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REVIEWING STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

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OPENING STATEMENT

REVIEWING STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

MONDAY, APRIL 15, 1991

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senator Charles E. Grassley.

[The press release announcing the hearing follows:]

[Press Release No. H-12, April 9, 1991]

TRADE SUBCOMMITTEE TO REVIEW STRUCTURAL IMPEDIMENTS INITIATIVE, SENATOR BAUCUS SEEKS STRATEGY FOR REMAINING U.S.-JAPAN TRADE ISSUES

WASHINGTON, DC—Senator Max Baucus (D., Montana), Chairman of the Subcommittee on International Trade, announced Tuesday that the Subcommittee will hold a hearing to review progress made in the Structural Impediments Initiative (SII) talks between the United States and Japan.

The hearing will be *Monday, April 15, at 10 a.m.* in Room SD-215 of the Dirksen Senate Office Building.

"The United States and Japan made progress on trade in the last two years, but many problems still remain. It is time for the United States to take a hard look at the issues that remain with Japan and settle on a strategy for addressing them. Since the Structural Impediments Initiative is the major ongoing trade negotiation with Japan, it seems the best forum to address these issues," Baucus said.

"At this hearing, I look forward to hearing from distinguished representatives of the U.S. business and academic communities on SII," Baucus said.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN OF THE SUBCOMMITTEE

Senator BAUCUS. This hearing will come to order.

Almost exactly 1 year ago, the United States and Japan concluded an interim report on the Structural Impediments Initiative, more commonly known as SII. From reading press reports at the time, one might easily have had the impression that the United States and Japan were on the verge of resolving their trade problems.

The Administration was so pleased with the progress made in the Structural Impediments Initiative report they decided not to cite Japan under the Super 301 provision of the 1988 Trade Act.

The Structural Impediments Initiative is a step in the right direction. It is an ambitious effort to address the underlying structural problems, both in the United States and in Japan, that are responsible for the bilateral trade imbalance. But we have still not achieved our objectives in SII or on United States-Japan trade issues generally. Much more remains to be done.

Unquestionably, we have made progress in opening the Japanese market to U.S. exports and reducing the trade imbalance. The annual trade deficit with Japan is down by $11.3 billion; that is a 22 percent improvement since 1988. U.S. exports to Japan increased by 30 percent between 1988 and 1990.

A series of trade agreements has been concluded with Japan, aimed at opening the Japanese market to U.S. exports of beef, semiconductors, forest products, supercomputers, and many other products.

However, the bilateral trade deficit with Japan has improved more slowly than that with our other trading partners. For example, during the same period that the deficit with Japan improved 22 percent, the U.S. trade balance with the European Community went from $10.3 billion deficit to $6.2 billion surplus.

The trade deficit with Japan is still four times larger than the deficit with any other nation. Moreover, Japan still imports far less as a percentage of total consumption than any other developed nation.

In addition, the rate at which Japanese imports are growing has slackened considerably in recent months. And finally, Japan still maintains far more barriers than other developed nations.

As in past years, the new national trade estimate devotes far more space to listing Japanese trade barriers than it does to any other nation. Sectoral barriers still block products ranging from rice to semiconductors. Economy-wide barriers that block all imports, such as the Japanese distribution system, also remain.

Even in sectors in which we have made progress, barriers remain. For example, Japan finally phased out its beef quota on April 1st, but the quota was replaced with a 70 percent tariff.

Obviously, much remains to be done before the Japanese market can be declared open.

Unfortunately, the United States treats the task of opening the Japanese market as if it were a 100 yard dash. We strive to reach an agreement by a set deadline. For a short period, we devote great energy to opening the Japanese market. But once we reach an agreement, we simply declare victory and walk away.

If we are ever to make real progress in opening the Japanese market, we must instead make the sustained effort of a marathon runner. We must approach the problem knowing that a final solution is years away.

We must still strive to reach specific agreements; but once they are concluded, we cannot walk away. We must carefully monitor implementation and stand up for our rights if agreements are violated. We must also be willing to press for further agreements as new barriers are identified.

At first, I was very encouraged by the Structural Impediments Initiative because I believed it was a step in the direction of establishing a marathon running strategy. The final SII agreement did include a series of followup meetings to review implementation and discuss further steps.

However, I fear that many in the Administration, particularly at the highest levels, still think like sprinters and not as marathoners. There is a core group of capable trade negotiators in the Administration who continue to focus on Japanese trade issues. But at its highest levels, the Administration now seems more interested in congratulating Japan for its contribution to the Gulf than in continuing to press to promote the interests of American exporters and workers.

Japan does deserve credit for its contribution to the Persian Gulf effort, but the contribution does not excuse trade barriers. We cannot afford to let our determination to open the Japanese market slip. We must continue firmly and resolutely to pursue our market opening objectives.

The Structural Impediments Initiative has made progress in addressing some of the Japanese structural trade barriers. For example, progress seems to have been made in increasing Japanese investment in infrastructure. But progress on the most important structural barrier—a web of exclusionary business practices—remains slow.

In Japan, a series of cartels in production and distribution—known as "keiretsus"—work to exclude imports from the Japanese market. Respected economists have estimated that these barriers keep Japanese imports 25 to 40 percent lower than would be expected in a developed nation.

The President's own Advisory Committee for Trade Policy and Negotiations has estimated that these barriers exclude as much as $11 billion in U.S. exports each year.

For the first time, the United States through SII sought to address these exclusionary business practices. In doing so, the United States finally did target the key trade barrier in Japan. Unfortunately, progress toward eliminating the exclusionary practices has been slow.

Japan has beefed up its policing of the Japanese Anti-Monopoly Act; but the keiretsus still function.

In some cases, Japan seems to have focused its "trust busting" on American firms doing business in Japan. If those firms are violating Japanese law, they should be prosecuted; but American firms certainly are not at the heart of Japanese keiretsus.

I was pleased by recent Anti-Monopoly Act actions against Japanese makers of cement and manhole covers. But we have yet to see any actions in major industries, like food distribution, semiconductors, or autos. Ending the exclusionary Japanese business practices will be a long process; but we must continue to press the case in the Structural Impediments Initiative.

We must press Japan to fully implement the commitments it has made to police its keiretsus and open its distribution system. And as we learn more about the problems U.S. exporters face in Japan, we should press for further steps.

The economies of the United States and Japan are now interdependent. Both the United States and Japan need each other. But that does not mean that all criticism of the current trading relationship is unwarranted "Japan bashing."

If the trading relationship between Japan and the United States is to grow, Japanese markets must be opened. Otherwise, calls for protectionism in the United States will begin to prevail.

Frankly, I believe that the current trading relationship between the United States and Japan is also sorely in need of new thinking. I have long advocated stepping back and taking a long, hard look at the trade problems with Japan. It is obvious that the current policy must be improved upon.

I still strongly support the SII because it does represent new and more holistic thinking about the United States-Japan trade issues. But the United States policy could benefit from an even more sweeping review, and I urge the Administration to undertake such a review. It is needed, and it would be in the best interests of both countries.

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

I note the presence of the Senator from Iowa, Senator Grassley. Senator, do you have a statement at this time?

Senator GRASSLEY. Mr. Chairman, I have no opening statement. I do want to take this opportunity, not only for myself, but also for the other people on this side of the aisle, to thank you for your leadership in holding this hearing.

This hearing is very important because it is very much the responsibility of Congress to see that the policies created by Congress are carried out as they should be. Our constitutional oversight is very important in ensuring that the end result Congress hopes for when it passes legislation is, in fact, carried out.

So, I look forward to this review to see whether what we hoped would be accomplished has, in fact, been accomplished. Too often, I feel that the United States comes up on the short end of an agreement. We negotiate something 3 or 4 years before the final results are to be reviewed; and, then, when we go through the review process, we see the accomplishments aren't quite what we were led to believe they would be when negotiations began.

I think the shortcomings we have experienced ought to tell our negotiators that we need to be more certain that an agreement is an agreement and that, in fact, the results we are promised are received.

So, I hope that standard is one that we hold high as we review these agreements.

Senator BAUCUS. Thank you very much, Senator.

We have this morning two panels. The first panel consists of Mr. John Howard, director of international investment and trade, United States Chamber of Commerce; Mr. R.K. Morris, director of international trade for the National association of Manufacturers.

Also, we will have the testimony of Mr. John Ong, who is chairman and chief executive officer of B.F. Goodrich, and that testimony will be presented by Ms. Gerrie Bjornson, who is director of government relations for B.F. Goodrich. In addition, Mr. Howard Samuel, who is president of the Industrial Union of the AFL-CIO, on behalf of the Labor-Industry Coalition for International Trade.

And finally, on the first panel, Mr. William K. Krist, who is vice president of international trade affairs for the American Electronics Association.

Will all of you please come forward? I might inform the witnesses that there is a five-minute rule on your testimony.

A green light will go on when you begin; and when there is one minute remaining, the amber light will show. All right. Mr. Howard, why don't you begin?

STATEMENT OF JOHN E. HOWARD, DIRECTOR, INTERNATIONAL INVESTMENT AND TRADE, UNITED STATES CHAMBER OF COMMERCE, WASHINGTON, DC

Mr. HOWARD. All right. Thank you, Mr. Chairman, for the opportunity to testify here today.

Let me echo first that, as you have noted, the Japan-United States economic relationship is as important as any in the world today. Japan is our largest trading partner outside of North America; it is also the second largest source of foreign direct investment in the United States.

For these reasons and others, it is clearly in the best interests of the United States to do whatever needs to be done to strengthen that relationship.

Still, our relations remain in a consistent state of tension. While Japanese hesitance to contribute more to the Gulf war effort had exacerbated some of those tensions, the trade imbalance and related market access problems remain the single-most important irritant to our bilateral relationship.

You have recalled that the Structural Impediments Initiative, or SII, was launched in tandem with the Administration's first Super 301 announcement in May of 1989. While the Chamber had earlier recommended that the USTR identify various trade and investment policies and practices in Japan, as well as in Brazil, India, and Korea, as priorities under Super 301, many of the more systemic or generic kinds of practices in Japan were relegated to the SII process.

We are pleased with the Administration's commitment to addressing these issues; but we are concerned about the SII's lack of statutory timetables and procedures.

In February of 1990, in our followup submission to USTR, the Chamber had concluded that no change had occurred at that time that would justify not identifying those nations and those policies and practices again as priorities under Super 301 in 1990.

It is true that Japan seemed to recognize the importance of coming to an agreement with the United States on many of these issues and had, in fact, agreed to take some steps toward liberalization. Nonetheless, while the Chamber recognized the importance of this progress, it believes also that much of this progress—whatever progress, in fact, has been achieved—can be attributed directly to leverage afforded under the Super 301 provisions.

We will note, for example, in Korea, which had agreed a few days before the first announcement to enter into a series of agreements with the United States, that outcome was in fact, in our view, a direct outcome of the leverage—the threat, if you will—of their being listed under Super 301 at the time.

There is no question, as you have noted, that the Japanese in some areas have made some progress. There has been something of an increase in anti-monopoly enforcement, although not as much as we would like. The Japanese Patent Office is hiring more staff;

it is making an effort to reduce the time required to issue a patent. And the licensing period for large stores is expected to be cut to twelve months by the end of this year.

However, the job is not finished. There are still problems in a variety of sectors; and while the nature of our membership precludes us from getting into the specifics of some of these individual sectors, we would note that there are still in general problems in procurement. There are still problems in the customs process.

There is more streamlining that needs to be done; and the long-term impact of the Anti-Monopoly Reforms is anything but clear at the moment.

You know, there is no question that the American competitive position in world markets requires that we address some of our own problems, in particular the cost of capital, our educational crisis, and a variety of other issues.

However, these problems in no way justify abandoning our resolve or weakening our resolve to open foreign markets that are currently closed.

U.S. businesses continue to face a wide array of barriers abroad that foreign companies do not face in the United States; and as you just noted a second ago, there is more space in the NTE for Japan than for any other country.

Nonetheless, the bottom line is that U.S. negotiating resolve is as important as it has ever been at this time. As we have said before, our negotiators, who have been steadfast in these matters, need and deserve our support and even an occasional prodding when they appear to falter.

Neither Congress nor the business community should be under any illusions that the real progress that has been achieved is the result of unilateral Japanese conversion to free market principles. Such progress is the result of the sustained application of leverage and, as Ambassador Hills has herself said on a number of occasions, a credible threat of retaliation.

I will stop at this point.

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

Senator BAUCUS. Thank you. Next is Judge Morris.

STATEMENT OF R.K. MORRIS, DIRECTOR, INTERNATIONAL TRADE, NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Mr. MORRIS. Thank you, Mr. Chairman. Thank you very much for your leadership on this issue and for the opportunity to testify this morning.

NAM, the National Association of Manufacturers, continues to believe that the Structural Impediments Initiative is a potentially useful tool for improving economic cooperation between the United States and Japan.

We believe, however, that it is a mistake to expect revolutionary changes from SII. As long as the SII continues to show promise, the two governments should stick with it; but we cannot afford to rely upon it as more than a component of American economic policy towards Japan.

NAM recently reached some conclusions with respect to some of the pressing issues affecting United States-Japan trade. Specifically, we believe that a new United States-Japan semiconductor agreement should be concluded, preferably in time to take up where the current one would leave off, if it expires in July.

We also believe that U.S. trade policy generally would be strengthened by enactment of the Trade Agreement Compliance Act, which you introduced earlier this year.

These issues are discussed more fully in my prepared remarks. There are some broader considerations that I would like to discuss.

At the risk of simplifying to the point of caricature, Japan is an economic superpower experiencing some difficulty in coming to grips with its success. The United States is an all but unchallenged military and diplomatic power that turns red with embarrassment when the topic turns to economics.

The attitudes, policies, and developments behind these differences have been in existence and have been operating for some time. Japan had its first surplus with the United States in 1965 and has never looked back. U.S. trade with the world went into surplus for the first time in 1971.

Dramatic steps were taken by President Nixon to deal with what today would be regarded as a trivial surplus of only slightly over $1 billion. Now, we think of a trade deficit as anything less than $100 billion as good news.

Throughout the 1980s, the United States amassed a backlog of merchandise trade deficits amounting to almost $1 trillion, the lion's share of that red ink—over $400 billion—was accounted for by trade with Japan.

These are large phenomena. NAM does not purport to know either their exact causes or exactly what should be done. We believe strongly that markets are the best arbiters of economic success, both domestically and internationally; but we recognize the need to take note of the possibility that our views of markets and competition may not be the same as those of others.

U.S. political literature is replete with statements to the effect that, so long as trade is fair and free, Americans can outwork, outproduce, outcompete any other country.

It is useful to compare this American view of market competition with the view of markets that are official of Japan's Minister of International Trade and Industry shared with his OECD colleagues in 1970. "After the war, he said," Japan's first exports consisted of such things as toys and other miscellaneous merchandise and low quality textile products.

"Should Japan have entrusted its future in the theory of comparative advantage to these industries, characterized by intensive use of labor? If the Japanese economy had adopted the simple doctrine of free trade and had chosen to specialize in this kind of industry, it would have almost permanently been unable to break away from the Asian pattern of stagnation and poverty.

"The Ministry of International Trade and Industry decided to establish in Japan industries which required intensive employment of capital and technology" and so forth. The rest, as they say, is history.

I do not cite this to criticize Japan, but to suggest aspects of America's own thinking about international economic policy that might benefit from an intensive review.

NAM's President, Jerry Jasinowski, wrote to President Bush on March 13 to ask that he establish a Presidential Task Force to undertake a comprehensive rethinking of American economic policies and goals, especially as they relate to Japan.

We very much appreciate, Mr. Chairman, your support of this petition. We will be grateful if a copy of our letter to President Bush could be included in the record.

Senator BAUCUS. It will be included.

Mr. MORRIS. Mr. Jasinowski explained in his letter that we have no interest in blaming Japan for made-in-America competitiveness problems, but that Japan, more than other major ally, calls into question some long-standing premises governing America's post-war economic policies, both at home and abroad.

The letter recommended that this task force, which might be regarded as an Economic Team B, look at familiar assumptions and the implications of those assumptions for the next several decades. It is important to NAM that our purpose not be misunderstood.

Given the nature of the world economy, a close economic relationship between the United States and Japan is essential to the prosperity of both countries. NAM expects that relationship to become broader and deeper.

In virtually every sector, American manufacturers find themselves increasingly involved with Japanese companies, as their suppliers, their customers, their partners, and their competitors.

NAM itself is more regularly in contact with Japanese business organizations, such as the Keidanren. Our preference is to nurture rather than disturb these relationships. Nevertheless, we are concerned that the overall United States-Japan relationship is today very unbalanced; and that, without the kind of reassessment NAM has called for, the risk of serious disruptions will continue to intensify.

Further, the nature of that relationship is changing for a number of reasons. As I mentioned, Japan is just beginning to adapt to the fact that it is an economic superpower. Last week's base-closing announcements were a reminder that we have different adjustments to make.

We must adapt to a world in which the major external challenge is characterized less by nuclear confrontation and more by international commercial competition, keeping in mind that the commercial rivals are not enemies but allies, friends, and partners.

Inasmuch as we are daily strengthening our economic ties to Japan, there are relatively few new actions, vis-a-vis Japan, that the United States can or should initiate without first conducting the kind of review that we have asked President Bush to undertake and that we hope he will.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Morris and the NAM letter to President Bush appear in the appendix.]

Senator BAUCUS. Thank you very much, Judge. Next is Ms. Gerrie Bjornson.

STATEMENT OF JOHN D. ONG, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BF GOODRICH, AKRON OH; STATEMENT PRESENTED BY GERRIE BJORNSON, DIRECTOR, GOVERNMENT RELATIONS, BF GOODRICH, WASHINGTON, DC, ACCOMPANIED BY HOWARD D. SAMUEL, PRESIDENT, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, WASHINGTON, DC ON BEHALF OF THE LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE, AND JOHN A. RAGOSTA, COUNSEL

Ms. BJORNSON. Mr. Chairman, Senator Grassley, my name is Gerrie Bjornson. I am the director of government relations for the BF Goodrich Co., and I am appearing on behalf of John Ong, our chairman and chief executive officer, who is co-chair of the Labor-Industry Coalition for International Trade.

LICIT, as you may know, was formed in 1979 to represent the common interests of American workers and American firms in increased, balanced, and equitable international trade. Our membership includes twenty major U.S. manufacturing firms and labor organizations.

LICIT is pleased that the Senate Finance Committee is holding hearings on the Structural Impediments Initiative. Obviously, securing a more equitable United States-Japan trade relationship is very important for American businesses and workers.

LICIT has recently started a study on private restrictions on trade, such as anticompetitive and exclusionary business practices. Although the GATT has brought down trade barriers, such as tariffs and quotas, these more subtle barriers remain. We want to document the extent to which these restrictions reduce U.S. access to foreign markets, as well as offer concrete suggestions for addressing them.

This privatized protectionism exists with many of our competitors, but it is certainly an important issue in our trading relationship with Japan. Howard Samuel, who is the Co-Chair of LICIT, will offer our initial observations on the Structural Impediments Initiative and private restrictions on trade.

In addition, we also have LICIT Counsel, John Ragosta, with us this morning.

Senator BAUCUS. Mr. Samuel, go ahead.

Mr. SAMUEL. Thank you, Mr. Chairman. I am Howard Samuel, Co-Chair of LICIT, also President of the Industrial Union Department of the AFL-CIO.

The issues that the United States has raised in the SII are central to resolving the United States-Japan trade problem, such as the savings investment imbalance, the distribution system, keiretsu relationships, and exclusionary business practices.

Unfortunately, it is not clear that the SII will lead to sweeping reforms in Japan's economic policies and private business practices.

Japan's record of compliance with trade agreements is less than perfect. We do not dispose of our trade problems with Japan; we recycle them. It is also not clear that Japanese business and government elite agree that significant changes in their economic strategy are desirable or necessary.

