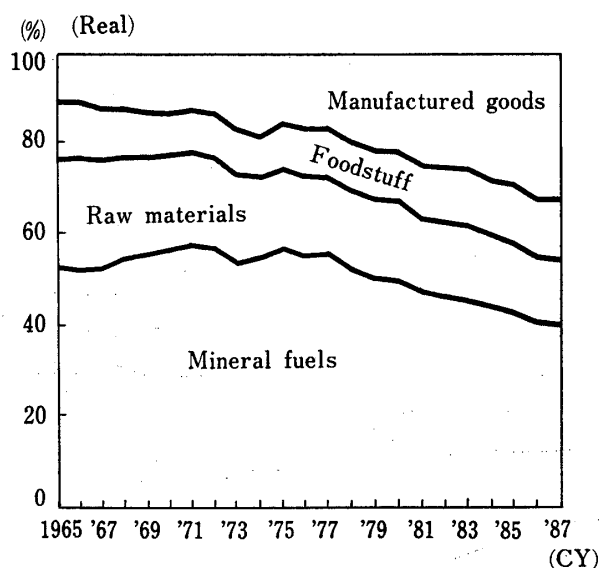
Next, let us examine Japan's trade surplus and its main causes. Despite the adjustment of exchange rates, Japan's balance of trade surplus expanded greatly in 1987. A large contributing factor was the decline in the value of imports resulting from the sharp fall in oil prices in and after late 1985. Changes in the prices of oil and primary commodities cause significant changes on the import side as well, and Japan has a high level of dependence on overseas sources for oil and primary commodities, which weights the import structure heavily towards these products.

A high proportion of oil and primary commodities in imports, and a similarly high proportion of manufactured goods and machinery in exports, is characteristic not only of the Japanese trade structure, but also of those of Western nations such as West Germany, where there is also a large trade surplus in manufactured goods concurrent with a large deficit in non-manufactured goods. (Fig. 2-1)

Long term trends in the Japanese export structure have shown the following features.

The steady increase in Japan's exports, at the same time, brought about noticeable ups and downs among commodities, mirroring the movement of comparative advantages. Until around 1964, nondurable Consumer goods, Such as clothing and miscellaneous good, and also labor-intensive intermediate goods, such as fiber yarns and textiles, moved into the limelight. With these commodities decayed after 1965, capital-intensive goods, including steel and chemical goods, constituted the mainstream

