

# Asia Pacific

I S S U E S

**Analysis from the East-West Center****No. 8****October 1993**

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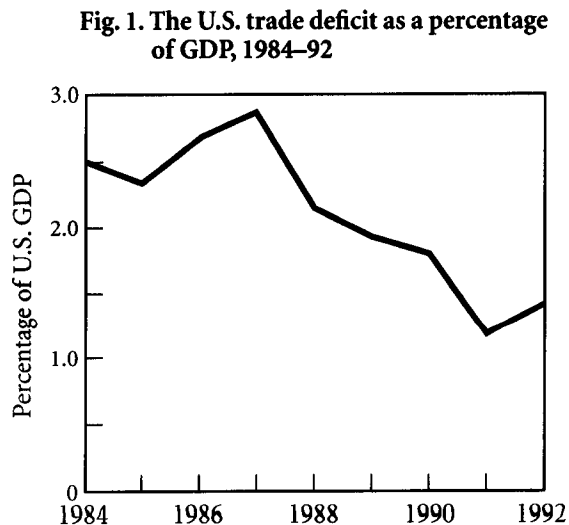
**S U M M A R Y** U.S. trade deficits with Japan and other countries have led many to believe that Asia is the source of America's trade problems—and that Latin America is the “natural market” for the United States. In fact, the worldwide U.S. trade deficit has declined sharply, and the country's best markets are in East Asia. Japan spends \$50 billion on U.S. products, two-thirds of them manufactured goods, and U.S. sales are booming almost everywhere else in Asia. Though Mexico is a rapidly growing market, U.S. exports to the rest of Latin America in 1992 were \$35 billion—less than U.S. sales to just Korea, Taiwan and Singapore. America's misplaced anxiety about Asia, and over-emphasis on Latin America, could relegate the United States increasingly to the Western Hemisphere. This in turn could lead to the hardening of the world into three blocs—in Europe, the Americas and Asia—each organized around a powerful industrial economic base and each suspicious of the other.

### Distorting the Trade Deficit

United States support for free trade areas in the Western Hemisphere derives mainly from its worries about U.S. trade deficits everywhere else. But those worries are terribly exaggerated. What has largely gone unrecognized is that after the record high of \$152 billion in 1987, America's trade deficit then fell every year through 1991, when it was \$66 billion. The 1992 rise, to \$84 billion,<sup>1</sup> was about half its 1987 peak, and was the first increase since 1987. The rise clearly was not caused by a slowdown in U.S. exports: they grew by \$26 billion, but imports rose even more (\$45 billion). This reflected both recovery in the United States and slowdown in Europe and Japan. (For example, Japan's burst "bubble" led Japan Air Lines to slow its receipt of large aircraft—America's leading export.)

The deficit has fallen from 2.8 percent of Gross Domestic Product (GDP) in 1987 to 1.4 percent in 1992 (fig. 1). Despite the many press and congressional references to America's "ballooning deficits," the dollar-value of the trade deficit in 1992 was \$20 billion *less* than it had been in 1984 (fig. 2).

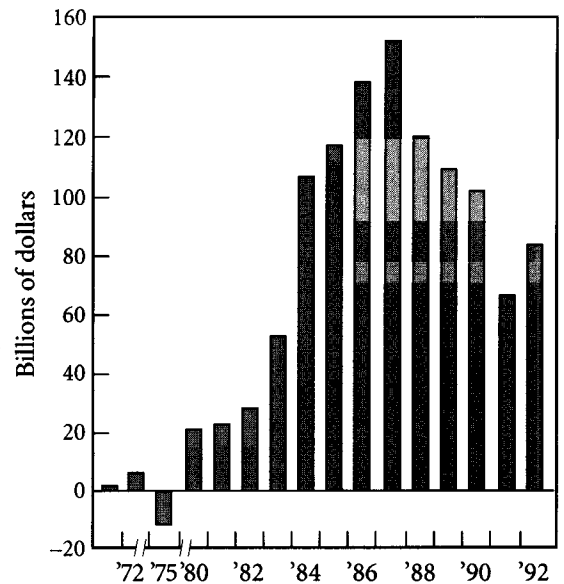
Even more significant—and dramatic—has been the decline in America's trade deficit as a percentage of global U.S. trade (fig. 3). This is the most important measure because it tells us the size of the deficit within the context of constantly increasing U.S. trade. The trade deficit has



