

U.S.- Japan Trade Talks: Hope for Progress

By Edward Lincoln

It is customary for Americans to start talks with a joke and Japanese to start with an apology. Well, I am an American but I have never been very good with jokes. I like jokes but I can never remember them, so it has been a liability. So maybe I'll start with the apology, which is that I am here to tell you about the Structural Impediments Initiative (SII), but there are people in this audience who know more about this topic than I do because they're intimately involved with it. But I'll do my best and try to focus a bit more on the background and what we ought to expect from the SII or what we ought not to expect from it.

Let me start with some explanation as to why we are going through this exercise of structural impediments talks. I think there are three different ways in which we can explain why this has happened. First, it represents a learning process about where the difficulties in the U.S.-Japan trade relationship lie. Second, it is a matter of diplomacy with Japan. And third, it is a matter of political maneuvering between the U.S. executive branch and Congress. I'd like to say a few words about each of these.

The first way we can view these talks is as a learning process. The goal of the U.S. government, over the last 45 years at least, has been a world characterized by fewer barriers to trade. Free trade is a word that I don't like very much because we do not have free trade and will not get free trade. But it has been the policy of this country and other industrialized countries to reduce barriers around the world. For many years that effort focused on tariffs and quotas, which were the standard means by which countries restricted imports.

We have made much progress with that effort, including with Japan. Japan has the lowest average tariff levels of all industrial countries, as of the end of the Tokyo round of GATT negotiations in 1979. And Japan really has very few quotas in place. In fact, the number of quotas in Japan compares very favorably to the number in other countries.

Two Indicators. The dilemma is that Japan continues to behave differently than other countries. Tariffs have come down, the quotas have been eliminated, and yet, if one looks at the trade data, one sees that Japan behaves very differently from most other countries. My interest lies particularly in two statistics — one is the ratio of manufactured imports to gross national product (GNP), and the other is an indicator of what economists call "intra-industry trade." That is to say, if we look at trade in separate industries, for example, calling motor vehicles an industry, intra-industry trade is a two-way flow of products (exports and imports) in that particular industry.

It turns out that in both indicators, Japan is at the low end of the scale. It has a lower ratio of manufactured imports to GNP than any other industrial country, and lower than many

Edward Lincoln is a Senior Fellow at the Brookings Institution, Washington, D.C.

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developing countries. India, for example, a developing country that I think of as being quite protectionist, has a ratio of manufactured imports to GNP that is roughly triple the level of Japan, with Japan being under 3 percent.

Striking Disparity. In the area of intra-industry trade, we can see the same thing. Japan is at the bottom of the list of industrialized countries, along with Australia, in this case. And Australia, again, is a country that I think of as being rather protectionist. Not only is Japan at the low end in these international comparisons, but it has not changed very much over the past 20 to 25 years. In most other industrial countries we find both of these statistical indicators rising over-time; ~~as trade-barriers have fallen and other countries' import penetration has increased.~~ This has been the case in the United States, in Europe, Canada, and elsewhere. Generally, the level of intra-industry trade as a share of total trade of most industrialized countries has been rising gradually over time, but not in Japan. It was the rather striking disparity between the evidence we have of greater market opening in Japan and the lack of any real change in the ratio of intra-industry trade to total trade and of manufactured imports to GNP in this country that led to a lot of rethinking in the U.S. of what the problems were in dealing with Japan in the 1980s.

I would add to this that over the past decade, as we have had more and more frequent negotiations with Japan, there has been a rise in frustration on the part of U.S. negotiators. In the negotiating game, we are usually the aggressor and the Japanese are on the defensive side. And the Japanese have played a very clever and very good defensive game, in which they started with the assumption that it was their duty to defend domestic markets and not to open them up. But that's a very frustrating experience. I think American negotiators perceived that they were dealing with a national government that did not have much interest in opening up, and this perception is not calculated to lead to very good feelings.

So we have been casting around during the 1980s for new and different ways to tackle this problem and get the Japanese government to understand the nature of the problems and why we were unhappy with them. I would add that in this learning process we have moved from tariffs and quotas to the next level of fairly obvious and deliberate non-tariff barriers — standards, licensing procedures, and customs procedures. So we spent a fair amount of time in the 1980s dealing with those issues. We have made some progress on some of those. There has been a fair amount of rewriting of laws in Japan which set standards. And yet, I think we were left with the strong impression that, while we dealt with some of those issues successfully, there are still other deeper and broader social phenomena in Japan, that continue to cause Japan to behave differently than other industrial countries.