Fig. 2-1 Changes in Composition of Commodities in Terms of Import Value

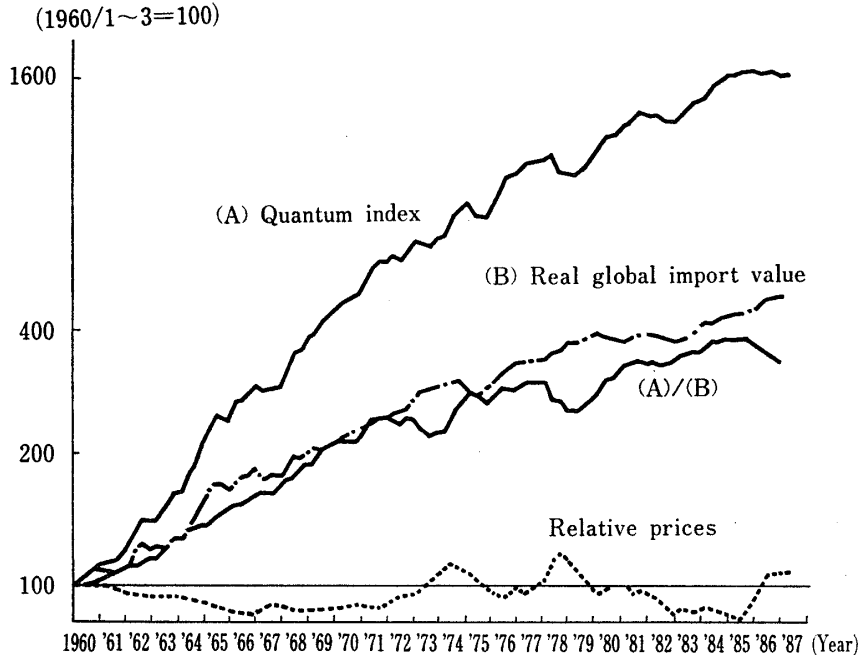


- Notes : 1. MOF, "Trade Statistics"  
 2. Figures based on yen, prices set with the standard of 1980  
 3. Figures for 1987 represent a seasonally adjusted average of the January-May period

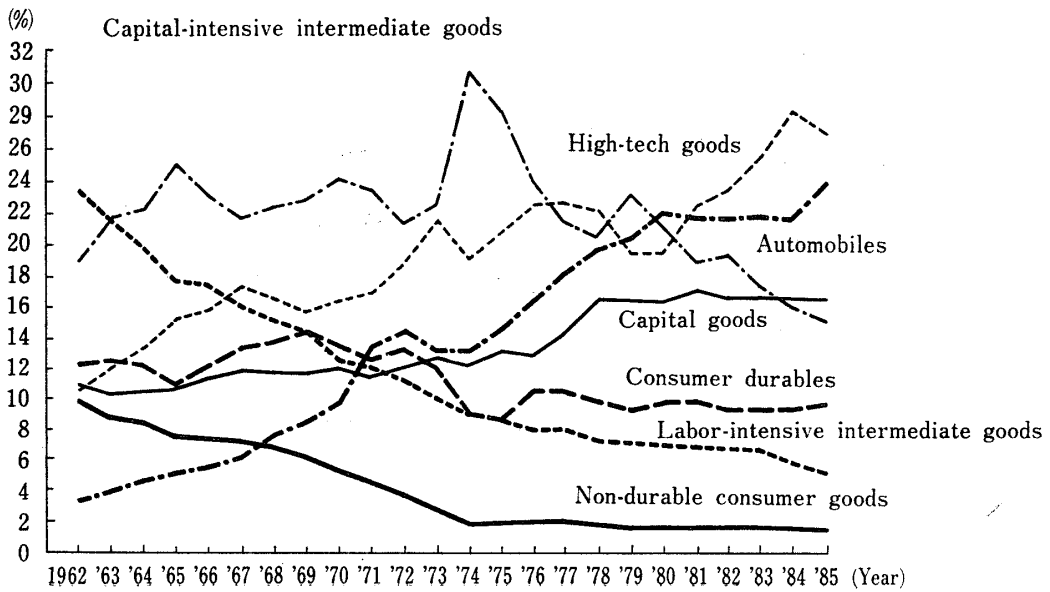
Source : EPA, "Economic Survey of Japan 1986-1987" p. 149.

Fig. 2-2 Trends and Characteristics of Japan's Postwar Exports

(1) Trends of Japan's export volume



(2) Component ratio of Japan's export value by type of goods (on a dollar basis)





Notes : 1. MOF, "Statistics on Foreign Trade"; IMF, "International Financial Statistics"; Asian Economic Research Institute, "Trade Statistics of United Nations and OECD"

2. Fig. (1)

◦ Figures are seasonally adjusted, quarterly basis.

◦ Relative prices=customs-cleared export prices index (on dollar basis) divided by weighted average of wholesale price index for six major industrial countries.

◦ Both the real world imports value and relative prices are extrapolated for the Oct.~Dec. term of 1986 and the Jan.~Mar. term of 1987.