Japan is gaining, not losing, market share in the key industries of the twenty-first century. Japan is investing more in new plant and equipment than the United States is, despite having a population half our size.

As for the notion that Japan's trading partners will insist on reform, let me remind you that foreign dignitaries and U.S. negotiators have been warning Japan for years that "a trade crisis is just around the corner" or that "the current situation is unsustainable."

At this point, Japan's leaders probably take these warnings with a grain of salt, particularly since on the U.S. side, half the negotiators end up eventually on the Japanese payroll.

Given the uncertain prospects for the SII, it is very important that the Administration and the Congress develop clear criteria for determining whether the SII has been a success.

Attached to my written testimony, Mr. Chairman, are graphs which illustrate some potential yardsticks—imports of manufactured goods; intra-industry trade, which is two-way trade within the same sector; and foreign investment in Japan.

As you can see from the graphs, Japan is substantially less open to foreign goods and investment than other industrialized nations.

LICIT is particularly interested in two issues raised by the SII: anticompetitive practices and industrial targeting. Over the years, anticompetitive and exclusionary business practices have been the cause of trade disputes in a number of sectors, such as amorphous metals, construction, and polysilicon.

Aside from these sectoral disputes, exclusionary business practices limit Japan's imports of manufactured goods generally by a substantial amount. LICIT also believes that Japan's practices of targeting particular industries and technologies remains a serious issue.

For example, Japan has at least twenty-two different high-tech tax promotion systems. One of these was recently extended until 1993 and provides incentives for 132 very specific technologies.

As part of the SII, the Government of Japan has made a number of commitments with respect to government-sponsored industry advisory committees and study groups, which have been an important element of Japan's industrial strategy.

Japan agreed, for example, that the results of the deliberations of government advisory committees should be made public, that foreigners should be invited to participate, that any "visions" should not be used to enhance the competitiveness of particular companies, and that the significance of imports should be emphasized.

The U.S. Government should make the implementation of these recommendations a priority. A greater awareness of these practices could provide the United States with an early warning system and allow the United States to respond proactively.

Now, Japan is not the only country which engages in or tolerates these practices. Anticompetitive practices in the European market have been a problem for U.S. manufacturers of heavy electrical equipment. Between 1975 and 1988, U.S. producers did not win a single order from an EC purchaser with a domestic production base.

For that reason, LICIT believes that these issues need to be addressed, not only as part of SII, but also in multilateral fora, such as the OECD or the GATT. Since it may be too late to include these issues in the Uruguay Round, the United States may have to pursue other interim measures.

It has generally been the case that the United States has had to act bilaterally or even unilaterally to persuade the rest of the world to address a new issue in the context of the GATT. It was the use of trade laws, such as Section 301 and Special 301, which convinced our trading partners to begin serious negotiations on intellectual property rights and trade in services.

It is reasonable to expect that the United States will have to pursue a similar strategy if it wishes to create international rules against anticompetitive practices and industrial targeting.

In closing, may I note, Mr. Chairman, that we should also take our commitments under SII seriously within the United States; but I suspect that those subjects will be the subject of another hearing. Thank you.

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

Senator BAUCUS. Thank you, Mr. Samuel. Our final witness is Mr. Krist with the American Electronics Association.

STATEMENT OF WILLIAM K. KRIST, VICE PRESIDENT, INTERNATIONAL TRADE AFFAIRS, AMERICAN ELECTRONICS ASSOCIATION, WASHINGTON, DC

Mr. KRIST. Thank you very much, Mr. Chairman. The American Electronics Association appreciates the chance to testify here today, and we want to commend this committee for its long-standing interest in United States-Japan trade problems.

We believe our commercial imbalances in electronics are a cancer eating away at both the international trading system and the long-term health of the U.S. electronics industry. You know the numbers on the trade deficit; and the electronics area has paralleled the broad manufacturing numbers.

In electronics, our trade deficit of $20 billion has stayed that way regardless of currency changes and regardless of the fact that the United States and Japan have entered into fifteen trade agreements since 1979.

We think that those numbers understate the competitiveness problem that we have. The Japanese electronics industry is producing increasingly offshore, particularly producing consumer electronics in Southeast Asia, Mexico, and other areas. In short, our deficit is being transferred to those countries, but it still remains a deficit with the Japanese electronics industry.

Worse yet, forecasts in electronics are that the deficit is going to increase substantially between now and 1995 and, indeed, between now and the year 2000.

More worrisome yet, the global competitiveness position of the U.S. electronics industry has been dropping rapidly. In 1985, U.S. electronics companies had some 64 percent of U.S. electronics production worldwide; by 1989, 4 years later, this had dropped to about 50 percent.

We believe the Structural Impediments Initiative talks are of great importance. We want to see them aggressively implemented. Let me just comment on three principal areas of interest to us, although there are a lot of other subjects of great importance.

First is intellectual property protection. It takes longer to get patents, particularly on advanced leading edge technology, in Japan than any other developed country. Perhaps worse is the practice of patent flooding that takes place in Japan.

In the SII talks, Japan pledged to bring the patent time down to 2 years; but as far as we can tell, it is not doing anything to deal with the practice of patent flooding.

The second area I want to comment on is the business structure in Japan, which allows a great deal of collusive business arrangements that would be illegal in the United States. In the SII talks, Japan did agree to some measures here, although I don't think they go far enough.

For example, the Japan Fair Trade Commission has issued draft guidelines regarding the policy by manufacturers towards distributors and, where there are continuous trade relationships among Japanese companies.

However, they are doing very little to raise the penalties for antitrust enforcement or really to change the colllusive business practice structure.

The third area I want to comment on is "buy Japan" behavior. This is pervasive throughout the Japanese economy, but particularly in industry and government procurement. Let me just mention two manifestations of this "buy Japan" behavior.

The first is the area of government procurement of computers. The U.S. industry has more than a 35 percent share of the Japanese commercial computer market. By contrast, we have less than a 10 percent share of Japanese Government procurement.

We are particularly disturbed by this, given pledges in 1985 and on other occasions by the Japanese Government to make government procurement a model of an open trading system. We think that Japanese Government purchases of foreign computers need to be enormously expanded.

The second manifestation of "buy Japan" behavior I would like to comment on is the practices of Japanese subsidiaries in the United States. By MITI's data, Japanese electronics companies in the United States only source 23 percent of their parts and components locally. They import 74 percent from Japan.

By contrast, in Asia they procure 44 percent locally, and they import only 44 percent from Japan. In Europe, they procure 36 percent locally and import 56 percent from Japan.

In short, what we are finding is that the Japanese keiretsu system is coming to the procurement practices of Japanese companies here in the United States.

We also agree that the U.S. Government needs to do a lot to implement its SII commitments. One that I would particularly like to note is export promotion. We think that the U.S. Government's effort on export promotion needs to be substantially increased. In particular, we would like to see a market cooperator program for industry, such as the United States has for agriculture. This has proven its effectiveness over the last several decades.

Mr. Chairman, I will be happy to answer any questions. Thank you very much.

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

Senator BAUCUS. Thank you all very much.

First, I would like to know generally which of the various goals under the SII in your collective view are being reached and which are not. I wonder if you could essentially prioritize our objectives and prioritize them according to the degree of success that we are or are not reaching.

I am just going to go right down the line, and I will begin with you, Mr. Krist. Which of the SII objectives are more successful than others? Which ones?

Mr. KRIST. There are some that I didn't mention, miscellaneous ones that are of importance to electronics, like the 24-hour customs clearance and things like that, which I think they are making progress on.

On the collusive behavior, which is extremely critical, I think that they are living up to the letter of the commitments; but I don't get the feeling that there is a change in attitude in Japan on collusive behavior.

For example, they are proposing to increase the penalty on illegal sales from 2 percent to 6 percent. Well, the profits are probably vastly more than that; in other words, you have a structure in place where it still pays to enter into an illegal arrangement because you get to keep most of the profits.

Senator BAUCUS. What about infrastructure? Are we making progress there?

Mr. KRIST. Well, we seem to be. I think that is of less importance to our industry than a lot of the other issues. In fact, I would argue, that the right course would be for the United States to be greatly committing to increase our infrastructure.

One of the tests will be how open Japanese infrastructure development is to foreign suppliers.

Senator BAUCUS. All right. Judge Morris?

Mr. MORRIS. Thank you, Mr. Chairman. We would hope actually to have a chance to, either ~~in writing~~ or otherwise, to respond to this after the release of the May report next month.

Senator BAUCUS. All right.

Mr. MORRIS. So that we have a better feel for what the two governments feel they have accomplished.

When we have had the opportunity to testify in the past, we noted that the most important issues for us would be market access issues. Those were things like a distribution system, like the price levels, like the keiretsu system.

We also have noted that what is important to us is not simply the changes which occur but what our Government learns about Japan in the process.

So, the pluses are that there have been some changes in these areas, particularly as John Howard noted the change in the large store laws.

Senator BAUCUS. Yes.

Mr. MORRIS. The big minus is the collusive behavior associated with keiretsu has not changed that dramatically; but if I may add one point?

Senator BAUCUS. Surely.

Mr. MORRIS. The catch and one of the reasons that we have asked the President to initiate a review is so that he can take into account the analyses that have gone on in this process and figure out what will not change.

Senator BAUCUS. All right. Mr. Howard?

Mr. HOWARD. My answer, I guess, will be somewhat a relative answer. In some areas, we have had more progress than in others, but nowhere is it finished.

As I noted earlier, some of the areas where progress, I think, has been more pronounced is the large store law, the beginning of an increase in antimonopoly enforcement, the increasing staffing of the patent office.

And areas where there is still progress to be made include such things again as government procurement, customs administration, and the like.

So, I think, on a relative scale, that would be my response.

Senator BAUCUS. All right. Mr. Samuel?

Mr. SAMUEL. I could perhaps only comment, Mr. Chairman; I would like to turn it over to Mr. Ragosta for more detail. The indications of improvement should be disclosed in terms of the results; and the fact is that Japan's imports of manufactured goods are still extraordinarily low for a country of that size and development.

And interindustry trade is also extraordinarily low and distorted for a country of that size.

Senator BAUCUS. All right.

Mr. SAMUEL. So, I think that, although there have been some improvements, they haven't yet been sufficient to change trade patterns.

Senator BAUCUS. Mr. Ragosta?

Mr. RAGOSTA. Senator Baucus, quickly, I think the three key areas for LICIT would be the distribution system, the keiretsu, and the anticompetitive activities.

As the members of the panel have indicated, a number of things have occurred on paper, for example, in distribution, the large-scale retail store law; but that is at the retail level. That doesn't really free up distribution for industrial products necessarily.

What we aren't seeing are results in the market. Now, that will occur over the next several years. LICIT is recommending that, in evaluating the SII, Congress and the Administration look at objective criteria to determine whether or not there have been real changes in the market.

Senator Baucus. Now, one of the panelists on the next panel will say—and I don't want to put words in his mouth—but that some of these keiretsus are real tame, at least compared with others. That is, some provide some stability, for example, whereas others, although they may provide some stability to the Japanese company or to the labor force, come with offsetting disadvantages which outweigh the advantages.

Are there any keiretsus or collusions in the view of any of you on the panel that are all right?

Mr. KRIST. Well, I think one thing that is positive about the Japanese system is that it does encourage companies to have long-term relationships, and I think that that is positive.

I think the real problem is that the Japanese system behaves very differently from the U.S. system; and, therefore, the key is to look at the results that take place in the marketplace.

Senator BAUCUS. All right. My time is up; but before I turn to Senator Grassley, very briefly: Does anyone have any view on the degree to which some keiretsus are permissible?

Mr. SAMUEL. I can't speak about specific keiretsus; I can speak about some of the characteristics. It seems to me that exclusionary and monopoly characteristics regardless should be discouraged.

As Mr. Krist indicated, the fact that they do promote long- term ownership is something that probably we should follow in this country to a certain degree.

Senator BAUCUS. Senator Grassley?

Senator GRASSLEY. Let me continue where you left off with regard to the keiretsus. I was struck by Mr. Krist's testimony on the first page of his summary, where he talks about "buy Japan" attitudes.

Mr. Krist said, and I quote: "Japanese electronics companies in the United States purchase only 23 percent locally and import 74 percent from Japan, preferring instead to source from their own keiretsus."

My question is not directed to you, Mr. Krist, but to the rest: Is this practice something that is found only in the electronics industry, or do any of you believe that it is prevalent throughout the U.S. infrastructure as well?

Mr. RAGOSTA. I might just note that in the automobile sector, there have been allegations that the same practices are occurring. I believe there have been studies by the Congressional Budget Office to this effect.

Currently, the FTC is studying at Congressional request the importation of keiretsu into the U.S. automobile industry; and we will be interested to see their results because, in fact, the data do show very a low degree of domestic content in Japanese auto transplants and a very high degree of purchasing only from the related companies.

Senator GRASSLEY. With regard to the rest of your industries, like the U.S. Chamber and the National Association of Manufacturers, do you have an overview you could give us?

Mr. MORRIS. I would make the comment, Senator Grassley, that there is general concern about the problems that have been raised, that a number of people are sympathetic and read with interest the report of the U.S. economist, Mordechai Kreinin, who examined behavior in Australia, in other words looking at the behavior of foreign firms operating in Australia, coming to the conclusion that Japanese firms behave differently in that they source through Japan to a much higher degree than other firms.

The question relates directly, it seems to me, to Senator Baucus' question because it is not so much what is wrong with the keiretsus, as how we adjust to them. In other words, the long- term relationship as Bill Krist talks about, and some of our members believe that they have good relationships and want to retain those.

So, the question is: How do you adjust to something that you can't change? In the United States then, the question of whether it is right or wrong becomes more profound; and yes, there is definitely concern throughout our membership.

Senator GRASSLEY. All right. Along this same line, then, let me ask whether any of you think our tariff rates adequately address this practice?

Mr. KRIST. I don't think they would, Senator, no. Our tariffs with Japan are basically very low and of course, Japan's tariffs are very low towards us. Japan's formal barriers overall are low; it is basically a question of the socioeconomic practices that really discourage imports.

Senator GRASSLEY. All right. On a more general point, a few weeks ago we had a semiconductor hearing in this committee. From an economic standpoint, I pointed out that we had only reached 13 percent of a 20 percent stated goal. Consequently, we saw the following loss in the U.S. economy: U.S. tax loss about $100 million; research and development loss of about $150 million; collateral investment loss of about $150 million; and lost employment of 10,000-plus jobs.

My question is: Does the Japanese Government and, more importantly, the U.S. Government, in your opinion, understand the economic impact on the United States of agreements not fulfilled?

Mr. SAMUEL. My guess is that the Japanese Government does understand it, and the United States does not.

Mr. KRIST. I would agree with that. I didn't have time to mention in my testimony, but we also support the Trade Agreements Compliance Act.

When we first started doing research on Japan, it took us three weeks to get copies of these fifteen agreements in electronics since 1979. There isn't even a central repository anywhere in the Government of agreements; there is no effort to systematically try to make sure agreements are being enforced.

So, I would agree with that. I think Japan does, and the United States does not.

Senator GRASSLEY. Do you think we should be pursuing a 301 petition against Japan for unfair trade practices when they occur instead of trying to negotiate away these unfair practices?

I think Mr. Howard spoke to this point in his testimony, but I would like to have each of the rest of you respond.

Mr. SAMUEL. Senator, I think I was the one who mentioned it in my testimony.

Senator GRASSLEY. I am sorry; maybe you did.

Mr. SAMUEL. And I pointed out that it is largely only through the use of 301 and Special 301 that we have been able to achieve real gains, that pure negotiations, not backed up by some specific action, have not resulted in very much over the years.

Mr. HOWARD. I would second that comment. As we have said many times in the past, the exercise of leverage through that statute is very important towards getting progress in negotiations, even when there is no actual action taken pursuant to that law.

Mr. MORRIS. We agree that the law has been very helpful and that agreements reached under it need to be enforced; but we are not convinced that it is adequate. We believe that you may need to have a broader Government view, and that is why we have called for the kind of review that we have in our letter to President Bush.

The figures that Mr. Krist brings out underscore this because you have to ask, when you see Japanese firms behaving differently in our market than they do in Europe and elsewhere in Asia, you have to ask the question: To what are they responding? And how do those responses ultimately affect the American economy?

Mr. HOWARD. I think finally it is important to note that a lot of this is attitudinal—for lack of a better term—on our country's part. We have noted before that in other countries between Europe, there is a different attitude towards taking the actions needed to achieve reciprocity or other standards of fairness.

That calls to mind one incident when our vice president was meeting with some European foreign officials, and the point was made to him that: In the United States, you guys make a big deal about taking trade actions; you go through all these public hearings and exercise all these guilt feelings, whereas here in Europe, we just simply do it.

It is not something they make a big deal of to the extent that we do here. So, I guess to the extent that this sort of attitude emanates down from the top, that will result in a more effective approach to these problems.

Senator GRASSLEY. In conclusion, then, Super 301 works. Are you saying we just need to make more use of it and more often?

Mr. HOWARD. As you know, Super 301 was sunsetted after two listings; it is not now currently in effect. Our initial early support for that statute was not predicated on it having a sunset. If it is viewed that an extension of it—a simple extension only—would be useful, we would certainly support that. But that by itself is not enough.

There has to be the will to do what needs to be done in the Government to make these things work.

Mr. SAMUEL. And I think we would agree that the availability of Super 301 is a tool in our toolbox, which is extremely important; and we should have it available to use when necessary.

Senator BAUCUS. Thank you, Senator. On that point, just let me reaffirm. Does every panelist agree that Super 301 should be extended?

Mr. MORRIS. I have to say, Mr. Chairman, that we—any of us—never formally supported Super 301; we believed that the Super 301 that did exist had some positive results. On the other hand, we also believe that in many ways it has been overtaken and that what is called for now is probably not a Super 301, that a good step back in the assessment of American goals ought to precede the insistence on American retaliation.

Senator BAUCUS. All right.

Mr. KRIST. Senator, we don't have a position on Super 301 right now, either. I would agree very much with what Mr. Morris said earlier; the problem with Japan is a very broad, fundamental difference in system. And what is really needed is, as you said in your opening comments, a marathon by the United States to really take that system seriously and address it.

The Super 301 tends to be much more of a short-term——

Senator BAUCUS. I understand, but why not both? For example, Korea went to great lengths to open up its markets to avoid being listed under Super 301. And it seems to me that both Super 301, special 301, and so forth and the long-term reproach that you are talking about all make sense and that they are not exclusionary.

They all have their benefits and should be pursued together. Do you disagree with that?

Mr. KRIST. As I said, AEA does not have a position on Super 301 right now; and I think there is a lot to sort out.

Senator BAUCUS. Does anyone disagree that Super 301 should be extended?

Mr. MORRIS. I would just reiterate. I have no mandate to argue for it, but neither have I a mandate to argue against it. And therefore, we just have to abstain on that point at this time.

Senator BAUCUS. Let me play devil's advocate for just a second, back to the keiretsus. Some could argue that if we can't beat them, join them; that the United States businesses should establish similar exclusionary business practices. Why not? What is the answer?

Mr. KRIST. I think America's system is vastly better. Our electronics industry is——

Senator BAUCUS. But why? That is a conclusionary statement; what are the reasons?

Mr. KRIST. You know, the strength of our system has been that people have developed good ideas for electronics products, and they have been able to go out and form companies that twenty years later become an Apple Computer.

Our system has been able to generate all kinds of new products that the Japanese system has not been able to do.

Senator BAUCUS. But there are a lot of Japanese electronics products these days that people think are pretty good.

Mr. KRIST. But most of them were designed here, like the VCR. And our system has just been very creative; I think it is very supportive of individual liberty. And if we get our act together, it is very supportive of the highest standard of living in the world.

If we continue not to get our act together, it is not going to turn out to be that way.

