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JAPAN'S KEIRETSU SYSTEM

HEARING

BEFORE THE

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JAPAN'S KEIRETSU SYSTEM

WEDNESDAY, OCTOBER 16, 1991

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Baucus, Riegle, Rockefeller, Roth, and Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H-43, Oct. 9, 1991]

BENTSEN SCHEDULES HEARING ON JAPAN'S KEIRETSU SYSTEM, CHAIRMAN CONCERNED ABOUT EFFECTS ON U.S. COMPETITIVENESS

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, Wednesday announced a hearing next week on Japanese keiretsu practices and their impact on U.S.-Japan economic relations.

The hearing will be at *10 a.m., Wednesday, October 16, 1991,* in Room SD-215 of the Dirksen Senate Office Building.

Bentsen (D., Texas) said he wants to learn more about the effect of the Japanese keiretsu—groups of related companies that span many different areas of business—on the ability of American companies to compete in Japan and on Japanese companies operating in America.

"Keiretsu relationships can give rise to anti-competitive business practices and stifle greater foreign competition in the Japanese market. The administration has attempted to deal with these problems through the Structural Impediments Initiative talks with Japan, but has admitted that progress on keiretsu has been disappointing," Bentsen said.

"But the problem is not limited to Japan. We now are seeing examples of the keiretsu system being replicated by Japanese firms that invest in the United States. It has a direct effect on American jobs and competitiveness when these firms establish and then rely on related companies for their supplies, rather than buying from American producers," Bentsen said.

"At this hearing, we'll be focusing on both of these dimensions of the keiretsu issue, and looking for comments from our witnesses in identifying the existing problems and the best means for dealing with them," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order.

Earlier this year I led the fight on the floor of the Senate to give fast track on trade negotiations. The reason I did that is because past trade negotiations normally have led to expansions in trade on both sides, and have helped bolster the economy of our country.

We have seen some real progress on the export front. Last year our total exports grew by $30 billion. We turned a large trade deficit with Europe into a trade surplus. We saw in 4 years our exports to Mexico double. But, unfortunately, those kinds of gains still elude us when we talk about the Japanese market.

Last year we had a $41 billion trade deficit with Japan. That is 40 percent of our total trade deficit. This year's trade deficit with Japan is running slightly ahead of last year. Last month Japan's surplus with us went up 7 percent. And Japan had its largest monthly surplus ever overall.

Now, sure, that is better than the peak $57 billion deficit that we had with them back in 1987, but it is only a $5 billion improvement since 1985. That is even though we have seen the dollar go down approximately 50 percent in its relative value to the yen. That hardly qualifies as a success story.

If you really want to understand what is happening to the economy of your country, take your dollars overseas and see what they will buy today. Or if you want to see it in reverse, look at the fire sale you are having in this country of assets to foreign interests who spend currencies that have become much stronger than the dollar.

In addition to that, many of our trade gains with Japan have come from sales of farm products are raw materials. Japan still takes only 3 percent of its GNP in manufactured imports. In our country we take over 10 percent. Almost 80 percent of what Japan sends us is machinery, vehicles, and parts. That compares with less than one-third of what we send to Japan.

Now why do our trade problems with Japan persist year in and year out when we solve them with other countries? Why, despite years of negotiations on formal barriers like tariffs and quotas, do our companies still have a tough time gaining a strong foothold in Japan?

One of the main problems is the impact of Japan's keiretsu. Those are the huge corporate groups that cut across industries, that share business strategies and financing and top officials. Keiretsu have a vast influence in Japan. You do not have to take an American's word for it; take a look at an article by a prominent Japanese industrialist in the Harvard Business Review. He writes, "Keiretsu is the ultimate force in Japanese industry."

Now in theory keiretsu are not necessarily bad. A stable relationship with suppliers, sharing information on research and business strategy, and moving top officials from one part of a keiretsu group to another can make some economic sense. But on the other side keiretsu have some very pernicious affects.

They limit the rights of small shareholders. They restrict distribution channels and that raises the cost for consumers. And most important, they make it really tough for foreign firms to sell in Japan.

Today the effects of keiretsu are also being felt here at home. As Japanese manufacturers open U.S. plants, they bring their subcontractors with them, their suppliers, Japanese suppliers, often part of the same keiretsu. They tend to keep buying from those suppliers.

Let me give you an example of that. When we talk about Japanese transplants in this country and who they buy their parts from, they buy less than 20 percent of their parts from American-owned firms.

Now keiretsu obviously are not the full explanation for the problems American firms are having in trying to develop business in Japan. Let me cite you a couple of recent examples of other problems. Down in Texas we have a premier ice cream company, called "Blue Bell." Now they had some Japanese businessmen who came into see them, studied their product, their manufacturing, the formulas for their ice creams, and who then went back to Japan and filed for the trademark under their ownership—Blue Bell's trademark. Really outrageous!

When the company told me about it I contacted Ambassador Carla Hills and she intervened and the Japanese reversed their position.

Let me give you another example. A few weeks ago the General Accounting Office reported to me that Japanese firms are withholding state-of-the-art electronics equipment from American firms while they provide the same equipment to Japanese companies.

So dealing with keiretsu barriers certainly will not solve all of our trade problems with Japan, but it certainly can make the playing field a little more level.

In today's hearing this committee will hear from both business leaders and scholars, as well as a very distinguished Senator who will bring a great deal of experience to the consideration of this issue. I look forward to hearing those views concerning these problems and means by which we might address them.

I would like to now defer to my colleague, the Chairman of the Subcommittee on Trade, Senator Baucus.

STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you very much, Mr. Chairman. I compliment you for holding these hearings.

Frankly, I believe that Japan's keiretsu system may be the single most important impediment today to better trade relations with Japan. It's a very nebulous concept to some. Many Americans don't know very much about it, what it means, can't identify it by name.

But I think most Americans can identify it in practice. They know it is a major problem with Japan. They know that Japan is too closed. I believe, frankly, that there are many ways that the United States can address it. I suggest that it is not only through the structural impediments initiative, but I think a Section 301, a broadly defined Section 301, could be appropriate to address Japan's keiretsu system.

There are a lot of different tacts, a lot of different angles, lots of different ways that we can approach the general problem. It goes without saying that much of the reason for the trade deficit between the United States and Japan is due to some problems here at home. But it is also true that much of the reason for the trade deficit that we have with Japan is due to the Japanese keiretsu and other measures which erect barriers to Americans doing business and selling goods in Japan.

I think that the Japanese do not wear black hats. They are not the Darth Veders of the world. We Americans do not wear white hats. We are not more purer than the driven snow. We have trade barriers ourselves. But it is equally true that the shade of gray of Japanese hats is a lot darker than the shade of gray of American hats.

The keiretsu is one reason why the shade of gray of Japanese hats is so much darker than the shade of gray of American hats. I hope that these hearings are a major step forward in addressing this very unfair practice that the Japanese undertake.

Thank you very much, Mr. Chairman.

The CHAIRMAN. I am very pleased to have Senator Carl Levin, who represents a State that is particularly impacted by this concern and this problem.

I would say to my distinguished friend that I am charged with management of the unemployment compensation pension bill on the floor, so I will leave it under the able chairmanship of my friend, Senator Baucus. Tell us about it.

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM MICHIGAN

Senator LEVIN. Thank you, Mr. Chairman. You are doing God's work there as well as here. Thank you.

This keiretsu system which this committee is looking into today is a system of interlocking businesses and exclusionary practices which is literally devastating American industries and draining our Nation of jobs.

The Small Business Subcommittee, which I chair, has looked into keiretsu and we have discovered the impact, particularly on small businesses in America.

Mr. Chairman, I wish American firms were just competing with individual Japanese firms. Instead they have to compete with a nation—Japan, Inc.—a coordinated network of banks, trading, insurance, steel, textile, construction, electronic, food and other companies. American companies are not going one-on-one with Japanese companies. They are up against a 500 pound gorilla.

A recent article on the Japanese keiretsu system in the Washington Post listed six of the principal horizontal keiretsu. One of them is the Fuyo keiretsu. Now while the name Fuyo is not well known in the United States, the Fuyo keiretsu includes companies whose names are household words. Take a look at it on that chart over here. That is just a part of one keiretsu. That one part includes Hitachi, Nissan, and Canon. That part does not even include other major industries which are also part of keiretsus, including trust banking, forestry, coal mining, pulp and paper, chemicals, petroleum, rubber, nonferrous metals, nonelectric machinery and on and on.

So in one part of one keiretsu, one interlocking group, we have such companies as Hitachi, Nissan and Canon. The proof of this network and other networks' existence is open and obvious if we would just open our eyes.

In 1989, Mr. Chairman, 70 percent—70 percent—of the stock of publicly-traded Japanese corporations was held by other corporations. This chart shows that.

Think about that one fact in terms of keiretsu and what the Chairman said here about the small role that small stockholders therefore have in Japan. Seventy percent of the stock of Japanese publicly-held corporations is held not by individual stockholders but by other corporations. You cannot have a clearer proof of the interlock than that percentage. Proof of the impact of keiretsu is also clear. And, indeed, the current U.S. Trade Representative lists keiretsu in her annual report on foreign trade barriers.

These interlocking relationships give Japanese companies a tremendous advantage over American companies. Japanese companies have little pressure to maximize dividends, enabling them to take losses, to strangle competition and to win market share in one area, while being supported by profits in other areas.

Another important result is that the company interlocks make it next to impossible for outsiders to access the Japanese market. There is a protected home market in Japan without price competition from imports, which allows Japanese firms to reap the large profits at home which are necessary price aggressively abroad to gain market share abroad.

A recent price survey jointly conducted by the United States and Japanese Governments indicates that this is exactly what is happening in the auto parts sector. That study shows that identical or comparable auto parts cost on average 340 percent more in Japan than in the United States. That is a joint United States-Japanese study.

For instance, this Japanese-made shock absorber costs $83 in Japan. This shock absorber, the same one, costs $18 in the United States. This American-made shock absorber costs about the same, $23. A wiper blade which costs $12 in Japan costs $3 here. An ignition coil which costs $93 in Japan costs one-eighth as much here.

Mr. Chairman, if there were a free market in Japan we would be selling them a heck of a lot more auto parts with those price differentials.

In fact, it is estimated that overall Japan would import $30 billion more each year were it not for the keiretsu relationships. And moreover, as the Chairman indicated, these business networks and these exclusionary practices are being duplicated in this country. Hundreds of Japanese parts makers have followed the Japanese auto makers which established assembly operations in the United States.

So rather than creating jobs these transplants have actually displaced jobs because they have often shut out traditional American parts makers, preferring to source from Japanese parts makers instead. After years of prodding and promises to give American parts makers a chance to compete for sales, traditional American parts still account for less than 20 percent of the value of the vehicles made by Japanese transplants here in the United States.

Study after study has documented this problem. It is clear what is happening and the future of the American auto parts and other industries is now on the line. Every 16 hours of every day an auto parts manufacturer goes bankrupt in the United States. It is not that they cannot compete, but that they are not being given a chance to compete.

Parts makers in America successfully compete in every single market in the world except Japan. Our auto parts trade is in balance with the rest of the world. Only in Japan do we have this huge deficit and a significant cause of it is keiretsu. We have been virtually shut out of the Japanese $102 billion parts market and now we are being similarly locked out of part of our own domestic market.

Mr. Chairman, the $10 billion auto parts trade deficit which we had in 1990 grew from a $2 billion deficit in 1984, and if we do not take action it is expected that by 1994 there will be a $22 billion trade deficit just in auto parts between ourselves and Japan.

This administration, like those before it, proposes more studies and more talk. But the administration's own industry advisory committee has made some concrete recommendations to stop the hemorrhaging.

In June the Auto Parts Advisory Committee, chaired by Jack Reilly, who you will hearing from shortly, publicly urged the administration to begin preparation of both Section 301 and antidumping proceedings against Japan. Yet 4 months later, no action has been taken on these recommendations.

The Auto Parts Advisory Committee has shown leadership and courage and vision; and it is now up to the administration and up to the Congress to do the same. But the truth is, I am afraid, that this administration is not going to act unless prodded by the Congress to act or required to act by law. That is the history. That is the sad fact. So it is up to us to do the prodding and the legislating. I just see no other alternative.

No more studies, please. Action is so long overdue that that has been said for 10 years, that action is long overdue. This committee has the lead role. I urge you just to finally say yes to legislation which places equivalent restrictions on the goods of countries which discriminate against American goods.

That is where we are. We have been there for years. I would urge this committee to act on legislation, to place those equivalent restrictions on countries that discriminate against American goods, like the Japanese keiretsu system, whether it is auto parts we are talking about, electronics, wood products, whatever. It is time for this Congress to act.

I thank you, Mr. Chairman, and other members of the committee for again both holding these hearings and for allowing me to testify.

[The prepared statement of Senator Levin appears in the appendix.]

Senator BAUCUS. Thank you very much, Senator. I think you made a very compelling statement and it is one I think that others who have studied the issue would generally agree with. I also believe that there has been a lot of talk and not enough action.

Frankly, I recommend two major specific actions which I think this country can undertake to specifically address the keiretsu problem. Number one, I believe that—and I will be introducing legislation to accomplish this—we should extend Super 301. Congress must extend Super 301 and under Super 301 an action should be taken to address many of our problems with Japan.

This is more in the nature of a Super 301 matter and that is all the more reason why I think this Congress must enact such legislation.

Second, I believe that there is a major opportunity here for the United States to commence action on Article 23 of the GATT; the Impairment and Nullification provision of the GATT. That is, Japan has undertaken the obligation of lowering tariffs. But at the same time, Japan has nullified and has impaired those benefits with its keiretsu and other closed actions.

The keiretsu problem confronts not only America, but also other industrialized countries of the world. There is a major opportunity for a multi-lateral action in addition to American unilateral action to address the problem. I very strongly urge the U.S. Government to commence under Article 23 an impairment and nullification action in the GATT with Japan.

Now it seems to me that those two actions and others will begin to address some of the problems that we face with the Japanese keiretsu system.

I would now like to turn to my colleague, Senator Riegle, for any statements or any questions he may have.

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

Senator RIEGLE. Thank you, Chairman Baucus. I want to commend my colleague from Michigan, Senator Levin, for an excellent statement and presentation today. I think it really helps lay the problem out very graphically.

I want to say to you, Mr. Chairman, how much I appreciate the comments that you have just made with respect to an extension of Super 301 and the other trade actions that are available to us in efforts with our trading partners.

This is a very serious problem. Our economy is struggling as we all know. Every part of the country is having economic difficulty of one kind or another. In the State of Michigan where I and Senator Levin come from the unemployment rate has just risen again to 9.7 percent. In the industrial heartland areas of the country we are seeing the accumulating damage of these predatory trading practices and particularly the keiretsu practices.

We have had to deal with those in an unfair trading regime over many years when most unfair trade practices were going on only in Japan. Now that Japanese companies have established on-shore U.S. affiliated operations they have transferred the keiretsu practices into our own domestic economic arena. In my view, this Japanese "business" practice is doing great damage, in an uncompetitive way to the basic structure of American firms. We see that particularly in the U.S. auto parts industry.

Our biggest deficit problem with Japan in the trade area is in the auto sector. There was a deficit in 1990 of over $31 billion. It is an extraordinary problem. It affects a lot of States. The Senator from Delaware is here and has some manufacturing in his State that are also impacted, although not nearly to the degree we would see in Michigan.

As has been noted the Reagan administration started negotiations with Japan on this problem 4 years ago. The latest round of talks ended just 2 weeks ago and those talks focused on commissioning a study.

The whole business, the rope-a-dope strategy, by the Japanese of talking and suggesting only that studies be taken is a way of really avoiding dealing with the problem. This clearly is not acceptable. We do not need another study to know about the problem of keiretsu. We know that cross shareholding links between suppliers, assemblers and dealers, block U.S. car and part sales exit in Japan, as well as in the United States.

The USTR's advisory committee has already done a study which found that 85 percent of the value of parts used in Japanese transplant cars is traced to Japanese-affiliated companies. That obviously raises the question: By any meaningful definition is that an American car? I think it is not. In addition, I do not believe that the keiretsu and the products produced by its members are in the spirit or nature of the way our trading relationships are supposed to work.

We recently, as you know, had the Honda audit which showed that the Honda Civic is not a North American car under the terms of the United States-Canadian FTA and, by virtue of its less than 50 percent of the content. Honda's U.S. content was substantially below what the law requires. This is just one obvious manifestation of the kind of deliberate trade cheating that has been going on.

Automobile transplants operations in this country, will soon represent over 25 percent of U.S. production of cars. That is up from essentially a zero percent level just a decade ago. If the keiretsu is not broken, the U.S. auto parts industry will shrink at least another 15 to 20 percent. I think in large measure this industry will become severely damaged and possibly a dying industry. I think that has tremendous economic implications for our future with respect to our strategic defense capabilities in components and in other ways as well.

It is interesting to note that the Europeans have put a 16 percent limit on Japanese market share for autos for the next decade. The Europeans are thought of a free traders. But I think they have felt the notion that any nation which allows open access to another country's market and at the same time allows maintenance of a closed market at home is just not a workable proposition.

The decision by the Europeans to establish a 16-percent limit for Japanese autos, about half of what is now the situation in the United States, is in recognition of the fact that the total foreign penetration for foreign autos in the Japanese market is less than 3 percent. I think this number speaks very powerfully for itself and alludes to the inequitable situation that has arisen with regard to market access.

The United States has become the dumping ground for the world's excess auto capacity; and as that capacity continues to grow I think we are going to find ourselves, more severely damaged with respect to American high value-added manufacturing capability, particularly in the area of cars and trucks, which can be transferred to other industries.

In my view, the Bush administration has shown no understanding of this problem nor any serious interest in wanting to deal with it. It has a great interest in foreign policy generally, but not when it comes to international trade and persistent trade cheating. The Bush administration has been weak in these areas and its policy has been one of yielding to unfair practices rather than being aggressive, confronting them and, putting an end to such practices of our trading partners.

Here, I think we could take a chapter out of the book that the Europeans have shown us in terms of the way to deal with these kinds of practices. I think that Congress has to give the Japanese car companies the choice between ending the cartel-like practices or losing part of their overall access to the U.S. market. I feel very strongly about this and I am, in conjunction with others, developing legislation which is nearly completed, which will deal directly with this problem.

That legislation will likely be bipartisan and bicameral and it will deal with both transplant and imported automobiles. The United States has got to insist on a fair trading regime with its trading partners. We do not have such a system today. It is doing great damage to this country and in the absence of a direct and quick response to the Japanese, it is going to take legislative action to correct this important relationship. I am prepared to do everything in my power to see that we take forceful and effective legislative action toward this end.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Senator.

Senator Roth.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE

Senator ROTH. Thank you very much, Mr. Chairman. Let me start out by saying like Senator Levin and Senator Riegle, I think it is very, very important that we have a healthy American automobile business.

I would also say that I think it is critically important that those nations who depend upon exports as a means of prosperity have to reciprocate in having access to their markets in the same degree.

One of the things I am going to be interested in today, and I congratulate the Chairman for calling these hearings, is whether keiretsu is the entire problem. I am much interested in a study or working paper by Prof. Lawrence B. Krause.

He points out that the economies of the United States and Japan are closely linked, nevertheless tensions continue to grow out of that economic relationship. He says one of the roots of that tension may well be the most basic in that it rests on the fact that the model of capitalism practice in Japan is quite different from that traditionally known in the United States.

The U.S. model grows out of a neo-classical economic theory in which individual economic agents attempt to maximize their own utility. Individual business firms try to maximize profits. It goes on to say the government's role in this model is to counter market failures and to ensure proper workings of the market.

To do this, the government usually takes an adversarial role to business. The whole model rests on the belief that competitive product markets are possible. Then he goes on to say that by way of contrast the Japanese model is based on group maximization. It is societal not individual satisfaction that is being maximized.

Societal satisfaction is promoted by close cooperation between government and business. Individual firms do not maximize shortrun profits but market share because a large market share guarantees the survival of a firm. Households are expected to seek security by practicing traditional virtues primarily through their own savings. A role of the government is promote growth and to lead the market to find approximate market outcomes fast than if left alone.

He goes on to say the reason that to American business the game seems to be stacked against them. The American Government hinders the American firms combative weapons while the Japanese Government helps its firms.

As the complaint is stated the playing field is not even. So one of the things, Senator Levin, I am going to be interested in today is whether keiretsu is the problem or is it only part of the problem. And as we enter a global economy which we seem to be doing, do we have to have some kind of standard rules of play that govern all the bodies or how do we avoid this problem.

I am not sure it is just a matter of keiretsu. I have a feeling that the tensions are caused by even deeper problems than that. Would you care to comment?

Senator LEVIN. I tend to agree with you that keiretsu is part of the problems and the whole societal difference is at the heart of the matter. Frankly, I do not think we can change Japanese society. I think we are making a mistake if we attempt to try to change Japanese society. I think we ought to defend our own economy, act to defend our own economy, and not rely on them to change their way of life in order to protect our economy.

It is in our hands. We in the Congress, and the President, have the responsibility of protecting this economy and seeing its growth. For us to continue for year after year after year to bat our head against all the barriers that we find in Japan, instead of simply telling the Japanese as other countries have done, we are going to basically place restrictions on your products when you place restrictions on ours because we have no choice. It is not because we are mad at you. It is not because we do not admire you. It is because we cannot survive with you placing barriers on our goods and we letting your goods in freely.

So I tend to agree with what you said, Senator Roth. I think we ought to quit trying to bat our head knocking down those Japanese walls and instead just reach the conclusion, as every other country in the world has, that we have got to treat them no differently than they treat us. In the area of business there is no other rule which works.

If I could make one quick comment, Mr. Chairman, on your point; and I also welcome as Senator Riegle did, your comment about supporting the extension of Super 301.

The problem with simply extending it is that it is too easy to evade. The President did not even name Japan in the last round. Japan, who is the biggest part of the trade deficit problem, by far there is no one that comes close, was not even named. Japan whose restrictive and discriminatory practices are by far the clearest and the worst was not even named under Super 301 when it was on the books.

So we have to strengthen Super 301 and I have a bill in which will do exactly that, along with Senator Byrd, Riegle and others, to require the President to place equivalent restrictions on the goods of countries that discriminate against American goods.

It is a very simple principal. It is very fair. The whole world will understand it, including the Japanese, that when restrictions are placed on AMerican goods by a country and when that is found by the administration's own Trade Representative, that based on those findings that you first try to negotiate the elimination of the restrictions and if after a year that does not succeed, you simply place equivalent restrictions on the other country's goods.

There is no other way to do this. We have tried the other ways—the talk, the structure impediment initiatives, the studies, the jaw boning. Not just for 10 years. We go back to 1960 with Japan. We go back to President Nixon saying we have turned a corner in trade. They are going to open their market.

President Nixon said this in the late 1960s. It is just simply time for us to act, to take our own economic future in our own hands, not out of peak, out of reality. Not out of anger with them, but with an understanding that there is no other choice but for us to act in our own behalf.

So I welcome your comment about extending Super 301. But because it was so easily evaded when it was on the books it must be strengthened to require the placing of equivalent restrictions. Obviously, you have an escape valve in the case of national security. But you have to place a requirement for a response for reciprocal treatment.

Again, I thank the Chairman and the other members of the committee for having me as a witness.

Senator BAUCUS. Thank you, Senator.

You are right that we have to extend Super 301. You are also right that the extension of Super 301 has to be effective. There is no doubt that Super 301 must be extended and second that it must have teeth in it. I think it should be changed in a way to make it more effective.

I must say, however, that any statute is only as good as its provisions and only as good as the efforts of the enforcer to make the statute work. I believe that the United States—I know others in this panel, and I know you do, agree that the United States must redefine national security to include not only military security, but also economic security.

Which is to say that we will address this problem the more we have the proper statutory authority and the more that trade barriers are higher up on the administration's list of priorities. I believe firmly that President Bush and Secretary Baker must pay equal attention to trade problems and economic problems in the world, including the problem we are generally addressing, as they do to other foreign policy and military matters around the world.

Frankly, it is only when the President gives co-equal emphasis, if not more emphasis, to these general economic problems that we have a meaningful solution to the problems we are now addressing.

Thank you.

The Senator from Michigan.

Senator RIEGLE. Mr. Chairman, I want to mention two other points that have not yet been mentioned today. I will do it very briefly because I am conscious of the time.

I think there are two other keiretsu elements present in addition to the ones that we have discussed already this morning. Specifically, I am referring to the manufacturing and trade issues. I think there is a legal and political problem with the keiretsu. I'd like to give an illustration of each.

Under our political system we have a certain why in which campaign funds are raised in races for people running for national office. Under one system, political action committees are formed in which those monies can be channeled to candidates based on their position on issues.

In recent elections the Imported Automobile Car Dealers Association has become a major political action force; the strength of contributions that the association raises on behalf of the International Automobile Car Dealers in effect kind of a cartel.

In the last election cycle, at the Federal election level, political action donations by the imported car dealers to Federal candidates exceeded the amount of those made by the domestic automobile companies and the United Auto Workers combined, which would be the principal players on that side here in the United States.

What I think this shows is a growing trend toward the similar strategy being applied in the area of campaign finance to try to take and mold and shape and I think sort of twist off its proper foundations, legislative policy in this country, by means of that kind of high powered and very expensive high dollar political activity.

The second is in the legal area. It has been very interesting to watch Japan as well to hire so much of the most expensive and highly talented legal skill in this town. We have a lot of lawyers in Washington. Probably more than any other place in the map of the world.

Many have been hired by the Japanese companies to come in and lobby aggressively, including many people who views the revolving door to be first in government in the administration dealing with these kinds of trade issues and in the trade area generally, and who then go through the revolving door, leave government, go into the private practice, sign on at very high fees for Japanese clients, and then work the system.

We have had one outrageous example of that with respect to the Honda audit which was interfered with by one such person who I think represents the revolving door problem. But it is not an isolated situation. It is a situation that is much broader than that.

If you add the political keiretsu and the legal system keiretsu on top of the manufacturing and trading keiretsu it is more than this country can really handle in any fair and meaningful way. Those issues need to be put out on the table. They need to be understood and they need to be deal with directly.

Thank you.

Senator BAUCUS. Thank you, Senator.

I know Senator Grassley is here. Senator, do you have a statement you wish to make at this time or any questions you want to ask of Senator Levin?

Senator GRASSLEY. Mr. Chairman, I do not have any questions; and for an opening statement, I request unanimous consent to just insert it in the record.

Senator BAUCUS. Okay.

[The prepared statement of Senator Grassley appears in the appendix.]

Senator BAUCUS. Thank you very much, Senator.

Senator LEVIN. Thank you.

Senator BAUCUS. Now the panel which includes Mr. John Reilly, president and CEO of Tenneco Automotive. John is also the chairman and appearing on behalf of the Auto Parts Advisory Committee in Illinois. Mr. Dana Mead, executive vice president, International Paper; accompanied by Dr. Irene Meister, vice president of International Paper Institute.

Mr. Reilly, why don't you begin?

STATEMENT OF JOHN P. REILLY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TENNECO AUTOMOTIVE, ALSO CHAIRMAN AND APPEARING ON BEHALF OF AUTO PARTS ADVISORY COMMITTEE, LINCOLNSHIRE, IL

Mr. REILLY. Thank you. I would like to begin by thanking Senator Bentsen and the rest of the committee for providing the U.S. auto parts industry an opportunity to discuss the critically important issue of trade with Japan.

I am here today on behalf of the Auto Parts Advisory Committee. APAC is a national advisory committee established by the Fair Trade and Auto Parts Act. It was included in the Omnibus Trade and Competitiveness Act of 1988. The committee advises the Department of Commerce on programs to increase sales of U.S. made auto parts and accessories to Japanese auto manufacturers on a worldwide basis.

The auto parts industry is the largest manufacturing sector in the United States. Sales in 1990 exceeded $100 billion. Additionally the industry employs over 600,000 people in large companies, such as my own, it's a small single product producers.

Our industry has accomplished much in the last 18 months towards understanding trade issues with Japan. I would like to briefly highlight some of what we have learned. As stated before, the current trade deficit with Japan stands at $41 billion. The automotive sector at $31 billion represents 76 percent of the problem.

APAC commissioned the University of Michigan to independently study the deficit issue and then forecast the most likely deficit for 1994. The projection is staggering. The automotive deficit is forecast to grow by 50 percent, reaching $46 billion in 1994. More critical to our business is that the issue is shifting from completed vehicles to parts.

The parts deficit was $2 billion in 1984 when the discussion started between the two governments. It reached $10 billion in 1990 as shown before. It is projected in 1994 to grow by over 100 percent to $22 billion.

The University of Michigan also undertook a case study. This study dealt with transplant sourcing and trade content. The Michigan researchers chose Honda. They felt Honda led in domestic sourcing. The study showed the following: 38 percent of the total vehicle, the value of the total vehicle was imported from Japan; 46 percent came from Japanese transplant suppliers and only 16 percent came from traditional domestic sources.

It is incredibly difficult to believe that the world's largest parts supplying country is competitive in cost and quality on only 16 percent of the transplant business.

A third major project is the after market pricing study. This was jointly sponsored by the Department of Commerce and Japan's Ministry of International Trade in industry. The study was conducted on 20 different auto parts. It found on average that prices in Japan were 340 percent higher than they are in the United States as referred to by Senator Levin. For example, a spark plug that sells for $3.77 in the United States costs $14.44 in Japan.

The fourth replacement project look at the replacement part distribution system in Japan and it is very close to a monopoly. Car dealers control over 60 percent of the after market repair work. And on some of the high value parts and repairs the figure is over 80 percent.

What does all of this mean to our industry? The forecast deficit is obviously unacceptable to both to you as managers of the U.S. economy and to us as managers of a very vital industry. If the deficit trend continues until the year 2000 it is estimated that over 50 percent of today's auto parts companies will be out of business.

The pricing and distribution studies help explain this situation. With an extremely profitable after market in Japan a parts supplier is free to blend original equipment and replacement market prices. Since open channels of distribution in Japan are minimal it is extremely difficult for United States and other companies to penetrate the Japanese after market.

Also, Japanese parts suppliers have the ability to underprice original equipment parts, thus avoiding any foreign competition. U.S. parts producers believe consumers are best served by open markets, markets that respond to real market prices and qualities——

Senator BAUCUS. Mr. Reilly, I regret to tell you in advance of this 5 minute rule. So why don't you go ahead.

Mr. REILLY. I just have a second here. Thank you.

Senator BAUCUS. Well, you can take a few more seconds if you wish.

Mr. REILLY. Thank you.

To respond to real market prices and qualities and are not hampered by artificial barriers to entry. But increasingly we recognize that there are structural differences in the market and also in the relationship between suppliers and vehicle producers. We do not want more studies. We do not need more meetings. What we want is an increased opportunity for more business.

The U.S. parts industry is at a very critical point. Unless immediate and significant action is taken by the Japanese vehicle manufacturers to quickly reduce their historical purchasing patterns, increased government intervention will be required.

In this regard APAC recommendations included suggestions that the U.S. Government begin preparation of self-initiated dumping in Section 301 actions. These are recommendations, I might add, that were unanimously endorsed by the President's Export Council and by more than 90 members of Congress.

In conclusion, I would like to repeat that the United States and Japanese Governments have been in bilateral trade discussions on auto parts since 1984. It is now time for less discussion and more positive business results.

Thank you again, Senators. I would be happy to answer any questions.

Senator BAUCUS. Thank you very much, Mr. Reilly.

[The prepared statement of Mr. Reilly appears in the appendix.]

Senator BAUCUS. Mr. Mead, I will give you the same amount of time. It is about 7 minutes.

Mr. MEAD. Okay. Thank you. I wondered if I was getting the warning or not. Thank you very much, Mr. Chairman.

Senator BAUCUS. You bet.

STATEMENT OF DANA MEAD, EXECUTIVE VICE PRESIDENT, INTERNATIONAL PAPER, PURCHASE, NEW YORK, ACCOMPANIED BY DR. IRENE W. MEISTER, VICE PRESIDENT, INTERNATIONAL, AMERICAN PAPER INSTITUTE, NEW YORK, NY

Mr. MEAD. As you noted, my name is Dana Mead and I am executive vice president of International Paper, which is the world's largest paper company. With me is Dr. Irene Meister. She is vice president, International of the American Paper Institute, and she is also chairman of the Industry Sector Advisory Committee on paper products; therefore she is deeply involved in these issues.

I am testifying today on behalf of the API, which represents more than 90 percent of the production capacity of the U.S. paper industry.

Japan is the world's second largest producer and consumer of paper and paper board although its natural resources, as you know, are very limited. Import penetration of paper products in Japan is the smallest in the world—3.7 percent from all sources, 2.2 percent from the United States.

Imports from the United States of printing and writing papers account for only two-tenths of 1 percent of total Japanese consumption of 9 million metric tons. By contrast, and despite our own domestic resources and a strong domestic industry, import penetration for the same printing and writing papers in the United States is 14.7 percent.

Our paper industry is the most competitive in the industrialized world—the result of our abundant resources, long term investment in world scale facilities and state-of-the-art technology.

Since a picture is better than 1,000 words, allow me to present two charts illustrating our cost competitiveness, vis-a-vis Japanese printing and writing paper producers. Wood fiber is the most important component of cost in the production of paper. This chart shows that the cost of wood in Japan is significantly higher——

Senator BAUCUS. Could you bring that chart around so maybe more of us could see it? The cameras and the desks are in the way.

Mr. MEAD. What this depicts is the relative cost of hardwood chips which is an important component in paper. This shows the significant difference in the cost in all three regions of the United States vis-a-vis the average cost of the product in Japan.

This next graph shows a comparison between the United States and Japanese delivered cost for uncoated woodfree printing paper used for commercial printing. As you can see, eight of the U.S. mills in this chart—those are depicted by the dark line on the bottom—have lower costs than the most competitive Japanese mill. The Japanese mills are depicted in gray on the upper left of the chart.

We have been told by MITI and by Japanese distributors that quality, timely delivery and the ability to meet specific preferences of Japanese customers, rather than cost, are the determining factors for sales in Japan.

An extensive study of U.S. printing and writing producers found that U.S. paper companies desiring to compete in Japan are fully prepared to meet Japanese quality, preference and service requirements, and to support long-term relationships with Japanese customers.

I can assure you that my company can meet all of these requirements, and, in fact, over the past few years has spent considerable amounts of money and resources to do exactly that.

In view of the U.S. paper industry's competitiveness, why are we not doing any better in the Japanese market? Tariffs remain one barrier, but they alone are not sufficient to explain our low level of penetration. We believe that the prevailing Japanese business system coupled with an ingrained preference for dealing with traditional, that is Japanese, suppliers is at the root of our access problems.

An independent study of the inter-relationships in the Japanese pulp and paper industry found both strong vertical integration—which often includes the paper producers, the distributors and the end users within the same keiretsu—and close horizontal relationships between different paper producers within the same keiretsu.

In addition, as we have already heard, financial institutions in the various keiretsus have strong relationships with paper producers, distributors and printers as both shareholders and lenders. The major Japanese printing and writing paper producers hold significant equity shares in the major Japanese distributors of these papers, and, in many cases they have close ties to the printers and other end users.

Since several major paper producers in Japan belong to the same keiretsu, taken together, they wield extensive control over distributors and other customers in which all have shares and interlocking interests. This translates basically into effective market control, resulting in a reluctance to purchase or distribute imported papers which compete with their owners' products. There are numerous specific examples of this which time does not permit us to detail.

The Japanese system of financing through keiretsu banks subsidizes a number of inefficient high cost paper mills, resulting in overcapacity to the exclusion of more competitive imports. In addition, the Japanese system of rebates to distributors during cyclical downswings discriminates in favor of domestic producers.

In conclusion, what solutions do we envision in our quest for greater access to the Japanese market? First, let me say that the paper industry is pleased to be one of those sectors which is under active discussion between American and Japanese Government negotiators. But talks alone will not help us.

We feel that a strong signal must be sent by the Government of Japan to the business community that exclusionary practices which hinder imports will not be tolerated. There are several steps that the Japanese Government can undertake now to open the Japanese market to increased imports of printing and writing papers, among them: First, to create a mechanism to monitor progress on imports of paper products and to report such information; second, to develop incentives for distributors and customers to use imported paper; third, to enforce recently adopted anti-monopoly guidelines. And finally, and perhaps most importantly, to investigate the structure of distribution, pricing, financing and other business activities in the Japanese paper sector with a view to correcting those practices which hinder imports.

We believe these steps would reinforce our efforts to sell printing and writing paper on a long-term basis. We are prepared to meet the service, quality and performance requirements of the Japanese market. Because of our competitiveness on a world scale, we believe that paper is a prime example of an industry where substantial strides can be made in opening the Japanese market.

Senator BAUCUS. I am going to have to ask you to summarize, Mr. Mead.

Mr. MEAD. Mr. Chairman, we are most grateful to you for the opportunity to discuss this and we are prepared to answer any questions you may have.

Thank you.

Senator BAUCUS. Thank you, Mr. Mead.

[The prepared statement of Mr. Mead appears in the appendix.]

Senator BAUCUS. Could you please indicate the most important specific Japanese quality requirements that differ from say those in the United States with respect to say color of paper or other specific specifications that the Japanese people, consumers, want the efforts your company is undertaking to attempt to address those specifics?

Mr. MEAD. Senator, the primary specification requirement is formation, which is a papermaker's term which relates to smoothness and printability.

Over the last 3 years we have spent a considerable amount of money in updating some of the equipment on which we produce the paper to improve that formation. We are right now, with paper that we are sending into Japan for trials, meeting all of the Japanese specifications for formation.

In fact, the paper has been characterized by some of the customers as having "Japanese" formation. That is the primary specification. Our paper is as bright, as white, it has a comparable shade, is cut as accurately, is packaged as well as any of the Japanese papers. Our paper runs better than Japanese paper because we put more softwood in it which gives it higher runability and strength.

Senator BAUCUS. Paper for what purpose?

Mr. MEAD. The paper that we are talking about is what we call printing and writing papers which primarily are papers that go through copiers, that are printed on nonimpact as well as laser printers from a computer, envelope papers and commercial offset printing papers.

Senator BAUCUS. So as far as you are concerned there are no quality specifications that the Japanese consumers prefer that your company and others are not meeting?

Mr. MEAD. That is correct. Or not prepared to meet.

Senator BAUCUS. Or prepared to meet?

Mr. MEAD. Yes, sir.

Senator BAUCUS. Could you also tell me the degree to which you have examined U.S. antitrust law, either domestic or foreign. I suppose the domestic would apply more to autos and transplants in the United States. But could you both just briefly touch on the degree to which you have explored remedies through U.S. antitrust law and also remedies in Japanese antitrust law and what the outcome of those efforts has been.

Mr. REILLY. Through APAC we have not done any extensive investigation of the antitrust implications. So we have not pursued that avenue of relief.

Senator BAUCUS. Mr. Mead, has your industry?

Mr. MEAD. Senator, we have not looked at U.S. antitrust laws vis-a-vis this issue; but, of course, we have looked at Japanese antitrust laws. As you know they have recently adopted quite strong provisions amending their anti-monopoly guidelines. In our view if they were fully pursued and enforced, it would go a long way toward encouraging some opening of the Japanese market to outside products.

As Dr. Meister reminds me also, that API has submitted some information to the government with our views on this issue. But we think that further enforcement, stronger commitment to the laws already on the books in Japan would go a long way towards doing something about it.

Senator BAUCUS. Okay.

Mr. Reilly, I understand there is a little bit of a split within your industry as to the degree to which the United States would pursue a Section 301 in auto parts. Could you elucidate, please?

Mr. REILLY. Sure. I would be happy to comment.

Most U.S. parts companies are attempting to get business from the Japanese transplants and to also do business in Europe and Australia and even in Japan. If they have a token amount of business or if they have even more than a token amount they are very hesitant although they feel that there are some significant problems to step forward and be held accountable because they are pursuing the business and they feel that they will not have an opportunity to get that Japanese business if they pursue a 301.

Senator BAUCUS. I am really addressing it—I do not know much about this, but apparently there is an organization called the Motor and Equipment Manufacturer's Association, which I understand has more of a consultive approach rather than advocating a Section 301 approach.

Would you explain that, please?

Mr. REILLY. I am vice chairman of MEMA and I will be Chairman in a couple of months.

Senator BAUCUS. Are you going to straighten them out?

Mr. REILLY. MEMA has attempted through conferences such as one-on-one in various meetings with the car companies to get more business. So in a positive relationship they are trying to get the vehicle producers and the American parts companies together to attempt to solve the problem. They have been on a friendly relationship with JAMA, which is the Japanese Auto Manufacturing Association, in attempting to resolve issues.

They have been hesitant to discuss 301. They are working more on the positive aspects, hoping they can solve it through various meetings. They have not taken a position on 301, have not recommended a 301.

Senator BAUCUS. Thank you.

Senator Riegle?

Senator RIEGLE. Let me thank you both for your testimony.

Let me ask you, Mr. Mead, how long has your company now been trying to sell competitively in the Japanese market?

Mr. MEAD. We have had an office in Japan for 25 years.

Senator RIEGLE. So you have really worked at this?

Mr. MEAD. But basically, Senator, that office was involved in selling raw materials into Japan and it is a very typical story. We have been sending in raw materials and they have been manufacturing finished products and exporting them.

We have made a concerted effort for the last 3 years to increase our imports of uncoated printing and writing papers to Japan, which I am really talking about this morning on the charts.

Senator RIEGLE. Yes. Right.

Mr. MEAD. When I say concerted, it has involved literally thousands of hours of activity and millions of dollars of investment to meet Japanese quality, service and other preferential requirements.

Senator RIEGLE. I think that is an important history because you have been in the country now for a quarter of a century. You certainly are no strangers to Japan. You understand their practices; they understand you. You have made a concerted effort as an established company in Japan to now move into the commercial sales area and you have been rebuffed in the ways that you have described here today.

Let me ask you this. It seems to me that what is happening here is that the Japanese predatory trading practices of having full access to our market, two-tier pricing, and keeping the home market to themselves is working very successfully. In other words, Japan has become an economic power house because of that strategy. That strategy has really generated enormous economic benefits and advantages for Japan.

I think it is self-reinforcing. In other words, I think once a nation has a strategy like that, it can work so effectively, particularly say vis-a-vis the United States, without any incentive to change. In other words, as long as it is working and Japan is piling up enormous economic benefits and gains it seems logical for this country to reinforce and continue the strategy as long as it can.

I can see why after a while it would be very difficult for Japan, even if someone in the system wanted to change it, not to change. Change would be difficult because of the sheer forward momentum and economic advantage that is fostered by the system. In essence nobody is going to sort of throw in a winning hand so to speak.

It seems to me the United States has no strategy and no material way to cope with Japanese trading practices—our lack of plan to deal with halting such practices—in effect reinforces the Japanese strategy of gaining and maintaining market share and economic strength at American's expense. One of the reasons Japan's strategy is working so well is that from the point of view of the national response here in our country we have essentially let it happen.

Is there any reason to think that Japan in and of itself will change these practices as long as it is succeeding so well, unless there is some direct intervention by, say, the American Government speaking on behalf of the economic interest of the United States? Japanese practices are going to continue because they are part of a powerful and effective working strategy unless there is some direct intervention by this government.

Mr. Reilly and then Mr. Mead.

Mr. REILLY. I would like to just back up for a second. We have been attempting to penetrate the Japanese market since 1978 and we have had a technical center over there for 3 years; and we have about 1 to 2 percent market share in Japan. By way of comparison we have 55 percent of the Philippines, 30 percent Malaysia, and 40-45 in Hong Kong. So we are successful in that part of the world and have not been successful in Japan.

I think it is going to take political pressure to get change in the historical purchasing patterns. The Japanese have been incredibly successful in their home market and I think it is hard for us to change the structure of their market and we probably cannot do that. I think as Senator Levin indicated maybe that is not what we should attempt to do. We should just insist upon more balanced trade in this market. I think political pressure is required to get a meaningful shift in those purchasing patterns.

Senator RIEGLE. Mr. Mead?

Mr. MEAD. I do not think there is any doubt, sir, that it is going to be difficult. But, notwithstanding the cultural and structural impediments to doing this, there are clear economic reasons that in the long term would make sense for Japan in the case of paper to improve or to increase its imports. They are economic.

Dr. Meister has looked into this in a lot of detail. Let me just ask her for just a second to clarify and add a little bit to that point.

Dr. MEISTER. Senator, we have done a very careful survey of the financial conditions of the paper industry in Japan, and certainly by comparison with our industry, it is actually a weak industry as far as the Japanese are concerned. Just to give you one example, an average profit margin for Japanese paper companies in the 1985 to 1989 period, and we deliberately took a 5-year period so that it is not just one bad year, is about 2.7 percent, and for the United States, it is 6.2 percent.

Those are very telling stories. And just to add, there are a number of other U.S. companies—IP is our largest company—but there are other companies as well which are also very active in the industry advisory committee. They are all prepared to meet Japanese customers' requirements. So it is our industry's position that much needs to be done.

Thank you.

Senator RIEGLE. My time is up. Thank you.

Senator BAUCUS. Thank you very much, Senator.

Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

I have a lot of sympathy for what Mr. Riegle said in the sense that the Japanese economic model seems to be working very well. There is an old saying from their standpoint, if it is not broken, why fix it. I think that is the nub of our problem in many ways.

Let me ask you, I think it was you, Mr. Reilly, I am not sure, but I would like to hear from both of you. Are you suggesting that perhaps we should move to some kind of managed trade? One of you talked about balanced trade. Are you suggesting that the government should try to negotiate some kind of a managed trade picture?

Mr. REILLY. I think what we need is fair trade, not free trade.

Senator ROTH. What do we mean by fair trade?

Mr. REILLY. An equal opportunity to get the business in Japan and an equal opportunity to get the transplant business here. If that does not occur then I think, and it has not been occurring, then other actions will have to be taken, such as dumping and those types of things.

An analogy I use, if I may, if you look at the U.S. parts industry it is kind of like playing a basketball game where we can compete very, very hard in most areas on our home court, that being the United States. But it is very difficult to cross the center line and get into the other side of the court.

Over time if that analogy of a basketball game continues you are not going to win too many unless you can play both offense and defense. Eventually your industries will continue to go downhill. That is exactly what we are finding in North America with the parts industry and the continual bankruptcy.

So you have to have the ability to compete in all markets if you want to survive long term.

Senator ROTH. I think we are all in agreement with that. I think the question is: How do we arrive there? My first question, because you talked about balanced trade, I was not certain and still not entirely certain, whether you are talking about some kind of managed trade. But I take it you are not. Is that correct?

Mr. REILLY. I do not think we can go with a continual free trade philosophy at all costs.

Senator ROTH. Would you favor managed trade?

Mr. REILLY. I guess I would ask for your definition.

Senator ROTH. Well, where governments negotiate and try to agree on a percentage in any given product.

Mr. REILLY. I think in certain industries, and one potential being the parts industry, that that may be a very appropriate solution to this problem.

Senator ROTH. Mr. Mead?

Mr. MEAD. Sir, no, we are not proposing managed trade. We are looking for solutions through very active, and I should say aggressive, negotiations with the Japanese to improve the conditions under which we can import and compete. Our frustration is that here we have the most competitive industry in the world and we are unable to take advantage of that in a global business which paper has become in a country which is the second largest market in the world.

Senator ROTH. Well let me ask you, if I might, this question, Mr. Mead. Basically, how one did business was traditionally a question for each sovereign nation to determine. But as we enter into a global world trade the rules by which you trade become somewhat important.

Now should we try to negotiate some kind of international rules and regulations as to what makes up fair trade? If your answer is yes, should a practice like keiretsu be declared illegal or what is our approach? In this country under our antitrust laws it would undoubtedly be subject to the antitrust. But the Japanese will argue with you that this has created a very effective product and that it would be a mistake to back off.

But should we try to get some international rules that would control this kind of situation?

Mr. MEAD. If I may, Senator, Dr. Meister spent a number of decades working on international rules and the terms of trade. I am going to ask her to approach that quickly for you, if I may.

Senator ROTH. Briefly.

Dr. MEISTER. Thank you.

Yes, Senator, we still believe that the rules can be greatly improved and they need to be. And certainly especially through strengthening of GATT.

We also believe that we cannot perhaps change the existence of keiretsu, but it has been proven that keiretsu have specific trade effects which hindered exports, and we believe that our government should be actively and intensely discussing these hinderances with the Japanese Government, and, for industries like ours, calling for their removal.

Senator ROTH. My time is up.

Senator BAUCUS. Thank you.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman. I am sorry to all three of you that I missed your testimony, but I do not think I am missing the point of this. I mean what we are basically talking is a kind of organization where you have a flat out perfectly constructed instrument to accomplish with total discipline, total support, total requirements to do whatever advances the Japanese product in the international market, perfect financing, all the rest of it.

We all recognize that. We then in America in discussions of this sort constantly then collapse. I mean we all agree that everybody wants fair trade and everybody—the phrase was used, we have to play offense and defense; we have to have a level playing field. Somebody brings up the words "managed trade" and what do you mean by "managed trade"? Well, I am not sure, but no matter how you define it; it sounds close to something like the government being really serious about intervening.