3. Fig. (2)

SITC classification

◦ Non-durable consumer goods :	553, 571, 654, 656, 657, 831, 841, 842, 851, 863, 892, 895, 899
◦ Labor-intensive intermediate goods :	611, 612, 613, 631, 632, 633, 651, 652, 653, 655, 662, 663, 664, 665, 667, 691, 692, 693, 694, 698
◦ Capital-intensive intermediate goods :	512, 513, 514, 515, 521, 532, 5332, 5333, 5512, 554, 561, 581, 599, 621, 629, 641, 642, 661, 671, 672, 673, 674, 675, 676, 677, 678, 679, 681, 682, 683, 684, 685, 686, 687, 688, 689, 862
◦ Consumer durables :	666, 696, 697, 7241, 7242, 725, 733, 812, 821, 8618, 8619, 891, 893, 894, 896, 897
◦ Capital goods :	695, 7111, 7112, 7114, 7117, 712, 715, 717, 718, 719, 722, 723, 726, 7291, 7292, 7294, 7295, 7296, 7299, 731
◦ High-tech goods :	7249, 7293, 7297, 734, 714, 735, 541, 5511, 5331, 531, 8611, 8612, 8613, 8614, 8615, 8616, 8617, 862, 863, 864, 7113, 7115, 7116, 7118, 7151, 95101, 95102, 95103, 95106
◦ Automobiles :	732

Source : Economic Planning Agency "Economic Survey of Japan 1986-1987" p. 151.

exports. Next, the automobile and electronic machinery and equipment (high-tech industries) grew rapidly. However, the ratio of the total, which used to be at around 30%, sharply fell, reaching 15% in 1985. In contrast, high-tech goods, centering on semiconductors, computers and videocassette recorders, became the largest mainstream exports, followed by automobiles and capital goods. (Fig. 2-2)

As a result of the shifting of ranking among commodities, exports gradually came to center on some specific items, with 10 top-ranking commodities accounting for 54% of the total in 1985. This trend is considered to be related to the fact that enterprises have flexibly shifted their weight toward commodities scoring brisk demand. This constituted a major reason for bringing about a high elasticity of income.<sup>8)</sup>

7) See EPA "Economic Survey of Japan 1986~1987" p. 149~150.

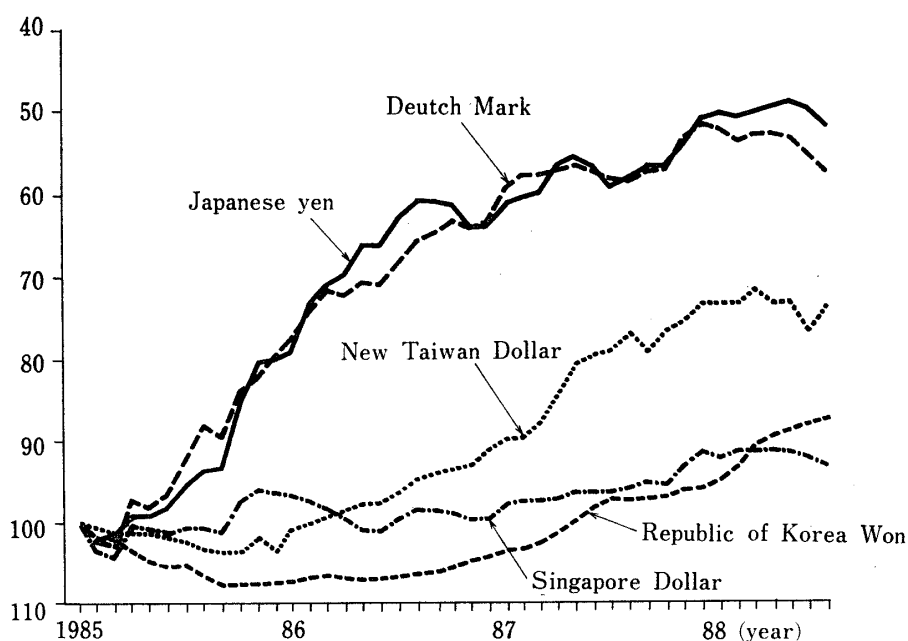
8) The globalization of trade has mostly involved exports of relatively small number of specialty products of a type which readily give rise to trade friction. As a result, Japan has been forced to accept voluntary or involuntary export limitation.

