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116

U.S.-Japan Trade
Relations: Time for
an Agonizing
Reappraisal

Edited by Martin L. Lasater



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The Heritage Foundation
214 Massachusetts Avenue, N.E.
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U.S.A.
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**U.S.-JAPAN TRADE RELATIONS:
TIME FOR AN AGONIZING REAPPRAISAL**

Senator Frank Murkowski, Republican of Alaska

H.P. Goldfield, Assistant Secretary, Commerce Department

Dr. William Niskanen, Chairman, Cato Institute

Minister Peter Sato, Embassy of Japan

The Lehrman Auditorium
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U.S.-Japan Trade Relations: Time For An Agonizing Reappraisal

Martin L. Lasater, Director, Heritage Foundation's Asian Studies Center

This morning, we are addressing one of the most important public policy issues facing the United States, the question of U.S.-Japan trade. As all of you know, last year, the United States registered a record trade deficit of \$170 billion. Over one-third of that deficit, nearly \$60 billion, was with Japan. Since 1984, the U.S. trade deficit with Japan has grown over 300 percent.

Coupled with this enormous trade deficit is a common perception that Japan is an unfair trading partner. Currently, Washington is engaged in a series of sometimes frustrating negotiations with Tokyo over such issues as auto parts sales; barriers to foreign construction firms; access to Japanese public works projects, such as the Kansai Airport; barriers to foreign lawyers; restrictions on agricultural imports such as beef, citrus fruits, and rice; barriers to the sale of U.S. superconductors and supercomputers; and the dumping of Japanese semiconductors.

Significantly, the criticism in the United States of Japanese trading practices is echoed in many other parts of the world. In Asia, for example, the complaints about Japan from South Korea, the People's Republic of China, Taiwan, and Southeast Asia are similar to those faced by the United States: Japanese products dominate certain domestic markets, yet domestic products seemingly encounter major obstacles entering Japan.

But this grossly oversimplifies an extremely complex set of problems. Annually since 1973, for example, American productivity has increased 2.2 percent, while Japanese productivity has increased 5.6 percent. Moreover, many Americans prefer Japanese products because of their higher quality. By contrast, many Japanese do not want American products. A recent poll taken by Lou Harris and Associates found that, while two-thirds of Americans wanted to purchase Japanese goods, only 14 percent of Japanese wanted to buy American products.

It would be unfair to claim that Japan has not done a great deal to meet U.S. demands for more open markets. Since 1981, Tokyo's tariffs have been lower than those of the United States and the European Economic Community. Moreover, nontariff barriers, such as quotas on cigarettes and agricultural products, and standards and certification requirements on imported goods have been lowered.

In addition, Japan is cooperating with the United States to depreciate the dollar over the yen. Last year, for example, the yen increased in value from 260 yen to the dollar to 150 yen. This is equivalent to giving American products a 40 percent cost advantage in competition with comparable Japanese products. Perhaps most significant, Prime Minister Yasuhiro Nakasone has undertaken a major effort to reorient the Japanese economy away from such heavy dependence on exports to a consumer driven economy such as our own.

Finally, it should be mentioned that friendly relations with Japan remain the cornerstone of U.S. policy in East Asia. For strategic and political reasons, it is

essential that the trade problems between Washington and Tokyo not be allowed to undermine the U.S.-Japan defense alliance.

We are honored today to have a distinguished panel of experts to discuss U.S.-Japan trade problems. Our first speaker will be Senator Frank Murkowski, Republican from Alaska, and ranking minority member of the Senate Subcommittee on East Asian and Pacific Affairs. In his capacity as Chairman of the Republican Conference Task Force on International Trade Policy, Senator Murkowski has been especially active in the Kansai Airport issue. Senator Murkowski will discuss congressional attitudes toward Japan and the trade issue. Senator Murkowski.

Senator Frank Murkowski

It is not my intention to be unduly harsh on our trade relationship with our neighbors in Japan. I think it fair to point out, however, that the significance of the trade imbalance with Japan is such that it represents a high degree of symbolism so far as the United States Congress is concerned. We are approaching a deficit figure of about \$60 billion, and I think the buck had best stop in that range.

Today is a rather important anniversary. A year ago our Ambassador to Japan, Mike Mansfield, went to a meeting in Osaka at which he gave a specific message. That message was that the United States wanted to submit bids and tender for participation in the construction project planned at Kansai, the international airport being constructed on Osaka Bay, as well as for future major public works projects that have been announced for the next decade, totaling approximately \$62 billion.

I am sure you are all aware of the Kansai project. It involves the construction of what will truly be one of the construction wonders of the world. It is an \$8 billion project, an airport three miles out in Osaka Bay, two miles long and a half-mile wide, some of it built in as much as 90 feet of water. I have been to the site, and it is a gigantic and extraordinary undertaking.

In the past twelve to sixteen months, U.S. negotiators have made numerous efforts to engage in reasonable negotiations on the issue. Secretary of Commerce Malcolm Baldrige, Under Secretary for International Trade S. Bruce Smart, Deputy U.S. Trade Representative Michael B. Smith, Assistant Secretary for Trade Development H.P. Goldfield, myself, and many others, have traveled to Japan to carry the message that we are interested in participating in this project. In addition, there have been numerous letters written, communique signed, congressional hearings held, news conferences called, and floor statements made that have been dedicated to this issue. The results, needless to say, have been very disappointing.