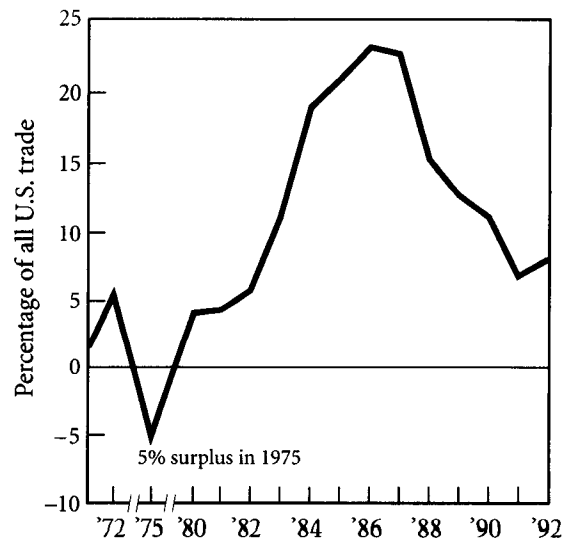
actually fallen from a level equivalent to almost 24 percent of trade in 1987 to 8 percent in 1992. That was less than it had been 15 years earlier—in 1977—when the deficit was 10 percent of total trade.

There is a simple reason why America's trade deficit has returned to the same relative level as 15 years ago: U.S. exports have grown sharply, while its imports have been much more restrained. A good example is trade with Japan. From 1985 to 1992, U.S. exports there have more than doubled—from \$22.6 billion to \$47.8 billion—but in the same period, imports have risen by less than a

**Fig. 2. The U.S. trade deficit, 1971–92**



**Fig. 3. The U.S. trade deficit as a percentage of all U.S. trade, 1971–92**



**President Clinton  
has ignored the  
doubling of U.S.  
exports to Japan**

third. Indeed, both in 1990 and 1991 the United States imported less from Japan than in 1989, and moved ahead again only in 1992.

The fact is that America's foreign trade position is in far better shape than conventionally thought. The common view is that the United States continues to experience very large, still-growing and presumably unacceptable trade deficits. Its corollary is that American exports cannot compete in world markets. Both views are more myth than fact, but they have powerfully distorted American trade policy. In reality, both in dollar-size and relative to the size of overall U.S. trade, America's trade deficit has fallen sharply. The further reality is that U.S. exports are demonstrably successful—especially in Asia. And it is these job-creating exports that move the American economy in the right direction.

Nevertheless, the powerful symbolism of a trade "deficit" lives on, with all its connotations of state weakness and profligacy. That is why the deficit with Japan has come to mean, for many Americans, that Japan is strong and America is weak. The Clinton administration apparently shares this view—choosing to focus on U.S. trade deficits, rather than its already-healthy exports—even when both are in the same market.

President Clinton made this clear during his first formal press conference on 24 March 1993. When he spoke about trade, Japan was his entire focus—but not as America's largest overseas market, with \$48 billion in U.S. imports each of the last three years. Instead, the president spoke with irritation only about the U.S. trade deficit with Japan, saying: "The persistence of the surplus can only lead one to the conclusion that the possibility of obtaining real, even access to the Japanese market is somewhat remote."<sup>2</sup>