And of course when you think of the government you think of the entire U.S. Government. It might just be some little intervention. But I mean my heavens you could have then almost said the words "industrial policy" and then you could have equated that with the national self interest and then Bill Roth would have walked out on you, and we would have closed down the hearing. We cannot do that.

The question is whether America is serious about this stuff or not. This is a nice little Kabuki dance. We have these hearings about keiretsu—everybody knows what keiretsu is now and everybody can pronounce the word—so we have to talk about it. We have been talking about this for 20 years.

You have been doing battle, and what I find generally is that industry likes to find the solution that will help that particular industry. But if you get into the broader solutions, and discuss government intervention, unless you are somebody who is really smart about this, like Bob Galvin, you just do not want to do it.

I think auto parts probably does. You are getting killed. You may not be in business 10 years from now. The fact that you would be fairly exercised about that makes some sense to me.

But what are you three people for? I mean what are you for doing? How would you use antitrust laws? Why isn't the GATT part of the process? I have a number of Japanese—in fact the majority of Japanese businessmen that I talk with—and I go over there fairly regularly, who said they really would have preferred the Gephardt amendment which set out a standard they could have filled as opposed to a rash of 301's, Super 301's, which is ballistic warfare back and forth with the entire bilateral relationship traumatized in the meantime.

Managed trade, what do you mean by that? What do you want to see happen? What do you want to see us do?

Mr. REILLY. I would ask the U.S. Government—APAC made 13 recommendations, 13 specific recommendations, to the U.S. Government, and I would like to see those 13 recommendations acted upon. To date, we made those to the Department of Commerce, we have not had a response.

Senator ROCKEFELLER. I am sorry. I do not have them in front of me. Were they in your testimony?

Mr. REILLY. I have them here.

Senator ROCKEFELLER. Would you go through them and tell me which ones you would like, and I will make sure that all three of you agree with them.

Mr. REILLY. Well, we had one on dumping. Okay? And I could read the specifics on that. One on Section 301. One on foreign trade zones.

Senator ROCKEFELLER. You know, I am the chairman of the Senate Steel Caucus and I care passionately about steel, and my steel people are all over the place talking about doing dumping cases when this voluntary restraint agreement runs out. They may not be able to win those things because they are not going to be able to show injury.

So they talk 201 or 301 and then secretly in the back of our minds we kind of know that 201's and 301's, although they have worked in the past, they may not work for them in the future. We throw out, let's do 301, let's do dumping, let's do whatever. But they probably will not be done. Or if they are carried through; they end up being reviewed by new people in the government. There is no continuity. Those people stay there for 2 years and then they are gone into the private sector.

Mr. REILLY. I guess we acknowledge that there are some problems with getting things accomplished. But our best effort are some specific recommendations that we think should be addressed by the U.S. Government and enacted upon. I think those are steps at correcting the problem if that occurs.

Senator ROCKEFELLER. Do you think that your Government, and I do not mean the onslaught of Uncle Sam—I am sorry that I am not being particularly pleasant about this—but do you think your Government for which you pay taxes is doing what it reasonably ought to do in a free enterprise system to be helpful to your interests?

Mr. REILLY. I think our government is divided and that there is not a consensus and that they are not representing the industry the way they should, is my answer to that question.

Senator ROCKEFELLER. And the two others of you agree with that?

Mr. MEAD. Well, I cannot speak for the auto parts industry, Senator. But for the paper industry what we would say is first that we think some progress has been made by our government. I mentioned earlier that the paper industry has been elevated to bilateral talks with the Japanese and we feel that some progress is being made, but we feel it has to be faster, it has to be more aggressive.

We have submitted a number of recommendations to the trade representatives and asked them to follow up aggressively with those. They are basically summarized in my oral testimony. They basically say, have the Japanese Government do what it says it is going to do on anti-monopoly laws, on sending a strong signal that American products are acceptable in the market and should be encouraged to be used whether or not you are owned by another paper company or whatever and so forth.

So we would say we would like to be more aggressive and we do have specific things that we would like to see done in Japan. Our problem is not with imports into the United States of Japanese paper. Our problem is absence of exports of U.S. paper into this very large and growing market where we should be.

Senator ROCKEFELLER. Thank you.

Senator BAUCUS. Thank you very much, Senator.

Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman.

One or both of you had a discussion with Senator Baucus about antitrust laws and enforcement. My question refers to refer to something I am not sure I know as much about as I should. However, I hope you are familiar with what is known as Presidential Councils in Japan.

It is my understanding that in Japan these meet regularly every month to exchange views on general economic and financial situations, promising businesses, the state of R&D, the maintenance of intergroup trade marks and company names and labor problems. I have also been told that they talk about subjects that include the policies of the entire group's public relations activities, rehabilitation of financially troubled companies and key personnel appointments to mention just a few.

I would like to know your view of that process. When you talked about enforcement of antitrust law, do you see those activities as unlawful conspiracies that ought to be prosecuted and whether they involve fixing prices and rates.

Mr. MEAD. Irene, why don't you take that first and pick up on it.

Dr. MEISTER. Mr. Mead has requested that I respond to your question, Senator. There are a number of attempts it seems, and I am emphasizing this word, on the part of the Japanese Government to have a more strict enforcement of their new laws. We as an industry have submitted details of where we felt there was a failure still in that law that was not adequate. We recommended to our government a number of areas where it can be improved. This went through the advisory process.

Specifically, I think that Congress set up the advisory process on individual industry sectors and we believe that that is working. We believe that the committee of chairs of the advisory committees is helpful to air our differences between industries. I do not think we necessarily need to imitate the Japanese. We just have to be much stronger than we have been before. That is what is required now.

Senator GRASSLEY. Well, my question was specifically to what I believe is an institution called Presidential Councils where top corporate people meet every month and discuss all the things I mentioned. Something that we would not allow to happen among corporations in our competitive system. We would consider these activities a violation of our antitrust law. Do you see them as violating antitrust law? Do you see that as something that our government ought to be going after?

Dr. MEISTER. It certainly should be looked into if it is indeed conspiracy among the companies.

Senator GRASSLEY. Well, do you think it is a conspiracy? What I want out of you is, how do you look at it? Do you look at it as falling into that category?

Dr. MEISTER. As far as our industry is concerned, Senator, we do not know much about this Council. We have no idea how it operates. We know how the Japanese paper industry operates and we have analyzed that.

Senator GRASSLEY. Okay. Let me ask Mr. Reilly then if he knows and how he views it.

Mr. REILLY. It is completely different, obviously, than it is here, in the Japanese the relationship with their supplier is different than it is here. And it does lead to longer associations and great difficulty for U.S. companies to break into those areas.

I am sure as you stated under our law it would be frowned upon. I am not sure what we can do.

Senator GRASSLEY. In a question raised earlier by Senator Riegle you talked about using political pressure. I do not find fault with your saying that, but, is there some place that our government can use political pressure on the Japanese, saying, this is unfair competition to us, and in fact, we do not allow this in our country. The fact that you allow it is one of many pieces of a puzzle that makes you unfairly competitive to us.

Mr. REILLY. I do not think we are going to break down the keiretsus and those things. I think it is very difficult and it has worked well for them. I think we just have to insist that they buy our parts in Japan and in the United States; and I think it is very difficult for the United States to tell them how to run their inner structure of their economy.

But I think we can truly insist that they fix the balance problem we have over here.

Senator GRASSLEY. Then what good does it do us to recommend to them they have to have tougher antitrust laws and enforce those antitrust laws?

Mr. MEAD. To add to what Dr. Meister said, Senator, the Japan Fair Trade Commission, which is the body, the government body, which is charged with enforcing, is the one that we are asking be given more teeth. Our government certainly can reinforce the fact that it ought to be given more teeth because, frankly, it is in a struggle with the other side of the equation and that is the side that is pushing very hard for industrial growth, expansion and all the other things.

That is one of the specific things that we have asked. And clearly, there are examples where it has not been able to enforce its mandate and we should as one of our policies be pushing very hard that they do what they promised to do.

Senator GRASSLEY. Here is one short followup. Do you sense a will to enforce these laws as you suggested this agency or group should be doing?

Mr. MEAD. I would say it is very mixed.

Senator GRASSLEY. Thank you, Mr. Chairman.

Senator BAUCUS. I have just a brief question. I remind all of us that we have to be quite succinct. There will be several votes that begin at 12:15. That gives us 45 minutes and we have another panel. Two more panels, actually.

But the very specific, very general question I would like just very short, like one sentence answers from each of the two of you is this. We have a problem here. No one dispute that. The question is: What is the solution?

One approach could be to try to force the dismantling of the keiretsu. Another is just force in some way benchmarks to make sure that they buy our products, regardless of whether they dismantle or not. The third is for the United States to adopt some of the same practices that they have.

Very briefly, which of the three tends to make the most sense for each of you? Mr. Reilly?

Mr. REILLY. I definitely do not think we should adopt their practices because our consumer has much lower prices for all of these products in this country. I think that forcing them to break up the keiretsus does not make a lot of sense. So the second one that you mentioned, very simply forcing a solution to the problem.

Senator BAUCUS. Some result tests too. They have to approach a certain benchmark where they purchase a certain percent of products. Something along that line.

Mr. REILLY. Insisting that the deficit not grow and decline basically.

Senator BAUCUS. Okay.

Mr. Mead?

Mr. MEAD. One, do not adopt their system; two, push very hard in our case on the exports into Japan; and three, put pressure on to make them do what they have promised to do, whether it be through anti-monopoly law, through relaxation in some of the import restrictions and so forth.

Senator BAUCUS. Okay. I have no further questions.

Thank you very much, both of you, for your testimony here today.

The next panel will be Dr. Edward Lincoln, senior fellow of the Brookings Institution here in Washington, DC; Mr. Doug Rosenthal, partner of Coudert Brothers in Washington, DC.

Okay, Mr. Lincoln, 5 minutes.

Mr. ROSENTHAL. Could we reverse order?

Senator BAUCUS. You can do whatever you want.

Mr. ROSENTHAL. I am the antitrust lawyer and there have been several questions asked about antitrust and Professor Lincoln and I have agreed that perhaps it would be appropriate for me to respond to a few of the questions you put on the table.

STATEMENT OF DOUGLAS E. ROSENTHAL, PARTNER, COUDERT BROTHERS, WASHINGTON, DC

Mr. ROSENTHAL. My name is Douglas Rosenthal and I have been practicing international antitrust law for 18 years. Some of those as Chief of the Foreign Commerce Section of the Anti-Trust Division of the Department of Justice.

It is striking that there is a quick, direct and efficient way to deal with the problems that have been identified this morning, at least make substantial progress towards dealing with those problems. And it is not by getting the Japanese to enforce their antitrust law; it is by us enforcing our own antitrust law.

Furthermore, because Congress passed a law in 1914 that established the private right of action; it is not necessary to ask the U.S. Government to help you. I thought it was particularly interesting that neither of the two industries which have just appeared on the prior panel have seriously considered a private antitrust action under United States antitrust law, because the law in place does provide an effective means for going forward against the very practices that we are talking about.

These practices, as have been described, sound very much as if they may well be violations of our own antitrust law today. And Congress passed a law which could apply in U.S. foreign commerce and which could apply to the foreclosure of U.S. export competition from foreign markets. In fact, it seems to be a secret to a number of trade experts that over the past 80 years there have been a total of 17 antitrust actions which have been filed by the U.S. Government and by private citizens and corporations which have effectively enforced the U.S. antitrust laws to break up networks of domestic and foreign enterprises which have foreclosed U.S. exporters from foreign markets.

I really do think your question, Senator Baucus, "Have you explored an antitrust option for the auto parts industry in Japan to try to get access there, and whether the paper industry could use this to get access in the Japanese markets when they are selling a competitive product at a substantially lower price without significant transportation costs?" is a very good one, and I believe the answer is that on close inspection cases might well be developed.

The final point I would make in response to your question and concern is, I think one reason that people do not think more about antitrust is that there is a perception that antitrust is long and expensive and does not produce results. There have been a couple of cases that have gotten a great deal of publicity which have not been effective.

But in my prepared remarks I have identified several cases, including one in one of the industries that was here before you this morning, where the case was over in less than 2 years at a very small fraction, I suspect, of the investment that has been put into trying to get trade relief and trying to get action from the Japanese Government.

I offer you the simple suggestion that the antitrust laws can be used effectively and cheaply and probably more cheaply than the armamentum of trying to lobby for trade actions that we have seen in this area so often before.

I have heard stories this morning about how we have been trying to do this for 10 or 12 or 14 years. I do not know of an antitrust case that has not been resolved in less than 14 years. And I do not know of an antitrust case in this area which has sought to get access to a foreign market which has not succeeded in substantially less time. That is the case, whether it is brought by the U.S. Government or whether it is brought by private parties.

The final point I would like to make opens a broader theme, but it seems important. I think one of the problems we have in the United States is that those who are antitrust experts and those who are trade experts are going in two different directions. They do not pay much attention to each other. They look at each other warily. Anti-trust lawyers are skeptical about whether the trade laws can be used as a means to truly promote open markets; and trade lawyers think antitrust lawyers and experts are naive and doctrinaire.

There has got to be a dialogue here. They ought to be working for the same goal. We are all concerned with open markets. My testimony contains some specific suggestions of ways in which that dialogue should go forward.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Rosenthal.

[The prepared statement of Mr. Rosenthal appears in the appendix.]

Senator BAUCUS. Mr. Lincoln.

STATEMENT OF EDWARD J. LINCOLN, SENIOR FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Dr. LINCOLN. Mr. Chairman, thank you for having me here. I would like to start by saying that I am just absolutely delighted that this hearing is taking place.

Senator Rockefeller has suggested that we have been dealing with this issue for 20 years. Well he may have known about it 20 years ago; I knew about it. But I think that broadly speaking the American public has known very little about Japanese business practices and in that ignorance has tended to assume that business in Japan must be like business in the United States because we are both capitalist countries.

I think it is very importrnt that we have open hearings of this sort as an educational process.

On the other hand, I think we have also heard a fair amount of hyperbole this morning and I think we have also heard a fair number of practices in Japan described that are not part of keiretsu at all. I would like to come back to that in a minute.

When we look at the issue of keiretsu I must also say that it is absolutely delightful that we are having this hearing on the day after Ronald Coase was given the Nobel Prize in Economics, because keiretsu goes at the heart of what it was that he was given the nobel price for, which is the question of what is a corporation. Where do we draw the boundary and where do we make the decision about what will be done inside the company and outside?

When he did that research more than 40 years ago he had in mind a simple model in which there is a decision between market transactions and internal firm transactions. What the Japanese are now coming at us with is to say they do not have any theoreticians like Ronald Coase who have given some elegant structure to this, but they do have corporations that have over the last 30 years evolved a set of relationships that are in between those two alternatives. They are neither entirely within the firm, nor are they the arms length market transactions that we think of as being the alternative.

We are now getting from the Japanese Government, and from Japanese academics, a lot of talk that says how can the United States attack us about these practices. These business relationships evolved because they were economically efficient. They enabled Japanese manufacturers to reduce manufacturing costs, reduce defects, reduce warranty costs, generally increased the quality of their products, and in addition to that enabled a more rapid pace of product change.

Our automobile parts industry may have a lot of legitimate problems in dealing with the Japanese. But if we are going to argue about this issue on a government-to-government basis, one of the first things we hear back from the Japanese is how come the Japanese automobile industry can introduce entirely new models in half the time and half the cost of the American industry. The Japanese would argue that the keiretsu structures are an important part of that.

On the other hand, we also have to recognize that what we consider keiretsu is really a broad category of practices. keiretsu is not a single thing. My own belief is that we have a mixture of some very important innovations in the way firms operate that we ought to be imitating in the United States, in response to the question that was asked earlier. But there are other practices that go beyond what is efficient, reasonable, and acceptable in the context of our society and even in the context of Japanese society—practices which are not necessary for efficiency and amount to no more than old boy networks, back scratching and collusion.

So I think it is entirely legitimate that we look at these organizations with a critical eye, both the horizontal keiretsu that I think

Mr. Pickens will talk about, and the vertical keiretsu that we have been talking about primarily up to this point.

I would agree that antitrust policy is one of the ways in which we ought to be attacking this problem—both in the United States and in Japan. Japan has had an antitrust law, by the way, since 1947. It was reinforced modestly a year or so ago in response to our SII initiative or helped by that initiative. I think we ought to be pursuing both Japanese antitrust and the United States antitrust.

Let me finish though with a couple of comments about what are and what are not keiretsu practices. Perhaps the trade deficit is due to the existence of keiretsu to a minor extent, but not caused by it. The chart showing 70 percent of corporate shares being held by other corporations, is only partly due to keiretsu. The rest of it is simply a broad pattern of corporations owning shares in other companies, whether they belong to the same keiretsu or not. This is a problem, but it is not specifically a keiretsu problem.

Trademark violations we heard about early this morning have nothing to do with keiretsu. It is a problem and we ought to be attacking it vigorously, but you do not have to have a keiretsu to come up with such violations.

The low share of our penetration in the Japanese semiconductor market, is partly a keiretsu problem, but there is a lot more to it.

Dumping does not have to be a keiretsu problem. A lot of what we are seeing here is activity which cuts across keiretsu lines. This is collusion or conspiracy among firms that belong to an industry, each one of which is in different keiretsu structures. That, I think, reinforces the point that antitrust policy is something that we ought to focus on more heavily, whether it is a matter of changing our laws or simply putting more attention on looking at Japanese corporations in that context.

Well, with that I would like to stop.

Senator BAUCUS. Thank you very much, Dr. Lincoln.

[The prepared statement of Dr. Lincoln appears in the appendix.]

Senator BAUCUS. Mr. Rosenthal, I was intrigued with your remarks. Are you saying that U.S. antitrust law have sufficient extra territorial application in Japan or any other country?

Mr. ROSENTHAL. The courts have said that the limits on U.S. extra territorial enforcement are largely set by what comports with the due process standards of our constitution. Generally, the courts have over the last 60 years expanded the scope of our jurisdiction.

All of the trends of globalized trade and the interpenetration of the effects of conduct in one jurisdiction into another jurisdiction have further expanded this. The problem of getting personal jurisdiction seems to me to be a less serious one because we are generally talking about Japanese firms that have made a commitment to entering the U.S. market, that are present, that are found in the United States.

Therefore, I think on the whole—of course, each case has to be looked at on its own particular facts—but on the whole in the industries that we have been talking about, particularly auto parts, jurisdiction is not a problem.

Senator Grassley asked a question about the Presidents' Clubs in Japan and contacts between officials of competing firms. I think it was Senator Rockefeller who asked whether it is the keiretsu problem alone that we are concerned about.

Professor Lincoln focused on something quite important. It would be a mistake to focus on this "tentacled interpenetration" of companies as exclusively the problem. I think the real problem is more what Senator Grassley was getting at. There is a different culture about competition in Japan which facilitates horizontal information exchange, whether they are members of the same keiretsu or not. And often they are not. They are from either different families or no family at all.

But that there is horizontal collusion in, for example, jointly bargaining to keep the prices of suppliers down for the benefit of all competitors at a particular level or to make sure that the distribution process works to the satisfaction of all. It is a comfortable relationship of a great deal of communication among Japanese enterprises that are competitors and that, in fact, do compete in some ways. It is, of course, known to all of us that Nissan takes very seriously its competition with Toyota; and yet there is probably information exchanged between employees of Nissan and Toyota as Senator Grassley intimated, that we would never permit to take place between General Motors and Ford.

That, I think, is the heart of what our antitrust laws can focus on. One of the tools that the Congress and the courts have given to antitrust enforcement is extensive discovery. If subpoenaed documents are not produced from records abroad by firms within our jurisdiction, U.S. courts can impose sanctions similar to the sanctions that would exist in a trade case if people were not forthcoming with information.

Senator BAUCUS. Well if this is such a wonderful remedy again why has it not been utilized more often? Why hasn't the auto industry explored antitrust action? Why hasn't the paper industry explored this more fully?

I mean if it is in our business interest to do so and if the availability of antitrust laws is as wonderful as you seem to indicate, why haven't U.S. industry pursued this more often?

Mr. ROSENTHAL. Well in my testimony I give a few examples of where U.S. companies have done it and have succeeded extremely well.

Senator BAUCUS. There are not very many.

Mr. ROSENTHAL. Not very many; and I suppose there are a few reasons. One I indicated is that people who think about trade problems are not in touch with people who are thinking about competition, policy and law.

Look at the Senate itself. This committee has jurisdiction over trade law and policy; the Judiciary Committee has jurisdiction over antitrust and competition law and policy. I sense very little interaction and shared perspective about how both areas of law and policy can be used to reinforce each other and looking at areas in which there may be some conflict and need for resolution.

Second, a great deal of American industry, I think, was terrorized by the antitrust laws in past years and by abuses in antitrust enforcement.

Senator BAUCUS. I was going to mention that. I think the last decade has not been a high mark for antitrust action.

Mr. ROSENTHAL. Well there have been an overenforcement, particularly by the private bar of certain areas against domestic companies. But some of the best and most appropriate antitrust enforcement is by American companies, not by strike suit plaintiffs lawyers.

Senator BAUCUS. Dr. Lincoln, because this is complicated, why not just some kind of results test, benchmarks at a certain percent or a certain proportion of goods must be purchased or aim toward a price benchmark and a differential between domestic and foreign prices?

I am just trying to find some results test that gets at the heart of the problem rather than all these mushy efforts to address keiretsu and so forth. Do you think various results tests and benchmarks make sense?

Dr. LINCOLN. In some sense that is what we do. We are upset with semiconductors because we have seen a very low market share for American products in Japan for many years. Automobile parts face the same kind of problem. At least implicitly, results are how we measure progress in trade problems with Japan.

We have a problem here though because for the last 45 years we have carefully crafted an international system that has tried to avoid those kinds of rules for international trade. I believe in the system that we have, and by and large it has worked to our benefit.

Nevertheless, there may be some particular products in Japan where the problems are very severe. Semiconductors obviously has become one of those industries over the last several years in which the resistance of the Japanese system as it now exists may be so strong, and our determination politically and economically to break into those markets is so vigorous that a managed trade settlement may be the only outcome that is acceptable between the two countries.

I do not like those solutions, but on an occasional basis that may be necessary.

Senator BAUCUS. I tend to think you are right.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I am very interested by this discussion generally because I recall the early stages of the SII talks, the structural impediment talks, and the Japanese were very critical about us and some of our practices; and we were critical about them and some of their practices. I tended to think that both sides were right.

When you get into a discussion about what are we going to do about this, it is the instinct of all of us, certainly myself, to jump on the opposition. In other words, immediately attack the opposition. You have to make the Japanese system change; you have to make them come to heel; you have to make them be like us.

As you indicated that is not the way the world works. On the other hand, the world has to work that way in some form. Because if you do not do a 301 or you do not go after them on dumping or antitrust or whatever, they are going to think that we do not really care about that, which is what in fact they think and what they were telling us in the SII. I am trying to suggest that we need new philosophical approaches.

For example, in the National Institute of Science and Technology reauthorization bill, some of us wanted to redirect $10 million for the commercialization of technology innovations, including those that the National Institute for Science and Technology comes up with through its Advanced Technology Program. In other words, not just basic research but how you take it to product, which as we all know is where we are weakest. The Japanese criticize us on that and, of course, they are quite correct.

I am going to offer that amendment, but it came down from the White House that by golly if that was done the entire authorization bill would be vetoed because the government does not intervene in something like commercialization when American business can do that on its own, even as we know American business is not going to do that. It is absurd, isn't it?

So instead we attack Japan and we have reason to attack because their system is too closed. But we also are following the natural American instinct to litigate everything possible and always blame the other person, because that is a sure way not to have to do something yourself.

Bob Galvin, who I mentioned before, started something very intelligent with Motorola which we all know about. He says nobody does business with my company anymore on a subsidiary, subcontracting, whatever basis, unless they are full applicants for the Malcolm Baldrige Award. In other words, they had better be good, according to United States standards, or else we do not do business with them. And he owns the company, so he can pretty much say that.

Philosophically, that really intrigues me. In other words we say to American business, I do not know how you would do this; we are asking for your help. Those of you who do business overseas, and who come to us because you want our help on a dumping case or an antitrust case, we do not want to talk to you and have no interest in spending any government money on doing anything that you want us to do in helping you unless you meet certain criteria, i.e. you are serious about the way you do business, you are serious about the way you compete overseas, you are seriously trained in the Japanese language or the Korean language or the German language so that you can successfully do business overseas and that you have been over there and that you are trying.

I do not have to finish what I am saying. You know exactly what I am talking about. Of course that is a naive suggestion—except a combination of being tough on them and holding them accountable and working within their cadence. We are trying to bring them to international accountability plus our doing what we ought to do ought to be conpetitive, that is as a private business.

Can you respond to that?

Dr. LINCOLN. I think that is absolutely correct. Boeing Corp., Northrup, and other American companies are moving down the same route that Motorola has. A lot of the driving force behind that is because they have looked at their Japanese competition or the way in which the Japanese behave and have decided it is something that they can learn—without going to some of the extremes that exist in Japan. You do not have to own 20 percent of the stock of the subcontractor and send your retired employees there to get the desired kind of long-term relationship, communication, and commitment to quality on the part of the parts suppliers.

I am not entirely sure what Government can do in that process. That is going to be primarily something that American business learns on its own. But at the very least, if we have to go on an occasional basis to a managed trade outcome because no one is willing to budge on either side, I think it would be very foolish of our government to get involved in that process and negotiate without some quid pro quo from the American industry that it will live up to the standards that the Japanese would expect if they are going to come into the market.

Senator ROCKEFELLER. Including quality of product?

Dr. LINCOLN. Including quality of product.

Senator ROCKEFELLER. Thank you very much.

Dr. LINCOLN. I was very impressed in hearing from International Paper that they have chosen to jump through those hoops in Japan. Now maybe they still face some problems and will need some help. But I think that the first step was the right one.

If the Japanese want X, Y, and Z, you give them X, Y, and Z and you give them more than that. And then see if you still have a problem. Then if it is a problem, that is the point to come to the U.S. Government and see if something else needs to be done.

Senator BAUCUS. Thank you very much, Senator.

Senator Roth?

Senator ROTH. Dr. Lincoln as an acknowledged expert in this area, are we on a collision course economically with Japan or are we as a country in the private sector beginning to make progress in meeting the challenge from Japan? How do you see the overall performance of Japan? Is it beginning to open up or how would you evaluate its performance?

Dr. LINCOLN. I think we have made some progress over the last decade. It has not always been obvious. We have had a lot of contentious negotiations. We have seen the share of manufactured imports to GNP in Japan rise after 1985, due primarily to exchange rates. Imports became cheaper and the Japanese bought more. But the ratio of imports to GNP has gone from roughly 2.5 percent to 4.0 percent. The United States is about 8.0 percent.

Our economy, by the way, is not all that open in terms of how much we actually absorb relative to the size of our economy. The European countries absorb a lot more. But we have been higher than the Japanese. We have had some improvement from the Japanese, but they are still not up even to where we are at the present time. The process needs to continue in Japan, but it is moving the right direction.

I do think we have made some progress on some of the more obvious trade barriers in Japan, and in some cases our exports to Japan have responded to the removal of those barriers. Cigarettes, although we may feel some moral qualms about that market, has been one area where barriers were removed and the Japanese did buy more as a result. We can see the result very clearly.

I think also in our American automobile industry, if we look at defects per car coming off of the assembly line, there was a fairly dramatic decline in defects over the course of the 1980's. I would like to believe that this improvement was primarily in response to competition from the Japanese.

So I do not see that we are moving closer and closer to a collision course. I think there will continue to be some tension. Certainly on something like keiretsu we will continue to battle away, but we are learning a great deal from the Japanese and I think that is the way a lot of American business feels.

Senator ROTH. You heard the testimony from Mr. Rosenthal and his belief that the antitrust laws offer a solution to our problems. Let's assume that we think keiretsu should be dismantled in Japan. Do you see antitrust being a solution in that kind of a situation or is antitrust more a solution to where they do substantial business here?

Dr. LINCOLN. It would not be a very effective tool to dismantle keiretsu in Japan. I am not sure we want to entirely dismantle them.

Let me give you an example. Under Japanese antitrust law banks are permitted to own 5 percent of the outstanding shares of the other corporations. Banks tend to hold close to that 5 percent level in a broad array of corporations, inside and outside their own keiretsu. That level could be reduced to zero. We could put pressure on the Japanese to reduce permissible holidays to zero.

But if that change were made in Japan what we would find, in my estimation, is simply that the shares held by the banks would then be sold to their keiretsu partners. So the pattern of long-term stable share owners would remain even if the banks were written out of the process.

So antitrust law has to deal with the behavior of these organizations when it involves American companies. There must be some kind of an angle on which the keiretsu affects competition in the United States.

Mr. ROSENTHAL. Or in export markets. Do not lose sight of the fact that U.S. antitrust laws can deal with foreclosure of U.S. exporters even when there are no sales in the United States.

Senator ROTH. Yes, I am aware of that, Mr. Rosenthal. If I have time I will ask you a question or two.

Many of the problems that we see affecting fair trade have traditionally been considered domestic matters and not international, such as the keiretsu. I mean how you apply it to antitrust, which has been traditionally has been a domestic problem.

Do you see that we should seek to get some international rules in some of these areas as to what is legal and what is not legal?

Dr. LINCOLN. Absolutely. I think we have moved far beyond the point where something like antitrust policy should be viewed in a domestic context. Competition in far too many industries is on a global basis. We are talking about the structure of these industries across these global markets.

I think we are very definitely going to need discussion over the next decade, not just on a United States-Japan bilateral basis, but on a broad multi-lateral basis about the rules of competition. There has already been some discussion of that sort. I believe, in fact, the Canadians have put forth some proposals about using the OECD as a format for discussing antitrust policy.

Senator ROTH. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much.

I called these hearings on keiretsu so we could hopefully have a better understanding and see how we might meet this kind of a problem in our trade with Japan.

Sorry I have not been able to be here the full time, but I have been managing a piece of legislation on the floor of the Senate.

In looking at your testimony, Dr. Lincoln, one of the things you think we should do is have much stronger enforcement of our antitrust laws, as I understand it. But another is "affirmative action," which I take to mean in your terms "managed trade." And yet when you steer in that direction you normally get some strong criticism.

How do you think you can reconcile that and meet those kinds of complaints in trying to put something like that in process?

Dr. LINCOLN. I deal with it personally by saying we do not want to destroy or disrupt the carefully constructed system of international trade rules that we have devised over the last 45 years. They have served the world well. But that there may be some particular instances in which managed trade is the only viable solution to an impacted problem.

The CHAIRMAN. Give me an example.

Dr. LINCOLN. Semiconductors.

When you have an American industry that has had roughly a 10 percent market share in Japan that has gone neither up nor very far down for 20 years, despite the removal of a variety of overt trade barriers in Japan, something obviously has gone wrong.

Here is an industry where we have what I would characterize as a fairly determined Japanese industry policy to foster the development of this industry, which the Japanese Government does not want to back off of. We do not want to back off of the maintenance of a viable semiconductor industry in the United States. And if neither side wants to back off of those government policy positions, then some form of managed trade may be the only outcome. That is what we have ended up with, a performance standard for penetration of Japan.

The CHAIRMAN. When you talk about some of the American companies getting closer to their suppliers, developing a much closer liaison there, it sounds like that is a trend toward the keiretsu approach in this country.

Dr. LINCOLN. Absolutely.

The CHAIRMAN. Do you suggest that? Is that in process?

Dr. LINCOLN. Yes. And those companies are doing it in some cases from having looked at the Japanese. Boeing is an example of that process. They have quality standards which suppliers must meet, and those suppliers are monitored more closely in the early years of the relationship. Motorola was mentioned as demanding that its people be able to apply for the Baldrige Award. I think Boeing is also moving in that direction.

Senator BAUCUS. Thank you very much. It is very helpful.

Our final panel consists of Mr. T. Boone Pickens, general partner of Mesa Limited Partnership. Mr. Pickens is out of Texas. I do not know anyone who has more direct experience with the problem we are addressing than Mr. Pickens. So we are honored to have you here, sir.

The CHAIRMAN. Let me say, Mr. Chairman, that I am delighted to have my friend, a very able businessman from Texas, with broad international experience. Some he has enjoyed; some he has not. But he has been part of a high profile attempt to break into the investment market of Japan, and I think his experience is particularly helpful to us in better understanding the situation. I am delighted to see him here.

STATEMENT OF T. BOONE PICKENS, JR., GENERAL PARTNER, MESA LIMITED PARTNERSHIP, AND PRESIDENT, BOONE CO., DALLAS, TX

Mr. PICKENS. Thank you, Chairman Bentsen and members of the Senate Finance Committee. Thank you for the opportunity to testify today.

I applaud your interest in Japan's keiretsu system. This marks the fifth time that I have testified before Congress about my Japanese experiences. I provided written testimony on another occasion. My testimony has evolved from hearing to hearing as I have learned more and more about Japan's business practices.

At first, the issue was fairness in Japan's refusal to grant an American board representation in a Japanese auto parts company called Koito Manufacturing, even though Boone Co. was Koito's largest shareholder. But I have learned a lot about the Japanese economy since my first testimony. Despite what the Japanese want you to believe, they are not making inroads to the U.S. economy because they are smarter or they work harder.

Simply put, their economy is rigged and the keiretsu system is one of the most sinister aspects of the Japanese economy.

My story has been well documented. As you know, I sold my shares in Koito earlier this year. So I have no conflicts of interest at this hearing today. I have no investment in Japan. It became clear that corporate Japan did not want any American to see the anti-competitive nature of the keiretsu system from the inside.

Some say I was a victim of Japan's system. I am more concerned that Japan's anti-competitive, cartel-like keiretsu is increasingly victimizing the U.S. economy. It is clear to me that Japan's keiretsus not only violate United States and Japanese antitrust laws, they violate every principal of free and fair trade.

When I first began telling Congress about keiretsus, Japan's Government denied that they existed. When pressured by our government, they admitted their existence last year. I warned Congress that Japan was exporting the system to the United States in violation of our antitrust laws and they denied that, too.

Earlier this year we pulled the cover off Japan's keiretsus in the United States with the Mid-America project. The Mid-America project was a coalition of business and labor groups that studied foreign investment in a six-State region—Kentucky, Ohio, Tennessee, Illinois, Michigan, and Indiana.

The chart I brought with me today depicts Toyota's keiretsu, which is the one in red; and the Nissan keiretsu, which is in blue. Now this came directly out of the Mid-America project. A map found that 1,200 keiretsu dominated Japanese companies were operating in those six States.

Now Japan's keiretsus have become a dominant force within the American automotive industry and according to the MAP study 73 percent of the companies that belong to Toyota's keiretsus in Japan now operate in the United States. They supply Toyota's American operations. Nissan's keiretsu influence in that six State region reaches 76 companies, and Honda's controls 37 Japanese companies in that same area.

Now let me give you some insight. In retrospect, I am astounded that we encouraged the Japanese to come to America and build automobile factories here. They must have been very happy when we insisted that they do that, because they did it and they brought everything with them that operates in Japan.

Let me give you some insight into how Japan uses the keiretsu system to gain an unfair economic advantage over U.S. companies. At a House Ways and Means Committee hearing last year, the IRS said a number of Japanese companies, including Toyota, are dodging U.S. taxes. They are getting away with it by underreporting their U.S. earnings and the cost to the U.S. taxpayer has been estimated at up to $50 billion a year.

On every $100 of gross sales the Japanese report 12 cents of taxable income. Foreign firms, all of them, 82 cents and U.S. companies $5. That came from that IRS report to House Ways and Means.

In 1987 Japan's transplant had U.S. revenues of $182 billion. But their taxable income was only $219 million. That is not taxes; that is only $219 million taxable income on $182 billion of revenues.

Today we know all we need to know about the keiretsu system and the threat it poses to America's open free-market economy and our very sense of fair play. I understand that Senator Riegle has plans to introduce a bill that will attack Japan's cartel-like behavior. These keiretsus limit the ability of U.S. auto parts companies to sell in Japan or to Japanese transplants in the United States and I applaud and support Senator Riegle's initiative.

But we should do more. I believe that Congress should direct the FTC and the Internal Revenue Service to use every means at their disposal to dismantle the keiretsu system. I urged the FTC to act nearly 2 years ago. Maybe you will have more luck than I did on that. But I am not worried about competing with the Japanese.

Properly led, we have the best workers in the world in this country. But we deserve a level playing field. We will not have that until these cartels are dismantled.

Thank you.

Senator BAUCUS. Thank you very much, Mr. Pickens.

[The prepared statement of Mr. Pickens appears in the appendix.]

Senator BAUCUS. Just a couple of questions come to my mind. One, I asked Mr. Mead if the auto parts industry has recommended solution. He essentially said do not try to dismantle the system, but rather adopt some kind of results test so we can sell in their market, using that approach. Yet I heard you say we should attempt to dismantle the system.

Is there some conflict there or are you both agreed, but just have a different way of saying it?

Mr. PICKENS. No, I agree. I think we should fight on several fronts. The first one is that we should—these are simultaneous—press to get into the Japanese markets. Second, that I think that they are in violation of our antitrust laws. So I think with that we dismantle.

If we go back and look at when our antitrust laws were developed in this country it was about the turn of the century. I think that we are turning back the clock that far back to allow this to take place in America. I think we press right in. I think the laws are in place to take care of the situation.

Senator BAUCUS. Did you attempt an antitrust remedy?

Mr. PICKENS. We did. It was interesting, in Japan they are in violation of their own antitrust laws, and I discussed the issue with our Japanese lawyers. I said, well let's try and take a look at trying to do something in Japan with this. They said there are only six antitrust lawyers in all of Tokyo. That gave me an idea on what we could export to Japan. [Laughter.]

That did not seem to be a real solution. But the Japanese are going to do nothing with this. Here, we went to the FTC with it. They took, you know, some depositions and explored the idea and everything else. But I do not think they pursued it in an aggressive manner.

Senator BAUCUS. But Mr. Rosenthal when he testified earlier, indicated that in his judgment U.S. antitrust law would have, if not in all cases, but could very well have sufficient extraterritorial application in Japan. I mean, did you pursue U.S. antitrust laws that apply to in Japan?

Mr. PICKENS. In Japan?

Senator BAUCUS. Yes.

Mr. PICKENS. You know, we are talking about spending a lot of money here when I got into this. When I talked to the Federal Trade Commission they wanted me to go out and develop a lot of things and bring them back to them which, you know, I commend them. If I do the leg work and the investigation well it helps.

But we got $50,000 to $100,000 in it in legal fees and that is about all we wanted to do. So we never did anything more than scratch the surface on how we might apply our antitrust laws back to the Japanese in Japan.

Senator BAUCUS. And basically because of the cost, the legal cost?

Mr. PICKENS. That basically was it, yes, time and cost. We did not feel we could afford to do that.

Senator BAUCUS. If you were willing to spend that much more do you think the chances were good that you would have a sufficient remedy?

Mr. PICKENS. Probably.

Listen, the first thing, I hate to be identified as a Japanese basher. I really do not see that as—that is not my feeling about it. I think a Japanese are natural trading partners with us, with the second largest economy in the world. We have to do business with them. They have to do business with us.

But what I want them to do is that somehow, and maybe I have been accused of being overly simplistic on these things, but level the playing field and get it where we can do business in Japan like they do business here. I get frustrated with how they put us off and they are very clever about how they do it. They are going to do everything they can to continue the system that they have in place because it is working and it works extremely well for them.

We need to do everything we can to straighten this out where we have, say, the same opportunities that they have.

Senator BAUCUS. Just one brief question. To what degree should we adopt in America some of the same procedures that the Japanese apply? That is the lean machine approach, where a company goes back to its suppliers and has a quality audit of its suppliers and a closer work relationship between a company and its suppliers. To what degree should we in America do some of the same?

Mr. PICKENS. Well, see again, I think that is in violation of our antitrust laws. I think the company that I had the interest in, the 26 percent interest in, all the shots were called by Toyota. All the management personnel came out of Toyota over to Koito. It was actually a subsidiary of Toyota, but Toyota had 19 percent and I had 26 percent. They had 20 Directors on the Board, Toyota had 4, I had none. I could not even get one person on the Board. And I even said somebody that I would designate, not me. If was so objectionable to them we would put somebody else on.

Let me just conclude.

Senator BAUCUS. Very briefly, because the Chairman is going to want to ask some questions and there is a vote going on. We really do not have the time here.

Thank you.

Mr. Chairman?

The CHAIRMAN. That was a good line of questioning. I was interested when you were talking about six antitrust lawyers in all of Tokyo, and those probably being hired by the corporations to defend them.

Mr. PICKENS. I am sure they are.

The CHAIRMAN. As I recall, Mr. Pickens, 2 years ago or so when they started the Structural Impediments Initiative, you insisted at that time the keiretsu be a part of the negotiations. Yet 2 years later, the negotiators admit they have made very little headway in that regard.

Do you think that is still one of the avenues of pursuit?

Mr. PICKENS. Well I would pursue every place I could. I think the Japanese understand that better than anything else, is that every place they turn there is some heat on them to do something.

On the SII talks, you know, they admitted that they had a keiretsu. They admitted that they may have problems with the keiretsu. I thought that our trade representative tried very hard to get something done. But I do not think that that can be accomplished at that one point.

I think you are going to have work on several fronts. You are going to have to push all the time. I think when that happens, if they can just focus on one area of pressure, I think they will do very well to deflect it. But if it is on several fronts, I think they break down or they will break down. I think that is what we have to do.

The CHAIRMAN. We talked a lot about the manufacturing skills and abilities in that regard. But what you were really doing was trying to make an investment in their market. That is where you ran into trouble. And in trying to exercise what we would think of as the normal rights of a stockholder in this country.

What do you see that we can do there?

Mr. PICKENS. Well the market is rigged. I said that the first time that I went to Japan 3 years ago and spoke before the National Correspondence Luncheon there. I said it is a rigged stock market. It is easy to see because they have the cross ownership, which was spoken to here just a few minutes ago. It is cross ownership and they do control; and it is not like our market.

I hate to see every morning on the financial news where they give me what happened in the Japanese market yesterday, just closed and it is up or it is down. It is rigged is what it is. I mean there is not any reason confusing people with a rigged market and act like it has some significance because I do not believe it does.

Now what you could do with it is really open it up and stop the cross ownership and let the stockholders have rights in Japan which they do not have. Today an average stockholder goes in and buys 100 shares of Koeito or something else, it is sort of like placing a bet at the race track. I mean you have no—there is nothing for you there. You have no say. You are not identified as an owner. You can see the payoffs that took place here just recently.

Even the company that I had an interest in, Koeito, got a kickback of $1 million. For what, I do not know. But that was reported.

The CHAIRMAN. Tell me what you see happening in the Japanese investment market. You are seeing the stock market down 40 percent since January in Japan. You are seeing this cross ownership of a lot of sterile investments in effect or dormant investments or those that are not paying major dividends. You are seeing a price/earning multiple which has decreased from incredible heights.

Are you seeing any loosening up of that kind of an affiliation: a willingness of some of the financial institutions now to sell off some of these types of traditional cross investments that they have been having as part of the keiretsu policy?

Mr. PICKENS. No. I think that you may see some movement around, but you will not see the control change. That is the system. They are going to stick with it.

The CHAIRMAN. Even as the financial market has been shaken to some degree, as you have seen happen to real estate there what happened to real estate here, and as you have seen substantial holdings by financial institutions in some of those situations, you still do not see a shake up at all?

Mr. PICKENS. No. I think you are going to see the individual shareholders start to lose interest in investing in it because they are going to lose confidence. You know, you cannot force investment—Japan is open enough and independent enough that the individual on the street does not have to invest in the stock market. I think that you will find that they will drift away and the cross ownership will actually be more pronounced than it has been in the past. As the public loses confidence they are going to get. They will put the money into passbooks or CD's or whatever.

The CHAIRMAN. That is what you are anticipating. Do you see any of that happening?

Mr. PICKENS. I cannot tell you that I have because I am not that current on the Japanese market.

The CHAIRMAN. I see we have a vote coming up.

Well we are delighted to have you. No one that I know can speak with more first-hand experience about that kind of confrontation.

Mr. PICKENS. If I could conclude on one point. All I ever asked them for was representation. Now they tried to tag me with green mail. I never once offered them green mail or they never offered once me green mail. I did not ask for it. But what I wanted was representation and I honestly almost drove them crazy because I would not ask for anything but representation on the board of directors.

So it was interesting to see how it played out. But they let me know several months ago that I could come and stay as long as I wanted to, I was never going to get on that Board. That was it. And I believed them. I believed them. They really made a believer out of me on that.

Thank you very much.

The CHAIRMAN. Thank you.

Senator BAUCUS. Thank you very much.

The hearing is adjourned.

[Whereupon, the hearing adjourned at 12:25 p.m.]

APPENDIX

Additional Material Submitted

Prepared Statement of Senator Charles E. Grassley

Thank you Mr. Chairman.

The issue we are about to discuss this morning is of great importance to me. One cannot help but feel that American business can compete with any foreign competitor domestically as well as abroad so long as no barriers are in place.

Over the course of several years I have had the pleasure of receiving information from one of our witnesses, Mr. Boone Pickens on the subject of "Keiretsu's." In fact, I have found that information to be of immense value for other hearings held in this committee as it relates to U.S./Japan trade.

What was most fascinating to me was the last correspondence I received from Mr. Dickens in which he enclosed a report produced by the non-profit mid-America project. In that report it is indicated that Japanese cartels have become a dominant economic force within America's automotive industry. For example, the map study states that 73 percent of the companies that belong to Toyota's keiretsu in Japan now operate in the six-state region, supplying American plant operations.

Mr. Chairman, it's one thing for us to have to compete with these cartel in Japan, it's another when they begin transplanting this process to the American shores.

It is important also to note Mr. Chairman that the keiretsu is not a new phenomenon. In fact they came about after World War II when Japan was forced to abandon "clan or family" ownerships in which the head of the clan ran the businesses. When the keiretsu was established we saw the formulation of groups of companies tied by a common industry or financial interest, and centrally coordinated by a bank, trading company or major manufacturer. Together, Japan's keiretsu groups are called "Japan, Inc."

If one really wanted to, you could trace the origins of Japan's keiretsu's back as far as ancient history . . . from Japan's earliest written "kokiji, record of ancient matters" (circa a.d. 712) through the yamato and nara periods when emperors reigned, and during the time of the shogunate military governments, which ruled from 1180 until 1888. As you can see Mr. Chairman, Japanese society has continuously been made up of alliances of clans and classes.

The issue that concerns me the most is that we have always had, for example, patterns of U.S. investment in Europe or of European investments in the United States. While we saw this as a natural business evolution of each trying to gain entry into each others market and develop local ties, with the Japanese it is largely a one-way street. It is this non-reciprocation and the insertion of keiretsu's into the United States that is a great concern to me and one which I look forward to our witnesses shedding some light on this morning.

Prepared Statement of Senator Orrin G. Hatch

Mr. Chairman, while we need to examine any and all impediments to the operation of a workable free market system, our ultimate goal, I hope that we can proceed in a fair-minded way.

Today's session examines the Japanese "keiretsu" practices. As we know, keiretsus inhibit competition by controlling the supplier, distribution and marketing subsystems; these are the key mechanisms of any free market economy.

Our concern here is twofold: first, we need to know more about the keiretsu system as it operates in Japan.

—Our trade negotiators have engaged the Japanese in discussing the trade-restrictive practices of keiretsus since 1989. And the Japanese have openly admitted to the adverse effects they pose on our trade relationship.
—They have also agreed to more rigorously enforce their Anti-Monopoly Act. And I understand that progress on that account has not been impressive.
—In a few words: if the Japanese expect others to open *their* markets and economies, the Japanese will have to reciprocate. This means making keiretsu practices visible and controllable, enforcing Japanese anti-trust laws, and extending real minority shareholders rights to foreign investors.

The second issue before us today is whether by intent or by default keiretsu-type practices are slipping into the day-to-day operations of the growing number of Japanese transplant companies in the U.S., and especially in the automobile industry.
There is understandably much interest in the issue. The UAW as well as American manufacturers have joined forces in establishing workplace conditions that they see as fair. Of course, their impression of fairness is not universally accepted.
Senator Riegle has a bill before us, the "Fair Trade in Motor Vehicles and Parts Act of 1991," that presents some interesting impressions of what is fair. The Riegle bill, which is joined in the House by similar measures from representative Richard Gephardt and others, sees U.S. original equipment manufacturers, the so-called "OEM" sector, losing out to Japanese parts manufacturers that have transplanted to the U.S.

—Senator Reigle's bill has some merit. For example, Honda of America has told me that 75 percent of its Accord has U.S. OEM parts. However, when I asked them what share of that 75 percent belongs to Japanese transplants, I was told that no information had been compiled on that question. That's too bad, I want to be even-handed, but I demand full disclosure and good information.
—At the same time, I must disagree with my good friend from Michigan, when he narrowly defines U.S. auto-part makers as someone, that is a legal person, who:
1. Operated in the U.S. before 1981, and
2. Is non-Japanese.