### (3) Promoting the Shift to a Domestic-demand-led Economy and Contributing to a Better World

Regarding the trend of exports in the foregoing, it is noteworthy that Japan's export volume has been marking time for the three and a half years since the October-December term of 1984, despite the fact that the real global imports have continued to advance. It is true that in spite of buoyant demand exports were temporarily in the doldrums in the two decades ending in 1974. But the figure swung upward in a half year or so. In the decade ending in 1984, the export volume also dropped in 1975 and 1982 due to sluggish demand overseas (especially in the U. S.) and in 1978 owing to the yen's appreciation. At these times, however, the figure swung up again in one to one-and-a-half years. Taking these facts into consideration, the recent sluggish growth of exports has lasted an unprecedentedly long time. Thus, in observing the course of the Japanese economy, a significant point will be whether this long stagnation marks a turning point in Japan's exports, or is a temporary phenomenon resulting from the yen's upturn. (Fig. 3-1)

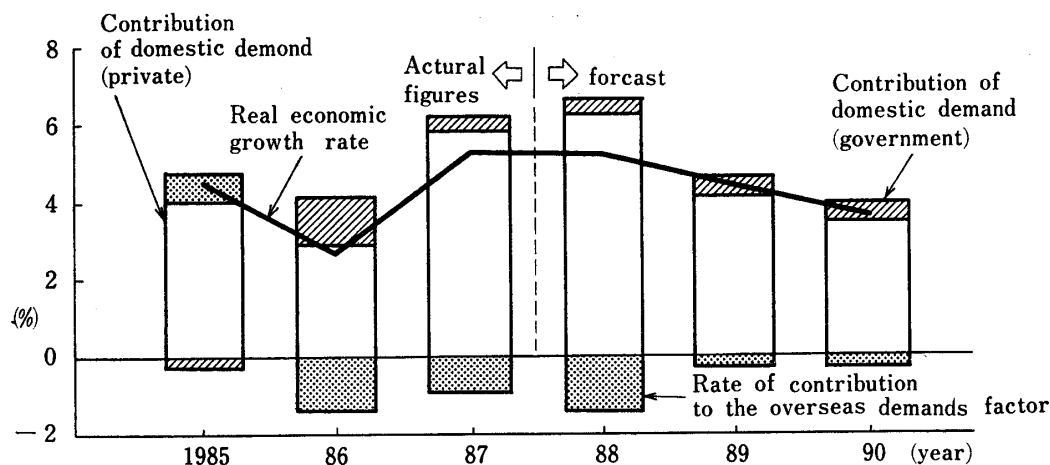
Various factors, of course, should be taken into consideration in predicting the future course of Japan's export: whether or not Japanese industries are have new promising products to export; and what Japanese firms are going to do with parts exports when they boost offshore production. However, what can be said here is, at least, Japan's export structure has changed considerably. Thus export volume will not increase as easily as it used to. In this sense, Japan's economic restructuring is steadily proceeding also from the export side.

Fig. 3-1 Changes in the Exchange Rate Against the U. S. Dollar  
(1985 Jan=100)



Source: IMF "International Financial Statistics"

**Fig. 3-2** Contribution of Domestic and Foreign Demand to Economic Growth  
(growth rate and contribution)



Source: *Nihon Keizai Shimbun*, Jan. 1, 1989.

The Japanese economy for fiscal 1987 achieved a domestic demand-led economic growth pattern in which the surplus in current balance was decreased and growth was obtained by domestic demand expansion due to rapid rise of business activities. During this phase of upward increase in business activity, change in economic structure or transformation of the Japanese economy by means of domestic demand-pulled growth has been well supported by positive adaptations of households and businesses to the new environment.<sup>9)</sup> This transformation has played a role in continuing the economic expansion of Japan. (Fig. 3-2)