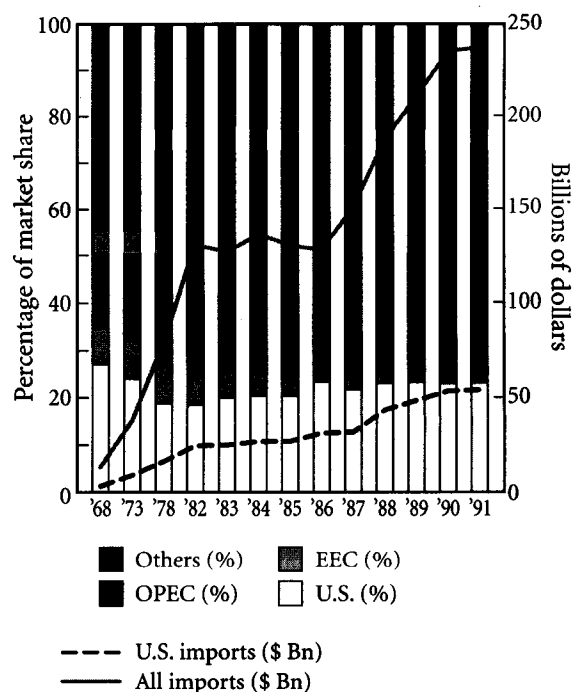
Mr. Clinton is wrong about both the "persistence" of the deficit with Japan and about America's presence in Japan's market. When the deficit was at its worst, in the mid-1980s, it equaled half of U.S.-Japan trade, but it has fallen to a third of their trade today. Even in dollar terms, the deficit is several billion dollars smaller now than it was then, and U.S.-Japan trade is far larger now than it was in the 1980s. Likewise, in assuming that

the deficit is the whole story, the president has also ignored the doubling of U.S. exports to Japan since the mid-1980s. In 1991, two-thirds of U.S. exports to Japan were manufactured products, and as Japan's global imports have grown sharply, so have its imports from the United States (fig. 4). Indeed, the 23 percent U.S. share of Japan's expanding import market has been rock steady; only the bursting of Japan's "bubble" has restrained its recent growth.

### It's Not Asia vs. Latin America

The United States trade deficit with Japan—and almost everywhere else in Asia—has led many to believe that Asia is the source of America's trade problems. That belief has been reinforced by another myth: that Latin America is the "natural market" for the United States. Two economists who make that case are Lester Thurow, former dean of the MIT Business School, and Sydney Weintraub, a prominent economist at the University of Texas who specializes on Latin America. When they compare Latin America and Asia as

**Fig. 4. Market share and value of Japan's imports, 1968–91**



Source: Calculated from IMF Direction of Trade Statistics, Various Years. Data for 1992 not yet available.

markets for U.S. trade and exports, they describe the two in largely zero-sum terms: Asia as distant, largely closed and not quite fair, and Latin America as proximate, open and receptive. A good illustration is Weintraub's recent advocacy of NAFTA, where he writes that trade with Mexico is good for America, but trade with Asia is not: "There is an advantage for the United States to have imports, if they come at all, come from Mexico rather than from some other country, *say, an Asian tiger*. The reason is that most of Mexico's foreign exchange earnings turn right around and are spent in the United States. Most imports into Asian countries come from non-U.S. sources, *such as Japan*."<sup>3</sup>

There is no basis, either in logic or evidence, for that statement. Of course "most imports"—in almost all countries—"come from non-U.S. sources." How could it be otherwise, unless the United States literally dominated all world trade? Nor is it true that most Asian countries import "most" from Japan. In Korea, the United States and Japan hold nearly equal market-shares (in

1991 Japan sold \$21 billion and the United States \$19 billion), and in Taiwan the U.S. share has been a steady 22–26 percent for more than 25 years. Indeed, it is Japan whose share of Taiwan's import market has most sharply declined (fig. 5).