Good legislation establishes broad principles which guide the President in the establishment of public policy. I don't like fingering the Japanese, when there may be, or will be, other countries: Korea, Germany, France, that could fit the same bill.
But the establishment of 1981 as the threshold date in determining what is a U.S. manufacturer seems short-sighted. After all, one percent of the American workforce of 118 million persons work for Japanese companies. By Senator Riegle's standard, therefore, we eliminate from eligibility as a U.S. OEM the tens of thousands of U.S. workers in such plants as Honda in Marysville, Ohio; Nissan in Smyrna, Tennessee; Mazda in Flat Rock, Michigan; Subaru in Normal, Illinois; and Isuzu in Liberty, Indiana—in fact, I wish I could have included Utah in that list!
But let me return to the more salient issue before us—what share of auto parts for Japanese vehicles is denied U.S. makers? The Japanese admit to a standard of about 40 percent of their parts' requirement coming from Japan. USTR and the Commerce Department say that about 20 percent of the requirement comes from U.S. OEMs. *This means that roughly 40 percent of the parts for Japanese-made vehicles in the U.S. are provided by the so-called Japanese "transplants." Is that too high? I believe it is.*
Mr. Chairman, I have some real reservations about the practices of transplants. Their employment policies have had very mixed reviews. The Federal District Court in Chicago, in a 1990 case, found a Matsubishi subsidiary, Quasar, to be in violation of the national origins provisions of our 1964 Civil Rights Act. It seems they discriminated against American employees by dismissing great numbers of them, while retaining their Japanese counterparts.
But, to balance my argument, the Japanese auto giants, like Toyota, Honda and Nissan, have taken note of our statutes and case law, and are making a conscious effort to promote Americans, and, I am happy to add, to hire more minorities and women.
The second concern that I have regarding the transplants, Mr. Chairman, relates to something that I know bothers every member of this particular committee: tax evasion.

—The IRS just reached a settlement with Toyota for $1 billion. It seems that the Japanese parent was charging much higher prices for sales of vehicles to its U.S. subsidiary. This type of systematic overcharging kept the U.S. company's expenses high and, of course, its taxes low. That's what a Japanese-managed U.S. transplant can do, and that worries me.

—Nor am I any happier with the IRS case against Yamaha Motors U.S.A. In this case, the company paid only $5,272.00 to U.S. tax collectors in a period covering four years. It seems that Yamaha Japan just loaded up its U.S. subsidiary with massive numbers of vehicles which, even though they couldn't sell, became a business expense. The IRS estimated that the company owes $127 million in taxes.

—Here, again, I want to be fair. After all, U.S. companies also look for ways to avoid taxes. I refer to the case of Westinghouse which, the IRS reported, booked 27 percent of its 1986 domestic profit to the low-tax Commonwealth of Puerto Rico—even though its sales in that region are negligible!

Mr. Chairman, this hearing will help us better understand the impacts on U.S. trade that derive from the keiretsus. Most of my questions, understandably from what I've said so far, deal with the transplants' activities. For example, I would like to know why the U.S. auto parts industry, which feels very threatened, has taken so long in demanding an investigation under Section 301 of the Omnibus Trade Act of 1988?

I would like to start with that question and welcome hearing from the panelists. Thank you, Mr. Chairman.

Prepared Statement of Senator Carl Levin

Mr. Chairman, members of the Committee, I appreciate your allowing me to testify today and your holding this hearing on keiretsu and it's impact on our nation. The Japanese keiretsu system of interlocking businesses and exclusionary practices are literally devastating American industries and draining our nation of jobs. Hearings in the Small Business Subcommittee on Innovation, which I chair, have made clear that many of these jobs are in small businesses.

I wish American firms were just competing with individual Japanese firms. Instead they have to compete with a nation, Japan Inc. American companies are competing with a coordinated network of banks, trading, insurance, steel, textile, construction, electronic, food and other companies which are linked together.

American companies aren't going one on one with Japanese companies. They're up against a 500 pound gorilla.

A recent article on the Japanese keiretsu system in the Washington Post listed six of the principle horizontal keiretsu. One of them is the Fuyo keiretsu. While the name Fuyo is not well known in the United States, the Fuyo keiretsu includes companies whose names are household words. Take a look at it—names such as Hitachi, Nissan, and Canon are just a part of it.

These networks strangle foreign competitors because it's not just one company, it's a network of banks, insurance and other companies that they are up against.

The proof of the networks' existence is open and obvious if we'll but open our eyes. In 1989, 70% of the stock of publicly traded Japanese corporations was held by other corporations. This stock is rarely sold. In the U.S., such corporate interlocking ownership is negligible. Indeed, the current U.S. Trade Representative lists keiretsu in her annual report on foreign trade barriers.

These interlocking relationships give Japanese companies a tremendous advantage over their American companies. Japanese companies have little pressure to maximize dividends, enabling them to take losses to strangle competition and win market share in one area while being supported by profits in other areas.

Another important result is that the long-standing company ties make it next to impossible for outsiders to access to the Japanese market. This creates a protected home market without price competition from imports which allows Japanese firms to reap the large profits at home necessary to price aggressively abroad to gain market share.

A recent price survey jointly conducted by the U.S. and Japanese governments indicates that this is exactly what's happening in the auto parts sector. The study showed that identical or comparable auto parts cost on average 340% more in Japan than in the U.S.

For instance, this Japanese-made shock absorber costs $83 dollars in Japan, but only $18 here! And this American-made shock absorber costs about the same here, $23. A wiper blade which costs $12 in Japan, costs only $3 here. An ignition coil which costs $93 in Japan costs one-eighth as much here. If there were a free market in Japan we'd be selling a heck of a lot of auto parts with these price differentials.

Moreover, these business networks and exclusionary practices are being replicated in this country. Hundreds of Japanese parts makers have followed the Japanese automakers which established assembly operations in the U.S. But rather than create jobs, the transplants have actually replaced jobs because they have often shut out traditional American parts makers, preferring to source from Japanese parts makers.

After years of prodding, and promises to give American parts makers a chance to compete for sales, traditional American parts, still account for less than 20% of the value of the vehicles made by the Japanese transplants here in the U.S.

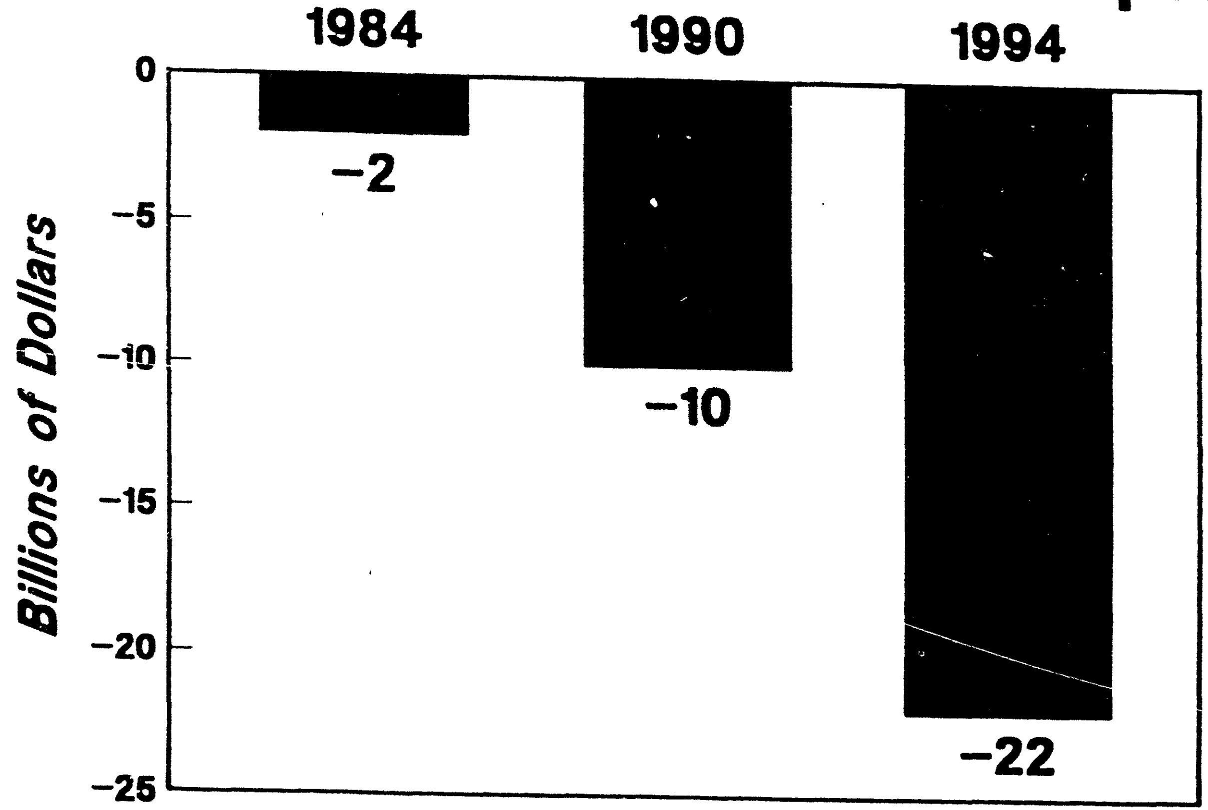
Study after study has documented the problem. It's clear what's happening, and the future of the U.S. auto parts and other industries is now on the line. Every 16 hours, a U.S. parts company is going bankrupt. It's not that they can't compete, but that they're not being given a chance to compete. U.S. parts makers successfully compete in every market except Japan—our auto parts trade with the rest of the world is in balance. Japan is the exception. We've been virtually shut out of the Japanese $102 billion parts market, and are now being similarly locked out of a part of our domestic market.

Our $10 billion auto parts trade deficit is expected to more than double in the next three years if we do not act. While this administration, like those before it, presses for more studies and more talks, the administration's own industry advisory committee has made some concrete recommendations to stop the hemorrhaging. In June, the Auto Parts Advisory Committee, chaired by Jack Reilly who you will be hearing from shortly, publicly urged the administration to begin preparation of both Section 301 and antidumping proceedings against Japan.

Yet four months later, no action has been taken on these recommendations. The Auto Parts Advisory Committee, has shown vision, courage and leadership. It's now up to the administration to do the same. This administration is not going to act unless prodded by Congress or required to act by law. I see no alternative but to move ahead legislatively.

No more studies. Action is long overdue. This Committee has the lead role. I urge you to just say "yes" finally to legislation which places equivalent restrictions on the goods of countries which discriminate against American goods, be they auto parts or electronics or wood products.

U.S. Auto Parts Deficit With Japan



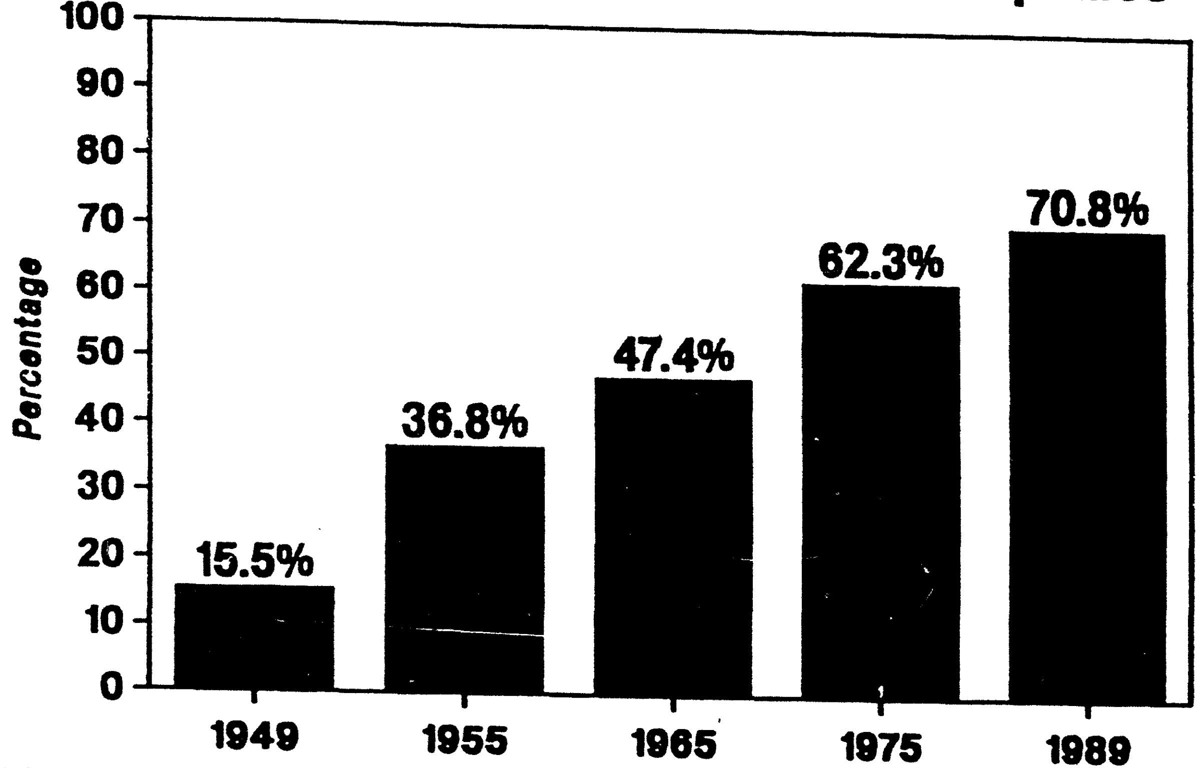
Source: University of Michigan

FUYO KEIRETSU

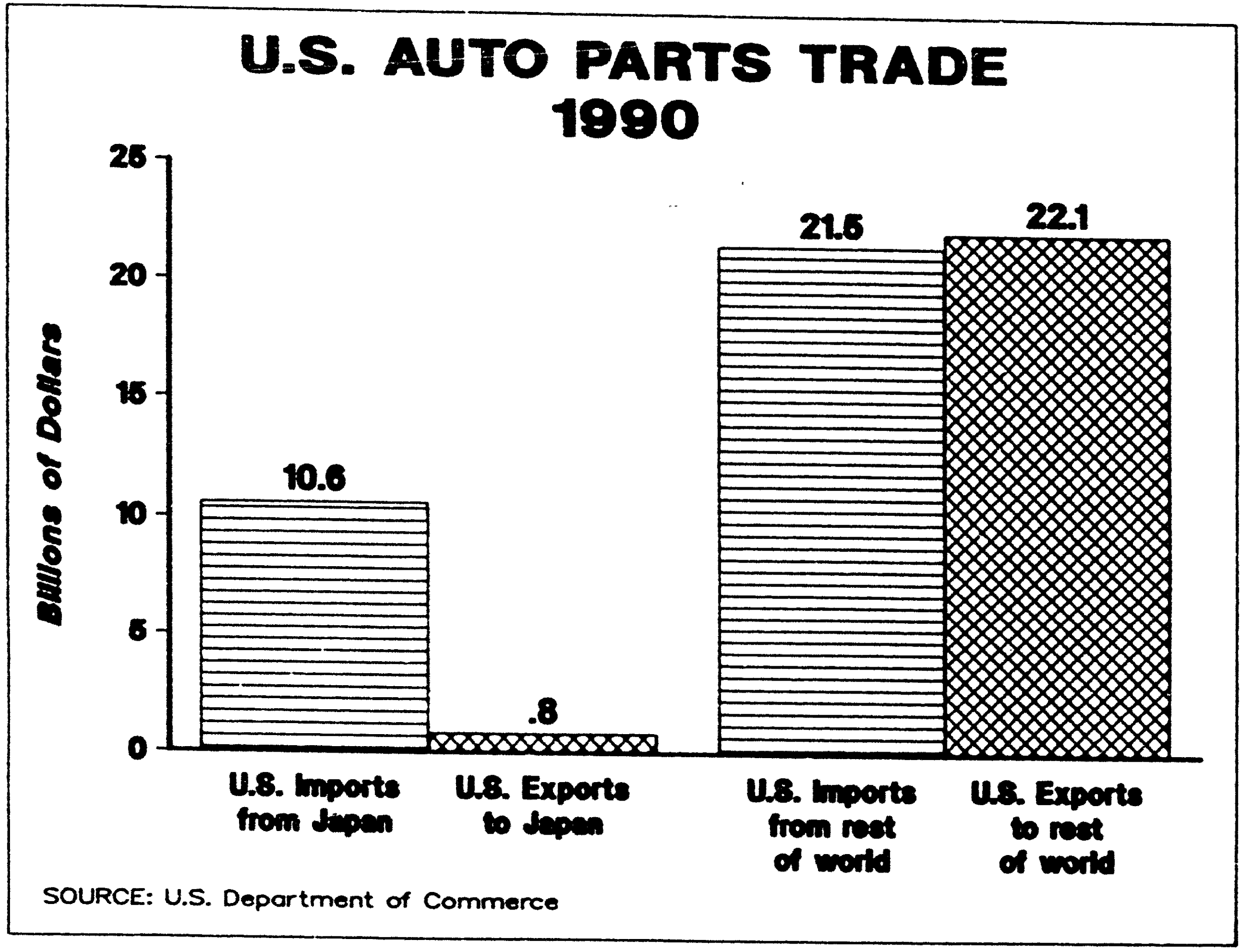
INDUSTRY	MEMBER COMPANY
Commercial Banking	Fuji Bank
Life Insurance	Yasuda Mutual Life Insurance
Trading	Marubeni
Construction	Taisei
Food & Beverages	Nisshin Flour Milling Sapporo Breweries Nichirei
Textiles	Nisshinbo Industries Toho Rayon
Glass and Cement	Nihon Cement
Steel	NSK
Electric Machinery	Hitachi Oki Electric Industry Yokogawa Electric
Transportation Equipment	Nissan Motor
Precision Instruments	Canon

Note: Other major industries include trust banking, nonlife insurance, forestry, coal mining, pulp and paper, chemicals, petroleum, rubber, nonferrous metals, nonelectric machinery, transportation, communications and services.
Source: Washington Post, October 6, 1991

Percent of Shares of Japanese Publicly Held Companies Owned by other Companies



SOURCE: Washington Post, October 6, [illegible]


U.S. AUTO PARTS TRADE
1990
Billions of Dollars
0
5
10
15
20
25
10.6
.8
21.5
22.1
U.S. Imports from Japan
U.S. Exports to Japan
U.S. Imports from rest of world
U.S. Exports to rest of world
SOURCE: U.S. Department of Commerce

PREPARED STATEMENT OF EDWARD J. LINCOLN

The term *keiretsu* has become quite popular in the United States, and yet it is used in a rather loose manner. In a Japanese context, it refers to two rather specific and quite different business structures—broad horizontal groupings of firms and vertical groupings of large manufacturers with their parts suppliers or distributors.

The horizontal *keiretsu* are loose agglomerations of firms across industries with no clear center to the organization. The names of some of the largest of these groupings are quite familiar to Americans: Sumitomo, Mitsubishi, Mitsui, Sanwa, Fuyo, and Dai-Ichi. The first three of these groups have a number of companies with the group name. Despite the origin of most of these six groups in prewar *zaibatsu*, which were very tightly controlled conglomerates, none of these groupings has the centrality of control or purpose that one would expect from a conglomerate. Neither the banks nor the large trading companies which are members of these groupings are clear leaders. Coordination, to the extent that it exists, comes formally through periodic meetings of the presidents of these participating companies and other informal contacts. To some extent, members appear to show preference to purchasing products from other members of the group, and this preference is supposedly stronger in the case of helping out fellow firms with the introduction of new products (such as super computers).

An important aspect of the horizontal *keiretsu* is their invulnerability to foreign takeovers and their relatively secure financing. One of the features of these groupings is that each firm holds small percentages of the shares of the others, including holdings of up to five percent by the banks in the group. Taken together, these stable, interlocking shareholdings preclude any undesired outsider from obtaining control without full approval of target firm and the rest of the group. These interlocking equity ties had been quite loose, but became tighter in the late 1960s when Japan began liberalizing its capital controls. At the present time, the percentage of outstanding shares of member companies in the big six horizontal *keiretsu* held by other members in their group varies quite widely (see table on following page). In none of them is the average interlocking ownership at all close to a majority. Even for these firms, therefore, protection from takeovers does not come entirely from within the keiretsu group stockholdings.

Table.—HORIZONTAL KEIRETSU TIES

[By percent]

Group	Equity held within group	Share of loans from within group
Mitsui	17	22
Mitsubishi	28	20
Sumitomo	24	25
Fuyo	16	18
Sanwa	16	19
Dai-Ichi	12	11

Just as a random example, Sumitomo Electric Industries, Ltd., has 21 percent of its shares held by other Sumitomo group firms, with the largest block (7.2 percent) in the hands of Sumitomo Life Insurance, followed by the two Sumitomo banks (5 percent held by Sumitomo Trust Bank, and 3.1 percent held by Sumitomo Bank). But in the list of the top ten shareholders for this company are a number of other financial institutions outside the Sumitomo group, including Nippon Life Insurance (6.6 percent), Mitsubishi Trust Bank (4.7 percent), Mitsui Trust Bank (4 percent), Dai-Ichi Life Insurance (3.9 percent), Yasuda Trust Bank (3.2 percent), Daiwa Bank (2.6 percent) and Toyo Trust Bank (2.6 percent). This implies that the phenomenon of stable share holders is far more widespread than the keiretsu, and that it would be a mistake to place the main focus on this feature of the Japanese economy on them alone.

A similar pattern is evident for bank borrowing. Firms in these groups almost always have their largest single loan from a group bank, but total borrowing from group banks is not a majority of the borrowing (on average) for firms in any of these groups. Reliance on group banks, in fact, has been slowly dropping for the past two decades, implying that at the margin, firms have preferred to go outside the group to raise money. However, the maintenance of a group bank as the largest individual loan source does imply important responsibilities. Should a group firm find itself in financial difficulty, then the group bank has the responsibility to put in to play a rescue operation or to make the decision to either let the firm go bankrupt or force it into a merger. Group loyalty in times of trouble could well work against the interests of foreign firms. It is interesting, for example, that when Mazda almost failed in 1974, the rescue was performed by Sumitomo Bank, and Ford Motor Company (owner of 24 percent of the shares) appears to have been uninvolved.

The vertical *keiretsu* are quite a different phenomenon, and the ties are often much tighter than in the loose horizontal groupings just described. During the 1950s and 1960s, large Japanese manufactures wanted to strengthen their relationships with both parts suppliers and distributors of their final products. This process had a number of advantages for the large firms, including the following:

• Long-term, and relatively exclusive relationships made the large firms more willing to share proprietary information with their suppliers, facilitating the design and production of new and different products in a time of rapid economic growth. Closer communication also enhanced quality control.

• The Japanese labor market has been characterized in the past by large wage differentials by size of firm, and the movement of more labor-intensive operations to smaller subcontractors provided a means to save labor costs. This motive may remain today even though wage differentials have diminished considerably.

• Permanent employees in large firms faced mandatory retirement at age 55 (now 60 at many firms). In the paternalistic employment environment of Japan, smaller subsidiary firms became a convenient means to place employees for their post-retirement employment, while simultaneously strengthening the social bonds between the firms.

• Permanent employment for employees at large firms also implies an undesired inflexibility in labor costs. Sloughing off more of the work on small subcontractors became a means of adding flexibility back into the system; in hard times, accounts payable to subcontractors could be stretched out, or pressure could be applied to cut prices, or entire firms could be dropped to help control the costs of the main firm.

These relationships between large and small firms are quite unequal, and some of the advantages to the large firms listed here suggest that the smaller parts suppliers in these relationships are put in a difficult position. However, the system had some advantages for these firms as well:

• Access to scare investment capital during the rapid growth years prior to 1973. Small firms faced discrimination by the banks in obtaining loans (higher interest rates and absolute unavailability of money). A *keiretsu* tie to a large manufacturer could provide money, often through the form of trade credit, to finance expansion.

• Being tied to a successful large firm in a growing industry was a good long-term position for a small firm to be in. Suppliers might be hurt in recessions, but in the long run, they counted on rapidly expanding sales.

Typically these relationships encompass a number of dimensions. Sometimes the main firm may own part of the equity of the parts supplier (as in the case of Toyota's ownership of a minority interest in Koito), but this is not necessary. The parent firm, will, however, almost certainly be active in providing debt financing for the supplier. In return, all or most of the output of the small firm will be purchased by the parent. The straight business bonds are cemented through a variety of very important social bonds including the frequent social gathering of small groups of employees from each side to eat and drink. Movement of retiring employees from the parent firm is another feature of cementing these bonds. Finally, for those cases in which managerial personnel become involved in arranging marriages (still a feature of Japanese society, although for only a minority of adults), subcontractors become a convenient source of marriage partners.

American interest in the *keiretsu* dates back to the Second World War. The prewar *zaibatsu* were broken up during the Occupation—the holding companies that controlled them were eliminated (and made illegal) and family ownership was eliminated and disbursed widely to the public. during the 1960s, there was some question as to whether these groups were coalescing back into something akin to their prewar form. Eleanor Hadley, who had been instrumental in the breakup of the *zaibatsu*, concluded in a major study in 1970 (*Jananese Antitrust*), that the *keiretsu* continued to be much looser than the prewar *zaibatsu*. That characterization remains valid today.

More recently, American interest has revolved around the impact of these groupings on manufactured imports in Japan. Even if the ties are not as exclusive as in the prewar period, the preference for in-group business transactions can certainly act as an import barrier. One recent study by Michael Gerlach ("*keiretsu* Organization in the Japanese Economy," in Chalmers Johnson, et al., eds., *Politics and Pro-*

ductivity: How Japan's Development Strategy Works) does not tackle the import issue directly, but argues that as much as 50 percent of the trade of Japanese firms may be confined within their vertical and horizontal *keiretsu* relationships. Robert Lawrence has gone further and has provided the first estimate of what the impact of *keiretsu* might be on imports. A careful econometric study, making use of a detailed data set which allows separation of all major Japanese firms into those that do or do not belong to vertical and horizontal *keiretsu*, Lawrence concludes that the existence of the *keiretsu* may depress Japanese imports of manufactured goods by as much as 50 percent ("Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups," *Brookings Papers on Economic Activity*, 1991, No. 1, pp. 311–341). That estimate is quite dramatic, and is subject to some controversy. Nevertheless, it would be fair to say that the prevailing majority conclusion of American scholars familiar with keiretsu is that they do have a negative impact on Japanese imports.

The Japanese response to the emergence of this issue in the Structural Impediments Initiative, and the American academic work supporting that position, has been a spirited defense of the economic efficiency of these structures. Representative of this defense is Masaru Yoshitomi, head of research at the Economic Planning Agency (which is part of the Japanese government). One of the differences between Japanese and American manufacturers, he argues, is that large Japanese firms produce a smaller portion of the final value added of their products in-house than do their American counterparts. Therefore, what they buy from closely associated *keiretsu* firms is somewhat akin to what American firms choose to produce for themselves, so there should not be a negative impact on imports. Furthermore, one of the strong features of Japanese firms has been their ability to simultaneously drive down manufacturing costs while reducing defect rates in final products, as well as their ability to shift to production of new designs rapidly. Yoshitomi believes that the enhanced communication and trust that comes from close *keiretsu* ties greatly facilitates these attributes of Japanese manufacturers, and is superior as an organizational format to in-house production (because subcontractors behave more responsibly since they are independent profit centers). In this characterization, *keiretsu* are efficient economic structures, and, therefore, the United States government has no legitimate grounds for attacking them.

We must admit that the Japanese counterargument has some merit. Responding to the Japanese example, some American firms (including firms such as Boeing and Northrop) are moving to press their suppliers into closer relationships, involving more careful screening of output and closer communication. Since final products in all industrial countries involve substantial use of parts produced by other firms, long-term relationships which facilitate better quality control, greater flexibility or coordination of delivery schedules, and more rapid design change are all economically advantageous.

Not all Japanese authors have uniformly defended the *keiretsu*. The Japan Fair Trade Commission has been critical of *keiretsu* structures in distribution, in which manufacturers have exercised power or control over firms distributing their products, at both the wholesale and retail level. Hideto Ishida, a staff member of the Fair Trade Commission, wrote a highly critical article in 1983 ("Anticompetitive Practices in the Distribution of Goods and Services in Japan," *Journal of Japanese Studies*, vol. 9, no. 2, summer 1983, p. 317–334) of these structures (before the Structural Impediments Initiative existed). While the vertical groupings between manufacturers and their parts suppliers may have some economic rationale, it is difficult to see any rationale other than exercise of market power behind the distribution *keiretsu*. The Fair Trade Commission has been interested, but relatively ineffective, in combating this phenomenon.

However, the Japanese defense cannot be accepted in its entirety for three reasons. First, there is a question of fairness. As suggested above, many of the *keiretsu* ties formed, or were strengthened in the 1950s and 1960s. This was a time when very stiff import and investment barriers prevented many foreign manufactured products from entering the market. In the absence of overt barriers at that time, far more U.S. firms would have been included in these vertical relationships. Those firms that did manage to penetrate at that time have tended to be some of the most successful foreign firms in Japan. Once formed, though, these relationships have subsequently proved fairly impervious to the efforts of foreign manufacturers to break into the market.

Second, even if some aspects of these ties are economically efficient, other aspects are clearly beyond what is necessary to produce efficient products. The flow of retired employees, the personal comraderie, and marriage ties all create strong and durable social bonds which are noneconomic. The remarkable feature of the vertical *keiretsu*, in fact, is that they may have produced some economic efficiency despite the obvious temptation to inefficiency that Americans see as inherent in old-boy ties.

Third, the efficiency argument only applies to the large manufacturer-parts supplier vertical structures. An efficiency argument is difficult to sustain for the horizontal *keiretsu*. Their existence seems to be due more to the desire to minimize foreign ownership as capital markets liberalized. There is an information-sharing explanation for these organizations, but there is no reason why information sharing should be locked up in these organizations (and they are by no means the only channels through which business information flows freely).

A major dilemma arising from the *keiretsu* problem is what the U.S. government can do about the problem. Virtually none of structural features or behavioral patterns of the horizontal or vertical *keiretsu* groups is illegal under Japanese law. Elimination of the right of the banks to hold up to five percent of the outstanding shares of other firms was one route pursued in the SII talks, but this change would do little to alter the existence of the horizontal *keiretsu*, as other group firms would simply absorb the shares formerly held by the banks (as happened when the limit was lowered from 10 percent to 5 percent in the late 1970s). As is obvious from the Sumitomo Electric example above, financial institutions in general, including those outside the *keiretsu*, are collectively major shareholders, but even this broader role could be transferred to non-financial institutions if the law were changed.

There are two possibilities for action which could get further attention:

1. Affirmative action. For those products for which a systematic bias away from imports is a problem, some form of affirmative action may be necessary. This is simply another term for results oriented negotiations, or, as some would put it, managed trade. Engaging in such a strategy is not desirable as a general approach, and carries great danger in eroding the liberal trade regime that has served the world well in the postwar period. Nevertheless, it may be unavoidable as a solution to particular trade problems where strong *keiretsu* structures, or other problems, have severely limited the role of American products.

2. Antitrust enforcement. Although many aspects of keiretsu structure and behavior are legal in Japan, there may be room for using both Japanese and American antitrust law to combat some of the practices involved. The existing law in Japan could be amended to eliminate the remaining consumer products for which resale price maintenance is allowed. Even the existing law could probably be used to limit the ability of Japanese manufacturers to exercise *keiretsu* control over distributors of their products, which has been a problem for foreign businesses trying to penetrate Japan in markets for consumer goods. American antitrust law should also be viewed as an appropriate vehicle. This is certainly true for those Japanese firms operating in the United States, but the time may have also come for reconsideration of the applicability of U.S. law to the behavior of foreign firms in their own countries that has an impact on the ability of American firms to compete in those markets. As the market for many products becomes more global, the ability to maintain competitive markets at home depends to an increasing degree on the ability of American firms to sell in foreign markets.

Neither of these suggestions implies a radical change in Japanese *keiretsu*. In my view, it is unreasonable to suppose that the U.S. government can bring about the elimination of these organizational features of the Japanese economy, and it is not entirely clear that we should want to do so. At best we can attack the more egregious aspects of behavior. On the other hand, American firms may need to do more to emulate some of these practices themselves. Discussing the issue of the *keiretsu* in the SII context should be continued, however, even if the possibilities for radical change are very low. Awareness and moral suasion are important elements of bilateral bargaining, and awareness of American displeasure—and possible punitive action—can have an impact on administrative guidance given by the Japanese government to the private sector, as well as on the choices made by Japanese firms.

Furthermore, we should not become mesmerized with the *keiretsu* as a problem. In my opinion, industry collusion—a form of behavior that cuts across *keiretsu* lines—may be a more serious problem. Some of the major problems in bilateral trade, such as the inability to penetrate the Japanese semiconductor market, lie more in this form of collusion than in the exclusive ties due to *keiretsu*.

As a final comment, it is also important to recognize that some of the problems which Americans attribute to the *keiretsu* are themselves actually much broader phenomenon in Japan. The holding of equity by stable shareholders to prevent unwanted takeovers, the cementing of business ties with strong and continuing social contact, and other features of the Japanese environment affect virtually all firms and not just those which are identifiable as belonging to a horizontal or vertical *keiretsu*. Whether anything can be done at the level of government policy to alter some of these basic and deeply embedded characteristics of Japanese behavior is problematical.

Prepared Statement of Dana Mead

My name is Dana Mead, and I am Executive Vice President of International Paper company. IP is the world's largest paper company. With me is Dr. Irene W. Meister, Vice President, International of the American Paper Institute (API). I am testifying today on behalf of the API, a trade association representing more than 90% of the production capacity of the U.S. paper industry. We greatly appreciate this opportunity to discuss with you our quest for increased access to the Japanese market, specifically for printing/writing paper. We will present to you the reasons why we believe that our market penetration in Japan is unjustifiably low, and what steps we recommend to alter that situation.

Japan is the world's second largest producer and consumer of paper and paperboard, although its natural resources, particularly wood and energy, are very limited. Import penetration of paper and paperboard products in Japan is the smallest in the world, 3.7% from all sources, 2.2% from the U.S. Currently, we are focusing specifically on access for printing/writing papers in which our industry is especially competitive because imports from the U.S. of these papers account for only 0.2% of total Japanese consumption of 9 million metric tons. Our industry is the most competitive in the industrialized world—the result of abundant resources, long term investment, world scale facilities and state of the art technology. In spite of this, and because the U.S. market is totally open, import penetration for printing/writing papers in the United States is 14.7%.

We are very pleased and are grateful to the Administration that access to the Japanese market for printing/writing paper has been made a topic of discussions between the U.S. and Japanese governments under the aegis of the U.S.-Japan Trade committee. In order to provide our negotiators from the Office of the United States Trade Representative (U.S.T.R.) with the best possible objective information, we have commissioned two studies: One on cost competitiveness, by a well known international consulting firm on forest products; the other on interrelations between the various business entities in Japan, by the law firm of Dewey Ballantine.

Wood is the most important component of cost in the production of paper, and Chart 1 shows that the cost of wood in Japan is significantly higher than in any one of the U.S. regions. Since Japan depends to a great extent on imported wood chips, wood costs in Japan were calculated in terms of weighted average cost of domestic and imported wood.

Another important cost component is purchased fuel; and here again, the cost in Japan exceeds substantially the cost in the United States (Chart 2). The same is true of purchased electricity. Unit cost of labor is only slightly higher in Japan. These cost factors—fiber, energy and labor—represent 65-75% of the mill manufacturing costs for these grades of paper.

Furthermore, a significant factor of competitiveness is the production capacity of machines or scale. Chart 3 clearly shows that the difference between the U.S. and Japanese machine sizes is very significant, allowing U.S. producers to achieve greater economies of scale.

The next two charts are key, for they show *delivered* costs in Japan for two major products of our industry. The mills selected for analysis by the independent consultant represent a good cross-section of U.S. and Japanese producers.

Chart 4 shows a cost comparison on delivered basis (CIF Japan) between the U.S. and Japan for coated groundwood offset printing paper, also known as lightweight coated paper or LWC. This is a commodity grade used in publications and print advertising. The cost/supply curves on this graph are presented on an index basis. The weighted average cash manufacturing cost was calculated for the Japanese mills and assigned a base value of 100. Then, each of the U.S. and Japanese mills was indexed against this base. The solid line represents the U.S. mills while the dotted line represents the Japanese mills. The mills are placed in ascending order, starting with the lowest cost mill on the left. Each step of the curve represents the delivered cost associated with a case mill. In this example, there are six U.S. mills and six Japanese mills. The total cumulative capacity of the case mills is represented by the length of the curve on the horizontal-axis. The cumulative coated groundwood paper capacity of the analyzed U.S. mills was 1.7 million metric tons, or about 40% of the industry, while the cumulative capacity of the Japanese mills was 650,000 metric tons, nearly 80% of Japanese production capacity. The index represents costs in the 1st Quarter of 1991 at an exchange rate of U.S. $1 = Yen 137. The chart clearly shows the significant degree of U.S. competitiveness for this grade of paper.

The next chart for uncoated woodfree web offset printing paper is even more dramatic because U.S. competitive advantage is especially great for this and other uncoated printing/writing papers where fiber is a dominant component of cost. The paper on this chart is used for commercial printing and publishing. Eight U.S. mills in this chart have lower delivered costs than *the most* competitive Japanese mill.

The findings reported by our independent consultant are fully substantiated by a major study on the U.S. pulp and paper industry recently released by the largest Japanese securities firm, Nomura.

On a number of occasions we have been told by the Ministry of International Trade and Industry (MITI), and by Japanese distributors, that cost competitiveness is only one aspect of market penetration, and that quality, timely delivery and the ability to meet specific preferences of Japanese customers are the determining factors for sales in Japan. API has made an extensive survey of U.S. printing/writing producers on these factors and found that U.S. paper companies desiring to compete in Japan are fully prepared to meet Japanese quality, preference and service requirements, and to support long-term relationships with Japanese customers. I can assure you that my company can meet all of these requirements and, in fact, has spent considerable amounts of money and devoted considerable resources to doing just that.

In view of the U.S. paper industry's competitiveness, a natural question arises as to why we are not doing any better in the Japanese market. Tariffs remain one governmental barrier that still stands in the way. At present, Japanese tariffs on printing/writing papers range between 4.1% and 4.6%, and they are being discussed in the context of Uruguay Round negotiations. However, tariffs alone are not sufficient to explain our low level of penetration. We believe that the prevailing Japanese system of doing business, coupled with an ingrained preference for dealing with traditional—i.e., Japanese—suppliers, is at the root of our access problems.

For this reason, the U.S. paper industry has been most supportive of the U.S. government' efforts in connection with the Structural Impediments Initiative (SII) with Japan. We believe that many of the issues that were highlighted in the SII, such as keiretsu relationships, a complex and opaque distribution system and exclusionary business practices are indeed among the major reasons why the U.S. paper industry has not been more successful.

Because we wanted to be objective, we undertook an independent study of the interrelationships that exist in the Japanese printing/writing paper industry and their impact on imports.

This study found that the printing/writing paper industry in Japan is characterized by strong vertical integration—which often includes paper producers, distributors and end users within the same *keiretsu*, or corporate group. And, there are close horizontal relationships between different paper producers within the same *keiretsu*.

The major Japanese printing/writing paper producers hold significant equity shares in the major Japanese distributors of these papers, and, in many cases, they have close ties to printers and other end users. Since several major paper producers in Japan belong to the same *keiretsu*, taken together they wield extensive control over distributors. A close examination of these ties demonstrates that for each of the nine largest paper distributors in Japan, there is a strong positive correlation between the degree of paper supplier ownership and the extent to which the distributor sources paper from the owner. Indeed, the share in the distributor's paper supply is almost always greater than the supplier's ownership share of the distributor. The supplier-distributor relationship is mutually supportive. In periods of business downturn, when a distributor might suffer financial difficulties, it requests and obtains credit from the paper supplier. These practices translate into effective market control, resulting in distributors' reluctance to handle imported papers which compete with the paper of their owners. The study cites a report by a U.S. paper producer, who was informed by a major Japanese trading company that it would not consider purchasing any paper from his company because the trading company did not wish to "disrupt their relationship" with the Japanese suppliers. In the past, the Japanese government has clearly encouraged purchases from domestic suppliers.

In addition to the equity relationship between paper manufacturers (suppliers) and distributors, there are close equity and lending relationships between the banks and paper suppliers and distributors with whom they do business. This tends to restrict purchases from unrelated suppliers. Empirical evidence demonstrates that a distributor will often source paper from suppliers with whom it shares a principal bank. This relationship is particularly strong when the bank holds an equity interest in the distributor or is a major lender.

The strategic role of an affiliated bank as a source of financing within the tight-knit Japanese paper distribution system—suppliers, distributors and end users—is reinforced by two practices which are common in Japan, but nowhere else in the industrialized world.

1. The Japanese use a selling practice by which a firm price is not established at the time of the sale. Rather, the supplier invoices the distributor the list price at the time of the sale, but should the market price weaken, the supplier rebates to the distributor the difference between the list and market price.

2. Payment for paper deliveries is commonly made through promissory notes with a due date, usually 90-120 days from the contract date. These unsecured promissory notes are, in some cases, endorsed from end user to distributor to producer to bank. The purpose of this system is to ensure that sufficient financing is available to maintain continuity of production of end products and thus assure a market for paper producers.

These two, mutually supportive, financial arrangements allow suppliers to exert a strong influence on their customers to the exclusion of "outsiders," including foreign suppliers.

We feel that financing, through *keiretsu* banks, is a very important factor that makes the Japanese paper market very different from any other world market where cost and quality competitiveness are determining factors. In a nutshell, the Japanese system of financing subsidizes a number of inefficient, high cost paper mills, resulting in frequent over-capacity to the exclusion of more competitive imports. Japanese demand for printing/writing papers has been very healthy, yet one of the significant problems in the Japanese market is continued oversupply which means that additional capacity is being added, and somehow financed, even though for most grades this capacity is not cost competitive with international suppliers.

API has made a study of financial results of the Japanese and U.S. paper companies. As in all cyclical industries, there are Ups and downs in the paper industry, but what is consistent for the *Japanese* paper industry is the low level of return, even in strong world market conditions. For example, the average profit margin for Japanese paper companies in the 1985-89 period was 2.7%; for U.S. companies, it was 6.2%. Moreover, the five year average return on assets for major Japanese pulp and paper companies was 4.5%, while the equivalent ratio for the major U.S. pulp and paper companies was 10%.

What solutions do we envisage in our quest for greater access to the Japanese market? The paper industry is very pleased to be one of the sectors under active discussions between American and Japanese negotiators, but talks alone will not help us. We are looking for tangible results that would come from those discussions. We are interested in practical solutions—i.e. a meaningful share of the Japanese market Because the U.S. market is open to Japanese exports of numerous products including paper, Japan will have to make a major effort to open their market to products where we are competitive, such as paper.

While the Japanese government appears to be making an effort to address some of the systemic barriers highlighted in the SII negotiations, we feel that a much stronger signal must be sent by the government of Japan to the business community that exclusionary practices *which hinder imports* will not be tolerated. There are several steps that the Japanese government can undertake to open the Japanese market to increased imports of printing/writing paper, among them:

- create a mechanism to monitor progress on sports of paper products and report such information;
- develop incentives for distributors and customers to use imported paper;
- enforce recently adopted anti-monopoly guidelines; and perhaps most importantly;
- investigate the structure of distribution, pricing, financing and other business activities in the Japanese paper sector with a view of correcting those practices which hinder imports.

We believe these steps would reinforce our efforts to sell printing/writing paper on a long a term basis. We are prepared to meet the service, quality, and performance requirements of the Japanese market. Because of our competitiveness on a world scale, we believe that paper is a prime example of an industry where substantial strides can be made in opening the Japanese market

We are most grateful to this committee for an opportunity to discuss our case with you.