Currently, it is our understanding that over \$1 billion in contracts have gone to Japanese firms and only three U.S. firms have received any consideration. One is the Delnote Company, which received a contract of about \$883,000 for measuring instruments. It happens that this firm is the only one that produces this particular line of instruments. Rexnord, a Wisconsin firm, received \$400,000 in license fees; and Bechtel was awarded a contract for about \$200,000. This totals

about \$1.4 million on an \$8 billion project. So I think it is fair to say that the Japanese bureaucracy has been able to stonewall our efforts rather effectively so far.

I would like to contrast what Japanese construction firms have done in the U.S. market in recent years. Their business has increased from less than \$50 million in 1981 to over \$2 billion in 1985. It is expected to reach \$3 billion for 1986. Most of the construction work done by Japanese construction firms in the U.S. has been negotiated. Much of it was for automobile plants closed to open bidding from American construction firms. It was an ideal opportunity for Japanese construction firms to gain experience over here and still work within the Japanese system in cooperation with Japan's automobile companies.

The Kansai project marks the first of some \$60 billion of public works projects projected through the next decade. These are areas in which U.S. firms have technical expertise and competitive ability if given the opportunity.

According to the U.S. Trade Representative, American firms have expressed strong interest in participating in these projects. Last March, U.S. and Japanese officials met to discuss foreign participation at Kansai. Immediately thereafter, the president of Japan's largest construction industry trade association held a press conference indicating that foreign firms were not welcome to participate in the Kansai project. In October, a report submitted by industry representatives indicated seminars would be held on the proposed bidding. This was in cooperation with Japanese government efforts to provide insights to American firms on how the process would begin.

However, nothing of substance has happened. Certain U.S. observers and Japanese industrial experts have described the Japanese business practice as a rather interesting arrangement called the "Dango" system. Companies sit down and negotiate at closed meetings among the major construction firms and affiliated suppliers as to just who is going to get the job and under what circumstances. We may look at it as anticompetitive behavior, but it is specifically a rotation of winning bids among insiders.

The Dango is enforced through boycotts and threatened boycotts of customers who move outside the system or subcontract. In the United States, it would not get very far before being stopped by the courts.

Prime contractors basically tell their subcontractors not to work for foreign firms. One U.S. firm has a construction license in Japan, but the boycott has been so effective that this firm has not been able to build its own building. It has only been able to build two Mrs. Field's Cookie Shop storefronts. That constitutes the sole penetration of U.S. construction in Japan in the last decade. The message the Japanese are giving us is "foreigners need not apply."

We must recognize the fact that almost \$2 billion in rehabilitation work in Manhattan alone was done by a joint venture with a Japanese construction firm and that the Japanese owners and major players active in keeping U.S. firms out of Japan have expanded and profited from business interests in the United States. It is

our contention that the Kansai issue is one where America must take its stand on trade, because of the inequity that is obvious in this particular case.

Now, the alternatives are reciprocity amendments, which we have available to us through the Airport and Airways Improvement Act. We have about \$25 billion worth of construction coming up in the next ten years in airport construction in the U.S., and we could appropriately eliminate those companies that do not allow us to participate in their public works projects.

A major piece of existing legislation is Section 301 of the 1974 Trade Act.¹ I am holding in my hands the 301 draft-filing petition, produced and ready to go. We are in the process of communicating on this with the Administration, but the decision is going to be made shortly.

I think it is fair to say that Prime Minister Nakasone has been very responsive to the concerns we have expressed. I have had the opportunity to meet with him on several occasions and have urged him to open Japan's markets. But the traditional linkage between the Japanese bureaucracy and the private sector is such that we really have not been able to penetrate their markets, in spite of the Prime Minister's reassurances.

I intend to introduce an amendment this year with military construction authorization. Last year, we spent about \$300 million in Japan on our bases that were under lease to the Japanese government. About \$285 million of that was done by Japanese construction firms, architects, and engineers, and about \$15 million by U.S. firms. My amendment will mandate that there be a joint venture of U.S. firms with Japanese contractors before military construction is carried out in Japan.

Kansai is symbolic of the entire market access problem in Japan. It is an issue that the average American can understand. It is not something you wear. It is not something you eat. We have allowed the Japanese contractors into our market, but they have not allowed us into theirs. It is that simple.

We have to apply the principle that leverage in diplomacy is occasionally necessary. We have a "best customer" relationship with Japan. We are their largest customer. The access to our markets is worth an extraordinary amount to Japan. But I do not think Japan has been responsive to the best customer relationship that would be seen normally in everyday business. You take good care of your best customer, but Japan has not done that in the case of the U.S.

As you know, 56 of my colleagues have introduced the Omnibus Trade Bill (S. 490). We are going to get trade legislation this year; there is no question about it. I think we have to keep up the pressure. The Japanese have observed us over a period of time and come to the conclusion that we really are paper tigers. We do not have continuity. We have yet to take a stand on trade, and until we do, I do not think we are going to get their attention. But if we do, they will respond by opening up their markets more fully to us.

1. This section gives the President a tool to deal with the unfair trade practices of other nations.

So basically, the U.S. Congress fully intends to pursue the Kansai issue. If it is necessary to proceed with the 301, we are prepared to do that. We feel it is simply a matter of reciprocity. The Kansai Airport issue is the place to stand up for our interests.

Mr. Lasater: Thank you, Senator Murkowski. I would like Minister Peter Sato to comment briefly on your remarks. He is Economics Minister at the Embassy of Japan. He joined the Foreign Service in 1958, and has served in London, Jakarta, Hong Kong, and three postings in the United States.

Minister Peter Sato

I certainly appreciate the Senator's frank remarks on the Kansai Airport project. It is very unfortunate that this case has become the "litmus test" of our trade relationship.

