

**U.S.-JAPAN RELATIONS:  
ACCOMPLISHMENTS, NEXT STEPS,  
FUTURE CONSIDERATIONS**

**JEFFREY E. GARTEN**

**Occasional Paper No. 18**

Mr. Jeffrey E. Garten  
Under Secretary of Commerce for International Trade

Keynote Address  
"Global Partnership or Bilateral Competition?:  
Emerging Issues in U.S.-Japan Economic Relations"  
Columbia University  
December 2, 1994

**Occasional Paper Series  
Center on Japanese Economy and Business  
Graduate School of Business  
Columbia University  
December 1994**

**U.S. - JAPAN RELATIONS:**  
**ACCOMPLISHMENTS, NEXT STEPS, FUTURE CONSIDERATIONS**

Remarks by  
**JEFFREY E. GARTEN**  
Under Secretary of Commerce for International Trade

Before the  
Center on Japanese Economy and Business  
Columbia Business School  
New York, N.Y.

December 2, 1994

It is a great pleasure to be back here at Columbia, where I once taught at the Business School. I've had many rewarding professional experiences over the years -- in the military, in the government, and on Wall Street -- but without any doubt my time at this university was among the highlights.

I owe my association with Columbia to Professor Hugh Patrick, who directs the Center on Japanese Economy and Business, which is sponsoring this conference. In 1991, Hugh was kind enough to ask me to preview my upcoming book, A Cold Peace: America, Japan, Germany and the Struggle for Supremacy, before a group of Business School students. After the presentation, he, Professor David Biem, a few students and I went out to dinner. Hugh and David both asked me if I ever thought about teaching. The rest is history, and I'm greatly indebted to both of them for having gotten me involved.

When I was at the Business School, my comparative advantage, I think, was in bringing real world experiences to the classroom. I taught my courses in international finance and trade entirely through case studies, many of which I had once participated in. Whenever I told old war stories it was like an electric bolt hit the class, so great was the appetite among the students for "how it actually works." But for *me* the big challenge was putting the real world into the broader context, to extract the lessons, good and bad, that made any particular case more significant than the events themselves. In this respect the best thing about teaching here was that I was forced to think as hard as my students.

Today I want to try to apply the same thought process to American relations with Japan. I will start with a review of the Clinton Administration's policies over these past two years. Then I'll turn to the agenda for the next two. But most importantly, I would like to draw back and reflect on the overall strategic context of our relations for the remainder of this decade, and to point to some of the lessons we have learned and the broader challenges which we now face.

My bottom line is that we will need a much more strategic approach to Japan. First, we will have to figure out not only how to negotiate contentious issues but how we can align ourselves with the forces of change in our number one Asian ally. Second, we will need to go beyond our decade-old obsession with Japan as an economic superpower posing unique challenges and integrate our policies toward Japan into the broader Asian context in which our interests

over. The socioeconomic model which allowed the nation to favor producers over consumers is tarnished and is slowly eroding. The high yen will continue to cause major dislocation in parts of Japan's industry.

But this is only half the story. The high yen is also forcing Japanese firms to cut costs and hone production techniques to remain competitive. Under this pressure, we will see in the next few years Japanese products which are of higher sophistication and quality. We will see a workforce in Japan which is more flexible and skilled. If, as is always possible in a world of fluctuating exchange rates, the yen depreciates significantly against the dollar, we will face renewed export surges.

In short, we should not underestimate or overestimate the challenge, but it would be dangerous and irresponsible to be complacent.

As I will discuss later, moreover, we can no longer think of Japan as so totally distinct from the rest of Asia. Japan now trades more with its Asian neighbors that it does with us. Its production systems are increasingly integrated with the rest of Asia. Its influence in world affairs is closely tied with its identification with broader Asian interests. In this most dynamic region of the world we need to cooperate closely with Japan, even while it is our fiercest competitor.