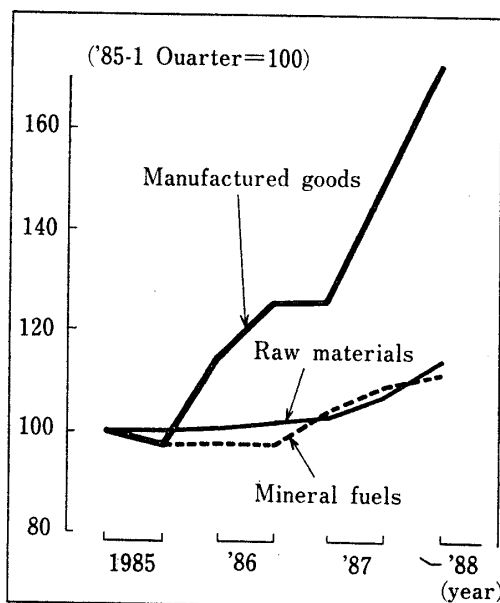
Japanese Economic structure have changed on a large scale. The first change is in the movement in the component of commodities for imports. Reflecting the sharp drop in crude oil prices, the ratio of imports of manufactured goods to the import total topped 40% on a yen basis for the first time in 1986 and reached the highest level on record. The ratio, afterwards, has been increasing, with the figure reaching about 50% in the January~May term of 1988. (Fig. 3-3) This shows that Japan's import structure has shifted from a raw material-oriented pattern.<sup>10)</sup>

However, a steady decrease of Japan's trade surplus will not necessarily help the U. S. reduce its trade deficit (Table 3-1). The slow correction of the U. S. trade imbalance is attributable partly to a smaller decline of the dollar against the currencies of such nations as the NIEs of Asia, as compared to its sharp fall against the currencies of Japan and European nations. But, the greatest factor undellying

9) Sales prospects in the domestic market are extremely favourable for large television set, automobiles, video tape recorders, etc. this is due to the fact that the manufacturers have switched their attention away from exports and given serious consideration to domestic demand.

10) Imports to Japan from the newly industrialized regions, mainly in South East Asia, and the European community, had the best performance during 1987. There was growth for textile fiber products from South East Asia, and automobiles and chemicals from the European Community. From the united states, there was no longer Increase.

**Fig. 3-3** Changes in Composition of Commodities in Terms of Import Value  
(volume basis)



Source: Ministry of Finance, "Trade Statistics"

**Table 3-1** Trends of Imports and Domestic Demand  
(nominal GNP) (unit: \$ billion)

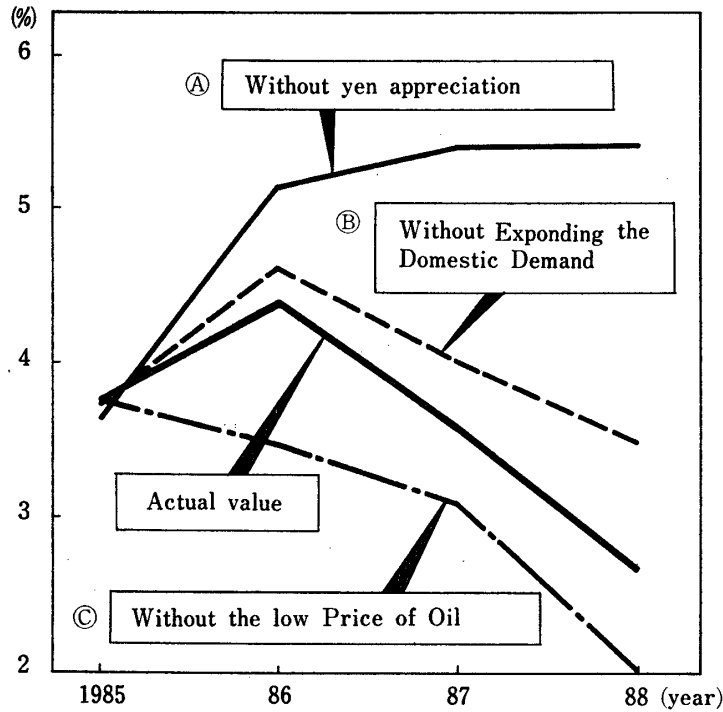
		1970→80 (average)	80→85 (average)	85→86	86→87	the first half 87→88 Annual rate
U. S.	G N P	171.6	255.6	225.3	286.5	336.2
	Domestic Demand	169.3	278.6	251.8	305.1	313.7
	Imports	25.8	26.0	34.0	68.3	72.0
Japan	G N P	85.6	54.4	635.4	419.1	525.4
	Domestic Demand	86.8	42.4	599.2	414.9	536.2
	Imports	14.7	0.2	3.1	41.1	125.2