Chart 1

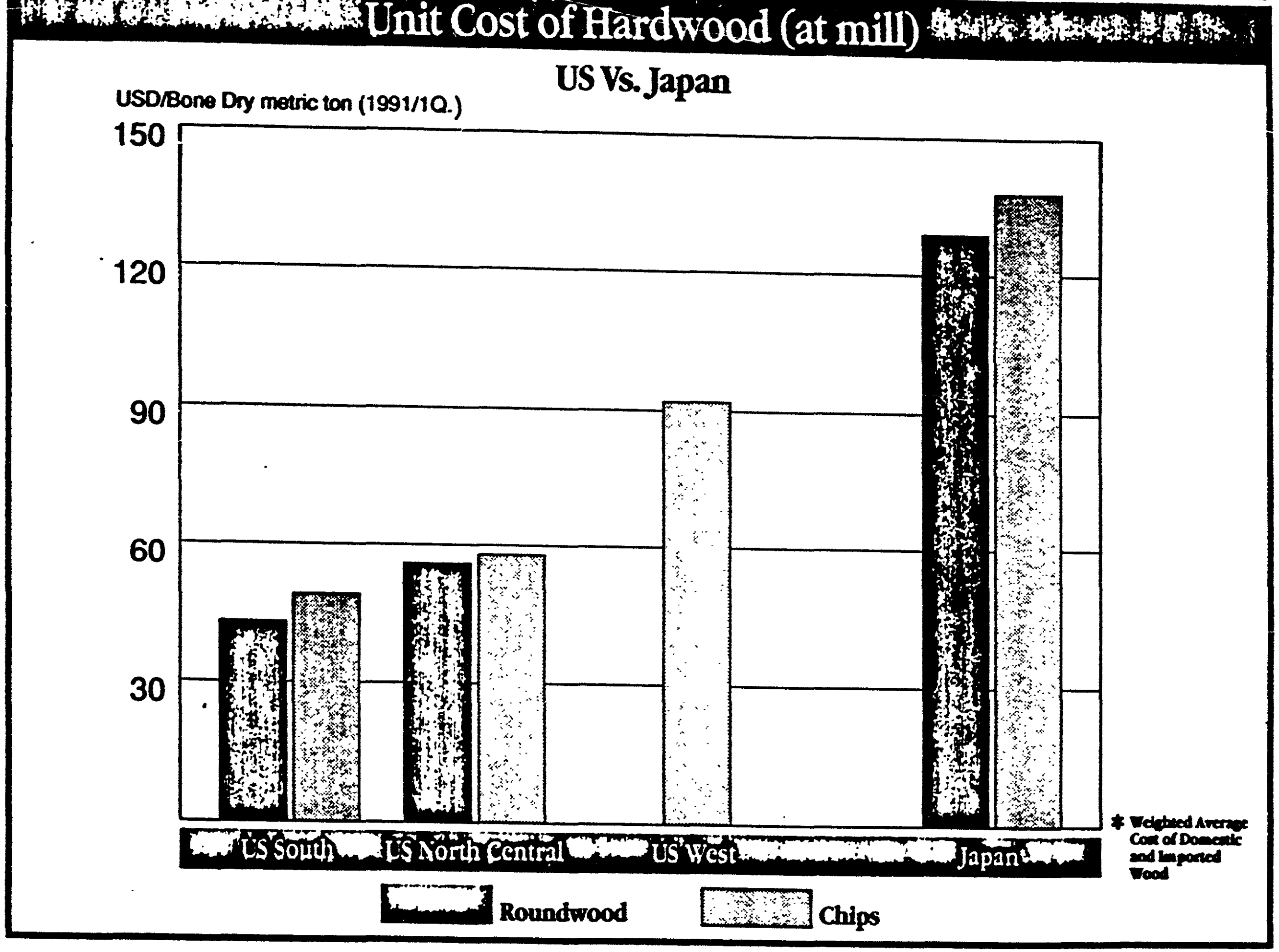

Unit Cost of Hardwood (at mill)
US Vs. Japan
USD/Bone Dry metric ton (1991/1Q.)
150
120
90
60
30
US South
US North Central
US West
Japan*
* Weighted Average Cost of Domestic and Imported Wood
Roundwood
Chips

Chart 2

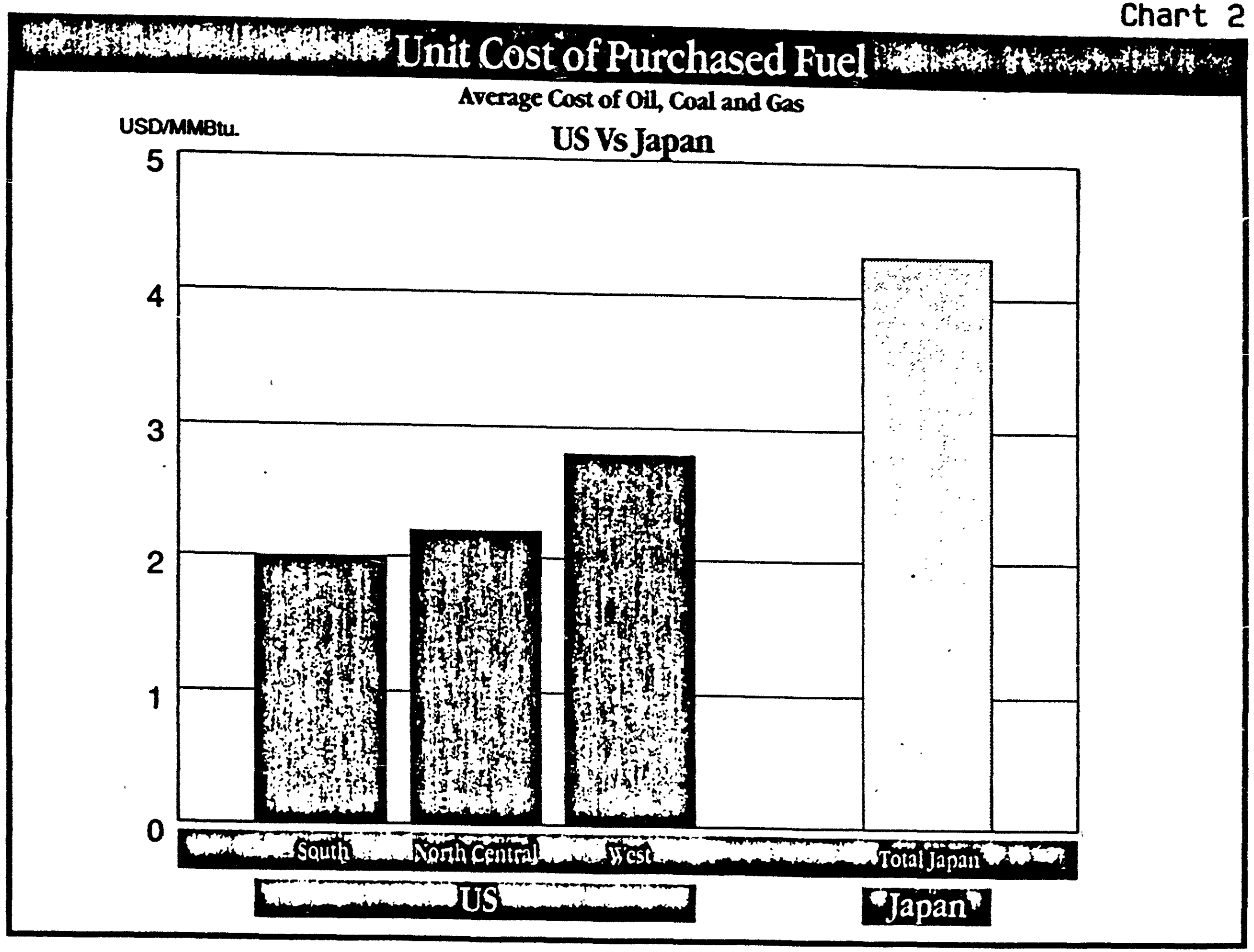

Unit Cost of Purchased Fuel
Average Cost of Oil, Coal and Gas
US Vs Japan
USD/MMBtu.
5
4
3
2
1
0
South
North Central
West
Total Japan
US
Japan

Chart 3

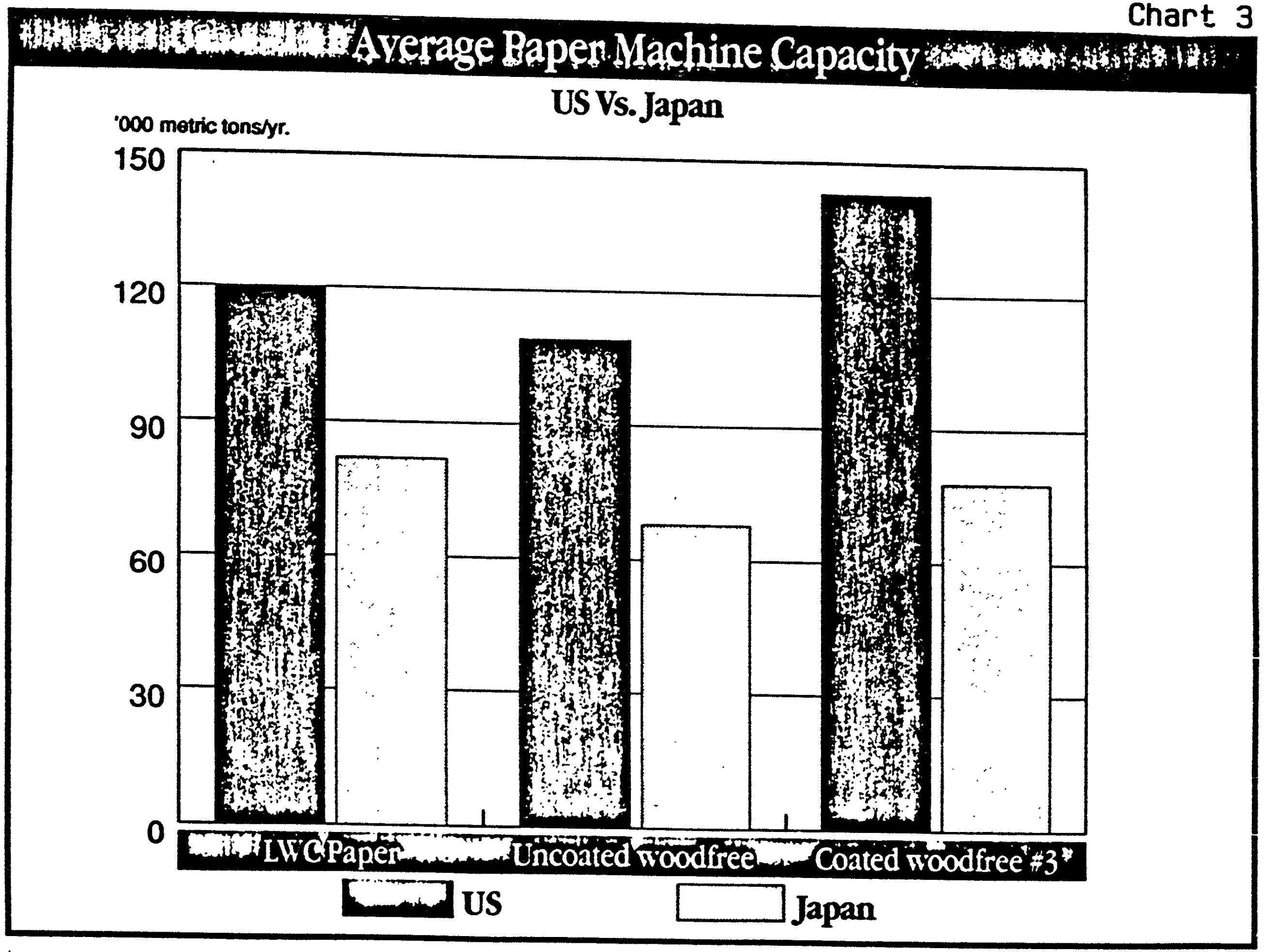

Average Paper Machine Capacity
US Vs. Japan
'000 metric tons/yr.
150
120
90
60
30
0
LWC Paper
Uncoated woodfree
Coated woodfree #3
US
Japan

Chart 4

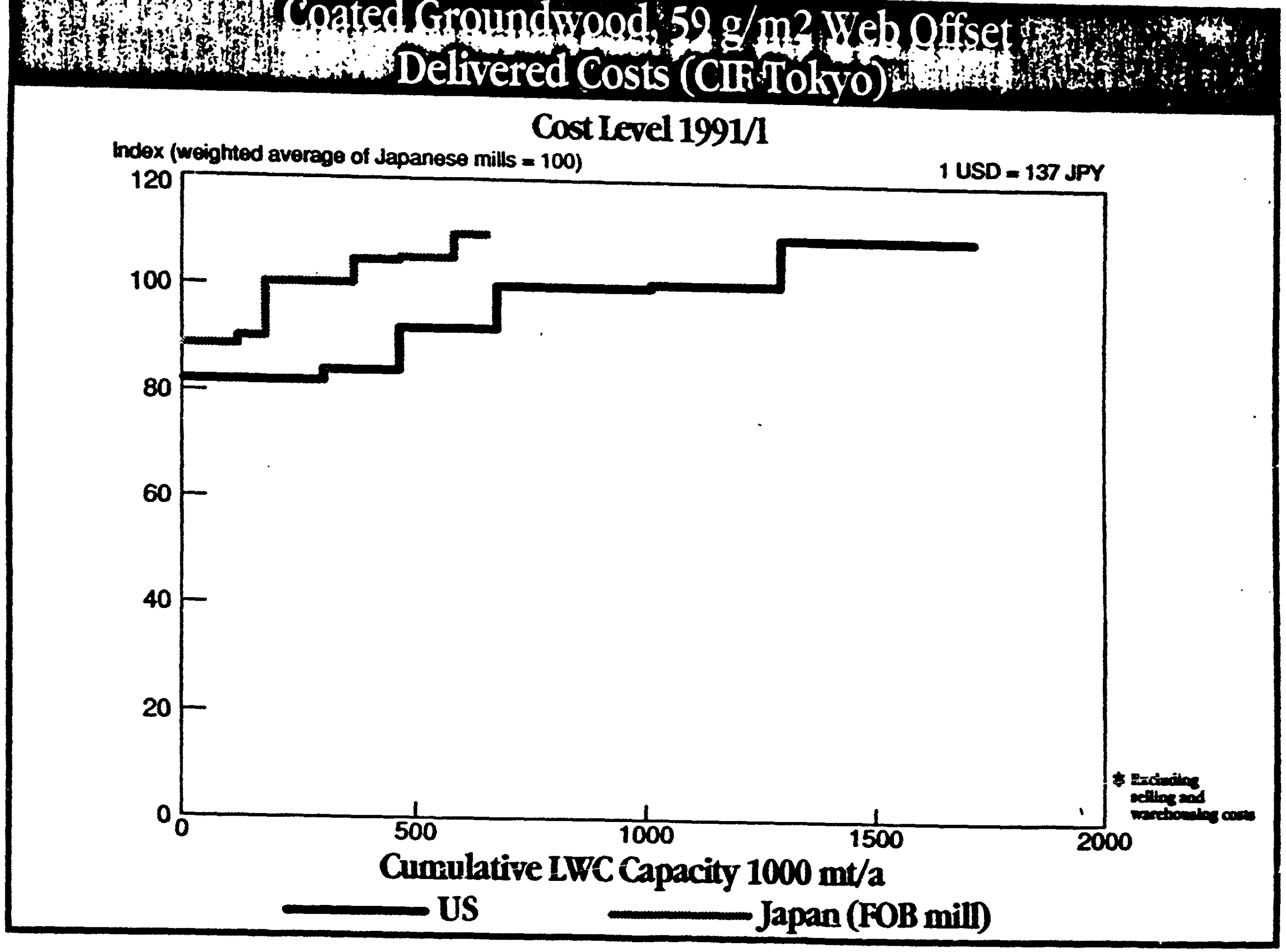
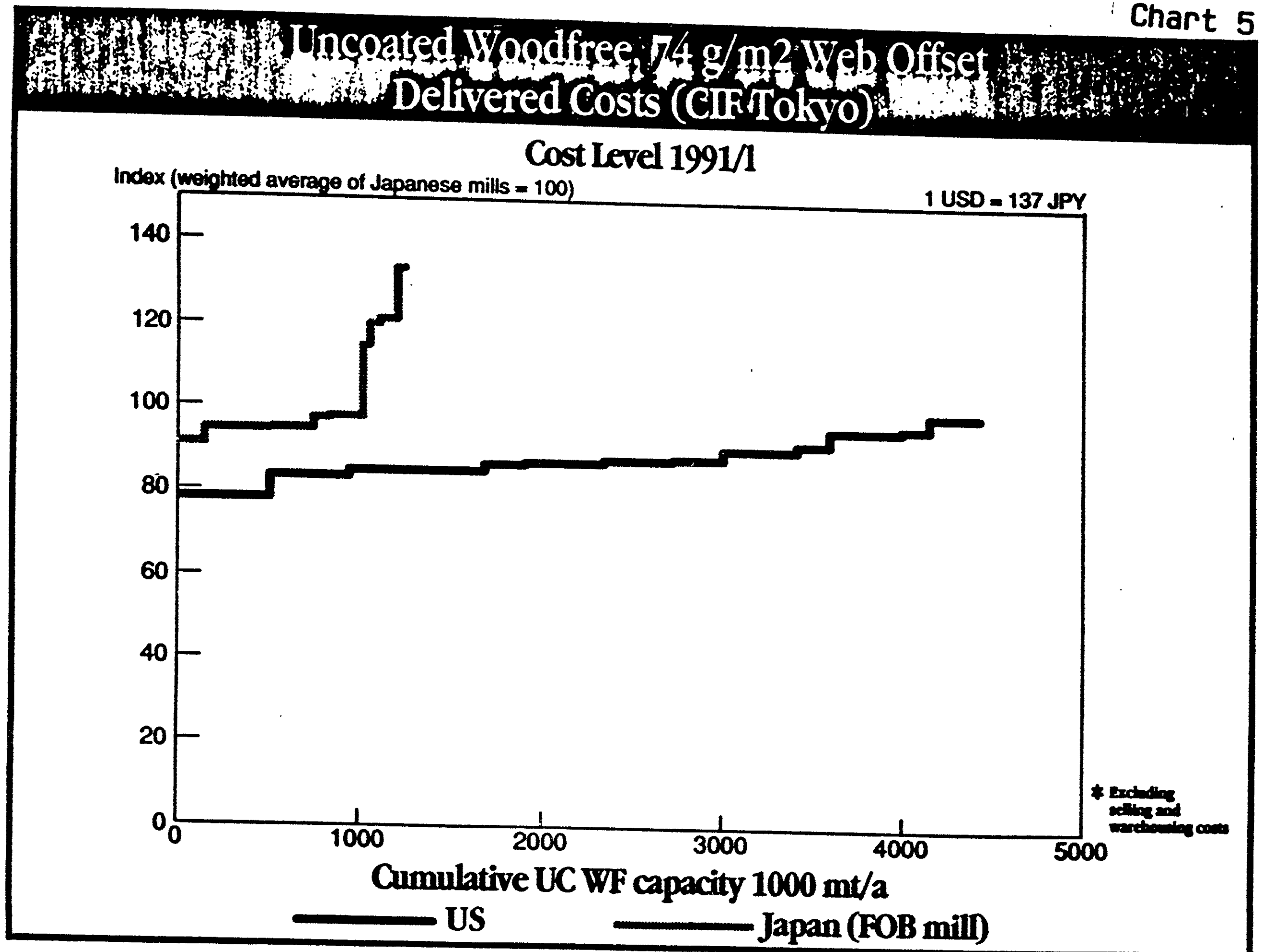

Coated Groundwood, 59 g/m2 Web Offset
Delivered Costs (CIF Tokyo)
Cost Level 1991/1
Index (weighted average of Japanese mills = 100)
1 USD = 137 JPY
120
100
80
60
40
20
0
0
500
1000
1500
2000
* Excluding selling and warehousing costs
Cumulative LWC Capacity 1000 mt/a
US
Japan (FOB mill)

Chart 5



Uncoated Woodfree, 74 g/m2 Web Offset
Delivered Costs (CIF Tokyo)
Cost Level 1991/1
Index (weighted average of Japanese mills = 100)
1 USD = 137 JPY
140
120
100
80
60
40
20
0
0
1000
2000
3000
4000
5000
Cumulative UC WF capacity 1000 mt/a
US
Japan (FOB mill)
* Excluding selling and warehousing costs

PREPARED STATEMENT OF T. BOONE PICKENS, JR.

Mr. Chairman and members of the Senate Finance Committee, my name is Boone Pickens.

I appreciate this opportunity to appear before you today to share my views about the Japanese keiretsu system. Almost two years ago I appeared before many of you during the Trade Subcommittee's initial hearing on the Structural Impediments Initiative. Since that time I have had to hold onto my hat, because I have had quite a ride.

Without going into the excruciating detail of my constant frustrations in trying to penetrate the Japanese investment market, I want to give you a case history of my saga. I remain convinced that the treatment that I received in Japan should not be considered an isolated incident but should be looked upon by Members of this Committee—and, for that matter, by all policy makers here in Washington—as evidence of the structural barriers that are deeply ingrained in the Japanese economy.

BOONE CO.'S INVESTMENT

As most of you already know, I have some personal knowledge about this issue because my private investment firm, Boone Co., was for approximately two years the largest shareholder of Koito Manufacturing Company, Ltd., a Japanese automotive lighting company. After an initial purchase of approximately 20 percent of the stock of 1989, Boone Co. increased its holdings to approximately 26 percent before eventually divesting the stock several months ago. During Boone Co.'s tenure as a shareholder, Koito's next largest shareholder, Toyota Motor Corp., owned approximately 19 percent of the Koito stock. I soon found out that being the largest shareholder accorded me no opportunity whatsoever to participate in the affairs of the company.

Make no mistake about it, I invested in Koito to make a profit. However, in March of 1989, I—like almost every other American—had never heard of the keiretsu system and could not possibly have anticipated the enormous effect that this insider's gambit would have on Boone Co.'s investment. In 1989, I simply saw Koito as a company that was producing a good product but was not marketing that product wisely and was too dependent upon one purchaser, Toyota.

After two years of banging my head against the wall, I now know that the keiretsu system enables Toyota to exercise control over virtually every major corporate decision at Koito. With just 19 percent of the Koito stock, in contrast to the 26 percent owned by Boone Co., Toyota called the shots because of the keiretsu system.

Initially, the powers that be in the keiretsu sought to withhold information from Boone Co. In the financial world information is power. Without access to even the most elementary financial data, we were never able to make truly informed investment decisions. My repeated requests to examine Koito's books and records were ignored or denied, or the company provided only unresponsive answers to my questions. Even legal action in Japan was ineffective.

To supplement the campaign to isolate and ostracize Boone Co., the Koito board tried to humiliate me personally—and 50 other American shareholders—during the annual Koito shareholders' meeting on June 28, 1990. We traveled thousands of miles and were prepared to discuss shareholders' rights, management's accountability and Koito's profitability. Yet, when we tried to offer constructive debate or concrete proposals for reform, the chairman of the meeting barely acknowledged our presence.

Even worse, the chairman permitted the annual shareholder's meeting to deteriorate into a racist, sexist American-bashing event. During all of this commotion, each member of the Koito board of directors watched and acquiesced. They were silent—but apparently willing—parties to the orchestrated abuse.

In looking back on that event, I am still amazed at the ability of the Koito board to act—or fail to act—with such impunity. I have participated in and actually run many public shareholder's meetings here in the U.S. Never, never have I witnessed such denigrating remarks directed at shareholders in our country, and I know exactly why. The American people would not permit such treatment of foreign shareholders in this country. The offending board members of a U.S. company would be forced to resign in disgrace because of the public outcry over such complicity.

The keiretsu leaders at Toyota were so adamantly opposed to my becoming a member of the Koito board because they did not want an outsider to get an insider's look at the operations of the keiretsu. Toyota is perched atop a pyramid of companies that are so subservient as to be "subsidiaries" of Toyota, their keiretsu "parent." Toyota has installed its own former employees in key management positions at Koito. As a result, the Koito management is more responsive to the needs and wants of Toyota than to the Koito shareholders. For example, Toyota receives favorable pricing on parts that Koito supplies. Because of this preferential pricing, Toyota receives "hidden dividends" from Koito.

The keiretsu parents are not only riding the backs of their keiretsu subsidiaries, but they are also extracting profits at the expense of small investors in Japan. While Boone Co. had already divested its Koito stock by the time the most recent securities scandal in Japan was revealed, I took note of the stories. The details of the scandal evidenced more of the same exclusionary and self-dealing business practices that permeate the Japanese economy. On a massive scale, the Japanese investment houses made up losses for their corporate customers while small investors lost millions. I could be a pretty successful market player if my broker told me that he would make up all of my losses.

KEIRETSU AMERICAN STYLE

As a result of my eye-opening experience in Japan, I began to take an interest in the economic activities of the keiretsu parents here in the United States. I was astonished to learn of the extensive network of keiretsu-related companies in the automotive industry which have established wholly-owned subsidiaries or joint ventures in the U.S. Within the last few years, several hundred Japanese autoparts companies have followed their keiretsu parents to middle America.

These companies have flocked to the Mid-west, many times with the active support of state and local governments. Yet, policy makers in Washington and elsewhere have taken little interest in examining the extent of this massive influx.

Therefore, in December of 1990, I joined with several labor and business leaders to form the Mid-America Project ("MAP"). MAP is a non-profit research and educational entity that produced a report to document the extent of the investment made by the Japanese automobile manufacturers in a six-state area comprised of Michigan, Indiana, Illinois, Ohio, Kentucky and Tennessee.

MAP's efforts bring into dramatic focus the economic power of the keiretsu in Mid-America. MAP found that approximately 1200 keiretsu-dominated companies are now operating in the region. Moreover, 73 percent of the companies that belong to Toyota's keiretsu in Japan are now in business in the U.S. The other two of Japan's "Big Three" have similar operations in the U.S. Nissan's influence reaches 76 companies domestically, and Honda controls 37 companies in the U.S.

We are witnessing a change in control of the U.S. automotive industry. What I find so ironic about this entire process is that our own political leaders have jump-started the whole process. We have witnessed bidding wars—with the taxpayer's funds being auctioned off—to attract this foreign "investment." Note that I put investment in quotes.

Are we really getting our money's worth for these tax expenditures? The empirical evidence that is starting to become available suggests that the keiretsu parents are not having a positive net effect on employment. The U.S. General Accounting Office released a study that documents the loss of thousands of jobs in the U.S. auto-parts manufacturing industry. Moreover, there is increasing evidence that these keiretsu parents are not really providing American workers much of an employment opportunity at all. On July 23, 1991, the Employment and Housing Subcommittee of the House Government Operations Committee heard from a panel of U.S. workers who used to work for Japanese companies in the U.S. These workers alleged systemic job discrimination and hiring and promotion practices that favored Japanese employees.

Of course, as Members of the Finance Committee, you are already well aware of the allegations about the underpayment of U.S. corporate income taxes by Japanese companies operating in the U.S. In 1987, Japan's transplants had U.S. revenues of $182 billion and had only $219 million in taxable income. If U.S. companies had such favorable tax treatment in Japan, I am sure that they would have little trouble in competing.

CONCLUSION

Mr. Chairman, I could go on—literally for days—about the inequities that American workers and businessmen face as a result of the keiretsu. What I find most disturbing is that despite all of the publicity about the adverse effects of the keiretsu—both here and in Japan—keiretsu parents just keep on increasing market share in the U.S. automobile market and establishing more keiretsu subsidiaries here in the U.S. In my opinion, we are selling our economic souls for the bargain basement price of a few bottom-of-the-rung jobs. Our sweat becomes their equity, which is then sent across the Pacific and put to work to expand the power and influence of the keiretsu.

Unless we act soon, we are going to start paying a dramatic price for forfeiting control of our economic destiny. I for one do not want to leave such a legacy to the next generation. Therefore, I urge you to take a strong stand and pursue trade policy that measures up to the challenge. I am not talking about knee-jerk protectionism; I am talking about strong, unyielding demands that Japan open its markets to foreign goods. I understand that Senator Donald Riegle (D-MI) has indicated that he plans to introduce a bill to attack the cartel-like behavior that limits the ability of U.S. autoparts companies to sell in Japan or to Japanese transplants in the U.S. I applaud his efforts and urge the Committee to work with him on the legislation. Moreover, I urge you to reauthorize Super 301 and hope that the President applies it aggressively and consistently. The Japanese are artful negotiators with years of training, so they will understand a clear and unequivocal message.

Attachment.

Keiretsu, USA

A REPORT ON

JAPANESE CARTELS

IN MID-AMERICA

Keiretsu, USA

A Tale of Japanese Power

MAP

Chairman - *Jerry Monahan, Cincinnati, Ohio*

Co-Chairman - *Boone Pickens, Dallas, Texas*

Treasurer - *Steve Barger, Louisville, Kentucky*

Associate - *Robert Farrington, Columbus, Ohio*

Associate - *Jerry Hammond, Versailles, Kentucky*

Associate - *Tim Nichols, Lansing, Michigan*

Research Analyst - *William Londrigan, Louisville, Kentucky*

July 1991

Mid - America Project, Inc.

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Preface

From 1945 until the 1980s, most Americans heard little and knew little about Japan. In the 1980s, Japan again became the focus of American attention as Japanese "reverse" investments became the mainstay of economic development programs in mid-American states. Extensive public relations campaigns were launched to create positive American attitudes about Japan as concurrent and massive Japanese marketing efforts were directed at American consumers.

Even so, Americans are only now becoming aware of fundamental differences between Japanese and American social and business concepts. In contrast to American ideals of personal liberty, Japan's emphasis on group loyalty results from ancient traditions of social organization into "clans and classes," a cultural form kept alive in modern corporate Japan.

Forced to abandon "clan" or family ownership at the end of WW II, Japan evolved a new corporate clan-form - *keiretsu*. Described as "a combine without a head," *keiretsu* are groups of companies tied by common industry or financial interest, and centrally coordinated by a bank, trading company or major manufacturer. Together, Japan's *keiretsu* groups are called "Japan, Inc."

While much has been written about the transplantation of *keiretsu* to the USA, little concrete evidence has been previously presented to support this "*Keiretsu*, USA" hypothesis. This report focuses on Japanese direct investments in mid-American states, presenting evidence of the significant replication of Japan's *keiretsu* system in the USA.

> For a number of reasons, Japanese direct investment in the United States has attracted special attention. Japanese firms have been the most spectacular competitors to US-based corporations, and there is naturally curiosity and concern about whether they can repeat their successes in the United States. Japan has also been the principal ... source of financing for the US current account deficit - and some have asked whether Japanese investors will continue to accept a passive role. Finally, there is a general sense that Japanese firms may behave differently from other foreign firms, either because of their protected domestic base or because they have a different culture and institutional structure. [1]

> It [Japanese investment] differs greatly from the pattern of US investment in Europe or of European investment in the United States, whose purpose was to gain market entry by acquiring or developing local ties ... between Europe and the United States, there has been a mutual investment flow; while with Japan, it is largely a one-way street. U.S. companies or real estate are sold to Japanese, but the opposite rarely occurs. And it is this non-reciprocation that is at the heart of the question about Japanese investment. [2]

Comparing Japanese companies operating in mid-America with similar data on their operations in Japan revealed striking similarities in ownership and financial relationships. Focusing on the system defined by those relationships and the potential impact on mid-American social institutions and values, this report is intended to provide a reliable point of reference for organizational and personal decisions about Japan and Japanese investments in the USA.

Summary

The Mid-America Project is a regional coalition of business and labor leaders established in December of 1990 to investigate foreign investment in the six-state area including Illinois, Indiana, Kentucky, Michigan, Ohio and Tennessee. In 1991, MAP support has grown to include over 850 correspondents in 42 states, representing trade union, business and academic interests.

"Keiretsu, USA" is the product of independent research by MAP which documents the arrival in America of Japan's anti-competitive *keiretsu* corporate structures with their supporting value system. The report discusses the origins and underpinnings of *keiretsu*, and details the mid-American *keiretsu* companies of the "New Big Three" Japanese auto transplants, *Nissan*, *Toyota* and *Honda*.

Information was gathered from state and Federal agencies, news reports, journals, books and directories. As data was coded into the MAP computer, it immediately became evident that Japanese industrial and commercial development in mid-America was far more extensive than originally expected. In April 1991, MAP published an initial report identifying 1,197 Japanese affiliated companies operating in the six-state MAP region.

Analysis was performed on data in these 1,197 files, and the resulting information compared with Japanese directories listing company ownership and corporate groupings. Using Dodwell Marketing Consultants' publications as the primary authority on *keiretsu* in Japan, pieces of the mid-American *keiretsu* puzzle are fitted together in a report presented in three sections:

* **"What Is Keiretsu?"** examines *keiretsu* in Japan, its evolution, rationale, structures, features, operations, and detrimental effects on Japan's small businesses, workers and consumers.

* **"Keiretsu, USA"** uses *keiretsu* in Japan as a base of comparison, and details the replication of *keiretsu* structures in the USA by three major Japanese manufacturing groups - *Nissan*, *Toyota* and *Honda*.

  Nissan's "Keiretsu, USA"
  24 main group companies
  51 separate affiliate operations
  76 total operations with Nissan ownership or equity

  Toyota's "Keiretsu, USA"
  23 main group companies
  54 separate affiliate operations
  88 total operations with Toyota ownership or equity

  Honda's "Keiretsu, USA"
  19 main group companies
  27 separate affiliate operations
  37 total operations with Honda ownership or equity

* **"Keiretsu Impact On USA"** discusses detrimental effects of *keiretsu* operations on America's businesses, workers and consumers.

Keiretsu is rev :led as much more than an economic theory or a business system, as *keiretsu* or its predecessor forms have been a way of life in Japan for generations. The critical concern for America is the lack of a prompt and positive response to the *keiretsu* challenge which promises to permanently and adversely affect democratic social structures and free market mechanisms.

Concluding recommendations indict competing economic development agencies of state and local governments for ill-advised and excessive public subsidies of *keiretsu* industries. The recommendations call for Federal and state regulatory agencies to replace economic development offices as the primary interface with foreign companies.

The report concedes the difficulty of proving anti-trust violations by the *keiretsu* companies, as *keiretsu* coordinating mechanisms operate outside the purview of US laws and courts. Consequently, full use of other regulatory tools is urged as a means to monitor the operations of transplanted *keiretsu* companies until anti-trust laws can be reviewed and strengthened.

In addition to Congressional enactment of *keiretsu*-proof anti-trust laws, foreign investor registration requirements and prohibitions against public subsidies to foreign industries are recommended, as are restrictions on direct legislative lobbying by foreign corporations.

Other recommended public policy changes include special emphasis on tax compliance of foreign firms' US affiliates and subsidiaries, and methodical investigation of the employment and environmental practices of all foreign industrial corporations operating in the United States.

"Keiretsu, USA" concludes that America now faces a series of critical choices regarding the *keiretsu* philosophy and value system. Will America again embrace monopoly capitalism, which it out-lawed a century ago? Will free markets convert to *keiretsu* markets? Will traditional American family and national allegiances be subordinated to company allegiance? Will individual freedom be displaced by group loyalty? Will Americans trade personal liberty for corporate peace and harmony?

If Americans give no answer to these questions, the choices will be made by others, and may be impossible to change. **"A Tale of Japanese Power"** clarifies the only options open to America: to say **"yes"** - or to say **"no"** - to *keiretsu*. Considering *keiretsu* alternatives to America's tradition of freedom and personal liberty, the report concludes that there is but one answer which America can give to the *keiretsu* question, an unequivocal **"no."**

What Is Keiretsu ?

Keiretsu has become a hot topic in America. The subject is generating numerous media articles and reports, as well as investigations by Congressional Committees and various Federal agencies. Even with this intense level of attention and the current volume of published material, there is yet no simple explanation of *keiretsu*. Like Japan itself, *keiretsu* doggedly defies simplification.

According to *Kenichi Imai*, an industrial policy expert at *Hitotsubashi* University in *Tokyo*, "... the term *keiretsu* is used to refer to so many different kinds of industrial groups in Japan that generalizing about all of them ... makes little sense." [3]

A review of the root elements of the word *keiretsu* adds to the mystery. *Keiretsu* may be simply construed to mean "economic or corporate group," it could refer more generally to an "ordered and structured system," or it could be literally interpreted as "a form of punishment." [4] From America's perspective Japanese explanations of *keiretsu* seem vague and contradictory.

Before presenting evidence of *keiretsu* operations in America, the origins and history of the concept must be examined. Understanding where and how *keiretsu* and its *zaibatsu* predecessor began is essential to understanding what it has become, and where it may lead.

The origins of Japan's present integrated corporate structures, the *keiretsu*, are to be found in ancient Japanese history. From Japan's earliest written "Kokiji, Record of Ancient Matters" (circa A.D. 712) through the *Yamato* and *Nara* periods when emperors reigned, and during the time of the *Shogunate* military governments, which ruled from 1180 until 1868, Japanese society has continuously been made up of alliances of clans and classes. [5]

Shogunate power was vested in alliances with regional warlords and their armies of *Samurai*, the warrior class who handled many of the administrative functions of government. Land holdings and business privileges were bound by a system of vassalage, and the earliest Japanese markets and handicraft industries were organized around the castle towns ruled by the *Samurai*. This was the Japan that European traders discovered around the middle of the sixteenth century.

Following a succession of internal military conflicts from A.D. 1560 to 1615, the *Tokugawa* clan established unchallenged supremacy over all the land. Members of the *Tokugawa* family ruled as *Shoguns* from their capitol at *Edo*, and loosely coordinated the administration of more than two hundred semi-autonomous regions. The heads of subject clans guaranteed their allegiance to the *Shogun* by leaving their own family members in *Edo* as the *Shogun's* hostages.

Despite political feudalism, the *Tokugawa* era saw the development of commodity markets and a monetized economy as urban centers grew in population. The class system was legally codified, with the *Samurai* warriors at the top of a four-tiered system, above peasants, artisans and merchants. By the 19th century, peasant uprisings signaled the beginning of the end of *Shogunate* power.

Zaibatsu: Origins of Keiretsu

From 1640 until 1853, Japan was closed to foreign trade and foreigners. Virtually an island fortress, Japan was ruled by feudal lords, the *fudai daimyo* or *tozama*, who were hereditary heads of Japanese clans, or *Daimyo* families, and whose power was coordinated by a *Shogun* who was superior in authority even to the Emperor. Policed by a warrior class, the *bushi* (*Samurai*), the oppressive and rigidly classed Japanese society existed in almost complete isolation from the Western world and economic and social changes driven by the industrial revolution. Japanese citizens were forbidden to leave the country on penalty of death, Japanese laws were savage, trials were conducted by torture, and periodic peasant uprising were quickly and brutally extinguished.

Japan's agrarian economy, lacking industrial technology and modern forms of finance, existed in this same traditional form until the appearance of US Navy Commodore Perry's "black ships" in *Tokyo* in 1853. Ordered to enter Japan and open the country to Western (US) trade, Perry's visit was a major shock to Japan's closed society and the catalyst for the rapid transformation of Japan from feudal to industrial nation.

With US Navy ships anchored in *Tokyo* harbor, uninvited and unwelcome, the Japanese rulers realized they were defenseless to attack by modern weaponry as the main Japanese armament remained the sword. The resulting cultural shock brought about the overthrow of the ruling *Tokugawa Shogun*, and the installation of the *Meiji* Emperor as head of government in addition to his role as hereditary sovereign. The Emperor gathered the most progressive and informed men in Japan into a new government which promptly began one of the most radical and rapid national transformations in recorded history.

This beginning of modern Japan, the *Meiji* Restoration, marked a complete reversal of national policy. From virtually complete isolation, Japanese agents and students were sent abroad to investigate Western education, customs and practices. Technology was given the highest national priority as trade and diplomatic missions were dispatched to study foreign industries. With amazing speed, Japan transformed itself from a feudal society into a modern and powerful industrial state.

Such abrupt and rapid change had a major impact on domestic politics and economics. In politics, transformation was accomplished through a compromise between the emerging merchant class and the remaining elements of the *Samurai*. This compromise allowed the former feudal warriors and lower class merchants to achieve a higher level of bureaucratic influence within the modern Japanese state than they had ever attained under the old feudal system.

The feudal bureaucrats of the *Meiji* government recognized two immediate needs for the future growth of the Japanese state: an adequate supply of skilled industrial labor, and the accumulation of capital. *Meiji* efforts to meet these needs were neither for the purpose of producing goods for mass consumption, nor for the development of consumer markets.

The initial goal of the *Meiji* government was to centralize and modernize the standing army and police force to increase the military preparedness of the Japanese state against internal disturbances as well as outside aggression. From the very beginning of industrial Japan, labor supply and capital were directed by the bureaucracy to industries considered strategic, or necessary for the development of a modern defense force. "Thus, the first stage of industrialization in Japan was inextricably interwoven with the military problem, and it fixed the pattern for its later evolution." [6]

The *Meiji* government directly controlled strategic industries: mining, ship-building, transportation, communications and heavy industry. After the controlled industries had fully developed and achieved an acceptable level of efficiency, they were placed in "private hands." These "private hands" were a few favored families who were financial and political supporters of the *Meiji* government, who were allowed to purchase key industries at extremely low prices. These family-owned corporate enterprises became known as *zaibatsu* (zi-baht-su).

Zaibatsu families originally numbered only four, yet they controlled a Japanese economy made up of large holding corporations with interests in many different industries. In this respect, the *zaibatsu* resembled modern Western corporate conglomerates. More important, the *zaibatsu* system retained traditional class and clan distinctions. *Zaibatsu*, literally "country (rural) cliques or factions," [7] is also defined "plutocracy". [8] Plutocracy, according to Webster, is "government by the wealthy" or "a controlling class of rich men."

> The prewar *zaibatsu's* structural organization resembled that of hierarchy in which the holding companies and/or the *zaibatsu* family held the shares of all the companies belonging to it and exercised centralized vertical control. Under the paternalistic command of the holding company and/or the *zaibatsu* family, banks belonging to the hierarchy controlled the financial aspects of its operation and trading companies dominated the distribution of goods. [9]

Zaibatsu enterprises grew rapidly and "... were next in importance to the government and the banking system in Japan's economic development." [10] Much of the early financial success of the *zaibatsu* resulted from the cash flow they generated from their trading activities. Thus, the trading company component *(sogo shosha)* of the *zaibatsu*, which had its roots in pre-*Meiji* mercantilism, formed the core of *zaibatsu* activity. "The *zaibatsu* were able to overcome Japan's poor capital accumulation problem and, by the time of World War II, had amassed tremendous power. The two largest, for example, *Mitsui Bussan* Co. Ltd. and *Mitsubishi* Trade Co., accounted for over 70% of Japan's foreign trade." [11]

The evolution and concentration of Japanese industry into the four great *zaibatsu* (*Mitsui*, *Mitsubishi*, *Sumitomo* and *Yasuda*) affirmed the pronounced Japanese social tendency to group formation. The giant *zaibatsu* conglomerates of interrelated industrial, financial and commercial concerns came to dominate and control Japan's economy until 1945. "... the four great *zaibatsu* in the prewar days, were fully integrated into the Japanese economy and wielded overwhelming power, accounting for approximately a quarter of the paid-up capital of all Japanese companies." [12]

Following World War II, the Allied Occupation recognized "... *zaibatsu* concentration of industrial and economic power as one reason for the war and divided them into a number of separate corporations: the *Mitsui* group became some 180 different companies." [13] Passage of anti-*zaibatsu* laws in 1945 was intended to end extreme concentrations of economic power which had controlled and dominated Japan's economy from 1868 to 1945. By this enactment, the huge family-owned industrial, commercial and financial combines which were the *zaibatsu* were thought to have been legislated out of existence.

It is remarkable that three of the four original *zaibatsu* have survived in the modern Japanese corporate structure. Even more curious is that the *zaibatsu* names *Mitsui*, *Mitsubishi*, and *Sumitomo* are becoming "household names" in the USA. "The present *Mitsubishi*, *Mitsui* and *Sumitomo* Groups essentially are historical extensions of the prewar *zaibatsu*." [14] Many of Japan's largest modern corporations, as well as present ministries of the Japanese government, can trace their roots directly back to the *Meiji* Restoration of 1868.

Keiretsu: Zaibatsu Revisited

> A *keiretsu* is a group of companies in different industries that maintain significantly closer inter-firm relationships than seen among autonomous (non-*keiretsu*) companies. *Keiretsu* relationships are effected through cross-shareholding, interlocking directorates, intra-group financial commitments, and membership in the councils and president's clubs of each *keiretsu*. The member firms in a *keiretsu* conduct many joint activities, including R & D projects, transfer of technology, and the undertaking of new ventures of all types both at home and abroad. Member firms try to keep as many business relationships (purchase, sales, and services) as possible among themselves, and help each other cope with business fluctuations by employing redundant personnel, providing financial assistance, and many other means. [15]

When the *zaibatsu* were outlawed following WW II, they were split into a number of smaller companies. The Allied Occupation banned holding companies, cross-shareholding and interlocking boards of directors, the devices by which *zaibatsu* families had managed and controlled vast financial empires. *Zaibatsu* banks, however, were not substantially reorganized. It was the *zaibatsu* banks around which the *keiretsu* ultimately formed to fill the power vacuum resulting from the *zaibatsu* breakup.

> The new [post-war] Japanese government abolished the Occupation ban on cross-shareholding and interlocking boards of directors, thus allowing a new structure called a *keiretsu* (economic group) to come into being as the major banks and trading companies formed networks of companies. These alliances were linked by cross-shareholdings, common banking affiliations, and the use of the same trading company to procure raw materials and to distribute products. [16]

In addition to the *keiretsu* reconstructed from prewar *zaibatsu*, several new major groups were integrated. The *Fuyo* group partially succeeded the *Yasuda Zaibatsu*, and the *Dai-Ichi Kangyo* and *Sanwa* groups formed around leading city banks, formalizing alliances of major bank clients. These new groups then expanded by purchasing shares in former *zaibatsu* companies as the Japanese government systematically sold off its corporate holdings.

The immediate post-occupation groups included *Mitsui, Mitsubishi, Sumitomo, Fuyo, Dai-Ichi Kangyo*, and *Sanwa*. Formed around banks and trading companies, these groups are characterized as "horizontal *keiretsu*." During this period, "vertical *keiretsu*" were also formed around large industrial corporations such as *Nissan, Toyota, Hitachi* and *Toshiba*.

Keiretsu are essentially a reincarnation of the *zaibatsu*, the main functional difference being the absence of rigid hierarchy or family control. "Unlike the old *zaibatsu*, where a holding company or family both managed and controlled the group directly, the new industrial group has decentralized management and control ... '**a combine without a head**'." [17]

Keiretsu are structured with no readily identifiable hierarchy to avoid direct violation of anti-monopoly laws. They exist as a network of interrelated and interdependent companies revolving around a bank, a trading company, or a large industrial firm. While the structure gives an appearance that inter-group relationships are tenuous, they are highly coordinated by "group consensus" and informal "club" meetings, rather than the direct family control of the *zaibatsu*.

While the *keiretsu* system provides a shield from anti-trust problems by avoiding the direct ownership and management of the *zaibatsu*, the objectives and effects are similar. Markets are controlled by eliminating competition through exclusive relationships and coordinated strategies. The current economic power and size of *keiretsu* can be more fully appreciated when the combined sales of *keiretsu* companies is compared to General Motors: "... the *Mitsubishi* Group has total sales of over $300 billion, while the *Dai-Ichi Kangyo* Group has close to $400 billion. By comparison the largest U.S. business organization, General Motors, has sales of only about $103 billion." [18]

Basically, a *keiretsu* is a multi-company trust without a holding company. Instead of direct corporate control through majority equity ownership, *keiretsu* substitute "presidential councils" for a holding company, widely disperse the ownership of group company stock, and rely upon group interdependence for control, rather than individual or family ownership.

While similar to pre-war *zaibatsu*, the *keiretsu* system is superior in practice since the dispersion of control insulates member companies from antitrust restrictions while conforming to the accepted Japanese group social model. The old group system of large scale capital concentrations has thus been revived, group tendencies reinforced, and *keiretsu* institutions, collectively referred to as "Japan, Inc.," are prospering enormously.

Keiretsu Types And Characteristics

Keiretsu are defined as either "horizontal" or "vertical," a distinction that refers to the direction of group company relationships. In the horizontal group, less control is exerted from a principal or central company. In the vertical group, companies are usually centered around a major assembler or manufacturer who coordinates the activity of all group members.

Horizontally-connected: Horizontal *keiretsu* are conglomerate groups which include companies engaged in a diverse variety of business activities and industries. Horizontal *keiretsu* are normally grouped around trading companies and/or large banks. Some horizontal *keiretsu* include entire vertical sub-groups as part of the main horizontal group, operating in similar fashion to more independent vertical groups.

Vertically-integrated: Vertical *keiretsu* are made up of companies whose activities revolve around a large principal company, usually a manufacturer. Vertical groups may also maintain associations with various members of a related horizontal *keiretsu* for specific procurement, financing and product distribution functions.

Distribution keiretsu: A distribution *keiretsu* is a combine of retailers, wholesalers and distributors which facilitate distribution of the products of a particular manufacturer or group. Distribution *keiretsu* operations are largely responsible for complaints about Japan's "complicated distribution system."

Examples: The following charts are reproduced from the directory entitled Industrial Groupings in Japan - The Anatomy of the "Keiretsu" - Ninth Edition 1990/91, published by Dodwell Marketing Consultants, Tokyo, Japan. The charts illustrate each major type of *keiretsu* and the variant described above:

Chart A - The *Fuyo* Group; horizontal.

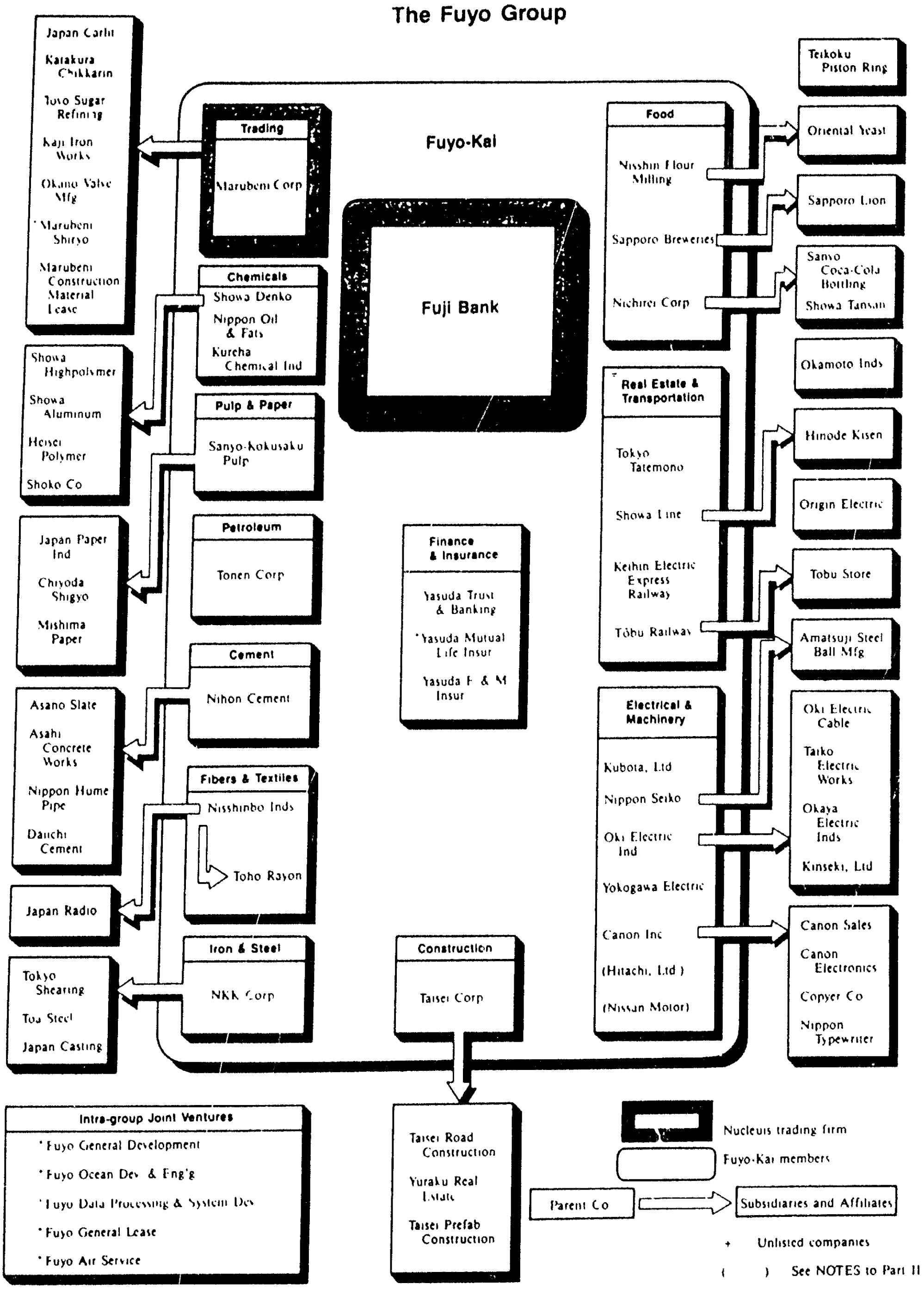
Chart B - *Toshiba* Corp.; vertical.

Chart C - The *Mitsubishi* Group; horizontal, with vertical sub-groups.

Chart C.1 - The *Mitsubishi* Motors Group; vertical sub-group.

