

**UNITED STATES—JAPAN STRUCTURAL  
IMPEDIMENTS INITIATIVE (SII)**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON INTERNATIONAL TRADE  
OF THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE  
ONE HUNDRED FIRST CONGRESS  
SECOND SESSION

MARCH 5, 1990

(Part 3 of 3)



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1990

36 078 • .

For sale by the Superintendent of Documents, Congressional Sales Office  
U.S. Government Printing Office, Washington, DC 20402

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# CONTENTS

## OPENING STATEMENTS

	Page
Baucus, Hon. Max, a U.S. Senator from Montana, chairman of the subcommittee .....	1
Danforth, Hon. John, a U.S. Senator from Missouri .....	3
Riegle, Hon. Donald W., Jr., a U.S. Senator from Michigan .....	25

## COMMITTEE PRESS RELEASE

Finance Subcommittee on Trade to Hold Hearing on U.S.-Japan Structural Impediments Initiative .....	1
---	---

## ADMINISTRATION WITNESSES

Williams, Hon. S. Linn, Deputy U.S. Trade Representative .....	5
Dallara, Hon. Charles H., Assistant Secretary for International Affairs, U.S. Department of the Treasury .....	9
McCormack, Hon. Richard T., Under Secretary, Economic and Agricultural Affairs, U.S. Department of State .....	11
Farren, Hon. J., Under Secretary, International Trade Administration, U.S. Department of Commerce .....	13
Taylor, Hon. John B., member, Council of Economic Advisors, Executive Office of the President .....	16

## PUBLIC WITNESSES

Stallkamp, Thomas T., chairman, Acustar, Inc., a Chrysler Motors company, Troy, MI .....	33
Lovett, Stephen M., vice president, international trade, National Forest Products Association, Washington, DC, accompanied by John A. Ragosta, Dewey, Ballantine, Bushby, Palmer & Wood, Washington, DC .....	35

## ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

Baucus, Hon. Max:	
Opening statement .....	1
Dallara, Hon. Charles H.:	
Testimony .....	9
Prepared statement .....	43
Danforth, Hon. John:	
Opening statement .....	3
Farren, Hon. J. Michael:	
Testimony .....	13
Prepared statement with exhibits .....	48
Lovett, Stephen M.:	
Testimony .....	35
Prepared statement .....	82
McCormack, Hon. Richard T.:	
Testimony .....	11
Prepared statement .....	84
Joint Report of the U.S.-Japan Working Group on SII .....	85
Riegle, Hon. Donald W., Jr.:	
Opening statement .....	25

IV

	Page
<b>Stallkamp, Thomas T.:</b>	
Testimony .....	33
Prepared statement .....	107
<b>Taylor, Hon. John B.:</b>	
Testimony .....	16
Prepared statement .....	109
<b>Williams, Hon. S. Linn:</b>	
Testimony .....	5
Prepared statement .....	112

# UNITED STATES-JAPAN STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

MONDAY, MARCH 5, 1990

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

The hearing was convened, pursuant to notice, at 10:08 a.m. in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the subcommittee) presiding.

Also present: Senators Riegle and Danforth.

[The press release announcing the hearing follows:]

(Press Release No. II-9, Feb. 8, 1990)

## FINANCE SUBCOMMITTEE ON TRADE TO HOLD HEARING ON U.S.-JAPAN STRUCTURAL IMPEDIMENTS INITIATIVE

WASHINGTON, DC—Senator Max Baucus (D., Montana), Chairman, announced Thursday the Subcommittee on International Trade will hold a hearing next month to assess progress in the U.S.-Japan Structural Impediments Initiative (SII) talks.

The hearing is scheduled for Monday, March 5, 1990 at 10 a.m. in room SD-215 of the Dirksen Senate Office Building.

SII is a bilateral trade negotiation between the U.S. and Japan on issues such as the Japanese distribution system and collusive Japanese business practices.

Senator Baucus said, "Japanese internal barriers to trade, such as collusive business practices, inefficient distribution systems and price fixing, severely restrict U.S. exports. Eliminating these barriers is critical to reducing our \$50 billion bilateral trade imbalance. U.S. business deserves a chance to compete in the Japanese market."

The U.S. and Japan have agreed to conclude the SII negotiations by August, 1990, with a mid-term report due this spring. Baucus commented, "This hearing will provide the Subcommittee with an update on the talks, and allow the Subcommittee to explore alternative measures to open the Japanese market if SII does not prove successful."

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

Senator BAUCUS. The hearing will come to order.

We have now entered a critical period for United States-Japanese relations. Anti-Japanese sentiment in the United States is rising fast. Large majorities of Americans see Japan as an economic threat and see Japanese trade barriers as inexcusable. They are demanding action, not talk.

In light of all this, it would have seemed that last weekend's Bush-Kaifu summit was a time for action, not for platitudes. Unfortunately, it appears that Prime Minister Kaifu came to the United States prepared only to talk. Promises were made. But every U.S.

President since President Nixon has heard promises of a more open market from Japan. Most of those promises have been empty.

We have had some notable successes in opening the Japanese market in recent years. The 1988 agreement to open the Japanese beef market, for example, is a major success. And Japan has been increasing imports of manufactured products, albeit from a low base. But the fundamental structural problems still remain.

Last year, studies by the Brookings Institution and the Institute for International Economics concluded that Japan imports 25 percent to 40 percent less than would be expected for a nation at its level of development.

The President's Advisory Committee on Trade Policy and Negotiations concluded that Japanese trade barriers were costing the United States as much as \$30 billion each year.

Progress must be made toward eliminating these Japanese structural barriers.

President Bush deserves credit for giving trade policy a higher priority than his immediate predecessor. But a summit is not enough. If we are going to make progress toward eliminating Japan's structural barriers we must apply consistent, steady pressure. The Structural Impediments Initiative, SII, is the forum in which we can apply that steady pressure. SII was launched last June, along with the three Super 301 cases, against Japanese trade barriers. It was intended as a broad forum in which a variety of impediments to trade and other economic problems could be discussed.

As I have said before, the SII may be the most important trade negotiations that the United States has ever launched. It is the only one that promises to get at the heart of the trade problem, the Japanese structural barriers that hinder U.S. exports.

Certainly, we Americans must also make progress toward eliminating our own structural problems, like our Federal budget deficit. Hopefully, SII will promise an opportunity to address those structural problems here at home. But the U.S. budget deficit does not excuse Japanese trade barriers.

I have applauded the administration for launching the SII and I am willing to give it a chance to succeed. I am not, however, willing to wait forever.

Press reports indicate that the SII talks are now deadlocked. If progress is not forthcoming, I intend to introduce legislation that requires that trade related issues in SII be pursued through Section 301 investigations.

Japan has benefited more from a free and open world trading system than any other nation, but while doing so, it has kept its markets relatively closed.

Now Japan has a choice. It can either follow the lead of the rest of the world and open its markets or it can keep its markets closed and have the rest of the world follow its lead. I obviously hope Japan opens its markets.

I look forward today to reviewing the progress the administration has undertaken, such progress as there is, and I hope in this hearing to lay the groundwork for much greater progress in the future.

And now I would like to turn to Senator Danforth who has been very active in trade matters, who is a strong ally of mine, and very helpful to this committee.

Senator Danforth.

**OPENING STATEMENT OF HON. JOHN DANFORTH, A U.S.  
SENATOR FROM MISSOURI**

Senator DANFORTH. Mr. Chairman, thank you very much.

As is sometimes the case and life in the Senate, I have a commitment to be at two places at the same time, and the other commitment is one that I just cannot get out of, so I am going to have to leave. I want you to know that it is not for lack of interest. The subject matter that is before this subcommittee now is of extremely keen interest to me and to many of us. But I do have another commitment that I have promised to keep and that I just cannot get out of.

I do appreciate this opportunity to make a comment. I feel very strongly about it. In fact, on Saturday, I am leaving for Japan and I hope to make about the same points when I am in that country.

Mr. Chairman, for as long as I have been on the Senate Finance Committee we have had numerous hearings, we have marked up bills dealing with U.S. trade relations, and especially we have expressed our concern about our trade relationship with Japan. Oftentimes, those expressions of concern have involved a very strong feeling on the part of many of us on the Finance Committee.

I don't think that the situation we are now facing has any real relationship to the kind of concern that we have expressed in the past. In the past, we talked principally about unfairness. In the past, we talked about the loss of jobs in this country because of unfair foreign trade barriers and of the need for open markets around the world. But I think that the nature of our concern now is of much greater magnitude, of a much different quality, that the concern we have had in the past. My concern now is not just about incidences of perceived unfairness. My concern is no less than a concern for the future of the world's economic system and the ability of the United States of America to carry that world economic system almost single-handedly.

A week ago yesterday, there was an election in Nicaragua. Late last week, the chief economic advisor of Mrs. Chamorro arrived in Washington asking for \$300 million. Poland, Hungary, all of Eastern Europe is looking to the United States asking for help to show that democracy works. But the fact is that we don't have the money to provide sufficient help to the entire world to keep democracy alive—even if it could be done simply by spending money, by making grants. I don't think it can be.

If freedom is to work throughout the world, if the world economic system is to prosper, it must be propelled, not by gifts, but by growth. And growth has to be created by an open trading system, and it is just as simple as that.

Since World War II, the United States single-handedly has been the engine of growth. Nobody else is there to help. Oh, Singapore maybe, and Hong Kong. But we have been asked to do it all: Keep our market open; consume.

Our Japanese friends say, well, we should change our policy so that we consume less and save more. And I agree with that, but aren't they in trouble if we do? Who is going to do the consuming? Who is going to be the engine of growth? We cannot do it all ourselves any more. We are not able to do it. And the question is whether there is anyone else out there who has any sense of responsibility for freedom, whether there is anybody out there who has any sense of responsibility for the free world's economic system, other than the United States.

Now we have all kinds of initiatives going with respect to Japan right now. Super 301, the winding up of the first year, the commencement of the second year; the SII negotiations. As Senator Baucus pointed out, the concern that we have is that with all of this talk, once again, as always, nothing is going to happen. Oh, we might sell a satellite, or we might sell a supercomputer to the Japanese Government. When we do, many press statements will be put out, and our administration will claim victory.

In fact, however, it won't be a victory at all. We will not have tackled the structural or systemic barriers in the Japanese market. It will be a public relations job which attempts to buy us off. But public relations jobs are not sufficient to keep a world economic system going. It won't do the job. And if the administration believes that the sale of a satellite or the sale of a supercomputer—or yet another promise—is going to be sufficient, then Congress will act again. In the 1988 Trade Act, we tried to take some discretion away from the administration. If we didn't go far enough in 1988, believe me, we can go further. It is not just a sense of rage on the part of the American people. We have had that for years. It is a sense of commitment to a world which is becoming free; and a sense that that commitment cannot be met by the United States alone.

We are concerned that Europe isn't going to do it. We are concerned that EC-92 may mean the possibility of less access to the European market for those of us outside. Who is going to be left? Who is going to consume all these Japanese products? Is the pressure going to be evermore on us? Well, we cannot maintain that commitment forever all by ourselves.

I thank you, Mr. Chairman, for the opportunity to make that statement. Obviously, I feel very, very strongly about it. The next few months are going to be telling months for Japan. The next few months are going to be very telling months for the Bush administration. I cannot join you, Mr. Chairman, in extending congratulations to the Bush administration yet. They have not done enough, as far as I am concerned, to warrant congratulations. The jury is out as far as this Senator is concerned. Thank you very much.

Senator BAUCUS. Thank you very much, Senator. I appreciate your constructive comments.

Let's begin with a panel which consists of Hon. Linn Williams, Deputy U.S. Trade Representative; Hon. Charles Dallara, Assistant Secretary for International Affairs, at Treasury; Hon. Richard McCormack, Under Secretary at the Department of State; Hon. Michael Farren, Under Secretary, Department of Commerce; and Dr. John Taylor, member of the Council of Economic Advisors.

Mr. Williams, why don't you begin.

**STATEMENT OF HON. S. LINN WILLIAMS, DEPUTY U.S. TRADE REPRESENTATIVE**

Mr. WILLIAMS. Thank you, Mr. Chairman.

The members of this panel and other representatives of the U.S. Government and representatives of the Government of Japan concluded the third round of SII talks on February 22-23. We should emphasize at the outset, as we always have, that SII is a unique bilateral undertaking between sovereign governments and is an iterative process. It has, therefore, no set patterns or benchmarks. It is also a mutual process. We are responsible ourselves, as you have said, for our own competitiveness.

The Japanese participants have fairly identified U.S. practices that may be barriers to exports from the United States, and we have considered and shall continue to consider them carefully.

It is also important to note that the SII has already had some, although very modest, effect in Japan.

Having said all that, however, the question is, where in the process we find ourselves? And we find ourselves not as far along as we had hoped. This was a point emphasized strongly by the President in Palm Springs.

We started this process last summer with the political commitment of both governments. We expected to discuss initially some concrete, detailed proposals at a meeting scheduled in January. That meeting was delayed at the request of the Japanese Government because of Japanese elections. It was rescheduled, again at the request of the Japanese Government, to February 22-23, and we, therefore, reasonably expected the February meeting to represent a substantial step forward.

What we heard at that meeting, however, was not enough, in our judgment, to be considered effective, lasting or credible. It was predominantly a defense of the status quo with the prospect of only minimal further action.

President Bush, in Palm Springs, expressed the importance of trade issues to the entire United States-Japan relationship and to global trade, and he sought there to energize Japanese efforts, with the SII and with sectoral issues.

We had developed in Tokyo our own ideas on how the Japanese system might respond to the structural issues we had raised. We presented our ideas in some detail during that meeting. Contrary to initial press reports, they were not demands, they were not rejected, and we made clear at the meeting that they were also not the only ideas that we would consider responsive.

It appeared in Tokyo that our levels of expectation and those of the Government of Japan are different. We addressed those differences during that meeting and we expect those differences to narrow.

We understand that the election in Japan is just over and a new cabinet just formed. But we believe—and we stated in Tokyo, and the President stated in Palm Springs—that it is time to focus. We have no doubt as to the good intentions of the Japanese participants, but we sensed that they might not have, or might not believe they have, sufficient political guidance to proceed on many points.

In Palm Springs, the President requested that political guidance and Prime Minister Kaifu appeared to agree to provide it.

Our structural concerns remain the same: the savings/investment gap, particularly focusing on increasing investment in infrastructure; land use policy; the distribution system; exclusionary business practices; keiretsu business groupings; and pricing mechanisms.

We have focused on these areas because we believe that changes in them will improve current account balances and market access. We have also taken care to articulate our points in these areas with two additional elements in mind.

First, we drew extensively on Japanese sources and on some of the internal debate that is occurring in Japan on structural issues. Most of the specific ideas we advanced in Tokyo can be found in reports of the Japanese Government or Japanese business groups.

Second, we made an effort to identify constituencies within Japan that might agree, for their own reasons, with the ideas we advanced for our reasons. Let me briefly identify some of those linkages.

Senator BAUCUS. This is an important statement, Linn, so disregard the amber light here. You can take a few extra minutes.

Mr. WILLIAMS. Thank you, Senator.

Japan's producer-orientation is pervasive. The Japanese Government subjects nearly half of all bank deposits to interest rate controls. Many deposit rates are held to below 1 percent. Meanwhile, Japan spends less of its GNP per capita on infrastructure than most other industrialized countries. The benefits of these low interest rates, low infrastructure expenditures and other policies are, in effect, passed on to Japanese companies in the form of a lower cost of capital to those companies. That is a comparative disadvantage to foreign companies. Adam Smith did not do that. The Japanese Government did that.

At the same time, the Japanese consumer would obviously benefit from higher interest on family savings and greater infrastructure. The concept of "sharing the wealth" of the Japanese economy more with the Japanese consumer did not originate with us. It is a matter of the relationship of the Japanese Government to its own people; but we believe the Japanese people would support, for their own reasons, what we are proposing, for our reasons.

The distribution system in Japan, in our view, operates as another disincentive to imports. There is a relative lack of infrastructure for imports, as contrasted to exports, and, as a result of government policies, the system is expensive and closed.

Toys 'R Us, for example, faces the prospect of considerable expense and delay as a result of the Japanese Government's implementation of a law, the Large Retail Store Act, that permits its Japanese competitors to control its destiny in Japan. Japanese companies, by contrast, can buy entire shopping centers in Hawaii and do so by obtaining little more from the government than a zoning permit.

When Japanese cigarette producers started selling in the United States, they gave away one box with each purchase, a perfectly sensible way to open up a new market.

When Pearle Vision gave away one extra pair of eyeglasses with each purchase in Japan, however, it received a warning that it may have violated a Japanese law that permits its competitors to establish so-called codes of conduct that prohibit premiums and, therefore, discourage new entrants into the Japanese market.

A better distribution system should make foreign companies and products more competitive and at the same time benefit the Japanese consumer.

It is in the structural barriers to market access, especially exclusionary business practices, that USTR has its greatest institutional concern. These practices fall into four categories: One: practices that are or should be covered by principles of antitrust law; two: government-business relations; three: procurement practices of private firms; and four: the patent system.

We believe that the enforcement of the antimonopoly law can be substantially strengthened and made more transparent. Moreover, we believe that changes in the law may be necessary to provide for higher and more certain penalties, and to provide for realistic and effective private rights of action to enjoin illegal acts and to recover the damages resulting from them. No plaintiff has ever succeeded in Japan in getting a reimbursement of its damages under either of the two provisions of Japanese law that permit private rights of action for monopolistic acts.

In a recent ruling by the Japanese Supreme Court, a plaintiff in a kerosene price-fixing case was denied damages despite the fact that the Japan Fair Trade Commission had found the existence of a price-fixing cartel. A justice of the Japanese Supreme Court wrote that Japanese law should be changed to permit recovery of such damages. And we agree.

In two recent, well-publicized instances of bid rigging and price-fixing by Japanese construction companies at the Yokosuka Naval Base and the Kansai Airport, the amount of the fines imposed by the Japanese Government on the Japanese companies was substantially less than the profits they had made from their illegal acts. And when the United States threatened to sue to recover what it had been overcharged at Yokosuka, that was widely viewed in Japan as an exceptional response. It should not be an exceptional response.

The recent liberalization of beef imports was good news for the United States, but it was sobering to learn soon thereafter that several Japanese companies were operating a cartel to import it. They were warned by the JFTC and may now have ceased their anticompetitive behavior, but, by controlling prices, they increased the price to the Japanese consumer and reduced the reason for that consumer, or a primary reason for that consumer, to buy foreign beef.

One need not wonder why foreigners believe that Japanese companies collude and have every reason to continue to collude. Collusion in Japan is profitable, and the bill is paid by foreign companies in the form of loss business, and by Japanese consumers, in the form of higher prices.

The Japanese Government bears considerable responsibility for this and other exclusionary business practices by Japanese companies. These practices have been shaped over decades by formal

trade barriers and regulations, and by the engagement of the Japanese Government with Japanese businesses in "visions," study groups, the promotion or tolerance of cartels and administrative guidance, all in an effort to protect domestic companies and to order competition within the domestic market.

Many of our most divisive bilateral trade disputes—satellites, supercomputers, wood products and semiconductors, to name a few—originate in these policies of the Japanese Government. In the SII, we seek, therefore, to control and make transparent those processes, and to make the Japanese Government accountable, to its own public and to foreign companies, for its actions. Long delays, pregrant opposition, and the narrow scope of patents operate to exclude innovative products from the Japanese market.

Texas Instruments waited almost 30 years before it received a patent for its semiconductor. During that time, the Japanese developed an entire industry.

As a good overview example, Allied Signal produced a product called amorphous metal. It took Allied Signal almost 12 years to get a patent in Japan on an amorphous metal product that, among other things, increases the efficiency of electric power generators. Eighteen months after Allied filed for its patent in Japan, the Japanese Government began to support and subsidize the development of amorphous metals by Japanese steel companies. No Japanese utility has ever bought Allied Signal's amorphous metal product, but instead has continued to buy lower efficiency silicon sheet steel products from those same Japanese steel companies.

When Allied Signal's major patents run out soon in Japan, Japanese companies, aided by their government, will be poised to exploit a market that should have been Allied's. U.S. companies and the U.S. Government will have every reason to be skeptical about the openness of the Japanese markets if Japanese utilities finally buy their first amorphous metal products only when Japanese companies enter that market.

Our substantial interest in significant measures to address exclusionary business practices that harm U.S. companies is fair and appropriate. Any success we might have in changing them would also benefit Japanese consumers and taxpayers, who would pay less for a variety of goods and services, from construction and electric power through satellites and wood houses. The issue is: will the Japanese Government listen?

These market access structural practices—exclusionary business practices, distribution impediments and keiretsu—are not primarily "cultural," nor are they uniquely Japanese. They are practices that United States or European companies would probably engage in themselves if the laws and policies of their countries, or of open-market economics, permitted them to.

These practices are primarily the result of Japanese Government policies. The application of other policies can change them. It is a question of will, not of reach.

Similarly, the desire for consensus decisionmaking is not unique. We know of no government official or politician who would not prefer to make every domestic constituent happy and to have an unlimited time in which to do that if their trading partners would continue to tolerate it.

If Japan were a small isolated economy, these policies and practices might not matter so much to others. If the global economy were not becoming integrated at increasing speed, there might be little enough world and time to move slowly at home. But Japan is an important economic power, not a small, isolated country; and this is a potentially historical time. If open trade is good for us, why is it not good for others? Hence, the U.S. policy of this administration of aggressive open trade.

It is time now for Japan and the Japanese people to consider and assume the responsibilities of their market to the global trading system.

Senator BAUCUS. Thank you very much, Mr. Williams. Our next witness will be Mr. Dallara.

(The prepared statement of Mr. Williams appears in the appendix.)

**STATEMENT OF HON. CHARLES H. DALLARA, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY**

Mr. DALLARA. Thank you, Mr. Chairman. I have a statement which I have submitted and would appreciate it being entered in full in the record.

Senator BAUCUS. Without objection, all statements will be so entered into the record.

Mr. DALLARA. I will, given the time, perhaps not read the entire length of it this morning, Mr. Chairman.

Let me begin, however, by agreeing with Mr. Williams' assessment of the most recent SII discussions in Tokyo. Indeed, little progress was achieved in that round of discussions. However, as Ambassador Williams indicated, President Bush and Prime Minister Kaifu have just concluded 2 days of talks in Palm Springs. I have just returned from attending those meetings, Mr. Chairman, and I must say I was impressed at the amount of attention given to economic and trade issues, including but not limited to the SII issues.

The President clearly underscored in those talks the importance of reducing our trade deficit with Japan, not by restricting our markets or managing trade, but by further increasing our exports to Japan, and he stressed in that connection the need to insure the success of these SII talks, calling for a redoubling of efforts to achieve meaningful results. He noted, in fact, that valid U.S. ideas have been put forward by the American negotiators to the Japanese team, and that we, not just at our level but at the head of state level, look forward to hearing the Japanese response to those ideas.

There has been much public discussion of the SII since it was launched last summer. In this discussion, I have read and heard some views which I think may reflect some misconceptions about the purpose, objective or nature of these talks.

If I may, I would like to take a few minutes to address some of those views and possible misconceptions.

First, the objective of the SII talks. The objective has been, as Ambassador Williams has indicated, to identify and solve structur-

al problems in both countries that stand as impediments to adjustment in trade and balance of payments accounts with the goal of contributing to the reduction of payments imbalances. Let me elaborate for a moment on that goal of contributing to reductions in the imbalances.

For a number of years, the United States, Japan, and other industrialized countries have engaged in a cooperative effort to reduce global payments imbalances. This process of economic policy coordination has produced some results, but the results are clearly not enough, globally or in connection with the United States-Japan relationship. As we looked last year at the remaining size of the imbalances, and the structural impediments which, as you noted, Mr. Chairman, appeared to block further progress in the trade front, it was agreed within the administration and launched by President Bush and Prime Minister Unno, a set of talks focusing on the structural barriers. These barriers run across many key product sectors, tending to close out foreign competition, and as has already been stated, they involve pervasive, exclusionary and anti-competitive practices. Put simply, they unfairly block the access of U.S. firms to the Japanese market, not just for export but for investment, and they inhibit the correction of those imbalances which still need further reduction.

Some have voiced a view, Mr. Chairman, that we are addressing these problems in Japan in order to avoid tackling our own structural problems at home. The President made clear this weekend that is certainly not his view, and you have, this morning, Mr. Chairman, reaffirmed for us that you also view these talks as a two-way street and that the United States must address its own structural problems as part of this process: indeed, many of the issues which are now high on the agenda of the administration and Congress. For example, the need to reduce further the fiscal deficit as part of our effort to reduce public dissavings and the need to boost private savings. And here I would note in particular the President's proposals for the establishment of Family Savings Accounts, the need to strengthen the competitiveness of American industry. And here I would note in particular the President's proposal for a capital gains tax cut. All of these areas have not only been areas receiving growing attention by the administration and by Congress, but they have been areas raised by the Japanese in these talks.

We have listened carefully to the Japanese Government's suggestions and ideas, and indeed intend to continue our efforts as part of these talks to address the structural problems.

Another misconception that I have heard is that it is unreasonable for the United States to expect to reform totally the structure of the Japanese economy in 1 year. Indeed, if this had been our goal, Mr. Chairman, it would indeed have been unreasonable. But that is not what we set out to accomplish. The structural issues raised in these talks are, as you have noted, complex and they are deeply embedded in many cases into the Japanese economy.

Senator BAUCUS. Mr. Dallara, I gave Ambassador Williams a couple of minutes beyond the 5. I would like to urge you, if you will, to hold it within the 5 as best you can. But since I gave him a

couple more, I will do the same for you. I urge you to appropriate close when you think it makes sense.

Mr. DALLARA. Well, I won't impose upon your patience. Certainly.

The changes which we have pursued are ones which will take time, time to build a consensus in Japan, time to pass new laws and time to phase in reform. But by acknowledging the time that it will take to complete this process, I do not wish to be misinterpreted. It is essential that actions to correct the problems begin now, and that the process of removing the impediments continue over some period of time.

It is important, however, to recognize that the effects of these changes will themselves not appear overnight in our trade or current account imbalances. However, if comprehensive change is pursued and is enacted by the Japanese Government and the Japanese political and economic leaders, Over time the improvements which we seek can lead to a lasting reduction in frictions between our two governments.

One final concern—and I will be very brief, Mr. Chairman, but I think it needs touching upon—is that we have been charged with making demands that intrude upon Japanese culture. Let me state that our intent here is not to challenge Japanese culture; however, it is inevitable that when one seeks to make fundamental changes—economic changes—as we are trying to do, one faces practices that have several dimensions to them. Who would argue, for example, that our low national savings rate is strictly a narrow economic problem? The world economy is interdependent, and there are few, if any, issues that can be excluded from international dialogue. Japan cannot be expected to be integrated into the world economy from the perspective of its export and financial sectors, and yet persist in insulating itself with respect to its import sector and foreign investment in Japan.

With that, Mr. Chairman, let me just say that I have touched in my written statement on many of the detailed linkages which we see here, however, I would be willing to answer questions, but I will conclude my statement at this point.

Senator BAUCUS. Thank you very much.

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

Senator BAUCUS. Our next witness is Mr. McCormack.

**STATEMENT OF HON. RICHARD T. McCORMACK, UNDER SECRETARY, ECONOMIC AND AGRICULTURAL AFFAIRS, U.S. DEPARTMENT OF STATE**

Mr. McCORMACK. Thank you very much, Senator. It is good to be here this morning and I appreciate the opportunity to brief you on the work we have been doing on the Structural Impediments Initiative.

As my two colleagues have previously covered a great deal of the material that I would have otherwise have touched upon, I will simply submit my statement to the record and just make a very few brief comments.

As my colleagues have mentioned, President Bush met with Prime Minister Kaifu in Palm Springs on Friday and Saturday this past weekend. The economic side of the United States-Japan relationship was a prominent part of the wide-ranging discussions the two heads of State held on our bilateral relationship. Indeed, the President stressed to Prime Minister Kaifu that success in SII and other trade issues now under discussion is vital for the preservation and possible expansion of our many-faceted relationship. In particular, he noted the importance of the spring interim report. The President said as well that we must put our economic relationship on a sound footing if we are to achieve the full promise of our relationship.

Most of the work that the State Department has concentrated on has been on the distribution system of Japan, so perhaps I will say a word or two about that.

We put forth a number of specific ideas for improving the distribution system in Japan. Obstacles and inefficiencies in the distribution system make it difficult for newcomers; whether they are Japanese or foreign, to get established or expand on the Japanese market. They are also one of the main reasons why prices for the Japanese consumer are so high.

We identified three major areas of concern. One, inadequate physical structure that slows and restricts the movement of foreign manufactured goods from the docks to consumers; excessive government regulation that acts to restrict imports directly and indirectly; anti-competitive practices that allow manufacturers to exert undue influence over the distributors; restrict marketing efforts of newcomers; and set discriminatory product standards.

We also noted the need for an aggressive Japanese Government program to pull imported goods into and through the distribution system.

The following were some of our ideas in detail. First, we felt that it was important to increase public investments in airports and air cargo facilities, in warehousing, in road networks, in Customs, and other entry processing facilities. We felt it was important to get a commitment to deregulation with a fixed time table for removing restrictive laws and regulations affecting our import entry and distribution. We felt it was important to eliminate anti-competitiveness practices which limit the ability of foreign and domestic newcomers to penetrate the Japanese distribution system. We felt it was important to increase import penetration of the distribution system rapidly in the near term, and to demonstrate the Government of Japan's genuine commitment to becoming an import superpower.

I would also like to underscore the comments that have been made by my colleagues that these structural impediments talks are certainly not an attack upon the culture of Japan. In fact, when you take a look at some of the practices that we are trying to deal with here, you find that they are hardly unique to Japan at all. If you take a look at many of the structures and practices that occurred in the United States in the 1920's, you will find remarkable and dramatic parallels to what occurred then to what is occurring now in Japan and what we are trying to deal with in these structural impediments talks.

In the 1920's, we had the struggle between the mom and pop stores, which were politically very powerful in that particular period, versus the chain stores, the large wholesale groups that were attempting to move in then. During that period of the 1920's, there was in many cities pervasive contract spreading, which was collusion among contractors to spread the work around amongst themselves at prearranged prices. In Japan, this was called "dango."

In the 1920's, there was a dangerous land booming bubble in Florida, which had potentially very unpleasant consequences for the United States. In Japan today, land prices are excessively high, and that constitutes a potential problem we are trying to get at here.

In the 1920's, there was pervasive protectionism, the Smoot-Hawley tariff, and other things which prevented the debtor countries of that era from being able to export to the United States to pay off their debts. Today, we find a great deal of protectionism of various kinds in Japan that we are trying to get at that.

So, in summary, what I am saying here is that this is not an attack upon the culture of Japan. We are trying to deal with specific economic practices which we feel are wrong and which prevent Japan from becoming a full participant in the free trading system of the world, and we are working very hard to try to bring this about.

Thank you very much.

Senator BAUCUS. Thank you, Mr. McCormack.

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

Senator BAUCUS. The next witness will be Mr. Farren.

**STATEMENT OF HON. J. MICHAEL FARREN, UNDER SECRETARY,  
INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPARTMENT  
OF COMMERCE**

Mr. FARREN. Thank you, Mr. Chairman. It is a pleasure to be here today. I have submitted testimony for the record. I will summarize it now, sir.

Senator BAUCUS. Thank you.

Mr. FARREN. Since early 1985, the dollar has depreciated 45 percent against the yen. Emergency economic measures implemented by Japan in 1987 have stimulated domestic demand. We would have expected these two factors acting together to have had a more favorable impact on our bilateral trade balance than has been the case.

The U.S. trade deficit with Japan has decreased only marginally, by less than 15 percent, from \$56.3 billion in 1987 to \$49 billion last year, a reduction of \$7.3 billion. By comparison, the U.S. trade performance with the EC improved by \$22.1 billion, from a \$20.6 billion deficit in 1987 to a \$1.5 billion surplus in 1989. With West Germany alone—until last year the world's number one exporter—our deficit declined by almost half, from \$15 billion to \$8 billion.

Our balance with East Asian newly industrialized economies also improved more than with Japan, \$9.8 billion over the 1987-89 period, a shift of almost 29 percent.

The failure of traditional adjustment mechanisms to produce comparable changes in Japan's external surplus led us to conclude that there are structural factors in the Japanese economy that obstruct imports and distort the rational functioning of the economy. This is where the SII talks represent a departure. They are explicitly results oriented with the result defined in terms of our external balances.

President Bush reaffirmed the objectives of SII during his meeting with Prime Minister Kaifu this past weekend.

I believe it would be useful to review the results of the joint Commerce-MITI price survey at this point. The price mechanism has been the area where the Commerce Department has concentrated much of its effort.

We conducted the survey in October, focusing on the prices of 121 products sold in both the United States and Japan. To provide you with a more detailed account, we have offered you and committee staff an extensive study, or explanation, put together by the Commerce staff which conducted the survey.

We expected the survey to verify that prices of identical or closely comparable goods produced in the United States and third countries are generally higher in Japan than in the United States by more than would be accounted for by transportation and other costs associated with exports, and that a significant proportion of identical or closely comparable goods produced in Japan is more expensive in Japan than in the United States.

The survey results do, in fact, demonstrate that prices are higher in Japan than in the United States for comparable products. Almost 90 percent of the surveyed goods produced in the United States and over 95 percent of the surveyed goods produced in third countries are priced higher in Japan. On average, prices of both United States and third-country goods were over 70 percent higher in Japan than in the United States. Forty percent of the goods originating in Japan were more expensive in Japan.

The implication of this is that Japanese producers practice price discrimination on at least a fairly wide scale, charging lower prices abroad, and Japanese structural barriers have a greater impact on prices of Japanese-made goods sold at home than on prices of those goods when exported.

The findings of the Commerce-MITI survey seem clearly plausible, particularly since they are consistent with numerous other studies, including several Japanese reports that show the cost of living and price levels to be considerably higher in Japan than in the United States.

The survey results have significant implications. The overwhelming proportion of United States and third-country goods, and the large share of Japanese products priced higher in Japan unmistakably point to the impact of structural impediments which preclude normal free market forces from operating. The higher prices in Japan clearly reflect the pervasive and harmful influence of inefficiencies, such as the complex and multi-layered distribution system, and of obstacles to competition such as trade barriers, exclusionary business practices, and government regulations.

The survey seems to demonstrate, as has long been charged, that Japanese corporations use a protected domestic market, with Japa-

nese consumers paying higher prices, in order to price aggressively in foreign markets, thereby gaining market share and often normally wounding foreign competitors. The survey demonstrated that consumer electronics prices in Japan and in the United States showed the smallest differences in actual price levels. The largest differences in manufactured product prices exist where a U.S. industry is fighting to retain market share. This may indicate that American consumers can look forward to paying Tokyo prices when U.S. industries are destroyed and Japanese firms dominate our markets.

To say it simply, the price differential acts as a barometer of the degree to which the market mechanism is distorted by trade barriers and competition is suppressed. The pricing issue is especially important in light of the political visibility of the subject in Japan. Rising public consciousness of the Japan/foreign price differentials promoted the LDP to form a party-government headquarters committee to deal with the pricing issue. The MITI response to our joint survey is typical of prior reactions to criticism of this kind. MITI has proposed a number of surveys that appear to focus on pricing practices of foreign firms in the Japanese market. Implicitly, the premise of the proposed MITI surveys seems to be that higher prices in Japan are the fault of foreign firms, not of a closed market. The MITI reaction is symbolic of the reluctance of Japan to acknowledge that a problem of Japanese-making even exists.

In most cases, Japanese response to U.S. suggestions has been to defend the status quo, as pointed out by Ambassador Williams. Repeal of the large retail store law was ruled out by Prime Minister Kaifu during the general elections, meaning that the Japanese market will be closed to competitive U.S. retailers like Toys 'R Us, which is being shut out of Tokyo. Increased investment in public works projects is reportedly being resisted by the Ministry of Finance due to inflationary concerns, which means that Japan's huge pool of savings will flow into redundant industrial capacity, and that industries like the auto industry will have enormous overcapacity worldwide. Revision of the anti-monopoly law is unacceptable, according to Fair Trade Commission Chairman Umezawa, in statements he made at a press conference, which means that firms like Allied Signal, also mentioned by Ambassador Williams, will continue to confront collusion among Japanese firms, thereby denying U.S. products access to the Japanese market.