As was rightly mentioned, our Prime Minister has been heavily involved with this project. He has instructed us to open the project as much as possible. There should be equal and fair opportunity to enter the market created by the Kansai Airport construction.

What often happens is that there is a little "in-fighting" among us. In the Japanese bureaucracy, there are internationally oriented bureaucrats as well as domestically minded bureaucrats, just as you have here in the United States. But these two groups have been making progress and are trying to seek policies more accommodating to U.S. interests in this project.

I certainly agree that the construction market has to be opened up in the interests of free trade and for the interests of vitalizing the construction market in Japan. The issue is how we can do this. The first stage of construction has to go on so that we can construct the airport facilities by 1993. There is very congested air traffic already, so expeditious construction is essential.

We now have contracts with some U.S. firms. To name a few, Bechtel signed a contract at the end of January for design of the airport facilities. Although the value of the contract is small, the implications of their entering the Japanese market is significant. I am sure U.S. industries will enjoy more competitive, open, and fair market access over the next three or four years.

Mr. Lasater: Dr. William Niskanen, Chairman of Cato Institute, will now comment. He has served with the Council of Economic Advisors from 1980 to 1985, and was intimately involved in constructing what has become known as Reaganomics.

Dr. William Niskanen

There is very little disagreement about the basic unfairness of the procedures that have been used to let the contracts for Kansai. I think the issue for the United States is whether a carrot or a stick is a better instrument to achieve our objectives and which approach is more consistent with a long-term favorable relationship with Japan.

My own judgment is that, in a relationship in which we want them to do something, we should exchange something that they want, such as dropping barriers to the access to part of our market. This would be more likely to be productive and to sustain the relationship than it would be to threaten to harm the Japanese if they do not do what we want, which is totally inconsistent with maintaining a good relationship with Japan or anybody else over a long period of time.

The paper tiger image of the U.S. is an unfortunate analogy. Our relationship with the world should not be that of a tiger of any kind unless there is a clear threat to our national security interests. The issue here with Japan is one of tactics and of the character of the U.S. response. It is not one of the basic unfairness of the practices of the Japanese.

Guest: Senator, you spoke of pending 301 action. Have you any indications that the USTR is nearing a decision on its willingness to self-initiate a 301 case?

Senator Murkowski: The answer to that is yes. The USTR is nearing a decision, and the closer that I get to initiating one, it seems the nearer they get to proceeding with their own.

Guest: You cited the Omnibus Trade bill. As you know, the bill strips the President of some of his discretionary authority. Are you in favor of such changes in the trade status?

Senator Murkowski: Well, ordinarily no, but I think it is reasonable to say that our patience in working within the system, is being exhausted. I think this is one of the reasons there seems to be a bipartisan movement on the trade legislation. Working within the conventional system has not worked to the degree that we had hoped.

We have become a debtor nation. There is more foreign ownership in the United States today than we have foreign ownership overseas. We have a substantially greater trade imbalance. We have lost market shares throughout the world in virtually everything we have produced. We are now about a billion-and-a-half dollars in service trade imbalance. We are buying more services than we are selling.

As a consequence of the trade imbalance, we have seen Japan take those dollars and purchase our assets. They are financing our deficit. Money goes where the return is highest, and the risk is lowest, and the United States offers that opportunity. That is good, but by the same token, the power and influence of one who holds another's debt is significant. I was a banker in Alaska for 24 years, and if I held somebody's debt, I had quite a bit of leverage on him. And this same phenomenon is occurring in the United States.

No one in our government is accountable for our trade policy. We have a terrible time finding somebody who will accept responsibility. It is difficult to tell who's accountable--the Executive Branch, the State Department, USTR, Department of Commerce. I think we are reaching a point where Congress is frustrated enough to take a stand.

Guest: What would Japan have to do specifically in order to avoid a 301 case being brought?

Senator Murkowski: The place to start would be competitive bidding. It is very, very hard to get any information on the planning at Kansai as to what constitutes phase one, phase two, or phase three. This is proprietary information. I think it fair to say if you are not involved in phase one, your chances of participating in other phases to any extent are rather remote, because phase one includes the architectural design and engineering.

The Japanese government refers to the Kansai Airport as a project of the private sector. But any realist knows you cannot build a 6 to \$8 billion airport and expect to amortize it with landing receipts. The Japanese government is behind the project. Otherwise, it could never be financed.

Guest: Do I understand correctly that it is not possible for American companies to participate in phase one at this point?

Mr. Sato: I think opportunities still exist to supply facilities such as trucks, ferries, crushing machines, and so forth. This is a process that will continue to 1993. Meetings have been held with U.S. Administration officials to explain how to deal with these processes over the next couple of years.

Guest: Dr. Niskanen, you raise the intriguing question of using "carrots" as opposed to "sticks." Senator Murkowski has outlined rather explicitly some possible sticks, but we haven't heard any explicit carrots. I would appreciate it if you could give some examples of carrots you think might be used instead of sticks, and then if the Senator has time, I'd like to know his opinion of the efficacy of those carrots.

Dr. Niskanen: There are all kinds of actions by the U.S. that Japan would like to change. We cannot export oil from Alaska to Japan, and Japan would be a good market for that oil. We are not allowed to export logs from public forests in the West. We have recently arranged for a semiconductor cartel that raises the price of computer chips to all users around the world.

These are actions by the U.S. that the Japanese would like to see changed, and in most cases, the changes would serve our interests as well. I think there is a basis for trading concessions, and that approach, both on a bilateral and multilateral basis, has proved to be the only viable, sustainable, productive way to reduce trade barriers over a period of time. The other approach is that of a "bully boy," which is both demeaning to us and not very effective.

