Comments and Discussion

Paul Krugman: Robert Lawrence has produced an important paper—one that offers the seal of approval of the economics establishment to the charge that Japan’s markets for manufactures are tacitly closed to imports. His conclusion is that Japan imports about 40 percent fewer manufactures than it would if its markets were as open as those of the average non-Japanese OECD country. That is, with freed markets it would import about 80 percent more. Given the imprecision necessarily involved, let’s round it up and say that Japan might, if it would only open its markets, double its manufactures imports. We realize immediately that the paper is saying something very explosive. Let me say at the start that I believe that Lawrence is very probably right, although some of the methods used are a little shaky. I am much less certain about the political economy offered here, which prescribes trade liberalization as the answer to Japan’s worsening relations with its trading partners. Before I turn to this question, however, let me review the logic of the economic analysis.

The basic piece of evidence on which the conclusions rest is the estimation of a number of import equations based on a differentiated-products model of trade in manufactured goods. Flatteringly, the paper offers this approach as one based on the monopolistic competition models of trade volume developed by Elhanan Helpman and me. However, Lawrence extrapolates considerably from the highly stylized analysis that Helpman and I offered. We used the assumption of zero transport costs as a fundamental simplifying device; Lawrence, because he is interested in reality, is obliged to modify that approach to take transportation costs into account.

Now the step from the no-transport-cost theoretical model to the realistic transport-cost-inclusive empirical model is not a rigorous one.
In fact, as anyone who has worked on the problem knows, it is very difficult to derive a tractable multicountry model of the volume of trade in the presence of transport costs. This task is hard in conventional models; it is if anything harder when we allow for increasing returns, because there are all kinds of complicating effects that arise from the fact that countries with large domestic markets tend to be favored locations for industries subject to large economies of scale. So the equations estimated here are inspired by the Helpman-Krugman model rather than derived from it.

What makes this worrisome is that the role of transport costs is crucial in assessing Japan’s openness to imports. Japan is the only resource-poor advanced country not in Europe, and the only large industrial nation with no industrial neighbors. We need to answer whether the geographical isolation of Japan is enough to explain its low share of imported manufactures, yet we lack a really well-specified model that lets us assess this issue. The Lawrence paper has what I think is a more plausible test that makes better use of the available data than any other effort to date, but even it is not completely satisfying because the empirical result is not firmly grounded in theory.

In spite of this unease, I agree that the rough estimate that Japan should be importing about twice as many manufactures as it does is plausible. Let me offer two less formal pieces of evidence that seem to support this. First, suppose we compare Japanese imports of manufactures with the “nonlocal” manufactures imports of the United States and the European Community. In 1984 the United States imported manufactures from sources other than Canada equal to 4.8 percent of GNP; the EC imported non-EC manufactures equal to 6.5 percent of GNP; Japan’s manufactures imports were only 2.9 percent of GNP. Admittedly, Japan is poorer in resources than either the EC or the United States, which should show up in lower manufactures imports as well as higher exports; but Japan is also smaller than the other two economic units, which would lead us to expect a higher import share. So it would not be unreasonable to expect Japan to have a manufactures import share comparable to that of the EC, which would indeed involve a doubling of those imports.

Second, compare U.S. trade with Japan and that with Germany. As Lawrence points out, Germany and Japan are virtual twins in their net trade patterns. In 1984, however, U.S. manufactures exports to Germany
were 45 percent of U.S. imports, whereas U.S. manufactures exports to Japan were only 23 percent of U.S. imports. Once again, one can suppose that if the Japanese were as well behaved as the Germans their import share would roughly double.

Let me now turn to the problem of political economy. Suppose we accept that Japan should be importing twice as many manufactures as it now does. What we conclude from this depends critically on two questions, one of which the paper does not answer, the other of which it answers in a way that I find implausible.

The question the paper fails to answer is why Japan imports less than it should. At the beginning of the paper two alternative hypotheses are offered: tacit government policy or the “invisible handshake” of Japan’s cartelized industrial structure. It makes a tremendous difference which of these you believe is the truth. If government policy is the villain, then all a liberal-minded Japanese government needs to do is reform itself. Japan’s economic glasnost might be hard to sell to its bureaucrats, but we might have some hope that forceful leadership could change the situation quickly. If the problem is instead rooted in industrial structure, then the government presumably would have to engage in a long-term program of antitrust and moral suasion to bring down the barriers. The paper gives us no clue as to which story is the right one, and thus as to how patient Japan’s trade partners will have to be. My reading of the anecdotal evidence is that industrial structure is unfortunately very important in the closure of Japan’s markets, and thus that even with the best will Japan’s government cannot deliver trade liberalization at all rapidly.