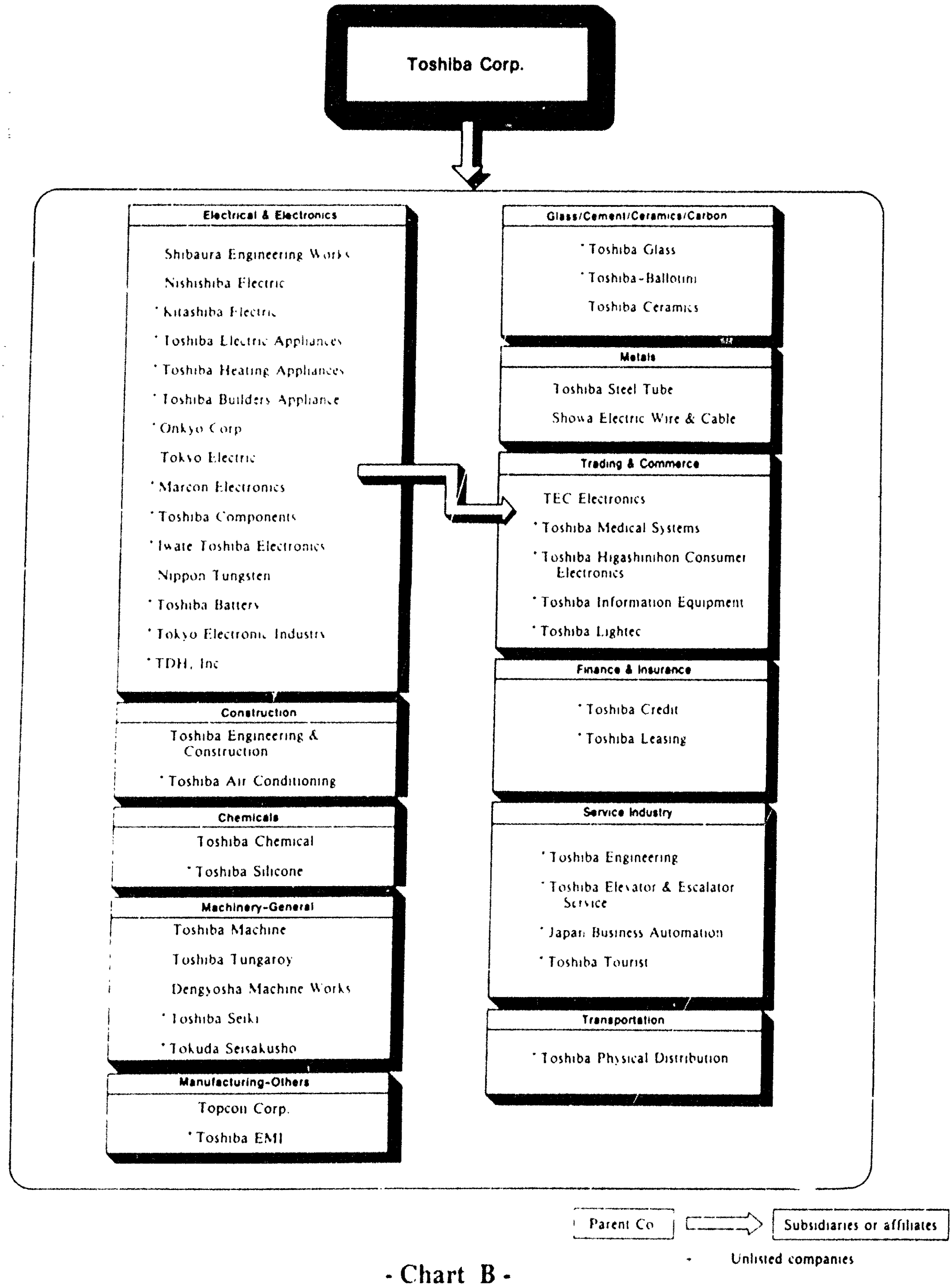
Chart D - The *Matsushita* Group; distribution.

The Fuyo Group



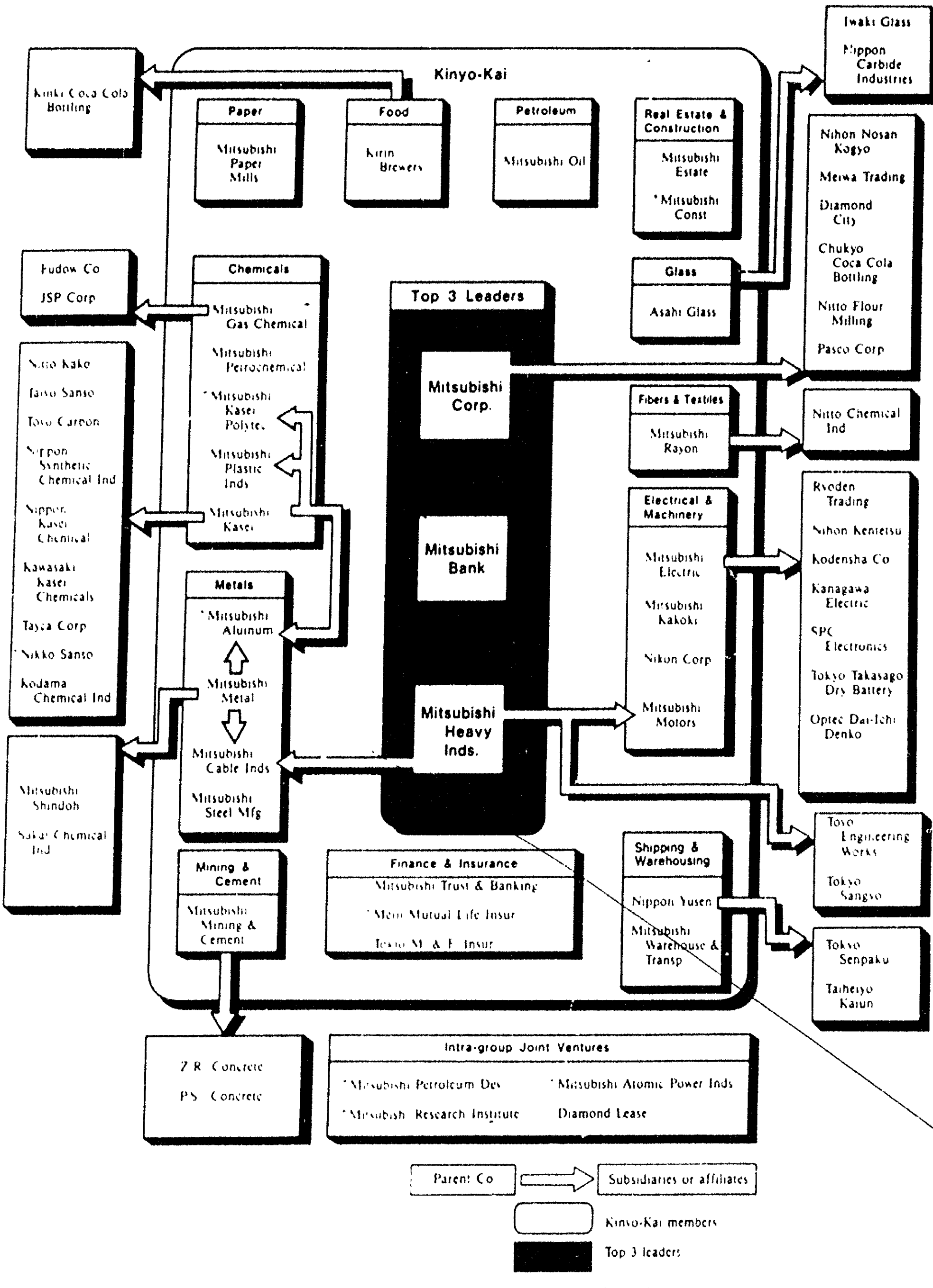
- Chart A -

The Toshiba Group

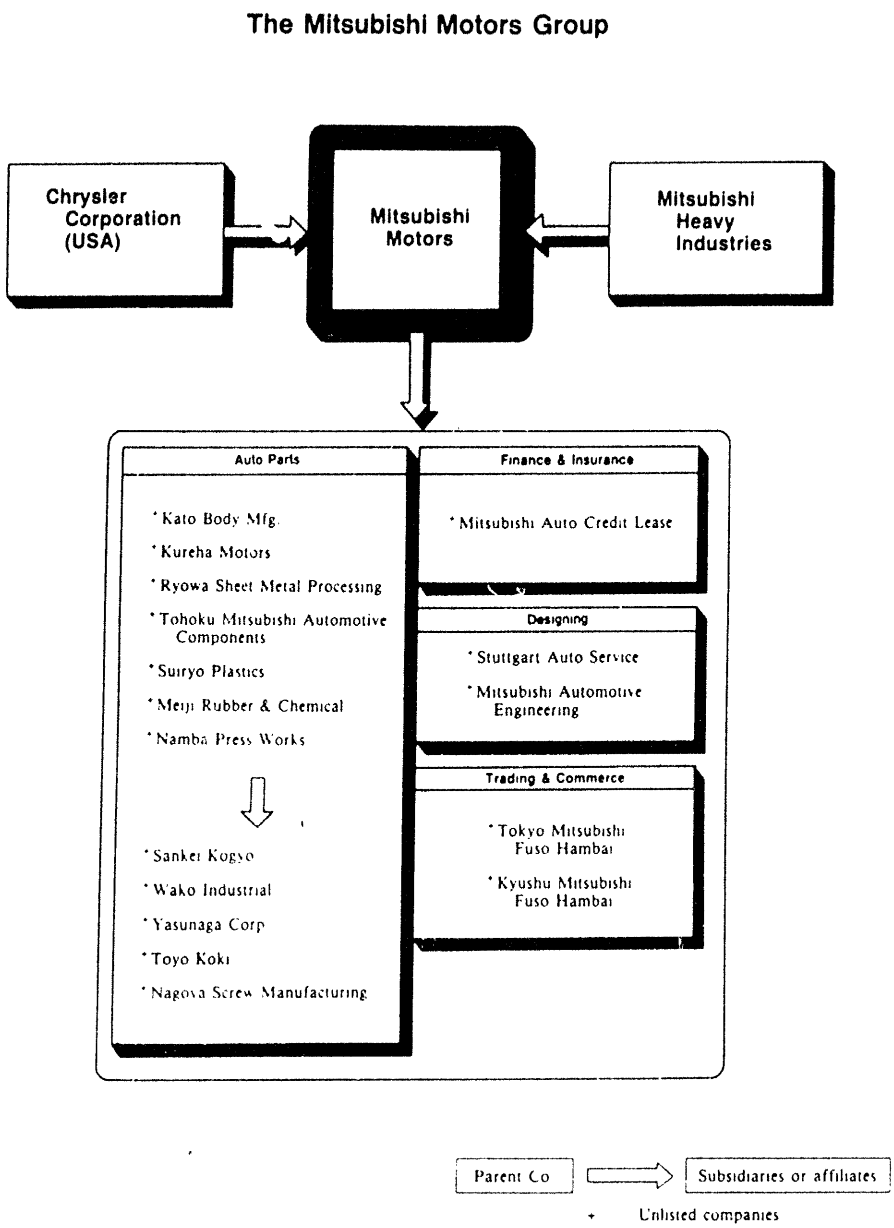


- Chart B -

The Mitsubishi Group

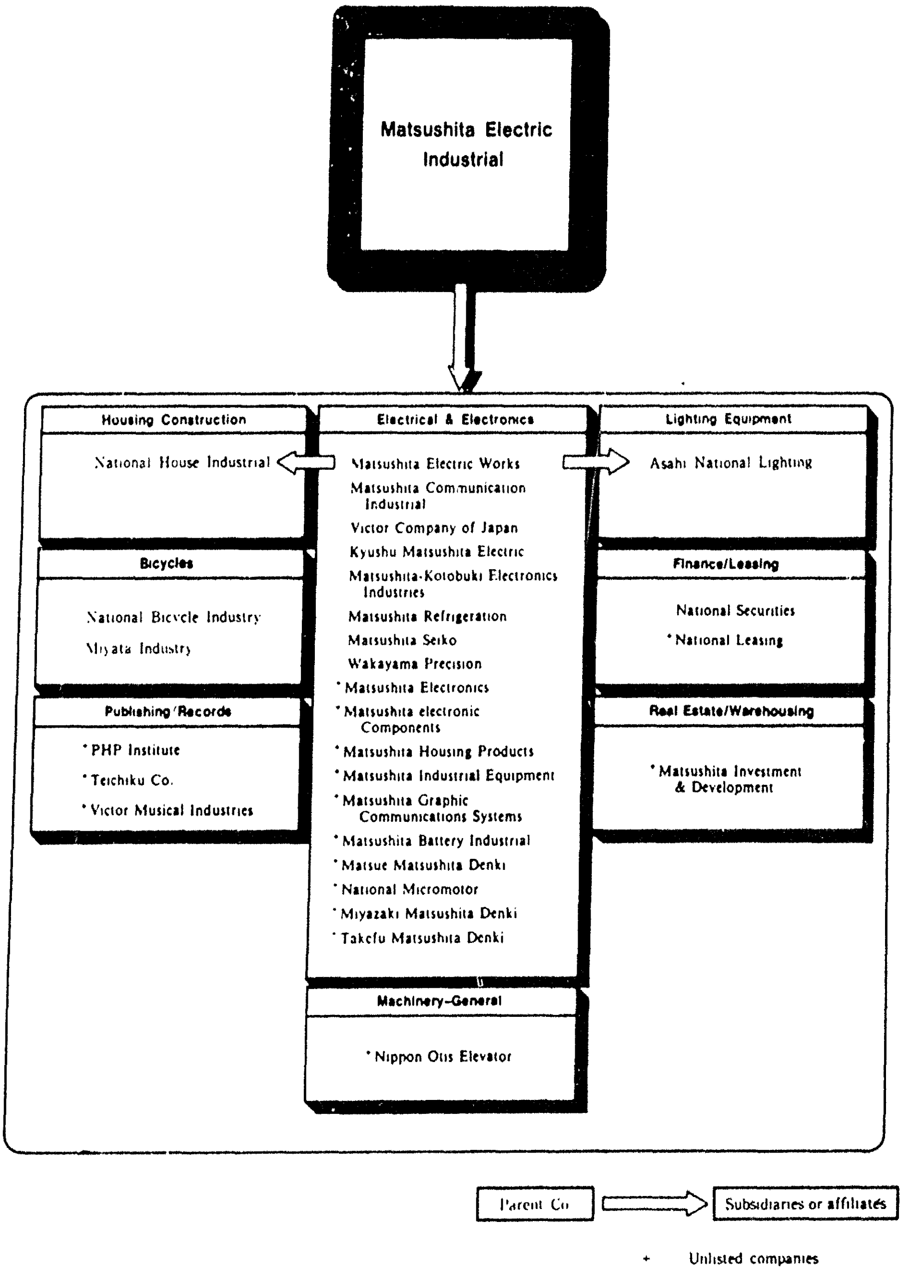


- Chart C -


The Mitsubishi Motors Group
Chrysler Corporation (USA)
Mitsubishi Motors
Mitsubishi Heavy Industries
Auto Parts
* Kato Body Mfg.
* Kureha Motors
* Ryowa Sheet Metal Processing
* Tohoku Mitsubishi Automotive Components
* Suiryo Plastics
* Meiji Rubber & Chemical
* Namba Press Works
* Sankei Kogyo
* Wako Industrial
* Yasunaga Corp
* Toyo Koki
* Nagoya Screw Manufacturing
Finance & Insurance
* Mitsubishi Auto Credit Lease
Designing
* Stuttgart Auto Service
* Mitsubishi Automotive Engineering
Trading & Commerce
* Tokyo Mitsubishi Fuso Hambai
* Kyushu Mitsubishi Fuso Hambai
Parent Co
Subsidiaries or affiliates
* Unlisted companies

- Chart C.1 -

The Matsushita Group



While there are distinct types of *keiretsu*, common characteristics of all types distinguish *keiretsu* as a unique corporate form. When compared to corporate structures in the US and Europe, such common characteristics also describe the nature and function of *keiretsu*.

Cross-shareholding: Of all the aspects of keiretsu, cross-shareholding has drawn the most attention due to its pivotal role in *keiretsu* dynamics. In pre-war Japan, the *zaibatsu* family functioned as a holding company controlling a majority of the shares of its group companies. For instance, the *Mitsui* family held 63.8% of all stocks issued by *Mitsui Zaibatsu* companies and the *Sumitomo* family held 83.3% of all stock issued by its *zaibatsu*. [19] Central control and ownership was practically absolute in the *zaibatsu*.

> ... unlike the prewar *zaibatsu*, the latter day *keiretsu* has no holding company at its center ... In the absence of holding companies and with limitations upon the amount that can be owned in another firm, the institution of cross-shareholding was born. **It is the corporate equivalent of blood brotherhood.** [20]

> ... the growing companies of the 1950s and 1960s hit upon the idea of selling equity to each other, often with no cash changing hands. So each member of the prewar groups, and some newcomers as well, joined the new *keiretsu* in which the equity went around in a circle. [21]

As *keiretsu* is not dependent upon central control, share ownership is widely dispersed, and concentrations avoided. Cross-shareholding by companies in each *keiretsu* group is the method utilized "... to protect each group company from outside control or takeover threats, maintaining one another's status through interdependence." [22]

It is difficult to determine actual control of Japanese corporations by looking strictly at equity holdings. Seldom will one company hold a majority of the equity of any other group company. Instead, group control is a product of a maze of interlocking corporate shareholdings.

> This system of group equity has been exasperating to Western companies and governments because its logic is so different. Japanese companies, with what at first appears to be a public equity structure, are in reality privately held. This arrangement would not be allowed under the investment laws of the US and a number of European countries - companies would have to explain that only some of their stock was actually for sale. [23]

> They keep these shares within their conglomerate family, in a pattern of reciprocal shareholding. Because the shares are considered 'political' shares rather than investments, they are never sold. To keep over half of a company's shares in such cross-holding deals eliminates the possibility of take-overs by outsiders. [24]

> The recent attempts of T. Boone Pickens to seize control of *Koito*, a *Toyota* group member, show just how powerful the group system is. *Toyota* owns only about 15 percent of *Koito*, and Pickens was able to buy up shares totaling more than 25 percent. Yet, he couldn't gain a seat on the *Koito* board ... no other shares seemed to be for sale, even at an offering price well above what the shares would fetch on the open market. [25]

> Based on annual reports issued by listed companies and by the life insurance industry (whose members are unlisted), a breakdown of share ownership shows that one hundred firms owned 40 percent of shares outstanding in March 1989, while listed companies and life insurers own 60 percent. With the inclusion of shares owned indirectly by corporations through trusts and by other listed firms, **Japan Inc. owns 70 percent of itself.** [26]

A generation after WW II, a substantial portion of the corporate wealth of Japan is still owned by *zaibatsu* "ghosts." "It is ironic that the six big *keiretsu* today own a quarter of total shares outstanding - the same proportion held by the *zaibatsu* when they were dissolved in 1945." [27]

While the Anti-Monopoly Act supposedly ended the *zaibatsu*, the spirit of *zaibatsu* is alive and well inside the *keiretsu*. Cross-shareholding within each group maintains a group interdependence which serves as a substitute for the "family" identity formerly provided by the *zaibatsu*. So, while "... holding companies are still illegal in Japan, the so-called groups [*keiretsu*] preserve the spirit, if not the letter of the *zaibatsu* organization." [28]

<u>Coordinated Financing:</u> In addition to providing group members protection against hostile takeovers, the *keiretsu* system also provides a low cost source of financing for group members.

There are important differences between the Japanese and American systems of corporate finance. One key difference is that US banking laws prohibit commercial banks from holding direct equity interests in other corporations. Japanese banks are under less stringent restrictions, and hold substantial fractions of all paid capital in Japanese corporations.

This significant difference provides Japanese banks with the dual mechanism of debt leverage and equity ownership to multiply their influence over client corporations. This is precisely what occurred following the Allied Occupation, as Japanese banks were exempted from anti-monopoly restrictions to allow greater flexibility in the restructuring of Japan's economy.

> Given the debate in the United States over the cost of capital for businesses, one question is whether or not the members of a bank-centered *keiretsu* are able to gain access to loans under preferential conditions. Even though interest rates might be the same for inside and outside borrowers with similar credit ratings, member firms probably have received preferential access to available funds ... They also can receive favorable terms of repayment and extensions, if necessary. [29]

Such an integrated system gives banks inordinate power to coordinate whole segments of industries and markets, the *keiretsu* trademark. Curiously, after generations of operating under banking regulations designed to prevent just such an effect, increasing calls are heard from US banking and business analysts and writers for revisions of US banking laws which would create the very conditions the present US laws prevent.

Information and Management Sharing: While exchange of information and personnel in not unknown in US business circles, it is quite different from the deliberate and planned process of *keiretsu*.

> Another feature that helps Japanese industrial groups forestall disputes or other problems that might destroy valuable trading relationships is extensive information sharing. Sitting at the center of a *keiretsu* are core group members generally consisting of a "main" bank (e.g., a lead lender to the group, such as *Mitsubishi* Bank), a major industrial corporation (e.g., *Mitsubishi* Heavy Industries), and/or a large trading company (e.g., *Mitsubishi* Corporation). These core companies, the bank in particular, form the hub of a vast information-sharing network. Because most companies in the group will borrow at least some of their funds from the group's main bank, which will also own up to 5% of each company's outstanding shares, much financial information about their performance will be funnelled to the bank in the natural course of its monitoring activities. [30]
>
> Adding to the information flow will be a number of senior bank "alumni," formally retired from lifelong careers at the bank (usually around age 55) and placed by the bank's president in "second careers" as senior officers and directors of the bank's borrowing clients. [31]

Keiretsu information sharing greatly advanced in 1970 with the creation of "Group Think Tanks." Premier among these new agencies was the Mitsubishi Research Institute, founded May 8, 1970 and provided with 1,000,000,000 Yen. The Institute was supported by 27 Mitsubishi Group companies "... with access to the research capability of the Mitsubishi Economic Research Institute, computer software and systems science of Mitsubishi Atomic Power Industries and the industrial economics, especially techno-economics, research facilities of the Advanced Techno-Economic Information Center." [32]

Presidential Councils (shacho-kai): Not only are *keiretsu* president's councils or clubs an integral part of normal Japanese business operations, but they are interwoven into as complex a network of relationships as are the companies themselves. While few outsiders are privy to *shacho-kai* meetings and pictorial evidence of such meetings is scarce, these meetings are the central point from where "Japan, Inc." is coordinated and managed.

> The *shacho-kai*, or president's council, which meets regularly, is an institution for mutual control, in that the participating presidents of all the major firms in a corporate group attend not as stockholders of their own companies, but as representatives of the stock their company holds in all the other member companies. [33]

> Their resolutions are not binding on members, and they fiercely resist the image of being a group-level policy-setting body. Nevertheless, their activities do extend to the level of coordinating group public relations, controlling the use of group trademarks, managing group joint ventures in research and production, and even discussing top personnel appointments in the group. They are also quick to identify financial trouble spots in the group and assist in workouts under the guidance of the main bank or another group core stakeholder. [34]

> The presidential councils meet regularly every month (once every three months for one group) to exchange views on the general economic and financial situation, promising business, the state of R & D, maintenance of intra-group trademarks and company names and labor problems. The subjects also include the policies of the entire group's public relation activities, rehabilitation of financially-troubled group companies, key personnel appointments, etc. [35]

Of all *keiretsu* functions and activities, it is in the *shacho-kai* that we can really see "where the rubber meets the road," where political activity, finance, research, technology transfers, market strategies and personnel exchanges are coordinated. It is almost inconceivable to Americans that the heads of Japanese companies might be able to regularly meet to discuss intra-company details without engaging in specifically unlawful conspiracies to rig markets, or fix rates and prices ... but this is the routine in Japan.

> The *Mitsubishi Kinyo-Kai* (*Mitsubishi* Friday conference) consists of the chairmen and presidents of the 29 companies including those of the three nucleus companies. The council meets on the second Friday of every month to exchange views and information and to make decisions on group activities, including the allocation of political contributions. [36]

> Sixty nine *Sanwa* Group companies such as *Sanwa* Bank, *Nissho Iwai* and *Hitachi Zosen* operate a council to promote cooperation with the People's Republic of China in technology transfers and joint venture operations. Fifty *Sanwa* Group firms including *Sanwa* Bank, *Hitachi Zosen* and *Suntory* formed an inter-industrial committee, 'the *Sanwa* Bio *Kenkyu-Kai*', to engage in joint R & D and information exchange in the biotechnology field. [37]

> The (*Mitsui*) Group has two councils: the *Nimoku-Kai* (Second Thursday conference) and the *Getsuyo-Kai* (Monday Conference). The *Nimoku-Kai* is composed of the chairmen and presidents of 24 group companies while the *Getsuyo-Kai* is composed of the executive directors of 75 group companies. In an intra-group cooperation scheme initiated to help revive and reconstruct troubled group companies, or more positively, to help enhance managerial know-how, an advisory council will be set up within each group firm on an ad hoc basis. Each advisory council comprises the chairmen and presidents of group companies as well as of non-group companies having close relations with the *Mitsui* Group. [38]

> The *Fuyo-Kai*, the Group's presidential council, is composed of the presidents of the 29 companies ... The Group also comprises sub-councils; the *Fuji-Kai*, which consists of the *Fuyo-Kai* companies' vice presidents and the *Fusi-Kai* of planning department managers. Such companies as *Nissan* Motor and *Hitachi*, Ltd. participate in the council though they act rather independently. *Nissan* Motor also maintains close relations with the Industrial Bank of Japan in terms of personnel and financing. *Hitachi*, on the other hand, is a member of the *Sanwa* Group's *Sansui-Kai* and the *DKB* Group's *Sankin-Kai*. Another council, the *Juyo Kondan-Kai* including 67 companies, was formed to exchange information and to promote intra-group product purchasing. [39]

It is in the presidential clubs that Japan, Inc. coordinates every facet of Japan's global economic empire. The cooperative functions already discussed have their genesis here, as do other unique functions of *keiretsu*: the "mutual appointment of officers," the "common use of trading companies" and so-called "selective intervention" decisions, which pit the combined might of corporate Japan against outside or foreign threats to a group or group member. The clubs are also where decisions are made regarding rotation of personnel from company offices to government ministry posts, a practice frowned on in America, while routinely facilitated in Japan.

> Key industrial group companies send staff members to their subsidiaries, affiliates and other companies related to their respective groups as top ranking officers. This is one powerful means along with capital participation and financing, of strengthening group cohesiveness and controlling those companies. Private companies belonging or not belonging to industrial groups also employ various retired upper-echelon officials of Government Ministries and public corporations. The officials generally enjoy close contacts with the companies prior to retirement, and continue to play important roles in fostering and coordinating Government-industry relations. [40]

The interlocking *shacho-kai* represent a broadly coordinated, thoroughly collusive, competitive advantage for Japan, Inc. It is difficult to imagine American business leaders of different companies openly engaging in systematic discussion of nuts and bolts business details, or coordinating market strategies and business plans.

Keiretsu Impact In Japan

Japanese and US trade negotiators agreed in the Strategic Impediments Initiatives (SII) report that *keiretsu* relationships "... promote preferential group trade, negatively affect foreign direct investment in Japan, and may give rise to anti-competitive business practices." [41] As Japan increases direct investment in the US, a developing US *keiretsu* may be expected to reproduce effects in America similar to the *keiretsu* impacts measured in Japan.

Impact on Japanese Consumers: The massive concentrations of wealth and power in Japan today were created by a dedication to common purpose which is now uncommon in America. In the aftermath of WW II, the Japanese people were imbued with a near-religious fervor to reconstruct Japan, "... to eat stones and sleep on logs for twenty years until Japan was America's industrial equal." [42] This commitment has not diminished by any apparent measure, even though Japan now boasts one of the highest per capita incomes in the world.

> At current exchange rates, Japan's per capita GNP is among the highest in the OECD area, and net external assets are the largest in the world. However, the high income level appears not to be fully reflected in the quality of life. There are various factors explaining the gap between Japan's economic strength and its standard of living; for example, the high cost of living, poor housing and infrastructure, and long working hours. Reducing this discrepancy would contribute to both sustainable domestic demand-oriented growth and enrichment of the quality of life. [43]

> Japan's stock market has produced an unparalleled concentration of wealth and power in the hands of a few companies, recreating in a different form the *zaibatsu* that the American Occupation forces sought to dismantle. While this is all to the good of Japan-as-producer, it is another matter whether it helps Japan-as-consumer or the world at large. [44]

Originally justified to pay the enormous costs of post-war reconstruction, high prices for consumer goods are still rationalized by pervasive inculcation of the notion of Japan as "a small island nation, lacking in natural resources." This is the self-image Japan continues to cultivate, at home and abroad, an image which colors consumer attitudes and Japanese life from grade school to retirement. By this device, Japanese consumers are conditioned to pay, without much complaint, some of the highest prices in the world for their energy, food, household goods, property and housing.

Impact on Small and Medium Employers: Group enforced loyalty has created a virtual vassalage business system in Japan. In addition to the group-vassal status of Japan's long suffering "salaryman," or mid-level management employee, and small and medium factories, thousands of sub-contractors are similarly held hostage. Many of these are back-room shops which turn out cheap, high quality components for larger Japanese manufacturers.

> *Tomioka* calls the subcontractors the 'shock absorbers' of the Japanese business cycle - the smaller firms on the receiving end when large firms find they can no longer carry the fixed costs of their labor force and must 'shift the strain' (*shiwayosa*). [45]

Small Japanese shops (called sweat-shops in the US) commonly employ entire families, without effective regulation of hours or safety, with no unemployment or workers' compensation insurance. Many of Japan's small business owners work under conditions that even low-wage American workers would reject. Even so, the real and imagined benefits of being part of a business group are reinforced by the *keiretsu* and diffused throughout Japanese society.

> I know something about the tension between small companies and the big *keiretsu* or industrial groups that swallow them up, as a shark swallows small fish for food. I started my own company 40 years ago. My best friend and I built a small painting factory literally in the ashes of World War II, and we worked there day and night. Gradually the company grew, we hired more staff, orders expanded, and so did our lines of business. By the 1960s, when Japan's electronics revolution was ready to take off, my company was big enough to become a major parts supplier to one of the nation's largest and best known electronics companies. What I didn't realize was that as soon as I succeeded in becoming such a supplier, I was considered part of its "family." I was expected to be loyal to that company no matter what the sacrifice. For example, I was forbidden to accept orders from any other company, even when times were slow at my main client and my equipment sat idle. [46]

Collectively, the *keiretsu* create a monolithic business block which co-opts criticism, both from affected businesses and private citizens. The system has so successfully resurrected Japanese commerce from the destruction of WW II that internal criticism of Japanese trade policies or commercial institutions is viewed as virtual disloyalty to Japan. A central feature of Japanese culture, this cradle-to-grave conditioning to group loyalty effectively insulates all Japanese institutions from criticism, and militates against any suggestion that "group concensus" could be wrong. The group-within-a-group-within-a-group that is "Japan, Inc." also describes "Japan, the nation."

Impact on Labor and Labor Unions: Agrarian-based Japanese trade unions flourished until the late 1930s when virtually all unions were disbanded as Japan became a military state. Such institutions as the Thought Police ensured that industrial democracy did not disrupt *zaibatsu* war production. By war's end, both the factories and unions had ceased to exist.

The re-organization of trade unions was an integral component of the Allied Occupation plan to modernize Japan. By the late 1940s, Japanese unions were active in the slowly rebuilding industrial sector. Free trade unions were expected to prevent the recurrence of such power concentrations as the *zaibatsu*.

In the first of many World War II after-shocks, Japan's trade unions became a casualty of the Korean war. Unprepared for major action so soon after WW II, the Allies faced logistic problems which Japan's recovering industries promised to solve. Billions of dollars of military contracts in the early 1950s boosted Japan's industry and economy, reorganizing under the new *keiretsu* system.

Conservative critics of the Occupation agenda, noting that Japan's new unions included "radical elements," equated such elements with the communist agitators of American unions in the 1930s. The changing priorities of the Allied Occupation allowed Japan's new union movement to be sacrificed to the demands of political expediency and industrial efficiency. In actual effect, the *keiretsu* were given license to kill off free trade unions.

As US support for Japanese unions was withdrawn, scheduled union elections were cancelled and union leaders fired. It was then no surprise when the *Nissan* company, facing a long and bitter strike in the early 1950s, took advantage of the political climate, and with the coordinated support of all the automotive *keiretsu* companies, broke both the strike and the national auto union movement. In the place of free trade unions, "enterprise unions," or "company unions" became the accepted and encouraged substitute. With this change, the *keiretsu* controlled both capital and labor in Japan.

> The structuring of, the Japanese union on a company rather than an industry or skill basis adds to the mutual benefit feeling within the corporation. To ensure life long employment for its members, the unions allow contract or part-time non-union employees as well as liberal sub-contracting to cover peak or seasonal demands. This together with the bonus system allows the employer a more variable wage bill and reduces the cost problems of the life long employment system; much business risk is simply passed on to the workers. This of course also causes under-employment and in 1975 the Research Department of the Industrial Bank of Japan estimated over 2 million workers were still employed largely as a result of the life employment system. [47]

With or without free unions, no one can view the accomplishments of Japan's workers without a sense of awe. Diligent, efficient, loyal, intelligent and amiable are reputed hallmarks of the Japanese worker. Whatever else may be said about Japan and the efficacy of Japanese institutions, Japan's great economic successes have been largely the product of the Japanese workers.

> I'm exhausted and so cold and sleepy that I barely make it back to the dorm. During our break, I could see that everyone was shivering. There are only two steam radiators in our flimsy plastic-paneled locker room. One worker said, with his teeth rattling, "Have you read today's paper? They [*Toyota*] made one hundred million dollars profit! They earn six or seven hundred thousand dollars a day by making us work in this hole." [48]

> Japanese workers are often portrayed as secure in their jobs, protected by paternalistic employers who share everything with their workers, from company values to canteens and rest rooms. But according to psychologist Pamela Briggs, Japanese workers generally endure rather than enjoy their work. "They do so with the aid of considerable quantities of alcohol, a culturally-accepted way of relieving stress." This endurance and "mask of acceptance," she says, "owes much to the notion of *bushido* (warrior spirit) but does not mean that they are happy in their work." Less than a third of Japanese workers enjoy *Shushin koyo* - lifetime employment. Most face uncertainty and receive little state welfare once unemployed. Workers' may stay with a company throughout their working lives. But this is due less to loyalty than to the way in which workers are rewarded through profit-related wages and behavior bonuses for "positive attitudes." [49]

The Japanese worker has never known liberty as Americans live it, except for brief periods, too soon ended. The very concept of liberty or individual freedom seems alien to Japanese culture. All effort, all endeavor is subsumed into the group agenda, with no room for differences or debate. "The nail that sticks up will be hammered down" continues to be the way of life for Japan's working men and women, a view on the very opposite pole from America's values.

Keiretsu, USA

A key element of pre-war *zaibatsu* empires were Japanese trading companies, or *sogo shosha*. In post-war *keiretsu*, trading companies still play key roles. *Sogo shosha* provide information and coordination to group companies, import and export huge quantities of steel, machinery, chemicals, textiles, lumber and food as they scour world markets procuring raw materials.

Some trading companies are the core elements of giant horizontal *keiretsu*, functioning as general trading companies. Some provide support within vertical *keiretsu*, concentrating on particular industries, products, or raw materials.

One of Japan's oldest and best known trading companies, *Mitsui* & Co., Ltd., dates back 300 hundred years when it was called *Mitsui Bussan*. Following the war, the *Mitsui zaibatsu* was split up, but regrouped in 1959 and changed its name to the present *keiretsu*, The *Mitsui* Group. [50] (Chart E)

When the *Mitsui Keiretsu* became interested in American markets in 1966, a trading company office was established in New York, followed by a container terminal in Oakland, California in 1968 and a textile trading company in New York in 1971, Astral International Corp. By 1985, *Mitsui* had fifty-two separate direct investments in the US, with over 16,500 US employees. [51]

Similarly, the *Sumitomo Keiretsu's* (Chart F) first investment in the US was their trading company, which established an office in New York in 1952. By 1985, *Sumitomo* had more than fifty separate direct investments in the US, employing over 5,000. [52]

Following the lead of *Mitsui* and *Sumitomo*, other Japanese firms began to recognize American markets as the most lucrative and open. In 1988, Japanese foreign direct investment in the US had increased to such a degree that it was second only to Great Britain in total foreign direct investment. [53]

Along with increased Japanese direct investment came *keiretsu*.

American Keiretsu

By 1985, *Mitsui* and *Sumitomo* had "... the largest numbers of *keiretsu*-affiliated firms in the United States ..." [54] yet, Japanese investment in the automobile industry generates the most concern regarding the transplantation of *keiretsu*. This unwelcome attention resulted from the Japanese automotive *keiretsu's* heavy reliance on group suppliers, which are numerous and vertically integrated. Huge amounts of publicity which the landing of each transplant facility attracted, large government subsidies to transplants, and the fact that the automobile is of special importance to Americans aggravated these concerns. It was large-scale Japanese investment and concentration in the US auto industry which has produced the harshest criticism.

> Although the experience of one industry may not be generalizable, the automobile industry has special economic and political importance due to its integral position in the industrial structure of both countries, its strategic importance in Japanese trade, its broad spill-over effects both in terms of technology and inter-industry relations, its critical position in U.S. industrial society, etc. [55]

One of the first to note the transplantation of *keiretsu* was a reporter for the Chicago Tribune. After visiting the site of *Toyota's* new auto assembly plant in Georgetown, Kentucky he wrote:

> This is Japan, Inc., come to America - a tightly integrated invasion that, by accident or design, seems much more planned and coordinated than most Americans realize ... there is a pattern, so far little-noticed, that makes this Japanese development far different from US investment abroad. The pattern is visible in various stages in different industries ... It is a pattern of vertical development, literally a separate Japanese economy inside the American economy ... [56]

Subsequent studies and reports began to give strong hints that the Japanese move to the US was quite different than previous foreign direct investments, accurately describing or mentioning *keiretsu* directly.

> By 1984, political pressures and threats of 'local-content' legislation ... persuaded even *Toyota* to commit itself to producing cars in the United States ... Yet the movement of *Nihon* Radiator, *Kanto Seiki*, *Nippon Denso*, and several other Japanese auto-parts manufacturers into the United States to supply the American plants of their parent firms suggested that another Japanese strategy was to transfer abroad as much of the domestic manufacturing system as possible. [57]

> Motivated by the move of Japanese automakers to the United States ... more and more Japanese auto parts producers, most of which are tied into the above-described *keiretsu* network, began to follow suit. [58]

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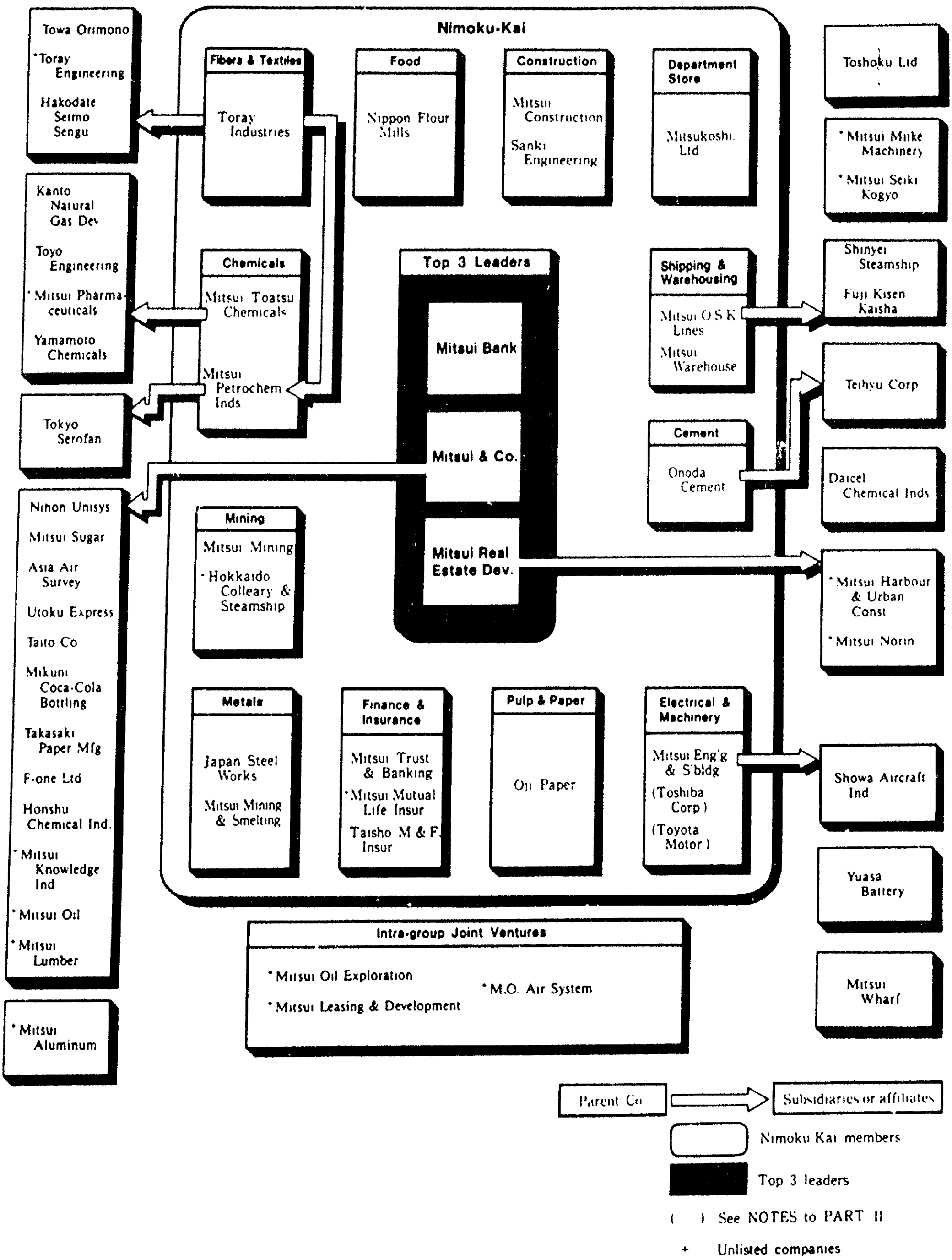
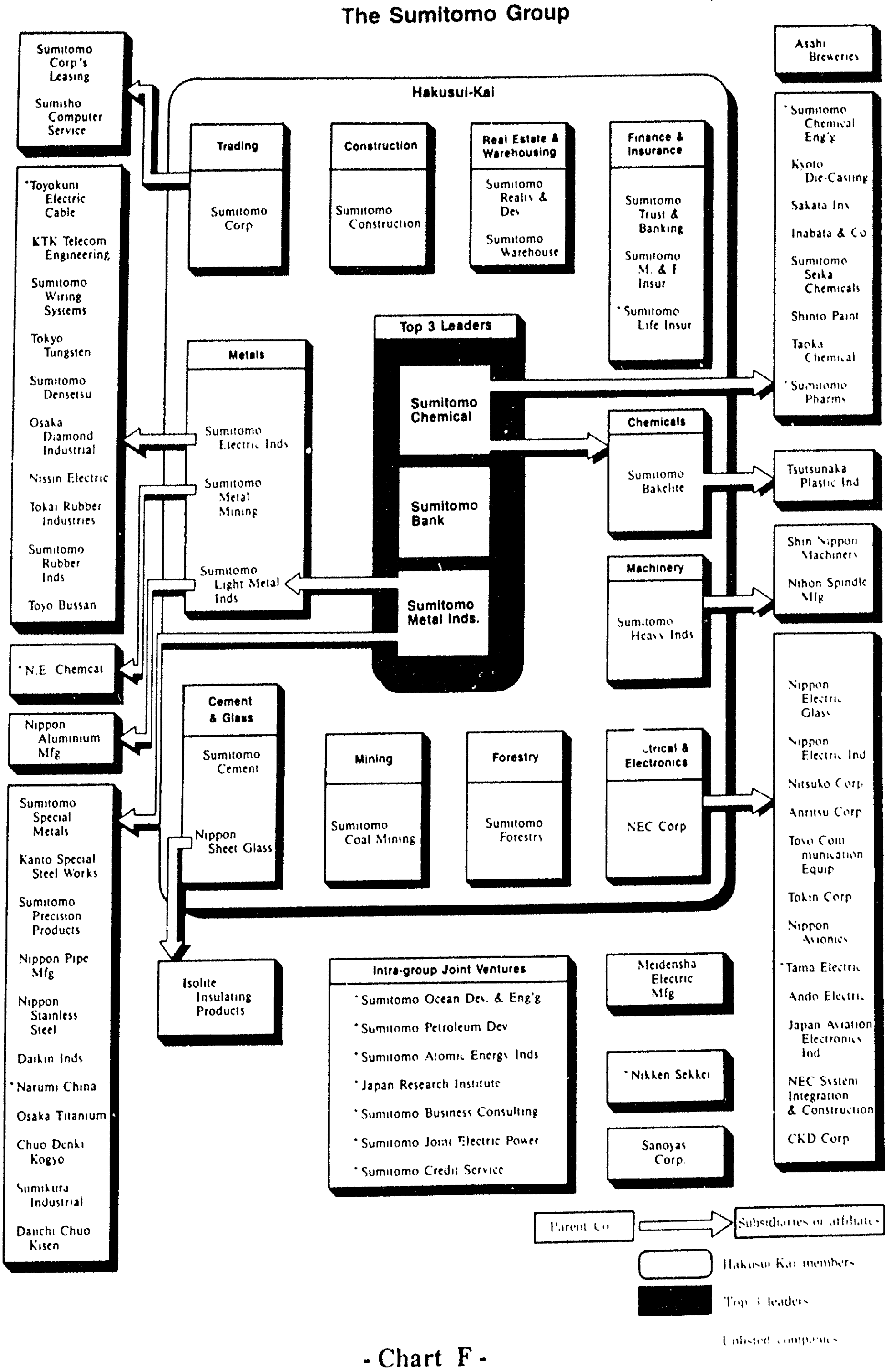
The Mitsui Group



- Chart E -

The Sumitomo Group



- Chart F -

> There are many other major Japanese companies in the United States that have *keiretsu*-like structures. It is simply the way the Japanese do business. Individuals band together as groups. The groups band together as companies. And the companies band together as parts of bigger systems. The patterns of vertically integrated, inward looking activity that *Mitsubishi* is creating in autos is being created in many different sectors and many different American states.[59]

<u>MAP Research Method:</u> Preliminary findings established that the Japanese auto transplant network concentrated in the mid-American states of Michigan, Ohio, Illinois, Indiana, Kentucky and Tennessee. Many information sources exist on foreign direct investment in the US, but no single source of comprehensive data on Japanese company locations, affiliations and products was identified.

Information from state governments in the six-state region, primarily economic development offices, was collated with data from directories of Japanese corporations, from both US and Japanese publishers. (see page 22) Collated data was coded into a computer database of MAP design, producing a file of 1,197 records, each representing an individual location of Japanese activity in the study area.

These 1,197 unique locations represent individual Japanese investments or companies operating in the financial, insurance, transportation, construction, electronics, machine tool, rubber, steel, and automotive industries. Sorted by state, the highest concentration of Japanese investments in the six-state area was Illinois - 451; followed by Michigan - 301; Ohio - 218; Tennessee - 94; Indiana - 71; and Kentucky - 62.

The initial hypothesis questioned whether Japan's *keiretsu* components had been transplanted to the six-state MAP region. Before testing the hypothesis on relationships/affiliations between transplanted Japanese companies, an extensive literature review was performed on books, periodicals and reports on Japan's history, economic system and corporate structure.

Information pertinent to identified transplant manufacturers, component suppliers and related supply and service companies was extracted and evaluated. As home-office and parent corporation information was coded, it became evident that Japanese automobile manufacturers were the principal entities among area Japanese investors. (see inside-back cover for approximate density, location)

Special attention was given to authoritative sources of information from Japanese publishers, particularly the voluminous and graphically illustrated publications of Dodwell Marketing Consultants. Composite data extracted from Dodwell references was selected for use as the central base for comparison of existing *keiretsu* in Japan to developing Japanese networks in mid-America.

* **Information Sources, Japanese Business Locations In MAP Area:**

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Disclosure, Inc., Bethesda, MD

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* **State Government:**

Illinois Department of Commerce and Community Affairs, Chicago, IL

Indiana Department of Commerce, Business Development Division, Indianapolis, IN

Kentucky Cabinet for Economic Development, Office of International Marketing, Frankfort, KY

Michigan Department of Commerce, International Division, Lansing, MI

Ohio Office of Business Development, Columbus, OH

Tennessee Department of Economic and Community Development, Nashville, TN

A company-by-company comparison of *keiretsu* structures in Japan with the parent corporations of US transplant companies in MAP's database was performed. An initial computer sort by parent company produced patterns of similarities between transplant companies associated with each major Japanese auto assembler in mid-America and their *keiretsu* in Japan. For the purpose of example, *Nissan*, *Toyota* and *Honda* are used as illustrations in the sections which follow.

After studying Dodwell's schematic representations of *keiretsu* in Japan, MAP decided to present research findings in similar format. Charts G, I and L are composites of related information from Dodwell publications. These charts present data from Dodwell Marketing Consultants' Anatomy of the *Keiretsu*, and concurrent data from Dodwell's Structure of the Japanese Automobile Industry, which provides a more detailed accounting of the affiliated supply companies of the Japanese auto industry *keiretsu*.