Despite this mutual importance and interdependence, our economic relationship with Japan remains uneven and unbalanced. Japan enjoys essentially unfettered access to the U.S. market. Yet too many U.S. firms, and those from other countries for that matter, continue to face intractable barriers when they try to export to Japan -- notwithstanding Japan's status as one of the biggest markets and richest countries in the world. These difficulties are evident in the big bilateral trade and investment imbalances that successive Administrations have been pointing to for well over a decade, as well as Japan's rising trade surpluses with the rest of the world.

The impact of Japan's protectionism on the U.S. is substantial. According to a number of studies, if Japan were to eliminate all its barriers to trade, U.S. exports to Japan would increase somewhere in the range of \$9.0 and \$18.0 billion each year. In terms of the overall current account balance, this may not sound dramatic. But, assuming that \$1 billion in U.S. exports

umbrella which allows us to address not only industry-specific barriers, but also the underlying macroeconomic and structural obstacles confronting U.S. companies when they try to do business in Japan.

At the outset, the Administration made it clear that the Framework would be different from previous Administrations' initiatives. Specifically, we wanted to obtain *measurable* gains in access to Japan's market. When the Framework was launched, Japan agreed to promote a "significant increase" in global imports of goods and services, including those from the United States. The idea was that we wanted not just to negotiate the removal of trade barriers, but also to see concrete, measurable results in the marketplace. In addition, President Clinton and then-Prime Minister Miyazawa agreed that Summit meetings would take place twice a year to monitor the progress achieved in the opening of Japan's market, as well as to discuss macroeconomic developments. These meetings would shine the most politically intense light on the negotiations that we could think of.

Let me begin with the macroeconomic dimension. By tackling underlying macroeconomic problems, we hope to foster an economic environment in Japan that encourages consumption and domestic demand and leads to an economy that is more open and receptive to imports. Accordingly, as part of the Framework, Japan promised to actively pursue strong and sustainable domestic demand-led growth, a highly significant decrease in its current account surplus, and a significant increase in global imports of goods and services.

Since the Framework was launched, Japan has made some progress in its efforts to stimulate domestic demand. For example, Japan recently announced a 10-year, 630 trillion yen stimulus package to get the economy going. In addition, it is implementing a 5.5 trillion yen income tax cut in Japan fiscal years 1995 and 1996, and 3.5 trillion yen thereafter. It is worth noting, however, that, after three years, the consumption tax will be raised to partially offset the loss of revenue caused by the income tax cut. We welcome these stimulative measures and hope that Japan will take whatever additional steps are necessary to build on this progress and ensure that the economic recovery is firmly in place.

In addition, we have reached five specific agreements so far under the Framework.

Japan also agreed to rely, as much as possible, on international procurement standards and to reduce the number of sole-source contracts that favor Japanese firms. Very importantly, the agreement also includes qualitative and quantitative criteria to evaluate progress, along the same lines that I described for medical technology procurement.

Under the second accord, NTT agreed to improvements in its procurement process similar to those agreed to by the Japanese government. As a result, U.S. companies can expect better, more timely information on NTT's procurement process, multiple opportunities to shape requests for proposals before they are issued, and technical specifications that will not exclude them.

Insurance. Japan agreed to enhance the transparency of its insurance regulations, to introduce specific reforms, and to strengthen antitrust enforcement. Specifically, it will put administrative guidance in writing and publish standards for the approval of licenses and new products. Tokyo also will introduce a system for large commercial insurance in which companies will be allowed to introduce products by "notifying" regulators instead of going through the cumbersome prior approval process -- thereby easing the hold of its regulatory officials. Japan also says it will strictly enforce the Antimonopoly Act against unfair trade practices and study *keiretsu* business practices in its insurance sector. The agreement also includes qualitative and quantitative criteria to measure progress.