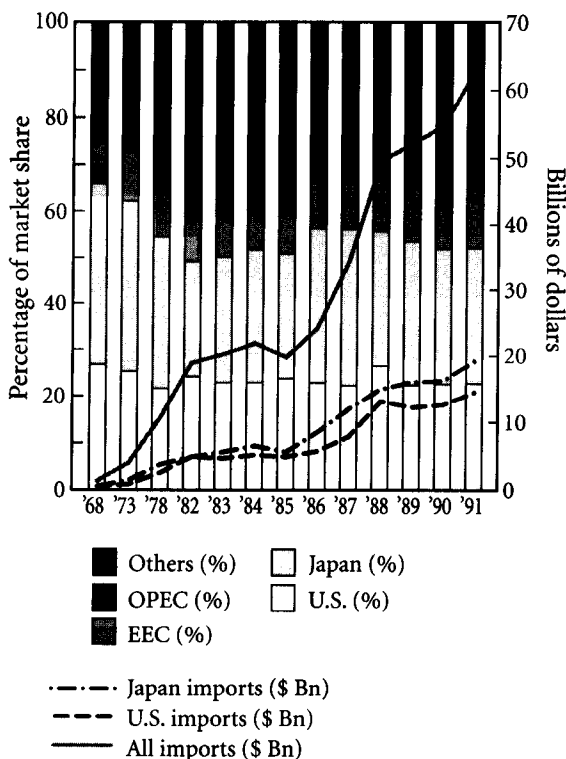
This American export record has made Taiwan and Korea the sixth- and seventh-largest U.S. markets—despite Japan's proximity to its former colonies, its far larger investments in both and its ties of culture and language. Yet the view persists that Latin America is the "natural market" for the United States. For example, a recent book on U.S. trade and investment in Latin America argues that while Mexicans spend their dollars on American products, Asians use theirs only to buy U.S. Treasury bills: "While developing countries in Asia tend to use their trade revenues from the United States to purchase government bonds, *thereby supporting the U.S. trade deficit*, Mexicans use their export receipts from the United States to buy U.S.-made goods and services."<sup>4</sup>

Likewise, the "developing nations" advisor to New York's Salomon Brothers investment and banking house commented early in 1993 that it is mainly Latin Americans who buy U.S. goods: "Everybody's worried about the economy. Where is the place that we, the U.S., export, and from which we could get the most jobs? It's not Japan or Europe. *It's Latin America. . .*"<sup>5</sup>

The evidence does not support these views. Just Korea and Singapore, for example, with a combined population of 47 million, buy more from the U.S. than all of South America—with a population of more than 300 million (fig. 6).

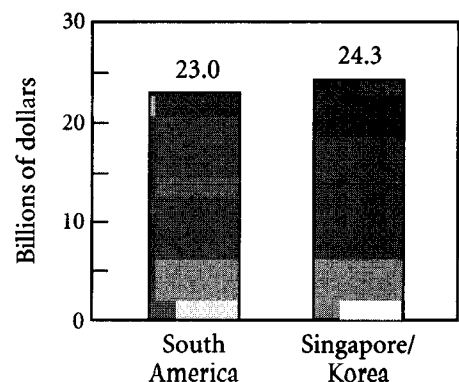
Moreover, Korea and Singapore—along with

Fig. 5. Market share and value of Taiwan's imports, 1968–91



IMF data for 1992 not yet available.

Fig. 6. U.S. exports, 1992



**Some Asians feel  
that regionalism is  
the order of the day**

Taiwan—are also among the top 10 importers of America’s manufactured goods. No *South* American nation is in that group; in all of Latin America only Mexico ranks that high. But years of public attention to our Asian trade deficits, reinforced now by President Clinton’s voice, have smothered those realities, and put Asia further beyond the pale in American thinking. One result is that the already-strong U.S. commitment to create NAFTA, and the growing U.S. interest in “free trade” arrangements in South or Central America, have both been reinforced by the false belief that no other regions are such good markets for the United States.

NAFTA proponents, and others who urge special U.S. arrangements with Latin America, may welcome that support, but zero-sum advocacy has its price. Especially to the extent that Asia is portrayed as America’s trade “enemy,” there are likely to be unintended and negative results. The most obvious is the needless American support for protectionism against Asian products—needless because it is based on false information. Beyond that, prominent Asians—hearing increasingly that the United States regards Latin America as its “natural market”—are inclined to respond that if Washington is going to build a Western Hemisphere trade group, then East Asians may have little choice except to form their own.