Even more fundamentally, there is an all but explicit underlying assumption that the Japanese surplus must be maintained at or near current levels as a hedge against anticipated oil price increases, which means that American workers will continue paying the insurance premium, with the price being American jobs and a diminishing U.S. standard of living.

It is clear that the Japanese bureaucrats—as is capable as they have been in building Japan's export machine and protecting it from U.S. trade actions in the past—can no longer effectively deal with these issues without the full involvement of Japan's political leadership.

Senator BAUCUS. I must ask you to summarize your statement, Mr. Farren.

Mr. FARREN. I believe that that is, in fact, what President Bush initiated this weekend in bringing the Japanese leadership into the process of resolving the SII issues and other bilateral trade issues. And we believe that progress can be made.

Senator BAUCUS. Thank you very much.

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

Senator BAUCUS. Dr. Taylor.

**STATEMENT OF HON. JOHN B. TAYLOR, MEMBER, COUNCIL OF ECONOMIC ADVISORS, EXECUTIVE OFFICE OF THE PRESIDENT**

Dr. TAYLOR. Thank you, Mr. Chairman. I have a written statement that I would like to ask be placed in the record. I will, of course, summarize as my colleagues have.

Senator BAUCUS. Thank you.

Dr. TAYLOR. The central aim of the Structural Impediment Initiative is to identify and remove unnecessary regulations and other structural barriers that impede the operation of free and competitive markets in Japan as well as in the United States. The removal of such barriers is the surest and the most lasting way to reduce trade imbalances, increase exports, and thereby reduce trade frictions between our countries. It would also directly benefit the Japanese and American people, and strengthen the bilateral economic relationship between our two countries. A strong bilateral economic relationship between the United States and Japan is essential to needed improvements in the entire multilateral trading system. Keeping this relationship strong will pay added dividends by expanding trading opportunities for the United States and other countries.

The SII approach is superior to a managed trade approach, which would require the U.S. Government to attempt to achieve different patterns of imports and exports than would be dictated by private markets. Unlike managed trade, SII is in keeping with the trend to freer markets that has accelerated remarkably throughout much of the world during the last year. Indeed, it would be ironic and disturbing to the nations of Eastern Europe if the United States, the nation that has been the leader in moving toward freer trade and more open markets in the postwar world, were to turn toward managed trade at this critical juncture.

The first SII topic, saving/investment, is based on the premise that the overall trade and current account imbalances in both the United States and Japan reflect the gap between domestic savings and domestic investment. Neither the \$152 billion deterioration in the United States current account from 1981 to 1987, nor its 20 percent improvement since then can plausibly be explained by changes in the level of formal trade and structural barriers in foreign markets. These barriers remain unacceptably high in the Japanese market, but it would also be implausible to attribute the \$82 billion increase in Japan's current account surplus from 1981 to 1987, nor its decline by more than \$20 billion since then to changes in Japan's structural or trade barriers.

Changes in saving/investment imbalances provide a much more satisfactory explanation for these huge swings in the current account imbalances, and any further improvements in the current ac-

counts will require additional reductions in the savings/investment gap. Not surprisingly, therefore, the structural impediments affecting saving and investment have figured prominently in our discussions.

The President believes that it would be unwise to pursue policies that reduce savings, especially at this time of saving shortage throughout the world. The U.S. side has, therefore, focused attention on reducing the savings and investment gap in Japan by raising investment, and in particular, by raising the level of Japan's investment in public infrastructure.

Japan's public infrastructure is in many areas quite primitive for a wealthy industrialized country. For example, even today, less than half of Japanese homes are connected to sewer systems. In the mid 1970's, a target to connect 100 percent of all dwellings to sewerage facilities by 1985 was widely discussed in Japan.

Economic research and historical experience indicates that an increase in public infrastructure investment in Japan would significantly reduce the Japanese trade surplus. There is very little controversy here; econometric models agree. But like the other SII changes, this would be a lasting remedy, not a short-term fix. It is important, therefore, Mr. Chairman, that progress be measured, especially in the short term, by the actions taken, not solely by changes in trade flows.

The administration is also concerned with structural barriers that significantly affect the product and country composition of trade flows even if they have no impact on the saving and investment balance. It is cold comfort to individual companies in the United States hampered by such impediments to know that there may be an offsetting gain elsewhere in the economy. The existence of large price differentials, which Mr. Farren indicated, suggest that these barriers are indeed significant.

Our Japanese counterparts have provided us with a list of structural concerns regarding the U.S. economy. Our low savings rate, the need to improve our education system are part of that. These are, of course, areas where the President has already made several important proposals to take action, including his programs for deficit reduction, the family savings account, the capital gains tax reduction, and the Social Security integrity and debt reduction fund.

Our bilateral relationship with Japan should not be viewed as a zero-sum game. By focusing on these structural changes that have already had significant domestic constituency, the SII seeks to exploit a potential commonality of interest to allow for faster and further progress.

To date, Mr. Chairman, that faster and further progress we seek has not materialized. However, it would be premature to pass judgment on SII prior to key milestones established when the initiative was launched.

Just to summarize, Mr. Chairman, the cooperation of Congress in supporting the President's budget, saving and education initiatives is essential to the success of SII. We hope we will receive your support. Positive action on the President's initiatives would greatly improve economic performance in the United States by increasing growth, employment, productivity, and competitiveness. It would

also increase the likelihood of success in the SII talks and of all the international gains that would come from that success.

Thank you. I would be happy to answer any questions you may have.

[The prepared statement of Dr. Taylor appears in the appendix.]  
 Senator BAUCUS. Thank you very much, Dr. Taylor.

I think we have established the importance of the talks and the importance of the Structural Impediments Initiative. One key question. To the degree to which the administration team is satisfied with the progress of the talks, is Japan taking this initiative seriously or is it not? Was the Bush-Kaifu summit just a performance on the world stage to sound good but not really do much? That is, were those just words or were they not deeds?

I would like to ask all of you what evidence—tangible, concrete evidence—do you have that Japan is taking these talks seriously enough to achieve results. Mr. Williams, I will begin with you first.

Mr. WILLIAMS. Mr. Chairman, as we have said from the outset, all of us, we are not satisfied with the progress of the talks. We believe there is evidence that the Japanese side is taking the talks seriously. As I mentioned, in the Japanese budget, there were some modest changes that reflected the SII talks. There are an unusually, we are told, large number of Japanese agencies involved in the process. The LDP has a special committee engaged to address the SII issues.

The basic question I guess is whether the Japanese side sees this as a damage control exercise, a kind of public relations exercise, or whether they see it as one requiring serious substantive effort. I think on that point, the jury is out. I think, as the President stated in Palm Springs, the proof is in the results and we have not yet seen the results.

The President's message in Palm Springs was not what the Japanese refer to as "Kabuki" at all. From the U.S. side, I think all of us who were there know that the President's commitment, the level of commitment and the personal energy and knowledge that he put into and imparted to the process, is extremely unusual for trade issues. I think one has to go back 30 years before Presidential interest reaches the level of knowledge and involvement of President Bush.

Again, I think the question is on the Japanese side: How will they absorb and react to the attempt to energize the process in Palm Springs? And there, as my colleagues have said, it is too early for us to pass judgment.

Senator BAUCUS. Would anyone disagree with that assessment? Would you care to modify it in any way?

Mr. McCORMACK. No. I just would like to make one supplementary comment.

I do not underestimate the difficulties that the Japanese political structure faces in trying to bring these changes about. What you have here is the classic case of special interest versus the general interest.

Japanese authorities, Japanese writers, Japanese scholars have all identified that the collective, the general interest of Japan would benefit by having a retail structure that would permit goods to be sold to the people at lower prices. But this is going to impact

negatively on those people who have small stores today that profit from low volume but high profit margins. And you can go through each one of the exercises that we are engaged in on this particular structural impediment initiative, and you can see where a special interest that currently has a cozy deal is going to be impacted negatively if these changes are made.

But the encouraging thing is that the Japanese themselves have identified that collectively their people will benefit if they can move in the general direction that we are trying to urge them to move, and, therefore, I am hopeful that we will see some important progress now that the election is by the board, now that we are moving toward this interim report that is going to take place in the next month or so, now that we are moving toward the final report, which will have to be done before the summit, that these things that we are proposing will get some important degree of acceptance within the LDP party in Japan.

Senator BAUCUS. There is a long list of items that the administration is pursuing: the distribution system, Keiretsu, land use planning, and the list goes on. What items are at the top of the administration's list? That is, what are their priority items? Or are they all equally important?

Also, there are various agencies involved on the U.S. side. I assume that not all agencies are entirely in agreement as to which of the items are most important. And I know that at different times different agencies chair these meetings, which raises the question of who is in charge here? I will begin with you again, Mr. Williams—what are the priorities here?

Mr. WILLIAMS. Mr. Chairman, in fact, there is no disagreement among these agencies on the nature of how we proceed with the talks. We all believe that we have to have successes, as you have phrased them, in every area. The first reason is the lumpy pillow analogy. If you have a lump in the pillow and you push it down, another lump pops up. You haven't done yourself any good. So from the standpoint of succeeding overall, we feel we must proceed on all of these issues at the same time.

Within each of these issues there has been more or less progress and there will be more or less degree of detail. That is another level of concern. At the level of concern that you have raised, we believe we moved them all forward at the same pace.

There is another reason for that. In the complex trade-offs in Japan that Under Secretary McCormack mentioned it is in some ways easier for the Japanese to make those trade-offs if the areas are broader and all parts of the Japanese Government participate in them than it is if we appear to be singling out one or two or three agencies in the process.

Finally, with respect to the question of the management of the system. It is our view here—having had, we confess, some initial misgivings, as you had, to see five people instead of one person addressing an administrative position—that, in fact, the process has worked very well. What we have been able to do—and you, who have followed the trade situation for many years, will I think appreciate this more than others—is to pull together a broad consensus within the executive branch at a very early date in a very im-

portant process. That is important both to our ability to negotiate with the Japanese and to our ability, ultimately, to succeed.

The notion of a chairmanship has become a purely administrative act, and each of the agencies performs its function and helps the others admirably. In fact, an external observer would say that the U.S. Government has held together cohesively while the Japanese Government has shown some fissures from time to time on important issues.

Mr. DALLARA. Mr. Chairman, may I just add a few brief points here?

Senator BAUCUS. Yes.

Mr. DALLARA. I think we do see these issues as all perhaps spokes of one wheel. And if you look at a wheel and you say, well which spoke is the most important, it is very hard to differentiate, because they all go to the center which is a center now dominated by exclusion, discrimination against foreign products and foreign investment. And they are very much interrelated. We haven't discussed this morning the issue of Keiretsu, but it is perhaps the underside of the exclusionary business practices which Ambassador Williams mentioned. In other words, the Keiretsu, the interlocking corporate structure of Japan, forms the structure which in many respects then leads to many of the exclusionary practices which he has touched upon. We need to approach that problem from both angles, both from the process of the structure itself, because the Keiretsu needs to be open. Their ties need to be loosened. And from the practices which the structure produces. And if we can approach that problem from both angles perhaps we will have a significant chance of making real progress. Thank you.

Senator BAUCUS. Well, does that mean then, as I hear your collective answer, that only success in all areas will indicate whether or not the United States is successful? I mean major successful in all. That is, failure in one constitute a veto over the others with respect to success?

Dr. TAYLOR. Mr. Chairman, it is successfully measured by how much progress is made in each of the areas. We hope to make as much progress as we can in all of the areas. Some of the areas overlap.

Senator BAUCUS. Well, how much is that?

Dr. TAYLOR. Well, let me just give you a couple of examples. In the case of public infrastructure investment, that goes in the direction of both reducing the savings and investment gap and improving the current account. It also, if it is devoted to improving airport facilities and roads, goes toward making the distribution system more effective and making it easier for foreign firms to enter the market. So it goes in a number of different directions. There are different kinds of issues about capacity and inflation which the Japanese have raised. We think we put together a good set of arguments as to why our proposals would not be inflationary. But you may be pushing in one area capacity versus another. May be airports versus roads might be an area where compromise could be taken.

Senator BAUCUS. Well, let's just look at those for a moment. Let's take the distribution system. What constitutes a success with respect to Japanese distribution inefficiencies? By what standard will

the administration measure whether we have achieved a successful resolution?

Mr. McCORMACK. The ultimate standard that will have to be used—

Senator BAUCUS. Which is?

Mr. McCORMACK. Is what appears in terms of increased import sales and opportunities in Japan. And that is a standard which will become clear in the next 2 or 3 years. What we do not want to see is a general commentary that does not result in a lot of very specific actions.

Now take the distribution system. There currently is a law, called the Large Scale Retail Law, and that law basically says that if the local smaller stores in the area will not agree to a larger store being set up, no large store can be set up. That prohibits the K Marts of this world from establishing a major—

Senator BAUCUS. I understand. But is success going to be the elimination of the Large Retail Stores Act?

Mr. McCORMACK. We have strongly urged that that take place. We have put that on the table.

Senator BAUCUS. Will that be the standard by which you judge?

Mr. McCORMACK. That will be one of the standards. We have asked that the airport facilities be expanded to make it possible for more imports to come in through there. We have asked that seaport facilities be expanded so that more imports can come in through there. We have asked that a whole series of practices whereby individual stores are tied to individual manufacturers and not allowed to handle other people's goods and services be changed.

We have provided a whole series of very specific implementation steps which I would be happy to send you that we have asked the Japanese to seriously address and we know they are.

Senator BAUCUS. I would appreciate seeing that list if you could send that.

Mr. McCORMACK. All right.

[The report appears in the appendix.]

Senator BAUCUS. Well, let's take another area, the Keiretsu. By what standard will we know whether or not we have achieved success in dismantling the Keiretsus?

Mr. DALLARA. Mr. Chairman, I would not concentrate so much on whether or not we set up a standard measured by individual steps but by whether or not we see a genuine opening in the Keiretsu structure that allows U.S. corporations to penetrate that structure with respect to U.S. exports and with respect to U.S. investment. So again, it seems to me that we have to look at whether or not we believe we have steps which will lead to a genuine opening in that structure. And recognizing the lags involved, but nevertheless, looking very closely for an improved environment that leads to real increases in U.S. exports into the Japanese economy, and a real increase in U.S. investment. The investment environment is an issue that concerns us greatly. It is partly restricted because of the cross shareholding which exists now. In the Mitsubishi group, for example, there are 171 firms ranging throughout the economy. These firms control almost 3 percent of total final sales in the Japanese economy. The linkages are financial through cross sharehold-

ing and through commercial bank and other financial arrangements. There are also linkages of procurement and purchasing.

Again, I would summarize by saying that we need to see real evidence that U.S. firms are able, without being sent in 14 different directions over 14 months, or 14 years, to market their products and to face fair and even-handed competition within these markets. And that U.S. investors would wish through either greenfield operation or through purchase of current facilities in Japan are able to actually engage in direct investment. Right now, Japan has the lowest level of foreign direct investment in its economy of any of the major economies by far, and it is time that that changed as part of this process as well.

Mr. FARREN. Mr. Chairman, if I can also say, we are in the midst, obviously, of talks which really constitute negotiations on these issues. I think it would be a major mistake for us to try to define in a hearing of this kind what constitutes success. In negotiations with the Japanese, and for that matter, other governments' officials, typically they will say well, you have 20 issues on the table. "What do you really care about? What is important?" You identify five that you really care about. They will say, "Fine. Obviously the 15 do not matter. Let's now negotiate on which of the five we are able to give you." That is not the situation we want to find ourselves in, because I think the analogy that Assistant Secretary Dallara made to the spokes of the wheel is absolutely correct. We need action in each one of these areas in order to have overall success. We are talking about trying to eliminate some of the generic problems that U.S. exporters have in the Japanese market. And it is not going to be achieved by a simple piecemeal approach to a given solution. That is fundamentally the basis of having an overall structural impediment initiative itself. That is why I would be very reluctant to see us identify "success" here, because I know you are looking for us to be successful overall in the final result we are trying to achieve.

Senator BAUCUS. That is a good point. Thank you.

Mr. FARREN. I think it would be a mistake for us to try to say what's important and what's not. As the President said, and as I think was pointed out here, final success is going to be in the results. To quote the President, he said, "The proof of the pudding is in the eating." We have to see where U.S. exporters have opportunities in Japan that they have never had before, and we have to see our bilateral trade imbalance be corrected in a relatively short period of time. We have seen it happen in other markets. We believe that if the trade distortions are eliminated in Japan, it can be achieved there as well.

I frankly, having been involved in trade issues now since 1983 in the executive branch, think the U.S. Government has already gotten something out of the structural impediments initiative, in that you have five Government officials sitting here who are representing agencies that are the focal point of U.S. trade concerns in absolute agreement on what the nature of the problem is.

Senator BAUCUS. We are becoming more Japanese that way.

Mr. FARREN. And we really have achieved a consensus on what we need to do in the way of results, and have come together and put on the table for the first time an answer to the question, which

I have heard stated over and over again, "but what can you really do about the Japan trade problem?" We have put together a package that, if it is acted upon by the Japanese, I believe can correct the problem. That in and of itself is a major contribution to the process.

Senator BAUCUS. Do you all agree that the criteria should be results-oriented in the sense that we will achieve success if we can export to Japan on the same basis as to other countries that do not have these discriminatory practices? Is that the ultimate criteria here?

Dr. TAYLOR. Yes. I would say the open markets are the ultimate criterion. But results, Mr. Chairman, should be measured in terms of the actions that are taken.

Senator BAUCUS. Sure.

Dr. TAYLOR. Not so much in the short-term at least in terms of the actual changes in trade flows.

Senator BAUCUS. Well, that is what Carla Hills said, that she expects some sort of immediate down payment from Japan to determine whether SII is successful. Mr. Williams, what does she mean by that?

Mr. WILLIAMS. That is one of the aspects of the point that Mr. Farren has made. We do not want, at this stage or even in the interim report, to let issues drop away, and we are therefore reluctant to go into great detail on what would constitute a successful package or even a successful blueprint. We have in our own minds the broad outlines of what we expect would produce in our judgment a successful result by the final report in July and in the commitments that may come later. If it is a "sow's ear," we will call it a "sow's ear." We are not prepared to call it a "silk purse."

Senator BAUCUS. I appreciate that.

I heard from everyone on the panel that we are looking for results measured in terms of exports. It wasn't the criterion that I heard from you, Dr. Taylor. Do you agree with that?

Dr. TAYLOR. Mr. Chairman, we are looking for a criterion in terms of opening markets, in terms of actions taken, such as increasing public infrastructure investment. The translation of those actions into actual changes in exports and imports takes time. Economics does not suggest that these would be instantaneous. They suggest that they would be long lasting and permanent in their effects.

So to measure success in the short term by changes in exports and imports directly would be a mistake. Look at the actions that are put in these reports. Look at the steps that are taken to measure the success.

Senator BAUCUS. Well, frankly, I think the primary standard should be exports. Are we results-oriented? Are we actually getting products in or are we not?

I would like to turn the subject now to a slightly different issue. I appreciate the comments that some of you have made that we are not attacking the Japanese cultural practices at all. That is, we are concerned only with practices which discriminate against America's ability to do business in Japan.

How many of the present practices that we are focusing on in Japan, if practiced in this country today, would be actionable

either by a private person or by a government U.S. attorney's office? The Keiretsu, for example, or the Large Store Retail Act, and others which violate U.S. law if practiced in the United States.

Mr. WILLIAMS. On the market opening issues, which I think are the focus of your question, the Keiretsu, the distribution system, exclusionary business practices; without having researched it, I would say most if not all collusional behavior and would be a violation of antitrust law. It is, of course, not unlawful to have small retail distributors. What this country would probably find a restriction on trade is the ability of competing companies to order the market against their competition. By and large, it is those sorts of factors we have identified in exclusionary business practices and distribution.

In the area of Keiretsu, there are disclosure requirements in the U.S. there are not limitations on cross share holding, except in the area of financial institutions. One can make a case, I think, that Japanese trading companies perform the same function and perhaps should come under the same sort of regulation. Most importantly, in this country related party transactions must be disclosed, so that shareholders and, ultimately, the public are able to see whether those related party transactions are fair.

It is the absence of that information that drives much of the world's concern with the Keiretsu practices. Regardless of the percentage of cross ownership that these companies have, it is the business they do with one another, to the exclusion of other companies, that is the issue foreign companies raise. So again, by and large, most of these practices, if done in the United States, would constitute violations of one law or another, or at least would be subject to disclosure and private action against or on behalf of the company.

Senator BAUCUS. The SII was launched in part to avoid certain provisions of Super 301—time constraints, for example. What happens though if the administration pursues SII and is not successful? Then do you suggest that we use Super 301 and name some of these practices as Super 301 practices in order to get results?

Mr. WILLIAMS. It is too early, Mr. Chairman, to speculate on what happens if we are not successful since we still retain optimism that we will be. I would have to say that, having identified barriers to trade and achieved a wide consensus within the U.S. Government that certain aspects of Japanese policy are barriers to trade. I think it would be very difficult for us to ignore the existence and effect of those barriers in any future trade policy. Therefore, if we are not able to resolve them in the SII, it seems to me that we will have to look to other ways to resolve them. One of them, I suspect, will be the provisions of the 1988 act that would allow us to look at them more closely and under a restricted time frame.

Senator BAUCUS. Well, I must say I generally agree with your statement. In fact, I am preparing legislation that would require the trade-related issues in SII to be pursued through Super 301 investigations. Frankly, hope I do not have to introduce it, because we all hope that we reach a successful conclusion without resorting to stronger action. But in the event that these talks are unsuccess-

ful, there is a very good chance that I will introduce that legislation and urge the Congress to adopt it.

Mr. WILLIAMS. Mr. Chairman, we appreciate your forbearance. Having stressed the importance of identifying the barriers and of needing to do something about them, we have tried to articulate our concerns using Japanese sources and using approaches that would allow the Japanese Government and the Japanese people to decide that what we were seeking for our reasons was in their interest for their reasons. We are very much hoping that this kind of process, as contrasted to the more normal "zero sum" trade negotiations in which we regularly engage, will be both successful and constructive.

Dr. TAYLOR. Mr. Chairman, if I might add.

Senator BAUCUS. Sure.

Dr. TAYLOR. Some of the topics in the SII, such as the savings and investment issues, do not lend themselves well at all to actions such as Super 301. It is a much different type of structure. And that is one of the reasons we came forth with this initiative because we knew how important it was.

Senator BAUCUS. I appreciate that. And some of the items are more actionable than others under Super 301. That is definitely true.

I think a very basic point here though is, as the world is becoming freer politically, certainly Eastern Europe, Nicaragua, and even the Soviet Union, that the focus will turn to whether the world is becoming free in an economic sense. And as some countries become more democratic, whether countries like Japan will open up economically. It is imperative that Japan does so. Japan is still the most closed industrialized country in the world.

As I mentioned in my opening statement, no country has benefited more from the world's open and free trading system than has Japan. It is imperative that, following the LDP successful elections, that Japan does act to open its market very quickly. Because if Japan does not act very quickly, I think that the United States and other countries will take whatever actions they must take to stand up for their collective rights.

It is not that we are trying to take advantage of Japan. Far from it. These talks are basically to be sure that Japan does not take advantage of us.

We are here engaged to stand up for our rights, that is, to further open the free trading system so that all people can mutually benefit.

Thank you very much. I appreciate your comments this morning.

Senator RIEGLE. Mr. Chairman, may I make a statement?

Senator BAUCUS. Oh, I am sorry. Senator Riegle, it is good to see you.

Senator RIEGLE. Thank you, Senator Baucus.

Senator BAUCUS. Thank you.

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

Senator RIEGLE. Let me say, first of all, how much I appreciate your leadership on this, and the intensity with which you are pur-

suings this issue as the chairman of this very important subcommittee. And I also think that the questions that you were posing to our witnesses here are very important ones in terms of laying the foundation of exactly what is happening now and where do we go from this point.

There are several questions that I want to raise here before we let this panel go.

First, let me just ask you for the record—and I will address to you, Mr. Williams—the bilateral trade deficit with Japan last year, for 1989, would be approximately what figure?

Mr. WILLIAMS. You are talking about the number?

Senator RIEGLE. Yes.

Mr. WILLIAMS. It is about \$49 billion.

Senator RIEGLE. \$49 billion. That is the figure that I have been using as well. Is there any indication yet this year that that number has changed appreciably from what we saw in 1989?

Mr. WILLIAMS. I think it is too early to tell, Senator. The \$49 billion number represents a decrease of \$2 billion from 1988. At the same time, the bilateral trade deficit with Europe went from a deficit of \$9.5 billion to a surplus of \$1.5 billion. Our trade balance with Korea also improved. In other words, the balance with Japan improved, but considerably less so than with other countries.

Senator RIEGLE. Well, the improvement was very, very modest. And actually we are running at about the same rate insofar as I can tell in looking at the trade data so far this year. And I notice Mr. Farren is nodding affirmatively, so I think that would be his view as well. But that means that Japan is out of the trade relationship and a lot of the unfairness that is built into the trade relationship is taking \$4 billion a month net out of the U.S. economy. That is an enormous amount of money. Now that is not all of our trade deficit. That is just the bilateral trade deficit with Japan, by far the largest we have with any country. But the fact that we are making such modest improvement, where we are seeing improvement in other areas of the global economy, I think show that these structural impediments, and I think to some extent as well a lack of will on the part of the Japanese to address the things that keep this deficit at such a high level, are things that now really have to be confronted.

And I was encouraged by the fact that the President—our President—appears to have really focused with some personal intensity on this issue in the summit meeting. And I applaud him for that. And it is very important that the President—our President—be hands-on on all the big issues, but very particularly with respect to this trade issue and particularly as it relates to Japan.

Let me ask you, how much of the time at the summit was spent on trade issues versus other issues?

Mr. WILLIAMS. Senator, if one includes the private meetings, I would say half is not an overestimate.

Senator RIEGLE. So at least half?

Mr. WILLIAMS. At least half. Would any of the other two who were there have any different percentage?

Mr. DALLARA. Senator, let me just say that it was not only, in my view, a question of the time spent on this, but the emphasis and vigor which the President dealt with these issues, I can affirm that

he was very clear. He was very specific in the need for prompt action, not only on SII, but on the other immediate trade issues that are on the agenda. And in the discussions he clearly focused on this \$49 billion deficit which you mentioned, and in fact, in his closing remarks said, look, our exports to Japan have improved, but make no mistake about it, we need that deficit to come down.

Mr. WILLIAMS. One could also sense that the intensity level clearly went up when trade issues were being discussed.

Senator RIEGLE. Now it is encouraging to me to hear you report that over half the time at the summit was devoted to the trade issue, and that the President was leading that discussion himself, I take it. Is that also a fair summary?

Mr. DALLARA. Absolutely, Senator.

Senator RIEGLE. I know he and I have talked about this issue. And we have gone over in the past the data in the trend lines about the enormous problem of the United States becoming a debtor nation to such an enormous extent and the part of that that relates to this unyielding trade deficit that we have with Japan. So it is encouraging for me to hear that that much time was given to it.

I would like you to review just briefly what understandings were reached? What will now happen?

Mr. DALLARA. Perhaps I could say a word, Senator, on that, because I think what will now happen, we have to be honest and say it is not entirely clear what will now happen. But it is clear that the Prime Minister gave his commitment to the President to intensify efforts to resolve trade problems and, in particular, the Prime Minister stressed the importance that he views the SII talks and the importance of tackling the structural problems in his economy within the context.

Let me quote briefly if I may, Senator, from Prime Minister Kaifu's closing remarks.

"The SII is extremely important to consolidate this positive aspect." And he was referring to the fact that the imbalances had already come down somewhat. "I am determined to firmly tackle structural reforms of Japan as one of the top priorities of my new cabinet."

And then he goes on to say that he hopes the United States on its problem will promote structural adjustment as the President indicated. So the commitment at a political level was clear. And, frankly, what was so sorely needed in these talks was political guidance, because we have been dealing with our counterparts for three lengthy sessions, and we realize that they were in the midst of an election, but, nevertheless, it was clear to us that there was a lack of political guidance. And, therefore, we are very hopeful that political impetus, the essential ingredient really, in my view, to make these talks a success was imparted by these discussions in Palm Springs this weekend.

Senator RIEGLE. Well, in addition to that, were any specific understandings reached as to things that will improve the situation or are we still in the process stage?

Mr. DALLARA. It was not the intent of President Bush this weekend to try to use this weekend to obtain specific commitments on individual issues, Senator.

Senator RIEGLE. All right.

I go through this because I want the record very clear so that we have got something to work from and measure as we get down the road. So at this point, while there was a frank exchange, we are talking about a process of adjustment and specific targets were not the focus of this set of meetings. Is that right?

Mr. DALLARA. Well, let me just say that while seeking specific commitments was not the focus of this meeting, the President was specific about the trade problems that we face. I mean, it was more than just a general discussion. And I think that it would be up to the President to decide really how much of the details of those discussions he wishes to reveal, and certainly is not up to us. But I can confirm to you that he was clear and he was specific on not only the need for overall improvement in our trade problems, but in dealing with particular problems on the immediate agenda.

Senator RIEGLE. Well, let me ask you this. You are all serious people, and I appreciate the fact that you are doing this work, and that you are serious about it, and that you are forthright in your answers today. I think that is all very constructive.

If we were to take that bilateral deficit down at the rate of \$5 billion a year, it would take us 10 years. If we were to take it down at the rate of \$10 billion a year, it would take us five years. Obviously, if we pick a higher target rate for improvement, we can take it down and get a balance sooner than that.

I would like some sense for the time frame that you are looking at here. Are we talking about getting this deficit down to zero or a rough balance over 5 years, over 3 years, over 10 years? Without getting into the specifics, what do you have in mind?

Mr. TAYLOR. Senator, let me try to address this complicated question about how fast trade imbalances would be reduced in response to the proposals we put forth. We put forth the correct proposals, and they will have action on these imbalances. But what we know for sure is that they will have action on the overall trade deficit of the United States and the overall trade surplus for Japan.

The prediction about what will happen to the bilateral deficit is much less clear. It depends on many, many other factors besides savings and investment imbalance. And I, in particular, would say that we shouldn't use that bilateral deficit as the only indication of trade barriers. If trade barriers exist, we should get rid of them and that is what we are doing. But it is only one indicator and it is not the best indicator. There are examples in history where bilateral deficits and surpluses have existed for years and years without being traced to trade barriers.

In the SII talks, I think we made a significant addition to the ways which one can monitor these trade barriers. And Mr. Farren discussed this earlier, Senator. We have looked at price differences between the United States and Japan as a barometer of trade barriers. In many respects, this is a much more sound measure, a sounder barometer of trade barriers that exist. And when we take actions that will reduce those price differences, I can say we will be achieving a substantial success.

Whether this bilateral trade deficit itself comes down is a much more difficult—

Senator RIEGLE. Well, let me tell you something. You had better have a plan to bring it down because if you think it is sustainable or that we can roll along with other adjustments that leave us with a bilateral trade deficit of \$50 billion a year, I think that not only is the wrong economic conclusion but, believe me, you don't want to send that signal back over all of these cameras that are around the room today to our friends in Japan. I think the number has to come down and I think you had better set some targets.

Does anybody at the table have anything in mind in the way of some sort of aggregate target? I am not getting into the components right now, because you, in effect, said that you need some maneuvering room with regard to that. And I understand that. But it seems to me you have got to be able to give some clear sense as to what our target is for getting that bilateral deficit down. Do you hope to bring it down \$10 billion over a 2-year period, for example? Who can address that?

Mr. WILLIAMS. Senator, we made this point earlier when we were discussing with the chairman specific targets within the structural impediments. If you are asking, have we looked at what we think we are likely to accomplish with the structural barriers that we are addressing, the answer is yes. A lot of what that result is depends on what the package turns out to be, what sort of regression analysis one applies to it, what happens in this country, the competitiveness of U.S. firms, whether Europe benefits to some extent. So it has many parts to it.

Our reluctance to give you a number is not based on any sense that the deficit is unimportant. To the contrary, we assure you the deficit is important. It is not based on any sense that we haven't looked at it. To the contrary, we have. We are reluctant to state a number because, if we do, and we give you either a conservative or an aggressive one, we have thrown the process off. We are fully prepared to be judged fairly on the merits of whatever comes out of this. We have been honest with you before; we will be honest with you again on what we think is happening and will happen. But to set a target is going to put us in the position with the Japanese of under-reaching, over-reaching, badly reaching, doing something that doesn't, frankly, make sense to us at this stage of the process.

Senator RIEGLE. Well, I understand that, and I don't want to be unsympathetic to that point. But I think you work for the American people, and they have a right, I think, to understand what the goals are that we are setting for ourselves. And I think you must have some broad goal that you identify and that you can speak to. And I think at a minimum, for example, you ought to be able to say that that trade deficit with Japan ought to be cut in half. Just to pick a figure out of the air, it ought to go from roughly \$50 billion to \$25 billion over some time period. And if you have in mind 10, or 15, or 20, or 30 years, and you don't feel you can talk about it, then there is a very big implication that goes with that. And if you have in mind it is 2 or 3 years, and you don't particularly want to talk about it, then that has an entirely different implication. But I don't think you can just speak to the Japanese audience on that issue. I think you have got 240 million Americans that really want to know whether or not we have got some ballpark goal for ourselves here that we are working against. I think you have to set

something. I assume you have it internally. And if you don't, you should have. I think you ought to put it in some parameters. I am not asking you to pick an absolutely discrete dollar figure, but I think you have got to have some realistic yardstick that you are establishing that you are working to, that they know you are working to, and to which you are then measured by us and by the people of this country.

Dr. TAYLOR. Senator, we take this very seriously. We take the current trade deficits and surpluses globally as unsustainable, something that we should work to bring down. The President has stated that the improvements have to speed up again. The reduction in the overall trade deficit for the United States has to be reduced faster than it is expected to be reduced at this time. We think the Japanese surplus should be reduced faster than it is expected to be reduced at this time. And that is why we are putting those initiatives forward.

I can tell you that economic evidence suggests that an increase in public infrastructure investment in Japan, or—and this is equally important—a reduction in our budget deficit will translate into a substantial reduction in the global trade imbalances for the United States and Japan. And that was what I would tell both the American people and the Japanese people.

Senator, the translation of those global changes and to bilateral changes in the deficit is much more difficult to estimate. We think we are doing the right thing in terms of making proposals to open markets to make it feasible and much easier for U.S. firms to enter Japanese markets. We think that is the right way to go. And the results in terms of the bilateral deficit, while we think will come down, are just impossible to predict with any precision.

Mr. McCORMACK. Senator, let me just make one quick comment here about your concern about the signal that is being sent.

I just want to assure you that I have been present at Cabinet level discussions with the Japanese where it was made very clear that the current trade imbalance between the United States and Japan cannot continue with it at its current level and it must come down.

Senator RIEGLE. Come down to what?

Mr. McCORMACK. A specific figure was not cited, but the emphasis was very clearly made that this figure simply must come down.

Senator RIEGLE. Well, we all know it has got to come down. But, look, I am trying to help you. And I think you can worry too much about the sensitivities of decisionmakers in Japan. And I don't say that disrespectfully to them. They have worked very hard to produce the economic success they have and it ought to be acknowledged. And there are a lot of things the United States has to work harder to accomplish in terms of the problems that we face.

But, for example, if we are going to talk in terms of taking this down at a rate of \$5 billion a year, the bilateral deficit, it is going to take us 10 years to get to a balance. And 10 years is a long time. And without doing the math, that adds a lot of international debt cumulatively that we will owe the Japanese into the future.

If we set a goal of taking it down roughly on the average of \$10 billion a year, it takes us 5 years.

I would think at a minimum, we ought to be between those two figures. We ought to say that somewhere, whether we were shooting for a balance in 5 years or shooting for a balance in 10 years, I would certainly hope it is not outside those bounds. If you want to be inside those bounds, that would be very good news, and would like to hear that if you think it is possible to get it all done short of 5 years from now. But I think it is time to set some target goals here in the aggregate—in the aggregate—that we can think about and talk about and debate. Because if you have got a road map for yourself that has this thing coming down slowly over a very long period of time, then we have got a very fundamental difference and we are going to have to have it out.