Long-Term Relationships. Let me provide you several examples. Japan is characterized, for example, by much longer term buyer-seller relationships than we have in general in the United States. Now, the Japanese can tell you, quite rightly, that they think that this is economically efficient; by establishing long-term business relationships you can engage in transactions between buyer and seller that are more difficult in the United States. Some American economists and political scientists have gone down that same route and have said that the United States ought to rethink the contractual relationships we set up in the private sector and that there may be advantages in longer-term relationships.

However, in the 1950s and '60s, Japan was a nation characterized by very high tariff and quota barriers. So, when, in the post-war economy, Japanese firms were establishing and strengthening these kinds of long-term relationships, foreign companies were not permitted to be there to compete with Japanese firms. So, even without the tariffs and quotas, these

relationships are now relatively fixed and are not very open to foreign companies who come in and say, "I've got a product that's better and cheaper." The Japanese response is "Well, that's fine, but I already have this very good and very productive relationship with somebody else here in Japan." At this level we are not always dealing with issues where one could say, "Japan is wrong." But right or wrong, Japan has features of its economy that create a bias against imports. Moving from that conclusion to figuring out exactly what is right and wrong or what to do about it is much more difficult.

Dominated By Manufacturers. A second problem is what I see as the rather dominant role of manufacturers over the distribution system in Japan. I believe it is important to be very precise about this issue because there is a lot of confusion. Many Americans have talked loosely about the problem of a complicated distribution system in Japan, with multiple layers of wholesalers, and little tiny resalers and how inefficient it is. That is not the issue at all. The real problem is that the system is dominated by the manufacturers in a way that we have moved away from in the United States. We went through a period, mainly in the 1940s and on into the 1950s with some very important landmark anti-trust cases, that undermined the ability of manufacturers to control the behavior of distributors, which has now brought about the existence of independent discount retailers such as 47th Street Photo in New York.

By and large, you cannot do that in Japan. In some cases Japanese firms are doing things that are illegal even under their anti-trust law. But there is also a greater ability for manufacturers to legally control distributors. Again, it is not necessarily that the Japanese are wrong. But by giving manufacturers control over distributors, the Japanese system makes it much more difficult for any newcomers to break into the system. You have to be able to find someone to distribute your product, and especially in the area of consumer products in Japan, you may discover that those distribution channels are blocked by Japanese products, and you are not going to have an easy time breaking in.

Few Foreign Takeovers. A third area is what I would call the relative unwillingness of Japanese firms to allow themselves to be bought by foreign companies. This gets into questions of what you might call the "stable shareholder problem." But on a more fundamental level, it is not that Japanese stock is locked up with a group of stable shareholders. It is that, when push comes to shove, Japanese shareholders and corporate managers do not allow the firm to be sold to foreign interests if the firm is not doing well. They will do something else. They will sell it to another Japanese firm or they will bail it out, but selling out the firm to foreigners is rather low on their list. One can see some foreign takeovers in Japan, but relative to what happens in other countries, there are very few.

I was at a conference not too long ago at which the case of Sansui, a small manufacturer of consumer electronics, was raised five or six times as an example of a Japanese company being taken over by a foreign — in this case a British — firm. I kept thinking, "Could not someone please give me a different example?" But there are not very many other examples, and most of them are very friendly mergers and acquisitions that are the outcome generally of a very long preexisting relationship. Merck, an American pharmaceutical company, for example, bought Banyu, a small Japanese pharmaceutical company, several years ago, but Merck had had a joint venture with this firm for twenty or twenty-five years. So there was a long-standing relationship that was now being fully consummated, when Banyu was not doing very well.

Another problem is relatively weak antitrust enforcement in Japan. Japan does have an antitrust law. The U.S. wrote it for them. And they do have an enforcement agency, the Fair Trade Commission. But, relative to the United States, enforcement is weak. There are virtually no private suits under antitrust law in Japan, so all the enforcement is done by this one small agency, which has a total employment of just over five hundred people. Japan is a big country, and with few antitrust enforcement officers, the law is not enforced very well. I think that much of the U.S.-Japan trade problem is an antitrust problem. Americans can say, "Fine, Japanese have good products, high quality and some first rate corporations." That is all right, but it is not always sufficient to explain Japanese success in the market, so we need to look at the way in which firms compete in the marketplace. What we see in Japan is a fair amount of collusive behavior that creates an advantage in the marketplace that goes beyond having a good product, with good quality, at a good price.