Note: Statistics obtained from respective countries.

Source: Ministry of International Trade and Industry.

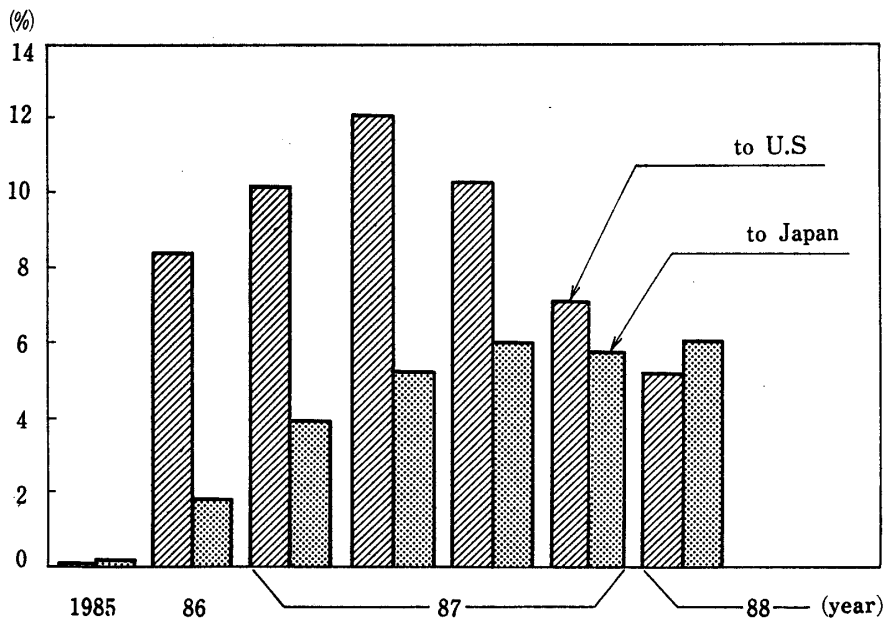
the trade imbalance is that the U. S. has not yet sufficiently corrected the import-dependent nature of its economy. Reflecting this, the U. S. trade deficit with the European Community is declining and that with Japan has stopped rising (Fig. 3-4), while on the other hand, its deficit is increasing in trade with the Newly Industrializing Economies of Asia and other Southeast Asian countries at a considerably rapid pace. (Fig. 3-5) In short, if the U. S. really hopes to reduce its trade deficit nothing is more important than its own efforts. The U. S. must now regain international competitiveness, taking advantage of the recent fall of the dollar. It must also

**Fig. 3-4** The Appreciation of Yen and Japanese Current Account Surplus (Ratio to GNP)



Ⓐ '85 Jan~Mar \$1=¥255.5    Ⓑ '85 Jan~Mar 1 barrel=\$28.6  
 Source: Economic Planning Agency.