The U.S. administration’s strong support for NAFTA has quickened the pace of interest and support for Asian regionalism. That’s why Australian Prime Minister Paul Keating, who most certainly wants a continued American presence in Asia, has warned that if GATT fails, a Pacific trading group might emerge to counter the EEC and NAFTA. And as former Prime Minister Margaret Thatcher wrote recently in the *Far Eastern Economic Review*, there is a fear in East Asia that NAFTA will emerge as “another trade bloc. . . . This in turn has led Asians to start thinking about the possibility of their own regional trade bloc.” Jagdish Bhagwati, a leading scholar of the post-war international trading system, has said that European and American Free Trade Areas have “created a sense elsewhere that regionalism is the order of the day and that others must follow suit.”<sup>6</sup>

In Asia especially this promises to lead to an outcome opposite the long-term interests of the United States: the formation of an East Asian economic bloc. That development, particularly if it means a role of economic leadership for Japan in East Asia, will have serious consequences. It will inevitably worsen the already-troubled U.S.-Japan economic relationship, and it is likely to threaten their political ties as well. And just as important, the emergence of regional trade blocs could deny the United States an opportunity to expand its exports to the large and very prosperous markets of Asia.

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**When A Trade Deficit Matters**

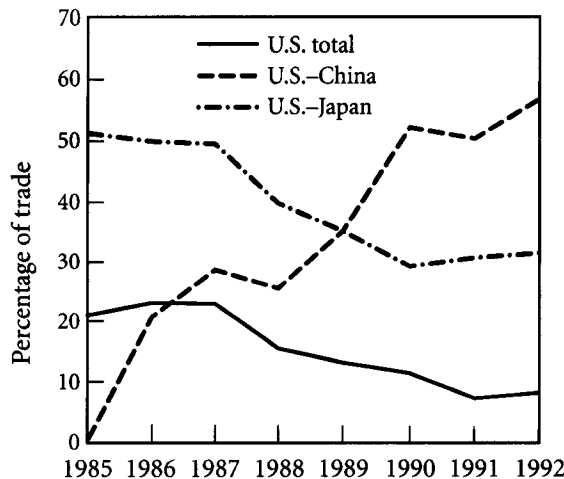
Our misplaced anxiety about Asia, and over-emphasis on Latin America, results from more than just the American penchant to ignore the economists’ advice not to worry about bilateral trade deficits. What Americans have also ignored, in their fixation with annual and even monthly bilateral deficits, is what is most meaningful about deficits: their *relative size* and their *direction*. Just as a child who lifts 10-pound barbells is an impressive sight—but an adult doing the same thing is not—a trade deficit’s size is meaningful mainly in the context of the overall trade of which it is a part. Likewise with direction: The important question for Americans is not simply whether a trade deficit is going up or down, but how its direction compares with the bilateral trade—particularly the U.S. export portion—of which it is a part.

We can illustrate the importance of size by examining America’s two largest deficits—with Japan and China—and comparing them with the pattern of the worldwide U.S. trade deficit (fig. 7). The worldwide deficit has fallen—from almost 25 percent of total trade in 1986–87 to 7–8 percent in 1991–92. The U.S. deficit with Japan has declined from more than 50 percent in 1985 to just over a third today. But with China (the PRC) the deficit has risen sharply: from almost nothing in 1985 to nearly 60 percent of U.S.-China trade in 1992 (table 1). The deficit with China rose from \$6 million in 1985 to \$18 billion in 1992.

The importance of direction is powerfully illustrated by comparing U.S. exports to China and Japan, in the light of America's trade deficits with each (fig. 8). In China, where there are small and only slowly growing U.S. exports, we see a steeply rising deficit. In Japan, where there are already-high and generally growing U.S. exports, it shows a substantially declining deficit. Both deficits are large, but in what ways does either one matter, if at all?