Original charts were constructed utilizing information developed from the MAP database. Charts H, J, K, and M illustrate the respective *Nissan*, *Toyota* and *Honda keiretsu* frameworks in mid-America. Comparing the composite Dodwell Charts G, I and L with MAP Charts H, J and M reveals similarities in content and structure between "*Keiretsu*, USA" and *keiretsu* in Japan.

Charts H, J, K and M represent the corporate and/or equity relationships within the *Nissan*, *Toyota* and *Honda keiretsu* identified in mid-America. The design of the charts depicts the vertical nature of the relationship between central group assembly companies and supply and service components. "Non-group" companies in which *Nissan* and *Toyota* have an equity interest and long-term supplier relationship are appended in the right-side columns of Charts H and J.

Non-group companies, while not integral group members, are a common *keiretsu* feature and are included here by reason of equity relationships or supplier/producer relationships with the primary group company. "While Japanese carmakers do purchase a great deal from firms in which they have an equity position, they also maintain long-term relationships with independent suppliers, and even with firms that clearly belong to a rival carmaker's *keiretsu*." [60]

MAP Chart Construction and Layout: Charts G, I and L are composites of Dodwell's information and represent *keiretsu* as they appear in Japan. These charts are coded "+" to match their respective counterparts identified in mid-America, as depicted in Charts H, J and M.

Charts H, J and M contain information on "*Keiretsu*, USA" companies and are constructed according to common rules:

* *Nissan*, *Toyota* and *Honda* are the respective core companies of each group, just as they appear in *keiretsu* in Japan. (Charts G, I, and L)

* Parallel to core company names are main plant locations in mid-America: Smyrna, Tennessee for *Nissan*; Georgetown, Kentucky for *Toyota*; Marysville and East Liberty, Ohio for *Honda*. *Nissan* also has identifiable connections with *Isuzu*, a transplant partner in a Lafayette, Indiana plant.

* Chart columns below main assembly plant names are group auto parts suppliers and distributors. Each box enumerates a separate installation of a group member company, with the parent or major shareholder of each supplier/distributor sub-group designated by a solid line beneath the corporate name.

* A percentage number below the name of the sub-group parent represents the fraction of stock held by the core company (*Nissan*, *Toyota* or *Honda*) in the particular group member, as registered in Japan.

* Below the percentage (if present) are the names, locations, products, and joint venture partner (if applicable) of the mid-America locations of the related *keiretsu* suppliers.

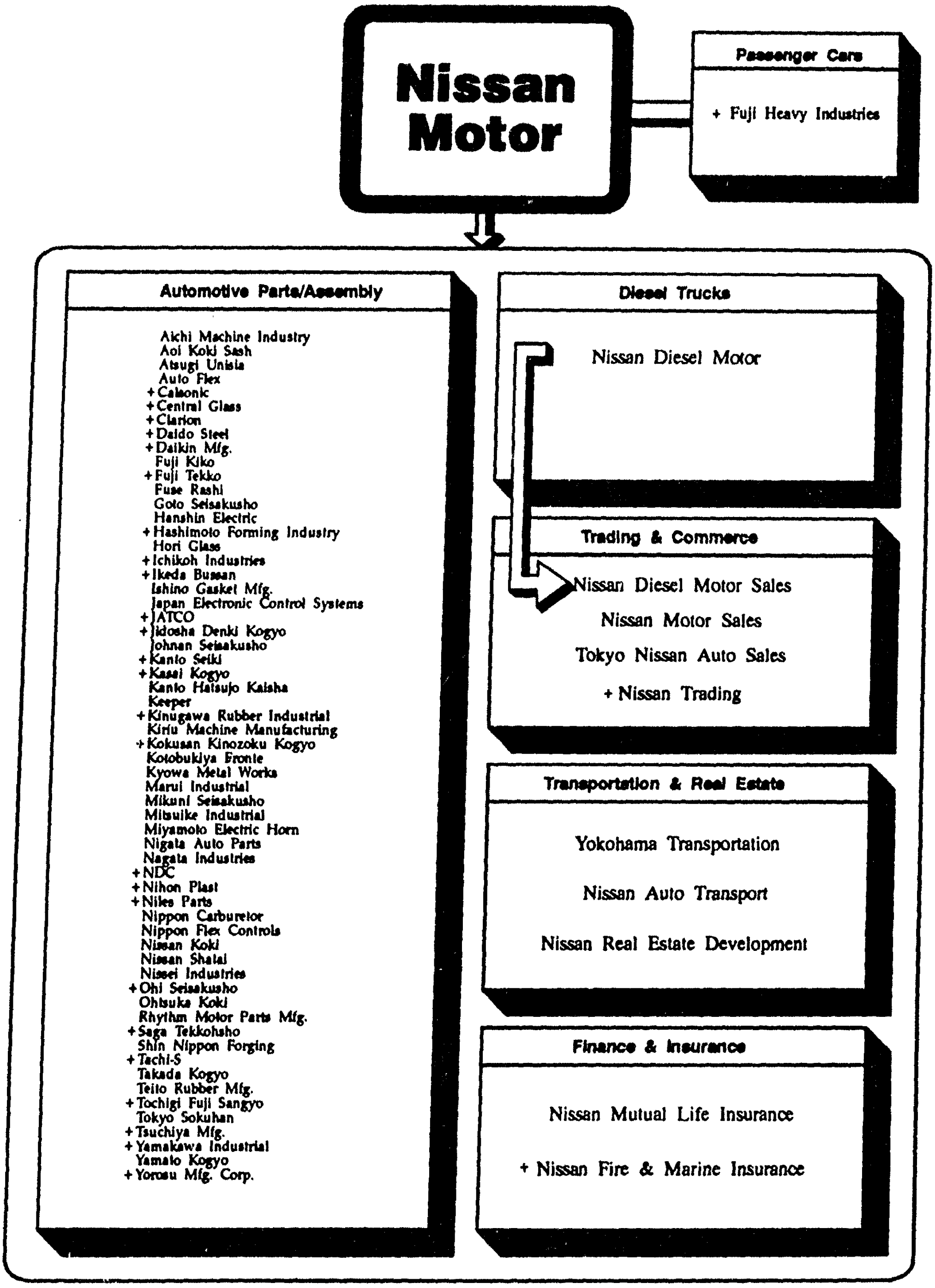
* Distribution, research and development, trading and commerce, finance and insurance members of each group are listed on the far right side.

* The "Notes" section is an integral part of the charts, providing clarification or additional information on specific items.

* Right-hand columns list related non-group companies with the respective ownership interests of core companies. "Non-group" in this instance should be interpreted to mean that listed companies are not part of the *Nissan* or *Toyota* groups, but could be either independent, or part of another group. Banking and finance relationships with horizontal *keiretsu* are also listed.

* Chart K lists companies not directly affiliated with a core company *keiretsu*, but reveal shared equity ownership by *Nissan* and *Toyota*. These companies tend to be larger than group companies and may have a level of autonomy not found within the *keiretsu*. Note that the level of ownership by *Toyota* and *Nissan* in such companies is approximately equal.

Nissan Motor Group Japan*



Source: Dodwell Marketing Consultants, Tokyo Japan.** ***Industrial Groupings in Japan: The Anatomy of the "Keiretsu" - Ninth Edition **and** ***The Structure of the Japanese Auto Parts Industry - Fourth Edition.***

- Chart G -

Nissan Keiretsu

Founded in 1928, *Nissan* was originally *Nippon Sangyo* (Japan Industries). By 1945, the *Nissan* Group included 74 firms and was referred to as a "new *zaibatsu*."[61] *Nissan* was ordered dissolved following the war, successfully re-forming in the 1950s. In 1966, *Nissan* was merged with Prince motors. In 1968, at the urging of the Industrial Bank, *Nissan* made an investment in *Fuji* Heavy Industries because of decreasing sales of *Fuji's Subaru* cars. While *Nissan* Motor currently owns only 4.5% of *Fuji* Heavy Industries stock, *Fuji* Heavy Industries is a member of the *Nissan Keiretsu.*

Today, *Nissan* Motor is the second largest automobile manufacturer in Japan with a supply base of 171 primary parts suppliers organized in two separate *kyoryokukai*, or group councils.[62] One supplier group depends mainly on *Nissan* business and is coordinated by *Nissan* through the president's council (*shacho-kai)* called *Takara-Kai.* The other *kyoryokukai* of low tier suppliers is the *Shoho-Kai.* The history and development of *Nissan's kyoryokukai* is one of continuous integration and control.

> Soon *Nissan* developed a formula. On a vital piece of equipment, something without which the line might shut down, *Nissan* wanted the supplier company to be a direct subsidiary and wanted 90 percent of the stock. For all intents and purposes, these companies became part of *Nissan* itself. On parts for which there were alternative suppliers if needed, *Nissan* wanted 40 percent of the stock. That in itself was a virtual takeover. It allowed family companies to remain family companies, but it made sure they fit the specifications of *Nissan* and that the will of *Nissan* would be decisive. If the company refused to accommodate, *Nissan* - or *Toyota* or one of the other bigger companies, for the same process was going on throughout the industry - simply went elsewhere ... It was an offer that few turned down. Almost as soon as the deal was done, however, the owner learned that he was no longer master of his own shop.[63]

Given this history and the structure of the *Nissan Keiretsu* (Chart G), the response of the President of *Nissan* to the question of whether *Nissan* gives preferential treatment to its group companies is remarkable:

> "... national or corporate origin is of no consideration to *Nissan* in choosing suppliers ... the notion that so-called family relationships dictate their sourcing decisions is, to be blunt, ridiculous ... *Nissan* cannot afford and could not survive by basing their parts procurement decisions on non-economic criteria."[64]

This assertion is tremendously misleading. The "non-economic" argument attempts to preempt the view of *keiretsu* as a viable economic system by implying that such a system could not work. In fact, Nissan does make sourcing decisions based on *keiretsu* relationships, despite disingenuous denials. The very nature of *keiretsu* yields *Nissan* and other auto transplants the direct and considerable benefits of lower "transaction costs" and overhead expenses which are passed along to lessor members of the *Nissan Keiretsu* as competition and market conditions require.

The power which *Nissan* holds over group supplier companies was recently demonstrated when *Nissan* dismissed the chairman of *Ichikoh* Industries, *Tesuya Tsukatani*. According to Mr. *Tsukatani*:

> ... *Nissan* used threats and intimidation to remove him from leadership of the automotive lighting company ... Mr. *Tuskantani* accused *Nissan* of waging a four-year campaign to take over *Ichikoh's* business, even though the automaker owns only 20.9% of the lighting supplier's stock. He said *Nissan* executives told him that if he didn't resign, they would slash orders from *Ichikoh*. *Nissan* accounts for half of *Ichikoh's* business. [65]

In response to questions regarding Mr. *Tsutankani's* accusations, the spokesman for *Nissan* termed the charges, "ridiculous". From this exchange, it is evident that not all Japanese business officials are happy with how the *keiretsu* functions. It is the suppliers which are continually squeezed so that the companies at the center of the *keiretsu* remain profitable.

Light Body Trucks & Passenger Cars
Nissan Motor Manufacturing Corporation U.S.A
Smyrna, TN

Nissan Motor

Fuji Heavy Industries, Ltd.[4]

Nissan Motor Group & Affiliate Automotive Parts and Supply Companies Operating in Mid-America[1]

Calsonic Corporation
33.2% - 39,731,000 shares[2]

Calsonic Yorozu Corp
Morrison, TN
Heating, Air Conditioning and Exhaust Systems
Joint Venture - Yorozu Corp., Japan

Calsonic Manufacturing Corp
Shelbyville, TN
Heating, Air Conditioning and Exhaust Systems

Calsonic International, Inc
Southgate, MI
Marketing, Sales & Engineering

CEI Company, Ltd
Springfield, TN
Motor Actuators for HVAC
Joint Venture -
Delco Electronics, Kokomo, IN

Central Glass Company
8.8% - 17,701,000 shares

Carlex Glass Company
Vonore, TN
Auto and Truck Windshields and Windows
Joint Venture -
Ford Glass Company

Clarion Company, Ltd.
12.8% - 14,935,000 shares

Clarion Manufacturing Corporation of America
Walton, KY
Automotive Audio Equipment

Clarion Corporation of America
Elk Grove Village, IL
Distributor, Car Audio Products and Telephones

Clarion Corporation of America
Troy, MI
Automotive Audio Equipment

Clarion Corporation of America
Nashville, TN
Sales and Marketing

Daido Steel Co., Ltd.
5.5% - 23,026,000 shares

Daido Steel (America), Inc
Des Plaines, IL
Distributor, Steel Products

Ohio Star Forge Company
Warren, OH
Hot Forged Parts for Automotive Bearing, etc

Daikin Manufacturing Co.
Daikin Clutch Corporation
Belleville, MI
Clutches, Clutch Disc Assembly & Pressure Plate Assembly

Rockwell Clutch Company
Florence, KY
Heavy Tractor Trailer Clutches
Joint Venture -
Daikin Clutch (40%) Rockwell (60%)

Fuji Tekko Co., Ltd.
34.0%

Fuji Tekko Company, Ltd
Southfield, MI
Market Research

Hashimoto Forming Industry
24.0%

H A Parts Products of Indiana Company (Happico)
Greencastle, IN
Decorative Automotive Trim
Joint Venture -
Automotive Molding Co., Warren MI

HAPPICO
Bowling Green, KY
Decorative Automotive Trim
Joint Venture -
Automotive Molding Co., Warren, MI

Ichikoh Industries, Ltd.
20.5% - 18,960,000 shares[3]

Ichikoh Manufacturing Inc
Shelbyville, KY
Rear View Mirrors

Ichikoh America, Inc
Ann Arbor, MI
Exterior Rear View Mirrors

Ichikoh Engineering, Ltd
Ann Arbor, MI
Industrial Robots For Injection Molding Machines

Ikeda Bussan Co., Ltd.
43.0%

Ikeda Interior, Inc
Sidney, OH
Manufacture Auto Seats

Ikeda of America Inc
Farmington Hills, MI
Interior Trim, Headliners, Trunk Garnish and Seats

Ikeda Interior Systems Inc
Murfeesboro, TN
Interior Trim
Joint Venture -
Kinugawa Rubber Co., Ltd - Japan
(Also Nissan Group Company)

Ikeda Engineering Corporation
Farmington Hills, MI
Research and Development
Seats and Interior Systems

Vintec Company
Smyrna, TN
Seats, Headliners -
Headquarters Office
Joint Venture With Johnson Controls, Inc

Vintec Company
Murfreesboro TN
Seat Manufacturing

Vintec Company
Murfreesboro, TN
Interior Trim, Headliners

Japan Automotive Transmission Company
JATCO
65.0%

Japan Automotive Transmission Company
Southfield MI
Distributor Automotive Transmission

Jidosha Denki Kogyo Co., Ltd.
20.9%

Jideco of Bardstown, Inc
Bardstown, KY
Windshield Wiper Motors, Cruise Control, Power Windows

Kanto Seiki Co., Ltd.
35.7%

Kantus Corporation
Lewisburg, TN
Instrument Panel Clusters, Electronic System Controller

Kantus Engineering Co Ltd
Southfield, MI
Engineering Automotive Parts

Kasai Kogyo Co., Ltd.
24.6%

M-Tek, Inc
Manchester, TN
Interior Plastic Parts

Kinugawa Rubber Industrial Company, Ltd.
24.3% - 14,844,000 shares

CKR Industries, Inc
Winchester, TN
Rubber Weatherstrips
Joint Venture -
Chardon Rubber, OH

Kokusan Kinozoku Kogyo Co., Ltd.
25.0%

Kokusan Kinozuku Kogyo Co., Ltd
Farmington Hills, MI
Distributor, Door Handles, Cylinder Locks Hardware

Alpha Technology Corporation
Howell, MI
Manufacture Steering Column Door Handle, Ignition Switches, etc

NDC Company, Ltd.
76.8%

NDC Company, Ltd
Southfield, MI
Sales Engine Bearings and Sound Absorption Material

Nihon Plast Co., Ltd.
30%

Neaton Auto Products Manufacturing, Inc Eaton, OH
Steering Wheels, Inner Fenders, Glove Boxes Panel Clusters, etc

Niles Parts Co., Ltd.
40.0%

Niles Parts Co., Ltd
Farmington Hills, MI
Liason Office For Electronic Components

Ohi Seisakusho, Ltd.
34.0%

Ohi-Atwood Automotive
Frankfort, KY
Window Regulators, Door Locks, Door Hinges, Parking Brakes etc
Joint Venture -
Atwood Industries, IL

Ohi U S A Corporation
Southfield, MI
Representative/Sales Office

Saga Tekkosho Co., Ltd.
33.4%

Dexter Fastener Technologies, Inc
Dexter, MI
Automotive Fasteners
Joint Venture -
Saga Tekkosho, Japan (45%)
Shinsho America Japan (5%)
Ring Screw Works U S (50%)

Tachi-S Co., Ltd.
20.2%

Tachi-S Engineering U S A
Farmington Hills MI
Automotive Seating Design, Prototypes and Related Hardware

Techno Trim, Inc
Ann Arbor, MI
Seat Trim and Covers
Joint Venture -
Johnson Controls Automotive Systems Group, MI

Techno Trim Inc
Maysville KY
Auto Seat Covers
Joint Venture -
Johnson Controls Automotive Systems Group MI

Techno Trim, Inc
Greencastle IN
Auto Seat Covers
Joint Venture -
Johnson Controls, Inc

Setex, Inc
St Marys, OH
Car Seats
Joint Venture -
Johnson Controls, Inc

Tsuchiya Co., Ltd.
57.1%

Tasus Corporation
Bloomington, IN
Paint Masking Systems, Weather Seals
Joint Venture -
Schlegel Corporation, NY

Tennex Industries
Murfreesboro, TN
Air Cleaners Carbon Canisters, Fuel and Oil Filters

Tennex Engineering, Inc
Southfield, MI
Design Engineering Center

Tochigi Fuji Sangyo K.K.
20.9%

Tochigi Fuji Industrial Co., Ltd
Southfield, MI
Sales Office Power Trains

Yamakawa Industrial Co.
34.0%

Yamakawa Manufacturing Corporation of America
Portland, TN
Stamping Parts Metal Body Parts

MSP, Inc
Portland TN
Metal Processing
Joint Venture -
Marubeni Corp., Japan

Light Body Trucks & Passenger Cars

Subaru Isuzu Automotive, Inc.
LaFayette, IN

Fuji Heavy Industries
50%

Isuzu Motors[5]
50%

Fuji Heavy Industries Co., Ltd.

4.5% - 24,775,000 shares

Fuji Heavy Industries USA, Inc
Des Plaines, IL
Distributor, Industrial Engines

Fuji Industries USA Corporation
West Bloomfield, MI
Automotive

Subaru Automotive Svcs. Co
Southfield, MI
Parts Procurement Office

Subaru of America, Inc
Addison, IL
Regional Sales Office - Automobiles and Parts

Distribution

Nissan Motor Corporation
Memphis, TN
Sales, Marketing, Distribution

Nissan Motor Corporation, USA
Smyrna, TN
Distribution

Nissan Motor Corporation, USA
Aurora, IL
Distributor

Nissan Motor Corporation, USA
Worthington, OH
Distributor, Autos and Parts

Non-Automotive

Nissan Industrial Equipment Company
Memphis, TN
Sales and Marketing, Forklifts

Barrett Industrial Trucks, Inc.
Marengo, IL
Forklifts, Industrial Equipment

Finance & Insurance

7.2% - 14,888,000 shares

Nissan Fire and Marine Insurance Company, Ltd.
Nashville, TN
Representative Office, Insurance

Research/Development

Nissan Research and Development U.S. Headquarters
Plymouth Township, MI
Research on Emission Controls, Parts

Nissan Research and Development, Inc. - Laboratory
Ann Arbor, MI
Research on Emission Controls

Trading & Commerce

Nissan Trading Corp., U.S.A.
Southfield, MI
Trading Company

Nissan Trading Co., Ltd.
Nashville, TN
Sales and Marketing, Trading Company

Notes: Nissan

1) Source of Data on Nissan Motor Group in Japan *Industrial Groupings in Japan 1990-1991: The Anatomy of the "Keiretsu"*, published by Dodwell Marketing Consultants, Tokyo, Japan

2) All ownership figures in this space are for Nissan Motor Company, Ltd

3) The following automotive companies also own shares in Ichikoh Industries, Ltd.:
Toyota = 6 3%
Isuzu = 3 0%
Daihatsu = 2.7%

4) Fuji Heavy Industries is an affiliate of Nissan , Nissan holds 4.5%, or 24,775,000 shares FHI

5) General Motors Corp. Holds 38.2% of Isuzu Motors - 349,561,000 shares

6) The Following automotive companies also own shares in Diesel Kiki Co , Ltd.:
Isuzu = 20 4%
Robert Bosch = 11.3%
Although an affiliate of Isuzu, Diesel Kiki maintains close relations with Nissan Motor Co., Ltd

7) The following Nissan Motor Group Companies also have interest in Nippon Oil & Fats Co.:
Nissan Fire & Marine Insurance 3 2%
Nissan Mutual Life Insurance 3 2%

8) Isuzu Motors also owns 8 4% of Press Kogyo

9) Nissan Motor and its group companies maintain close financial ties with the Industrial Bank of Japan (IBJ) and Fuji bank. IBJ finances the majority of Nissan Group activities.

Non-Group Companies With Nissan Ownership Operating in Mid-America

Diesel Kiki Company, Ltd.[6]

10.2% - 24,333,000

Diesel Kiki USA Co , Ltd
Troy, MI
Auto Parts

DK Technologies, Inc.
Troy, MI
Research, Development, Marketing

Nippon Oil & Fats Co.

3 9% - 8,421,000 shares[7]

Michigan Metal Coatings Co.
Sterling Heights, MI
Metal Coating

NTN Toyo Bearing Co., Ltd.

2.9% - 11,920,000 shares

NTN-Bower Corporation
Franklin, MI
Corporate Headquarters

NTN Technical Center, Inc
Ann Arbor, MI
Research and Development, Bearings

NTN Elgin Corporation
Elgin, IL
Manufacturer, Ball and Tapered Roller Bearings

NTN Driveshaft, Inc.
Columbus, IN
Automobile Driveshafts

NTN Bower Corporation
Macomb, IL
Manufacturer, Rolling Bearings

NTN Bower Corporation
Bingham Farms, MI
Roller Bearings

NTN Bearing Corp of America
Southfield, MI
Manufacturer, Bearings

NTN Bearing Company, Ltd
Des Plaines, IL
Ball and Roller Bearings, Constant Velocity Joints

NTN Bearing Company
Medina, OH
Anti-Friction Bearings

Press Kogyo Co., Ltd.

3.8% - 3,770,000 shares[8]

P.K. USA, Inc.
Shelbyville, IN
Chassis and Frame Suspension, Plastic Interior Trim Panels

Riken Corporation

4.9% - 4,150,000 shares

Riken of America, Inc.
Niles, IL
Distribution, Pistons, Piston Rings Seal Rings, Valves

Modern Industrial Plastics, Inc.
Brookville, OH
Mfg , Auto Suspension Parts

Modern Industrial Plastics, Inc.
Dayton, OH
Mfg , Seals, Coatings, Gaskets

Tokico, Ltd.

2 4% - 2,974,000 shares

Tokico Manufacturing Corp
Berea, KY
Auto Shock Absorbers

Tokico America, Inc.
Dearborn, MI
Shock Absorbers, Brake Master Cylinders, Wheel Cylinders, etc.

Banking & Finance[9]

Fuji Bank, Ltd.

1.9% - 47,695,000 shares

Fuji Bank, Ltd.
Chicago, IL
Banking

Industrial Bank of Japan, Ltd.

2.2% - 51,999,000 shares

Industrial Bank of Japan, Ltd.
Chicago, IL
Banking

Yasuda Trust & Banking Company, Ltd.

2.2% - 20,053,000 shares

Yasuda Trust & Banking Company, Ltd.
Chicago, IL
Banking

Mid-America Project

Original Research by Mid-America Research

- Chart H -

Nissan Motor Manufacturing Corporation USA: *Nissan* Motor's light body truck and passenger car manufacturing plant in Smyrna, Tennessee was completed in 1983 and represents a capital investment of $1.2 billion. Estimated production is 240,000 vehicles annually. [66] The Smyrna facility is *Nissan's* flagship US operation, around which it has located a network of *keiretsu* group supplier transplants and affiliates directly from Japan.

Fuji Heavy Industries, Ltd.: Through its relationship with *Fuji* Heavy Industries, *Nissan* has access to *Subaru-Isuzu* Automotive, Inc. in Lafayette, Indiana. Cross-shareholding, supplier/producer relations and crucial management appointments contribute to this relationship: *Nissan* holds 4.5% of *Fuji* Heavy Industries; *Subaru* assembles small passenger cars for *Nissan* and has been a long term supplier/producer; [67] *Nissan* Diesel's President recently became the President of *Fuji* Heavy Industries to assist during *Fuji's* financial downturn and to "... give *Nissan* Motor Co. a big say in the future of ailing *Fuji*." [68] The 1991 announcement that "*Nissan* Motor Co. will broaden its alliance with *Fuji* Heavy Industries, Ltd., by shifting production of 60,000 *Nissan Pulsars* a year into an under-used *Fuji* assembly plant in Japan" [69] emphasizes the fact that *Nissan* has a greater interest in the *Subaru-Isuzu* Automotive joint venture than is readily apparent.

Cross-Shareholding with Isuzu: In addition to its relationship with *Fuji* Heavy Industries, *Nissan* also has considerable cross-shareholding with *Isuzu*: through *Fuji* Heavy Industries, *Nissan* takes part in the *Subaru-Isuzu* Automotive joint venture; *Isuzu* holds 3.0% of the *Nissan* group company *Ichikoh*; *Nissan* holds 10.2% of Diesel *Kiki* Co. (also dba *Zexel*), an *Isuzu* group company; *Nissan* holds 3.8% of Press *Kogyo* Co., of which *Isuzu* owns 8.4%; *Nissan* owns 13.4% of *Akebono* Brake Co. of which *Isuzu* owns 5.2%. The high degree of cross-shareholding between *Nissan* and *Isuzu* exemplifies the degree of cooperative relationships which exist in the "competitive" Japanese automobile industry.

Nissan Motor Group Affiliates in Mid-America: At present, 24 of *Nissan's* main Japanese *keiretsu* parts and supply companies have established operations in mid-America. Affiliates of the 24 main group companies which have located in mid-America total 51, including manufacturers, distribution points, warehouses, and representative offices. *Nissan Keiretsu* affiliated firms in turn own, or are joint venture partners, in all 51 of *Nissan's* "*Keiretsu*, USA" companies. Employment figures indicate that at least 16,500 workers are now employed in the *Nissan* "*Keiretsu* USA."

Of the 51 identifiable *Nissan* related locations in mid-America, only 2 are *keiretsu* company joint ventures; 4 are jointly ventured with other Japanese-owned companies. There are only 16 joint ventures between Japanese and non-Japanese companies among the 51 *Nissan* companies of "*Keiretsu*, USA."

Distribution - R & D - Trading & Commerce - Finance & Insurance: Just as the *Nissan keiretsu* in Japan includes segments not directly related to the manufacture of auto parts and equipment, **Chart H** also includes locations of *Nissan's "Keiretsu*, USA" distribution, research and development, trading and commerce, and finance and insurance affiliates. Without these supporting *keiretsu* functions, the mid-American *keiretsu* of *Nissan* would lack elements essential to support and assist the entire group.

Nissan "Non-Group" Companies: Non-group companies with *Nissan* ownership operating in mid-America manifest other *keiretsu* dynamics in the automobile industry in which automobile manufacturers acquire stock in certain suppliers, even though these suppliers are not in the principal manufacturer's *keiretsu.*

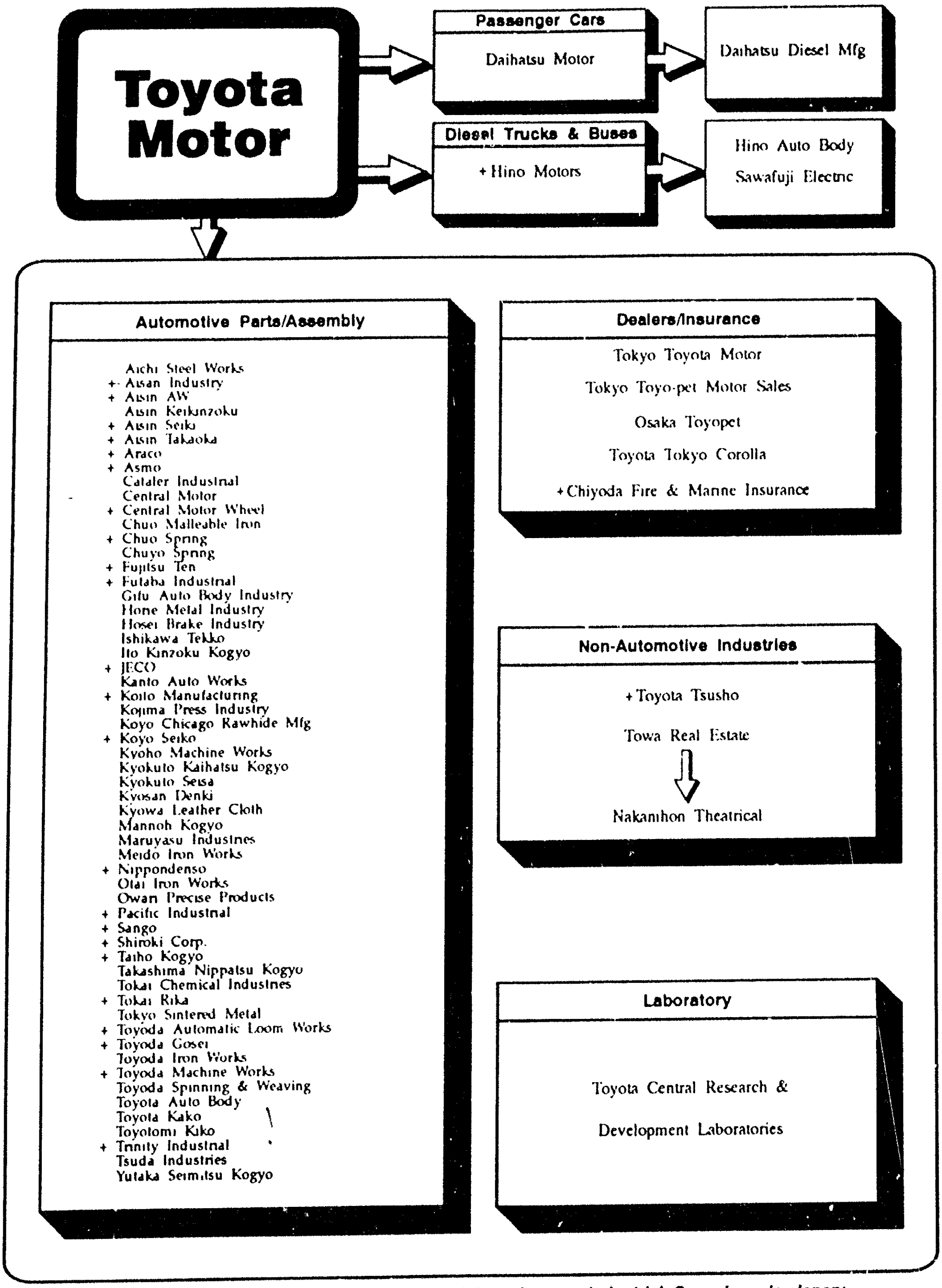
Such firms may be members of another *keiretsu* group, maintaining loyalty to their own group while dealing with *Nissan's* group on a business level. This is a common aspect of *keiretsu* group dynamics and provides yet another dimension to the total integration of Japan's coordinated industrial and trade strategy. For instance, although Diesel *Kiki* Company is an affiliate of the *Isuzu* Group, "It has close relations with *Nissan* Motor." [70] Through this device, non-group companies in which *Nissan* may or may not hold an equity interest contribute to the success of *keiretsu* operations in mid-America.

There are 6 companies considered non-group with *Nissan* ownership. These 6 companies have a total of 17 locations in mid-America, bringing the total number of companies in mid-America that are either group members or non-group with *Nissan* ownership and/or supplier relationships to 68 (not including non-group companies with both *Nissan* and *Toyota* ownership). **(Chart J)**

Banking & Finance: *Nissan* maintains close financial ties with both the *Fuji* Bank (**Chart B**) and the Industrial Bank of Japan (*IBJ*). Dodwell's reports that the *IBJ* finances the majority of *Nissan* Group activities. [71] Such a relationship is typical of "vertical *keiretsu*" interaction with the core banks of large "horizontal *keiretsu*" and reveals how the interlocking *keiretsu* relationships are strengthened through cross-shareholding and finance.

Comparison: Comparing *Nissan's keiretsu* structure in Japan to the *Nissan* network in the USA, it is clear that *Nissan* has transplanted essential elements of its *keiretsu* structure to mid-America, and has organized the elements into a group structure patterned after its *keiretsu* in Japan.

Toyota Motor Group Japan*



*Source: Dodwell Marketing Consultants, Tokyo Japan. ***Industrial Groupings in Japan: The Anatomy of the "Keiretsu" - Ninth Edition*** **and *The Structure of the Japanese Auto Parts Industry - Fourth Edition.***

- Chart I -

Toyota Keiretsu

The founding of *Toyota* dates back to 1918, when *Toyoda Sakichi* established *Toyoda* Spinning and Weaving. [72] It was not *Toyoda Sakichi*, however, who was directly responsible for today's *Toyota* Motor Company. The automotive aspect of the *Toyoda* family business was begun in 1926, when *Kiichiro Toyoda* was given 1,000,000 *yen* by his father, *Sakichi*, to experiment with motor vehicles. This experimentation later took place as a department within *Toyoda* Automatic Loom, which is the true forerunner of *Toyota* Motor Company.

When the Japanese automobile industry law was passed in 1936, restricting foreign automobile producers, *Toyota* Automatic Loom was provided with additional impetus to invest further in the automobile business. Bank loans were arranged through group affiliations and "... the *Mitsui* group provided about half of all outside funds through stock purchases and bank credit." [73]

As *Toyota* expanded, it spun off departments into separate companies which were integrated into the *Toyota Keiretsu* (*Toyota* Auto Body, *Aisin Seiki*, *Toyoda Gosei*). [74] (Chart I) After the war, *Toyota* added more companies to its group:

> *Toyota* not only led the Japanese automakers in founding subsidiaries; it was also the first to organize unaffiliated subcontractors. *Toyota* began an early suppliers association in 1939 by arranging for 20 local companies to meet under the name of the *Toyota* Subcontactors Discussion Group, sometimes called the *Toyota* Cooperative Association... After World War II, it expanded the association on a regional format; the 3 main branches had 160 members by 1958. Although some of these firms were not exclusive suppliers, membership in the association changed little between the 1950s and the early 1980s. Approximately 220 firms participated in 1984, of which 80 percent had plants in *Aichi* or surrounding *prefectures*. [75]

The 175 suppliers are organized into a supplier organization named the *Kyoho-Kai*, literally meaning 'a club for co-prospering with *Toyota*'... the main purpose of this organization is for *Toyota* to implement a common strategy and set rules for its suppliers. [76]

Today, *Toyota* has 220 primary auto parts suppliers and over 1000 secondary and tertiary suppliers which are organized into two *kyoryokukai* called *Kyoho-Kai* and *Eiho-Kai*. [77] It should not be surprising that "*Toyota* has already invited US suppliers to meetings in Las Vegas and *Tokyo* and has formed an organization of US local suppliers - the Bluegrass Automotive Manufacturers Association - to help develop better suppliers." [78]

Pertaining to the report of the US investment research group (MAP), *Toyota* Automobile argues, "There are no affiliate dealings, domestic or foreign. We don't understand what they mean by 'affiliation'." [79]

Similar to the situation in which *Nissan* used its power over its supplier, *Ichikoh* Industries, *Toyota* has also recently exercised its considerable control and influence over one of its suppliers. In the *Toyota* case, the *keiretsu* supplier was *Koito* Manufacturing Company, which makes automotive lighting and is a member of the *Toyota Keiretsu*.

When Texas oilman T. Boone Pickens purchased 20.2% of *Koito* in 1989, he became the largest single shareholder in *Koito*. Since he was the largest single shareholder, Pickens reasoned that he was entitled to at least one, if not several, seats on *Koito's* board of directors. This was not to be the case as *Koito* and *Toyota* orchestrated efforts to not only prevent Pickens from having a seat on the board of directors, but also prevented him from reviewing the books of the company in which he was the primary shareholder.

Toyota and *Koito* were able to stymie Pickens even though *Toyota* held fewer shares of *Koito* stock, because *Toyota* had previously arranged for several *Toyota* representatives to sit on *Koito's* board, holding *Koito's* supplier relationship with *Toyota* hostage. The Pickens/*Koito* battle is a prime and current example of how mutual support and coordination within a *keiretsu* operates to thwart shareholder and corporate democracy. [80]

> Because of their control over their parts suppliers, the 'New Big Three' [*Toyota*, *Nissan* and *Honda*] are able to squeeze profits ruthlessly from them. As a group, Japan's auto parts makers are among the least profitable listed companies. *Toyota* had a 6 percent operating profit margin in 1989, while *Toyota* Auto Body and *Kanto* Auto Works had a 1.8 percent margin. The smaller companies suffer most because they have no alternative but to supply a single automaker. [81]

Passenger Cars

Toyota Motor Manufacturing Corporation U.S.A.
Georgetown, KY

Toyota Motor

Toyota Motor Group & Affiliate Automotive Parts and Supply Companies Operating in Mid-America[1]

Aisan Industry Co., Ltd.
30 4%[2]

Aisan Industry Co , Ltd
Southfield, MI
Carburetors/Fuel Injection Systems

Aisan Industry Co , Ltd
Schamburg, IL
Automotive Parts

Franklin Precision Industry, Inc
Franklin, KY
Auto Engine Parts

Aisin - AW
20 0%

AW Transmission Engineering USA
Plymouth Township, MI
Auto Transimission Remanufacture

Aisin Seiki
22 3% - 57,851,000 shares[3]

Aisin Seiki U S A Manufacturing, Inc
Seymour IN
Body Moldings, Windo Frames, etc

Aisin USA, Ltd
Plymouth Township, MI
Auto Parts

Aisin USA, Ltd
Oak Brook, IL
Transmission Parts

Aisin Seiki Company, Ltd
Ann Arbor, MI
Research on Automotive Parts

Aisin Takaoka
38 3%

Aisin Takaoka Co , Ltd
Ann Arbor, MI
Brake Drums

Intat Precision, Inc.
Rushville, IN
Engine Castings, Differential Parts
Joint Venture -
Intermet, GA

Araco, Inc.
72 5%

Trim Masters, Inc
Bardstown, KY
Door Trim Panels
Joint Venture -
Araco, Inc., Japan
Toyota Tsusho, Japan
Hoover Universal, MI

Trim Masters, Inc
Harrodsburg, KY
Door Trim Panels
Joint Venture -
Araco, Inc., Japan
Toyota Tsusho, Japan
Hoover Universal, MI

Asmo Company, Ltd.

Asmo Company, Ltd
Southfield, MI
Engineering for DC Motors

Asmo Manufacturing, Inc.
Battle Creek, MI
Plastic Tanks,
Retractable Head Light Motors

Central Motor Wheel
60 4%

Central Light Alloy Co
Paris, KY
One Piece Aluminum Wheels

Central Manufacturing Co
Paris, KY
Aluminum & Steel Wheels
Joint Venture -
Toyota Tsusho, Japan
Kelsey-Hayes, MI
Central Motor Wheel, Japan

Chuo Spring Co.
22 6%

ACK Controls, Inc
Glasgow, KY
Automatic Cable Cotnrols
Joint Venture -
Chuo Spring, Japan - 36%
Kokoku Steel Wire, Japan - 15%
Babcock/Acco Controls, MI - 49%

Central Spring, Inc
Southfield, MI
Wire Products for Automobiles

Fujitsu Ten Corp., Ltd.
35 0%

Fujitsu Ten Corp of America
Farmington Hills, MI
Automobile Audio Equipment

Fujitsu Ten Corp of America
Rushville, IN
Automobile Audio Components

Futaba Industrial
13.7%

Futaba Corporation of America
Plymouth Township, MI
Vacuum Fluorescent Display Modules

Futaba Corporation of America
Schaumburg, IL
Vacuum Fluorescent Display Modules

JECO, Inc.
34.3%
JECO, Inc
Carmel, IN
Importer/Exporter Clocks, Motor, etc

Koito Manufacturing Co.
19.0% 30,506,000 shares[4]

Koito Manufacturing Co , Ltd
West Bloomfield, MI
Representative Office

North America Lighting, Inc
Flora, IL
Manufacturing Automotive Lighting
Joint Venture -
Koito Manufacturing, Japan
Ichikoh Industries, Japan
Hella North America, Germany

North American Lighting, Inc.
Salem, IL
Manufacturing Automotive Lighting

Koyo Seiko Company, Ltd.
17.7% - 32,917,000

American Koyo Corporation
Westlake, OH
Bearing

TRW Koyo Steering Company
Vonore, TN
Power Rack and Pinion Steering
Joint Venture -
Koyo Seiko , Ltd Japan
TRW, Inc. OH

Koyo Corporation of U S A
Southfield, MI
Bearings, Steering & Machine Tools

Nippondenso Company
23% - 164,641,000 shares[5]

Nippondenso Tennessee, Inc
Maryville, TN
Instrument Clusters

Nippondenso Tennessee, Inc
Maryville, TN
Starter, Alternators

Nippondenso Tennessee, Inc
Maryville, TN
A/C Amplifiers

Nippondenso Technical Center
Southfield, MI
Auto Electrical Parts

Nippondenso Sales, Inc
Des Plaines, IL
Sales/Marketing, Spark Plugs

Purodenso Company
Jackson, TN
Air Filters, Oil Filters
Joint Venture -
Nippondenso Company, Japan - 50%
Purolater Company, OK - 50%

Nippondenso Manufacturing U.S.A., Inc.
Battle Creek, MI
Condensors, Evaporators

Nippondenso Sales, Inc.
Southfield, MI
Sales, auto Parts

Michigan Automotive Compressor, Inc.
Parma, MI
Air Conditioner Compressors
Joint Venture -

Nippondenso Co , Ltd
Toyoda Automatic Loom Works

Pacific Industrial.

Pacific Industries, Inc.
Fairfield, OH
Mfg Tire Valves

Sango Company
66.5%

Arvin Sango, Inc.
Madison, IN
Exhaust Pipes

Shiroki Corporation
12 0% - 8,014,000 shares

Shiroki - Excel, Inc
Elkhart, IN
Trim Moldings For Doors

Shiroki corporation
Southfield, MI
Automotive Market Research

Shiroki Corporation
Smithville, TN
Window Regulators, Seat Adjusters

Taiho Kogyo
52.2%
Taiho Corporation of America
Southfield, MI
Air Conditioner Parts, etc.

Tokai Rika Company, Ltd.
30.1%
Tokai Rika, U.S.A., Inc
Southfield, MI
Electrical Switches

Toyoda Automatic Loom Works, Ltd.
24.8% - 64,954,000[6]

Toyoda Automatic Loom Works
Southfield, MI
Air conditioner Compressors

Toyota Industrial Equipment
Indianapolis, IN
Fork Lifts

Toyoda Machine Works
23.9% - 22,085,000 shares[7]

Toyoda/TRW Machine Works
Morristown, TN
Power Steering Pumps
Joint Venture -
Toyoda Machine Works - Japan
Toyota Tsusho Co - Japan
TRW, Inc MI

Toyoda Machinery USA, Inc.
Howell, MI
Flexible Transfer Lines
Machine Tools

Toyoda Machine USA, Inc.
Arlington Heights, IL
Machine Tools, Robots, etc.

Toyoda Machine USA, Inc.
Wixom, MI
Sales/Mfg , Machine Tools

Toyoda Grinders For Industry
Wixom, MI
Grinders

Toyoda Gosei Co., Ltd.
40.5%

Toyoda Gosei Co., Ltd.
Madison Heights, MI
Sales Office, Plastic Products

TG (U.S.A) Corporation
Madison Heights, MI
Steering Wheels

Trinity Industrial Corp.

Trinity Industrial of America
Georgetown, KY
Paint Finishing Systems

Trinity Industrial Corporation
Livonia, MI

Non-Group Companies With Toyota Ownership Operating in Mid-America

Distribution

Toyota Motor Distribution
Carol Stream, IL
Distribution, Auto Parts

Toyota Motor Distribution
Cincinnati, OH
Auto Allocation
Parts Distribution

Hino Motors

10 3% - 36,062,000 shares

Hino Diesel Trucks (USA) Inc
Des Plaines, IL
Distribution, Trucks and Parts

Research/Development

Toyota Tech Center USA, Inc
Ann Arbor, MI
Emissions R & D
Quality Assurance Evaluation

Toyota Motor Corporate Svcs
Southfield, MI
Engineering, Purchasing

Trading & Commerce

Toyota Tsusho
21.8% - 49,715,000 shares[8]

Toyota Tsusho Corporation
Maryville, TN
Trading Company

Toyota Tsusho America, Inc
Southfield, MI
Trading Company

Toyota Tsusho America, Inc
Georgetown, KY
Processing for Steel, Export/Import - Steel, Machinery, Machinery Parts, automotive Interiors

Finance & Insurance

Chiyoda Fire & Marine Insurance Company, Ltd
40.6% - 129,182,000 shares

Chiyoda Fire & Marine Insurance, Ltd
South Chicago, IL
Insurance

Chiyoda Fire & Marine Insurance, Ltd
Lexington, KY

Japan Storage Battery Company

4 3% - 6,930,000 shares

Enpak, Inc
Memphis TN
Automotive Batteries
Joint Venture -
Japan Storage Battery Co , Japan
GNB, Inc , MN

Kansai Paint Company, Ltd.

3 2% - 7,957,000 shares

Kansai Paint (America), Inc
Troy, MI
Paints

NOK Corporation

4 4% - 6 709 000 shares

NOK Incorporated
Rolling Meadows IL
Oil Fills and Filling Devices

Freudenberg-NOK
General Partnership
Plymoth Township, MI
O ' Seals, Dust Covers O Rings
Joint Venture -
NOK Corporation, Japan
Carl Freudenberg, W Germany

OSG Manufacturing Co.

2 9% - 2,000,000 shares

OSG Tap & Die, Inc
Glendal Heights IL
Distributor, Cutting Tools Taps Dies

Teikoku Piston Ring Co.

7 1% - 1,830,000 shares

Teikoko Piston Ring Co
Northfield, IL
Piston Rings

Toyo Radiator Co., Ltd.

4 7% - 3,537,000

Toyo USA, Inc
Nashville, TN
U S Headquarters

Toyo Radiator Co , Ltd
Northfield, IL
Mfg Radiators, Oil Coolers, etc

CoPar Industries Inc
Hopkinsville, KY
Aluminum, Copper, Brass Radiators

Tsubakimoto Chain Co

4 2% - 7,722,000 shares

Tsubakimoto Precision Products
Chicago IL
Distributor, Bearings

Union Chain Company
Sandusky, OH
Mfg Chains for Machinery

U S Tsubaki Inc
Wheeling, IL
Timing Chain Drive Components

Tsubaki Conveyors of America Inc
Portland TN
Metal Parts for Conveyor Systems

Tsubaki Conveyors of America, Inc
Wheeling IL
Mfg Transmissions, Sprockets, etc

Tsubaki Conveyors of America, Inc
Southfield, MI
Conveyor Systems

Tsubaki Chain Company
Troy, MI
Timing Chains

Banking & Finance

Mitsui Bank, Ltd.

4 3% - 75 754,000 shares

Mitsui Bank Ltd
Chicago IL Banking

Mitsui Taiyo Kobe Bank
Lexington KY
Liaison Office for Banking

Mitsui Trust & Banking Co., Ltd.

1 9% - 21,2000,000 shares

Mitsui Trust & Banking Co Ltd
Chicago IL
Banking

Sanwa Bank, Ltd.