Senator BAUCUS. What is that "act" you are referring to? What does "getting our act together" mean?

Mr. KRIST. I guess the key things are really well known. It is the cost of capital. education, a technology policy, and taking trade seriously.

Senator BAUCUS. So, you believe if we do all of that, and if the Japanese do not practice exclusionary business practices or pursue other structural impediments, not only will American businesses do very well, but in your view they will outproduce the Japanese counterpart. Is that your view?

Mr. KRIST. Yes, although I think there is also a lot of responsibility on U.S. industry. But I heard you say that we have to take the Japanese practices very seriously and deal with them right away, and actually deal with them, not just talk about them.

Mr. SAMUEL. Mr. Chairman, if I could comment on just two aspects? It is tempting, of course, to look at that system and say why don't we emulate it. I don't think our society and our culture would permit it.

We are still wedded, although it is very old, to the Sherman Antitrust Act and would not like to see anticompetitive practices of that kind take over our country.

On the other hand, I think there are some areas that the keiretsu have helped promote, which is a much more deliberate and purposeful trade policy, which we ought to look at very seriously.

And as a matter of fact, I think we have been looking at it seriously and are moving in the direction of making sure that international trade bolsters our economic welfare and doesn't undermine it.

Senator BAUCUS. Let me ask another question. To what degree will complete success in the SII address the imbalance with Japan? What percent of complete SII success—your best guess?

Mr. MORRIS. Well, it's a start.

Mr. KRIST. It's a start.

Mr. HOWARD. I would say the same thing. It is very difficult to quantify these things.

Senator BAUCUS. One percent? 99 percent? Your best guess—just rough. I am not going to hold you to it, but just give me a rough guess. I mean, you have to know what we are dealing with here. You have to have some sense.

Mr. RAGOSTA. Senator, I believe in the next panel Mr. Lawrence is going to testify to some econometric analysis concerning what the effect on exports to Japan would be if the keiretsu system were eliminated and the distributional problems resolved.

I think the difficulty the panel has is imagining complete success of the SII process in dismantling distribution barriers, keiretsu barriers and anticompetitive activities in Japan.

Senator BAUCUS. What, you have no faith? [Laughter.]

Mr. MORRIS. Actually, if I may, Mr. Chairman, NAM believes that the correlation in terms of adjusting the imbalance will come more with a U.S. determination, both Government and business, to be competitive, to shift our priorities, not simply the response to a particular negotiation.

Senator BAUCUS. Senator Grassley, any more questions?

Senator GRASSLEY. Yes. I wanted to ask a question about a report on the Japanese which recently appeared in The Wall Street Journal. The headline says, "Japanese Poll Indicates United States. Pleas for Opening Markets Are Sinking In."

The article refers to the name of Japan's largest financial newspaper, the newspaper presumably published the poll. The poll concluded that 47 percent of Japanese citizens basically agreed with U.S. claims that Japan should review its domestic economic mechanisms and open markets more to correct the trade imbalance.

About 40 percent thought the U.S. position was basically inappropriate, although many of them said the United States had some legitimate points.

That article is the first time I have ever seen any poll of Japanese opinions questioning Japanese policy on this issue. Do any of you have any insight as to whether or not you think there is a change in attitude in Japan towards opening up markets, in light of the fact we generally have been led to believe that the Japanese were very much in support of their government's programs?

Mr. KRIST. I do think there is a growing awareness of Japanese consumers that they would benefit from opening the market, although I think government policy and the business structure really slow down that impact in the other sectors of the economy.

The beef example is a classic; they opened the beef market a little bit and raised the tariff 70 percent. So, the Japanese consumer doesn't get to see the benefits of an open market; and it is such a delayed reaction that I think the process is moving way too slow in Japan.

The other reaction, of course, in Japan is an increasing resentment of the United States; and I think a lot of that is coming out of a half-hearted approach towards Japan. We seem to go back on the same issues, rather than negotiating an issue and then insisting that it be fully and rapidly implemented.

Senator GRASSLEY. Mr. Chairman, I think the point keeps coming back time and time again that we just don't have enough consistency in purpose or in policy to see something through to the end. I appreciate the reinforcement of that point by this panel.

Senator BAUCUS. Thank you, Senator. I have one question, Judge Morris. Do you think that the Administration is capable of conducting a good, thorough Team B analysis—a Team B review?

Mr. MORRIS. Yes, Mr. Chairman, we do. I mean, that obviously was the expression of faith on our part in asking the President to undertake such an exercise. In a sense, a Team B-like review is something that only those in power can or would undertake in that it is something that you do when you are on a particular course and wish to reexamine it.

If the political system gives you a new course, then you don't need a Team B. But if you want to reexamine the course that a particular Administration is on, then they do.

I think the President does understand the major shifts that are happening in the world. I think he is concerned about U.S. competitiveness and the persistence of the Japan problem. And I am hopeful that he will respond favorably to our request.

Senator BAUCUS. All right. Thank you very much. I have no further questions. Senator?

Senator GRASSLEY. No, Mr. Chairman.

Senator BAUCUS. Thank you very much for your very helpful testimony.

Our next panel consists of Mr. Robert Lawrence, senior fellow at the Brookings Institution; and Mr. Kevin Kearns, a fellow at the Economic Strategy Institute here in Washington, DC.

All right. Mr. Lawrence, why don't you begin.

STATEMENT OF ROBERT Z. LAWRENCE, SENIOR FELLOW, THE BROOKINGS INSTITUTION, WASHINGTON, DC

Mr. LAWRENCE. Thank you very much, Mr. Chairman. It is a pleasure to be here before you today.

The Structural Impediments Initiative calls for increased policing of antitrust violations in Japan and specifically for an increased focus on the behavior of Japanese corporate groups, which are called keiretsu.

I have been doing some research on the question of keiretsu, and my research suggests that these policies are in fact, warranted. In my research, which I did for the Brookings Institution, I evaluated three positions.

One position is the claim that these keiretsu essentially have no effect on Japanese trade. This is a position associated with many Japanese actually, and, in fact, by many Japanese economists in particular. Their view is there may be these group relationships; but in essence, they don't dominate market decisions.

Second, there is an alternative claim; and that is that these groups indeed have an exclusionary impact—and purely an exclusionary impact. And if that is the case, the prescription is pretty simple; it calls for much tougher antitrust measures.

And then finally, there is a position which I term the "dilemma position." This view acknowledges that these keiretsu may indeed inhibit the entry of newcomers, both Japanese and outsiders; but on the other hand, it argues that these keiretsu could enhance efficiency.

Therefore, the argument is that Japan faces a painful choice: on the one hand, opening its economy; and, on the other, if it does that, losing all of these efficiency benefits.

The problem that I have been trying to work on is trying to sort out what the evidence suggests as to which of these three views is correct.

My strategy in my study was to try to distinguish between the argument of exclusionism, on the one hand, and efficiency on the other by looking at not only what happens in import markets, but also what happens in export markets, the argument being that the evidence in the import markets could be compatible both with exclusionary behavior and with, in fact, some improved efficiency.

Indeed, Japanese imports may be low where these keiretsu tend to dominate, in principle, because the keiretsu make them more efficient. Therefore, I chose to look in addition at what happens in export markets.

If the keiretsu have efficiency benefits, they should show up in export markets as well. On the other hand, if they only show up through these discriminatory practices, they won't enable the Japanese to boost their exports. That was essentially the strategy in the study.

What I found, in fact, was that you can reject the view that the keiretsu have no impact on Japanese imports. I did find that the more prominent keiretsu were in an industry, the lower the share of imports in that industry; and this relationship was statistically significant, and it was quantitatively significant.

My analysis of Japanese exports, on the other hand, gave mixed results. I found that those keiretsu which include firms from many different industries—the horizontal type keiretsu—there is no evidence that they boost exports at all.

As I indicated, what I found in the case of these horizontal keiretsu—the large groups—I could find no beneficial impacts on Japanese exports; I could find negative impacts on the imports.

And I concluded, therefore, that these should form the major focus for antitrust measures.

Looking at the vertical keiretsu—the kind of keiretsu that exists, say, for a Toyota or a Nissan, a single firm—a large firm in its relationship with its assemblers—there, I got a more mixed picture. They inhibited imports, and there was some moderate statistical support for the view that they boosted exports.

That suggested a more measured approach to those forms of keiretsu.

My research also looked at the distribution system. What we got out of the SII talks was overwhelming evidence that imported products are priced at much higher prices in Japan than elsewhere.

Some have argued that this practice indicates that foreigners are choosing to price their products extremely high when selling to Japan. What my research indicated was overwhelmingly that foreign products in Japan are actually brought in by Japanese distributors.

Particularly, U.S. exports tend to be purchased by Japanese trading companies in this country and then sold in Japan. If there are high prices on American products, therefore, it is because the distributors are marking them up; and those distributors are not the foreign firms, but the Japanese distributors.

And that suggests to me, in conclusion, that in thinking about the policies, generally I think the SII talks were on the right track. Antitrust ought to be enforced.

I don't support a simple per se doctrine which would go for all keiretsu, but I certainly would support a much greater monitoring and indeed prosecution of exclusionary practices where these are found to prevail.

When it comes to the distribution system, I think again there is evidence that it functions like a privately administered tariff mechanism, that the markups on foreign products are inordinately high.

I think some of the rules which allow distributors to have sole import monopolies contribute to these practices; and, therefore, I think we ought to step up those enforcement practices as well.

Thank you very much, Mr. Chairman.

Senator BAUCUS. Thank you very much, Mr. Lawrence, for that cogent, illusive statement. Mr. Kearns?

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

STATEMENT OF KEVIN A. KEARNS, FELLOW, ECONOMIC STRATEGY INSTITUTE, WASHINGTON, DC

Mr. KEARNS. Thank you, Mr. Chairman, for the opportunity to appear here today.

There is no doubt that the United States-Japan relationship is of paramount importance, yet it is my strong belief that neither our security nor our economic relationship with Japan is on sound footing today and that a thorough review of America's Japan policy is necessary to begin to set things right.

A little over a year ago, I published an article which called for the establishment of a Team B to review our various policies toward Japan. I expressed the concern that many of the components of our current Japan policy were based on preconceptions about Japan, which were no longer applicable to the economic and technological superpower that Japan had become.

The Team B mechanism was used successfully by President Bush in 1976, when he was the Director of Central Intelligence; and at that time, he reassessed U.S. thinking about Soviet strategic intentions.

My motivation in proposing Team B was not to criticize Japan or the current Administration. Rather, I believed that the diplomatic, economic, and security agendas of the United States and Japan are quite different and that our policy-makers are ignoring significant divergences in the organization and operation of the two countries' economies.

As we have already heard this morning, there are serious problems with SII. Our negotiating strategy is based on the erroneous notion that the Japanese are already pretty much like us; and with a little prodding, their economy and business organizations can be made to conform to our laissez-faire economic theory.

Essentially, we have a clash of two very different economic systems, but our policies refuse to acknowledge that basic reality. The fact is that the Japanese do not share our neoclassical economic model of how companies and markets should operate.

One major difference is that our laissez-faire thinkers are not concerned with the composition of our economy and our trade. They do not distinguish between making manufactured goods and agricultural goods, between computer chips and potato chips, as it were; but Japan and other trading partners do care about the composition of their economies.

These countries support particular industries and target American counterparts precisely because they think that those industries are important engines of future economic growth. However, as evidence that SII and other negotiations are working, both United States and Japanese officials point to the fact that the trade deficit has fallen about $15 billion since the record of $56 billion in 1987.

At first glance, the new numbers seem to indicate Japan is opening is protected market and that American industry is meeting the Japanese challenge. But first glances are deceiving.

The how much of the bilateral trade deficit no longer tells the whole story. Just as important is the composition of the deficit: what is being traded and where in the Japanese global production base it is coming from.

In fact, during the last 3 years of declining deficits—that is, since 1987—the plight of critical American industries relative to their Japanese competitors has actually worsened.

As indicated on the charts to my left, our economic future apparently lies not in such goods as office machines, computers, and electrical and power generating machinery, where the trade deficits by sector have actually worsened since the peak deficit year in 1987.

Our economic future apparently lies in logs, breakfast cereals, meat, fish, and metal ores, where the U.S. trade surplus has expanded.

So, if you analyze the trade figures by sector, you will find out that the United States is doing quite well in commodities; but actually, the deficit is increasing in all the key machinery sectors.

Senator BAUCUS. Would you explain to us, please, what each of those bars represents?

Mr. KEARNS. Yes, certainly. The chart on the right is a trade surplus; we have surpluses in these items with Japan. The green bar is 1987, and the brown bar is 1990.

So, in each category—wood, cereals, meat and fish, and metals and ores—our trade surplus has increased. We are selling more to

Japan in those categories than we did in 1987, which was the peak deficit year. That, in itself, is a good trend.

However, when you look at our manufacturing categories—our main manufacturing categories, 1987 and 1990 compared—there are deficits; and the deficit has increased in each one of these key machinery sectors since 1987. 1987 was the year that the deficit was so bad that we couldn't live with it.

Well, if you take a look at the $15 billion deficit reduction, on the surface that might look great. The deficit is down; SII is working; the other negotiations are working.

But when you get into the composition of the deficit and look at what we are trading and where our economy is headed, you have to draw the conclusion that we are in trouble in the manufacturing sector and in high tech sectors, and that we are becoming a nation of lumberjacks and scrap metal collectors.

I have nothing against scrap metal collectors or lumberjacks, but I think we don't want our entire economy going that way overall.

So, I think what we need to do, Mr. Chairman, is take a fresh look at our trade relations with Japan, at our security relations with Japan.

I think that we are operating on conceptions about the Japanese economy which simply don't hold true in the global competitiveness environment in which we find ourselves today, and that we need to run—the Administration needs to run—a Team B to begin to set things right. Thank you.

Senator BAUCUS. I am sorry. I interrupted you and asked you to explain those charts. If you have another minute or two you want to take, go ahead and take it.

Mr. KEARNS. That is fine, Mr. Chairman. The point is that the trade deficit, which you cited at the beginning of your remarks, is down; but we have to look very closely at the trends behind that, and the trends are not at all comforting.

Senator BAUCUS. All right. Thank you very much.

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

Senator BAUCUS. Dr. Lawrence, what operational significance do your conclusions have for our negotiators in the SII talks? That is, which of these keiretsus and exclusionary practices should we seek to dismantle and which ones not? And where do we draw the line?

Mr. LAWRENCE. My analysis is done at a very aggregative level. And presumably, when antitrust enforcement is actually carried out, it is done at a firm level. However, I do believe that at the aggregative level, the evidence should help to establish priorities.

With that in mind, I would say that what I draw is, number one, the conclusion that antitrust enforcement and entry barriers are a major problem of considerable importance. We are not misplaced in our emphasis that these practices require much more stringent policing.

And I would just say that we need an approach which looks at what the Japanese themselves will do and what we can get them to do in negotiation, and also what we could do within the United States, both with respect to practices within the U.S. economy, but indeed with respect to practices that affect the competitive outcomes in the United States but may be going on in Japan.

Senator BAUCUS. Is there any way you could quantify—or say, "tarrify"—the effect that these exclusionary business practices have? Let's take all the SII topics. If that were converted into a tariff on U.S. products into Japan, what would the level of that tariff be? What would the range be?

Mr. LAWRENCE. Well, it is a very tricky question to answer. I would just say that my judgment is that these are significant, very significant. In other words, I think that, to be precise, if I were to put in zero for the keiretsu variable in my regressions, I would conclude that foreign manufacturers—I don't do it just for the United States—but that manufactured imports could be something on the order of 50 percent higher.

Translating that into a tariff equivalent takes some calculation; but all I would say is that my estimate is extremely significant. It is an important effect.

Senator BAUCUS. Some of the U.S. beef exporters believe that, even though we have reached a trade agreement with Japan where the quota is eliminated and now there is a 70 percent tariff, there is a practical matter that distributors in Japan keep the high price level to consumers—the distributors themselves in effect get the benefit, the profit.

Mr. LAWRENCE. Absolutely. In fact, that is another way to answer your question. I don't want to ascribe the full distribution margin to keiretsu per se. Whatever it is, the fact is that one of the very useful things that was achieved by the Structural Impediments Initiative was this joint survey between MITI and the U.S. Department of Commerce.

And they established, when it comes to consumer products, indeed a weighted average, which I present in my testimony that typically American products are about twice as expensive. American consumer goods are twice as expensive when sold in Japan than they are in the United States.

So, we have there some estimate of a very, very high markup; and so, we could translate that back—I couldn't do it off the top of my head—into some kind of a very high tariff equivalent.

So, the question is: What can we do to bring that margin down? I think this should be an extremely high priority. It involves continuous monitoring of these prices and then exploration of the major mechanisms that are keeping these prices higher.

Senator BAUCUS. Do you think this argument that Super 301, 301, and Special 301 provide necessary leverage to reach an agreement, to get results?

Mr. LAWRENCE. I think in some cases they have. However, I, too, would like to see a much more coordinated framework being established. I am not saying that these ought not to be there; but I would like to put our relationship also on a much more sound and long-term basis.

I actually believe we ought to have a joint vision between the American and Japanese Governments; and indeed, it may even be multilateral, with the Europeans participating, in which we would lay out where we think our economies ought to be over the next twenty years, and then, what steps each of us has to take in order to achieve that objective.

Senator BAUCUS. That sounds like managed trade to me.

Mr. Lawrence. Not at all—the very opposite. The kind of vision I have in mind is the kind that the Europeans had, when they decided they wanted a single European marketplace. That was the vision.

They wanted the free flow of goods, services, labor, and capital. That was their goal; and then, they asked: How do we get there? And they came up with 279 different measures that had to be taken to remove impediments to that ultimate goal.

And I think we should be doing exactly the same with the Japanese.

Senator BAUCUS. I guess the Team B review, which I take it you support?

Mr. LAWRENCE. Well, the Team B review is a unilateral and first effort at what we want to achieve. But I think, in all of these cases, it has to be multilateral; we have to understand whether Mr. Kearns is right and the Japanese conception of how the world should work is really so different from ours that we cannot agree on common elements, or whether as I believe we in fact have common goals and objectives and, therefore, can mutually plan the rules of the game that would allow us to achieve those objectives.

Senator BAUCUS. My time is up. We can get back to this. Senator Grassley?

Senator GRASSLEY. Mr. Kearns, the last two or three sentences of your testimony, just before your charts, lead me to question whether you are speaking about a 301, or what specifically might you recommend?

Mr. KEARNS. I am sorry, Senator. Where are you referring?

Senator GRASSLEY. I think it is the last three sentences of your testimony. "It is time for policy makers to stop trumpeting their putative trade successes . . . "

Mr. KEARNS. Right. Yes, sir. I think what we need to do is we need to declare a short moratorium on all our talks with Japan—on all our trade talks—and to step back and reevaluate.

It is clear to me from looking at the trade statistics—the 1990 statistics—and hearing the statements of both United States and Japanese officials that they think that this decline in the trade deficit means that we are on our way to solving all our problems.

I don't think that is what the decline in the trade deficit means; and I have seen a number of projections which show that 1990 is going to be the bottoming out, and the trade deficit is going to begin to climb again for the next several years.

The trade deficit does not begin to address the question of foreign direct investment by Japan and others in our economy—whether that is good or what portion of it is good, what portion is harmful.

It doesn't begin to address things like technology policy. It doesn't really address the business organization, the behavior of Japanese firms in the United States.

So, I think we need to step back, form a Team B or a Presidential Task Force or whatever you want to call it, and examine these issues in much more detail and set a framework for U.S. policy toward Japan, and then reengage the Japanese based on a comprehensive framework.

Senator GRASSLEY. Is this halt mean to send a signal that we will be more confrontational as we approach trade negotiations in the future?