Senator BAUCUS. I think the Senator makes a very good point here. And I very much hope that the interim report that comes out in April can begin to address some of these points, because if the President's action report is accurate that up to \$30 billion of the imbalance is due to trade barriers in Japan that is very significant. We know that some of the trade imbalance is due to American practices. But I think it is critical that that interim report address the standards by which we can judge whether or not we are successful. Otherwise, that interim report is not going to amount to much.

So the Senator makes a very good point. And I strongly advise the administration to push very vigorously to find the answers to those questions.

Mr. DALLARA. I will be very brief. But I think none of us deny, Mr. Chairman and Senator Riegle, the importance of bringing that deficit down in a significant way. But it is equally important, in our view, how it is brought down. I mean it does us no good if the Japanese look and say, well, perhaps we can satisfy the Americans with an \$8 billion reduction if it is temporary and if it is by simply artificial restraints of their exports or artificial boosting of our imports which will not last.

One of the keys of this process it seems to me is the need for change on a systemic lasting basis. If we can break through and remove some of those problems in the Japanese distribution system, if we can open Keiretsu, we can reduce these imbalances, not just significantly but in a reasonable time frame. And I can assure you that none of us are looking at a 15-year time frame. We can not only do it in a reasonable time frame in a significant way, but we can do it on a lasting basis. And that is, I believe, fundamental to solving these problems with Japan because if we allow them to take measures which are administrative and not structural to solve these problems, we will have a short-term solution that will be hitting us back in the face.

Senator RIEGLE. Well, I agree with that.

Senator BAUCUS. If I might say so, I think we agree with the point that you are making that this is not a simple matter. But I urge you strongly to take to heart what the Senator from Michigan is saying and what I am saying, because we need some results here. We have heard a lot of talk in the last several years, and some action, but not nearly as much action as is needed.

Senator RIEGLE. And if I may add, Mr. Chairman, just one additional point. And I know we have other witnesses to hear from this morning.

Senator Danforth and I wrote the Super 301 procedures that is there and it is there for a reason. And we mean for it to work in terms of actually bringing about bottom line results that we can see. And I am all for a good open dialogue and constructive give and take with the Japanese, and so forth. And it is an essential part of the process. And as I say, I think the President deserves some real credit for taking the initiative, and going out and getting right in the center of it. But this deficit has to start coming down and these structural barriers have to change and they have to start changing now. And these numbers have to start reflecting it. And if we don't see at least a \$5 billion improvement—if the best we can do is go from roughly 52 to 49 with the other changes that were in place, and everything else that was out there, if we can't take this down in \$5 billion increments, or more—I think more will have to be done. I think you should have a clear understanding with the Japanese of a dollar figure goal of which the structural impediments initiative is obviously a central reform that would contribute to meeting that goal undertaken. But there are other things that can be done as well. But the financial consequences to this country and the job consequences to this country are so severe that this process can't take forever. It has got to move faster. And you have got to have tough, discrete goals. And we can't just waltz around it. I mean, there has to be goals set and we have to know what they are.

I want the Japanese to know what they are. I want the people in my State and across the country to know what they are so that we know whether we are meeting them. And if we are not meeting them, then I think they are going to be fully of a mind to want to have a new team. And they can have a new team and a new team there, and a new team in the White House and every other place. I don't presume that will be the outcome unless we fail to perform. But we have got to set these goals and we have got to be more open and direct about it.

Mr. Farren?

Mr. FARREN. Senator, just to—

Senator BAUCUS. This is the last statement. I am going to have to go on now.

Mr. FARREN. Just to close out on this point.

We are not trying to escape. We want to be straight forward and, clearly, we understand your points. I think if we were to set some goals it would actually, probably, underestimate what would likely to happen with a fully open market in Japan. Frankly, I think \$5 billion is probably lower than any number we ought to be throwing out.

Senator RIEGLE. I am all for a higher goal.

Mr. FARREN. If in 1987 we had said we would turn the deficit around with Europe 100 percent, from a \$20 billion deficit to a surplus of \$1 billion, having been in the Commerce Department in 1987, I would have assumed that was unachievable. If we had said in 1987 with regard to Germany, which is a very aggressive exporter, that we would turn the deficit around from \$16 billion—nearly

\$16 billion—to \$7.9 billion in 2 years, I would probably say that was overestimating what we could do. And that is why I think setting a goal out into the future, particularly at this point in the talks, is a mistake. But, clearly, with an open market in Japan, we should be able to see just as rapid a turnaround as we saw in Europe. And, frankly, the same economic factors were at work in Japan as were at work in Europe. We should be looking at a deficit today that is significantly lower than what it is. The pricing problem is indicative of structural barriers in Japan's economy that impede trade and balance of payments adjustment.

Senator BAUCUS. All right. Well we are going to be looking at that interim report very, very closely. Thank you very much. We appreciate it.

Our next panel consists of Mr. Thomas Stallkamp, of Chrysler Motors, as well as Mr. Stephen Lovett, who is the vice president of International Trade for the National Forest Products Association.

Mr. Stallkamp and Mr. Lovett, we are pleased to see you both here. Mr. Stallkamp, why don't you lead off.

**STATEMENT OF THOMAS T. STALLKAMP, CHAIRMAN, ACUSTAR, INC. A CHRYSLER MOTORS COMPANY, TROY, MI**

Mr. STALLKAMP. Fine. Thank you. Good morning, Senator.

Senator BAUCUS. Good morning.

Mr. STALLKAMP. I would like to thank you for the opportunity to present our views this morning. We have filed a statement which I would just like to go through quickly and summarize.

Senator BAUCUS. All statements will be included in the record.

Mr. STALLKAMP. My name is Tom Stallkamp. I am Chairman of Acustar, which is Chrysler Corp.'s parts-making subsidiary.

Acustar designs, manufactures and sells a wide variety of automotive parts from electronics, electrical systems, trim components, down to thermal products and glass. Our 1989 sales were over \$3.5 billion.

Due to our heritage, our sales have been primarily to domestic manufacturers, GM, Ford, and Chrysler, but for the last 3 years we have been aggressively seeking sales both to European and Japanese OEM original equipment manufacturers, and also to Japanese transplants in the United States.

Our report on success in export sales has been mixed. While we have export business from VW, Renault, Volvo, and others, we have only been able to get domestic Japanese transplant business from Diamond-Star, a Chrysler joint venture with Mitsubishi Motors. Our direct sales to Japan are even more limited—less than \$3 million—and all of that to Mitsubishi for a special transmission.

The transplants favor their established family, or Keiretsu suppliers, that we have heard about this morning. And they have been encouraged to come to the United States by their parent firm. Meanwhile, though, they control the sourcing in Japan through the use of the Keiretsu system often for non-economic justifications through selected use of specifications. For example, we recently made a sales call on one of the Japanese transplants in the United States, and were told that they were very interested in doing business with us. However, when we requested drawings and specifica-

tions on which to quote, we were told it was proprietary information, and that we should purchase a car, take it apart, decide what components we wanted to supply, build a prototype, and then they would consider purchasing from us. By the time this could be done, the vehicle would be redesigned and the parts would likely be changed significantly to make the effort useless. This is not so with the Europeans who have responded very well to our sales efforts.

Third, they maintain engineering and sourcing control in Japan. And, fourth, they use exclusionary non-anticompetitive business practices and delays.

In response to the political pressure which has been applied through SII, MITI has recently announced a series of import expansion programs, assigning targets to Japanese part manufacturers for purchase in the U.S. However, we feel it will provide greater benefit primarily to the Japanese part suppliers than to Americans for two reasons. One is again, the structural impediments currently in place—the distribution barriers and the Keiretsu system—which makes it harder to sell into Japan. And, second, the proposed tax credits against corporate income taxes, which equals 5 percent for the year-to-year increase on the value of imports, are available only to Japanese manufacturers, while other companies—foreign companies—exporting into Japan receive only a limited tax deferral over a 5-year period. Things have started to change, however, it is important to look at the substance of that change. Several Japanese suppliers with whom we deal privately have acknowledged that they have "Buy American" targets for North American content now assigned from MITI; however, these targets are not results targets, they are "make effort" targets, and are a direct result of the political pressure that the U.S. Government has been applying. This latest round may be merely another delay tactic.

Past experience shows that an elaborate quotation exercise of sourcing to Keiretsu suppliers both here and in Japan may be merely a delay. There must be an opening of real actual trade. Purchase targets should be set and monitored. The United States must accelerate, not reduce, its pressure for equal trade treatment.

To reduce our efforts now, just as the Japanese are feeling the pressure, would be to admit that they are right. The automotive portion of the U.S. trade deficit has increased in 1989, as we heard, from 42 to 44 percent of the total deficit. The automotive portion, including automobile parts, of the bilateral deficit with Japan is over \$35 billion, or 69 percent of the total, up from 64 percent last year. This is unsustainable, yet it shows no signs of improvement.

Efforts have been underway to open the Japanese parts market for many years. It has previously been a priority for the U.S. Government. Yet no real results have been forthcoming.

Given the proportion of the merchandise trade deficit that the automobile sector represents, we fail to understand how it cannot be considered a priority for the United States. Utilizing the Super 301 provision of the Trade Act would put teeth into the current cosmetic attempts by the Japanese to source from the United States.

An amendment to the 1988 Trade Act, which was sponsored by Senator Riegle, cited government toleration of the systematic anti-competitive practices as actionable under Section 301. That is a pri-

ority practice which should be included in Super 301 this year. Auto parts is a prime example of one sector affected by this practice. Elimination of such impediments will permit natural economic factors to guide sourcing decisions and allow us to compete on the basis of price and quality.

The Japanese respond only to political or economic pressure.

Senator BAUCUS. You will have to summarize as best you can.

Mr. STALLKAMP. U.S. companies can compete if permitted access to markets. We ask only for removal of the unfair one-way practices and some recognition of support from our Government. With that, we can and we will truly be able to open the doors for trade. Thank you.

Senator BAUCUS. Thank you very much.

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

Senator BAUCUS. Mr. Lovett?

**STATEMENT OF STEPHEN M. LOVETT, VICE PRESIDENT, INTERNATIONAL TRADE, NATIONAL FOREST PRODUCTS ASSOCIATION, WASHINGTON, DC, ACCOMPANIED BY JOHN A. RAGOSTA, DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD, WASHINGTON, DC**

Mr. LOVETT. Thank you, Mr. Chairman.

My name is Steve Lovett. I am international vice president of the National Forest Products Association and a member of the steering committee of the Alliance for Wood Products Exports.

Thank you for the opportunity to discuss the relationship between the SII and the Super 301 process. The wood products industry will certainly be in the vanguard of support for SII. At the same time, the industry strongly urges Congress to insist that real progress be made in opening the sectoral markets which have been identified as Super 301 trade priorities.

The SII should not substitute for the bilateral process as the vehicle for addressing structural barriers for wood products. Reform of Japan's distribution system and anticompetitive activities are important long-term goals, but they will not open the Japanese wood products market until the tariff, standards, code, and other nonstructural barriers are eliminated. This is my central message to the committee.

The oft-heard Japanese refrain that the industry does not try hard enough to penetrate the Japanese market is not true for the wood products industry. For more than 20 years, this industry has spent hundreds of man-years and millions of dollars to further penetrate the Japanese market. In short, we know the Japanese market. We know that value added sales of wood products to Japan would increase dramatically were it not for Japan's tariffs and non-tariff barriers.

Elimination of barriers could increase export of U.S. wood products by more than \$2 billion annually. The barriers confronting the U.S. wood products industry are varied. The important thing is that the barriers form an interlocking system and therefore a comprehensive resolution is necessary to gain market access, regardless of whether these barriers are structural or non-structural.

Japan's practice of applying no tariffs on raw materials and escalating tariffs on value added products results in effective rates of protection on many wood products of two or three times the nominal rate. This deliberate system of tariff escalation skews Japan's imports toward raw materials and away from value added products. In effect, the system robs the U.S. industry of its competitive advantage. Less than 30 percent of Japan's imports of U.S. wood products by value in 1988 were processed. By comparison, 92 percent of Europe's imports from the United States and 88 percent of the imports from the United States and the rest of North America are processed products.

Unnecessary restrictions in Japan's wood standards and building codes also severely restrict the importation and use of wood. For example, Japan prohibits the construction of three- and four-story garden apartments and multi-use commercial buildings out of wood.

Complicated certification procedures literally mean that U.S. wood products sit on the docks for weeks or months awaiting inspection and approval. These are only a few examples of the standards and codes barriers.

Japan misclassifies a number of laminated wood products in its tariff schedule, artificially increasing the tariff from 3.9 percent to 15 to 20 percent. This has a big bottom line effect on U.S. companies.

Japan provides its wood industry with numerous subsidies. Of particular concern to the U.S. industry are subsidies that tend to offset market opening efforts which result in increased protection.

For example, in the MOSS talks, Japan authorized over \$1 billion in grants and government-guarantee loans to counteract the effects of market liberalization. This must not happen again.

Land and housing policies in Japan severely limit the consumption of wood products by favoring agricultural uses of land over residential uses. While the Japanese people have been crowded into housing half the size, on the average, than Americans enjoy, farmers grow rice between high rises in Tokyo. Reform in this area would not only dramatically increase importation and use of wood products, but would substantially improve Japan's standard of living.

Anticompetitive practices abound in Japan's wood products industry. If Japan refused to sanction or tolerate cartels in logs, lumber, and plywood, whether temporary rationalization cartels or otherwise, U.S. wood products producers would have a better opportunity to compete fairly in Japan.

And, finally, Japan's distribution system seriously increases the cost of wood products. One study showed that the cost of shipping lumber from Seattle to the Japanese city of Kobe was less than the cost of sending the lumber a few short miles from Kobe further into Japan. Relief in this area could be very valuable. For starters, the administration should include wood products among those products which it monitors to determine if Japan's price structure is excessive.

Liberalization of the Japanese market could result in enormous long-term gains for both the Japanese consumer and potential U.S. suppliers. The wood products industry strongly supports the Struc-

tural Impediments Initiative which addresses structural barriers of clear relevance to the wood products trade.

We have also asked the administration to discuss specific wood products structural issues in the Super 301 negotiations. However, we are concerned that the SII not be viewed as an alternative to sectoral talks. If the U.S. wood products industry is to gain real market access, progress must be made on the full range of Japanese barriers, both structural and nonstructural. Elimination of minor technical barriers will not result in real—i.e., measurable—export gains. What we heard earlier this morning was encouraging. We would hope that Congress and the administration will follow through and insist that results be measurable in the marketplace.

Senator BAUCUS, our industry is grateful for your support and attention to the Japanese trade issues. Your leadership is critical to the successful opening of the Japanese market for wood products.

Thank you very much for this opportunity to testify today.

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

Senator BAUCUS. Thank you. Mr. Lovett.

You made, I think, a couple of key points, Number one, it is important, as you said, that we achieve substantial results in the Super 301 talks, not only for supercomputers and satellites but also for processed forest products. At an earlier hearing on that subject, the U.S. Forest Products Industry established that if Japan were to open up that market for process forest products, U.S. processed forest products exports to Japan would increase by \$1 to \$2 billion. Is that correct?

Mr. LOVETT. Yes, sir. We are putting together specific examples out of the Japanese market and we will have those numbers for you very soon. We think it will be over \$2 billion.

Senator BAUCUS. Now, that is just with respect to the sectoral talks that is under Super 301. Is that correct?

Mr. LOVETT. That is correct.

Senator BAUCUS. Now, you are also making another very important point. That is, that structural impediments are a further impediment to American forest products industry efforts. Is that correct?

Mr. LOVETT. Yes.

Senator BAUCUS. And what is your best guess as to the amount of additional U.S. forest products that could be sold in Japan if the administration is successful in these SII talks? That is, above and beyond the approximate \$2 billion additional sales as a consequence of successful resolution of the Super 301 talks?

Mr. LOVETT. We will work on that, sir. I cannot tell you right now.

Senator BAUCUS. Can you roughly approximate? I mean, what magnitude are we talking about here?

Mr. RAGOSTA. Senator Baucus, my name is John Ragosta. I am with counsel for the Alliance for Wood Products Exports.

We have focused on the sectoral issues because of the timing issue which Senator Riegle raised before. If you can reform land/housing policies in Tokyo, for example, you could increase the land area by 50 percent, open for residential construction in the metropolitan Tokyo area. That would result in a building boom which would certainly be to the benefit of the wood products industry. We

have not been able to make the kind of macrocomparisons that you are talking about. But I think you are talking about literally billions of dollars and we are talking about one sector.

Senator BAUCUS. How would you define a successful outcome? I will ask this of both of you. How would each of you define a successful outcome of the SII talks? What is your measure? Senator Riegle made a very important point. We have to have an easily understood objective measure if we are going to determine whether we are successful or not.

Mr. STALLKAMP. I guess from our standpoint we agree with the statements this morning that there have to be targets. And the real result is purchases. It is not quotations and it is not studies. And it is only going to result in an improvement if there are actual purchase orders and exports going to Japan. So we feel strongly that the only real measurement is the one that is used by the marketplace in the commercial world, and that is exports, hard exports, not promises, into the future.

The issue of timing is very important. And in our different businesses we do have to accept that there is a transition period. But I would submit that in most of the businesses that export from the United States there is some immediate improvement that could be made.

Senator BAUCUS. Mr. Lovett.

Mr. LOVETT. I think there is a real danger here to try to focus on any measure of success other than results which can be measured in the marketplace. I think that we have encountered several areas in the Super 301 process which reflect on the SII process, and that is that it is possible to make changes to law, to make paper changes, which, because of an interlocking network of practices, do not result in real market access, that is results that can be measured in increased exports. And this is the real danger in this whole process, is that we claim a win for fiddling with Japan's legalistic description of what it does, and that the wins are not really translated into dollars, and, therefore, not wins at all.

Senator BAUCUS. Do either or both of you support my introduction of legislation that would make the structural impediments—that is the most appropriate ones—actionable under Super 301 if we are unsuccessful in the present negotiations?

Mr. STALLKAMP. As we said in our statement, we are beginning to see the Japanese respond to pressure, and to relax now from increasing that pressure is probably what is expected of us. In traditional American practice, as soon as we see a response we back off. I guess I would agree with you that we do need to continue the pressure in a variety of ways, and the SII and Super 301 are just two of them. But our message is to relax now, would be a mistake. We must continue to prod and to encourage some progress.

Mr. LOVETT. Senator Baucus, we think the example that you have set in this process with your dedication to achieving results has been exemplary and we would very much support that legislation and all of the other strong steps that you are taking to make this process work.

Senator BAUCUS. I am not sure I expected a different answer to that. Thank you very much.

Senator Riegle.

Senator RIEGLE. Thank you, Mr. Chairman.

I appreciate the testimony of both witnesses today, and it is very important that we get this factual base down so that we have got these tracking mechanisms. And I want to again congratulate you, Senator Baucus, for your leadership on this issue. And you also, of course, have, I think just done a very valuable and difficult piece of work on the clean air legislation, working for weeks on end, day and night, to try to produce a package that was a balanced package for this country. And I really admire the leadership you have given on that issue. Others have been involved as well, but you have really been the lead horse on this. And it is difficult enough to lead on one issue without leading on others at the same time, but you are doing that with respect to the trade issue, and I certainly appreciate it, as does I think a broad group of parties at interest who represent the manufacturing base of this country, because we have got serious problems there, as our witness from Chrysler is testifying today.

I want to say one thing while the press people are still in the room with respect to this goal setting issue. It is an enormously complicated issue. And I don't mean to oversimplify in any way the trade issue and the bilateral trade problem that we have with Japan into a single discreet number. On the other hand, I think if we don't set tangible goals and work toward them, we don't get there. And it seems to me that taking that deficit down from roughly \$50 billion, \$49 billion, where it was, to a figure of say \$25 billion—cutting it in half—I think that ought to be our goal over the next 2- to 3-year time period. And I think it is achievable. I think it is a target that we should set, and I don't think we will get there if we don't set it. Now I don't ask anybody else for the moment to agree with that, but that is the kind of progress that I think we have to expect to extrude from the process of adjustment here. A very substantial part of it I think has to come from dismantling the structural trade barriers in Japan that keep out wood products, keep out manufactured goods, keep out American cars and a lot of other things. And part of it has to come from a tougher internal drive for efficiency and other corrections that we need to make internally, and that is an important part of the puzzle as well. And I don't minimize that by any means.

But the comparisons are obvious in terms of the progress we have made with Europe and other parts of the world, that the Japanese has consistently worked to keep us and keep our products out of their markets. In the case of automobiles, the latest data that I have is that of the total market for car sales in Japan today is a figure of about 7.2 million cars and trucks per year. Only 2½ percent are supplied from abroad by foreign suppliers. And of that 2½ percent, the United States actually has less than one-half of 1 percent of those sales in Japan. That is a figure or about 19,000 cars and trucks in total that we were able to sell there.

On the other hand, in terms of the openness of our market, our total foreign imports of cars and trucks—car imports, alone for the moment—in our country is 27.5 percent and the Japanese account for, by far and away, the lion's share of that amount. So they have been enormously successful in this country, and they have been successful because of the openness of our market to them.

Their market is closed to our cars for all practical purposes. I once had a Chrysler dealer in Detroit that wanted to open a dealership in Tokyo. I wrote to Ambassador Mansfield and asked him how we should go about enabling this particular American retailer to set up shop in Tokyo to try to sell Chryslers at retail, and we got a very polite but tortured letter back sometime later saying, I'm sorry. That can't be done. Well, that is just nonsense. And it is one of the reasons why the world I think ends up becoming more unstable rather than stable because you have unfair trade practices.

So I appreciate the testimony that you have given today. Are we seeing any significant progress in terms of being able to sell cars and trucks at the retail level in Japan on anything like the basis that Japanese companies can sell here in the United States?

Mr. STALLKAMP. Well, there has been a comparison. If we were to sell as many cars and the parts that go on them made by domestic manufacturers in Japan as Chrysler alone sold last year in Europe, that would equal \$1 billion. We sold 50,000 vehicles—Jeeps, minivans, and convertibles—in Europe last year. And Chrysler alone sold about 1,200 vehicles in Japan. That is up, in their words, 50 percent, because last year we only sold 600.

Senator RIEGLE. Yes. But percentage increase does not mean anything when the volumes are so low.

Mr. STALLKAMP. Absolutely. Right.

So it is an example where an immediate target could be helped. And the other point we would like to make is that there is a dual problem beginning, and that is with the transplants continuing to import substantial percentages of chips from Japanese manufacturers. And so the vast majority of the manufacturing jobs are made in Japan, even though the assembly jobs may be coming for transplants. The kits, which are as valuable as the car itself, and sometimes up to 70 percent Japanese content, are continuing to come over, supporting the system that grinds on.

So, yes, I think we could make some immediate improvements selling vehicles, particularly the ones that have been attractive in Europe.

Senator RIEGLE. Let me just finish—I know my time is up, Mr. Chairman—by saying that I strongly support the suggestion that Mr. Stallkamp has made here that auto parts be made a priority practice in the second round of Super 301, which will be announced by the Trade Representative by April 30. I think, clearly, they qualify. It represents a lion's portion of the bilateral deficit, and it is something that needs to be done. And I support it and I intend to work toward that end.

Senator BAUCUS. Thank you, Senator.

One final point. Both of the industries you represent have made successful efforts to sell products in Europe. I think your success in Europe demonstrates that your industries produce and market a very high quality product. And certainly American-processed forest products are superior in the world. I don't think anyone denies that.

And as you mentioned, Mr. Lovett, the vast lion's share of U.S. forest products sales to Europe are processed forest products. A very small percentage is logs and unprocessed forest products. But the exact opposite is the case in Japan. Seventy percent of the

forest products sold in Japan are unprocessed—logs and chips—and a very small percentage is processed forest products, such as plywood, liner boards, fiber boards, lumber, et cetera.

And as you point out, Mr. Stalkamp, Chrysler has a very high volume of sales in Europe. The Europeans are buying American cars in Europe, but the Japanese are not buying American cars.

And the point obviously is that while it is true that in some areas quality of product might be a factor in explaining the U.S. trade deficit with Japan, it certainly is not true with respect to processed forest products, because we have the world's best quality processed forest products. And the Europeans are buying American automobiles, and I am sure the Europeans have discriminating taste when it comes to quality. It seems to me therefore, that Japan should open up its markets to allow the Japanese consumer the opportunity to buy not only Japanese cars but American cars as well.

Thank you both very much for your testimony.

Mr. STALLKAMP. Thank you.

Mr. LOVETT. Thank you.

Senator BAUCUS. The hearing is adjourned.

[Whereupon, at 12:33 p.m., the hearing was concluded.]



# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED

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PREPARED STATEMENT OF CHARLES H. DALLARA

### INTRODUCTION

Mr. Chairman and Members of the Committee, I welcome this opportunity to discuss the U.S.-Japan Structural Impediments Initiative (SII).

The SII talks are at a critical juncture. We have just concluded a third round of discussions in Tokyo, held on February 22 and 23. An interim assessment of the SII talks is scheduled to be concluded by early April, and a full report is due before the Economic Summit in Houston in July. Little progress was achieved in our latest round of SII discussions. But as you are all aware, President Bush and Prime Minister Kaifu have just concluded two days of talks in Palm Springs. I have just returned from attending those meetings, where economic and trade issues were an important part of the discussions. Among these issues, the SII talks were prominent, as were, of course, a number of other specific trade problems. The President underscored the importance of reducing our trade deficit with Japan, not by restricting our markets or managing trade, but by further increasing our exports to Japan.

The President also stressed the need to ensure the success of the SII talks, calling for a redoubling of efforts to achieve meaningful results. He noted that valid U.S. ideas have been put forth about removing structural impediments in the Japanese economy, and that we look forward to the Japanese Government's response to our ideas.

There has been much public discussion of the SII since it was launched last summer by President Bush and former Prime Minister Uno. In this discussion, some misconceptions about the purpose and goals of the SII have arisen. I would like to take this opportunity to review what the Administration set out to achieve through the SII process, and to correct some of the misconceptions which may exist about the SII. The objective of the SII talks has been to identify and solve structural problems in both countries that stand as impediments to adjustment in trade and balance of payments accounts, with the goal of contributing to the reduction of payments imbalances. There is a market access component to this objective that Ambassador Williams will address. I will concentrate here on the goals of promoting trade and balance of payments adjustment, and of reducing our deficit and Japan's surplus.

For a number of years, the United States, Japan, and other industrialized countries have been engaged in a cooperative effort to reduce global payments imbalances through the macroeconomic policy coordination process. This process has been largely successful in beginning to reduce global imbalances. Changes in domestic demand patterns and a significant realignment of exchange rates since 1985 have produced considerable improvement in global payments imbalances.

Nevertheless, the imbalances remain large, and it was clear to us as we surveyed the situation a year ago that there remained numerous structural barriers in both the Japanese and U.S. economies that were obstructing trade and slowing the process of reducing trade imbalances. These structural barriers are economy wide, running across many key product sectors. On the Japanese side, they include a costly and inefficient distribution system, an inter-locking structure of business groupings—called "keiretsu"—that tends to close out foreign competition, and pervasive exclusionary and anticompetitive business practices. Such structural barriers unfairly block the access of U.S. firms to the Japanese market and inhibit correction of trade imbalances.

Some have voiced the view that we are tackling these structural problems in Japan as an excuse to avoid confronting our own problems at home. That is certainly not the case. We recognize that structural problems exist on the U.S. side as well, including insufficient public and private saving. A unique aspect of these talks is that they were intended from the start to be a two-way street, in which both governments would be able to offer ideas as to how the other's economic structure could be improved and impediments removed.

President Bush, in fact, reaffirmed this point last weekend in Palm Springs. The Japanese have emphasized with us, for example, the need for the United States to further reduce our fiscal deficit in order to reduce government dissaving, and to take actions to boost private savings and to improve the competitiveness of American industry. They have welcomed the initiatives in the President's FY1991 budget towards this end, including the proposals for Family Savings Accounts and a capital gains tax cut. We hope that Congress will act swiftly on these proposals, so that we can address our structural problems. As the President stated, our task is to make the American economy even stronger and more competitive, and that is a task for America, not Japan.

Another misconception that I have heard regarding the SII is that it is unreasonable for the United States to expect to reform totally the structure of the Japanese economy in one year. If that had been our goal, it would indeed have been unreasonable. But that was never what we set out to accomplish. The structural issues raised by the United States in these talks are complex and in many cases deeply embedded in the Japanese economy. It will require time to make the wide-ranging changes we seek—time to build a political consensus in Japan behind the changes, to seek passage of new laws through the Diet, and to phase in reforms.

It is essential that actions to correct these problems begin now; however, the process of reducing and removing rigidities will need to continue with further steps over a period of time. As Ambassador Hills has stated, we need an initial down payment, with a blueprint of additional steps.

The results of structural change will not occur overnight. But if the actions are comprehensive and meaningful, as we hope they will be, they can have fundamental and lasting positive effects on our trade problems, reducing barriers and helping significantly to bring our deficit down. The issues we have raised are generally systemic in the Japanese economy. They are not amenable to a quick fix. But if over time these barriers to free and fair trade, these impediments to adjustment, are removed, they can affect the ability of U.S. firms to export and invest not just in one or two specific sectors, but in many sectors: from auto parts to retailing, from personal computers to supercomputers, and from telecommunications equipment to movies and videos. If these barriers are really removed, the need for solving problems on a sector-by-sector basis should be greatly reduced.

I would also like to address another concern that has been voiced in regard to the SII, that the USC is making demands that intrude on Japanese culture. Let me state that our intent here is not to challenge Japanese culture; however, it is inevitable that when one seeks to make fundamental economic changes, as we are trying to do, one faces practices that have several dimensions to them. Who would argue that our low national savings rate is strictly a narrow, economic problem?

I would stress that the world economy is interdependent, and that few, if any, issues can be excluded from international dialogue. Japan cannot be integrated into the world economy from the perspective of its export and financial sectors, and yet persist in insulating itself with respect to its import sector and foreign investment in Japan. Japanese economic growth has been greatly aided by the easy access Japanese products enjoy in foreign markets; Japan must also open up its market to foreign products.

Some observers have also asked just how the various issues we have pursued with the Japanese can affect our trade. The linkages are complex and in some cases indirect and hard to trace. But these are not just esoteric subjects to be studied by academicians. They constitute real problems for U.S. businesses trying to export to or invest in Japan. I would therefore like to take this opportunity to outline for you some of these linkages. On the issues where the Treasury Department has the lead, I will also briefly touch on some of the ideas we have put to the Japanese about how to correct their impediments.

*Saving and Investment*

Japan's saving and investment patterns are a central piece of the U.S. Government's agenda in the SII talks. The level of public investment in Japan has been declining as a percentage of GNP over the past several years, while the government budget surplus has been rising. Some of the Japanese Government's own goals for expanding and modernizing social capital have not been met. For example, the government set a target of 9.0 square meters of parks per capita by 1985, yet by the end of 1985 the amount of park space per capita had reached only 4.9 square meters. The OECD recently reported that Japan lags behind other industrial countries in important categories of social infrastructure: for example, the OECD estimated that in Japan there exist only 21 kilometers of motorway per 1000 cars, compared to 375 kilometers in the United States, and 30.6 kilometers in West Germany. At the same time there are high rates of public and private saving in Japan, including a general government surplus which will equal 2.0% of GNP in 1990 according to OECD Secretariat projections. Therefore, the U.S. Government has put forward in the SII the idea that Japan should take steps to increase public sector investment through a multi-year program to improve public infrastructure.

Increased public investment will reduce the gap that exists between savings and investment in Japan. A nation's current account balance is, by definition, essentially equal to the difference between national saving and domestic investment. In Japan's case, this means that its external surplus is equal to its excess of domestic saving over investment. Therefore, an increase in public investment by the Japanese government will have its counterpart in a lower Japanese trade and current account surplus. I would like to point out that we are *not* trying to encourage the Japanese to save less, rather we are encouraging the Japanese government to invest more in infrastructure, which will help improve the quality of life in Japan, as well as reduce the trade surplus.

American firms will also benefit directly from certain forms of public infrastructure spending. For example, public investment in airports, ports facilities and commercial distribution systems should facilitate the importation and distribution of U.S. goods and services in Japan, increasing U.S. exports and Japanese imports, and contributing to more rapid current account adjustment.

*Land Use*

Japanese tax and urban policies governing land use are a second structural impediment that the U.S. Government has raised in the SII. Land use policies work to prevent external adjustment through the savings-investment mechanism that I have just described. Namely, current Japanese land use policies discourage the conversion of agricultural land to other purposes, with the result that small, largely uncompetitive farms continue to exist in the midst of metropolitan areas such as Tokyo. The result is a reduction in the supply of land for residential and business investment, and reduced consumption of housing-related consumer durables, some of which are imported.

But the housing issue is more than just a savings and investment issue. High land prices discourage new business entrants, both domestic and foreign. For example, a U.S. insurance firm wishing to buy land for office space may find prices prohibitive. Similarly, a U.S. auto firm considering the purchase of a small area to use as a showroom, may be deterred by the high price of land. Not only is the cost of retail or office space prohibitive, but new entrants must compete against incumbents who purchased land several years ago when prices were lower. At the same time, existing businesses in Japan benefit from the rising land prices, which increase the value of existing businesses' assets and improve their ability to borrow against this collateral.

The U.S. Government has therefore suggested that Japan eliminate impediments that discourage the conversion of agricultural and under-utilized land to residential and business uses, through the institution of more neutral tax and regulatory policies. As a result we should see greater Japanese investment in housing and residential construction, and a corresponding reduction in the surplus of savings over investment, which has generated Japan's current account surplus. Greater availability of housing will increase Japanese consumption of housing-related consumer durables, including imported durables.

*Distribution System*

A third structural impediment in the Japanese economy is the distribution system. Problems in the Japanese distribution system include excessive regulation,

inadequate infrastructure and anti-competitive practices within the distribution system. These factors discriminate against new market entrants, both domestic and foreign. Prices of goods are raised at each level of the many-layered system. In the case of impediments created by the Japanese distribution system, the link to an increase in U.S. firms' exports and in Japanese imports is direct and obvious. Elimination of barriers in the Japanese distribution system will reduce the prices of both foreign and domestic products, and will provide opportunities for new products to be introduced. Imports to Japan will increase as a result. Under Secretary of State McCormack will provide further background on this issue.

#### *Exclusionary Business Practices*

A fourth structural impediment the U.S. Government has raised is a broad category of exclusionary business practices. Some exclusionary business practices would be considered violations of antitrust and antimonopoly laws in the United States or in Japan, for example bid-rigging, market-sharing arrangements or price-fixing. While other practices the U.S. Government cites under the SII are not strictly illegal, they nevertheless have the effect of excluding foreign firms from the Japanese market. Ambassador Williams will provide further background on this problem.

#### *Keiretsu*

Keiretsu ties, or the network of formal and informal ties among independent Japanese companies, constitute a fifth structural impediment to external adjustment. Keiretsu are the large groupings of Japanese companies which extend through many sectors of the economy. These disparate companies are tied together through links such as cross shareholding and personnel ties. For example, the Mitsubishi group, which alone accounted for 2.9% of total sales in Japan in 1987, includes among its members Japan's largest chemical company and its largest brewery, as well as Japan's fifth largest bank and its fifth largest automobile company. Keiretsu ties foster preferential group trade at the cost of outside suppliers, help facilitate exclusionary business practices, and deter foreign direct investment, especially mergers and acquisitions.

These keiretsu ties pose clear barriers to foreign firms attempting to penetrate the Japanese market. In order to honor long-term relationships, keiretsu members often purchase products from other keiretsu members, even in some cases where a cheaper or better foreign product may be available. The U.S. Government has therefore suggested that the Japanese Government take actions to open keiretsu to greater competition with outside firms. For example, we have suggested that the Government of Japan strengthen requirements for public disclosure of business information, and that shareholders' rights be strengthened. These actions will shed light on indistinct keiretsu ties, and will increase keiretsu firms' accountability to shareholders. We have also discussed the cross shareholding problem.