Bias Against Social Infrastructure. A final example is a series of issues related to savings and investment. Investment perhaps is the more productive area to look at, in which, for whatever reason, political forces in Japan have created a set of policies and investment allocations that are somewhat different from the United States. For example, I think there continues to be something of a bias against social infrastructure investment in Japan. Japan still has what I see as a fairly high need for a lot of capital investment to help handicapped people. How many subway train stations in Japan have escalators? Very few. You cannot guarantee that if you find a station with an escalator, you are going to get off at a station that also has an escalator. And there are no elevators. One can see the contrast, for example, with the Washington subway system, which is very striking when compared to that of Japan.

Japan can spend a lot of money engaging in "social infrastructure" investment against which it has a bias. Getting rid of all those concrete telephone poles that sit right in the middle of sidewalks all over Tokyo and tend to force one out into the street is yet another example. These kinds of investments can take place in Japan without having to acquire expensive property, which is always the excuse why infrastructure investment is low, or has lagged behind in Japan.

On the investment side, one also can point to inefficient land use, brought about especially by tax policies in which farmers essentially do not pay property taxes so long as they promise to keep on farming. This is totally bizarre. As any of you who have been to Japan know, the minute you get into the Tokyo suburbs you will see vegetable plots, in areas where property values are very high. If the land taxation system changes, a lot of this would be altered rather quickly.

Impact on Trade Behavior. These are what I see as being fairly important structural problems. But there has been a lot of hand wringing on both sides of the Pacific about whether it is proper for the United States to be even talking about them because they are domestic Japanese issues. My response is that they are domestic Japanese issues, but they do have an impact on trade behavior. They are features of Japan that have led to a pattern of trade that is very different from other industrialized countries and different in ways that do not look very good for Japan. One of the underlying premises of our postwar trading system, in which we have all tried to lower barriers, is that we would not have countries which are way "off the spectrum," either in one direction or the other, with large trade imbalances or unusual restrictions on import penetration.

The international trade rules we have do not work very well if people feel that some country, in this case Japan, is very much an outsider in a way that leads other countries to feel that it gains more benefits from the system than do other countries. So I think we should talk about structural issues.

Heavy-Handed Act. Now, let me turn to the second reason we are going through this exercise: "diplomacy." Congress passed the Trade Act of 1988, including section Super 301. Under that section of the law, it was very clear to the executive branch that Japan would have to be named. There was virtually no doubt. I was in Japan in May of 1988, when the announcement was made, and I was startled that some Japanese government officials were surprised that Japan was named (at least officially they were surprised). It was obvious to me as soon as the law passed that Japan would have to be named.

And yet I think that in the executive branch there was a lot of unhappiness over this provision. It was not necessarily the case that the Executive did not want to have Super 301 at all, but it was not the kind of negotiating instrument that the executive branch would prefer. To make a crude analogy, I guess that USTR would have preferred a stiletto and what they got was a meat cleaver. There is an advantage to being able to retaliate in dealing with trade negotiations but to do it in the framework of Super 301 is a little heavy-handed.

Certainly from the standpoint of the State Department, which has to be concerned with diplomacy, it is not a very diplomatic thing to put in print that you think a country, as opposed to particular products in that country, is unfair. We implicitly say so all the time, but to put that down in writing is not particularly diplomatic.

Softening the Blow. Therefore, I see the Structural Impediments Initiative as part of an effort to soften the blow on Japan, and as such, it is a very clever maneuver. First, in our Super 301 attack on Japan, we have only named three products -- telecommunications, satellites, forest products, and supercomputers. We have negotiated all three of these before, and those previous negotiations did not clear away all of the problems. It seems to me eminently reasonable that we should be able to make further progress within the specified time frame on these three products. Second, we put these other structural issues, that we believe we should be talking about, onto a separate but parallel track. These talks are not part of Super 301, and are not officially even a negotiation. Japan will have to make some concessions, but these are talks. We can tell the Japanese that we have to talk about these issues, but we are not going to put them into the antagonistic framework of Super 301.

Furthermore, the U.S. government made a very deliberate move to call these talks a reciprocal process. On one day we can beat up on the Japanese and the next day the Japanese can beat up on us and complain about low U.S. savings rates or whatever. We should not forget that. As this process continues next spring and the Japanese make some concessions, all the focus will be on what the Japanese are going to do, and not on what the United States is going to do. But the structure of the talks does provide more of an opportunity than in the past for the Japanese to complain about us.