Mr. KEARNS. I think it means that we are setting our house in order. I don't think we have to worry so much about how the Japanese would react. I think we Americans can step back and examine our policies objectively.

Our Japanese allies often fault us for not being coordinated. They came up with a whole bunch of SII suggestions themselves for our Government and for our economy. So, I am sure they would be delighted if we stepped back and took a look and pulled things together.

Senator GRASSLEY. Also, I asked you about 301. I assume that your answer is that 301, of and by itself, is not enough. You are suggesting that we need a more comprehensive view?

Mr. KEARNS. That is correct, Senator. I think it is a useful tool; but, in and of itself, it won't accomplish the goals that I think we need to accomplish.

Senator GRASSLEY. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you, Senator. Mr. Kearns, you have performed a very useful service in many ways. One is with the information on those charts.

This is a problem that has bothered me a lot as well; that is, sure, we are exporting a lot of raw materials, but we want to export value-added products, that is the manufactured products that create jobs and boost a nation's income. And that is where we, as Americans, frankly have to be more diligent.

I come from a natural resource State. We very much appreciate the wheat and the forest products and beef that we export to many countries, including Japan; but we are all Americans, too. Our country as a whole must do a much better job exporting the higher value product—the higher end product—than we have been thus far.

I frankly believe that it is probably an intentional policy of Japan to import our natural resources, but not import our manufactured products because that obviously is to the benefit of the Japanese national income to do so.

Mr. KEARNS. May I comment on that, Senator?

Senator BAUCUS. Yes.

Mr. KEARNS. The strange thing is that even in the commodities, as we have heard this morning—in the instance of beef, for instance, of Japan's putting on a 70 percent tariff; opening the market but then following with a tariff. Even though we are doing quite well in commodities, we could be selling a lot more if the Japanese market were truly open.

So, we cannot draw the conclusion that, because we do have growing trade surpluses in commodities, their market is open even in that category.

I am glad to see that people engaged in natural resource production are doing better; but overall, it is not enough for us as an economy. We have to concentrate on the high value-added goods, the manufactured and high tech goods if we are to succeed.

Senator BAUCUS. If there were Team B review, what do you think it would conclude? What is your best guess?

Mr. KEARNS. Well, I think if it is run in a fair manner and it is not coopted, it would provide a framework for Japan policy. I think it would conclude that we need to have more concrete goals in our trade policy; I don't know if you want to call it managed trade results or oriented trade.

Right now, so many of our trade negotiations involve process. We are opening the Japanese market; we are getting them to accept principles. But we don't have hard and fast results by which we can measure trade achievements; and that is why we have to fall back on a general measure like the trade deficit.

So, I hope Team B would come up with very specific recommendations for our relations with Japan.

Senator BAUCUS. Mr. Lawrence, what sectors of the Japanese economy are most tightly controlled by the keiretsus? Which ones stand out?

Mr. LAWRENCE. Well, I think there is a broad range. I think it's clear, for instance, if we start with natural resources that when it comes to distributing agricultural products, you know the United States has some super trading companies in this area—Cargill, Continental, and so on, in the grains.

And yet, we carry an inordinately small share. Those firms are responsible for an inordinately small share of our agricultural exports to Japan. So, it is a very striking case; and I would say that the dominance of those Japanese distribution companies in that area is overwhelming.

When it comes to electronics products, it is also clear that in the distribution system, there are a number of Japanese distributors of manufacturers who have a very large number of retail stores that are effectively closed to products which they do not manufacture.

The result is that a large amount of the retail electronics industry simply has floor space on which American or foreign products would never appear unless they were brought in by those entities.

The dominant effects are more subtle to pick up in the area of machinery, and that is actually very important for American sales since we are a major capital goods exporter. That is where you would believe that we could benefit.

Again, I couldn't cite you very specific sectors; but I will say that the evidence at the aggregate level for sectors like machinery is extremely pronounced. I mean, you can see it there.

Senator BAUCUS. Thank you. I have no further questions. Has anyone said anything sufficiently outrageous to prompt a response from either of you at this point?

[No response.]

Senator BAUCUS. Nothing further? All right.

Mr. LAWRENCE. I disagree somewhat with Mr. Kearns' prescription, in particular the outcome. I am not adverse to our reviewing our relationship, asking where we stand. I think that we ought to continue, contrary to what he has said; I think ultimately our goal has to be a level playing field, getting the rules of the game such that there is free entry.

I think, after that, we should let the market decide who wins and loses in the competition. And what I really fear is that a move towards trying to manage results is likely to reinforce the cartelization process in Japan. The only way you can achieve those quantitative numbers is for the MITI in Japan essentially to enforce them.

And I don't think that that is the kind of Japan we want to see.

Senator BAUCUS. But isn't the answer really somewhere in between?

Mr. LAWRENCE. I think in some cases——

Senator BAUCUS. That is, it is not totally a level playing field, and it is not totally process-oriented, nor is it totally managed. It is probably somewhere in between.

Mr. LAWRENCE. Probably. I think when it comes particularly to some things like Government procurement—you see, I am not fearful that we are going to cartelize the Japanese Government; it is already a single buyer.

And where we have evidence like we heard earlier on that in computers it is buying practices that are clearly very different than the Japanese private sector, I would not be averse to a quantitative number being suggested as indicative of nondiscriminatory practiee.

Senator BAUCUS. But my experience is that quantification helps. It helps one know whether or not one is achieving goals, and benchmarks help. I know, for example in the United States-Japanese beef and citrus negotiations, that it was apples and oranges until the negotiators agreed to try to "tarrify" everything, that is, find a common denominator with which to negotiate. And this quantified—described a number—in tariff terms to the quota; and only then were they able to negotiate and reach an agreement.

I believe that quantification does make a major difference in most cases; but I agree that we run the risk of cartelization and carving up, which is going to have very, very detrimental economic effects as well.

It is just like a lot of things; there is a little bit of truth in everything. We just have to be pragmatic about it. The major goal, as I see it, is what is in the best long-term interests of both countries; but more precisely, how do we best raise the living standards of most people in both countries? That is really the question.

Thank you very much. We appreciate your testimony.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

APPENDIX

Additional Material Submitted

Prepared Statement of Senator Max Baucus

Almost exactly one year ago, the U.S. and Japan concluded an interim report on the Structural Impediments Initiative or SII. From reading press reports at the time, one might easily have had the impression that the U.S. and Japan were on the verge of resolving their trade problems. The Administration was so pleased with the progress made in SII that it decided not to cite Japan under the Super 301 provision of the 1988 Trade Act.

SII is a step in the right direction. It is an ambitious effort to address the underlying structural problems—in both the U.S. and Japan—that are responsible for the bilateral trade imbalance. But we have still not achieved our objectives in SII or on U.S.-Japan trade issues generally. Much more remains to be done.

JAPAN'S TRADE RECORD

Unquestionably, we have made progress in opening the Japanese market to U.S. exports and reducing the trade imbalance. The annual trade deficit with Japan is down by $11.3 billion—a 22% improvement since 1988. U.S. exports to Japan increased by 30% between 1988 and 1990. A series of trade agreements have been concluded with Japan aimed at opening the Japanese market to U.S. exports of beef, semiconductors, forest products, supercomputers, and many other products.

However, the bilateral trade deficit with Japan has improved more slowly than that with our other trading partners. For example, during the same period that the deficit with Japan improved 22%, the U.S. trade balance with the EC went from $10.3 billion deficit to a $6.2 billion surplus. The trade deficit with Japan is still four times larger than the deficit with any other nation.

Also, Japan still imports far less as a percentage of total consumption than any other developed nation. Moreover, the rate at which Japanese imports are growing has slackened considerably in recent months.

Finally, Japan still maintains far more barriers than other developed nations. As in past years, the new National Trade Estimate devotes far more space to listing Japanese trade barriers than it does to any other nation. Sectoral barriers still block products ranging from rice to semiconductors. Economy wide barriers that block all imports, such as the Japanese distribution system, also remain.

Even in sectors in which we have made progress barriers remain. For example, Japan finally phased out its beef quota on April 1st, but the quota was replaced with a 70% tariff remains in place.

Obviously, much remains to be done before the Japanese market can be declared open.

THE BUSH ADMINISTRATION'S JAPAN POLICY

Unfortunately, the U.S. treats the task of opening the Japanese market as if it were a 100-yard sprint. We strive to reach an agreement by a set deadline. For a short period, we devote great energy to opening the Japanese market. But once we reach an agreement, we simply declare victory and walk away.

If we are ever to make real progress in opening the Japanese market, we must instead make the sustained effort of a marathon runner. We must approach the problem knowing that a final solution is years away.

We must still strive to reach specific agreements. But once they are concluded we cannot walk away. We must carefully monitor implementation and stand up for our rights if agreements are violated. We must also be willing to press for further agreements as new barriers are identified.

At first I was very encouraged by SII because I believed it was a step in the direction of establishing a marathon running strategy. The final SII agreement did include a series of follow up meetings to review implementation and discuss further steps.

However, I fear that many in the Administration—particularly at its highest levels—still think like sprinters, not marathoners. There is a core group of capable trade negotiators in the Administration who continue to mind Japanese trade issues But at its highest levels, the Administration now seems more interested in congratulating Japan for its contribution to the Gulf than in continuing to press to promote the interests of American exporters and workers.

Japan does deserve credit for its contribution to the Gulf effort. But the contribution does not excuse trade barriers. The trade issue must be kept on the front burner. No issue in the bilateral relationship between the U.S. and Japan is more important than trade. We cannot afford to let our determination to open the Japanese market slip. We must continue firmly and resolutely to pursue our market opening objectives.

REVIEW OF SII

SII has made progress in addressing some of the Japanese structural trade barriers. For example, progress seems to have been made on increasing Japanese investment in infrastructure. But progress on the most important structural barrier—a web of exclusionary business practices—remains slow.

In Japan, a series of cartels in production and distribution—known as keiretsus—work to exclude imports from the Japanese market. Respected economists have estimated that these barriers keep Japanese imports 25% to 40% lower than would be expected in a developed nation. The President's own Advisory Committee for Trade Policy and Negotiations has estimated that these barriers exclude as much as $11 billion in U.S. exports each year.

For the first time, the U.S. through SII sought to address these exclusionary business practices. In doing so the U.S. did finally target the key trade barrier in Japan. Unfortunately, progress toward eliminating the exclusionary practices has been slow. Japan has beefed up its policing of the Japanese Anti-Monopoly Act. But the keiretsus still function.

In some cases, Japan seems to have focused its "trust busting" on American firms doing business in Japan. If those firms are violating Japanese law, they should be prosecuted. But American firms certainly are not at the heart of Japanese keiretsus.

I was pleased by recent Anti Monoploy Act actions against Japanese makers of cement and manhole covers. But we are still to see any actions in major industries, like food distribution, semiconductors, or autos. Ending exclusionary Japanese business practices will be a long process But we must continue to press the case in SII.

We must press Japan to fully implement the commitments it has made to police its keiretsus and open its distribution system. And, as we learn more about the problems U.S. exporters face in Japan, we should press for further steps.

CONCLUSION

The economies of the U.S. and Japan are now interdependent. Both the U.S. and Japan need each other. But that does not mean that all criticism of the current trading relationship is unwarranted "Japan bashing."

If the trading relationship between Japan and the U.S. is to grow, Japanese markets must be opened. Otherwise calls for protectionism in the U.S. will begin to prevail.

Frankly, I believe that the current trading relationship between the U.S. and Japan is sorely in need of "new thinking." I have long advocated stepping back and taking a long, hard look at the trade problem with Japan. It is obvious that the current policy can be improved upon.

I still strongly support SII because it does represent new and more holistic thinking about U.S.-Japan trade issues. But U.S. policy could benefit from an even more sweeping review. I urge the Administration to undertake just such a review. The world cannot tolerate a trading system in which the second largest economy remains largely closed to imports.

Prepared Statement of John E. Howard

I am John Howard, Executive Director of the U.S. Chamber's Market Access Subcommittee. The Subcommittee's mandate is to identify and seek the elimination of foreign barriers to U.S. trade and investment. It is in this capacity that I am appearing before the Trade Subcommittee today to discuss the Japan-U.S. Structural Impediments initiative, or SII.

Let me say first that the Japan-U.S. economic relationship is as important as any such bilateral relationship we have in the world today. We are the world's two largest national economies. With a combined two-way total merchandise trade of nearly $140 billion in 1990, Japan is our largest single trading partner outside of North America. Japan has over three times as much direct investment in the U.S. as the U.S. has there. It is clearly in the best interests of the United States to do whatever needs to be done to strengthen that relationship.

And yet, Japan-U.S. economic relations continue in a persistent state of tension. While in recent weeks, those relations have been strained further by Japan's hesitation in contributing funding to the Gulf War effort, the continuing trade imbalance, exacerbated significantly by ongoing barriers to U.S. exports and investment, remains the single most important irritant to our bilateral relationship.

In 1988, Congress culminated years of debate over Japan-U.S. trade relations when it passed the Omnibus Trade and Competitiveness Act (P.L. 100-418). That Act, totalling several hundred pages in its final printed form, covered literally dozens of domestic and international economic issues—market access, export promotion, import remedies, foreign investment, education and training, and U.S. competitiveness, to name just a few categories. However, no single provision received as much focus both during and after debate on the 1988 Trade Act as did the so-called "Super 301" provisions of that Act. And no provision of that Act was aimed as directly *and* as broadly at perceived Japanese unfair trade practices as was that provision.

Origins of the "Structural Impediments Initiative"

You will recall that the SII was launched in tandem with the first of two "identifications of trade liberalization priorities" that were required under the "Super 301" provisions. Those provisions stipulated that trade liberalization priorities were to include "priority practices, including major barriers and trade distorting practices, the elimination of which are likely to have the most significant potential to increase United States exports, either directly or through the establishment of a beneficial precedent." The legislative history further stipulated that this language was "not intended to result in the identification of only token practices" or "limited to those barriers in the (*National Trade Estimates*) *report.*"

On March 24, 1989, in its first "Super 301" submission, the U.S. Chamber of Commerce recommended that the United States Trade Representative (U.S.T.R.) identify various trade and investment practices in Japan (as well as in Brazil, India and South Korea) as "priorities" under "Super 301." In Japan, those priorities included: export targeting; administrative guidance; discriminatory public procurement; restrictive business practices and distribution channels; restrictive customs administration, discriminatory standards, testing, certification and regulatory requirements; inadequate intellectual property protection, and trade agreement violations.

In its first "Super 301" announcement, on May 25,1989, the Administration announced that it had identified in Japan exclusionary government procurement practices in the satellite and supercomputer sectors, and technical barriers to trade in the forest product sector, as priority practices deserving of "Super 301" investigations and negotiations. However, it had reserved many of the structural barriers which constitute the most pervasive and systemic impediments to U.S. exports as a whole for the SII which, unlike "Super 301," is not subject to any specific, statutorily-mandated timetables and procedures. More specifically, the issues reserved for the SII included "structural impediments to trade and balance-of-payments adjustment, and such anticompetitive practices as bid-rigging, market allocation and group boycotts," as well as "rigidity in the distribution system and pricing mechanisms."

In its second "Super 301" submission, dated February 16, 1990, the U.S. Chamber noted that, ongoing SII negotiations notwithstanding, no changes had occurred by that time which were significant enough to justify Japan's exclusion from a second "Super 301" identification by the U.S. administration. It was true that Japan seemed to recognize the importance of coming to an agreement with the U.S. on many of the referenced issues, and also had announced that it intended to implement various incentives to increase domestic consumption and imports. However, given the absence of significant market-opening change in Japan, the Chamber still believed that most of the barriers identified in its first "Super 301" submission still warranted further scrutiny under that statute. The Chamber believed then, as it does today, that much of the progress we have made with Japan, both within the "Super 301" context and as put of the SII, can be attributed directly to the leverage afforded under "Super 301."

JAPANESE TRADE LIBERALIZATION AND THE SII

On June 28,1990, the Japanese and U.S. governments issued the *Joint Report of the U.S.-Japan Working Group on the Structural Impediments Initiative.* To our knowledge, this is the last official and unified documentation of progress made during the course of the SII negotiations. In the *Joint Report,* the government of Japan is recorded as committing itself to the development and implementation of plans which would, among other things, improve access to the distribution system; strengthen Antimonopoly Act enforcement; promote imports through tax incentives and other measures; increase transparency and less discrimination in public procurement; strengthen the functions of the Japan Fair Trade Commission (JFTC) as regards *keiretsu* relationships; and improve functioning of and information concerning pricing mechanisms.

Since the *Joint Report* was issued, we have attempted to monitor Japanese progress toward trade and investment liberalization through ongoing consultations with our member companies, government officials and other public sources of information, such as the *National Trade Estimates* report. Admittedly, there are some signs of progress in efforts to re-orient Japanese trade policy toward greater openness. For example:

• The JFTC has increased the size of its investigative staff and appears to be adopting a more aggressive posture toward the enforcement of anti-monopoly laws. The JFTC took 18 formal actions last year, as compared to six the year before. The JFTC is also increasing the level of fines for violations from 2% to 6% of sales (although the U.S. is seeking a 10% level).

• The Japanese Patent Office (JPO) is hiring more staff and making an effort to reduce the time required to issue a patent to about two years. This would represent a significant improvement from the six-year period our members have experienced in the past.

• The licensing period for large stores in Japan—an important component of the distribution system—is expected to be cut from 18 months to 12 months by the end of 1991.

However, there are numerous areas in which adequate progress remains to be achieved. Problems persist with respect to obtaining transparency ad non-discrimination in government procurement. While the JFTC has drafted new atimonopoly guidelines concerning restrictive business practices and distribution systems, those guidelines are still under review. It remains to be seen whether those guidelines, once implemented, will result in increased access for U.S. companies across-the-board. Additional streamlining of Japanese customs procedures is still needed. Overall, we expect that it will take several years more at the least, given the current rate of progress, to achieve the market-opening results we seek

CONCLUSION

Preservation of the American position in the world marketplace requires that the U.S. address its own competitive challenges. In particular, lower capital costs and strengthened educational performance are critical to meeting successfully this challenge. However, while the U.S. clearly must act to correct its own structural impediments ad elevate the importance of trade in its policymaking circles, this in no way justifies weakening its resolve to open foreign markets, whether through multilateral, bilateral or even unilateral means. U S. businesses continue to face a wide rage of trade barriers and distortions in other countries that do not burden those countries' businesses operating in those countries or in the U.S. The U.S. must continue to give the necessary support to its negotiators and even prod them into tougher positions when they appear to falter. The U.S. must make it even clearer that it takes its legitimate trade rights very seriously ad is prepared to take unilateral action if necessary and appropriate to defend those rights.

There is nothing protectionist about asserting America's legitimate trade rights. On the contrary, it is clearly in the best interests of not only the U.S. economy but also the world trading system.

PREPARED STATEMENT OF KEVIN L. KEARNS

Mr. Chairman, thank you for the opportunity to appear today to discuss the growing frictions in the U.S.-Japan bilateral relationship. There is no doubt that this relationship is of paramount importance to the citizens of both countries, yet public opinion polls on both sides of the Pacific show that we view one another with increasing hostility and suspicion, especially after the controversy surrounding Japan's contributions to the Gulf War effort. It is my strong belief that neither our security nor our economic relationship with Japan is on sound footing and that a thorough review of America's Japan policy is necessary to begin to set things right.

A little over a year ago I published an article on the state of U.S.-Japan relations, which called for the establishment of a Team B to review our various policies toward Japan in a comprehensive manner and to fashion a more cohesive, realistic policy toward this important ally. I expressed the concern that many components of our current policy were based on pre-conceptions about Japan which, while they may have been valid during the post-war period, were no longer applicable to the economic and technological superpower that Japan had become.