**Fig. 3-5** Trends in Asian NIES Exports by Region (Compared with previous year. Contribution in increasing export of NIES)



Notes: IMF "Direction of Trade Statistics" Statistics obtained from respective Countries.  
 Source: Bank of Japan "Monthly Report"

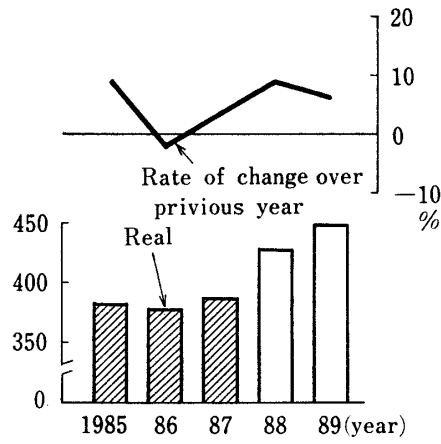
improve the domestic production foundation and boost its exports.<sup>11)</sup>

**Conclusion**

The major problem confronting the world is the trade and budget deficits of the U. S. Their correction requires the effort of the U. S. to curtail its own fiscal deficit. The fact that this curtailment is very difficult to achieve should be kept in mind. However, Japan cannot remain a spectator of this serious problem facing the

11)

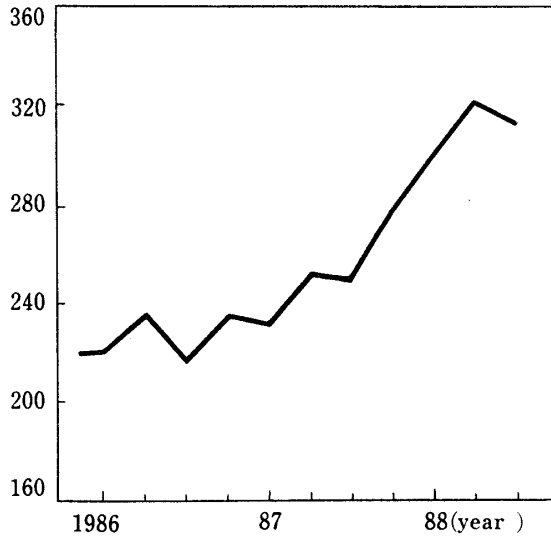
Trends in Plant and Equipment Investment in U. S. Industry  
(unit : billion)



Note : 88, 89=forecast  
Source : U. S. Department of Commerce

U. S. Merchandise Exports Are Booming

(Unit: Billion)



Note : Quarterly export values are at an annual rate.  
Source : U. S. Industrial Outlook 1989.

Americans. Japan must take the initiative to suppress protectionism in order to protect the free trade system through the achievement of an external equilibrium that is internationally harmonious and makes a positive contribution to the international economy and community.

It is necessary for Japan to construct an internationally harmonious economic structure. To this end, structural adjustments must be quickly promoted, while expecting further effects generated by the high appreciation of the yen. An increase in overseas investment<sup>12)</sup> and establishment of market access<sup>13)</sup> will help serve such an end. Japan's imports, as analyzed in section 3, have already increased substantially. Japan's domestic-demand-led economic policy and yen appreciation will contribute to the rectification of the external balance.<sup>14)</sup> The expansion of domestic demand should serve primarily to facilitate economic restructuring of the international deflationary effects of the process of rectifying the external imbalance through yen appreciation, and the shrinkage of the U. S. trade and fiscal deficit. For the sake of the development of the world economy, Japan and other Western nations must assume a part of burden of the world which the U. S. has borne thus far. Cooperation with the Newly Industrializing Economies in development is also required.