2 3% - 5[illegible] 307,000 shares

Sanwa Business Credit Corp
Chicago, IL
Finance

Sanwa Bank Ltd
Cleveland OH
Representative Office

Sanwa Bank Ltd
Chicago IL
Banking

Sanwa Bank Ltd
Lexington, KY
Banking - Non-Depository

Tokai Bank, Ltd

5 2% - 95 915 000 shares

Tokai Bank Ltd
Chicago IL
Banking

Tokai Bank Ltd
Columbus OH
Representative Office

Tokai Bank, Ltd
Lexington, KY
Banking

Notes: Toyota

1) Source of Data on Toyota Motor Group in Japan *Industrial Groupings In Japan 1990-1991 Edition The Anatomy of the "Keiretsu"*, published by Dodwell Marketing Consultants, Tokyo, Japan

2) All ownership figures in this space are for Toyota Motor Company, Ltd

3) Toyoda Automatic Loom also own 4 6% of Aisin Seiki

4) Nissan Motor Company also owns 6 0% of Koito Mfg (9 543 000 shares)

5) Toyoda Automatic Loom owns 7 6% of Nippondenso Co (54,032,000 shares)

6) Nippondenso company owns 4 3% of Toyoda Automatic Loom Works, Ltd (11,324,000 shares)

7) Toyoda Automatic Loom Works, Ltd owns 6 2% of Toyoda Machine Works (5,741,000 shares)
Nippondenso Company owns 4 2% of Toyoda Machine Works (3,947,000 shares)

8) Toyoda Automatic Loom works owns 10 7% of Toyota Tsusho (24,499 000 shares)

Mid-America Project

Original Research by Mid-America Research

- Chart J -

<u>Toyota Motor Manufacturing Corporation USA:</u> Aside from its joint venture with General Motors at the NUMMI facility in Fremont, California, *Toyota's* only other automobile manufacturing plant in the United States is near Georgetown, Kentucky. *Toyota's* investment in the Georgetown plant initially totaled more than $800 million. An engine plant was added later and in 1991, *Toyota* announced plans to double the size of the assembly facility. From 1988, when *Toyota* began production, to June 1991, *Toyota* produced 500,000 Camry cars at a former cow pasture in central Kentucky.

<u>Toyota Motor Group Affiliates in Mid-America:</u> MAP has identified 23 parts or assembly companies doing business in the US which are also part of *Toyota's keiretsu* structure in Japan. These 23 *Toyota Keiretsu* companies have branched out to a network including 54 auto parts plants, distribution points and offices operating under various names in *Toyota's* "*Keiretsu*, USA." Employment figures indicate that at least 12,000 workers are now employed by the *Toyota* companies in America. Of the 54 mid-American operations of *Toyota's keiretsu* suppliers, 10 are joint ventures. These include other Japanese companies as well as *Toyota Keiretsu* members, ventured with American and West German firms.

<u>Cross-Shareholding Among Toyota Keiretsu:</u> Key members of *Toyota's keiretsu* in Japan - *Toyoda* Automatic Loom, *Toyoda* Machine Works, and *Nippondenso* - each hold large stakes in one another and in the *Toyota* Motor Corporation. *Toyota* Motor holds 23% of *Nippondenso* and *Toyoda* Automatic Loom holds an additional 7.6%, for a total of 30.0%. Similarly, *Toyota* Motor owns 23.9% of *Toyoda* Machine Works, *Toyoda* Automatic Loom owns 6.2%, and *Nippondenso* owns 4.2%, for a total of 34.3%. Not only do these shared equity interests give *Toyota* influence over its member companies, they also provide protection from outside investors. Each of these major *Toyota* affiliates now operates in the US.

From information gathered by MAP, it is clear that *Toyota* uses shareholding leverage to strengthen relationships within its *keiretsu*. In the majority of group operations in the US, *Toyota* holds more than a 20% share of each company. In only four cases does *Toyota* own more than a 50% interest in group companies operating in mid-America. This identified structure of *Toyota's* US affiliates whose parent companies are *Toyota Keiretsu* members in Japan indicates the extent to which *Toyota's keiretsu* has been transplanted to mid-America.

<u>Distribution - R & D - Trading & Commerce - Finance & Insurance:</u> With extensive distribution, research and development, trading and commerce, finance and insurance operations developed throughout the US, the framework of the *Toyota Keiretsu* structure, including these support and guidance operations, has been replicated in mid-America.

__Banking & Finance:__ *Toyota's* extensive banking relationships lend important financial muscle. Originally, *Toyota* was part of the *Mitsui* Group, a horizontal group descended from a pre-war *zaibatsu*. While *Toyota* later broke away from the *Mitsui* group to form its own vertically-organized *keiretsu*, *Toyota* maintains close relations with the *Mitsui Keiretsu* (**Chart E**) and enjoys observer status in *Mitsui's* premier Presidential Council (*Nimoku-Kai*). *Toyota* also serves on *Tokai* Bank's Presidential Council (*Wakaba-Kai*) and holds a 5.2% stake in *Tokai* Bank, one of the world's largest banks.

__Non-Group Companies:__ *Toyota's* ownership interest in 7 non-*Toyota* group companies operating in mid-America demonstrates that traditional *Toyota* suppliers, even though outside the *Toyota Keiretsu*, have followed *Toyota* to mid-America. The total number of operations represented by *Toyota*-related non-group companies is 16. Of these, 2 are identified as joint ventures.

When added to the 54 *Toyota* group companies located in mid-America, the total number of transplant companies with either a direct group relationship or a simple equity/supplier relationship with *Toyota* is 70 (does not include companies which have both *Nissan* and *Toyota* ownership). (**Chart K**)

__Comparison:__ Comparing *Toyota's keiretsu* structure in Japan to the *Toyota* network in the USA reveals that *Toyota* has transplanted essential elements of a *keiretsu* structure to mid-America, and has organized the elements into a group structure patterned after its *keiretsu* in Japan.

Non-Group Companies in Mid-America With Toyota and Nissan Ownership

Akebono Brake Industry Co.,Ltd.

Toyota -
13 3% - 10,533,000 shares

Nissan -
13 4% - 10,649,000 shares

Isuzu -
5 2% - 4,115,000 shares

Hino -
2 4% - 1,899,000 shares

Akebono Brake Systems
Engineering Center
Farmington Hills, MI
Research and Development,
Brake Systems

Akebono America Inc
Northbrook, Il
Distributor, Brake Parts

Ambrake Corporation
Elizabethtown, KY
Mfg, Disc and Drum Brakes
Joint Venture -
Akebono Brake Industry, Japan
Delco Moraine, OH

Jidosha Kiki Co., Ltd.

Toyota -
1 5% - 912,000 shares

Nissan -
1 5% - 876,000 shares

Isuzu -
5 6% - 3,199,000 shares

Jidosha Kiki Company, Ltd
Southfield, MI
Electrical Componets

Bendix-Jidosha Kiki Corp
Gallatin, TN
Vacuum Power Brake Boosters
Joint Venture -
Jidosha Kiki Co, Ltd, Japan
Bendix Div. of Allied Signal, IN

JS Technos Corporation
Russellville, KY
Brake Parts

Kayaba Industry Co.

Toyota -
8 7% - 18,660,000 shares

Nissan -
8 2% - 17,558,000 shares

KYB Industries, Inc
Franklin, IN
Auto Shocks and Struts

KYB Corporation
of America
Lombard, Il
Distributor, Automotive Shock
Absorbers and Hydraulic
Components

Mitsuboshi Belting, Ltd.

Toyota -
4.7% - 4,855,000 shares

Nissan -
8 2% - 17,588,000

MBL (U S A) Corporation
Lombard, IL
Rubber and Polyurethane Belts

MBL (U S A) Corporation
Walled Lake, MI
Machine Products & Tools

Nachi Fujikoshi Corp.

Toyota -
5 8% - 13,182,000 shares

Nissan -
4 2% - 9,577,000 shares

Nachi Technical Center
Plymouth Township, MI
Bearings, Cutting Tools

Nachi Robotic Systems, Inc
Farmington Hills, MI
Industrial Robots and
Related Products

Nachi America, Inc
Elk Grove Village, IL
Importer/Distributor,
Cutting Tools, etc

Nippon Piston Ring Co.

Toyota -
8.6% - 5,522,000 shares

Nissan -
8.9% - 5,670,000 shares

NPR Of America, Inc
Farmington Hills, MI
Sales and Engineering,
Powered Metal Products

Goetze Corporation
of America
Muskegon, MI
Engine/Cylinder Head Gaskets,
Valve Guides, Piston Rings, etc.
Joint Venture -
Nippon Piston Ring, Japan
Goetze AG, W. Germany

Sanoh Industries

Toyota -
9.1% - 2,725,000 shares

Nissan -
9 6% - 2,888,000 shares

Hisan, Inc
Rochester, MI
Sales, Steel Tube for
Brake and Fuel Lines

Hisan, Inc.
Finley, OH
Mfg, Steel Tube and Tube Assemblies
Joint Venture -
Sanoh Industries, Japan
ITT Higbie Mfg, MI

Toyo Tire & Rubber Co.

Toyota -
5 5% - 8,925,000 shares

Nissan -
3 3% - 5,427,000 shares

Toyo Tire (U S A) Corp
Elk Grove Village, IL
Distributor, Tires

- Chart K -

<u>Non-Group Companies with Joint Toyota/Nissan Ownership:</u> Another positive indication of coordination and cooperation among Japanese automakers is the existence of companies in which several competitors share equity. (**Chart K**) There are 10 companies identified in mid-America in which *Nissan* and *Toyota* share ownership, even though the 10 companies are not formally part of either the *Nissan* or *Toyota Keiretsu.*

Labeling these companies "non-group" does not mean that they do not belong to other *keiretsu* groups; only that they do not belong to either the *Nissan* or *Toyota* groups.

The number of locations represented by non-group companies on **Chart K** is 18. When these 18 locations are added to the list of mid-American *Nissan* and *Toyota* group members, and companies in which they hold an equity interest, the totals become 76 for *Nissan* and 88 for *Toyota.* In the joint ownership of these non-group companies, *Nissan* and *Toyota* shares are nearly identical.

Such uniform sharing of equity supports the supposition that *Nissan* and *Toyota* have common and equal access to the output of these jointly owned firms. This reinforces the contention that cooperative relationships throughout the Japanese corporate network extend well beyond the limits of individual *keiretsu* groups.

It is this complex network of homogeneous corporate relationships which has earned the label of "Japan, Inc."

Honda Motor Group Japan*

Honda Motor

Automotive Parts/Machinery

Asama Giken
Atsumi Mfg.
Daiichi Denso Buhin
+Denshi Giken
+F.C.C.
F. Tech
+Hirata Press Industry
Honda Foundry
Honda Lock
+Keihin Carburetor
+Keihin Seiki Mfg.
+Kikuchi Metal Stamping
Marujun Seiki Kogyo
Mitsuba Electric Mfg.
Miyaco Hydraulic Brake Mfg.
+Morikawa Sangyo
+Musashi Seimitsu Industry
+Nissin Kogyo
+Sankei Giken Kogyo
+Seiki Giken Kogyo
+Showa Manufacturing
+Stanley Electric
+Takao Kinzoku Kogyo
Tokyo Rika Mfg.
+Tokyo Seat
+Toyo Denso
+Toyo Roki Seiso
Tausuki Seisakusho
Yachiyo Industry
+Yamashita Rubber
+Yanagawa Seiki
Yutaka Giken

Trading & Commerce

Honda International Sales
Steel Center
Honda Trading

Transportation & Warehousing

ACT Maritime
Komyo Co,
+Honda Express

Real Estate

Honda Kaihatsu

Service Industry

Suzuka Circuit Land
Honda Airways

Laboratories

Honda Engineering
Honda Access

Finance

Honda Finance

*Source: Dodwell Marketing Consultants, Tokyo Japan. *Industrial Groupings in Japan: The Anatomy of the "Keiretsu" - Ninth Edition* and *The Structure of the Japanese Auto Parts Industry - Fourth Edition.*

- Chart L -

Honda Keiretsu

The post-war development of the *Honda* corporate structure is responsible for some visible contrasts with operations of older, more traditional Japanese auto transplants. For instance, *Honda* was the first of the major Japanese auto assemblers to establish substantial production operations in mid-America.

Of all of the Japanese transplants, *Honda* has tried hardest to cultivate the notion that it is "Americanized". This was effectively proclaimed in a series of national magazine and newspaper articles. [82] *Honda's* on-going advertising program attempts to reinforce this perception. [83]

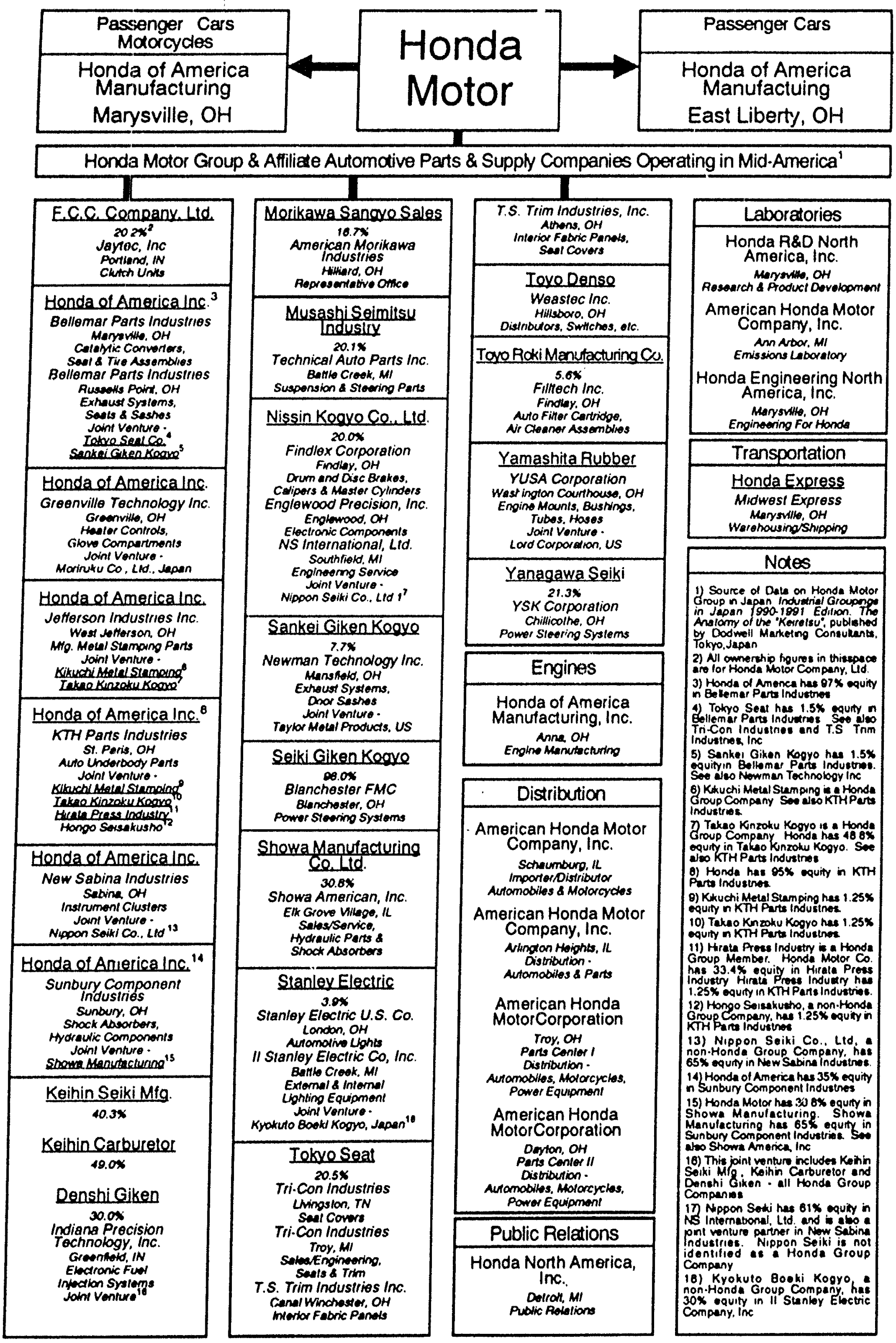
Honda attempts to justify its claim to a high level of "Americanization" by emphasizing the "local content" of parts and supplies which go into their vehicles. *Honda* also published their corporate goal of "Increasing domestic content of Ohio-built autos and motorcycles to 75 percent in 1991." [84] With *Honda* selling more vehicles in the USA than in Japan, the obvious strategy is to sell the notion that *Honda* is as American as General Motors.

The question of what represents "local content" has apparently not been fully answered. An April 1991 study by the University of Michigan [85] reveals that "... only 16 percent of the Accord's parts and 20 percent of the Civic's come from 'traditional' US suppliers - a group that excludes Japanese parts makers doing business here and US-Japan joint ventures." [86]

> Thus, legitimate questions arise as to whether Japanese firms and joint ventures should be considered 'domestic'... many see *Honda's* efforts as little more than a public relations exercise. They argue that *Honda* exaggerates the portion of the car's components - about 70 percent - that come from the United States ... to blunt criticism of its success against the Big Three car makers ... "*Honda's* self-proclaimed Americanization is a myth", said Sheldon Friedman, director of research for the union [UAW]. [87]

Honda denies it has a *keiretsu*. Roger Lambert, *Honda* company spokesman, told Associated Press, "*Honda* does not participate in *keiretsu* and never has been organized in that way". [88]

Dodwell Marketing Consultants, the accepted authority on *keiretsu* in Japan, has constructed a picture of *Honda's keiretsu*. (**Chart L**) Like *Nissan* and *Toyota*, *Honda* has replicated its *keiretsu* structure in mid-America. (**Chart M**)



Passenger Cars
Motorcycles
Honda of America Manufacturing
Marysville, OH
Honda Motor
Passenger Cars
Honda of America Manufactuing
East Liberty, OH
Honda Motor Group & Affiliate Automotive Parts & Supply Companies Operating in Mid-America[1]
F.C.C. Company, Ltd.
20.2%[2]
Jaytec, Inc
Portland, IN
Clutch Units
Honda of America Inc.[3]
Bellemar Parts Industries
Marysville, OH
Catalytic Converters, Seat & Tire Assemblies
Bellemar Parts Industries
Russells Point, OH
Exhaust Systems, Seats & Sashes
Joint Venture - Tokyo Seat Co.[4] Sankei Giken Kogyo[5]
Honda of America Inc.
Greenville Technology Inc.
Greenville, OH
Heater Controls, Glove Compartments
Joint Venture - Moriruku Co., Ltd., Japan
Honda of America Inc.
Jefferson Industries Inc.
West Jefferson, OH
Mfg. Metal Stamping Parts
Joint Venture - Kikuchi Metal Stamping[6] Takao Kinzoku Kogyo[7]
Honda of America Inc.[8]
KTH Parts Industries
St. Paris, OH
Auto Underbody Parts
Joint Venture - Kikuchi Metal Stamping[9] Takao Kinzoku Kogyo[10] Hirata Press Industry[11] Hongo Seisakusho[12]
Honda of America Inc.
New Sabina Industries
Sabina, OH
Instrument Clusters
Joint Venture - Nippon Seiki Co., Ltd[13]
Honda of America Inc.[14]
Sunbury Component Industries
Sunbury, OH
Shock Absorbers, Hydraulic Components
Joint Venture - Showa Manufacturing[15]
Keihin Seiki Mfg.
40.3%
Keihin Carburetor
49.0%
Denshi Giken
30.0%
Indiana Precision Technology, Inc.
Greenfield, IN
Electronic Fuel Injection Systems
Joint Venture[16]
Morikawa Sangyo Sales
16.7%
American Morikawa Industries
Hilliard, OH
Representative Office
Musashi Seimitsu Industry
20.1%
Technical Auto Parts Inc.
Battle Creek, MI
Suspension & Steering Parts
Nissin Kogyo Co., Ltd.
20.0%
Findlex Corporation
Findlay, OH
Drum and Disc Brakes, Calipers & Master Cylinders
Englewood Precision, Inc.
Englewood, OH
Electronic Components
NS International, Ltd.
Southfield, MI
Engineering Service
Joint Venture - Nippon Seiki Co., Ltd 1[17]
Sankei Giken Kogyo
7.7%
Newman Technology Inc.
Mansfield, OH
Exhaust Systems, Door Sashes
Joint Venture - Taylor Metal Products, US
Seiki Giken Kogyo
98.0%
Blanchester FMC
Blanchester, OH
Power Steering Systems
Showa Manufacturing Co. Ltd.
30.8%
Showa American, Inc.
Elk Grove Village, IL
Sales/Service, Hydraulic Parts & Shock Absorbers
Stanley Electric
3.9%
Stanley Electric U.S. Co.
London, OH
Automotive Lights
II Stanley Electric Co, Inc.
Battle Creek, MI
External & Internal Lighting Equipment
Joint Venture - Kyokuto Boeki Kogyo, Japan[18]
Tokyo Seat
20.5%
Tri-Con Industries
Livingston, TN
Seat Covers
Tri-Con Industries
Troy, MI
Sales/Engineering, Seats & Trim
T.S. Trim Industries Inc.
Canal Winchester, OH
Interior Fabric Panels
T.S. Trim Industries, Inc.
Athens, OH
Interior Fabric Panels, Seat Covers
Toyo Denso
Weastec Inc.
Hillsboro, OH
Distributors, Switches, etc.
Toyo Roki Manufacturing Co.
5.6%
Filtech Inc.
Findlay, OH
Auto Filter Cartridge, Air Cleaner Assemblies
Yamashita Rubber
YUSA Corporation
Washington Courthouse, OH
Engine Mounts, Bushings, Tubes, Hoses
Joint Venture - Lord Corporation, US
Yanagawa Seiki
21.3%
YSK Corporation
Chillicothe, OH
Power Steering Systems
Engines
Honda of America Manufacturing, Inc.
Anna, OH
Engine Manufacturing
Distribution
American Honda Motor Company, Inc.
Schaumburg, IL
Importer/Distributor
Automobiles & Motorcycles
American Honda Motor Company, Inc.
Arlington Heights, IL
Distribution - Automobiles & Parts
American Honda MotorCorporation
Troy, OH
Parts Center I
Distribution - Automobiles, Motorcycles, Power Equipment
American Honda MotorCorporation
Dayton, OH
Parts Center II
Distribution - Automobiles, Motorcycles, Power Equipment
Public Relations
Honda North America, Inc.
Detroit, MI
Public Relations
Laboratories
Honda R&D North America, Inc.
Marysville, OH
Research & Product Development
American Honda Motor Company, Inc.
Ann Arbor, MI
Emissions Laboratory
Honda Engineering North America, Inc.
Marysville, OH
Engineering For Honda
Transportation
Honda Express
Midwest Express
Marysville, OH
Warehousing/Shipping
Notes
1) Source of Data on Honda Motor Group in Japan Industrial Groupings in Japan 1990-1991 Edition. The Anatomy of the "Keiretsu", published by Dodwell Marketing Consultants, Tokyo, Japan
2) All ownership figures in thisspace are for Honda Motor Company, Ltd.
3) Honda of America has 97% equity in Bellemar Parts Industries
4) Tokyo Seat has 1.5% equity in Bellemar Parts Industries. See also Tri-Con Industries and T.S. Trim Industries, Inc
5) Sankei Giken Kogyo has 1.5% equityin Bellemar Parts Industries. See also Newman Technology Inc
6) Kikuchi Metal Stamping is a Honda Group Company. See also KTH Parts Industries.
7) Takao Kinzoku Kogyo is a Honda Group Company. Honda has 48.8% equity in Takao Kinzoku Kogyo. See also KTH Parts Industries
8) Honda has 95% equity in KTH Parts Industries.
9) Kikuchi Metal Stamping has 1.25% equity in KTH Parts Industries.
10) Takao Kinzoku Kogyo has 1.25% equity in KTH Parts Industries.
11) Hirata Press Industry is a Honda Group Member. Honda Motor Co. has 33.4% equity in Hirata Press Industry. Hirata Press Industry has 1.25% equity in KTH Parts Industries.
12) Hongo Seisakusho, a non-Honda Group Company, has 1.25% equity in KTH Parts Industries
13) Nippon Seiki Co., Ltd, a non-Honda Group Company, has 65% equity in New Sabina Industries.
14) Honda of America has 35% equity in Sunbury Component Industries
15) Honda Motor has 30.8% equity in Showa Manufacturing. Showa Manufacturing has 65% equity in Sunbury Component Industries. See also Showa America, Inc
16) This joint venture includes Keihin Seiki Mfg., Keihin Carburetor and Denshi Giken - all Honda Group Companies
17) Nippon Seiki has 61% equity in NS International, Ltd. and is also a joint venture partner in New Sabina Industries. Nippon Seiki is not identified as a Honda Group Company
18) Kyokuto Boeki Kogyo, a non-Honda Group Company, has 30% equity in II Stanley Electric Company, Inc

- Chart M -

<u>Honda of America Manufacturing:</u> *Honda* Motor's first US investment was for the construction of a motorcycle facility in Marysville, Ohio which started production in 1979. This was closely followed by the announcement of *Honda's* intention to build an auto assembly plant at the same location.

Honda began auto production at Marysville in 1982, having by then invested over $800 million in US production plants. Marysville, Ohio is *Honda's* flagship complex, with assembly and related parts manufacturing facilities. By 1984, *Honda* announced it would double its US car production to 300,000 cars per year and has since completed a second auto assembly plant at East Liberty, Ohio. *Honda* was the first Japanese company to build an automobile in the US and the first to locate two wholly-owned auto production facilities in mid-America.

<u>Honda of America Ownership:</u> Unlike *Nissan* or *Toyota*, several *Honda* supply firms in mid-America are owned directly by *Honda's* US subsidiary, *Honda* of America, Inc. Such direct ownership is usually shared with other *Honda* Group companies and with Japanese manufacturers not in the *Honda* group. Examples of directly owned inter-group joint ventures include Bellemar Parts Industries, Jefferson Industries, KTH Parts Industries (one KTH joint venture partner is not in the *Honda* Group), and Sunbury Component Industries. Examples of equity-sharing with non-*Honda* group companies include Greenville Technology, Inc. and New Sabina Industries.

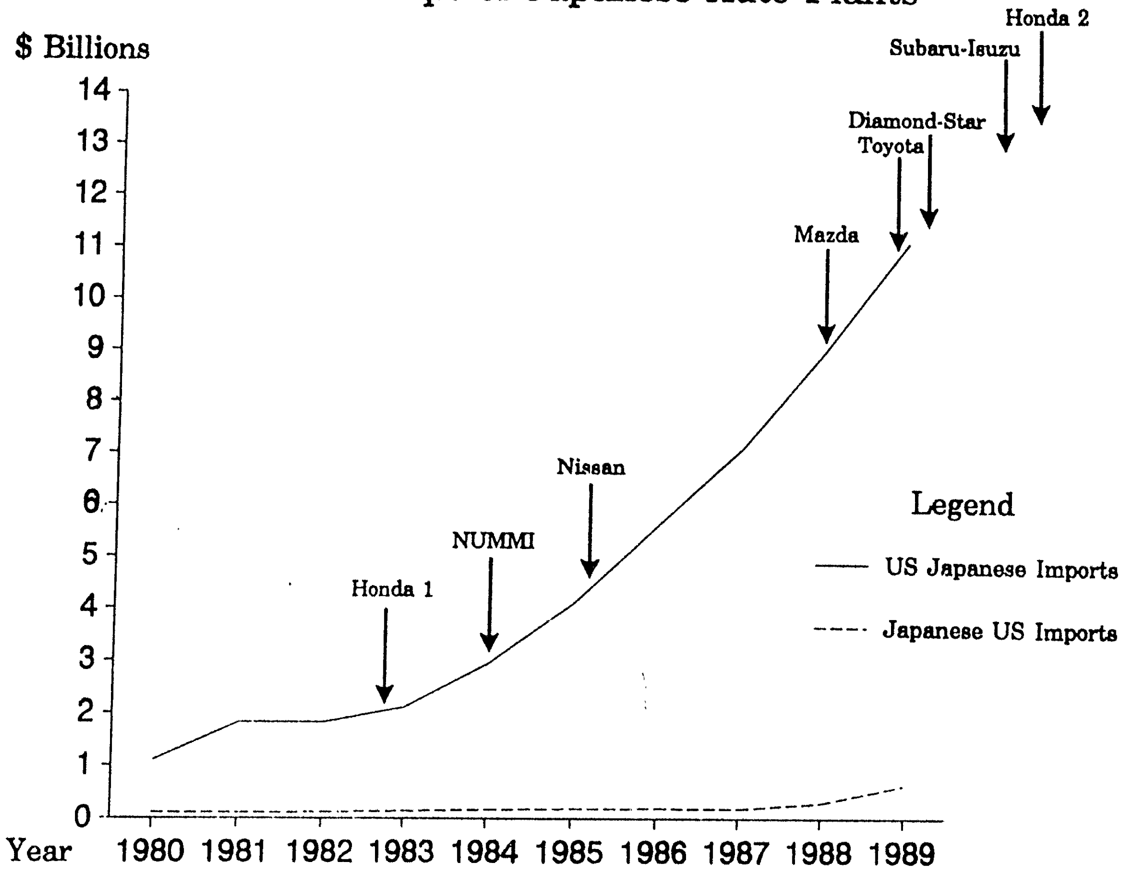
Although *Honda's* suppliers are purportedly not organized into *kyoryokukai*, it appears that *Honda* exercises control over its mid-American suppliers through joint ventures in which Honda has a direct, often a majority, equity interest.

<u>Honda Motor Group Affiliates in Mid-America:</u> At present, 19 of *Honda's* main Japanese *keiretsu* parts and machinery companies have established operations in mid-America. Affiliated operations of these 19 main group companies in mid-America total 27. When *Honda's* affiliated engine, distribution, transportation, laboratory and public relations operations are added, the total becomes 37.

Joint ventures among the 27 affiliated parts and machinery companies total 11. Of the 11 joint ventures, 4 are joint ventures among *Honda* group companies; 4 are joint ventures between *Honda* group companies (including *Honda* of America) and non-*Honda* group Japanese companies; 1 is a combination of *Honda* companies and a non-*Honda* group company; and 2 include *Honda* group members and American firms (Newman Technology Inc. and YUSA Corporation).

<u>Comparison:</u> Comparing *Honda's keiretsu* structure in Japan to the *Honda* network in mid-America reveals that *Honda* has transplanted essential elements of its *keiretsu* structure to mid-America, and has organized the elements into a group structure patterned after its *keiretsu* in Japan.

US Imports of Japanese Auto Parts
and Start-ups of Japanese Auto Plants



Source: Department of Commerce and USITC

- Chart N -

Many Americans praised the introduction of Japanese auto plants into the US and have supported generous cash and tax incentives given to these firms in the quest for jobs. Even so, the apparent impact of this trend on domestic auto production raises serious questions as to the wisdom of such a policy. A recent General Accounting Office (GAO) report concluded, "The manufacture of Japanese cars in the United States cost Americans 36,000 jobs in 1988 and 1989." [89] Not only has this impact been felt in direct job loss, it has also significantly impacted the Japanese/American trade imbalance.

US Automobile Plant Openings and Closings [90]

JAPANESE TRANSPLANT OPENINGS

1982 - Honda, Marysville, OH
1983 - Nissan, Smyrna, TN
1984 - Toyota/GM, Fremont, CA
1987 - Mazda, Flat Rock, MI
1988 - Mitsubishi/Chrysler, Normal, IL
1988 - Toyota, Georgetown, KY
1989 - Subaru/Isuzu, Lafayette, IN
1989 - Honda, East Liberty, OH

US PLANT CLOSINGS

1987 - GM, Norwood, OH
1988 - GM, Leeds, MO
1988 - Chrysler, Kenosha, WI
1988 - GM, Pontiac, MI
1989 - GM, Framington, MA
1990 - GM, Lakewood, GA
1990 - Chrysler, Detroit, MI
1990 - Chrysler, St. Louis, MO

Such impacts were foretold by former US Trade Representative Clyde Prestowitz, who in 1986 cautioned a group of Kentucky Congressmen visiting Japan, "... that for every Japanese plant that opened in Kentucky, an American one in Michigan was likely to close." [91] While Prestowitz was referring to auto parts supply plants, his statement applies precisely to auto assembly plants since, "The eight assembly plants that the Japanese built in the U.S. in the 1980's put precisely that many Big Three car factories out of business in the past three years." [92]

Market Impact: The issue for American business is not whether Japanese companies are more competitive and American companies less competitive. At issue is whether or not American policy makers will allow the continued existence of an internal market system which is not designed merely to compete, but is structured and deployed to systematically eliminate competition.

> The *keiretsu* form of industrial organization is one of Japan's most important contributions to modern capitalism. At the same time it clearly violates Western conceptions of anti-trust and makes a mockery of much of the economic theory that is predicated on the workings of "market forces." Western nations have yet to come up with a competitive match for Japanese *keiretsu*, and the problem is becoming acute as *keiretsu* relationships are extended to North America and Western Europe through direct investment by Japan. [93]

> The Japanese *keiretsu* system may be more efficient economically. Diamond-Star can produce a car more cheaply than General Motors or Ford in part because of its new low-cost base in Illinois, but also because it has so many members of the *Mitsubishi* group willing and able to accept such a low rate of return for a sustained period of time. These companies, all dedicated to enhancing *Mitsubishi's* role in the auto industry over the course of decades, also do not face pressure to enhance shareholder value or to pay big dividends. There is no contest in terms of the scale of the competing organizations. If General Motors or Ford tried to establish the same degree of vertical integration as the *Mitsubishi* group, there would be howls of indignation. If it is bad for an American company to be vertically integrated inside the United States, why is it good for a Japanese company? In effect, the U.S. government has one set of rules that apply to American companies in America, and another set that applies to Japanese companies in America. [94]

> Nowhere is that fallout more striking than in the auto-parts industry. Japanese suppliers, following Japanese auto makers here, are squeezing out U.S. primary parts manufacturers, and the increased competition and bad times in Detroit have forced the Big Three to consolidate supplier bases by abandoning suppliers of lesser quality. As a result, the number of U.S. suppliers has shrunk 35% to 2,200 from 3,400 in 1979, according to Automotive Parts International, a trade publication. Some have been swallowed by larger companies, others have dropped to the level of subcontractor, and still others have folded. During the same period, the Japanese suppliers in the U.S. have grown more than 600%, to 280 from fewer than 40. The total is expected to hit 300 sometime in 1991. [95]

While US free market rules compel companies to **compete for market-share,** *keiretsu* market rules encourage companies to **cooperate to share the market.**

Labor Impact: The clearest *keiretsu* impact on US labor is the loss of jobs. Fewer workers are employed by US auto firms as imports and transplants replace US assembly and parts manufacturing. The United Auto Workers estimates that 225,000 production jobs, union and non-union, have been lost in the auto industry since 1978. The Japanese auto *keiretsu* have built new factories which are not unionized, "... competing with or replacing unionized facilities. In this case, union jobs have been replaced by non-union jobs." [96]

> The UAW has estimated the number of jobs required to produce the parts that go into a car. A traditional Big Three assembly plant, which turns out 200,000 cars annually, purchases approximately 90% of the value of the parts and supplies for its vehicles in North America. This generates about 25,000 additional jobs. A similar transplant assembly plant buys only about 30% of its parts and supplies locally and generates employment of around 7,000. For every 200,000 Big Three cars displaced by transplants, then, more than 15,000 parts and supplier workers in North America lose their jobs, according to the UAW estimate. [97]

> The most important reason the Japanese favor peripheral areas like the South is the absence of labor unions, the first definition of 'good' labor-management relations. [98]

> The structuring of the Japanese union on a company rather than an industry or skill basis adds to the mutual benefit feeling within the corporation. To ensure life long employment for its members, the unions allow contract or part-time non-union employees as well as liberal sub-contracting to cover peak or seasonal demands [40% of workers in ship building]. This together with the bonus system allows the employer a more variable wage bill and reduces the cost problems of the life long employment system; much business risk is simply passed on to the workers. This of course also causes under-employment and in 1975 the Research Department of the Industrial Bank of Japan estimated over 2 million workers were still employed largely as a result of the life employment system.
>
> The executives of a company union, indeed, are watched closely by management for their talent in handling negotiations. The chairman of the struggle committee who drives the company to its knees by hard bargaining will be promoted to management. If he behaves himself thereafter, five years later he may be handling labor negotiations for the company. [99]

> The bottom line of Japanese corporations concerning the question of unionization is whether the unions are willing to work together with management to productively promote what I call humanware technology. This has been the forte of Japanese management during the development of industrial relations in postwar Japan. [100]

Keiretsu labor/management philosophy is diametrically opposed to that of US free trade unionism, which does not tolerate a view of people as "humanware."

Equal Opportunity Impact: During the early 1980s, Japanese development in the US was the subject of sporadic media reports, many extolling the benefits of newly created jobs and business opportunities. In the 1990s, both the tone and the frequency of press reports have altered dramatically.

No longer uniformly positive, the press now routinely reports job losses, plant closings and the growing concerns of Americans about the level and nature of Japan's increasing influence in the USA. One subject that has been featured prominently is the alleged tendency of *keiretsu* transplant companies to discriminate against Americans employed by companies they acquire.

> ... some mighty names in Japanese industry - *Matsushita, Sumitomo, NEC* Electronics - settled lawsuits charging discrimination against American managers during the last year ... critics say Japanese companies in the United States are top-heavy with Japanese managers. Japanese men hold more than half of the top 20 or so management jobs in many Japanese banks and trading companies in America, and sometimes all but one or two. The proportions are smaller in most manufacturing companies, but they still far exceed the proportions of Europeans in the top ranks of European companies in America, or of Americans in American companies abroad ... the Japanese share a common tradition and approach to doing business, they say, it is simply more efficient and comfortable for them to look to themselves for leadership, at least for now. [101]

Job Safety Impact: The incidence of repetitive-motion injuries on *keiretsu* factory production lines is a subject of growing concern. The "just-in-time" production system pioneered by Japan's manufacturers is famous for production line speed and worker efficiency, but there is a price to pay for increased "tach speed," or the pace of the assembly or production line. Unfortunately, that price is paid primarily by the line worker.

Workers injured at *Toyota's* Georgetown, Kentucky assembly plant have formed a support group, "Injured Workers of Kentucky." *Toyota*, currently the object of United Auto Workers organizing efforts, is the company credited with developing the "just-in-time" or "lean production" system in the 1950s. According to Jacky Ammerman, one of the support group organizers, *Toyota* workers are fearful about discussing in-plant conditions, even their on-the-job injuries.

> "A lot of people are afraid," she said. She urged the five who did not attend [the organizational meeting] to tell their friends that they are participants and that "there's nothing to be afraid of." Ammerman, Lisa Crawley and Margaret Rice - founders of the organization - were injured at the *Toyota* Motor Manufacturing Inc. plant in Georgetown. ... all three have or are thought to have thoracic-outlet syndrome, a repetitive-motion injury that causes disabling pain and swelling in the hands and arms. "Very few people know our lives as we are forced to live them," Crawley said ... "you can't shop alone, can't even take out the garbage ... you wonder if you'll be able to rock your grandchildren." [102]

Conclusion

Alliances of clans and classes has been the central dynamic of Japanese culture for many centuries, and generally describes the Japan of 1991. As the relatively new concept of **individual liberty and freedom** is the central theme of American thought and institutions, so the much older value system of group alliances and loyalty is the primary base of Japan's self-view and world-view.

Respectively, these vastly different value-views form the basis of personal and national ethics in the US and Japan. Resolution of conflicts produced by Japan's growing influence inside the US will require a mutual sympathy for these respective points of view. Even so, it's difficult for cultures to empathize when their basic value systems oppose one another at such sharp angles.

From Japan's perspective, the *keiretsu* concept is shielded from criticism on ethical or moral grounds, as *keiretsu* premise and practice are based on the highest order of national and personal values - group loyalty. On the other hand, America's ethical base values individual freedom ahead of group loyalty and ranks independence above conformity. Thus, when either Japan or the US attempts to practice their respective "golden rule" on one another, the perverse result describes what must be the **mother of all international paradoxes.**

How can America open "closed Japan?" How does America include Japan in a "free and open" society, when "free and open" has quite different connotations to each nation? To America, "open markets" mean fair and unrestricted markets. By US "free market" reckoning, integrity of the free market mechanisms is more highly valued than market product or producers. Based on faith as much as on practical utility, this reflects American reinforcement of the liberty concept.

How can Japan enclose "open America?" How can Japan include the open US business structure in an exclusive Japanese market system with structured biases against outsiders? To Japan, "open markets" mean markets which are accessible to *keiretsu* products and services. As product and producer are the Japanese priorities, the US should logically form or join *keiretsu* ..., but here, the paradox takes firm hold on Japan, whose social structure precludes assimilation of *gaijin*, or foreigners. This cultural bias is at once strength and weakness, a device for Japan's perpetual reinforcement of the group loyalty concept.

For Americans who think Japan susceptible to American logic or reason, the experience of the "Blue-eyed *Shogun*," Douglas MacArthur, should be instructive. Given full authority over Japan, exceeding even the prerogatives of the Emperor, MacArthur's best efforts at structural reform produced few fundamental changes. Beyond beginning cultural liberation of Japanese women and major land ownership reform, the Allied Occupation changes intended to eliminate group control of wealth and power in Japan turned out to have been illusory, the specific change of *zaibatsu* into *keiretsu*, functionally cosmetic.

Despite the warnings of those who believe that US/Japanese relations must be considered outside the cultural framework, it must be acknowledged that the fundamental precepts of the US and Japan are opposites, where independent West meets interdependent East. Until this admission takes place, understanding can not begin. Still, there is agreement in the US that something must be done about Japan, Inc. Proposals on America's most appropriate belated response fall generally into three categories: **negotiation, competition, or conversion.**

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Negotiation: Despite interminable rounds of US/Japan trade discussions, no satisfactory resolution is yet in sight. American trade policy refuses to officially acknowledge the reality of the systemic collusion which is *keiretsu*. Aside from isolated outbursts of frustrated individuals, US trade and foreign policy continue to operate on the simple-minded (or deliberately deceptive) premise that Japan is identical to America, with similar institutions, goals, and values. Of all the peculiar aspects of our love-hate relationship with Japan, America's willful self-deception is the strangest, and most dangerous.

The not-so-simple truth is that Japan is ice to American fire, the epitome of difference. To think our differences subject to resolution by pretending otherwise is a guarantee of disappointment. If Douglas MacArthur and the Allied Occupation couldn't fundamentally alter Japan with ultimate authority, what piddling chance might we have today with none? We surely can't believe that trade negotiations might succeed where martial edicts failed.

Despite the best efforts of a generation of trade negotiations, tangible results are difficult to find, and produce disillusion and frustration as often as solution. Aside from the difficulty of qualifying the substance of an agreement, it is often hard to tell when agreement has been reached. Even the concept of "yes" means different things to the US and Japan.

The incessant rounds of "talks" and "agreements" will most likely furnish busy-work for the growing ranks of "trade experts," job security for cadres of Japanese and American bureaucrats. In any event, any agreement on principles or practices will be difficult to enforce, given the transparency of the *keiretsu* system. Negotiations can not resolve the basic conflict.

Competition: The traditional free market view holds that the US must redouble efforts to foster competition globally, removing all trade barriers to create a global "free trade zone" where all nations operate under a common set of rules, and are theoretically equal. It should be evident that this would yield even greater advantage to Japan's *keiretsu* combines, which would continue to operate as a separate, not integral, part of any global market. In addition, any established rule is subject to *keiretsu* interpretation.

> For now, Japanese firms have a measure of protection from legal action and/or public censure because of conflicting perceptions and ideologies among Americans on the effects of *keiretsu*. However, in their own interest and in the interest of bilateral economic harmony, it is to the advantage of Japanese *keiretsu* firms to actively explain why they, unlike firms in other nations, prevent or severely restrict sales of OE (original equipment -auto parts suppliers) to U.S. distributors and importers. If no adequate explanation can be offered, they must desist from the practice. The political costs of the failure to explain this practice are mounting. [103]

Recent efforts of The Federal Trade Commission to investigate "alleged" collusion among Japan's US transplants illustrates the difficulty of applying US standards to Japanese activity. [104] It is unlikely that much hard evidence of illegal conspiracy or specific anti-trust violation will be found in the US precincts of the Japanese *keiretsu*. While the production end of *keiretsu* is evident in mid-America, the brains and business end remain safely in Japan, beyond the jurisdiction, or even comprehension, of US courts and regulators. [105] While both the US and Japan may agree that competition must be free and fair, the vastly different views on when these conditions occur accelerate national disagreements, in direct proportion to the level of competition.

<u>Conversion:</u> A competing view holds that US education, finance and commerce systems must adopt Japanese methods. This strategy is advocated by those who apparently fear the ultimate results of unresolved trade frictions with Japan more than they fear the economic trauma and dislocation such conversion would produce. This "if you can't beat 'em, join 'em" approach is proposed as being necessary to guarantee America's global competitiveness. Structural conversion advocates focus narrowly on the trade and finance aspects of the problem.

Conversion proposals to adopt features of the *keiretsu* banking system, for example, would be no mere technical adjustment for US banks, but would represent a macro-change for the entire US economy. Central *Keiretsu* banks hold equity interest in group corporations, favoring their own equity holdings at the expense of other businesses. The inevitable lending bias restricts competition by starving otherwise viable companies of affordable expansion capital.

Removing existing US restrictions on bank ownership of clients, now a keystone of the US free enterprise system, would start a chain reaction of economic events which would reverberate through the entire framework of US finance and corporate law. The banking question may be academic, as the *keiretsu* appear to be rapidly "adopting" the US financial system by investment, merger and direct acquisition.

> In the 1980s, Japan solidified its place as the world's largest creditor nation by purchasing Wall Street know-how. Since 1985, Japanese investment in the finance industry has ranked second in terms of both dollars and deals ... *Nikko* Securities bought its 20% stake in the (Blackstone Group) firm ... For about $500 million each, *Sumitomo* Bank bought 20% of Goldman Sachs, and *Nippon* Life Insurance picked up 20% of Shearson Lehman ... [106]

In addition to business and banking impacts, conversion to the Japanese economic model would dramatically impact US labor. As US employers look with envy on Japan's industrial "peace and harmony" and contrast the apparent dedication of Japan's workforce with the independent attitudes of their American employees, they should also take the time to count the cost Japan has paid. **What the Japanese people trade for industrial "peace and harmony" is "liberty,"** that premier American birthright, now all too little understood or appreciated.

The "peace and harmony" quotient in the Japan success equation is not the product of any careful "balance" between capital and labor. It is rather the total absence of any form of liberty or workplace democracy which requires balancing. As the *keiretsu* network expands throughout the world, Americans must recall that the success of present-day "Japan, Inc." was built by the toil, sweat and unimaginable sacrifice of an entire generation of Japanese people.

Of all the various proposals, structural conversion of the US economy to the *keiretsu* model is the most frightening. Such change would produce a modern-day mirror image of the radical economic changes wrought by the *Meiji* government in 19th Century Japan. The magnitude of shock to the high-tech, industrialized economy of the USA and its 250 million people would be impossible to calculate.

__The Bottom Line:__ The basic question is no longer what is, or is not, fair. It has become a question of whether the United States will continue to be "**America**" or will become "**Keiretsu, USA.**" The answer to that question depends on whether America's private citizens, business and union leaders, and public officials say "**yes**" or "**no**" to *keiretsu*. Most have not yet been asked.

Lacking Japanese traditions or mechanisms for "group concensus", our US alternative is general debate, yet that debate, which should have taken place twenty years ago, has not begun. We are late - very late - in even fashioning the question. Our energies are now expended in "effect" arguments, instead of striving to reach for the root causes of friction with Japan. The focus must turn now to causes, and to an honest, even if painful, recognition of *keiretsu*.

> Through the *keiretsu*, the Japanese transfer strong industry ties to the United States and build a separate economic structure of assemblers and suppliers, avoiding ties with local industry. Evidence of this process is already present in the Japanese-American auto industry. The strong, but often hidden vertical linkages among Japanese companies can inhibit and destroy U.S. competitors. [107]

The euphoric welcome Japanese *keiretsu* factories receive when they announce their locations in American towns and counties is reminiscent of the Trojans' joy when they first viewed the Trojan Horse. The historical warning that sad episode produced, "Beware of Greeks bearing gifts," seems to be lost on this generation of Americans, or has at least escaped the attention of US economic development officials. If "Greeks bearing gifts" warrant suspicion, surely some degree of caution should be reserved for "Japanese bearing jobs."

America is allowing economic development desperation to rule public policy. Governors and state legislators who queue up to reward *keiretsu* transplants with hundreds of millions of public "incentive" dollars seem oblivious to any danger. They do not acknowledge that the magnificence of Japan's industrial expansion into America disguises an older, darker side of *keiretsu* - that *keiretsu* create and maintain static social structures, not based on rules of equal opportunity, but on ancient martial "clan and class" distinctions.

For more than a thousand years, Japan's warriors and planners have studied from the same text on offensive strategy, the writings of Sun Tzu. According to Colonel Nishiura Susumu of the War History Office of the Japanese Defense Agency, "Over one hundred separate editions of the Sun Tzu have been published in Japan, including one devoted to the application of his principles of war to commerce." [108] Sun Tzu's martial caveats, nearly twenty five hundred years old, are once again put to the test by Japan's current economic offensive:

> **The best policy is to take a state intact; to ruin it is inferior to this. Thus, those skilled in war subdue the enemy army without battle. They capture his cities without assaulting them and overthrow his state without protracted operations ... Your aim must be to take All-under-Heaven intact. This is the art of offensive strategy.** [109]

As long as free trade/free market dogma prevents an open and honest debate of Japanese trade and investment impact on America, the *keiretsu* may do much as they please in the USA. Americans must understand that *keiretsu* are not mere engines of free market competition, but are vast and powerful forces which are structured and deployed to wage and win a global economic war.