The China deficit poses the more difficult question. The sharp rise in the U.S. trade deficit with China—exactly opposite the U.S. experience with Japan—is caused by the near stagnation of American exports to China, while its imports

Fig. 7. U.S. trade deficits as a percentage of U.S. trade, 1985–92



from China have exploded: Since 1985 U.S. imports from China have grown by 560 percent, but its exports to China have risen by just 90 percent. Despite China's exceptional 11–12 percent annual economic growth, U.S. exports there remain small and generally are growing slowly.

This contrast between burgeoning imports and slow-growing exports is the stuff of which politically explosive trade disputes are made. If bilat-

Fig. 8. U.S. trade with Japan and China

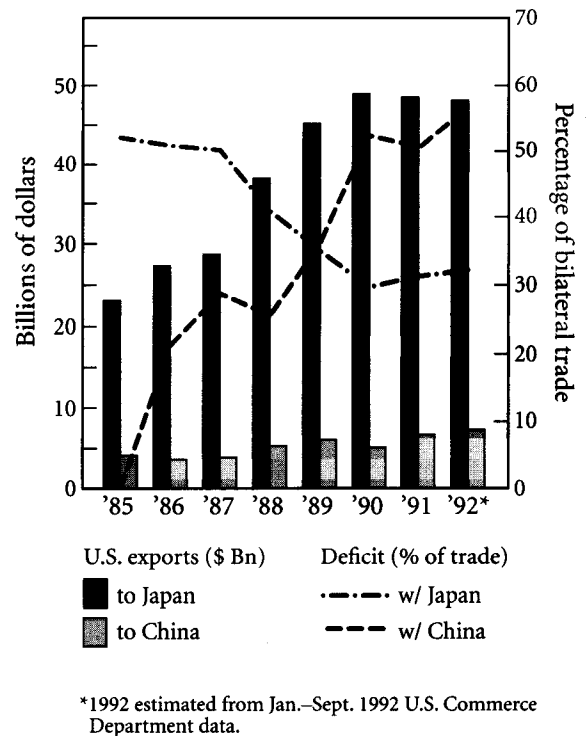


Table 1. Looking at the U.S.-China trade deficit in context

The U.S.-China(PRC) trade deficit grew from almost nothing in 1985 to 60 percent of trade in 1992. It could be argued that this exaggerates the deficit because it does not include trade with Taiwan and Hong Kong (sometimes seen as parts of a growing "three Chinas" reality). But combining the three would falsely represent the China deficit as smaller than it is. This table, which shows U.S. trade deficits as a percentage of its trade with countries as unrelated as Indonesia and Germany, shows that U.S. deficits are in widespread decline. The rising China deficit, in other words, is unique.

	1986	1987	1988	1989	1990	1991	1992
Indonesia	56%	63%	50%	48%	28%	26%	24%
Taiwan	56	54	34	36	33	27	23
Germany	41	39	29	19	20	10	15
Singapore	17	21	16	10	10	6	8
Korea	33	35	28	19	12	5	7
Hong Kong	49	42	29	21	17	7	4

**The U.S. economy is not more closely related to the Western Hemisphere than to Europe or East Asia**

eral deficits matter at all, and in political terms they do, it is only in the context of such disproportionality. To the extent the China deficit is seen by Americans as a political issue—which in this case means a political liability—it will need to be balanced or justified by some asset, political or otherwise. But it is not self-evident that there are significant benefits to the United States, either now or in the near future, that meet that test. Even now, China's domestic politics, as well as its foreign policy, are largely indefensible to Americans, and that will compound the problem of the deficit.

Japan—whose deficit with the United States has declined steadily and substantially—is at least moving in the “right” direction. More important, the nearly \$50 billion in U.S. exports to Japan highlights three main points about U.S. trade with Japan:

- Japan is America's *largest* overseas market, especially for American manufactured products;
- the United States is Japan's largest supplier, and regularly accounts for about 23 percent of its import market; and
- Japan's imports of U.S. goods have risen sharply in almost every recent year.