The 8.96 million yen question, however, is whether opening of Japanese markets would really ease trade frictions. Here I just do not agree with the paper’s premise. What Lawrence does is to compare Japan with Germany, which runs a manufactures trade surplus as large relative to GNP as Japan’s, but with seven times as large an import share—and which excites little hostility from the United States. However, even a liberal Japan would not look like Germany—it would still, on the paper’s estimate, export three times as much in the way of manufactures as it imports, essentially because Japan is not in the middle of Europe. Furthermore, I cannot believe that lack of friction with Germany can be explained by German manufactures imports. Recall that most of the intra-industry trade of Germany is within Europe. The
United States sells Germany only 45 cents' worth of manufactures for every dollar it buys, as compared with Japan's 23 cents. Is it really plausible that the difference in popular perception can be attributed to the fact that the voice of the worker who loses his job to German competition is drowned out by the voices of 0.45 exporters, while his colleague who lost out to Japanese competition has only 0.23 exporters to argue with? I am not convinced.

My own alternative hypothesis is that conflict with Japan is due primarily to a different aspect of its trade performance—the rapid growth of Japanese exports and the rising Japanese market share. Unlike the Germans, the Japanese keep invading new markets that the United States regards as its private preserves. My guess is that this creates tension for both rational reasons, such as the problem of adjustment to increased competition, and irrational ones, such as fear and envy. Of course this is a very pessimistic diagnosis, since it says that the only way for Japan to have more friends is to be less successful. We can only hope that the paper is right, and that a liberal Japan would be able to run current account surpluses in peace. I just wouldn't count on it.

**General Discussion**

A number of participants questioned Lawrence's choice of model with which to analyze trade differences between Japan and other OECD countries. Martin Baily wondered why the Helpman-Krugman model had been chosen over a model such as Heckscher-Ohlin, in which comparative advantage is critical and specialization occurs in production. If the Japanese do not have a taste for product diversity, then the latter model is more relevant, and low imports of manufactured goods would be expected because Japan has a comparative advantage in producing manufactured goods. In light of this model, William Branson reasoned that the peculiar thing may be that Japan imports any manufactured goods at all. Lawrence conceded that comparative advantage ideally should be integrated into the model. But with differentiated goods, Japan nonetheless would have significant imports of manufactured goods according to the Helpman-Krugman model. Hendrik Houthakker believed the model's assumption of unitary income elasticities did not apply in Japan for U.S. imports and that the model was too
restrictive in this and other respects. He also observed that Japan is not as geographically isolated for purposes of trade as its distance from Europe and the United States would suggest. Geographically Japan’s natural trading partners are the newly industrialized countries in the Pacific Basin, so one might examine the volume of imports from those countries for evidence of import restraints.

William Brainard elaborated on Paul Krugman’s remark in his formal comment on the paper that the strong conclusions of the Helpman-Krugman model need not apply once transportation costs are introduced. In the presence of such costs, the cross-price elasticities at the product level would be crucial in determining import and export shares. If goods were close substitutes, even minor transportation costs would dominate trade patterns. He therefore questioned whether the regression results presented by Lawrence, even though they allow for transportation costs, provide a test of the Helpman-Krugman model and whether they can identify departures from normal patterns of imports and exports in the presence of transportation costs. Accepting Lawrence’s verdict that Japan spent relatively less on imported manufactured goods than other industrial countries, Brainard reasoned that the paper had not persuasively demonstrated why this was so. In the same vein, Lawrence Summers emphasized that Lawrence’s statistical analysis did not provide proof of “trade barriers” in Japan. The low level of imports could be explained by differences in tastes, language, and geographic location.

Marcus Noland questioned whether Lawrence’s results demonstrate any greater Japanese import restriction than have previous studies. For example, the study by Bergsten and Cline that Lawrence cites concludes that Japan does not have above-normal protection. Adjusting the Bergsten-Cline estimates to make them apply to total Japanese trade implies that Japan’s import restrictiveness is in the range of $7 billion to $15 billion, which is in Lawrence’s range. Noland also questioned the author’s reliance on expansionary fiscal policy in Japan to help reduce the trade surplus. He noted that estimates of that effect are small relative to the magnitude of Japan’s trade surplus, both globally and with the United States. An analysis by the Bank of Japan concluded that over a two-year period, the government’s recently announced plan to provide a $6 trillion yen stimulus package would lower the total Japanese trade surplus by $3 billion to $3.5 billion and lower the bilateral surplus with the United States by about $1 billion. Noland’s own estimates were
somewhat higher in the first case and around $1.3 billion in the second case. Given such small effects of a fiscal stimulus, Noland concluded that significant reduction of the trade surplus would occur only if a high yen changes the structural features of the Japanese economy, such as the distribution system, that hamper trade.

Charles Schultze questioned whether an increase in intra-industry trade would shield Japan from protectionist measures, as Lawrence hoped. In his view, efforts to obtain protection are not organized along broad industry lines, but rather arise from competitive fears of producers representing fairly specific product categories. Greater intra-industry trade, as measured using SIC codes, would not remove these political pressures to stem foreign competition.