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The U.S.-Japan Trade Agreement of September 1994: Contending Views of Believer and Skeptic High Government Official vs. Pensioner of Cardiff by High Government Official vs. Pensioner of Cardiff

Foreword

The Japanese trade surplus with the United States began in 1968 and has continued and grown every year since then except 1975. It is currently running at about \$60 billion, some three times the amount needed to provide minimum health care for every American citizen. American administrations charged with dealing with this problem come and go. Each one claims to bring fresh knowledge and fresh approaches to the problem. In most cases, the people assigned to deal with the Japanese trade problem are economists and trade specialists, almost never people with knowledge and experience of Japan and the Japanese economy.

In this Working Paper, JPRI offers a discussion on the latest claimed “breakthrough” toward opening the Japanese market. We have solicited the views of one of the few insiders who is actually qualified to discuss the Japanese economy. His remarks are off-the-record because of the bureaucratic obstacles to candid discussion by a person in his position. The response is from a skeptical observer who argues that the history of Action Plans, Maekawa Reports, MOSS Talks, and Structural Impediments Initiatives makes it likely that the Americans are once again deluding themselves. Needless to say, this is not an academic discussion. The future of the Japanese-American relationship, not to mention the alliance, hangs in the balance.

Japan Policy Research Institute

The U.S.-Japan Trade Agreement of September 1994: Contending Views of Believer and Skeptic High Government Official vs. Pensioner of Cardiff

High Government Official vs. Pensioner of Cardiff

BELIEVER

High Government Official: The administration has come in for its share of criticism in the past year over its approach to trade negotiations with Japan. But the agreements reached at the end of September should demonstrate that the criticism was misdirected. Like most

new administrations, this one took some time to develop its full trade strategy and tactics, a process that necessarily involves adjustments based on experience. However, the administration did agree rather quickly in the spring of 1993 that a new element was needed in trade negotiations with Japan. This judgment was based on the widespread evidence of continued low levels of manufactured imports overall, the continuing parade of problems brought to the government by companies facing market access problems in Japan beyond their ability to solve on their own, and the evidence that a number of agreements in the past did not have the hoped for market-opening impact. From that conviction came the decision to press for objective criteria included in trade agreements to enable both governments to evaluate success or failure.

The Japanese government agreed to the general principle of objective criteria in the Framework Agreement of July 1993. Since that time, however, there has been a barrage of accusations to the effect that the outcome would be managed trade; the Japanese government claimed that it could agree only to the types of data to be observed in follow-up meetings, but could not accept any notion of the desired or anticipated future direction of change. Admittedly, the administration did not have a very clear idea a year ago about the specific language it wanted to use for these objective criteria, and the Japanese side was very successful in mounting a public relations attack. But the agreement of September 1994 contains some specifics about government procurement of telecommunications equipment and medical equipment, NTT procurement, insurance, and (in principle only) flat glass that should make clear to all what the U.S. negotiators were after.

For those who have not studied the agreements, here is some of the language. For government procurement of telecommunications equipment, the quantitative objective criterion is: “Annual evaluation of progress in the value and share of procurements of foreign telecommunications products and services covered by the Measures and Guidelines to achieve, over the medium term, a significant increase in access and sales of competitive foreign telecommunications products and services by: [a list of 5 separate measurable items—the value and share of foreign procurements, number of government agencies purchasing foreign products, number and value of contracts stemming from the decrease in single tendering, number of tenders submitted by domestic and foreign suppliers, and the relative competitiveness of foreign products and services].” The agreement on government procurement of medical equipment and on NTT’s procurement of telecommunications equipment both have roughly similar language. The insurance agreement also has objective criteria, in which the governments will review the change and rate of change in the number of approvals for new or modified products and rates, the value of premiums issued by foreign firms, and the market share of total insurance premiums for foreign insurance companies. Flat glass is agreement in principle only, so the actual details have yet to be negotiated.

Several points are worth making about these objective criteria and how they relate to the overall language of the agreements:

1. There are no specific numerical targets included in government procurement and insurance. Japanese accusations in the press that the U.S. was seeking numerical targets in

these negotiations were wrong, and the final agreements demonstrate this. This was not, by the way, a last-minute U.S. concession. The language on criteria is essentially what was tabled last spring, and even prior to that the proposed language avoided specific numbers.