Recommendations

Unfortunately, the primary official US interface with *keiretsu* transplants and their supporting networks is a complex of competing economic development agencies of state and local governments. These agencies have facilitated the importation of *keiretsu*, competing to award the most generous public subsidies and tax abatements, by fast-tracking environmental permits, and by generally leading the public relations cheering section for Japan and Japanese investors.

None of this public generosity acknowledges critical differences between American and Japanese values and attitudes. *Keiretsu* is much more than an economic theory or a business system. *Keiretsu* or its predecessor forms have been the way of life for generations of Japanese. Lacking some enlightened US response, *keiretsu* may also become a way of life for unknowing Americans.

America has the tools to contain *keiretsu* problems, if it can find the will to use them. Effective public policy requires that regulatory agencies of the Federal, state and local governments, not their economic development offices, become the principal US interface with transplanted Japanese corporations.

* **<u>The US Congress</u> must enact anti-trust laws which can not be exploited by foreign-based economic systems; enact registration requirements for foreign investors; prohibit public subsidies and tax abatements for foreign corporations; restrict direct lobbying by foreign businesses.**

* **<u>Tax collection agencies</u> should regularly audit "cost transfer" and international accounting procedures of all foreign companies' US subsidiaries, affiliates and joint venture partners to determine full tax liability and ensure full tax payments.**

* **<u>Labor departments</u> should give priority to investigating employee hiring, pay, promotion, layoff, fringe benefit and job safety practices of all foreign-owned business operations in the US, to guarantee that Federal and state labor laws and regulations are obeyed.**

* **<u>Environmental agencies</u> should review environmental histories of foreign industrial corporations, and closely monitor the operations of their transplanted industries in the USA to guarantee complete and consistent environmental protection compliance.**

If adequately informed, Americans have the common sense and the courage to arrest the development of *keiretsu* structures and *keiretsu* philosophy in the USA. We owe that much to America's children, and to the children of Japan. The inexorable advance of *keiretsu*, if not soon contained, may be the catalyst for world conflict not imagined even in this violent century.

America's unequivocal answer to *keiretsu* must be "no."

Endnotes

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Postscript

* **6/08/91 CIA-Funded Study Says Japan Lacks Global Responsibility:** "The draft document, titled 'Japan 2000,' terms the Japanese 'racist' in their tendency to discriminate against ... foreigners. ... Japan is an economic superpower whose world dominance appears inescapable and incontrovertible, absent some dramatic unified reassertion of Western intent ..." Washington Post, Paul F. Horvitz, International Herald Tribune.

* **6/11/91 Bush Brother Said to Aid Firm Tied to Japan Mob - Help Reportedly Given in Buying Company:** "Bush [Prescott] was hired as a $250,000 consultant, according to SEC documents." Washington Post, Kathleen Day and Paul Blustein.

* **6/16/91 Meanwhile, the Meltdown in Motor City - This Time, America's Big Three Automakers May Be Headed for the Scrap Heap:** "We can quibble about details, so long as we don't delay until irreparable damage has been done to domestic auto manufacturers and parts suppliers. If the problems are not addressed now with autos, we will be facing the same situation in five years with the computer and other flagship industries ..." Washington Post, Kevin L. Kearns, Economic Strategy Institute.

* **6/17/91 A Japanese Lawyer Takes On The System, Big Corporations:** "I am doing what government officials and other corporate lawyers cannot," says Mr. Ishizumi, who quit a career-track post at the Ministry of International Trade and Industry, or MITI, to launch his crusade. "Corporations have become so gigantic that we need some checks and balances." Wall Street Journal, Marcus W. Brauchli.

* **6/17/91 US Asserts Honda Eluded Car Tariff - Autos From Canada Are Called Misuse of Free-Trade Pact:** "After a yearlong audit, the United States Customs Service has concluded that Honda took improper advantage of the United States-Canada free-trade agreement to avoid paying millions of dollars in duties on cars imported into the United States from its Alliston, Ontario, plant." Special to the New York Times, Robert Pear.

* **6/17/91 U.S. Business Relationships: Color Them Brutish:** "... we probably would have welcomed joining a keiretsu if they existed here. On the other hand, if such groups were pervasive, how would we have started, who would have helped finance us, and how would we have broken into an established, closed system?" Wall Street Journal, Hugh Aaron.

* **6/22/91 Foreign firms deal unfairly with unions, Fraser says:** Ex-UAW President Douglas Fraser, addressing labor lawyers at the Hyatt Regency-Louisville, assailed foreign firms' anti-union tactics in U.S. plants (photo caption) "They get away with it, he told about 100 labor attorneys ... because of inadequate labor laws and anti-union feelings nurtured by U.S. employers." Courier Journal, Joe Ward.

* **7/02/91 Textbooks tone down Japan's past, papers say:** "Japanese newspapers said yesterday that a new batch of elementary school textbooks tones down Japan's aggression during World War II, leaves out details of Japanese atrocities and caters to nationalism." Herald-Leader wire services.

PREPARED STATEMENT OF J.P. REILLY

I would like to begin by thanking Senator Bentsen and the rest of the committee for providing the U.S. auto parts industry an opportunity to discuss the critically important issue of trade with Japan.

I am here today on behalf of the Auto Parts Advisory Committee. APAC is a national advisory committee established by the Fair Trade In Auto Parts Act, which was included in the Omnibus Trade Competitiveness Act of 1988. The committee advises the Department of Commerce on programs to increase sales of U.S.-made auto parts and accessories to Japanese automotive manufacturers worldwide.

The auto parts industry is the largest manufacturing sector in the U.S., with over $100 billion in sales in 1990. Additionally, the industry employs over 600,000 people in companies ranging from large firms like my own to small, single-product producers.

Our industry has accomplished much in the last 18 months towards resolution of these issues. I would like to briefly highlight some of what we learned.

The current trade deficit with Japan stands at $41 billion. The automotive sector at $31 billion represents 76% of the problem. The University of Michigan was commissioned by APAC to independently study the issue and forecast the most likely deficit for 1994. The projection is staggering. The automotive deficit is forecast to grow by 50%, reaching $46 billion in 1994.

More critical to our business is that the issue is shifting from vehicles to parts. The parts deficit was $2 billion in 1984 when the discussions started between the two governments. It reached $10 billion in 1990. It is projected in 1994 to grow by over 100% to $22 billion.

The University of Michigan also undertook a case study that dealt with transplant sourcing and trade content. The Michigan researchers chose Honda, which they felt led in domestic sourcing. They showed that 38% of the total value of the vehicle was imported from Japan, 46% came from Japanese transplant suppliers and 16% from traditional domestic suppliers.

It is incredibly difficult to believe that the world's largest parts supply base is cost and quality competitive on only 16% of the transplant business.

A third major project is the Aftermarket Pricing Study, which was jointly sponsored by the Department of Commerce and Japan's Ministry of International Trade and Industry. The study was conducted on 20 different auto parts. It found on average that prices in Japan were 340% higher than in the U.S. For example, a spark plug that sells for $3.77 in the U.S. costs $14.44 in Japan.

The fourth research project looked at the replacement part distribution system in Japan. It is close to a monopoly. Car dealers control over 60% of aftermarket repair work and on some high-value parts and repairs, that figure is over 80%.

What does this all mean to our industry?

The forecast deficit is obviously unacceptable both to you, as managers of the U.S. economy, and to us, as managers of a vital industry. If that deficit trend continues until the year 2000, it is estimated that over 50% of today's auto parts companies will be out of business.

The pricing and distribution studies help explain this situation. With a highly profitable aftermarket in Japan, a parts supplier is free to blend original equipment and replacement market prices. Since open channels of distribution in Japan are minimal, it is extremely difficult to penetrate the Japanese aftermarket.

Also, Japanese parts suppliers have the ability to underprice original equipment parts to avoid competition. U.S. parts producers believe consumers are best served by open markets that respond to real market price and quality and are not hampered by artificial barriers to entry. But increasingly, we recognize that there are structural differences between the markets and also in the relationship between suppliers and vehicle producers.

We don't want more studies. We don't need more meetings. What we want is an increased opportunity for more business. The U.S. parts industry is at a critical point unless immediate and significant action is taken by the Japanese vehicle manufacturers to quickly reduce historical purchasing patterns. Increasing government intervention will be required.

In this regard, APAC recommendations, which were unanimously endorsed by the President's Export Council and by more than 90 members of Congress, include the recommendation that the U.S. government begin preparation of self-initiated dumping and 301 actions.

In conclusion, the U.S. government and Japanese have been in bilateral trade discussions on auto parts since 1984. It is now time for less discussion and more positive business results.

Thank you again, Senators.

PREPARED STATEMENT OF DOUGLAS E. ROSENTHAL

Chairman Bentsen, Members of the Committee. I am pleased to accept your invitation to discuss anticompetitive conduct by networks of Japanese firms, (loosely called keiretsu), and how U.S. antitrust law may be used to attack this conduct when it injures U.S. consumers and U.S. exporters.

The problem of opening up Japanese markets to U.S. competition has generally been addressed by Americans in three ways. Some U.S. firms have petitioned under our **trade laws** to limit Japanese access to our markets so long as Japanese firms compete unfairly here. Some have sought **diplomatic initiatives** by the Executive branch to persuade the Japanese government to remove legal and "structural" impediments to U.S. exports to Japan. Some have formed **joint ventures and strategic alliances** with Japanese enterprises to gain access to the Japanese consumer. Each approach has produced some successes and several failures.

If the goal is to promote competitive markets and a level playing field, the trade laws are frequently counterproductive. Many American firms which have won import relief from aggressive Japanese competition have squandered the profits such trade protection yields, failing to plow them back into upgrading U.S. production to meet Japanese competition. Voluntary restraint agreements and other forms of trade relief have probably led Japanese manufacturers to establish U.S. subsidiaries that are largely immune from trade law enforcement three to five years earlier. Downstream producers have suffered by having to pay anticompetitive prices for key imports, and U.S. jobs have had to be exported. In the end, the U.S. consumer has been forced to overpay, and he or she does not buy American when trade relief expires, or becomes less effective, because confidence has been lost in the quality of some of our domestic output. Also, the foreign nations in which we want to sell are now importing our trade laws and turning them against our firms in their home markets.

While U.S. Executive branch officials are often conscientious and well-meaning, what they can accomplish through diplomacy is limited by (a) the political limits on the ability of Japanese government officials to remove many domestic structural impediments, (b) the superior talent and resources available to Japanese government officials to resist our arguments; they are, the elite of the Japanese educational system; and (c) the lack of incentives for Japanese officials to comply substantially with U.S. requests for market access, so long as the Japanese consumer continues willingly to be victimized.

And then of course, some U.S. firms have gained access to the Japanese market—as to those products for which the Japanese consumer does demand high quality and reasonable price, as with Coca Cola, and the products of Walt Disney; or where Japanese firms have not produced competitive products—the Boeing 747 and some U.S. chemicals and pharmaceuticals. In general, access to Japanese markets for U.S. high tech products has required a sharing of U.S. technology, through licensing, with Japanese joint venture partners. The widespread unwillingness of many Japanese firms today to license their technological innovations to U.S. firms suggests that U.S. firms may often be selling their ideas too cheaply, hence paying too much for market access.

A fourth approach to the promotion of open competition in U.S. and Japanese markets has been tried infrequently. It is the use of **U.S. antitrust law** by U.S. firms to fight largely private conduct in Japan, often by networks of vertically and horizontally associated Japanese enterprises, foreclosing U.S. firms from open access to Japanese customers. The Sherman Act, passed 101 years ago, was drafted to apply to U.S. foreign commerce with other nations. For 80 years it has reached not only anticompetitive restraints in U.S. domestic markets, but also foreclosure of U.S. export trade by private anticompetitive acts engaged in by foreign persons abroad. The only limitation is that the exercise of U.S. jurisdiction over foreign persons for foreign acts injuring U.S. **export** trade must be consistent with U.S. Constitutional standards of due process. There have been at least 17 such cases successfully prosecuted over this period. There have also been several cases brought against Japanese firms for conspiring to restrain unreasonably U.S. import trade. But both categories make up a very small part of filed antitrust cases.

The antitrust laws as they are today, without further amendment, can be used to attack at least three kinds of anticompetitive conduct which have, at various times, been ascribed to certain Japanese keiretsu. If significant progress could be made in addressing these problems, I suspect the keiretsu problem, in fact the broader problem of an unlevel playing field in U.S.-Japan trade, would be substantially ameliorated.

The first problem is that of **Japanese buyer cartels**. These are horizontal networks of Japanese customers which exercise market power in dealing with U.S. exporters, setting the terms of trade by foreclosing competition among themselves and by agreeing to boycott, jointly, those U.S. suppliers who refuse to trade on their terms. In 1982, there was a successful case brought by the Justice Department, *United States* v. *C. Itoh,* to break up a buyer's cartel for processed seafood, and also a successful private action against a buyers' cartel for wood chips, the *Daishowa* case.

Astonishingly, five years later, near the end of the second term of the Reagan administration, the Department of Justice announced it was no longer interested in enforcing the antitrust laws against private foreclosure of U.S. exports to foreign markets. The ostensible justification was that the primary goal of antitrust enforcement is to promote consumer welfare in U.S. domestic markets. U.S. exporters were left to fend for themselves, even though Congress had said in the Foreign Trade Antitrust Improvements Act of 1982 that conduct directly foreclosing U.S. export competition was actionable under U.S. law. The present head of the Antitrust Division, Jim Rill, has hinted that he is prepared to reverse this policy. It is rumored that he is looking for an appropriate export foreclosure case to bring. So far, none has apparently been found.

The second problem is **exclusion** of an American firm from the Japanese market by a horizontal network of **competing** Japanese firms. This is illustrated by a 1988 suit brought by the Union Carbide Corporation against Komatsu Electronic Metals Co. and five other Japanese firms, for conspiring to hold down the price of high purity polysilicon, the main raw material used in producing silicon wafers on which semiconductors can be etched. Carbide, an exporter of polysilicon, also claimed it was boycotted by wafer customers, even when it offered its product at a lower price than the conspiracy had set. The case has been settled to Carbide's satisfaction.

In May, 1990, as you know, the House Judiciary Committee held a hearing on the topic of my testimony. Mr. Pickens and Janet Steiger, Chairman of the Federal Trade Commission, were two of the witnesses. During the hearing, Congressman Tom Campbell, an expert in the law and economics of international competitiveness, asked Chairman Steiger if U.S. antitrust law could be applied to an agreement among, hypothetically, Nissan, Toyota and Honda, to drive down the price of auto parts in Japan, "so that each of them would then be able to export their product to America more cheaply." While she ducked the question diplomatically, the answer is "yes." A similar allegation was made in the *Carbide* case and, if jurisdiction over this conduct had been litigated, I am confident a violation would have been found. Such conspiracies are little different from the buyer cartels discussed above. While not all restraints of trade are unreasonable, for example short term covenants not to compete when a business is sold, horizontal price fixing agreements have almost always been held per se antitrust violations.

The subject, I gather, of a pending FTC investigation is whether networks of Japanese automobile companies use horizontal collusion to gain power over the manufacture of automobile parts for use in producing Japanese brands of cars, both in U.S. and Japanese factories. There should be no doubt about the illegality of this conduct, on either shore, if it can be established. Conspiracies to restrict the quantity or price of auto parts manufactured in Japan for use in Japan or for export to the United States, or to exclude U.S. parts suppliers from the opportunity to compete to supply parts to U.S. factories manufacturing Japanese brand cars is illegal. During the time I was in the Antitrust Division in the 1970s, we brought such a case against Japanese ball bearing manufacturers.

Given these examples, one might wonder why this antitrust tool for promoting open competition in U.S.-Japan trade has not been used more frequently. The antitrust laws, unlike the administrative trade laws, provide a remedy for actual damages; they give the ones injured direct control over the prosecution of their claim, rather than their having to rely on government investigators to do the job; they provide for treble damages where liability is established, and for extensive discovery of documents and witnesses to establish their case; if they prevail, the defendants have to pay the fees of their attorneys; if they do not, they do not have to pay the fees of the defendants' attorneys.

I suspect the answer is that many people think that antitrust suits are too expensive and time-consuming. The single case which has given antitrust this poor reputation is probably the Zenith case, decided by the Supreme Court in 1986. It was there held that it was "inherently implausible" that the Japanese color television industry could conspire for 20 years to monopolize the U.S. color television market by driving U.S. competitors out of the business with a scheme to sell at a predatorily low price. Since color tvs are now actually cheaper than when the conspiracy was allegedly hatched, 20 years earlier (adjusting for inflation), it seemed dubious to the Supreme Court that a scheme of predation was at work. Predation, selling at a loss to injure your competitor, only makes sense if you raise prices to monopoly levels once you have driven him out. After 11 expensive years, and 40 volumes of "essential evidence" culled for Supreme Court review, this implausibility was not rebutted.

This case should not be the norm of what to expect if one brings an antitrust case against a Japanese conspiracy that is well pled. The *Daishowa, C. Itoh* and *Carbide* cases, referred to above, took about one-tenth the time and a small fraction of the resources expended in Zenith. There is much that could be said about why the Zenith case got out of control. All that need be said here is that there were better theories of liability that were not pursued. A big dumping or subsidy case is usually no cheaper and sometimes more expensive than a carefully crafted antitrust suit. U.S. companies which find themselves victimized by Japanese keiretsu should compare the pros and cons of all options, including filing an antitrust suit.

The importance of providing opportunities for manufacturers of auto parts to compete with automobile manufacturers who produce or cause others to produce parts for their brands is illustrated by changes in the cost of fenders for a 1980 Honda Accord in the U.S. market in the six years between 1983 and 1989. Until 1983, the Honda family was the sole manufacturer of such fenders. In 1983 independent competing manufacturers entered the U.S. market for the first time offering their product for $114. At that time, Honda was charging $151. By 1989, competition in the aftermarket for Honda automobile parts had reduced the price of a 1980 Accord fender to $93, notwithstanding the interim inflation. In contrast, the front door for the same model 1980 Accord, which cost $110 in 1983, cost $159 in 1989. There is no independent competitor presently selling these doors in the U.S. market.

Part of the problem here may be **horizontal** arrangements among Japanese auto manufacturing nationals. The problem also could be **vertical** restrictions which limit the access of parts manufacturers to customers without offsetting efficiency justifications. When the U.S. Department of Justice participates in diplomatic negotiations with Japanese government officials, I understand it complains about the anticompetitive effects of keiretsu-related vertical supply and distribution restrictions reducing the access of U.S. exporters to customers in Japan. However, the Justice Department appears relatively untroubled about vertical restrictions by Japanese and U.S. equipment manufacturers which have an anticompetitive purpose and effect in U.S. domestic markets, with no offsetting efficiencies.

There is presently pending in the U.S. Supreme Court (in a case in which I am involved), an appeal by Eastman Kodak from a decision of the Ninth Circuit Court of Appeals, refusing to dismiss an antitrust claim by 18 small, independent companies which maintain and repair Kodak copiers and microfilmers. The plaintiffs claim that Kodak drove them out of business by monopolistic practices. Citing the *Zenith* case, Kodak replies that it is "inherently implausible" that it could monopolize aftermarkets for Kodak replacement parts, and the servicing of Kodak equipment since Kodak faces "fierce" competition in the basic equipment markets for copiers and microfilmers. Kodak argues that because it lacks a 30% share of these basic equipment markets (itself a matter of dispute), it cannot possibly restrict aftermarket competition for parts and service for its equipment. Surprisingly, the Department of Justice has agreed and supports Kodak's appeal. If that argument prevails, it would mean that Honda would be free to seek to restrict independent manufacturers of parts for Honda cars since Honda is nowhere close to having a 30% share of sales in the U.S. automobile market. The impact on the American automobile consumer if the Supreme Court agrees with Kodak and the Department of Justice will be enormously adverse, as the quoted price with respect to Honda replacement parts indicates.

When Japanese observers see this inconsistent approach by U.S. officials to vertical restrictions in the Japanese market, as contrasted with their response to vertical restrictions in the United States market, they understandably doubt the sincerity of U.S. diplomatic protests about Japanese structural impediments. How can U.S. antitrust officials undercut U.S. trade policy seeking to promote international competition, by refusing to bring export foreclosure cases, and by refusing to promote competition in U.S. parts and service aftermarkets for expensive, high technology, basic equipment such as automobiles and copiers? One answer is that Chicago School economic theory, which often fails to accord with economic reality, has gained too much ascendance in antitrust enforcement and in judicial decisions in antitrust cases. However, a second reason is that trade law and policy and antitrust law and policy, which should interrelate and complement one another, have taken divergent tracks.

This Committee is responsible in the Senate for trade law and policy, while the Judiciary Committee is responsible for antitrust law and policy. I have the impression there is little interaction, let alone efforts at collaborative decisionmaking between the two. From personal experience there is constant tension between the Department of Justice (and the FTC) on the one hand, and the Office of the U.S. Trade Representative, the Department of Commerce, and the International Trade Commission on the other. The lack of coordination is symptomatic of some fundamental hostilities. Antitrusters see the trade field as more interested in protecting companies that are unwilling and unable to compete; and trade experts see antitrusters as doctrinaire and naive about the realities of anticompetitive practices which can sometimes only be attacked by fighting fire with fire.

After World War II, the effort was made to develop a world trade organization in which an international antitrust law would be developed in tandem with the GATT Treaty. That effort might have succeeded had U.S. officials of the day not gotten cold feet. Revisiting the need and possibilities for a reconciliation of trade and antitrust law and policy should be an agenda item for the next international trade negotiation after the Uruguay Round. National trade laws do need to become more attentive to competition concerns. It is inefficient and inappropriate, for example, that there is no "meeting competition" defense available to the respondents in a U.S. antidumping action, as there is to a defendant in a price discrimination suit under the Robinson-Patman antitrust law. It is similarly wrong that existing U.S. trade law gives International Trade Commissioners no opportunity, let alone obligation, to take into account the effects of antidumping relief on U.S. consumers and the U.S. economy in determining the scope of antidumping relief to be awarded. This is provided, and not altruistically, in Canadian and European Communities antidumping laws.

Reciprocally, U.S. antitrust law needs to show more concern with (1) the anticompetitive effects of keiretsu-like vertical restraints in parts and service aftermarkets, (2) predatory commercial subsidies by foreign governments which adversely affect unsubsidized U.S. producers and (3) the possibility that sometimes, as a practical matter, the best way to reduce foreign import barriers is to threaten to erect barriers against foreign exporters so long as market access is a one-way street. This last statement should not be understood to be an endorsement of retaliatory action by the United States in a manner incompatible with our existing GATT Treaty obligations. As Senator Moynihan has properly argued, adherence to international legal obligations is not only the right thing to do but in the long run it provides the most effective basis for mutual responsibility and shared expectations.

Finally, it would be a mistake to assume that the United States is always seeking to promote competition in U.S.-Japanese trade and the Japanese are always seeking protectionism. In my 18 years as an international antitrust lawyer, I have seen conspiracies in which American firms have participated aimed at exploiting Japanese customers and aimed at excluding from the U.S. market Japanese imports of higher quality which were not being offered at a predatory price because U.S. competitors were unable or unwilling to try to compete with those imports.

The prospects are not all gloomy. New guidelines by the Japanese antitrust agency, the Japan Fair Trade Commission, now provide that an acquisition and holding by one enterprise of securities issued by another, which is its customer or supplier, may be held unlawful if it is used as a means of reinforcing anticompetitive behavior. Japanese officials are beginning to look more closely at anticompetitive practices by Japanese keiretsu. We should nourish this development by avoiding ethnocentrism. Instead, we should appeal to the interests of the Japanese consumer who has as much to gain as we do from the true opening of U.S.-Japan trade. Thank you Mr. Chairman.

Mr. Rosenthal has specialized in international antitrust law for 18 years. he was Chief of the Foreign Commerce Section of the Antitrust Division of the U.S. Department of Justice from 1977 to 1980. He is now a partner in the international law firm Coudert Brothers. Mr. Rosenthal has participated in several major international litigations and has advised both American and Japanese enterprises. For several years he has acted as a legal adviser on issues of international jurisdiction to the Government of Canada. He is the author (with William Knighton) of *National Laws and International Commerce: The Problem of Extraterritoriality,* Chatham House 1982, and has authored more than three dozen articles on issues of international law and economic policy. He is a member of (a) the Board of Advisors of the BNA Antitrust and Trade Regulation Reporter, (b) The Council on Foreign Relations, and (c) The American Law Institute.

COMMUNICATIONS

STATEMENT OF THE AUTOMOTIVE PARTS & ACCESSORIES ASSOCIATION

Mr. Chairman and Members of the Committee: Nearly a decade ago, this Committee held a December 1981 hearing to review a high-level U.S.-Japan auto parts market opening initiative to resolve a growing auto parts trade crisis. At the time, we faced what then was a staggering $1 billion parts trade deficit with Japan, even though America enjoyed a global parts trade surplus. As one element of Japan's commitments, it slashed its 25 percent auto parts tariffs to zero, effective April 1, 1981. U.S. exports did not grow, however, because invisible keiretsu barriers intertwine car makers and suppliers so tightly that they pose structural impediments far more insurmountable than any tariff wall. Indeed, although the 1980's were punctuated by three major initiatives to crack keiretsu created barriers, the U.S.-Japan auto parts trade deficit soared to $10.5 billion in 1990. Moreover, were it not for our deficit with Japan, America's auto parts makers would have had a global trade surplus last year.

Writing to President Bush last July 17, some 90 House Members explained that the "bedrock reality of systematic exclusion of outsiders " had frustrated a decade's worth of high-level talks including MOSS and SII. The systemic barrier was explained by the Members:

> The essence of the auto parts problem is that the large Japanese manufacturers discriminate against U.S. parts makers and in favor of traditional Japanese suppliers, many of which are affiliated to their own keiretsu—families of companies with interlocking directorates, shareholding, and contractual and personal ties.

APAA believes we can benefit from the lessons of the 1980 initiative. Convinced that the continued competitive strength of American original equipment (OE) and replacement parts suppliers hinged on gaining access to the Japanese OEMs taking unprecedented new car market shares, the Carter Administration's USTR negotiated a program to overcome any impediments to trade between competitive U.S. suppliers and Japanese vehicle makers.

The results-oriented plan featured a Japanese government sponsored parts buying mission, purchasing goals, timetables, and monitoring. It had all the elements needed to begin breaking through the impediments posed by the closed Japanese auto maker/supplier "family" or keiretsu structure. In fact, at the only follow-up meeting in February 1981, MITI committed Japan to a $300 million parts import goal in 1981. That would have cut the deficit 20% the first year, and substantial subsequent improvements were promised.

Mr. Chairman, this promising plan was abandoned for the VRA, and it took the VRA's expiration in 1985 for our industry to fight its way back from policy exile. Administration officials at that time agreed that improved parts market access held the key to reducing automotive products trade deficits and auto parts issues became hot again. And, parts policy is continuing to heat up as government and industry leaders consider the prospect of a doubling of the bilateral automotive parts trade deficit to $22 billion by 1994, as projected by the University of Michigan.

Keiretsu's impact is captured in the 1989 USTR trade barrier report's conclusion that Japan's auto making/supplier "family" structure precludes "nonfamily" suppliers from "original equipment and replacement (aftermarket) auto parts markets for Japanese vehicles." Given the transplanting of keiretsu to America, APAA believes this finding should trigger an alarming call to action, and APAA is most pleased, Mr. Chairman, with your interest in keiretsu's impact on our industry competitiveness.

Congress, the Administration, our association and industry have worked hard to put the wind back in our market opening policy sails. Together with teams of Administration negotiators, we have built a strong case for the reform of anticompetitive Japanese parts sourcing and distribution practices. APAA believes that the sound negotiating framework established by the Administration in SII, coupled with a revived Super 301, would give us, in effect, a second chance at the results-oriented approach we lost in 1981. With the parts trade deficit now the faster growing share of the bilateral automotive products deficit, it is vital that we set a sound parts trade policy course and permit nothing to alter it.

APAA wishes to underscore the House Members' warning to President Bush that "Time is running out for the U.S. auto parts industry," and their call for the President to "initiate a concerted campaign to stop the erosion of the traditional domestic supply base of the U.S. auto parts industry." Upon presenting their policy recommendations to Congress last June, the Auto Parts Advisory Committee (APAC) affirmed the need for action, concluding: "The APAC Interim Report and numerous private studies document the unjustifiable and unacceptable imbalances in auto parts trade with Japan and sales to Japanese automotive companies."

APAA AND THE INDUSTRY WE SERVE

APAA members make and sell the entire spectrum of automotive parts, accessories, tools, equipment, chemicals and supplies. APAA's 900 U.S.-based manufacturing members represent a very significant share of the universe of 2,000 firms cited by USDOC as being engaged primarily or solely in automotive parts and accessories production for both OE and aftermarket consumption.

Thus, when I speak of APAA as industry's representative, the term refers to this vast number of firms, It does not imply that APAA speaks for every firm in the industry universe nor that APAA is the only group representing the large, diverse U.S. parts industry.

My statement will address APAA's policy objectives, the urgent need for a results-oriented approach, the continued threat to American suppliers' sales, jobs and profits, an assessment of Japanese and U.S. government policies, and APAA's recommendations for stronger future parts trade policy. In his October 16 testimony before the Committee, Mr. Reilly addressed APAC's policy recommendations. APAA fully supports these policies as pro-competitive—not protectionist—and believes they attack the heart of keiretsu—discriminatory sourcing practices and market predation.

APAA'S POLICY PRESCRIPTION

Mr. Chairman, APAA has never desired closed U.S. markets. Rather, we have argued since 1980 that the answer to our problems rests in opening Japanese parts procurement and distribution systems to accord American firms and workers the same fair commercial consideration Japanese firms receive here. A similar theme recently was struck by the Auto Parts Advisory Committee (APAC) in terms of its "overriding goal—to attain the same free and fair access to Japanese auto parts markets that Japanese suppliers enjoy in the United States market." APAC's December 1990 interim report to the Secretary of Commerce, Overview of U.S. Automotive Parts Trade With Japan, chronicles American industry and government's ambitious decade long market opening campaign—including the Quayle Initiative, post-MOSS talks, and the Structural Impediments Initiative (SII).

URGENT NEED FOR ACTION

In considering the urgent need for shaping and sustaining a strong U.S.-Japan auto parts trade policy, it is useful to revisit the 1980 policy initiative and the lessons of the VRA. In crafting the 1980 policy, the Administration perceived a threat to the U.S. supplier industry, then at its zenith, and took pro-active measures to ensure its continued global competitiveness and its place as the anchor for America's industrial and employment base. No protectionism was invoked, the U.S. simply sought to assure a fair chance to compete. At the time, U.S. parts makers controlled some 90% of the content of all new cars sold in America. And, of course, no transplanted Japanese car makers or transplanted Japanese supplier satellites yet existed, and the nature of the closed Japanese keiretsu procurement model still was little understood.

The VRA provided a swift and rude introduction to keiretsu, as the Japanese system rushed to end run the VRA and establish U.S. assembly plants. The experiences of those premier American supplier participants of the 1980 Japanese parts buying mission, who had faced structural barriers to exports, soon were being mirrored by those traditional American suppliers who could not break into this new transplant assembly market.

American frustration with the poor domestic sourcing record of transplant assemblers was summed up by the bipartisan leaders of the Senate and Senate Finance Committee in their July 1987 letter to Prime Minister Nakasone.

The Senators contended that transplant assemblers in 1985 and 1986 had assembled 240,000 and 460,000 passenger vehicles respectively using "knock down kits with virtually all components made in Japan." The Senators noted that the U.S. "assumed that as Japanese companies increased their automobile production capacity in the U.S., exports from Japan would decline in some corresponding way. "Rather, they contend "total automotive exports are continuing to increase at a rapid pace." That pace has greatly quickened since then. In the worst type of "coals to Newcastle" trade, Japan used the falling dollar not to buy more U.S. parts, but rather to build a new Japanese supplier base next door to the vast underutilized base of qualified traditional American suppliers. These transplanted parts makers, like their Japanese OEM customers, also bypass qualified second-tier American suppliers of subcomponents and materials.

The mad land rush by Japanese suppliers in 1986-87 coincided with the year long auto parts MOSS talks. It stood as a repudiation of the so-called market forces which both nations agreed should guide parts procurement and which, if followed, certainly would have favored greater procurement from existing U.S. suppliers.

By 1990, the increased vehicle market share held by Japanese imports and transplant production, as well as Japanese controlled third-country production, had brought Japan's auto makers/suppliers near, and perhaps past, the point of controlling the majority of the content of all new cars sold in America.

TOTALITY OF KEIRETSU

Japan's control of America's automotive industry will continue to tighten as U.S. manufacturers of high-value added, engineered functioning auto parts remain locked out of the increasing new car market share held by Japanese nameplates. Failure to crack these OE markets also denies U.S. firms the manufacturing scales necessary to make replacement parts production economical. Thus, Japanese OE suppliers' are assured a continued lock on lucrative replacement parts sales for many functional components and systems.

Notwithstanding transplant assemblers' frequent pledges to increase U.S. parts sourcing, they generally have restricted their interest to those products where quality U.S. firms have advantages over Japanese-based competitors, because of shipping issues related to weight and/or bulkiness, energy intensiveness of products and commodity scarceness. Such items include tires, seating systems, glass, batteries, dashboards, carpeting, steel, paints, resins, glues, striping and decals.

The University of Michigan study estimates that Japanese sourcing of these generally lower value items has not been enough to lift traditional U.S. suppliers to even a meager 12.5% share of the total customs valuation per average transplant vehicle assembled in 1989. Moreover, with the exception of tires and batteries, none of the commodity or stock type items lends itself to replacement sales, although it is the aftermarket which yields our industry's greatest volume and profit.

Of course, the long track record of American firms' sales of these nonfunctioning auto products and low-value added commodities to transplant assemblers—and the occasional sale of advanced U.S. products that have no Japanese competitor—have not been enough to curb the explosive growth of Japan's auto parts trade surplus with the U.S., which jumped from $1 billion in 1980 to $10 billion plus in 1989. Nor will it be. Japanese gains are coming much faster now. The parts trade deficit, which exploded ten-fold in ten years, will more than double to $22 billion within four short years.

Nor is there any light at the end of the tunnel, but rather a constant flow of imported parts pulled by two powerful locomotives. The first represents demand by transplanted Japanese OE suppliers and their keiretsu OEM parents, and the second signifies aftermarket service parts demand for the burgeoning number of Japanese nameplate vehicles on the road.

The University of Michigan projections of the skyrocketing parts trade deficit and the conclusions about traditional American suppliers' meager access to transplant assemblers have contributed greatly to America's trade data base. The numbers cut through the smoke of post-MOSS JAMA data to show that the billions of dollars in reported American parts sales are not so much new business breakthroughs for historically excluded U.S. firms, but merely a replication of keiretsu ties in the U.S.

In a major policy breakthrough, the 1989 USTR trade barriers report captured the magnitude of the problem, explaining that as "nonfamily" suppliers U.S. parts makers are "precluded from both the original equipment and replacement (aftermarket) auto parts markets for Japanese vehicles." USTR adds that "The United States is trying to persuade Japanese vehicle manufacturers to increase their purchases of competitive, high quality U.S. auto parts."

That vote of confidence in our industry was seconded by Commerce Secretary Mosbacher, who in a June 1991 statement said: "We have world class auto parts manufacturers. They deserve the opportunity to compete toe to toe with the Japanese industry on a level playing field. Trade is a two way street."

There is no shortage of such parts makers, Mr. Chairman. In fact, one important common denominator of American parts trade in 1980 and 1990 is the fact that in each year American products sold well everywhere but Japan. Exclusive of Japan, the U.S. would have enjoyed a global parts trade surplus last year.

Further attesting to American industry's competitive performance is the fact that American suppliers remain competitive in every category, despite suffering vastly inferior economies of scale. For example, Japanese firms supplied 14 million plus units of Japanese nameplate production in 1990, while traditional U.S. suppliers' sales were curbed by Big Three output of only 8 million units.

We know our industry's strengths, as do the Japanese, but U.S. suppliers must make immediate and sustained strides in winning sales in Japanese parts markets, if they are to offset the staggering losses in their Big Three customer base. Thousands more U.S. firms' futures and payrolls, in turn, are tied to the fortunes of their American supplier customers' success.

A recent statement by industry expert David Cole reveals that for more than three years now one American automotive supplier firm has gone bankrupt every 16 hours, and the pace will quicken. The only commodity in short supply is time. Yet, despite the USTR report and what should be an alarming call to action, the U.S. has not struck a plan to save U.S. ownership of the parts making foundation of our auto industry. Indeed, after a decade of passive, and sometimes absent policy, everything that the aborted 1980 plan was designed to avert has occurred. Mr. Chairman, APAA believes we are ten years overdue for a no-nonsense, results oriented policy that tells the Japanese in volume and tone that cannot be ignored that the price of continued openness is evidence of reciprocal trade and investment access for U.S. suppliers in their markets.

The need for a tough market opening policy is even more urgent when we consider the totality of keiretsu. The keiretsu linkage between car maker parents and supplier families is but one part of the keiretsu family circle. These car company-headed financial/industrial groupings include banks, trading companies, capital goods producers, materials suppliers, construction firms, insurers, and so on. These self-sufficient families continue to follow Japanese investors, bypassing existing, qualified American firms. Japanese bankers will finance the new plants and Japanese construction firms will build them; Japanese capital goods will equip them; and they will rely on Japanese materials. Japanese investment, like trade, means keeping the money in the family.

Japan's drive to exclude the existing U.S. supplier base is sure to sweep aside with it that significant portion of American owned business dependent on our industry's survival and strength. The toll taken by this Japanese-styled version of industrial manifest destiny will be recorded in the widening bilateral trade and current account gaps. With the loss of American-owned business, we will export control of American sales, profits, wealth, jobs, technology, and indeed our sovereignty to Japan.

STATUS OF AMERICAN SALES, EMPLOYMENT, PROFITS

Clearly, the huge industrial column supported by the American-owned automotive industry is under unprecedented stress, as the dominant Japanese business system relentlessly cuts away at the huge American-owned automotive supplier base.

That prompt resolute action is required is underscored by the APAC report's discussion of U.S. industry's sales, jobs and profits.

First, regarding sales access, APAC concludes that:

> Issues of access to Japanese original equipment (OE) and replacement parts markets never have been more critical than today. The continued strength of competitive American OE producers and the future for competitive U.S. replacement parts, or aftermarket, suppliers depend on sales access to the growing Japanese nameplate share of the U.S. vehicle market being assembled in Japan, the U.S., and third markets.

APAC adds:

> While Japanese nameplate vehicles continue to expand in sales and market share, U.S. passenger car output has declined significantly with few vehicles exported other than to Canada. To offset this decline and more importantly to grow, competitive U.S. firms and workers must supply Japanese parts markets. *The urgency of this issue is seen in the ten-fold growth in the U.S.-Japan auto parts trade deficit, from $1 billion in 1980 to $10.5 billion in 1989, which has accompanied vast growth in the number of Japanese nameplate vehicles assembled and sold here.* (Emphasis added)

APAC also addresses the impact that Japanese transplant assemblers have on national employment. Referring to 1986 UAW research and a 1988 GAO report, APAC noted:

> The UAW found that transplants have cost the nation 75,000 auto-related jobs and the GAO estimated the loss at 45,000. These numbers are even more significant considering the projected doubling of transplant production in the 1990–1992 period. The explanation lies in two factors: (1) transplants largely have taken sales away from vehicles of the domestic-based firms rather than substantially reducing the level of Japanese vehicle exports to the U.S., and, (2) the high value of imported parts and materials assembled into the transplant vehicles shows continued reliance on Japanese supplier relationships at the expense of U.S.-based suppliers.

The APAC report adds the caveat that "Increased U.S. sourcing of parts will reduce the projected job losses."

APAA would note, however, that unless such increased local sourcing represents new sales access for traditional U.S. suppliers, American equity, profits, R&D and skilled jobs will continue to be exported. On the issue of supplier displacement, APAC cites auto analyst Maryann Keller's very apt assessment that "The U.S. is not served very well by Japanese parts companies displacing fully competitive American parts manufacturers simply because of ties between Japanese auto companies and their parts manufacturers."

APAA contends that this point holds true whether the exclusionary ties span an ocean or a short hop on the interstate. American jobs without American equity is not enough. We urge the Subcommittee's consideration of the APAC conclusion that "Unless U.S.-owned auto parts suppliers obtain increased sales to the Japanese market, the U.S. current account balance with Japan for auto parts profits—like the auto parts trade segment—will be overwhelmingly one way—to the benefit of Japan and detriment of the U.S."

JAPANESE POLICY DOMINANCE

The need for Japanese government action in resolving bilateral trade problems is underscored in a joint APAC/DOC statement issued during the June 1990 post-MOSS talks, in which APAC expressed its belief "that the Japanese motor vehicle industry and the Japanese government must change current practices to provide U.S. suppliers with fair access to the Japanese market—just as they have free and fair access to our market."

In its discussion of Japan's transport needs, a 1979 Japanese government report concluded that its auto parts industry had to be "cultivated and strengthened as the foundation of the auto industry as a whole." APAA long has recognized the inextricable linkage between Japan's automotive business model and Japan's touted industrial policy. Indeed, as we have discussed above, the tight knit auto maker/supplier "family" bonds forged during Japan's postwar targeting, and the closed auto parts procurement and distribution systems that APAA long has fought to open, are being replicated in the U.S. The MITI-orchestrated relocation of this Japanese automotive juggernaut and its devastating displacement of Big Three car production is dislocating many competitive U.S. OE and replacement parts suppliers.

Since the early 1980's APAA has sought to restore elements of the 1980 market opening initiative, believing that success in reforming Japanese practices requires market opening goals, timetables, and the political will to act if Japanese markets remain closed.

While rejecting these so-called managed trade proposals for auto parts, we would note that the Administration has selected a similar approach elsewhere. While the U.S. shuns managed trade in auto parts, Japan's government has perfected an organized trade or managed competition approach. For example, MITI manipulated the VRA, so that rather than the marketplace determining shares as would have occurred under the 1981 quota bill, MITI would allocate sales. MITI gained enormously by being able to rein in the big OEM's with sales ceilings and endeared itself to the small producers by assuring them a sales floor.

In a second case, MITI in 1987 reorchestrated Japanese parts makers' U.S. investment plans to encourage joint ventures with existing U.S. firms, when it recognized growing political tension over the ongoing invasion by wholly owned Japanese facilities.

According to 1989 DOC survey findings of sales impediments facing our industry, some U.S. firms have been "forced into a joint venture with the traditional Japanese supplier," as the admission price for transplant access. No panacea to an inequitable trading system, these often lopsided joint ventures tap the U.S. firm's Detroit-customer base without delivering reciprocal access to the Japanese customers' vast home market production.

APAA also believes that Japan consistently has dominated, or managed, the parts trade agenda, as best demonstrated by the MOSS experience. Today, nearly four years after the concluding MOSS round, little U.S. sales progress is evidenced in significantly cracking Japanese parts markets for high value-added components and systems. MOSS failed in its primary goals of reforming Japanese sourcing practices in large part because of the control the U.S. allowed Japan to exert over the agenda itself.

Sidestepping America's primary MOSS objectives, Japan cherrypicked lesser items such as trade promotion and sales monitoring from our negotiators' list of objectives. Five of seven negotiating sessions were mired down by the issue of how Japan would self-monitor post-MOSS progress. Rather than crafting a system that measures the genuine successes of traditionally excluded U.S. firms, the agreement our government endorsed allowed Japan credit for purchasing from their transplanted traditional suppliers now locating in the U.S.

This means our government effectively is rewarding Japanese OEM's for keeping the same tight bonds that the negotiations were intended to loosen.

With the advent of the SII process, APAA found USTR and the interagency panel very responsive in setting the SII agenda firmly towards the reform of Japan's anticompetitive and exclusionary business practices. Unlike the MOSS talks where Japan successfully deflected the spotlight from its "private business" practices, the 1988 trade act's revision of S. 301 has made both the impact of Japan's business system on U.S. firms and any government toleration legitimate issues for the bilateral agenda.

Having made a strong case for Super 301 designation of Japanese keiretsu-created trade barriers—as did many organizations representing our industry and a broad cross-section of the U.S. economy—APAA was disappointed by the April 1990 decision not to pursue Super 301 with Japan. However, we applauded the fact that the Administration acted to upgrade the auto parts MOSS talks to subcabinet level, or Super MOSS as we know it. The first Super MOSS meeting in June 1990 produced a Market Oriented Cooperation Plan (MOCP) with significant Japanese commitments, which if implemented could resolve longstanding barriers to U.S. sales.

APAA POLICY RECOMMENDATIONS

All negotiating vehicles: SII, the post-MOSS talks and the 1988 trade act's Quayle amendment market access initiative should buttress one another, adding strength to our appeal to the Japanese government for dismantling what the 1988 trade act calls unacceptable Japanese barriers to U.S. OE and aftermarket sales.

Continued Japanese intransigence has led APAA to urge Super 301 revitalization. Other variations on this theme which APAA would support include Super 301 enforcement of Japan's SII commitments or use of existing S. 301 to enforce SII.

As stated earlier, APAA fully backs APAC's policy recommendations, especially those urging the Administration to begin preparation of self-initiated actions under our S. 301 and anti-dumping trade remedy laws.

Let me summarize five additional APAA trade policy recommendations:

(1) APAA supports reintroduction and enactment of last session's Fair Trade in Auto Parts Act. Its excellent provisions included a mandated self-initiated S. 301 investigation, separate tracking of sales progress made by historically excluded U.S.-based parts makers, and a Justice department review of Japanese transplant practices. APAA seeks one change, that the bill extend the present market opening initiative by five years, through 1998.

(2) Since private, not government, barriers are at issue, it is vital to define successful outcomes. The 1980 bilateral parts trade approach should be revived, including an update of Japan's 1980 parts purchase target, the establishment of timeta-

bles, and a monitoring system that measures the progress of heretofore excluded U.S. suppliers.

(3) Remind Japan that the potent Levin/Riegle amendment of Section 301 now holds foreign governments accountable for the lack of fair commercial consideration of U.S. products.

(4) Focus the SII negotiations on closing the gap between Japanese antitrust law and the reality of anticompetitive Japanese business systems. We believe that unless Japan expands the opportunity for private remedies for violations of its Antimonopoly Act, meaningful progress will not be attained.

(5) Continue joint trade development efforts, such as the recent DOC design conference, with stringent, bilateral follow-up monitoring of related sales progress.

Mr. Chairman, APAA also would like to share its thoughts on several domestic policy areas where Congress and the Administration can act to sustain the survival and growth of a competitive American automotive supplier industry.

(1) APAA urges that Congress and the Administration reject any design protection legislation that includes motor vehicle parts. In short, such legislation would establish a ten-year car-company monopoly over the design, production, distribution and sale of replacement parts.

While this legislation would eliminate consumer choice, raise prices, and take away the consumer's control over vehicle maintenance, it also would have profound impact on parts trade.

The Japanese practice, whereby keiretsu supplier family members control component design and development, has been a key impediment to world-class competitive suppliers seeking fair commercial consideration. Under this legislation, American parts makers very likely would be blocked permanently from selling OE and replacement parts for the burgeoning number of Japanese nameplate vehicles on U.S. roads.

APAA also believes that a totally benign U.S. policy, blind to the arrival of foreign-owned parts procurement systems closed to the U.S., threatens to undermine our manufacturing base, economy and security. We can begin at home by taking step to stop unilateral concessions to foreign parts imports and investment.

(2) Finally, federal leadership is needed to encourage state use of funds to promote the export sales and global competitiveness of state suppliers. Legislation may be needed to bar state use of federal grants to assist foreign investment that dislocates U.S. production. A similar ban already applies to interstate dislocations.

A North American effort, including all three federal governments, the states and provinces, is needed to curb counterproductive foreign investment subsidies. The expansion of Japanese vehicle and parts production into North America at a time when the new car market is flat results in a shrinking of U.S. firms' shares.

CONCLUSION

In closing, let me reiterate that all APAA policy recommendations are pro-competitive and seek solely to gain traditional U.S. suppliers their fair shake at supplying all global parts markets. If allowed to compete, we know these firms' sales will increase.

Of course, APAA does not doubt for a moment that local content will continue to increase if the closed Japanese system completes its drive to preclude—and exclude—U.S. suppliers. That increase, however, will come at great peril to American economic interests and would hollow out the American automotive industry, costing both American ownership of the automotive parts industry and the takeover of America's auto making sector. Such developments ultimately could result in foreign control of the nation's vast automotive-related manufacturing base.

The only way to avert the loss of the American-owned automotive industry is to reform Japanese automotive industry procurement practices to give traditional U.S. parts makers and their workers the same fair commercial consideration Japanese firms receive here. Given the fair chance to compete, APAA believes that thousands of traditional U.S. automotive suppliers and millions of American workers will meet that challenge with world-class competitive products.

We look forward to continuing our work with this Committee and other Members of Congress as well as with Administration leaders towards attainment of our reciprocal market access goal. APAA remains committed to the implementation of a policy that recognizes as does Japan's that our nation's strength rests on the foundation of a vital auto parts industry.