#### Other Accomplishments

We have also had some major accomplishments outside of the Framework. These include:

Construction. In January 1994, under pressure from the United States to open its construction market, and in response to Japanese domestic pressure to reform its scandal-ridden procurement system, Japan announced an action plan to reform its public sector construction market. This plan, coupled with additional understandings reached in an exchange of letters between Commerce Secretary Brown and the Japanese Ambassador to the United States, will significantly increase business opportunities for foreign firms in Japan's public construction market, where 1993 contracts exceeded \$300 billion. Tokyo agreed to use an open and competitive bidding system instead of the closed

### Evaluation

How to assess what has happened so far? No one could say that we achieved everything we wanted. But given the historical difficulties of negotiating with Japan, the Administration's record is good -- especially, as I mentioned before, in light of recession and constant political changes in Japan. Nevertheless, the trade balance has continued to deteriorate. This, I would say, is a result of several factors. First, there has been rapid growth in the U.S. which sucks in imports, combined with slow growth in Japan which has the opposite effect. Second, Japanese trade barriers have been very slow to fall. Third, for a variety of reasons -- sky-high costs, subtle barriers, lack of effort -- American firms have not been investing enough in setting up shop in Japan. Such investment, were it to occur, would have a "pull effect" on the sale of U.S. components from U.S. parent companies to their Japanese affiliates.

In addition to the disappointing trade figures, there is a growing fatigue and weariness among the negotiations on both sides of the Pacific which makes the future agenda more difficult.

### THE NEXT TWO YEARS

We have a significant agenda for the next two years. We plan to continue discussions with Japan on macroeconomic policy. We plan to continue pressing for more open markets for U.S. exporters. We will broaden the scope of the Framework to emphasize such issues as investment and deregulation. And we will step up our export promotion efforts to assist specific U.S. companies to sell into the Japanese market.

### Unfinished Business

To begin with, we have some unfinished business to wrap up.

Automotive trade is one of our top priorities -- both autos and auto parts. Roughly 60 percent of the bilateral deficit is in autos and parts, and, frankly, we have little to show for our efforts over the past 18 months. In fact, our automotive deficits are rising.

Our attempts to solve this problem focus on three areas: the sale of original equipment parts to Japanese companies in Japan as well as in the U.S.;

In the context of our Framework discussions with Japan, the U.S. is encouraging Japan to adopt a broad set of principles to guide its deregulation efforts over the next five years. To facilitate this process, we recently tabled an extensive list of specific suggestions for deregulation across a wide range of sectors.

More than just helping U.S. firms, deregulation would also help Japanese citizens. All segments of Japanese society -- from the consumer to the small shopowner to the largest corporations -- are entangled in a web of excess regulation. Over ten thousand regulations are in place, many of which serve no useful purpose. Some discriminate against foreign firms while others affect all firms equally. The bottom line, however, is that these regulations are unreasonable burdens to commerce and removing them would be better for everyone.

#### *Monitoring Progress and Compliance*

Even after various agreements are reached, however, our work is not finished -- we still need to aggressively monitor them for effective implementation. Indeed, an essential component of all agreements is to include follow-up monitoring mechanisms.

This monitoring mechanism generally involves regular bilateral meetings to discuss progress made or problems that may have been encountered in implementing agreements. These meetings are critical in raising issues at the earliest possible stages, as well as in keeping up a good working dialogue with our Japanese counterparts. They can be formal or informal. On the formal side, to take an example, we will be meeting with Japan's Ministry of Health and Welfare later this month to discuss progress in implementing the medical/pharmaceutical Market-Oriented Sector-Selective (MOSS) agreement, concluded several years ago. We also will hold an informal meeting with the Construction Ministry to discuss our recently reached construction agreement.

Let me stress that we take the monitoring process very seriously, and we devote considerable resources to it. After all, it doesn't matter how good a trade agreement may be if it is not properly implemented.



services, and information services. Both MITI and the Ministry of Post and Telecommunications have issued "vision papers" which emphasize the creation of a vast Japanese information infrastructure. Along these lines, we are working with our MITI counterparts to acquire information on developments in this sector. I have been in contact with industry and government experts in the U.S. and Japan, and I'm sure this market has the potential to be enormous.