The Team B mechanism was used successfully by President Bush in 1976 when he was Director of Central Intelligence to reassess U.S. thinking about Soviet strategic intentions. At that time there was growing skepticism about the accuracy of U.S. policy assumptions brought on by increases in Soviet strategic capabilities. The net effect of the original Team B was to replace the doctrinaire and largely incorrect point of view then dominating U.S. thinking with one that corresponded correctly to emerging Soviet military realities.

My motivation in proposing Team B was not to criticize or bash Japan. Nor was my intention to impugn the current Administration. Rather I believed that the diplomatic, economic and security agendas of the United States and Japan were quite different, and that our policy makers and Japan's were ignoring basic and significant differences, especially in the organization and operation of the two countries' economies, in pursuit of a forced harmony. Japan's indecision during the Gulf War and its seeming reluctance to support the allied war effort are but the most recent manifestation of the fact that the Japanese often do not share our view of the world, even on matters that we view as critical to both our interests.

If our trade negotiating strategies are based on outmoded or incorrect assumptions, or if our perceptions are clouded by economic theories which no longer correspond to the realities of global competition, our policies cannot succeed. Therefore, it is critical that we see the Japan of today clearly and distinctly, and act and react accordingly, if we are to have a mutually beneficial relationship.

As we have heard already this morning there are serious problems with the SII negotiations, and with the seemingly endless stream of other trade and economic negotiations. both before and after SII. Our negotiating strategy is based on the erroneous notion that the Japanese are already pretty much like us and with a little prodding their economy and business organizations can be made to conform to our laisse-faire economic theory.

But the fact is that many foreign companies and governments, not just the Japanese, do not share our neo-classical economists' view of how economies and markets should operate. One major difference is that our laissez-faire thinkers are not concerned with the composition of our economy and our trade. They believe that the makeup of both should be left up to the market, and thus do not distinguish between making manufactured goods and agricultural goods, between computer chips and potato chips.

But making and exporting low-tech and agricultural products simply doesn't provide the same opportunities to generate wealth and spin off new industries as does high-tech production and trade. What laissez-faire theorists fail to account for is the simple fact that Japan and other trading partners do care about the composition of their economies. These countries support particular industries, and target American counterparts, precisely because they think those industries are important engines of future economic growth. Two examples are the European targeting of our commercial aircraft industry with Airbus and the Japanese targeting of our semiconductor and supercomputer industries.

Unfortunately, the current paradigm provided by neo-classical economics is not a good roadmap of the new, post-cold-war economic realities. Unless we expand our economic theory and our policies to encompass the fact that the world often does not operate according to our principles, we will never have successful results from our trade negotiations.

However, the Administration and the orthodox economic thinkers insist that SII will eventually work. Even though our negotiating track record with the Japanese is abysmal and we seem to renegotiate the same issues again every few years, we are now to believe that SII will someday do the trick. As evidence that SII and the other negotiations are changing our economic relationship for the better, both U.S. and Japanese officials point to the fact that the trade deficit has fallen substantially—to $41 billion in 1990 from $49 billion in 1989. And the gap stands far below the record of $56 billion in 1987.

At first glance, the new numbers seem to indicate that Japan is opening its protected market and that American industry is meeting the Japanese challenge. But first glances are deceiving. The "how much" of the bilateral deficit no longer tells the whole story. Just as important is the composition of U.S.-Japan trade—i.e. what is being traded and where in the global Japan production base it comes from.

The deficit has been cut in several ways. First, Japan has increased its purchases from America. But the dollar volume of its exports of manufactured goods in most sectors has outpaced the growth in dollar volume of its manufactured imports from America. To offset the expanding manufacturing deficit, Japan has increased its purchases of commodities, which is fine in itself but troubling when measured against manufacturing is declining competitive position.

Second, Japanese companies have located some assembly plants in the United States. These plants don't provide the same range of jobs or domestic content as their U.S. counterparts, but they do improve the trade numbers by the amount of value added to essentially Japanese goods by American workers.

Finally, Japanese companies have moved assembly plants to third countries—transferring export statistics from Japanese to other countries' trade figures and reducing the deficit attributable to Japan. In Thailand for example, 46 Japanese electronic companies have been established since 1985. While Japan's consumer electronics exports to America were down substantially in the past three years, exports of microwaves, VCRs and color TVs from Japanese companies operating in Thailand have skyrocketed. Exports from Japanese affiliates in other Asian countries and Mexico are also up dramatically. Thus to conclude that more competitive American companies are causing the bilateral deficit to fall would be erroneous.

In fact during the last three years of declining deficits with Japan, the plight of critical American industries, relative to their Japanese competitors, has actually worsened. What do the statistics indicate about U.S. exports? As indicated on the accompanying charts, they say our economic future lies not in such goods as office machines, computers, and electrical and power generating machinery—where, in spite of the fact that we sold more to Japan, the sectoral trade imbalances of peak deficit year 1987 have actually expanded by over $2.3 billion. Apparently the future lies in logs, breakfast cereals, meat, fish and metal ores—where the U.S. trade surplus has expanded by $3.6 billion.

How can our top policy makers and trade negotiators be satisfied with results such as these? They are satisfactory only if we don't care what we make, only if we don't care whether we work as scrap metal collectors or highly skilled, highly paid technicians.

SII, the MOSS talks and other trade negotiations with Japan have not produced real improvements in our trade or overall economic performance. The problem is that our approach is always process-oriented and not results-oriented. Successive American administrations have had an aversion to results-oriented trade, which they see as a distortion of free-market principles. Yet without measurable goals agreed on by both sides, there is no way to tell if the agreements are working and the results are satisfactory.

The American preference for championing principles instead of discussing results essentially leaves it to the other side to determine what the results will be. This approach to trade is analogous to going into arms control talks with negotiating instructions to get the other side to agree to the principle that the world would be more peaceful if there were fewer nuclear weapons and then leaving up to them to act accordingly. Of course, we don't do this. We fight hard over the specifics—the numbers of launchers and war heads and delivery systems. we want to eliminate, and what trade offs are possible.

As long as our trade negotiations avoid results, there will be no substantial changes in the current trading regime. Japanese companies live in corporate paradise now: they have a free trader's access to the American market and protection against most foreign competition in their home market. Why should we expect to convince the Japanese to abandon the economic system which is producing such well-being for them, in favor of our system, which is slowly but surely bringing about the de-industrialization of America?

Does the Administration really expect Japan to break up the Mitsui group and the other keiretsu? Or to adopt a U.S. style distribution system? Or to abandon industrial policy and government administrative guidance to industry? It is both naive and arrogant of us to think that the Japanese will change with just the right amount of pressure from our trade negotiators.

A number of Japanese have pointed out that U.S. expectations of SII are too unrealistic. Yoshi Tsurumi, a professor of international business at the City University of New York, said recently, "Japan's structural problems are too embedded in its system to justify the false hopes of resolving them in trade negotiations." And a senior Japanese trade negotiator commented that the Japanese practice of organizing into industrial conglomerates known as "keiretsu" was critically linked to the political structure of Japan, if only because these keiretsu offer generous election-time donations to the ruling Liberal Democratic Party. He warned, "If you change these practices, the LDP government cannot survive."

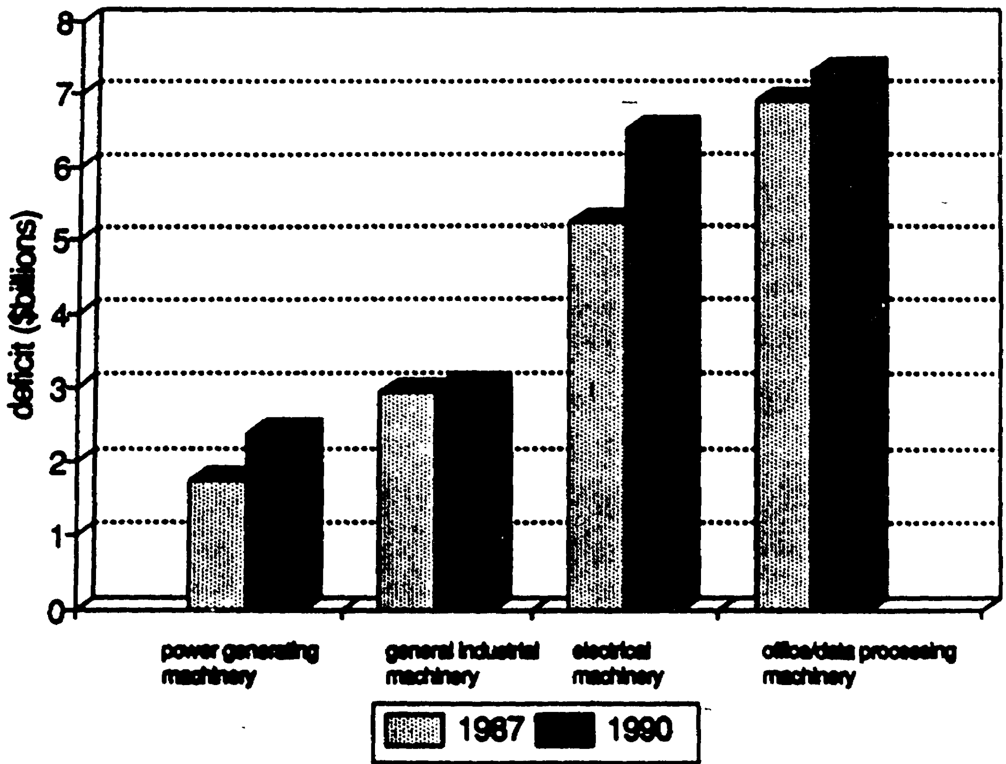
The U.S. government's policy toward Japan has remained embedded in a post-World War II perspective that is no longer appropriate. As part of our security alliance against the Soviet Union, we gave special privileges to Japan so that it would become economically strong and resistent to the potential encroachment of communism. In today's world, this strategy no longer makes sense. For all of the Bush Administration's recent rhetoric of a "new world order," it has failed to recognize the radical change that has taken place in the global economic landscape over the past forty years. And our policy toward Japan has hardly changed since the immediate post-war era.

Japan is one of our most important allies, and yet I am concerned that our relations will grow increasingly troubled unless the U.S. government adopts new policies which will promote U.S. economic and commercial interests, as well as military and diplomatic interests.

In the past three weeks, the CEOs of the Big Three auto makers have met with the President about the problems of competing with Japan's auto cartels and the National Association of Manufacturers, representing thousands of American firms, has written the President requesting a complete review of U.S.-Japan economic relations. These actions underscore the urgency with which our manufacturing companies view the situation. What American manufacturers know that White House economists don't is that the decline in the trade deficit is not an accurate measure of the success of SII or our nation's competitiveness vis-a-vis Japan.

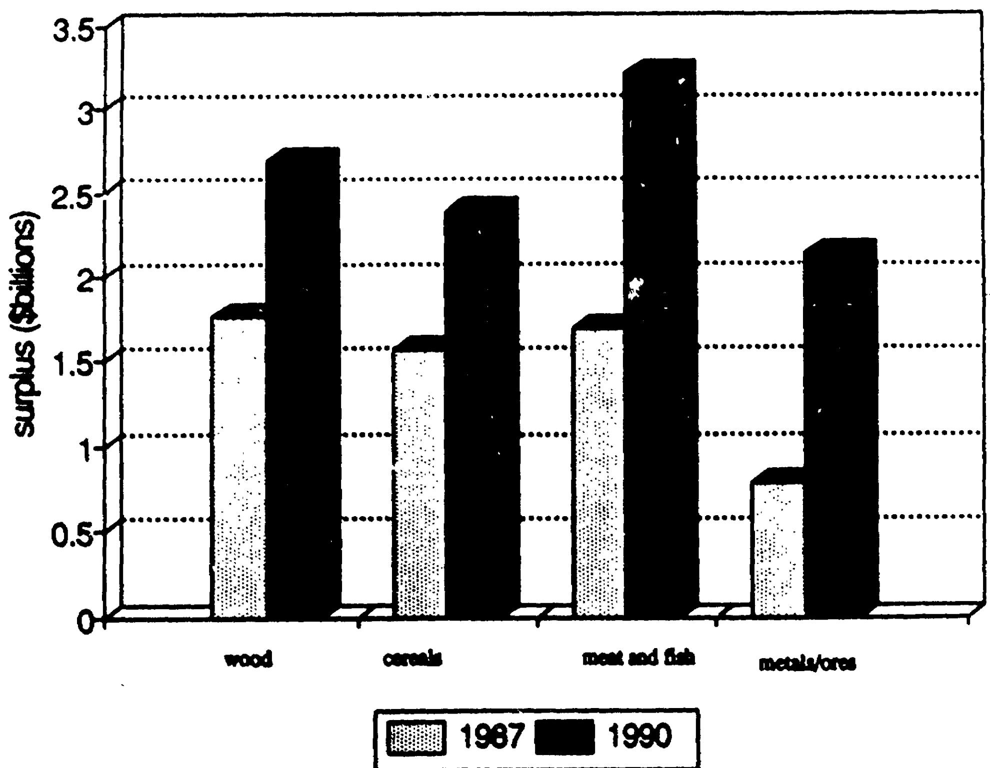
It is time for policy makers to stop trumpeting their putative trade successes, put economic ideology aside and take a hard look at the composition of trade relations with Japan and the future of the American economy. Team B is the place to start.

U.S. TRADE DEFICIT WITH JAPAN IN KEY MACHINERY SECTORS



ource: Economic Strategy Institute

U.S. TRADE SURPLUS WITH JAPAN IN SELECTED COMMODITIES



Source: Economic Strategy Institute

Prepared Statement of William K. Krist

Thank you for providing me the opportunity to testify before the subcommittee today. The subject of Japanese and U.S. implementation of the structural impediments initiative talks is extremely important to our industry. This subcommittee is to be commended for its long standing interest in U.S. Japan trade issues.

The American Electronics Association believes that the U.S commercial imbalance with Japan is a cancer eating away at both the health of the international trading system and the health of the U.S. industrial base. Both the U.S. and the Japanese governments need to pay greatly increased attention to solving the substantive problems in our commercial relations.

As you know, the American Electronics Association represents over 3,500 members from all over our nation. Our members manufacture goods in all segments of electronics, including components, computers, telecommunications, and software. Our industry employs some two and half million workers, more than autos and steel combined. Products produced by our industry are vital to the U.S. national security and critical to the growth of many other sectors of our economy.

Trade Deficit

As you know, the U.S. trade deficit in electronics with Japan sky rocketed during the 1980s. At the beginning of the decade our trade deficit was less than $4 billion. By 1986, the bilateral electronics deficit had soared to over $20 billion and is still over $18 billion annually.

Unfortunately, this trade deficit number obscures the real deterioration in competitiveness between the U.S. and Japan. Japan has been aggressively investing in Southeast Asia, Mexico and other markets. Much of Japanese consumer electronics now enters the U.S. from these countries. Further, the forecasts that we have seen on the trade balance are that our deficit with Japan will continue to deteriorate substantially. For example, the Japanese Electronics Industry Development Association projects that in 1995 the U.S. will produce $260.8 billion in electronics while consuming $301.9 billion. This would be a trade deficit of $41.1 billion. For 1995 JEIDA projects Japan's production would be $265.9 billion and their consumption $190.7 billion, for a surplus of $75.2 billion. Obviously, given these numbers we will have a huge imbalance with Japan.

By the year 2000, these numbers will deteriorate even more, with the U.S. electronics trade deficit projected by JEIDA to rise to $59.9 billion, while the Japanese surplus rises to $107.3. billion. Other reputable sources project similar substantial longer term declines in the U.S. electronics deficit with Japan.

It is noteworthy that our trade deficit in electronics with Japan has not responded to currency changes. With the substantial dollar devaluation in the latter half of the 1980s, our trade balance with Europe shifted from deficit back to its historic surplus. With Japan however, our trade imbalance stayed level at approximately $20 billion annually. We believe it is also extremely significant that our trade imbalance with Japan remains despite numerous trade agreements in electronics entered into between the U.S. and Japan. Between 1979 and 1989 there had been a total of 15 agreements related to electronics trade and market access issues between the U.S. and Japan. These include agreements with NTT, a high tech agreement, an agreement on semiconductors, an agreement on supercomputers, an understanding on communications satellites, the MOSS talks on electronics medical equipment and telecommunications, supercomputers, and the science and technology agreement. Clearly, individual agreements without a comprehensive strategy for monitoring and implementation will not be successful.

Decline of U.S. Competitiveness

Even more serious than the trade deficit however, has been the overall pattern of U.S. electronics competitiveness vis-a-vis Japan. The U.S. share of global electronics production by U.S. capital owned companies has plummeted rapidly in recent years. In 1985, of a total world wide electronics market of $448 billion, U.S. owned companies produced $286 billion of electronics products for a 64% share of the world market. By 1989, the value of U.S. production had increased to only $360 billion, while the total world market rose to $734 billion. This means that U.S. owned companies had a 49% share in 1989. This represents a drop in global share of 3½% annually. Given the importance of electronics in our economy and to our national security, we do not believe that this situation is acceptable.

We recognize that the U.S. electronics industry bears considerable responsibility for correcting this deterioration. Specifically, our industry needs to step up its efforts to improve quality and to penetrate foreign markets.

As you know, many U.S. electronics companies have undertaken extensive quality programs and have applied for the Baldridge Quality Award. In fact, we are the only industry to have a winner of the award each year since its inception. Even within our association, we have implemented a major quality program and we are urging all of our members to do the same.

To penetrate the Japanese market, we established an office in Tokyo in 1984. This office has now assisted hundreds of U.S. companies in entering the Japanese market and has established a number of programs to help our companies already in Japan. In 1989, there were some 360 U.S. electronics companies in Japan employing 72 thousand Japanese workers. By contrast, Japanese companies in the U.S. employ only 52 thousand workers. We recognize the need for our industry to make substantial efforts to sell in Japan and are prepared to meet this challenge.

IMPORTANCE OF SII

We believe that the structural impediments initiative talks between the U.S. and Japan are extremely important. A number of measures need to be taken by both the U.S. government and the Japanese government to deal with our competitiveness problems.

AEA closely followed the SII talks. In fact, we called on all the relevant agencies every two months. We found the Administration very receptive to our concerns and very willing to work closely with the private sector. We were also impressed that for the first time in trade talks with Japan, all agencies of the U.S. government spoke with one voice.

We view Japan as this nation's number one trade problem. U.S. trade problems with Japan are not being addressed in the Uruguay Round. Accordingly, it is extremely important that this bilateral effort with Japan continues as a top priority for the U.S. government.

There are three principle areas of interest to AEA member companies in the SII talks. These are: intellectual property protection, collusive behavior of Japanese industry and the "buy Japan" mentality. Let me briefly discuss each of these areas.

INTELLECTUAL PROPERTY PROTECTION PROBLEMS

With regards to intellectual property protection, Japan has one of the longest average periods of patent pendency in the developed world. U.S. companies have waited up to 12 years to obtain a patent at which point their technology is often obsolete. We are also concerned about the practice of patent flooding in which large numbers of applications are filed to cover trivial changes in known technology. The extremely narrow scope allowed for claims, compulsory licensing, and the practice of cohesive cross licensing are also problems.

We support the objective stated in the SII talks that Japan will reduce the average time for patent issuance to two years.

Our understanding, however, is that Japan intends to do this primarily through electronic filing. We do not believe that simply shortening the time period for physical filing would solve the problem our companies experience in intellectual property protection. The Japanese government also needs to address the problem of patent flooding. Currently, U.S. companies are required to deal with each application by Japanese companies, which is a very expensive proposition when competing against huge Japanese conglomerates. We believe that Japan needs to make structural improvements in its patent system, as well as shorten the time period for granting protection.

COLLUSIVE BUSINESS ARRANGEMENTS

The second key problem area facing U.S. companies in Japan is the business structure where Japanese firms in the same "keiretsu" have preferential purchasing arrangements with one another. Many U.S. companies have been in situations where their Japanese customers are in the same keiretsu group as their competing Japanese manufacturers. Typically, the Japanese customers elect to purchase inferior equipment made in the same keiretsu rather than more advanced equipment made by an American manufacturer.