Senator Murkowski: Our sensitivity to the growing trade imbalance has been communicated to our trading partners over an extended period of time. The question is the propriety of the U.S. taking a position, and if so, what that position should be and what the issue should be.

I happen to believe that Kansai should be the issue, because it is relatively easily understood. It has a broad enough base, the question of equity is evident

enough--Japan does \$1.8 billion in construction business in the United States, we do none in Japan. We have attempted to work within the system to communicate our concerns, but we have not seen Japan open its markets.

There are inequities here. But as Minister Sato has indicated, these inequities are in degrees. For example, some U.S. rock crushing equipment has been purchased for Kansai: but that was an extraordinary bit of happenstance. Two prefectures are involved in the Osaka airport. One allowed the U.S. equipment in, and the other did not.

These are the situations that are occurring because of the breakdown of the Japanese system, and I would say we are lucky to have that much of the market. Another issue was explained to me by the President of the Kansai International Airport project. Kansai is a very sensitive issue with Japanese labor groups and with the construction industry. He told me 1 percent of all Japan is going to be involved somehow in the construction of Kansai or in the support base associated with the construction. I do not doubt that for a minute.

I responded by pointing out that the open market accessibility in the United States employs maybe 20 or 25 percent of Japan's working population. The Japanese do not make that connection, or they do not want to, and that is the point that Kansai represents. The problem is our inability to participate. I would hope that Minister Sato could help us get some information on phases one, two, and three. We, and I think the American General Contractors Association, and the various professional groups, have been absolutely stonewalled in trying to find out what is happening in the next phase, what is the system layout of this gigantic project, so we can solicit future business.

Mr. Lasater: Senator Murkowski, I appreciate the time you have you have been able to spend with us this morning.

At this time, I would like to turn the presentation over to Minister Peter Sato, who will discuss U.S.-Japan trade issues from the point of view of Tokyo.

Mr. Sato: Thank you. Frankly, I feel a bit uneasy. I do not think the issues concern only the Kansai Airport project. The United States and Japan have such enormous, dynamic relations. Today's subject is the U.S.-Japan trade relationship, a time for an agonizing reappraisal. And I think we Japanese are agonizing over how to come out of this difficult situation without serious damage to the overall relationship.

I certainly understand as a countryman, and especially as a diplomat, why so much has to be discussed about my country. I would say our relations are very important, dynamic, and crucial, not only to both of us, but also to the rest of the world. I hope the dialogue this morning is productive and rewarding. In this spirit, I would like to present my perspective on our economic and trade relations. It will include three aspects: our overall bilateral relations; our trade relations; and finally, Japan's actions in macroeconomic policies and market access improvement measures, including ongoing negotiations.

First, I would like to say a few words on how I see our bilateral relations. I am sure these views are shared by many here today. In my view, today's U.S.-Japan relationship is stronger, more dynamic, and broader than it has ever been before. The emergence of such relations is a unique occurrence in the history of our bilateral relations. As the world's two largest, most productive industrial democracies, the U.S. and Japan share a partnership of extreme importance, encompassing trade, security, political cooperation, science and technology, and virtually all other areas of human endeavor.

The importance of the U.S. and Japan to each other is, of course, not simply an invention of diplomats, business people, and academics who have specific stakes in the relationship. Our political partnership is deeply rooted in shared values and interests as sister democracies dedicated to freedom. Our growing economic interdependence results from the dynamic interaction of our two free enterprise economies, the first and second most productive societies on earth, generating between us about one-third of world GNP.

Because of the values we share, and the power of our combined talents and resources, our partnership is also of enormous importance to the rest of the world. As President Reagan and Ambassador Mike Mansfield in Tokyo put it: there is no relationship that is more important to peace and prosperity in the world than that between the United States and Japan.

Among other things, I would like to emphasize that our relationship is an activist partnership, which can survive only as we work together tirelessly to make it work. Even so, we are bound to have periodic stresses and strains such as we have experienced these last several years. In my view, these are the growing pains that go with the process of maturing. The challenge to diplomacy and political leadership is to formulate and adjust our differences while expanding the areas of effective cooperation between us.

Second, I would like to address the question of our trade relations. Let me be very clear that Japan, your largest overseas trading partner, recognizes fully that a \$60 billion U.S. trade deficit in 1986 is a very serious problem. So deep is the concern of the U.S., that it threatens not only the well-being of the American economy, but also the stability of the world trading system and the vitality of the free world economy.

Under these circumstances, an increasing number of people link the growing U.S.-Japan trade deficit with an allegedly "closed" Japanese market. Is it really so, I would like to ask. Let us take a moment to have a closer than usual look at the trade figures.

Between 1981 and 1986, the U.S. deficit with Japan tripled, but with the rest of the world, it quadrupled. Factoring out Japan, it in fact quintupled. Or take the absolute erosion of U.S. trade accounts. With Japan, it worsened by \$40.5 billion to reach a deficit of \$58.6 billion. But with the European community, it deteriorated by an equally alarming \$35.1 billion in a downhill slide from an \$8.7 billion surplus in 1981 to a \$26.4 billion deficit in 1986.

Indeed, if the questionable point is that of closed markets in Japan, how can we explain the U.S. export performance overall? Over the same period, while the U.S. exports to Japan increased by 23.2 percent, total U.S. exports, not counting exports to Japan, actually fell by 10 percent.