We are trying to break new ground in our approach to promoting U.S. sales in this sector. In the past we were asleep at the switch in sectors where we were ahead but where Japanese firms were gathering momentum. Then, when we woke up, we found that the Japanese had caught up with us, penetrated our market, and shut us out of theirs. With information technology we want to try to *preempt* problems. We are gearing up to say something like this to our Japanese friends:

"It's true that the U.S. is years ahead of you in most areas of information technology. We also know that you plan to spend more than a trillion dollars in this decade to catch up. We are watching carefully how you do this. We are intent on making sure that you do not follow the models of the past in which you follow a Japan-first industrial policy which keeps out foreign firms even as you take advantage of their markets, their technology, etc. We will therefore be expecting that all your policies -- intellectual property rights, deregulation, government procurement, preferential financing -- conform to generally accepted international standards, not to Japan in the habits of the past. And if not, we will be sounding the alarm everywhere we can, and at the earliest possible time. Our objective is to not be unnecessarily contentious; on the contrary it is to prevent the trade problems before they become acute."

Information technology is only one of the sectors that respond to fundamental changes in Japanese society. Another target area for us is medical equipment, responding to the inevitable ageing of Japanese society. We also want to take advantage of the penchant for more leisure activity by promoting U.S. entertainment products and services. We know that Japan requires massive upgrading of its housing stock; as a result, this should be significant opportunities for the U.S. residential construction and building materials industry, too.

In this regard, I stand by the ideas I described in A Cold Peace -- close cooperation among the major countries -- including the U.S. and Japan -- is by no means assured. The absence of a unified common enemy has reduced the urgency of a tight alliance which overshadows differences over economic relations. Commercial competition has become much more significant, and less susceptible to cooperative management. This is all the more true in an era when the industrial nations will be growing slowly, and when the scramble for the Big Emerging Markets -- the Chinas, the Indias, the Brazils -- will be downright brutal.

If we look at the leadership of the West and Japan -- at President Clinton, Chancellor Kohl, and Prime Minister Muryama, for example -- it is easy to conclude that they themselves understand the importance of building a global economic system in which trade expands, and in which cooperation overshadows competition. But the political forces surrounding them present each of these leaders with significant challenges. In fact, it is no exaggeration to say that in the three most important countries, we are seeing political internal upheaval. As a result of the recent Congressional elections here at home, it will take a major effort for our two parties to work together to lead the way toward a liberal world economy. In Japan, politics have not been so uncertain in many decades. Chancellor Kohl just won election by the narrowest of margins, and already speculation is rife about the tenure of his administration.

The point is, in these uncertain times, it will become more difficult than it has been in many decades to rise above the temptation to turn inward, and to avoid letting our international economic policies drift. All the more reason to redouble efforts to open the world economy. All the more reason for the U.S. to think through how its economic ties with Japan -- our most important bilateral relationship -- can be improved.

As I indicated, the Clinton Administration has accomplished quite a lot with Japan these past two years. I also think that the agenda we have set for 1995 - 96 is exactly right, focusing as it does on a handful of critical issues including macroeconomics, deregulation, export promotion, and several important sectors and structural issues. But there will also be a need to think through some broader strategic questions. Here are a few of them:

deregulation of the market for replacement parts for autos, which also keeps prices high, restricts choice, and gives government micro-management responsibility.

It is much easier to talk about aligning ourselves with progressive forces in Japan than to do it effectively. What is required is a degree of subtlety and patience that does not always characterize U.S. policy -- in any Administration. But there are some things we should be able to do. First, as I mentioned before, we should pick negotiation targets which respond to clear consumer benefits in Japan. Second, the American Government could sponsor global comparative price surveys which underscore how Japanese consumers are being taxed by Japan's own policies.

Beyond this, however, it's time for the U.S. private sector to do more on its own behalf. There's nothing preventing our trade associations from hiring Japanese public relations firms from doing high profile market research to bring home to Japanese consumers what protection is costing them in various industries and products. At a time of reduced budgets, I am certain that the onus of aligning with change in Japan should not be just on the U.S. Government. To the contrary, American business will have to do much more not just as individual companies but as associations.