2. The criteria are only part of much broader and very detailed agreements about changes in a variety of practices that have impeded sale of foreign products in markets for government procurement and insurance. For government procurement of telecommunications equipment, the procedural changes include: provision of more detailed information on procurement earlier in the cycle each year; invitation for comments from all suppliers on all aspects of planned purchases (including technical specifications, technology, and budgets for systems) before the requests for proposals are finalized; use of international standards (official standards, or de facto standards) when available so that widely used foreign products have a fair chance in Japan; adoption of “overall best value” bid evaluation (so that foreign products with more features and somewhat higher prices are not automatically dropped from consideration); and reduction in the number of sole source contracts. Again, the agreements covering NTT and government procurement of medical equipment have largely similar provisions. These are the guts of the agreements, bringing greater transparency and less idiosyncrasy to the purchasing process.

3. The objective criteria are an important and innovative addition to the procedural provisions of the agreements. The concern in the past has been that agreements on procedure or regulation have been only halfheartedly implemented. But the procedural changes just obtained, if fully implemented, should have a strong positive effect on purchases of foreign goods and services in these areas, because American and other foreign firms have world class products that do well in competitive markets outside of Japan. The opportunity for manipulation of the new system by the purchasing entities or by the domestic Japanese industry obviously exists. Therefore, it is important that the agreements acknowledge an expected outcome so that the two governments have some basis at the planned review sessions for evaluating whether the agreements were successful or not. In these agreements, therefore, the Japanese government is now committed to the principle that the market opening measures will bring about their intended outcome: a significant increase in the sales of competitive foreign products and services. This should provide an incentive for implementation of the procedural changes in good faith. Should the agreements fail to yield significant increases in purchase of foreign products and services, then the review process will draw attention to that fact, and open the way for further action--including the possibilities of strengthening implementation or negotiations for further market opening measures.

4. These are all most-favored-nation agreements; the language on procedures and objective criteria in all of the agreements refers to foreign products and services. Obviously the U.S. chose to negotiate in those product areas where there are globally competitive American firms. But the changes in procedure and potential increases in sales are available for the benefit of all, as has been the case in the past.

Most observers who have been critical of the Clinton Administration’s negotiating tactics were concerned about the possibility of objective criteria leading to managed trade. I hope that above comments have helped to allay these fears.

But some have been critical from the opposite direction--that the administration should have been pursuing managed trade of the sort represented in the semiconductor agreement. However, as has been abundantly clear for the past year, the Japanese government will not consider anything resembling specific market share targets set by government in the issues under negotiation. More important, the Administration believes that in the areas just negotiated, better market access can and will come from the kinds of regulatory and procedural changes discussed above. It believes that these changes will lead to significant increases in the sales of foreign products without locking in particular outcomes. The objective criteria should help in evaluating the success of implementation, but they should not detract from the centrality of changing regulations and procedures in Japan to make markets more open.

Emphasis on procedural changes backed up by objective criteria does not mean, however, that alternative approaches can be ignored. Some of the entrenched relationships and behavior patterns in Japan are not amenable to solution through regulatory or procedural changes. That is why the U.S.'s approach to auto parts and flat glass has included requests that the industries involved announce voluntary purchase plans (although even in these areas, regulatory and procedural changes are vitally important as well). These industries involve cartel or vertical buyer-seller relationships that are particularly difficult to alter, especially in the presence of weak antitrust enforcement. The U.S.'s requests represent a form of affirmative action that is the only viable method for obtaining change that leads in the direction of greater openness and competition. Voluntary plans are not ideal, but doing nothing about these access problems is not a reasonable alternative.