The issue of bilateral trade deficits is in large part one of equity, or “fairness,” not usually a main concern in economics, but a powerful one in politics. The reason is straightforward: It is not any particular size trade deficit, but the size and growth of America's exports that mainly contribute to and affect the employment of the American people and the well-being of the U.S. economy. Consequently, where U.S. exports to a partner are disproportionately small, while imports from that partner are very large, American complaints will have much legitimacy, and U.S. trade policies to reduce those deficits will have much political support. But in the absence of that clear evidence of disproportionality, a bilateral trade deficit has no intrinsic significance. As the economists long have argued, it reflects only the myriad of independent purchasing decisions by consenting adults.

### **Don't Go Beyond NAFTA**

The United States must recognize the importance of its market in Japan as well as its equally large and receptive markets throughout East Asia, especially in the context of the debate over NAFTA. It is important, in other words, to put Asia and Latin America into perspective. Mexico's importance—especially the strategic advantages to the United States of a more prosperous and stable Mexican economy—is undeniable. Similarly, it is impressive that U.S. exports to Mexico have risen so sharply, even without NAFTA. In 1992 they reached \$40.5 billion, a 22 percent increase from the year before.

But the markets in the remainder of Latin America are simply not in that category. In 1992, in all of South and Central America, including the Caribbean, U.S. exports were \$35 billion. That is less than U.S. sales to just Korea, Taiwan and Singapore.

Brazil, the largest of the South American economies, bought \$5.7 billion from the United States in 1992, compared with \$14.6 billion spent by Korea. Chile, often mentioned as the “next” NAFTA candidate, imported \$2.4 billion from the United States. That's about a quarter of the \$9 billion the United States exported to Singapore—with 2.8 million people and only 225 square miles at low tide. Or compare Chile with Malaysia, because their economies are roughly analogous. Their per capita incomes are in the same league (Malaysia at U.S.\$2,670 and Chile at U.S.\$2,300); their populations are not much different (Malaysia has 18.4 million people and Chile 13.5 million); and they have roughly similar levels of U.S. investment. Yet in 1992 the United States sold \$4.4 billion to Malaysia—nearly double the \$2.4 billion exported to Chile.

These comparisons are not meant to minimize the importance of the Latin American markets. Rather, they stress that the exports and investments of the United States make it a uniquely trilateral economic actor. The United States has an obviously strong trade and investment role in the Western Hemisphere, but its economy is not more closely related to that region than to Europe

or East Asia. If Washington succeeds in passing NAFTA, and then in extending NAFTA to Central or South America, it will relegate the United States increasingly to the Western Hemisphere, in economic terms the least attractive of the three world regions, and it will encourage the hardening of world politics into three blocs.

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#### NOTES

1. *U.S. Foreign Trade Highlights 1992*, U.S. Dept. of Commerce, June 1993.
2. *The New York Times*, 25 March, 1993.

3. Sidney Weintraub, "Free Trade in North America: Has its Time Come?," *World Economy* 14(1), 1 March 1991: 62 (emphasis added).
4. Chris C. Carvounis and Brinda Z. Carvounis, *United States Trade and Investment in Latin America*, p. 78 (emphasis added).
5. John F. Purcell, head of the Emerging Global Markets Research Group, Salomon Brothers, in *The New York Times*, 21 March 1993 (emphasis added).
6. Jagdish Bhagwati, "The Threats to the World Trading System," *World Economy* 15(4), July 1992: 454.

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#### About the Author

**Bernard K. Gordon** is a professor of political science at the University of New Hampshire, and has taught in Japan at Kyoto University and Kobe University. During 1992-93 he was a visiting fellow at the East-West Center in the Program on International Economics and Politics. He is the author of several books on Asia, most recently *New Directions for American Policy in Asia* (Routledge, 1991) and writes often for the *Wall Street Journal*. He can be reached at the University of New Hampshire in Durham, N.H. 03824.

Telephone: (603)862-1995

Facsimile: (603)862-0178