In the SII talks, of course, Japan did agree to take some steps to reduce collusive behavior among Japanese companies. For example, the JFTC agreed to formulate guidelines concerning antimonopoly act enforcement with regards to marketing policy by manufacturers towards distributors, and will establish guidelines where continuous trade relationships exist among Japanese companies. JFTC has now issued draft guidelines which we believe do include some very useful provisions in these areas. However, they still do not come out as strongly against cartel and collusive activity as we feel is necessary to overcome decades of permissive practices.

And these draft guidelines are under attack from MITI and from the Keidanren—Japan's powerful business advisory group—precisely because they would limit collusive behavior.

Japan also agreed to submit legislation to raise surcharges against cartels and to strengthen the damage remedy system. In this area we have substantial concerns that Japan is not going nearly far enough. Current penalties against monopolistic practices are de minimus, averaging roughly 2% of sales against unlawful cartels. Japan is proposing to raise this to only a 6% surcharge of total sales during the period in which they participated in a cartel. Small businesses would pay only 3%, wholesalers 1% and small retailers 1%.

This penalty is still de minimus and would have no substantive impact on discouraging collusive behavior by Japanese industry.

Additionally, the JFTC has issued guidelines with regard to sole import agent agreements. While these were noted in the SII report, we believe this is a fundamentally incorrect direction. If foreign companies wish to have sole import agent agreements and market forces indicate that this is desirable, there should no prejudice against doing so.

In summary, while some progress appears underway in this area, we believe Japan has a huge way to go to deal with the extensive and systemic collusive relationships of its business community.

"BUY JAPAN"

The third basic area I would like to discuss is the "buy Japan" mentality. This mentality is pervasive throughout Japan, including both industry and government. We believe the Japanese government's efforts to overcome this extreme cultural bias have been inadequate. The only area where Japan has made a serious effort to deal with this problem has been in the area of semiconductor procurement, although even here, the U.S. share of the Japanese market remains far lower than it ought to be under normal market forces.

Let me focus on two particular manifestations of this "buy Japan" mentality that we believe need to be immediately and effectively addressed.

COMPUTER AND SOFTWARE PROCUREMENT

The first area is that of Japanese government procurement of foreign computers, peripherals, software and services. The U.S. industry has earned over 35% share of the Japanese commercial computer market. Regarding Japanese government purchases however, our share has been held to significantly less than 10%. We are particularly concerned about this because in a 1985 market access plan, Japan committed to having its government be on the leading edge of demonstrating the importance of being open to foreign suppliers.

Our share is being held down by frequent single tendering by Japanese entities, study groups that design bid specifications that foreign companies do not participate on, insufficient lead time for open tenders, and lack of any dispute resolution mechanism that foreign companies can use to protest against unfair bid procedures. Our companies report statements by Japanese government procurement officials that the agency will buy from the same Japanese supplier that they had bought from for thirty years, "even if the American product is better and cheaper."

PROCUREMENT BY JAPANESE U.S. SUBS

The second manifestation of the "buy Japan" mentality is the procurement pattern of Japanese subsidiaries in the U.S. According to MITI's own data, Japanese electronics companies in the U.S. procure only 23% of their parts, components and other purchases from local U.S. sources and import 74.3% from Japan. By contrast Japanese companies in Asia procure 43.6% locally and import 44.3% from Japan. In the EEC 35.8% is procured locally and 56.7% procured from Japan.

Japanese investment in America was originally touted as a measure to alleviate the trade imbalance. In fact, given Japanese procurement patterns here in the U.S., Japanese investment is having the opposite effect. Our companies are being shut out of purchases by Japanese subsidiaries here in the U.S. Over 60% of the procurement officers of Japanese subsidiaries in the U.S. are Japanese, not Americans and they bring their strong prejudices with them. What Japanese investment has actually brought has not been prosperity, but keiretsus to our shores. We believe that this is a totally unacceptable situation and vigorous action is needed by both Japan and the U.S. to immediately change these patterns.

To deal with the buy Japan mentality in the SII talks it was agreed that results of Japanese advisory committees and study groups will be made public, and that the government of Japan will encourage private firms to make their procurement procedures transparent and nondiscriminatory against foreign goods. We believe these measures by themselves are inadequate to deal with this problem. Furthermore, we have not yet seen effective implementation of these proposals.

U.S. EXPORT PROMOTION

As you know, the U.S. government also committed to undertake a number of important measures in the SII talks. Among other steps, the U.S. government agreed to expand its export promotion efforts. In fact, the number of foreign commercial officers in Japan has increased markedly. However, the Commerce Department's budget for trade promotion has been increased only marginally. We believe the U.S. government needs to do substantially more in export promotion. The Agriculture Department has a proven and effective program for promoting agricultural exports—the Market Cooperator Program. We believe that this program, which has been in existence for a several decades, is an important reason why U.S. agricultural interests are more aggressive exporters than is U.S. industry.

AEA has been advocating a market cooperator program for industry and in fact, such a program was authorized in the Export Administration Act. Unfortunately this act has been tied up in political maneuvering between the Congress and the Administration and the Market Cooperator Program is accordingly stalled.

We urge this committee to support authorization and appropriation of funds for the Market Cooperator Program. Under such a program, we believe a number of associations could substantially increase their efforts to enter the Japanese market. This program needs to be supplemental to the programs already existing in Commerce, and not a displacement of other programs. Initial funding for the Market Cooperator Program is being requested at only $6 million.

CONCLUSION

The U.S. electronics industry has long understood that American companies have to compete globally or they will lose their ability to compete domestically.

However, Mr. Chairman, we see a serious collision ahead between the present trade policies of Japan and the legitimate exporting imperatives of the United States. Our two countries have been the best of allies. both our peoples and our governments share the goal of an open and growing global trade system.

But Japan's single minded drive for global trade domination threatens both our relationship and open trade.

Table 1.—EXPORT UNIT VALUES AND PRICE DATA FOR SELECTED U.S. CONSUMER PRODUCTS, 1989

Item	U S Exports to JAPAN Unit value ($ unit) (1)	U S Exports to GERMANY Unit value ($/unit) (2)	Unit value ratio (3) (1)/(2)	Retail price ratio JAPAN USA (4)
Spark Plugs	9 0	6 3	1 43	2.49
Electric Shavers	18 2	10 6	1 72	2 00
Calculators (w/batteries)	55 8	70 5	0 79	1 70
Color Film 16-35mm	10 2	5 1	2 01	0 87
Prepared/toasted Cereal	1 7	1 8	0 91	1.79
Chocolate, filled	3 8	2 5	1 50	1 63
Jams/Fruit Jelly	1 7	1 3	1 38	1 26
Whiskey, Bourbon, Rum, Vodka	3 0	2 5	1 19	(2) 2.79
Denim pants, Men	66 5	69 9	0 95	1.74
Pens	27 6	36 6	0 75	2.23
Perfumes	3 4	14 3	0 24	1 35
Golf Clubs, complete	34 0	28 8	1 18	1 94
Golf Balls	7 4	6.8	1 08	1.45
Weighted Averages (1) =			1.17	1.99

Sources: Unit value data from Dept of Commerce, Bureau of the Census, U S Merchandise Export Trade, reported in the National Trade Database Ratio of Japanese retail prices to U S retail prices (Column 4) from Dept of Commerce / MITI Joint Price Survey (1989).
Notes: (1) Weights used were U S export values to Japan (2) Figure for Whiskey, etc is the mean figure given by the price survey

PREPARED STATEMENT OF ROBERT Z. LAWRENCE [1]

Mr. Chairman: It is a pleasure to appear before your committee. In the Structural Impediments Initiative (SII), the U.S. Government argued for increased anti-trust enforcement and in particular for increased policing of Japanese corporate groups known as *keiretsu*. Since I have recently been studying the effects of *keiretsu* on Japanese trade, I will focus my testimony on this issue.

The Joint Report, issued at the conclusion of the SII, recognized that certain aspects of economic rationality of *keiretsu* relationships notwithstanding, there is a view that certain aspects of *keiretsu* relationships also promote preferential group trade, negatively affect foreign direct investment in Japan, and may give rise to anti-competitive business practices." The Government of Japan agreed to strengthen its Fair Trade Commission's (FTC) monitoring of transactions among *keiretsu* firms and to take the necessary steps to eliminate any restraints on competition that might arise. Recent reports do suggest some increase in the activities of the Japanese FTC, but also indicate considerable political resistance to their policies. Moreover, the recent 1991 National Trade Estimate Report on Foreign Trade Barriers published by the U.S. Trade Representative included exclusionary business practices and *keiretsu* among "particularly important areas where additional progress is needed."

What are *keiretsu*? The term does not refer to a single phenomenon. Indeed, because of this imprecision, many Japanese view the policy discussion on *keiretsu* as ill-informed. It is important, therefore, to be clear in making generalizations. One form of *keiretsu* involves affiliation between firms over a wide range of industries. These so-called **horizontal** groups include three descendants of former *zaibatsu* groups (Mitsui, Mitsubishi and Sumitomo) and three of more recent vintage (Fuyo, Sanwa and Daiichi-Kangyo). These groups are called horizontal (or sometimes financial *keiretsu*) because in addition to manufacturing companies, these groups typically include a lead bank, a trust bank, life and trust insurance companies, and a general trading company. Members of each group exchange shares, have interlocking directorates, jointly appoint officers and other key personnel, hold meetings of presidents and engage in joint investment undertakings in new industries.

Another form of *keiretsu* is composed of one or more large independent industrial concerns and their subsidiaries, allied firms, important customers and subcontractors. These so-called **vertical** *keiretsu* are usually concentrated in a single or limited number of industries: e.g., Toyota and Nissan in autos, Nippon Steel in metals and Hitachi, Toshiba, and Matsushita in electronics.

Finally, a third form prevails in the distribution system. Several manufacturers have organized their own distribution *keiretsu* in which retail and wholesale outlets are tied together through a number of links. These are to be found in the distribution of automobiles, consumer electronics, cosmetics, pharmaceuticals, cameras and newspapers.

Relationships among group members are extremely complex. Practices and obligations vary and groups differ in their degree of integration. Moreover, extra-group dealings and relationships are also common—group members may have similar *keiretsu*-type relationships with non-group companies. Members in some vertical groups rely on particular horizontal groups for certain services. Nippon Steel, for example, has a close relationship with Mitsubishi and Mitsui, Toyota with Mitsui, Nissan with Fuyo and Matsushita with Sumitomo. Hitachi is actually a member of three different presidential councils.

What impact do these relationships have? In the debate over *keiretsu* three contrasting positions can be distinguished: The first (benign neglect) is that these relationships do not have important effects on Japanese economic performance. A second view (trust-busting) takes the contrary position. The *keiretsu* create entry barriers for newcomers and engage in anti-competitive practices. Proponents of this view seek stricter anti-trust enforcement against the *keiretsu*, not only by the Japanese authorities but also by the U.S. government. A third view (the dilemma position) concedes that these relationships have a negative impact on Japanese imports and the ability of foreign firms to enter the Japanese market, but argues that *keiretsu* have also been an important reason for the superior performance of the Japanese economy. *Keiretsu* linkages are seen as providing risk- and information-sharing benefits to their members. They may also be a more efficient substitute for vertical integration permitting reliable supply while preserving corporate flexibility. Proponents of this view see Japan as confronted with a painful trade-off between open-

[1] The responsibility for this statement is mine alone and does not reflect the views of the Brookings Institution, its officers, trustees, or' other staff members.

ness and efficiency. One way of avoiding this tradeoff might be to incorporate foreign firms into the *keiretsu* structure. Indeed some see recent agreements between Mitsubishi and Daimler Benz as an effort in this direction.

Which of these views is correct? In a study which will shortly be published by the Brookings Institution, I have tried to evaluate these views.[2] In particular I have tried to explore whether *keiretsu* are associated with discriminatory import-reducing practices, improved competitive performance or both. Reduced imports could be associated with *keiretsu* either because of discrimination against foreign products, or because *keiretsu* enhance the performance of Japanese firms. Outside of Japan, however, *keiretsu* are likely to be less able to engage in discriminatory practices. If *keiretsu* are also associated with increased exports, therefore, this would suggest that they do improve competitiveness.

My study used an econometric model developed by Professor Peter A. Petri. My statistical analysis found that in general the higher the share of *keiretsu* firms in an industry's sales, the lower the share of imports in Japanese consumption. I found large negative effects on imports associated both with *keiretsu* with members from several industries (horizontal) and for those with a principal manufacturer and its suppliers and distributors (vertical).

In the case of exports, however, the results were different. The horizontal *keiretsu* were *not* associated with higher export shares but the vertical were. However, the statistical significance of the relationship between vertical *keiretsu* and exports was relatively weak.

In sum, *horizontal keiretsu are associated with a significant reduction in imports but have no effect on exports*—a result supportive of the trust-busting position, particularly since it suggests that the lower imports were not due to greater competitiveness. By contrast, vertical *keiretsu* are associated with a significant reduction in imports as well as a positive effect on exports. This result provides some support for the dilemma position with regards to vertical keiretsu.

THE DISTRIBUTION SECTOR

Another issue in the SII initiative concerned the distribution system. The joint survey conducted by MITI and the U.S. Department of Commerce provided overwhelming evidence that foreign goods, particularly consumer goods with brand names, *are* more expensive in Japan than in other countries. But some have argued that again, this evidence poses a dilemma for Japanese authorities. It is claimed that the prices of American goods are high because American firms have decided to sell their products at high prices. Lower distribution margins brought about by increased competition could reduce total profits of American firms in the Japanese market and thus reduce U.S. export earnings. Efforts to make the distribution of foreign goods more competitive could, therefore, allegedly hurt precisely those foreign firms which have taken the trouble to sell in Japan. Indeed, by lowering the profits of these firms, the Us-Japan foreign trade balance might actually worsen.

In fact, these concerns are unwarranted. Foreign firms play a remarkably small role in selling their products in Japan, and the evidence below indicates they are typically paid only world market prices. Most of the unusually high prices for foreign products are due to Japanese distributors. Thus the beneficiaries of increased competition in the Japanese distribution system would be Japanese consumers and American exporters.

Distributor Nationality. Department of Commerce surveys suggest that Japanese firms dominate U.S. intra-firm exports to Japan. In 1988, only 17 percent of U.S. exports to Japan were shipped by a U.S. firm to a Japanese affiliate of that firm. Even though their share has been declining, in 1988 *Japanese* affiliates in the United States still shipped 36.4 percent of U.S. exports to Japan back to their Japanese parents (these were mainly trading companies). Since these numbers omit the value of U.S. exports sold to unaffiliated Japanese distributors, they understate the role of Japanese distributors in selling U.S products.

Price Evidence. Unit value trade data also help illuminate this question. I randomly selected (categories ending in 1,3 and 6) a sample of 40, 3-digit SIC code export unit values for U.S. exports to Germany and Japan, and German exports to the United States and Japan in 1987. An average of these data weighted by export values indicated that American goods were almost identically priced when exported to Germany and Japan. Similarly the average unit value of German goods exported to Japan was just 14 percent higher than the average unit value sold to the United

[2] Robert Z. Lawrence, "Efficient or Exclusionist? The Import Behavior of Japanese Corporate Groups," *Brookings Papers on Economic Activity, 1:1991*, forthcoming.

States. Surveys indicate, however, that brand goods are much more expensive in Japan than in Germany or the United States. This suggests that by and large, Japanese distributors rather than exporters are responsible for the higher Japanese prices.

The joint survey of the U.S. and Japanese governments during the SII talks found that most American products were much more expensive in Japan than in the United States. Indeed as reported in Table 1, weighted by export values, the consumer goods in their survey were 99 percent more expensive in Japan than in the United States. Yet the unit value data indicate that the weighted average of the unit values of these products when sold to Japan was only 17 percent higher than when sold to Germany.

Unit-value data (which measure prices per ton, for example) are subject to measurement error. However, the direction of the bias is not obvious. If this preliminary evidence is confirmed by more extensive surveys, it suggests that efforts to reduce the prices of imported products in Japan by reducing distribution margins would have a positive impact on import volumes and would not, for the most part, hurt foreigners who are exporting to Japan.

Policy Implications. Some may interpret this evidence as indicating support for managed trade. But that is not the case. A managed trade approach is more likely to strengthen cartel-like behavior and have numerous unintended side-effects.[3] Others may object that *keiretsu* practices are not an legitimate topic for international negotiation since they reflect private practices rather than public policies. But in all countries, the government assumes responsibilities to police private commercial behavior. In the SII agreement, both the United States and Japanese governments implicitly accepted the notion that competition policy should, in fact, be a topic for international negotiation.

Anti-trust violations should not go unpunished. However, in addition to their discriminatory effects there are clearly cases where *keiretsu* relationships do improve efficiency. As might be expected, these efficiencies tend to be associated with vertical rather than horizontal linkages. Given the complexity and pervasiveness of this phenomenon, it is difficult to support extreme approaches which would either ban these linkages or tolerate them under all circumstances. Instead vigilance and "a rule of reason" approach which pays particular attention to the behavior of firms in horizontal *keiretsu* seems called for. There is no substitute for an intensive investigation of these practices to determine where they should be emulated by others and where they should not be tolerated. There is strong evidence policy should move beyond simple benign neglect.

This is also true in the case of the distribution system. The Japanese FTC has defended the practice of granting sole import licenses and restrictions on certain forms of parallel imports as necessary to facilitate the entry of foreign products into Japan. However, economic theory suggests that it is rational for monopolists to apply high mark-ups when demand conditions are permited. If markups and thus prices are high, import volumes will be low. As long as this monopoly can be enforced, Japanese consumers and foreign exporters will be hurt. Indeed a distribution system with high markups on foreign goods is the private-sector equivalent of a system of high-tariffs. The distributors rather than the government collect the revenue. In the light of this evidence, efforts to increase the channels for foreign entry into the Japanese distribution are not misplaced.

PREPARED STATEMENT OF R.K. MORRIS

Mr. Chairman, Members of the Subcommittee, I am R.K. Morris, and I am director of international tra l for the National Association of Manufacturers. On behalf of NAM and its me. bers, let me say that we are grateful to you and to this Subcommittee for the persistent attention you have paid to the issues associated with the U.S. economic relationship with Japan, and we appreciate the opportunity to express some of our views and concerns this morning.

SUMMARY

NAM continues to believe that the Structural Impediments Initiative, which was launched by the U.S. and Japanese governments in the spring of 1989, is a poten-

[3] For a more complete discussion see Robert Z. Lawrence and Charles L. Schultze, *An American Trade Strategy: Options for the 1990s* (Brookings Institution, 1991), especially the paper by Laura Tyson and the comments by Avinash Dixit.

tially useful tool for improving economic cooperation between the United States and Japan. Certainly, some judgments can be made on the basis of last year's "final report" and related subsequent developments. We believe, however, that it is a mistake to expect revolutionary changes from the Structural Impediments Initiative; that so long as SII continues to show promise, the two governments should stick with it; but that we cannot afford to rely upon it as more than a component of America's economic policies towards Japan.

The NAM has, for example, recently reached conclusions about some of the more pressing issues affecting America's trade with Japan. Specifically, we believe that a new U.S. Japan agreement on semiconductors would serve the interests of both countries. We hope such an agreement can be negotiated soon, so that it will be ready to take effect when the current agreement expires in July.

We also believe, Mr. Chairman, that U.S. trade policy generally would be strengthened by enactment of the Trade Agreement Compliance Act, S. 388, which you introduced earlier this year.

I should like to return later to each of these topics, Mr. Chairman. There are, however, broader considerations which should perhaps be discussed first.