There is room for disagreement here; after all, American economists disagree on the appropriate degree of antitrust enforcement at home as well. But auto-parts and flat glass involve business practices and fixed relationships that go far beyond the economic efficiency of long-term contracting--and behind most of these practices there is an implicit or explicit buy-Japan principle. There are other examples that could be cited, such as the laminated structural wood beams for the skating rink being built for the Nagano Winter Olympics. The contract specifies that Japanese products will be used despite the fact that American firms are the global technological and price leaders--our beams are stronger by a considerable margin, and considerably lower in price than the Japanese product. The Nagano government and the contractor are busy passing the buck back and forth on this one (i.e., who chose to put this clause in the contract), but the simple fact is that foreign products were excluded categorically for no reason other than nationalism. If they want to be nationalistic, then it should be explicit, but, as is often the case, all parties are denying any intent to favor domestic products.

SKEPTIC

Pensioner of Cardiff: While you have tried to make the administration's case, let me, for the sake of argument if nothing more, take the opposite side. The presumption behind your remarks is that the negotiations were carried out on both sides in good faith. I cannot see how negotiations can proceed without that presumption, but I think there is ample evidence

that on the Japanese side they were not carried out in good faith. The Japanese got what they wanted: another couple of years of the pretense of attending to the problems, another couple of years of record-setting trade surpluses, and another couple of years before internal pressures within Japan have to be attended to. The evidence that Japan, Inc. exists, is functioning, and knows what it is doing is overwhelming. Your own example of structural wooden beams for the Nagano Olympic building is typical. Mark Tilton's interviews this summer in Tokyo all say the same thing (as reported in *JPRI Critique No. 2*). No less figures than Morita Akio of Sony, Sakakibara Eisuke of the Ministry of Finance, and Matsumoto Koji of MITI have told us in detail that Japan, Inc. lives and how it works; yet we refuse to believe anything they say.

Why is this? I don't know but I suspect that it is because contemporary American social science does not understand or know what to do with ideology as a factor or a variable. The situation is somewhat comparable to the concept of totalitarianism in studies of the former Soviet Union. It so scared the people who invented it that for the past twenty years, younger Soviet specialists, with no direct knowledge of the Bolshevik system, refused to use it and accused anyone who did of being a war-monger and a reactionary. Now that the Cold War is over we have droves of Soviet scholars coming forth to say that, of course, the USSR was a totalitarian society. That was why it had a world-class military-industrial complex and nothing else! Something comparable exists in Japan studies. The concept "Japan, Inc." refers to something that has existed since at least the 1930s--the state's playing guidance roles and setting its own incentives for a market-based private-ownership economy with results that could not have been anticipated based on models of the socialist displacement of the market. The Japanese have acknowledged the existence of this structure a thousand times over, but they have also, understandably, tried to prevent foreigners from using it against them. Foreigners who did use concepts like Japan Inc. were accused of being revisionists, Japan-bashers, racists, and worse. But the Japanese need not have bothered. Most foreigners are unable to envisage a Japan, Inc., largely because of the implications such an acknowledgment would have for themselves and their vested interests in Anglo-American capitalism as presently practiced. Therefore, they have to believe that the Japanese want to negotiate the dismantling of their very effective system and that the structures causing historically unprecedented flows of money into Japan are amenable to reform. I do not see the evidence for any of this. But I see lots of evidence of Americans' willful self-delusion.

I would have thought that when the administration came into office it would already have understood that in dealing with Japan, it was dealing with a different kind of capitalist system than the Anglo-American model. That should be no obstacle at all to successful economic exchange with Japan, but it would require that the relationship be managed to achieve desirable outcomes, since procedures are, by definition, different and do not synchronize. Had the administration brought section 301 cases in its first quarter in office over rice and construction I am certain that we would be much further along today. The U.S. government, going back to Clayton Yeutter, has promised rice farmers in California and Arkansas that it would take action over rice in the Uruguay Round or under section 301. Rice in itself may not be that important--but then neither are any of the things you've

been negotiating over for the past 18 months (except autos and auto parts, where the talks failed)--but it was perfectly symbolic of the Japanese system.

The same was true of the construction industry. When Clinton went to Japan for the summit in the summer of 1993, the corruption of the construction industry was just being laid out for him: for the past thirty years, the world's largest public works budgets had been protected from any form of international competition so that the construction firms could pay off LDP politicians 3 percent on each contract. The Japanese have been exposing a corrupt system of public works that is comparable only to that being revealed in post-Cold War Italy. Arrests were being made in Japan virtually while Clinton and Kantor were in the country, and yet they walked away from their implications.