Finally I might add that as a matter of diplomacy, we have chosen a very opportune time to engage in these talks. There is more discussion and pressure for change within Japan on many of these issues than I have ever seen before. All throughout the 1970s and even lingering on in the early '80s, Japan was absorbed in the problems of the oil shocks. Unemployment was rising and much of the progressive change that had begun in Japan in the early '70s was choked off. It really was not until after 1985, with the large appreciation

of the yen, that Japan began to think in terms of progressive change in its own society again. Now that domestic talk is really getting quite loud. So we have entered into the SII process at a relatively favorable time.

Political Compromise. The third reason for the SII talks was political maneuvering with Congress. I think this is fairly obvious. Super 301 was basically a political compromise in response to Congressman Richard Gephardt's proposed amendment to the bill, which tried to manage trade imbalances comprehensively. If the imbalance is too high and the U.S. government determines the imbalance to be the result of unfair trade practices, then the government would impose barriers on Japanese exports (or other countries' exports) to the United States until the imbalances go down. I think that was a rather foolish initiative, foolish because it would not work, and because the Japanese would respond to it in the wrong ways. Super 301 came as a political compromise to the Gephardt proposal.

Given the existence of Super 301, and that the executive branch agreed to it, the executive branch had to make sure that they carried out the law in a way that would demonstrate to Congress that they were doing something about the trade "problem" with Japan. There is always a need for activity or motion on the part of the executive branch. If the Executive wished to soften the blow of Super 301, it really had to have something else going on, to prove to Congress they were not just trying to weasel out from under congressional intent on Super 301. So I think the SII become a mechanism to demonstrate good faith to Congress.

Let me turn to where we seem to be at the moment. This is where I feel the weakest, because the U.S. government has been very quiet about what has actually happened at the two rounds of talks that have taken place. My impression is one of very little progress, whatever it is that progress is supposed to be. Not very much has happened yet. The U.S. government has identified the issues, including those I have laid out here. The Japanese, in turn, have identified American issues that they want to talk about. However, the talks have not yet moved beyond that stage into deeper discussions of what some of the new or different policies might be.

Clear Leader Lacking. But I would like to say a couple of things about what I see going on. First, I think the U.S. side has a bit of a problem, because of very divided responsibility. That is, structural issues obviously cut across many areas, and USTR, Treasury, and Commerce, are basically holding equal authority in the SII process with additional input coming also from Justice, State, the Council of Economic Advisors, and the Office of Management and Budget. Now, it may be that in this exercise there is less dissension among these different actors than in the past. I am not close enough to figure that out. But at the very least I do not see a clear leader.

And again, the U.S. side still seems to be trying to figure out what to ask for, which is a problem. There is a fairly short time frame for doing all of this, and here it is December, while officials are still engaged in trying to decide just what to ask for. If the Japanese want to play a defensive game, this is exactly the kind of thing that they would like to see. If the Americans do not really know what they want, then the Japanese can work on that, and not have to give up very much. We have placed ourselves in a position where there must be some progress; something visible must happen in this initiative by next spring, as Carla Hills, the U.S. Trade Representative, herself has stated. That means the Japanese government must make some sort of announcement of a change in policy on some (it could

not possibly be all) of the issues that have been raised, so that the American government can say that it got something out of the talks.

If you are following this issue, I would expect March and April to be rather noisy for both SII and Super 301. Just extrapolating from past experience, March and April are the perfect times to be applying pressure because of the upcoming industrial nations summit meeting, which both the Japanese government and our government seem to pick as a convenient lever, or as a time frame in which to get some progress. The Japanese, especially, do not want to go to the industrial nations summit with big problems hanging over them with the United States. So we put a lot of pressure on Japan.

Japanese Bluff. Let me turn to the Japanese side a bit and say something else about where we stand on this process. Since the Upper House elections for the Japanese Diet in June 1989, when the Liberal Democratic Party (LDP) lost control of the Upper House for the first time, there have been many statements by the Japanese government to the effect that discussing structural change was fine but now they cannot do anything. Japanese leaders maintain that the Socialists might take over, that no one knows what the policy will be in the government and that the present is a bad time to be making any decisions whatsoever.

I wish to say two things about this. First, I think that mostly it has been a bluff. It does not matter whether the LDP, or the Socialists, or some coalition runs Japan. The domestic pressures in the direction of structural change are the same. Except perhaps in agriculture at the moment, there is no reason to believe that the Socialist Party, or the other opposition parties, actually would be less responsive to trade issues than the LDP.