An important aspect of our discussions on keiretsu is the barriers keiretsu pose to direct investment by foreign firms in Japan. The network of cross shareholding among keiretsu firms reduces the number of actively traded shares, thereby reducing the opportunities for foreign direct investment in Japan. The following figures testify to the difficulties faced by foreign investors in Japan: in recent years, direct investment by foreign-owned firms has accounted for about 17 percent of West German total assets, and about 9 percent of U.S. assets, but only about 1 percent of Japanese total assets. It is important to open up the Japanese economy to foreign investment, in order to help us preserve the freedom with which Japanese and other firms invest in this country, and also to provide U.S. firms with an investment base from which to operate and expand in Japan.

Some of the keiretsu reforms would increase opportunities for foreign investment in Japan. In addition, we have suggested the Japanese Government consider eliminating its broad authority to screen and block foreign investments, and that the Japanese Government articulate a basic policy welcoming foreign investment.

#### *Pricing Mechanism*

Finally, the effects of the various structural impediments above are clearly reflected in high domestic prices in Japan. The U.S. Government has raised the pricing mechanism as a distinct issue which both results from and symbolizes the existence of market rigidities in Japan. Foreign goods generally cost more in Japan than abroad, as do a significant number of Japanese goods, and this price gap is much too large to be explained by transportation costs alone. These price differentials provide us with one barometer by which the presence of structural impediments in Japan to market competition can be gauged.

Actions to address each structural barrier identified above would help reduce the excessive price tags carried by foreign products, and would increase the scope and

volume of foreign products imported into Japan. Under Secretary of Commerce Farren will give additional detail on this issue.

#### STRUCTURAL IMPEDIMENTS IN THE U.S. ECONOMY IDENTIFIED BY THE JAPANESE

As I have already noted, the SII is a two-way street and, for its part, the Government of Japan has identified structural impediments in the U.S. economy which it believes slow adjustment in the U.S. current account deficit. I will summarize for you the major points raised by the Government of Japan.

Many of these issues, such as our low national savings rate and the competitiveness of U.S. firms, are already the subject of national concern in the United States independent of the SII. Indeed, a number of GOJ proposals have already been suggested in various forms by members of both parties in Congress. Several of the Japanese points are mirrored in President Bush's State of the Union address and in the FY91 budget proposal. Nevertheless, Japanese concerns have heightened our own awareness of the need to address U.S. economic weaknesses, in order to improve the functioning of the world economy.

First, the Japanese Government has underscored the importance of raising U.S. *public and private savings rates*. As I described earlier, the saving/investment imbalance is the counterpart of the U.S. current account deficit. Eliminating Federal Government dissaving through progressive reduction of our budget deficit is a top priority of the Administration. Success in this area will directly reduce public dissaving. The President's FY1991 budget plan proposes reduction of the deficit to 1.1 percent of GNP, from a high of 6.3 percent in FY1983 and 2.9 percent in FY1989.

There is also a growing consensus on another point raised by the Government of Japan, that is the importance of raising private saving in the United States. The Savings and Economic Growth Act, announced in the President's State of the Union address, features the introduction of the Family Savings Accounts I mentioned earlier, and the reduction of capital gains tax rates. All these measures are intended to lower the cost of capital in order both to enhance the competitiveness of U.S. exporters and improve trade imbalances with Japan and other countries.

Another structural impediment identified by the Japanese Government is aspects of *corporate behavior* that reduce U.S. competitiveness. The Government of Japan has suggested that U.S. firms have a short-term profit orientation which contributes to the external imbalance. In a recent speech, Secretary of the Treasury Brady also echoed this concern, and called for an improved financial environment in order to prompt investors and corporate managers to take a more long-term perspective. A Working Group of the Economic Policy Council has been studying the U.S. high cost of capital and its impact on investment time horizon. In addition to increased savings and lower taxes on capital gains, the Treasury Department has undertaken a study of our corporate governance system to develop means to encourage long-term investment by shareholders. A capital market reform bill presently pending in Congress addresses market inefficiencies which increase volatility, hence raising the cost of capital and discouraging long-term investment.

The Government of Japan also calls for structural reforms in other areas of the U.S. economy. The Japanese Government has offered ideas to increase *research and development* efforts in the United States, to increase the effectiveness of U.S. *export promotion* programs, and to improve our programs for *workforce education and training*. In each of these areas we acknowledge the need to strengthen our efforts, and indeed, efforts are currently underway.

#### Closing Remarks

In closing, it is important to stress that the SII departs from standard U.S.-Japan negotiations, and represents a unique, systemic approach to reducing trade and payments imbalances. That the U.S. and Japanese governments have embarked on this initiative together is notable in itself, and if we are successful in our efforts to remove impediments, this could constitute a significant move toward a lasting improvement in our external imbalances, and in U.S.-Japan relations. In fact, we believe the SII offers the best hope for comprehensive, long-term improvements in the U.S.-Japan trading relationship.

During last weekend's meeting, Prime Minister Kaifu acknowledged that the trade imbalances are still very large and that the SII talks are extremely important in consolidating the improvements that have already begun. He expressed a determination to tackle firmly structural reform in Japan as one of the top priorities of his Cabinet. Of course, we will need to see exactly what actions will be taken, but I came away somewhat hopeful that last weekend's meetings between President Bush and Prime Minister Kaifu will impart a new political impetus to these talks, which is needed in order that progress can be made. As we move toward the preparation of

the interim assessment next month and a full report this summer, we hope we can look forward to the support of this Committee and the full U.S. Congress.

#### PREPARED STATEMENT OF J. MICHAEL FARREN

Mr. Chairman, it is with great pleasure that I appear before your subcommittee today to discuss the status of the U.S.-Japan Structural Impediments Initiative (SII)

#### OVERVIEW

In July 1989 President Bush and then-prime Minister Uno launched the Structural Impediments Initiative "to identify and solve structural problems in both countries that stand as impediments to trade and balance of payments adjustment, with the goal of contributing to the reduction of payments imbalances."

This clear statement of goals is at the same time both a logical evolution of past efforts to deal with the phenomenon of Japanese trade and a stark departure from past approaches.

The United States and Japan have labored together for almost three decades to reduce Japan's formal trade barriers and to coordinate policies that affect trade. In the late 1980's, the focus shifted to a more macro approach. Since early 1985, the dollar has depreciated 45 percent against the yen; emergency economic measures implemented by Japan in 1987 have stimulated domestic demand.

We would have expected these two factors acting together to have had a more favorable impact on our bilateral trade balance than has been the case.

- The U.S. trade deficit with Japan has decreased only marginally—by less than 15 percent—from \$56.3 billion in 1987 to \$49.0 last year, or \$7.3 billion.
- By comparison, U.S. trade performance with the EC improved by \$22.1 billion—from a \$20.6 billion deficit in 1987 to a \$1.5 billion surplus in 1989—a shift of 107 percent.
- With West Germany alone—until last year the world's number one exporter—our deficit declined by almost half—from \$15 to \$8 billion.
- Our balance with the East Asia NICS also improved more than with Japan—\$9.8 billion over the 1987-89 period—a shift of almost 29 percent.

The failure of traditional adjustment mechanisms to produce comparable changes in Japan's external surplus, led us to conclude that there are structural factors in the Japanese economy that obstruct imports and distort the rational functioning of the economy.

These structural impediments prevent transmission of normal market signals in Japan. They rob Japanese consumers of the benefits of full, free-market oriented competition. They preclude the kind of market-based adjustment which we have seen in our trade with other countries, and which we had expected would bring our trade with Japan into better balance.

This is where the SII talks represent a departure. They are explicitly results-oriented, with that result defined in terms of our external balances. President Bush reaffirmed the objectives of SII during his meeting with prime minister Kaifu this weekend.

#### U.S. POINTS OF INTEREST

The U.S. has identified six main areas of concern in the Japanese economy: the gap between Japanese public saving and investment behavior; land use policies; keiretsu relationships; the distribution system; pricing mechanisms; and exclusionary business practices. I will go into greater detail on pricing since commerce has the lead on the pricing issue, although policy changes effected by the Government of Japan in the other areas will all have an impact on pricing.

#### PRICING MECHANISMS

Here I believe it would be useful to review the results of the Joint Commerce-MITI Price Survey presented at the November 6-7 SII plenary. Officials of the U.S. Department of Commerce and the Japanese Government, primarily from the Ministry of International Trade and Industry (MITI) jointly conducted a survey in October of the prices of 121 products sold in both the United States and Japan. The goods were priced over a two-week period in four cities: Tokyo, Osaka, Chicago, and New York. To provide you with a more detailed account, I am submitting for the record two staff reports on the survey that were prepared by the international trade administration.

The price survey was originally proposed by the Japanese Government in September at the SII meetings in Tokyo. The United States viewed the survey as an excellent opportunity to determine whether, as previous anecdotal and statistical evidence indicated, prices were generally substantially higher in Japan than in the United States. More precisely, the United States expected the survey to verify that

- Prices of identical or closely comparable goods produced in the United States and third countries are generally higher in Japan than in the United States by more than would be accounted for by transportation and other costs associated with exports; and

- A significant proportion of identical or closely comparable goods produced in Japan is more expensive in Japan than in the United States.

The survey results do in fact demonstrate that prices are higher in Japan than in the United States for comparable products.

- Almost 90 percent of the surveyed goods produced in the United States, and over 95 percent of the surveyed products produced in third countries, are priced higher in Japan. On average, prices of both U.S. and third-country goods were over 70 percent higher in Japan than in the United States.

- Forty percent of the goods originating in Japan were more expensive in Japan. This is a high proportion when one considers that under competitive and efficient market conditions, transportation costs would normally cause Japanese goods to be priced higher abroad.

The implication is that:

- Japanese producers practice price discrimination on at least a fairly wide scale, charging lower prices abroad and/or
- Japanese structural barriers have a greater impact on prices of Japanese-made goods sold at home than on prices of those goods when exported.

The survey was conducted under exceptional circumstances—in a very compressed time period, with all phases of the operation based on ongoing and often difficult negotiations between the U.S. and Japanese sides. Consequently, neither the product-selection process nor the actual gathering of the price data could be implemented in as systematic or comprehensive a manner as would be true in more typical price surveys. Nevertheless, we are convinced that the results are valid.

The findings of the Commerce/MITI survey seem clearly plausible, particularly since they are consistent with numerous other studies that have compared the cost of living in the United States and Japan and prices of goods sold in both countries. It is particularly noteworthy that several Japanese studies show the cost of living and price levels to be considerably higher in Japan than in the United States.

The survey results have significant implications:

- The overwhelming proportion of U.S. and third-country goods, and the large share of Japanese products, priced higher in Japan unmistakably point to the impact of structural impediments, which preclude normal free market forces from operating.
- The higher prices in Japan clearly reflect the pervasive and harmful influence of inefficiencies such as the complex and multilayered distribution system and of obstacles to competition such as trade barriers, exclusionary business practices, and government regulations.
- The survey seems to demonstrate—as has long been charged—that Japanese corporations use a protected domestic market, with Japanese consumers paying higher prices, in order to price aggressively in foreign markets, thereby gaining market share and often mortally wounding foreign competitors.
- The survey demonstrated that consumer electronics prices in Japan and in the U.S. showed the smallest differences in actual price levels. The largest differences in manufactured product prices exist where a U.S. industry is fighting to retain market share. This may indicate that American consumers can look forward to paying Tokyo prices when U.S. industries are destroyed and Japanese firms dominate our markets.

To say it simply, the price differential acts as a barometer of the degree to which the market mechanism is distorted by trade barriers and competition is suppressed.

The pricing issue is especially important in light of the political visibility of the subject in Japan. Rising public consciousness of Japan/foreign price differentials prompted the LDP to form a party-government "headquarters" to deal with the pricing issue. The group, headed by prime minister Kaifu, has called for correction measures which include publication of price differences for Japanese consumers'

benefit, and requesting industry to provide information to help reduce price differences.

The MITI response to our joint survey is typical of prior reactions to criticism of this kind. MITI has proposed a number of surveys that appear to focus on pricing practices of foreign firms in the Japanese market. Implicitly, the premise of the proposed MITI surveys seems to be that higher prices in Japan are the fault of foreign firms—not the closed markets of Japan. The MITI reaction is symbolic of the reluctance of Japan to acknowledge that a problem of Japanese making even exists.

Price changes have a direct effect on the Japanese consumer and the Japanese market. This makes the issue of prices a very sensitive one for Japanese politicians. The effectiveness of reforms in Japan will show up in both price adjustments and changes and eventually, in the trade balance.

#### JAPANESE POINTS OF INTEREST

Like fair trade, the SII process is a two-way street.

The Government of Japan has identified seven features of the U.S. economy:

- savings and investment patterns;
- corporate investment activities and supply capacity;
- corporate behavior, including leveraged buyouts and short term vs. long term profit outlook;
- government regulations, including export controls, voluntary export restraints, and anti-trust regulations;
- research and development;
- export promotion;
- workforce training and education.

According to the Japanese, problems in these areas inhibit U.S. economic efficiency, or otherwise impact our external balances.

We agree with many of these points:

- the United States does need to increase savings and lower the cost of capital. The family savings plan and the capital gains tax cut proposed by President Bush will help to increase private saving and stimulate long term investment.
- even though the U.S. is the world's leading exporter, we need to make U.S. firms even more competitive and export-oriented. The commerce department is currently finalizing an export promotion program specifically for Japan which we plan to use as a model for subsequent application in other countries.
- there is no question that we need to improve our educational system in the United States. The administration signalled its commitment to take action in this area when President Bush announced his national education goals in the state of the union address.

#### PROGRESS TO DATE

The first two SII meetings concentrated on identification of structural barriers in the U.S. and Japanese economies and analysis of their effects. At the February 22-23 plenary in Tokyo, we gave the Government of Japan a fairly detailed and substantive list of suggested policy actions, such as increasing investment in public works projects to 10 percent of GNP, repeal of the large-scale retail store law, strengthening of the anti-monopoly act, increased staff and budget for the Japan fair trade commission, making tax policy neutral with respect to alternative uses of land, and putting limits on mutual holding of non-controlling stock among Japanese firms (cross-shareholding).

In the pricing area, we believe that the reforms which would have the most immediate benefits are those which impact:

- the physical ability of suppliers to provide products to consumers
- the competitive environment in which business takes place
- the ability of foreign firms to invest/establish in the market, and
- the ability of more competitive suppliers to maintain their cost advantage without artificial requirements (caused by \* \* \*

The Japanese have indicated willingness to increase the JFTC staff and budget, impose a tax on farmland within urban areas in FY1992, review all cartel laws, make it easier for private enterprises to file a suit under the anti-monopoly law, and conduct further price surveys. These steps are welcome.

However, in most cases, the Japanese response has been to defend the status quo.

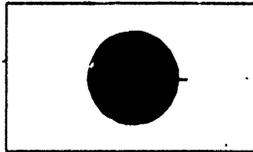
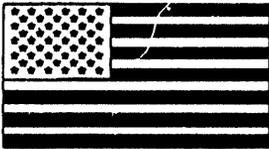
- repeal of the large-scale retail store law was ruled out by Prime Minister Kaifu during the general elections; meaning that the Japanese market will be closed to competitive U.S. retailers like Toys 'R Us, which is being shut out of Tokyo.
- increased investment in public works projects is reportedly being resisted by the ministry of finance due to inflationary concerns; which means that Japan's huge pool of savings will flow into redundant industrial capacity, and that industries like the auto industry will have enormous overcapacity.
- revision of the anti-Monopoly law is unacceptable according to Fair Trade Commission Chairman Umezawa, in statements he made at a press conference. Which means that firms like Allied Signal will continue to confront collusion among Japanese firms, thereby denying U.S. products access to the Japanese market.



**UNITED STATES DEPARTMENT OF COMMERCE**  
**International Trade Administration**  
 Washington, D. C. 20230

**STAFF PAPERS**

**STRUCTURAL IMPEDIMENTS INITIATIVE**



**THE JOINT DOC/MITI PRICE SURVEY**

- 1. METHODOLOGY AND RESULTS**
- 2. CASE STUDY OF CAPITAL GOODS PRODUCTS**

These reports are analytic documents and should not be construed as statements of Department of Commerce policy

**TRADE INFORMATION  
 AND ANALYSIS**

**DECEMBER 1989**



## FOREWORD

In October 1989, as part of the Structural Impediments Initiative (SII), officials of the U.S. Department of Commerce and Japan's Ministry of International Trade and Industry (MITI) jointly conducted a survey of prices of identical or closely comparable goods sold in both Japan and the United States. The survey took place over a two-week period, with goods being priced in Tokyo, Osaka, Chicago, and New York.

Consistent with many previous surveys (including some by the Japanese themselves), the results of our joint survey indicated a clear pattern of higher prices in Japan than in the United States. Prices of 90 percent of the goods originating in the United States and 95 percent of the items produced in third countries were higher in Japan, generally by substantial margins. Furthermore, almost half of the goods made in Japan also cost more in Japan, even though, under normal competitive circumstances, the domestic price of a given good will almost always be lower than the price of that same good sold abroad.

It is sometimes argued that lower prices in the United States resulting from Japanese pricing practices should not be of concern to us--that they in fact work to our advantage. Such a view is misguided. Because of higher prices in Japan--and the forces that cause them--the Japanese standard of living suffers, U.S. exporters are placed at a disadvantage in competing in Japanese markets, and U.S. efforts to improve its balance of trade are impaired.

The findings of the survey provide convincing evidence of formidable obstacles to U.S. exports to Japan. Because of the significant implications of the survey for U.S.-Japanese trade, ITA's Trade Information and Analysis section has prepared two staff papers. The first--"Methodology and Results"--summarizes the survey, explaining how it was carried out and presenting the results. The second--"Capital Goods: A Case Study"--explores why prices of capital goods run higher in Japan. It concludes that the inefficiency of the distribution system and restrictions on competition, mainly impediments to entry, are largely to blame.

The joint Commerce-MITI survey was a milestone in the SII process. The prevailing pattern of higher prices in Japan demonstrated by the survey underscores the existence of structural impediments to trade with Japan and the need for remedial action. Higher prices not only directly curtail the volume of goods exporters can sell there, but, more important, they are symptomatic of inefficiencies and anticompetitive practices. The SII talks are intended to alleviate these trade distortions.

  
J. Michael Farren  
Under Secretary  
for International Trade



**UNITED STATES DEPARTMENT OF COMMERCE**  
**International Trade Administration**  
Washington, D. C. 20230

**STAFF PAPER**

**THE JOINT DOC/MITI PRICE SURVEY:**

**METHODOLOGY AND RESULTS**

Prepared by:  
Martin J. Kohn  
Trade Information  
and Analysis

**DECEMBER 1989**

This report is an analytic document and should not be construed as a statement of Department of Commerce policy



THE JOINT DOC/MITI PRICE SURVEY:  
METHODOLOGY AND RESULTS

Executive Summary

Officials of the U.S. Department of Commerce and the Japanese Government, primarily from the Ministry of International Trade and Industry (MITI), jointly conducted a survey in October of the prices of over 100 products sold in both the United States and Japan.

The survey was part of the Structural Impediments Initiative (SII), and the results were presented by the U.S. side at the SII meetings in early November.

The SII, announced in July, is a series of year-long discussions between Japan and the United States. These discussions are intended to identify, and eliminate or ease, structural impediments in both Japan and the United States that are contributing to the U.S. trade deficit with Japan and are inhibiting U.S. exports to Japan.

The U.S. side agreed to participate in the price survey to determine whether, as previous anecdotal and statistical evidence indicated:

- o Prices of identical or closely comparable goods produced in the United States and third countries are generally higher in Japan than in the United States by more than would be accounted for by transportation and other costs associated with exports; and
- o A significant proportion of identical or closely comparable goods produced in Japan is more expensive in Japan than in the United States.

The survey is integral to SII because, if the above two hypotheses are true, it would indicate the presence of structural impediments. These impediments include:

- o Inefficiencies within the Japanese economy (such as the complex and multilayered distribution system) that drive up prices; and
- o The frequent absence in Japan of free, open and competitive markets--because of such factors as trade barriers, exclusionary business practices, and government regulations--that limit or deny access of foreign goods to Japanese markets.

The survey results in fact support the two hypotheses:

- o Almost 90 percent of the surveyed goods produced in the United States, and over 95 percent of the surveyed products produced in third countries, are priced higher in Japan.

- o Forty percent of the goods originating in Japan were more expensive in Japan. Since under competitive and efficient market conditions, one would expect Japanese goods to be priced lower in Japan, this is a high proportion. The implication is that (a) Japanese producers practice price discrimination on at least a fairly wide scale, charging lower prices abroad and/or (b) Japanese structural barriers have a greater impact on prices of Japanese-made goods sold at home than on prices of those goods when exported.

Other noteworthy points about the survey follow:

- o Of the 121 products surveyed, 83, or nearly 70 percent, were more expensive in Japan. A simple average of Japanese/U.S. price ratios for all 121 items indicated that, on average, prices in Japan exceeded those in the United States by 39 percent.
- o The products covered by the survey were grouped into six broad categories--automobiles, automobile parts, electronic goods, food, non-food consumer goods, and capital goods. In five of these product groups, a high proportion of the goods--ranging from 68 to 96 percent--was priced higher in Japan than in the United States. Only in the electronic goods category did a minority of the items surveyed--38 percent--cost less in Japan than in the United States, apparently because most of these goods were made in Japan.
- o Price differentials were generally far greater in cases where prices in Japan exceeded those in the United States than in cases where prices in the United States were above those in Japan. For example, 70 percent of the products that cost more in Japan were at least 25 percent more expensive. But price differentials for only 37 percent of the goods that cost more in the United States reached or exceeded 25 percent.
- o To obtain meaningful aggregate measures of price differentials for the goods surveyed, it was necessary to compute weighted averages. Six such averages, designed to reflect the relative importance of the goods priced in the overall trade of the United States and Japan and in the consumption patterns of the two countries, were calculated. Product groups were rearranged from the original six categories and weighted by U.S. exports and imports, Japanese exports and imports, and by weights from the U.S. and Japanese consumer price indexes (CPIs). All six weighted averages showed that the overall price level in Japan exceeded that in the United States by a wide margin.

The DOC-MITI price survey was designed and carried out in a compressed time period, with all phases of the operation based on ongoing and often difficult negotiations between the U.S. and Japanese sides. Consequently, neither the product-selection process nor the actual gathering of the price data could be implemented in a fully systematic or comprehensive manner. Nevertheless, the survey results seem clearly plausible, particularly since they are consistent with the findings of several other similar studies, including some conducted by the Japanese themselves.

## THE JOINT DOC/MITI PRICE SURVEY: METHODOLOGY AND RESULTS

In October, officials of the U.S. Department of Commerce and the Japanese Government, primarily from the Ministry of International Trade and Industry (MITI), jointly conducted a survey of the prices of 121 goods sold in both the United States and Japan.

The survey was part of the Structural Impediments Initiative (SII). The SII project, officially announced in July and expected to continue through mid-1990, is a negotiating process through which the U.S. and Japanese governments intend to help reduce the U.S. trade deficit with Japan and stimulate Japanese imports of U.S. goods. Specifically, the two governments are holding ongoing discussions aimed at identifying, and easing or removing, structural impediments in both Japan and the United States that contribute to the deficit and inhibit U.S. exports to Japan.

### How Price Differences Relate to Structural Impediments

The price survey was undertaken as part of SII mainly because of the U.S. view that the Japanese pricing process reflects a variety of structural impediments. More precisely, on the basis of anecdotal evidence and price indices, surveys and studies, it is evident that price levels in Japan for the last several years have been higher than they are in the United States. This differential implies obstacles to a more satisfactory U.S.-Japan trade balance and a larger volume of U.S. exports to Japan. These obstacles include:

- o Systemic inefficiencies in the Japanese economy--such as a complex, multi-layered distribution system and land use policies that sharply elevate the cost of land--that drive up prices. Some of these factors--e.g., the distribution system--appear to have a particularly detrimental impact on exports to Japan since they evidently affect prices of Japanese imports more than those of domestically produced goods.
- o The absence of free, open and competitive markets. Where such markets exist, the law of one price should prevail--that is, prices should differ only by transportation costs and excise taxes. (U.S. Census Bureau data indicate that transportation costs add about 4 or 5 percent to the value of goods in U.S.-Japanese trade.) Greater price differentials would trigger the flow of goods from lower to higher price countries, narrowing or eliminating the gap. Therefore, the persistence of substantially higher prices in Japan indicates that this arbitrage process is being blocked.

Among the consequences of these characteristics of Japanese markets is the ability of many Japanese firms to practice price discrimination. To the extent that domestic and foreign markets are segmented from one another, firms with sufficient power to set prices in the markets in which they operate can charge different prices in each of these markets. In fact,

there is ample evidence that Japanese firms, seeking either profit maximization or expansion of market share (or both), often charge lower prices abroad than at home.

Lack of competition also can deny or limit access of foreign goods to Japanese markets. Access can be impeded in many ways, including trade barriers, exclusionary and collusive business practices, and government regulations.

The U.S. objective in participating in the October price survey was to examine--on the basis of up-to-date price data collected with both official U.S. and Japanese participation--two hypotheses:

- o Prices of identical or closely comparable goods produced in the United States and third countries are generally higher in Japan than in the United States by more than the normal costs associated with exports; and
- o A significant proportion of identical or closely comparable goods produced in Japan is more expensive in Japan than in the United States (as opposed to virtually all such goods costing more in the United States, as would be true under competitive and efficient market conditions.)

If, as the U.S. side expected, these hypotheses were confirmed, it would provide valuable corroborative evidence of structural impediments.

In fact, as described below, the survey results supported both hypotheses. The overwhelming proportion of U.S. and third-country goods surveyed cost more in Japan than in the United States, as did about 40 percent of Japanese-produced goods.

It should be pointed out that--with the exception of the capital goods covered in the survey--the survey was restricted to determining prices. It did not attempt to ascertain the causes of price differentials for other categories of goods sold in the United States and Japan. The explanations for the higher prices of capital goods in Japan are included in the attached report by Barbara N. McLennan on the work of the survey's capital goods pricing team.<sup>1</sup>

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<sup>1</sup> Dr. McLennan's report indicates that there are two major reasons that capital goods are likely to be priced higher in Japan than the United States. First, the multi-tiered, complex distribution system puts upward pressure on distribution costs. Second, the market for capital goods is far less competitive in Japan than the United States. According to Dr. McLennan, Japanese capital goods markets are generally oligopolistic, with a price-leader firm for a given good or group of goods setting prices that other firms find it necessary or desirable to follow.

### How Survey Was Established and Carried Out

The price survey was originally proposed by the Japanese at the SII meetings in September. The United States accepted the proposal in principle but indicated that the survey would have to include more than the handful of consumer goods suggested by the Japanese. Japan agreed to a broader survey. The two sides also agreed to conduct the survey jointly and complete it in time for a presentation of the results at the November 6-7 SII meetings in Washington. The survey was jointly designed and conducted by the Department of Commerce's International Trade Administration (ITA) and MITI.

The key elements of how the survey was set up and the procedures followed are summarized below:

- o Prices were surveyed sequentially in four cities--Tokyo, Osaka, Chicago and New York--from October 18-28.
- o Over a hundred products sold in both countries were priced, of which 121 were actually used in reporting the results to the SII meeting on November 7. (Airline tickets and express mail were surveyed but were not reported in the data, reflecting a decision to omit prices of services in reporting the survey results.)
- o The products priced included goods produced in the United States, Japan, third countries, and, in a few cases, in more than one country.
- o The products surveyed were selected through negotiations between DOC and MITI officials. The intent was to choose goods that were important in U.S.-Japan trade or in the overall trade of the two countries. These criteria were followed to the extent possible. However, because of the complexities of the negotiating process and the unavailability of many products to the price surveyors, this standard could not be met in all cases. For example, the capital goods included in the survey were limited to medical and scientific equipment and instruments.
- o The products were grouped into six broad categories--food products, miscellaneous consumer goods, electronic products, automobiles, automobile parts, and capital goods.
- o Many of the consumer goods were sold in several types of retail outlets. Thus, where possible and applicable, individual items were priced in department stores, specialty stores, and discount stores.
- o Generally, the price recorded was the actual price exclusive of sales tax to the final buyer at the point of sale at the time the product was surveyed. Thus, if an item was sale-priced during the survey, the sale price, not the usual price, was noted.
- o There were some exceptions to this procedure:
  - sales taxes on cigarettes and movie tickets were included in the prices of these items.

- When sellers of such goods as automobiles and capital goods indicated that actual prices varied according to a range of discounts from list price, the midpoint of the range of the discounted prices was taken as the price.
- Prices of capital goods were obtained from corporate officials engaged in sales and distribution of these products. Prices of automobiles were gathered from automobile dealers.
- o The prices were collected by teams, one for each product group. Each team was jointly headed by a U.S. and a Japanese official.
- o The two leaders of each team signified their agreement on the data collected by signing the forms on which the data was recorded. The information used in computing the survey results was drawn from these forms.
- o Comparisons of dollar and yen prices were made by converting yen prices to dollar prices at an exchange rate of 142 yen to the dollar. This was the average yen/dollar rate during the period the survey was conducted.

### Findings of the Survey

#### Unweighted Results

The survey results strongly indicate that a very high proportion of identical or closely comparable goods originating in the United States or third countries is substantially more expensive in Japan than in the United States. The survey also furnishes convincing evidence that the share of identical or closely comparable Japanese-made goods that is higher priced in Japan than in the United States is much greater than would be expected under competitive market conditions.

A summary of key findings of the survey--also shown in the accompanying figures and tables--follows:

- o Of the 121 products surveyed, 83 products, or 69 percent, were priced higher in Japan than in the United States. (These and all other comparisons in this section are based on comparing the lowest price of a given item in Japan with the lowest price for the same item in the United States.)
- o The simple average of the ratios of the Japanese to the U.S. price for all 121 products is 1.39--that is, prices on an unweighted basis were 39 percent higher on average in Japan than in the United States.
- o Of the 35 products that originated in the United States, 31 (89 percent) were priced higher in Japan. On average, these 35 products were 71 percent more expensive in Japan.

o Of the 24 products produced in third countries, all but one (96 percent) were more expensive in Japan. Prices of third-country goods averaged 72 percent higher in Japan.

o The high percentage of third-country goods that cost more in Japan and the large percentage differential between the Japanese and U.S. prices for these goods provide solid evidence that substantially higher prices in Japan than in the United States are not peculiar to U.S. exports but are common to exports to Japan from other countries as well.

o Of the 48 products originating in Japan, 19 (40 percent) were more expensive in Japan. But, overall, prices of these 48 items averaged 1 percent less in Japan.

o Higher prices for Japanese-made goods in the United States than in Japan is what one would expect to find under normal (competitive) market conditions. The fact that as many as 40 percent of goods originating in Japan cost more in Japan

suggests that (a) the Japanese are practicing price discrimination on a fairly large scale, charging lower prices abroad and/or (b) Japanese structural impediments have a greater impact on prices of Japanese-made goods sold at home than on prices of exports of such goods.

o Fourteen of the goods surveyed were made either (a) in both Japan and the United States or (b) in either Japan or the United States and a third country. Of these goods,

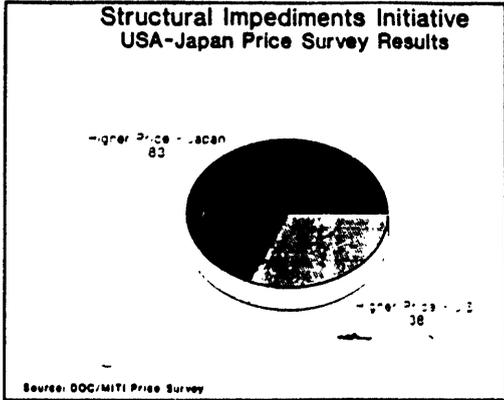


Figure 1

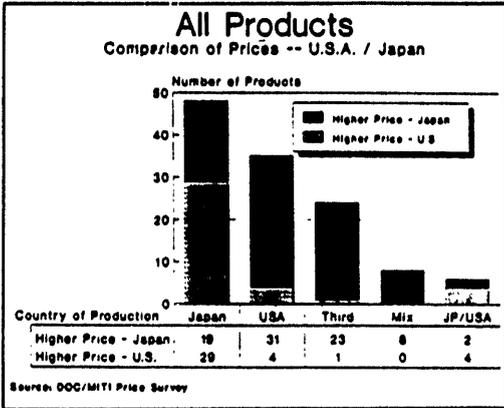


Figure 2

ten (71 percent) were priced higher in Japan than the United States.

For five of the six product groups, prices were predominantly higher in Japan than in the United States. The lone exception was electronic goods, where only 13 of 34 goods (38 percent) were more expensive in Japan. The low proportion of electronic goods priced higher in Japan seems strongly influenced by the fact that 26 of the 34 items surveyed were made in Japan. Eighteen of the 26 Japanese-made goods cost more in the United States.

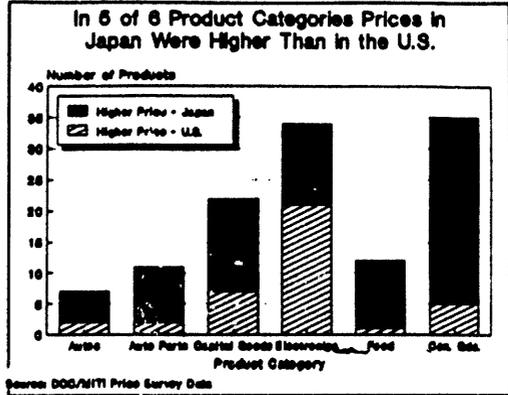


Figure 3

(As noted, Japanese/U.S. price ratios are likely to be considerably lower for goods produced in Japan than for goods produced abroad.) For the other five groups, the share of goods costing more in Japan ranged from 68 percent for capital goods to 96 percent for food. In each of these five groups, the goods made abroad greatly outnumbered goods made in Japan. (Figures 6-11, following page 7, provide details by product groups.)

For all six groups, prices were higher on average in Japan than in the United States. The margin by which prices in Japan exceeded those in the United States ranged from 2 percent for electronic goods to 97 percent for auto parts. (Although the average price for electronic goods was higher in Japan, the number of electronic goods that were more expensive in Japan was fewer than the number of such goods that cost more in the United States.)

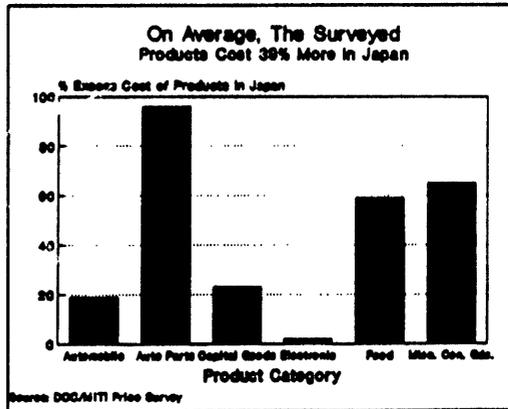


Figure 4

- o Within each of the six product groups, the average ratio of the price in Japan to the price in the United States was higher—generally by a large margin—for goods made in the United States or third countries than for goods made in Japan. (Table 1.)

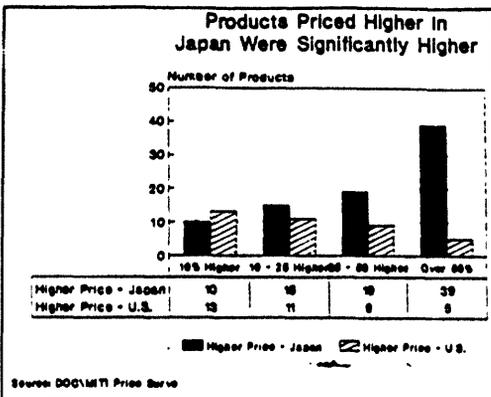


Figure 5

- o Price differentials were generally far greater in cases where prices in Japan exceeded those in the United States than in cases where prices in the United States were above those in Japan.
- o For the 83 products where prices were higher in Japan, the differential was at least 10 percent in 73 instances (88 percent), at least 25 percent in 58 instances (70 percent), and over 50 percent in 39 instances (47 percent).