### What is the right balance between negotiating sectoral issues and broader reforms?

Whenever I get together with friends and colleagues to discuss our strategy toward Japan, the issue arises as to whether we should be focusing more on macroeconomic issues like growth, or savings and investment patterns, or whether the emphasis should be sector specific. The history of successive Administration efforts has been that both approaches have been tried -- along with, I might add, exchange rate issues (Yen - Dollar Accord) -- and that the verdict is inconclusive. Nothing has prevented the trade balance from worsening from the U.S. perspective. Nothing has made Japan a "normal" importer, relative to other OECD countries. My own view is simple: we need a continuous full-court press on all areas. The issue is not whether the pressure should be maintained, but how? Which brings me to some additional considerations.

Third, we must be careful to explain to other Asian countries why we are pressing so hard to get into the Japanese market, and to try to enlist their support. As I will show in a minute, we have not done a good job of this.

But fourth, we cannot let up on Japan, giving it a "sanctuary market" in which it is free to exploit everyone else while able to protect its own firms from competition. In the long-run we and everyone else will suffer.

It's a tall order to manage all this right. There is a lot to balance, and we are unlikely to achieve all our goals to our and others' satisfaction. But we can do much better in the balancing act than we have to date.

#### **What is the right balance between bilateral and multilateral pressure?**

This brings me to the broader issue of bilateral vs. multilateral approaches. I do think we could be more skillful in reinforcing our bilateral efforts with both public and behind-the-scenes multilateral diplomacy. Remember, Japan agreed to open its rice market under GATT's auspices. This commitment was easier to achieve multilaterally than bilaterally because the U.S. did not stand alone in demanding liberalization. Indeed, many important trading nations vocally supported us. We could be more proactive in urging GATT, the IMF, the OECD, APEC, and others to focus on Japanese practices that do not conform to world standards.

The momentum given to APEC to move towards freer trade over the next twenty years, and the imminent establishment of the World Trade Organization gives the United States a freer start in thinking about multilateral economic diplomacy. During the Cold War we devoted enormous energy to multilateral political diplomacy in arms negotiations and in the U.N. Security Council. This was international politics at its most intense. At times we do this in the economic arena, but only episodically -- generally at the tail-end of a big negotiation like the Uruguay Round. But the time has come to devote more effort -- much more -- to multilateral economics. Pressing Japan through those channels will be crucial.

wrote en masse created a distorted view of our policies. So, we need to have our public relations act together at home, too.

We also learned a second lesson -- that we should be careful not to allow our expectations, or those of the public, to rise to unrealistic levels. When it comes to negotiations such as the Framework, results are difficult to achieve and slow in coming. In addition, there are many major constraints on negotiations with Japan. Wall Street has taken a great interest in U.S.-Japan trade, and market considerations have become an important factor in what we do. Political changes in Japan have been dramatic, and they are not over, with the result that big decisions are harder to make in Tokyo than ever before. And our ability to take tough trade action -- while an option we must preserve and use when necessary -- is constrained increasingly by a world economy which has become so interconnected.

If unrealistic expectations arise, disappointment when agreements are finally reached are inevitable. Concessions will not be seen as compromises, but as capitulations. But the very nature of a negotiation is that you must compromise. As a result, I think we need to differentiate better between what is achievable now and what it achievable five or ten years from now, and adjust our private and public expectations accordingly.

## CONCLUSION

Let me conclude with the idea that the single most important aspect of our policy toward Japan lies not in trade negotiations, but at home in the United States. President Clinton was dead right as a presidential candidate, and he has been dead right ever since as President. It is our own economic rejuvenation that will do most to improve our competitive position vis-a-vis Japan. If we continue to create good jobs; if we redouble efforts in education, and in the training of our workforce; if we continue the President's program to invest in our technological infrastructure; if we continue to mount an aggressive National Export Strategy characterized by closer cooperation between government and business and by a relentless focus on the Big Emerging Markets of the future; if we continue to reduce the federal budget deficit -- if we do all these things, we will become more competitive around the world, our standards of living will rise, and the "Japan problem" will be far less significant in America's future, and far easier to handle.