Second, all the speculation is that the Lower House election in the Diet will be held in February. If that happens, the timing is perfect. Japan will have the election out of the way before going through a noisy March and April. And the current betting in Tokyo is that the LDP will not lose the Lower House elections, which does not surprise me. If people in Japan cast the symbolic votes, what better way is there than to vote against the LDP in the Upper House? The Upper House has virtually no political power. Voting against the LDP in the Lower House is something else. I think there is a lot of concern in Japan, that there would be uncertainty and turmoil if there was actually a change in the party running the government. People will think twice about this before voting against the LDP.

I might add that the big scandals which fed into the election results last summer seem to be over and done with. The Recruit scandal is out of the newspapers. The sexual scandals involving Prime Minister Uno last summer are also gone. There have been pressures to make sure that no new scandal erupts. So I do not think the LDP is going to lose. I think the timing and outcome of the election will make the negotiating atmosphere a little bit easier on the Japanese side. They will lose their excuse for not being able to come up with some results.

Reasons for Optimism. Now let me finish up with an assessment of where we stand. In true academic fashion, there are reasons to be optimistic and reasons to be pessimistic. On the optimistic side, I think we are discussing important issues. We are beginning to get down to fundamental reasons why Japan's trade behavior is so different from that of other countries. I think this represents a useful and important learning process on the U.S. side, and also on the Japanese side. I am also optimistic because I do see an atmosphere of interest in change within Japan that I have not seen very much before. There are now more

domestic groups willing to speak up fairly forcefully in some cases in favor of greater openness. Even manufacturers, whose interests may not extend any farther than opening up the market so they can get their own products produced overseas back into Japan, are pushing for change. Japanese manufacturers did not export very much from their overseas subsidiaries back to Japan in the past. For manufacturing subsidiaries of Japanese firms in Southeast Asia, that percentage is beginning to rise. Even that is progress.

And finally, I am optimistic because I think we will get something next spring. It might not be a lot, but there will be some kind of visible progress the U.S. government can bring home and show to Congress as the result its efforts. At the very least, we ought to be able to do something with the large-scale retail store law in Japan, which has restricted the opening and the size of new, large discount stores in Japan. This is an administrative change; the Diet does not have to act upon it. Politicians have to be consulted and the LDP has been very worried because small shopkeepers support the LDP, but it is an administrative change; something that MITI can decide without having to create new legislation. I think there will be room by next spring for some modest changes in enforcement of that law.

Expecting Too Much. But there are also some reasons for pessimism. Here I think we really need to be serious. The very term "structure" implies things that do not change very much or do not change very fast. There is a real danger in thinking that the Structural Impediments Initiative is going to make "great" progress. We are not going to make "great" progress.

Consider land taxation. That is even more difficult to change than getting rid of the mortgage interest payment subsidy in our tax system. We are asking the Japanese to do something substantial and important, and there are many Japanese economists now who also want to change the system of Japanese land taxation, but it will not be easy and will not happen fast. The last tax reform, which ushered in the consumption tax, took more than ten years and I think that land taxation will probably take at least that long. So it would be a great mistake to think that a lot is going to happen on this issue.

That leads me to another reason for pessimism, which is that Congress may expect too much out of the SII talks. I started off by saying that the executive branch needs to go through a show of motion and activity in relation to Japan. But I am a bit concerned that, at the end of the day, the U.S. Congress will be dissatisfied with what comes out of it. I would prefer if Congress could see SII as the beginning of a process, not a one-shot deal in which we blast Japan open, but the beginning of a very useful dialogue through which we keep the lines of communication open with Japan. We ought to put pressure on those areas where it is appropriate, and let structural change run out over an extended period of time.

Learning Process. In the end I see the SII talks as a worthwhile initiative. I am not sympathetic with the sarcasm I hear from many of my academic colleagues who think the whole thing is just a waste of time and another silly Washington initiative to beat up on Japan. But I do have rather low short-run expectations about what is going to come out of it. I would like to see a longer time frame, in which we treat this as the beginning of long-term dialogue. In that process, we still need to go through more of a learning process on the U.S. side.

Even by next spring, we will just be beginning to scratch the surface of understanding the structural features of Japan that really need to be changed. And I would add that traditional economics has not been very helpful in all of this, because economists tend to say Japan is a

capitalist country, which behaves by the same rules or in accordance with the same models, as all other capitalist states, so that Japan cannot be different from us. It has taken a long time to get away from that very simplistic view of Japan.

Finally, I think we need more time for some coalition-building with Japan. This is a good time to be dealing with structural issues, but if we are going to be successful, we need to do more to pump up those Japanese groups which are basically on the same side of the issues as we are — consumers, manufacturers, academics, whoever it is who happens to be on our side of the issue. These groups should be given whatever encouragement we can give them