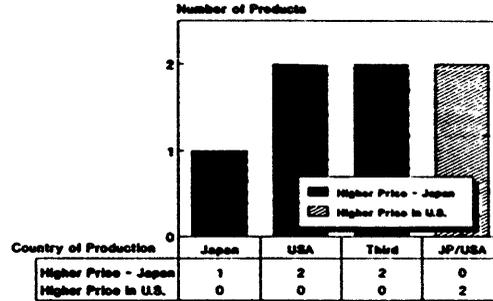
Table 1.—Unweighted Average Japanese/U.S. Price Ratio by Product Group and Country of Origin

Product Group	Country of Origin	
	Japan	U.S. or Third Country
Automobiles	1.20	1.33
Automobile parts	1.35	3.85
Capital Goods	1.03	1.42
Electronic Goods	.93	1.45
Food	.45	1.72
Miscellaneous Consumer Goods	1.01	1.78

- o For the 38 products whose prices were higher in the United States, the differential was at least 10 percent in 25 cases (66 percent), at least 25 percent in 14 cases (37 percent) and over 50 percent in five cases (13 percent).

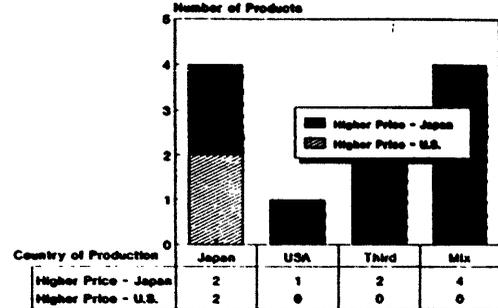
Figures 6-8

**Automotive**  
Comparison of Prices -- U.S.A. / Japan



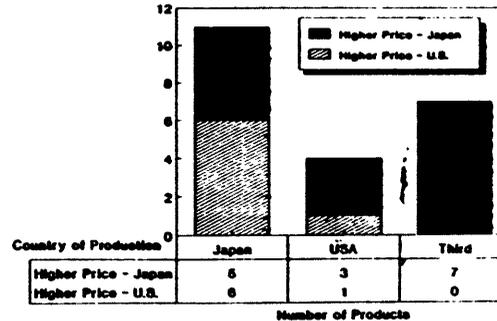
Source: DOC/MTI Price Survey

**Automotive Parts**  
Comparison of Prices -- U.S.A. / Japan



Source: DOC/MTI Price Survey

**Capital Goods**  
Comparison of Prices -- U.S.A. / Japan



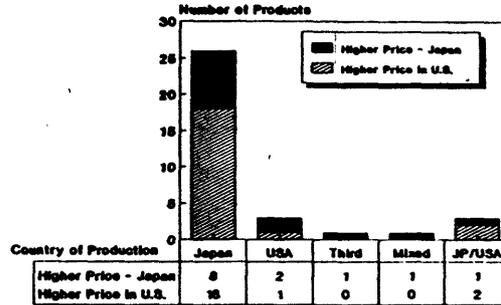
Source: DOC/MTI Price Survey

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Figures 9-11

### Electronic Products

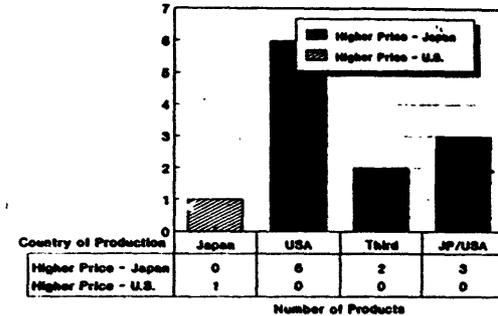
Comparison of Prices -- U.S.A. / Japan



Source: DOC/MTI Price Survey

### Food

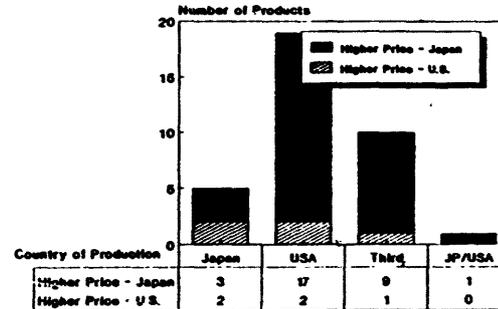
Comparison of Prices -- U.S.A. / Japan



Source: DOC/MTI Price Survey

### Miscellaneous Consumer Goods

Comparison of Prices -- U.S.A. / Japan



Source: DOC/MTI Price Survey

### Weighted Results

The survey results as presented above clearly suggest a pattern of higher prices in Japan than in the United States for goods sold in both countries. However, these results cannot validly be used to generalize about aggregate price differences since all 121 products, at least implicitly, were given equal weight. In aggregating the results, no attempt was made to assess the relative importance of the component products according to any particular standard.

In this section, we attempt to provide an additional dimension by computing several weighted averages for the Japanese/U.S. price ratios. Specifically, we calculate six indexes of the overall Japanese/U.S. price ratio, aggregating various product-group price ratios according to the weight of those groups in U.S. and Japanese foreign trade and in the domestic consumption of the two countries.

Four of these weighted averages or indexes are trade-weighted. The 121 survey products are divided into 34 product groups corresponding to 3-digit SITC product groups. The Japanese/U.S. price ratios for each of the 34 individual product groups is calculated by taking a simple average of the component ratios in each group. These 34 simple averages are then aggregated into four separate weighted averages by weighting each of the product groups by its share in (a) total U.S. exports, (b) total U.S. imports, (c) total Japanese exports, and (d) total Japanese imports. Trade figures for 1987 were used.

The other two indexes are computed by applying weights from the U.S. and Japanese consumer price indexes (CPIs). Where the U.S. CPI is used, the 99 consumer goods priced in the survey—capital goods are necessarily excluded from CPI weighted indexes—are broken up into 21 product groups corresponding to U.S. CPI categories. As with the trade-weighted indexes, Japan/U.S. price ratios for individual product groups are computed by taking simple averages of the component ratios of each group. The overall average is then computed by weighting the price ratio of each product group by the group's relative weight in the CPI. The same procedure is used in calculating the index weighted by the Japanese CPI. However, a different set and smaller number of product groups is used, with the 99 Japan/U.S. consumer goods price ratios being divided into 16 categories.

There are admittedly debatable aspects to the weighting procedures just described. Most important, there is no guarantee that the products within the subgroups to which the weights were applied are valid samples of the those subgroups. The products within a group thus may not constitute a valid proxy for that group. Furthermore, the use of simple averages to represent the Japanese/U.S. price ratio for individual product groups may diminish the accuracy of individual group ratios.<sup>2</sup> Another problem is that the subgroups in which the 121 products were placed account for only a relatively small share of total exports, imports, or

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<sup>2</sup> The accuracy of product-group Japanese/U.S. price ratios is threatened not only because these ratios are unweighted averages but because the components from which they are calculated are an indiscriminate mix of Japanese/U.S. price ratios for Japanese- and foreign-made goods. As noted, these ratios are likely to be much lower for goods produced in Japan than goods produced abroad.

Table 2.-- Summary of Price Indexes Constructed From Data Collected During the SII Price Survey Project

DESCRIPTION	NUMBER OF	NUMBER OF	AVE. PERCENT	SHARE OF
	PRODUCTS IN SAMPLE	GROUPS IN SAMPLE	EXCESS OF JAPAN'S PRICES VS. U.S. PRICES	TOTAL IN ADJUSTED INDEX 1/
Simple Average of the Japan Price Excess for All Products	121	N.A.	39%	N.A.
Average of the SITC Group Japan Price Excess - Weighted by U.S. Imports 2/	121	34	32%	30%
Average of the SITC Group Japan Price Excess - Weighted by U.S. Exports	121	34	39%	21%
Average of the SITC Group Japan Price Excess - Weighted by Japan's Imports	121	34	51%	13%
Average of the SITC Group Japan Price Excess - Weighted by Japan's Exports	121	34	20%	43%
Simple Average of the Japan Price Excess for All Consumer Goods	99	N.A.	44%	N.A.
Average of the U.S. CPI Group Japan Price Excess - Weighted by Adjusted U.S. CPI Weights 3/	99	21	60%	24%
Average of the Japanese CPI Group Japan Price Excess - Weighted by Adjusted Japanese CPI Weights 4/	99	16	62%	42%

Average of the Average..... 43.47%

1/ The "SHARE OF TOTAL" in the case of trade weights refers to the percent of total trade represented by the 3-digit SITC product groups that were found to contain SII products. In the case of CPI weights, the "SHARE OF TOTAL" refers to the percent of all products that constitute the CPI index that are represented in CPI product groups containing SII samples.

2/ Three-digit SITC product groups. Revision 2.

3/ U.S. CPI product groups and weights are described in U.S. Department of Labor Bulletin 2261, "Relative Importance of Components in the Consumer Price Index", 1965.

4/ Japan's CPI product groups and weights are described in Statistics Bureau, Management and Coordination Agency, "Monthly Report on the Consumer Price Index", July 1969.

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consumption in all six cases. The maximum proportion was 43 percent, for Japanese exports. However, despite the methodological imperfections, the weighted averages we have calculated are designed to yield more meaningful results for aggregate measures of Japanese/U.S. price ratios than computations based on unweighted averages.

The results of our weighted average calculations are summarized in the accompanying table. All six weighted averages show that, in the aggregate, prices in Japan exceed those in the United States by a substantial margin.

When weighted by U.S. imports, the prices of the 121 products are 32 percent higher in Japan than in the United States. Application of U.S. export weights raises the difference to 39 percent (the same percentage by which prices in Japan exceed those in the United States when a simple average of the 121 price ratios is taken).

When Japanese export weights are used, the margin of Japanese over U.S. prices is only 20 percent. The excess is considerably higher--51 percent--when Japanese import weights are applied.

The highest differentials occurred when CPI weights were used. Based on U.S. CPI weights, prices of the 99 consumer goods products were 60 percent higher in Japan than the United States. The margin was slightly higher--62 percent--when Japanese CPI weights were applied. Both CPI-weighted average differentials are substantially higher than the differential of 44 percent obtained from computing a simple average of Japanese/U.S. price ratios for the 99 consumer items.

#### ITA-MITI Survey Consistent With Other Studies

The ITA-MITI price survey was designed and carried out in a compressed time period, with all phases of the operation based on ongoing and often difficult negotiations between the United States and Japan. Consequently, neither the product selection process nor the actual gathering of the price data could be implemented in a fully systematic or comprehensive manner. The survey thus does not claim--nor was it ever intended--to meet a rigorous standard of statistical validity.

Nevertheless, the survey results seem clearly plausible, particularly in light of their consistency with the findings of several other similar studies--including some conducted by the Japanese--a few of which are summarized below.

Perhaps the most comprehensive recent examination of comparative living costs was conducted by Japan's Economic Planning Agency (EPA). The EPA study, entitled "Commodity Price Report of 1989" and released in September 1989, surveys prices of over 400 items in Tokyo, New York, and Hamburg in November 1988. The survey found that at the 1988 average exchange rate of 128 yen per U.S. dollar, the cost of living in Tokyo was nearly 39 percent higher than in New York. With respect to some of the key components, prices of foodstuffs and of clothing and footwear were 44.9 and 49.3 percent higher on average, respectively, in Tokyo than New York. A more wide-ranging study of living costs in 52 of the world's major cities by the Union Bank of Switzerland (UBS) in the spring of 1988 also

demonstrates that prices in Tokyo were higher than those in New York. The UBS study surveyed 111 items that are found in the market basket of a typical European family of three. The results showed that these goods cost 96 percent more in Tokyo than New York. Regarding major sub-categories, UBS found that prices in Tokyo were higher than those in New York by 161 percent for foodstuffs; 87.5 percent for moderately priced women's clothing; 81 percent for moderately priced men's clothing; 148 percent for household appliances; and 50 percent for comparable automobiles. The results of the UBS survey were published in the 1988 edition of the UBS publication, Prices and Earnings Around the Globe. The study was conducted in the spring of 1988, when the market exchange rate was 126.6 yen per dollar.

An ongoing study by the United Nations that tracks living costs of UN executives in the world's major cities also concludes that it is more expensive to live in Tokyo than New York. Based on a survey of the prices of about 200 goods and services that are representative of items in the market basket of international personnel, the UN reports (in the October 1989 issue of the U.N. Monthly Bulletin of Statistics) that in June of 1989, when the exchange rate was 140 yen per U.S. dollar, living costs were 34 percent more in Tokyo than in New York (excluding costs for housing).

Unpublished data of the U.S. Department of Labor, comparing real levels of gross domestic product (GDP) in major industrialized countries, indicate that the level of prices on items that compose GDP in Japan was 81.5 percent higher than the comparable GDP price level in the United States. These comparisons were based on the 1988 average market exchange rate of 126.2 yen per U.S. dollar.

#### Conclusions

While the DOC-MITI survey was neither as rigorous nor as comprehensive as those conducted, for example, by the BLS, the results were nevertheless plausible and have significant implications:

- o There seems little doubt that prices are typically higher in Japan than in the United States, given that (a) 83 of the 121 products were higher priced in Japan than in the United States, (b) Japanese prices exceeded U.S. prices by large percentages on average, on both an unweighted and weighted basis, and (c) the results of the ITA-MITI survey are consistent with those of many other surveys,
- o With 31 of 35 U.S.-made products and 23 of 24 third-country-made products more expensive in Japan, the evidence is clear that exporters to Japan face imposing impediments and barriers.
- o The fact that as many as 40 percent of the Japanese-made products are more costly in Japan suggests that the Japanese are either engaging in price discrimination on a fairly broad scale and/or that goods originating in Japan are also affected by Japanese structural impediments.

Except to a limited extent for the capital goods covered, the survey does not explain why prices are generally higher in Japan. There are several possible reasons, however, including:

- o **Complex and redundant distribution systems that add to costs;**
- o **Lack of competitive markets, allowing firms to set prices and impose limitations on the distribution of goods, especially imports; and**
- o **Inhibitions and biases against imports reflecting close relationships among Japanese companies in keiretsu.**

Even where they retain the ability to set the prices for their goods in Japanese markets, U.S. and other foreign firms--because of restrictions on the quantities they are permitted to sell--are likely to raise prices in order to maximize profits on the few sales they can make.

Prepared by Martin J. Kohn, with contributions from Al-Brueckmann, Doug Cleveland, Victoria Hater, John Jelacic, Pat Kirwan, Jon Menes, Alan Unsworth, and ~~Ter~~ <sup>Ter</sup>ta Woods. Trade Information and Analysis also wishes to acknowledge the active participation of the staffs of US&FCS, Import Administration, and the Office of Japan and several other offices in IEP in the actual conduct of the survey, and of Marge Donnelly of Science and Electronics' in the capital goods study and report.

December 1989



**UNITED STATES DEPARTMENT OF COMMERCE**  
**International Trade Administration**  
Washington, D.C. 20230

**STAFF PAPER**

**THE JOINT DOC/MITI PRICE SURVEY:  
A CASE STUDY OF CAPITAL GOODS PRODUCTS**

Prepared by:  
Barbara N. McLennan  
Trade Information  
and Analysis

DECEMBER 1989

This report is an analytic document and should not be  
construed as a statement of Department of Commerce policy



THE JOINT DOC/MITI PRICE SURVEY:  
CAPITAL GOODS: A CASE STUDY

Executive Summary

The Department of Commerce and the Japanese Ministry of International Trade and Industry (MITI) conducted interviews with sales representatives and distributors of capital goods to determine the prices of various capital goods and how those prices were set. The price survey and interviews took place as part of the ongoing Structural Impediments Initiative (SII).

The prices of capital goods in Japan were significantly higher than in the U.S. for a majority of the products surveyed. The price level for these products was higher than can be accounted for even with the addition of local fees and transportation costs.

Two explanations for this price difference were put forth by the respondents to the price survey:

- o Japanese markets are more oligopolistic than U.S. markets, and established Japanese firms can exercise market power, restricting entry of new competitors.
- o The Japanese distribution system is more complex and layered than the U.S. distribution system. In fact, products imported into Japan face two more distribution layers than products manufactured in Japan.

The Joint DOC/MITI Price Survey:  
Capital Goods: A Case Study

The Negotiations

One of the unique features of the price survey was the inclusion of a number of capital goods, that is, products utilized by business as part of the production process, or by professionals in their work. Very little prior information exists as to pricing practices, price levels, or price comparisons between the two countries with respect to such products. The inclusion of these goods was, in itself, the product of a difficult negotiation process. The proposal that capital goods be priced in the survey was at the initiative and insistence of the U.S. government.<sup>1</sup>

After negotiations, by October 18, the list of accepted capital goods included laser printers and floppy disk drives (which it was agreed would be priced by the electronics pricing group), carpet tiles (to be priced by the consumer goods pricing team), and oscilloscopes. At the same time, liquid chromatographs (DOC proposal) and spectrum analyzers (MITI proposal) were added. Pricing of these products took place on Wednesday afternoon, October 18, and all day Thursday, October 19. Two additional products, dental casting machines and dental porcelain furnaces, were added on Friday, October 20, after specific negotiation between the U.S. capital goods team leader and representatives of the Japanese Ministry of Health and Welfare (MHW).<sup>2</sup>

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<sup>1</sup>Even after arrival in Japan of the U.S. pricing team on October 16, 1989, the Japanese government resisted the inclusion of these products. On the evening of October 17, 1989, the U.S. presented MITI officials with a proposed list of products. MITI officials resisted, stating their view that pricing of capital goods presented special difficulties, possibly requiring the participation of professionals familiar with the particular products and raising issues relating to corporate confidentiality. They requested clarification on how the U.S. list of capital goods was selected, and stated their preference to restrict the price survey to consumer goods. They indicated their desire that the study be conducted in accordance with principles of comparability, objectivity and openness; i.e., that the results, if tested in similar circumstances, could be duplicated. The U.S. responded that the goods proposed were a reasonable list because they were sold in both markets, the goods were chosen based on the recommendations of industry experts at the Department of Commerce, and capital goods are important to the U.S. trade balance. MITI then responded specifically to each proposed product. They accepted several, objected to a few based on the need for the participation of other ministries, objected to others based on their belief that it would be impossible to find prices for them, and indicated that several were still under consideration.

<sup>2</sup>MHW took the position that since medical and dental products were within its area of expertise, it wished to be consulted. MHW sent a representative to the pricing team on the dental products who signed off on the price sheets in Tokyo and Osaka. No MHW representative participated in the surveys of these products in the U.S.

### The Capital Goods Priced

The capital goods finally agreed upon by both governments included scientific instruments and dental products. The scientific instruments included the following:

- o Digital storage oscilloscopes: oscilloscopes are instruments, widely used in research and industry, which make electric signals and wave forms visible on a cathode ray screen. Digital storage oscilloscopes (DSOs), introduced about five years ago and employing a newer technology, are gradually eroding the market for older style analog oscilloscopes.
- o Liquid chromatographs: These are devices that analyze chemical mixtures by separating them into their constituent parts. The equipment produces a "chromatogram" on recording paper, or on a computer screen, which indicates to technicians the nature and concentration of each element. Liquid chromatographs are used, for example, to provide drug testing analyses. Liquid chromatograph systems include specialized pumps and data processing equipment.
- o Spectrophotometers: Instruments used to determine the chemical composition of matter. These devices are designed to combine the necessary optical, electronic and mechanical mechanisms needed to subject compounds to a source of radiation, and to record the resulting spectrum.
- o Dental Casting Machines: Used by dentists and dental technicians to cast molds for bridges and crowns. These devices are more commonly found in dental laboratories than in individual dentist offices. Also, they have substantial endurance; once a laboratory or dentist has one, it will not need to be replaced soon. The product, for this reason, is sold in single units.
- o Dental Furnaces: Primarily used by dental technicians for highly specialized work on bridges and crowns in dental laboratories. In the U.S., only a minority of dentists have one in their office, though every dental laboratory will have one. Also, a durable item, these products are rarely replaced and are purchased in single unit lots.

### Procedures Used to Obtain Prices

The capital goods team consisted of one designated leader for each country who, at the end of the survey, signed off on a sheet summarizing the results of interviews conducted with corporate representatives with respect to the pricing of the designated products. In addition, the U.S. group included a varying representation of individuals from the Embassy and from Washington (a maximum of five people at any one time); the MITI team generally consisted of the team leader and one other person, with the addition of the MHW representative in the survey of the two dental products in Japan.

Prices were obtained on the basis of interviews which generally followed a specific format. In Japan, independent distributors (some exclusive agents, some not exclusive),

manufacturer's sales representatives, trading company officials, and importers were interviewed. In the U.S., most persons interviewed were manufacturers' sales representatives; only two represented national distributors of dental products. However, a number of telephone interviews were conducted directly with manufacturers who sold directly to end-users, as well as to a national importer/distributor of third country products. The latter also sold directly to end-users.

Since a determination of the market price to the end-user was the objective of the price survey, sales representatives and distributors interviewed were asked a series of questions. They were asked about their relationship to the manufacturer; their customers (retailers, sales agents, or end-users); the precise specifications of the products being priced; their list prices to the end-user; their average, maximum and minimum discounts, and the proportion of their customers who received discounts. The representatives and distributors were also asked to describe their warranty and credit policies.

The products priced in both countries were identical in terms of technical specifications and manufacturer. Responses to the price survey team were generally courteous and informative.

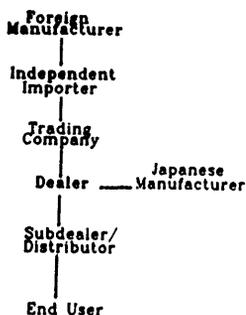
In Japan, interviews were quite formal and thorough, often taking over an hour. Most of the interviews in the U.S. were conducted, as in Japan, by visiting sales persons employed either by the manufacturers or national distributors. Distributors and sellers of capital goods in the U.S. did not generally have as much time to allot to a government survey on short notice as in Japan. The U.S. interviewees were, for the most part, sales representatives who either call on prospective customers or attend trade shows.

#### The Firms Surveyed: A Comparison of U.S. and Japanese Distribution Systems for Capital Goods

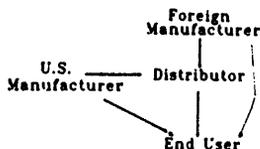
Business functions performed by the various sales levels were quite different in Japan, compared to the U.S. The Japanese distribution structure for the products surveyed was much more complex and varied than its U.S. counterpart (see flow chart on next page). The majority of the firms interviewed in Japan described themselves as exclusive agents or distributors. These firms were independent of the manufacturers in terms of corporate ownership, but generally they maintained no inventory. The manufacturers made the sales (i.e., handled promotional activities and took orders), manufactured the products to order, but actual delivery (and presumably, some paper work) was handled by these distributors. Sometimes such agents or distributors sold to sub-dealers. All of the levels in the distribution chain were described as profitable. List prices always were set by manufacturers who printed the brochures and price lists. Final market prices, however, were negotiated downward, via discounts, between final distributor and end-users. For products imported into Japan, the distribution chain was even longer. A third-country manufacturer's products were imported by an independent exclusive importer; the products were then handled by an exclusive trading company related to the importer who, in turn, sold to sub-dealers and other independent distributors. The prices of imported products into Japan were set by Japanese distributors, local sales representatives of the import firms, the Japanese trading companies or importers handling the imported products.

Figure 1  
Flow Chart of U.S. and Japanese Capital Goods Distribution Chain

**Japanese Distribution System  
of Capital Goods**



**U.S. Distribution System  
of Capital Goods**



The U.S. market was much less complex than the market in Japan. In the U.S., sales were made either directly from the manufacturer to the end-user, or from a national distributor one level away. There were no other links in the distribution chain for these product groups.

Price Comparison

In all, 22 capital goods products were priced. Of these, 15 were priced higher in Japan, 68 percent of the total. Of the fifteen, five were made in Japan, seven were made in Europe, and three were made in the U.S. Of the seven products priced lower in Japan, six were made in Japan, one in the U.S. Table I summarizes the prices of capital goods as found in the SII pricing survey.

It can be seen from the table that, of the prices that were higher in Japan, the prices of imported products were considerably higher than the prices of Japanese manufactured goods. The five Japanese-made products priced higher in Japan were, on average, 11.44 percent higher than in the U.S.; the European-made products were priced an average 49.37 percent higher in Japan than the U.S.; U.S.-made products sold in Japan averaged 42 percent higher than their corresponding prices in the U.S. This is depicted in Figure 2. Each product priced higher in Japan is depicted as a three dimensional box. The height of each box is proportional to the amount by which the price of the product in Japan exceeds its price in the U.S. Thus, the tallest rectangle for the U.S. depicts dental casting machines, which (see Table 1) were 72.9 percent more expensive in Japan than in the USA. It can be

Table 1

## Prices of Capital Goods Re SII Pricing Survey

-----  
Prices Higher in Japan By Country of Origin:  
-----

Product	Price/ Japan	Price/ USA	% Japanese Prices Higher than USA
<b>Japan:</b>			
Spectrophotometer	8504	7013	21.26%
Spectrophotometer	13556	12062	12.39%
Spectrophotometer	15282	13651	11.95%
Spectrophotometer	5704	5344	6.74%
Chromatograph	10446	9962	4.86%
Average:			11.44%
<b>Europe:</b>			
Oscilloscope	13681	7500	82.41%
Oscilloscope	13882	7825	77.41%
Oscilloscope	12678	7500	69.04%
Oscilloscope	12678	10270	23.45%
Chromatograph	12294	8381	46.69%
Chromatograph	13873	9828	41.16%
Chromatograph	7254	6880	5.44%
Average:			49.37%
<b>USA:</b>			
Casting Machine	744.7	431	72.78%
Porcelain Furnace	2391	1878	27.32%
Oscilloscope	10423	8235	26.57%
Average:			42.22%
Average all products:			36.25%

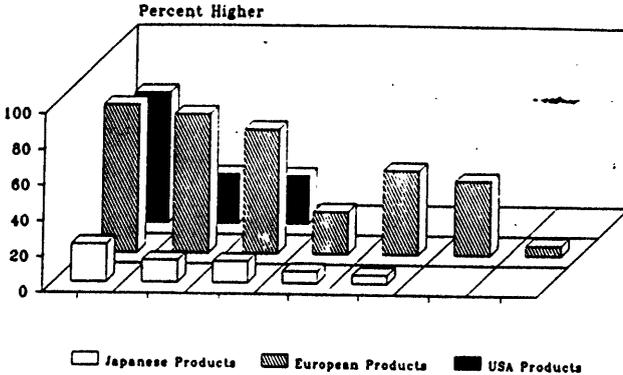
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Products priced Lower in Japan:  
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<b>USA:</b>			
Chromatograph	39806	42875	-7.16%
<b>Japan:</b>			
Oscilloscope	7028	7680	-8.49%
Oscilloscope	3507	3830	-8.43%
Chromatograph	3019	3179	-5.03%
Oscilloscope	5599	5745	-2.54%
Oscilloscope	4789	4860	-1.46%
Chromatograph	3636	3647	-0.30%
Average:			-4.38%
Average all products:			-4.77%

seen from Figure 2 that, uniformly across all of these products, imported goods, whether third country or U.S.-made, were higher in price than Japanese-made products by more than what can be accounted for by transportation and additional distribution costs.

Figure 2

## Capital Goods That Priced Higher in Japan



Source: DOC/MITI Price Survey

This finding is reinforced when it is noted (see Table 1) that of the seven products priced lower in Japan than in the U.S., six were Japanese made (one was of U.S. manufacture); no third country product priced in the SII survey was priced lower in Japan than in the U.S.

### Discount Policies, Payment Terms, and Warranty Policies

The manner by which final prices to the end-user were negotiated differed greatly between the two countries. In Japan, the relationships between seller and customer were longstanding and based on personal trust. It is quite normal for Japanese distributors to grant discounts to customers, but often the size of the discount depends on the relationship with the customer. Different distributors stated this fact in different ways, but essentially, knowledge of the credit-worthiness of a customer appeared to be the main variable in determining whether, and to what extent, discounts on price would be granted. Some firms permitted volume discounts or small discounts for early payment.

In the U.S., sales representatives granted discounts, but within narrower ranges than their Japanese counterparts. Most of the U.S. companies surveyed had contracts with the U.S. government which directly affected the range of prices to other customers—generally companies tried to keep the same price level to all customers, whether government or commercial.

While the overall price level for most of these products was higher in Japan (15 out of 22), Japanese products were discounted from their list as often as in the U.S. (12 of the 22 products were discounted in each country). The Japanese list price, however, was generally substantially higher than in the United States (14 out of 22 of the products had higher list prices in Japan; of these, ten had list prices that were more than 25 percent higher in Japan than in the U.S.).

In Japan payment terms were fairly uniform and most payments were made by promissory note or in cash within 90 to 120 days of purchase. No company interviewed in Japan arranged credit or leasing terms for its customers.

In the U.S. payment terms were generally net/30 (full payment in cash within 30 days of purchase). However, several distributors stated that they would allow or arrange credit terms, through related finance companies, independent lenders or leasing companies.

Warranty policies also differed between the two countries. In Japan, capital goods warranties were uniformly with one year free servicing. Sometimes installation and training were included; in other cases these services involved additional charges. Warranty costs normally were borne by the manufacturer or trading company (on imported products). On occasion, the trading company shared the costs of warranties with the foreign manufacturer. In the U.S., warranties were more variable and finely tuned to the durability of the product. Some manufacturers guaranteed certain parts for only thirty days, while the main bodies of certain products were guaranteed for three years. One manufacturer provided a 90-day labor warranty on all new equipment. In the U.S., warranty costs were normally borne by the manufacturers.

Structure of the Markets: Evidence from the Interviews as to How Prices Were Set and Why They Differ in the Two Countries

The primary purchasers for the capital goods priced were businesses; professional offices; and, governmental, commercial, and university research laboratories.

The primary users of the products are highly-trained engineers, scientists, and technicians. For these end-users, according to many of the people interviewed in both countries, the quality and functionality of the product were more significant in making the selection of which product to buy than price. It was pointed out that scientists and technical workers learn their craft by using the technical equipment. They became familiar with operations and characteristics of machinery early in their training, often during their graduate education. In the process, they became accustomed to particular brands of equipment,

and when satisfied they are very cautious about changing brands.<sup>3</sup> As a consequence, in both the U.S. and Japan the principal users are essentially very cautious, careful, well-trained staff members who place great value on the reputation of the brand names.

An interesting aspect of this finding, noted by several manufacturers' sales representatives interviewed in Japan, was that U.S.-made products had substantial name recognition and were highly regarded, in terms of quality, in the Japanese market. The dental casting machine, which was U.S.-made and was widely known by specialists in Japan, was described as the best-selling piece of equipment of its kind in Japan, having overcome a powerful Japanese competitor. Other U.S.-made products (oscilloscopes, liquid chromatographs, and spectrophotometers) also were described as being known for their high quality in the Japanese market; this was used to explain why these products were sold at prices considerably higher than their Japanese counterparts in the Japanese market.

On the other hand, it was also noted by interviewees in Japan, that the Japanese market structure for scientific instruments was far less competitive than in the United States. Several persons interviewed in Japan described the scientific instrument market as dominated generally by a single Japanese manufacturing firm who was a price leader and had the power to affect pricing throughout the Japanese market through the firm's general discount policy. This firm generally had two to three competitors—who, as a rule attempted to keep their prices very close to the price leader. Some of the leading competitors to the price leader were non-Japanese (i.e., U.S. or third country) manufacturing firms in conjunction with joint venture partners or exclusive importers and trading companies.

The majority of persons interviewed in Japan stated unequivocally that prices were set in Japan by the manufacturers for Japanese-made goods and importers and trading companies for imported goods. The margins of distributors and sub-dealers were set through negotiations with customers, only within the narrow range permitted by the list price level established by the price leader. In Japan, all the players (i.e., manufacturers, importers and distributors) knew each other very well and seemed to follow very similar methods of establishing final prices to their customers.

In the U.S., pricing appeared to be more market-determined. The people interviewed were all aware of being involved in close competition and were concerned about retaining market share. Manufacturers' sales representatives often stated their concern that their competitors would find out their prices, and also indicated great interest in their competitors' practices. In these product groups, the markets consisted of numerous entrants and no clear price leader.

In 1987, the U.S. market for oscilloscopes was supplied by five U.S. companies<sup>4</sup> along with entrants from Japan as well as several European countries. For liquid chromatographs,

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<sup>3</sup>This is one reason that scientific instrument firms have major discount programs for universities.

there were nineteen U.S., three Japanese, and two European manufacturers<sup>4</sup> and for spectrophotometers, there were 18 U.S.,<sup>4</sup> 2 Japanese, and 3 European producers. In dental products, there were fewer manufacturers than in the scientific instruments areas (three U.S. manufacturers of porcelain dental furnaces, six U.S. manufacturers of dental casting machines).<sup>5</sup> However, according to the dental distributors interviewed in the U.S., there were two national distributors of dental instruments, numerous catalog and mail order supply houses, in addition to direct sales from manufacturers. Discounts were available on virtually all sales, depending on volumes sold or other characteristics about which customers could bargain, i.e., a dentist furnishing a complete office, could bargain for volume discounts on partial orders.

In the U.S. market, competition was quite intense for all of the capital goods surveyed-- indeed, one of the national distributors interviewed stated that his company had the lowest price in the market, and if we (the survey team) found otherwise, he wanted to know why. In general, U.S. respondents to the price survey, though much more rushed and difficult to reach than their Japanese counterparts, were far more interested in being informed of the results of the price survey for U.S. products. Apparently they regarded it as an economical way to keep abreast of the pricing practices of their own competitors.

Conclusion: Why Capital Goods Cost More in Japan than in the U.S.

The prices of capital goods in Japan were significantly higher than in the U.S. for a substantial majority of the products surveyed. The price level for these products in Japan was higher than can logically be accounted for by local fees and transportation costs. In economic terms, the "law of one price" does not seem to be holding, and barriers to entry for foreign capital goods products into the Japanese market are substantial.

The price differentials may be explained by the following factors, which were evident from the interviews with capital goods sellers in the U.S. and Japan:

- o prices in Japan are higher because markets in Japan are far more concentrated than in the U.S.:

In Japan, a single manufacturer can set the price and act as price leader. All other entrants, including importers and trading companies, are price takers. This kind of market will naturally result in higher profit margins, than where prices are openly bargained in a free market with free participation by many entrants.

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<sup>4</sup>Current Industrial Reports, 1987.

<sup>5</sup>Medical Device Register.

- o prices in Japan are higher than in the U.S. because the Japanese distribution system is far more complex:

In Japan, there are many levels of distribution between the manufacturer and the end-user; each of these levels makes a profit. This raises the final price to the customer at the end of the distribution chain. For imported products, there are more levels of distribution than for those made in Japan; imported goods must be handled by importers and general trading companies in addition to the normal distributors and/or manufacturer's sales representatives. Imported products into Japan are thus much higher priced than they are in the U.S. In the U.S., in comparison, purchases of domestic and imported products are made either directly from the manufacturer or from distributors engaged in direct competition with other distributors and the manufacturers.

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#### PREPARED STATEMENT OF STEPHEN M. LOVETT

##### BARRIERS TO THE JAPANESE WOOD PRODUCTS MARKET AND THE STRUCTURAL IMPEDIMENTS INITIATIVE

My name is Steve Lovett. I am Vice President of the National Forest Products Association and a member of the Steering Committee of the Alliance for Wood Products Exports. Thank you for permitting me to appear today to discuss the importance of the Structural Impediments Initiative to the U.S. wood products industry. I also would like to discuss briefly the relationship of the SII with the Super 301 process, in which market access to Japan's wood products market has been designated a trade liberalization priority.

The U.S. wood products industry is internationally competitive in both price and quality. On a unit cost basis, our costs average much less than Japanese costs. In fact, we are generally regarded as the most efficient producers of wood products in the world.

The oft-heard Japanese refrain that U.S. industry does not try hard enough to penetrate the Japanese market is not true for the wood products industry. For more than twenty years, this industry has spent hundreds of man-years and millions of dollars seeking to further penetrate the Japanese market. In short, we know the Japanese market. We also know that our sales to Japan would increase dramatically were it not for Japan's tariffs and non-tariff barriers. In fact, elimination or significant reduction of these barriers could increase exports of processed U.S. wood products by from \$1 to more than \$2 billion annually.