U.S.-JAPAN CONTRASTS

At the risk of simplifying to the point of caricature, Japan today is an economic superpower that is experiencing some difficulty in coming to grips with the implications of its success and status. The United States is an all but unchallenged military and diplomatic superpower that turns red with embarrassment when the conversation turns to economics. This is especially true for those who take seriously the unofficial motto of the NAM, which is, "Manufacturing Creates America ' s Strength."

The attitudes, policies, and developments behind these differences have existed and have been operating for a long time. In 1965, Japan's trade account with the United States moved from deficit to surplus. In 1971, U.S. merchandise trade slipped into a deficit position with he world at large. By today's standards, the 1971 deficit was trivial—just over one billion dollars—but dramatic steps were taken by President Nixon to try to cope with problem. These included, among other things, the imposition of a temporary import surcharge.

Today we regard a U.S. trade surplus of anything less than $100 billion as good news. Throughout the 1980s, the United States amassed a backlog of merchandise trade deficits amounting to almost a trillion dollars. The lion's share of the red ink, overly $400 billion, was accounted for by our trade with Japan. And, of course, the deficit with Japan is entirely in manufactured goods.

These are large phenomena affected by and affecting millions of activities and decisions. NAM does not purport to know either the exact causes of these developments or exactly what should be done about them.

We believe strongly that markets are the best arbiters of economic success, both domestically and internationally, but we recognize the need to take note of the possibility, if not the fact, that our view of markets and competition may not be the same as that of others

Our political literature is replete with statements by presidents, members of Congress, and business leaders to the effect that, so long as trade is free and fair, America can outwork, out-produce, and out-compete any other country. Even the excellent 1985 *Report of the President's Commission on Industrial Competitiveness* contained an echo of this view [1]

Mr. Chairman, I would suggest that it is useful to compare this American view of market competition with the view of markets that an official of Japan's Ministry of International Trade and Industry shared with his OECD colleagues in 1970:

> After the war . Japan's first exports consisted of such things as toys and other miscellaneous merchandise and low-quality textile products. Should Japan have entrusted its future in the theory of comparative advantages in these industries characterized by intensive use of labor?
>
> . . . If the Japanese economy had adopted the simple doctrine of free trade and had chosen to specialize in this kind of industry, it would have

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[1] The report offered this definition of competitiveness: "Competitiveness is the degree to which a nation can, *under free and fair market conditions*, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens." (Emphasis added)

This definition is a good one but would have been improved by the omission of the underlined passage. In fact, firms and countries must compete under prevailing conditions, whatever they might be, even while they may be working towards "free and fair" conditions almost permanently been unable to break away from the Asian pattern of stagnation and poverty.

The ministry of International Trade and Industry decided to establish in Japan industries which require intensive employment of capital and technology, industries that in consideration of comparative costs of production should not be the most inappropriate for Japan, industries such as steel, oil refining, petrochemicals, automobiles, aircraft, and electronics, including electronic computers. From a short-run viewpoint, encouragement of such industries would seem to conflict with economic rationalism. But from a long-range viewpoint these are precisely the industries of which income elasticity of demand is high, technological progress rapid, and labor productivity rises fast."

My purpose in citing this example is not to criticize Japan. It is only to suggest aspects of America's own thinking about international economic policy that might benefit from an intensive review.

NAM LETTER TO PRESIDENT BUSH

As you know, NAM's president, Jerry Jasinowski, wrote to President Bush on March 13 to ask that he establish a Presidential task force to undertake a comprehensive rethinking of American economic goals and objectives, especially as they relate to Japan.

We explained in the letter that we have no interest in blaming Japan for made-in-America competitiveness problems but that Japan, "more than any other major ally (or trading partner) calls into question some long standing premises governing America's postwar economic policies both at home and abroad."

The letter recommended that this task force, which might be regarded as an economic Team B, look at familiar assumptions and the implications of those assumptions for the next several decades. The letter itself did not specify the assumptions in question or recommend any new policy. Its premise is that these are things that should flow from the Team B exercise itself.

The letter did suggested that the task force consider questions such as the following:

- What assumptions have guided American economic policy toward Japan to date?
- Are these assumptions as likely to be valid in the coming decade as they have been in the past?
- Row do they compare with the major premises behind Japanese policies, especially those affecting the relationship between government and industry?
- If these present relationships continue, what will happen to the United States with respect to living standards, leading edge technologies, R&D-intensive exports, per capita income in the year 2000 and beyond and other key measures?
- If the trends in these areas are negative, what lessons might we learn from other countries? From ourselves? What new assumptions should apply?

The letter in question is not a call for new negotiations. It is a plea for an internal, American reassessment of U.S. assumptions, objectives and policies. Nevertheless, it has been widely reported in Japan. My impression is that Japanese reactions have been mixed. Those Japanese business people who have shared their views with us seem to understand why we believe a review of this kind is needed.

It is important to NAM that our purpose not be misunderstood. Given the nature of the world economy, a close economic relationship between the United States and Japan is essential to the prosperity of both countries. NAM expects that relationship to become broader and deeper than it is today.

In virtually every sector, American manufacturing firms find themselves increasingly involved with Japanese companies—as their suppliers, as their customers, as their partners, and as their competitors. The NAM itself is in more regular contact with Japan's Keidanren (Japan Federation of Economic Organizations) than we have been in the past. As you may know, Mr. Chairman, NAM organized and hosted an International Private Sector Conference on the Uruguay Round at the end of January. Our purpose was to demonstrate the worldwide business support that exists for a successful conclusion to the Uruguay Round.

As far as we are concerned, that meeting was a success. It would not have been so, however, if the Keidanren and other foreign trade associations had not decided early on to give the effort their full support. We value support of that kind. Our preference is to nurture rather than to disturb the relationships that make such cooperation possible.

Nevertheless, we are concerned that the overall U.S.-Japan economic relationship is today very unbalanced and that without the kind of reassessment NAM has called for, the risk of serious disruptions will continue to intensify.

RELATIONSHIP TO SII

As I have indicated, Mr. Chairman, NAM supports the SII process. There is no direct link between that position and our petition for a Presidential task force along the lines outlined above. If there is any link at all, it is this. For both the United States and Japan, the Structural Impediments Initiative is an exploration of possible domestic changes that Japan might make in response to requests from the United States and to changes we might make in response to requests from Japan.

Presumably, these negotiations have given all of the U.S. participants a broader and deeper understanding of Japan. We need to continue to press for change in Japan. At the same time, we should perhaps make some domestic judgments about those aspects of Japanese economic life that are not likely to change in any relevant, postulated time frame and to which we in the United States may need to adjust. That is one example of the kind of information we would hope to see developed by the task force we have suggested to the President.

I have dwelt on the Team B proposal, Mr. Chairman, because we believe it is the most useful, single thing the U.S. Government could do at this time. We recognize, however, that this is a proposal for knowledgeable people to take two steps back from the crush of daily decisions and to do some zero-based budgeting with respect to U.S. economic goals.

SII ASSESSMENT

In the meantime, judgments need to be made. We face resistance to American exports in Japan in a range of products from rice, to automobiles, to slot machines, to semiconductors, and a number of pragmatic proposals for dealing with specific problems have been made.

Because of the nature of the National Association of Manufacturers, we are not in a position to comment on all of these, but we can on some of them.

It is premature to assess this past year of SII negotiations. It would be better to wait for the report due late next month before making such judgments. As I said at the outset, NAM has regarded the Structural Impediments Initiative as a potentially constructive and beneficial process from its inception. We have also felt, however, that to be genuinely successful SII will need the perpetual spotlight of political interest over a period of several years.

The practical benefit of SII is twofold: (i) It has helped us all gain a better understanding of the obstacles to mutually beneficial economic cooperation between the United States and Japan; and (ii) it has suggested useful areas of change. There are lots of promises in the April 1990 final report. So far, however, none of these have yet dramatically changed the landscape for American companies doing business in Japan.

TRADE AGREEMENT COMPLIANCE ACT

You, Mr. Chairman, have our appreciation and our full support for the Trade Agreement Compliance Act, S. 388. It may be that someday, perhaps as a result of the Team B review, the Administration will have a foundation for U.S. trade policy other than the complaints of individual firms and industries. For the moment, these are our country's principal guide in such matters, and they have led to important results. The U.S.-Japan Semiconductor Agreement of 1986 is an example.

If U.S. manufacturers are to bear the burden of proof with respect to foreign barriers to American competitiveness, they are entitled to some assurance that agreements to reduce those barriers will be respected. They deserve to have written into law a clear petition process that guarantees that evidence of trade agreement violations will be reviewed and acted upon. Your bill, Mr. Chairman, gives American business that kind of process, and it does it in a way that is fully consistent with U.S. obligations under the General Agreement on Tariffs and Trade. We appreciate it, we support it, and we look forward to its early enactment.

SEMICONDUCTOR AGREEMENT

Finally, Mr. Chairman, I should like to use this occasion express NAM's view that there should be a new semiconductors agreement to replace the 1986 U.S.-Japan Semiconductor Agreement, when it expires at the end of July. It is true that the current agreement has not fully met the expectations of U.S. industry, but it has been helpful in several respects and should be continued in some form.

By way of background, I would note that it was unusual, though not unprecedented, for NAM to support the Semiconductor Industry Association's 1985 Section 301 petition, which we did in 1986. It was unusual because NAM generally does not comment on sectoral trade issues. We did so in that case because we were convinced that the issues raised by the petition and the industrial conditions it sought to address were (and are) important to American manufacturers across a broad spectrum of industries.

The SIA's 1985 petition described the nature and effects of certain Japanese industrial policies (targeting) as applied to semiconductors and the related practices of Japanese firms. It sought the assistance of the U.S. government (a) to curb the serious effects of Japanese dumping practices and (b) to open Japan's own semiconductor market beyond the limited market share to which non-Japanese firms had historically been limited, effectively if not legally.

The 1985 petition and contemporaneous antidumping cases led to the 1986 agreement. That agreement and the associated side letter addressed both of those issues. They have been instrumental in bringing about the progress that has been achieved in recent years. They have not, however, solved the problems in these areas in the sense that further action can be regarded as unnecessary. The United States, hitherto the world leader in the production of semiconductors, is now second to Japan in chip production and chip consumption. The damage caused to the U.S. industry by Japanese dumping has not been significantly reversed. As for U.S. participation in the Japanese semiconductor market, though it is greater than it would have been in the absence of the 1986 agreement, it is far short of both:

(a) U.S. market share for semiconductors in the other major markets for these products, and

(b) the clearly understood goals for the agreement.

Beyond these considerations, NAM has certain special reasons for supporting a new agreement that I should like to bring to the attention of the Subcommittee.

Cooperation Among U.S. Firms. The NAM is especially sensitive to the difficulties associated with differences among U.S. firms over the kinds of issues addressed by the 1986 U.S.-Japan Semiconductor Agreement and the proposed follow-on agreement, namely, issues of pricing and sourcing. The ability of U.S. semiconductor producers and many of the U.S. industrial users of their products to reach an agreement on these issues as they relate to U.S.-Japan trade is laudable. We believe the governments concerned should give significant weight to this development.

U.S.-Japan Ties and Manufacturing Inputs. The NAM also applauds all of those involved in the relationships that have been built between U.S. semiconductor producers and Japanese users of semiconductors against the background of the 1986 Agreement. Capital goods and industrial inputs like semiconductors are among the special strengths of the American export sector. Trade in these products depends upon close working relationships between buyers and sellers. To the extent that the 1986 Agreement has encouraged such relationships between U.S. and Japanese firms it must be regarded as a success.

U.S.-Japan Relationship Overall. As I have said, the U.S.-Japan economic relationship affects virtually all American manufacturers and is therefore of great concern to NAM. We note that the relationship is characterized by several serious differences and that its continued success will depend upon the ability of the two countries to generate long-term solutions to commercial disputes. These solutions must be responsive to the legitimate commercial interests of both the United States and Japan. We are concerned that if the 1986 Semiconductor Agreement is not replaced by an effective follow-on agreement, the gains of the last few years will be lost to the detriment of the overall relationship as well as that of firms in both countries.

Industrial Targeting. To the extent that the issue for NAM has been foreign industrial targeting and America's responses thereto, events in other parts of the world underscore the need for these responses to be seen as credible and ultimately successful. In this connection it is fair to note that other U.S. trading partners have singled out semiconductor production for special consideration in their economies. The Republic of Korea is in the process of implementing a $40 billion five year plan "for technology development and plant investment in sophisticated industries, including semiconductors," [2] and the European Community channels more than $1 billion to research and development for its microelectronics industry.

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[2] 1991 U.S. INDUSTRIAL OUTLOOK, U.S. Department of Commerce, page 17-6.

In light of these considerations, NAM urges the U.S. Government and the Government of Japan to negotiate a new, five-year semiconductor agreement. This agreement should itself clearly state a market-access goal for foreign participation in Japan's semiconductor market sufficient to constitute significant movement toward market liberalization in Japan.

In addition, the next U.S.-Japan semiconductor agreement should contain provisions to quickly address any new dumping of semiconductors by Japanese firms on world markets. While recognizing the progress that has occurred in this area, we also recognize that world market conditions are such that new dumping in this sector remains a possibility and one which must be addressed in any new agreement.

CONCLUSION

We cannot avoid the reality, Mr. Chairman, that the U.S.-Japan economic relationship will be a major determinant of the future of both countries. The nature of that relationship is changing rapidly for a number of reasons. Both Japan and the United States, for example, now confront the need to make major adjustments.

Japan is only beginning to adapt to the fact that it now an economic superpower.

Last week's base-closing announcements were a reminder that, here in the United States, we have different adjustments to make. We must adapt to a world in which the major external challenge is characterized less by nuclear confrontation and more by international commercial competition, keeping in mind that commercial rivals are not enemies but allies, friends and partners.

Inasmuch as we are daily strengthening our economic ties to Japan, there are relatively few new actions vis a vis Japan that the United States can or should initiate without first conducting the kind of review of U.S. policies, interests, and objectives that we have asked President Bush to undertake.

Thank you.

NATIONAL ASSOCIATION OF MANUFACTURERS,
Washington, DC, March 13, 1991.

The PRESIDENT,
The White House,
Washington, DC.

Dear Mr. President: You and your administration deserve great credit for the remarkable military and diplomatic successes of the last eight months. The Coalition victory has done more than return Kuwait to the Kuwaiti people. It has greatly enhanced America's confidence in itself. Praise is also due for the work you have done to help shape a new, more democratic Eastern Europe and new and more cooperative relationship with the Soviet Union. The National Association of Manufacturer believes it is now time for a reassessment of America's relationship with Japan. Our concern is not just with U.S. policies towards Japan, but with those economic assumptions that affect our relationship with Japan—and potentially with other economic competitors.

For a number of years now, NAM has been deeply concerned about America's international competitive prospects, as exemplified in particular by our relationship with Japan. The purpose of this letter is to suggest a broad and constructive reappraisal of the traditional assumptions governing that relationship, with a view towards forging a healthier ad more realistic partnership.

I want to be clear about the nature of our concern. The large trade deficit the United States has had with Japan for the last several years is only one of several worrisome symptoms. Indeed, the slide in the value of the dollar between 1985 ad 1988, combined with the shift to demand-led growth in Japan, has resulted in a modest improvement of the bilateral imbalance. Yet by almost any measure, Japan's share of manufactured imports is low, ad its corporate behavior seems resistant to certain values that firms in other industrial countries take for granted. Many America companies have come to believe that Japanese goals appear to be more intensely national, ad more thoroughly coordinated ad pursued, than our own.

Addressing these differences has now become imperative because our future has become so closely intertwined with Japan's. Given the nature of the world economy, we believe that a close economic relationship between the United States and Japan is essential to the prosperity of both countries. We expect that relationship to become broader ad deeper than it already is. We value the significant contributions to our security and defense that Japan has already made. Our fear is that if the very serious problems in the relationship are not addressed soon, both countries will suffer damaging setbacks, both political ad economic.

The Structural Impediments Initiative represents one major attempt to tackle the underlying causes of the trade problem. We strongly support U.S. efforts in this difficult arena, and we appreciate that progress is being made.

What we propose is something even more fundamental: a comprehensive rethinking of American economic goals and objectives, especially as they relate to Japan. It is not our intention to "blame" Japan for our long-term competitive problems, many of which are of our own making. It is rather that Japan, more than any other major ally, calls into question some long-sliding premises governing America's postwar economic policies both at home and abroad.

We recommend that you establish a special Presidential task force to undertake this reassessment. This group should consist of individuals who have your respect, both inside and outside your Administration. Its mandate should be to re-examine familiar assumptions and the implications of those assumptions for the next several decades. It should address such questions as:

- What assumptions have guided American economic policy toward Japan to date?
- Are these assumptions as likely to be as valid in the coming decade as they have been in the past?
- How do they compare with the major premises behind Japanese policies, especially those affecting the relationships between government and industry?
- If these present relationships continue, what will happen to the United States with respect to living standards, leading-edge technologies, R&D-intensive exports, per capita income in the year 2000 and beyond, and other key measurements?
- If these trends are negative, what lessons might we learn from other countries? From ourselves? What new assumptions should apply?

These questions deserve fresh thinking, if only because the stakes are so high. In addition, we are convinced that it is healthier to air our concerns, thoughtfully and honestly, than to paper them over. s is especially true in the case of Japan, where confidence in the U.S. alliance has already been shaken, and where signals from the United States seem mixed, to say the least. NAM believes that the United States will be less divided and more confident of whatever course it pursues if all of the important assumptions behind our policies have been fully and candidly reviewed. Going through this process will make us a better ally and trading partner, regardless of the outcome of the study.

It is for these reasons that we hope you will establish a special Presidential task force—a "economic Team B," as it were—on U.S. international economic policy, with special reference to Japan. If you agree to do so, we would welcome the opportunity to offer further suggestions about its composition and its mandate.

Respectfully yours,

JERRY J. JASINOWSKI, *President, National Association of Manufacturers.*

PREPARED STATEMENT OF JOHN D. ONG

Mr. Chairman and Members of the Committee: the Labor-Industry Coalition for International Trade (LICIT) is pleased to have the opportunity to testify at this hearing on the Structural Impediments Initiative. My name is Howard Samuel. I am of the President of the Industrial Union Department, AFL-CIO, and the co-chair of LICIT.

LICIT was formed in 1979 to represent the common interest of American workers and American firms in increased, balanced and equitable international trade. Our membership includes 20 major U.S. manufacturing firms and labor organizations. A membership list is attached.

THE GOOD NEWS AND BAD NEWS ABOUT SII

I would like to begin my remarks by noting some of the positive aspects of the SII. First, it helped create a consensus within the Administration that there is more than one way to organize a market economy. It is very difficult to study the Japanese economy and not conclude that is different, in important and fundamental respects, from the U.S. economy.

As a result, the issues the United States raised are central to resolving the U.S.-Japan trade problem, such as the savings/investment imbalance, the distribution system, keiretsu relationships, exclusionary business practices and land policy. At one point, the United States identified more than 200 structural barriers that reduce foreign access to the Japanese market and prevent the elimination of trade and investment imbalances.

Second, the SII has led to some reforms, such as reducing the amount of time it takes to open a retail store, increasing the budget of the Japan Fair Trade Commission, establishing a high-level Import Board, requiring greater disclosure of keiretsu relationships, and expediting customs clearance procedures.

Unfortunately, there are several reasons to doubt that the SII will lead to the sweeping reforms in Japan's economic policies and private business practices which are necessary to establish a more equitable relationship.

First, Japan's record of compliance with trade agreements is less than perfect. We do not dispose of our trade problems with Japan, we recycle them. One such "golden oldie" is the Japanese distribution system. President Nixon reached an understanding with Prime Minister Tanaka on liberalization of this sector in 1972. Unfortunately, two years later, Japan enacted the Large-Scale Retail Store Law, which gave small shopkeepers in Japan veto power over any new retail outlets over 500 square meters. Now, nearly twenty years later, we are negotiating over the time limit for processing applications for new stores.