More seriously, what is being hailed as a success for the trade negotiations is a serious failure for the Japanese political system. I agree with Professor Sasaki Takeshi of Todai that the three main political issues in Japan today, regardless of parties and leaders, are (1) Japan's use of military power for peace keeping operations or any other purpose; (2) the division within the *zaikai* over the need for deregulation and enhanced competitiveness in order to live with the high yen; and (3) bureaucratic domination of the political system. I also agree with him that No.1 is not as important as it is portrayed to be so long as the American security guarantees are more or less in place. No.3 is the most important, but it has very little political force in it because no one knows how to change the system. The Japanese government has always been bureaucratically dominated, and the public ultimately trusts the elite bureaucracy more than it does ill-informed, time-serving, corrupt politicians. No.3 will change, if at all, only because of the changes going on in No.2.

That is to say, the only dynamic element in the Japanese political process at the present time, the only element with any energy in it, is what the high-yen is doing to the *zaikai*. Those companies hurt by the high yen want deregulation, changes in the "three sacred treasures" of labor-management relations, off-shore investment, and freedom from keiretsu obligations. Those industries that are protected or that do not face international competition (e.g., the teachers' unions), do not want any change at all in regulation, job security, seniority wages (*nenko joretsu*), protectionism, buy-Japan policies, and so forth. *Zaikai* disunity also directly affects the bureaucratic apparatus, since the bureaucracy at the bureau level (*genkyoku*) is itself divided between those client industries that would profit greatly from deregulation and those that would not.

In a more general sense, the *Gaimusho* has stated that Japan must before long shift from an essentially producer-driven economy to an essentially consumer-driven economy in order to maintain peace and stability in East Asia. Japan has long recognized that the historic role of the United States in the economic development of capitalist Asia was not its armies, or its atom bombs, or its diplomats, but its markets: the fact that Americans buy the products of Japan, the NICs, Southeast Asia, and mainland China. They also recognize that the Americans cannot continue playing that role much longer for various reasons: the American economy is not growing fast enough, the produce of Asia is now too large for any single distant market, Americans should consume less and save more for the health of their domestic economy, and Americans must give first priority to Mexico and Latin

American rather than to Japan and its offshore manufacturing platforms in East Asia. Japan must reform itself to become a major absorber of the exports of the rest of Asia and it must do so within the next five years-or face quite severe reactions by its neighbors aimed at Japan itself. It needs to shift from being a Victorian economy to an Edwardian economy, which would also greatly benefit Japan's own consumers and workers.

Unfortunately, American trade policy has taken the pressure OFF for either greater domestic democratization within Japan or the shift to a consumer-oriented economy. By pretending to negotiate and accepting face-saving but meaningless results, no longer justified even by the exigencies of the Cold War, the United States has aligned itself squarely with the forces of reaction in Japan. If you want deregulation in Japan, a shift to consumer sovereignty, and the bureaucracy turned into a true agency of a democratic will, there is no alternative to pressure--the pressure of the high yen, the pressure of section 301, the pressure of closing markets in the United States, and the pressure of aroused Japanese citizens who might suppose that their protests would, for the first time, make some difference. What we have not gotten from this administration is any kind of informed pressure to produce a stable, long-range, *modus vivendi* with Japan. The American people know this. That is why for the past two years they have been scaring themselves with best-sellers about relations of conflict and war with Japan (Michael Crichton's *Rising Sun* and Tom Clancy's *Debt of Honor*). The success of these books is one of the few genuine market indicators of what Americans really think.

Given the fragility of this agreement I think it is reasonably certain that those most relentless, least culture-bound markets--the ones in international currencies--will again take over and start to make Japanese products unsalable anywhere except in Japan itself. That is certainly not the best way to deal with this problem, but it is what's left. In fact, if the Bank of Japan would quit "managing" this particular market (one where it approves of managed trade), the market would go ahead and solve the trade imbalance between Japan and the rest of the world in accordance with quite familiar economic principles. Both the High Government Official and The Pensioner of Cardiff have elected anonymity for this round of discourse on the nature of talking trade with Japan. Please respect the desire of these two individuals to share their views without attribution.