Many analysts point out that one of the real causes of the U.S. trade deficit lies in the overvaluation of the dollar during the first half of the 1980s. The fact is that exactly the reverse is happening in Japan. The sharp and rapid yen appreciation is working very effectively and visibly in Japan. In 1986, a 13 percent decline in Japanese yen exports to the United States translated through the exchange rate realignment into a 23 percent increase in U.S. dollar imports from Japan.

The decline of yen export earnings means drastically reduced profits for Japanese corporations. Sooner or later, they will have to adjust their export prices. Yen appreciation also will increase imports. This in effect is translated into increased purchasing power for Japanese consumers. In fact, last year Japanese imports of manufactured goods rose by 31.3 percent worldwide and 53.4 percent from the United States. The percentage of manufactured goods imported from the United States stands at 60.7 percent of the total market.

The currency realignment is clearly welcome, but a few items of exports in 1986 have shown the decline in yen values. For example, color TVs, down 56 percent; steel sheets, 30 percent; VCRs, 21 percent; photo equipment, 17 percent.

The other aspect of currency realignment often overlooked is the impact it has on the longer term structural adjustments. These always cause enormous pain. As some U.S. industries have done during five years of dollar overvaluation, some Japanese companies will shift to overseas production rather than export of finished products. This is already happening with autos, electronics, and other products.

Now, I come to the third point. What action have we taken under the stronger yen? In fact, Japan has taken a variety of steps that are supportive of the currency realignment. Currency realignment is not the only strategy to remedy the economic imbalances that now exist between our two countries. Economically, currency appreciation without policy induced domestic expansion could result in a recession, which is bad for everybody. Politically, without such domestic stimulus, calls to reverse the exchange rates realignment will gain momentum. Our policy has to address industrial structural changes, which are bound to come through the mechanism of currency realignment.

Japan has implemented a variety of measures to expand domestic demand. The \$23 billion stimulus package and the recent 1987 fiscal year budget proposal both lay emphasis on increased public works and housing investment. Tax reform is aimed at increasing disposable income. And contrary to the view that is recently gaining currency here, the Japanese economy is in fact entering the phase in which domestic demand is becoming the engine of growth. Trade will, in fact have a negative influence on growth.

For fiscal 1987, starting in April, we forecast real GNP growth to be 3.5 percent. Domestic growth will contribute 4.3 percent, while net exports will drag this down by 0.8 percent.

What about structural adjustment? While it is associated with more overall efficiency and balance, it also means pain for some. Nowhere in the world is structural realignment an easy task politically. In Japan's case, the implementation of structural reform means that the government is going to engage in a conscious effort for structural adjustment. As Prime Minister Nakasone said, "Japan cannot remain an island of solitary prosperity anymore."

Structural adjustment is needed as the economy changes, but it also plays an ancillary role in relieving the pains of the yen appreciation and is the driving force behind domestic demand expansion. It will also enhance the desirability of imports, making domestic demand expansion more effective in terms of increasing imports.

In industry terms, it is a policy to shift production of export goods into production of goods for domestic consumption or overseas production and to shift domestic production into more use of imports. In macroeconomic terms, it is a policy to narrow the gap between investment and savings. In the former context, Japan has already decided to cut domestic coal production by 50 percent and to phase out the domestic production of metallurgical coal altogether. In the latter sense, the recent domestic demand measures and tax reform were all aimed at this specific objective.

The domestic demand expansion policy and the structural adjustment policy are aimed indeed at improving the quality of life of the Japanese people and of altering Japan's import-export strategy. Quantity-wise, we have a pretty full line, but quality-wise, we lag far behind other industrialized nations in the world.

We believe that we ought to improve qualitatively our way of life, our standard of living. We feel we should achieve that goal through the process of economic adjustment. On the import-export scene, when you see an increase in exports, imports do not increase proportionately. We know we must alter our economic structure. In the spirit of the international division of labor, industries that have the most international competitiveness may be encouraged to shift into other types of production.

These are the moves that are already visible through the combination of currency realignment, domestic demand expansion policies, and the structural adjustment policies. I have outlined several strategies Japan has taken to remedy the trade imbalance. This does not at all mean that I am not sensitive to the "closed market" perception of Japan. On the contrary, I recognize that trade deficits and trade problems are not exactly the same.

As one of the primary beneficiaries of the free international trading system, Japan has a special obligation to take the initiative in further improving our market access to the fullest extent possible. Japan's efforts over the past several years in enhancing market access have been unprecedented and unparalleled elsewhere. Just a few were mentioned by Mr. Lasater at the outset in his introduction. Last year

alone, we reduced or totally eliminated tariffs on over 1,800 items. This includes zero tariffs for telecommunications equipment, computers, CD scanners, and certain sporting goods. The cigarette tax, too, falls to zero in April.

Substantial tax cuts on wine, paper products, and aluminum products have also been approved. The telecommunications market has been fully liberalized with the resulting boost of U.S. businesses in Japan, both in services and equipment; and financial and capital market liberalization is proceeding rapidly, making the Tokyo market consummate with its standing as a world financial center, alongside New York and London.

The medical equipment and pharmaceutical market also has been streamlined to the satisfaction and interest of U.S. industries. Further, we made significant progress during 1986 in simplifying import standards and certification procedures to bring these practices into a closer harmony with international practices. Test data on electrical appliances, for example, are now accepted by the Japanese government from an American firm, Underwriter Laboratories, Inc., the UL approval.

In addition to these steps, Japan has been a staunch ally of the United States in promoting the Uruguay Round, the new round of multilateral trade negotiations to reduce the remaining barriers to trade in goods and services and to devise new rules for new areas and even to address the question of intellectual property rights.