Second, even if Japan *does* honor its commitments, many of the provisions of the SII are rather vague. As Japan expert Kozo Yamamura noted, the final report of the SII is:

> "[R]eplete with promises of laws to be drafted and passed, studies to be made, surveys to be conducted, administrative procedures to be changed, and data to be gathered."

Finally, it is not at all clear that Japanese business and government elite believe that significant changes in their economic strategy are desirable or necessary. Japan is gaining, not losing, market share in the key industries of the 21st century. Japan is investing more in new plant and equipment than the United States is, with a population half our size. Japanese firms are establishing positions of strength in the rapidly growing markets of the Pacific Rim. As for the notion that Japan's trading partners will insist on reform, foreign dignitaries have been warning Japan for years that "a trade crisis is just around the corner" or that "the current situation is unsustainable." At this point, Japan's leaders probably take these warnings with a grain of salt. It is difficult to point to compelling incentives for Japan to discard a tried-and-true economic strategy that has worked, albeit at the cost of some friction with its trading partners.

HOW SHOULD WE MEASURE SUCCESS?

Given the uncertain prospects for the Structural Impediments Initiative, it is very important that the Administration and the Congress develop clear criteria for determining whether the SII has been a success. Otherwise, the United States will have no way of determining whether to continue or abandon this approach.

The goal of SII is to break down the structural barriers which restrict the access of foreign firms to the Japanese market and contribute to the present imbalances in trade and investment. Several yardsticks could be used to measure progress towards this goal. (The attached charts illustrate the extent to which Japan is substantially less open to foreign goods and investment than other industrialized countries.)

1. **An increase in imports of manufactured goods:** Japan's imports of manufactured goods are currently at 3 percent of Japan's GDP. By some estimates, this is 40 percent lower than one would expect of a country of Japan's size and stage of development.

2. **An increase in intra-industry trade:** Japan's trading patterns are unique in that it tends to have very low levels of imports in the products that it exports. To give just one example, from 1980 to 1989, Japan exported more than 61 million motor vehicles while importing less than 800,000. As a result, Japan's competitors are caught between the "rock" of an export drive and the "hard place" of Japan's closed home market.

3. **A reduction in the price gap:** A survey conducted by the Ministry of International Trade and Industry and the Department of Commerce concluded that prices of identical goods were, on average, 39 percent higher in Japan than in the United States. The Department of Commerce stated that this was at least partially attributable to "exclusionary business practices" and "the frequent absence in Japan of free, open and competitive markets."

4. An increase in foreign direct investment in Japan: Foreign direct investment accounts for less than 1 percent of Japan's total assets, as compared to more than 10 percent in the United States. Japan's high level of inter-corporate shareholdings

(roughly 70 percent of the stock listed on the Tokyo Stock Exchange does not trade hands) makes it very difficult for foreign firms to acquire Japanese firms.

In short, the United States must emphasize results over process. If we do not, it is unlikely that this exercise will lead to a more equitable and balanced U.S.-Japan economic relationship.

SII AND ANTICOMPETITIVE PRACTICES

Even if Congress and the Administration set clear goals, business and labor will have to become more involved in their implementation. LICIT is particularly interested in two issues raised by the SII—anticompetitive practices and industrial targeting. Over the years, anticompetitive and exclusionary business practices have been the cause of trade disputes in several sectors:

- **Amorphous metals:** Allied-Signal has had difficulty selling its product because of Japanese obstruction of its efforts to obtain patent protection, pressure from a 34-member "Amorphous Metal Group" to license its technology to Japanese companies at unreasonable terms, and a concerted refusal by Japanese electric utilities to buy Allied's product.
- **Construction:** U.S. participation in the Yen 60-80 trillion Japanese construction market is restricted by the so-called *dango* system. This is an informal system for rotating wining bids among Japanese construction firms, especially for public contracts. The national or local government agency involved prepares a list of the firms which are eligible to bid on the project. The construction firms usually get together before the bids are submitted, and determine among themselves which firm will actually get the contract.
- **Polysilicon:** In 1988, Union Carbide filed a suit in U.S. District Court against seven Japanese manufacturers of polysilicon and silicon wafers (used in the production of semiconductors), charging that they had formed an illegal cartel to control prices. According to Union Carbide, Japanese manufacturers met regularly (since at least early 1983) to share supply and demand data on the Japanese and worldwide polysilicon and wafer markets. They also allegedly agreed to set purchase prices, coordinate an increase in polysilicon production above anticipated demand to maintain artificially depressed prices, and restrict imports of polysilicon from non-Japanese sources. Not coincidentally, MITI had formed a "High-Purity Silicon Issues Study Group" with the industry, which recommended a reduction in imports and import prices. This concerted action has had the effect of driving many U.S. manufacturers out of the business. One of the alleged cartel members bought Union Carbide's polysilicon plants, which ended the lawsuit and increased Japan's share of the world market from 30 to 45 percent.

Aside from these sectoral disputes, exclusionary business practices limit Japan's imports of manufactured goods more generally. Robert Lawrence of the Brookings Institution concluded that keiretsu relationships may reduce Japanese imports by as much as $35 billion (although yen depreciation would offset some of the impact of this change.)

SII AND INDUSTRIAL TARGETING

LICIT also believes that Japan's practice of "targeting" particular industries and technologies remains a serious issue. For example, Japan has at least 22 different high-tech tax promotion systems. One of these was recently extended until 1993 and provides incentives for 132 very specific technologies. In at least one instance, Japanese tax authorities helpfully provide a picture of the U.S. equipment they want Japanese manufacturers to clone.

As part of the SII, the Government of Japan made a number of commitments with respect to government-sponsored "industry advisory committees and study groups," which have been an important element of Japan's industrial strategy. Japan agreed that the results of the deliberations of government advisory committees should be made public, that foreigners should be invited to participate, that the substance of the discussions should not be anti-competitive in nature, that any "visions" should not be used to enhance the competitiveness of particular companies, and that the significance of imports should be emphasized.

The U.S. Government should make the implementation of these recommendations a priority. Japan's policy of targeting certain industries and technologies through visions, elevation laws, government subsidies, tolerance or encouragement of anti-competitive practices, discriminatory government procurement, administrative guidance, creation of public corporations, tax incentives, forced technology transfer, formation of R&D consortia, and induced investment through signalling to financial institutions, has often led to U.S.-Japan trade friction. A greater awareness of these practices could provide the United States with an "early warning system" and allow the United States to respond proactively. Obviously, the United States has fewer and fewer options if Japanese government targeting is allowed to lead to overcapacity, dumping, market access problems, and the erosion of U.S. market share and technological leadership.

The 1990 National Trade Estimate highlights the problem of Japan's industrial targeting. It notes, for example, that Japan's 1983 "Long Range Vision for Space Development" set forth a policy for the autonomous development of a satellite industry, and that "Japan has targeted its aerospace industry for development . . . [which] could lead to trade problems in the future."

In LICIT's view, the U.S. Government should devote significantly more resources to the collection, translation, dissemination and analysis of information on Japan's trade and industrial policies. Without such an initiative, it will be impossible for U.S. Government officials and industry representatives to judge whether Japan's policies are changing in ways that are consistent with the spirit of the Structural Impediments Initiative.

BEYOND SII

LICIT believes that the issues of anticompetitive practices and industrial targeting are important for U.S. trade policy as a whole. Japan is not by any means the only country which engages in or tolerates these practices. The European Community, for example, has spent billions of dollars to target the civilian aircraft industry. Anticompetitive practices in the European market have been a problem for U.S. manufacturers of heavy electrical equipment. Between 1975 and 1988, U.S. producers did not win a single order from an EC purchaser with a domestic production base. By comparison, imports accounted for 10 to 20 percent of U.S. consumption of power transformers, and 10 to 25 percent of steam turbine generators.

For that reason, LICIT believes that these issues need to be addressed not only as part of SII, but also in multilateral fora, such as the OECD or the GATT. Since it may be too late to include these issues in the Uruguay Round, the United States may have to pursue other interim measures. It has generally been the case that the United States has had to act bilaterally or even unilaterally to persuade the rest of the world to address a new issue in the context of the GATT. It was the use of trade laws such as Section 301 and Special 301 which convinced our trading partners to begin serious negotiations on intellectual property rights and trade in services. It is reasonable to expect that the United States will have to pursue a similar strategy if it wishes to create international rules against anticompetitive practices and industrial targeting.

Finally, I would like to note in closing that we should take our commitments under SII seriously. These include actions to increase savings, expand investment in new plant and equipment, encourage longer corporate time horizons, strengthen investments in new technologies, promote exports, and improve the quality of education and training in the United States. It is somewhat ironic that the United States is pressing Japan to increase its investments in infrastructure, while making no such plans for its own economic future. Japan, for example, plans to spend 60 trillion to wire the nation with a fiber optic communications system by the year 2015. An equivalent commitment to economic and technological leadership is needed in the United States.

LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE MEMBER ORGANIZATIONS

Allegheny Ludlum Corporation

The BFGoodrich Company

Amalgamated Clothing and Textile Workers Union

Cincinnati Milacron Inc.

Communications Workers of America

Corning Glass Works

International Union of Electronic, Electrical, Salaried, Machine and Furniture Workers

International Brotherhood of Electrical Workers

American Flint Glass Workers Union

Inland Steel Industries, Inc.

International Ladies' Garment Workers Union

Industrial Union Department, AFL-CIO

International Association of Machinists and Aerospace Workers

Motorola, Inc.

Oil, Chemical and Atomic Workers International Union

United Paperworkers International Union

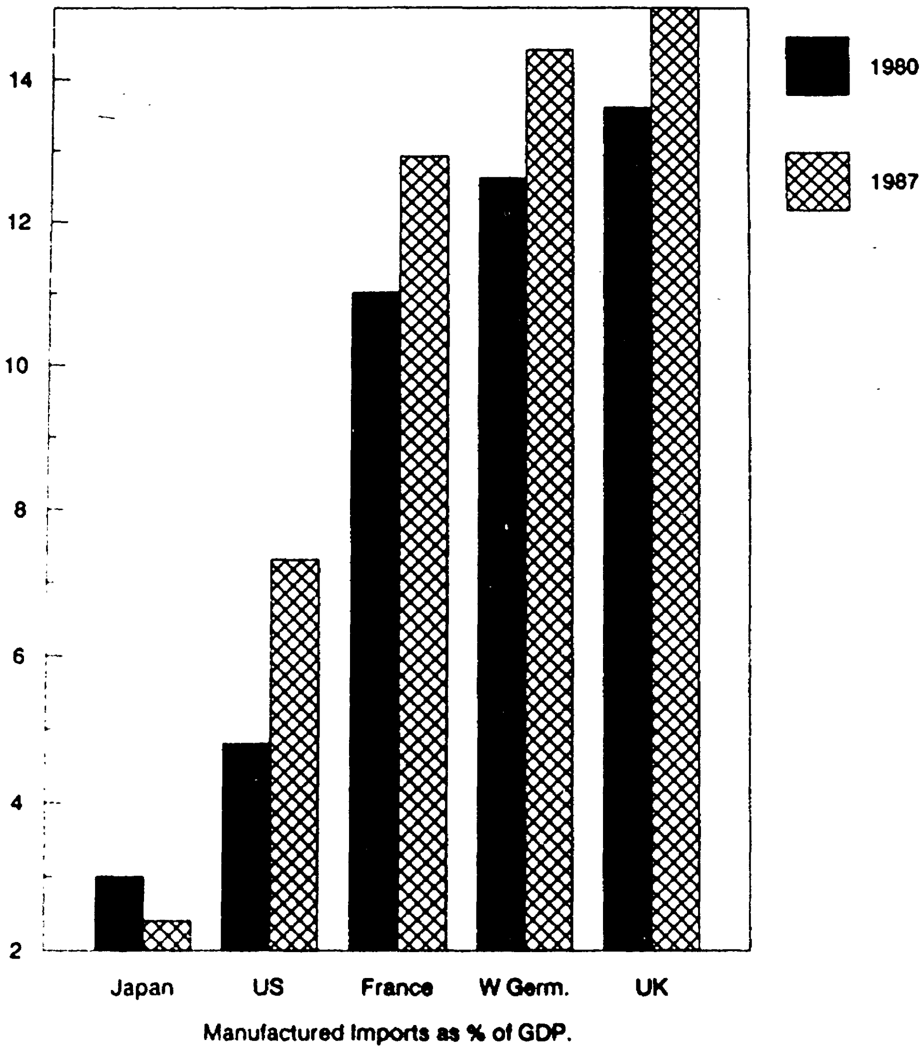
United Rubber, Cork, Linoleum and Plastic Workers of America

United Steelworkers of America

TRW, Inc.

LICIT is a coalition of industrial unions and corporations that was formed in 1980. The coalition is a voluntary association representing a broad spectrum of American industry and is not an official arm of any labor or business group. LICIT's charter states that the coalition "seeks to represent the common interest of American workers and American business in promoting increased, balanced, and equitable trade among all nations of the world. Without reference to outdated slogans of 'free trade' and 'protectionism' it will support adoption of government policies and industry practices which encourage open, fair competition for foreign products in the United States market as well as for American made products in foreign markets."

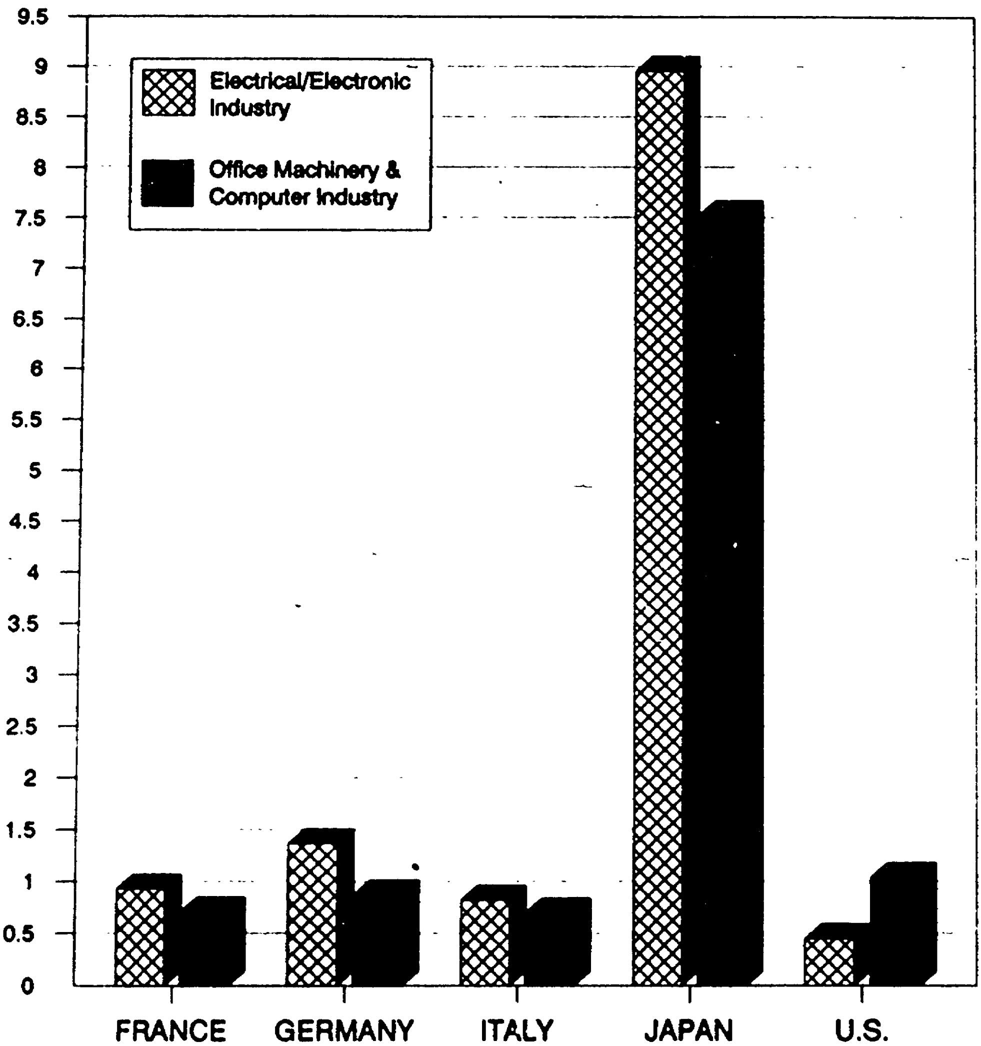
Imports of Manufactured Goods
of Selected Countries



Source: Edward Lincoln, *Japan's Unequal Trade*, 1990

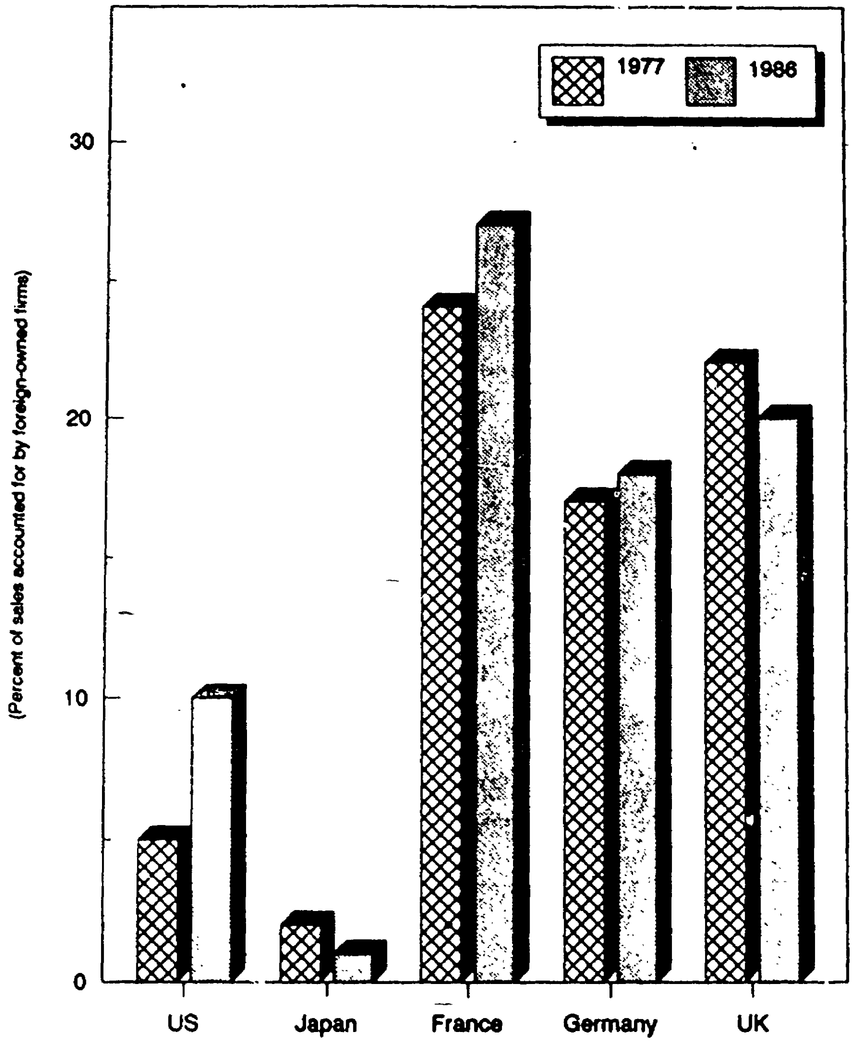
EXPORT/IMPORT RATIO

1987



Source: OECD, Foreign trade data bank.

The Role of Foreign Direct Investment in the G-5 Countries



Share of foreign-owned firms

Source: D. Julius and S. Thomsen, "Foreign-owned Firms, Trade, and Economic Integration, *Tokyo Club Papers* 2. London: Royal Institute of International Affairs, 1988.