The Alliance for Wood Products Exports was formed to assist the U.S. industry reach its potential in the Japanese market. We have identified an inter-related web of tariff and non-tariff barriers impeding importation and use of wood products. In May of 1989, the Administration identified these barriers to Japan's forest products market as a trade liberalization priority under the Super 301 provisions of the 1988 Trade and Competitiveness Act. Negotiations to eliminate these barriers are underway, and the industry is providing whatever support is possible.

The barriers confronting the U.S. wood products industry are varied. Some of them are "structural" in nature, while others are not. The important thing to keep in mind is that this system of barriers works together, and that a comprehensive resolution is necessary to obtain real market access progress.

##### NON-STRUCTURAL BARRIERS

*Tariffs and tariff escalation* is a key problem. Japan's practice of applying no tariffs on raw materials and escalating tariffs on value-added products results in effective rates of protection on many wood products of two or three times the nominal rate. For example, a recent Department of Commerce Study showed that Japan's 10% tariff on softwood plywood provides an effective rate of protection of over 26%. This deliberate system of tariff escalation skews Japan's imports toward raw materials and away from value-added products. In effect, the system robs the U.S. industry of its competitive advantage. For example, less than 30% of Japan's imports of U.S. wood products by value in 1988 were processed. By comparison, 92% of Europe's imports and 88% of the imports in the rest of North America are processed.

Unnecessary restrictions contained in Japan's *wood standards and building code* also severely restrict importation and use of wood. For example, Japan prohibits the construction of garden apartments and commercial buildings out of wood. The Ministry of Construction treats Oriented Strand Board, a high-technology wood product that has gained increasing use in U.S. housing, as particleboard, effectively prohibiting its use for that purpose. Complicated certification procedures literally mean that U.S. wood products sit on the docks for weeks or months awaiting inspection and approval. These are only a few examples of the standards and code barriers which impede both importation and use of wood products.

Japan also misclassifies a number of laminated wood products in its tariff schedule, artificially increasing the tariff from 3.9% to 15-20%. This has a big bottom-line effect on companies which have the ability to sell more laminated lumber in Japan. Japanese customers want these products, but this illegal misclassification limits our ability to export.

Finally, Japan provides its wood industry with numerous *subsidies*. Of particular concern to the U.S. industry are subsidies intended to offset market opening efforts and which result in increased production. For example, after the MOSS talks, Japan authorized over \$1 billion in grants and government-guaranteed loans to counteract the effects of market liberalization. This must not happen again.

#### STRUCTURAL BARRIERS

In addition to the barriers discussed above, other barriers to Japan's wood products market are structural in nature.

One such structural barrier is inefficient *land and housing* policies in Japan, which severely limit the consumption of wood products by favoring agricultural uses of land over residential uses. While the Japanese people live crowded into housing half the size, on average, that Americans enjoy, farmers grow rice between the high-rises in Tokyo. Reform in this area would not only dramatically increase importation and use of wood products, but would substantially improve Japan's standard of living.

*Anticompetitive practices* abound in Japan's wood products industry as in other industries. If Japan refused to sanction or tolerate cartels in logs, lumber and plywood (whether temporary "rationalization" cartels or otherwise), U.S. wood products producers would have a better opportunity to compete fairly in Japan.

And finally, as with many other products, Japan's *distribution system* seriously increases the cost of wood products. One study showed that the cost of shipping lumber from Seattle to the Japanese port of Kobe *was less* than the cost of sending the lumber a few short miles into Japan. Relief in this area could be very valuable. For starters, the Administration should include wood products among those products which it monitors to determine if Japan's price structure is excessive.

#### SUPER 301 AND SII MUST WORK TOGETHER

Liberalization of the Japanese market could result in enormous long-term gains for both the Japanese consumer and potential U.S. suppliers. The industry fully supports the Structural Impediments Initiative, which addresses structural barriers of clear relevance to the wood products market. We have also asked the Administration to discuss these specific wood products structural issues in the bilateral forest products negotiations.

We strongly support the Administration's efforts in SII. However, we are concerned that SII not be viewed as an alternative to the Super 301 talks. If the U.S. wood products industry is to gain real market access, progress must be made on the full range of Japanese barriers, both structural and nonstructural. For example, the tariff escalation problem must be resolved. Elimination of minor technical barriers will not result in the objective of real export gains.

As such, the Structural Impediments Initiative should not substitute for the bilateral 301 negotiations as the vehicle for addressing structural barriers for wood products. Reform of Japan's distribution system and anticompetitive activities are important long-term goals, but they will not open the Japanese wood products market until the tariff, standards, code and other "non-structural" barriers are eliminated. This is my central message to this Committee.

The Alliance for Wood Products Exports, on behalf of the U.S. wood products industry, urges Congress to support structural reform in Japan. The wood products industry will be in the vanguard of support for SII. At the same time, the Alliance strongly urges Congress to insist that real progress be made in opening the sectoral markets which have been identified as Super 301 trade priorities.

## PREPARED STATEMENT OF RICHARD T. MCCORMACK

Chairman Baucus, members of the committee, I appreciate the opportunity to participate in this briefing of the Senate Finance Committee Subcommittee on International Trade on the status of our Structural Impediments Initiative (SII) with Japan. This session is well-timed. My colleagues and I returned last weekend from Tokyo, where we held the third plenary meeting of the SII talks with our Japanese counterparts.

And as you know, President Bush met with Prime Minister Kaifu in Palm Springs on Friday and Saturday of this past weekend. The economic side of the U.S.-Japan relationship was a prominent part of the wide-ranging discussions the two heads of state held on the state of our bilateral relationship. Indeed, the President stressed to Prime Minister Kaifu that success in SII and in the other trade issues now under discussion is vital for the preservation and possible expansion of our many-faceted relationship. In particular, he noted the importance of the spring interim report. The President said as well that we must put our economic relationship on a sound footing if we are to achieve the full promise of our relationship.

To date the U.S. and Japan have held three plenary meetings on the Structural Impediments Initiative. Our most recent meeting was in Tokyo February 22 and 23. This meeting had been scheduled for mid-January. We agreed to postpone that meeting at the request of the Japanese Government because of political sensitivities related to their nationwide diet elections February 18. Our next meeting will be held April 2 and 3 here in Washington.

These plenary meetings have been attended by as many as 14 ministries and agencies of the Japanese Government. Our own team has had seven departments at the table. The meetings have provided each side an opportunity to present its views on the structural problems that inhibit the adjustment of the U.S. current account deficit and the Japanese trade surplus.

From the outset, we have considered the SII talks a two-way street. We have not hesitated to express our views about the Japanese economy, and the Japanese likewise have pointed out structural problems in the U.S. economy and made suggestions on necessary improvements. We have listened carefully to their ideas, and, indeed, some of the suggestions were reflected in the President's state of the union address. As you know, President Bush is taking policy initiatives to increase private savings, reduce the budget deficit and strengthen our educational system and competitiveness—all areas of keen interest to the Japanese, as they are to us. We need to take these steps not just for success in SII, but because they are necessary to ensure an economy that is vital, productive and competitive into the next century.

As this committee knows from our previous discussions, our SII team is looking closely at six categories of structural rigidities in the Japanese economy: We are pressing the Government of Japan to significantly increase public investment in infrastructure (airports, roads, sewage, etc.) in order to reduce Japan's savings/investment imbalance; to deregulate and remove obstacles in its distribution system; to enforce more strongly its anti-monopoly law, to ease land-use policies in order to increase the supply of land available for housing and building; to ensure that pricing mechanisms are free of structural rigidities; and to take tougher measures to eliminate exclusionary business practices. The state department has specific responsibility for the distribution system, and if the committee would like, I would be happy to go into detail in the discussion period about the impediments we are addressing in Japan's distribution system.

It is important for us to recognize that we are asking for fundamental reforms in the structure of the Japanese economy. Even if we are successful and achieve significant results, it will be some time before these are fully reflected in the bilateral trade statistics. Some areas—for example infrastructure expenditures—could bring important early benefits to U.S. firms and exports. Other changes will result in structural shifts that produce trade results more gradually. But our aim is to remove the fundamental structural barriers in both our economies, thereby ensuring a true market oriented economic relationship between our two countries, with American manufacturers and investors free to operate in Japan on the same basis as Japanese exporters and investors operate in this country. We expect that the medium term effects on our bilateral trade balance will be far more significant than the individual results of past negotiations aimed at problems in specific product sectors.

The SII talks are proceeding on a tight timetable. President Bush and former Prime Minister Uno agreed at the Paris summit in July that the U.S. and Japan would jointly issue an SII interim report in the spring with the final report due this summer. We are working toward the interim report at this time. We have been

quite specific in suggesting to the Japanese Government our ideas about the types of changes we believe would be necessary to ensure meaningful structural reform. We are looking for change now, as well as a commitment to specific change in the future. We need timetables for implementation, and we will need to consider, before this exercise is completed, what mechanisms are necessary to continue to monitor implementation of what is finally agreed.

Until February 18, the ruling party in Japan, the LDP, was preoccupied with their diet election. We recognized the political realities. As I noted, we agreed to postpone the January meeting until after the election because we recognized that a number of the issues we wished to take up had considerable domestic sensitivity, as special interests felt threatened by changes in the status quo. It was in our interest to keep \$11 issues from becoming political footballs. But at the next \$11 session the Japanese side must move rapidly to provide solutions to the SII problems we have been discussing for six months. We expect them to come to grips with \$11 in a forthright and imaginative way and work for a meaningful interim report. We have been working—and the Congress as well has been sending effective messages—to point out that politically tough choices must be made now. We are looking for a strong commitment by Prime Minister Kaifu and the LDP to undertake bold, creative actions.

We are looking for real progress at the April 2 meeting, and expect that the interim report that comes out of that session will give a clear indication of the direction that our economies will move in the 1990's—to a truly open, market driven system that provides benefits to the consumers and producers of both countries, that offers entrepreneurs of both countries the ability to compete in trade and investment in each country, and that harnesses the dynamic economies of our two countries to work together on a host of historic challenges—from encouraging the global movement toward democracy and market economics to preserving the environment and promoting global prosperity and development. I firmly believe that the U.S. and Japan can accomplish a great deal for the world, but for such a global partnership to be successful, our economic relationship must be open, equitable, and cooperative. We see success in \$11 as an absolute necessity, and will be working intensively over the next few months to bring the talks to a successful conclusion.

Attachment.

## JOINT REPORT OF THE U.S.-JAPAN WORKING GROUP ON THE STRUCTURAL IMPEDIMENTS INITIATIVE (SII)

### STRUCTURAL IMPEDIMENTS INITIATIVE

The Japan-U.S. Working Group on the Structural Impediments Initiative (SII) provides the attached Final Report on the SII talks. The Working Group believes that this report is a historic document that contains significant, extensive efforts and actions on both sides. These actions should complement the economic policy coordination efforts which have been made through multilateral fora and should contribute to a reduction in external payments imbalances. In this regard, it is to be noted that while the large external imbalances of the two countries have shown substantial reduction in recent years, the two Governments are strongly committed to make efforts for the further reduction of their respective external imbalances. The above-mentioned actions should also lead to more efficient, open and competitive markets, promote sustained economic growth and enhance the quality of life in both Japan and the United States. Both Governments are firmly determined to achieve these goals.

The SII was launched by President Bush and former Prime Minister Uno in July 1989 to identify and solve structural problems in both countries that stand as impediments to trade and to balance of payments adjustment with the goal of contributing to the reduction of payments imbalances. Five Plenary sessions of the Working Group were held between September 1989 and June 1990. An Interim Report on progress was issued on April 5, 1990.

Both the U.S. and Japanese Governments have already taken initial steps and have developed plans for further actions to ensure continuing momentum in solving the structural problems that impede balance of payments adjustment. Both Governments believe that the Final Report represents substantial progress to address structural problems.

The Working Group strongly reaffirms its continuing commitment to solve structural problems in both countries that stand as impediments to trade and balance of payments adjustment.

In order to jointly follow up the year-long SII exercise, the SII Working Group will continue the meetings under the interagency structure of the SII in a flexible, open and evolving manner which is characteristic to the SII, and agreed to meet three times in the first year and twice a year thereafter, most probably in spring and autumn and other times mutually agreed, at a level of Vice/Deputy Minister and Under Secretary/Assistant Secretary, to:

- review progress achieved regarding issues identified in the Final Report;
- discuss matters relevant to problem areas already identified in the SII and the need for actions to address them; and
- produce in spring of each year a written report respectively on the progress made by each country toward solving its structural problems thereby contributing to the reduction of external imbalances, review the reports together, and issue them with a joint press release.

After three years, the SII working Group will review the follow-up process, taking into account measures in the Final Report that extend beyond three years.

These talks have taken and will take place outside Section 301 of the U.S. Trade Act.

The working Group believes that in addition to its beneficial effects on the U.S. and Japanese economies, the SII process will benefit other countries and the global economy generally.

#### SAVING AND INVESTMENT PATTERNS

##### *I. Basic Recognition*

###### *1. Reduction in the Current Account Surplus*

As a result of appropriate policies pursued to sustain solid economic growth led by strong domestic demand, Japan's current account surplus has been reduced remarkably from 4.5 per cent of GNP in FY 1986 to an estimated 1.9 per cent in FY 1989, which is less than half the level of FY 1986. This downward trend is projected to continue in FY 1990.

Impressive growth of imports, along with increases in overseas travel expenditures by the Japanese people reflecting in part an increased emphasis on leisure, has contributed to this positive trend. U.S. exports to Japan have increased faster than U.S. exports to the rest of the world.

To make further progress on the basis of this positive trend, the Government of Japan will continue to undertake economic policies aimed at promoting sustained non-inflationary growth led by domestic demand.

The Government of Japan recognizes the need to continue to reduce its current account surplus and strongly reaffirms its commitment to work actively toward that end. While the Government recognizes the utility of making available savings for certain other parts of the world, including Eastern Europe, it further recognizes that a further reduction of Japanese current account surplus is compatible with Japan's ability to continue to export long-term capital. Thus, the Government commits itself to place a high priority on continuing a steady reduction in its current account surplus which will, together with the efforts of other major industrial countries, foster world growth and financial market stability. The Government of Japan also recognizes that a reduction of the imbalance between domestic savings and investment is important to that process. This will help further a reduction in the current account surplus.

###### *2. Recognition of the Need for and Importance of Social Overhead Capital Improvement*

The Government of Japan recognizes that there remain areas where Japan is still behind other major industrialized countries in terms of the levels of social overhead capital accumulation, though the pace of improvement has been rapid—partly as Japan was historically a slow starter in this field—with annual public investment (lg) four times as large as that of the U.S. measured against GNP.

The Government of Japan will continue to pursue its policies to increase and promote steady accumulation of social overhead capital, based on the keen recognition of the need for and importance of social overhead capital improvement.

This would, through sustained non-inflationary growth of domestic demand, facilitate further reduction in the current account surplus.

## II. Measures to be Taken

### 1. Positive Measures in the FY 1990 Budget

(1) FY 1990 budget was enacted on June 7, with the expenditures for public works which surpass the historic high level of the previous fiscal year at 7,444.7 billion yen, despite the revenue constraint caused by unsuccessful sales of NTT stocks in the previous fiscal year, and notwithstanding the vigorous expansion of the economy expected in FY 1990 which does not warrant additional stimulus.

The investment by the public sector on GNP basis (lg) would add up to 26.3 trillion yen, including the public works expenditure by local governments financed entirely by themselves (in the Local Public Finance Program) and the expenditures of the public work executing agencies financed through the FILP (Fiscal Investment and Loan Program) which rose 7 per cent, respectively, over FY 1989.

(2) Total cumulative expenditures in seven out of eight sectoral long-term plans, which are to expire at the end of FY 1990, are expected to exceed the projected target expenditures as a result of further emphasis placed on social overhead capital in the FY 1990 Budget.

### 2. Toward Further Improvement

(1) The Government of Japan intends to increase and promote steady accumulation of social overhead capital, from a medium to long term perspective, as the nation heads for an aging society toward the twenty-first century.

For that purpose:

(i) The Government of Japan has newly launched the "Basic Plan for the Public Investment," which serves as guiding principles for steady accumulation of the social overhead capital toward the twenty-first century. This plan covers a decade from FY 1991 to FY 2000, and provides a basic blueprint of the basic direction of the public investment for the decade. Firm implementation of the public investment over the medium term based on this Plan, with due regard to balanced development of the economy, is expected to provide a basis for sustainable non-inflationary growth led by strong domestic demand, and this should, along with other measures, facilitate further reduction in the current account surplus.

The annual total of public investment and of investment in each sector will be determined through yearly budgets, according to prevailing circumstances, and compatible with the basic lines of this plan.

Building on the principle "to boost domestic investment, improve social overhead capital and to reduce the shortage of investment relative to savings and to the size of the Japanese economy," the Plan includes the aggregate investment expenditure of about 430 trillion yen for the decade, up drastically from the estimated 263 trillion yen in the previous decade from FY 1981 to FY 1990.<sup>1</sup> This plan shows that the Government of Japan has taken the decisive step toward considerably increasing the public investment far above its previous pace.

This plan enunciates that the share of public investment related to "living environment and cultural functions,"<sup>2</sup> which is directly linked to the everyday life of the people, would be raised from a few points over 50% of the total in the previous decade to about 60% of the total during the period of the plan.

Through the firm implementation of the plan, the levels of social overhead capital accumulation of Japan would be broadly comparable to those of other major industrial countries at the beginning of the twenty-first century.

In addition, the aggregate expenditures of the investment by such entities as JR and NTT which used to be included in the public investment prior to their privatization, are expected to be approximately 25 trillion yen for the coming ten years.<sup>3</sup> This is the amount of expenditure that the Government of Japan fully expects to be realized.

Adding this with the 430 trillion yen shown above would bring the total figure to about 455 trillion yen.

(ii) As to the eight categories of social overhead capital whose current plans are to expire at the end of FY 1990 (i.e., March 1991), the ministries concerned will formulate larger long-term plans with the positive and specific targets as

<sup>1</sup> The aggregate investment for the first five years calculated on the basis of an average annual increase is expected to be about 182 trillion yen.

<sup>2</sup> Public investment related to "living environment and cultural functions" includes investment for; water supply, sewers, parks, green spaces, waste disposal facilities, housing, local roads, subways, and welfare as well as educational facilities.

<sup>3</sup> Estimation based on the continued current annual expenditure.

indicated in Table 1. By the end of FY 1990, yen figures shall be developed for most of the eight sectoral plans which are consistent with the ten year plan in order to improve the quality of life in Japan. It is envisaged that larger long-term plans for certain other key areas, such as roads, will also be formulated as the current plans expire on a scale similar to that for these plans.

(iii) The yearly expenditure for social overhead capital should be decided flexibly considering the prevailing economic and fiscal conditions, paying due attention to avoiding inflation and overheating of the economy as well, given the significant role that the public investment plays as a counter-cyclical measure in Japan, and compatible with the basic lines of the plan and the targets in (ii) above.

(2) In allocating the expenditure among various types of social overhead capital, utmost consideration should be given, as much as possible, to those closely linked to the improvement of the quality of life.

(3) In the implementation of public investment, including the above plans, the Government of Japan will make effective use of the legislative form of the budget that authorizes contracts incurring treasury liabilities over the succeeding fiscal years, in order to secure maximum efficiency in executing public investments within the constitutional framework of the single year budget system.

(4) The Government of Japan will make more effective use of the FILP (Fiscal Investment and Loan Program) funds to improve social overhead capital. Such effective use would include financing urban redevelopment projects through the Japan Development Bank. In allocating the FILP funds, utmost consideration should be given, as much as possible, to housing and other projects contributing to enhancement of the quality of life of the people. More effective use of the FILP funds will also include attaching major importance to allocation of the funds, for feasible projects, with a view to achieving the long-term plans of social overhead capital in such areas as housing, roads and airports.

(5) The Government of Japan will see to it that overall efficiency is increased in promoting the complex multi-jurisdictional development projects like the Kansai International Airport and the Tokyo Bay Area Development, by ameliorating systems for securing better communication and closer cooperation among the related ministries.

(6) Land Use, Deregulation, etc.

(i) The Government of Japan will give due consideration to effective utilization of publicly held lands in metropolitan areas for urban facilities, urban redevelopment, and public housing projects to ensure smooth implementation of public works. The Government of Japan will see to it that the discharged track yard site in Shiodome should be highly utilized as multi-functional urban space responding to the needs arising from internationalization, and as a regional transportation hub. Related urban infrastructure including subways and roads should be furnished as well.

(ii) The Prime Minister's Office will be central in vigorously promoting utilization of super-subterranean space (about 50 meters below surface or deeper in metropolitan areas) for social overhead capital including urban infrastructure in metropolitan areas and thus securing more effective use of land. Aide-ranging issues—legal, safety, and environmental—need to be addressed carefully in the process.

(iii) More active use of various resources in the private sector, such as financial resources, technology and know-how, is important for the improvement of social overhead capital, as seen in such cases as the Kansai International Airport and the Trans Tokyo Bay Road Project. The Government of Japan will continue to promote further deregulation and provide various incentives as needed in order to make the best use of these private sector resources in the improvement of the social overhead capital.

(iv) The Government of Japan will effectively activate the special act which aims at promoting organized development of housing sites and railways in greater metropolitan areas, thereby improving the quality of life of the residents and promoting orderly development of the region.

For example, discussions are being held on the formation of the basic plan, including the appropriate form of managing entities, for a new railway line called the "Joban New Line."

(7) The Government of Japan reconfirms the principle of non-discrimination in the Japanese construction market, and will continue to work with the U.S. Government in faithfully implementing and reviewing the provisions of the U.S.-Japan Major Projects Arrangements.

### 3. Private Consumption: Leisure Opportunity and Flexibility in Consumer Finances

(1) As to curtailing work hours, the Government of Japan launched a trial, starting this April, of 40 hour weeks for those government employees on shift work schedules, to pave a road to complete 5 day weeks for all government employees, and will encourage curtailing work hours in the private sector.

(2) As to improvement of consumer credit convenience, the interim report by the Credit Industry Committee of the Council on Credit Sales recommends that "concerning the introduction of revolving credit function to the credit cards issued by bank affiliated companies, it is appropriate to allow bank affiliated credit card companies to register under the Credit Sales Law within two years, with the existing restriction on access to bank teller machines by credit card companies removed." The Government of Japan will endeavor to implement this recommendation after consulting with the parties concerned.

(3) To quote a few examples of extended operating hours of automated teller machines, major financial institutions have since May lengthened operating hours of their machines on Saturdays, and some institutions have started to operate their machines on Sundays as well.

The Government of Japan will welcome business decisions of the financial institutions to lengthen operating hours of their teller machines when they so decide based on their own commercial considerations, while there are no restrictions on the operating hours at present.

Table 1

Category	Targets of the Plans
Housing	To increase average floor space per unit to approx. 95 m <sup>2</sup> in FY 1995, aiming at improving quality of housing stock (cf. average floor space per unit in 1988 was 89 m <sup>2</sup> ).
Sewers	To increase sewerage service coverage ratio by approx. 10 percentage points during the period of the plan and to promote drainage programs, aiming at better urban environment (cf. sewerage service coverage ratio in March 1989 was 40%).
Parks	To increase park space per capita to more than 7 m <sup>2</sup> in FY 1995, aiming at better urban environment with full of greenery and amenity (cf. park space per capita in March 1989 was 5.4 m <sup>2</sup> ).
Waste Disposal	To increase waste treatment percentage ratio to the mid-80's in FY 1995, aiming at more hygienic and comfortable living environment (cf. waste treatment percentage ratio in March 1989 was 78%).
Traffic Safety	To construct sidewalks, etc. of approx. 25,000km in aggregate during the period of the plan, where current risk to pedestrian safety is high (cf. sidewalks, etc. in March 1989 were 99,712km in aggregate length).
Port Facilities	To construct berths for foreign trade terminal of approx. 30km in aggregate during the period of the plan, to cope with increased foreign trade cargoes and enlarged vessel size (cf. existing foreign trade terminal berths in March 1989 were 60km).
Airports	To increase the index of aggregate runway length as measured against population and land area to approx. 880 in FY 1995, and to initiate new construction of a substantial amount during the period of the plan in order to accommodate future aviation needs, with due regard to the levels in industrial nations. This would result in increasing aggregate runway length by 18% during the period of the plan (cf. the index of aggregate runway length in March 1989 was 742).
Seashore	To increase improvement ratio of seashore which needs protection by approx. 10 percentage points during the period of the plan (cf. the improvement ratio in March 1989 was 40%).

### LAND POLICY

#### I. Basic recognition

The land problem is one of the most serious domestic problems facing the Government of Japan. The Government of Japan has, as a first step, already enacted the Basic Land Act<sup>1</sup> last December. Recognizing the need such as for the increase of supply of housing, as well as the supply of land for buildings, with necessary facilities, such as public and commercial facilities, the Government of Japan will imple-

<sup>1</sup> The Basic Land Act stipulates:

- (a) basic principles regarding land such as giving priority to public welfare;
- (b) responsibilities of the central and local governments, private enterprises and individuals; and
- (c) basic elements concerning land policies.

ment a wide range of specific measures as set forth in guidelines such as the Priority List of Land Policies, also announced last December, and as set forth below.

Due to these measures, it is expected that housing and other demand will be boosted, leading to greater import-opportunities.

1. Promotion of further supply of housing and land for buildings in metropolitan areas.
2. Comprehensive review and adjustment of the land taxation system with the objective of making taxes more equitable, neutral and simple.
3. Greater utilization of idle and underutilized land owned by the central or local governments or other public land.
4. Improvement and increase of infrastructure necessary to facilitate increase in the supply of housing and land for buildings.
5. Review of the Land Lease Law and the House Lease Law.
6. Review of divisions between Urbanization Promotion Areas and Urbanization Control Areas and promotion of specific deregulation measures.
7. Rationalization of the official assessment of land value.

## *II. Measures to be Taken*

1. In order to take the following measures, the Government of Japan has already enacted in this June the amendments of the "Special Measures Law for Facilitating Supply of Residential Land etc. in Major Metropolitan Areas", the "City Planning Law" and the "Building Standards Law".

(1) Improvement of the existing system to enable the formulation of master plans regarding the supply of housing and residential land across two or more prefectures.

(2) Establishment of a new system for identifying and promoting the utilization for housing, business and commercial purposes etc. of, idle land such as unused plant sites.

(3) Improvement of current city planning and other systems in order to facilitate the conversion of agricultural land within urbanization promotion areas to residential land.

In line with (2) above, the Government of Japan will establish a system for identifying idle land by the end of 1990 through the amendment of the "City Planning Law". The Government of Japan will encourage local authorities to actively and expeditiously utilize the system. Through these measures, substantial increase of the supply of housing and residential land in metropolitan areas would be expected.

2. (1) The Government of Japan is conducting a comprehensive review on the land taxation system on the basis of such basic principles of taxation as equity, neutrality and simplicity, and in accordance with the principles expressed by the Basic Land Act and with other land policies. A study has been initiated by the Sub-Commission on Land Taxation established in April under the Government Tax Commission.

The Sub-Commission has met almost once a week, and has so far held 13 meetings since this April. It issued a paper on May 29, entitled "Main Issues in the Review of Land Taxation" which clarifies main issues to be considered in the course of the review of land taxation.

Subsequently on June 22, the Sub-Commission issued a paper entitled, "For the Review of Land Taxation," which sorts out opinions expressed by the commission members concerning land taxation.

In these papers, the Sub-Commission presented the following two points as points of reference for the review of land taxation: first, it is important to pursue appropriate tax burden on an asset of land, from viewpoints of equity and neutrality of taxation, and this consequently contributes to efficient utilization of land; second, land taxation, as a part of land policy, can play an important role in promotion of efficient utilization of land, preventing speculative land transactions.

The paper issued by the Sub-Commission on June 22 contains various opinions concerning appropriate tax burden on transfer, holding and acquisition of land, including issues related to (2), (3), and 7(1), (2) below, which indicate, inter alia, that the Government of Japan will conduct a review with a view to addressing the deferment system of payment of the inheritance tax and the fixed assets tax, as well as consider the possible strengthening of the special land holding tax on idle land.

The Government of Japan highly appreciates that the Sub-Commission has satisfactorily progressed the discussion and expects that the discussion will lead to land tax reform which contributes to such land policies as efficient utilization of land.

Taking account of the issues provided in the above mentioned papers, the Sub-Commission will continue to discuss possible changes in the land taxation system and issue a report by early November.

The Government of Japan will make out a draft of a revised land taxation system, with giving serious consideration to the report, and submit the necessary legislation to the Diet by the end of FY 1990.

(2) with respect to the taxation system on agricultural land within urbanization promotion areas of the major metropolitan areas, the Government of Japan, together with necessary adjustments and improvements in the related policies, will conduct a review with a view to addressing the deferment system of payment of the inheritance tax and the fixed assets tax, in accordance with the Comprehensive Land Policy Plan, so that the results will be smoothly implemented from FY 1992.

(3) In addition to the establishment of the new system for idle land mentioned in 1. (2), a review will be made with regard to the possible strengthening of the special land holding tax on idle land.

3. The Government of Japan is now examining, toward the end of FY 1990, the utilization of State-owned land in the major metropolitan areas and, in accordance with its findings, will try to enable the land to be utilized for, through sales and other arrangements, appropriate private projects of urban district development, urban facilities, urban redevelopment and public housing projects, except those cases where preservation of land for public use is necessary. The Government of Japan is urging local governments to take similar measures with regard to local government-owned land.

The Government of Japan will complete the identification of idle and underutilized State-owned land by the end of FY 1990. The Government of Japan will set a goal of converting idle and underutilized State-owned land to productive use by the end of FY 1991, and will carry out the conversion according to the goal.

Effective utilization of the extensive land owned by the Japanese National Railways Settlement Corporation in metropolitan areas will also be ensured.

4. In order to increase the supply of housing and residential land, installation of the required infrastructure will be steadily pursued. In this context, based on the target indicated in the "Saving and Investment Patterns" chapter, the Government of Japan is engaged in the formulation of a larger five-year plan for housing construction, improvement of sewerage and urban parks, etc.

Following the report submitted by the Administrative Reform Council in October 1987 etc., two circular notices were issued to give guidance concerning the utilization of the eminent domain system. As a result, the number of eminent domain operations authorized in FY 1989 increased largely by more than 20 from the previous year. The Government of Japan will encourage the more vigorous use of eminent domain.

The Government of Japan will encourage more effective use of subterranean property, and studies will also be conducted on the system concerning public use of the deep underground from various aspects including legislation in order to encourage its utilization.

5. In order to meet the changed circumstances and to improve the legal relationship between lessors and lessees, and taking into account the desirability of greater availability of housing, a review of the Land Lease Law and the House Lease Law is being conducted, and an outline of the draft amendment of these laws may be ready by as early as the end of FY 1990. The Government of Japan will then submit the necessary legislation to the Diet without delay. These measures are expected to induce a more appropriate use of land and an increase in the supply of good quality houses for lease.

6. In order to encourage effective utilization of land and to facilitate the planned conversion of agricultural land to residential land within urbanization promotion areas, the Government of Japan will promote timely and appropriate review of divisions between Urbanization Promotion Areas and Urbanization Control Areas, and change of zoning designations. Particularly in major metropolitan areas, review of divisions between the two Areas will be promoted to provide for the growing housing demands.

The Government of Japan has enacted in this June the amendments of the "City Planning Law" and the "Building Standards Law" to establish the "District Plan to Promote Intensive Use of Residential Land" which will help ensure the relaxation of limits on building heights, total floor area ratio, etc. for quality projects contributing to the increase of housing supply and the formation of a better urban environment. Specific deregulation measures will be operated under this system by the end of 1990 with other existing systems.

7. In order to rationalize the official assessment of land value, the Government of Japan will:

(1) rationalize the land value assessment for inheritance tax calculation expeditiously, taking into account the nature of the tax with a view to making the assessment closer to the market value; and

(2) give guidance to local governments to rationalize their land value assessment for fixed assets tax calculation at the time of the reassessment of the land valued in FY 1991; and advise them to make public the land values of the standard points.

#### DISTRIBUTION SYSTEM

##### *I. Basic Recognition*

Concerning the distribution system in Japan, the Government of Japan attaches great importance to the enrichment of consumer life in Japan through further improving efficiency, ensuring market access, and building physical infrastructure. Based upon such recognition, the Government of Japan will promote the implementation of a broad spectrum of measures:

1. The distribution of import freight will be accelerated and its cost will be reduced by the improvement of airports, harbors, and other import infrastructure.

2. Customs clearance procedures and other import procedures will be further expedited to correspond to the increasing trade volume, while maintaining such functions as realizing a proper and fair sharing of the tax burden, and ensuring the health and safety of the people.

3. Deregulation of the distribution system will be further promoted with regard to a variety of laws and regulations, such as the Large-Scale Retail Store Law, with a view to enriching consumer life in Japan.

4. As to trade practices concerning distribution, an improved environment will be sought from the standpoint of promoting competition and securing market openness.

5. Wide-ranging measures with lasting, structural impact will be implemented in order to expand imports, thereby improving the efficiency of Japan's market structure including the distribution system.

##### *II. Measures to be Taken*

###### *1. Improvement of Import-related Infrastructure*

###### (1) Airport Improvement

(a) Based on the Fifth Five-Year Plan for Airport Improvement (FY 1986-90), the improvement of the New Tokyo International Airport, the off-shore expansion of the Tokyo International Airport and the improvement of the Kansai International Airport are being vigorously promoted as the three most important projects. In particular, completion of the second phase construction of the New Tokyo International Airport and the first phase construction of the Kansai International Airport will double the cargo handling capacity as the cargo handling area will expand from about 20 hectares at the New Tokyo International Airport alone to about 50 hectares at the two airports combined. This expansion of capacity, together with the improvement and the expansion of the regional airport and airport-related cargo handling facilities, is a significant step toward the goal of ensuring airport capacity sufficient to meet the demand for international air services for some time to come. The airport-related cargo handling facilities at the New Tokyo International Airport and at the Baraki Terminal are being improved and expanded responding to the increasing demand for international air cargo handling. Considerable efforts are also being invested in the improvement of local airport facilities: For instance, the construction of the New Hiroshima Airport is now vigorously under way with December, 1993 as the target inauguration date.

(b) (i) The Sixth Five Year Plan for Airport Improvement, to be initiated in FY 1991, will include Yen targets and specify airport and airport facility projects to substantially increase airport capacity sufficient to meet medium-to-long term growth of the demand in international air transportation. (The details of the Sixth Five Year Plan will be formulated in autumn in 1991.)

(ii) The Aviation Council is now discussing as one of the main agenda for the Sixth Plan various improvements of airport facilities, including the overall concept of the Kansai international Airport and increased use for international service of regional airports.

(c) Improvement of roads related to import is being promoted in line with the Tenth Five-Year Plan for Road Improvement (FY 1988-92).

###### (2) Harbor Improvement

Harbors are being improved in line with the Seventh Five-Year Plan for Harbor Improvement (FY 1986-90). In recent years, imports of manufactured goods have been rising rapidly, and therefore, in order to be able to respond to these increasing imports, the improvement of container terminals for overseas trade and large scale multi-purpose terminals for overseas trade will be given high priority in the context of the Eighth Five-Year Plan now being prepared to be initiated in FY 1991. Concerning warehouse facilities, the Government of Japan is promoting private investment in facilities through such means as low-interest loans by the Japan Development Bank (JDB) and favorable tax measures. Since FY 1989, special emphasis is being placed on promoting the improvement of warehouse facilities dealing primarily with imported goods through a special low-interest loan facility. Thanks to these measures, warehouse companies in the Tokyo and Osaka metropolitan areas plan to expand their facilities by 16% by the end of FY 1991.

### *2. Expeditious and Proper Import Procedures*

In order to ensure rapid entry of normal cargo imports into the Japanese distribution system, the Government of Japan goal is 24 hours clearance (from presentation of import declaration to import permit) through entry procedures for imports by 1991. The Government of Japan will ensure adequate budget resources and make regulatory changes necessary to accomplish this goal.

#### *(1) Customs Clearance Procedures*

Automated Processing System will be introduced for customs clearance of sea cargoes from 1991 to 1992. In addition, the Japanese Customs will further improve and rationalize the customs clearance procedures, in accordance with the report by the Japan-U.S. Customs Experts Group. This will include efforts for achieving, within a few years, the implementation of upgrading of NACCS (Nippon Air Cargo Clearance System), expansion of the scope of the Provisional Examination System and its procedural simplification, and introduction of the Automated Risk Judgment System supported by the Customs Data Base.