I should also touch upon the more positive aspects of our economic relations. There is \$25 billion in Japanese direct investment in the U.S., creating 200,000 American jobs. Parts and components supplies, joint R&D, marketing, distribution, collaboration, and the like also strengthen our commercial relations but defy traditional notions of cross-border trade and bookkeeping thereof.

The experience of Japanese and U.S. companies in blending our two corporate cultures has demonstrated that our private institutions are highly compatible. They are naturalized in what may turn out to be the most challenging opportunity of the century: the building of a truly integral global economy based on private enterprise operating freely and fairly in open world markets.

Finally, just a brief word on some of our ongoing consultations, such as the one on semiconductors, concerning which we highly value the understanding reached last July between our two governments. This agreement uniquely represents a new pursuit of our cooperation in high technology industries. We need to make extraordinary efforts to keep the agreement alive, and so our part is exercising every possible measure to implement it. This is a time-consuming process. I can assure you that my government appreciates the agreement and does not regard it as a mere piece of paper.

The Japanese are deeply concerned about the U.S. trade deficit. But the stark truth is that U.S. trade problems will not be dissolved by a protectionist trade bill. Attempts to balance imports and exports, or to define reciprocity by legislation, are doomed to failure since they only open the door for nations to write their own rules in a fragmented and shrinking world economy.

The U.S. and its trading partners, including Japan, should instead be focusing on tasks that have a more direct bearing on trade distortions. We have to create more sustained parallel economies through the coordination of economic and monetary policies. Because of the economic interdependence of our respective national economies, nobody can go it alone anywhere in today's global economy.

This is not a time for exchange of recriminations. I believe this is a time when governments should join together in order to cope with the most difficult economic situation the world has ever confronted. I think a common goal should be a joint effort to change this situation. Thank you very much.

Mr. Lasater: Mr. Minister, thank you very much for a strong and persuasive presentation of your government policies. Now I would like to turn the floor over to Dr. Niskanen, who will discuss the global implications of escalating trade tensions between the U.S. and Japan.

Dr. Niskanen: Most public discussions of trade issues, apparently including this seminar, are an attempt to find a foreign explanation for a domestic problem.

In this case, the perceived problem is the large trade deficit in manufactured goods with Japan. U.S. political officials are all too quick to attribute this condition to Japanese policies and business practices that promote exports or restrict imports. The primary explanation of this condition, however, is more straightforward. The U.S. now has a large balance of payments deficit because total savings by Americans is substantially smaller than total investment in the U.S. Moreover, the trade deficit in manufactured goods is even larger, because the U.S. has a net surplus of trade in agriculture and services. Japan has a large balance of payments surplus because total savings is larger than investment in Japan. Moreover, the Japanese trade surplus in manufactured goods is even larger, because they have substantial net imports of food, fuel, and services. The intersection of these macroeconomic conditions is the primary explanation of the large bilateral trade deficit in manufactured goods between the U.S. and Japan.

It must be recognized that measures to promote exports or restrict imports have no effect on the total balance of payments of any country, unless such measures also change the savings and investment balances. Measures that directly affect exports or imports, however, may affect bilateral balances and the product composition of trade. The rapid increase in the U.S. trade deficit in manufactured goods with Japan cannot be attributed to a change in trade policies by Japan. The facts are clear. The average tariff on imports by Japan is now the lowest among the summit countries. The range of products covered by formal nontariff barriers is also the lowest among the summit countries. Moreover, the net restraints on imports by Japan have declined since 1980, a period during which the net restraints on imports by the U.S. increased for the first time during the postwar years.

Some conspicuous formal restraints continue to limit Japanese imports, primarily of agricultural goods and of services. In addition, the differences in regulations, business practices, distribution systems, consumer preferences, language, and culture continue to limit Japanese imports of some goods and services. But

these differences are also a barrier to Japanese exports. The difference is that the Japanese have made enormous investments to overcome these informal barriers, especially compared to the U.S. The number of Japanese who speak English, for example, is probably 100 times the number of Americans who speak Japanese. The U.S. auto makers, for example, have yet to market a righthand drive car in Japan. The many Japanese firms and the increasing number of American firms that have developed profitable markets in the other country, however, are proof that these informal barriers can be overcome with some investment, patience, and intelligence.

This is indeed a time for an agonizing reappraisal of the U.S. macroeconomic policies and conditions that have led to the large U.S. balance of payments deficit. The primary reason that this deficit has increased so rapidly since 1980 is that the government deficit did not decline as usual during the recovery years. For example, the U.S. should review the importance of continuing to station about 100,000 troops in Japan and Korea. A reduction in U.S. spending for this purpose would reduce the U.S. payments deficit. In turn, increased defense spending by Japan and Korea would reduce their payments surplus. The bilateral trade deficits with Japan and Korea should not, by themselves, be considered a problem but, as this example illustrates, they can provide a useful basis for reviewing policies that have contributed to these conditions.

This should also be a time for an agonizing reappraisal of the pointed, not very subtle, Japan bashing by both the U.S. Administration and Congress. The many current and proposed trade policies that are directed against Japan would have no effect on the total U.S. payments deficit and no substantial effect on the bilateral trade deficit with Japan. Such policies would make both of us poorer, reinforce the ugly residual racism in both countries, and weaken the important political and security relations between the world's two largest economies. The U.S. balance of payments deficit is "Made in America," not in Japan. We should respond to a concern about the deficit by correcting those U.S. policies that have led to this condition, not by blaming Japan, or any other nation, for a problem of our own making.