#### References

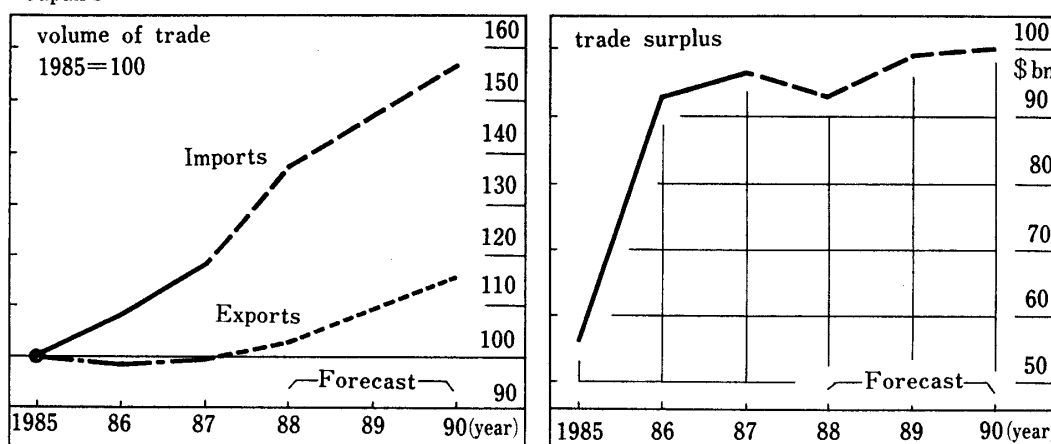
1. Arye L. Hillman and Heinrich W. Ursprung [1988] "Domestic politics, Foreign Interests, and International Trade Policy" *American Economic Review*, September.

12) Japanese companies are increasingly internationalizing their activity recent trends in foreign direct investment include:

- i) increased investment in north America, particularly in capital and technology-intensive industries.
- ii) increased direct investment in finance, insurance and other service industries; and iii) an increased proportion of investment in Asia and Europe in fiscal year 1987.

13) European automobile companies such as BMW Japan, Volvo Japan, Mercedes-Benz. Japan etc., which had already strengthened their marketing systems in Japan, have increased their sales rapidly every year.

14) Japan's



Sources: OECD; Nomura Research Institute (*The Economist*, January 7, 1989).

2. *Business week* [1988] "The Myth of Japan's Middle Class" August 29.
3. ————— "The Scriptwriters for Japan's New Global Role" October 13.
4. ————— "Spending is Up, but so Are Price" December 26.
5. ————— [1989] "Consumers Dig Deeper into Debt" January 23.
6. Economic Council [1987] Policy Recommendation of the Economic Council—Action for Economic Restructuring.—
7. ————— [1988] Economic Management within a Global Context.
8. Economic Planning Agency [1987] Economic Survey of Japan: white paper, Tokyo Japan.
9. ————— [1988] —————
10. Gene Koretz [1988] "Dont Bank on Baby Boomers to Hike the Savings Rate" *Business week*, November 21.
11. Haruo Mayekawa, others [1986] the Report of the advisory Group on Economic Structural Adjustment for International Harmony.
12. Exective office of the president [1989] Budget of the United states Government 1990.
13. International Monetary Fund [1988] Annual Report 1988.
14. James, C. Cooper and Kathleen Madigan [1989] "Will the Economy's Strength Be its own worst Enemy?" *Business week*, January 16.
15. Japan External Trade Organization [1988] White Paper on International Trade 1988. Tokyo, Japan.
16. Jeffrey A. Frakel and Katharine Rockett [1988] "International Macroeconomic Policy Coordination When Policymakers Do not Agree on the True Model" *The American Economic Review* June.
17. Ministry of International Tarde and Industry [1987] white paper on International Trade, Tokyo Japan.
18. ————— [1988] —————
19. Ryuzo Sato [1988] The U. S. Japan Trade Imbalance From The Japanese Perspectives, working Paper No. 2479. National Bureau of Economic Research. INC. Cambridge.
20. *The Economist* [1988] "The Diaspora Comes Home" May 28.
21. ————— "Feeling Poor in Japan" June 11.
22. ————— "America's Export Dream" July 23.
23. ————— "The Next Japans" July 30.
24. ————— "Now the World is Japan's Co-prosperity Sphere" August 13.
25. U. S. Department of commerce [1988] U. S. Industrial Out Look.
26. ————— [1989] —————

※ **Fig. 1-1** (p. 2) seasonaly → seasonally  
 ※ **Fig. 1-4** (p. 5) builadings → buildings  
 ※ **Fig. 3-2** (p. 11) demond → demand