#### *(2) Import Procedures other than Customs Clearance Procedures*

In accordance with the report submitted by the Japan-U.S. Experts Group on Import Procedures, which was established with a view to achieving more expeditious and proper import procedures and consists of agencies concerned, the Government of Japan will, after study as necessary, start any of the following measures as soon as it becomes feasible and make efforts to implement them within three years.

(a) Establishment of an integrated import processing system under the cooperation between Customs and other agencies with jurisdiction over import procedures through measures such as setting up of Liaison Committee consisting of agencies with jurisdiction over import procedures, simultaneous processing of customs clearance and procedures required by other import-related laws, and facilitation of information transmission among agencies with jurisdiction over import procedures.

(b) Promotion of pre-arrival processing by introduction of pre-filing system, improvement and expansion of pre-export examination system, including promotion of acceptance of overseas examination data, enlargement of blanket handling system, etc.

(c) Physical improvement and expansion of cargo processing system, including expansion of working hours.

### *3. Deregulation*

#### *(1) Large-Scale Retail Store Law*

As dynamic changes are called for in the distribution industry, deregulation measures will be taken in order to meet new needs of consumers, to enhance the vitality of the distribution industry and to ensure smooth procedures for opening new stores. Deregulation measures will be put into place by both the central Government and local public authorities.

The following deregulation measures will be implemented by the Government of Japan.

(a) Deregulation measures that will be immediately taken (such measures as those for an appropriate implementation of the law)

(i) In order to ensure smooth coordination procedures and to facilitate the opening of new stores and expansion of existing stores, the following deregulation measures for an appropriate implementation of the law came in effect on May 30, 1990, subsequent to the deliberation by the Joint Conference of the Industrial Structural Council and the Small and Medium Enterprise Policy Council on April 27, this year. These are the maximum meas-

ures which are legally possible under the current Large-Scale Retail Store Law (LSRSL).

(aa) Shortening of coordination processing period for opening stores:

The coordination processing period will be less than one and a half years. The day the items required by the public ordinance (tsutatsu) are presented on the plan to open the store with the relevant regional Bureau of the Ministry of International Trade and Industry (MITI) is regarded as the announcement day of the store opening. All the applications will be received.

(bb) Exceptional measures concerning floor space for import sales:

Regarding floor space for import sales, coordination procedures will be exempted for an increase up to a specific scale (100m<sup>2</sup> or less of the floor space).

(cc) Exemption of coordination procedures for the increase of a certain increase in floor space:

Coordination procedures will be exempted for certain cases such as a floor space increase up to a specific scale (whichever is the smaller, 10% of the existing floor space or 50m<sup>2</sup>).

(dd) Relaxation of the scope of regulation on closing time and the number of business holidays:

Closing time under regulation will be relaxed from "after six o'clock p.m." to "after seven o'clock p.m." The number of business holidays under regulation will be relaxed from "less than four days a month" to "less than 44 days a year."

(ee) Enhancement of transparency in the coordination procedures:

Transparency of the coordination procedures will be improved through such measures as further disclosure of the outcome of the deliberation in the Council for Coordinating Commercial Activities, quarterly publication of the status of coordination activities and establishment of the office for receipt and processing of the inquiries by the interested parties including those wishing to open stores.

It is confirmed that, as has been the case in the past, the ongoing coordination procedures will not prevent other procedures required by other laws and regulations (such as Building Standards Law and City Planning Law) from being pursued in parallel nor will they prevent those wishing to open stores from advertising for potential tenants. It is also confirmed that in case of acquisition of existing retail outlets through corporate acquisition (including those by foreign firms), the coordination procedures are not required.

(ii) Regarding separate regulation by local public authorities, the central Government, together with the above measures, is making its utmost efforts by, for example, notifying each prefectural Governor to take necessary corrective measures as local public authorities in the light of objectives of the law.

(iii) In order to ensure an appropriate implementation of the law and of separate regulation by local public authorities, the Government of Japan will take necessary follow-up steps including the checking of the status of implementation of the above measures. For this purpose, Headquarters for the Promotion of Smooth Coordination of Store Opening and Headquarters for Regional Promotion were established in the Ministry of International Trade and Industry (MITI) and in its regional Bureaus and Department from May 21 to 30, this year, with the first meeting of the Headquarters for the Promotion of Smooth Coordination of Store Opening taking place on June 1, in an effort to follow up the steady implementation of the above measures.

(iv) In order to ensure an appropriate implementation of the above measures thus to expedite the processing of the coordination procedures, the fiscal 1990 budget establishes a new division called the Distribution Industries Division in MITI (as of July 1, 1990) and increases by ten the number of officials concerned (as of October 1, 1990). Further efforts will be made to expand and strengthen the institutional set-up.

(v) In order to accelerate changes in the distribution industry and to expand manufactured imports, together with the above measures, steps will be taken to help promote imports by the distribution industry including small and medium distributors. To achieve this objective, the budget, the fiscal loans and investment plan, and the tax reform of FY 1990 have established tax incentive measures to promote manufactured imports, grass-root

import expansion activities of small and medium distributors, international comprehensive distribution centers, expansion of import promotion fairs by local retailers, and others. Further efforts will be exerted to expand and reinforce such measures.

(b) Amendment of the law which is to be submitted to the Japanese Diet during the next regular session

The Government of Japan will immediately start preparation for the amendment of the law aiming at submitting the bill during the next regular session of the Japanese Diet, by initiating the deliberation of the relevant council.

(i) Standpoint of the amendment

(aa) Sufficient consideration upon consumer interest.

(bb) Ensuring expedited processing of the coordination procedures.

(cc) Ensuring the enhanced clarity and transparency of the procedures.

(dd) Consideration upon international request to Japan to increase imports.

(ii) Items considered as the elements of the amendment

(aa) Introduction of exceptional measures of coordination procedures concerning the floor space for import sales aiming at more import expansion.

(bb) Shortening of coordination processing period for opening stores. (The objective of efforts is to shorten the period to approximately one year.)

(cc) Enhancing clarity and transparency of coordination procedures for opening stores.

(dd) Restraining local public authorities' separate regulations.

(ee) Others

(c) Review after the above-mentioned amendment of the LSRSL

The LSRSL shall be reviewed further two years after the above-mentioned amendment of the LSRSL. This study will include an analysis of the law's impact on consumers and competition in the retail sector and, based thereon, the need for a basic review of the law and further action. In order to make the first point clear, the above-mentioned amendment shall include a provision stating that the effectiveness of the implementation of the amendment will be examined and that, based on this result, examination will be made on matters including removal of regulations applied to specific geographical areas.

(2) Regulation concerning premium offers and advertisement

The regulation of premium offers by the Act Against Unjustifiable Premiums and Misleading Representation, including that by Fair Competition Codes, is designed to ensure fair competition in the market place and to protect consumer interests. Obviously, this system is not intended to be an impediment to new entry by foreign or domestic firms, and the Fair Trade Commission (FTC) has enforced and will continue to enforce this system so that it does not impede such new entry.

The FTC, however, is currently reviewing all existing Fair Competition Codes on premium offers so that they will not work as impediments to new entry by foreign or domestic firms, and will give priority to completing this review, and any relaxation as necessary, as early as possible with respect to Codes relevant to foreign trade or investment. As part of such an undertaking, the regulation by the Fair Competition Code on Premium Offers in Chocolate Industries will be relaxed for the second time in July this year. The regulation of eight Codes will also be relaxed as early as possible this year and, among them, newspaper advertisements with coupons are scheduled to be allowed by this summer.

In reviewing the Codes, the FTC will hear the opinions of foreign firms and foreign businessmen.

Guidance on Fair Trade Conferences by the FTC will be tightened lest they should take any action beyond their proper objectives.

(3) Regulation concerning liquor sales and other businesses

(a) The Guidelines for Liquor Sales Licensing were amended, and their implementation has been improved since last September by such measures as the easing of the licensing criteria for large retail shops and the simplification and clarification of those for average-sized liquor shops. Under these measures, liquor sales licenses were planned to be issued to all the large retail shops (with a floor space of more than 10,000m<sup>2</sup>) and to about 5,000 average-sized shops by 1994. In accordance with the Interim Report of the SII, the Government of Japan has decided on front-loading licensing to large retail shops, which are expected to sell more imported liquors. The issuance of licenses to all of those shops will be completed by the fall of 1993.

(b) On trucking business, a law was approved by the Diet at the end of last year and the Government of Japan has decided to promote deregulation. The revised law altered 'the method of entry regulation from the licensing system to a permit system while abolishing the supply-demand adjustment regulation, and changes the permit system for fare regulations to a notification system. (The revised law is due to take effect on December 1 this year.)

(c) With regard to the Pharmaceutical Affairs Law regulation concerning general sales of pharmaceuticals, the Government of Japan took deregulation measures which include the reduction of items sellers should be equipped with for the tests of drugs to about one third of the previous number.

(d) In NTT, discounts for bulk contractors of the "free dial" (toll-free calls) have been introduced this June. Reduced postal rates have been made available for direct mails and catalogues sent out in large numbers for business purposes. These have become possible by the introduction of the advertising mail service in October 1987 and the catalogue parcel service in September 1989.

#### 4. Improvement of trade practices

(1) The FTC received a recommendation on June 21 from the "Advisory Group on Distribution Systems, Business Practices and Competition Policy," consisting of scholars and business experts.

The main contents of the recommendation are as follows.

[1] The FTC should formulate guidelines concerning the Antimonopoly Act enforcement with regard to marketing policy by manufacturers towards distributors and by distributors towards manufacturers in the field of consumer goods' distribution, taking fully into account merits and demerits of concerned business conduct from the viewpoint of competition policy.

In formulating the guidelines, the following points should be taken into consideration.

a. To alleviate excessive interference into business activities of trading partners, and to promote more active and independent business conduct.

b. Especially to promote price competition among companies.

c. To enhance openness of markets in order that new entrants, whether domestic or foreign companies, can more freely enter the market or perform more active business activities.

The guidelines may include the following types of conduct and other issues.

a. Resale price maintenance: --

b. Suggested retail or wholesale prices by manufacturers which come under resale price maintenance.

c. Non price vertical restraints (restraints on dealing with competitors' products or imported goods, territorial or customer restriction, and restraints on sales methods), interference into distributors' business, rebates or allowances, return of unsold goods, dispatching salespersons to shops, systematizations regarding purchasing of commodities by large scale retailers, coercion into purchase, and coercive collection of contribution, which fall into unfair trade practices.

d. Group boycott formed among competitors or among trading partners which falls into private monopolization or unreasonable restraints of trade when they substantially restrain competition in certain fields of trade or else which fall into unfair trade practices.

e. Application of the Antimonopoly Act regarding unfair trade practices to dealings between parent and subsidiary companies.

[2] Although sole import agent agreements are an important instrument for new entry of imported goods, it may sometimes cause anti-competitive effects upon domestic distribution. Therefore, the FTC has to review its current guidelines by clarifying its interpretations with regard to manufacturers' import, sales at high price in domestic markets, and undue inhibition of parallel imports, in order to effectively tackle these anti-competitive effects.

Furthermore in case foreign companies or sole import agents are engaged in anti-competitive conduct, the FTC has to apply the Antimonopoly Act strictly.

[3] Individual companies, especially big companies, should desirably enhance their legal affairs division and make compliance programs, etc. in order to prevent violations of the Antimonopoly Act.

The FTC, based on these recommendations, will formulate and publish guidelines by the end of FY 1990 which will clarify, as concretely and clearly as possible, the

criteria regarding the enforcement of the Ant monopoly Act so that fair competition with regard to trade practices in the distribution sector will not be hindered. In formulating such guidelines, drafts will be made available in advance to the agencies concerned at home and abroad, so that they may provide comments to the FTC before the guidelines are finalized. The FTC will strictly enforce the Antimonopoly Act according to these guidelines.

The FTC has enhanced its investigation system so that it can intensify information gathering on illegal activities under the Antimonopoly Act and strictly eliminate such activities. The FTC will continue its endeavor to enhance steadily its investigation system.

(2) The Ministry of International Trade and Industry (MITI), after hearing the opinions of foreign business organizations in Japan and having received a recommendation from the Council on June 20, formulated and presented to the industries concerned on June 25, a guideline for improving trade practices aiming at simplification, clarification and increased transparency of trade practices. The MITI is encouraging the industry concerned to take positive steps to improve trade practices. Contact points for processing complaints from foreign businesses will be established in MITI and the industries concerned.

### *5. Import Promotion*

(1) Japanese Government has introduced a new package of comprehensive import expansion measures in order for Japan to become a world leading importing nation. It includes:

- (a) creation of tax incentives to promote manufactured goods imports;
- (b) considerable increase in budget allocation for import expansion measures such as the establishment of an information network for promotion of imports and the dispatch of experts to western countries and other forms of human exchanges in search of products to be exported to Japan;
- (c) strengthening and expansion of the low-interest loan facilities for import promotion;
- (d) elimination of tariffs on more than 1,000 products

Having received Parliamentary approval in the Diet, these measures are now being implemented. In addition, agreement has been reached between the MITI and the U.S. Commerce Department for trade expansion. Efforts are thus being made to make the measures more effective in cooperation with those of the export countries.

(2) The Government of Japan will establish, in the Trade Conference (an inter-agency committee chaired by the Prime Minister), the Import Board (tentative name) consisting of both Japanese government officials and private business persons including foreign business persons. The board will summarize general requests and opinions of the board members that relate to import expansion and facilitation and will report them to the Trade Conference.

(3) Regarding concrete complaints by foreign firms concerning market openness and import smoothness, including import procedures, the Office of Trade and Investment Ombudsman (OTO) will continue to receive them at all times and promptly process those claims. With such meeting having taken place on May 29 this year, OTO will continue to hold meetings of the members of the OTO Advisory Council as well as the members of the Special Grievances Resolution Meeting with the members of the foreign Chambers of Commerce in Japan, including the members of the American Chamber of Commerce in Japan (ACCJ) at the latter's request, which will continue to provide opportunities for the latter to express their opinions on the improvement of access to the Japanese market including issues relating to the standards and certification system. Appropriate government agencies concerned will study these opinions with a view to improving the openness of the Japanese market and will report back the results of their consideration. Moreover OTO will improve its management, such as participation of foreigners in the OTO Advisory Council Meeting, as special members.

The Government of Japan will initiate a new review in the area of standards, certification and testing, where it will review existing regulations and practices with regard to standards, certification and testing, including matters connected with industry association standards, to ensure that processes are transparent and that standards and testing are performance based where appropriate. As a first step, this new review will take up standards, certification and testing which are raised by ACCJ, other foreign chambers of commerce and other interested parties through the OTO and other appropriate channels.

## EXCLUSIONARY BUSINESS PRACTICES

*I. Basic Recognition*

Maintenance and promotion of fair and free competition is an extremely important policy objective, which not only serves the interest of the consumers but also increases new market entry opportunities including those of foreign companies. Based upon such recognition, the Government of Japan will implement wide-ranging measures.

1. Enhancement of the Ant monopoly Act and its enforcement.
2. Greater transparency and fairness in administrative guidance and other government practices.
3. Encouragement of transparent and non-discriminatory procurement procedures by private companies.
4. Facilitation of patent examination disposals including a shorter examination period.

*II. Measures to be Taken**1. Enhancement of the Antimonopoly Act and its Enforcement*

The Government of Japan or the Fair Trade Commission (FTC) will take the following actions, including legislative action, which are necessary or appropriate in achieving the goals set forth in the Report regarding enhancement of the Antimonopoly Act and its enforcement.

*(1) Resorting More to Formal Actions*

The Fair Trade Commission (FTC) will strictly exclude, through resorting more to formal actions, activities violating the Ant monopoly Act, by expanding and enhancing the investigatory function of the FTC and increasing its proof-collecting capacity against illegal activities. Especially, the FTC will rigorously deal with such conduct as price cartels, supply restraint cartels, market allocations, bidrigging, and group boycotts, and will take formal actions against them when they are found violating the Antimonopoly Act.

In addition, a system for consultations and complaints from foreign businessmen and foreign firms was established in the FTC on June 8 and a special official (Officer in charge of Consultation from Foreign Firms) was appointed, in order to make it easier for foreign businessmen and foreign firms to have consultations or make complaints concerning the Ant monopoly Act, to report cases of violation of the Act, and in order for the FTC to address such cases as violations of the Ant monopoly Act promptly and adequately.

*(2) Ensuring Greater Transparency*

In order to ensure transparency, to enhance the deterrent effect and to prevent similar illegal activities from occurring, the contents, including the names of the offenders, the nature of the offense and circumstances surrounding it, of all formal actions such as recommendations and surcharge payment orders will be made public. Warnings will also be made public other than in exceptional cases.

*(3) Increase in Budgetary Allocation*

In June this year, the Government of Japan increased the number of personnel in the FTC investigation department and created new divisions:

- (a) Allocation of 25 new officials (129-154), resulting in a 20% increment in staff,
- (b) Establishment of one new office for strengthening violation detection (1-2 offices),
- (c) Establishment of two new divisions for enhancing investigative functions (6-8 offices),
- (d) Establishment of one new division in the Osaka Local Office for enhancing investigative functions of local offices (1-2 offices).

The Government of Japan will continue with its efforts to steadily improve and strengthen the FTC.

*(4) Surcharges*

In order to enhance enforcement against violations, the Government of Japan plans to submit a bill to revise the Antimonopoly Act to the Diet during the next regular session, to raise the surcharges against cartels so that they effectively deter violations of the Antimonopoly Act. A consultative group consisting of scholars and other experts has been set up under the auspices of the Chief Cabinet Secretary, to consider the concrete contents regarding the raising of surcharges. Moreover, group boycotts will also be regulated as cartels if they substantially restrain competition, and will be subject to surcharges if they influence prices.

**(5) Resorting to Criminal Penalties**

More criminal penalties will be utilized in the future, by the FTC's accusation of illegal activities violating the Antimonopoly Act to seek criminal penalties for them.

Relevant governmental agencies (the Ministry of Justice, prosecuting authority and the FTC) have initiated coordination in enhancing systems to cope adequately with any case violating the Antimonopoly Act. As a specific measure, a liaison-coordination was set up in April between the Ministry of Justice and the FTC, to examine matters such as accusation procedures. The group is working with a view to reaching a conclusion by the end of this year. There is also a plan to establish a point of contact between the prosecuting authority and the FTC for exchange of opinions and information on concrete problems of each case being considered to be accused.

The FTC will, from now on, actively accuse to seek criminal penalties on the following cases, and this policy was made public on June 20:

(a) Vicious and serious cases which are considered to have wide spread influence on people's livings, out of those violations which substantially restrain competition in certain areas of trade such as price cartels, supply restraint cartels, market allocations, bidrigging, group boycotts and other violations.

(b) Among violation cases involving those businessmen or industries who are repeat offenders or those who do not abide by the elimination measures, those cases for which the administrative measures of the FTC are not considered to fulfill the purpose of the law.

On June 20, 1990, the Minister of Justice, in a publicly released statement, called on all the chief prosecutors, on the occasion of the Annual Meeting of Chief Prosecutors, to provide to the FTC any relevant information on Antimonopoly Act violations they have obtained during the course of investigation or otherwise. In addition, he directed all the chief prosecutors to make special efforts to vigorously pursue cases where the FTC has accused a criminal violation of the Antimonopoly Act.

**(6) The Damage Remedy System**

A study on the effective use of the current damage remedy system provided in the Section 25 of the Antimonopoly Act is currently undertaken by a study group set up in the FTC, in order that any individual party suffering damage from violation of the Antimonopoly Act can resort effectively to damage remedy suits. The study group has publicized the results of its deliberations on June 25. The FTC will implement the recommendations of the study group, effective immediately, and will take necessary measures, including the following, so that the current damage remedy system will be able to be effectively utilized:

(a) In order to deter violations of the Antimonopoly Act through proper and swift recovery of damages caused by such violations, the FTC intends to play a more active role in damage remedy suits under Section 25 of the Antimonopoly Act.

(b) In order to alleviate plaintiffs' (injured parties') burden of proof concerning violation and damage, the FTC will take the following measures:

aa. the FTC will describe its findings on the violation as concretely and clearly as possible in its document of decision.

bb. when the FTC submits its opinion pursuant to Section 84 of the Antimonopoly Act, it will describe as much as possible its judgment on the relevance or causal relations between violations and damages, the amount of damages, and the measure used for its calculation. The FTC will also append as far as possible, the materials and the data which are the bases of its views.

cc. the FTC will, upon request of the court, submit to the court materials and data necessary to prove the existence of violations, or the amount or causation of damages. Plaintiffs (injured parties) will be permitted, according to the civil procedures, to review such materials and data upon receipt by the court.

dd. the FTC will retain originals or copies of materials and data obtained in the course of investigations resulting in formal decisions of violation of the Antimonopoly Act that might be relev't to proof of violation, or the amount or causation of damages, in a private damage action based on such violation.

(c) The FTC will fully publicize the damage suit system under the Section 25 of the Antimonopoly Act.

(d) The FTC will take necessary actions, including measures similar to those listed in paragraph (b) above, to ensure that the private damage remedy can be utilized effectively when the FTC finds that a trade association has violated the Antimonopoly Act.

Moreover, with regard to the question of filing fees of private damage remedy suits based upon the section 25 of the Ant monopoly Act, the Ministry of Justice and the FTC will continue to study the matter as to whether or not there is room for improvement.

(7) Effective Deterrence against Bidrigging

(a) The Government of Japan will continue to make efforts to eliminate bidrigging on government-funded projects. In this regard, procuring agencies will rigorously deal with any bidrigging cases, and will vigorously apply against firms found to have engaged in such bidrigging administrative measures, including suspension from designation, that are effective in deterring bidrigging activities. Moreover, such procuring agencies will increase their vigilance against bidrigging activities on their procurements, and will on their own judgment report relevant information regarding such activities to the FTC.

(b) The FTC will enforce the Antimonopoly Act strictly against bidrigging in all industries.

(c) The National Coordinating Committee for Implementation of Public Works Contract Procedures (NCC) has revised its model guideline on designation suspension, extending the period of suspension and expanding the district of application of suspension in Ant monopoly Act violation cases. Through this revision, in certain cases, the minimum period of designation suspension has been doubled and it is to be applied on a nationwide level.

Upon the above-mentioned revision, governmental agencies and public corporations have been taking steps to revise their guidelines on designation suspension, and most of them have completed the revision of the guidelines in an expeditious manner since June this year.

(d) In reviewing the fines provided in the Criminal Code, the Ministry of Justice is considering an increase in the maximum fine under the Criminal Code 96-3 concerning bidrigging, and will endeavor to amend the Criminal Code to that effect at the earliest time possible.

*2. Government Practices*

(1) The Government of Japan has been making strenuous efforts to promote deregulation. On the basis of the recommendations of the Provisional Council for the Promotion of Administrative Reform, a Cabinet decision on Deregulation Policy Proposals was adopted. Based upon these Proposals, improvements in the system and its implementation will be made as soon as possible, through such means as expeditious considerations in the relevant Councils.

(2) Administrative Guidance

In order to ensure comprehensive and government wide transparency and fairness of administrative guidance, the Government of Japan will ensure that administrative guidance conforms with its intention that administrative guidance does not restrict market access or undermine fair competition. The Government of Japan will implement its administrative guidance in writing as much as possible. It will make the administrative guidance public when it is implemented, unless there are strong reasons not to do so, for example, when it is related to national security or when a publication of the administrative guidance causes, or may cause, such harm as might result from divulgence of trade secrets.

(3) Advisory Committees and Study Groups

The Government of Japan confirms the following principles:

(a) The results of the deliberations of government-sponsored "industry advisory committees and study groups" shall be made public.

(b) Where the subject of discussion is related to consumer interests, the committee or study group shall invite, as members, those who can effectively represent consumer interests.

(c) Where the subject of discussion is relevant to the interests of foreign companies, the committee or study group shall make efforts to hear the opinions of foreigners or representatives of foreign companies who represent the balanced and general interests of foreign companies.

(d) Study groups, in Japanese practice, consist of those who have outstanding knowledge or experience on the subject of discussion and are able to make valuable contributions to the discussions. Likewise, when study groups address mat-

ters relevant to the interests of foreign companies, qualified foreigners will be considered for participation in such study groups.

(e) The substance discussed in the committees and study groups shall not be anti-competitive.

(f) The "visions" developed by the Government shall not be used to enhance the competitiveness of particular companies in the Japanese market.

(g) In the "visions" involving trade matters, the significance of imports shall be emphasized.

(4) with regard to the exemptions from the application of the Antimonopoly Act, they are exceptional dispositions exempting certain special cases from the general rules of the Antimonopoly Act. The exceptional treatment has therefore always been kept to a minimum.

The exemptions from the application of the Antimonopoly Act should be at a minimum, and the necessity of existing exemptions will be reconsidered with a view to promoting competition policy. The scope of exemptions will also be reviewed, even in cases where they will be maintained, beginning with the exemptions, if any, which impede import trade or investment.

No recession cartel based upon the Antimonopoly Act is currently in effect. The FTC will not allow recession cartels to be used to impede imports.

### *3. Procurement Practices of Private Firms*

(1) The Government of Japan confirms its view that procurement by private firms should be left to the decisions of the buyers and the efforts of the suppliers under free competition at the market place, and that any action in violation of the Antimonopoly Act hindering market competition must be resolutely eliminated.

(2) The Government of Japan believes that, as a matter of course, procurement by private firms should be non-discriminatory against foreign goods.

(3) The Government of Japan, therefore, highly appreciates the "Guidelines of Procurement Policies," announced by the Japan Federation of Economic Organizations (Keidanren) on April 24, as a voluntary effort of the business sector in Japan and supports those guidelines. In addition, the Government of Japan will encourage, from an international viewpoint, private firms to make their procurement procedures transparent and non-discriminatory against foreign goods as soon as possible, and will conduct statistical surveys of those procedures annually for three years following the publication of this report.

### *4. Effective Patent Examination*

Regarding the patent system, consideration on the harmonization of patent systems is under way in multilateral fora such as WIPO and GATT. The Government of Japan, together with the U.S. Government, will actively participate in, and contribute to, the discussions there.

The Government of Japan has vigorously promoted comprehensive policy measures to expedite patent examination disposals, which include the continual increase in the prescribed number of officials of the Patent Office (increase of patent examiners; by 30 persons each in FY 1989 and in FY 1990), commencement of the world's first electronic filing of patent applications (special measures laws including the revision of the Patent Law; approved by the Diet on June 7, 1990, and to start the electronic filing in December, 1990), as well as the contracting with a specialized outside agency for prior art search necessary for patent examination (10,000 cases in the budget of FY 1989 and 20,000 cases in the budget of FY 1990). Through such comprehensive measures, the situation of the patent examination delay has already started to improve.

The Government of Japan will use its best efforts to reduce the average patent examination period of Japan to 24 months within five years.

For the implementation of the above, the Government of Japan will make continuous and significant annual increases of the prescribed number of patent examiners and other officials of the Patent Office which are to be newly implemented under a special consideration in addition to the on-going comprehensive measures.

Apart from the ordinary examination procedure, the accelerated examination system, which terminates the examination in a short period, has been introduced, and its active utilization is expected.

## KEIRETSU RELATIONSHIPS

### *I. Basic Recognition*

Certain aspects of economic rationality of Keiretsu relationships notwithstanding, there is a view that certain aspects of Keiretsu relationships also promote preferen-

tial group trade, negatively affect foreign direct investment in Japan, and may give rise to anti-competitive business practices. In order to address this concern, the Government of Japan intends to make Keiretsu more open and transparent and to take necessary steps toward that end. The Government of Japan will take measures in its competition policy and enforce the Ant monopoly Act strictly, so that business transactions among companies with the background of Keiretsu relationship would not hinder fair competition and thereby have an exclusionary effect on foreign firms attempting to export, market or invest in Japan.

The Government of Japan will also implement a wide range of policies to facilitate the entry of foreign enterprises into the Japanese market.

## *II. Measures to be Taken*

### *1. Strengthening the Function of the Fair Trade Commission*

(1) The Fair Trade Commission (FTC) will strengthen its monitoring of transactions among Keiretsu firms, including but not limited to, those which have cross shareholding relationships, to determine whether these transactions are being conducted in a way that impedes fair competition. If such monitoring reveals that the effect of the cross shareholding may be a substantial restraint on competition, the FTC will restrict cross shareholding or order transfers of shares held in the cross shareholding to remedy the illegal situation; if the monitoring reveals that cross shareholding is used as a means of effecting an unfair trade practice, the FTC will take appropriate measures, including restriction on cross shareholding or transfers of shares held in the cross shareholding, to remedy the illegal situation. Further, if such monitoring reveals that anti-competitive practices are occurring, the FTC will take appropriate measures to prevent and remedy the anti-competitive practices. The FTC will include in its annual report any results and such actions as have been taken.

In this connection, on June 21 this year, the "Advisory Group on Distribution Systems, Business Practices and Competition Policy" established by the FTC, consisting of scholars and business experts, issued recommendations with respect to the continuity and the exclusiveness of the transactions among companies in the same Keiretsu group whether or not cross shareholding is involved. Main contents of the recommendations are as follows:

[1] Although continuous trade relationships may have been formed due to certain reasonable motives, impediments to competition, such as entry barriers, should be removed. For this purpose, regarding the exclusiveness in transactions among companies where a continuous trade relationship or a shareholding relationship exists, the FTC should establish guidelines setting out the conduct which may be illegal under the Antimonopoly Act. The guidelines should include following types of conduct:

- a. Cartels regarding customer restrictions, and market allocation cartels, among competitors.
- b. Group boycotts formed among competitors or among trading partners which fall into private monopolization or unreasonable restraint of trade when they substantially restrain competition, or else which fall into unfair trade practices.
- c. Unilateral refusals to deal, exclusive dealing, coercing to deal or mutually beneficial reciprocal dealing, and other anti-competitive conduct associated with continuous trade relationships, which fall into unfair trade practices.
- d. When shareholding is used as a means of ensuring the effectiveness of conduct listed in a, b, and c above, or when dealing is refused etc., because of the absence of a shareholding relationship, the FTC should clarify its interpretation that such conduct could be regulated from the viewpoint of unfair trade practices. Furthermore, when it is envisaged that unfair trade practices can not be eliminated effectively without ordering disposition of stocks, the FTC can order such disposition.

[2] Individual companies, especially big companies, should desirably enhance their legal affairs division and make compliance programs, etc., to prevent violations of the Ant monopoly Act and other exclusionary practices. It is also desirable to improve transparency of Presidents' meetings within corporate groups through such means as providing the public with information on their activities.

On the basis of the recommendations, the FTC will set up and publish guidelines by the end of FY 1990, which will clarify, as concretely and clearly as possible, the criteria regarding the enforcement of the Antimonopoly Act with respect to the continuity and the exclusiveness of business practices among companies in the same

Keiretsu group, with a view to ensuring that business practices among companies in Keiretsu groups will not hinder fair competition, and thereby contributing to the promotion of fair and more open transactions among them without any discrimination against foreign firms. In formulating such guidelines, drafts will be made available in advance to the agencies concerned at home and abroad, so that they may provide comments to the FTC before the guidelines are finalized. The FTC will strictly enforce the Antimonopoly Act in accordance with the guidelines.

(2) The FTC will conduct regularly, roughly every two years, close analysis of various aspects of Keiretsu groups, including supplier-customer transactions, financing arrangements among group firms, personal ties, and special emphasis on the role of general trading companies in Keiretsu groups. The results of these analyses will be published. The FTC will take steps, including stricter enforcement of the Antimonopoly Act, to address anti-competitive and exclusionary practices uncovered in the FTC analyses. Furthermore, the FTC will survey the transactions among companies in specific industries regarding such issues as the effect of cross shareholding among companies which have trade relations.

(3) The Chief Cabinet Secretary will issue a statement which affirms that the Government of Japan will implement a wide-range of measures so that Keiretsu relationships will not hinder fair competition and transparent transactions and thereby the entry of foreign firms into the Japanese market will be facilitated as well as calling upon Keiretsu firms for their cooperation to that effect.

## *2. Foreign Direct Investment*

(1) The Government of Japan will issue a clear policy statement affirming its strong commitment to an open foreign direct investment policy, encompassing the principle of national treatment. This statement will be issued as soon as possible following release of the SII Final Report.

(2) The Government of Japan will submit, after due legal examination, a bill to amend the Foreign Exchange and Foreign Trade Control Law in the next ordinary Diet session.

The current Foreign Exchange and Foreign Trade Control Law enables the Government of Japan to restrict the foreign direct investment and importation of technology into Japan in any industrial sector on the grounds that the investment and the importation of technology might adversely and seriously affect similar domestic business activities or the smooth performance of the Japanese economy.

The Government of Japan, recognizing that these provisions are neither appropriate nor fit to the present practices of the law and that such broad restrictions are not needed on a general basis, will abolish these provisions of the law and replace them with new provisions to ensure that restrictions will only be applied to those cases which concern national security or related interests as described in Article 3 of the Code (Code of Liberalization of Capital Movements of OECD) and to cases in sectors as reserved under the Code. Recognizing the objectives of the OECD Code, the Government of Japan continues to review carefully its reservations within the framework of the OECD Code.

In relaxing or abolishing the provisions relating to the present prior notification requirements for foreign direct investment and importation of technology into Japan, the Government of Japan will positively examine the possibility of replacing prior notification requirements with ex post facto notification procedures for cases clearly excluding those which concern national security or related interests as described in Article 3 of the Code and those in sectors as reserved under the Code.

(3) The low-interest loan facility offered exclusively to foreign companies and Japanese affiliates of foreign companies by the Japan Development Bank (JDB) and the Okinawa Development Finance Corporation was drastically expanded in June. In addition, a corresponding facility was also established in the Hokkaido-Tohoku Development Finance Corporation in June. Furthermore, advisory offices for the promotion of foreign direct investment in Japan are to be set up in the overseas representative offices of the JDB in order to support foreign companies investing in Japan in cooperation with Embassies, Consulates-General and JETRO offices. Appropriate offices of JETRO or these advisory offices in cooperation with Embassies and Consulates-General provide information useful in arranging beneficial ventures between foreign firms and Japanese companies and arrange seminars and missions for potential investors (JETRO offices only).

## *3. Revision of the Take-Over Bid System*

Regarding the Take-Over Bid (TOB) system, the Government of Japan submitted to the Diet a bill calling for abolition of the prior notification requirement for TOB's, prolongation of the take-over period and so forth. The bill was approved on June 15.

#### 4. Enhancement of the Disclosure Requirements

(1) In order to introduce the so-called 5 percent rule, which requires the disclosure of substantial ownership in shares, the Government of Japan submitted to the Diet a bill. Together with the revision of the TOB system, the bill was approved on June 15. The new rule would also require continuing reporting as investors above the five percent threshold acquire or dispose of blocks of shares in an amount equal to one percent or more.

(2) with respect to the disclosure requirements related to the Keiretsu problem, the Government of Japan will enhance them as follows:

[1] With respect to reporting of related-party transactions, the Government of Japan will expand the scope of related-party disclosure requirements to such as specified by the standard of FASB statement No. 57 in the United States, so that they will include a company's transactions with its affiliated companies, major shareholders (holding 10 percent of the shares or more) and any other significant related-parties, in addition to transactions with its parent company and with the directors of the company concerned.

Such reporting will include the nature of the relationships, description of the transactions, and their amounts.

[2] With respect to the consolidated financial statement required by the Securities and Exchange Law, the Government of Japan will amend the rule so that the consolidated financial statement will be disclosed in the primary annual statement instead of being provided as its attachment.

[3] The Government of Japan has implemented the rule for segmented financial reporting on a consolidated basis from the business year beginning on or after April 1, 1990, under which sales amounts and operational profits and losses by industry as well as sales amounts in home country and abroad will be disclosed.

[4] The Government of Japan will further improve disclosure requirements on unconsolidated financial report as well to include sales amounts to each major customer, defined as those accounting for over 10 percent of total revenue, in addition to the current requirements for disclosure including amounts receivable and amounts payable by major parties.