Mr. Lasater: Thank you, Dr. Niskanen. We will now hear from Mr. H.P. Goldfield, the Assistant Secretary of Commerce for Trade Development. Mr. Goldfield is also a member of the Board of Directors of the Export-Import Bank of the United States. He has had quite a bit of experience negotiating with the Japanese, so he can give us insight into how the Administration perceives the trade issue.

H.P. Goldfield

Thank you. I think that things are getting more difficult in terms of our bilateral trading relationship. From the U.S. perspective, we look at a variety of discrete issues from two perspectives. One is the perspective of what is fair; and the second is, is it costing us jobs in terms of any unfairness by denying U.S. companies the access that they should have.

From the Japanese perspective, I think they are in a particularly difficult time because they are facing our demand for fairness and access, and they are facing the effects of a highly appreciated and strong yen on their own domestic economy. They also face pressures from the domestic manufacturers not to give in, to keep their market share, to do more rather than less. They certainly do not want to face increased competition in their domestic markets.

There are three issues that I think are potentially the most disruptive to the U.S.-Japan relationship. We start from a premise that we would like to strengthen the relationship, and that there are ways to do so.

The first issue is supercomputers, where I think we have seen very little progress in recent discussions. Ambassador Michael B. Smith of the Office of the U.S. Trade Representative, Under Secretary S. Bruce Smart of the Department of Commerce, and Assistant Secretary Douglas W. McMinn of State for Economic and Business Affairs were not extremely happy with the results of the bilateral talks last month. We are looking at our options. Basically our concern is Japanese targeting of an industry that has enormous economic and strategic importance to the United States. The issue is access by U.S. companies to the Japanese market, particularly the government market, and the potential predatory practices that the Japanese may be contemplating or have committed in our market.

I do not think that there has been a great deal of progress in supercomputers, and I think that the Administration is going to be reviewing our options in the very near term to determine what the appropriate response should be for the lack of access by our companies to the Japanese market for supercomputers.

The second potentially disruptive issue is semiconductors. It is our belief that there is continual Japanese dumping in third country markets, that market access to U.S. companies in the Japanese market may have actually declined rather than met some of our stated targets. I do not believe that U.S. companies have been dumping, although there have been charges by the Japanese side that this has occurred. And most important, the credibility of the negotiated settlement of a dispute is really at stake. A great amount of time was spent, both at the staff and policy level, negotiating a settlement giving U.S. companies access to the Japanese market and prohibiting dumping by Japanese semiconductor companies in third country markets. But we are not seeing the implementation of that settlement. That causes frustration and a serious reaction by both the Administration and Congress.

Another issue is the Kansai Airport, which is very difficult and must be looked at from two perspectives. From the Japanese perspective, it is their view that they have moved mountains. They have even provided one U.S. company with a small contract. They have taken a significant step in allowing a foreigner to participate in their very large public works construction market. We estimate that market to be about \$62 billion over the next ten years. We have had no access to the construction market in the past. Recently, we have seen a couple of very small contracts. From our standpoint, those small contracts are moving pails of dirt. That is the way our industry views it. They are not moving a mountain.

The question is, will we see some greater and more substantial contracts in the near term that will allow us the time to work out the issue. From my own discussions with my counterparts in the Japanese government, the Ministries of Construction and Transport, MITI, and the Ministry of Foreign Affairs, I think a consensus will be built in a rather short time from the Japanese perspective. It is a very difficult issue for them. The construction industry has been a powerful domestic political force for the last two decades. Yet there is some sense that there needs to be fair competition that would afford foreign companies the opportunity to compete for that \$62 billion worth of public works construction in areas where they have competitive and comparative advantage.

But again, the political pressures here at home are such that we feel as though we have every right to fairness. Japanese companies have free access to the U.S. construction market. They have done substantial work in this market. They are free to compete. But we do not have the same access to their market. This is not fair, and something ought to be done to resolve that. We should not have to wait a long time for that resolution. It boils down to the simple question: will the Japanese do enough in the short term to allow the longer term change of their system to occur and allow U.S. companies to participate, or will there be only a small contract here and there. I do not think the U.S. will view a few small contracts as sufficient proof that the Japanese public works construction market is open to U.S. competition.

So I think we are close to a crunch point. Will the very near future bring more contracts in the initial construction of the \$8 billion Kansai Airport project and give us enough time to work out a change in the system that will then afford over the longer term greater opportunities for U.S. companies to compete and participate?

In terms of negotiating with the Japanese, they deserve much credit; they always do their homework. They have studied an issue every which way; they have every defense known to man on any point raised. I think we need to be just as diligent, not only in our preparation, but in our ability to stay at the table and to continually pound away at an issue.

Equally important, though, the credibility of the trading relationship is at stake if, when we reach a settlement, it is not implemented. That could do more damage to the fundamental relationship than any specific issue. When we sign an agreement and we are told something is going to happen, we should not have to be on top of that agreement every single minute of every single day of every single week of every single month to make sure that there is compliance. If we fail at the basic credibility of our relationship, I contend we are going to have a great number of trade issues that are going to cause the relationship major problems.

Mr. Lasater: Thank you, Mr. Goldfield. Now, do we have questions from the floor?

Guest: Dr. Niskanen, you talked earlier about the carrot approach to dealing with Japanese and some of the concern you have about the future of our relationship.

At the same time, you talked about our seeking greater market access. It seems to me that using the carrot approach all the time with the Japanese is in fact rewarding them for not abiding by bilateral agreements, international law, the rights that we have to pursue our own laws, and the rights that we have under the GATT.