Regarding [1], [2], and [4] above, the Government of Japan will implement the enhanced rules from the business year beginning on or after April 1, 1991.

The Government of Japan expects that these enhanced disclosure requirements will promote transparency of relations among firms.

#### 5. Reexamination of the Company Law

The Committee on Legislation will reexamine the Company Law with a view to enhancing disclosure requirements and shareholders' rights, and to simplifying mergers and acquisitions procedures.

### PRICING MECHANISMS

#### I. Basic Recognition

Based upon the recognition that it is undesirable, in realizing a high quality of life, for large and unreasonable price differentials between domestic and overseas markets to continue to exist for a long time, the Government of Japan will implement the following policies to adjust the differentials:

1. Obtaining information on price differentials and providing it to consumers and industries;
2. Regulation and strict enforcement of the Ant monopoly Act;
3. Promotion of imports and improving productivity;
4. Formation of more appropriate land prices;
5. Setting of public utility prices at more appropriate levels.

#### II. Measures to be Taken

##### 1. Implementation of Measures to Adjust Price Differentials between Domestic and Overseas Markets

The Government and the Liberal Democratic Party (LDP) established on December 4 last year the Government-LDP Joint Headquarters for Adjustment of Price Differentials between Domestic and Overseas Markets to promote comprehensive policy measures for the adjustment of the price differentials from a consumer-oriented standpoint. The membership consists of the Prime Minister as Chairman, with the Minister of State of Economic Planning Agency, the Minister of International Trade and Industry, the Chief Cabinet Secretary and the Chairman of Policy Affairs Research Council of the LDP as Vice Chairmen, and other Cabinet Ministers

and LDP leaders concerned. The Headquarters decided on 52 items as concrete measures to be taken for the adjustment of price differentials between domestic and overseas markets in its second meeting held on January 19 this year.

These concrete measures can be grouped into the following six pillars:

(1) The government agencies concerned will endeavor to obtain information on price differentials through such means as surveys of price differentials of goods and services between domestic and overseas markets, and, where needed, to take necessary measures such as providing the industries concerned with the information on price differentials in order to adjust and narrow the gap.

(2) The government agencies concerned will endeavor to improve the competitive condition in the distribution system by such means as deregulation and strict enforcement of the Ant monopoly Act.

(3) The government agencies concerned will endeavor to further promote import and/or improve productivity of the relevant industries for the purpose of contributing to the adjustment and narrowing of the price differentials between domestic and overseas markets.

(4) Efforts will be made to set prices for public utilities at more appropriate levels by further improving productivity of the—industries concerned and by examining from an international perspective their cost compositions and other elements of price formation.

(5) Based upon the deliberations of the Ministerial Conference for Land Policies, efforts will be made to rationalize land prices, especially in metropolitan areas, through close coordination among the government agencies concerned.

(6) The government agencies concerned will promote other policy measures which will contribute to the adjustment of price differentials, such as further deregulation, strict enforcement of the Antimonopoly Act and the dissemination of relevant information to the consumers.

The government agencies concerned will steadily implement the 52 measures included in the above six pillars. In July 1990, the Headquarters will review the implementation of the 52 measures to date and make public the results of such follow-up at that time, including, where needed, a clearer schedule for further implementation. The Government of Japan will be prepared to explain implementation measures in the SII follow-up process.

The government agencies concerned will thereafter publish the state of implementation each time any measure is implemented.

## *2. Continuous Implementation of Domestic and Overseas Price Survey and the Dissemination of Information to Consumers and Industries*

(1) Pursuant to the decision of the Joint Government-LDP Headquarters, the Ministries of International Trade and Industry, Health and Welfare, Agriculture, Forestry and Fisheries, Finance and Transport, which participated in the joint U.S.-Japan price survey conducted by MITI and the Department of Commerce, as well as the Japan Fair Trade Commission, have also conducted independent surveys under their jurisdiction.

MITI held meetings with consumers and industrial representatives in eight major cities to explain, as well as exchange views on the problem of price differentials. MITI also gave publicity to the problem through advertisements on newspapers and in pamphlets.

### *(2) Methodology for price survey*

The government agencies concerned will continue to endeavor to grasp the present conditions of domestic and overseas price differentials to provide detailed information to consumers and industries.

The surveys will be done mainly from the standpoint of consumers' interest. Methodology, product focus, identification of price differentials and analysis of the surveys will be undertaken transparently.

For the purpose of SII follow-up by the Government of Japan and U.S. Government, these issues will be addressed and discussed in a deliberative manner.

Such surveys will not be mandatory, nor will they compel the disclosure of trade secrets. The dissemination of comparative price information will not be done in a manner which discriminates against imports or interferes with individual firm pricing decisions.

## *3. Promotion of Deregulation*

The Second Council for the Promotion of Administrative Reform made an extensive study on deregulation, and the Government of Japan has been engaged in the promotion of deregulation based upon the recommendations of the Council.

Specifically, the Cabinet decided, in December 1988, on the General Plan for the Promotion of Deregulation to promote the reform of public regulations, basing its decision on the recommendations made by the Second Council. In addition, the Government of Japan decided to continue active promotion of deregulation in its Administrative Reform Plan of 1990 (Cabinet Decision, December, 1989), and the agencies concerned have been making the utmost efforts in accordance with this decision.

As the Second Council was dissolved on April 19 this year, the Government of Japan, after considering the most effective scheme thereafter for the continued promotion of administrative reform, including deregulation, decided to establish the Third Council in the Office of the Prime Minister. The bill for that purpose passed the Diet, on June 26. The Third Council will focus on the implementation of the recommendations of the Second Council and is expected to identify new areas for deregulation.

#### *4. Further Steps Based on the Final Report of the SII*

In addition to the measures listed above, the Government of Japan will take concrete steps with respect to the structural problems identified in this final report.

Some of them are described below, and it is expected that those steps will allow price mechanisms to work more effectively in the Japanese market.

These measures will be implemented in conjunction with the six policy pillars and 52 measures decided in December 1989 and January 1990 by the Government-LDP Joint Headquarters.

(1) Deregulation of the distribution system, including the Large-Scale Retail Store Law, liquor sales, trucking and other businesses

The government agencies concerned will endeavor to improve conditions for free and fair competition in the distribution system through various measures. These will include the immediate relaxation of implementation and subsequent amendment of the Large-Scale Retail Store Law and the Government of Japan encouragement to private firms to make their procurement transparent and non-discriminatory.

The Government of Japan has established the goal of 24 hour import clearance system (from presentation of import declaration to import permit) for normal cargo imports. This can have a positive long-term effect on the cost of imports entering the Japanese market.

(2) Promotion of fair and free competition in the market through the enhancement of the Antimonopoly Act and its enforcement

In order to enhance enforcement against violations, the Government of Japan plans to submit a bill to revise the Antimonopoly Act to the Diet during the next regular session, to raise the surcharges against cartels so that they effectively deter violations of the Antimonopoly Act.

More criminal penalties will be utilized in the future, by the FTC's accusation of illegal activities violating the Antimonopoly Act to seek criminal penalties for them.

Appropriate measures will be taken so that the current damage remedy system will be effectively utilized.

The FTC will not allow recession cartels to be used to impede imports.

(3) Increase of Japanese overhead capital

The Government of Japan notes that these efforts will include the substantial increase in social overhead capital, including that which relates to the entry and distribution of imported products in Japan.

Building on the principle "to boost domestic investment, improve social overhead capital and to reduce the shortage of investment relative to savings and to the size of the Japanese economy," the newly launched "Basic Plan for the Public Investment" which serves as guiding principles for steady accumulation of the social overhead capital toward the twenty-first century, includes the aggregate investment expenditure of about 430 trillion yen for the decade.

Through the firm implementation of the plan, the levels of social overhead capital accumulation of Japan would be broadly comparable to those of other major industrial countries at the beginning of the twenty-first century.

(4) Efforts to rationalize land prices

The Government of Japan will implement a wide range of measures with respect to the land problem. These include measures which encourage increased supply of available land for buildings with necessary facilities such as public and commercial facilities, including the establishment of a new system for identifying and promoting the utilization of idle land, such as unused plant sites, by the end of 1990. Local

authorities will be encouraged to utilize the new system. The Government of Japan will set a goal of converting idle and underutilized state-owned land to productive uses by the end of FY 1991.

The Government of Japan will also review the land taxation system, as well as the Land Lease Law and the House Lease Law in order to improve the legal relationship between lessors and lessees.

(Note) Full and precise contents of the measures above are described in the related part of this final report.

#### 5. Submission of the Results of Price Surveys and Joint Activities

Recognizing that changes in relative prices can be significantly related to structural matters, the Government of Japan and U.S. Government will cooperate on SII follow-up action to track price differentials in the two markets.

(1) The Government of Japan will submit the results of price surveys relevant to the SII follow-up process and discuss them with regard to SII issues.

(2) The Government of Japan will conduct joint price surveys with the U.S. Government, as agreed. These surveys will be discussed in the senior level SII follow-up process, and utilize methodology and procedures as described in Section 2.(2).

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#### PREPARED STATEMENT OF THOMAS T. STALLKAMP

Good Morning. I would like to thank you for the opportunity to present our views this morning on the important issue of impediments to trade with Japan. I am Tom Stallkamp, Chairman and CEO of Acustar, Chrysler Corporation's separate automotive parts subsidiary. This morning I would like to briefly draw some comparisons to our own experience between European and Japanese sales of auto parts, give some specific examples of the Japanese practice of "stonewalling" and show why we believe there are significant impediments that limit sales of U.S. auto parts.

Acustar designs, manufactures, and sells a wide variety of automotive parts in electronics, electrical systems, interior trim, glass, seat trim, thermal products and modular assembly. Our 1989 sales were more than \$3.5 billion. Due to our heritage of Chrysler and American Motors, our sales had been primarily to domestic manufacturers, GM, Ford, and Chrysler, but for the last three years we have been aggressively seeking incremental sales to European and Japanese original Equipment Manufacturers (OEMs) and Japanese transplants in the U.S. We are a profitable and well-financed company with 25,000 employees, including 500 engineers, at 25 plants in three countries, and are the recipients of several quality awards from the domestic OEMs.

Our success in export sales has been mixed. Let me give you an example:

- In 1989, we had identical displays in major automotive shows in Frankfurt, Germany and Tokyo, Japan. Our European show was done entirely on our own and was met with strong favorable reaction. We have received many requests for quotes and have already received several hard orders from European OEMs. In contrast, in Tokyo where we exhibited in conjunction with the U.S. Commerce Department, used a Japanese trading company as a representative and spent considerably more money, we received at best polite acknowledgment of "nice try," but no requests for quotes, no orders, no business.

This is not just coincidental or an isolated example. We have been aggressively seeking sales from the expanding Japanese transplants in the U.S. While we have export business with VW, Renault, and Volvo, we have been able to get domestic transplant business only from Diamond-Star, a Chrysler joint venture with Mitsubishi Motors Corporation (MMC) Direct export sales to Japan are even more limited—less than \$3 million—and all of that is to Mitsubishi for a special transmission.

The transplants favor their established "family" suppliers who have been encouraged to come to the U.S. by their parent firm. They control sourcing in Japan through the use of:

(1) *The "Keiretsu" system, often for non-economic reasons.* A Japanese electronics firm declined to use a U.S.-built microprocessor in an application for a U.S. customer, despite functional equivalence and a 66% lower price than the Japanese "in-house" version.

(2) *Selective use of specifications.* We recently made a sales call on one of the Japanese transplants, and were told that they would be very interested in doing business with us. However, when we requested the drawings and specifications, we were told that it was proprietary information, and we would have to purchase a car, take

it apart, decide what components we wanted to supply, design a prototype, and then they would *consider* purchasing it from us! By the time this could be done, the vehicle would be redesigned and the parts would likely be significantly changed to make the effort useless.

(3) *The real engineering and design decisions for the U.S. transplants are still made in Japan.* Even though the Japanese have set up vehicle design and manufacturing facilities in the U.S., they continue to control the critical detail part engineering and sourcing from Japan. Selling to them requires a full-time presence in Japan, which must be in place prior to obtaining quotations. This makes "closing the sale" much more costly and time consuming, and is eroding our technology base, displacing high-value jobs from traditional U.S. manufacturers as transplant capacity grows.

(4) *Use of exclusionary, anticompetitive business practices and delays in the U.S. and Japan.* A favorite Japanese expression is "it takes time to develop a relationship." That is an understatement! In contrast to the European OEMs or even the Koreans, the Japanese use a protracted quotation, evaluation and testing process to drag out sourcing.

In response to the political pressure which has been applied through SII, MITI has recently announced an Import Expansion program. However, it will provide greater benefit to major Japanese manufacturers, than American companies, for two reasons:

- *First*, structural impediments currently in place distribution barriers and the Keiretsu system—which block volume access to the Japanese market by foreign manufacturers, will naturally impede foreign manufacturers from taking full advantage of the program.

- *Second*, the proposed tax CREDITS, against corporate income taxes equal to 5% of the year-to-year increase in the value of imports will, in effect, be available ONLY TO JAPANESE MANUFACTURERS. Other companies which increase imports will only be allowed a tax DEFERRAL over a five year period.

For foreign auto companies, this is a serious disadvantage. For instance, if a car is imported by Toyota from their Kentucky plant, it would generate a 5% credit for Toyota, *even on the Japanese content of the vehicle.* A car imported and sold through Chrysler would qualify for a smaller tax deferral, generating an interest savings of about 1.5% Japanese manufacturers have all announced substantial re-export programs back to Japan from their U.S. subsidiaries. They have the volume distribution network to accomplish sales in the 20,000 to 40,000 unit range per manufacturer. The same is true for the Japanese parts transplants. They have access. We do not.

Things may be starting to change, but it is important to look at the *substance* of the announcements. Several Japanese parts companies with whom we interface have privately acknowledged they have "Buy American" targets for North American content from MITI; however, these are *not results* targets, they are "make effort" targets, and are a direct result of the political pressure that the U.S. government has been applying. This latest round is mainly another delay tactic. Past experience shows that elaborate quotation exercises are used by the Japanese to build its case for continuation of sourcing to "Keiretsu" suppliers both here and in Japan. We cannot be satisfied with more quotation exercises and studies. There must be an opening of export trade, particularly for higher technology parts such as electronic transmissions, emission control devices, and other capital intensive products. *Purchase* targets must be set and monitored. The U.S. must *accelerate, not reduce*, the pressure for equal trade treatment. Now is not the time to back down. We must continue to press the Japanese government through all existing means at hand. To reduce our efforts now, just as the Japanese may be feeling the pressure to change, would be a major mistake.

The automotive portion of the total U.S. trade deficit increased in 1989 from 42% to 44%. The automotive portion of the bilateral deficit with Japan is over \$35 billion, or 69% of the total, up from 64% in 1988. This is unsustainable, and yet shows no signs of improvement. Efforts have been underway to open the parts market for many years. It has obviously been a priority for the U.S. government, has been a formal negotiation under the MOSS talks, has been part of the Structural Impediments Initiative and yet, no real results have been forthcoming.

A strong case can be made that the exclusionary practices in which Japanese companies engage are long-standing, damaging to U.S. industry and must end. It was certainly the intention of this Committee that the tools which were provided in the 1988 Trade Act be fully implemented. In fact, the Senate version of Super 301 contained a provision which provided for the Finance and Ways and Means Commit-

tees to self-initiate cases under the provision, if the administration failed to fully implement the law. That provision was eliminated from the final version of the bill; however, it seems clear that the intention of the authors of the amendment was that priorities be addressed.

Given the proportion of the merchandise trade deficit that the automotive sector represents, Chrysler fails to understand how it cannot be considered a priority. Utilizing the Super 301 provision would put teeth in the current cosmetic attempts to increase U.S. sourcing by the Japanese. An amendment to the 1988 Trade Act, which was sponsored by Sen. Riegle, cited government toleration of systematic anti-competitive practices as actionable under Section 301. That is a *priority practice* which should be included in Super 301 this year. Auto parts is a prime example of one sector affected by this practice, which extends to other sectors as well. The elimination of such impediments will permit natural economic factors to guide sourcing decisions by allowing us to compete on the basis of price and quality.

The Japanese will only respond to political or economic pressure. U.S. companies can compete if permitted access to markets. Acustar has done so in some pretty tough world markets. We ask only for removal of unfair one-way practices and for some recognition of support from the U.S. government. With that, we can and will be able to truly "open the doors" for trade.

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#### PREPARED STATEMENT OF JOHN B. TAYLOR

Chairman Baucus, Members of the Committee, I am pleased to be here today to discuss the Structural Impediments Initiative (SII). The central aim of the SII is to identify and remove unnecessary regulations and other structural barriers that impede the operation of free and competitive markets in Japan as well as in the United States. The removal of such structural barriers is the surest and most lasting way to reduce trade imbalances, increase exports, and thereby reduce trade frictions. It would also directly benefit the people of Japan and the United States, and strengthen the bilateral economic relationship between our two countries. A strong bilateral economic relationship between the United States and Japan is essential to needed improvements in the entire multilateral trading system. Keeping this relationship strong will pay added dividends by expanding trade opportunities for the United States in other countries.

The SII approach is superior to the managed trade approach, which would require the U.S. Government to second guess market outcomes and to attempt to achieve different patterns of imports and exports. Unlike managed trade, SII is in keeping with the trend to freer markets that has accelerated remarkably throughout much of the world during the last year. Indeed, it would be ironic and disturbing to the nations of Eastern Europe, if the United States—the Nation that has been a leader in the move toward freer trade and more open markets in the postwar period—were to turn towards managed trade at this critical juncture.

The Council of Economic Advisers has taken a special interest in this important new initiative. My personal attendance at all of the SII talks reflects this interest. Significant economic issues cut across all six of the SII areas raised by the United States—saving/investment imbalances, pricing differences, land use reform, improvements in the distribution system, exclusionary business practices, and cross share-holding—as well as in the areas raised by Japan. I would like to focus briefly on these economic issues in these opening remarks.

The first SII topic—saving/investment—is based on the premise that the overall trade and current account imbalances in both Japan and the United States primarily reflect the gap between domestic saving and domestic investment. Neither the \$152 billion deterioration in the United States current account from 1981 to 1987, nor its 20 percent improvement since then, can plausibly be explained by changes in the level of formal trade and structural barriers in foreign markets. While these barriers remain unacceptably high in the Japanese market, it would also be implausible to attribute the \$82 billion increase in Japan's current account surplus between 1981 and 1987 or its decline by more than \$20 billion over the past two years to changes in Japan's trade or structural barriers.

Changes in saving/investment imbalances provide a much more satisfactory explanation of these huge swings in current account imbalances, and any further improvements in the current accounts will require additional reductions in the savings-investment gap. It is a matter of simple accounting that the overall current account position of any country is equal to the difference between domestic savings and domestic investment. Not surprisingly, therefore, structural impediments affecting savings and investment levels have figured prominently in our discussions.

It would be unwise to pursue policies that reduce saving, especially at this time of a saving shortage throughout the world. The United States side has, therefore, focused attention on reducing the saving/investment gap in Japan by raising investment, and in particular by raising the level of Japan's investment in public infrastructure. Japan's public infrastructure is in many areas quite primitive for a wealthy industrialized country. For example, even today less than half of Japanese homes are connected to sewerage systems. In the mid 1970s a target to connect 100 percent of dwellings to sewerage facilities by 1985 was widely discussed in Japan.

Adoption of a medium-term plan to upgrade and extend sewerage systems and other public infrastructure investment could result in a significant reduction in the gap between saving and investment in Japan and an improvement in the living standards for the Japanese people. An extrapolation of expenditures in previous efforts suggests that a major extension of sewerage coverage alone could entail hundreds of billions of dollars in public investment expenditures.

Of course, in order to avoid inflation and capacity constraints in construction industries, it would be appropriate to spread any major investment initiative over several years and to phase in the program gradually. Capacity constraints have been mentioned by the Japanese side during our talks. A clear and credible advance commitment to undertake a major investment initiative would enable the market to respond to the shift in demand away from exports towards public infrastructure investment without inflationary pressures. The market would respond by creating incentives for increasing capacity in the construction industry relative to export industries. The large unified budget surplus currently being run in Japan is a potential source of funding for major public investments.

Economic research and historical experience indicates that such a change would significantly reduce the Japanese trade surplus. There is very little controversy here; econometric models agree. To provide some perspective, note that a one percentage point increase in the share of Japan's GNP devoted to public investment would constitute roughly \$26 billion, while other forces might also affect the saving/investment gap—for example, there might be some reduction in private investment—econometric models suggest that a significant fraction of the \$26 billion would result in a reduction in the Japanese trade surplus. The changes in trade flows would take time, however, and one cannot rule out other developments—such as macroeconomic fluctuations—that would adversely affect trade flows. Like other SII changes this would be a lasting remedy, not a short term fix. It is important, therefore, that progress be measured—especially in the short term—by the actions taken, not solely by changes in trade flows.

It should be emphasized that the saving/investment accounting identity applies to overall imbalances, not to the bilateral trade imbalance between Japan and the United States. Bilateral trade imbalances are determined by many factors in addition to saving and investment. It would be quite possible, for example, for the United States and Japan, or any other two countries, to reduce their overall trade imbalance to zero and still maintain a significant bilateral trade deficit between them. Japan runs bilateral deficits with oil producing countries; if there is an overall current account balance, then bilateral surpluses would probably remain elsewhere in its accounts. Such bilateral surpluses or deficits would not in and of themselves be evidence of barriers, but in any case when such barriers exist they should be eliminated.

The Administration is also concerned with structural barriers that significantly affect the product and country composition of trade flows even if they have no impact on the saving/investment balance. It is cold comfort to individual companies in the United States hampered by such impediments to know that there may be an offsetting gain elsewhere in the economy. The existence of large price differentials for the same goods between Japan and the United States—confirmed and highlighted by the joint United States-Japan survey—suggests that these barriers are significant.—

We have therefore attached a high priority to making markets more competitive and deregulating the distribution system in Japan. A more vigorous enforcement of Japan's Antimonopoly Law would make it easier for new firms, including foreign firms, to enter Japanese markets. A more competitive distribution system would increase the costs of exclusionary business practices and improve access to Japanese markets. Progress in these areas can greatly improve market opportunities in Japan for United States exporters.

There is considerable overlap of the economic effects of structural changes in the different SII areas. For example, improvements in public distribution infrastructure, such as roads, customs facilities, and airports, would increase competitive opportunities for new entrants to the Japanese market. At the same time, the public expendi-

tures necessary to implement such worthwhile improvements would help to close the gap between the level of savings and domestic investment in Japan. Another example is land use policy. A reduction of the tax bias in favor of agriculture would foster increased residential investment (again closing the gap between saving and investment) and lower the cost of foreign direct investment in Japan. A more effective competition policy may reduce some of the exclusionary procurement practices associated with cross share-holding relationships.

Our Japanese counterparts have provided us with a list of their structural concerns regarding the U.S. economy. Our low savings rate and the need to improve our education system figure prominently among their concerns. These are, of course, areas where the President has already made several important proposals and it is in our own interest to take action. A significant increase in saving in the United States would tend to reduce the current account deficit through the mechanism I discussed earlier when discussing increases in Japan's public infrastructure investment.

The President's proposals for deficit reduction is an essential item of action. Reducing the Federal budget deficit is not only good domestic economic policy, it is good international economic policy. The proposed Social Security Integrity and Debt Reduction Fund, which would convert the Federal Government from a large net borrower to a large net saver, holds the potential for a significant correction in our trade imbalances. So do the President's proposals for a Family Savings Account, for eased withdrawal requirements in IRAs, and for capital gains tax reduction; all would provide incentive to increase private saving.

Some analysts have questioned the value of SII, asking why the United States should focus its attention on structural barriers in Japan that operate to hurt Japanese consumers, especially when the benefits of their removal will spread worldwide and not be targeted on the United States. The answer is simple: namely, that SII is the best available route towards achieving objectives of the United States. Certainly, it is far better than getting governments more in the business of managing trade through export-restraining arrangements, subsidies to basic industries, or any of the other ways that governments distort trade flows. Rather than try to mandate trade flows and market shares, SII seeks to insure that domestic and foreign firms have equal opportunities to compete and that markets, not governments, determine the outcomes.

Just as the national saving and education issues that the Japanese have raised in SII reflect concerns that are shared by many Americans, many American concerns about Japan are recognized in Japan as areas where change must come. An outside perspective can be helpful in focusing attention so that necessary changes can be made more rapidly. In a broad sense, SII provides a forum for international micro-economic coordination analogous to the mechanisms for international macroeconomic coordination established over the past five years.

Our bilateral relationship with Japan should not be viewed as a zero-sum game. By focusing on structural changes that already have a significant domestic constituency, the SII seeks to exploit a potential commonality of interest to allow for faster and further progress than could be obtained by highlighting purely adversarial aspects of our relationship.

To date, that faster and further progress we seek has not materialized. However, it would be premature to pass judgment on SII prior to the key milestones established when the initiative was launched.

We have just over one month to prepare the first interim report. President Bush and Prime Minister Kaifu reiterated the importance of progress at their meeting in Palm Springs this past weekend. The negotiating teams need to work hard to insure that meaningful and convincing progress on possible administrative, budgetary, or legislative actions is contained in that interim report. This will lay the groundwork for what we hope will be a substantial action-oriented final report in July.

The cooperation of the Congress in supporting the President's budget, saving and education initiatives is essential. We hope we will receive your support. Positive action on the President's initiatives would greatly improve economic performance in the United States by increasing growth, employment, productivity and competitiveness. It would also increase the likelihood of success in the SII talks and of all the international economic gains that would come from that success.

Thank you. I would be happy to answer your questions.

## PREPARED STATEMENT OF S. LINN WILLIAMS

Representatives of the Governments of the U.S. and Japan concluded the third round of SII talks on February 22-23. We devoted the first day to items identified by us as structural barriers in Japan to imports and the second day to items identified by the Japanese as barriers in the U.S. to exports.

We should emphasize at the outset, as we always have, that SII is a unique bilateral undertaking between sovereign governments and is an iterative process. It has therefore, no set patterns or benchmarks. Many changes will take time to implement; and many changes, when implemented, will take time to show up in the trade balance. The results of these improvements in market access, however, should be felt relatively quickly by many U.S. industries.

The SII is also mutual. We are responsible ourselves for our competitiveness. The Japanese participants have fairly identified U.S. practices that are or may well be barriers to exports from the U.S. Their ideas for changes were interesting and have been or will be considered in our own internal deliberations on our competitiveness.

It is also important to note that SII has had some effect already in Japan. The new Japanese budget provides for increases in the personnel of the Japan Fair Trade Commission, which administers the Antimonopoly Law, and of the Patent Office. There is also a substantial program, including tax credits, for the promotion of imports, and a modest increase for facilitation of customs clearance. Some changes in land policy are underway. The JFTC appears to be enhancing its authority and role within the Japanese Government. There are a number of studies underway, probably the most important of which concern the enforcement of the Antimonopoly Law, being undertaken by the JFTC, and domestic Japanese and world price differentials, being undertaken by MITI. Although in some cases there were efforts underway within Japan, SII has influenced these results.

Nevertheless, having begun the undertaking, the question is where in the process we find ourselves; and we find ourselves not as far along as we had hoped. This was a point emphasized strongly by the President in Palm Springs.

We started this process last summer with the political commitment of both governments. We expected to discuss initially some concrete, detailed proposals at a meeting scheduled in January. That meeting was delayed, at the request of the Japanese Government, because of Japanese elections. It was rescheduled, again at the request of the Japanese Government, to February 22-23; and we, therefore, expected the February meeting to represent a substantial step forward.

During the first day, the Japanese participants explained what the Government of Japan has done on SII issues and gave us some sense of what it is considering.

What we heard at that meeting, however, was not enough, in our judgment, to be considered effective, lasting or credible. It was predominantly a defense of the status quo with the prospect of minimal further action.

We had developed our own ideas on how the Japanese system might respond to the structural issues we had raised. We presented our ideas, in some detail, during the meeting. Our ideas have been given considerable thought by those in the Administration who have some knowledge of Japan, and points requiring specific expertise have been checked with experts. Contrary to initial press reports, they were not "demands," and they were not "rejected." We made clear at the meetings that they were also not the only ideas that we would consider responsive to our concerns, and we invited the Japanese to address the specific concerns in other ways.

It appeared in Tokyo that our levels of expectation and those of the Government of Japan were different. We addressed those differences during the meeting. We expect those differences to narrow, although we cannot assess at this point the course or degree that will take.

We understand that the election in Japan is just over and the new cabinet just formed. But we believe—and we stated in Tokyo, and the President stated in Palm Springs—that it is time to focus. We have no doubt as to the good intentions of the Japanese participants, but we sensed that they might not have, or believe they have, sufficient political guidance to proceed on many points. We cannot accept that everything in SII is a difficult political issue requiring detailed political guidance; and there was not much progress evident at the last meeting on the development of specific steps that would enable the Japanese participants, in our view, to raise the real political issues with their political leaders.

In Palm Springs the President requested that political guidance, and Prime Minister Kaifu appeared to agree to provide it.

Our structural concerns remain the same: the savings/investment gap, particularly focusing on increasing investment in infrastructure; land use policy; the distribu-

tion system; exclusionary business practices; keiretsu business groupings; and pricing mechanisms.

We have focused on these areas because we believe that changes in them will improve current account balances and market access. We have also taken care to articulate our points in these areas with two additional elements in mind.

First, we drew extensively on Japanese sources and on some of the internal debate that is occurring in Japan on structural matters. Most of the *specific* ideas we advanced in Tokyo can be found in reports of the JFTC, the Economic Planning Agency and various Japanese business groups.

Second, we made an effort to identify constituencies within Japan that might agree, for *their* own reasons, with the ideas that we advanced for *our* own reasons. Let me briefly identify some of those linkages.

Japan's producer-orientation is pervasive. The Japanese Government subjects nearly half of all bank deposits to interest rate controls. Many deposit rates are held to below 1%. Meanwhile, Japan spends less of its GNP per capita on infrastructure than most other industrialized countries. The benefits of these low interest rates, low infrastructure expenditures and other policies are, in effect, passed on to Japanese companies in the form of a lower cost of capital to those companies. That is a comparative disadvantage to foreign companies. Adam Smith did not do that. The Japanese Government did.

At the same time, the Japanese consumer would obviously benefit from higher interest on family savings and greater infrastructure, as studies, articles and polls in Japan have indicated. The concept of "sharing the wealth" of the Japanese economy more with the Japanese consumer did not originate with us. It is a matter of the relationship of the Japanese Government to its own people; but we believe the Japanese people would support, for their own reasons, what we are proposing, for our reasons.

The distribution system in Japan, in our view, operates as a disincentive to imports. There is a relative lack of infrastructure for imports, as contrasted to exports; and, as a result of government policies, the system is expensive and closed.

Toys 'R Us, for example, faces the prospect of considerable expense and delay as the result of the Japanese Government's implementation of a law, the Large Retail Store Act, that permits its Japanese competitors to control its destiny in Japan. Japanese companies, by contrast, can buy entire shopping centers in Hawaii and have to obtain little more from the government than a zoning permit. When Japanese cigarette producers started selling in the U.S., they gave away one box with each purchase, a perfectly sensible way to penetrate a new market. When Pearle Vision gave away one pair of eyeglasses with each purchase in Japan, however, it received a warning that it may have violated a Japanese law that permits its competitors to establish "codes of conduct" that prohibit premiums, and therefore discourage new entrants into the Japanese market.

A better distribution system should make foreign companies and products more competitive. At the same time it will also benefit the Japanese consumer.

It is in the structural barriers to market access, especially the area of exclusionary business practices, that USTR has its greatest institutional concern. These practices fall into four categories:

- (1) Practices that are or should be covered by principles of antitrust law;
- (2) government-business relations;
- (3) procurement practices of private firms; and
- (4) the patent system.

We believe that the enforcement of the Antimonopoly Law can be substantially strengthened and made more transparent. Moreover, we believe that changes in the law may be necessary to provide for higher and more certain penalties and to provide for realistic and effective private rights of action to enjoin illegal acts and to recover the damages resulting from them. No plaintiff has ever succeeded in getting a reimbursement of its damages under the two provisions of Japanese law that permit private rights of action for monopolistic acts. In a recent ruling by the Japanese Supreme Court, a plaintiff in a kerosene price-fixing case was denied damages despite the fact that the JFTC had found the existence of a price-fixing cartel. A Justice of the Japanese Supreme Court wrote that Japanese law should be changed to permit recovery of such damages. In two recent, well-publicized instances of bid-rigging and price-fixing by Japanese construction companies at the Yokosuka Naval Base and the Kansai Airport, the amount of the fine imposed by the Japanese Government on the Japanese companies was substantially less than the profits they made from their illegal acts. And when the U.S. threatened to sue to recover

what it had been overcharged at Yokosuka, that was widely viewed in Japan as an exceptional response.

The recent liberalization of beef imports was good news for the U.S., but it was sobering to learn soon thereafter that several Japanese companies were operating a cartel to import it. They were warned by the JFTC and may have now ceased their anticompetitive behavior, but, by controlling prices, they increased the price to the Japanese consumer and reduced the reason for that consumer to buy foreign beef.

One need not wonder why foreigners believe that Japanese companies collude and have every reason to continue to collude. Collusion is profitable—and the bill is paid by foreign companies in the form of lost business, and by Japanese consumers, in the form of higher prices.

The Japanese Government bears considerable responsibility for this and other exclusionary business practices by Japanese companies. These practices have been shaped over decades by formal trade barriers and regulations, and by the engagement of the Japanese Government with Japanese businesses in "visions," study groups, the promotion or tolerance of cartels and administrative guidance, all in an effort to protect domestic companies and order competition within the domestic market. Many of our most divisive bilateral trade disputes—satellites, supercomputers, wood products and semiconductors, to name a few—originate in these policies of the Japanese Government. In the SII, we seek, therefore, to control and make transparent those processes, and to make the Japanese Government accountable, to its own public and to foreign companies, for its actions.

Japanese sources indicate that the procurement practices of most Japanese companies are relatively closed to long-term relationships with foreign companies. Those procurement practices developed in a protected environment. Therefore, in our view, we believe the Japanese Government bears some responsibility for making even private procurement more open.

Long delays, pre-grant opposition and the narrow scope of patents operates to exclude innovative foreign products from the Japanese market. Texas Instruments waited almost 30 years before it received a patent for its semiconductor. During that time, Japanese companies developed an entire industry. It took Allied Signal almost 11 years to get a patent in Japan on an amorphous metal product that, among other things, increases the efficiency of electric power generators. Eighteen months after Allied Signal filed for its patent in Japan, the Japanese Government began to support and subsidize the development of amorphous metals by Japanese steel companies. No Japanese utility has ever bought Allied Signal's amorphous metal product but instead has continued to buy a lower efficiency silicon sheet product from those same Japanese steel companies. When Allied Signal's major patents run out soon, Japanese companies, aided by their government, will be poised to exploit a market that should have been Allied Signal's. U.S. companies and the U.S. Government will have every reason to be skeptical about the openness of Japanese markets if Japanese utilities finally buy their first amorphous metal products only when Japanese companies enter the market.

Our substantial interest in significant measures to address exclusionary business practices that harm U.S. companies is fair and appropriate. Any success we might have in changing them would also benefit Japanese consumers and taxpayers, who would pay less for a variety of goods and services, from construction and electric power through satellites and wood houses. The issue is: will the Japanese Government listen.

These market access structural practices—exclusionary business practices, distribution impediments and keiretsu—are not primarily "cultural," nor are they uniquely Japanese. They are practices that U.S. or European companies would probably engage in themselves if the laws and policies of their countries, or of open-market economics, permitted them to.

These practices are primarily the result of Japanese government policies. The application of other policies can change them. It is a question of will, not of reach.

Similarly, the desire for consensus decision-making is not uniquely Japanese. We know of no government official or politician who would not prefer to make every domestic constituent happy and to have unlimited time to do it if their trading partners would tolerate it.

If Japan were a small isolated economy, these policies and practices might not matter so much to others. If the global economy were not becoming integrated at increasing speed, there might be little enough world and time to move slowly at home. But Japan is an important economic power, not a small, isolated country; and this is a potentially historical time. It is time now for Japan and the Japanese people to consider and assume the responsibilities of their market to the global trading system.