Dr. Niskanen: In a case where actions by the Japanese or anybody else are in clear violation of an agreement between our countries, or on a multilateral basis, then we must pursue the dispute settlement mechanism that is specified in these agreements. With rare exception, these disagreements with Japan are not on matters in which there is a prior agreement that is binding. In other words, we are not trying to get them to do something that is consistent with prior agreement. It is not a matter of enforcing an international agreement.

I want to make the distinction, then, between matters in which there has been a prior agreement which we are trying to enforce, which are very rare with the exception of this most peculiar semiconductor cartel we have tried to set up, and other matters in which we are trying to change longstanding practices in Japan, which are not new restraints in most cases, but are longstanding restraints that we think limit our potential market. In those areas, where there is not a prior agreement, the only appropriate mechanism is to offer mutual, balanced concessions.

I would like anybody in the audience to identify cases where these current pressures are a consequence of a Japanese failure to abide by existing multilateral or bilateral agreements. Now, there is a fuss about the semiconductor agreement that was negotiated with Japan, but why anybody in the world would be surprised about the difficulties of enforcing a semiconductor cartel is beyond me. People must have been born yesterday to believe that you can enforce a cartel of the particular nature to which the Japanese agreed. My guess is that both U.S. and Japanese companies will find ways to get around it. I think it was a bad decision in the first place.

But that was an example of the U.S. getting the Japanese to agree to something in which there was no basis for enforcement under U.S. law. U.S. law bearing on countervailing duties does not provide the authority to protect against diversions through third countries. It is specific to the country and to the product. If there is direct or indirect diversion through third countries, there is no basis under U.S. countervailing duty law to respond to that condition.

Now, the only basis for it is the agreement that Japan signed with the U.S. last summer, which was basically to suspend the countervailing duty application. We are expressing puzzlement about why it has been difficult to enforce that particular provision of the treaty. That should not be a puzzle.

I would support using the power and influence of the United States when there is a clear violation of a prior agreement, either on a bilateral or multilateral basis. But in the case where we are trying to get them to change, in many cases, internal business practices that have no particular force of law, the proper approach is mutual concessions that will reinforce the value of the relationship over time.

The main thrust of my remarks is that it is the United States which needs to understand the origin of the trade deficit and to take the actions to reverse the conditions within the United States that led to that trade deficit. The Japanese may find it in their interests to change their fiscal policy in a way that reduces their savings or increases their public or private domestic investment. But that is their business.

I find it awkward for the United States government to be encouraging actions by other governments that are directly contrary to what we know is best for ourselves. But that is what we are doing in the case of Japan. Our trade deficit is a consequence of our spending more than we are producing, and we are importing a large volume of goods and services to make up the difference. It is not \$170 billion; the net is about \$143 billion.

We are spending more than we are producing, and that is not a sustainable situation over a period of time. Because we are not investing the difference, we are consuming the difference, and that is not sustainable. That situation has to be corrected in the United States; it cannot be corrected abroad. Either we have to increase our production and save the difference or we have to reduce private and public consumption somehow.

Mr. Sato: I tried to explain very briefly in my initial remarks that Japan is now changing. We have to expand or stimulate our business activities as a whole so that economic vitality is introduced into the system, and consequently, more imports purchased from abroad. Tax policy, budget policy, everything is now directed to alter the system of import-export structure.

Japan is quite conscious of the trade deficit situation here. We are still negotiating on some issues and we hope to solve the issues one after the other with more positive policy directions.

In terms of supercomputers, the issue now in Japan is how government agencies can purchase the U.S. supercomputers.

In semiconductors, as Dr. Niskanen has mentioned, it was a very, very agonizing negotiating process. As long as we reached the understanding, we want to abide by it. Every possible effort is being made to obtain strong cooperation from the government and the business community. Certainly it is a very difficult job to maintain the life of the agreement we have now, but the Japanese government is determined to resolve the issue. There should be no doubt about that.

Mr. Goldfield: Mr. Minister, one thing that often fades out of sight on the Japanese side is that the U.S. negotiators start from a premise of wanting to strengthen the relationship, not just win some sort of competitive advantage at the negotiating table. I think that is a basic difference at times between the negotiators on the two sides. It is not winning a point that is the most important goal; from our perspective it is strengthening the relationship as a whole.

With respect to Washington, we are going to see some new debates. The whole question of national security will include the fundamental question of

economic security, fundamental economic security, how we deal with the trade issue or investment. People are going to make a much closer examination of the relationship between our own economic security and our ability to defend Free World principles, whether that means on behalf of the Japanese, the Koreans, or our allies generally.

I think more and more people, particularly U.S. businessmen, are saying we are not going to have national security if we do not have economic security. And we are moving toward fewer manufacturing and R & D jobs. We are looking to give concessions to everyone else, but we are not getting the fairness or the market access that we need.

I agree with Dr. Niskanen that much of what needs to be done is within our own house. We must put our own house in order in terms of spending and savings. But I do think that there is a responsibility on the part of our trading partners not to take advantage of our market to such a great extent. We all consume. We all like to consume. We all probably spend more than we should. But we do so to the advantage not just of ourselves but of other economies, principally those of Japan, Korea, and Taiwan. I think these societies should show us some sense of responsibility.

We have made decisions that afford them unparalleled access to our markets and very large profits. We do not begrudge the profits, we do not begrudge the business. What we do begrudge is a sense of unfairness pervading their own markets. That is what we'll gain from the debate of the day, both in Congress and in the Administration. It is a question of fairness, it is a question of jobs, and it is a question of economic security.

Mr. Lasater: Unfortunately, our time has ended. This has been an extremely stimulating discussion, which has shed much light on some of the complexities facing Washington and Tokyo, as we attempt to iron out our trade differences. Thank you all for coming today.